

# Managing government finances

Total public sector spending in 2013-14 was £720bn, with 85% of government revenue raised through various forms of taxation. Departments are allocated different amounts of this, from DWP (more than £170bn) to the Cabinet Office (£500m).

How departments allocate this spending varies dramatically. For most departments, the majority of their spend is through Departmental Expenditure Limits (DEL), the spending that departmental leaders can allocate to meet their objectives. However, for some departments, most of their spend is Annually Managed Expenditure (AME), which is demand-driven and cannot be set in advance (for example, benefits and pensions).

Departmental expenditure can also be divided into resource spending (which covers the cost of running the department and spending on policies and programmes) and capital spending (that which adds to the public sector's assets, for example on buildings and roads).

In addition, departmental leaders must manage a portfolio of assets and liabilities. DECC (nuclear decommissioning) and DH (clinical negligence) are the departments with the largest liabilities, and these have risen over the past few years.

Departments also vary in the territorial extent of their spending. With devolution to Northern Ireland, Scotland and Wales, some departments have had most or all of their spending responsibilities devolved, although others still cover the whole of the UK.

We end the chapter by examining how departmental spending plans have changed since the 2010 Spending Review, and the extent to which departments are transparent about this. Our research concludes that, while departments clearly explain changes due to shifts in policy or transfers between departments, changes within financial years, which have resulted in significant underspends, are not explained.

## About the data

In looking at the financial picture **across government**, we use the Whole of Government Accounts (WGA). These are consolidated financial accounts of the whole public sector based on International Financial Reporting Standards. They have been published by the Treasury since 2009-10. We also used the Office for Budget Responsibility's *Public finance databank* as of October 2014.<sup>1</sup>

For more **detail on government departments**, we have used the reports and accounts published annually by each department. These contain consolidated financial statements for the departmental group as well as reporting against parliamentary supply estimates and the various spending control totals.<sup>2</sup>

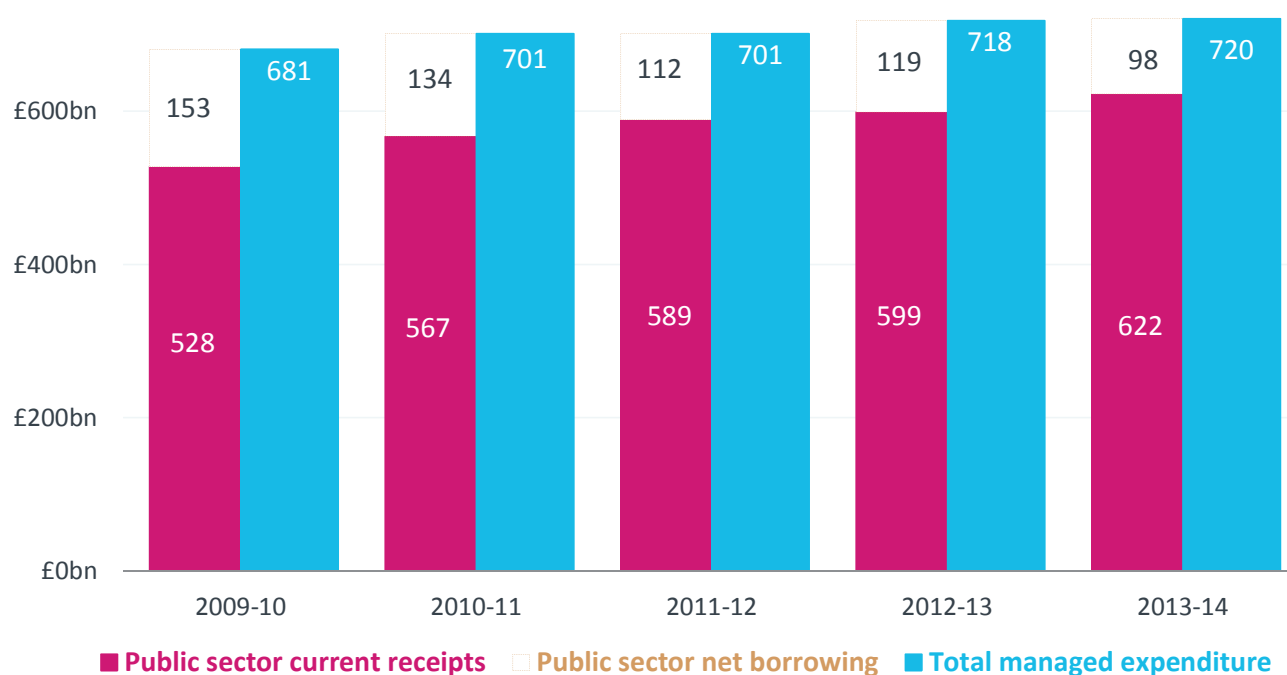
Our work on the **territorial spend of different departments** is based on *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy*.<sup>3</sup> This contains details of how spending allocations to the devolved administrations are decided.

In our work on **transparency**, we use the Public Expenditure Statistical Analyses (Pesa) and refer to Budgets and Spending Review 2010. Pesa is published by the Treasury every year and contains outturn and forecast figures for a large number of spending control totals. Spending Review 2010 set the forward spending plan for all departments for a five-year period: the annual Budget report contains updates to these forward spending plans.<sup>4</sup>

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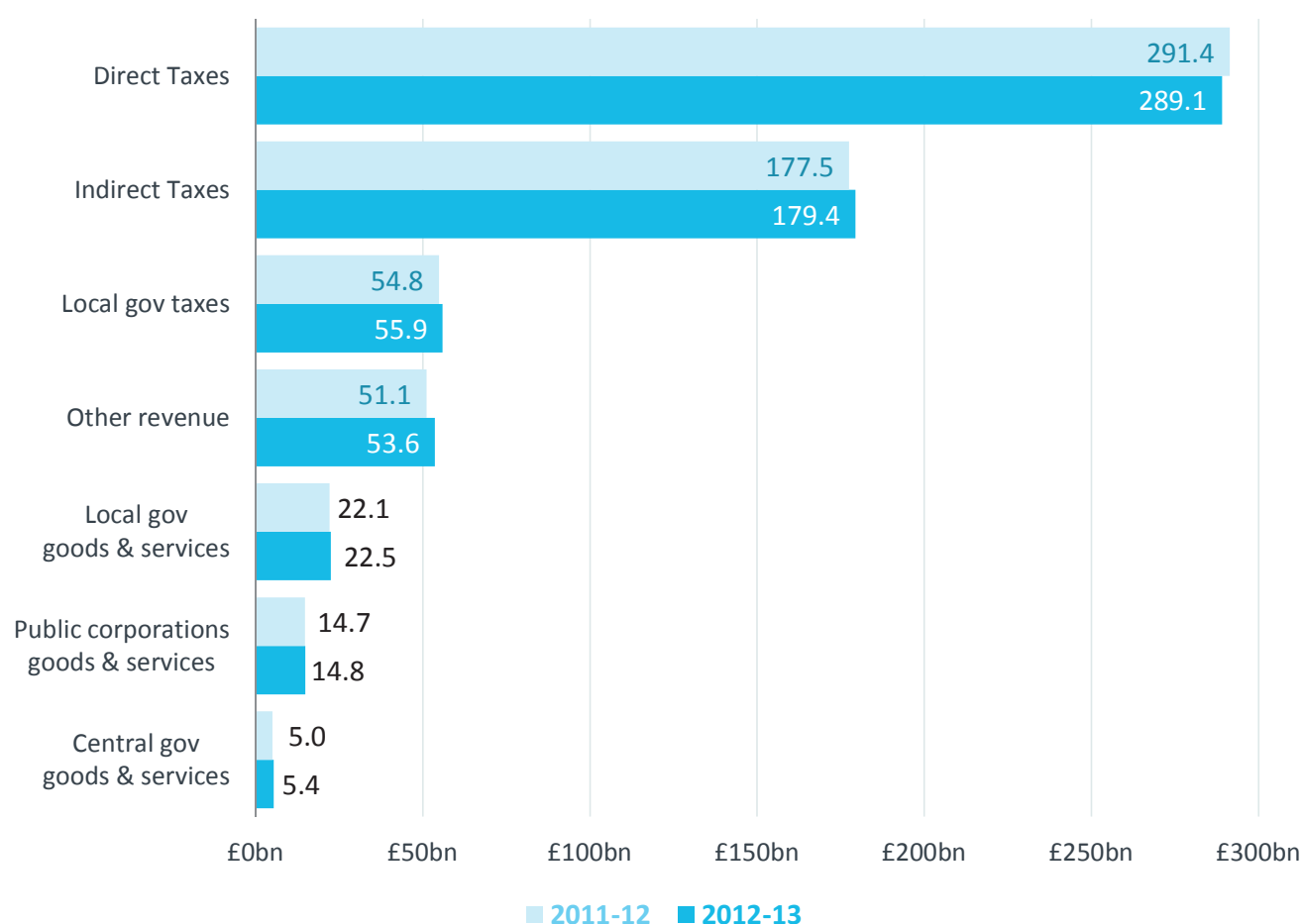
## Across government: total public sector spending of £720bn; DWP the highest-spending department

**Figure 2.1: Government revenue and expenditure, 2009-10 to 2013-14**



Source: Institute for Government analysis of OBR *Public finances databank*, October 2014.

Public sector spending in 2013-14 was £720bn, £98bn more than the £622bn raised through taxation and other revenue sources.

**Figure 2.2: Sources of government revenue, 2011-12 and 2012-13**

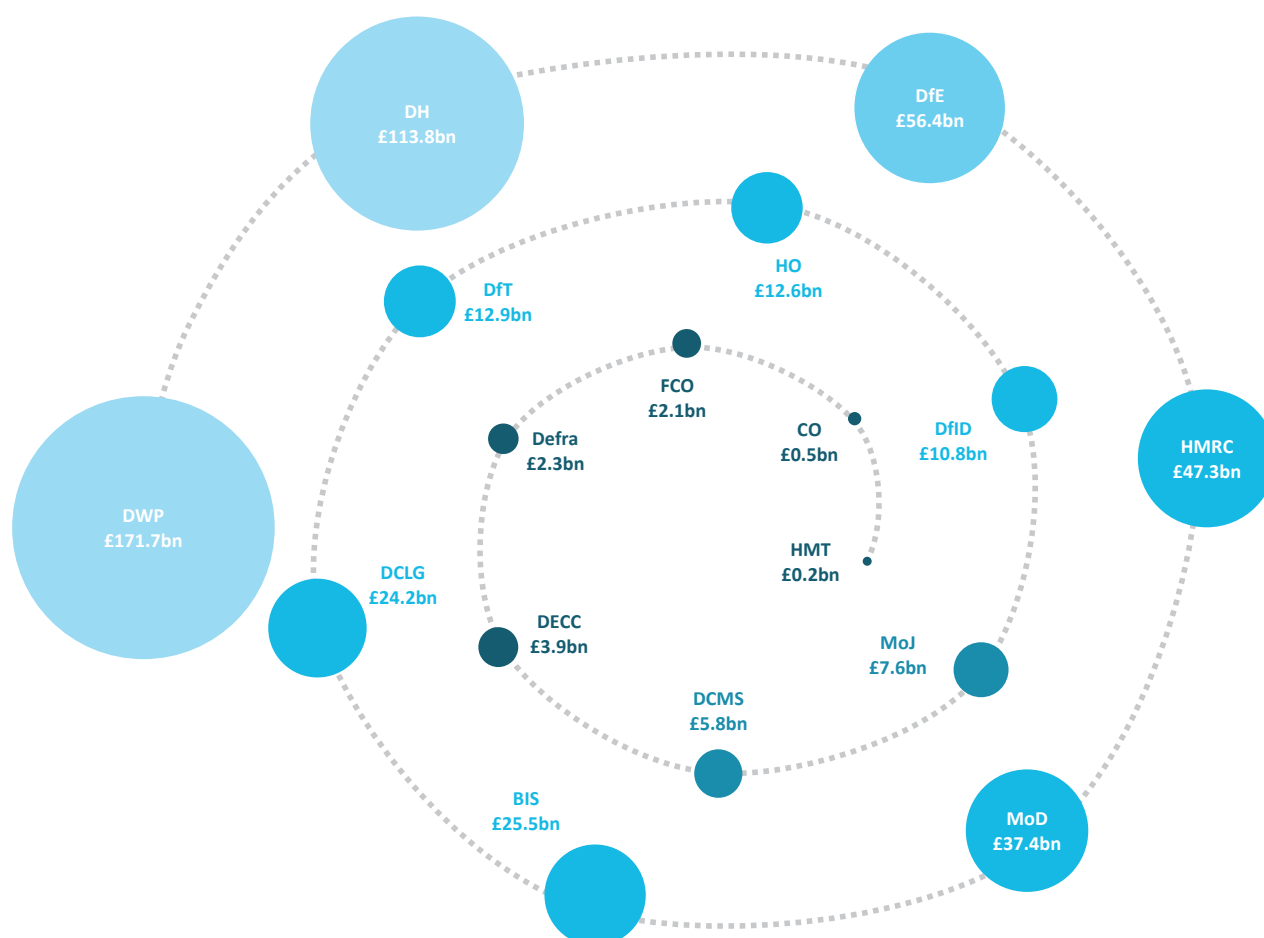
Source: Institute for Government analysis of WGA, Notes 3, 4 and 5.

The bulk – £524bn or 85% – of government revenue in the year to March 2013 came from taxation. Central government raised £289bn (47% of all revenue) in direct taxes, which include income tax, National Insurance contributions and corporation tax. Indirect taxes, which include value added tax, amounted to £179bn or 29% of all revenues.

Departments also receive income from goods and services they provide through their operations (£5bn or 1% of all revenue). The largest component of this is income related to the Nuclear Decommissioning Authority, and it also includes NHS income. Government's 'other revenue' (£54bn or 9% of the total) includes items such as industry levies, local government housing rental income, and income from EU funds.

The majority of these funds come together in the Government's Consolidated Fund and are allocated to departments on the basis of Spending Review and Budget negotiations and parliamentary approval.<sup>5</sup>

**Figure 2.3: Total Managed Expenditure by department, 2013-14**



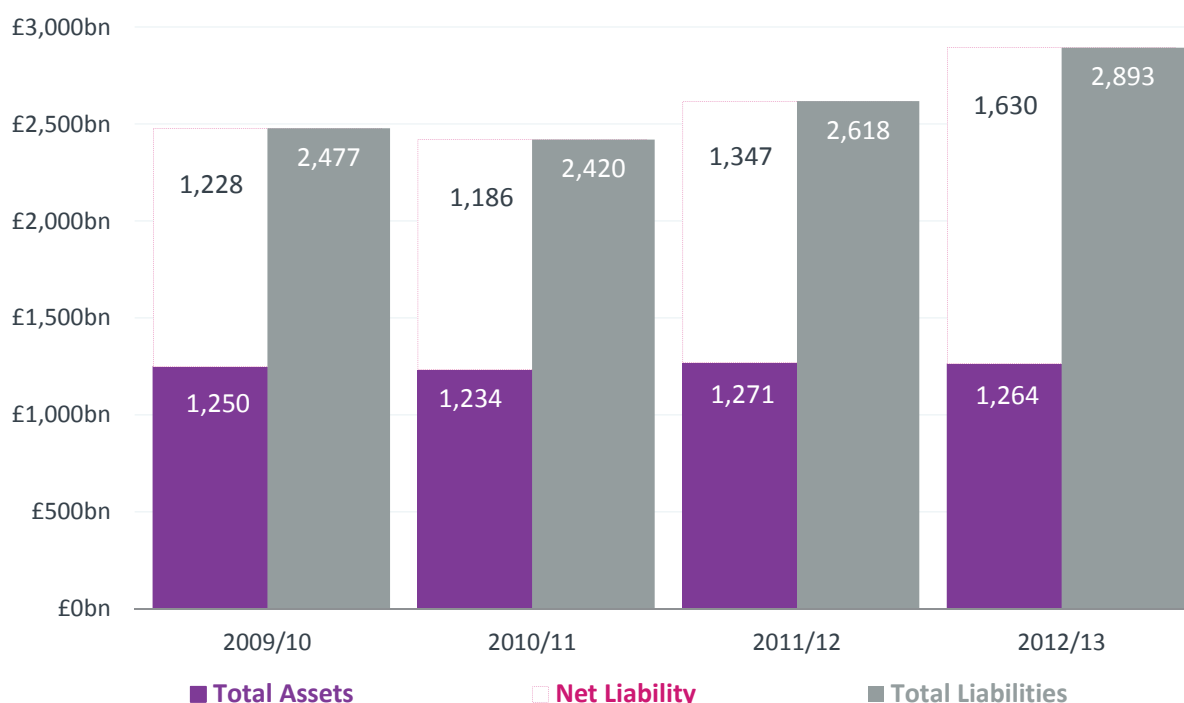
Source: Institute for Government analysis of Annual Reports and Accounts, 2012-13, planned total expenditure for 2013-14. We have combined total spending for DCLG Local Government and DCLG Communities to give a TME figure for DCLG. CO does not include spending on the Single Intelligence Account (which provides funding for the security and intelligence agencies, GCHQ and the Secret Intelligence Service), which was expected to be £1.7bn in 2013-14.

Total Managed Expenditure (TME) represents the total funds available to the department as decided at various fiscal events, which include the Spending Review, annual Budgets and parliamentary approval. It includes funds that are channelled through it and passed on to other bodies and organisations. TME varies considerably between departments according to their size, responsibility and function.

The two largest departments by size of budget are DWP and DH, each with TME of more than £100bn. Mid-sized departments, controlling annual budgets of between £10bn and £50bn, include DCLG, BIS and MoD. At the other end of the spectrum are departments with spending allocations of under £5bn, including the Cabinet Office with £500m TME, and the Treasury, with £200m TME.

## The Government's balance sheet: there is more to it than the public debt, and some liabilities have been growing fast

**Figure 2.4: Government assets and liabilities, 2009-10 to 2012-13**



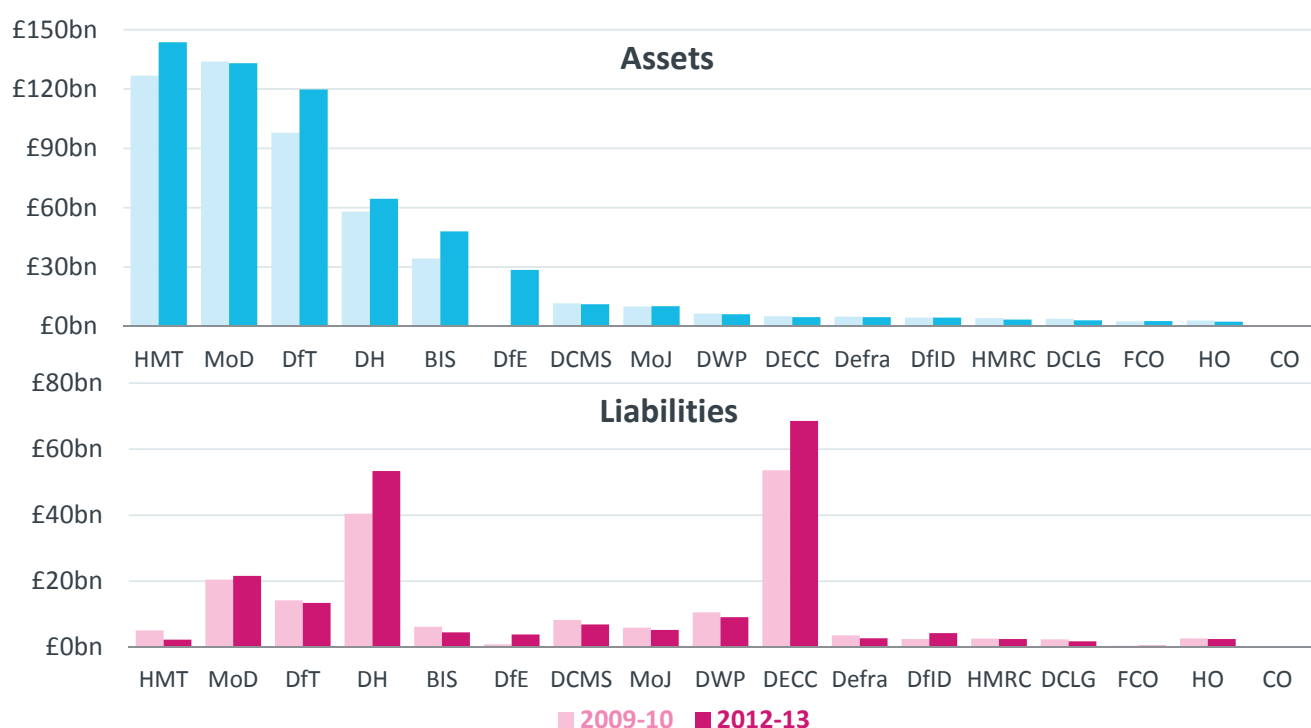
Source: Institute for Government analysis of WGA Statement of Consolidated Financial Position.

However, the spending allocations that departments receive are not the only financial resource that departmental leaders oversee. They are also responsible for a large portfolio of assets and liabilities.

At the whole-of-government level, assets amounted to £1.264trn in 2012-13. This is made up chiefly of property, plant and equipment (£747bn), such as buildings and roads. Government also holds assets in the form of loans and advances, such as loans to financial institutions (£47bn) and the student loan book (£36bn).

On the other side of the Government's balance sheet are its liabilities. In 2012-13, these amounted to £2.893trn, of which the largest components were obligations for public sector workers' pensions (£1.172trn) and government financing and borrowing – the public debt (£996bn).

While government debt is managed by the Treasury, and large portions of the pension liability reflect centrally made policy decisions about terms and conditions for public servants, much of the Government's balance sheet is managed by individual organisations, including Whitehall departments.

**Figure 2.5: Departmental assets and liabilities 2009-10 and 2012-13**

Source: Institute for Government analysis of departmental Annual Reports and Accounts (Consolidated Statement of Financial Position). The totals differ substantially from the whole-of-government balance sheet because departmental accounts do not include government debt, pensions accounts and local government assets and liabilities. Increase in DfE liabilities results from school assets newly consolidated in DfE accounts.

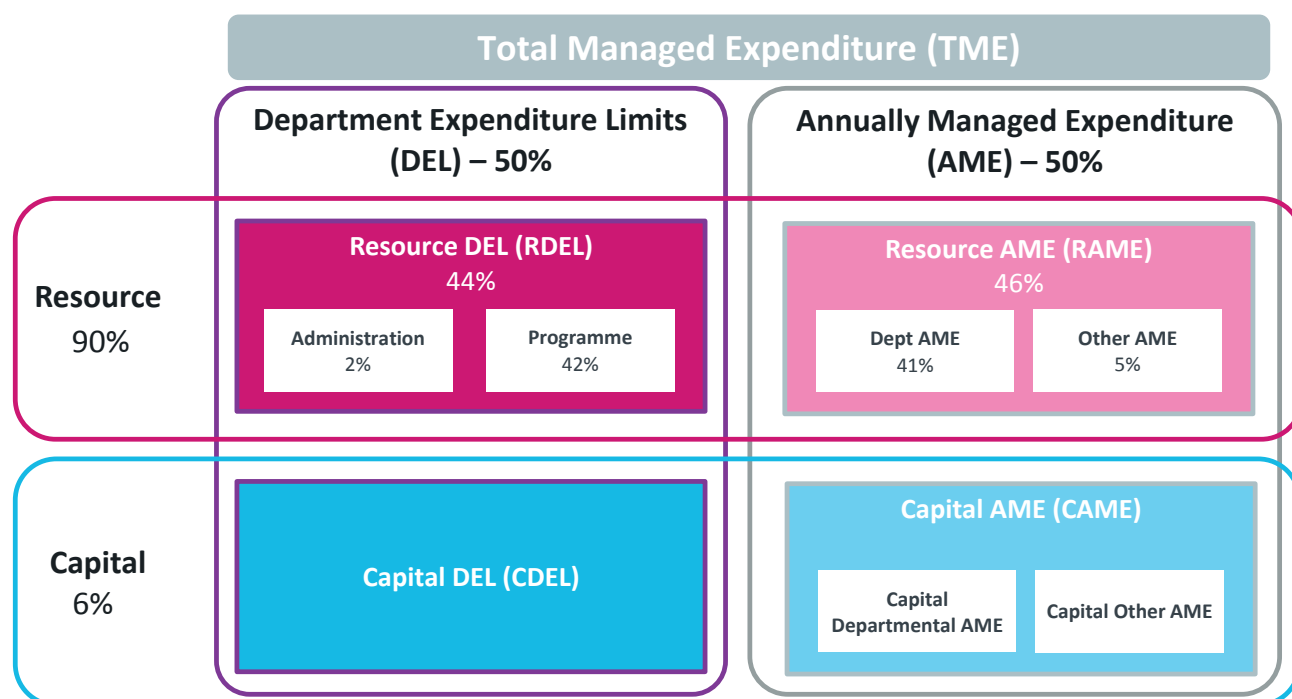
Departments vary widely in terms of the levels of assets and liabilities and the balance between them. On the asset side, the Treasury, MoD and DfT stand out. The Treasury's balance sheet reflects the large stakes that the state took in private sector banks in the wake of the financial crisis; MoD holds the military estate and the stock of weapons systems and ammunition; and DfT manages a large part of the road network. BIS, meanwhile, holds the student loan book. The significant change in the size of the DfE asset portfolio reflects the inclusion of academies' estates in this year's DfE accounts, whose share in the education system has grown. Notably, some assets are not included as the Treasury did not think they could be accurately valued: for example, DCMS does not include assets such as artworks in the galleries it sponsors or in the Crown Estate.

On the liabilities side, DECC and DH hold the highest totals. DECC's liabilities arise predominantly out of the Government's obligation to cover the cost of decommissioning nuclear power plants (£70bn), while about half of the DH liability is made up of provisions for NHS clinical negligence claims (£24bn). Both of these large, departmentally managed liabilities have grown in the year to March 2013. The nuclear decommissioning provision has increased by 26% since 2010 (9% in the past year), while the provision for clinical negligence claims has grown by 53% (24% in the past year).<sup>6</sup>

Stringent controls apply to the spending of public money, but there are fewer rules around the management of assets and liabilities across government. Where these exist, they are limited to a particular type of asset, such as the controls on government estate, which we discuss in the next chapter.

## Departments: DWP, HMRC dominated by demand-led spending; DfT and DECC by capital

**Figure 2.6: Breakdown of Total Managed Expenditure**

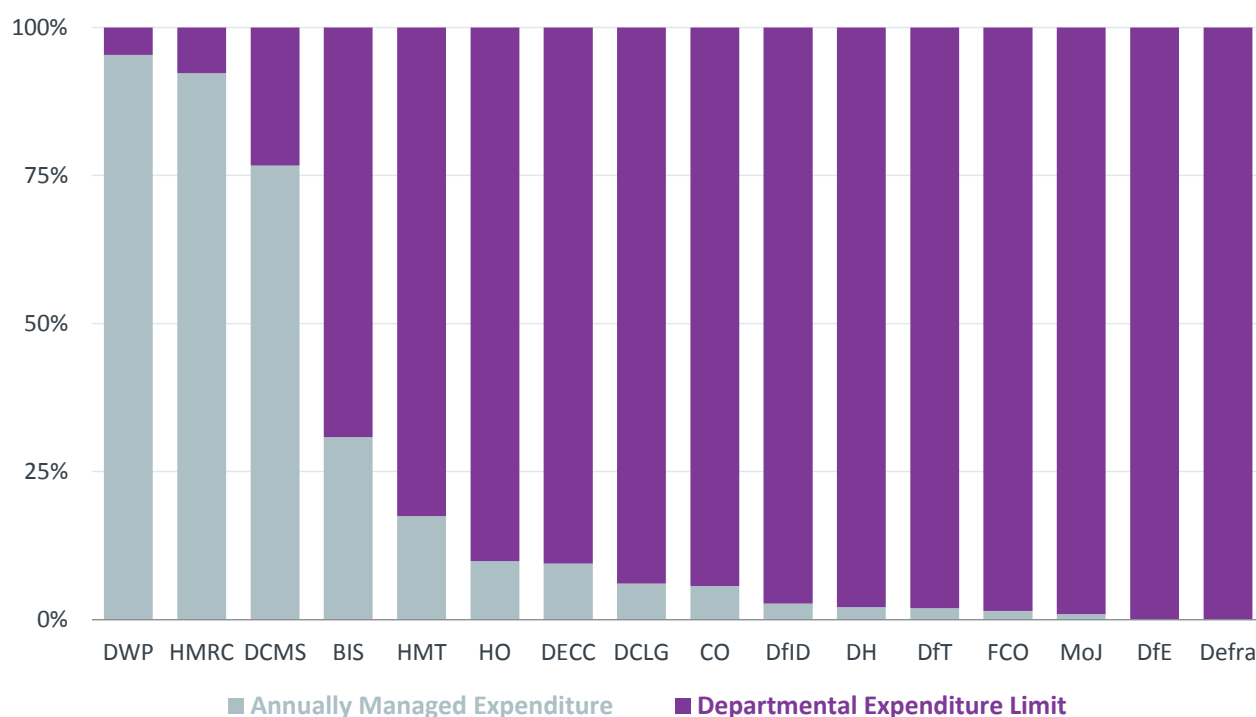


Source: Institute for Government analysis of Pesa 2014. Note that the resource and capital percentages here are aggregates of DEL and AME percentages and may not match resource and capital totals published in Pesa 2014. The resource and capital do not sum to 100% because we have excluded depreciation.

As part of the strict processes and controls applying to how and where departments can spend their money, a department's spending allocation for each financial year – its TME – is broken down into different categories, each of which can only be used for particular kinds of spending.

At the top level, departmental budgets are split between Departmental Expenditure Limits (DEL) and Annually Managed Expenditure (AME). DEL spending represents a known quantity, covering plans that departments are committed to: the spending that departmental leaders can allocate to meet their objectives. DEL budgets are often set for a multi-year period, with minor adjustments made within the annual reporting cycle. DEL spending is limited, meaning departmental leaders cannot overshoot their allocated DEL budget.

AME relates to 'volatile and demand-led' spending, which departments are obliged to undertake but which cannot be constrained in advance.<sup>7</sup> This may be because it relates to functions that are demand-driven, such as pensions or welfare payments, or subject to external factors (such as revenue from BBC licence fees).

**Figure 2.7: Departmental DEL and AME spending, plans for 2013-14**

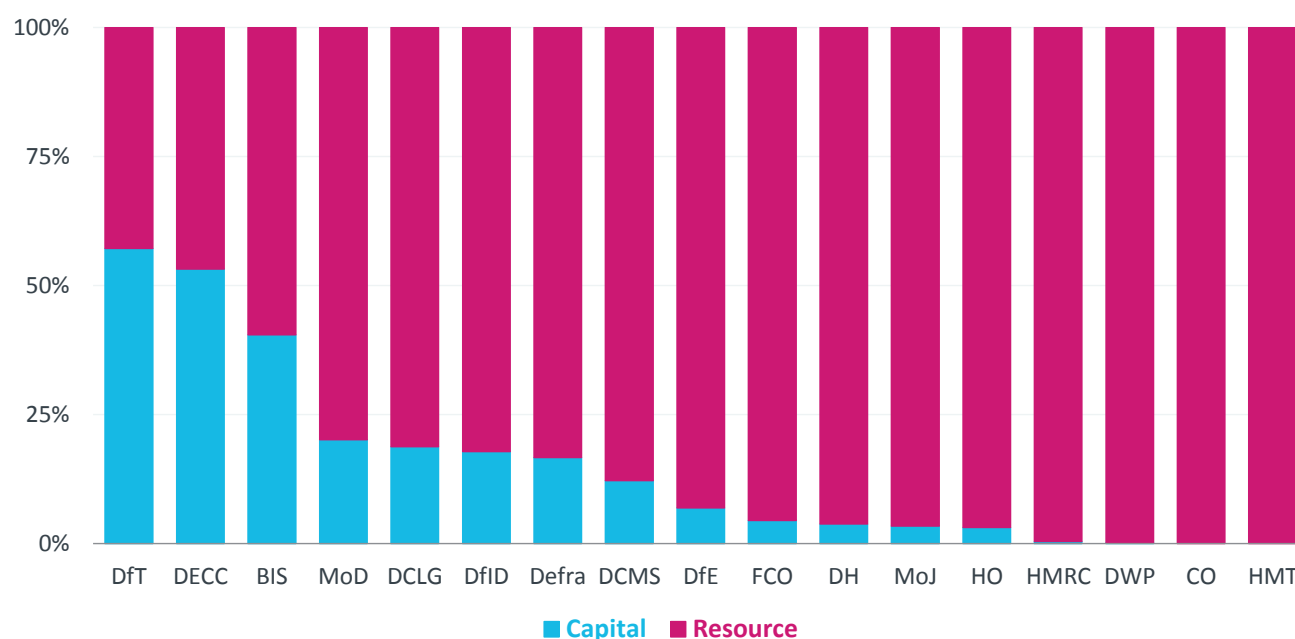
Source: Institute for Government analysis of Annual Reports and Accounts, 2012-13. HMT and DfID do not produce a CAME figure, so we have aggregated RDEL and CDEL, and RAME. We have aggregated DCLG Communities and DCLG Local Government. We have excluded MoD as it does not produce a figure for RDEL depreciation. In the documentation, AME for CO, DfE and Defra are shown as negative. This is due to AME spending set aside as provision for future spending which is no longer required being released back to the department and showing as income. Here we have excluded these released provisions.

The proportion of DEL and AME varies according to each department's policy responsibilities and functions. The majority of DWP and HMRC's spending is categorised as AME because they are responsible for policy areas that are demand led, such as pensions and welfare. For DWP, the largest single element of AME is the state pension (£83.4bn in 2013-14), followed by housing benefit (£17.7bn). HMRC's AME budget for 2013-14 includes £30bn for personal tax credits and £11.8bn for social benefits and grants.

DCMS and BIS have a smaller but still significant proportion of their annual spending categorised as AME. For DCMS, AME spend includes £3.2bn allocated to the BBC and other broadcasting bodies; for BIS, it includes £7.6bn on higher education (comprising spending on student loans).

Other departmental budgets – such as DfE and Defra – are almost entirely categorised as DEL.



**Figure 2.8: Departmental capital and resource spending, plans for 2013-14**

Source: Institute for Government analysis of Annual Reports and Accounts, 2012-13.

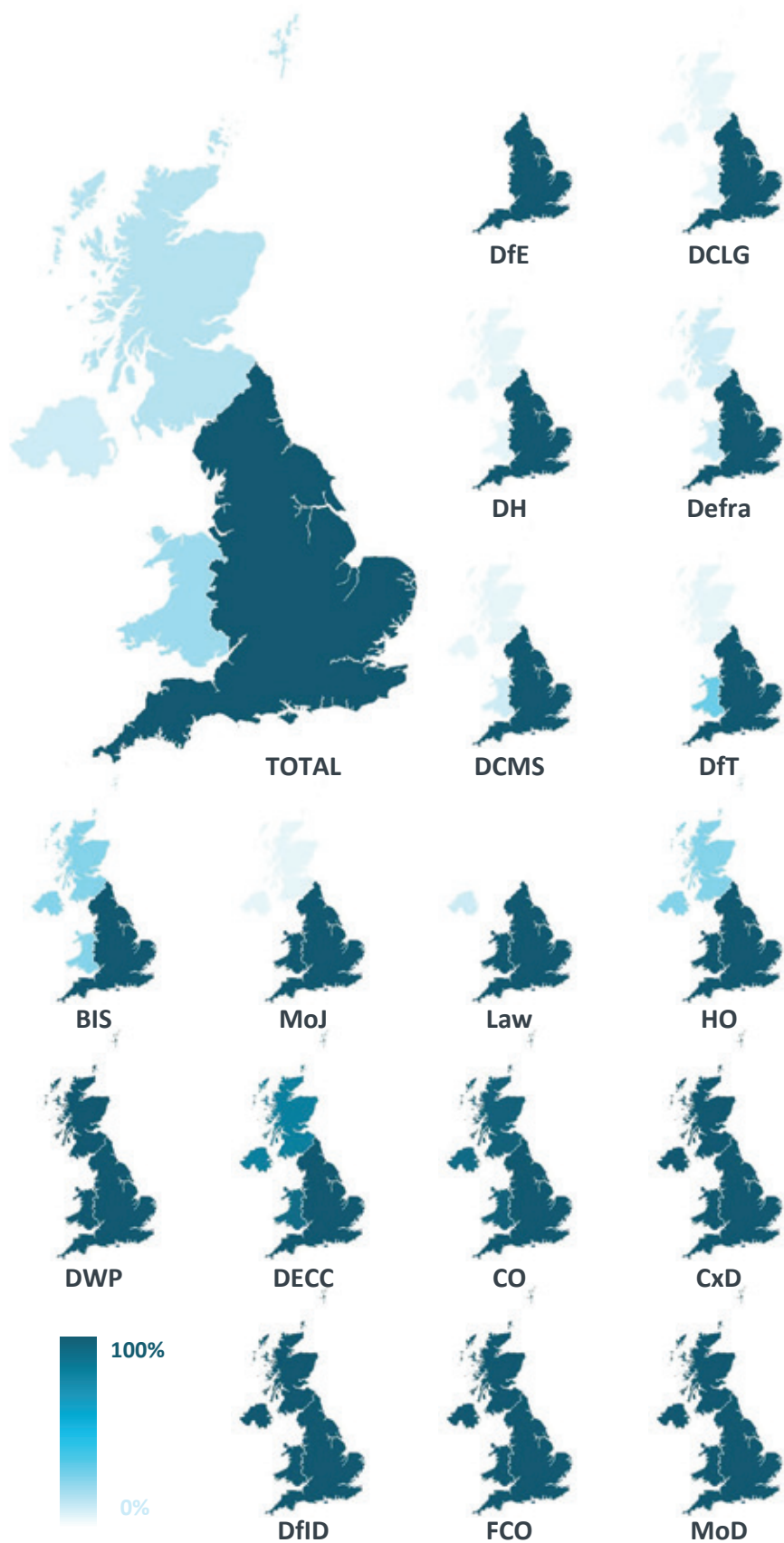
The other major division within TME is between capital and resource spending. Resource spending covers the department's day-to-day operations, and is further divided into administration spending, which covers departmental running costs including staff salaries and accommodation, and programme spending, which pays for departmental policies and programmes.

Capital spending adds to the public sector's fixed assets, such as transport infrastructure and public buildings. Funds earmarked for capital spending cannot be transferred to resource spending. This ring-fencing is intended to ensure that sufficient funds are invested in public sector assets to protect and maintain their value.

As with DEL/AME spending, the proportion of a department's total budget categorised as capital or resource spending depends on the nature of its policy functions and responsibilities. DfT, DECC and BIS have the highest proportion of spend allocated to capital budgets. Much of DfT's capital budget goes on maintenance of, and investment in, the UK's transport infrastructure: its capital budget for 2013-14 includes £3.4bn of spending on Network Rail, £1.1bn on Crossrail and £1.6bn on the Highways Agency. Much of DECC's £2.1bn capital budget is related to nuclear energy – £1.6bn on the Nuclear Decommissioning Authority and nuclear Site Licence Companies. BIS's large proportion of capital spend is due to funding it receives to cover student loans. Although this comprises a smaller proportion of its overall spending, MoD has the highest capital budget (£9.7bn) of all government departments, the majority of which is used to cover the cost of military equipment (£5.7bn).

Devolution: DfE the only England-only department by spend

Figure 2.9: Extent of devolved responsibility by department



Source: Institute for Government analysis of UK Government *Statement of Funding Policy*, 2010.

Some government departments cover policy areas and functions that apply to the whole of the UK, while others have responsibilities that are more or less devolved to different nations. The Government's 2010 *Statement of Funding Policy* sets out how funding levels to the devolved administrations are decided, giving a measure for each departmental programme indicating the extent to which it is devolved to Northern Ireland, Scotland and Wales.<sup>8</sup>

DfE is the only department where 100% of services and policies are carried out by the devolved administrations. Its funding therefore applies only to England.<sup>9</sup>

At the opposite end of the spectrum are departments that act on behalf of the UK as a single unit with no distinct responsibilities in any devolved territory. This category includes the FCO, MoD and DfID, since no foreign policy or defence responsibilities are devolved.

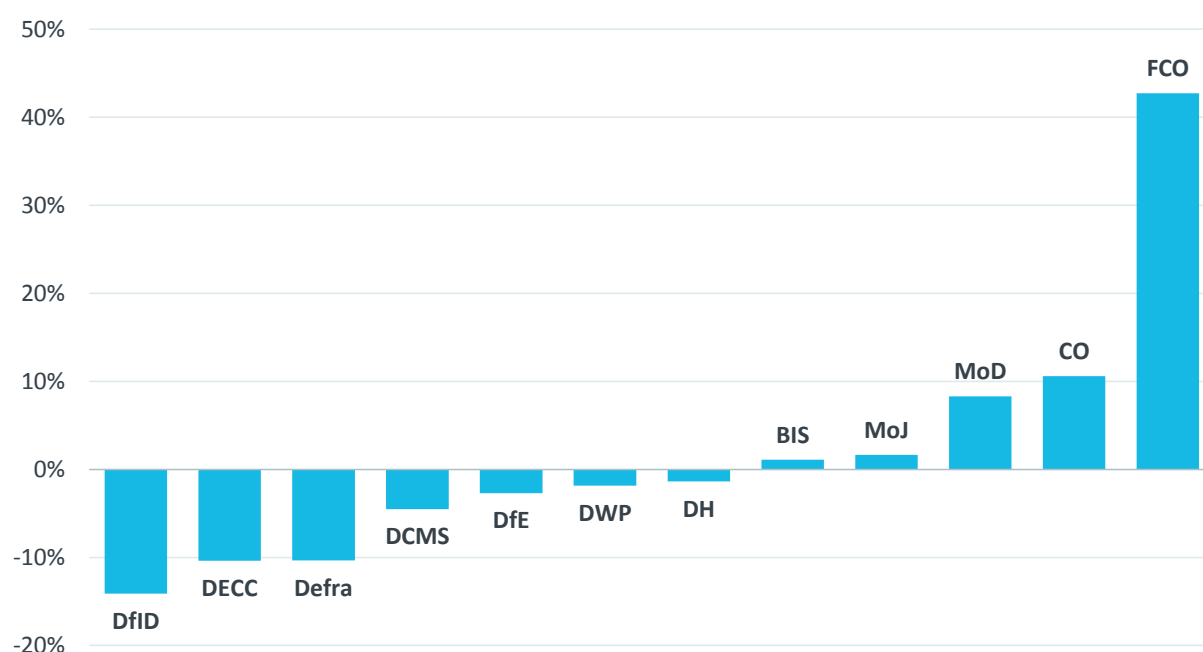
The majority of departments fall somewhere between these two extremes. Around three-quarters of the Home Office's programme spending covers England and Wales only; this includes spending on crime and policing, which are fully devolved to Scotland and Northern Ireland and funded by block grants to those administrations. The remaining quarter of programme spend is allocated to UK-wide programmes including Immigration, the Passport Agency, and Serious and Organised Crime.

DfT is an extreme example of the territorial sub-division of programme spending. It allocates programme expenditure to four different territorial groupings:

- numerous arm's-length bodies funded at a UK-wide level<sup>10</sup>
- bodies (such as the DVLA and Office of Rail Regulation) that apply to England, Scotland and Wales but not Northern Ireland
- Network Rail, the British Transport Police and capital rail projects (England and Wales only)
- other programmes and policies, such as the Highways Agency and Crossrail (England-only).

## Financial transparency: departments clear on policy changes, but not on in-year shifts in spending

**Figure 2.10: Percentage change in resource DEL 2013-14 between Spending Review 2010 plans and outturn**

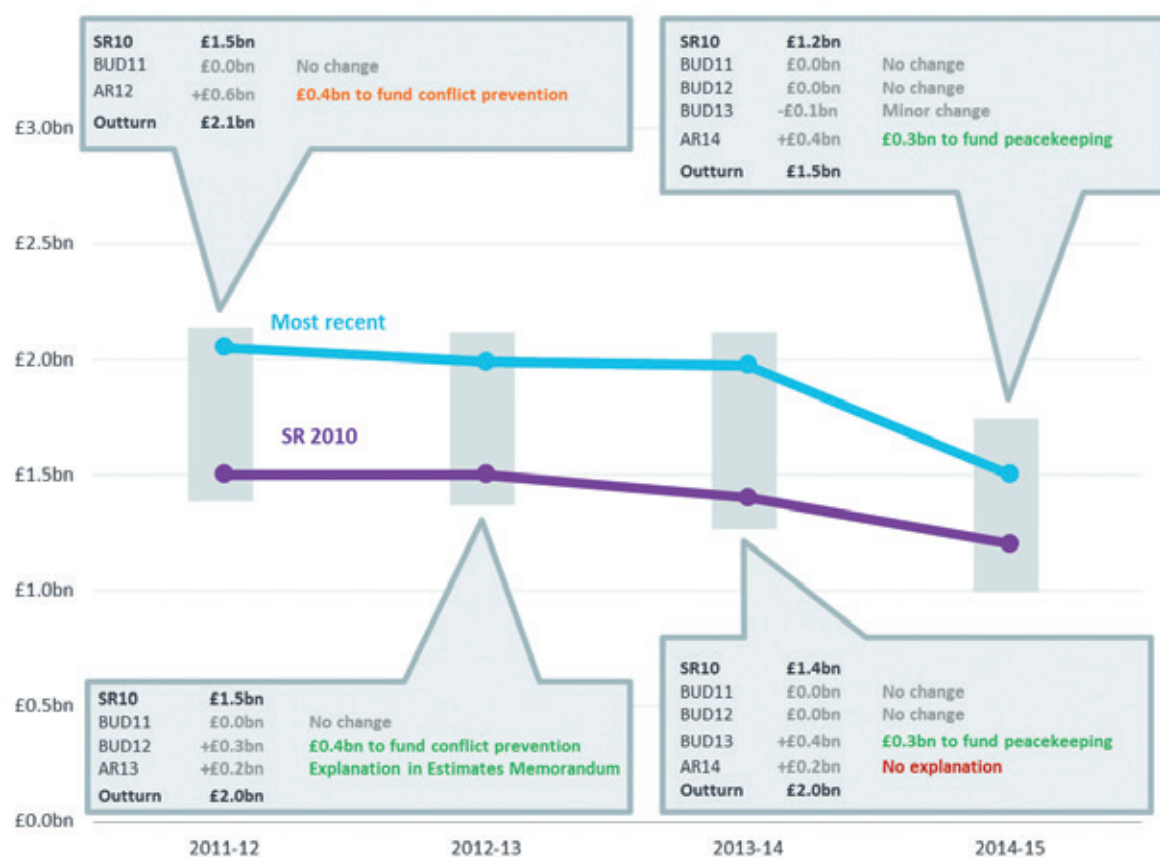


Source: Spending Review 2010 table 1 and Pesa 2014 table 1.5 (figures exclude depreciation). Pesa figures rounded to one decimal place to match Spending Review figures. HO, DfT and DCLG excluded from chart as figures affected by budget transfers between departments. CO is aggregated with the Single Intelligence Account in these figures.

The Coalition set itself a stretching challenge to reduce spending rapidly to address the deficit, and has done so quite successfully so far, reducing spending with very few reversals. The expected outturns for 2013-14's DEL relative to the amount expected in Spending Review 2010 show that, in many departments, spending is lower in nominal terms than was planned in 2010.

DEL budgets are generally set for multi-year periods (Spending Review 2010 set out forward plans across several financial years). More detailed spending controls are set each financial year through the Budget process, at which spending plans may be revised upwards or downwards. Comparing the original spending plan for each financial year with subsequent revisions and final outturn figures (as above) allows us to track changes in departmental budgets, to measure progress against financial targets and, when departmental budgets are increased or reduced, to identify when that change took place and why.

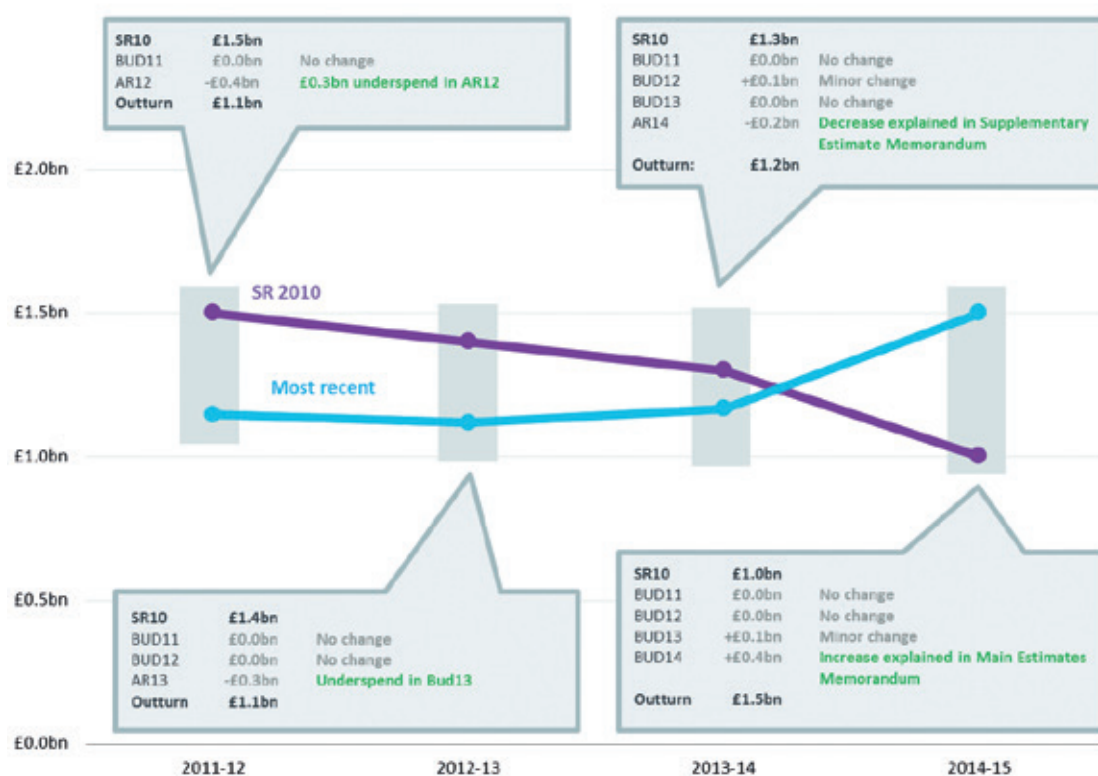
Below we select several departments that show significant changes in outturn, and indicate whether these are fully explained. Ideally, we would expect departments to explain the changes in the spending documents where they occur.

**Figure 2.11: Foreign Office – changes to spending plans since Spending Review 2010**

Source: Institute for Government analysis of Budgets 2010-14, Pesa 2011-14, Spending Review 2010 and FCO Annual Reports and Accounts, 2011-12 to 2013-14.

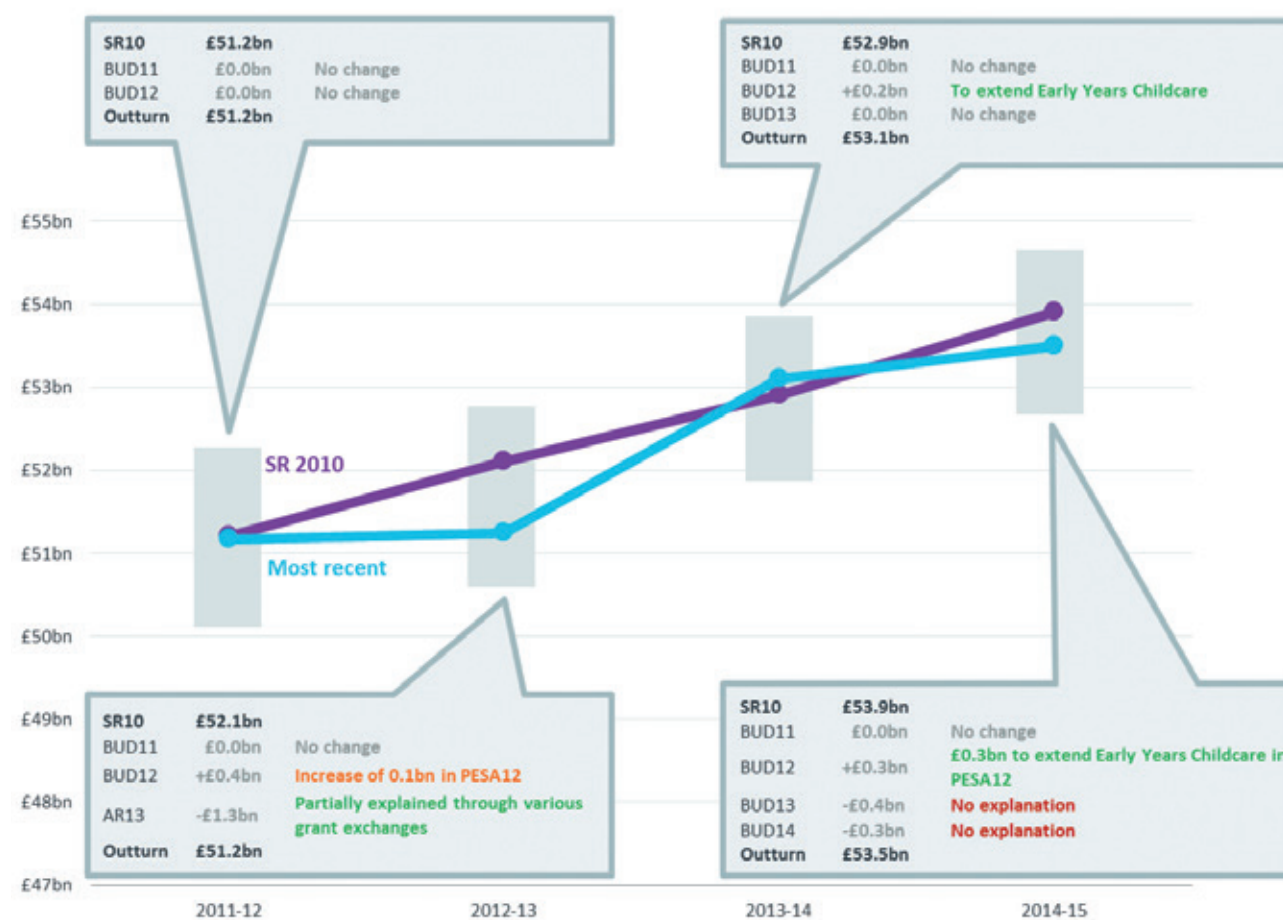
The Foreign Office's annual outturn has been consistently above plans set out in Spending Review 2010. In most cases where spending has increased, this has been due to a transfer of funding from the Special Reserve (which contains funding not allocated in the Budget) to cover peacekeeping operations and conflict prevention. These transfers were noted in Pesa. In financial year 2013-14, however, the final outturn figure was around £200m higher than set out in the previous fiscal report. There is no obvious explanation in the department's annual report for this increase in RDEL spend.

Figure 2.12: DECC – changes to spending plans since Spending Review 2010



Source: Institute for Government analysis of Budgets 2010-14, Pesa 2011-14, Spending Review 2010 and DECC Annual Reports and Accounts, 2011-12 to 2013-14.

DECC has consistently kept to the limits set down in Spending Review 2010 and underspent in financial years 2011-12 and 2012-13. Where outturn has fallen due to an underspend, this has been reflected in the Annual Report and Accounts. However, the department's outturn in 2013-14 was £200m lower than expected, and an increase has been projected for financial year 2014-15. There is no obvious explanation for these increases in this year's annual report or Budget 2014, but these changes are fully explained in Estimates Memoranda.

**Figure 2.13: DfE – changes to spending plans since Spending Review 2010**

Source: Institute for Government analysis of Budgets 2010-14, Spending Review 2010, Pesa 2011-14, and DECC Annual Reports and Accounts 2011-12 to 2012-13.

DfE has followed the spending trajectory set out in Spending Review 2010 relatively closely and with few revisions to each annual plan. Spending increases due to the decision to extend early-years childcare were clearly indicated in Pesa. Plans for financial year 2014-15, however, have been more volatile, with the spending profile rising at Budget 2012 before falling at Budgets 2013 and 2014. Again, we can find no explanation for these movements.

While these charts give only a partial account of the transparency of movements in departmental spending plans, the trends within them are common across a number of departments. Transfers of funding from one organisation to another (such as the drawdown of funds from the Special Reserve, as with the Foreign Office, or the transfer of transport grants from DfT to DCLG) or increases in spending due to new policy announcements (such as the extension of early-years childcare by DfE) are generally well documented in Annual Reports and Accounts or Pesa. It is far harder to track changes in spending within a department across a single financial year. Underspends are often only partially accounted for in the Annual Report and Accounts, and we can find no explanation at all in the annual Budget document.<sup>11</sup>

Movements in the other direction are even less transparent – in financial year 2013-14 both DECC and FCO reported higher outturn figures than indicated in Budget 2013, but we could find no explanation in the Annual Report and Accounts.

**Figure 2.14: Transparency of departmental spending plans**

Department	2011-12	2012-13	2013-14	2014-15	Average rank
DECC					1
DCMS					2
MOJ					3
DH					4
DfE					5
DWP					6
BIS					7
DfT					8=
DCLG					8=
FCO					9
DfID					10
MoD					11=
Defra					11=
HO					13
CO					15=
HMRC					15=
HMT					15=

Source: Institute for Government analysis of Budgets 2010-14, Spending Review 2010, Pesa 2011-14, and departmental Annual Reports and Accounts 2011-12 to 2013-14. Changes of less than £100m were excluded.

We have graded each department according to how transparently they account for movements in spending plans. For each financial year we compared the original spending plan, as published in Spending Review 2010, with each republication of the plan for that financial year (in annual Budget documents, Pesa and the department's Annual Report and Accounts), and noted whether the spending plan had changed and whether this change was explained.

We graded each department according to:

- whether an explanation was given for a change
- whether each movement was fully or partially explained
- where the explanation appeared.

We then ranked the departments based on their average transparency rating. DECC, DCMS and MoJ were given the highest rating. When changes appear in the forward spending plans for each of these departments, full explanations for these changes are generally given, either in the same document in which the change appears or in another published document. DECC scored well because although explanations for changes are not generally given in the same document in which that change first appears, full explanations for changes can be found in the department's Main Estimates Memoranda, which can be found via a link on the department's own website. No other department provides a link to these important financial documents.

At the other end of the scale, Cabinet Office, HMRC and HMT have the worst transparency rankings. This is due to inconsistencies in the way each of these departments is reported at different fiscal events, which makes it impossible to reconcile spending plans published in different documents. For example, in the annual Budget documentation HMRC is included in 'Chancellor's Departments', which means we cannot reconcile current spending plans to plans published at previous events, and therefore cannot track movements in spending plans across time. Similarly, in the Budget documentation, spending plans for the Cabinet Office include funding for the Single Intelligence Account: however, outturn figures in Annual Reports and Accounts are for the Cabinet Office only. It is not possible to reconcile plans published in the Budget with outturn figures.

Other departments received low scores for giving no clear explanation for changes in forward spending plans. For example, between Spending Review 2010 and Budget 2013, the Home Office RDEL spending plan for the financial year 2014-15 fell by £0.4bn. We could find no explanation for this drop. MoD also performed poorly on financial transparency, in part because the department does not publish RDEL depreciation figures in its annual reports, which makes it impossible to compare outturn with the original spending plan in Spending Review 2010.

Most departments fell somewhere in between, with some explanation given for most changes in plans. DWP and BIS are ranked in the middle of our table. They offered some explanation for most changes to forward spending plans, but it was not always possible to reconcile the change in forward plans with the explanation provided.