

*The UK Central Government Public  
Financial Management System*

A GUIDE FOR STAKEHOLDERS

## *Foreword*

**An effective public financial management system is essential for a strong state, the delivery of excellent public services, and a sustainable and growing economy.**

The UK central government public financial management system has evolved over several centuries to become one of the most advanced and transparent in the world.

It can be used to ensure Parliament can hold government to account, but to do so parliamentarians and other stakeholders need to be equipped with a sound working knowledge of the system.

**This document aims to reduce confusion and complexity, and provide a simple and clear explanation of the system for those who need to understand and work with our public finances.**

It is particularly focussed on the needs of Members of Parliament (MPs) who have a role in authorising the use of public funds by government and in subsequently holding ministers and officials to account for how those funds have been used.

Effective public financial management systems require informed scrutiny and oversight. By setting out how the framework operates our hope is that MPs and other stakeholders will be better equipped to fulfil this role.



*Michael Izza*

**Michael Izza**  
**Chief Executive**  
ICAEW






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This document provides an overview of the following areas.

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## COLOUR KEY

Throughout the report the following colours are used to identify different actors:

	Parliament
	HM Treasury
	Departments
	Comptroller & Auditor General
	General reference



### CONTACT

Ross Campbell FCA  
ross.campbell@icaew.com

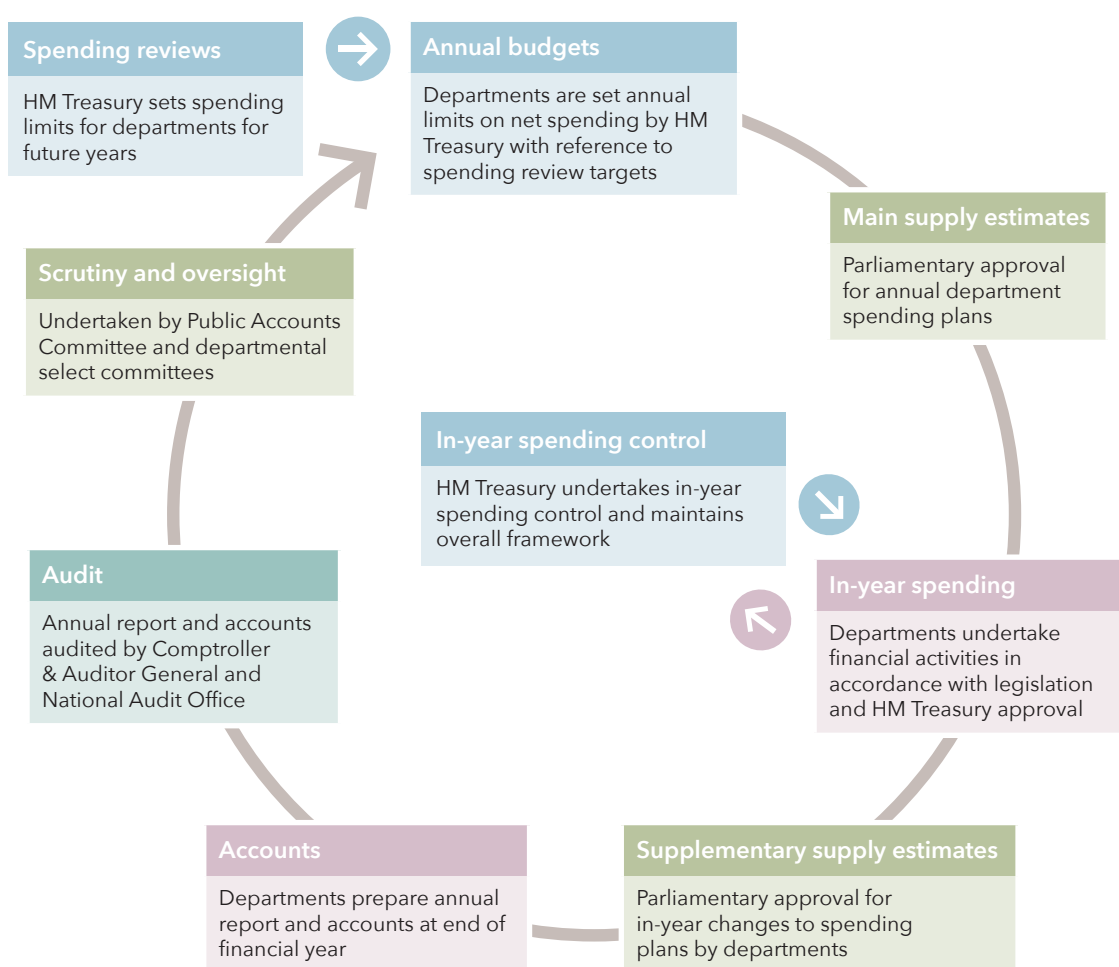


### AUTHOR

Phillip Trotter  
Independent Consultant

# 1. Key actors and their roles, powers, and responsibilities

The relationship between the government, acting on behalf of the Crown, and Parliament, representing the public, is central to how public finances are managed in the UK. While ministers seek to implement government policies and deliver public services through their departments, they can do so only when Parliament has granted the right to raise, commit, and spend resources.



The diagram highlights the key components of the central government public finance management cycle that we examine in this document. In this section, we focus on:

- (i) who the key actors are within this cycle;
- (ii) their roles, powers and responsibilities; and
- (iii) how they relate and interact with each other.

- Parliament
- HM Treasury
- Departments
- Comptroller & Auditor General



## *Parliament*

Parliament approves the legislation that provides ministers with the powers to carry out their policies. Through the annual **supply estimates** the House of Commons, in accordance with its **financial privilege** in Parliament, also approves the finance necessary for the provision of services.

Parliament scrutinises and provides oversight over government activity through the select committee system, and has extensive powers to examine policies, expenditure, administration and the delivery of services.

The Committee of Public Accounts (also known as the Public Accounts Committee or the PAC) was formed in 1861 and has a specific remit to examine financial accounts, scrutinise value for money, and hold the government to account for the quality of administration.

The PAC's remit is to focus on how spending has been undertaken rather than the merits of individual policies. This is the responsibility of departmental select committees.

### **SUPPLY ESTIMATES**

The means by which Parliament, through the House of Commons, approves department spending plans for a specific year.

### **FINANCIAL PRIVILEGE**

The House of Commons has financial primacy in Parliament. Only the Commons may decide on public taxes and public spending, and it may overrule any House of Lords proposal with cost implications.



## HM Treasury

HM Treasury has a statutory role and is responsible to Parliament for the control of public resources. It is required to respect and secure the rights of both the government and Parliament, ensuring in accordance with the Concordat of 1932 that departments have adequate legal authority to spend public resources. It undertakes this through:

### LEGISLATION AND POLICY APPROVAL

- All legislation with expenditure implications must have the support of HM Treasury.
- Policy decisions with financial implications must also be cleared with HM Treasury.

### FINANCIAL PLANNING SYSTEM

- Responsible for overall financial planning system and oversees the supply estimates.
- Manages in-year spending control system with departments.

### ACCOUNTING OFFICERS

- Responsible for appointment of departmental Accounting Officers.
- Treasury Officer of Accounts assists Accounting Officers in fulfilling their duties.

### CONCORDAT OF 1932

Established the principle that, where possible, the authority for government expenditure should flow from a specific act of Parliament rather than from any general authority.

### SPENDING REVIEWS

Set spending limits for individual departments and whole of government for future years.

### ANNUAL BUDGETS

Set spending limits for individual departments for the financial year.

HM Treasury sets spending limits for departments for future years through **spending reviews** which form the basis for **annual budgets**.



## *Departments*

Departments are under the overall control and direction of their ministers.

The **Accounting Officer** of each department is, acting within their ministers' instructions, responsible for the overall control and accounting of the department's resources.

While ministers and their departments operate with a significant degree of freedom, they must act within the standards expected by Parliament and the overall financial framework set by HM Treasury. It is the responsibility of the Accounting Officer to put in place and maintain adequate systems of governance and financial management to ensure that this is the case.

### **ACCOUNTING OFFICER**

Individual appointed by HM Treasury or designated by a department who is accountable to Parliament for the operations of their department and for the preparation of the annual accounts. This is usually the Permanent Secretary of the department, in other organisations (eg, agencies) it will be the chief executive or equivalent.



## *Comptroller & Auditor General*

The Comptroller & Auditor General (C&AG) is an officer of Parliament and independent of government. They report to Parliament through the PAC and attend meetings of that committee. They head the National Audit Office (NAO), whose role is to assist Parliament in scrutinising how public funds have been used.

The C&AG provides Parliament with two different types of audit. The first is a financial audit of the accounts of all central government bodies with two forms of opinion being provided on the accounts.

- The first is on whether the accounts provide a **true and fair view**; has the entity captured all relevant economic events and applied the accounting standards correctly.
- The second is an **opinion on regularity**; was the spending undertaken by the department and reflected in the accounts within the department's authority and consistent with the intentions of Parliament.

The other type of audit that is carried out by the NAO are value for money reports that assess the economy, efficiency and effectiveness with which public resources have been deployed in specific areas.

### **OFFICE FOR BUDGET RESPONSIBILITY (OBR)**

The OBR was created in 2010 to act as an independent fiscal watchdog. Its roles include evaluating government performance against its fiscal targets and assessing the long-term sustainability of the public finances. Although restricted to providing assessment and evaluating performance and not therefore a main actor in the framework, the OBR has become an authoritative voice in discussions on the public finances.



## 2. *Managing public money*

HM Treasury sets out how it seeks to meet Parliament's expectations for the control of public resources in the document *Managing Public Money*. It is an important document, because while HM Treasury is responsible to Parliament for the control of public resources and setting the rules for the administration of public finances, the responsibility for operating within these rules is mainly down to departments and public bodies themselves.

### KEY REQUIREMENTS

The key requirements of spending noted in *Managing Public Money* (MPM) are:

- **Regularity:** spending proposals must be within legal powers, parliamentary authority, or HM Treasury delegations; and be compatible with the agreed spending budgets;
- **Propriety:** a spending proposal should not breach parliamentary control procedures or expectations;
- **Value for money:** spending should be demonstrably better value than an alternative proposal, or doing nothing eg, it should be a cheaper, higher quality, or more effective outcome for the Exchequer as a whole; and
- **Feasibility:** there should be no significant doubts about whether the proposal can be implemented accurately, sustainably, or to the intended timetable.

Any spending which does not meet these standards falls short of Parliament's expectations.

All officials who have responsibility for public funds are required to follow the requirements and principles contained within MPM.

### ACCOUNTING OFFICERS AND MINISTERIAL DIRECTIONS

Each public body has an Accounting Officer, who is personally accountable to Parliament for the entity's use of public funds. All Accounting Officers can be called to Parliament to give account for their use of public money. This is normally through the PAC, where the Treasury Officer of Accounts, who has policy responsibility for the guidance in MPM, will be in attendance.

If a minister is contemplating a course of action which the Accounting Officer considers a breach of MPM principles then the Accounting Officer should set out in writing their objection or concerns about the proposal, requesting a formal written direction to proceed.

### KEY SPENDING REQUIREMENTS:

- Regularity
- Propriety
- Value for money
- Feasibility

If the minister does decide to proceed then the Accounting Officer is obliged to comply with the instruction. They are, however, required to send the relevant papers to the C&AG and the HM Treasury Officer of Accounts. The C&AG will then report the direction to the PAC, and in the event of a PAC hearing they will absolve the Accounting Officer of any personal responsibility for the course of action that the minister required them to follow.

### HM TREASURY APPROVAL

While departments need HM Treasury consent before either undertaking expenditure, or making commitments that will lead to expenditure, in practice authority for spend is delegated within certain limits. This delegation allows departments the freedom to manage their finances within agreed budgets and voted supply limits, while enabling HM Treasury to maintain overall control in accordance with its responsibilities to Parliament.

The **delegated limits** for each department are based on a range of factors, including the nature of expenditure and earned autonomy for effective financial management.

HM Treasury cannot, however, delegate authority for spending that is (i) novel, (ii) contentious, (iii) repercussive; or where (iv) there is a statutory requirement for HM Treasury approval.

Before approving such expenditure, HM Treasury will consider regularity, propriety, value for money and feasibility (usually assessed through a '**Green Book**' business case and the Accounting Officer's consideration).

MPM also provides examples of further issues requiring HM Treasury approval. These include new or changes to legislation with financial implications, new services, losses and write-offs, overpayments, gifts, contingent liabilities, and departmental lending. Parliament must also be notified of any **contingent liabilities** taken on by a department with a value of more than £300,000.

### DELEGATED LIMITS

HM Treasury can (and has in the past) reduce the delegated limits for departments that have not adhered to good financial management practices.

### EXAMPLES OF NON-DELEGATED SPEND

- Extra statutory payments
- Payments to compensate for official errors
- Non-standard payments in kind (in other words transfers of assets)
- Unusual financial transactions that would impose lasting commitments
- Unusual schemes or policies using novel techniques

### THE GREEN BOOK

The Green Book is HM Treasury's guidance for public sector bodies on how to appraise and evaluate proposals before committing funds to a policy, programme or project.

### ENHANCED OVERSIGHT OF CONTINGENT LIABILITIES

HM Treasury has recently strengthened its oversight of contingent liabilities, with a central team responsible for examining and signing off department requests to take on significant contingent liabilities.

## RELATIONSHIPS WITH ARM'S LENGTH BODIES (ALBs) AND SYSTEM ACCOUNTABILITY

### Framework documents

Public services are delivered through a range of organisations, and the relationship between a sponsor department and its ALBs is important.

Although delivery of activities may be delegated to an ALB, the sponsor department cannot relinquish responsibility for them and the department Accounting Officer remains accountable to Parliament for public funding provided to the ALB.

The sponsor department Accounting Officer must satisfy themselves that the ALB meets expected standards of governance, decision-making, and financial management, ensuring that Parliamentary scrutiny is maintained.

An agreed framework document between the sponsor department and ALB sets out the powers and responsibilities of each entity. It should be regularly reviewed and updated.

### System accountability

Recent government policy has emphasised decentralisation and localism as ways to deliver public services. Accounting Officers should not be directly responsible for, nor manage the actions of, local institutions delivering services where there are distinct local accountability arrangements. They are, however, still responsible for the proper use of public funds granted to them by Parliament, including those funds that have been disbursed to local bodies.

There is a duty on Accounting Officers to ensure that a statutory framework for legal duties and finance management is maintained so that effective accountability for public funds is not diminished under decentralised or local delivery models. Accounting Officers are expected to demonstrate this through accountability system statements, which explain how they achieve accountability for the funds they distribute to local bodies operating within their area of policy and service delivery responsibility.

### STEP IN RIGHTS

Sufficient powers need to be maintained to step in should there be issues with ALB governance, finance or wider performance. This includes the power to replace the ALB Accounting Officer if they do not act in accordance with their responsibilities.

### SYSTEM ACCOUNTABILITY IN MANAGING PUBLIC MONEY

Accountability system statements are relatively new and expanded coverage of them is expected in an updated version of MPM to be released in late 2017.

### FEES, LEVIES AND CHARGES

Fees, levies and charges for services are a way of increasing public revenues, reducing demand for certain goods and services, and ensuring that users of services pay for them. MPM contains specific guidance to ensure that fees, levies and charging regimes are effectively governed and managed. HM Treasury is expected to ensure that the government is not abusing its market or monopoly powers.

### 3. *Fiscal and spending framework*

An understanding of the fiscal and spending framework is crucial to being able to make sense of how the public finances are managed. This section provides an overview of this framework, with the following section explaining how spending is controlled in-year. The final section explains how it is accounted for back to Parliament, so that Parliament can ‘follow the money’ and see what expenditure was undertaken with the resources it approved.



By ‘**fiscal**’ we mean any activities relating to government revenues and expenditure. ‘**Spending**’ refers both to that spending that has immediate cash consequences and to all other non-cash items that have economic consequences such as depreciation, provisions and the write-down in value of assets.

The fiscal and spending framework uses **accrual-based** information, where economic events are recognised at the time at which they occur (eg, a service is provided), and not only when any related cash receipts and payments change hands.

**BENEFITS OF ACCRUALS**

Accruals provide a more comprehensive view of both the entire public sector and the individual organisation’s financial position and performance, especially with respect to assets and to liabilities incurred but not yet settled.

## I. HOW DOES GOVERNMENT SET ITS TARGETS FOR PUBLIC EXPENDITURE MANAGEMENT?

Very often the Chancellor will set out the targets for economic performance and public finance management in terms of the **fiscal aggregates** as *Fiscal Rules*.

The **fiscal aggregates** are widely accepted measures used in economics and statistical reporting. They come from the **National Accounts**. These are a set of economic accounts produced by the independent Office for National Statistics (ONS) in accordance with the European System of Accounts 2010 (ESA10) which the UK is currently legally obliged to use as a member of the EU. The ONS also determines which entities are **classified** to the public sector for National Accounts reporting purposes.

**Fiscal rules** are targets that guide spending decisions and provide reference for spending reviews and annual budgets.

Under the current government there are two main fiscal rules, these are:

**Deficit** - the structural deficit (cyclically adjusted public sector net borrowing) to be below 2% of Gross Domestic Product by 2020-21. This is described as '**the fiscal mandate**'.

**Debt** - public sector net debt to fall as a percentage of Gross Domestic Product in 2020-21. This is described as '**the supplementary target**'.

In addition, the government also has a target for welfare spending (excluding the state pension and those payments that are closely linked to the economic cycle) to lie below a welfare cap set for 2021-22. This target is not based on a defined fiscal aggregate.

The **Office for Budget Responsibility** has a mandate to use its public finance forecast to judge the government's performance against these targets. These forecasts are set out in its **economic and fiscal outlook** which is published in advance of significant fiscal events (in previous years usually the budget statement in March and the autumn statement in late November).

### CLASSIFICATION

All entities that are classified to the public sector will affect the fiscal aggregates. It is important, therefore, when setting up a new body or altering the controls which it may have over an existing entity, that government takes into consideration the potential impact of classification.

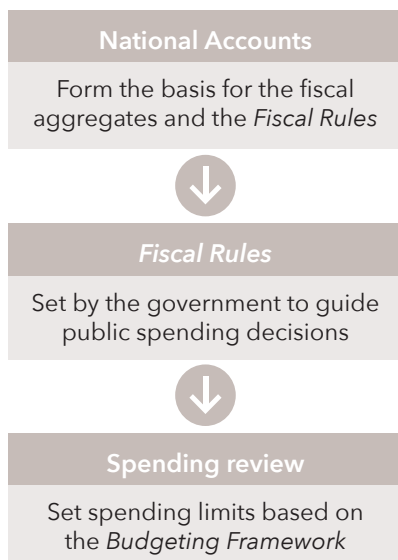
### DEFICIT

The deficit measures the difference between government spending and income in a single financial year. The most common measure used and the basis for the government's fiscal mandate is Public Sector Net Borrowing (PSNB). If income exceeds expenditure then the public finances are in 'surplus'.

### DEBT

Essentially, debt measures the stock of historic cumulative deficits run by the government. Each year that the government runs a deficit, therefore, it can be expected that the overall debt figure will also increase. The most common measure used and the basis for the government's supplementary target is Public Sector Net Debt (PSND).

## II. HOW DOES GOVERNMENT MATCH THESE TARGETS TO POLICY PRIORITIES?



The government uses **spending reviews** to set spending limits for future years and to direct resources to priority policy areas. The **Fiscal Rules** provide reference for **spending reviews**, which should aim to meet them while also ensuring the delivery of wider policy objectives.

Spending reviews have evolved from a system involving annual bilateral negotiations between HM Treasury and departments highlighted by flexibility, to one characterised by top-down control and firm multi-year budget settlements.

The October 2010 Spending Review under the Coalition Government set departmental budgets for four years from 2011-12 to 2014-15, including areas such as welfare and public service pensions that previously had seen significantly less control. It included spending reductions of £81bn while protecting certain areas of spending including aspects of health, overseas aid, and education.

Spending Reviews 2013 and 2015 saw further spending reductions, the continuation of protection in some areas, and the introduction of a **zero-based approach** to capital spending that aimed to prioritise those projects deemed to provide the highest economic value.

### ZERO-BASED BUDGETING

Under a zero-based approach, all activities and programmes must be re-costed from zero and justified by reference to a set of criteria. Those that do not meet the criteria will not be funded. This differs to incremental approaches to budgets where previously approved budgets for activities and programmes are adjusted up or down by a set amount.

### PARLIAMENT'S ROLE IN SPENDING REVIEWS

The Procedures Committee has highlighted that, given the growing importance of spending reviews, it is necessary to ensure that the outcome of these are debated in the House of Commons so that MPs are able to participate in the choices made. This currently does not occur and the committee has called for the government to allocate days to debate the outcome of each spending review.

### III. HOW ARE THESE RESOURCES MANAGED BY INDIVIDUAL DEPARTMENTS?

Resources are managed by departments using the **Budgeting Framework**. It is designed to control spending against the **Fiscal Rules** and incentivise departments to manage spending to provide high quality public goods and services that demonstrate value for money.

The **Budgeting Framework** is set by HM Treasury, and the rules that departments must follow are in the Consolidated Budgeting Guidance.

Spending is split into **departmental expenditure limits (DEL)** and **annually managed expenditure (AME)**, and within those categories spending is further split between **resource** and **capital**.

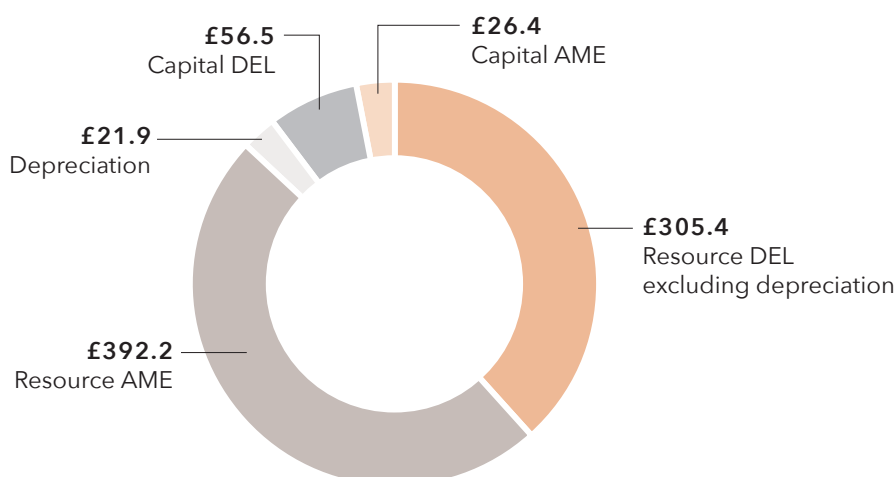
All spending is deemed by HM Treasury to be DEL unless agreed by the Chief Secretary to the Treasury. AME spending includes areas of spending that HM Treasury deems unpredictable, difficult to control, and of a size that departments would have difficulty managing within DEL budgets.

DEL is usually set over a four-year period at the spending review, whereas AME is forecast on a yearly basis. Departments are then set annual budgets split between resource/capital and DEL/AME.

These categories are examined in more detail in the next section on in-year spending control. As a percentage of **total managed expenditure (TME)**, which is a measure of all spending, resource AME, which includes spending on areas such as welfare, benefits and pensions, has grown to almost 50% as spending on public services has been more tightly controlled under austerity measures.

#### TOTAL MANAGED EXPENDITURE 2017-18 - £802.4bn

Source: HM Treasury Spring Budget 2017



#### COVERAGE

All entities classified to the public sector are subject to the **Budgeting Framework** as they affect the public finances. The budgeting flexibilities and freedoms they have then depend on sub-classification to central government, local government or other areas of the public sector.

#### RESOURCE

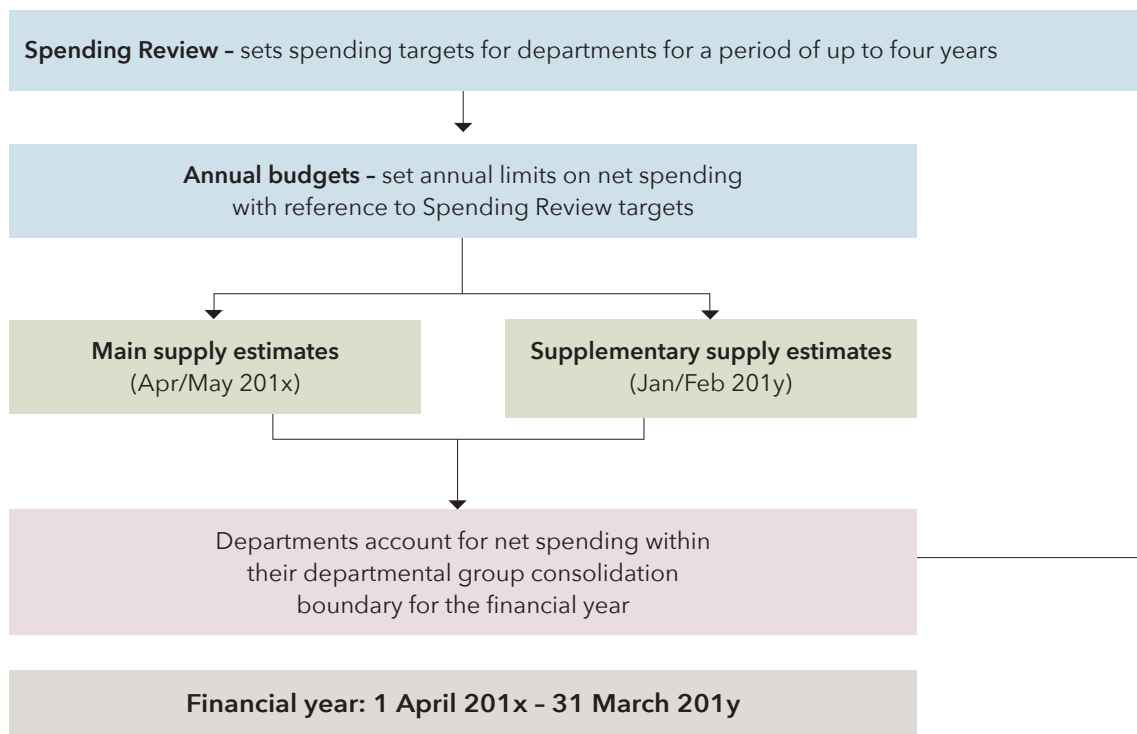
Resource spending includes expenditure on current items such as salaries, rents and utilities, and welfare payments.

#### CAPITAL

Capital spending includes spending on fixed assets that are expected to be used for more than one year, net policy lending and any capital grants to the private sector.

#### IV. HOW DOES PARLIAMENT MAINTAIN AUTHORITY OVER THE PUBLIC FINANCES?

Figure:  
Parliamentary financial  
accountability processes

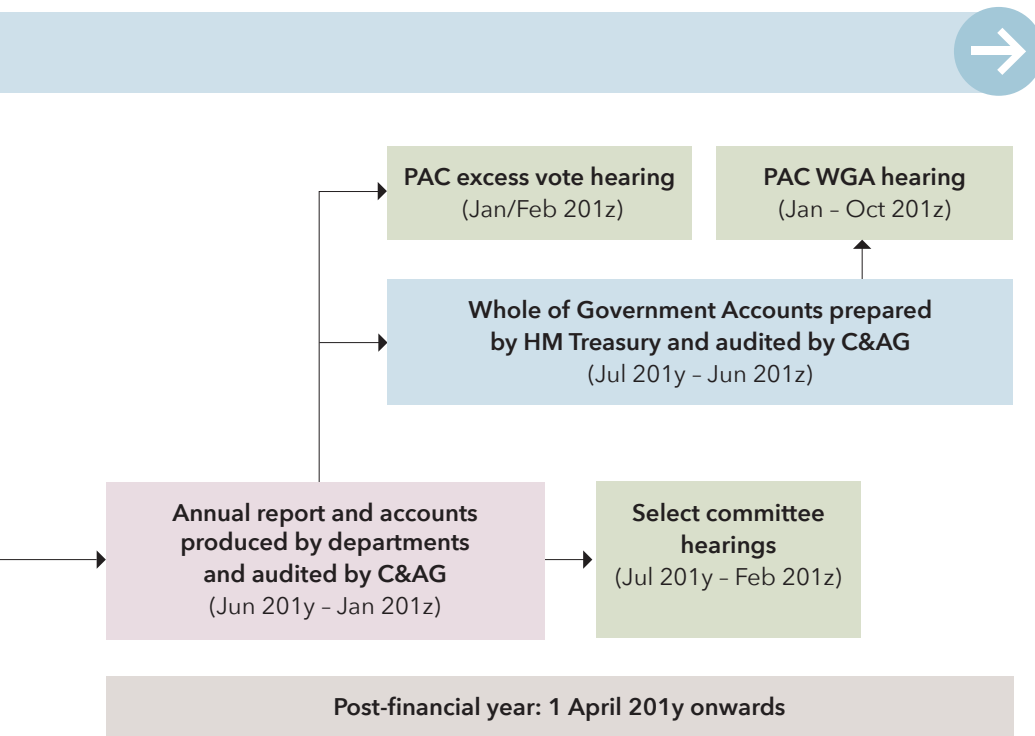


Supply estimates are a long-standing parliamentary process for providing legal authority to the government for spending and the retention of income. The House of Commons has financial privilege within Parliament in this area, and it is expected to scrutinise, debate and vote on spending in the supply estimates. Without this specific parliamentary approval, departments cannot legally use the majority of their resource, capital, and cash budgets.

Supply estimates are prepared by the department, reflecting the annual budget settlement with HM Treasury, and are presented to Parliament for the entirety of government by HM Treasury. They include all spending within a department’s budget, including spending by core departments and any arm’s length bodies controlled by the department and included within its accounts. They also include spending which already has its own statutory authority such as payments related to judges’ salaries and funding for the National Audit Office.

As well as the sought budget settlement supply estimates must also include a description, the **ambit**, of which services and purposes income and expenditure will be used for. To be legal, spending must be in accordance with the ambit.





**Main supply estimates** are presented around the start of the financial year to which they relate. In addition to the main supply estimates, there is also the possibility for a **supplementary estimate** whereby departments can seek additional resources, capital and/or cash during the financial year. This supplementary estimate is usually presented in January/February.

Any overspending by a department of the specific limits voted by Parliament is unauthorised and without legal authority until it is regularised by Parliament through a process known as an **excess vote**. The excess vote process draws critical attention to overspending so supplementary estimates enable departments to gain parliamentary approval for in-year changes to budgets, subject to prior HM Treasury approval, and avoid an excess vote. A **vote on account** is also published alongside the supplementary estimates.

When estimates are placed before Parliament, departments are required to also present an explanatory memorandum to their select committee. The **estimates memorandum** should provide the select committee with sufficient information to enable scrutiny of the estimate.

### DEVOLUTION

Funding from central government to the devolved administrations is mainly in the form of a block cash grant which is voted through the supply estimate of the Scotland Office, Wales Office and Northern Ireland Office. As such, while delivery of services may be devolved to the relevant Parliament of Assembly, the majority of the funding for those services is still subject to approval by the UK Parliament.

### MAIN SUPPLY ESTIMATES

These have previously been presented as soon as possible after the budget (usually in April) but there is the potential that this timing may change to before the beginning of the financial year, following the decision of the government to move the budget to the autumn.

### VOTE ON ACCOUNT

Provides departments with parliamentary authority for the resource, capital and cash expenditure needed for departments to operate and provide existing services from the start of the next financial year until main supply estimates are authorised.

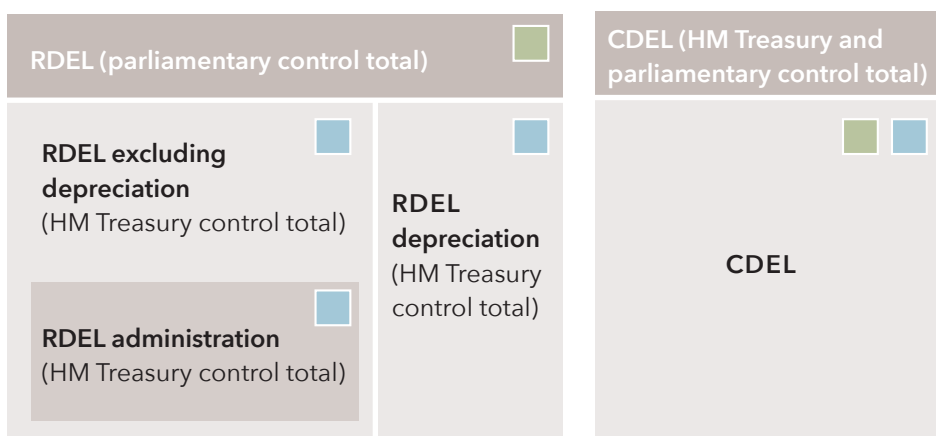
## 4. Spending control

The budgets set for departments by HM Treasury at spending reviews are expected to remain fixed. In practice, it is recognised that over the period covered by a spending review, departments may face changing policy and external circumstances, so the system allows for some flexibility.

### THE CONTROL OF DEL

Within DEL there are four key control totals that HM Treasury, through the budgetary framework, seeks to manage. These are:

- **Resource DEL (RDEL)** excluding depreciation - effectively current spending
- **Capital DEL (CDEL)** - spending on items deemed capital in nature
- **Administration budget** - spending on non-front line services within RDEL
- **Depreciation** - a ring-fenced budget within RDEL



Components of RDEL and CDEL and control totals

■ Parliament ■ HM Treasury

### HM TREASURY OR PARLIAMENTARY CONTROL TOTALS?

Only total RDEL and total CDEL are control totals for the purposes of Parliament and the estimates process. This means, for example, that a department could breach its HM Treasury RDEL excluding depreciation control total but avoid an excess vote (p20) because total RDEL has not been breached.

### THE CONTROL OF AME

AME spending is related to the cost of delivering policies which are demand-led (eg, pensions, unemployment benefits) or where expenditure is otherwise volatile, unpredictable and large compared with the department's total budget. This would make it difficult for departments alone to bear the risks associated with variations in spending.

AME spending is like any other, impacting on the fiscal framework in the same way as DEL spending. As such it requires monitoring and management and is subject to control by HM Treasury and Parliament. In practice, AME is now controlled in a similar way to DEL and increases in AME spending now require the approval of HM Treasury as well as parliamentary approval through the supply estimates process, which may require the department to make offsetting savings elsewhere including within DEL.

## MECHANISMS FOR CHANGING BUDGETS

There are two main mechanisms by which budgets can change:

i. DEL Reserve claims	
Increasing a department's overall spending power	Provides the department with additional budget

The DEL Reserve is a small unallocated amount within total DEL not allocated at spending reviews. It is supposed to be available only for:

***Genuinely unforeseen contingencies, which are unavoidable, and that departments cannot absorb by themselves.***

ii. Switches	
Changes and/or flexibility within existing budgets	Total budget remains unchanged

Although switches are preferred to DEL Reserve claims, because of the potential impacts on fiscal aggregates and financial management incentives, HM Treasury places restrictions on them. General rules are:

- **Resource to capital** - automatic approval as current expenditure is being replaced with spending on investment
- **Capital to resource** - only with HM Treasury approval as money earmarked for investments is being used for current expenditure
- **Depreciation to non-depreciation** - only with HM Treasury approval as this would be expected to increase borrowing (depreciation is non-cash expenditure whereas most non-depreciation spend uses cash either now or in the future)
- **Administration to non-administration** - automatic approval as funds are being spent on front-line service delivery
- **Non-administration to administration** - only with HM Treasury approval as this implies mismanagement and reduces the amount available to spend on front-line services

All switches must be formalised at the supplementary estimates so are subject to parliamentary approval. No switches can be made in a financial year once supplementary estimates have been finalised.

### DEL RESERVE CLAIMS

Claims on the Reserve need to be authorised by the Chief Secretary to HM Treasury. They are also expected to be repayable to HM Treasury and are non-recurrent (ie, they should not impact on department baselines or increase spending power in future periods).

### DEPARTMENTS DO HAVE FLEXIBILITY BETWEEN INDIVIDUAL PROGRAMMES

These rules on switching do not preclude departments from altering the level of funding between individual programmes within RDEL or CDEL, providing they have the legal authority in statute and in the supply estimates to spend the money on those activities.

A department can spend more on one programme and less on another without parliamentary authority. What is precluded is spending money on a new programme where there isn't the statutory authority and ambit cover to do so.

## MANAGING THE UNEXPECTED AND FLEXIBILITY

The spending control system also has mechanisms to manage overspending by departments and flexibility between years to improve financial management.

### URGENT CASH SPENDING

In addition to the control of DEL and AME spending, HM Treasury and Parliament also control the use of cash by departments through the **net cash requirement**. Where urgent cash spending is required that cannot await the approval of the relevant estimate, a **contingencies fund** exists that can be used to finance payments for urgent services in anticipation of parliamentary provision.

The use of the contingencies fund is exceptional as it effectively allows spending in advance of parliamentary approval. Advances must also be repaid when Parliament votes the necessary funds in the next estimate.

### OVERSPENDING

Overspending by a department will lead to a HM Treasury investigation and, if appropriate, the department's budgets will be reduced in the next year by an equal amount. In addition, HM Treasury may impose other penalties such as a lowering of delegated authority.

Any overspending of the specific limits voted by Parliament has to be regularised by Parliament in order to be within the lawful authority of the department. This is done through the **excess vote** process. Excesses are identified at the year-end when outturn is compared to the provision in the estimate and published in the annual report and accounts. Any spending outside the **ambit** will also require an excess vote.

### FLEXIBILITY BETWEEN YEARS

While budgets are fixed on an annual basis, there is limited flexibility for departments to carry forward a forecast DEL underspend from one year to the next through **budget exchange**.

Under **budget exchange**, departments may surrender an underspend to HM Treasury at the supplementary estimate in return for a DEL increase in the following year, subject to a percentage limit based on the size of the department's total DEL budget. Carry-over from one year is netted off what can be carried forward in the next year to prevent the accumulation of spending power over time.

### THE CONTINGENCIES FUND

In addition to urgent services the contingencies fund can also be used to provide funds temporarily to departments for necessary working balances or other temporary cash deficiencies.

### EXCESS VOTES AND THE PAC

The department will face an investigation by the NAO, with the Accounting Officer and minister being summoned to the PAC to explain the overspend. The PAC reports on any excess votes, and it is necessary for Parliament to grant formal retrospective approval to unauthorised spending at the next estimate.

### BUDGET EXCHANGE

Encourages departments not to adopt a 'use it or lose it' approach to budgets while preventing large underspends being carried forward that could hinder spending control and financial planning at the whole of government level.

### CAPITAL FLEXIBILITY

Additional flexibility has been granted to departments to carry forward CDEL if they are undertaking significant investment programmes due to the difficulty of managing spend within annual budgets on multi-year capital programmes.

## 5. *Annual report and accounts and audit*

All departments receiving supply are required under the Government Resources and Accounts Act 2000 to prepare annual accounts which must be laid before Parliament. The integrated accounting, budgeting and estimates framework created under the clear line of sight reforms, has made the UK one of the most transparent jurisdictions in the world.

### PUBLIC FINANCIAL MANAGEMENT REFORMS

Over the past two decades, several public financial management reforms have been introduced under successive programmes to improve accounting and wider financial management. Some of the most significant reforms have been:

#### Government Resources and Accounts Act (GRAA) - 2000

- Introduced accrual accounting into central government, allowing for production of accrual based reports and financial information which provides a more comprehensive view of the financial position and the cost and nature of activities.
- Required production of accounts based on generally accepted accounting practice (GAAP) which are the accounting standards used in business.



#### International financial reporting standards (IFRS) - 2009-10

- IFRS was adopted to ensure that government accounts remain consistent with UK listed companies.
- Allows departments to make use of already existing governance structures for the creation of standards designed to be robust enough for the largest commercial organisations and produce accounts to standards and in a format that is widely understood.



#### Clear line of sight - 2011-12

- Aligned the accounting treatment of government spending with that used in budgets and estimates.
- Elimination of misalignments gives opportunities for improved financial management and greater transparency, while also providing for improvements in accountability and more effective scrutiny.



#### Simplifying and streamlining - 2015 onwards

- Project designed to enhance the usefulness of the annual report and accounts produced by departments and other reporting entities in government.
- Aims to ensure that the annual report and accounts is a simple and short integrated document that enables the reader to understand financial and operational performance, key risks, and governance structures in place.

## RELIABILITY OF THE ACCOUNTS

Reforms have led to improvements in public finance management, and contributed to the UK’s public finances being among the most transparent in the world. The overall framework within which UK government accounts are produced means that users can expect a high degree of reliability and trustworthiness. The features of the framework are:

### 1. Robust standards with independent oversight

Reforms to introduce accounting standards used by businesses through the adoption of GAAP and then IFRS have played a key role in ensuring that the accounts of departments can be trusted.

Nevertheless, commercial accounting standards need some adaptation for the public sector context to meet the needs of users and provide appropriate financial management incentives. HM Treasury undertakes this using a transparent process. It must consult an independent statutory body, the Financial Reporting Advisory Board (FRAB), on any adaptations to IFRS and undertake wider public consultation. This ensures that adaptations and interpretations are legitimate and restricted to the minimum required.

### 2. Accounting Officer sign-off

Accounting Officers are responsible for the accuracy and quality of the information in their accounts and must sign them to indicate that, in their judgement, they meet the accounting standards and requirements set by HM Treasury.

### 3. Independent external audit

The accounts of all departments and other central government bodies are audited by the Comptroller & Auditor General (C&AG), an officer of Parliament independent of the government, who provides two forms of opinion on the accounts:

- (i) Do they provide a **true and fair view**? ie, are all relevant economic events captured and accounting standards applied correctly; and
- (ii) Is the spending in the accounts **regular**? ie, was it within the department’s authority and consistent with the intentions of Parliament.

Once audited, the accounts are then laid before Parliament (the expectation is pre-summer recess for most departments) and departmental select committees are expected to hold hearings on the annual report and accounts of their department.

If there is a problem with the accuracy or reliability of a set of accounts, the C&AG will provide a qualified opinion.

#### FRAB

Membership of the FRAB is comprised of representatives from government, the NAO, external experts, the Devolved Administrations, other public sector accounting standard setters and Parliament. The FRAB provides advice and guidance to HM Treasury and provides a report to Parliament on its work annually.

#### FAIR, BALANCED AND UNDERSTANDABLE

Recent reforms also require the Accounting Officer to confirm that the annual report and accounts when taken as a whole is fair, balanced and understandable.

#### QUALIFIED OPINION

There are a range of qualifications of the C&AG’s opinion on truth and fairness. These indicate the seriousness of the underlying financial management issue.

**Qualified opinion** - when the accounts are materially misstated in one area but the issue is not pervasive so they can be trusted in other areas.

**Adverse opinion** - when the accounts are materially misstated and the issue is pervasive.

**Disclaimed opinion** - when the C&AG is unable to provide any opinion at all on the accounts.

## WHOLE OF GOVERNMENT ACCOUNTS

The Whole of Government Accounts (WGA) are a consolidated set of financial statements covering the entire UK public sector. It includes over 6,000 entities, and is the only set of audited financial data covering the entire public sector.

The aim of WGA is to improve transparency, accountability and financial management. By bringing the public sector together in one place, and providing comparability across different parts of the public sector it assists in putting numbers into context. It also provides a new measure of the government's financial position and performance, including items like provisions, Public Finance Initiative financed programmes, and contingent liabilities.

This complements existing measures, both on a single year basis and through the time series that is being developed each year that WGA is published.

## MAKING USE OF THE ACCOUNTS

The quality of department accounts and WGA are a real strength of UK public financial management, providing a significant amount of audited financial information and other information (performance, governance, risk) that has been checked for consistency.

Matters leading to a qualification of the C&AG's opinion generally indicate failures in financial management that can signify wider performance management issues.

The balance sheet and associated notes provide information on liabilities that have been incurred which will reduce resources available for future spending, and assets that are available to deliver services or meet obligations that may not be available elsewhere.

And in WGA, the UK has a comprehensive audited view of the entire public sector's financial position and performance on an accounting basis. This is something few other countries have access to and it provides a different lens on the public finances, including wider measures of public sector debt, that can improve decision-making and accountability.

### QUALIFICATIONS

WGA is relatively new, with the first audited accounts being published only for the 2009-10 financial year. They have been subject to true and fair qualification by the C&AG. The timeliness of publication also needs to be improved.

Work has been undertaken across the public sector to reduce qualifications with some success, and HM Treasury has also looked to enhance performance reporting in the most recent WGA.

### FUTURE DEVELOPMENTS

The preparation, consolidation and audit of government accounts is likely to be profoundly affected by emerging technologies such as distributed ledgers (eg, blockchain). These technologies which increasingly operate on unstructured data, represent an opportunity to transform the speed and accuracy with which government financial information can be produced, but will require significant investment.

### WHERE TO GO FOR FURTHER INFORMATION

Further information on the UK public financial management system is available from:

**Scrutiny Unit** [www.parliament.uk/mps-lords-and-offices/offices/commons/scrutinyunit/](http://www.parliament.uk/mps-lords-and-offices/offices/commons/scrutinyunit/)

**National Audit Office** [www.nao.org.uk](http://www.nao.org.uk)

**HM Treasury** [www.gov.uk/government/organisations/hm-treasury](http://www.gov.uk/government/organisations/hm-treasury)

**ICAEW** [www.icaew.com/publicfinances](http://www.icaew.com/publicfinances)

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Training, developing and supporting accountants throughout their career, we ensure that they have the expertise and values to meet the needs of tomorrow's businesses.

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[www.globalaccountingalliance.com](http://www.globalaccountingalliance.com)

## ICAEW

Chartered Accountants' Hall  
Moorgate Place  
London  
EC2R 6EA  
UK

T +44 (0)20 7920 8100  
E [contactus@icaew.com](mailto:contactus@icaew.com)  
[icaew.com/publicfinances](http://icaew.com/publicfinances)

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