The NAO audits all central government bodies and a wide range of other UK and international public sector bodies. A significant part of my role is to support both Parliament and the public in holding government to account. I therefore strongly support continual improvements in the quality, accountability, transparency and utility of management information and accounts across government.

Public Administration and Constitutional Affairs Committee’s inquiry into the format and utility of monthly management accounts and departmental accounts

1 The National Audit Office (NAO) welcomes the opportunity to contribute to the Public Administration and Constitutional Affairs Committee’s inquiry into the format and utility of monthly management accounts used by Ministers, Permanent Secretaries and Departmental Boards, and the departmental accounts published for Parliament and the public.

2 The NAO, on behalf of the Comptroller and Auditor General (C&AG), carries out the external audit of the accounts of UK Central Government departments, and the accounts of a wide range of other UK and international public bodies.

Departmental Accounts

The current utility of departmental accounts

3 Published departmental annual reports and accounts, which are prepared on an accruals basis, give insight into the overall financial conduct of a department, its assets and liabilities, and its governance and control environment. By preparing departmental accounts to the same standard as the private sector, and by having them audited, they gain a great deal more credibility.

4 Accrual accounts can provide insight because they reflect, transparently and comprehensively, the financial consequences of each decision made by management. Accrual accounts require costs or income to be recorded when the underlying events occur – not just when the cash is paid out or received. Accounts prepared on an accruals basis show whether management’s decisions and activities have created assets or given rise to liabilities that will need to be met in the short or longer term.

5 Government’s accounts, as with all financial and non-financial information, are most useful to users and stakeholders when they are timely, robust, relevant, understandable and comparable.

   a) The timeliness of government’s financial reporting has improved significantly since accrual accounting was first introduced. Timely reporting enables Parliament to hold government to account in a more effective manner, while issues remain current. For the 2014-15 annual report and accounts cycle, all but two major government departments laid their annual reports and accounts in Parliament before the summer recess period began in July 2015.

   b) A key measure of ‘robustness’ of a set of accounts is the opinion provided by the external auditor. For the 2014-15 year of account the C&AG qualified his audit opinion for 15 accounts out of almost 400 accounts he audited. In 6 of these bodies,

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1 The Cabinet Office and the Department for Education laid their 2014-15 annual reports and accounts after the 2015 summer recess.
the qualifications arose because the C&AG identified material error or uncertainties in the accountings; in all other cases the C&AG qualified his audit opinion because his audit identified material irregular expenditure.

c) **Research carried out by HM Treasury**\(^2\) **found that current reporting in departments’ annual report and accounts is seen as difficult to navigate and a coherent narrative message is often lacking.** Similar challenges are also recognised in private sector corporate reporting\(^3\). HM Treasury’s response to addressing these issues is the *Simplifying and Streamlining Accounts* project\(^4\). This has introduced measures which, HM Treasury anticipates, should lead to government’s accounts better meeting the needs of the users. We discuss this initiative in more detail below.

6 Departmental accounts are a key element of the parliamentary accountability cycle and contain a range of information that can be of interest to stakeholders. Government’s finances and accounts are the particular focus of the Committee of Public Accounts (the PAC) and are also considered regularly by Parliamentary Select Committees\(^5,6\).

The Whole of Government Accounts (WGA) is a single set of accounts consolidating the financial activities of the UK public sector. As we have previously reported\(^7\), the WGA is now a key part of HM Treasury’s framework for improving public financial management and accountability to Parliament for the Government’s financial position. The WGA is increasingly being used within and outside of the Treasury to inform decisions which affect public finances. Whilst the C&AG has qualified his audit opinion on the WGA in each of the years it has been produced, HM Treasury’s stated goal is to produce timely, unqualified accounts that support strong financial management. This is important if WGA’s value as an accountability tool is to be optimised. The 2014-15 WGA has not been produced as quickly as the 2013-14 WGA, however it is expected to be completed shortly and we expect it will be the subject of a PAC evidence session. The WGA has also provided the basis for the NAO’s forthcoming study looking at the management of the government’s balance sheet, which will be available for Parliamentary scrutiny in due course.

**Reforms to the format of departmental accounts**

7 There have been a number of important reforms to the format of departmental accounts in recent years and the UK is recognised as having a mature public sector financial reporting environment. Statistics on the Government’s financial position are routinely published in the National Accounts, monthly Public Sector Finances Report, the Public Expenditure Survey Analysis and other sources. The WGA is designed to complement existing statistical information on public finances by providing an account based on International Financial Reporting Standards (IFRS) that are used in the private sector but adapted for use in the public sector. These standards require a wider range of assets and liabilities to be reported than the standards used to prepare the National Accounts.

8 **Accrual accounting was adopted by the UK public sector in the late 1990s.**

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\(^2\) HM Treasury, “*Simplifying and streamlining statutory annual report and accounts*”, Cm 8905, July 2014

\(^3\) [https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Cutting-Clutter.aspx](https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/Cutting-Clutter.aspx)

\(^4\) HM Treasury, “*Simplifying and streamlining statutory annual report and accounts*”, Cm 8905, July 2014


Increasingly, other national governments are adopting similar accounting frameworks. For example, the Federation of European Accountants has recently reported that some 17 EU countries now use accrual accounting for public sector financial reporting and several others are in the process of switching to it\(^8\).

9 IFRS-based accounting was adopted in the UK public sector in 2009-10, bringing public sector reporting into line with reporting requirements for listed companies. All listed EU companies are required to use EU-adopted IFRS and, at the time of writing, the IFRS Foundation and the International Accounting Standards Board reports that almost 120 jurisdictions globally apply IFRS\(^9\).

10 HM Treasury’s Clear Line of Sight reforms, introduced in 2011-12, have enhanced accountability. These reforms led to improved alignment between departmental budgets (set by the Government), estimates (approved by Parliament), and the accounts (prepared by departments).

11 We are supportive of HM Treasury’s Simplifying and Streamlining Accounts project\(^10\). HM Treasury launched this project in April 2013, with the aim of simplifying and streamlining the presentation of the statutory annual reports and accounts produced by central government entities so as to better meet the needs of users. Through the project, HM Treasury has introduced a range of reforms that will be adopted for the first time in government’s 2015-16 annual reports and accounts. The heart of these measures, as set out by HM Treasury,\(^11\) is to restructure the ARA into three integrated sections:

a) **The Performance Report** – HM Treasury expects this part to “tell the story” –this change is intended to address the criticism that government’s annual reports and accounts lack a coherent narrative. The new requirements introduce a number of common structural elements with the aim of improving comparability across departments while providing flexibility for bodies to tell their own story about their key activities and outcomes during the financial year;

b) **The Accountability Report** – the primary user of government’s annual reports and accounts is Parliament and this change is intended to bring together in one place, and with suitable prominence, the range of notes and disclosures required for Parliamentary accountability purposes. This includes the Statement of Parliamentary Supply (for departments) and, for all bodies, information about other matters such as losses and special payments and remote contingent liabilities. This section will also include the Governance Statement and the C&AG’s audit certificate and report.

c) **The Financial Statements** – this section will include the audited financial statements and disclosure notes for material balances only. HM Treasury has set out that the presentation of the financial statements will be revised to a manner aligned with that adopted by the WGA and in the commercial world, to aid consistency and comparability. The renewed focus on material matters is intended to bring a clearer focus on the “big picture”, by excluding less significant matters that may sometimes detract from the key issues. All central government departments, as well as their agencies and arm’s length bodies are required to follow the HM Treasury’s Financial Reporting Manual. Therefore, as well as the potential to bring greater clarity to reporting, a “big picture” focus also has the

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\(^10\,11\) HM Treasury, “Simplifying and streamlining statutory annual report and accounts”, Cm 8905, July 2014
potential to lead to greater efficiencies in accounts production and audit, particularly for smaller, less complex organisations, while sustaining comparability overall.

12 The changes arising from the Simplifying and Streamlining Accounts project have now been integrated into the 2015-16 Financial Reporting Manual, but it is too early to say whether or not the reforms have secured the intended benefits. We will expect to see improvements in reporting from 2015-16 onwards. It will be important for HM Treasury to monitor and assess the extent to which the reforms are bedding in and delivering the intended benefits, as well as assessing what, if any, further changes may be needed to the format and content of government’s annual reports and accounts.

Future improvements to accounts

13 We have no concerns with the current arrangements for setting the financial reporting framework for government accounts and advising on its future development. HM Treasury sets the government accounting framework. In our view, this role is consistent with HM Treasury’s overall responsibilities for public spending. In setting the accounting framework or making any changes to it, HM Treasury is advised by the independent Financial Reporting Advisory Board (FRAB). The FRAB is chaired by and comprises independent members. The Board has a wide and diverse membership, including a Member of Parliament, academics, standard setters, technical experts, as well as relevant authorities from government departments and officials from the NAO. The C&AG, who is an independent officer of the House of Commons, reviews all recommendations for membership of the FRAB, in accordance with the Government Resources and Accounts Act 2000 s24(2).

Improving scrutiny of financial information from the government

14 Published annual reports and accounts can help build trust and support enhanced scrutiny by being transparent, relevant and accessible to readers – whether Members of Parliament or members of the public. Our view is that the accessibility of the information within audited IFRS-based annual reports and accounts can be enhanced through better use of accompanying narrative, including companion documents and guides, greater use of trend analyses, insightful graphics and summary data, along with management information that links inputs, activity, performance and outcomes to the underlying accounting information. Such information, particularly where it can be accessed digitally and is tablet-friendly, would potentially satisfy many more users’ needs.

15 The Whole of Government Accounts (WGA) provides a good example of how government’s accruals-based, GAAP compliant financial statements can be an effective vehicle for Parliamentary scrutiny. The PAC has used the WGA as a means of engaging on a range of financial issues, such as clinical negligence liabilities, nuclear decommissioning liabilities and pension liabilities. The transparency of accrual accounts make these liabilities clearly visible to Parliament and other stakeholders. In our view, the ability to view the government’s entire portfolio of activities, together with performance and trend analysis information reported as part of the WGA12, and HM Treasury’s “Key facts and figures” companion document13 have helped users better understand what is being

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reported and what it means, and is illustrative of good practice that has the potential to be adopted more widely.

16 The aims of HM Treasury's *Simplifying and streamlining Accounts* project are that reporting better meets the needs of the users of the annual report and accounts and, where appropriate, reduces the burden on preparers. The proposals will require central government entities to invest greater thought in their reporting. Organisations will need to identify the key messages to their various stakeholders and communicate in a succinct, fair and balanced way. It is important that entities consider what disclosures are relevant and material to their organisation when considering what is to be disclosed - as well as how - in their annual report and accounts. Where annual reporting does not keep focussed on the material issues, it is more likely that readers will struggle to "see the wood for the trees".

17 We have seen improvements in the quality of the reporting in recent years, with a genuine step-change in the efforts made by some bodies to make their annual reporting easier to understand. The *Building Public Trust Awards*¹⁴ recognise trust and transparency in corporate reporting in both the private and public sectors. The NAO co-sponsors the award for excellence in public sector reporting. In 2015, for the 52 public sector annual reports and accounts we reviewed, we noted improvements in the quality of strategic reporting, with most public bodies presenting a clear strategic vision, often underpinned by relevant supporting objectives for their organisation. We also noted progress made by some bodies in making their annual report and accounts easier to understand, in particular, through the innovative use of graphics, summaries and highlights to demonstrate organisations' achievements.

18 Although transparency is improving, in our view there is still more for public sector bodies to do in providing open and balanced information on both positive and negative issues. There is still a little too much 'positive spin', as opposed to frank and balanced reporting. To promote transparency and support accountability, it is necessary for Parliament and the public to be given a candid and even-handed understanding of where government is doing well and in what areas it can improve. We also find variability in risk reporting across the sector, and while reporting on key performance indicators (KPIs) is progressing, it is not always made clear how the KPIs support the organisation's overall aims. Government has an obligation to report clearly on progress, performance and risks to delivery and success, so Parliament can understand the full picture of risk faced across government and can use this to make well informed decisions and hold government to account.

19 The Government recently launched Single Departmental Plans (SDP)¹⁵ for the 17 major departments. We consider this development in more detail later in our submission. We welcome the requirements of PES (2015) 10 which requires those departments with an SDP to report their performance against their SDP within their annual report and accounts. This is to be achieved using financial and non-financial analysis, graphics and trends, using at least one prior year period, and more as appropriate, with all information drawn from the underlying accounting system used to produce the accounts.

20 We encourage the Committee to challenge the Government on whether SDPs are providing an improvement in the basis for Parliament and the public to hold government to account. We expect to report on SDPs in the summer, drawing on lessons learned from previous initiatives such as Business Plans and Public Service

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¹⁵ Press release: *New single departmental plans set out how government will deliver its priorities by 2020*, 19 Feb 2016
Agreements. We will also be reporting on the most recent Spending Review. We anticipate that the PAC will be holding an evidence session on these reports.

Management Accounts

What is the purpose of monthly management accounts?

21 Monthly management accounts (MMA) should form an expected and integral part of an entity’s system of internal financial management and control. Their primary purpose is to help managers manage effectively. As such, the precise nature and content of MMAs will necessarily vary between organisations, depending on an entity’s operations and what is being managed. High quality MMAs – which integrate financial and performance information - are essential if managers are to make sound business decisions, where the financial consequence are well understood.

22 Preparing good quality MMAs can benefit organisations in a range of ways, for example, preparing MMAs can:

   a) Result in timely and relevant information being available to management, enabling controlling action or value for money decisions to be taken at an early stage.

   b) Support strong links between the finance function and the business, providing a consistent basis for challenge and facilitating decisions based on a holistic view of the business, which can enable the more effective use of public money.

   c) Lead to the early detection and correction of error, overspend and irregularity.

   d) Streamline the main IFRS accounts production process, with the finance team and business starting from a strong base of the MMA.

23 In our view, good management information integrates financial and operational performance information, is generated from the same information from which the financial statements are prepared and monitors the balance sheet position, as well as financial performance. In our view, good management information – whether financial or non-financial - has a number of essential characteristics. Good management information is:

   a) Robust – based upon assured, accurate and complete information that can be agreed to the underlying financial reporting systems and IFRS based accounts. Accruals based MMA are more reliable through including incurred costs and earned revenue to inform decision making.

   b) Timely and relevant – prepared in a timely manner enabling management to make business decisions with the most current data that is relevant to controlling the business. Information should be sufficiently granular to detect and correct material misstatements and draw out the key risks to the organisation.

   c) Understandable – Uncluttered, presenting financial and non-financial information to help explain trends in the data. Variances to planned performance are explained succinctly, clearly and are related to underlying business activities. Performance measures are relevant to the strategic objectives of the business.

   d) Comparable – Comparative figures for the prior year, year to date / trend analysis, and (re)forecast budgets enable the user to place current performance in context and make informed decisions.
How far do monthly management accounts currently meet this objective? Is their quality consistent?

24 Our 2013 cross-government review of this area found that the quality of management information in government is improving but there is still a lot of work to do before decisions are routinely based on robust management information. Government is transforming in response to changes in its environment, largely driven by the need to reduce spend. Many government departments are on a path of transformation that involves reducing headcount and moving to digital delivery models. Without strong business cases, based on robust management information and extensive consultation with users, our work continues to show that benefits may not be realised and costs may spiral.

How can the monthly management accounts be improved to ensure they are more useful to decision makers, particularly Permanent Secretaries, Departmental Boards and Ministers?

25 We have set out pervasive issues that can block improvements within government and lead to poor service for citizens. These are deep cultural issues and will take time and strong leadership to change. Good quality management accounts that engage senior leaders and support information-led decision making can help address some of these pervasive issues. High quality management accounts would include measures that show where costs, milestones or outputs are not meeting expected levels or agreed targets. This enables early intervention and action to be taken. Management accounts can also support proper accountability for public spending as well as helping the user to understand and evaluate performance, particularly where delivery is devolved or involves multiple arms of government. We would expect MMAs to evolve over time, through a process of continuous improvement. This will require users and preparers of MMAs to regularly assess both the information that is reported to the Board and the maturity of the organisation’s financial management. Senior leaders will have to demand good quality MMA and actively use them, if the standard is to improve.

26 Accountability System Statements are published documents that allow accounting officers to demonstrate that appropriate accountability mechanisms had been put in place in response to the decentralisation of power to local communities. There is scope for these Statements to provide more clarity to Parliament over how performance is monitored when decision making and money is devolved. Our recent report covers issues relating to accountability in greater detail, as well as making recommendations to improve accountability across government.

How could outcomes be integrated into the monthly management accounts, such as proposed by the MINIS system promoted by Lord Heseltine?

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16 Comptroller and Auditor General, Financial management in government, Session 2013-14, HC 131, National Audit Office, June 2013
18 Comptroller and Auditor General, Universal Credit: early progress, Session 2013-14, HC 621, National Audit Office, September 2013.
19 Comptroller and Auditor General, Programmes to help families facing multiple challenges, Session 2013-14, HC 878, National Audit Office, December 2013
20 Comptroller and Auditor General, Update on the Next Generation Shared Services strategy, HC 1101, Session 2013-14, National Audit Office, March 2014.
23 Reporting financial management information to the Board, Financial management and reporting self assessment tool, January 2012.
25 Comptroller and Auditor General, Accountability for Parliament for taxpayers’ money; Session 2015-16, HC 849, National Audit Office, February 2016
26 URN 12/1213, No stone unturned, in pursuit of growth, The Rt Hon the Lord Heseltine of Thenford CH, October 2012
27 We agree in principal with the concept of a consistent, cross-Whitehall set of management data that links inputs and activity (financial and non-financial) to performance and outcomes. We further agree with the concept of a responsible person for each area reported, in line with the Senior Responsible Owner (SRO) role for government projects, where the SRO is also accountable directly to Parliament. Any cross-Whitehall system of management information linking inputs, performance and outcomes should also consider other government entities where relevant, not just the main Departments, to enhance scrutiny and transparency across the full public sector delivery chain. It is not clear to us that management reporting within all government entities is currently of sufficient maturity to support such a system. A time series of comparable and consistent underlying data would enable trend analysis over time, supporting improved accountability for actions and outcomes.

28 The Government has recently launched Single Departmental Plans (SDP) for the 17 major departments. SDPs are expected to provide a framework to hold government to account for its performance against business as usual objectives, as well as its manifesto commitments. SDPs are expected to link inputs to outcomes on a consistent basis through performance measures, as agreed with the centre (HM Treasury and Cabinet Office). SDPs have been described, including by the Chief Executive of the Civil Service, as a real opportunity to dramatically improve government’s management and delivery through linking inputs, performance and outcomes on a consistent and sustainable basis over the term of the government.

29 Management accounts per se are, necessarily, specific to the needs of an entity’s management and their publication may, therefore, not meet an external user’s needs. SDPs may be able to fulfil these needs more effectively, potentially improving accountability within the public sector. The Committee may wish to consider how it will be able to challenge government both on and through their SDPs and consider whether government could learn from its previous experience with Quarterly Data Summaries. For example

a) How useful are published SDPs and reporting progress against them in annual reports and accounts for improving the scrutiny of public service delivery by Parliament and the public?

b) What framework will be in place to provide assurance to Parliament and the public over the reported data to avoid it becoming another way of presenting a ‘good news story’ or hiding ‘inconvenient truths’?

c) Will published SDPs bring things ‘in sight and in mind’, particularly where long or complex delivery chains are in place?

d) How frequently will the SDPs be updated to ensure Parliament and the public have relevant information and the opportunity to effect timely scrutiny and achieve positive impact?

30 We support the principle of making management information public where appropriate. However, from experience of the last spending review, the publication of such data can lead to the omission of detail vital to understanding the business, decisions taken or outcomes and therefore making the published information of limited use in holding government to account. Publication may also lead to additional burden through producing

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27 Giving evidence to select committees: guidance for civil servants, Cabinet Office, October 2014.
28 Press release: New single departmental plans set out how government will deliver its priorities by 2020, 19 Feb 2016
29 Comptroller and Auditor General, Managing debt owed to central government, Session 2013-14, HC 967, National Audit Office, February 2014
an internal and external version. The Committee may wish to explore whether the high level nature of the published SDPs provides Parliament and the public the data or tools to more effectively hold government to account. For example:

a) Published high level statistics on performance may appear out of context if no baseline or time series are given.

b) Without related inputs such as costs, how can outcomes be assessed as value for money?

c) Is there clear causality between the results reported and the actual activities of the government, especially where objectives cut across departments or sectors?

d) How many times is a fall in performance reported compared to a ‘good news story’?

e) Does a lack of graphics and trend data make it hard to assess how performance has impacted outcomes?

April 2016