Written evidence from David Kilpin1 (IGA 22)

Public Administration and Constitutional Affairs Committee
Inquiry into Government Accounts

Summary

There should be more focus on the requirements of consumers of financial information. To do this:

- more consumers of financial information should be represented on FRAB;
- further modifications to IFRS are required for the public sector context;
- all select committees should review their departmental accounts and express what they want from them;
- accounts would be more understandable if jargon was replaced with plain English and if financial data was closely accompanied by short explanations of what the numbers are showing;
- financial and non-financial information should be more closely integrated and explained; and
- government should make more use of technology so financial and non-financial information can be presented according to the user’s requirements.

How useful are the accounts as a tool to scrutinise government?

- Without accounts we would not know where money comes from and where it goes, and no one would be able to check whether it was right and make informed decisions. The challenge for any organisation is to report their accounts in a clear and unambiguous way. At present, central government organisations usually produce accurate accounts on a timely basis, but they can be ambiguous and difficult to understand.
- Select committee hearings on various accounts, including HM Treasury’s, the Department for Education’s and the Whole of Government Account, have permitted Parliament to scrutinise government’s use of financial resources and yet they have found them falling short of being completely accurate and clear.
- Management accounts used by the board to monitor spending are configured differently to the published accounts submitted to Parliament.
- We can therefore conclude that neither Parliament nor management find the current format of published accounts to be entirely satisfactory.
- The use of International Financial Reporting Standards (IFRS) permits accountants and economists inside and outside government, and across the world to understand what basis the accounts have been prepared under. It also allows accountants trained outside of government to be able to be able to move into the civil service, and vice versa. The development of government accounting standards that are significantly different from IFRS would drive up consultancy and audit costs, and may put off graduates from training in the government finance profession, creating another skills shortage. That said, IFRS do require a degree of modification for the public sector context, which HM Treasury fulfils via the Financial Reporting Manual (FReM). There is room for further modification; such as, valuing property, plant and equipment (which should be based on depreciated replacement cost rather than what it could be

1 David Kilpin, an accountant with public sector experience
sold for) and the suitability of the Statement of Changes in Equity in the public sector context (discussed below).

- Many accounts in the private sector are used by other financially literate stakeholders to make investment and financing decisions. The breadth of stakeholders in government accounts is broader and encompasses people who are able to understand financial principles (based on domestic accounts) but do not know accounting terminology.
  - Government accounts should therefore avoid using difficult accounting terminology and embrace plain English wherever possible. I have not found a situation where I cannot simplify the language so all members of my family can understand what, why and when transactions and balances are presented as they are. It should be possible for the government finance profession to develop a glossary or dictionary that they can all use as a basis.
  - All government accounts should try to embed a short paragraph at the start of each Note to the Account saying what the purpose of the note is, how it relates to their business and the reasons for any significant changes year on year. The description should be written in plain English and aid understanding and provide context rather than reconstitute the table of values into prose.
    - For example: *This note shows the amount of money that other entities owe X. The large balance in the Trade Receivables line is comprised primarily of amounts due from unpaid parking fines. The level of unpaid parking fines was X% of fines issued, which is a slight increase on previous years.*

Which parts of the accounts are, and are not, used by those scrutinising the government?

- The new 3-part format of annual reports is a welcome change, in particular the transfer of certain non-IFRS ‘Notes to the Account’ from the main financial statements to the Parliamentary accountability section of the Accountability part. However, I find it difficult to determine which paragraphs of the Accountability section are and are not audited. The FReM states that the statements should be clearly labelled as audited. Whilst government entities have tried to do this, I still find myself confused over whether certain paragraphs have or have not been audited. Since it is entirely right that some parts should be audited, I suggest that the whole Accountability part is audited.
- The reporting of outturn against budget in the Statement of Parliamentary Supply in the Accountability part is well intentioned but in reality it is overly complicated and it must be at risk of manipulation. This is an area that requires simplification. In particular, the presentation of DEL and AME confuses readers of the accounts. I can confirm that even Big 4 auditors of central government entities struggle to understand it. This is compounded by the lack of consistent application of the definition.
- There are some classifications that I do agree with:
  - Capital vs Revenue
  - Programme vs Administrative is useful, however I am not convinced that central government organisations understand the definitions and apply them consistently. I suggest three forms of expenditure:
    - Programme – the delivery of programmes and policies.
    - Policy – the research and development of policy. This category should also include the ‘write-off’ of expenditure on programmes that were announced but not rolled out in full due to practical
restraints or changes in political direction. Reporting of this may curb or prioritise the announcement of constant policy changes and policies that are announced but not implemented in full. It would require organisations to fully assess risk before committing funds.

- Administration – the corporate functions and any non-programme and non-policy items.

- Government departments are forbidden from overspending their annual budgets. On the face of it this sounds sensible but it can also lead to perverse decision making:
  - Organisations underspend for most of the year to ensure they have sufficient budget for any ‘surprises’; if no unexpected events arise, then organisations rush to spend their budget at year-end, which can lead to poor value for money.
  - Private sector contractors know that government organisations are restrained like this, and use the back-stop as a bargaining tactic during contract negotiations in order to get the best deal for them.

- To incentivise good decision-making, I suggest that government organisations adopt three year rolling budgets, and they are forbidden from overspending over any three year period.

- The presentation of Grant in Aid in the Statement of Changes in Equity is perplexing. This format makes it difficult for users to see if organisations have made a surplus or deficit. Grant in Aid should appear on the Statement of Net Expenditure, which could be re-titled as the Statement of Income and Expenditure.

- The purpose of the Statement of Changes in Equity is to allocate the surplus or deficit to the relevant reserves and make minor adjustments. This is important in company accounts because it shows the amount of available to pay shareholders as dividends. The situation is different for government, and I believe this Statement is not used by those scrutinising government finances, other than to find out how much grant in aid was received. I would suggest demoting it from the primary statements to a note supporting the reserves balances shown on the Statement of Financial Position. This would represent a departure from IFRS that the FReM could permit.

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**How could departmental accounts be improved to meet the needs of Parliament and the public?**

- Accounts should be presented to Parliament as fast as possible. Given the finite resources available this may require Parliament to requests government and auditors to prioritise certain large and high risk entities.

- The Whole of Government Account should show how much is being spent on the key functions of government: defence, police and fire services, healthcare, education, welfare, housing, and protecting environments, as well as interest on borrowing. Wherever possible there should be a clear link from these functions to the headings under which Estimates are prepared and reported against in the Statements of Parliamentary Supply in the departmental accounts.

- Ministers often announce more funding for initiatives, however it is not always clear where this funding comes from (more money from HM Treasury, underspends in other areas or cuts to other areas) or how and when it was spent. To address this, the financial and non-financial outcome of each announcement could be reported in a new section of the annual report and accounts.
As mentioned above, more interpretation of data needs to be embedded into accounts. This could include non-financial performance indicators to evaluate value for money, which auditors validate to ensure the data and messages being conveyed are true and fair. In effect, the accounts become Integrated Performance Reports.

If government made best use of technology, accounts could be presented in dashboards that are touch screen friendly, allowing users to
  o select how they want income and expenditure presented, for example,
    ▪ split by functions of government,
    ▪ split by objectives in Single Department Plans,
    ▪ split by components in consolidated accounts, or
    ▪ split according to the current headings;
  o drill down into figures that are of interest to them;
  o present data graphically to show trends and proportions; and
  o compare financial data with non-financial performance indicators, including inflation, employment rates and house building to crudely evaluate cause and effect.

To present data like this all public sector organisations (central and local government, health and education sectors) should adopt the same ‘language’ for tagging detailed financial balances and transactions. For example, the XBRL (eXtensible Business Reporting Language) is a global standard for exchanging financial information. The Treasury already has a language called the Standard Chart of Accounts that it uses for budgeting and compiling WGA; which BIS adopted and modified slightly for its purposes. Further consultation could make the Standard Chart of Accounts suitable for all public sector entities.

If government made best use of technology, it could present Parliament with audited 12 month ‘rolling’ accounts every quarter.

Auditors are required to disclose their materiality in the private sector. As I understand it, this allows stakeholders to understand the margin of error that figures may be subject to. Materiality, however, is based on quantitative and qualitative factors based on what could influence decision makers. In effect, auditors have already decided that the margin of error would not impact on the decisions made by key stakeholders. Often the quantitative level of materiality if based on a small percentage of income or expenditure. This means that materiality will run into tens of millions of Pounds. Disclosure of materiality in the public sector could be interpreted by the media that, in aggregate, auditors are not concerned about the waste of hundreds of millions of Pounds. I do not believe this to be the case. Such pressure may result in the media dictating what materiality should be, which will be very low, which will result in a level of micro-audit that would stifle government and be incredibly costly.

How far should other government accounts reflect the format of departmental accounts?

Members of the Public Accounts Committee were taken aback by the magnitude of certain figures in the Whole of Government Account when they scrutinised it for the first time in 2011. These figures had always been available in government accounts but WGA was the first time it was brought together in one place. This could suggest that the number of accounts is overwhelming and that it is too fragmented to obtain an overarching picture of what is going on in the public sector.

I would recommend that government reduces the number of accounts published. The data of the organisations who are no longer published would be reported and audited via the consolidated accounts. In the event of an issue requiring
further probing and transparency, Parliament could request that the organisation publishes its individual account, which would be audited; but this would be on an exceptional basis.

- Certain component accounts may be subject to other legislation (Charities or Companies Acts) that requires them to publish their accounts. This should not change overall, however, the number of accounts would reduce, which would reduce the time and financial burden on government organisations.

Who should have control over the format of Departmental accounts and WGA?

- FRAB’s membership is biased towards the suppliers of financial information, i.e. representatives from Whitehall. Its impact may benefit from more members who are consumers of financial information. MPs with accounting qualifications should be encouraged to join.
- Financial reporting has to be cost effective. It should not become a cottage industry that no one understands. Therefore non-accountants with a commercial background are also required.

How can we judge the success of Departmental accounts as disclosures of information to the public?

- If accounts are published on the Gov.uk website, then it should be possible to measure the success in two ways:
  - Monitor who accesses the accounts split into four categories: the source department, HM Treasury, the National Audit Office and other. Websites can monitor the source of their ‘hits’ by IP address.
  - Monitor feedback left in comments fields, like YouTube or LinkedIn does. Government departments could respond to these comments where appropriate.

How can financial scrutiny of Departments in both Parliament and outside be improved?

- Whilst all departmental select committees are responsible for scrutinising the accounts of their department, not all do. All select committees should scrutinise annual report and accounts with witnesses including:
  - the Accounting Officer, Director-General for Finance and Chair of the Audit Committee from the Department;
  - the Accounting Officers, Finance Directors and Chairs of the Audit Committees for any arm’s length bodies of interest; and
  - the Comptroller and Auditor General and Auditors for the Department and any arm’s length bodies of interest.
- In local government there is a requirement to publish the audit completion report. A similar requirement should be in place for central government. It should be possible for the Department, with the agreement of the auditor and relevant select committee to not publish aspects of the audit completion report that may place the government at a commercial disadvantage, identify specific people or undermine security efforts, including the identification of security weaknesses in IT systems.

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