

## Written evidence from Professor David Heald<sup>[1]</sup> (IGA 12)

### USES OF GOVERNMENT ACCOUNTS

#### Introduction

1. The opportunity is welcomed to submit written evidence to the Public Administration and Constitutional Affairs Committee Inquiry on government accounts. This memorandum draws on evidence (Heald, 2014) submitted to the Political and Constitutional Reform Committee's Inquiry (2014) into the implications of Fixed-term Parliaments, and on earlier academic work on parliamentary financial procedures (Heald and McLeod, 2002). I have also submitted written evidence to the Procedure Committee's Inquiry into Supply (Heald, 2016).
2. The Committee has set an extensive set of questions for those submitting evidence to address. My expertise and experience relate to financial reporting and the scrutiny role of parliaments, not to the internal management accounts with which I am not familiar. My evidence will therefore concentrate on the Committee's second objective: 'How both departmental accounts, other accounts and retrospective financial information given to Parliament [are used]' (Public Administration and Constitutional Affairs Committee, 2016).
3. As background to this written evidence, I quote my own evidence to the Procedure Committee's current Inquiry on Supply:

The United Kingdom takes eighth place on the *Open Budget Index 2015* (International Budget Partnership, 2015), somewhat lower than it has been but still near the top of a league table of 102 countries. However, there are certain pathological features of the UK public finance system that are relevant to the Committee's remit. Good technical processes are marred by abusive political practices, creating distrust in official numbers (Heald, 2016);

and also this Committee's website exposition about the present Inquiry:

This inquiry examines 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. The House of Commons and its Committees have not expressed a view of the accounts submitted to them by the Government since 2009. It is not clear that they are of any use to Select Committees, or to the public, in holding the Government to account. Despite this, the Government spends considerable amounts of money in producing and auditing them. Yet the published accounts are used by Ministers more to promote the Government's own achievements, than to provide useful tables (Public Administration and Constitutional Affairs Committee, 2016).

Towards the end of this memorandum, I will return to the implications of these quotations.

4. The Committee formulated the second question in its terms of reference as follows:
 

How both departmental accounts, other accounts and retrospective financial information given to [Parliament](#) can be improved to enable both MPs and the public to hold the executive to account. We will be examining the contents and format of the accounts and how far they are transparent to a lay user (Public Administration and Constitutional Affairs Committee, 2016).
5. My response to this formulation is:
  - a) Transparency has two dimensions: first, that relevant information is publicly available; and, second, that

intensive efforts are made to render the numbers accessible and interpretable: this is partly about presentation and partly about self-contained explanations

- b) The Treasury's achievements, in terms of moving public sector accounting to accruals on an IFRS-linked basis and of publishing audited Whole of Government Accounts (WGA), deserve recognition and praise
- c) In terms of public trust in government numbers and financial health, manipulative presentation seriously risks undermining this technocratic achievement. The public and the media do not necessarily distinguish between audited numbers and spun 'puff' numbers
- d) The alignment with commercial accounting and international standards, of which I strongly approve, inevitably means that the accounts and notes are complex documents. These will never be 'transparent to a lay user'. The role of information intermediaries is fundamental: this is a role which Select Committees, media and academics should play. Whereas I support sector-neutral accounting to the extent that this is feasible, the interpretation of certain accounting numbers [\[2\]](#) differs markedly in the government context from that of the private sector
- e) The relationship between public accounting and budgeting, on the one hand, and statistical accounting (ie national accounts) has intensified under the pressures unleashed by globalisation, fiscal crisis and austerity. Heald and Hodges (2015) analysed Eurostat's proposals for harmonised government accounting across the EU 28, in the context of this closer relationship between government accounting and the fiscal aggregates that are used for fiscal surveillance (Heald, 2013). These centralising pressures, up from the nation state, and intensified complexity are clearly obstacles to wider engagement. Convincing arguments have been advanced for having a powerful finance ministry (von Hagen and Harden, 1995), yet these do not invalidate the case for effective parliamentary scrutiny at the key decision points. Indeed, they probably strengthen it as evidence mounts about decreased public trust in democratic institutions.

## **Responses to the Committee's Specific Questions**

### **6. I respond only to those questions in relation to which I have experience and/or expertise.**

#### **The current utility of departmental accounts**

##### ***Q1: How useful are the accounts as a tool to scrutinise the Government?***

Unlike for the corporate private sector, there is a limited external user community for government accounts. The literature provides various lists of potential users (Drebin et al., 1981; Jones and Pendlebury, 2000; van Helden and Hodges, 2015) but not much evidence of actual external use. However, this should not be taken as a suggestion that government accounts have no purpose or value because:

- (a) they are a fundamental component of the public finance cycle that begins with Spending Reviews, proceeds to Estimates and execution, continues to accounts and audit, and is completed by the work of the Public Accounts Committee. With limited media coverage, the most credible user of departmental accounts is the relevant Select Committee, part of whose role is as information intermediary. Even if there were no actual external user, knowledge that government entities have delivered accounts and secured clean audit certificates is highly relevant to public confidence in the management of public finances. Since the cessation of the Comptroller and Auditor General's annual report on financial reporting and auditing – the final issue seems to have been for 2002-03 (National Audit Office, 2004) – this summary information appears not to be

publicly available.

(b) they provide the raw material for the fiscal aggregates which are compiled on the basis of European System of Accounts 2010 (ESA10). Quality and speed of production of government accounting data are manifestly important in the context of deficits, debt and external fiscal surveillance (Heald, 2013). The WGA is a super-consolidation of almost all the UK public sector (Treasury, 2015).

***Q2: Which parts of the accounts are used by those scrutinising the Government? Which parts are not?***

The term ‘accounts’ is sometimes used to denote solely the audited financial statements and notes, sometimes the ‘report and accounts’ documents as a whole. I am not aware of recent empirical work on the use of UK central government departmental accounts. A recent study of the IFRS-based accounts of the devolved administrations (Wall and Connolly, 2016) has confirmed the conventional wisdom of limited external use.

**Reforms to the format of departmental accounts**

***Q1: How could departmental accounts be improved to meet the needs of Parliament and the public?***

This question can more thoroughly be addressed when 2015-16 departmental accounts have been published, most of which will be done before the summer recess and during this Inquiry.

***a) What is best practice in public sector accounts across the world and why is it best practice?***

I do not have the comprehensive knowledge of current practice to address this question. However, countries such as Australia, New Zealand and South Africa have devoted much energy to accounting reform and I would expect that they exhibit good practice with regard to presentation. The Committee’s secretariat might usefully examine specimen accounts.

***b) What is best practice in the private sector and why?***

I do not research private sector reporting practice, but I have heard complaints about the allegedly excessive lengths of the reports of listed companies. Understandable pressures for additional disclosures can lead to length extensions that become an obstacle to communication. Circumstances differ in that there are active external users of corporate reports, many of whom are highly skilled at accounts interpretation.

***Q2: What if anything is missing from the Treasury 2014 Command Paper [Treasury, 2014] which laid out the new accounting procedures for 2015–16?***

This is a constructive document which shows awareness of how some of the obstacles to use might be addressed. Given the number of departmental and other accounts, revival of the earlier National Audit Office (2004) practice of publishing an annual survey would be valuable to those whose interests lie in the performance and integrity of the financial reporting system, not just in the report and accounts of individual entities.

The implementation of this Treasury project should be monitored over, say, the first three years, starting with the 2015-16 reports and accounts which will shortly be appearing. There are potential dangers for Parliament as primary user and for other external users:

- Report content being under the control of the reporting entity may lead to excessively positive portrayal, in public relations mode, rather than commentary which is valuable to users
- Simplification means elimination of information and some of this may erode usefulness for particular users
- What the public regards as important is difficult to forecast in a public sector context: the emphasis on

expenses, remuneration and related party transactions would not have been expected when Resource Accounting was first implemented in 2001-02

- More condensed publication puts greater weight on auditors, both in terms of guiding managements on disclosures and of auditors' willingness to make public their dissatisfaction in appropriate cases
- The argument that alignment of entity statements with the WGA presentation will help to accelerate the publication of the WGA seems excessively focused on preparer interests, given that modern information technology permits multiple analyses

***Q3: How far should other government accounts (for NDPBs and Agencies) reflect the format of departmental accounts?***

***Q4: How much more should government accounts be standardised?***

These questions will be considered together. In terms of the financial statements and other core financial information, standardisation across the public sector enhances comparability. Moreover, UK government accounting, controlled by the Financial Reporting Manual (FRM) and anchored on IFRS, is a promoter of standardisation. There is scope for customising the reporting vehicles in which the accounts sit but there might be a clash between entity stakeholders and those wishing to have comparability across government reports and accounts.

### **Future improvements to accounts**

***Q1: Who should have control over the format of departmental accounts and Whole of Government Accounts?***

***Q2: What independent body should advise on the format of departmental accounts in the future?***

These questions will be addressed together. The Treasury is the dominant player in the Spending Review-Estimates-Accounts-Audit cycle and it is appropriate that the Treasury controls the entire process. [3] When the Treasury proposed Resource Accounting and Budgeting (Treasury, 1994, 1995), it recognised that Parliament's role in granting Supply conferred upon it a right to be consulted on the Budgeting-Accounting segment of this cycle. At the technical level, key roles should be played by the Financial Reporting Advisory Board and by the National Audit Office. How government financial reporting should contribute to democratic accountability was expounded by Sir Andrew Likierman a decade before he became the architect and chief implementer of the Resource Accounting and Budgeting reforms (Likierman and Creasey, 1985). This view of public entitlements to information places great responsibilities on the Treasury to communicate clearly and with integrity.

I have been a long-term advocate and supporter of the Treasury's WGA project (Heald, 1998; Heald and Georgiou, 2009, 2011). The delivery of the WGA has been a significant achievement. In consequence, I was deeply disappointed when, in the 2011-12 WGA, the Treasury (2013) relabelled 'net deficit' [4] as 'net expenditure for the year'. The reasons I presume are because (a) the WGA net deficit is larger than the ESA10 deficit, and (b) 'net expenditure for the year' is opaque terminology that few will understand in this context.

I do not know whether this relabelling was approved by the Financial Reporting Advisory Board, and I am surprised that the Comptroller and Auditor General's audit certificate makes no reference to this manipulative use of language. This is a striking illustration of my distinction between 'nominal transparency' and 'effective

transparency' (Heald, 2003).

***Q3: How can we judge the success of departmental accounts as disclosures of information to the public?***

There is no straightforward answer to this question. Departmental accounts are one phase in the public financial management cycle. They have multiple functions to fulfil, including providing the basis for audit assurance that standards for financial reporting, regularity and propriety have been met. This is important not only in terms of that entity but also the validation of financial information that is subsequently used in the WGA and in the national accounts. By the nature of functional responsibilities and relative spending size, some departmental accounts will attract more external attention than others. Without compromising core financial information and the Treasury's standardised disclosure requirements, there is scope for experimentation in the way individual departmental reports seek to communicate information to Parliament and to the public. If there are external users for a particular departmental report, the presentation should be such so as to allow intermediate users to re-process information in forms that are accessible to lay users.

**Improving scrutiny of financial information from the Government**

***Q1: How can financial scrutiny of Departments in both Parliament and outside be improved?***

In a web posting for the International Budget Partnership, Heald (2015) distinguished between intrinsic obstacles to fiscal transparency and those which are constructed by policy actors to obstruct it. Four intrinsic obstacles and four constructed obstacles are summarised in Table 1. My view is that challenging the constructed obstacles, that is to say those that are put in place by policy actors, is the appropriate place to begin.

**Table 1: Obstacles to Fiscal Transparency**

<b>Intrinsic Obstacles</b>	<b>Constructed Obstacles</b>
<p><b>1.</b> Technical complexity of measurement systems, both financial reporting and national accounts</p>	<p><b>5.</b> Denial of legitimacy of claims to information (<i>downwards transparency</i>). Information about the financial affairs of state is regarded as the sole preserve of the executive, most likely in (a) non-democratic regimes, and/or (b) where the person and the role of ruler as public authority are not distinguished</p>
<p><b>2.</b> The well-delineated 'positive' state (which held assets and delivered services) has partly given way to a more-difficult-to-map 'regulatory' and 'contract' state (which has more complex and diffused modes of governance and extensive liabilities) (Majone, 1997). This process</p>	<p><b>6.</b> Volume and opaqueness used by governments as tools for managing hostile and aggressive media and for disabling and discouraging users of government financial information. High index scores for fiscal transparency may co-exist with inaccessibility</p>

has gone further in Anglo-Saxon countries than in much of continental Europe

3. Cognitive problems about numbers that make many elected politicians switch off, and which diminish citizen understanding

4. Relentless media negativity that interacts with government incentives to 'spin' and 'plant', thereby reinforcing the career advancement incentives of elected politicians not to commit to a scrutiny role

7. Perceptions of unfairness may validate cheating in the minds of those subjected to *upwards transparency*. Those lower down the principal-agent chain manipulate data (for example, project appraisals for Public-Private Partnerships) as a means of 'doing good by stealth', within constraints they cannot challenge

8. Perceptions that rulers engage in fraud and corruption leads to such practices becoming endemic across hierarchical levels. In such a cultural context, all are incriminated whether by commission (personal engagement in such practices) or omission (toleration of what others do, perhaps for reasons of self-preservation). Fiscal data will lack reliability as accounting records will be falsified

*Source:* Modified and re-sequenced version of Heald (2013, Figure 33.4 on p. 736), as published in Heald (2015).

## Concluding Comments

### 7. This section returns to the Committee's formulation of its second high-level question, repeated here for convenience:

How both departmental accounts, other accounts and retrospective financial information given to [Parliament](#) can be improved to enable both MPs and the public to hold the executive to account. We will be examining the contents and format of the accounts and how far they are transparent to a lay user (Public Administration and Constitutional Affairs Committee, 2016).

On the basis of the discussion above, I make the following observations:

- a) On the accounts 'production' dimension, the United Kingdom has much to be satisfied about, there having been an effective collaboration of the Treasury, National Audit Office and Parliament
- b) On the accounts 'consumption' dimension, there is much to be concerned about, particularly with regard to the obstacles to external use and to how the technocratic achievement of accruals accounting on a consistent basis across government can be undermined by a loss of public trust in official information, a process to which the Treasury has undoubtedly contributed<sup>[5]</sup>
- c) The usefulness of departmental accounts should not be discussed in isolation from other phases in the public financial management cycle (Allen et al., 2013):
  - the Spending Review process, with which Parliament has never effectively engaged since it was instituted in 1998
  - Supply Estimates, for which the promise held out for the 1995-96 Simplified Estimates has never been realised
  - accounts, the topic under present consideration

audit, for which the parliamentary role has been effectively delegated to the Public Accounts Committee which has concentrated on its Value-for-Money role

More effective parliamentary scrutiny should start from the Spending Review and then flow through the financial cycle (Heald, 2016).

d) Enhanced use of departmental reports and accounts would critically depend upon:

- Altered incentives for Members which encourage them to take scrutiny more seriously, and thus make the necessary investment in skills: the election of Select Committee chairs is a positive step
- A recognition by the Treasury, particularly by its Ministers, that the insensitive imposition of its will on Parliament has long-term costs in terms of reputation, trust, accountability and democratic legitimation. Genuine parliamentary engagement would be much more costly for the Treasury in terms of time and workload but, without that, little will be achieved in terms of enhanced parliamentary scrutiny
- Parliament as the designated primary user should recognise that comprehensive scrutiny of accounts every year is impractical. Recourse can be made to random selection of accounts and taking interest in those accounts that incur audit qualifications or special reports from the Comptroller & Auditor General. The respective roles in such scrutiny of the Public Accounts Committee and departmentally-focused Select Committees is a matter to be settled

8. Diagnoses of weaknesses are well-established and similar (Brazier and Ram, 2006; Wehner, 2010). Unless Parliament exercises more initiative and ambition in its scrutiny role, nothing will change.

Glasgow, 18 May 2016

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[2] For example, negative net assets in the UK Whole of Government Accounts. In a private sector context, this would suggest exclusion from capital markets and/or potential liquidation.

[3] In my oral evidence to the Procedure Committee on 10 May 2016, I explained my support for the Crown initiative on Supply and why I support a strong Finance Ministry (<http://parliamentlive.tv/Event/Index/5e683219-faaa-4140-a739-c24d21083e4a>). However, for legitimacy reasons, the Treasury has to earn the consent of other actors in the policy process: it should do this through open consultation process and by not undermining trust through manipulative presentation and spinning.

[4] The 'net deficit for the year' terminology had been used from 2009-10 (the first audited WGA) to 2010-11 (Treasury, 2012). The £94.4 bn reported net deficit for the year ended 31 March 2011 is shown in the 2011-12 WGA (Treasury, 2013) as the preceding-year comparator for net expenditure for the year.

[5] For example, leaking accurate and misleading information before fiscal events such as Budgets and Spending Reviews, thereby downgrading Parliament, and recourse to financial engineering as in the budgetary treatment of Public-Private Partnerships and student loans..