

GOVERNMENT INTERNAL AUDIT STANDARDS

GOOD PRACTICE GUIDANCE

The Role of Internal Audit - Resource Based Financial Systems



HM TREASURY

Assurance,
Control and Risk

December 2002

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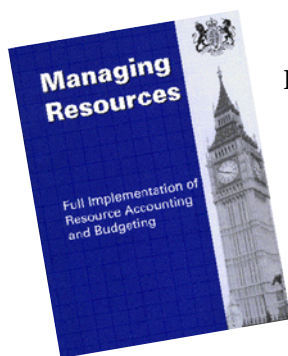
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1 INTRODUCTION

1.1 In April 2001, the Government moved to a new resource based financial management system. The changes are described in:



Full Implementation of Resource Accounting and Budgeting (RAB).

RAB is now an integral part of the financial management culture of central government and its subsidiary bodies. It applies to government departments and the agencies and NDPBs within their departmental boundary ie included within the departmental accounts. Chapter 1.5 of the Resource Accounting Manual (RAM) gives guidance on how the departmental boundary is determined.

1.2 **The purpose of this document** is primarily to identify the changes to departmental finance and accounting processes now that resource accounting has been introduced to central government and to provide internal auditors with guidance in resource based financial management systems, how to audit them and how they can encourage management in the better use of these new systems.

This Guide:

- concentrates on those aspects of the resource based Financial Management System, which may be new to internal audit or introduce new audit risks. Internal audit units may use the risk matrixes contained in Section 5 as a guide to the development of audit programmes /internal control questionnaires; and
- only contains guidance of a generic nature. Given the diversity of organisations across government it is impossible to give specific guidance relevant to all situations.

It is not:

- an Audit Manual;
- intended to be a fully comprehensive guide to the audit of financial systems, many of which have not changed under RAB and will be audited in the same way as before.

Section 2 describes the concepts and potential benefits of RAB and the impact it has on departments, and internal audit and its work.

Section 3 describes the financial control framework and the processes involved in obtaining and managing resources.

Section 4 explains the statements and main elements of the new accounting processes.

Section 5 explains the main financial data entries of the system and aspects Internal Auditors may wish to consider, with:

- a definition;
- audit notes;
- an example;
- risks, and the financial management impact of those risks; and
- ways in which risks might be mitigated or controlled.

1.3 The underlying assumption throughout this guidance document is that Internal Auditors will be familiar with the key accounting concepts (see Annex 1). Also that in the course of their work internal auditors will use the audit principles in Government Internal Audit Standards (GIAS) and the principles applicable to the accounting and disclosure requirements contained in the following documents as their primary sources of audit guidance:

- **the Resource Accounting Manual;**
- the principles applicable to resource budgeting contained in the **Consolidated Resource Budgeting Guidance**¹;
- **The Spending Review guidance;** and
- The standards of propriety and regularity contained in **Government Accounting 2000**.

These documents (and how to access them) plus further reference material can be found in Annex 2.

1.4 An increased awareness and understanding of RAB will enable internal auditors to make a greater and more valued contribution to the audit reviews of both core financial management systems and those other departmental systems which feed into the financial statements.

1.5 **Although the body of this guidance is lengthy at nearly 40 pages, it has been structured so that it can be read in individual sections or as a whole to address the differing level of detail likely to be required by Internal Auditors.**

1.6 This document will form part of the guidance on auditing specific business areas that will support GIAS and the underlying Good Practice Guidance.

¹http://www.hm-treasury.gsi.gov.uk/psd/rab/Consolidated_guidance/rb0cont.htm

2 THE EFFECTS OF THE CHANGE TO RAB

2.1 The benefits

2.1.1 The intended business benefits of RAB are:

- improved accountability to Parliament and the public;
- more openness in relation to financial reporting;
- improved use of assets through better informed decision making;
- improved financial management information enhancing financial management and aiding future planning (medium to long-term) and investment decisions;
- improved measures of performance; and
- improved fiscal control.

Management have a strong incentive to ensure that:

- the department achieves a satisfactory outcome in future spending reviews by bidding fully and accurately in resource terms;
- the information generated by effective in-year financial management is available on a timely basis to enable the reallocation of resources between departmental priorities when necessary;
- management of policy and service delivery areas have the best financial information available to support decisions taken on the use of scarce departmental resources; and
- the departmental resource accounts are given a clean audit opinion.

2.1.2 As with the development and implementation of any new system **internal auditors** will be concerned with:

- how effectively the outcomes and benefits of the system have been achieved; and
- the adequacy of risk management, control and governance of the system.

2.2 Impacts on departments and internal audit units

2.2.1 In undertaking internal audit reviews it is important to recognise that not everything has changed; many of the feeder systems to the accounts will remain unchanged. For other management processes there is no change, for example investment appraisal and debt management, although the risk profile may change as a result of RAB.

2.2.2 The fundamental change with resource accounting is the way in which government departments report on their spending and achievements. Resource accounting reports what resources a department has, how it has used them and what it has achieved in the year with them, not the amount of cash paid out and received. It combines:

- accruals accounting – which matches costs to the period in which they were incurred, and produces an operating cost statement (OCS), a balance sheet with assets and liabilities and a cash flow statement (CFS) (see Section 4 for more details on these statements);
- costs by objectives, which match the full cost incurred with each objective achieved; and
- output and performance reporting, showing what has been delivered.

In recording the full cost of such activities there are incentives for departments to improve the management of what they own and what they owe (assets and liabilities).

2.2.3 Resource budgeting extends the principles of resource accounting into the planning and in-year control of a department's costs, assets and outputs². For example, the likely accounting treatment of major expenditure needs to be understood at the time of budgeting, not just at year-end ie whether the expenditure is resource or capital DEL, and whether charges are applicable for the cost of capital charge or depreciation. Also, failure to identify the need to make a provision can create an unexpected problem in meeting resource requirements in later years.

2.2.4 Some aspects of RAB are new to central government. For example the need to maintain up to date values of a department's fixed assets, the concept of working capital, the costing of departmental objectives and the introduction of a "capital charge".

2.2.5 For many processes, RAB provides more incentives for good practice. These include improving management of assets by:

- ***developing better use of accruals based information*** - for in-year management of fixed assets and better management of working capital;
- ***identifying costs*** - departments find that they have more complete and relevant information on costs incurred through RAB. This enables managers to control and monitor budgets more accurately;
- ***performance measurement*** - departments have found that RAB helps deliver more comprehensive management information, which helps with the process of managing performance and which can be used to inform the decision making process; and
- ***a greater investment in financial management skills*** - across the organisation. Training is critical – there must be a sufficiency of key financial staff, adequately trained. Policy makers and operational managers also need to understand what financial information is available and how they can use it.

2.2.6 The change for internal auditors is in understanding the concepts of managing resources effectively so that, through their advice, management can ensure that the business benefits outlined in this Section are achieved and improvements made to the quality of their financial management systems.

2.2.7 The challenge for internal auditors is in building effective audit programmes that identify the critical areas in which departmental managers will require assurance and provide evidence that the organisation:

²Further guidance on Resource Budgeting is contained in "The Role of Internal Audit - Resource Budgeting"

- has made the successful transition to RAB; and
- has developed the accruals based management information systems required to embed both resource budgeting and resource accounting into routine financial management.

Note: There are a number of fictitious case studies, included in the Managing Resources series “Case Studies”. These illustrate the financial impact of business decisions and the need for everyone involved in the planning, controlling and accounting for public expenditure to understand the concepts and techniques of RAB.

2.3 Impact on financial statement audit work

2.3.1 In support of the Statement of Internal Control (SIC) management will require regular assurance on all material financial systems. The financial statements have traditionally been outside the audit scope of many central government internal auditors, being considered instead to be the remit of external audit. Recent developments in external audit methodology as applied by the NAO, and the increasing needs of management to ensure they have sound financial policies and financial controls in place to satisfy the financial aspects of corporate governance, mean that some departments may need to re-focus the work of internal audit to ensure that the appropriate assurance can be provided.

2.3.2 In looking at the respective roles of external and internal audit it is important to recognise the impact of a number of factors:

- **focus** - The C&AGs³ main responsibility is to Parliament, both in authorising the issue of public funds and in reporting the results of their audit of public sector accounts and VFM studies. Internal audit’s responsibility is to the Accounting Officer and providing him with assurance with the primary role of providing an annual opinion on the organisation’s risk management, control and governance to support the preparation of the SIC. It is important to recognise that neither has an obligation to conduct work to meet the needs of the other. The risk to the organisation of failures in the financial management system, which includes the financial statements, should therefore be included within the organisation’s risk assessment in relation to achievement of its objectives. As such the risks are important to internal audit in the preparation of its audit strategy;
- **changes in the role of the NAO in their approach to the audit of the financial statements** - In recent years and in concert with wider developments in external audit generally, the NAO has developed a revised approach to their financial audits so that the focus is more “risk-based”⁴. This places a key emphasis on gaining a broad understanding of a client’s business, its systems and controls so that NAO can consider how management addresses the risks to the accuracy and reliability of the accounts. This in turn puts a greater emphasis on in-year financial management. One of the results of this risk-based controls approach to the audit of the financial statements has been a move away from large amounts of sample testing.

³The Comptroller and Auditor General is appointed by Parliament to undertake a dual role. Authorising the issue of public funds to government departments; auditing the accounts of all government departments; executive agencies and a wide range of other public sector bodies and to report results to parliament. The NAO undertakes the work necessary to support the responsibilities of the C&AG.

⁴For details of the revised audit approach see NAO 2001 Annual Report – www.nao.gov/publications

NAO auditors are much more concerned with the risks facing an organisation and the controls in place to mitigate those risks. If the controls are sufficiently robust the NAO will seek to rely on them for much of its audit assurance. However, in accordance with UK auditing standards, the NAO will always want to carry out some substantive work during its audit, although this will often take the form of analytical work and not detailed sampling;

- **NAO expectations of departments** – The expectation is that:
 - o departments have sound and auditable financial accounting systems to help them produce resource accounts that do not attract a qualified opinion;
 - o the accounting systems are capable of supporting a variety of uses, such as the production of the various output cost statements and analyses required by RAM, the production of Spending Review information, the production of Resource Estimates, setting and monitoring resource budgets and production of interim management accounts; and
 - o there is a proper chart of accounts which enables the production of the various financial statements e.g. that income and expenditure can be analysed according to all elements in each “request for resource” and that identifies the direct costs attributable to the defined aims and objectives, as well as identifying the indirect costs which need to be apportioned to them⁵ ;
- **service for management** - Internal audit, being an internal resource for management, can provide assurance services on the full range of aspects of the financial systems, regardless of whether they are covered by the work of the external auditor. These might include:
 - o budget monitoring and control;
 - o forecasts – supply estimates and planning reviews;
 - o interim management accounts;
 - o financial systems implementation; and
 - o analytical reports and performance management systems.

2.3.3 In adopting a risk-based approach, the NAO will be seeking to confirm the operation and effectiveness of the controls on a regular basis. In doing so, NAO will liaise with internal audit to consider how far the work internal audit has done can be relied on rather than duplicated by NAO. The key to this process is timely and continuous dialogue with internal audit so that both parties understand each other’s objectives and respective programmes of work.

2.3.4 In the early days of RAB the NAO were often provided with financial statements which departments themselves acknowledged did not offer an accurate reflection of their financial position. Departments have since made good progress in producing quality accounts in line with the statutory timetable and the NAO now expects to be presented with financial statements which local management have already validated and which departments consider to be a “true, fair and regular” view (see paragraph 3.2.3 on Accounting Officer responsibilities). Whilst there is no suggestion by the NAO that internal audit should pick up this validation work, there is an increased potential for internal audit involvement in helping management ensure that they have reliable and accurate feeder systems in place for the production of the resource budgets and accounts.

⁵For more information see “Resource Accounts:Preparing for Audit” NAO publication November 1997 and NAO 113f – Resource Accounts Disclosure checklist.Both available on the NAO website in footnote 4.

2.3.5 In this context, internal auditors need to be aware of a new initiative for resource accounts to be prepared and presented for audit much more quickly (“Faster Closing”)⁶. The current timetable is for departments to submit their accounts to the C&AG by 30th November following the closure of the accounts, for them to be laid before Parliament by 31 January. This delay means the data is historical and produced far too late to be of value if action is required eg for the current financial year. The intention is that over the next few years the target deadline to submit the accounts to C&AG will be brought forward in a series of phased changes, to 30th June for the financial year 2006-2007. This reduced timing will align with existing practice in the private sector and developing elsewhere in the public sector, including abroad.

2.3.6 Some departments already produce their accounts in advance of the current timetable whereas others may need to make some significant changes to their culture, approach and procedures to prepare their resource accounts to the new schedules. The RAB system, if properly developed, adapted and used, could facilitate this initiative and make it easier to address. In particular departments could:

- undertake reconciliations of the accounts regularly in-year (eg quarterly or monthly) so that issues/discrepancies are resolved as they arise rather than deal with a backlog of historical problems at year-end;
- invite NAO to review the accounts mid-year to reduce the work and the demand for their efforts at their busy summer/autumn period; and
- carry out a “month 11” close on which to base final accounts.

Departments will need to produce a strategy outlining how they will attain the new timetable by the agreed deadline; Treasury will work with departments and the NAO in supporting this process.

2.3.7 The decision about the extent of internal audit financial systems work leading to the preparation of the resource accounts for audit is for Audit Committees and individual HIAs to decide, as part of their audit strategy and annual review of management’s risk analysis ⁷, and in consultation with their clients and the NAO. For some departments the risks will be greater than others and this will influence the extent of internal audit work required.

2.3.8 Some Accounting Officers may seek additional assurance by asking the Audit Committee to act as the forum at which draft accounts are directly considered prior to their finalisation and submission to external audit.

2.3.9 A number of Heads of Internal Audit, including HM Customs and Excise – **Figure 1** and Ministry of Defence – **Figure 2**, are increasingly recognising the value of including work in relation to the financial statements in their annual audit programmes. They consider this a part of the contribution internal audit can make in ensuring that the resource accounts presented by management to the NAO are “true and fair”, and by operating as a challenge function to management are ensuring that the business benefits of RAB are realised.

⁶For more information see “Faster Closing”, a document within the HM Treasury Managing Resources series.

⁷Good Practice Guidance - GIAS Standard 6

Figure 1 - HM Customs and Excise

HM CUSTOMS AND EXCISE

Working with the National Audit Office

In 1999, when the resource account dry run was introduced, H M Customs & Excise was organised into fourteen regional Collections, each resourced with an accounting centre and qualified accountant who prepared schedules for accruals, prepayments, provisions, etc. internal audit liaised closely with NAO and agreed an audit programme that encompassed a visit to each of the Collections and a joint review of the final adjustments leading to production of the accounts. We deployed a mixed internal/external audit team to the first location to ensure that the coverage addressed test schedules from both perspectives. We then split the remaining visits pooling our findings to identify trends, weaknesses and strengths. The NAO had prime responsibility for auditing production of the final accounts, whilst internal audit used the findings to evaluate the individual systems and address the weaknesses found. The following year each Collection submitted quarterly returns for adjustments over £5,000, culminating in a complete audit pack at year-end for all adjustments.

In April 2001 the department was re-organised into two business streams and a support service, which included centralisation of the accounting function. The production of vote resource accounts has therefore been rationalised, although the business streams will need to provide revenue adjustments for the Trust Statement.

Modified historic cost accounting (MHCA)

An in-house spreadsheet was designed to calculate depreciation of fixed assets on an MHCA basis. The spreadsheet was intended to be temporary whilst ORACLE, the software supplier of our fixed asset module & general ledger, provided a solution. However, into the fourth year, the generic solution has yet to be produced and until such time as it becomes available our current system will be used. To assure the accuracy, integrity and completeness of the calculations we employed a computer assisted audit tool, SpACE (Spreadsheet Auditing for Customs & Excise). This product was developed by HM Customs & Excise and is subject to Crown Copyright, we are also investigating the potential for exploiting it commercially. In addition to tracing dependencies, testing the links, formulas and any unused cells, the tool highlights the file structure and operation of the spreadsheet, which may lead users to make errors. The findings resulted in amendments to improve security and refine formulae whilst at the same time it provided management assurance that the depreciation calculated gave a true and fair account of our use of fixed assets.

Figure 2 - Ministry of Defence

MINISTRY OF DEFENCE

Assets held by industry

The MoD's balance sheet is significant and complex. As at 31 March 2001 the department's fixed assets totalled some £87Bn, of which more than £27Bn related to fighting equipment. There are occasions when assets are issued to contractors. This may be for repair or for use in a procurement project (eg to ensure compatibility or interoperability of the new equipment with existing equipment). Examples include vehicles, specialist equipment & facilities. The value of equipment held by contractors, at any point in time, may be material to the accounts and, as such, the department needs to maintain a complete record of all the assets held by its contractors.

During the 1999-2000 and 2000-2001 audits of the resource accounts, the NAO observed that the MoD did not have a complete record of the items (or their value) held by contractors. The FY 2001-2002 internal audit programme included an audit of the policy surrounding assets in industry and how these items were being accounted for in practice. The audit identified a number of weaknesses in the systems and control processes, including communication between the project managers requesting the items of equipment, the business managers providing them and the contractors receiving and using them and a lack of "joined up" IS. Management has since established a steering group, including internal audit representation, to oversee and manage the co-ordination and development of improved business processes. Although the practice of issuing MoD owned assets to industry was being increasingly questioned, it was really the adoption of resource accounting and the introduction of the concept of capital charging that forced the department to quantify the number and value of assets involved and review the whole process.

2.4 Impact on internal audit work

2.4.1 Internal audit can expect to be asked more frequently by management to provide assurance for corporate governance purposes that the material produced for use in the financial statements is robust. This may involve not only providing an assessment of the internal control environment within which systems used for the production of financial information operate, but also giving a view on the accuracy and completeness of the management information produced by those systems. This will require knowledge and understanding of the information that is being produced, how it will feed into the financial statements and a feel for what the outturn numbers should look like based on business knowledge. This assurance work coupled with ad-hoc work, specific in-year requests and discussion with NAO in relation to the programme of work (see 2.3.2 – 2.3.7), will influence the development of the audit strategy in relation to resource accounting.

2.4.2 The transition to resource accounting has exposed risks that may not have been adequately managed under the cash regime e.g. fixed assets and stock. Under the cash regime the value of assets and stock held was not so critical, consequently there was little pressure on departments to ensure these were properly utilised in the achievement of objectives or disposed of when no longer needed

in order to free up resource to use elsewhere. The transition has also highlighted the importance of sound financial management in order to provide the right financial information needed to support delivery of services and targets. An awareness of the type of business decisions management need to take, and how financial management information can support those decisions, is increasingly becoming a requisite part of an auditor's toolkit.

2.4.3 To **enable internal auditors to contribute** to the review of financial and management information systems, and to provide valued audit advice and assurances to management and the Accounting Officer, they need:

- to be aware of the new approach to accounting in government⁸ and the impact this has on the way in which departments now need to identify and manage their resource, and gain the benefits of the move to resource accounting (para 2.2.2);
- to ensure the concepts of good financial management and a sound control environment are incorporated into RAB processes (para 3.1.2);
- to develop the audit strategy in a way that meets the identified risks in the financial business area (para 2.3.2);
- to have a timely and continuous dialogue with external audit so that both parties understand each other's objectives and how the respective programmes of work fit together (para 2.3.3); and
- to know how to recognize that a department has successfully made the transition to the new resource-based budgeting, monitoring and reporting systems (para 2.1.1).

To help with the above, Section 5 contains explanations of some of the new accounting entries and the issues and risks they bear.

2.4.4 In providing an opinion to the Accounting Officer to support the SIC **internal auditors** have a further role to play during the audit cycle in advising management about:

- the adequacy of key financial systems and whether controls can be overridden;
- the reliability of key financial systems to provide accurate and relevant information for spending reviews and resource budgets;
- the significant risk exposure or weakness in control which might lead to poor financial decisions and/or adverse comment or qualification of the accounts;
- the capability of key financial systems to deliver the business benefits and support production of the resource accounts within statutory deadlines (para 2.3.5);
- the sufficiency of key personnel and adequacy of financial training; and
- the relevance of the internal structures to ensure that financial policy, budgeting and accounting functions and processes are properly aligned.

⁸This includes the resource accounting and budgeting process along with the underlying key accounting concepts, accruals accounting methodology, financial statements and notes to the accounts.

3 THE FINANCIAL CONTROL FRAMEWORK

3.1 Financial management

3.1.1 The requirements of corporate governance necessitate that organisations have a sound financial system. Poor financial management within organisations impacts on the ability of government funded bodies to make best use of, and account properly for, the public funds they receive. The same weaknesses may also expose the bodies to greater risk of fraud, error or impropriety within their financial statements. Such weaknesses can undermine the integrity of financial processes and can result in funds not being applied for the purposes authorised by Parliament⁹.

3.1.2 The following requirements are critical in enabling management to ensure sound financial management and to achieve the benefits of RAB:

- **good risk management** – that risks are identified, assessed for potential impact, that decisions are taken regarding the need for control measures to be imposed, and that controls are implemented and tested for effectiveness;
- **good financial management** – that follows RAB principles focusing closely on achieving outcomes and value for money (VFM) rather than inputs, and in-year monitoring and reporting arrangements that are relevant to the needs of both operational and senior management levels;
- **relevant, reliable and timely financial data**¹⁰ - that includes:
 - o variance analysis against budget;
 - o forecasts of operations, financial position and cash flow, and reconciliation to source records;
 - o analytical reports in accordance with user requirements; and
 - o management acting on financial management information in making business decisions and using it to align the organisation to achieving aims and objectives;
- **adequate human resources** – that there are sufficient key personnel who are adequately trained;
- **relevant internal structures** – that the internal structures and processes for financial policy, estimates, budgets and accounts are closely aligned;
- **a well constructed accounting system** – that the chart of accounts facilitates the provision of data reflecting the organisation hierarchy, business areas, aims and objectives, and type of expenditure;

⁹Government Accounting 2000 Chapter 4:Regulatory and Propriety HM Treasury July 1997.

¹⁰Managing Resources:Reporting to the Board

- **compliance** - with all accounting, corporate governance and investment requirements of HMT;
- **sound systems of internal financial control** – with established ground rules of responsibilities, delegations, authorities and processes, and compliance with documented procedures;
- **working within the wider corporate governance framework** – with clearly established management roles and responsibilities to identify, manage and monitor risk, and with a governance structure that recognises the importance of financial reporting and audit functions ie reporting through an Audit Committee;
- **effective prioritisation and management of assets** – that avoids end-of-year underspends and/or panic spending, with liabilities and investments being processed without delay; and
- **capital investment and capital management** – that is carried out in accordance with Treasury investment strategy best practice.

3.2 Accountability

3.2.1 Although the introduction of RAB has not had a significant effect on accountability issues, the requirement for a signed SIC has. This section has been included in this document in order to provide consolidated guidance on the financial and accounting issues within the context of RAB.

3.2.2 Parliament and government departments have a common interest in accountability – particularly in high quality financial management and stewardship and the construction of effective controls which are proportional to the levels of risk.

3.2.3 A key component in the system of Parliamentary accountability is the structure of Accounting Officers, who are appointed to have personal responsibility for:

- the propriety and regularity of the public finances for which he or she is answerable to Parliament¹¹;
- the keeping of proper accounts;
- prudent and economical administration;
- the avoidance of waste and extravagance;
- the efficient and effective use of all the available resources; and more generally for,
- ensuring that public funds and assets are only used to the extent and for the purposes intended by Parliament.

These responsibilities are set out in the Accounting Officer’s Memorandum. The statement of Accounting Officer’s responsibilities (which accompanies the signed accounts) further requires the Accounting Officer to prepare the accounts in compliance with the RAM.

¹¹HMT Regulatory and Propriety Handbook

3.2.4 Accounting Officers have a personal responsibility to sign a SIC. The statement is presented alongside the annual resource account and describes how the responsibility for reviewing the effectiveness of the internal control system has been discharged. An Audit Committee should advise the AO on the adequacy and effectiveness of the internal control processes necessary to mitigate the risks that might impact on the achievement of objectives¹².

3.2.5 The Comptroller and Auditor General (C&AG) is appointed with the consent of Parliament as the auditor for central government. On his behalf the NAO undertake the financial audits of resource accounts and report their findings to Parliament. They also carry out a programme of VFM studies looking at the economy, efficiency and effectiveness surrounding the use of public money and provide reports to Parliament. For these purposes the NAO have statutory rights of access to relevant documents and autonomy in the selection of areas for examination.

3.2.6 The Committee of Public Accounts (PAC) considers the C&AG's reports and may call Accounting Officers to provide further evidence about C&AG's findings. Following such hearings the PAC normally publish a report of their findings setting out their recommendations for improvements. The Government responds to those recommendations in a Treasury Minute that is coordinated, published and presented by the Treasury.

3.2.7 Further information about the accountability framework can be found in Government Accounting 2000 and in "Accountability", a document within the HM Treasury Managing Resources series.

3.3 The Spending Review and RAB

3.3.1 The Spending Review is the process by which departments identify their objectives, the resource required to achieve them and the means of measuring their performance. Submissions are put to HM Treasury for PSX (Ministerial Committee on Public Services and Public Expenditure) consideration and decision on their plans, to ensure national resources are put to best use in accordance with fiscal policy. The main features of the system are:

- ***fiscal rules*** - to ensure that public spending is sustainable and affordable, spending plans are set in accordance with the requirements for the Code of Fiscal Stability and must meet the strict fiscal rules set by the Government. The golden rule states that over the course of the economic cycle, the Government can borrow only to invest, whilst the sustainable investment rule requires that public debt should be held at a stable and prudent level;

¹² Policy Principles for Audit Committees can be found in DAO [GEN] 13/00

- **3-year budgeting – spending reviews** - so that departments have greater long-range certainty and flexibility to enable them to plan over a reasonable time period, spending plans are set on a three-year basis. Firm departmental budgets are allocated for three years. These are called Departmental Expenditure Limits (DELs). Other expenditure that cannot be managed on a three-year basis, and which satisfies a set of criteria, is kept outside DEL and is planned and reviewed as part of the annual budget process. This spending is called Annually Managed Expenditure (AME). This usually relates to demand-led, volatile and difficult to forecast spending. For SR2002 some examples of AME expenditure will include social security, debt interest and common agricultural policy payments. The Analysis of Resources, completed by a department as part of SR2002, presents a view of resources needed for each area of its business;
- **end year flexibility (EYF)** – to avoid wasteful end-year surges in spending as occurred under cash accounting, departments can now carry over in full, under spends from previous years;
- **separate capital budgets (used to acquire assets that have a productive life of more than one year)** – there is a separate DEL for capital, which protects long-term investment plans from current pressures. Departments prepare investment strategies (DIS), setting out how they will use this allocation to improve the stock of public capital. A proposal for capital spending in the Analysis of Resources is unlikely to succeed unless justified in the DIS; and
- **focus on outcomes** - departments, through their Public Service Agreements (PSAs) and Service Delivery Agreements (SDAs), agree to deliver specified outcomes and outputs in return for their resources.

3.3.2 2001-2002 was the first year of RAB. To allow departments to develop expertise in monitoring and controlling accruals based expenditure resource budgeting has been introduced in two stages:

- **stage 1** - spanning the years covered by the 2000 Spending Review (2001-2002 to 2003-2004), budgets moved onto an accrual basis. However the new non-cash costs introduced by RAB (depreciation, cost of capital¹³ and movements in provisions) were treated as part of AME. As a result these new costs were not included in the presentation of departmental settlements in the 2000 Review, but will be incorporated into resource DEL from 2003-2004; and
- **stage 2** - so as to realise the full benefits of RAB, there will be full implementation of RAB in the 2002 Spending Review (SR2002)¹⁴, which sets out plans for the years 2003-2004 to 2005-2006. This means that departments' main budgets for resource DEL (current expenditure i.e. spending on pay, goods, grants etc.) will include for the first time charges for:

¹³Cost of capital charge aka capital charge;cost of capital;capital interest

¹⁴www.hm-treasury.gsi.gov.uk/psd/sr2002/sr2002_home.htm

- o depreciation – allocation of the cost of an asset over its useful life;
- o a cost of capital charge – the cost of holding assets (physical and cash), currently levied at 6% of net assets; and
- o movements in provisions – committed future expenditure such as compensation payments. The Forecast Balance Sheet Analysis (part of SR2002) should highlight areas where contingent liabilities may lead to a provision or where a future contingent liability may arise.

A baseline conversion exercise of 2003-2004 stage 1 DEL figures was carried out in order to reach a starting point for SR2002 on a stage 2 basis.

Capital DEL - On the capital side, there are further changes:

- restrictions on the transfer of resources from capital DEL to resource DEL (maximum 2.5%) which could present risks to departments with large capital budgets. From 2004-2005 this concession will be removed. No limit is set on transfer of resource from resource DEL to capital DEL;
- grants paid to the private sector (e.g. grants to universities) will be managed through the resource budget instead of the capital budget. This reflects the fact that under RAB, spending is only treated as capital if it creates an asset on the Government's balance sheet; and
- so as to reflect the more commercial budgeting relationship for public corporations (PCs) under RAB, investment by PCs financed by their own resources will no longer count as part of the parent department's capital DEL.

The inclusion of new items in DEL, and the transfer between resource and capital DELs as a result of the move to resource budgeting, will mean some changes in the way in which the data is presented.

3.3.3 The introduction of RAB and the spending review process has profound implications for managers of public expenditure at every level of government. For the first time, departments' main budgets will include the **full economic cost of delivering government services on a resource basis** rather than simply the immediate cash consequences. Those involved in any aspect of managing resources now need to think in resource terms and to take a genuine look at resource consumption and at how resources are deployed.

3.3.4 In practical terms this means:

- spending is planned and controlled in accrual terms, i.e. it hits the accounts as it is incurred;
- departments will incur depreciation charges on their total net assets and need to budget for this in their resource DEL. This will encourage departments to factor the value of assets deployed into decisions about programmes and services. Decisions will need to be taken about the most effective way of maintaining and managing assets;
- departments' resource DELs incur a cost of capital charge reflecting the opportunity cost of the government financing that asset rather than spending elsewhere;
- departments need to manage the costs of using and holding capital;
- departments' resource DEL will include changes in provision which are discounted to current values;

- new treatment of capital investment funded by government and the wider economy;
- the activities of arms' length bodies are more fully reflected in the budget where the net resource consumption and capital spend impact on the department's DEL; and
- there is a new system of budgeting for PCs, reflecting more fully their commercial nature.

All departments will be affected to some degree by these important changes.

3.3.5 Managers of public expenditure will need to understand the practical implications of resource budgeting when making decisions, both during the spending review itself and the period of its operation. They will also need to think about whether systems are sufficiently robust in generating the information required.

3.3.6 The *Managing Resources Series – Case Studies* issued by HM Treasury January 2002 gives examples of how resource budgeting changes the way public expenditure is managed and controlled. A separate internal audit guide on “*The Role of Internal Audit – Resource Budgeting*” has been produced as a companion to this guide.

3.4 Adjusting budgets in-year

3.4.1 Good financial management and sound systems for tracking resources are absolutely essential to enable a department to make effective use of its resources; also to recognise and take advantage of the opportunities to adjust resources in-year when it proves necessary eg to resource an unexpected need. The options need to be considered in the following order.

Reallocation of existing resource

3.4.2 If the need arises to cover a shortfall of resource in one area of a department, the first option to be considered is to re-allocate resource between Requests for Resource (RfRs). As there is not necessarily a direct correlation between RfRs and Objectives, this action may be possible while keeping within the relevant resource budget. However, virement between RfRs does require HM Treasury and Parliamentary approval by means of a Supplementary Estimate.

Obtaining additional resource

3.4.3 If additional resource needs to be found in the course of a year whilst keeping within the 3-year plans set under the budgeting framework, a department has 4 options. These are:

- a request to switch provision from the capital budget to the resource (or current) budget;
- a draw-down of EYF;
- utilisation of the departmental unallocated provision (DUP); or
- a claim on the contingency reserve.

In some instances, as identified below, HM Treasury approval is again needed as part of the control regime.

Switching between the capital and resource budgets

3.4.4 There is only a small degree of flexibility given to departments to vire capital provision to resource budgets. This is to allow some sensible VFM decisions to be made. Departmental flexibilities are set out in the Departmental Investment Strategy (DIS). The standard rates for most departments were 5% in 2001-2002, then falling to 2.5% for 2002-2003 and 2003-2004. From 2004-2005 there will be no flexibility to transfer from capital to resource.

3.4.5 There is no limit set on transfers from resource DEL to capital DEL.

3.4.6 Although these rates are called entitlements, the Chief Secretary's approval is needed for any switch. This is normally through a Secretary of State/Chief Secretary correspondence exchange.

Draw down of end of year flexibility (EYF)

3.4.7 The EYF system enables departments to carry over 100% of unspent DEL provision against spending plans into the following financial year. In order to keep commitments resulting from EYF entitlements within overall DEL plans, Treasury treats a draw down of a departmental EYF as a claim on the DEL reserve. In almost all cases, resource and capital EYF draw down is treated as an automatic claim on the reserve, and explicit Chief Secretary approval is not required.

3.4.8 There is an exception to automatic entitlement. When a department has under spent, and has also made a successful claim on the reserve in-year, its EYF entitlement carried over is docked by the amount of the reserve claim. However in order to preserve longer term planning horizons for investment, capital EYF will not be docked as the result of a resource reserve claim.

Departmental unallocated provision

3.4.9 Most departments when faced with an unexpected need to resource an additional requirement will review and examine its DUP. Treasury recommends that between 1 and 1.5% of total DEL for each department is not allocated out to budget holders, but reserved as the DUP in case of unforeseen problems.

Claims on the contingency reserve

3.4.10 The contingency reserve is a small pot of both resource and capital provision that has not been allocated to departments. The money moves from there into departmental DELs when it is allocated and drawn down through Supplementary Estimates. The reserve is kept deliberately small. It currently averages approximately 1% of total DEL spending.

3.4.11 The function of the reserve is to assist departments with the costs of genuinely unexpected and unforeseeable events, which are of a size relative to their available resources that renders them un-absorbable. There is a presumption that if such events give rise to costs that are of moderate size, departments will be able to reprioritise to absorb them.

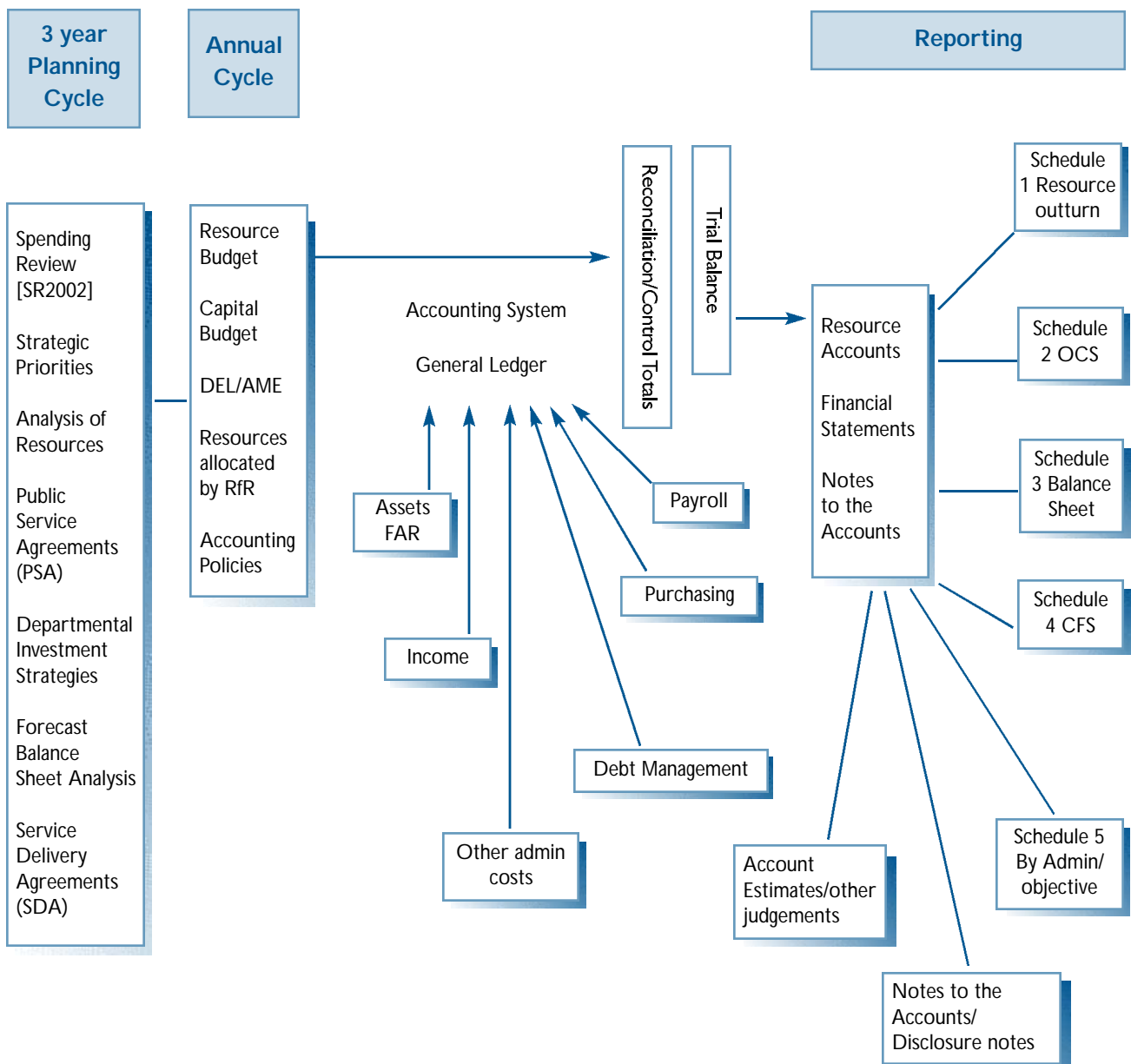
3.4.12 If a department thinks it has a case for a claim on the reserve, the relevant Secretary of State must write to the Chief Secretary in the Treasury explaining the circumstances, including details of offsetting savings being made by the department. Access to the reserve is only granted through the Chief Secretary's reply.

4 THE NEW ACCOUNTING SYSTEM UNDER RAB

4.1 RAB statements, features and requirements

4.1.1 The following Diagram 1 illustrates the financial planning and accounting systems. Below the diagram are some explanations of the contents and requirements of RAB accounting systems and their output. Examples of the Schedules can be found in the Managing Resources Series – Analysing resource accounts: user’s guide.

The Financial Planning and Accounting Systems



The resource accounts schedules

4.1.2 Summary of Resource Outturn (Schedule 1) shows how a department has used its resources during the accounting period compared with the original estimate, breaking the detail down to the level of a Request for Resource (RfR); it also provides a reconciliation of net resource outturn to the net cash requirement. To serve this statement and the associated note “Analysis of Resource Outturn” – income and expenditure must be analysed according to all elements in each RfR, income from the disposal of fixed assets appropriated in aid of fixed asset purchases must be separately identified and amounts payable to the Consolidated Fund must be identified in cash and accruals terms distinguishing between current and capital.

4.1.3 Operating Cost Statement (OCS) (Schedule 2) shows the resources consumed for the accounting period net of departmental income. Separate figures are required for income and expenditure by “administration” and “programme” activities. Irrecoverable VAT must be included within the reported VAT expenditure in the OCS and its notes. Income must be recorded net of VAT and expenditure capitalised must include irrecoverable VAT.

4.1.4 The Balance Sheet (Schedule 3) shows the department’s assets (eg money, land & buildings, vehicles, stock, plus items/debts owed by others to the department), liabilities (items owed by the department, usually money, to someone else) and their value to indicate the net worth of the department at a point in time. An example can be found at Annex 3.

4.1.5 The Cash Flow Statement (CFS) (Schedule 4) shows the department’s cash flow for the accounting period. Separate figures are needed for net cash outflow from operating activities, payments for fixed assets, receipts from the sale of fixed assets, financial investment, financing and changes in cash in the period. Information on cash is therefore provided with accruals accounts. The CFS sets out the cash generated or absorbed by the department in the period.

4.1.6 Resources by departmental aim and objectives (Schedule 5) analyses the department’s expenditure by its aim and objectives. Departments must be able to identify and apportion the direct and indirect costs attributable to the defined aims and objectives. The accounting records must be able to support the financial information in this statement.

4.1.7 Notes to the accounts – some notes to the accounts need figures in greater detail to provide the analyses required. Examples are movements on fixed assets, the reconciliation of net operating cost to control total and net resource outturn, the analyses of net resource outturn and net operating cost by function, and the analyses of net operating costs by spending body.

4.1.8 Where elements of the financial statements involve estimates or judgements, management must ensure that the information used by the departmental accountant(s) is robust and from a valid source, and that decisions are properly documented in order to preserve the audit trail.

The internal control environment

4.1.9 *The specifically financial aspects of corporate governance* - the way in which the Accounting Officer and the Management Board sets financial policy and oversees its implementation, including the use of financial controls and the process whereby the Accounting Officer reports on activities and progress to Parliament¹⁵.

4.1.10 *Accounting policies* - underpin the financial statements, must be appropriate to the specific circumstances of each department and must comply with the requirements of the RAM. Accounting policies should be reviewed each year; new policies may be required and may need to be disclosed, and some policies may need to be revised. The NAO should be consulted on any proposed changes to the accounting policies.

4.1.11 *The audit trail* - must be a clear and proper audit trail with the ability to track from the financial statements back through the prime accounting records to the underlying transactions and events (and back again) so that management and the auditor can substantiate the individual accounting figures. A proper audit trail:

- ensures that all, and only, proper transactions and balances are included in the accounts;
- comprises a positive set of links for each transaction or balance from source to account and back;
- must cope with bulk postings such as payroll e.g. through control totals; and
- must deal with paperless transactions e.g. through retention of trail data within the system.

4.1.12 *Data selection, entry and extraction facilities* - it is important that the systems, including those outsourced, incorporate facilities to download or otherwise access prime accounting records which support the figures in the financial statements. The systems should include “user-friendly” data extraction facilities¹⁶.

4.1.13 *Systems documentation* - a good standard of technical documentation is necessary for proper internal control and to support data selection and extraction.

4.1.14 *Data security* - accounting systems must comply with the requirements of BS7799 (Information Security Management).

4.1.15 *Departmental boundary* - departments will prepare consolidated resource accounts covering all entities within their departmental boundary (RAM 1.5). The principles of consolidation should be described in the departments accounting policies (RAM 10.1 - 10.2).

¹⁵Elements of the internal control environment recommended by the NAO can be found in the NAO publication “Resource Accounts:Preparing for Audit”

¹⁶Details of these can be found in the NAO publication “Resource Accounts:Preparing for Audit” and in the Managing Resources Series “Reporting to the Board”

5 DETAILED ASPECTS OF THE ACCOUNTING ENTRIES FOR INTERNAL AUDIT ATTENTION

Note: RAB has introduced a number of commercial accounting items into departmental accounts. To help internal auditors understanding, there follows some notes on a number of these items including indications of their significance, the potential risks, impact from those risks and some measures that can be put in place to manage and reduce those risks.

5.1 Cost of capital charge

5.1.1 The cost of capital charge reflects the fact that there is a cost associated with holding assets including money (cash at bank), regardless of the source of funding (the taxpayer, national savings, gilt markets etc). The Government has a choice as to how they use the resources they have available, but once a decision to use a resource for one purpose has been made, it must not be used for another. The charge is calculated at the Government's standard rate (currently 6%) of the current average value of net assets or, for Trading Funds, at a rate specified by HM Treasury.

Audit note

5.1.2 Given that net assets are generally the value of fixed plus current assets less any current and long-term liabilities, it can be seen that the creditor figure also has a direct impact on the cost of capital charge which depending on the overall value of creditors could be significant. (There are a number of exclusions to this calculation, such as donated assets and assets financed by grants, which are detailed in para 7.4.3 of RAM.) The higher the creditors figure is, the lower the cost of capital charge; the lower the creditors figure, the higher the cost of capital charge will be.

Risk	Impact	Ways in which the risk can be mitigated
Manipulation/false accounting to avoid the cost of capital charge	Reduced/false statement of cost of meeting objective	Training; established accounting policies and procedures; management checks/supervision

5.2 Current assets

Definition

5.2.1 These are assets an organisation might expect to consume within one year (eg cash and short term investments) or to turn in to cash (eg stocks), and amounts owed by repayment customers or other government departments (debtors).

Audit note

5.2.2 Current assets are subject to the cost of capital charge. Cash at bank/Office of the Paymaster General (OPG) or investments held unnecessarily, as contingency or just in case, will incur the charge. Keeping cash balances at bank to the minimum necessary will help reduce the cost of capital charge ie by not drawing funds down from the Vote into the General Fund until necessary and managing debtors efficiently (getting paid in good time to meet other cash requirements). Funds with the Paymaster General not drawn down from the vote do not attract the cost of capital charge.

Risk	Impact	Mitigation
Excessive cash held	Additional cost of capital charge	Control over cash flow

5.3 Fixed assets: tangible

Definition

5.3.1 A tangible fixed asset is defined as "an asset held for use on a continuous basis in the department’s activities; it has a physical substance and an expected economic life of more than one year". The normal categories of tangible fixed assets are:

- land and buildings;
- plant and machinery;
- fixtures, fittings, tools and equipment;
- assets in course of construction; and
- large IT systems.

Audit note

5.3.2 Tangible fixed assets need to be:

- recorded in fixed asset registers (FAR) with an identifiable audit trail e.g. reference numbers and labels;
- reconciled to general ledger balances;
- subjected to annual management checks for existence/continuing use/remaining life/obsolescence etc;
- re-valued annually using appropriate indices and considered for any permanent diminution in value (“impairment”);
- subject to proper purchasing procedures to ensure that all additions are identified and recorded; and
- subject to proper sales or write-off procedures to ensure all disposals are properly recorded.

In addition land and buildings should be subject to professional external valuation at intervals of not more than five years.

5.3.3 If risk of ownership of assets is transferred to the private sector under PFI/PPP/DBO arrangements, the asset is owned by the private sector and does not appear in the department's accounts or the FAR as an asset, saving the cost of capital and depreciation charges. Any rental, lease, operating charges etc from the private sector supplier is charged to the OCS under Resource DEL. Future payments would be recorded and disclosed¹⁷ as a provision/commitment (para 5.11.2).

5.3.4 Departments need to disclose separately, for each class of tangible fixed asset, depreciation methods used, useful economic life, total depreciation charged for the period, the cost or revalued amount at the beginning of the period and at the balance sheet date, movements and any material changes in the period.

Depreciation

5.3.5 Depreciation is the allocation of the cost of an asset over its useful life. Depreciation is a non-cash cost. Tangible fixed assets are depreciated at rates calculated to write them down to estimated residual value¹⁸, generally done on a straight-line basis¹⁹, over the estimated useful economic lives. Different assets have different useful lives e.g. Harrier jets may have a useful life based on flying hours, whilst computer equipment generally has a useful life of less than 5 years, due to rapid technological change. Departments are required to disclose in their resource accounts the useful life of each category of fixed assets. No depreciation is provided on freehold land and buildings since they have unlimited or very long estimated useful lives.

5.3.6 In addition, land and buildings should be subject to professional external valuation at intervals of not more than five years.

5.3.7 Changes to asset useful lives or depreciation rates have the potential to shift costs across years and change the profile of acquisitions. Departments need to consult the Treasury and the NAO if they want to make significant changes.

Heritage assets

5.3.8 Departments may have a number of heritage assets. These are assets that are preserved in trust for future generations because of their cultural, environmental or historical associations and include archaeological sites, buildings, historical/scientific equipment and antique furniture/silver etc.

5.3.9 Heritage assets may be operational or non operational. Operational assets are those that can be used to contribute towards the achievement of departmental objectives such as a building used for accommodation. They are valued and treated in the same way as other fixed assets.

¹⁷Instructions on disclosure for PFI/PPP/DBO can be found in the Technical Note attached to DAO (GEN) 12/99

¹⁸Residual value is the estimated value of receipts that would be obtained if the asset were sold at the end of its useful life

¹⁹Departments may decide what depreciation policy to adopt RAM 3.2.30

5.3.10 Non-operational heritage assets are valued where it is possible to do so. However it is often not possible to value these assets either because they are unique, irreplaceable or there was no readily ascertainable value.

5.3.11 Heritage assets are depreciated over their normal useful life in the same way as other fixed assets. However, the nature of some non-operational heritage assets is such that they will have an infinite life, in which case no depreciation is charged.

Risk	Impact	Mitigation
Incomplete/inaccurate asset register	Under or overstatement of asset values; incorrect cost of capital charge; incorrect depreciation charge; incorrect costings of objectives; qualified accounts/audit criticism	Sound FAR system in operation; asset existence verified annually; established FAR policy covering asset life, records of asset movement, depreciation methods, valuation method, revaluation frequency and timing, and disposal; link between purchase system and FAR; link from sales/disposal process to FAR
Stated asset values incorrect	Ditto	Sound FAR system in operation; asset existence verified annually; established FAR policy covering asset life, records of asset movement, depreciation methods, valuation method, revaluation frequency and timing, and disposal; link between purchase system and FAR; link from sales/disposal process to FAR; view depreciation and revaluation (indexation) of assets for reasonableness
Assets retained unnecessarily	Higher asset value than necessary; higher cost of capital than necessary; overstated cost of assets	Established process to review asset lives and confirm need to retain assets
Assets not linked to objectives	Asset values, depreciation charges, cost of capital charges incorrectly apportioned against objectives leading to false indication of budgetary performance	FAR system should ensure all assets are allocated/charged to objectives with annual verification (shared assets would need to be apportioned to relevant objectives)
Asset enhancement, including for software developed in-house, not recorded on FAR	Understatement of asset values; incorrect cost of capital charge; incorrect depreciation charge; incorrect costings of objectives	Sound FAR system in operation; link between purchase system and FAR; management awareness; policy and method to value the cost of in-house software development
FAR not reconciled to the General Ledger	Understatement of asset values; incorrect cost of capital charge; incorrect depreciation charge; incorrect costings of objectives	Periodic reconciliation/comparison

Risk	Impact	Mitigation
The cost of developing computer software in-house exceeds the capitalisation threshold but the asset (or enhancement) has not been capitalised	Missing entry on the FAR, incorrect asset valuation and capital charge	Reminders to consider cost of developing in-house systems. Management by central IT section

5.4 Fixed assets: intangible

Definition

5.4.1 These are non-financial fixed assets that do not have physical substance but are controlled by the department through custody or legal right.

5.4.2 There are three basic categories of intangible fixed assets:

- development expenditure;
- goodwill; and
- concessions, patents, licences (including bought-in software licenses), trademarks and similar rights and assets.

Audit note

5.4.3 The aim is to distinguish intangible assets from tangible fixed assets and secondly, to distinguish intangible assets from goodwill²⁰. These distinctions are important because of the different accounting rules that apply to each category. In particular, the rules for capitalising and revaluing intangible assets are much more conservative than those for tangible assets.

5.4.4 Development expenditure may be deferred to future periods. The criteria in RAM 3.10.1 – 3.10.5 should be met and the period of amortisation appropriate. Where development expenditure has been capitalised there must be a clearly defined project, the related expenditure must be separately identifiable and adequate resources must exist, or reasonably expected to be available, to enable the project to be completed.

5.4.5 Intangibles are to be accounted for in accordance with RAM 3.10. The NAO should be consulted on the recognition and accounting for these assets. An intangible asset should be amortised over its expected useful life, unless this is considered to be indefinite. There is a refutable presumption that the life will be twenty years or less. Where the life is longer than twenty years, the asset should be reviewed annually for impairment; to the extent that the carrying value of the asset exceeds its recoverable amount, the asset is impaired and should be written down.

²⁰Goodwill is not expected to arise in government departments' resource accounts, only purchased goodwill may be capitalised

5.4.6 Notes to the Accounts need to disclose, in respect of each class of intangible fixed asset – methods used to value intangible fixed assets, methods and periods of amortisation and reasons for choosing those periods, including the effect of any material changes made. Additionally, the following must be disclosed at the year-end:

- the method of valuation;
- the cost or revalued amount at the beginning and end of the period;
- a reconciliation of the movements, showing additions, disposals, revaluations, transfers, amortisation, impairment;
- the methods and periods and reasons for choosing those periods; and
- the reason for and the effect of changing useful economic lives.

Internally developed intangible assets

5.4.7 Processes should be in place to review the potential for internally developed and commercially purchased intellectual property rights/patents/copyrights etc to be commercially exploited and so separately capitalised. An internally developed intangible asset may be capitalised only if it has a readily ascertainable market value. In all other cases the costs of developing intangible assets are to be written off as they are incurred. (In-house developed software should be accounted for as a tangible fixed asset.)

5.4.8 Very few intangible assets have a readily ascertainable market value. Where they do, and revaluation takes place, the department needs to disclose the basis for the valuation and the details of the valuer.

5.4.9 Capitalisation of internal costs of obtaining copyrights, patents, licenses and similar rights is generally not permitted even though they may satisfy the conditions of indentifiability embodied in the definition of intangible assets. Internal auditors should refer to the RAM for the current rules.

Purchased intangible assets

5.4.10 An intangible asset purchased separately from a business should initially be capitalised at its cost.

Example

5.4.11 A government department has paid design costs for an electric environmentally friendly van fitted with a hoist for the mechanical loading of messenger trolleys to aid the distribution of office mail between its buildings within London. The total cost of the design work is classed as purchased intangible assets over a 10-year period. The useful economic life is the same as the useful economic life of the fixed asset (electric van).

Calculation

Cost	=	£500,000
Useful Life	=	10 years
Depreciation/Amortisation	=	£50,000 per annum charged to the OCS.

Risk	Impact	Mitigation
Intangible assets not identified and recorded	Incorrect asset value;incorrect cost of capital;incorrect amortisation;incorrect cost of objectives;qualified accounts/audit criticism	Defined policy for recording and valuing intangible assets;link between purchase system and FAR; regular process to confirm existence of intangible assets; management awareness
Intangible assets not apportioned to relevant objectives	Incorrect asset value;incorrect cost of capital;incorrect amortisation;incorrect cost of objectives;qualified accounts/audit criticism	Defined policy for recording and valuing intangible assets; regular process to confirm existence of intangible assets; management awareness
Asset valuation incorrect	Incorrect asset value;incorrect cost of capital;incorrect amortisation;incorrect cost of objectives;qualified accounts/audit criticism	Defined policy for recording, valuing and amortising intangible assets; regular process to confirm existence and current value (and impairment) of intangible assets;management awareness
Development costs may not be correctly calculated and fully recorded	Incorrect asset value;incorrect cost of capital;incorrect amortisation;incorrect cost of objectives;qualified accounts/audit criticism	Defined policy for recording, valuing and amortising intangible assets; regular process to confirm existence and current value (and impairment) of intangible assets;management awareness

5.5 Stock and work-in-progress

Definition

5.5.1 At any time an organisation may hold several categories of stock including:

- goods purchased for re-sale;
- consumables stores;
- raw materials and components used in the production and repair process;
- partly finished goods (usually called work-in-progress); and
- finished goods.

Audit note

5.5.2 The NAO should be consulted on the determination of the classes of item to be included in the balance sheet as stock.

5.5.3 Where stock is deemed to be material²¹ departments require:

²¹The definition of materiality must be discussed and valuations assigned in advance of the audit with the departments' external auditors/NAO auditors

- stores accounting procedures along with records of receipts and issues, the opening and closing balances, the current balance of stock, location, stock value, cost of holding stock;
- reconciliation of stock to the records and to the general ledger balance;
- properly evidenced stock-takes periodically, and ideally at year end;
- regular review of stock values on the records and current cost;
- annual consideration of obsolescence/write-off; and
- proper procedures to control receipts, issues and write-offs.

5.5.4 Where work in progress (limited to rechargeable work), is material this will require:

- an auditable job costing system to track costs including:
 - o records of labour input;
 - o overhead absorption rates; and
 - o additional direct costs.

The proposed basis of valuation should be discussed with the NAO.

5.5.5 Records should be kept of discrepancies found during stock-takes and an audit trail retained of any write-offs or amendments to stock records. The audit trail should be capable of demonstrating the value attributed to the stock for continued use and be able to demonstrate that this meets the requirement of being current replacement cost. Where stock cannot, or will not, be used eg due to physical deterioration or obsolescence, they should be written down to their net realisable value – the actual or estimated net sale proceeds. For work in progress other than for goods produced for stock, the value should be the lower of the current replacement cost and the net realisable value (the actual or estimated selling price less further costs).

Valuation Cost

5.5.6 Items of stock have sometimes been stated in the financial statements at estimated replacement cost where this is lower than the historical cost. Stock held by government departments is valued in accordance with regulations laid down in the RAM i.e. current replacement value.

Example

5.5.7 A government department has 20 batteries for its electric environmentally friendly van in store and valued at £1,000 each. The value of the batteries is currently £20,000. During the current financial year, the department buys another 10 batteries and this time pays the supplier £1,200 per battery. The supplier therefore receives £12,000. Government departments use current replacement cost to value their stock. Only one price is recorded for an individual stock item, therefore the revised value of the 30 batteries recorded on the Balance Sheet is 30 x £1,200 = £36,000. The difference between the original value of the 20 batteries @ £1,000 and 20 batteries @ £1,200 (ie £4,000) is credited to a stock revaluation reserve.

Risk	Impact	Mitigation
Inaccurate/incomplete stock records being fed to accounting system	Incorrect asset value;incorrect cost of capital;incorrect cost of objectives;possible qualified accounts/audit criticism	Defined policy for holding, recording, valuing stock; regular stock takes confirming stock condition; regular review of stock valuation
Incorrect stock valuation	Incorrect cost of capital;incorrect cost of objectives;possible qualified accounts/audit criticism	Defined policy for holding, recording, valuing stock; regular stock takes confirming stock condition; regular review of stock valuation
Stock not apportioned to objectives	Incorrect cost of objectives	Defined policy for holding, recording, valuing stock; regular stock takes confirming stock condition; regular review of stock valuation
Excess stock held	Cost of objectives higher than necessary;higher cost of capital than necessary;higher storage overhead costs than necessary;possible loss of stock from deterioration and theft	Regular review of stock levels,demand levels, re-order levels,need of stock, quality of stock/fit for purpose
Stock issued but held locally in case, rather than used	Accrued costs charged at incorrect time;impairs stock control	Defined policy on holding stock centrally
Work-in-progress and long term contracts not recorded adequately	Incorrect valuation;incorrect cost of capital;incorrect cost of objective;possible qualified accounts/audit criticism	Defined policy and guidance on identifying and valuing work in progress

5.6 Cash and bank

Definition

5.6.1 Cash will consist of cash in hand such as petty cash and, where material, stocks of postal orders and stamps, and balances at banks and financial institutions. It will also include cash balances with the OPG that have been drawn down from the Vote into the General Fund.

5.6.2 One of the main differences between cash and resource accounting is that under resource accounting amounts withdrawn from OPG and other accounts are reflected in cash balances when cheques and payable orders are generated and not when encashed. Balances are those shown on bank statements plus deposits not yet recorded and less cheques and payable orders issued but not presented to the bank for payment.

5.6.3 The cash balances will be found on the balance sheet in current assets under the heading cash at bank and in hand. A note to the accounts will provide further analysis.

5.6.4 The main feeder systems producing data on cash inflows and outflows will be accounts payable, accounts receivable and banking.

Audit note

5.6.5 During the year there should be:

- regular reconciliation of bank statements with cash balances;
- checks that all cash balances are accounted for; and
- management checks of cash in hand balances and that cash is held securely.

Proper arrangements should be in place to ensure that reliable figures are provided for cash in hand at the year-end. This will normally entail all forms of cash as in 5.6.1, plus confirmation of year-end balances from all commercial banks employed by the department and bodies within its boundary. Departments should have a complete and up-to-date list of commercial bank accounts in use during the year, including those with nil balances and others closed before the year-end. The year-end reconciliations of the bank and Paymaster balances to the figures reported in the accounts are important audit evidence.

5.6.6 There should also be in-year control of cash flow by ensuring:

- cash balances are neither excessive nor inadequate to meet demands;
- receipts are banked promptly and cleared expeditiously;
- bank accounts have clearly defined purposes and are set up in a manner that encourages good control;
- there is a programme of staff awareness and training;
- sound departmental policy/procedures are established for all business areas with emphasis given to likely timing of payments and receipts; and
- central finance units monitor performance of business units with the Forecast CFS.

Risk	Impact	Mitigation
Cash not accounted for properly	Possible qualification of accounts	Defined accounting policy
Balances for cash in hand and at bank are incorrect	Incorrect asset value;incorrect cost of capital charge;possible qualification of the accounts/audit criticism	Defined accounting policy and procedures to control cash balances
Departments may not have adequate systems to forecast cash requirements	Excessive cost of capital;unnecessary draw down of cash;cheques are dishonoured;possible audit criticism	Defined accounting and banking policy and procedures to control cash supply

5.7 Debtors

Definition

5.7.1 Debtors are an asset and are defined by RAM (3.13.1) as “amounts receivable as at the balance sheet date, no matter when they fall due for payment”. Essentially they are amounts owed by third parties for goods and services provided by the department. Debts arise at the point when an invoice is issued for the provision of these goods and services. Prepayments arise when payment is made to a third party in advance of the services being received by the department e.g. advance rental for telephone lines or other utility standing charges. RAM also requires that:

- the value of debtors shown in the Balance Sheet is after allowance has been made for bad or doubtful debts;
- where there are both debtor and creditor balances arising from transactions with a third party (i.e. they are both a supplier of goods and services and a customer) the balances should not be netted off (that is that any money owed by the department for goods and services received from the organisation is not set off against any money owed by the same organisation for goods and services received from the department); and
- a distinction is drawn between amounts receivable within one year and those due after more than one year. This distinction will normally be made in the notes to the accounts.

5.7.2 The main categories of debtors are likely to be:

- trade debtors;
- deposits and advances e.g. season ticket advances;
- prepayments eg payments in advance of receipt of goods and services such as those laid down by contract/memorandum of understanding (MOU) in respect of international collaboration projects where the department is not host project manager (these are categorised with debtors because should the project be cancelled that money would be returned to the department);
- accrued income, that is income that has been earned and is expected to be received, but for which the invoice has yet to be issued; and
- other debtors eg grants payable and recoverable, overpayments.

5.7.3 Debtor balances are found on the balance sheet under current assets and in the notes to the accounts where debtors will be analysed by their category within the groupings of amounts falling due within one year or over one year.

5.7.4 The main feeder systems containing data on debtors will be those dealing with accounts receivables.

Sources of information:

5.7.5 Data for the debtors' figures comes from various sources including:

- pay feeder files – advances of salaries/ staff loans etc;
- records of goods and services provided to 3rd parties on repayment; and
- bills feeder files for details of invoices raised by the department.

Audit note

5.7.6 For trade debtors, if significant, departments will require systems and procedures as below:

- a sales ledger system, differentiating between “trade” and “other”;
- the means of generating an aged analysis of debtors;
- procedures for review of, and policy for providing for, bad and doubtful debts;
- controls to ensure that debts cannot be written off without proper authority;
- adequate separation of duties;
- ready audit access to system-held invoice information or hard copy; and
- ability to download listings.

Risk	Impact	Mitigation
Inadequate debtor control	Loss of resource due to monies not brought to account, pre-paid goods service not received; increased cost of objectives; increased draw down of cash incurring additional cost of capital; possible qualification of the accounts for the misstatement of debtor balances	Established accounting policy, procedures and guidance on debtor control including: <ul style="list-style-type: none"> • adequate management review of reasonableness of debtor balances • invoices raised completely, accurately and in good time • adequate audit trails for debtor balances • debts reviewed and pursued effectively • appropriate methods used to establish doubtful or bad debts
Accounting system does not differentiate between short and long term debtors	Difficulty forecasting short-term receipts impairing ability to forecast cashflow requirements	Ensure there is an adequate system in place to forecast timing as well as value of receipts

5.8 Investments

5.8.1 Investments include:

- shares of limited companies held in the name of the Secretary of State of the sponsoring department;
- interests in subsidiary undertakings;
- interests in associated undertakings and/or joint ventures which fall outside the departmental boundary; and
- loans and public dividend capital issued to public bodies not consolidated in departmental resource accounts.

An example is the shares held by the Ministry of Defence in the Atomic Weapons Establishment. An asset, not used directly in the operation of an organisation's business will be considered an investment.

5.8.2 Government Accounting requires departments to maintain a register of Investments (Government Accounting para 23.3.5).

5.8.3 Grants payable or paid are recorded as expenditure in the period. They are not recorded as investments.

Audit note

5.8.4 A Register of investments should be kept and maintained for proof and control of ownership. There also need to be records of current valuation of investments to support the accounting entries.

5.8.5 Longer-term investments, including shares in limited companies, should be reported at market value, the source and calculation are important audit evidence. Movements in valuation, other than impairment, need to be recorded through the revaluation reserve. Arrangements need to be in place to capture this information, and share certificates should be available as audit evidence.

5.8.6 Short-term investments, including the use of surplus funds, in marketable securities should be recorded as current assets at market value. Movements are included in the OCS. The calculation of market value is important audit evidence.

Measurement

5.8.7 Although investments should be categorised as either fixed or current assets, there is no need for bodies that have adopted MHCA (such as central government departments), to make this distinction for valuation purposes. Investments, other than public dividend capital, should be valued at market value. Historical cost is used to value public dividend capital in instances where market value is not available, but this is subject to HMT approval. Joint ventures and associated undertakings that are outside the departmental boundary are to be recorded using the equity method of accounting. Chap 11 RAM and Finance Reporting Standard (FRS) 9 refer.

Risk	Impact	Mitigation
Not all investments identified, entered on register and in resource accounts, or associated with relevant objectives	Inaccurate disclosure of investments; inaccurate valuation of assets leading to incorrect cost of objective and cost of capital charge; possible qualification of the accounts/audit criticism	Established policy, procedures and guidance complying with RAM and FRAB ²² ; register of investments kept and regularly maintained
Insufficient proof of ownership of investments	Inaccurate disclosure of investments; inaccurate valuation of assets leading to incorrect cost of objective and cost of capital charge; possible qualification of the accounts/audit criticism	Register of investments kept and regularly maintained with reference to ownership documents
Investments incorrectly classified and valued	Inaccurate valuation of assets leading to incorrect cost of objective and cost of capital charge; possible qualification of the accounts/audit criticism	Established policy, procedures and guidance complying with RAM

5.9 Creditors

Definition

5.9.1 Creditors are amounts a department expects to pay to third parties such as commercial suppliers, other government departments for goods and services already received. Grants due to be paid by departments to other organisations should also be recorded as a creditor in accordance with when grant entitlement criteria are met. Creditors may be short or long term. The department may expect to pay either within the next year (short term) or sometime later (long term). Long-term creditors may include payments due for the unexpired portion of finance leases or monies due to contractors in respect of long-term retentions.

5.9.2 A department incurs a cost as soon as it receives and accepts goods or services and should account for the resulting liability accordingly. This may mean accounting for costs before the invoices for those costs have been received. Creditors and accruals are essentially the value of work completed and goods received but not yet paid for, or payments that have “matured” but have yet to be paid, ie the invoice has been received but not yet paid (Government Accounting column notes after para 16.3.7). Accruals are estimates of the value of work completed for which an invoice has yet to be received.

²²Finance Reporting Advisory Board

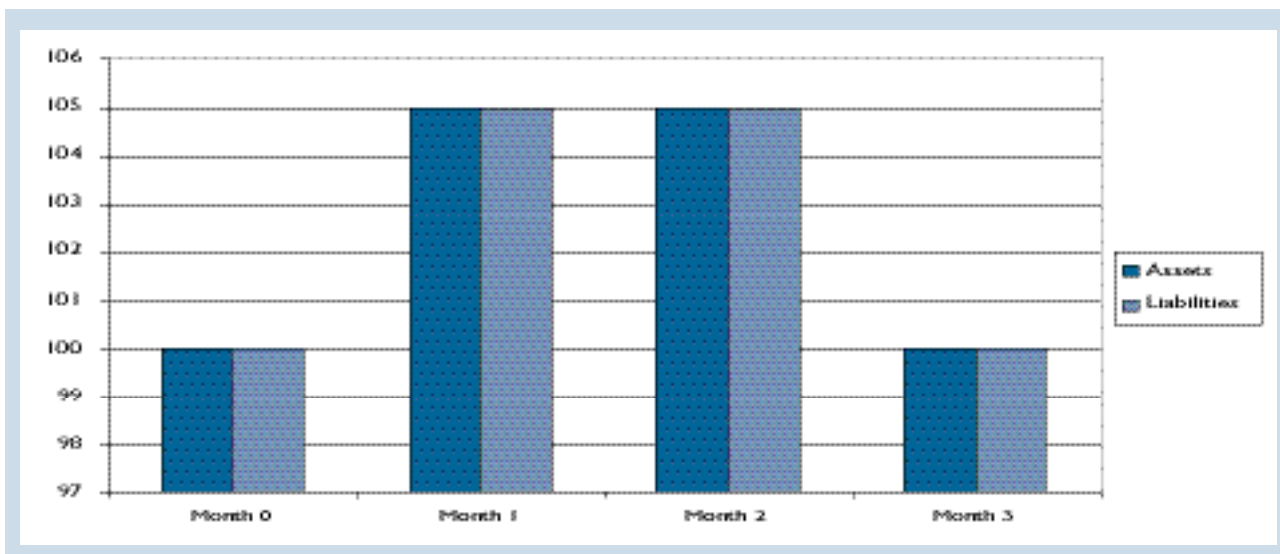
Audit note

5.9.3 For trade creditors, if significant, departments will require systems and procedures as below:

- a purchase/purchase order system;
- unique physical referencing between orders, goods received notes and invoices;
- ready physical access to documents;
- adequate separation of duties;
- access to listings of balances by supplier and by invoice;
- ability to age-list balances; and
- ability to download listings.

Example

5.9.4 The department places an order for 10 vehicles. It takes delivery of all 10 vehicles in month one. The contract requires invoices to be raised the month after delivery and payment to be made within 30 days of receipt of the invoice. Therefore the department receives the vehicles in month one but doesn't pay for them until month 3. The graphs below illustrate the accounting transactions.



Month 0 is the total value of the department's assets (cash, fixed assets stock etc) and liabilities (long & short term creditors) before the vehicles are purchased. Month 1 shows the increase in fixed assets representing the value of the vehicles bought matched by an increase in liabilities since the department has yet to pay for them. Month 2 shows that there is no change in the total value of assets and liabilities since month 1. The accrual is simply replaced by a creditor since the department now has the invoice. Month 3 reflects the decrease in assets and liabilities as the department uses some of its cash (an asset) to settle the outstanding invoice (liability).

Note that the value of assets and liabilities in month 0 and month 3 are the same. This reflects the fact that the department has simply converted one type of asset (cash) into another (fixed assets). The overall value of assets has remained unchanged.

Sources of Information

5.9.5 Creditor information is obtained by comparing systems that record details of invoices received (local and departmental level) with the bill payment feeder systems.

5.9.6 As accrual items require business knowledge and foresight, they tend to be obtained from local systems, monthly records and manual journals etc with supporting evidence of management review.

Risk	Impact	Mitigation
Level of creditors and accruals incomplete or inaccurate, may be multiple entries between accruals, creditors and payments	Creditors under or overstated leading to inaccurate accounts statements; may upset cash flow forecast; cost of capital charge could be inaccurate; data entry or timing errors could lead to duplication of entries between accruals, creditors and paid figures; possible qualification of the accounts/audit criticism	Established policy, procedures and guidance complying with RAM; good audit trail of transactions and system in place to manage reduction of debt from commitment through to payment avoiding double entries; processes and reviews in place to confirm accuracy of creditors figure

5.10 Liabilities and provisions

Definition of liabilities

5.10.1 Current liabilities - include liabilities an organisation would expect to pay within the next year such as amounts owed to commercial contractors, claimants and other government departments.

5.10.2 Long-term liabilities - are liabilities an organisation would expect to pay but not within the next year such as provisions for future decommissioning costs, or some contract retentions.

5.10.3 A contingent liability - is defined as either:

- a possible obligation arising from past events whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the organisation’s control; or
- a present obligation that arises from past events but is not recognised because it is not certain that a transfer of economic benefits will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability.

5.10.4 The Balance Sheet will only include known liabilities in respect of items where goods or services have been received by the organisation by the end of the accounting period. It will therefore exclude contingent liabilities where the probability of the liability falling due is very remote. Though not included in the Balance Sheet those liabilities will need to be disclosed in the notes to the accounts. Some examples of contingent liabilities, and their treatment, are:

- guarantees of risks – ECGD £29bn compared to balance sheet net liabilities of £2.5bn (March 2000); and
- claims for injuries to prison staff and prisoners – Home Office £6m - £4m actually provided in balance sheet.

Definition of provision

5.10.5 A provision should be made when an entity is required to recognise a present obligation, legal or constructive, as a result of a past event and it is probable that a transfer of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. An example would be provisions for redundancy costs, where the decision to make staff redundant has been taken before the end of the accounting period, but the actual costs will be paid out in later years.

5.10.6 No provision can be made if a decision has not yet been made regarding an obligation on the organisation.

Present provision

5.10.7 If in doubt, a judgement of whether a past event is likely to give rise to a present obligation should be based on all available evidence pertaining at the balance sheet date.

Past provision

5.10.8 This arises where an event in the past puts an obligation on the organisation to make a settlement (payment). An obligating event is one that cannot reasonably be avoided. Some likely areas requiring provisions include:

Decommissioning costs - where the department is obliged, legally or constructively, to bear the costs of remedying environmental damage, contamination, or to performing restorative work.

Pensions and superannuation - only to the extent by which the accruing superannuation liability charge (ASLC) has not been completely discharged by payments of contributions.

Early departure costs - where the employer is responsible for costs beyond the normal benefit awards for termination of employment.

Revaluation of assets - as a result of an asset revaluation exercise, provisions will need to be created.

Bad debt provision - arises where an existing debt is unlikely to be settled.

Re-organisation costs - where the department is already committed to the re-organisation, and only in respect of costs that are not associated with ongoing or new activities.

Others - such as an onerous contract.

Valuation of provisions

5.10.9 Best estimates should be used to value a provision. This will normally be the amount that

the department would rationally pay at the balance sheet date to settle the obligation or transfer it to a third party.

5.10.10 If a provision is made for an item, which will be settled many years in the future, the value of the provision is discounted at the standard public sector real rate set by HM Treasury (currently 6% - see RAM 4.3.7) to arrive at its net present value. For example the MOD estimates its total nuclear decommissioning costs at around £16bn, but this is discounted to an actual provision of £3.8bn in the Balance Sheet.

Accounting and budgeting for provisions and liabilities

5.10.11 There is a difference between accounting for a provision or contingent liability in the annual resource account and budgeting for provisions/contingent liabilities. Departments can budget for whatever provisions they think they will need but the annual resource account can only show provisions/liabilities as a result of something that has actually happened e.g. a redundancy. The cost has already been incurred even though the exact amount and timing of the payment is not known. Examples are:

- pension and superannuation liabilities;
- redundancy and restructuring costs;
- compensation claims;
- decommissioning costs; and
- obsolete or damaged stock, or irrecoverable work-in-progress.

The costs are provided for in full in the OCS as soon as there is an obligation even though the actual cash may not be paid out for some years.

Audit note

5.10.12 In considering the need for provisions, departments need to look beyond their boundary to consider associated organisations which may be unable to meet all their liabilities and where eventual charge will fall on the department.

5.10.13 The criteria for recognising provisions are set out in RAM 4.3 and this is an area into which the NAO will be looking to ensure compliance. There should be adequate records and procedures in place for the recognition and valuation of any provision or liability to justify its entry in the accounts and/or notes to the accounts. These should include:

- description and nature of the obligation;
- expected timing;
- indication of all and any uncertainties regarding the amount and timing; and
- amount of any reimbursement and any assets identified for the reimbursement.

The proposed entries should be reviewed and approved by management and the central accounts team before being entered. Management also need to undertake regular reviews of the likely costs to reflect changes in circumstances, legislation and current values.

Risk	Impact	Mitigation
Provision not made for dilapidations	Future liabilities not certain	Regular professional review of building values
Provisions made or liability declared prematurely	Overstatement of liability reducing cost of capital charge and availability of resource	Established policy, procedures and guidance complying with RAM; proper records and procedures must be in place for the recognition, timing and valuation of provisions
Provision not made for bad debts	Shortfall of resource	Sound system of debt management
Future liabilities not identified	Shortfall of resource	Established policy, procedures and guidance complying with RAM; proper records and procedures must be in place for the recognition, timing and valuation of provisions; ensure subsidiary bodies also comply
Budget manipulation by false creation of provisions	Over provision of budgets; excessive cost of objectives, reduction in net assets figure and thus the cost of capital	Established policy, procedures and guidance complying with RAM; proper records and procedures must be in place for the recognition, timing and valuation of provisions
Inconsistent approach across department to estimating provisions	Under or over statement	Established policy, procedures and guidance complying with RAM; proper records and procedures must be in place for the recognition, timing, valuation and revaluation of provisions
Politically sensitive issues identified in the accounts as a liability	Political and/or international reputation damage or embarrassment	Guidance/procedures so that sensitive issues are not identified in the accounts

5.11 Contingencies and commitments

Audit note

5.11.1 Departments will need to have a system to identify potential contingencies - both contingent gains and contingent losses. On the basis of prudence, contingent gains should not be recognised in the accounts. Contingent losses should be recognised if there is sufficient evidence to indicate that the loss will occur. Such contingent losses, which are not recognised in the accounts, should be disclosed by way of a note unless the loss is regarded as remote.

5.11.2 Similarly, departments should have a system to identify obligations for making future payments - usually in relation to commitments on contracts for non-routine services or business activities that are non-cancellable (or cancellable only at significant cost) extending beyond the balance sheet date. Examples would include major building works and PFI contracts. Though not shown on the balance sheet these will need to be disclosed by way of notes to the accounts, distinguishing between capital commitments and other.

Risk	Impact	Mitigation
Potential contingent gains and losses not recorded	Incorrect budgeting;shortfall of resource	Established policy, procedures and guidance complying with RAM;proper records and procedures must be in place for the recognition and valuation of contingencies
Future commitments not recorded	Incorrect budgeting;shortfall of resource	Established policy, procedures and guidance complying with RAM;proper records and procedures must be in place for the recognition and valuation of commitments

5.12 Taxpayers equity

5.12.1 The capital and reserves section of the Balance Sheet is termed the taxpayers equity. This shows how the net assets were arrived at. The main categories of taxpayers' equity are the *general fund*, the *revaluation reserve* and the *donated asset reserve*.

General fund

5.12.2 This represents the total assets less liabilities not funded by other reserves and financing items. Parliamentary Vote funding, and some other sources of funding, are not treated as income on the OCS but are instead credited to the general fund. Net operating costs for the year are debited to the general fund. The general fund therefore represents the total assets less liabilities not funded by other reserves and financing items.

Revaluation reserve

5.12.3 This reflects any changes to the value of fixed assets resulting from professional revaluation, indexation, changes in use and impairment reviews since they were first entered in the first opening balance for that organisation (usually 1 April 1996 or 1997).

Donated asset reserve

5.12.4 Reflects the value of any fixed assets gifted, or loaned indefinitely to an organisation, for which no money changed hands. Loaned assets are items over which the taxpayer has no claim; should they no longer be required, they would be returned to the original benefactor or sold and the proceeds returned to the donator. Only if the original donator could not be identified or found would the taxpayer have a claim.

Balance sheet equation

5.12.5 Ultimately, if the organisation were to sell all its assets and pay off all its liabilities, whatever is left would go back to Parliament and to any benefactor who loaned assets so the balance sheet equation can be rewritten thus:

Assets = general fund + revaluation reserve + donated assets reserve + liabilities

It can be seen that someone, be it the taxpayer, commercial suppliers or employees has a claim over every asset.

The value of assets = the value of claims on these assets

5.12.6 Added together **fixed assets, current assets, current liabilities and long-term liabilities** make up the organisations **net assets**.

5.12.7 General audit objectives for assets and liabilities

Completeness - there are no unrecorded assets, liabilities, events or other undisclosed items.

Existence - an asset or liability exists at a given date.

Rights and obligations - an asset or liability properly pertains to the department at a given date.

Valuation - an asset or liability is recorded at an appropriate carrying value.

Presentation and disclosure - an item is disclosed, classified and described in accordance with the RAM.

Consolidating assets and liabilities for the departmental resource account

5.12.8 Departments need to consolidate all the entities within the departmental boundary. Important considerations here are:

- that the financial statements of entities as used for consolidation purposes are suitable for inclusion in the department's resource accounts i.e. they must be signed and audited before being consolidated into the resource account;
- that any re-classification of income, expenditure, assets or liabilities of entities being consolidated as required to support resource account disclosures is feasible and auditable;
- that other information to support additional resource account disclosures from entities being consolidated is available and auditable;
- that the accounting periods of all the entities are coterminous and they have uniform accounting policies;
- that the process of adjusting assets and liabilities is carefully considered where, for example, fixed assets or stock are sold or transferred to organisations within the boundary, or where there are amounts owing to and from the parties. Particular attention should be paid to the identification of transfers, for example as a result of machinery of government changes; and
- the process of adjusting revenue and expenses. Departments must look to eliminate the effect of "intra group" transactions for items such as overheads re-allocated and other shared costs.

ANNEX 1 KEY ACCOUNTING CONCEPTS

Accruals

An accrual relates to expenses that have been incurred (eg the good or service has been provided) but no invoice has been received and the payment has not been made. It means that expenses should be recognised in the year in which the good or service has been provided. A liability to pay the amount in the next year should be included in the balance sheet. With end-year flexibility mechanisms in place, there should be no strong incentive for departments to shift expenses from one year to the next by not recognising accruals.

Assets

Assets are generally items acquired by departments, which the department uses for more than 1 year to assist in the delivery of its services. The same rules apply as for expenses, ie the asset is accounted for when the asset is received, not when it is paid for. Common classifications of assets are – fixed assets (vehicles, land, buildings, IT systems, finance leases) and current assets (cash, debtors, stock). There are also intangible assets (patents, trademarks) and financial assets (loans). Stocks count as current assets. So do bullets.

Subject to de minimis limits, expenditure on the acquisition of fixed assets is capitalised on an accruals basis. Tangible fixed assets are valued at the lower of replacement cost and recoverable amount. Revaluation of fixed assets should be credited or debited to a revaluation reserve.

Asset recognition threshold

Departments have to determine the monetary threshold for treating what would normally be considered capital expenditure as an expense (resource expenditure). Some departments may set this at £1,000, others at £20,000. The purchase of a single computer for £900 may be treated as an expense, whereas the purchase of 100 computers for £90,000 would be treated as creating an asset.

It is important to be aware of the threshold, so that purchases planned by a department can be appropriately classified as an expense or as an asset (capital). It has particularly important implications for government budgeting if a department changes its threshold. For example, increasing the threshold may move capital into expenses (resource). In the absence of identifying offsetting cost reductions or receiving additional spending approval, this may adversely affect the amount the department is able to spend on delivering its services.

Capitalisation

Costs are capitalised that are directly attributable to the acquisition or enhancement of a fixed asset – ie an item that has a value to the department lasting more than a year. For example, if a department decides to construct a building, the fees for the architect, will be capitalised even if the cost is less than the department's asset recognition threshold.

Contingent Liabilities

Contingent liabilities are liabilities that are not recorded on the balance sheet because there is uncertainty about the likelihood of actually having to pay them, the amount to be paid or the timing of the payment. Contingent liabilities must however be listed in the notes to the accounts.

Departments should monitor their contingent liabilities carefully. Large contingent liabilities that become more certain and therefore become actual liabilities can be significant in financial terms. Departments need strategies in place to manage these amounts so that meeting any of the costs arising does not significantly reduce their ability to provide services.

Cost of capital charge

Government as a whole incurs an interest cost for borrowing to finance investments by departments. This is also described as government's cost of capital. To improve transparency and ensure the full cost of services is reflected in departmental accounts, this borrowing cost has been devolved to departments as a "capital charge".

In general terms, the capital charge is calculated as a percentage (currently 6%) of the department's net assets (assets less liabilities). Some assets are excluded from the charge (eg donated assets). The charge is a non-cash cost – ie departments do not have to make a cash payment, but it is a cost in their budgets, Estimates and resource accounts. The cost of capital charge is apportioned between administration and programme costs in the operating cost statement (OCS), in the same proportion as assets are deployed by the department in delivering either administration or programmes.

In SR2002, departments will bear the risk associated with changes in the cost of capital charge (in SR2000, it was ring-fenced outside departments' budgets). This will act as an incentive to departments to manage their net asset position through divesting themselves of surplus assets (thereby reducing the cost of capital charge) and managing their working capital (eg paying creditors on time, rather than early, will reduce the charge).

Depreciation

Depreciation is the allocation of the cost of an asset over its useful life. Different assets have different useful lives. For example, Harrier jets may have a useful life based on flying hours, whilst computer equipment generally has a useful life of less than 5 years, due to rapid technological change.

Depreciation is a non-cash cost. The public sector usually uses "straight-line" depreciation – ie if an item lasts 3 years, one third of the cost (less any residual value at the end of the 3 years) would be depreciated each year.

Departments are required to disclose in their resource accounts the useful life of each category of fixed assets. Changes to asset useful lives or depreciation rates have the potential to shift costs across years and change the profile of acquisitions. Departments should consult the Treasury and the NAO if they want to make significant changes. For new assets, it is very important to factor in the associated resource cost such as depreciation and other asset related costs such as maintenance and the capital charge.

Gains or losses on disposal

Gains or losses on disposal represent the difference between the proceeds from the sale of a fixed asset and its net book value (its value in the balance sheet) when it is sold. So a gain/loss on the sale of a fixed asset which is recognised in a department's OCS in one period usually reflects either an accounting policy which has resulted in over/under depreciation charged to its OCS in previous periods or unexpected price movements.

Joint ventures

A joint venture is an entity in which the reporting entity holds an interest on a long-term basis and is jointly controlled by the reporting entity and one or more other venturers under a contractual arrangement.

An entity jointly controls a venture with one or more entities if none of the entities alone can control that entity, but all together can do so and decisions on financial and operating policy essential to the activities, economic performance and financial position of that venture require each venturer's consent.

Liabilities

Liabilities are generally amounts owed by the department. There are current liabilities (creditors due within 1 year) and non-current liabilities (amounts falling due after more than 1 year).

Operating leases and finance leases

Under present arrangements, operating leases are treated as an expense and finance leases as an asset. To determine which applies in a particular case, there are various tests relating to ownership and control of the item subject to the lease. A change to the accounting rules is currently being considered which might result in all leases being regarded as capital and appearing on the balance sheet.

Where significant projects involve lease or buy decisions, a project evaluation is needed – guidance is available in the Treasury's "Green Book". It is important to understand the types of options for leasing available and the full costs and benefits to the department. This is because the cost to government of borrowing to invest in assets is generally much lower than the cost of capital accessible to business providing operating leases.

PFI contracts

An analysis of the risks associated with a PFI contract will be carried out to determine the level of risk transfer. If sufficient risk has been transferred to the private sector, the contract is treated as "off balance sheet". If sufficient risk remains with the public sector, the contract is "on balance sheet".

For off balance sheet treatment:

- there is no impact on the balance sheet unless the contract involves the sale of an asset, in which case this will be removed from the balance sheet; and
- the rental charge under the contract is charged to the OCS over the terms of the lease; profit or loss on the sale of an asset is also charged to the OCS.

For on balance sheet treatment:

- the initial amount recorded on the balance sheet as a fixed asset and as a liability should be the fair value of the property; the liability is reduced as payments for the property are made; and
- the asset should be depreciated over its useful economic life and an imputed finance charge on the liability should be recorded on the OCS. A cost of capital charge at the Government's standard rate, calculated as a percentage of the average net book value of the fixed asset over the year, is also a charge to the OCS. A cost of capital credit will also be recorded on the liability, but will fall outside DEL in SR2002.

Where PFI contracts involve payments for assets and services, the payments for the assets will be treated as above, with the remainder of the PFI payments (ie the full payments, less the capital repayment and the imputed financing charge) recorded as an operating cost.

Prepayments

Prepayments are amounts paid in advance of when the service is delivered. For example, a department may pay an annual retainer fee upfront to a contractor to be on call to supply additional equipment or to undertake emergency maintenance work at short notice (if required). The portion of the payment that is prepaid is not an expense in the current period – instead, it is treated as an asset in the current period. Prior to the introduction of end-year flexibility (EYF), departments may have had an incentive to pre-pay expenses from the current year's budget. This no longer applies.

Provisions

A provision is an actual liability of uncertain timing or amount. It is also a cost that increases expenses (resource cost) in the current year. Examples include provisions for bad debts (uncollectable amounts – this is very significant for departments such as the Department for Work and Pensions); provisions for negligence (significant for the Department of Health). As provisions are liabilities, they reduce the department's cost of capital charge.

There will often be an element of judgement involved in establishing the correct amount to include as a provision. Provisions represent a significant area of risk for government's management of the budget position. This is because the establishment by departments of large unbudgeted provisions can increase in-year expenditure beyond that expected, by bringing forward expenditure from future years to earlier years or the current year.

Revaluation reserve

The revaluation reserve is part of taxpayer's equity (the department's net assets) shown on the balance sheet. The revaluation reserve shows the accumulated and unrealised amount of revaluations of fixed assets and stock.

Revaluations and impairments

Assets are required to be revalued annually. This has implications for the department in terms of depreciation and cost of capital charge. Upwards revaluations are generally recorded in the asset revaluation reserve – ie they are not treated as "income" or offset current year expenses. Downward revaluations may either be transferred to the asset revaluation reserve or treated as an expense.

If an asset is considered impaired, this means that there is a permanent reduction in its value. The amount written off from the value of an asset is an expense in the current year.

From a fiscal management viewpoint, downward revaluations that are treated as an expense, and impairments that have not been budgeted for, are a cost to the department's resource budget and as such could reduce the amount of resources departments have available to spend on service delivery.

Statement of Recognised Gains and Losses

The Statement of Recognised Gains and Losses (SRGL) sets out the changes in the revaluation reserve and any prior year adjustments to opening balances in the balance sheet. The SRGL is included in Schedule 2 of the departmental resource accounts with the OCS. Items recognised in the SRGL fall outside departmental budgets.

Stock

Stock includes consumable stores, goods or other assets purchased for use or resale by a department in the provision of its services. Stocks are recorded on the balance sheet.

ANNEX 2 REFERENCES AND FURTHER READING

HMT Government Accounting 2000

<http://www.government-accounting.gov.uk/current/frames.htm>

HM Treasury Resource Accounting Manual

<http://www.resource-accounting.gov.uk/current/frames.htm>

Departmental resource accounting guidance

Consolidated Resource Budgeting Guidance

http://www.hm-treasury.gsi.gov.uk/psd/rab/Consolidated_guidance/rb0cont.htm

The Government Internal Audit Standards [GIAS];

The best practice guidance on Standard 6 – Audit Strategy, and

The guidance on co-operation between Internal and External Audit²³.

Booklets in the Managing Resources series published by Treasury:

- Implementing resource based financial management
- Analysing resource accounts: an introduction
- Analysing resource accounts: user's guide
- Better decision taking in departments (2nd edition)
- Maximising the benefits for departments
- A strategic approach to finance training
- Case studies
- Reporting to the Board
- Accountability
- Faster Closing

<http://www.hm-treasury.gsi.gov.uk/fmra/managingresourcesseries.htm>

RABIG letters

<http://www.hm-treasury.gsi.gov.uk/psd/rabig/RabigLettersHome.htm>

Accounting Standards updates

<http://www.hm-treasury.gsi.gov.uk/psd/accounting/account/acstand.htm>

²³GIAS and other audit documents can be found on the APA website:www.hm-treasury.gsi.gov.uk/fmra/apa/homepage.htm

2002 Spending Review –

http://www.hm-treasury.gsi.gov.uk/psd/sr2002/sr2002_final_guidance/sr2002guidhome.htm

FRS 4 – Capital Instruments, Accounting Standards Board,

FRS 5 – Reporting the Substance of Transactions, Accounting Standards Board

FRS 9 - Associates and Joint Ventures Accounting Standards Board, Nov 1997

FRS 10- Intangible Assets & Goodwill

FRS 18 - Accounting policies ASB Feb 2001

Resource Accounting – Valerie Archibald ISBN 0-9536688-1-9

Preparing for Audit – NAO

<http://www.nao.gov.uk/guidance/resacct1.htm>

HMT Regularity and Propriety Handbook

<http://www.hm-treasury.gov.uk/mediastore/otherfiles/162.pdf>

Enquiries about hardcopies of HM Treasury documents should be directed to the Public enquiry Unit Tel 020 7270 4558 (GTN 270 4558)

ANNEX 3 EXAMPLE BALANCE SHEET

BALANCE SHEET - SCHEDULE 3 [DEPARTMENTAL YELLOW]

Balance Sheet	Schedule 3		31 March 2001	
[Departmental Yellow]				
as at 31 March 2002		Note	£000	£000
Fixed assets:		10	39,923	
Intangible Fixed Asset	Development costs,intellectual property rights	11	550	
				40,473
Tangible Fixed Assets	Land & buildings,plant machinery, vehicles IT			
Current assets:				
Stocks	Capital spares,stocks,spare parts	13	4,087	
Debtors	Trace debtors,VAT refunds due from HMC & E	14	9,236	
Cash at bank and in hand	Balance on sub imprest a/cs,advances by foreign Govt & collaboration projects	15	1,930	
			15,253	
Creditors (amounts falling due within one year)	Trading creditors,payments received on account, accruals obligations under finance leases,amounts owed to other govt departments	16	(3,651)	
Net current assets				11,602
Total assets less current liabilities				52,075
Creditors (amounts falling due after more than one year)	Retentions on completed projects,obligations under finance leases,amounts owed to other Govt departments			
Provisions for liabilities and charges	Nuclear decommissioning,early retirement, environmental clean-ups,pensions,legal obligations etc.	17	(24,721)	
				(24,721)
				27,354
Taxpayers' Equity				
General fund	The total value of the taxpayers investment in the organisation	23		16,561
Revaluation reserve	Increases/decreases to value of fixed assets	18		10,593
Donated asset reserve	Value of assets donated to the organisation (i.e. not paid for by it)	18		200
				27,354

ANNEX 4 GLOSSARY

Accounting policies

The way the organisation applies the standards set out in the Resource Accounting Manual.

Accounting standards

Standards are issued or adopted by the Accounting Standards Board and are applicable to the financial statements of an organisation. They are intended to ensure that the financial statements present a true and fair view of its state of affairs and its income and expenditure.

Accruals accounting

A method of recording expenditure as it is incurred, and income as it is earned, during an accounting period. By contrast, cash accounting records cash payments and receipts when they are made or received.

Accruals to cash adjustments

Adjustments that are listed in the Schedule 1 Reconciliation of resources to cash requirement, which include: non-cash cost of capital, depreciation, changes in provisions and establishment of new provisions, and non-cash working capital adjustments.

Agency

This is an entity which may be a department in its own right or part of a department. If the agency is part of a department, its accounts are consolidated in the resource accounts of the parent department.

Aim

All departments have an Aim. It is a high level statement describing the Government's policy objective for that department. The Aim is divided into a number of Objectives which describe in more detail how the department will achieve its Aim. The Aim is set out in the resource accounts in Schedule 5.

Annually Managed Expenditure (AME)

AME is a concept used for resource budgeting. It is public expenditure that is managed annually because it is less able to be estimated or controlled by the department than expenditure included in the DEL. AME has both resource and capital elements.

Assets

Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events. See Current Assets and Fixed Assets. Assets are included in Schedule 3 – Balance Sheet. Assets are valued at the lower of cost or recoverable amount.

Balance Sheet

A financial statement, which shows the assets, liabilities and capital of an organisation on a particular date, normally the end of the accounting period.

Capital

See Capital Expenditure.

Capital budget

The capital budget of a department comprises all new capital spending, proceeds from the sale of assets and net lending (loans provided to departments less loans provided by departments). It includes an allocation for the investments made by public corporations and non-departmental public bodies. Both Annually Managed Expenditure (AME) and the DEL can include components of the capital budget.

Capital expenditure

Under UK GAAP, comprises expenditure on new construction, land, extensions of, and alterations to, existing buildings and the purchase of any other fixed assets (eg machinery, plant and vehicles) having an expected working life of more than one year. Also see Current Expenditure.

Capital grants

Contributions towards expenditure on fixed assets made by central government departments to organisations in the private sector and other parts of the public sector.

Cash accounting

A method of accounting which records cash payments and cash receipts as they occur within an accounting period. This is the method government used before it moved to accruals accounting.

Cash Flow Statement

A statement of cash inflows and outflows during an accounting period.

Central government

Government departments and their executive agencies and most non-departmental public bodies. The central government sector does not include local authorities, public corporations (including NHS Trusts) or nationalised industries.

Consolidated fund

Government revenue from taxes and other sources is collected daily into the Consolidated Fund. Payments from the Consolidated Fund finance central government spending.

Consolidation

The process of incorporating the results of linked entities into a single account, which involves the elimination of inter-entity transactions and balances.

Contingent liability

A possible liability that in certain circumstances could become an actual liability. If a department has identified contingent liabilities, these will be included in a note to the resource accounts.

Cost of capital

The opportunity cost of capital invested.

Cost of capital charge

Government as a whole incurs an interest cost for borrowing to finance investments by departments. This is also described as government's cost of capital. To improve transparency and to ensure the full cost of services is reflected in departmental accounts, this borrowing cost has been devolved to departments as a "capital charge". In general terms, the capital charge is calculated as a percentage of the department's net assets (assets less liabilities). Some assets are excluded from the charge eg donated assets. The cost of capital charge is apportioned between administration and programme costs in Schedule 2 - Operating Cost Statement, on the basis of the purpose for which the assets of the department are employed.

Creditor

Monies owed to another entity by the department. Creditors are included in the resource accounts in Schedule 3 – Balance Sheet and further details are generally included in a note to the accounts.

Current assets

Current assets include cash or other assets, which can reasonably be expected to be converted to cash in the normal course of business, including stocks, debtors, accrued income and payments made in advance. Current assets are included in Schedule 3 – Balance Sheet of the resource accounts.

Current expenditure

Expenditure which is neither capital expenditure nor financial expenditure. It also includes grants.

Current liabilities

Liabilities incurred in the normal course of business which fall due within one year and include creditors, accrued expenditure and deferred income. Current liabilities are included in the resource accounts in Schedule 3 – Balance Sheet.

Debtor

Monies owed by another entity to the department. Debtors are included in the resource accounts in Schedule 3 – Balance Sheet. There may also be more detailed information included in a note in the accounts.

Departmental aim

See Aim

Departmental Expenditure Limit (DEL)

DEL is a concept used for resource budgeting. It is public expenditure which forms departments' multi-year budget plan against which spending is managed. The DEL has separate elements for capital and current spending.

Departmental Investment Strategy (DIS)

The DIS sets out the department's plan to invest in assets of the scale and quality of capital needed to deliver public services. Each DIS sets out: a strategic policy context; current asset base; new investment plans; and systems and processes.

Depreciation

A measure of the wearing out, consumption or other reduction in the useful life of a fixed asset whether arising from use, passage of time or obsolescence through technological or market changes. For intangible assets, the term amortisation is used instead of depreciation. The amount of depreciation charged in the resource accounts is included in the Tangible Fixed Assets note in the resource accounts.

Donated asset reserve

The net book value of donated assets recorded in the accounts. This reserve will be included in the Taxpayers' Equity section of Schedule 3 – Balance Sheet.

Estimate

See resource-based estimate.

Financial statements

Prepared annually by departments in accordance with the Resource Accounting Manual. They comprise Schedules 1 to 5 and notes to the accounts.

Fixed assets

Assets with an expected life of more than one year held for use on a continuous basis, eg land and buildings, patents. Fixed assets usually comprise tangible and intangible fixed assets and are included in Schedule 3 – Balance Sheet. Further information may be included in the notes to the accounts.

Gain/loss on disposal of fixed assets

The difference between the proceeds on sale of the fixed asset and the net book value of the asset. Details on fixed asset disposals are included in the notes to the resource accounts.

General fund

Included in Taxpayers' Equity in Schedule 3 – Balance Sheet and comprises the difference between the net assets and the other reserves included in Taxpayers' Equity.

Generally Accepted Accounting Practice (GAAP)

See UK GAAP.

Grants and subsidies

Payments to entities external to the department to provide goods or services consistent with the department's Aim and Objectives (included in Schedule 5 of the resource accounts) that are not required to be repaid. Grants and subsidies usually form part of programme costs in Schedule 2 – Operating Cost Statement.

Impairments of asset value

A reduction in the recoverable amount of a tangible fixed asset below its value recorded in the accounts.

Income

Monies received or accrued by the department from providing goods or services. Income can be either related to administration or programmes and is included in Schedule 2 - Operating Cost Statement.

Intangible assets

Fixed assets which do not have physical substance but are identifiable, are controlled by the entity and have estimated useful lives of more than one year. Examples include patents and copyright. Information on a department's intangible assets will be included in a note to the resource accounts.

Investments

Financial and non-financial assets (fixed or non-current) that are expected to provide a rate of return to government and/or to further the department's objectives. Individual departments may hold investments in public corporations.

In-year monitoring and control

This is the monitoring and control of departmental expenditure by the Treasury during the year against the budget agreed in the spending review and authorized by Parliament in the Estimates.

Liabilities

Liabilities are obligations to transfer future economic benefits as a result of past transactions or events. Current liabilities are liabilities incurred in the normal course of business and which fall due within one year, including creditors, accrued expenditure and receipts in advance.

Maintenance

Ongoing recurrent costs of maintaining assets.

Net book value

Comprises a class of assets at cost or valuation less depreciation on that class.

Net operating cost

Comprises the sum of the net administration costs and the net programme costs included in Schedule 2 – Operating Cost Statement.

Net programme costs

Gross programme costs less programme income included in Schedule 2 – Operating Cost Statement.

Net resource outturn

Comprises the net voted resources (including operating costs net of income and excluding expenditure on capital).

Non-cash items

See Accrual to cash adjustments.

Objectives

A department's objectives are statements of policy which describe how the department will achieve its Aim. Departments list their objectives in Schedule 5 of their resource accounts and allocate the current year's net operating costs across the objectives. The Public Service Agreement (PSA) targets describe, in measurable terms, how the department will achieve its objectives.

Office of HM Paymaster General (OPG)

OPG is part of the National Investment and Loans Office. Its function is to provide Treasury with financial information to support its analysis of control of government expenditure principally as an aid to monitoring. OPG also undertakes the management of contracts with a privatised supplier of pay services – the Paymaster Agency – and the Bank of England to ensure delivery of services to OPG banking customers. The main customers are government departments and National Health Service bodies.

Operating Cost Statement

A statement showing resources consumed during the year by the department in providing its services. It includes both administration and programme expenditure.

Operating leases

Leases other than finance leases. Finance leases transfer substantially all the risks and rewards of ownership from the lesser to the lessee. Lease payments are included in administration costs in Schedule 2 – Operating Cost Statement.

Opportunity cost

The cost of a resource in terms of its best alternative use. This concept is behind government's decision to impose a cost of capital charge on departments.

Other expenditure

Is a subset of other administration costs and comprises all other administration costs included in Schedule 2 – Operating Cost Statement, other than those specifically listed by the department in the notes to the resource accounts.

Outturn

The outturn is the actual results reported by a department in its resource accounts.

Programme costs

All other costs other than administration costs. Generally includes the cost of providing services directly to the public. Programme costs are included in Schedule 2 – Operating Cost Statement and are also further detailed in a note to the resource accounts.

Propriety

Is the requirement that expenditure and receipts should be dealt with in accordance with Parliament's intentions and the principles of parliamentary control, including the conventions agreed with Parliament (and in particular with the Public Accounts Committee (PAC)) (see the HMT Regularity and Propriety Handbook).

Provision

A liability of uncertain timing or amount shown in the resource accounts. Examples of provisions are: bad debts provision, provision for early retirement and pension commitments. Provisions are netted from the value of assets in Schedule 3 – Balance Sheet and are itemised in the notes to the resource accounts.

Public Service Agreements (PSA)

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

Receipt

Represents the actual cash received in return for providing a good or service or from the sale of capital assets. Contrast this with income, which represents the income earned (not necessarily received) from sales of goods and services.

Regularity

Is the requirement for all items of expenditure and all receipts to be dealt with in accordance with the legislation authorising them, any applicable delegated authority and the rules of Government Accounting (see the HMT Regularity and Propriety Handbook).

Request for Resources (RfR)

An accruals-based measure of current expenditure which forms part of a Resource Estimate. It represents the basic unit of Parliamentary control. Each RfR is listed in Schedule 1 – Summary of Resource Outturn, Schedule 2 – Operating Cost Statement and in the note to the accounts which analyses the net resource outturn by function within each RfR.

Reserves

This is a generic description of the accounts included within Taxpayers' Equity in Schedule 3 – Balance Sheet. Reserves include: General Fund, Asset Revaluation Reserve and Donated Assets Reserve.

Resource accounting

A set of accruals accounting techniques for reporting on expenditure by departments and the relationships between expenditure and departmental objectives.

Resource Accounting Manual

The Resource Accounting Manual is the authoritative statement of resource accounting principles against which departmental resource accounts are prepared and audited. The manual is based on UK generally accepted accounting practice (GAAP) adapted where appropriate to take account of the public sector context. The manual is endorsed by the Financial Reporting Advisory Board, an independent board set up to advise the Treasury on the application of financial principles and standards contained in the manual. The Board continues to keep the manual under review.

Resource accounts

Resource accounts are prepared annually and present the financial results of the department for the relevant year. They are prepared on the basis of generally accepted accounting practice and in accordance with the Resource Accounting Manual.

Resource based estimate

A statement presented to the House of Commons in which a department asks for the approval of its estimated expenditure for the coming financial year. The Estimate summarises the resources required and the associated net cash requirement.

Resource budgeting

Resource budgeting involves using resource accounting information and principles as the basis for planning and controlling public expenditure by departments.

Revaluation reserve

An account within Taxpayers' Equity in Schedule 3 – Balance Sheet that shows the accumulated and unrealised amount of revaluations of fixed assets and stock.

Revaluations

The annual process of determining the value of an asset to ensure that assets included in Schedule 3 – Balance Sheet are recorded at the lower of replacement cost or recoverable amount.

Schedule 1 – Summary of Resource Outturn

The Parliamentary control schedule in the resource accounts comparing Outturn with Estimate for both resource expenditure and the overall cash requirement of the department. This schedule is only required to be prepared for departments, and is not required for agencies that are not departments. Schedule 1 includes a Reconciliation of resources to net cash requirement, explanations for variances and an analysis of income payable to the Consolidated Fund.

Schedule 2 – Operating Cost Statement

A financial statement in the resource accounts which shows resources consumed during the year by the department in providing its services. It includes both administration and programme expenditure and related income. A Statement of Recognised Gains and Losses is also included as part of Schedule 2.

Schedule 3 – Balance Sheet

A financial statement in the resource accounts which shows the assets, liabilities and Taxpayers' Equity of a department or agency at the end of the accounting period.

Schedule 4 – Cash Flow Statement

A statement of cash inflows and outflows during a year. It includes a reconciliation of operating costs in Schedule 2 – Operating Cost Statement, to operating cash flows, an analysis of capital expenditure and financial investment, and an analysis of financing.

Schedule 5 – Resources by departmental aim and objectives

Allocation of the net operating cost from Schedule 2 to the objectives of the department. Agencies that are not departments are not required to prepare Schedule 5 on the basis that they do not have objectives separate from those of the department.

Service Delivery Agreement (SDA)

For the major departments, the SDA underpins the Public Service Agreement (PSA) and provides the detail on how targets will be delivered, as well as how government will modernise and reform itself to help deliver the targets. For smaller departments that do not have a PSA, the SDA sets out the outcomes they will deliver and how they will deliver them.

Spending Review

The public expenditure framework involves setting firm three-year plans. The most recent Spending Review, SR2002, set out departmental budgets for the years 2003-2004 to 2005-2006.

Staff costs

Includes wages and salaries, social security and other pension costs. Information on each of these categories is included in the Staff numbers and costs note to the resource accounts.

Statement of Recognised Gains and Losses

Sets out the changes in the Revaluation Reserve and any prior year adjustments to opening balances in the Schedule 3 – Balance Sheet. It is included in Schedule 2 – Operating Cost Statement.

Stock

Includes consumable stores, goods or other assets purchased for use or resale by the department in the provision of its services. Stocks are included in Schedule 3 – Balance Sheet and where stock balances are material, further detail will be included in the notes to the resource accounts.

Supply estimate

See resource-based estimate.

Tangible fixed assets

Assets, which have a physical identity such as buildings, furniture, plant and equipment, which are used by the department to provide the infrastructure for the provision of its goods and services. A note to the resource accounts provides information on the tangible fixed assets held by the department.

Taxpayers equity

The difference between total assets and total liabilities in the balance sheet. Comprises General Fund, Revaluation Reserve and Donated Assets Reserve.

Trade creditors

Creditors which arise in the normal course of activities of a department. See Creditor.

UK Generally Accepted Accounting Practice (GAAP)

The accounting and disclosure requirements of the Companies Act (1985) and pronouncements by the Accounting Standards Board (principally accounting standards and Urgent Issues Task Force abstracts), supplemented by accumulated professional judgement.

Working capital

Working capital is the difference between the balances of current assets and current liabilities included in the balance sheet. The cost of capital charge that departments are required to pay provides an incentive to departments to improve the management of these assets and liabilities.

ANNEX 5 ABBREVIATIONS

The following list contains the main abbreviations used within this document and its ANNEXES, and referred to generally in respect of resource accounting and budgeting or government finance

AME	Annually Managed Expenditure
ASLC	Accruing superannuation liability charge
C&AG	Comptroller and Auditor General
CFS	Cash Flow Statement
DBFO	Design, build, finance, operate
DEL	Departmental Expenditure Limit
DIS	Departmental Investment Strategy
DUP	Departmental Unallocated Provision
EYF	End year flexibility
FAR	Fixed asset register
FRAB	Finance Reporting Advisory Board
FRS	Finance Reporting Standards (issued by the Accounting Standards Board)
GAAP	Generally Accepted Accounting Practice
GIAS	Government Internal Audit Standards
MHCA	Modified Historic Cost Accounting
MOU	Memorandum of understanding
OCS	Operating Cost Statement
OPG	Office of the Paymaster General
PAC	Public Accounts Committee
PC	Public corporation
PFI	Public Finance Initiative
PPP	Public Private Partnership
PSAs	Public Service Agreements
PSX	Ministerial Committee on Public Services and Public Expenditure
RAB	Resource accounting and budgeting
RAM	Resource Accounting Manual
RfR	Request for Resources
SDAs	Service Delivery Agreements
SIC	Statement of Internal Control
SR	Spending Review
SRGL	Statement of Recognised Gains and Losses
VFM	Value for money