

IFAC

Public Sector

Committee

June 2002

RESOURCE ACCOUNTING:
Framework of Accounting Standard
Setting in the UK Central
Government Sector

Issued by the International

Federation of Accountants

This Occasional Paper was approved for publication by the Public Sector Committee of the International Federation of Accountants. It was published in June 2002.

Information about the International Federation of Accountants can be found at its website <http://www.ifac.org>.

Copies of this paper may be downloaded free of charge from the internet site.

International Federation of Accountants
535 Fifth Avenue, 26th Floor
New York, New York 10017-3610 USA
Fax: +1 212-286-9570
edcomments@ifac.org

Copyright© June 2002 by the International Federation of Accountants. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the International Federation of Accountants.

ISBN: 1-887464-87-5

Acknowledgement

The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) is indebted to David Loweth for preparing this occasional paper. The views expressed are those of the author and are not those necessarily of the PSC or IFAC.

David Loweth is Head of the Central Accountancy Team at Her Majesty's Treasury in the UK. He is a member of the Public Sector and Not-for-profit Committee of the UK Accounting Standards Board (ASB) and attends the ASB as an observer on behalf of Sir Andrew Likierman, Head of the Government Accountancy Service. He is also a member of the Council of the Chartered Institute of Public Finance and Accountancy (CIPFA) and a member of CIPFA's Accounting and Auditing Standards Panel.

The paper alludes to a number of publications in the series Managing Resources, published by the UK Treasury. A number of these publications can be accessed at www.hm-treasury.gov.uk.

Preface

An increasing number of jurisdictions are launching projects on the adoption of the accrual basis of accounting. Some jurisdictions have already migrated from the cash basis to the accrual basis, while others are substantially down the accrual road.

The advantages of the accrual basis are widely acknowledged. They include better policy planning, more informed approaches to asset management and a focus on fairness between different generations (inter-generational equity). A fuller discussion of the main aspects of accrual based accounting is provided in the PSC's Study 11 *Governmental Financial Reporting: Accounting Issues and Practices*, published in May 2000.

The challenges for those moving to the accrual basis can be daunting. It can therefore be helpful for jurisdictions to know something of the issues, both anticipated and unanticipated, which have arisen in jurisdictions adopting the accrual basis and how those issues have been dealt with.

This paper considers the experiences of the United Kingdom, which decided to move to an accrual basis for both budgeting and financial reporting in 1995. It highlights some of the key arguments influencing the decision to adopt an accrual system, not just for financial reporting, but also for budgeting. It also locates accrual based budgeting and reporting in a wider performance management context. It particularly considers how the UK undertook the task of creating the infrastructure for accrual accounting and budgeting in the form of a standard-setting framework and an authoritative manual of accounting policies, principles and treatments.

RESOURCE ACCOUNTING: FRAMEWORK OF ACCOUNTING STANDARD SETTING IN THE UK CENTRAL GOVERNMENT SECTOR

CONTENTS

	PAGE
INTRODUCTION.....	1
WHAT IS RAB?.....	1
HISTORY: THE ROAD TO RAB.....	2
RAB COVERAGE AND SCOPE.....	3
WHY RAB?.....	4
WHAT IS RESOURCE ACCOUNTING AND WHO DETERMINES THE STANDARDS?.....	6
INDEPENDENT OVERSIGHT OF THE TREASURY’S RESOURCE ACCOUNTING POLICIES: THE FINANCIAL REPORTING ADVISORY BOARD (FRAB).....	14
AUDIT OF RESOURCE ACCOUNTS.....	16
A PUBLIC SECTOR INTERNATIONAL AGENDA?.....	18
APPENDIX A: ACCOUNTING STANDARDS AND THEIR APPLICABILITY TO RESOURCE ACCOUNTING.....	19
APPENDIX B: ACCOUNTING STANDARDS AND THEIR APPLICABILITY TO RESOURCE ACCOUNTING.....	21
APPENDIX C: IPSASS: COMPARISON WITH THE RAM AS OF MARCH 2002.....	24
APPENDIX D: RESOURCE ACCOUNTS: EXPRESSIONS OF AUDIT OPINION.....	28
GLOSSARY.....	29
FURTHER INFORMATION: SOME BOOKLETS IN THE “MANAGING RESOURCES” SERIES.....	33
USEFUL WEBSITES.....	34

Introduction

1. The start of the UK Government's 2001–02 financial year, in April 2001, heralded a new era in public sector financial management reform, with the full implementation of Resource Accounting and Budgeting (RAB). The Treasury Press Notice announcing the change¹ noted that the implementation of RAB represents “*a major milestone in the biggest overhaul of financial management in Whitehall since Gladstone's reforms of the mid-1860s.*” The Chief Secretary to the Treasury, Andrew Smith, said at the time, “*This is a very significant day for Government. From now on, the Government will be using best practice in financial management... The implementation of resource accounting and budgeting puts Britain among the world leaders in public service reform.*”
2. The purpose of this paper is to give some history and background on RAB. Its primary focus is the framework for accounting standard-setting that the Government has adopted for the central government sector. In line with the definition determined by the UK Office for National Statistics (ONS) this framework covers:
 - Government departments and their executive agencies. Executive agencies have been established to undertake the executive functions of Government, as distinct from policy advice, although formally they remain part of a Government department. The concept of setting up such agencies followed a 1988 report by the Efficiency Unit to the Prime Minister *Improving Management in Government: the Next Steps*;
 - The devolved administrations in Scotland, Wales and Northern Ireland; and
 - Executive Non-Departmental Public Bodies (NDPBs). These are bodies that have a role in the process of Government, but which are established at arm's length from departments, either through specific legislation or Royal Charter, and may carry out executive, regulatory, administrative or commercial functions.

What Is RAB?

3. RAB is an accrual based approach to Government accounting and budgeting, which also reflects Parliamentary control and a move to focus on outputs, rather than inputs. The term “resource accounting” was devised to highlight that the change proposed by the UK Government goes wider than simply the adoption of accrual accounting techniques. Other key aspects are the link between inputs and departmental aims, objectives and outputs. Further details on what is resource accounting are set out below.

Resource budgeting involves the use of resource accounting information as the basis for planning and controlling public expenditure. Not all countries that have adopted accrual accounting share views on the merits of accrual budgeting for government, but the UK is one of those which believes that it is better for budgeting and accounting to be determined on the same accrual basis. The case for resource budgeting, and its role as an element in the Government's drive to provide world class public services, is set out in the November 2001

¹ Treasury Press Notice 40/01, 1 April 2001

Treasury document *Better Management of Public Services: Resource Budgeting and the 2002 Spending Review*.

4. RAB translates the Government's policy priorities into departmental strategies and budgets, and then reports to Parliament on the efficiency and effectiveness of the services provided. The overall aim is to enhance government service delivery. Further details are given in the guide *Full Implementation of Resource Accounting and Budgeting*, published in April 2001 as the first in a series of *Managing Resources* guides which is available on the Treasury website at www.hm-treasury.gov.uk.

History: the Road to RAB

5. Until recently, central government planned and reported its financial performance on a cash basis, with budgets set in an annual Public Expenditure Survey (PES), and Estimates and Appropriation Accounts presented to Parliament. This remained the case even as accrual accounting was implemented across the rest of the public sector: in the nationalized industries and public corporations, local government and the National Health Service (NHS). The regime for government departments remained on a cash basis, even when accrual accounting was advocated and developed for other parts of the central government sector (executive agencies and NDPBs). A description of the previous cash system of accounting for the Parliamentary grant and the requirements for the preparation of annual Appropriation Accounts are set out in Chapter 12 of the Treasury document *Government Accounting*, which can be accessed at www.government-accounting.gov.uk.
6. RAB started life with an announcement by the Chancellor of the Exchequer in his November 1993 Budget Statement of the Government's intention to introduce resource accounting across central government. While this was the first mention of RAB, the initiative was based on financial management principles which were initially set out in the Financial Management Initiative (FMI) of 1982. A Green Paper *Better Accounting for the Taxpayer's Money: Resource Accounting and Budgeting in Government* followed in 1994. A White Paper with the same title was produced in 1995 and gave a Government commitment to move to RAB. As such, the White Paper set out the Government's plans to complete the final stage in applying accrual based principles to the public sector.
7. The White Paper envisaged the following timetable for RAB:
 - The first year for which resource accounts are published and laid before Parliament would be 1999–2000;
 - The first Survey (now called a Spending Review, and conducted every 2 years) on a resource basis would be carried out in 2000; and
 - Subject to the approval of Parliament, the first fully resource-based Supply Estimates would be presented for 2001–02.
8. The timetable has been met in full, though not without its challenges along the way. Departments have inevitably faced technical accounting challenges, for example, the

Ministry of Defense has had the task of identifying and valuing fixed assets to a value in excess of £87 billion (as of 31 March 2001). But the development and implementation of a reform as fundamental as RAB has inevitably required a major cultural change across the whole of central government. While the Treasury led the project, the achievement of delivery has rested with departments. An assessment of how the project has been managed is set out in the December 2001 Treasury booklet *How the Resource Accounting and Budgeting Project was Managed*.

9. Perhaps the most significant, and concentrated, part of the timetable came in an 11-day period during July 2000, when a number of events put in place the major building-blocks to introduce RAB:
 - On 18 July, the 2000 Spending Review was published, setting out the Government's plans for public spending for 2001–04 in resource terms;
 - On 19–20 July, the two relevant Parliamentary Select Committees (the Public Accounts Committee and the Liaison Committee) gave Parliamentary authority for the Treasury to introduce resource-based Supply from the financial year 2001–02 and, at the same time, replace Appropriation Accounts with resource accounts; and
 - On 28 July, the *Government Resources and Accounts Act (GRAA) 2000*, repealing some of the legislation which had been in place since 1866, gave statutory backing to the Parliamentary aspects of the move to RAB, as well as enabling clauses for the preparation of Whole of Government Accounts (WGA).

RAB Coverage and Scope

10. In terms of the scope of RAB, it covers:
 - All UK central government departments, over 40 in all. With restructurings and mergers, the numbers keep changing, but for 1999–2000, there were 42 departmental resource accounts. For 2000–01, there were 45 accounts. Executive agencies are included within each department's resource accounts; and
 - Seven of the main government pension schemes for public sector employees.
11. In addition, a number of “devolved bodies” in Scotland, Northern Ireland and Wales produce resource accounts. For Wales and Northern Ireland, this is required under legislation: Wales is covered by the GRAA; Northern Ireland has passed its own version of the GRAA. For Scotland, the production of resource accounts is the result of an agreement between the Treasury and the Scottish Executive, in consultation with the Scottish Parliament. A number of Parliamentary bodies, including the National Audit Office, also produce resource accounts on a voluntary basis.
12. RAB does not cover the main central funds of Government (in particular, the Consolidated Fund and the National Loans Fund), NDPBs, Trading Funds, National Health Service (NHS) Trusts, and other public corporations, and local government. These areas will be dealt with as part of the development of WGA, which will be commercial-style accounts covering the

whole of the public sector. The intention is that WGA will be published for 2005–06. Further details of the WGA program can be found at www.wga.gov.uk.

13. The numbers involved are huge. A simple aggregation (rather than consolidation) of the resource accounts for 1999–2000 reveals net operating costs of £297 billion (with a billion defined as a thousand million), fixed assets of £238 billion, net current assets of £8 billion, and creditors and provisions totaling some £28 billion.

Why RAB?

14. The 1994 Green Paper made clear that, at the heart of the changes, RAB will provide better information for better management decisions, so that government departments improve the use of their resources to fulfill their objectives. This was particularly the case with information on capital assets, where the limitations of cash accounting are most pronounced. The Paper commented that “[w]ith cash accounting, spending on what is used over many years is recorded only when the money is spent. No subsequent account is taken of whether the asset is still in use, has reached the end of its useful life, or has been sold.” In a 1995 report², the Comptroller and Auditor General (C&AG) agreed “Cash-based accounts also lack any framework for accounting for assets and liabilities: once an asset is acquired, it effectively disappears from the accounts.”

15. Another commentator was even more blunt. Writing in his column in *The Times*, Robert Bruce stated:

There are some things that appear so extraordinary that you honestly cannot believe they are true. One of these is that the majority of accounting systems of the Civil Service...of the mighty ministries which power everything from the economy to battleships are run on accounting principles that are marginally less sophisticated than those of your local cricket club.

16. In the 1995 report referred to above, the C&AG set out the benefits over cash accounting even more clearly, saying that accrual accounting would:

- **Provide a better picture of the true costs of a department’s activities**, by taking into account all relevant costs including the use of assets, the costs of capital and non-cash costs, and relating these more directly to any revenues generated by those activities. The report noted that, for many years, departments had produced unaudited and informal “memorandum trading accounts” to show the true cost of many activities where this was needed. Under resource accounting, this information would be much more readily available and derive directly from a department’s accounting systems; and
- **Improve stewardship and accounting for assets and liabilities**, as departments would have to draw up balance sheets for the first time.

² Report by the Comptroller and Auditor General *Resource Accounting and Budgeting in Government* (House of Commons Paper HC123 Session 1994-95, 25 January 1995).

17. The Parliamentary Committee of Public Accounts (PAC) appeared to accept that there would be benefits, noting in its report of May 1995³ that:

It (i.e., cash accounting) is not the most informative way of presenting financial information however. With cash accounting, there is no requirement to match expenditure with revenues for the period to which they relate, and capital spending is brought to account wholly in the year in which the capital purchase or disposal is made. Cash-based accounts also lack any framework for accounting for assets and liabilities: once an asset is acquired, it effectively disappears from the accounts.

18. In a memorandum to the PAC, the Chartered Institute of Public Finance and Accountancy (CIPFA) had sought to emphasize the benefits of the move to accrual accounting:

The shift away from the traditional cash based system of government accounting to one based on accruals will, in our view, bring significant benefits. But some commentators have expressed concern that the changes will diminish the importance of cash and encourage government departments to use those creative accounting devices highlighted in some recent well publicised company collapses. We believe those concerns are misplaced and wish to reassure the Committee on this point.

Certainly, accruals accounting does introduce a greater element of subjective judgement into the accounting process compared to the more “objective” nature of cash accounting. However, no form of accounting is entirely free from manipulation and cash accounting is no different, as evidenced by the traditional “year-end” surge whereby departments hurry to use up their budget by the end of March and, in the past, by the deferral of payment of outstanding bills.

19. Having said that, the PAC’s initial endorsement was cautious, in particular with regard to the resource budgeting proposals, as in the same report it said that:

At present, the Supply process is cash-based, and some may fear that a change to accruals or resources would open the door to looser control over cash and the greater use of accounting devices to circumvent Parliamentary authority or misrepresent financial performance. The Comptroller and Auditor General makes clear that the Treasury fully intend keeping a close eye on cash since proper cash management is a key business function for government, as it is for any business...the new arrangements should preserve the principle that there should be a limit to the resources or cash authorised by Parliament, and that departments must return to Parliament for further authority, wherever possible in advance. Departments should also recognise the greater incidence of judgements and approximations in resource budgets and accounts when compared with cash, and ensure that it is possible to match what Parliament has voted with what departments have accounted for.

20. The PAC’s support strengthened over the years, so much so that in giving its agreement to the implementation of RAB in July 2000, the Committee was keen to stress that:

Unless resource Estimates and resource accounts form the bedrock of financial management in departments, much of their benefit will be lost. Sound management accounts should be part and parcel of departmental systems.⁴

³ Committee of Public Accounts *Resource Accounting and Budgeting in Government* (15th Report, Session 1994-95, House of Commons Paper HC407, 1 May 1995).

⁴ Committee of Public Accounts *Progress on Resource Accounting and the Adoption of Resource-Based Supply* (29th Report, Session 1999-2000, House of Commons Paper HC556, 19 July 2000).

Linked to this aspect was the desire to provide a better picture of the true costs of departments' activities, the provision of improved data to inform decisions on the allocation of resources as part of a more strategic approach to public expenditure, and more and better-focused information resulting in enhanced accountability to Parliament.

What Is Resource Accounting and Who Determines the Standards?

21. Resource accounting is the application of accrual accounting to the accounts of central government departments and pension schemes. It focuses on resources consumed over an accounting period rather than just cash spent, and relates resources consumed to departmental objectives. Resource accounts also record assets and liabilities existing at the end of the reporting period. For example, resource accounting will record the cost of holding and consuming fixed assets through, respectively, a charge for depreciation and a charge for the cost of capital. Resources consumed are recorded goods and services when they are received, rather than when they are paid for. Income is recorded when it is earned, rather than when the cash is received.
22. When accrual accounting is adopted it is essential that the accounting principles, policies and treatments underpinning the initiative are clearly set out for accounts-preparers. In the UK, resource accounting policies are set out by the Treasury in the *Resource Accounting Manual* (RAM), which departments are required to follow when preparing their resource accounts. The first working version of the RAM was produced in July 1997 and was prepared after examining all the extant accounting standards for their relevance and applicability to resource accounting, taking into account:
 - the not-for-profit environment; and
 - the requirements of budgeting and Parliamentary control.
23. New versions of the RAM are prepared for each financial year, and take into consideration new accounting standards issued by the ASB. The Treasury also prepares separate, but broadly consistent, accounting guidance for NDPBs.

The Starting Point

24. In the 1994 Green Paper, the Government said it was starting from the presumption that the accounting principles and conventions to be adopted for resource accounting should follow UK Generally Accepted Accounting Practice (UK GAAP) and in particular the accounting and disclosure requirements of the Companies Act 1985 and accounting standards (described in more detail below). It was argued that such an approach should give broad consistency between central government and other parts of the public sector, and more widely with the private sector. However, it was also recognized that UK GAAP would need to be supplemented in some respects to derive a framework of accounting principles appropriate to the requirements of central government.
25. This view was confirmed in the Government's 1995 White Paper on resource accounting and budgeting, which made clear that resource accounts would be based on UK GAAP adapted

where appropriate to take account of the public sector context. The accounting concepts and policies which would apply under RAB were set out in more detail in a Treasury document which was released at the same time as the White Paper⁵ and it was noted in the White Paper that this summary, plus a more detailed code of practice, would form the Resource Accounting Reference Manual, now referred to as the RAM.

26. This commitment to use UK GAAP — as adapted — as the basis for resource accounting was reinforced in a number of significant ways:
- First, the publication in 1998 of *The Code for Fiscal Stability*, which sets out the principles guiding the formulation and implementation of fiscal policy and by strengthening the reporting requirements incumbent on the Government. The Code contains a specific commitment for the Government to apply “*best practice accounting methods*,” as represented by UK GAAP, to the extent reasonably practicable; and
 - Second, the GRAA contains a specific legislative requirement for resource accounts to present a true and fair view, to conform to GAAP “*subject to such adaptations as are necessary in the context of departmental accounts*,” and to have regard to any guidance issued by the ASB (or any other body prescribed for the purposes of setting accounting standards).

But Why Have a Framework at All?

27. The reasons for having a framework at all were set out in the C&AG’s 1995 report. This report referred back to a 1989 PAC report⁶, in which the Committee laid out what it considered should be the main objectives of government financial reporting:
- Providing Parliament, and Select Committees in particular, with information which is reliable and sufficient as the basis for examination of departments’ performance in carrying out policies, functions, programs and projects;
 - Providing Parliament with information which is reliable and sufficient as the basis for its consideration and approval of the levels of finance voted to services in the Appropriation Act (and the balance of allocation between services);
 - Ensuring departments’ accountability by demonstrating their stewardship of the money voted by Parliament; and
 - Providing Parliament systematically with information on performance which is reliable as an assurance of the economy, efficiency and effectiveness with which departments are operating services and as the basis for selective enquiries.

28. In order to meet these objectives, the C&AG’s view is that:

Financial statements need to be produced within a set of principles and rules which ensure that information is presented in a consistent manner which is understandable and meets the needs of the users of the statements. For example, in the private sector, companies are required to prepare

⁵ *Resource Accounting and Budgeting in Government: A Summary of Accounting Policies — Working Draft* (HMT, July 1995)

⁶ Committee of Public Accounts *Financial Reporting to Parliament* (18th Report, Session 1998-89, House of Commons Paper HC354)

accounts in accordance with accounting standards which aim to ensure that the accounts provide a true and fair view of their financial performance and standing. Without such a framework, financial statements are open to manipulation and can mislead rather than inform their users. Such a framework is more important for accruals accounts, which require the preparer to make more judgements and estimates than is the case for cash accounts. Standards are necessary to govern these judgements and to provide an agreed benchmark against which the auditor can examine them; and so that the reader of the accounts can know the basis on which they have been prepared.

Setting Accounting Standards in the Private Sector

29. Since August 1990, the Accounting Standards Board (ASB) — an independent body — has had responsibility for the setting of accounting standards in the private sector. Its work is overseen by the Financial Reporting Council (FRC), which makes appointments to the Board and ensures that its activities are adequately funded. Financial support is provided by the accounting profession, the Government and the City of London (through the London Stock Exchange). Before then, standard setting had been carried out by a CCAB (Consultative Committee of Accountancy Bodies) body, the Accounting Standards Committee (ASC).
30. These arrangements were put in place following a review by the Dearing Committee, established by the CCAB, which published its report *The Making of Accounting Standards* in 1988. As well as recommending the setting up of the ASB, the Dearing Committee report addressed the specific question of how accounting standards might be applied to the public sector, stating:

That there should be an underlying unity of approach to accounting standards across the public and private sectors, with accounting standards normally applicable in the public sector so that unnecessary differences in accounting and financial reporting between the two sectors are reduced; and so that standards apply even-handedly to both sectors, except where clearly inappropriate.⁷

So Why Have Different Standard-Setting for Central Government?

31. The ASB is clear as to where the responsibility rests for applying this underlying unity of approach. In its *Foreword to Accounting Standards*, the ASB states:

The prescription of accounting requirements for the public sector in the United Kingdom is a matter for the Government. Where public sector bodies prepare annual reports and accounts on commercial lines, the Government's requirements may or may not refer specifically either to accounting standards or to the need for the financial statements concerned to give a true and fair view. However, it can be expected that the Government's requirements in such cases will normally accord with the principles underlying the Board's pronouncements, except where in the particular circumstances of the public sector bodies concerned the Government considers these principles to be inappropriate or considers others to be more appropriate.⁸

32. As noted above, in looking at the ASB's accounting standards, the Government has had to take account of the following:

the accounting policies to be used will form the basis of how central government spending will be planned and controlled. This highlights an important distinction between RAB and what happens in

⁷ Report of the Review Committee under the Chairmanship of Sir Ronald Dearing. *The Making of Accounting Standards* (Sep 1988)

⁸ ASB: *Foreword to Accounting Standards* (June 1993).

the private sector; where the main focus of applying UK GAAP is to the reporting of outturn. Accounting policies under RAB have to be robust enough to support the control process in determining the resource budgets and cash requirements of departments; and

some aspects of UK GAAP are based on commercial considerations, which by and large do not exist in the public sector. This follows the situation in other parts of the public and not-for-profit sector, where GAAP is supplemented by specific requirements for that sector.

33. Therefore, in order to take account of these important considerations, the Government view is that in some areas there is a need to (i) deviate from UK GAAP, (ii) add a further prescription, or (iii) apply a public sector interpretation. One particular departure to note is the proposal that the resource accounting “boundary” for each departmental group should be based not on the criterion of “control” as set out by the ASB⁹, but according to how central government expenditure is planned and controlled. This has been a continual issue of debate, as the PAC noted in its December 1996 report¹⁰.

We note that the purpose of the departmental boundary, according to the Treasury, is very different from the purpose of what would be consolidated under GAAP. In other words, it is principally designed to meet the Government’s additional objectives to help Government in the planning, monitoring and management of public expenditure. If the purpose of the departmental boundary were the same as the purpose of what would be consolidated under GAAP, namely the provision of comprehensive and meaningful financial information to parliament, there is no doubt that the boundaries of the resource accounts would be set wider. This appears, therefore, to be an example of inconsistency between objectives...should there be any conflict between objectives, those designed to provide Parliament with information would need to take precedence. And...the aim should be to ensure that GAAP is applied fully to resource accounting.

...we do not wish the implementation of resource accounting to be delayed and so we shall not, at this stage, press the view that the boundaries of resource accounts should be set wider. However, we look to the Treasury to explain more fully how, in practice, they will determine those Non-Departmental Public Bodies which are to be inside, and those which are to be outside, the consolidation boundary.

34. As a result of taking into account such considerations, the RAM contains some adaptations to UK GAAP, notably:
- Government departments are required to prepare departmental resource accounts covering all entities within the resource accounting boundary. As noted above, the boundary is based on in-year budgetary control requirements, and fulfils a different purpose from consolidated accounts in the private sector which are based on different control criteria set out in GAAP. The resource accounting boundary consists of: the department, including its on-vote executive agencies, and non-executive non-departmental bodies (NDPBs) accounted for on-vote, executive NDPBs where there are good control reasons for inclusion in departmental resource accounts — for example where a department has the power to amend an executive NDPB’s previously agreed budgets for all or any part of its expenditure and to require any further expenditure to comply with the amended budgets, and NHS purchasers. The boundary is being re-examined during 2001–02, as outlined in paragraphs 44–47 below.

⁹ Accounting Standards Board, Financial Reporting Standard (FRS)2 *Accounting for Subsidiary Undertakings* (July 1992).

¹⁰ Committee of Public Accounts *Resource Accounting and Proposals for a Resource Based System of Supply* (9th Report, Session 1996-96, House of Commons paper HC167; 16 December 1996)

- There are six primary financial statements, of which two are additional to commercial accounts, and the others contain adaptations of those found in commercial accounts to take account of the resource accounting context. The two additional statements are:
 - The “summary of resource outturn,” which provides for control by Parliament by showing outturn against Estimate; and
 - The “statement of resources by departmental aim and objectives,” which links resource inputs to departmental objectives.

The other financial statements are: the “operating cost statement” (an adaptation of the profit and loss account); the “statement of recognised gains and losses” (an adaptation of the statement of total recognized gains and losses, STRGL); the “balance sheet” and “cash flow statement” (both of which contain adaptations to the equivalents in commercial accounts). Appendix A compares in more detail the financial statements under resource accounting and the private sector.

- The concept of “value in use,” used in determining the valuation of fixed assets in the balance sheet, has had to be adapted to take account of the non-profit making circumstances of the vast majority of central Government activities. This is because, in commercial accounts, “value in use” takes account of future cash flows obtainable from continued use of those assets. In the RAM, value in use is assumed to be at least equal to the cost of replacing the service potential provided by the asset, unless there has been a reduction in that service potential.

35. Appendix B covers more comprehensively the application of the ASB’s accounting standards to resource accounting.

But Who Should Set the Standards?

36. The Green Paper noted that the Treasury would publish accounting guidance as a supplement to GAAP where necessary. However, this proposal came in for a lot of criticism from commentators responding to the Green Paper. The C&AG, in his 1995 report, noted that:

It would be inappropriate for those responsible for preparing financial statements to have the sole responsibility for deciding on the standards such statements should follow.

Clearly the Treasury should have a major role in the development of accounting requirements specific to central government. However, Parliament and other users of the accounts, auditors and professional bodies should also play a part in the setting of these requirements. And, since such accounts may become the means of demonstrating that departments have complied with the Appropriation Act, it is particularly important that Parliament should have a say. In Canada, the United States and Australia, the arrangements provide for an independent body to oversee and approve central government accounting standards.

37. The then Treasury and Civil Service Select Committee (TCSC) picked up on this theme. In its March 1995 report¹¹, it stated that:

¹¹ Treasury and Civil Service Select Committee *Simplified Estimates and Resource Accounting* (4th Report, Session 1994-95, House of Commons Paper HC212, 27 March 1995).

The Committee strongly supports the view that accounting regulation should be seen to be independent in order to ensure that resource accounting commands public confidence. We therefore recommend that the oversight and approval of accounting standards for central government should be conducted independently of HM Treasury, and recommend that the Treasury and the National Audit Office should come forward with proposals as to how this might be achieved.

38. The PAC also picked up on this theme in its report of May 1995, concluding that:

At the end of the day, it will be for the Treasury to approach Parliament and seek the Committee's agreement to accounting standards. We would prefer if this were done after explicit and systematic consultation with other interested parties, most likely through an independent body whose members included the Treasury, representatives of departments, the National Audit Office and the accountancy profession...We therefore consider that there should be an independent body to oversee and approve these accounting standards for central government, and we expect the Treasury to come forward with proposals as to how this might be done.

39. The issue of who should set the standards was also raised during the passage through Parliament of the Bill that became the GRAA. In order to allay concerns that the Treasury could simply set its own standards, the specific requirements of the GRAA referred to in paragraph 24 above were inserted.

Specific Accounting Concepts and Policies

40. The 1994 Green Paper made clear that the five accounting concepts that underpinned UK GAAP at the time would also all apply to resource accounting. These were:

- **Going concern** — accounts should be prepared on the basis that the entity will continue to operate for the foreseeable future. The Treasury's 1995 *Summary of Accounting Policies* made clear that resource accounts would assume this;
- **Matching/accruals** — income and expenditure should be matched to the services provided or consumed in the same accounting period;
- **Consistency** — accounting policies should be applied consistently both within, and between, each accounting period. Policies should only be changed on the grounds that the new policy gives a fairer presentation of the transactions and of the financial position. The Treasury's *Summary* made clear that any significant changes which would impact on expenditure control should only be made after prior discussion with the Treasury;
- **Prudence** — proper allowance should be made for all known and foreseeable losses and liabilities; income should only be included where there is a reasonable certainty of it arising; and
- **Materiality** — compliance with UK GAAP would only be necessary where the amounts involved were material to a true and fair presentation of the financial results of an entity.

41. Of these five concepts, the first four were set out in the then ASC's Statement of Standard Accounting Practice (SSAP) 2 *Disclosure of Accounting Policies*,¹² which has now been superseded by Financial Reporting Standard (FRS) 18 *Accounting Policies*, while the fifth is

¹² Accounting Standards Committee, November 1971.

held to be consistent with UK GAAP. Under FRS18, going concern and accruals are still held to play a pervasive role in financial statements, but consistency and prudence are now felt to be desirable qualities of financial information, rather than underpinning concepts (consistency as an aspect of comparability; prudence as an aspect of reliability — see below). Instead, FRS18 and the 2001–02 version of the RAM highlight a number of objectives against which the appropriateness of an entity’s accounting policies have to be judged, namely:

- **Relevance** — resource accounts are to provide information about financial performance and financial position that is useful for assessing the stewardship of management and for making economic decisions. Financial information is relevant if it has the ability to influence those decisions;
- **Reliability** — financial information is reliable if it reflects the substance of transactions and other events that have taken place, is free from bias and from material error, is complete and, under conditions of uncertainty, has been prudently prepared;
- **Comparability** — information in an entity’s financial statements gains greatly in usefulness if it can be compared with similar information about the body for some other period or point in time, and with similar information about other bodies. Such comparability is usually achieved through a combination of consistency and disclosure; and
- **Understandability** — information provided by resource accounts needs to be capable of being understood by users having a reasonable knowledge of the business of the public sector and economic activities and accounting and a willingness to study with reasonable diligence the information provided.

42. The Treasury’s *Summary* also proposed a number of further accounting concepts which would underpin resource accounting, all but the first specific to the Government:

- **Substance over form** — resource accounts should be prepared so as to reflect the economic substance and financial reality of the transactions and activities underlying them, rather than only their formal legal character. This accords with the ASB’s FRS5 *Reporting the Substance of Transactions*¹³, which was introduced to deal with the problem of “off-balance sheet” finance in the commercial sector, which became prevalent during the 1980s. This is covered in a separate chapter in the RAM;
- **Basis for public expenditure control** — this concept derives from the fact that resource accounting is also intended to underpin the Government’s planning, monitoring and management of public expenditure;
- **Modified Historic Cost Accounting (MHCA)** — the *Summary* noted that accrual accounting in the public sector has for a number of decades attempted to reflect the effect of changing prices, and proposed that the present policy of MHCA should be maintained and used for resource accounting. Valuing assets at current value is felt to be more relevant than historical cost, in that it allows bodies to ascertain a more realistic measure of costs, provide a measure of the opportunity cost of holding the assets, and provide a better basis for comparability. Under MHCA, fixed assets are valued at the lower of

¹³ Accounting Standards Board, April 1994.

replacement cost and recoverable amount, with recoverable amount being defined as the higher of net realizable value and value in use. This is referred to as the “value to the business,” or deprival value model, which seeks to assess what loss a department would suffer if it was deprived of the asset. Under MHCA, asset values are reviewed annually and — where an asset’s value has changed materially — the valuation is adjusted in the financial statements. The review comprises either revaluation through professional valuation or indexation; and

- **Notional cost item** — in order to show the full cost of service provision, certain notional cost items should be included in resource accounts (such as the audit fee), even though there may be no associated cash transaction.

The Control Boundary

43. As noted above, the departmental resource accounting boundary is being reviewed, in the light of two key developments:

- The use of a different boundary for resource budgeting; and
- The development of WGA, and the proposal to prepare Central Government Accounts (CGA) as an interim step towards preparing WGA for the whole public sector.

44. On resource budgeting, for the 2002 Spending Review (SR2002, covering the period 2003–04 to 2005–06), executive NDPBs (as designated for CGA purposes) will be fully consolidated with their sponsoring department for budgeting purposes, because of the extent to which they contribute to the achievement of departmental objectives. However, public corporations (including Trading Funds) will not be consolidated. Instead an equity accounting treatment will be adopted, with departments including the equity stake in each public corporation on their balance sheets, and scoring interest and dividends flows in their resource DEL. In formulating the SR2002 budgeting guidance, the Treasury has sought to align budgeting and accounting policies. It would therefore make sense to “extend” the resource accounting boundary to align with the SR2002 resource budgeting boundary.

45. For WGA, Section 9 of the Government Resources and Accounts Act 2000 requires that the WGA boundary must be set on the basis of UK GAAP, subject to any adaptations necessary in the context. The Treasury has therefore adapted the consolidation tests in FRS2 for the public sector context in order to determine which bodies should be included in WGA. In particular, where any one of the tests is met the undertaking will be a subsidiary for WGA purposes:

- For corporate entities, the tests as set out in FRS2 are satisfied:
- The Crown is a quasi-member¹⁴ of the undertaking and the Crown, the Monarch or Ministers (on behalf of the Government) have a right to appoint or remove directors¹⁵

¹⁴ A quasi-member is defined as follows:

- Parliament or the Crown has established the undertaking under Act of Parliament or Royal Charter; or

holding a majority of the voting rights at meetings of the board¹⁶ on all, or substantially all matters:

- The Crown has the right to exercise dominant influence over the undertaking:
- By virtue of provisions contained in the undertaking’s memorandum or articles¹⁷, an Act of Parliament or through the activities of the body being substantially restricted by specific legislation.
- By virtue of a control contract:
- The Crown is a quasi-member of the undertaking and Ministers control a majority of the voting rights in the undertaking:
- The Crown has a participating interest¹⁸ in the undertaking and:
 - it actually exercised dominant influence¹⁹ over the undertaking; or
 - it and the undertaking are managed on a unified basis.

46. The Financial Reporting Advisory Board (FRAB) approved these tests during 2000 and ONS now also uses them as the basis for its decisions on whether bodies should be classified to the public sector or not. Under the tests, WGA will include departments, NDPBs, public corporations and local government. The inclusion of local government differs from the approach of some other jurisdictions which have adopted whole of government accounts, such as New Zealand and Australia. This reflects the different structure of what is defined as “whole of government” in the UK. It should be noted that the boundary of CGA will not be GAAP-based, but instead adopts the same definition as applied by ONS (i.e., bodies classified to the public sector under the FRS2 tests, which are more than 50 per cent grant funded). The FRAB has agreed the proposed CGA boundary as a pragmatic approach, subject to the current review and a firm commitment to move from CGA to full WGA.

Independent Oversight of the Treasury’s Resource Accounting Policies: the Financial Reporting Advisory Board (FRAB)

47. Given the weight of opinion that there should be an independent oversight of resource accounting standards, as noted in paragraphs 37–39 above, the Government — in its 1995 White Paper — proposed the setting up of a Financial Reporting Advisory Board (FRAB) in order to advise the Treasury on the application of accounting principles and standards to the financial reporting requirements of resource accounting. This proposal was examined by the

• Parliament, via HM Treasury, has a right as a result of legislation to receive dividends or quasi-dividends; or

¹⁵ Parliament would be responsible for any overall liability (deficit on accumulated reserves) arising from the operations of the undertaking. Directors refer to the members of the governing body of the undertaking.

¹⁶ The Board refers to the governing body of the undertaking.

¹⁷ The term “memorandum and articles” encompasses equivalent governing instruments in an undertaking.

¹⁸ A participating interest is an interest:

• Conferring any right to share in the profits or the liability to contribute to the losses of the undertaking, or

• Giving rise to an obligation to contribute to the debts or expenses of the undertaking in the event of a winding up.

¹⁹ “dominant influence” refers to influence that can be exercised to achieve the operating and financial policies desired by the holder of the influence, notwithstanding the rights or influence of any other party.

Treasury Committee (TC) in March 1996²⁰. In a memorandum to the Committee, the Treasury noted that the FRAB had been set up to introduce an independent element into the process of setting financial reporting standards for Government and would help to ensure that, as far as possible, resource accounting would be governed by UK GAAP and that any departures from, or modification to, UK GAAP would be fully explained. The FRAB, which originally had nine members (drawn from Government departments and agencies, public sector audit bodies, the accountancy profession and academia) was given terms of reference to:

- Advise HM Treasury on the application to central government bodies of financial reporting principles and standards;
- Examine the Resource Accounting Reference Manual; and
- Keep the Manual under review and consider any proposals for material change.

48. In return, the Treasury undertook to:

- Ensure that all relevant matters are drawn to the attention of the Board;
- Consider all advice received from the FRAB; and
- Forward to Parliament a report on the FRAB's activities, setting out the resource accounting policies to be adopted and subsequent material changes, together with the view of the Board.

49. The TC welcomed the establishment of the FRAB, but with the caveat that "*Only time will show whether the Board (the FRAB) has in practice introduced a sufficiently independent element into the process.*" In response to a specific recommendation by the TC, a Parliamentary observer also joined the FRAB until the general election in 1997. Since then, Parliament has not nominated a successor. In a further memorandum to the TC, the Treasury²¹ agreed that once the RAM was fully considered, it would review the FRAB's operations in terms of its composition, remit and reporting arrangements to Parliament. These developments were welcomed by the TC in its December 1996 report²² and the PAC, in its report of the same month.

50. The FRAB endorsed the first working version of the RAM, and has since then approved all subsequent amendments. As promised, the Treasury reviewed the operation of the FRAB after it had completed its work on the first working version of the RAM, and as part of the review considered how independent the Board had been in practice. The review concluded that the FRAB had operated independently in terms of its composition, the role of the Chairman, and the adequacy of its arrangements for reporting to Parliament. This conclusion took into account the FRAB's view that, although the Treasury involvement might give rise

²⁰ Treasury Committee *Resource Accounting and Budgeting in Government: The Financial Reporting Advisory Board* (5th Report, Session 1995-96, House of Commons Paper HC309, 27 March 1996)

²¹ Treasury Committee *Resource Accounting and Budgeting* (Minutes of Evidence, Session 1995-96, House of Commons Paper HC584-i, 8 July 1996).

²² Treasury Committee *Resource Accounting and Budgeting* (2nd Report, Session 1996-97, House of Commons Paper HC186, 18 December 1996).

to the FRAB's independence being challenged, overall the process had worked well and members did not consider that their independence had been compromised.

51. The FRAB prepares its own report of its activities. This is forwarded to the Treasury Committee and the PAC. It has reported in July 1997, and annually since 1999. The GRAA now places a statutory requirement on the Treasury to consult an advisory board, and to lay the report of that advisory board's activities before Parliament. The FRAB's 2000–01 report, published on 20 June 2001, is the first to be prepared under the legislation. This provision was put into the legislation following concerns which had been expressed that the standard-setting process lacked an independent element.
52. The FRAB continues to meet periodically (some 6–7 times a year) and will continue to discuss and advise on all future proposed amendments to the RAM, as well as amendments to the accounting guidance for NDPBs and Trading Funds. The FRAB is also being consulted on proposals for accounting policies relating to WGA, as that project develops. The remit of the FRAB has recently been further extended to cover Scotland, Northern Ireland and NHS Trusts. The membership of the Board has been extended to reflect this widened span of responsibilities, and now — as well as an independent chairperson — comprises representatives of (number of representatives are identified in brackets):
 - The ASB (1);
 - The C&AG (1);
 - The Audit Commission (1);
 - Government departments and executive agencies (2);
 - The National Statistician (1);
 - The Treasury (1);
 - NDPBS (1);
 - The Scottish Executive (1);
 - Audit Scotland (1);
 - The Department of Finance and Personnel, Northern Ireland (1);
 - The Department of Health (covering the NHS) (1); and
 - An independent economist (1).

Audit of Resource Accounts

53. All resource accounts are audited by the C&AG on behalf of the House of Commons. The C&AG is an official of the House of Commons and is entirely independent of the Government. The current C&AG is Sir John Bourn. The C&AG audits the accounts to a “true and fair” view standard (the same as is used for company accounts). This is more appropriate to the audit of accruals accounts than the “properly presents” standard used for appropriation accounts. In addition, the C&AG conducts the audit to provide assurance that resource accounts meet the expected standards of regularity (that is, that resources have been

used as Parliament intended and that the financial transactions of the department are in accordance with the relevant authorities). From the 2001–02 financial year, the C&AG’s audits of resource accounts are conducted in accordance with the provisions of the GRAA 2000.

54. The conduct of the audit is a matter for the C&AG to determine within his statutory powers and responsibilities. That said, the C&AG follows the standards set by the Auditing Practices Board (APB) and the guidance provided in the APB’s Practice Note 10 (revised) *Audit of Financial Statements of Public Sector Entities in the United Kingdom*. The C&AG’s audit opinion is in the form required by Statement of Auditing Standard (SAS) 600 and Practice Note 10. In particular, the opinion:
 - (a) makes a clear distinction between the responsibilities of the department for preparing the accounts and the C&AG’s responsibilities as auditor;
 - (b) provides an opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the GRAA 2000 (the Exchequer and Audit Departments Act 1921 for 1999–2000 and 2000–01) and directions made thereunder by the Treasury; and
 - (c) provides an opinion as to whether, in all material aspects, expenditure and income have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

55. As well as expressing an opinion on the resource accounts, the C&AG is required to make a report on his examination of the accounts. The form and content of the report is entirely a matter for the C&AG to determine within his statutory powers and responsibilities. Where there is no substantive comment to make, the report is generally in the form of a single sentence appended to the audit opinion in the form, “*I have no observations to make on these financial statements.*” Where there is a substantive report, it is referred to in the audit opinion, but is quite separate from it.

56. The first audited and published resource accounts were in respect of the financial year ending 31 March 2000, although departments were required to produce dry-run accounts for the 1998–99 financial year. The C&AG’s *Financial Auditing and Reporting: 1999–2000 General Report* noted that a total of 30 bodies (out of 52) had not received an unqualified “informal” audit opinion on their 1998–99 dry-run accounts. For 1999–2000 and 2000–01, there have been significant improvements, with a total of 12 bodies (out of 49) not being given an unqualified audit opinion for 1999–2000, and 8 (out of 52) in 2000–01, and improvements in the severity of the qualifications given. The table below compares the overall position for 1998–99 to 2000–01, showing the number of unqualified accounts, and the numbers in each category of qualification (in increasing degree of severity). Appendix D gives further details of the expression of audit opinions.

Audit Opinion	1998–99	1999–2000	2000–01
Unqualified	22	37	44
Qualified (scope limitation/disagreement)	18	9	6
Adverse Opinion	5	0	0
Disclaimer	4	3	2
“Nil” opinion ²³	3	0	0

57. The Treasury anticipates further improvements for 2001–02. While the level of audit qualifications are very high when compared to those for company accounts, they reflect the fact that a number of Government departments face some significant and complex challenges in the adoption of accrual accounting.

A Public Sector International Agenda?

58. In the private sector, the international convergence of accounting standards has become the top priority for standard-setters. This development is being mirrored, albeit more gradually, in the public sector. The adoption of accrual accounting by national governments is a growing phenomenon. Over one half of all member countries of the Organization for Economic Co-Operation and Development (OECD) have adopted accrual accounting to some degree, and more are planning to do so. A number of economies in transition and developing countries are following suit. The OECD itself has been convinced of the benefits of accrual over cash accounting for a number of years, and as long ago as 1993²⁴ commented that:

While the advantages of cash are acknowledged in terms of assessing short term economic impact and compliance with spending limits, the ability of cash information to enable informed decisions on the stewardship and financial position is constrained because it excludes physical and financial assets and liabilities. Alone it provides no basis for judgements on performance in terms of economy and efficiency.

59. As the trend towards greater international convergence in the accounting standards for corporate entities develops there will be a resultant knock-on effect on the standards applicable for public sector entities. The Treasury, therefore, keeps a close watch on PSC developments and comments on agenda papers for PSC meetings and responds formally to all PSC public consultation documents. The FRAB is kept informed of the degree to which any approach proposed for the UK central government sector complies with any relevant IPSASs. A summary comparison of the requirements of the RAM and IPSASs published to date is at Appendix C.

²³ ‘Nil’ opinions were given where the accounts were insufficiently developed to offer an audit opinion.

²⁴ OECD (1993) *Accounting for What? — The value of accrual accounting to the public sector.*

Appendix A: Accounting Standards and Their Applicability to Resource Accounting

Resource Accounting Statement	What does it show?	Private Sector Equivalent	Comments
Schedule 1: Summary of Resource Outturn	This is the Parliamentary control schedule which compares outturn with estimate for both resource expenditure and the overall cash requirement.	None. This schedule is unique to resource accounting.	The Schedule plays an important role in providing the link between resource budgeting and resource accounting.
Schedule 2: Operating Cost Statement	This shows the resources consumed during the year in support of both a department's own administrative expenditure and its program expenditure, net of departmental income.	Profit and loss account.	While similar to a profit and loss account, Schedule 2 does not follow the form of the profit and loss account as prescribed in the Companies Act. It has been designed mainly to meet the Treasury's budgetary control requirements and those of Parliament.
Schedule 2: Statement of Recognized Gains and Losses	This shows gains and losses arising on asset revaluations and any other gains or losses reported through reserves.	Statement of Total Recognized Gains and Losses (STRGL).	In the private sector, the STRGL includes the operating costs for the year. The Statement in resource accounts omits this, on the grounds that it would be misleading to include the net operating costs as a "loss" because it is not a loss in the commercial sense of the word. The net expenditure shown is incurred to obtain, in the main, non financial benefits.

Resource Accounting Statement	What does it show?	Private Sector Equivalent	Comments
Schedule 3: Balance Sheet	This shows the assets and liabilities at the year-end which are represented by taxpayers = equity.	Balance Sheet.	As in the private sector, the Balance Sheet provides a financial snapshot of the assets and liabilities of a body at one point in time. The layout used follows Format 1 prescribed in Schedule 4 of the Companies Act, striking a balance at total assets and liabilities. The main difference is in the “Taxpayers Equity” section of the statement, where the terminology replaces that of shareholders capital and reserves to reflect the central government context.
Schedule 4: Cash Flow Statement	This analyzes the net cash flow on both operating activities and capital expenditure and shows how the net cash flow has been financed.	Cash Flow Statement.	The Statement has been prepared in accordance with the relevant Financial Reporting Standard — FRS1 (revised).
Schedule 5: Statement of Resources by Departmental Aim and Objectives	A restatement of Schedule 2 to show spending during the year by aim and objectives.	None. This Schedule provides the equivalent of segmental information. However, its link to program aims and objectives makes it unique to resource accounting.	The purpose of this Schedule is to reanalyze operating expenditure and income according to the aim and objectives it is intended to serve.

Appendix B: Accounting Standards and Their Applicability to Resource Accounting

The table below lists those accounting standards in force as of June 2001 and how they apply in resource accounting (references are given to the relevant section of the Resource Accounting Manual, RAM).

SSAPs are Statements of Standard Accounting Practice, which were issued by the Accounting Standards Committee between 1971 and 1990.

FRSs are Financial Reporting Standards as issued by the Accounting Standards Board since 1990.

The table below does not cover UITF Abstracts. A list of UITF Abstracts and their applicability to resource accounts is given in Appendix 3 to the RAM.

Applicable Statements of Standard Accounting Practice

Standard	Title	Applicability to resource accounting
SSAP4	<i>Accounting for Government Grants.</i>	Applies, with one adaptation. Chapter 3.8 of the RAM requires that where a grant is received as a contribution towards expenditure on a fixed asset, it should be credited to a government grant reserve without the option of treating it as a deduction from the acquisition cost.
SSAP5	<i>Accounting for Value Added Tax.</i>	Applies. Chapter 8.2 of the RAM.
SSAP9	<i>Stocks and Long-term contracts.</i>	Applies, with adaptations. Chapter 3.12 of the RAM also sets out the accounting treatment for categories of stock which may not be adequately covered by the SSAP, notably: stockpile goods; confiscated, seized, forfeited and foreclosed property; and goods held under price support programs.
SSAP13	<i>Accounting for Research and Development.</i>	Applies, with the criteria for the capitalization of development expenditure adapted to take account of the not-for-profit context. Chapter 3.10 of the RAM.
SSAP17	<i>Accounting for Post-Balance Sheet Events.</i>	Applies. Chapter 8.3 of the RAM.
SSAP19	<i>Accounting for Investment Properties.</i>	Applies if any central government entities are judged to hold investment properties. Chapter 3.7 of the RAM.
SSAP20	<i>Foreign Currency Translation.</i>	Applies. Chapter 8.1 of the RAM.
SSAP21	<i>Accounting for Leases and Hire Purchase Contracts.</i>	Applies. Chapter 9.4 of the RAM.

Standard	Title	Applicability to resource accounting
SSAP24	<i>Accounting for Pension Costs.</i>	Applies. Chapter 4.5 of the RAM. But it should be noted that the accrued occupational pension scheme liabilities are shown as part of separate scheme statements which are not part of departmental resource accounts, but published alongside them. The statements are prepared on an accruals basis. Work is underway on the application of FRS17.
SSAP25	<i>Segmental Reporting.</i>	Does not apply. Paragraph 12.1.24 of the RAM makes clear that the information contained in Schedule 5 supersedes this requirement.

Applicable Financial Reporting Standards

Standard	Title	Applicability to resource accounting
FRS1 (revised 1996)	<i>Cash Flow Statements.</i>	Applies. Paragraphs 12.1.19 and 12.1.20 of the RAM.
FRS2	<i>Accounting for Subsidiary Undertakings.</i>	Partially applies. The requirements as to which entities are to be consolidated do not apply (RAM Chapter 1.5), but the principles in the standard apply otherwise (RAM Chapter 10).
FRS3	<i>Reporting Financial Performance.</i>	Partially applies. The sections in the FRS on extraordinary items, taxation and earnings per share are not relevant. The section on disclosures in respect of historical cost profits and losses does not apply. Chapters 7.5 and 7.6 and paragraph 12.1.20 of the RAM.
FRS4	<i>Capital Instruments.</i>	Applies if given situations arise.
FRS5	<i>Reporting the Substance of Transactions.</i>	Applies. Chapter 9 of the RAM.
FRS6	<i>Acquisitions and Mergers.</i>	Application in respect of departmental mergers and the transfers of functions between departments under consideration. See paragraph 8.8 of the RAM.
FRS7	<i>Fair Values in Acquisition Accounting.</i>	Not likely to be relevant.
FRS8	<i>Related Party Disclosures.</i>	Applies as adapted to take account of the central government context. Chapter 8.4 of the RAM.
FRS9	<i>Associates and Joint Ventures.</i>	Partially applies. Paragraphs 1.5, 4.5 and Chapter 10 of the RAM.
FRS10	<i>Goodwill and Intangible Assets.</i>	Partially applies. Goodwill unlikely to be relevant. Provisions on intangible assets apply. Chapter 3.10 of the RAM.
FRS11	<i>Impairment of Fixed Assets and Goodwill.</i>	Applies as adapted to take account of the not-for-profit nature of most central government activities. Chapter 3.2 of the RAM.

Standard	Title	Applicability to resource accounting
FRS12	<i>Provisions, Contingent Liabilities and Contingent Assets.</i>	Applies. Chapter 4.3 and 4.4 of the RAM.
FRS13	<i>Derivatives and other Financial Instruments: Disclosure.</i>	Applies. Chapter 8.7 of the RAM.
FRS14	<i>Earnings per Share.</i>	Not relevant.
FRS15	<i>Tangible Fixed Assets.</i>	Applies, as adapted. Chapter 3.2 to 3.6 and 3.9 of the RAM.
FRS16	<i>Current Tax.</i>	Not relevant.
FRS17	<i>Retirement Benefits.</i>	Will apply, as adapted. Disclosures for 2001–02 and 2002–03. Recognition and measurement for 2003–04 onwards.
FRS18	<i>Accounting Policies.</i>	Applies, as adapted. Chapters 1.3 and 2.2 of the RAM.
FRS19	<i>Deferred Tax.</i>	Not relevant.

Appendix C: IPSASs: Comparison with the RAM as of March 2002

This appendix gives a summary comparison of the IPSASs issued to date with the provisions of the RAM.

IPSAS1: Presentation of Financial Statements

The requirements of IPSAS1 are broadly similar to the requirements of the RAM, although some of the definitions differ. In particular, the RAM is more “customized” in using terminology relevant to the UK central government sector. Reflecting the UK context the RAM adopts a “true and fair” presentation rather than the “fair presentation” referred to in IPSAS1.

On components of financial statements, IPSAS1 requires the production of a statement of financial position, a statement of financial performance, a statement of changes in net assets/equity, a cash flow statement, and accounting policies and notes to the financial statement. The RAM goes further in mandating the production of two further primary statements Schedules 1 and 5. In addition, certain provisions of the RAM have also been developed with the read-across to resource budgeting in mind. Whilst IPSAS1 does not require this, it does encourage “*the inclusion in the financial statements of a comparison with the budgeted amounts for the reporting period,*” where the financial statements and the budget are on the same basis of accounting.

There are also differences in how the information will be presented in the financial statements, the statement of financial performance in particular. IPSAS1 adopts a distinction between operating and non-operating activities, whereas Schedule 2 of resource accounts makes the distinction between administration and program costs. IPSAS1 refers to a “surplus” or “deficit,” rather than a net operating cost. IPSAS1 also permits extraordinary items; the RAM does not.

IPSAS2: Cash Flow Statements

The requirements for cash flow statement in the RAM (paragraphs 12.1.19-12.1.29) follow those of FRS1 (revised), as adapted for departments in particular to take account of receipts due to the Consolidated Fund which are outside the scope of a department’s activities and payments of amounts due to the Consolidated Fund. In addition, the exemptions from the requirement to follow FRS1 (set out in paragraph 5 of the standard) are not available to bodies adopting resource accounting without specific approval from the Treasury. Given that the RAM states that FRS1 should be followed, and IPSAS2 is based on IAS7, the main differences, other than those already mentioned, are set out in Appendix II to FRS1.

IPSAS3: Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies

IPSAS3 refers to the reporting of a net surplus or deficit for the period, although it does permit the use of other terms to describe this amount in financial statements. As noted above, the RAM, by contrast, refers to “net operating cost,” which we believe is an appropriate term to use for the non-trading public sector, IPSAS3 also allows the reporting of extraordinary items. Again as noted above, the RAM does not allow for this.

In terms of the treatment of fundamental errors and changes in accounting policies, the RAM follows the provisions of FRS3, which requires prior-period adjustments to be made. IPSAS3 allows the same treatment for both.

IPSAS4: the Effects of Changes in Foreign Exchange Rates

The RAM (paragraph 8.1.1) states that SSAP20 will apply in foreign currency transactions. IPSAS4 is based on IAS21, which is largely comparable to SSAP20. There are, however, some minor differences concerning the translation of foreign currency monetary and a requirement that non-monetary items should be reported using the closing rate (RAM paragraph 8.1.6 specifies either the closing or contracted rate), non-monetary items carried at historical cost at the exchange rate as of the date of the transaction (not applicable in the RAM, such items will be revalued), and non-monetary items carried at fair value at the exchange rate that existed when the values were determined (RAM paragraph 8.1.9 specifies that this should be the date of any revaluation review).

IPSAS5: Borrowing Costs

The objective of IPSAS5 is to prescribe the accounting treatment of borrowing costs based on the provisions of IAS23. The benchmark treatment is that such costs should be immediately expensed, but an alternative treatment is permitted of capitalizing borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Borrowing costs are covered by FRS15, which permits the capitalization of directly attributable finance costs, but limits capitalization to that part of the borrowing that relates to expenditure so far on the tangible fixed asset. The RAM (section 3.9) sets out the criteria for permitting the capitalization of costs, in line with FRS15. However, it should be noted that, for the purposes of Whole of Government Accounts (WGA), the RAM (paragraph 3.9.7) does not permit the capitalization of capital charges.

IPSAS6: Consolidated Financial Statements and Accounting for Controlled Entities

The RAM (section 1.5) requires departments to prepare consolidated accounts covering all entities within their departmental boundary. The boundary is different from the concept of an “economic entity” in IPSAS6 and a “group” under UK GAAP because it fulfils a different purpose: it is based on in-year budgetary control rather than on control of financial and operating policies. The RAM states that the principles of consolidation set out in FRS2 should be adopted for all entities deemed to fall within the departmental boundary. As part of the development of the RAM the FRAB has also approved a set of tests, derived from FRS2, to assess whether bodies classified by the Office for National Statistics (ONS) as being in the central government sector, or as public corporations, exhibit the characteristics that would suggest, under a GAAP-based approach, inclusion in consolidated CGA.

The requirements of IPSAS6 are based on IAS27 and are broadly similar to FRS2.

IPSAS7: Accounting for Investments in Associates

The RAM (paragraphs 1.5.5, 3.11.5 and section 10.3) requires that associated undertakings which meet the relevant criteria set out in paragraph 1.5.5 should be accounted for using the equity method as set out in FRS9. The requirements of IPSAS7 are broadly similar to those of FRS9, and hence the RAM. One difference lies in the permitted treatment in the individual financial statements. IPSAS7 allows use of the equity method or cost or revalued amount, whereas FRS2 permits just cost or revalued amount.

IPSAS8: Financial Reporting of Interests in Joint Ventures

The RAM (references as for accounting for associates) requires that joint ventures which meet the relevant criteria set out in paragraph 1.5.5 should be accounted for using the gross equity method as set out in FRS9. The preferred treatment in IPSAS8 (based on IAS31) is the proportional consolidation method, with the equity method as an allowable alternative. Proportional consolidation is not permitted under FRS9, on the grounds that this treatment can be misleading as the key features of control are that the controlling party has the ability to direct or deploy what it controls without consultation and the ability to take benefits from what it directs or deploys without question of entitlement. This is not the case with a joint venture.

IPSAS9: Revenue from Exchange Transactions

There is, currently, no UK accounting standard on the treatment of revenue recognition. The RAM (paragraph 6.1.3) states simply that “All income should be recorded on an accruals basis at the transacted amounts, or the amounts at which customers are committed to pay.”

IPSAS10: Financial Reporting in Hyperinflationary Economies

The relevant UK requirements on this issue are set out in UITF Abstract 9. Appendix 3 of the RAM makes clear that Abstract 9 applies. Abstract 9 uses the relevant international accounting standard, IAS29, as a reference point. IPSAS10 is based on IAS29.

IPSAS11: Construction Contracts

The RAM (paragraph 3.12.7) requires that the provisions of SSAP9 be followed. IPSAS11 is based on IAS11. Both SSAP9 and IAS11 require the use of the percentage of completion method for the recognition and measurement of revenues, expenses and profits on construction contracts, although there are a number of differences, for example, IAS11 requires certain combining or segmenting of contracts, whereas SSAP9 does not; SSAP9 deals with the balance sheet presentation of contracts, but IAS11 does not.

IPSAS12: Inventories

The RAM (section 3.12) requires the application of the relevant UK standard, SSAP9, with some additional requirements to cover categories of stock which are deemed not to be covered adequately in the standard, namely:

- Stockpile goods and military reserve stocks;
- Confiscated, seized, forfeited and foreclosed property; and
- Goods held under price support programs (intervention stocks).

IPSAS12 is based on IAS2, the provisions of which are similar to SSAP9, the main difference being that SSAP2 does not permit the use of the Last-in-First-Out (LIFO) method of determining stock valuation. IPSAS12 also does not permit LIFO. IPSAS12 contains guidance on strategic stockpiles, but not on the two other categories covered in the RAM. IPSAS12 specifically deals with an inventory and work-in-progress not held for resale.

IPSAS13: Leases

The RAM (section 9.4) requires SSAP21 to be applied in relation to leasing transactions. IPSAS13 is based on IAS17, which adopts the same general approach to both lessee and lessor accounting as SSAP21, but with important differences in the detail. Both standards define finance leases as leases that transfer substantially all the risks and rewards of ownership to the lessee, with operating leases defined as any lease other than a finance lease. SSAP21 contains a rebuttable presumption that a lessee has a finance lease if the present value of the minimum lease payments at the inception of the lease amounts to substantially all (normally 90 per cent or more) of the fair value of the leased asset. IPSAS13 does not include this “90 per cent” test, but instead includes a number of examples of situations that would normally result in the classification of a finance lease.

IPSAS14: Events After the Reporting Date

The RAM (section 8.3) requires SSAP17 to be applied. IPSAS10 is based on IAS10 *Events after the Balance Sheet Date*, the provisions of which are broadly similar to those of SSAP17.

IPSAS15: Financial Instruments: Disclosure and Presentation

The RAM (section 8.7) requires the application of the relevant UK standard, FRS13. IPSAS15 is based on IAS32. The required disclosures under both FRS13 and IAS32 are extensive and are broadly similar, although in general the disclosure requirements of FRS13 are more specific than those of IPAS15.

IPSAS16: Investment Property

In general, investment property assets will not arise in the UK central government sector. Where they do, the RAM (section 3.7) makes clear that the relevant UK standard, SSAP19, applies. IPSAS16 is based on IAS40. There are clear similarities between IPAS16 and SSAP19, but there are a number of major differences. SSAP19 requires that all investment property is recognized at open market value; IPAS16 allows a choice between fair value or depreciated cost. Under IPAS16, gains and losses in fair value are taken through the income statement; under SSAP19 to equity (via the STRGL).

IPSAS17: Property, Plant and Equipment

The RAM (Chapter 3) makes clear that the relevant UK standard, FRS15, applies as adapted. FRS15 allows an option between revaluing tangible fixed assets or maintaining them at historical cost; the RAM requires revaluation in virtually all circumstances. IPSAS17 is drawn primarily from IAS16, which sets out a benchmark treatment of carrying assets at cost, but allows revaluation as an alternative treatment. The requirements of FRS15 and IAS16 are broadly similar in terms of scope and general measurement requirements and options. However, where entities adopt revaluation, there are differences in the method of determining losses on revaluation. The main difference is that FRS15 and the RAM use the “value to the business” model as the basis of valuation, whereas IPSAS17 uses the fair value basis.

Appendix D: Resource Accounts: Expressions of Audit Opinion

This appendix gives details of the expressions of audit opinion given on resource accounts.

The expressions of audit opinion used by the Comptroller and Auditor General (C&AG) are as set out in the UK Auditing Practices Board's Statement of Auditing Standards (SAS) 600 *Auditors' Reports on Financial Statements*.

Auditors' opinion	Explanation
Unqualified	Expressed when the auditors' judgment is that the financial statements give a true and fair view and have been prepared in accordance with relevant accounting or other requirements.
Qualified	
i. Scope limitation	Expressed when there has been a limitation on the scope of the auditors' work that prevents them from obtaining sufficient evidence to express an unqualified opinion.
ii. Disagreement	Expressed where the auditors disagree with the accounting treatment or disclosure of a matter in the financial statements, and in the auditors' opinion the effect of the disagreement is material to the financial statements.
iii. Adverse	Expressed when the effect of a disagreement is so material or pervasive that the auditors conclude that the financial statements are seriously misleading. Financial statements with an adverse opinion do not give a true and fair view.
iv. Disclaimer	Expressed where the possible effect of a limitation on scope is so material or pervasive that the auditors have not been able to obtain sufficient evidence to support, and accordingly are unable to express, an opinion on the financial statements.

In addition, the C&AG gives a separate and explicit opinion on regularity, in line with the good practice set out in Auditing Practices Board Practice Note 10 (revised) *Audit of Financial Statements of Public Sector Entities in the United Kingdom*. Regularity is a requirement that financial transactions should be in accordance with the legislation authorizing them, regulations issued by a body with the power to do so under governing legislation, Parliamentary authority and Treasury authority. The C&AG qualifies the regularity part of his opinion where he concludes that material financial transactions are not in compliance with the appropriate authorities. Where he is not able to obtain sufficient evidence to reach an opinion on regularity he qualifies the regularity part of his opinion on the grounds of a limitation of audit scope.

Glossary

The definitions used in this glossary reflect UK practice in the context of this Occasional Paper

Accounting Policies

The way the organization 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 financial statements of an organization. They are intended to ensure that the financial statements of an organization present a true and fair view of its state of affairs and its income and expenditure.

Accrual 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.

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.

Ambit

The description of the services included in the Resource Estimate.

Annually Managed Expenditure (AME)

AME 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 Departmental Expenditure Limit (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. Fixed Assets are assets with an expected life of more than one year, held for use by the organization. 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.

Balance Sheet

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

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.

Cash Accounting

A method of accounting which records cash payments and cash receipts as they occur within an accounting period.

Cash Flow Statement

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

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.

Cost of Capital Charge

The Government as a whole incurs an interest cost for borrowing to finance investments by departments. This is also described as the 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).

Departmental Expenditure Limit (DEL)

DEL is public expenditure which forms departments' multi-year budget plan against which spending is managed. DELs identify separate elements for capital and current spending.

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.

Departmental Investment Strategy (DIS)

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

Financial Reporting Advisory Board (FRAB)

Independent body, drawn from government, public sector audit bodies, the devolved administrations, the accounting profession, economists, national statisticians and academia, which advises HM Treasury on accounting principles and approaches and reviews the Resource Accounting Manual.

Government Resources and Accounts Act 2000 (GRAA)

Statute that, amongst other reforms, provides the legal underpinning for the introduction of accrual based resource accounting and the replacement of cash based appropriation accounts. It also provides the authority for whole of government accounts.

In-year Monitoring and Control

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

Non Departmental Public Bodies (NDPB)

A NDPB is a body with a role in the processes of national government or part of one. NDPBs operate at greater or lesser extent at arm's length from Ministers and are of three broad types: executive, advisers and tribunals.

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 targets describe, in measurable terms, how the department will achieve its objectives.

Operating Cost Statement

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

Outturn

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

Public Service Agreement (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.

Request for Resources (RfR)

An accrual based measure of current expenditure which forms part of a Resource Estimate. It represents the basic unit of Parliamentary control.

Resource Accounting and Budgeting (RAB)

The initiative to introduce GAAP based accrual accounting and budgeting into the central government sector in the context of wider public management reform.

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.

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.

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 Estimate

A statement provided to the House of Commons in which a department asks for the approval of its estimated expenditure for the coming financial year. The Estimate summarizes the resources and the cash required.

Resource Budgeting

Resource budgeting involves using resource accounting information as the basis for planning and controlling public expenditure. It introduces new concepts into budgets such as capital consumption and requires departments to match their costs to the time of the economic activity.

Service Delivery Agreement (SDA)

The SDA sets out in broad terms how the department's Public Service Agreement (PSA) targets will be achieved.

Spending Review

The new public expenditure framework involves setting firm three year plans. The most recent Spending Review, SR2000, set out departmental budgets for the years 2001–02 to 2003–04. It was based on firm and prudent limits announced in the March 2000 Budget and was in line with the fiscal rules.

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 judgment.

Working capital

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

Further Information

Some Booklets in the “Managing Resources” Series

Full Implementation of Resource Accounting and Budgeting (the “Blue Guide”)

An overview of the key components of resource accounting and budgeting. Assumes little or no prior knowledge of the subject.

Better Decision Taking in Departments (the “Green Guide”)

Aimed at anyone seeking examples of the benefits to departments of using a resource based approach to management.

Analyzing Resource Accounts: an Introduction (the “Short Red Guide”)

Provides a brief introduction to interpreting government departments’ annual resource accounts. Intended for general users, without detailed knowledge of either accruals accounts in general or resource accounts in particular.

Analyzing Resource Accounts: User’s Guide (the “Big Red Guide”)

Provides detailed advice on interpreting government departments’ resource accounts. Aimed at the technical user, it identifies areas of the accounts in which further analysis might be undertaken.

Maximizing the Benefits for Departments (the “Purple Guide”)

Enables departments to know if they had succeeded in getting the full benefits from the transition to the new resource based financial management system, and how any potential obstacles to success can be overcome.

A Strategic Approach to Finance Training (the “Pink Guide”)

A consolidation of existing guidance issued by the inter-departmental Finance Training Committee, together with some new material, to represent best practice in the light of developments in resource management. Aimed at members of the finance training community, especially those concerned with planning and delivering finance training in departments and agencies.

Case Studies (the “Orange Guide”)

Designed to widen understanding of how accrual based budgeting works, and how it changes the way public expenditure is managed and controlled, by giving precise examples of how transactions are recorded under the new resource budgeting system.

A number of Managing Resources publications are available on the Treasury website or hard copies can be ordered from anne.perryman@hm-atreasury.gsi.gov.uk (tel: + 00 44 20 7270 1749).

Useful Websites

<http://www.resource-accounting.gov.uk> — for the latest version of the *Resource Accounting Manual*

<http://www.government-accounting.gov.uk> — for *Government Accounting*

<http://www.hm-treasury.gov.uk> — Government Accountancy Service under “Other HMT sites” on Home Page for Finance Training Committee guidance etc

<http://www.wga.gov.uk> — for details of the Whole of Government Accounts (WGA) program

<http://www.ifac.org> — for copies of IPSASs, Eds of IPSASs and other Public Sector Committee publications