

11 Income and expenditure

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11.1 Introduction

11.1.1 This chapter sets out the accounting principles and standards that should be applied in preparing the entity's operating cost statement, income and expenditure account, or equivalent. It looks at each of the relevant accounting standards and, for Supply and Consolidated Fund Extra Receipts, there is a worked example of how the principles should be applied. Chapter 5 provides more detail on the disclosure requirements.

11.2 Income

Introduction

11.2.1 The following accounting standards deal with accounting for income:

IAS 18 *Revenue*; and

SIC 31 *Revenue – Barter Transactions Involving Advertising Services*.

IAS 18 Revenue and SIC 31 Revenue – Barter Transactions Involving Advertising Services

Applicability

11.2.2 IAS 18 and SIC 31 apply in full to all reporting entities covered by this Manual.

Objectives of IAS 18

11.2.3 The objective of IAS 18 is to identify the circumstances when revenue recognition criteria will be met. It also provides practical guidance on the application of those criteria.

SIC 31 consensus

11.2.4 The consensus in SIC 31 is that revenue from an exchange involving advertising services cannot be reliably measured by reference to the fair value of the services received. This is because reliable information is not available to the seller to support such measurement. However, a seller can reliably measure revenue at fair value of the advertising service it provides in a barter transaction by reference to its non-barter transactions that meet certain criteria specified in SIC 31.

Definitions

11.2.5 The following paragraphs provide definitions of the various types of income that departments covered by the requirements of this Manual might expect to receive. Funding from the following sources should not, however, be accounted for as income but as financing through the General Fund:

- Supply;

- grants and grants-in aid to non-departmental public bodies (see paragraph 11.2.18);
- grants from the Ministry of Justice to the Welsh Assembly Government;
- amounts from the National Insurance Fund in respect of welfare benefits;
- the Consolidated Fund in respect of standing services; and
- advances from the Contingencies Fund.

11.2.6 The parliamentary process and accounting arrangements determine how income is presented. The following sections look at the arrangements for government departments whose activities cover the whole of the United Kingdom, or that are responsible for activities in England or Northern Ireland and the arrangements in Scotland. There are separate arrangements in Wales, details of which can be obtained from the Welsh Assembly Government.

11.2.7 NDPBs and trading funds should refer to the following definitions as appropriate to their circumstances. There may be situations where, in consultation with their sponsoring bodies, non-departmental public bodies or trading funds cannot retain some of their earned income, but the norm is likely to be that all income earned by these entities will be retained as operating income. Non-departmental public bodies and trading funds should refer to paragraph 11.2.18 for guidance on accounting for grants and grants-in-aid.

Whole of United Kingdom, England and Northern Ireland Operating income and operating appropriations-in-aid (referred to as 'accruing resources' in Northern Ireland)

11.2.8 Operating income is any income generated by an entity in pursuit of its activities (generally referred to as fees and charges) or as part of managing its affairs (examples include rents, interest and dividends receivable). Departments covering the whole of the United Kingdom, and departments covering England or Northern Ireland must seek the approval of the relevant authority and obtain parliamentary approval to retain income which would otherwise be surrendered to the Consolidated Fund (that is, seek approval to appropriate income in aid of voted expenditure). *Managing Public Money* refers to operating income as operating appropriations-in-aid, and the Northern Ireland equivalent refers to accruing resources. In most cases, income will be retained in support of expenditure on the same Request for Resources (RfR), but, subject to its taking out a Supplementary Estimate, a department may retain income against one RfR against related expenditure on another RfR if there is a direct link between the two. Transactions between a department's RfRs in the *Statement of Parliamentary Supply* will be eliminated in the operating cost statement. National insurance contributions receivable by the National Health Service are also accounted for as operating income.

Excess appropriations in aid

11.2.9 Income (either operating or non-operating) in excess of the level authorised by Parliament to be appropriated-in-aid in respect of each RfR is not included in the calculation of net resource outturn. This income is treated as Consolidated Fund Extra Receipts for the purposes of parliamentary control within the Statement of Parliamentary Supply, and is paid into the Consolidated Fund. As excess income is calculated in respect of each RfR, it is possible for there to be excess income even though, in aggregate, income is within the limits set by Parliament. It is only possible to transfer excess income between RfRs by taking out a Supplementary Estimate.

Non-operating income and non-operating appropriations-in-aid

11.2.10 Proceeds arising from the sale of investments and fixed assets are accounted for as non-operating income. Departments should seek the approval of the relevant authority to appropriate in aid such income. Surpluses on the disposal of assets will be netted off expenditure in the operating cost statement only where they are no more than adjustments to depreciation (or amortisation) or impairment previously charged. The presumption is that this accounting treatment for profits will be more appropriate in respect of depreciable tangible fixed assets which are re-valued, and in respect of other surplus assets originally acquired for an entity's own use, and which have been written down to net realisable value. Other profits on disposal of assets will be treated as income in the operating cost statement. Profits on disposals are netted off the relevant expenditure section in the *Statement of Parliamentary Supply*, rather than appropriated in aid.

Other non-retainable income

11.2.11 Other non-retainable income includes any income or recovery of expenditure that cannot be classified as either appropriations in aid (operating or non-operating) or excess appropriations in aid. It should be recorded in the operating cost statement. In England and Northern Ireland this income is treated as Consolidated Fund Extra Receipts. (See also 10.2.8 on confiscated, seized and forfeited property.)

EU income

11.2.12 EU income from whatever source, other than receipts to be transferred to other member states or mandated bodies in other member states in respect of EU twinning projects, should be treated as income and shown separately on a gross basis in the operating cost statement. A distinction should be made on the face of the operating cost statement between receipts where:

- a) the entity is acting as an agent for the European Union in making payments to third parties in the United Kingdom; and
- b) the receipts are treated as negative public expenditure and reduce the burden on the United Kingdom exchequer.

In the case of EU twinning project receipts, amounts to be transferred to other member states to mandated bodies as EU funding for their part in the project are not income in the United Kingdom and so should be treated as third-party assets as the amounts held represent assets for which the department acts as custodian but in which the government has no beneficial interest.

11.2.13 EU income which is received by an entity in the capacity as an agent passing on the income to a third party may be netted off the relevant expenditure section in the *Statement of Parliamentary Supply*, rather than appropriated in aid. EU income received by an entity to fund its own expenditure should be appropriated in aid.

11.2.14 Where there is a delay in the receipt of EU funds, either direct from the European Union or via the Rural Payments Agency, the amount due should be treated as accrued income and shown in the statement of financial position. The notes to the financial statements should disclose separately accrued income relating to EU funding.

Items authorised to be netted off gross expenditure

11.2.15 Items of income that departments are authorised to net off gross expenditure in the *Statement of Parliamentary Supply* for purposes of parliamentary control, which relate to any recovery of expenditure recorded in the operating cost statement or to returns on investments, should appear in the operating cost statement. Other entities will not normally be authorised to net off income against expenditure. With the exception of EU income (see above), no income is recorded in the operating cost statement where an entity is acting as an agent for a principal or on behalf of a third party.

Scotland

11.2.16 Operating income is income that relates directly to the operating activities of the Scottish Executive, its Executive Agencies, the Crown Office and Procurator Fiscal Service and NHS bodies. It includes fees and charges for services provided, on a full cost basis, to external customers and public repayment work and from investments. Departmental Outturn Statements include both income applied without limit and income applied with limit as outlined by the Scottish Budget documents. For income categorised as being applied with limit, any excess income over that approved is surrendered to the Scottish Consolidated Fund. Operating income is stated net of VAT.

11.2.17 A separate note to the Scottish Executive Consolidated Accounts provides an analysis between income applied and income not applied. Income not applied includes amounts for surrender to the Scottish Consolidated Fund in accordance with the Scotland Act 1998 (Designation of Receipts) Order 2000 and excess receipts not covered by the Budget Act authority, which must by default be surrendered to the Scottish Consolidated Fund. All interest receivable is external to the departmental boundary and is not from other government departments and is included within operating income in respect of Voted Loans and Housing Association Loans.

Grants and grants-in-aid

11.2.18 Other than charitable NDPBs, who should follow the requirements of the Charities SORP, NDPBs should regard grants and grants-in-aid received for **revenue** purposes as contributions from controlling parties giving rise to a financial interest in the residual interest of the body, and hence should account for them as financing, i.e. by crediting them to the income and expenditure reserve. The treatment of grants and grants-in-aid received for **capital** purposes is described in chapter 6 (paragraph 6.2.58). Any proposal for alternative accounting treatment should be approved by the department responsible for the NDPB and the relevant authority.

11.3 Expenditure

Introduction

11.3.1 The following accounting standards deal with aspects of accounting for expenditure:

IAS 11 *Construction Contracts*;

IAS 21 *The Effects of Changes in Foreign Exchange Rates* and SIC 7 *Introduction of the Euro*; and

IAS 29 *Financial Reporting in Hyperinflationary Economies* and IFRIC 7 *Applying the Restatement Approach under IAS 29*.

- 11.3.2 Specific guidance is given on the treatment of administration and programme expenditure in the operating cost statement in paragraphs 11.3.3 and 11.3.4.

Administration and Programme Expenditure

- 11.3.3 In Spending Reviews, administration budgets are set for most central government departments (including their agencies) unless specific exemptions have been agreed. At present, the Ministry of Defence, the Export Credit Guarantees Department, the Forestry Commission and trading funds that are departments in their own right are excluded from the regime. The devolved administrations are also not set administration budgets in Spending Reviews, but these bodies operate their own arrangements for constraining the costs of running central government. Details of administration budget regimes can be obtained from the relevant authorities. Expenditure that does not fall within administration budgets is known as programme expenditure. Expenditure and income should therefore be shown separately in the operating cost statement under two headings – administration costs and programme costs. In Scotland, administration costs are those voted to, incurred by, and reported against the Administration Department.

- 11.3.4 The classification of expenditure and income as administration or as programme in the department's resource accounts should follow the definition of administration costs provided by the relevant authority. Agencies that are excluded from the administration budget regime should make it clear either in the operating cost statement or in the notes to the accounts that their expenditure is programme.

Student loans

- 11.3.5 Student loans are subsidised. They carry, in effect, a rate of interest equivalent to the rate of inflation. In order to reflect the full extent of the subsidy, an inflation adjustment should be debited to the operating cost statement and credited to the general fund.
- 11.3.6 The calculation of the adjustment will be the rate of general inflation applied to the average net balance of loans outstanding and provision for the subsidy. The inflation index to be applied will be the retail price index (RPI(X)), using the index figure for September during the year of account. The average balances should be the same as calculated for the cost of capital charge. The cost of capital charge and the inflation adjustment may be combined.

EU expenditure

- 11.3.7 Expenditure in respect of grants or subsidy claims, whether European Agriculture Guidance and Guarantee Fund, European Regional Development Fund, Financial Instrument for Fisheries Guidance, etc., should be recognised in financial statements as closely as possible to the time of the underlying event or activity that gives rise to a liability. In practice, entities may find that claims received or authorised may form a suitable approximation for the liability, if applied consistently.
- 11.3.8 Where material, all expenditure in respect of grants or subsidy claims, whether incurred on the entity's own behalf or whether the entity is acting as an agent for the European Union (with the exception of expenditure on twinning projects), should be accounted for gross and separately analysed within the notes on programme expenditure.

11.3.9 Where an entity provides services to a candidate country under a twinning project, relevant income and expenditure should be accounted for as EU income (see paragraphs 11.2.12 to 11.2.14) and related expenditure (paragraphs 11.3.7 and 11.3.8).

IAS 11 Construction Contracts

Applicability

11.3.10 IAS 11 applies in full to all reporting entities covered by the requirements of this Manual.

Objectives of IAS 11

11.3.11 The objectives of IAS 11 are:

- a) to prescribe the accounting treatment by contractors of income and expenses relating to construction contracts;
- b) to provide guidance on the application of the criteria for recognising contract revenue and contract costs in the accounting periods in which construction work is performed; and
- c) to require expected losses on long-term contracts to be immediately recognised as an expense.

IAS 21 The Effects of Changes in Foreign Exchange Rates and SIC 7 Introduction of the Euro

Applicability

11.3.12 IAS 21 and SIC 7 apply in full to all entities covered by this Manual.

Objectives of IAS 21

11.3.13 The objective of IAS 21 is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

11.3.14 An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in financial statements.

Interpretation of IAS 21 for the public sector context

11.3.15 The presentational currency will be the same as the functional currency (i.e. pounds sterling).

SIC 7 consensus

11.3.16 The requirements of IAS 21 regarding the translation of foreign currency transactions and financial statements of foreign operations should be strictly applied to the changeover to the Euro.

IAS 29 Financial Reporting in Hyperinflationary Economies and IFRIC 7 Applying the Restatement Approach under IAS 29

Applicability

11.3.17 IAS 29 and IFRIC 7 apply in full to all reporting entities covered by the requirements of this Manual.

Objective of IAS 29

11.3.18 The standard applies to all financial statements of a reporting entity whose functional currency is the currency of a hyperinflationary economy.

Interpretation of IAS 29 for the public sector context

11.3.19 As all entities covered by this Manual have a functional currency of pounds sterling, HM Treasury will notify classification of the economy as hyperinflationary if appropriate.

IFRIC 7 consensus

11.3.20 The consensus in IFRIC 7 is that in the reporting period in which the entity first adopts IAS 29, the entity shall apply the requirements of IAS 29 as if the economy had always been hyperinflationary. Opening statements of financial position, deferred tax and corresponding figures in the subsequent reporting period should be restated as prescribed by IFRIC 7.

11.4 Tax

Introduction

11.4.1 The following standards deal with accounting for tax:

IAS 12 Income Taxes, SIC 21 Income Taxes – Recovery of Non-depreciable Assets and SIC 25 Income Taxes – Changes in the Tax Status of an Entity or its Shareholders.

IAS 12 Income Taxes, SIC 21 Income Taxes – Recovery of Non-depreciable Assets and SIC 25 Income Taxes – Changes in the Tax Status of an Entity or its Shareholders

Applicability

11.4.2 IAS 12, SIC 21 and SIC 25 apply in full to those entities that are subject to the tax regime and to the extent that they have taxable activities.

Objectives of IAS 12

11.4.3 The objectives of IAS 12 are to specify the accounting treatment for:

- a) current tax, that is the amount of income taxes payable (recoverable) in respect of taxable profit (tax loss) for the period. Income taxes payable for current and prior periods are recognised as a liability. Income tax recoverable or overpaid is recognised as an asset; and
- b) deferred tax. This recognises future tax consequences of temporary differences between amounts included in financial statements (for income and expenditure and assets and liabilities) and those included in the tax assessment.

SIC 21 consensus

11.4.4 The consensus in SIC 21 is that the deferred tax liability or asset arising from the revaluation of a non-depreciable asset should be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that asset through sale, regardless of the basis of measuring the carrying amount of the asset.

SIC 25 consensus

11.4.5 The consensus in SIC 25 is that a change in tax status does not give rise to increases or decreases in amounts recognised directly in equity. The current and deferred tax consequences of a change in tax status should be recognised in profit or loss for the period, unless the consequences relate to transactions and events that result in a direct charge or credit to equity. Where that is the case, the tax consequences should be charged or credited direct to equity.

11.5 Notional expenditure

Introduction

11.5.1 To disclose the full cost of their activities, entities will sometimes include in their accounts notional costs as well as those actually incurred. For charitable NDPBs, notional costs may be included in the Statement of Financial Activities after 'Total resources expended' followed by a suggested new total of 'Total resources expended including notional costs'. Any notional costs will, however, also need to be reversed out within the Statement of Financial Activities. A suitable place for an additional heading dealing with the reversal is after the total 'Gains and losses on revaluation and disposals of investment assets' and before the total 'Net movement in funds'. Other NDPBs might reverse the entry below the result for the year or in the General Reserve.

Notional premiums

11.5.2 Notional insurance premiums will not be charged in the operating cost statement. Instead, expenditure in connection with uninsured risks (for example, accident repairs or asset write-downs) will be charged as incurred. Entities expected to recover full costs in accordance with fees and charges policy may show in a note to the accounts the effect of charging notional premiums.

Charging for the cost of capital

11.5.3 All entities covered by the requirements of this Manual, with the exception of Trading Funds, charge a notional cost of capital. Trading Funds are required to earn and pay over an agreed rate of return to their sponsoring departments or directly to the relevant authority. The cost of capital charge will apply to all assets and liabilities in the statement of financial position, with liabilities attracting a negative charge (i.e. a

credit). The cost of capital charges ensures an appropriate return on the taxpayers' equity. The calculation of the cost of capital is considered in paragraphs 11.5.12 to 11.5.15.

- 11.5.4 The charge will normally be at a real rate set by HM Treasury (currently 3.5 per cent) for all assets and liabilities. There are, however, exceptions which are detailed below.

Investments comprising public dividend capital or other forms of equity investment, either with or without voted loans

- 11.5.5 For investments represented by public dividend capital or other forms of equity investment, either with or without voted loans, the charge will be the higher of the Government's standard rate or the rate used for the purposes of calculating the body's target rate of return on capital employed as set out in the Treasury Minute applied to the underlying net assets of the body in question. The definition of the "underlying net assets" will be that used for the purposes of calculating the body's target rate of return on capital employed. For bodies that are not set a return on capital employed target, the charge will be the return as agreed between the department and the Treasury.

Investments, other than trading funds, comprising public dividend capital or other forms of equity investment, either with or without loans from the National Loans Fund.

- 11.5.6 For investments, other than Trading Funds, represented by public dividend capital or other forms of equity investment, either with or without loans from the National Loans Fund, the charge will be the higher of the Government's standard rate or the rate used for the purposes of calculating the body's target rate of return on capital employed applied to the underlying net assets of the body in question less any interest payable to the National Loans Fund. The definition of the "underlying net assets" will be that used for the purposes of calculating the body's target rate of return on capital employed. For bodies that are not set a return on capital employed target, the charge will simply be the return as agreed between the department and the Treasury less any interest payable to the National Loans Fund.

Investments in trading funds comprising public dividend capital either with or without loans from the National Loans Fund

- 11.5.7 For investments in Trading Funds represented by public dividend capital, either with or without loans from the National Loans Fund, the charge will be the higher of the Government's standard rate or the rate used for the purposes of calculating the trading fund's target rate of return on capital employed as set out in the Treasury Minute applied to the underlying net assets of the trading fund in question. The definition of the "underlying net assets" will be that used for the purposes of calculating the trading fund's target rate of return on capital employed. For trading funds which are not set a return on capital employed target, the charge will simply be the return as agreed between the department and the Treasury.
- 11.5.8 The National Loans Fund loan will be shown as a liability in the department's statement of financial position, and the interest payable on the loan(s) and repayments of principal will be paid directly to the National Loans Fund the department will account only for the amount of the cost of capital charge abated by the amount of the interest payable by the trading fund to the National Loans Fund. In effect, the interest payable to the National Loans Fund is a proxy for all or part of the

cost of capital charge, and the total of the cost of capital charge and the interest payable to the National Loans Fund will equate to the return required.

Investments comprising only loans (either voted or from the National Loans Fund) with no public dividend capital or other form of equity investment

11.5.9 For investments comprising only loans (either voted or from the National Loans Fund) with no public dividend capital or other form of equity investment, the charge will equate to the interest due from the body, calculated using the National Loans Fund rate of interest appropriate to a loan with the same date of issue and same repayment terms. Where there is more than one loan, the method of calculation will apply in respect of each loan separately. National Loans Fund loans, and voted loans which are made at National Loans Fund rates of interest, will therefore be at the correct rate of interest.

Other Exceptions

11.5.10 For donated assets, additions to heritage collections where the existing collection has not been capitalised, and cash balances with the Office of HM Paymaster General (OPG), the charge will be at a nil rate. Balances with the Bank of England will also bear a nil rate provided that the balances are formally included in the “Exchequer pyramid” which allows such monies to be used to reduce government borrowing.

11.5.11 For amounts due from, or due to be surrendered to, the Consolidated Fund, and liabilities in respect of advances outstanding from the Contingencies Fund, the charge will be at a nil rate.

Calculating the cost of capital

11.5.12 The average value of an item over a period should be calculated using daily values, i.e. as the arithmetic mean of the values in each day of the period. However, for items which do not exhibit volatility on a daily basis it will normally be sufficient to use averages over longer intervals (e.g. weekly, monthly, quarterly or annually) as an approximation. Where an item which is normally stable changes by a significant amount within such an interval, the average value should be weighted to take into account the time over which the change occurred.

11.5.13 To facilitate in-year control of cost of capital charges the following alternative calculation may be used in respect of tangible fixed assets and intangible fixed assets where revalued, or where depreciation or amortisation charges are calculated using opening values. The cost of capital charge will be based on opening values, adjusted pro rata for the following changes in-year:

- a) plus additional assets and subsequent capital expenditure on existing assets – at cost;
- b) less disposals – as value in opening statement of financial position (plus any subsequent capital expenditure prior to disposal);
- c) less impairments – the amount of the reduction being calculated from the value in the opening statement of financial position (plus any subsequent capital expenditure), or the acquisition cost of additional assets as appropriate;
- d) less depreciation or impairment charge.

- 11.5.14 Cost of capital charges for entities other than Trading Funds are notional and will not be transferred in cash. Departments should debit (credit if negative) the operating cost statement and credit (debit if negative) the general fund with the aggregate of the non-cash charges. NDPBs will reverse the cost of capital entry from the operating cost statement either on the face of the operating cost statement or through the General Fund where appropriate. NDPBs that are companies should reverse the cost of capital charge in arriving at the *Result of Ordinary Activities before Taxation*. Charities will need to reverse out the entry through the Statement of Financial Activities.
- 11.5.15 The standard rate applied to calculate the cost of capital charge should be disclosed in a note to the accounts. Where the rate for an item differs from the standard rate, the basis of calculation should be disclosed.