HM Treasury

Consolidated Budgeting Guidance:

2020-21

March 2020

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Contents

Foreword

Context

This document sets out the principles and standards underpinning the budgeting system mandated for use in central government. This budgeting system is a key part of the UK public spending framework. It enables the Treasury to control public spending, and appropriately incentivises departments to manage spending effectively.

Years of applicability

This budgeting guidance applies to in-year control from 2020-21.

Substantive changes to budgets

This section sets out the main areas where the guidance has been changed for 2020-21:

- Chapter 2 has been added to provide an overview of the overall Spending Control framework
- Chapters 3 and 8 have been updated to reflect clarifications to the implementation of IFRS 9
- Chapter 4 has been updated to updated to clarify the interaction between income retention and knowledge asset management
- Annex B has been updated to reflect the current guidance on Debt Management

Additionally, Chapters 1, 3-4, and 6-8 have been restructured and rewritten following a drafting review of this document that took place during 2019. These changes do *not* reflect substantive changes to the budgeting requirements. Rather, they are drafting changes designed to ensure the existing requirements are communicated as effectively as possible.

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

Chapter 1

Overview: introduction to budgeting

Introduction

1.1 This document sets out the principles and standards underpinning the budgeting system mandated for use in central government.

1.2 This chapter provides a general overview of the budgeting system. This includes an overview of:

- the purpose of the budgeting system (paragraphs 1.4-1.5)
- the interaction between budgets and the public spending framework (paragraphs 1.6-1.30)
- the roles of budgeting system participants (paragraphs 1.31-1.37)
- budgetary categories (paragraphs 1.38-1.51)
- adjustments to budgets (paragraphs 1.52-1.61)
- policies that affect other departments' spending (paragraphs 1.62-1.70)
- budget exchange (paragraphs 1.71-1.93)
- the scope of this guidance (i.e. which bodies should follow it) (paragraphs 1.94-1.102)
- different presentations of total spending (paragraphs 1.103-1.111)

1.3 Further chapters in this document provide guidance on the budgeting treatment for specific transactions. These chapters are organised by types of budgetary category or types of transactions.

Purpose of the budgeting system

1.4 The budgeting system set out in this document is the primary means by which HM Treasury controls public spending.

1.5 The budgeting system has two main objectives:

- to provide a structure under which the Treasury can control public spending. This supports the government in realising its fiscal objectives, in return supporting macro-economic stability; and
- to appropriately incentivise departments to manage spending effectively. This supports the provision of high quality public services that offer value for money to citizens

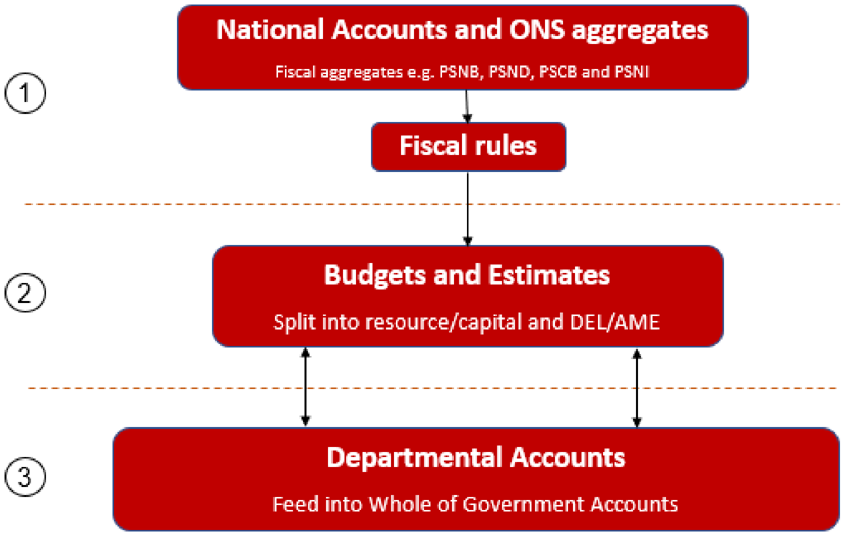
Interaction between budgets and the public spending framework

1.6 The budgeting system is designed to support the UK's public spending framework. It interacts with a number of different elements of the public spending framework:

- fiscal policy and national accounts
- departmental accounts
- Supply Estimates ('Estimates')
- cash requirements

1.7 Diagram 1.A provides a visual overview of the public spending framework.

Diagram 1.A – Public spending framework



The interaction between the budgeting system and each of these elements of the public spending framework is explained in more detail below.

Budgets, fiscal policy and national accounts

1.8 The budgeting system is designed to support the specific objectives for fiscal policy set by the government.

1.9 The Spring Budget 2020 was delivered to meet the following fiscal rules[1]:

- to have the current budget at least in balance by the third year of the rolling five-year forecast period
- to ensure that public sector net investment does not exceed 3% of GDP on average over the rolling five-year forecast period

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[1] HM Treasury is currently undertaking a review of the UK's fiscal framework and fiscal rules. The review will report back by Autumn 2020. When it is concluded, HM Treasury will lay before Parliament a new Charter for Budget Responsibility. The Autumn 2016 Charter therefore remains in force at the current time.

- if the debt interest to revenue ratio is forecast to remain over 6% for a sustained period, the government will take action to ensure the debt-to-GDP ratio is falling

1.10 These targets are measured with reference to fiscal aggregates, including:

- Public Sector Current Budget (PSCB), which is a measure of the difference between the government's current expenditure (total expenditure excluding capital investment) and its current receipts (principally tax receipts), plus depreciation costs
- Public Sector Net Investment (PSNI), which is a measure of the capital investment made by the government. This is the difference between the gross investment in fixed assets (such as hospitals or infrastructure), the depreciation on those assets, and any disposals of those assets

1.11 The PSCB and PSNI aggregates, along with other fiscal aggregates such as public sector net debt (PSND), are measured using the national accounts, which are a set of accounts showing economic activity throughout the UK, both in the public and private sector.

1.12 The Office for National Statistics (ONS), acting as an independent agency, prepares the UK's national accounts in accordance with the EU-legislated framework 'European System of Accounts 2010' (ESA10). ESA10 in turn is consistent with the System of National Accounts (SNA08), is an internationally agreed standard adopted by the United Nations and used globally. ESA10 and SNA08 provide a standardised international framework for preparing national accounts.

1.13 In summary, the budgeting framework supports the government's fiscal objectives, which are measured using fiscal aggregates derived from the national accounts. Therefore, the budgeting rules, where possible, are consistent with the ESA10 framework used to prepare national accounts

Budgets and departmental accounts

1.14 Departmental accounts are the publicly available audited annual report and accounts that report how departments have used the resources at their disposal. They are based on International Financial Reporting Standards (IFRS) as interpreted by the Financial Reporting Manual (FReM) (which is produced by the Treasury). The vast majority of transactions are treated in the same way in departmental accounts and national accounts: for example, pay is a current expense in any system of accounts.

1.15 Moreover, as part of the 'Clear Line of Sight' Treasury Alignment Project, the budgeting framework was amended to substantially align the treatment of transactions between budgets, Estimates and departmental accounts. The vast majority of spending by departments and their arm's length bodies (ALBs) scores in the budgets and Estimates at the same value and with the same timing as in departmental accounts. This ensures that financial reporting is consistent, transparent, accurate and straightforward, and keeps compliance costs down for departments.

1.16 However, there are some differences between budgets and departmental accounts. Most of these differences are largely due to differences between the ESA10 framework (on which national accounts, and therefore budgets, are based) and the IFRS framework (on which departmental accounts are based). For example, ESA10 has different rules regarding the treatment of research and development costs as compared to IFRS.

1.17 Additionally, there are differences between budgets and departmental accounts where controlling spending against information in departmental accounts may not provide the right incentives for departments. Annex A lists the main differences between budgets and departmental accounts.

1.18 When there are differences between budgets and departmental accounts, Estimates will normally follow the budgeting treatment (see section on budgets and Estimates below).

1.19 Considering that budgets and departmental accounts are substantially aligned, it will likely be most cost-effective for departments to determine how to score a transaction for budgeting purposes in the following way:

- start by considering the treatment of the transaction in departmental accounts
- consider whether the budgeting treatment is the same as the departmental account treatment or different, and so establish the budgeting and Estimates treatment
- as budgeting information generally feeds into national accounts, once you know the budgeting treatment and how it aligns with national accounts you can determine the fiscal effect of the transaction. This document spells out where budgeting information is not aligned to national accounts

1.20 In some places this budgeting guidance summarises or describes the accounting treatments in departmental accounts. This is done to provide context for the budgeting rules. However, the only authoritative description of accounting treatments is in the FReM.

Budgets and Estimates

1.21 Estimates are the mechanism by which Parliament authorises departmental spending. Estimates are generally presented using the budgetary framework in this document.

1.22 Estimates require Parliament to vote limits for different budgetary categories of spending, 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, as elements of the department's budgets may fall within non-voted spending. The sum of voted and non-voted spending in Estimates will equal the figures in departmental budgets.

1.23 In the same way as budgets, Estimates are voted net of retained income. Generally, any income retained in budgets will net off against voted limits in the Estimate. This is discussed in more detail in Chapter 4.

1.24 The Supply Estimates guidance manual contains full guidance on Estimates.

Budgets and cash requirements

1.25 The budgeting system is based on accruals accounting rather than cash accounting, consistent with both national accounts and departmental accounts. Accruals accounting provides a better basis for spending control, giving a more accurate picture of the expense incurred by a department in any period.

1.26 Cash is, therefore, not controlled directly through the budgeting system. Cash balances do not convey spending power and the availability of cash does not translate into budget cover.

1.27 However, cash is controlled elsewhere in the public spending framework. The Net Cash Requirement for Supply Expenditure is controlled through the Estimates processes. The concept of annuality is important in cash management; departments cannot carry forward cash from year to year. Departments need to surrender any unspent cash at the end of each financial year.

1.28 Changes in the expected level of use of cash provide useful monitoring information. For example, unexpected increases in cash outflows can serve as a trigger to check whether spending is rising above expectation. Departments should discuss the reasons for planned increases in the level of cash spending with their Treasury spending teams.

1.29 The Supply Estimates guidance manual provides more guidance about the Net Cash Requirement and the process for surrendering cash.

Summary of the interaction between this guidance and other public spending framework documents

1.30 This document only provides guidance on the budgeting framework. As described above, there are a number of other documents that provide guidance on other areas of the public spending framework. Please refer to Annex E for a complete list of other areas of guidance. Some of the most important pieces of guidance are summarised below:

Table 1.A: Public spending framework documents

Topic	Guidance
National accounts	European System of Accounts 2010 (ESA10)
Departmental accounts	Financial Reporting Manual (FReM)
Estimates	Supply Estimates guidance manual
Managing Public Money (i.e. guidance around accountability, governance, Parliamentary reporting responsibilities, etc.)	Managing Public Money

Roles of budgeting system participants

1.31 There are two main participants in the budgeting system: departments and the Treasury.

1.32 Throughout this document, references are made to 'departments.' This document generally applies to devolved administrations as well; however, some unique budgeting arrangements might be agreed between the Treasury and devolved administrations.

Role of the department

1.33 The budgeting system aims to ensure that departments have appropriate incentives to manage their business well, to prioritise across areas of spend, and to obtain value for money. Departments' roles in improving spending control are further set out in Chapter 2, and in Managing Public Money.

1.34 Sometimes departments or public bodies commission consultants to offer them suggestions for ways around the spending control framework. The Treasury has 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 Treasury spending team.

Role of HM Treasury

1.35 The Treasury is responsible for the design of the budgeting system and can offer advice and explanations in applying this system. It is only the Treasury which may finally determine the budgeting treatment of a transaction.

1.36 The guidance in this document cannot cover every case. Sometimes it is deliberately kept simple for departments because transactions are rare or typically small. There may be cases where if a large instance of such a transaction were to take place it would impact on the fiscal framework. In such cases the Treasury 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 or where the budgeting is unclear, they should contact their Treasury spending team before they undertake the transaction.

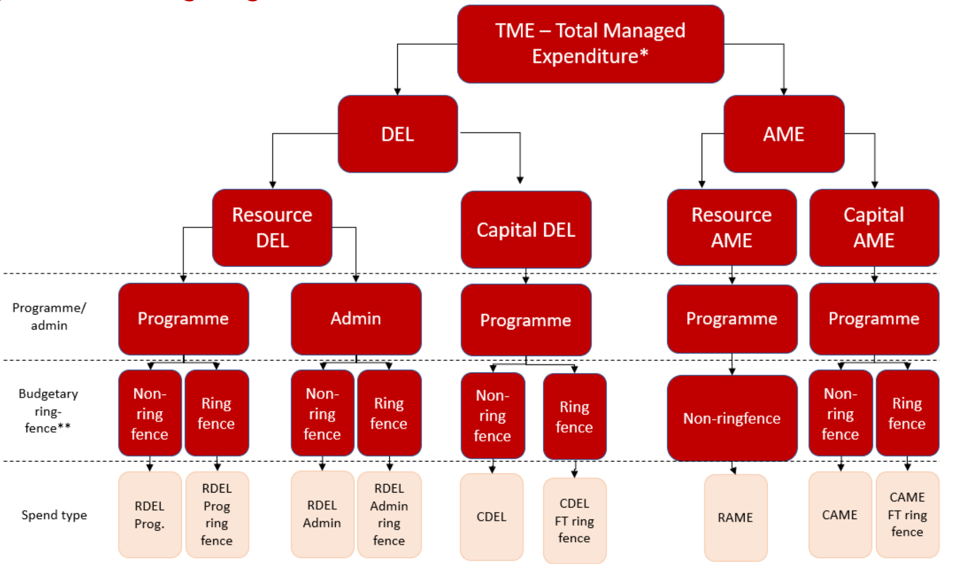
1.37 Treasury ministers have the right to modify the budgeting guidance at any time, although in practice we try to keep changes to a minimum and consult departments before making significant changes.

Budgetary categories

1.38 The budgeting framework disaggregates a department's budget into a number of different budgetary categories, each with its own control limit. These controls support the achievement of the fiscal framework and provide management incentives for departments. Each category, and the importance of spending control, is summarised below.

1.39 Diagram 1.B provides an overall summary of the different budgetary categories.

Diagram 1.B – Budgeting framework



* Total Managed Expenditure is made up of DEL and AME, plus accounting adjustments
** Budgetary ring-fences (the depreciation and impairment resource budget ring-fence and the financial transactions capital budget ring-fence) are separate from policy ring-fences. Not all departments are subject to the financial transactions ring-fence.

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

1.40 Departmental budgets are first disaggregated into two different categories:

- **Departmental Expenditure Limits (DEL)** –this budgetary category captures spending that is subject to limits set in the Spending Review (SR). Departments may not exceed the limits that they have been set
- **Annually Managed Expenditure (AME)** –this budgetary category captures spending that is subject to budgets set by the Treasury. 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

1.41 Within both DEL and AME, departments are expected to pursue efficiencies and prioritise expenditure in order to optimise value for money.

1.42 The combination of the resource/capital budgetary categories (described below) with the DEL/AME categories gives rise to a number of separate budgetary control and planning totals (for example capital DEL, resource AME). Departments and their Treasury spending teams should at all times have a shared understanding of what the control and planning totals are and how the department's spending matches up against them. See Chapter 2 for a more detailed discussion of tracking control and planning totals.

1.43 Appendix 2 to this chapter sets out the budgetary categories diagrammatically. Appendix 3 sets out a list of a department's control and planning totals.

Criteria for treatment in DEL or AME

1.44 The following paragraphs provide a brief overview of whether transactions should be recorded in DEL or AME.

1.45 Generally, all areas of spend are in DEL unless the Chief Secretary of the Treasury has determined that they should be in AME. The Chief Secretary may agree to put areas of spend 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 areas of spend are so large that departments could not be expected to absorb the effects of volatility in their DELs (for example, most welfare spending) or
- for other reasons, they are not suitable for inclusion in firm multi-year plans set in the SR. For example: lottery spending funded by the National Lottery and may not be reprioritised elsewhere. Certain levy-funded bodies, which serve particular industries, are also in AME – Appendix 4 to this chapter sets out the criteria determining whether levy-funded bodies should be in AME

1.46 Additionally, transactions may score in AME when they do not have an immediate impact on the fiscal aggregates (for example, revaluations or provisions). This document provides detailed guidance for these transactions.

1.47 The Treasury regularly reviews whether areas of spend in AME are still suitable for AME treatment. Where appropriate these are moved into DEL.

1.48 Normally, an area of spend 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 SR process.

Resource and capital budgets

1.49 In addition to being split into DEL or AME, departments' budgets are also split into *resource* and *capital* categories.

- Resource budgets capture current expenditure (including depreciation, which is the current cost associated with fixed assets). It is paramount for Treasury to retain control over the level of current spending. Within the resource budget some transactions will have an immediate or near-immediate impact on fiscal aggregates, for example pay and procurement. Other transactions will only have an effect in future periods, for example the take-up of provisions. Resource budgets are discussed further in Chapters 3 and 4
- Capital budgets capture new investment and financial transactions. It is important to control capital budgets alongside resource budgets because spending in this budget increases public sector net debt and government's borrowing requirements. Capital budgets are discussed further in Chapters 6 and 7

Programme and administration budgets

1.50 Resource budgets are further split into programme and administration budgets.

- **Programme budgets** capture expenditure on front line services
- **Administration budgets** capture any expenditure not included in programme budgets. They are controlled to ensure that as much money as practicable is available for front line services. Administration budgets are discussed further in Chapter 5

1.51 Appendix 1 to this chapter diagrammatically summarises the contents of resource and capital budgets.

Types of adjustments to budgets

1.52 Budgetary limits in each budgetary category are set at each SR. However, there can be subsequent adjustments within or between these budgetary limits. These adjustments 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 (for example introducing a charging regime). These represent 'real world' changes in spending or plans. There are restrictions on the adjustments that departments can make to budgetary limits in this area; this is discussed further in paragraphs 1.57-1.61 below
- **Classification adjustments** reflect changes in budgetary totals driven by changes in the way spending is classified rather than by actual changes in the level of spending. For example, changes in IFRS accounting standards or ESA10 national accounts standards that are implemented in the budgetary framework are 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 accounting policy changes need the agreement of the Treasury
- **Inter-departmental adjustments/budget cover transfers** reflect changes in spending plans as a result of an agreed transfer of budgetary cover from one department to another. Examples of where a transfer is appropriate include where there is an allocation from a 'shared pot', or when a department agrees to transfer cover to another department to cover costs incurred as a result of a change in policy

1.53 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 Online System for Central Accounting and Reporting (OSCAR) system

- inter-departmental adjustments/budget cover transfers lead to restated limits of the departments concerned

1.54 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.

1.55 It is the Treasury that ultimately determines what type of adjustment a change is. Departments that are in doubt should contact their Treasury spending team.

1.56 Annex E sets out where to find further guidance on types of adjustment. Appendix 5 to this chapter provides more guidance on Prior Period Adjustments, i.e. adjustments to budgets in prior periods.

Policy/plan adjustments and 'switching' across categories

1.57 As stated previously, departments are expected to accommodate policy/plan adjustments (which are real-world changes in spend) in their existing budget limits. One way they can achieve this is if spend increases in one area of a budgetary category (for example, capital DEL), a department can reduce spend in another area of that same budgetary category. Another way of accommodating policy/plan switches is to 'switch' budget provision from one budgetary category to another.

1.58 So that control totals are effective, departments are restricted in the switches they may make between budgetary categories:

- departments may not switch provision from AME to DEL. Departments may not exceed the DEL limits set in each SR; they cannot avoid exceeding these limits by switching provision from AME to 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. It is paramount for Treasury to retain control over the level of current spending via the resource budget; this control should not be risked via switches from capital to resource budgets. Departments may switch provision from resource budget DEL to the capital budget DEL but not from ring-fenced elements of those budgets

1.59 Departments are expected to manage their resource budget DEL as an integrated whole, optimising spending across different areas (including areas 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 some 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 resource DEL (or exceptionally resource AME) 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

1.60 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 Chapter 2). 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 resource DEL depreciation ring-fence will not be approved.

1.61 In addition, as part of the SR settlement, some spending might be subject to specific policy ring-fences. If so, departments may not move money across these ring-fences, except as specified in their SR settlement. Ring-fences are normally set at the level of resource DEL or capital DEL. However, closer controls (for example on administration spending) may be set.

Policies that affect other departments' spending

1.62 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.

1.63 There is 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 the 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
- 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

1.64 Where a department introduces a policy that benefits another department, it may seek a contribution to the costs to the implementation of that policy. This is to be agreed between affected departments and again the Treasury will not arbitrate.

1.65 The budget consequences of any new proposals, regardless of where they originate, fall to the department responsible for implementing the proposals.

Charging for services

1.66 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.

New burdens on local authorities

1.67 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.

1.68 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).

1.69 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

1.70 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 the Treasury.

Budget Exchange

1.71 Budget exchange is a mechanism that allows departments to carry forward a forecast DEL underspend from one year to the next. Budget exchange provides departments with flexibility to manage their budgets, while strengthening spending control and providing greater certainty in order to support effective planning.

1.72 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.

1.73 There is no scope to carry forward underspends that are not forecast in advance of the Supplementary Estimate.

1.74 Budget exchange is available on all DEL control totals (including non-voted DEL), subject to the usual restrictions on switches discussed in paragraphs 1.57-1.61.

1.75 Separate arrangements apply to the devolved administrations.

Approval process

1.76 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

1.77 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 1.B: Budget Exchange Limits

Size of Department	RDEL Limit	CDEL Limit
Total DEL[2] 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%

1.78 Resource DEL carried forward through budget exchange may not be switched between administration and programme budgets or between the ring-fences.

Preventing the accumulation of spending power over time

1.79 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 £20 million. It reduces its year one DEL to £980 million and increases its year two DEL by a corresponding amount to £1,020 million
- in year two the department forecasts an underspend of £30 million (against its new DEL of £1,020 million). It reduces its DEL by this amount, to £990 million. 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 £10 million to £1,010 million
- in year three the department forecasts an underspend of £10 million (against its new DEL of £1,010 million) and reduces its DEL by this amount, to £1,000 million. However, it cannot carry anything forward to year 4 as the £10 million carried over from year two is netted off

1.80 In the above example, we assume *all* other budget exchange rules are in effect.

Timing

1.81 The budget exchange process is 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

[2] Where total DEL = Resource DEL excluding depreciation + Capital DEL

the Treasury of the amounts that they wish to carry forward by late November/early December.

1.82 The in-year DEL reductions will be reflected 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

1.83 Departments may not generally carry-forward an underspend if they are simultaneously seeking to draw funds from the Reserve (the Reserve is discussed in more detail in Chapter 2). 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

1.84 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 2. 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

1.85 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.

1.86 To recognise this challenge, departments are offered greater flexibility to carry-forward capital DEL underspends related to significant investment programmes:

- to qualify for additional flexibility, the programme must have a capital DEL budget of over £50 million in the year in question
- carry forward will not count towards the standard capital DEL budget exchange limits, but may not exceed 20% of the programme's capital DEL 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:

1. 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
2. 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

1.87 It can be challenging for departments to match asset-sale proceeds with capital expenditure perfectly on an annual basis. Therefore, departments have additional budget exchange flexibilities to carry forward the capital DEL proceeds from the sale of fixed assets across multiple years so that they do not have to be spent in the same year. The Treasury will welcome proposals from departments.

1.88 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 capital DEL 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 Treasury spending team proactively as soon as such amounts are anticipated
- the asset sale in question must have been completed before budgets will be adjusted and
- receipts may not be switched between the general and financial transaction capital DEL boundaries

1.89 In some cases, departments may prefer to share 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 fixed asset sale, departments may surrender the proceeds in full to the Exchequer in exchange for a resource DEL uplift equivalent to 3.5% of the proceeds surrendered. This would be a non-baselined uplift in each year of the period for which resource DEL budgets had been set. The Treasury will consider each application on a case-by case basis.

1.90 In order that the Treasury can monitor the overall effect of these policies on the fiscal aggregates, departments should notify their Treasury spending team 6 weeks ahead of a fiscal event if they envisage using either of these flexibilities on asset sales in that financial year.

1.91 These flexibilities do not affect any other rules around the retention and utilisation of asset sale income.

1.92 For areas of protected spend, the Treasury may not be able to offer the asset-sale flexibilities above. Departments should discuss asset sales in areas of protected spend with their Treasury spending team directly.

Cascading Budget Exchange

1.93 Departments are responsible for deciding whether to cascade budget exchange, or an alternative system for carrying forward underspends, to their ALBs. Departments will be responsible for managing any pressures this would create within their DEL.

Which bodies does this guidance apply to?

1.94 The budgeting guidance in this document applies to all bodies classified by the ONS to central government.

1.95 The sector classification of bodies assessed by the ONS is published in their Sector Classification Guide publication.

1.96 The Treasury also publishes a guidance note on sector classification. In broad terms, bodies are in central government if they are owned or controlled by central government bodies and they are not a Public Corporation (which is a separate ONS classification). 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. 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 central government because it would be wholly controlled by the ALB.

1.97 Subsidiaries, interests in associates and joint ventures classified to central government are consolidated with parent bodies for budgeting. So, if an ALB sets up a public sector body that is not a public corporation it will be part of the ALB's DEL allocation from the parent department.

1.98 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 are independent and are not involved 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

1.99 Departments that are setting up a new body 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, who will classify the new body.

1.100 The Cabinet Office has a separate process for classifying central government bodies for accountability and governance purposes, using their own criteria. Where departments are setting up a new body they should also contact the Cabinet Office to discuss the governance arrangements. Throughout the rest of this document, the term 'arm's length bodies' (ALBs) is used to refer to all bodies in a departmental boundary that have been classified as central government by the ONS and will not use the Cabinet Office-specific classifications (such as NDPBs or executive agencies).

1.101 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.

1.102 Devolved administrations are part of central government for ONS purposes.

Presentation of total spending

1.103 Budgetary information can be used to present figures about central government spending in a number of different ways. The primary budgetary presentations of spending are summarised below.

Total Managed Expenditure

1.104 The government's main measure for reporting overall public spending is Total Managed Expenditure (TME), a measure drawn from the national accounts. 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.

1.105 The composition of TME is discussed in more detail in the Public Expenditure Statistical Analyses (PESA) document.

Resource and capital budgets

1.106 A department's resource budget is the sum of resource DEL and resource AME. The capital budget is the sum of capital DEL and capital AME.

1.107 Neither the resource budget nor the capital budget is a control total, since departments may not make switches from AME to DEL. They are still useful numbers to present since they show the total current and capital spending in the budgets of the department.

Total DEL

1.108 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

1.109 Depreciation here includes DEL impairments.

1.110 Depreciation is excluded from total DEL because adding together depreciation and investment may be seen by some as double counting the cost of assets.

Tax impacts on departmental budgets

1.111 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.

Appendix 1 to Chapter 1: Summary content of budgets

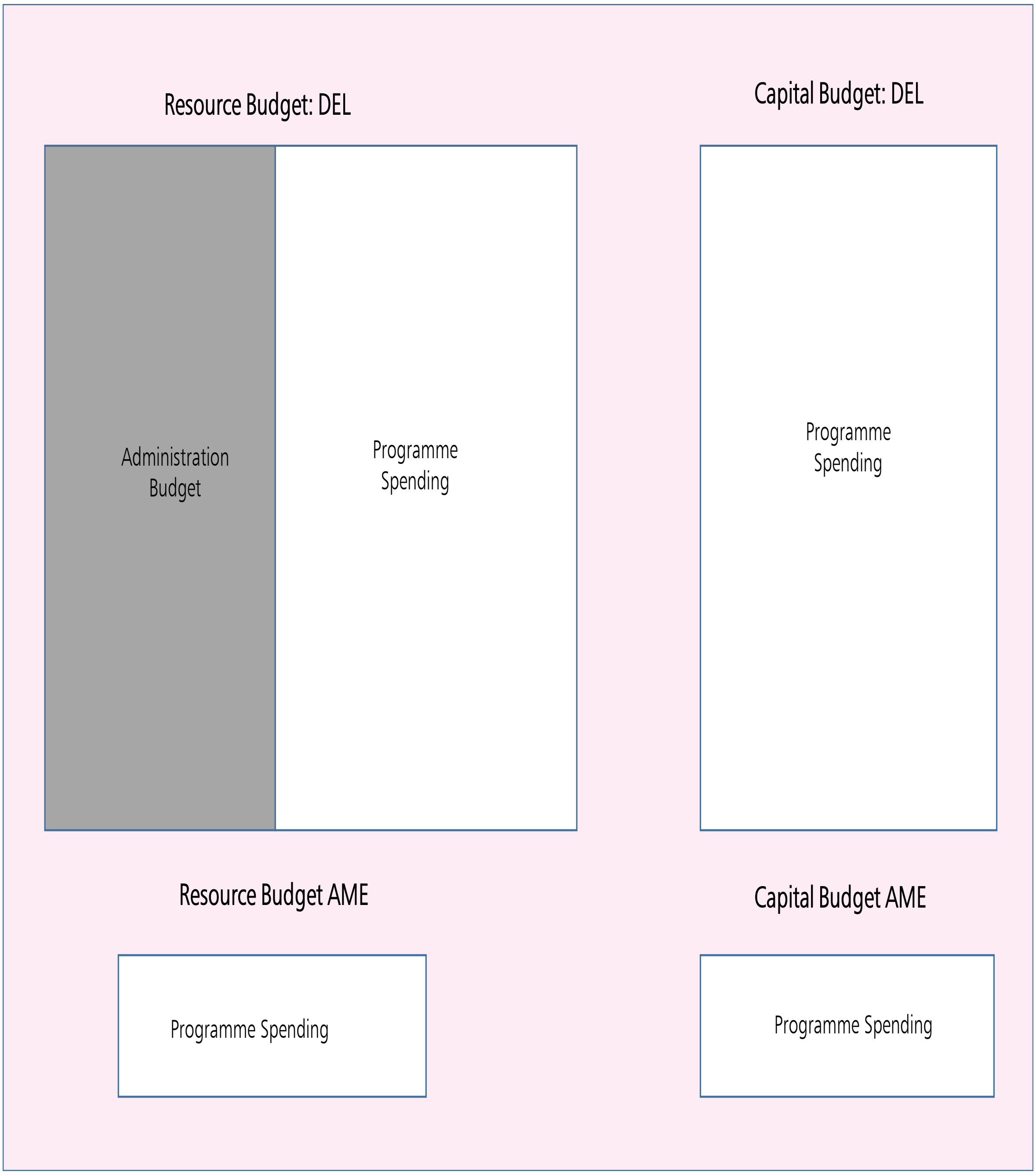
1.112 This table summarises the main standard contents of resource and capital budgets.

Table 1.C: Content of budgets

	Resource budget	Capital budget
Department's own transactions with the private sector	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. 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). Profit/loss on disposal of assets. Depreciation and impairments on the department's assets. *Less* income retained in DEL/AME, for example sale of services. Note: Excludes revaluations charged to revaluation reserve.	Expenditure on new fixed assets on an accruals basis; includes finance leases and other transactions that are in substance borrowing (i.e. on-balance sheet PPP deals). *Less* Net book value of sales of fixed assets. Net policy lending to the private sector. Capital grants to the private sector. Research and Development expenditure (per ESA10)
ALB transactions with the private sector	As the department. Note: the department's grant in aid to ALBs is excluded from budgets.	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)

Public Corporations	Subsidies paid to Public Corporations *Less* interest and dividends received from Public Corporations	Investment grants paid to Public Corporations Net lending to Public Corporations (Voted and NLF) Public Corporations' market and overseas borrowing (including on balance sheet PPP) *Less* equity withdrawals from Public Corporations

Appendix 2 to Chapter 1: Diagram of existing budgetary categories



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

1.113 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.

1.114 The control totals are:

- resource DEL (broken down into the non-ringfenced and depreciation ringfenced budgets)
- administration budget
- capital DEL (for some departments, broken down into the non-ringfenced and financial transaction ringfenced budgets)
- any department-specific policy ring-fences

1.115 The planning totals are:

- resource AME
- capital AME

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

1.116 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 using the criteria below. The AME treatment of individual bodies is kept under review.

1.117 Where an AME treatment has been approved for spending, the income from the levy must also be recorded in AME by the body.

1.118 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

1. 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
2. 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
3. the expenditure must be suitably ring-fenced. Normally, that would mean that the whole body should fall into this category
4. the body should be self-financing in cash terms. With no recourse to departmental grants or subsidies. Where, exceptionally, grants or subsidies are paid, the expenditure funded by those grants would score in DEL
5. 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
6. 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

1.119 Prior period adjustments (PPAs) are adjustments where data for an earlier year needs to be restated. 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 Estimates

1.120 Although PPAs are primarily an accounting concept, they also impact Estimates. From an Estimates perspective PPAs fall into two categories:

- a restatement of outturn 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, or a change in accounting policy under the department's control

1.121 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.

1.122 Where a PPA results from the correction of an error, or a department's choice to change accounting policy, it has the potential to change net budgets and thus the reported outturn for previous years. In such cases the Treasury 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. Such PPAs must therefore be included as non-budget expenditure in an Estimate.

1.123 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).

Materiality

1.124 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

1.125 Normally departments do not have any non-budget provision unless a genuine PPA is identified before the Supplementary Estimates are finalised. 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).

1.126 If there is insufficient non-budget provision in the Estimate for the PPA, then it will lead to an Excess Vote. The normal process for regulating Excesses will then be followed.

Negative PPAs: no need for approval

1.127 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.

Re-recording budgets on the database

1.128 Once the year in which the PPA features has passed, departments should re-state budgets to reflect the corrected budgetary outturn (DEL or AME, resource or capital) in the years affected on the OSCAR database. 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 departmental accounts and noted in the Estimate.

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

1.129 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, (for example 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

1.130 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 (i.e. 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 ALBs 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. The FReM provides further guidance on the accounting treatment for all business combinations under common control.

Chapter 2
Spending Control

Introduction

2.1 This chapter provides an overview of the overall spending control framework that allows the government to manage public money effectively. The budgetary framework is an important part of spending control.

2.2 At a high level, spending control is achieved through robust spending plans, set at Spending Reviews (SRs), and supported by a framework for delivering public value. Delivering these plans requires efforts in each of the following areas:

- Monitoring spending: ensuring there is accurate and timely management information about what is being spent in all parts of the public sector. This allows the government to monitor progress and intervene when plans go off track (see paragraphs 2.4-2.24)
- Managing spending: improving capacity and capability to manage spending and ensure that efficient and sustainable choices are made about how public funds are used. This requires systems and processes that allow the government to act to mitigate risks, and where risks do materialise, managing them within the spending limits set at SRs (see paragraphs 2.25-2.58)
- Delivering Public Value: ensuring that there is a plan for prioritising key outcomes, aligning activity towards delivering them (see paragraphs 2.59-2.65)
- Governance, scrutiny and oversight: from those responsible for managing public money at Ministerial and Official level and on Departmental Boards, to ensure that progress and practice is regularly reviewed and challenged (see paragraphs 2.66-2.86)

2.3 Each of these areas is summarised in this chapter, with a summary checklist at the end of each section for departments to consider. Additionally, refer to the Government Finance Function Strategy document for more detail on how efforts are being made to improve each of these areas across government.

Monitoring spending

2.4 The public sector, on behalf of the citizens, manages over £800 billion of public spending a year. It is essential that the government has good information about what it plans to spend, and what it actually spends. This information should be:

- Robust and reliable: so that data is accurate and forecasts are as good as they can be;
- Consistent: within and between organisations; and
- Timely: so that data is provided on a monthly basis and with minimum delay.

2.5 This is a prerequisite for effective spending control, and is the kind of information that any well-run organisation should have in any case. It enables the government to monitor spending; intervening where necessary to ensure the government delivers its plans.

2.6 All organisations that are part of the central government have the same responsibilities to produce and share robust, timely financial information to support the management of the public finances. Working with the Treasury, departments should agree with their ALBs how this need will be met. This duty is entirely consistent with the freedoms and flexibilities that departments and ALBs have to manage their money.

2.7 Departments and devolved administrations provide financial information to the Treasury via the Online System for Central Accounting and Reporting (OSCAR).

2.8 This information is published in a number of reports for Parliament and the public, providing the main source of central government expenditure data for the Budget, Supply Estimates, Public Expenditure Statistical Analyses (PESA), monthly Public Sector Finances and the national accounts.

2.9 Additionally, this information should be used in evaluation plans for new and existing programmes of spend (discussed in more detail below).

Robust, relevant data

2.10 Decisions about the management of public money must be made on the basis of robust and relevant information. This information must allow frontline organisations, departments and the Treasury to assess whether spending control totals will be met based on current plans and on actual spend to date. And it must allow risks to spending control to be identified and mitigated.

2.11 For the purposes of on-going spending control, all departments and devolved administrations must monitor and share spending information with the Treasury on a monthly basis.

2.12 Departments and the Treasury must agree what information will be provided, focusing on the core information needed to manage the public finances. The exact requirements for each department will be agreed with the Treasury, but will, at a minimum, include accurate information on actual and planned spend. This should include robust forecasts of full year spend, and a breakdown of monthly spend, every month from the beginning of the financial year. Forecasts should be based on departments' best information and an assessment of risks.

2.13 This is necessary to provide information to ministers about forecast levels of public spending, both to enable them to monitor the overall fiscal position but also to take spending decisions and to ensure expenditure is allocated in a way that provides value for money. Sound forecasts enable the government to ensure that departments are not overspending but also to identify in good time, and then reallocate, any underspends.

2.14 Departments and devolved administrations should confirm the accuracy of their OSCAR data by reconciling it to internal management information. Good practice is to have OSCAR fully aligned at every level or to be able to explain any differences.

2.15 The Treasury will support departments and devolved administrations by providing clear and comprehensive guidance on the classification of public spending data, and by providing a robust system (OSCAR) to collect, analyse and report this information.

2.16 Where the information currently provided is insufficient to monitor public spending effectively, the Treasury will agree with departments the steps needed to rectify this and how the department can be supported to achieve this. In addition to data on actual and planned spend, departments should provide detail on how SR plans will be implemented and achieved.

2.17 Where departments have a good track record of providing accurate and timely information, OSCAR data will already mirror internal management information, and flexibilities such as Budget Exchange will be fully available to these departments within the rules set out in this document.

2.18 For departments who produce or share less accurate or incomplete information, the Chief Secretary may take steps to minimise the risk to the public finances and to incentivise improvement. These may include restrictions of access to Budget Exchange and other budgetary flexibilities, lowered delegated authorities and mandating Departmental Unallocated Provision (DUP).

Consistent data

2.19 There must be consistent information about what the government is spending, both within and between organisations. Data should not be withheld. This ensures that decisions are taken on the basis of financial information that is as accurate and comparable as possible. Data supplied should be consistent with rules as set out in this document, and with definitions as stated in the Treasury Chart of Accounts.

2.20 Sharing of information must also be consistent. Departments should under no circumstances withhold basic data about public spending. The public has a right to know how its money is being spent. The Treasury is responsible for ensuring that spending is managed effectively, on behalf of citizens and Parliament. This fundamental role on behalf cannot be fulfilled without complete transparency about what is being spent.

Timely data

2.21 Without timely information, the government cannot take action to prevent plans going off track before it is too late.

2.22 A minimum of monthly data should be the presumption for spending departments and devolved administrations, and it should usually be available no more than one month in arrears.

Evaluation plan

2.23 As part of monitoring spending, everyone involved in the implementation of a new policy or programme should understand what its success or failure would look like. This makes it necessary to reach agreement on appropriate metrics for evaluating impact at the start, which can only be measured accurately if implementation is designed to facilitate collection of that specific data.

2.24 Bids for new programmes (and preferably legacy spend) should have robust evaluation plans included. Business case approval will not be secured without commitment to some measuring impact, an understanding of which is best gained through rigorous experimentation, for example a randomised control trial. Data collection and evaluation of this standard should be carried out throughout the policy's life – which should in the first instance be a pilot, with continuation subject to meeting the agreed success level against the observed metric. Please refer to the Green Book for more detail on business cases and spending bids.

Box 2.A: Monitoring spending checklist

1. All departments and devolved administrations must monitor and share spending information with the Treasury on a monthly basis. Departments and the Treasury must agree what information will be provided, focusing on the core information needed to manage the public finances. All organisations that are part of the public sector have the same duty to produce and share robust, timely financial information. The exact requirements for each department will be agreed with the Treasury, but will, at a minimum, include accurate information on actual and planned spend. Departments and devolved administrations should confirm the accuracy of their OSCAR data by reconciling it to internal management information. Good practice will be to have OSCAR fully aligned at every level or to be able to explain any differences.
2. The Treasury will support departments and devolved administrations by providing clear and comprehensive guidance on the classification of public spending data, and by providing a robust system (OSCAR) to collect, analyse and report this information.
3. Departments and devolved administrations must provide robust forecasts of full year spend, and a breakdown of monthly spend, every month from the beginning of the financial year, which reconciles with their internal management information.
4. The data provided to the Treasury must be consistent with the data departments use for internal management purposes, so that decisions are taken on the same basis and there is an agreed position on what departments are spending. Departments and devolved administrations should therefore confirm the accuracy of their OSCAR data each month by reconciling it to their internal management information.
5. Departmental Boards, supported by their Non-Executive Directors, are responsible for ensuring that the data provided to the Treasury is consistent with the information used internally.
6. A minimum of monthly data should be the presumption for spending departments and devolved administrations, and it should usually be available no more than one month in arrears.
7. All new programme spend (and ideally legacy spend) must have an evaluation plan.

Managing spending

2.25 Good business planning is an essential part of managing spending. Each public sector organisation should plan to use the limited budget that it has to achieve good value for money and ensure that efficient and sustainable choices are made about how public funds are used. This means keeping an eye on the medium and long term picture, re-assessing risks and evaluating alternative ways of achieving policy objectives.

2.26 In order to manage spending, departments need to assess risks and change priorities effectively. Key to this is:

- good risk management
- a robust approach to contingency so that when risks do materialise, they can be managed within existing budgets
- having the right skills and embedding spending control in the culture of public sector organisations
- controlling spending throughout the year and
- efficient cash management

Risk management

2.27 The Treasury has a range of risk management processes, based on its principle of devolving responsibility for managing spending as far as possible. In particular:

- Treasury spending teams work closely with their respective departments to identify and monitor risks to delivering SR plans
- those risks of the highest order, which would have a significant impact on the government's overall fiscal position, are monitored by the Chief Secretary on a monthly basis, when the latest intelligence on likelihood and scale of risks, and departments' plans to mitigate these are scrutinised
- the Chief Secretary conducts a programme of bilaterals with the relevant departments on a regular basis, to discuss how these risks are being managed and
- the Chief Secretary updates the Chancellor on a regular basis, ensuring oversight of the top level risks

2.28 Complementing this process, departments are expected to have:

- a rigorous approach to assessing risk, conducting an evidence-based assessment of the likelihood and scale of risks occurring, and sharing this with the Treasury. To support this, departments should regularly review their departmental financial risk management systems in discussion with the Treasury, agreeing priorities for improvement
- a proactive and collaborative approach to risk management: Public sector organisations, departments and the Treasury should work together to mitigate risks before they hit the public finances, using early warning systems to intervene in a timely way. Departments should share their in-depth assessment of spending risks with the Treasury on a monthly basis, agreeing mitigating actions and monitoring systems as presented to departmental boards and
- a process for continually monitoring AME, with an understanding of the volatility of the area of spending should be used to identify when spending is off track and where interventions should be made to bring costs back to planned levels so that forecasts are met

2.29 Please refer to the Orange Book for a more detailed description of risk management across government.

Approach to contingency

2.30 Apart from in a small number of exceptional cases, departments are expected to manage new pressures within their existing budgets. Departments are therefore expected to have a robust approach to contingency.

2.31 All departments should identify around 5 per cent of their allocated DEL that could be reprioritised to fund unforeseen pressures in their area of responsibility, and to share these plans with the Treasury. This amount can be made up either by contingency plans or by a DUP, or a combination of the two.

2.32 While recognising the differences between DEL and AME, departments with particularly large non-pension AME spending should consider options for reprioritisation across Total Managed Expenditure.

Departmental unallocated provision (DUP)

2.33 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 DUP.

2.34 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

2.35 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)

2.36 Exceptionally, a department may seek support from the Reserve. As part of the spending plans announced in SRs, 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 be stripped out when baselines are agreed for SRs. The failure to hold sufficient contingency will count against the department when decisions about granting support from the Reserve are taken.

2.37 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.

2.38 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 must be voted in Estimates and should normally be voted at Supplementary Estimates when such an assessment can most easily be made.

2.39 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

2.40 In addition:

- the Chief Secretary may ask for a lessons learned review in each case where Reserve support is approved. This review will be an independent or peer review as appropriate
- the process for assessing Reserve claims will take account of the department's or devolved administration's capability and past performance. This will include an assessment of the amount of Reserve funding allocated in the past, the number of Reserve applications received, and any cases where Reserve funding has been allocated and gone unspent in previous years
- particular conditions and/or penalties will be applied to Reserve claims that relate to failures of financial management, and inappropriate Reserve claims will be rejected

2.41 The Chief Secretary may also consider further remedial action for those who break the rules or clearly fall below expectations. This may include asking the NAO to investigate the value for money that the department achieves, conducting a financial management review, reducing delegated authorities, removing access to Budget Exchange and/or making deductions to administration budgets. In all cases, the Treasury retains the right to apply whatever penalties are appropriate to incentivise good financial management and value for money.

2.42 All additional funding from the Exchequer should be presumed to be a Reserve claim, except where agreed as part of the Budget Exchange system or explicitly stated otherwise in writing by the Chief Secretary.

The Reserve and contingent liabilities

2.43 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 crystallises, 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

2.44 Departments are expected to keep track of their authorised control totals on OSCAR, including any changes from Machinery of Government changes, other classification and transfer changes, issues from central funds, authorised transfers to resource DEL, 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:

- resource DEL (broken down into the non-ringfenced and depreciation ringfenced budgets)
- administration budget
- capital DEL (for some departments, broken down into the non-ringfenced and financial transaction ringfenced budgets)

2.45 Departments and spending teams should also have a mutual understanding of the planned levels, and risks of variance to plans, of

- resource AME
- capital AME

2.46 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

2.47 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 Chapter 1 for more details of how PPAs should be treated in budgets.

2.48 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 DEL (including the ringfenced and non-ringfenced limits, and the administration budget)
- capital DEL
- resource AME
- capital AME
- non-budget expenditure

Note that there are separate Parliamentary consequences of breaching budget control totals described in the Supply Estimates guidance manual .

2.49 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

2.50 When departments overspend against their control totals, there may be an offsetting reduction in the corresponding control total in the following year.

2.51 Breaches in departmental AME do not automatically incur a penalty (although they may result in an Excess Vote if the Voted limit is exceeded—see the Supply Estimates guidance manual for further details. However, unforeseen changes in spending may indicate poor financial management by departments. The department should therefore write to their Treasury 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.

2.52 Departments should discuss with their Treasury spending teams their proposals before their Minister writes to the Chief Secretary.

Box 2.B: The process for making Reserve claims

Departments and devolved administrations should contact their spending team at the earliest possible opportunity if they are considering applying for Reserve support, to ensure they have sufficient time to present their case. Where a decision is required urgently, and convincing evidence has not been provided, the presumption will be that the pressure can be managed by the Department or devolved administration.

Applications for Reserve support must be supported by written evidence, which includes a credible and detailed assessment of offsetting actions that have been taken and could be taken to manage the pressure and absorb it. More detail is set out in this chapter.

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. The final draw down of Reserve claims approved by the Chief Secretary will therefore be decided, and voted on, at Supplementary Estimates when such an assessment can most easily be made. In most cases Reserve claims must be repaid the following year by means of a reduction in the Department's, or devolved administration's, DEL.

Controlling spending through the year

2.53 Good spending control demands that public sector organisations monitor performance against objectives through the year and make adjustments to stay on track. This requires prompt and accurate management information systems coupled with active top management engagement.

2.54 There is no place for excess expenditure or low-value spending in the last quarter of the financial year. Any evidence of excessive spending at the year-end in areas that will not generate savings in future years will be taken into consideration in future decisions on spending issues, including the allocation of funding.

2.55 Spending must be properly managed throughout the year and Accounting Officers are in breach of their duties if they permit expenditure to be incurred without the due approvals in place.

Cash management

2.56 Together, public sector organisations handle a great deal of public money and carry out many financial transactions every working day. It is essential that these are handled in a way that is efficient and safe for the Exchequer as a whole. Accounting Officers are responsible for the credit risk to which public funds are exposed when held in commercial banks. It is important that they manage this risk actively, so that it is kept to a minimum.

2.57 For most public sector organisations, this in practice means using the Government Banking Service (GBS). Any excess cash is automatically entered into the Exchequer accounts at the Bank of England, both during and at the end of each working day. This enables the Debt Management Office (DMO) to manage the Exchequer's cash position efficiently by financing any net government overnight debt or investing any overnight balance. Any other arrangement would expose the government to increased credit risk and mean greater government borrowing, costing the Exchequer more overall.

2.58 Each public sector organisation should run its cash management and money transmission policies to minimise the cost to the Exchequer as a whole. This would normally mean using the Government Banking Service.

Box 2.C: Controlling spending checklist

Risk management

1 To support risk management, departments should regularly review their departmental financial risk management systems in discussion with the Treasury, agreeing priorities for improvement. Departments should share their in-depth assessment of spending risks with the Treasury on a monthly basis, agreeing mitigating actions and monitoring systems as presented to departmental boards.

Contingency

2 All major spending departments will be asked to identify around 5 per cent of their allocated DEL that could be reprioritised to fund unforeseen pressures in their area of responsibility and to share these plans with the Treasury. This amount can be made up either by contingency plans or by a DUP, or a combination of the two. While recognising the differences between DEL and AME, departments with particularly large non-pension AME spending should consider options for reprioritisation across Total Managed Expenditure.

The Reserve

3 The Chief Secretary may ask for a lessons learned review in each case where Reserve support is approved. This review will be an independent or peer review as appropriate.

4 The process for assessing Reserve claims will take account of the department's or devolved administration's capability and past performance. This will include an assessment of the amount of Reserve funding allocated in the past, the number of Reserve applications received, and any cases where Reserve funding has been allocated and gone unspent in previous years.

5 Particular conditions and/or penalties will be applied to Reserve claims that relate to failures of financial management or are inappropriate.

6 Departments may be expected to pay back Reserve funding in the following year.

7 The Chief Secretary may consider further remedial action for departments who break the rules or clearly fall below expectations.

Controlling spending throughout the year

8 Any evidence of excessive spending at the year-end in areas that will not generate savings in future years will be taken into consideration in future decisions on spending issues, including allocation of funding.

Cash management

9 Each public sector organisation should run its cash management and money transmission policies to minimise the cost to the Exchequer as a whole. This would normally mean using the Government Banking Service.

Delivering Public Value

2.59 The government is focussed on driving improvements in outcomes. Departments are expected to prioritise their key outcomes and align their activity to delivering them. There will also be an emphasis on improving public value in the delivery of these outcomes.

2.60 The introduction of the Public Value Framework (PVF) was the main recommendation of Sir Michael Barber's 2017 report on improving value in public spending. It is a tool for assessing how effectively public bodies are delivering value to the taxpayer. The framework sets out the action that departments should take to maximise the delivery of policy outcomes for the public money they receive, creating a set of criteria that can be used to develop a detailed understanding of how they can improve performance. Departments will be required to self-assess their delivery of priority outcomes against the PVF, which will enable them to identify changes they will make to improve their processes for turning funding into outcomes.

2.61 The Treasury will also use the Public Value Performance Tracker to support improvements to the evidence base that will underpin priority outcomes to inform future spending decisions

2.62 A key goal of the Public Value Performance Tracker is to link spending decisions to outcomes, recognising that getting to a robust understanding of this link in all areas is something to work towards. The Treasury is seeking to:

- drive improvements in performance, focused on key government priorities
- increase public value in the provision of public services across government and
- build capacity in robust performance monitoring and evaluation

2.63 In light of this, at the 2019 Spending Round the Treasury asked each department to:

- propose three to four priority policy delivery outcomes, including cross-departmental outcomes where appropriate– (these should not cover all the department's activities or spend)
- set out appropriate metrics they propose to use to track performance against these outcomes, provide data on performance to date and set out their plans for improving performance measurement for outcomes that are not currently robustly measured
- set out which elements of their proposed spending (including both baselined spending and bids) support these priority outcomes and metrics, and the estimated trajectory of these metrics over the SR period given their proposed spend
- set out progress made on improvements against the PVF they committed to in SDP 19/20, consider whether these are the areas departments want to continue improving over the SR period, or commit to making new improvements if appropriate and

- lay out their departmental experimental and evidence gathering capacity

2.64 Departments are required, as part of departmental settlements, to provide on a quarterly basis their latest data on performance against their priority outcomes.

2.65 The information on performance against estimated trajectories for metrics and against the PVF will be used to identify, at an early stage, where priority outcomes are at risk of not being achieved, and where departments need to take steps to maximise public value. It will be used to inform any interventions (such as Public Value Reviews, Costing Projects and 'deep dive' reviews) agreed by the department and the Treasury to improve this performance, and to make better evidence-based decisions on future spending including at future Budgets and SRs.

Governance, scrutiny and oversight

2.66 Robust governance, scrutiny and oversight are integral to ensuring that spending is controlled effectively. This means ensuring that:

- the authorities for departments to spend or commit public funds without prior Treasury approval are delegated in a way that reflects the level of risk to the Exchequer and
- mechanisms are in place through which those accountable for managing public money at ministerial and official level can ensure that the government's spending control objectives are delivered

Delegated authorities and approvals

2.67 The Treasury controls public expenditure. Parliament looks to the Treasury to make sure that:

- departments use their powers only as it has intended and
- revenue is raised, and the resources so raised spent, only within agreed limits

2.68 This means that formally, Treasury consent is required for all commitments to expenditure.

2.69 Without it, expenditure is irregular. This applies to both resource and capital spending.

2.70 Treasury approval:

- must be confirmed in writing, even where initially given orally
- cannot be implied in the absence of a reply and
- must be sought in good time to allow reasonable consideration before decisions are required

2.71 In practice, however, the Treasury delegates authority to departments to enter into commitments and to spend within predefined limits without specific prior approval. This is important for ensuring that those closest to the decisions on the ground have the authority to manage public money efficiently and effectively.

2.72 The Treasury agrees these delegated authorities in writing with each department, so there is clarity about where Treasury approval is required. Authorities are considered carefully to ensure they strike the right balance between the need for the Treasury to account to Parliament for the use of public money, and for the government to function efficiently.

2.73 In order to secure approvals, it is essential that big projects are appraised critically as business propositions. For large spending projects, there is a standardised process that all projects needing Treasury approval must follow.

2.74 Treasury approval is required at a minimum of three stages – Strategic Outline Case; Outline Business Case; and Full Business Case.

2.75 The Treasury will not normally approve business cases unless an assessment of delivery confidence has been carried out by the Major Project Authority in the Cabinet Office, or before receiving an up-to-date Approval and Assurance Plan.

2.76 Treasury will decide the level of scrutiny appropriate for each project approval under the Treasury Approval Point Framework, full details of which can be found here.

Ministerial governance

2.77 It is for Secretaries of State to ensure delivery of their own spending plans. The Treasury has a role in scrutinising these plans, ensuring that the overall plan is delivered.

2.78 The Chief Secretary conducts a rolling programme of bilateral meetings with the main spending departments, discussing progress in delivering their plans and the steps departments are taking to strengthen their approach to spending control. The Chief Secretary reports to the Cabinet, which oversees progress at the highest level.

Official level governance

2.79 The Accounting Officer role is a strength of the UK budgeting system and ensures that every public sector organisation has someone whom Parliament may call to account for the stewardship of the resources within its control. Accounting Officers are responsible for ensuring their organisation meets specific standards, as set out in Chapter 3 of Managing Public Money. These standards include:

- respecting Treasury spending limits and achieving sustainable spending plans
- ensuring that forward spending plans are sustainable in the medium term
- operating effective management information systems so that the department can give timely, accurate and realistic reports of its business to the Treasury
- acting within the law and meeting Parliament's expectations about transparency
- avoiding fraud, waste and other misuse of public funds and

- securing good value for the use of public money in the furtherance of ministers' objectives

2.80 Accounting Officers in departments are appointed by the Treasury. The Chief Secretary will write to the Secretaries of State and the Head of the Civil Service where they are concerned that Accounting Officers may fall short in fulfilling their responsibilities for managing public money.

2.81 In relation to the devolved administrations in Scotland, Wales and Northern Ireland, the Treasury will continue to explore opportunities to promote the sharing of best practice.

Departmental Boards

2.82 Each department is led by a Board chaired by the senior Minister in the department and supported by several Non-Executives with relevant business experience. The board guides the Permanent Secretary in implementation of the department's policies and spending plans. Members of the board are expected to challenge the department constructively to ensure that plans are robust and effective. They also seek to assess the more remote or subtle risks the department faces so that contingency plans can be put in place.

2.83 An effective board is able to view the department's business in a broad context, enabling it to improve its delivery, its readiness for exogenous shocks and its resilience. Such support for the permanent staff underpins the department's capability, including its ability to live within its budget.

2.84 Non-Executive Directors have a significant role to play in good management within departments including strengthening spending control through supporting and challenging the executive's decisions around the management of the department's business. The senior Non-Executives from each department form a network, which enables good practice to be propagated and can promote accurate delivery of spending plans. Lead Non-Executive Directors give a high priority to improving management information and risk management systems within departments, and work closely with their departmental boards to drive changes in these areas.

Scrutiny

2.85 It is important that departments secure good value for money for the resources they deploy. It is good practice to work cooperatively with the NAO, where studies of particular areas of departments' business can suggest greater efficiency or other improvements.

2.86 Departments that do not operate effective control and management systems, or which achieve poor value for money, can expect censure from the NAO.

Box 2.D: Governance, scrutiny and oversight checklist

Ministerial governance

1 The Chief Secretary conducts a rolling programme of bilateral meetings with the main spending departments.

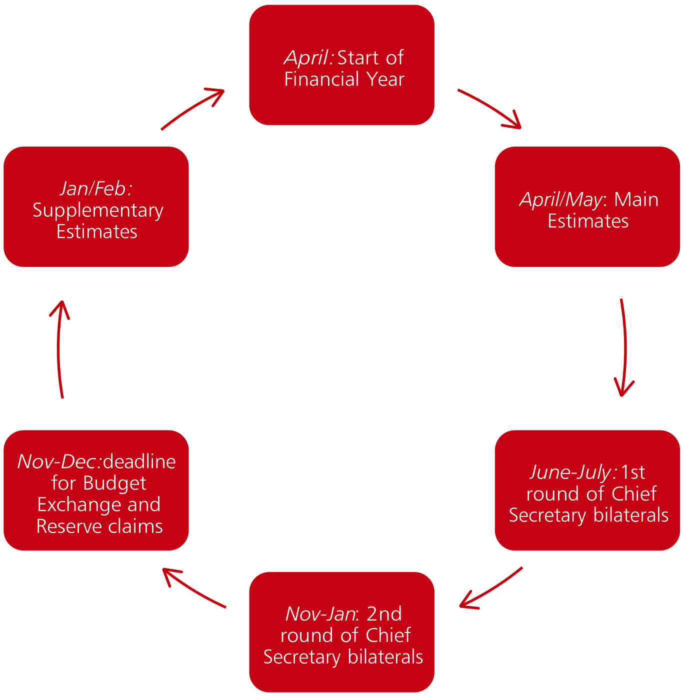
Official level governance

2 The Chief Secretary will write to the Secretaries of State and the Head of the Civil Service where he is concerned that Accounting Officers may fall short in fulfilling their responsibilities for managing public money.

Appendix 1 to Chapter 2: The annual spending control cycle

Monthly recurring actions:

- OSCAR returns
- Publication of the Public Sector Finances statistical bulletin.



Chapter 3

Resource Budget

Introduction

3.1 Current expenditure by government is one of the most targeted areas of spending control. The Public Sector Current Expenditure (PSCE) fiscal aggregate specifically monitors current expenditure. Current expenditure is also a key component of Public Sector Current Budget (PSCB) and Public Sector Net Borrowing (PSNB). Current expenditure is controlled through the resource budget.

3.2 The resource budget includes expenditure on pay; current procurement; current grants and subsidies; depreciation; and the creation, revaluation and release of provisions. The resource budget contains both transactions that have an immediate impact on the fiscal position (for example pay and procurement), and those that will have an impact in the future (for example impairments and provisions).

3.3 Since the resource budget includes the resource consequences of acquiring and owning assets (for example, depreciation and maintenance), departments should consider the inter-relationship of the resource and capital budgets when planning and monitoring expenditure. That consideration should help departments manage their entire asset base as well as considering annual changes to the asset base through new investments or disposals.

3.4 This chapter covers in detail the treatment of some specific areas of expenditure in the resource budget. This chapter provides guidance on the following areas:

- Grants and subsidies (paragraphs 3.7-3.15)
- Fixed assets (including depreciation, impairment and revaluation) (paragraphs 3.16-3.46)
- Current assets and liabilities (including inventory, trade receivables, and accounts payable) (paragraphs 3.47-3.57)
- Provisions (paragraphs 3.58-3.70)
- Other miscellaneous areas (insurance, tax credits, notional audit fees and European Union spending) (paragraphs 3.71-3.87)

3.5 See Chapter 4 for the treatment of income in resource budgets. See also Chapter 5 for the rules governing the division of the resource budget into administration and programme totals. See separate chapters for the resource budget implications of financial transactions, PPP deals, pensions, support for local authorities and support for public corporations.

3.6 For elements of current expenditure not specifically referenced in this document, departments should assume that this expenditure scores 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. Consult the Treasury with any queries.

Grants and subsidies

Overview

3.7 Departments may make unrequited transfer payments to businesses or individuals for a number of reasons. These payments must be classified for budgetary purposes as either capital grants, current grants or subsidies. Current grants and subsidies score in the resource budget; capital grants score in the capital budget.

3.8 There is a misalignment between departmental accounts and the national accounts in terms of accounting for grants and subsidies. The budgeting requirements in this area align with the national accounts framework.

3.9 The national accounts distinguish between current grants, subsidies and capital grants. Current grants and subsidies are recorded as current expenditure in the national accounts while capital grants form part of capital expenditure; as such, they affect the Public Sector Net Investment (PSNI) fiscal aggregate.

3.10 Departmental accounts do not distinguish between current grants, subsidies and capital grants. All grants and subsidies score as an expense in the departmental accounts and there is no associated capital impact.

Distinction between capital grants, current grants and subsidies

3.11 Capital grants are unrequited transfer payments, which the recipient has to use to either:

- buy fixed assets (land, buildings, machinery etc.)
- buy inventory
- 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

3.12 Payments of compensation to owners of capital goods destroyed or damaged by acts of war or natural disasters should be classified as capital grants. 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 regarding these payments.

3.13 Subsidies are current payments paid to profit-making bodies designed to influence levels of production, prices or wages.

3.14 Where an unrequited payment does not meet the descriptions in paragraphs 3.11-3.13, it should be treated as a current grant.

3.15 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. Capital grants, current grants and subsidies should be recognised when the payment is due to be made.

Fixed assets

Overview

3.16 Tangible (for example land, buildings, IT systems) and intangible (for example patents, IT software, trademarks) assets are referred to collectively in this document as 'fixed assets'. Fixed assets do not include financial assets such as investments (see Chapter 8 for their budgeting treatment).

3.17 Fixed assets impact on the resource budget mainly in terms of their subsequent measurement after they are acquired: through depreciation, maintenance costs and impairments. This chapter provides more guidance on these areas, including whether these elements should score in DEL or AME.

3.18 Chapter 4 sets out the resource budget impact of gains or losses on the disposal of fixed assets. Chapters 6 and 7 provide further guidance on the capital budget impact of new spending on fixed assets and their disposal.

Depreciation

3.19 Depreciation is a way of allocating the cost of an asset over its useful life. It is a measure of the decline in value of a fixed asset, as a result of normal wear and tear or obsolescence.

3.20 Depreciation is charged on fixed assets annually and scores in the resource budget. Depreciation is charged in budgets so that departments are held to account for the current cost associated with ownership of an asset.

3.21 Depreciation is a feature of both departmental accounts and national accounts. In national accounts, it is known as consumption of fixed capital, and impacts a number of fiscal aggregates.

3.22 Departmental accounts and national accounts use different methods to calculate depreciation. For budgetary purposes, depreciation values from departmental accounts should be used. These will depend on the accounting policies and estimation techniques used by departments. 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.

3.23 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.

3.24 Departmental accounts use the phrase depreciation for tangible assets, and amortisation for intangible assets—budgets refer to depreciation for all fixed assets.

DEL vs. AME

3.25 The general rule is that depreciation scores to DEL. The Treasury will agree that depreciation should score to AME only in exceptional cases.

3.26 Some of these cases include:

- where the purchase of assets is funded from the Lottery, a capital grant, or the private sector;
- an asset is a donation in kind; or
- an asset is purchased using the proceeds from a donation

In these cases, 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.

3.27 The intention of this exceptional treatment is to ensure departments have appropriate incentives and budgetary flexibility to accept grants. Chapter 7 contains further detail on the budgeting for receiving capital grants.

Depreciation ring-fence

3.28 As discussed in Chapter 1, the budgets for depreciation and impairments scoring in DEL are within a ring-fenced part of the resource DEL budget[1]. Departments should have a shared understanding with Treasury of what part of their resource DEL budget is within this ring-fence. Resource DEL budget can be switched freely into the ring-fence, but this ring-fenced cover cannot be moved out to fund other resource or capital DEL spending.

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

Impairment

Overview

3.30 Impairment is used to measure declines in value of fixed assets that are not captured by depreciation (for example, due to unforeseen damage or obsolescence that was not built into a depreciation schedule). Impairments of fixed assets score to the resource budget so that departments are held to account for the cost associated with these declines in value.

3.31 Impairments of fixed assets are recognised at the same time, and at the same amount, in budgets as in departmental accounts. The concept of impairment is not recognised in national accounts.

[1] In rare cases, depreciation of fixed assets may score outside the ringfence with Treasury approval.

3.32 Impairments for fixed assets are scored in a ring-fenced budget with depreciation, as described above.

DEL vs. AME

3.33 When a tangible fixed asset is impaired, the scoring of the impairment to AME or DEL is dependent on the reason for incurring the impairment. The same principles apply to intangible fixed assets, but where a department believes an intangible fixed asset is subject to one of the categories of impairment below it should first contact the Treasury.

3.34 The general principle used to distinguish whether an impairment scores to AME or DEL is whether the reason for the impairment is in a department's control (in which case, an impairment should score to DEL). 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 below categories are based on descriptions of impairment in the FReM.

3.35 The following types of impairment 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

3.36 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 Treasury, as these are rare events
- unforeseen obsolescence. 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 Treasury.
- other – Scores as AME. This category includes:
  - changes in market price (in some cases—see paragraph below)
  - 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 the Treasury

3.37 An impairment due to changes in market price will not automatically score in budgets. To the extent such an impairment can be offset against any revaluation reserve in the departmental accounts for the asset in question (see paragraphs 3.39-3.43 on revaluation), there is no budgetary impact. Once that element of the reserve is exhausted, impairments due to changes in market prices should score in AME (as they score to net expenditure in departmental accounts). This category of impairments 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 nonspecialised 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

Theft

3.38 Theft of assets is treated as a write-off or impairment of fixed assets or inventory, depending on what is stolen. Either way, the write-off or impairment will score to resource DEL (under the category of loss or damage resulting from normal business operations).

Revaluation

3.39 Revaluation involves periodically remeasuring fixed assets to ensure they are measured at a current value after taking into account impairment and depreciation (as opposed to a historical cost model). Revaluation can reflect both increases and decreases in the value of an asset.

3.40 In departmental accounts, some revaluation changes impact net expenditure; it is only these revaluations that score in resource budgets. In the national accounts, revaluations of fixed assets are reflected as a balance sheet change and do not impact current expenditure.

3.41 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 (for example physical damage) or a deterioration in the quality of service provided by the asset or
- a change in market price

3.42 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, recognised in net expenditure in the departmental accounts, and would score in DEL or AME depending on the cause of impairment (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 recognised in net expenditure in the departmental accounts and will score in AME.

3.43 Revaluations that result in an increase in the value of an asset will not score in budgets, as these are not recognised as part of net expenditure in departmental accounts.

Write-offs

3.44 Fixed assets are usually disposed of when they are sold to another party or when the department has consumed all of the economic benefits embedded in that asset and has depreciated or impaired the value of the asset to zero.

3.45 In some cases, fixed assets will need to be derecognised, even when there has been no sale or the value of the asset has not yet been depreciated or impaired to zero. This is referred to as a 'write-off.'

3.46 Write-offs of fixed assets should be recognised in the resource budget in the opposite category as where they were originally scored (for example, if the purchase of the asset originally scored in DEL, the write-off should be scored in AME and vice versa).

Current assets and liabilities

Inventories

Overview

3.47 Inventories are assets held for sale or assets used in production of goods and services for sale. In general terms, inventories will impact on the budget only when they are consumed or written-off, when they are scored to resource DEL. In exceptional instances, certain purchases treated as increases in inventory are included in the capital budget – see Chapter 6.

3.48 This is consistent with the national accounts framework; the consumption of inventory scores to current expenditure and affects fiscal aggregates accordingly. In the departmental accounts, inventory is recognised as a current asset as it is purchased and an expense is recognised when it is consumed.

3.49 For purposes of calculating a potential write-off of inventories, they should be valued at the lower of cost and Net Realisable Value (i.e. the actual or estimated net sale proceeds).

Impairment

3.50 The impairment of inventories always scores to the resource budget. Whether this impairment scores to AME or DEL depends on their initial budgeting treatment:

- the normal budgeting treatment of inventories is that inventory acquisition does not score in budgets, but use and write-off do score. In this case, all impairment of inventory would score in DEL whatever the cause

- exceptionally, the acquisition of some inventory scores in capital budgets (again, see Chapter 6). In that case, inventories are generally analogous to tangible fixed assets, and the rules for the DEL/AME treatment of impairments would follow the treatment for tangible fixed assets

Trade receivables and prepayments

3.51 Departments can create current assets when they have delivered goods and services, but are yet to receive payment (these assets are referred to as 'trade receivables' in this document), or they have prepaid for goods or services. These assets generally represent a movement in working capital, and only impact the budgeting framework through expected credit losses and write-offs.

Expected credit losses and write-offs

3.52 The expected credit loss (ECL) framework described in Chapter 8 applies to trade receivables; however, ECL is recognised in resource AME for trade receivables (as opposed to resource DEL for other loan receivables).

3.53 Write-offs for trade receivables and prepayments score to non-ringfenced resource DEL.

Long-term receivables and prepayments

3.54 In certain cases these types of transactions 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 these transactions as financial transactions in the capital budget of the department concerned. That scoring is intended to capture and control the impact of what is in effect lending.

3.55 Accordingly, departments should treat the whole amount of transactions that meet both of the following criteria as financial transactions in their capital DEL budgets:

- first, the transaction is either
  - a long-term receivable or prepayment (that is a receivable that will last over 12 months at the point that the prepayment is made) or
  - a short-term receivable or prepayment where there is an expectation that it will be renewed so that it is in effect long-term
- second, the total value of the receivable/prepayment involved is above £20 million (where there is a related group of prepayments, the £20 million limit applies to the group)

3.56 There is further guidance on the treatment of these long-term receivables and prepayments in Chapter 8.

Accounts payable

3.57 Similar to current assets, departments can create current liabilities where they have not yet paid for goods or services consumed, or they have received payment in advance of providing the goods or services to which the payment relates. These liabilities are referred to as 'accounts payable' in this document. These liabilities are treated as changes in working capital in the budget.

Provisions

Overview

3.58 A provision is a liability of uncertain timing or amount. A provision is recognised in the departmental accounts when:

- a department has a present obligation (legal or constructive) as a result of a past event,
- it is probable that a transfer of economic benefits will be required to settle this obligation, and
- a reliable estimate can be made of the amount of the obligation (for example 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 FReM.

3.59 The resource budget recognises the creation of a provision in AME at the same time that the departmental accounts do and in DEL when the provision is utilised. When recording provisions in the resource budget there are three key stages:

- the initial recognition, and any revaluation of the provision (such as the unwinding of the discount, or writing back down of the liability), score in resource AME
- the release of the provision scores as an equal and opposite (negative) amount in resource AME.
- if the provision is released because it is utilised, the corresponding recognition of a certain liability or the payment of cash scores in the resource DEL budget

The release and utilisation of a provision will net to zero in the resource budget. However, any utilisation of the provision does not net to zero within DEL. The additional budgetary impact from the release is to be absorbed within existing DEL budgets.

3.60 In rare cases, for example when the underlying spend scores in AME, the third bullet above will score in AME rather than DEL.

Rationale

3.61 In departmental accounts the drawdown of the provision and the release of the provision are simply a movement on the Statement of Financial Position (SoFP) (debit liabilities and credit accrued liabilities or cash).

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

3.63 This dual recognition is because in the national accounts the initial recognition of the provision does not score, rather the actual transfer scores when the liability becomes certain. Scoring the separate elements to the transaction in this way ensures that the information required for the national accounts is available and allows the Treasury to control spending in support of the fiscal framework.

3.64 This need to support the fiscal framework is a key consideration when looking at the impact of provisions in resource budgets.

Scoring examples

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

Table 3.A: 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

Exceptions to general treatment

3.66 Certain provisions in respect of capital spending score in capital budgets – see Chapter 6.

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

3.68 These rules do not apply to provisions in respect of student loans, whose treatment is set out in Chapter 8.

Contingent liabilities

3.69 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 department's SoFP, but are disclosed in notes to their 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.

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

Insurance

3.71 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 transfer that risk to the private sector. However, in certain circumstances departments will have insurance. Payments of insurance premia are current costs in resource DEL.

3.72 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.

3.73 Replacement of the asset will require the appropriate (most likely capital) budgetary cover.

Notional insurance payments

3.74 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.

3.75 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

3.76 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 departmental accounts. Classification of tax credits is based on two criteria:

3.77 **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.

3.78 **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.

3.79 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	Departmental accounts	Trust Statement
Tax Credits treated as integral part of the Tax System for national accounts					
Non-Payable Tax Credit	×	×	×	×	✓
Payable Tax Credit	✓	✓	✓	✓	×
Tax Credits not treated as integral part of the Tax System for national accounts					
Non-Payable Tax Credit	✓	×	✓	✓	×
Payable Tax Credit	✓	×	✓	✓	×

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

3.80 Notional audit fees score in the department's DEL as resource expenditure within administration costs. The expenditure needs to be separately identifiable on the Online System for Central Accounting and Reporting (OSCAR) database in order that it can be removed in the AME accounting adjustments to line up with Total Managed Expenditure as measured in the national accounts.

Costs of European Union spending

3.81 Under the financial settlement agreed through withdrawal negotiations, the UK makes residual financial contributions to the EU budget and receives funding covering a variety of policy areas under the 2014-20 Multiannual Financial Framework. This creates a cost to the Exchequer, through increasing the UK's gross contribution to the budget and reducing the UK's abatement.

3.82 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. In all cases, departments should engage with the Treasury at as early a stage as possible.

Annual budget negotiations

3.83 For financial year 2020-21, 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 departmental accounts, the principle that departments may be held responsible for additional costs to the Exchequer remains.

Funding inside departmental accounts

3.84 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.

3.85 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 departmental accounts

3.86 Departments may not include EU funding in their departmental accounts for one of two reasons:

- while the department is responsible for an 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

3.87 Since these transactions are outside of departmental 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.

Chapter 4
Income and the Resource Budget

Introduction

4.1 Departments will sometimes earn income, for example from the sale of assets, providing services, or from licenses or levies. In the budgetary context, there is an important question about whether or not this income should be retained in budgets and used to manage control totals via being set against gross expenditure. Generally, departments and ALBs may not retain income in budgets except where permitted.

4.2 This chapter specifically talks about the treatment of income in the resource budget.

4.3 This chapter provides:

- an overview of resource budget income, including Estimates and national accounts treatment of that income (paragraphs 4.5-4.15)
- an overview of the different mechanisms by which income can be retained in the resource budget (paragraphs 4.16-4.25)
- further guidance on individual types of income, including:
  - sales of goods and services (paragraphs 4.26-4.27)
  - royalties and rents (paragraphs 4.28-4.38)
  - income where special Chief Secretary permission is required for retention in the resource DEL budget (paragraphs 4.39-4.45)
  - profit or loss on disposal of assets (paragraphs 4.46-4.49)
  - other income (donations, National Lottery distributing bodies, and VAT) (paragraphs 4.50-4.58)
- the requirements around the retention of resource DEL income beyond what was agreed in Spending Review (SR) settlements (paragraphs 4.59-4.70)

4.4 See Chapter 7 for guidance on income in the capital budget; Chapter 8 for guidance on income from financial transactions; and Chapter 11 on departments' income from public corporations.

Overview

4.5 When considering whether income should be retained in the resource budget, the general principle is that income that passes through the

Statement of Comprehensive Net Expenditure (SoCNE) in the departmental accounts should normally be retained in resource budgets, at the same value and with the same timing.

4.6 Income passing through a department's Trust Statement is normally outside of budgets.

4.7 If income is retained in resource budgets, it means that it can be offset against gross expenditure and, therefore, can be used as a means of managing a department's resource budget control total. Resource budget income and expenditure are generally presented separately in Estimates, but are used to arrive at a single net resource budget control total.

4.8 Although income can be used as a means of managing the resource budget control total, there are restrictions over the amount of income that a department is allowed to retain beyond what was agreed in their SR settlements. This is discussed in more detail in paragraphs 4.59-4.70.

Estimates treatment

4.9 Generally, Estimates follow the budget treatment. So, income that can be retained in the resource budget can also be retained in Estimates, and will reduce the voted limits. Additionally, some income may be recorded in Estimates that is not recorded in budgets ('non-budget income').

4.10 In some cases there will be exceptions to the above where income is retained in budgets but the associated cash must be returned to the Consolidated Fund in the Estimate. These exceptions are referred to as Consolidated Fund Extra Receipts (CFERs).

4.11 Within Estimates, income is usually shown in an income column, except in certain circumstances, for example income from ALBs or where the department is acting as an agent, where it is netted off from gross spending.

4.12 See the Supply Estimates guidance manual for further details.

National accounts treatment

4.13 The presentation of income in budgets is different from their treatment in national accounts. This different presentation has no fiscal effect.

4.14 Although presentation of income is different in budgets and national accounts, national accounts criteria are relevant for determining the budgetary classification of income in some cases, such as sales of goods or services and taxes. These areas are discussed in more detail later in this chapter.

4.15 It is the Office for National Statistics (ONS) acting as an independent agency that determines the treatment of income in the national accounts. Annex E gives links to some guidance notes describing the national accounts treatment of income. If you are in any doubt about the national accounts treatment or the budgeting treatment you should approach HM Treasury.

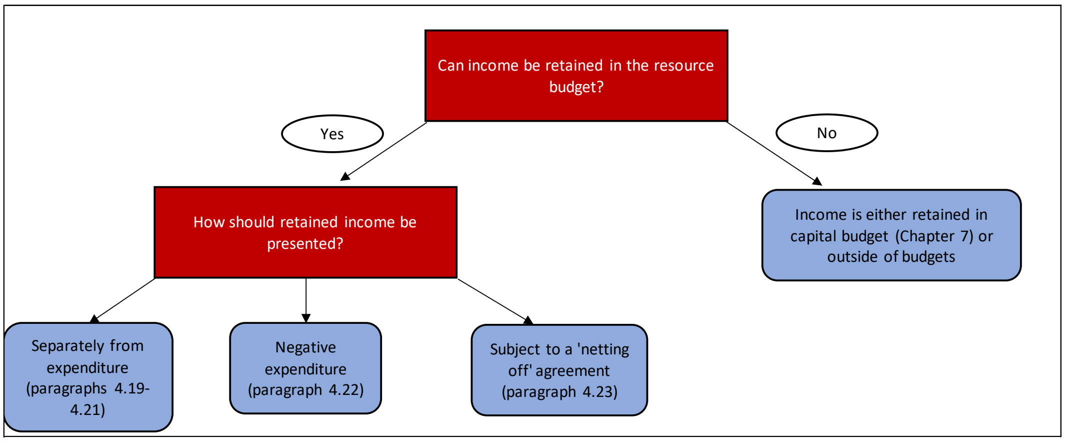
Budgetary classification of income

4.16 When determining the budgetary treatment of income there are two important questions to answer:

- Can the income be retained in budgets?
- How should the income be presented?

4.17 The diagram below gives an overview of the different budgetary classifications of income, based on the above questions.

Diagram 4.A – Budgetary classification of income



4.18 The following paragraphs provide more detail on how to answer the above questions by identifying the types of income that fall into different budgetary classification categories:

Income retained in the resource budget and presented separately from expenditure

4.19 The following forms of departmental income are retained and presented separately from expenditure in resource budgets:

- sales of goods and services (paragraphs 4.26-4.27)
- royalties and associated payments for use of Intellectual Property Rights (paragraphs 4.28-4.35)
- sales of some licences where the ONS has determined that there is a significant degree of service to the individual applicant
- income from insurance payments
- income in respect of compensation (where the ONS treat the income as impacting on the current budget)
- income from leases of property, plant and equipment (rental income) (paragraphs 4.36-4.38)
- those donations that are treated as current in the national accounts (donations can be capital as well) (paragraphs 4.50-4.53)

- income obtained from National Lottery distributing bodies that finances current expenditure (paragraphs 4.54-4.55)
- some income associated with financial transactions, such as interest and dividends (see Chapter 8 for further details)
- income from the EU that finances current expenditure (see Chapter 3 for further details).

DEL vs AME

4.20 By default, income which is recognised in the resource budget will score in DEL in budgets. Income will score in AME where the associated programme or body responsible for the income is also recorded in AME. Income associated with fair value changes for financial assets will also score in AME.

4.21 Departments and ALBs may find that some of the expenditure incurred in generating income will fall in AME due to its transaction type (for example provisions, revaluations etc.). This does not mean that the income, or even a portion of the income, should be recorded in AME.

Income retained and presented as negative expenditure in resource budgets

4.22 Profit on disposal of fixed assets is treated as negative expenditure in resource budgets. That is, it reduces the resource expenditure total rather than being presented separately as income. Profit on disposal of fixed assets is discussed in more detail later in this chapter in paragraphs 4.46-4.50.

Income retained and subject to a 'netting off' agreement in resource budgets

4.23 Income from levies and licenses treated as tax in national accounts, and fines and penalties, is normally not retained in the resource budget. However, this income can be retained where the Chief Secretary to the Treasury has explicitly agreed this through a 'netting off' agreement. This is discussed in more detail in paragraphs 4.39-4.45.

Income that may not be retained in resource budgets

4.24 The following income may **not** be retained in resource budgets:

- taxes, licence fees treated as tax in the National Accounts and levies, unless the Chief Secretary has specifically agreed to retain this income (see paragraphs 4.39-4.45)
- fines and penalties, unless the Chief Secretary has agreed to retain this income (see paragraphs 4.39-4.45)
- economic rents, other than those classed as rent of land
- income treated as capital (see Chapter 7 for further details), including
  - developer contributions that are capital in nature
  - income from the EU that finances capital expenditure

- equity withdrawals/super dividends

4.25 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).

Further guidance on individual types of income

Sales of goods and services

4.26 Sales of goods and services can be retained as income in resource budgets provided they meet the criteria to score as sales of goods or services in national accounts. 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. 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)

4.27 The Treasury has provided a guidance note on when transactions are sales of goods and services in the national accounts.

Royalties and rents

Royalties

4.28 Royalties, as defined in national accounts, are retained as income in resource budgets. Appendix E contains a link to a guidance note on the national accounts treatment.

4.29 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.

4.30 For something to be a produced asset, it should be an intangible asset 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.

4.31 The market value of the royalty should be the value recognised as income– in essence, what the market will pay. So the whole of the amount received for the royalty should be treated as income.

Resource or capital

4.32 There are scenarios where it is difficult to tell whether the income associated with intangible assets is a royalty (which is treated as current income in national accounts, and therefore in the resource budget), or a sale of the underlying intangible asset (which is treated as capital income in national accounts, and therefore in the capital budget). This is particularly the case when a single payment covers a number of years, or a payment is spread over a number of years.

4.33 The tests used by departmental accounts will be a guide as to whether an intangible asset has been sold, or is earning royalties. For more material cases, departments should consult the Treasury to ensure that they are treating the income in accordance with the national accounts.

4.34 In general:

- resource income - royalty for the use of an asset - would be an arrangement offering the user a right to use the asset for a period of time, where underlying ownership of the asset or resource stays with the vendor. Changes in the value of the asset would not normally affect the buyer as they would not be able to sell on their rights
- 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

Economic rents and other cases that are not royalties

4.35 The term "royalty" may be used in a number of cases other than as defined in national accounts. Such income is normally classified as economic rent in national accounts, and is outside of budgets—it is not retained. This income includes:

- "royalties", sales, or rents in respect of assets created in nature, for example North Sea Oil, the radio spectrum, or water (however, see rent of land in paragraph 4.36 below)
- "royalties" or sales in respect of concessions or franchises given by the government to run a commercial or government operation

Rent of property, plant and equipment

4.36 Rental income from leases of property, plant and equipment is retained in the resource budget. Property in this case includes buildings and land.

4.37 In addition to the rent of land, this category of retainable resource income includes rents payable to the owners of inland waters and rivers for the right to exploit such waters for recreational and other purposes. This category does not include rents on sub-soil assets, or of other natural assets (spectrum, etc.), which are generally recognised as economic rents and are outside of budgets.

4.38 Any proposal to retain income from rents of natural assets needs explicit Treasury agreement.

Chief Secretary agreements for income retention and netting-off: tax, licences, levies, fines and penalties

4.39 National accounts define taxes as 'compulsory, unrequited payments' to government. This definition includes some licenses and levies, and fines and penalties. "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 (for example pollution).

4.40 Generally, taxes should not be retained as income in budgets. However, in exceptional cases, the Chief Secretary to the Treasury may agree that this income can be retained as resource DEL income. Such agreements are called 'netting-off' agreements.

4.41 The Chief Secretary will bear in mind the criteria below when considering applications (there are separate criteria for licenses and levies, and fines and penalties):

Box 4.A: Criteria to be applied to applications for new 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, for example because of a difficulty in matching resources to unpredictable changes in externally driven demand. There needs to be a clear advantage over simply increasing 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 SR
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

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

1. will performance against policy objectives, for example 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

4.42 Departments who wish to propose that the above income be retained and netted off expenditure should contact their Treasury spending team for advice.

4.43 Consideration of netting-off proposals should normally be linked to SR 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 SR. As such an agreement to net-off income will be reached alongside an agreement to reduce the department’s resource DEL budget by a compensatory amount.

4.44 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

4.45 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.

Profit/loss on disposal of assets

4.46 Departmental accounts divide the proceeds from the sale of an asset into an element that covers net book value and a profit or loss on disposal.

4.47 The net book value scores as capital income (discussed further in Chapter 7). The profit/loss on sale scores in the resource budget. Any income associated with profit on sale is presented as negative expenditure—that is, it directly reduces a department's expenditure rather than being presented separately from expenditure with other retained income.

4.48 The level of profit on disposal scoring retained in resource DEL is limited to a maximum of £20 million, 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.

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

Donations

4.50 Donations received may benefit either resource or capital budgets. Donated assets and donations in kind are recognised in the capital budget, and are dealt with in Chapter 7. Other donations should be treated as income in the resource budget if they meet the description below.

4.51 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.

4.52 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 should be retained as income in the resource budget. The following are examples of such donations:

- a 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

4.53 There are certain types of donations that should be excluded from budgets. Examples of donations that may not be retained in budgets 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 – for example legacies to reduce the national debt.

Income from National Lottery distributing bodies

4.54 The government's hypothecated income from the National Lottery is a tax. The spending by the National Lottery distributing bodies scores as expenditure in AME.

4.55 Where a government department or ALB that is not a National Lottery distributing body obtains income from a distributing body to finance spending in resource DEL, it should retain the income in resource DEL.

VAT

4.56 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 should therefore not be included in budgets.

4.57 The actual cash paid corresponding to the VAT leads to an increase in receivables for the department. When the VAT is repaid that leads to a decrease in receivables and an increase in cash. The net movement in this receivables 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.

4.58 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 accounts payable until paid over to HMRC (or offset against recoverable input tax). The payment then clears the accounts payable balance.

Retention of additional resource DEL income beyond SR settlements

Background

4.59 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 for statutory services are typically constrained by law to recover no more than current costs, including depreciation (refer to Managing Public Money for further detail). In such cases it is illegal to plan to run surpluses and any surplus income would normally need to be returned to fee payers.

4.60 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.

4.61 In other cases, usually where departments are providing discretionary commercial services into a competitive market, income can generate returns that far exceed current costs of production. In these cases the Government has to balance two considerations:

- consistent with increasing public value, departments should be encouraged to identify and 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

Retention rules

4.62 Departmental budgets are set in the SR net of resource DEL income. The SR settlement therefore has to be informed by the expected level of resource DEL 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.

4.63 Departments will be allowed to keep the 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 resource DEL income up to 10% above the level envisaged for that year as part of the SR settlement without an adjustment to budgets. Note that this budgetary arrangement does not provide cover for departments to retain surpluses generated on statutory services where there is a legal requirement to charge only to cover costs (see paragraph 4.59 above).

4.64 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.

4.65 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 resource DEL income up to 5% of net spending in resource DEL without an adjustment to budgets.

4.66 If departments expect to retain more resource DEL 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 tend to look favourably on requests to retain income above forecast where:

- the additional income has arisen as a result of improved asset management, including commercialisation of retained assets; and
- the department can demonstrate value for money plans for the utilisation of the income

4.67 The Treasury recognises that, in exceptional circumstances, the 10% limit may act as a constraint on departments pursuing certain commercial opportunities that would represent value for money, and that were unforeseeable at the point of the last SR. The Treasury encourages departments to discuss such opportunities with their Treasury spending teams where this is the case.

4.68 The circumstances where a department may earn revenues from improved asset management may be quite broad. These could include value for money sales of assets or commercialising retained assets (for example through the sale of licenses or shares in joint ventures).

4.69 The Treasury recognises that some departments may wish to adopt innovation programmes whereby proceeds (including those in excess of forecast) from knowledge assets exploitation and innovation are reinvested in further research, development, Intellectual Property rights enforcement and protection for example patents, or partly distributed through bonuses to innovators. In these circumstances the Treasury is happy to consider the terms of such schemes in advance, and provide comment as to whether it appears such schemes may constitute value for money uses of income in excess of forecast. However, when considering approval the Treasury will want to take into account other factors, including the quantum of income and the specific plans for their use.

4.70 Finally, where, under departmental accounts, all the revenue from multi-year licensing contracts is required to be recognised up-front, it may be the case that departments cannot realise the benefit from this income, either as income received exceeds settlement limits or there is too narrow a time-frame for any income to be used. Where this occurs, the Treasury will consider giving departments increased spending power in later years, to properly incentivise departments to obtain value for money from multi-year licensing contracts.

Chapter 5

Administration Budget

What are administration budgets?

5.1 In Spending Reviews (SRs), 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 SRs, 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 SRs 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 DEL income 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 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 budgets[1]. 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 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

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

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 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 guidance manual.

Chapter 6
Capital Budget

Introduction

6.1 The main elements of capital budgets include the following:

- expenditure on fixed assets
- capital grants
- financial transactions (for example, lending and equity investments—see Chapter 8 for more detail)
- capital budget income, including the net book value on disposal of fixed assets (see Chapter 7 for guidance on capital budget income)

6.2 Capital spending by departments and ALBs generally scores in the capital budget at the same value and with the same timing as in accounts.

6.3 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, and departments should approach this carefully.

6.4 This chapter provides the following guidance for specific areas of the capital budget:

- Predicting capital values (paragraphs 6.6-6.8)
- Capital grants and grants in kind (paragraphs 6.9-6.12)
- Inventories treated as capital in budgets (paragraphs 6.13-6.18)
- Long-term receivables and prepayments treated as capital in budgets (paragraph 6.19)
- Provisions in respect of capital expenditure (paragraphs 6.20-6.27)
- Payables in respect of fixed assets (paragraph 6.28)
- Research and development costs (paragraph 6.29-6.31)
- Military equipment (paragraphs 6.32-6.34)

6.5 See separate chapters for the capital budget implications of financial transactions, PPP deals, support for local authorities and support for public corporations.

Predicting capital values

6.6 In line with the Financial Reporting Manual (FReM), fixed assets are carried at capital 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.).

6.7 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.

6.8 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.

Capital grants and capital grants in kind

6.9 Chapter 3 sets out the difference between current grants (which score to the resource budget) and capital grants (which score to the capital budget).

6.10 Additionally, departments can provide capital grants in kind (i.e. gifted fixed assets). Where a fixed asset is gifted by a department, capital budgets will show no net impact. However, departments should note that gifting an asset does not represent a write-off or a loss on disposal –as capital grants in kind, they are a transfer of value from the department to a third party.

6.11 To achieve the correct recording required for national accounts, departments must make up to two equal and opposite entries:

- the disposal of asset, as income in the capital budget equal to the net book value of the asset (as described in Chapter 7); and
- a capital grant, as a cost to the capital budget equal to the disposal value

6.12 There are no net budgetary consequences of this grant, 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.

Inventories treated as capital in budgets

6.13 Departmental accounts do not treat purchases of inventories as investment in fixed assets. Rather, inventory movements are treated as changes in current assets. Normally, budgets follow accounts in their treatment of inventories, and inventories are excluded from budgets until they are used, disposed of or written-off. See Chapter 3 for details.

6.14 The net acquisition of inventories is an item of capital spending in national accounts and increases TME. Therefore, it would be appropriate to score all net acquisitions of inventories in capital budgets. However, in the interest of keeping down compliance costs, the Treasury normally asks departments to follow the treatment in departmental accounts.

6.15 Different budgeting rules are, however, appropriate where the item being acquired for inventories would be the acquisition of a fixed asset if it were not being acquired for inventory. For example, land acquired by English Partnerships for reclamation and development scores as capital expenditure in capital budgets.

6.16 Similarly, if inventory acquisitions are large, or set to increase significantly, it may be appropriate to score them in capital budgets.

6.17 Where departments are aware of inventory acquisitions that might fall into the categories above, they should consult the Treasury on whether treatment in capital budgets would be appropriate.

6.18 Where inventories score in capital budgets they score like fixed asset transactions.

Long-term receivables and prepayments treated as capital in budgets

6.19 Normally, movements in long-term receivables and prepayments are treated as working capital and do not impact directly on budgets. However, in limited cases long-term receivables and prepayments are treated as imputed lending and impact the capital budget as financial transactions. See Chapter 3 and Chapter 8 for more detail.

Provisions in respect of capital expenditure

6.20 Chapter 3 provides general guidance on provisions, which normally score to the resource budget. Departments will sometimes need to record provisions in respect of capital expenditure.

6.21 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 will sometimes 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.

6.22 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

6.23 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.

6.24 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 departmental accounts would show an increase in fixed assets as well as the liability.

6.25 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.

6.26 In cases where HMT's GFR team have agreed that capitalising the provision is the correct treatment in the departmental accounts, the capital AME budget will score the recognition of the liability.

6.27 When the actual cash payment is transacted, this will score in capital DEL. The provision in capital AME will be released.

Payables in respect of fixed assets

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

Research and development costs

6.29 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.

6.30 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".

6.31 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 can be found in Annex C.

Military equipment

6.32 National accounts do not differentiate between single and dual use military equipment. National accounts instead differentiate 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 capital DEL budget.

6.33 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 departmental accounts. In the national accounts, these assets will be depreciated using a similar methodology to other fixed assets.

6.34 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

Introduction

7.1 Just as in the resource budget (described in Chapter 4), some income can be retained in departments' capital budgets to help departments manage their capital budget control totals. This chapter provides guidance on income that can be retained in capital budgets.

7.2 The following items of capital income may normally be retained in capital budgets within the terms set out below:

- income from fixed asset sales—limited to the net book value of the asset (paragraphs 7.4-7.6)
- income obtained from National Lottery distributing bodies that finance capital expenditure (paragraphs 7.7-7.8)
- capital grants from the private sector including developer contributions and capital donations (paragraphs 7.9-7.12)
- capital grants from the EU (paragraph 7.13)
- income received from exercising an overage (claw-back) agreement (paragraphs 7.14-7.17)
- income from sale of inventories that score in the capital budget (see section on inventories in capital DEL in Chapter 6)
- privatisation proceeds (see Chapter 8)
- income received from disposal of financial assets (see Chapter 8)

Only income in connection with DEL programmes scores in capital budget DEL.

7.3 This chapter also provides guidance on:

- The timing of recording income in the capital budget (paragraphs 7.18-7.20)
- When capital budget income can be retained above Spending Review (SR) settlements (paragraphs 7.21-7.22)

Further information on certain types of capital budget income

Disposal of fixed assets

7.4 When a department or ALB disposes of an asset, the net book value of this asset scores as capital DEL income.

7.5 Any profit or loss on disposal, i.e. the difference between net book values and actual sale value, scores in the resource budget—see Chapter 4 for more details.

Intangible asset income

7.6 There are scenarios where it is difficult to tell whether the income associated with intangible assets is a royalty (which is treated as current income in national accounts, and therefore in the resource budget), or this disposal of the underlying intangible asset (which is treated as capital income in national accounts, and therefore in the capital budget). This is discussed in detail in Chapter 4. Again, income from the sale of the underlying intangible asset is retained in the capital budget.

Income from National Lottery distributing bodies

7.7 The government's income from the National Lottery is a tax. The spending by the National Lottery distributing bodies counts as expenditure in AME.

7.8 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 capital DEL income.

Capital grants and capital grants-in-kind

7.9 The distinction between capital grants and current grants is described in Chapter 3.

7.10 Receipts of capital grants from outside of the public sector should be treated by departments as capital DEL income.

7.11 Donated assets and gifts of fixed 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 capital DEL budget:

- a capital grant equal to the market value of the asset which should be recorded as capital DEL income
- purchase of the asset at market value, this will score as capital DEL expenditure

7.12 Where a department receives an asset by way of donation or uses a capital grant to buy fixed assets, the depreciation of the asset should exceptionally be recorded in AME. See section in Chapter 3 on depreciation for further details.

Capital grants from the EU

7.13 Departments are reminded that residual income from the EU Budget is not free to the UK. The budget is part-funded by the UK through its payments to the EU under the financial settlement. 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 3, 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.

Overage agreements

7.14 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.

7.15 This clause represents a financial asset and should be recorded on the department's SoFP 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.

7.16 Since this financial asset comprises part of the value of the property being disposed it, in effect, allows the public sector to retain part of the value of the property. So, on disposal the scoring in capital DEL should be:

- total net book value of the disposed asset (capital DEL income)
- profit/loss on disposal of the asset (resource DEL)
- the Open Market Value (OMV) of the overage agreement (capital DEL expenditure)

7.17 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 capital DEL income.

Timing of recording of income

7.18 In general, departments should record capital income for budgets at the same time as they record it in the departmental accounts.

7.19 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 departmental accounts if exceptionally the accrual of the income has been related to work done at a quite different time.

7.20 Capital transfers from the EU should be recorded for budgets in line with departmental accounts. 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 capital DEL income

7.21 The same general principles discussed in Chapter 4 regarding income retention for resource DEL income apply to capital DEL income. In brief, departmental budgets are set in the SR net of capital DEL income. Departments are allowed to keep the capital DEL income that they obtain in the SR period up to the amount that was predicted in the SR.

7.22 Departments can also, in any year, where no other retention limit exists, retain capital DEL income up to 10% above the level envisaged for that year without an adjustment to budgets. If departments expect to obtain more income than provided for above, they should talk to the Treasury about further income retention. Again, see the guidance in Chapter 4 regarding when the Treasury will look favourably on income retention.

Chapter 8
Financial Transactions

Introduction

8.1 Financial transactions are defined in national accounts as transactions in financial assets and financial liabilities, such as lending or equity transactions. Financial assets and liabilities generally involve claims between parties that are settled in cash.

8.2 Financial transactions do not score as capital expenditure in national accounts. As they are exchanges of financial assets or liabilities, they do not score as spending generally.

8.3 However, financial transactions with the private sector generally impact government borrowing. For example, if a department loans money to the private sector, it is exchanging a liquid asset (cash) for an illiquid asset (the financial claim from the loan). This will increase public sector net debt (PSND), which is calculated as the difference between financial liabilities and liquid assets.

8.4 Consequently, financial transactions with bodies outside the budgeting boundary scores to a department's capital budget to reflect this impact to PSND. This is the case even though the transactions are not classified as capital in national accounts.

8.5 Financial transactions are generally referred to as financial instruments in departmental accounts.

8.6 If departments are unsure if the policy would give rise to a financial transaction, they should contact the Treasury for guidance.

8.7 Some financial transactions qualify as Official Development Assistance (ODA). The rules that govern the statistical reporting of ODA do not affect their treatment in the national accounts or budgets .

8.8 This chapter:

- gives an overview of financial transactions (paragraphs 8.9-8.17)
- details specific guidance for types of financial transaction:
    - loans (including expected credit losses and write-offs) (paragraphs 8.18-8.32)
    - long-term receivables and prepayments (paragraphs 8.33-8.35)
    - equity (paragraphs 8.36-8.41)

- privatisation (paragraphs 8.42-8.44)
- financial guarantee contracts (paragraphs 8.45-8.50)
- exchange rate changes (paragraphs 8.51-8.59 and Appendix 1)
- student loans (in Appendix 2)

Overview of budgetary implications for financial transactions

8.9 The guidance below provides an overview of how financial transactions impact both the current and resource budgets.

Capital budget impact

8.10 As described above, financial transactions impact on the capital budget when they are first entered into, and as they are settled.

8.11 For some departments with higher levels of financial transactions, financial transactions form a separate ring-fence within capital DEL budgets. Departments may not switch budget cover out of their financial transactions ring-fence (if they have one) without the explicit approval of the Chief Secretary.

8.12 Financial transaction budgets are presented on a net basis, unless specifically stated otherwise. This means that income from settlements of financial transactions may be recycled by departments, as long as the annual net financial transactions total is not exceeded.

Resource budget impact

8.13 Financial transactions involve the exchange of financial assets and liabilities. Financial transactions mainly impact on the resource budget through the returns received or paid on these financial assets or liabilities (for example, interest received/paid on a loan, or dividends received/paid on equity). Financial assets also impact on the resource budget through changes in their valuation.

8.14 There are a number of different classifications of financial assets in departmental accounts. The budgetary treatment of valuation changes of these assets is dependent on their classification in departmental accounts. Generally, changes in the value of financial assets which are recognised in the Statement of Comprehensive Net Expenditure (SoCNE) should score to the resource budget.

- for financial assets measured at amortised cost, expected credit losses generally score to resource DEL[1] (see paragraphs 8.27-8.30)
- for financial assets measured at fair value through other comprehensive income (OCI), expected credit losses generally score to resource DEL[1] (see paragraphs 8.27-8.30). Other changes in fair value recognised in OCI should be budgeted for following the same principles as fixed asset revaluation. Decreases in fair value will score to resource AME once any

[1] Expected credit losses for trade receivables and guarantees score to resource AME.

previous upwards fair value changes for that class of asset have been eliminated. Any other changes in fair value will not impact budgets

- for financial assets measured at fair value through profit or loss, changes in the fair value of these assets score to resource AME. If a department chooses to disaggregate interest or dividend income for these assets in its departmental accounts, that income should score as a benefit to resource DEL

8.15 For all financial assets, write-offs score in the resource budget.

8.16 As with fixed assets, the treatment of valuation changes for financial assets in budgets does not mirror their treatment in national accounts. National accounts do not recognise expected credit losses and treat changes in fair value as balance sheet movements only.

8.17 The above only provides a general overview of the treatment of financial transactions in budgets. The rest of this chapter goes into more detail about different types of financial transactions: loans (including expected credit losses and write-offs); equity transactions; and financial guarantees. The chapter also provides guidance about the impact of exchange rate changes on budgeting for financial transactions.

Loans other than student loans

Overview

8.18 One major category of financial transaction is loans. 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.

8.19 There is unique guidance on student loans contained in Appendix 2.

8.20 Departments normally loan money, rather than borrow money. This is because public sector borrowing is normally done centrally through the Exchequer and not through individual departments. Therefore, this guidance is written from the perspective of departments as lenders.

8.21 Loans need to be distinguished from deposits. In loans, a liquid asset (cash) is exchanged for an illiquid asset (the claim from the borrower). In deposits, a liquid asset (cash) is exchanged for another liquid asset (the deposit with the bank).

8.22 The making and withdrawing of deposits do not score in budgets. However, deposits themselves may attract interest income, and this income would score in budgets in resource DEL.

Summary of budget treatment of loans

8.23 The budget treatment of a loan is:

- the capital budget will score

  a) net lending (i.e. transactions in loan principal)

    b) capitalised interest as appropriate

- the resource budget will score

    c) interest income (resource DEL income)

    d) arrangement fees (resource DEL income)

    e) expected credit loss (resource DEL—see paragraphs 8.27-8.30)

    f) other changes in fair value of the loan (resource AME if at all—see paragraph 8.14)

    g) write-offs (resource DEL—see paragraphs 8.31-8.32)

8.24 This treatment generally captures the impact of loans on national accounts, and departmental accounts. Valuation changes in the financial assets associated with loans, namely expected credit losses and other changes in fair value, impact departmental accounts but not national accounts.

8.25 The above treatment is mainly applicable to loans which are measured at amortised cost or fair value through other comprehensive income in departmental accounts. For loans measured at fair value through profit or loss, fair value changes will score in resource AME, as described in paragraph 8.14. However, there should be a resource DEL impact for any write-offs, and interest income, if a department chooses to disaggregate interest income.

AME vs. DEL

8.26 Normally, lending scores in DEL. Where exceptionally a loan scheme may score in AME, 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 losses

8.27 Under the Expected Credit Loss (ECL) model, an entity calculates an allowance for credit losses on loans, or in other words the risk that loans will not be paid back because of a deterioration in the credit quality of a borrower. The ECL model is a forward-looking model, which means that predictions of future credit quality should be included in the assessment of risk.

8.28 Entities should calculate the ECL 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.

8.29 Changes in the value of loans receivable that relate solely to the application of the ECL model will score to the resource DEL budget. Where departments apply the ECL model, the forecast used should be robust and the amounts recognised should be discussed with Treasury spending teams. 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 resource DEL 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 ECL valued at 10%		£10 (but no increase in overall resource DEL control totals, these charges to the resource DEL budget have to be absorbed by adjusting spending elsewhere)
ECL revalued at 20%		£10 (but no increase in overall resource DEL control totals, these charges to the resource DEL budget have to be absorbed by adjusting spending elsewhere)
ECL crystallised		(£20) (but no increase in overall resource DEL as this covers half the Write-off)
Write-off of loan – now at 40%		£40 (£20 offset by the switch from the ECL)

8.30 ECLs are referred to as impairments in departmental accounts. However, they are not treated as impairments in budgets. Therefore, they are not included in the ring-fenced budget for depreciation and impairments of fixed assets.

Write-offs

8.31 All write-offs for financial transactions should score in DEL. Any previous changes to fair value recognised in AME must also be reflected in DEL to the full value of the write-off.

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

Long-term receivables and prepayments

8.33 Chapter 3 provides guidance for when trade receivables or prepayments should be treated as lending and therefore budgeted for as a financial transaction. Briefly, trade receivables or prepayments should be treated as lending when they are long-term and over £20 million. The scoring in such cases would be:

- the full amount of the long-term receivable or prepayment that would score as a loan in capital budgets

- any increase in the value of the long-term receivable or prepayment as the discount unwinds would score as increased net lending (a cost)
- as the long-term receivable or prepayment is utilised, it is treated as the repayment of a loan
- any ECLs or write-offs for the long-term receivable or prepayment would score according to the general principles for loans set out earlier in this chapter.

In other words, the treatment would be on a net basis like the treatment of loan principal. This scoring is intended to capture and control the impact of this lending on PSND.

8.34 Note that the transaction financed by the account receivable or prepayment would also score in budgets as normal.

8.35 Note also 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.

Equity transactions

8.36 Purchase and sale of shares or other equity in private sector bodies scores in capital DEL, as with other types of financial transactions.

8.37 Note that purchase or sale of shares will affect the amount of control the public sector has over a body. Where this transfer of control is significant then departments should consider the impact on classification of the body as part of the public or private sector– see Chapter 1 for details of classification.

Dividends and equity withdrawals

8.38 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.

8.39 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 Chapter 11 (the chapter on public corporations).

8.40 In departmental accounts, 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.

8.41 "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 income in budgets.

Privatisation proceeds

8.42 Privatisation proceeds score in AME, even where the asset or business being sold was on a DEL programme.

8.43 Sale of shares in a private sector PPP represents the disposal of a financial asset by the department. As a form of privatisation, the income scores as a benefit to capital AME.

8.44 Sale of shares in a public-sector PPP increases the public sector's financial liabilities. As above, the income scores as a benefit to capital AME.

Financial guarantee contracts

8.45 Departments sometimes guarantee the debt of bodies outside the public sector—these promises are generally known as financial guarantees.

8.46 In national accounts, financial guarantees generally do not impact on the fiscal position unless they are called. When financial guarantees are called, the corresponding payment is treated as a capital grant in the national accounts (with the corresponding fiscal implications).

8.47 In departmental accounts, financial guarantees are recognised when they are provided if they meet the IFRS definition of a 'financial guarantee contract.' For financial guarantee contracts, the treatment in budgets should generally follow the accounting. Other financial guarantees that are not recognised in departmental accounts would be outside of budgets until they are called.

8.48 Financial guarantee contracts impact on budgets in the following ways (note that financial guarantee contracts do not score to the financial transaction ring-fence):

- an initial resource AME cost when the financial guarantee contract is provided; this will be recorded as the SoFP value of the contract
- a benefit to resource AME when any guarantee fees are recognised
- resource AME impacts where remeasurement of the financial guarantee contract goes through the SoCNE (including any remeasurements for ECLs)
- a benefit to resource AME when the guarantee is derecognised
- capital DEL cost for payments associated with the calling of the guarantee

8.49 Again, national accounts treat the payments associated with the calling of all financial guarantees as capital grants, regardless of whether those guarantees met the definition of financial guarantee contracts in departmental accounts. Therefore, the last bullet point applies to all financial guarantees.

8.50 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, including meeting the requirements of the Contingent Liabilities Approvals Framework.

Exchange rate movements

8.51 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 of the foreign currency will affect the value of the financial asset or financial liability.

8.52 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
- when exchange rates fluctuate the revaluations of the financial asset or financial liability should be recorded as income/cost in AME 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

8.53 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

8.54 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.

8.55 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.

8.56 In order to maintain hedging as a useable option in budgets, the budgeting does not follow the national accounts treatment in this case. Instead the benefits/costs of a hedge are realised when the department incurs the associated expenditure or receives the income.

8.57 The following items must be recorded in budgets for exchange rate hedges:

- capital DEL
  - h) cost of purchasing the initial forward contract (usually this will be zero)

i) any capital expenditure funded through the forward contract. This should be valued at the daily spot rate at the point of purchase

j) the difference between the value of b and the value of the capital expenditure at the forward contract rate

- resource DEL

k) any current expenditure funded through the forward contract. This should be valued at the daily spot rate at the point of purchase

l) the difference between the value of d and the value of the current expenditure at the forward contract rate

- resource AME

m) 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)

8.58 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.

8.59 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
I 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: Student loans guidance

Impairments

8.60 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.

8.61 **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)

8.62 **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 (for example 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.

8.63 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).

8.64 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.

8.65 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

8.66 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)

8.67 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

8.68 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

8.69 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.

8.70 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.

Example revaluation of impairments—Higher Education student loans not subject to sale

8.71 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.

8.72 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.

Table 8.B: 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

8.73 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[2]	£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

[2] 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 department's resource and capital DEL in the same way as the department's own spending. Departments should normally use the output from the ALB's own accounts as the basis for working out the ALB's impact on budgets.

9.4 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 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 guidance manual.

9.5 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

9.6 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.

9.7 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.

9.8 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

9.9 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.

9.10 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

9.11 The ALB's impact on the department's resource budget DEL is made up of its gross resource consumption less its retained DEL income. Similarly, the capital budget DEL is net only of retained DEL income. Whether ALB income can be retained in DEL follows the same rules as for departmental income (see separate chapters). So, for example, charges for the sales of goods and services can typically be retained in DEL and the receipt of taxes are typically not. Expenditure financed in cash terms by non-budget income scores gross in budgets.

9.12 Where an ALB obtains income that is not cannot be retained in DEL, the department may arrange for the ALB to pass the cash to the department for surrender it 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 retained in DEL does not convey spending authority.

9.13 Where a levy-funded body over recovers income due to an incorrectly set levy, any excess income should be classified as a payable 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

9.14 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 (for example department or market). The cash raised by borrowing does not score as income in DEL.

9.15 Use of reserves – i.e. the run-down of savings – has the same effect overall as borrowing. Therefore expenditure financed by the use of reserves counts as spending in budgets.

Corporation Tax

9.16 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

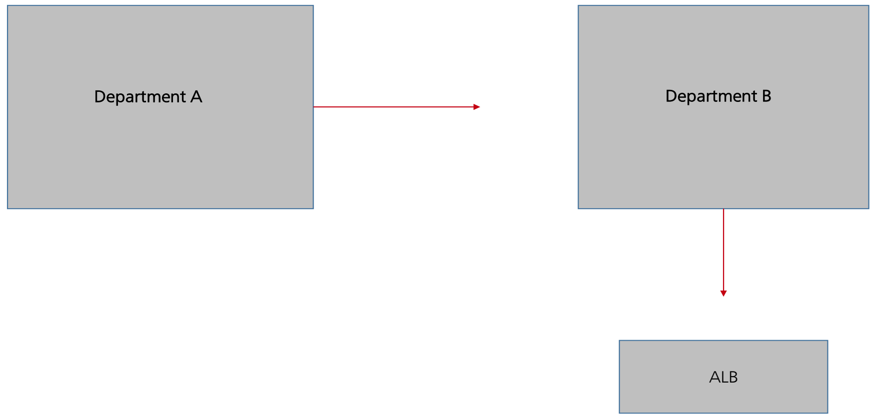
9.17 Depreciation charges may only be recorded in AME for grant funded assets where the grant originated from the sponsoring department.

Co-funded ALBs

9.18 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.

9.19 Where an ALB receives grant from more than one department then the following budgeting treatment will apply.

9.20 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 or capital and DEL or 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.



9.21 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

9.22 This treatment will apply to all grants that move between central government 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

9.23 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

9.24 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

9.25 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 DHSC'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

9.26 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.

9.27 For further information on the treatment of PPP in budgets, please see Chapter 13.

Devolved Administrations

9.28 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 do not distinguish between current and capital grants. Both go through the Statement of Comprehensive Net Expenditure (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. See Chapter 3 for descriptions of current and capital grants.

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. See Chapter 3 for the distinction between capital grants, current grants and subsidies.

Supported Capital Expenditure (Revenue)

10.6 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).

10.7 Departmental budgets score the capital value of SCE(R). The current support is paid by MHCLG as part of the Revenue Support Grant.

10.8 For certain outturn years, departments score the capital values of the predecessor regime, credit approvals.

10.9 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

10.10 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.

10.11 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 debt interest premia should score as a current grant in DEL budgets.

10.12 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 be retained in capital AME

Arm's Length Body support to Local Authorities

10.13 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

10.14 As part of the SR settlement departments are allocated a specific amount of resource DEL to fund the ongoing cost of local authority PPP projects.

Public Corporations accountable to Local Authorities

10.15 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.

10.16 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

10.17 MHCLG 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.

10.18 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 public sector net borrowing.

New burdens on Local Authorities

10.19 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.

10.20 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 local 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 MHCLG (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 Public Sector Classification Guide. If a body is not listed in the Public 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 the 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 PCs' planned spending (see paragraph 11.90)

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. 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 (UKGI) where appropriate. UKGI is a Treasury-owned company that operates 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	Subsidies paid to Public Corporations Less interest and dividends received from Public Corporations	Investment grants paid to Public Corporations Net lending to Public Corporations (voted and NLF) Public Corporations' market and overseas borrowing (including on balance sheet PPP) *Less* 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.

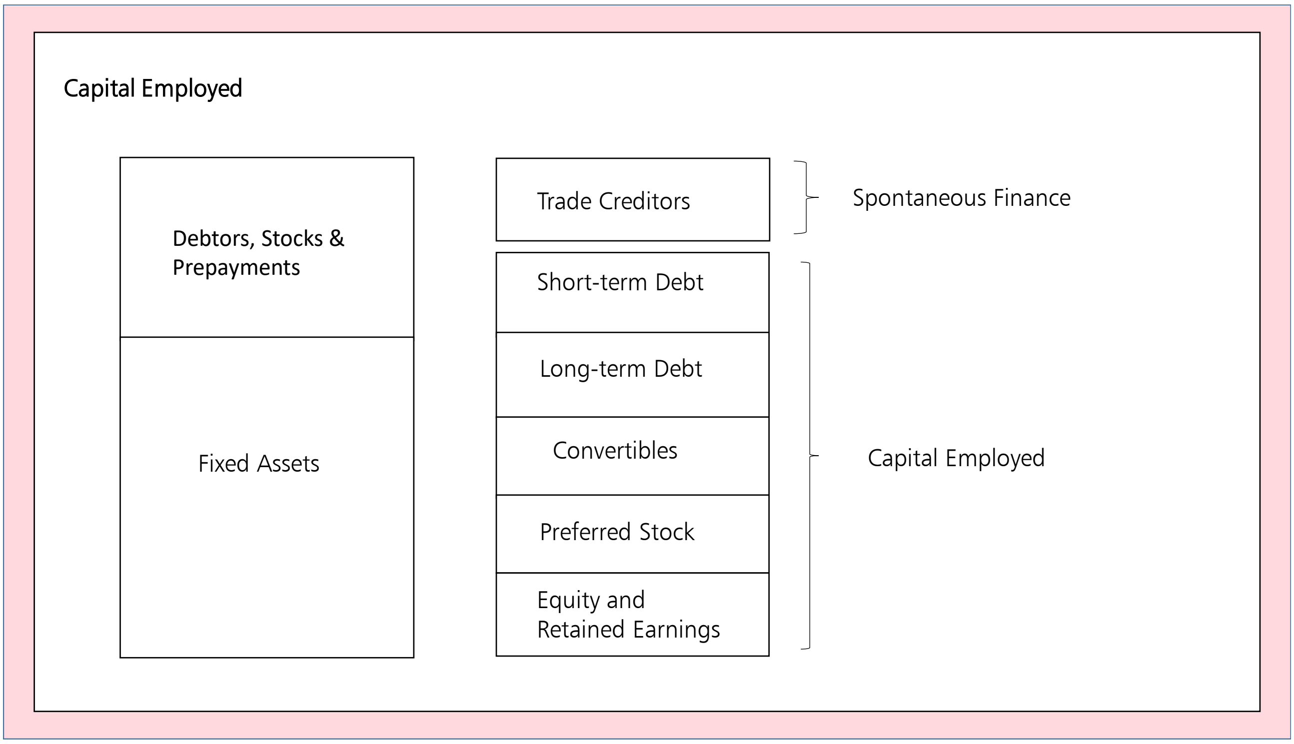
11.17 Departments must agree with Treasury on what is an appropriate rate of return for each of their PCs. This anticipated level of return should be considered alongside other sources of income at Spending Reviews (SRs) - see Chapter 4 for details on income in the resource budget.

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, SR 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 UKGI 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 household 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 National Loans Fund (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 £500 million and it had a PC with expected interest and dividend payments to the department of £30million, the net Resource budget would be equal to £470 million.

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 Public Corporations Market and Overseas Borrowing (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
- Departmental accounts 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, 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 departmental 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 set up an arrangement whereby 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 budgets and departmental accounts 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 departmental accounts 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 SRs on the expectation that the full agreed rate of return will be achieved.

11.53 The timing of dividend recognition in budgets generally follows departmental accounts. However, not all receipts treated as dividends in departmental accounts count as dividends for budgeting. Please see the section on equity withdrawals below.

Capital budget

11.54 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

11.55 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.

11.56 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

11.57 Capital grants are unrequited transfer payments that are intended to finance investment by the PC. Investment includes the acquisition of any fixed 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.

11.58 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.

11.59 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.

11.60 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

11.61 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.

11.62 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. 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

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

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

11.65 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

11.66 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.

11.67 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.

11.68 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.

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

11.70 In departmental accounts, 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.

11.71 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.

11.72 Where equity withdrawals do result in an actual repayment of shares or PDC then there is no difference in treatment between departmental accounts and budgets. Where a profit is taken to the SoCNE the department should discuss proposals with their Treasury spending team.

PPP and similar arrangements

11.73 For the treatment of PPP in budgets, please see Chapter 13 on PPP.

Treatment of Self-Financing Public Corporations

11.74 Certain PCs have been designated by the Treasury as Self-Financing Public Corporations and have special budgeting treatment. 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

11.75 The main rationale underpinning SFPCs is that the SR 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.

11.76 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.

11.77 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

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

Control of SFPCs

11.79 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.

11.80 The plan will include the appropriate rate of return and the arrangements for underperformance, see below.

Scoring in budgets

11.81 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

11.82 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

11.83 SFPCs should cover the agreed rate of return through their payments of interest and dividends.

11.84 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 resource DEL. 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.

11.85 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

11.86 During the SR period, departments may be able to negotiate a cap on their exposure to underperformance charges. On an exceptional basis (for example 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 (PPPs)

11.87 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 (for example 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.

11.88 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

11.89 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

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

Capital expenditure

11.91 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.

11.92 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

11.93 The information that is required is:

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

Gross Operating Surplus

11.94 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).

11.95 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

11.96 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 sector's involvement in joint ventures.

11.97 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.

11.98 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) IAS 19 allows departments to account only for the employer contributions payable to the pension scheme administrator (the accruing superannuation liability charge (ASLC)).

12.3 The employing department bears the cost of that ASLC in its resource 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 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 follows:

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 departmental 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 19. 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	**100**
		10	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 resource 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 resource AME 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 departmental 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 the Treasury 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

Leases and PPPs

13.1 The chapter sets out the budgeting guidance for Public-Private Partnerships (PPPs). It contains guidance for:

- An overview of the national accounts and departmental accounts recording of PPPs (paragraph 13.3-13.13);
- Specific budgeting guidance for PPPs, including:
  - The difference between on- and off-balance sheet PPPs (paragraphs 13.14-13.16)
  - Differences for public corporations (PCs) (paragraphs 13.17-13.18)
  - Barter deals (paragraphs 13.19-13.34)
  - Reversionary interests (paragraphs 13.35-13.39)
  - Termination payments (paragraphs 13.40-13.45)
  - The treatment of refinancing gains (paragraphs 13.46-13.69)

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.

PPPs: overview

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 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 There is specific guidance in the Financial Reporting Manual (FReM) on how to account for PPPs in departmental accounts (namely, in the FReM's interpretation of IFRIC 12). However, this guidance is *not* applied when determining the budgetary treatment of a PPP transaction.

13.6 The budgetary treatment for PPPs should follow the national accounts treatment. This ensures that budgets reflect the fiscal impacts of a PPP transaction.

13.7 The treatment of PPPs in national accounts is covered in Part VI of the ESA10 Manual on General Government Deficit and Debt.

13.8 Budgeting and national accounts standards fit together as follows:

On / off balance sheet for national accounts purposes

13.9 If a project is 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 Manual on General Government Deficit and Debt and in the supporting guidance on the statistical treatment of PPPs.

13.10 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 (ONS) 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.

13.11 Additionally, the Treasury 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.

13.12 In the fiscal framework, on-balance-sheet projects:

- score in PSNI and PSNB
- score in PSND
- score in the Maastricht general government measure of the deficit and stock of debt

13.13 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

13.14 Projects on balance sheet for national accounts purposes score in capital budgets like capital expenditure undertaken directly by the department or ALB. The value of the capital expenditure and the timing of recognition should follow the treatment in national accounts set out above.

13.15 Annual repayments under the PPP contract, i.e. the unitary charge, will be treated in the resource budget as a mix of:

- service charges (resource DEL)
- repayment of the imputed loan to the private sector (outside budgets) and
- the full amount of interest charged on the loan (resource DEL)
- depreciation of the asset (ring-fenced resource DEL)

Projects off balance sheet for national accounts purposes

13.16 Where the project is off balance sheet for national accounts purposes, the budgeting impact is as if the department or ALB 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

13.17 For most public corporations the budgeting system scores their external finance. External finance includes 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

13.18 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

13.19 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

13.20 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.

13.21 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.

13.22 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

13.23 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.

13.24 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.

13.25 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.

13.26 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.

13.27 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

13.28 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.

13.29 It is for departments to determine and record OMVs.

13.30 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.

13.31 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.

13.32 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.

13.33 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.

13.34 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.

Reversionary interests in PPPs

13.35 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).

13.36 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.

13.37 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 UK GAAP – note this only applies to projects signed before April 2009.

13.38 Under UK GAAP, 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.

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

in capital DEL:

- 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

in resource DEL:

- 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

PPP Termination payments

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

13.41 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.

13.42 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).

13.43 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).

13.44 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).

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

PPP refinancing gains

13.46 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

13.47 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.

13.48 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.

13.49 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 Treasury publication "Refinancing of Early PFI transactions" and in Eurostat's publication "A Guide to the Statistical Treatment of PPPs".

Refinancing

13.50 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.

13.51 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.

13.52 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.

13.53 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

13.54 In departmental accounts, on receiving the cash the department shows an increase in liabilities (payables).
Then annually:

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

13.55 The budgets follow the departmental 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: On-balance sheet PPP with sale and leaseback bartered element

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

Background

13.57 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.

13.58 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.

13.59 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

13.60 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	1 April YEAR 0	1 April YEAR 1	1 April YEAR 2	1 April YEAR 4	1 April YEAR 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

13.61 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

13.62 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 (FReM 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

13.63 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	CDEL income for the NBV of the transfer	Dr Prepayments Cr Fixed assets
Plot 2	1 April YEAR 1	£3 million	CDEL income for the NBV of the transfer	Dr Prepayments Cr Fixed assets
Plot 3	1 April YEAR 2	£4 million	CDEL income for the NBV of the transfer	Dr Prepayments Cr Fixed assets

Accounting for the occupation of the new building

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

13.65 The accounting entries are:

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

13.66 The £250 million is a capital DEL hit.

Accounting for the transfer of Plot 4

13.67 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	CDEL income for the NBV of the transfer	Dr Prepayments (if prepayment against service/interest charged Cr Fixed asset

Subsequent accounting

13.68 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 liability is outside of budgets.

13.69 The accounting entries are:

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

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

13.70 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).

13.71 The accounting entries are:

- Dr SoCNE
- Cr Prepayment

13.72 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

13.73 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.

13.74 The accounting entries are:

- Dr Long-term lease liability
- Cr Cash

13.75 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 liability. (Note: the accounting entries do not deal with Supply in respect of the net cash requirement.)

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

Final deal

13.77 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.

13.78 The accounting entries are:

- Dr Cash
- Cr Fixed Assets

13.79 There is capital DEL income in respect of the disposal of the asset.

Annex A

Difference between Budgets and Departmental Accounts

A.1 As a result of the implementation of the Treasury's Alignment project in 2011-12, there are very few differences between departmental accounts and budgets. 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.

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 departmental accounts.

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 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	Income that is classified as a capital grant, such as a donation that is to be used to finance acquisition of a fixed asset, scores in the capital budget.
Support for local authorities	Capital grants to local authorities score in the SoCNE and in capital budgets.
Public Corporations	Capital grants to public corporations score in the SoCNE and in capital budgets for public corporations 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 public corporations on the external finance basis.
PPP	PPP contracts recorded as service concessions in accounts will be recorded in budgets on the basis of national accounts (ESA10) standards, which may lead to a different balance sheet treatment of the asset. See chapter 13 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 *Intangible Assets* 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 SoCNE
	In a limited range of cases, purchase and disposal of inventories scores in capital budget, but are not transactions in fixed assets in departmental accounts, 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 local authorities score in the SoCNE and in capital budgets
	Capital budgets include Supported Capital Expenditure (Revenue) which does not feature in departmental accounts
Public Corporations	Capital grants to public corporations score in the SoCNE and in capital budgets
	Budgets for public corporations include Public Corporations Market and Overseas Borrowing (PCMOB) which is not included in departmental accounts (see Chapter 11)
	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 ESA10 standards set out in the Manual on Government Deficit and Debt (see Chapter 13 for 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 *Intangible Assets* 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 .

B.2 Overdue debt owed to central government at 31 March 2019 was estimated at £24.1billion.

Debt management

B.3 Government has a duty to manage its debts 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 Debt Strategy which outlines the government's aim to create a more consistent approach to debt management. Departments and their ALBs must work with Cabinet Office and HM Treasury to deliver this strategy through the following specific activities

- embed the Debt Functional Standard, assessing organisational maturity and identifying opportunities to further improve efficiency, effectiveness and performance
- contribute to the government pursuit of fair debt outcomes for all
- effectively monitor and consistently report debt data to the centre, and use this information internally to inform debt management strategies
- seek additional debt-related service capacity and capability through the private sector, in line with the NAO report on Managing Debt Owed to Central Government
- 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
- explore how to tailor debt management approaches to individuals' circumstances, and avoid different parts of government competing with each other, in line with the NAO report on Tackling Problem Debt

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. apply the principles of fairness for government debt collection, as set out in the Fairness Group Joint Public Statement, to ensure repayment plans are affordable and sustainable
6. identify and tackle policy barriers preventing effective debt management
7. include clear governance and reporting arrangements agreed with the Treasury for debt remissions and write-offs
8. 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:

9. report on key performance measures in their debt management strategies through the Consolidated Date Returns (CDRs) and annual review
10. apply the risk management framework on debt developed by Cabinet Office, capturing current and future risks, and report on risk management
11. apply the performance management measures set out below to improve the management of overdue debt owed to government
    - base debt collection measures on financial year-end forecasts for overdue debt, write-offs and remissions
    - additional debt metrics on overdue debt in organisational 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 the budgetary framework.

B.9 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. Chapters 3, 4 and 8 of this document specifically address debt.

B.10 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 ESA 10

Introduction

C.1 This annex provides further guidance to help assess whether expenditure meets the ESA10 definition of Research and Development (R&D) for budgeting and national accounts purposes. Appendix 1 provides a decision tree on capitalising R&D costs that is provided for departmental accounting and budgeting 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 should be capitalised and depreciated in budgets and national 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 and as capital within budgets.

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 Manual [2] 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:

12 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

13 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

14 uncertain about its final outcome (**uncertain**)

15 systematically performed. R&D is conducted in a planned way, with the process and outcomes documented (**systematic**) and

16 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 should 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.

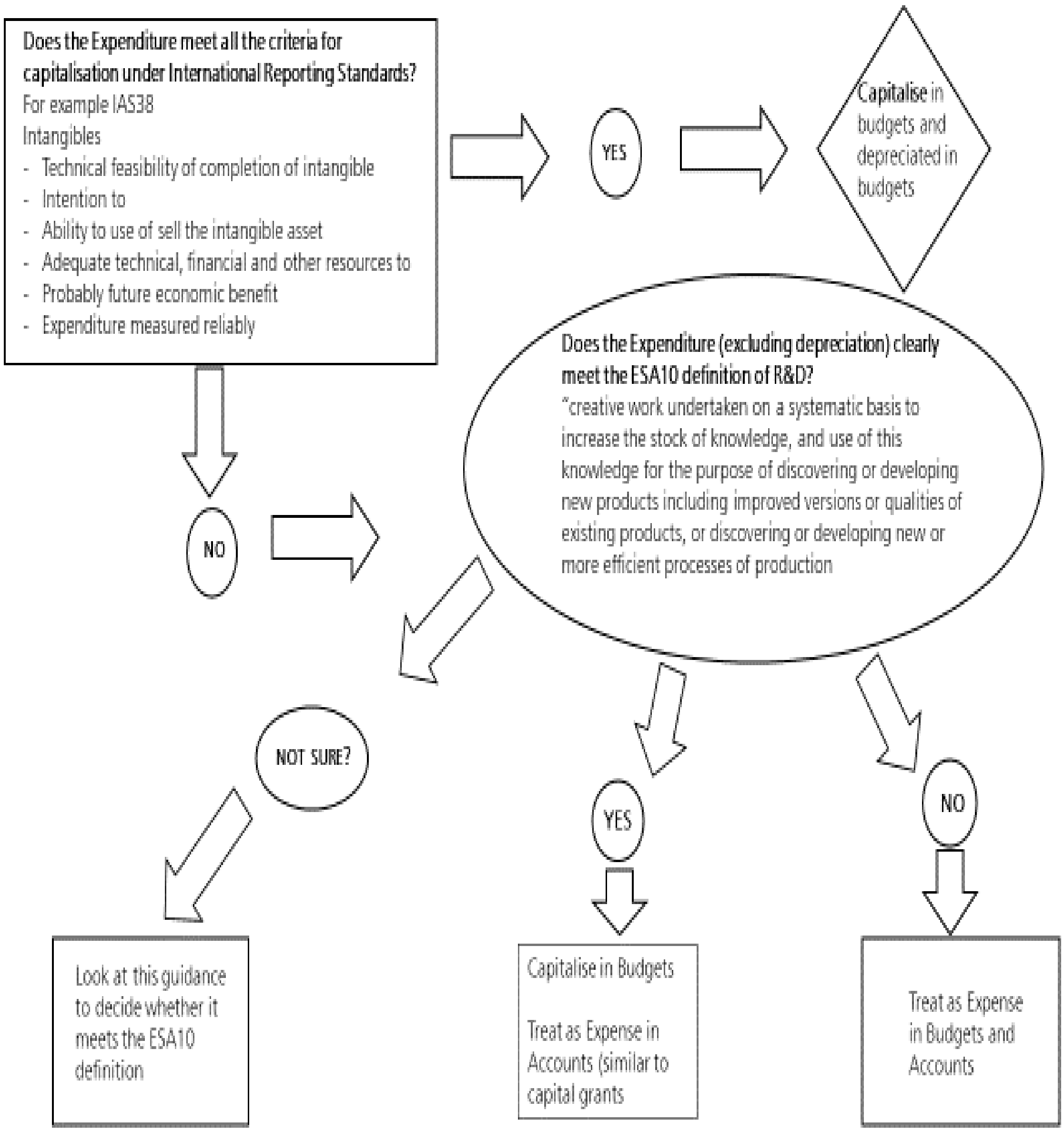
Small Business Research Initiative (SBRI)

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 inclusion[3]
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&D[4]

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
	Jazmin Glassborow	GEP	07775027439 jazmin.glassborow@hmtreasury.gov.uk
Budget Exchange	Jazmin Glassborow	GEP	07775027439 jazmin.glassborow@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
Treatment of receipts and income in the National Accounts and in budgets	Lesley Neill	GFR	020 7270 5338 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	New burdens team	Ministry of Housing, Communities and Local government	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 Spring Budget 2020 documents set out more detail around the fiscal rules and review of the fiscal framework

  Spring Budget 2020 - Publications - GOV.UK

- The Treasury's public website gives access to the 2016 Charter for Budget Responsibility

  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

- The PPP area 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/pfippp-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

- The Contingent Liabilities Approval Framework is at

  https://www.gov.uk/government/publications/contingent-liability-approval-framework

- The Government Functional Finance Standard sets expectations for the effective management and use of public funds.

  Government Functional Finance Standard

- 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 Please see below a list of abbreviations used in this document. Note a glossary of public expenditure terms is published as an appendix in Public Expenditure Statistical Analyses.

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
DEL	Departmental Expenditure Limits
DfID	Department for International Development
DHSC	Department of Health and Social Care
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
PSCB	Public Sector Current Budget
PSNB	Public Sector Net Borrowing
PSND	Public Sector Net Debt
PSNI	Public Sector Net Investment
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
Index

HM Treasury contacts

This document can be downloaded from
www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

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HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk