Consolidation principles and practices for the UK government sector

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Abstract—Government accounting reform has in certain industrialized countries become a recognisable component of market-oriented New Public Management reforms. A key dimension is the conversion of accounting from the traditional cash basis to accruals, usually anchored in GAAP as developed for that country's private sector. Taking the UK proposals for Resource Accounting and Budgeting, this paper shows that issues concerning consolidation are proving both important and troublesome. After reviewing private sector experience with consolidation, the structure of UK central government is carefully mapped. The limited area for consolidation proposed by the UK Treasury as the basis for constructing Departmental Resource Accounts is criticised. Attention is paid to the complex structure of public service delivery, with much of that now done by quasi-public organisations outside both the proposed departmental boundary and the national accounts aggregate of general government. This paper does not examine the related topic of Whole-of-Government Accounts.

1. Introduction

In recent years, significant changes have taken place in relation to government accounting across different countries. In the UK, these developments are included in a package referred to as Resource Accounting and Budgeting (RAB). This paper focuses upon the extent and forms of consolidation which are appropriate for accruals-based government financial accounting and reporting. While due attention is paid to developments elsewhere, the importance of context makes it valuable to discuss developments in relation to the specifics of the UK.

Some explanation of UK terminology is essential.1 Resource Accounting (RA) refers to the alignment of central government accounting and reporting requirements with those for companies incorporated under the Companies Act (1985, 1989), thereby complying with that body of principles and practice customarily described as 'UK GAAP'. A significant element is the switch from cash to accruals. However, it is explicit in Treasury policy documents that differences in circumstances between the private sector and central government may necessitate certain modifications of, and extensions to, UK GAAP; these have been incorporated into the Resource Accounting Manual developed by the Treasury and approved by the Treasury-appointed Financial Reporting Advisory Board (FRAB). The Treasury established FRAB in April 1996 to act as an independent element in the regulation of government accounting and reporting. The FRAB-approved Manual was released by the Treasury in July 1997 and then formally published, including updating amendments, in April 1998 (Treasury, 1998b).

Resource Budgeting (RB) has two components: the first is the conducting of the public expenditure planning process on a resource basis; and the second is the annual voting by Parliament of Supply (i.e. expenditure authorisation) on a resource basis.2 The Treasury has frequently stressed that its commitment to adopt both components of RB is an important reason why the Treasury itself must

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2 For ease of reference, a glossary of UK terminology appears in the Appendix.
have ultimate control over government accounting principles.

The purpose of this paper is to evaluate UK proposals for departmental financial accounting and reporting, focusing upon the delineation of the consolidated reporting entity (i.e. the production of consolidated Departmental Resource Accounts (DRAs)). The topic of consolidating all DRAs with other accounts into Whole-of-Government Accounts is not addressed. There is nevertheless a connection between the issues because the Treasury explicitly connects RA with its macro-fiscal data requirements, which are driven by international statistical standards for national accounts, notably the European System of National Accounts 1995 (Eurostat, 1996; Jones and Lüder, 1996).

The paper is structured as follows. Section 2 reviews UK government proposals on consolidation. Section 3 examines the substantive issues, dealing with the relevance of private sector experience and the specific UK public sector context. This discussion is also informed by international experience. Section 4 draws conclusions about UK developments, which need to be located in the wider context of financial management reforms in central government. Certain important issues, such as the origins of these reforms and the linkage with New Public Management (NPM), are excluded from the remit of this paper. However, it should be noted that the architect of the UK reforms (Likierman, 1995, 1996) has frequently portrayed accruals accounting and budgeting as reflective of an international trend (Lüder, 1988) and as a key part of the NPM agenda (OECD, 1993). Power and Laughlin (1992) have described these processes as the ‘accountingisation’ of the public sector.

2. UK government proposals on public sector consolidation

The then Chancellor of the Exchequer announced the RAB project in his November 1993 Budget Speech (Clarke, 1993). However, substantive details were not available until July 1994, when the Treasury published a consultative Green Paper (Treasury, 1994). For the purpose of this exposition, three diagrams focus attention upon the key issues concerning the area of consolidation for each DRA.

Figure 1 reproduces from the Green Paper the diagram which specified the scope of each DRA. The envisaged DRA covers the area of the principal circle, including the interior circles representing executive agencies (both vote-financed and trading funds). A significant set of governmental bodies is therefore shown outside their respective DRAs: nationalised industries, Non-Departmental Public Bodies (NDPBs), public corporations, National Health Service and local authorities (Deaton, 1996a; Deaton, 1996b).

The Treasury’s definitive policy statement appeared as a White Paper in July 1995 (Treasury, 1995a). Figure 2 reproduces the relevant diagram from the White Paper, with certain modifications and elaborations. In Figure 2, everything within the circumference of the principal circle will again be consolidated in the DRA. The core department is the total area of the principal circle less the areas of the two interior circles and the area of overlap with the NDPB circle. One interior circle represents vote-financed executive agencies; those agencies with trading fund status, though inside the DRA in Figure 1, are now outside. The second interior circle represents NHS purchasers; NHS providers are now outside the DRA. This differs from Figure 1, where the NHS was entirely outside. In practice, these are mostly unimportant (in expenditure terms) advisory bodies and some small non-self-accounting Executive NDPBs. All the big-spending Executive NDPBs are outside the DRA. Moreover, all public sector organisations represented by circles entirely outside the principal circle are beyond the departmental boundary and therefore will not be consolidated.

The shaded area of Figure 2 maps general government for the purposes of the national accounts. The definition of general government is of immense importance because of the way in which the Treasury has taken General Government Expenditure (GGE), or its variant GGE(X), as its ultimate control target (Thain and Wright, 1995).}

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3 An overall exposition of the proposed UK reforms can be found in the report to Parliament by the National Audit Office (1996).

4 Figure 2 differs from the equivalent Diagram 3 in the July 1995 White Paper (Treasury, 1995a) in three respects. First, the shaded area in Figure 2 denotes general government for national accounts purposes. Second, Figure 2 makes explicit that NHS purchasers are inside the departmental boundary and NHS Trusts are outside, whereas the White Paper’s Diagram 3 simply showed some overlapping between the principal circle and the NHS circle. Third, more detail is shown in Figure 2 regarding NDPBs: the overlap between them and public corporations is shown, as is the fact that those NDPBs with the status of companies limited by guarantee are outside general government.

5 See the Appendix for a discussion of the types of NDPB. In the text, the term ‘Executive NDPBs’ is used for convenience, though the correct term is ‘Executive etc. NDPBs’ (reflecting the importance of bodies with regulatory rather than executive missions).

6 See the entries for ‘Total Managed Expenditure’ in the Appendix. In national accounts, general
Beyond the departmental boundary, general government includes local authorities and those NDPBs outside the departmental boundary which are neither public corporations nor companies limited by guarantee. There is an overlap between NDPBs and public corporations, particularly with regard to economic development bodies. Moreover, some Executive NDPBs are incorporated as companies limited by guarantee and thereby classified to the private sector in the national accounts.

When RA is implemented in 2001–02, two forms of consolidation will be undertaken, with a third scheduled for later implementation. The DRAs of each of the 65 departments will consolidate organisations falling within the relevant departmental boundary. Moreover, organisations outside the departmental boundary will continue to follow the...
There is growing evidence that DRAs will acquire a dual function. They will serve as the basis source accounts may be of little value. However, we would welcome an account which brings together the income and expenditure, and the assets and liabilities, of central government. We suggest that the Treasury and the National Audit Office begin joint research to see how this might be done, and to report back to this Committee in due course (italics added).

The Treasury (1995b: para. 3.10) replied: The Government accepts that research should be taken forward as suggested but the introduction of resource

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7 There has never been any proposal for a 'super DRA', consolidating all 65 DRAs. The Public Accounts Committee (1995: para. 2(xii)) concluded:
We agree that a simple aggregation of departmental re-

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3. Consolidation in the public sector

This key section of the paper is structured in the following way. Given that UK GAAP is being extended to central government, it is useful to consider the relevance of private sector experience with consolidation. Attention then turns to the specific UK public sector context, beginning with problems in specifying the parent entity, before discussing alternative areas of consolidation.

3.1. Relevance of private sector experience

The very purpose of consolidation in the private sector is to transcend the question of legal relationships so that economic entities can be reported upon. Subsidiaries will have a distinct legal identity deriving from incorporation under the Companies Act. The decisive criterion for consolidation in UK GAAP is that of control and not that of ownership. Consolidated accounts bring in the financial position of all subsidiaries, some of which may be heavily indebted and, if not consolidated, would afford opportunities for off-balance sheet financing by the parent company. Moreover, consolidation brings together the financial results of the parent and all subsidiaries, thereby eliminating opportunities for income smoothing through timely dividend payments from subsidiaries to the parent.8

In consequence, defining the boundary of a reporting entity is of utmost importance, since this determines the entities which are encompassed by the consolidation report. A subsidiary is defined in the UK as any company which is controlled, directly or indirectly, by the parent or one over which the parent can exercise dominant influence, meaning that the parent can dominate the subsidiary's operating and financing decisions. Ownership is not considered as a separate criterion but is only regarded as an indicator of control. The current UK standard (FRS 2) insists that virtually all subsidiaries are consolidated,9 including those engaged in activities dissimilar to those of the rest of the group. For example, Marks & Spencer plc has since 1990-91 fully consolidated its subsidiaries dealing in financial activities. Previously, it had followed the provisions of SSAP 14 (ASC, 1978), which mandated that subsidiaries engaging in dissimilar activities should not be consolidated. These SSAP 14 provisions had opened up a mechanism which might have been used for off-balance sheet financing, thereby concealing the indebtedness of groups. These considerations motivated the decisions of the Financial Accounting Standards Board (FASB, 1987) in the US and the Accounting Standards Board (ASB, 1992) in the UK to mandate consolidation.

However, such use of regulation has been criticised in the agency-contracting literature as being

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8 It is not argued here that full consolidation is the only means of achieving this: the use of the equity method of accounting for inter-company investments produces a net profit figure which is identical to the one reported in the consolidated statements.

9 Under FRS 2 (ASB, 1992: para. 25), the exclusions from consolidation are subsidiaries: (i) which are held with a view to subsequent resale; (ii) where there are severe long-term restrictions over the parent's rights; and (iii) where their activities are so dissimilar from those of the rest of the group that their inclusion in the consolidated statements would be incompatible with the obligation to give a "true and fair" view.
economically costly. This literature has contended that the non-consolidation of subsidiaries engaging in dissimilar activities reflected the adoption of the most efficient contracting relationship, rather than opportunistic management behaviour in financial reporting (Mian and Smith, 1990). Such research findings did not, however, inhibit the ASB from extending the mandated area of consolidation. The notion of 'quasi-subsidiaries' has been devised as a mechanism for pulling certain organisations within the net of consolidation. A quasi-subsidiary is defined in FRS 5 (ASB, 1995b: para. 7): 

'...a company, trust, partnership or other vehicle that, though not fulfilling the definition of a subsidiary, is directly or indirectly controlled by the reporting entity and gives rise to benefits for that entity that are in substance no different from those that would arise were the vehicle a subsidiary.'

This formulation was introduced to catch any company which is in substance part of the same economic entity, but which would not have qualified as a subsidiary under either the Companies Act 1989 or FRS 2.

When devising accounting standards on consolidation, private sector standard-setters did not explicitly state the conceptual basis of their requirements. Indeed, ED 50 (ASC, 1990) was the first UK pronouncement to refer to the potential usefulness of consolidated statements to parent company and minority shareholders. The former were identified as 'the users for whom consolidated accounts are primarily prepared' (para. 28). This view was reiterated in ASB's draft Statement of Principles for Financial Reporting (ASB, 1995a: para. 7.17), though it was also acknowledged that consolidated statements may provide a frame of reference for other report users, such as the creditors of subsidiary companies.

The conceptual approach adopted by ASB is a hybrid between the two major concepts of consolidation, which both suggest that parent company shareholders are the primary external users of consolidated statements but differ on the nature of the consolidated information which would best serve their interests. Proportional consolidation, for example, stresses the ownership interests of the parent company shareholders. Consolidated statements are viewed as a modification of the parent company financial statements in order to account for the ownership interests of the parent company in other entities. Consequently, only the parent company's share of each subsidiary's assets, liabilities, revenues, expenses, gains and losses are included in the consolidated statements. On the other hand, the entity concept considers consolidated statements to be those of an economic entity which consists of a parent company and any company controlled by it; consolidated statements are prepared for the purpose of reporting the resources which are controlled—rather than owned—by the parent company shareholders, and the results achieved with these resources. Unlike proportional consolidation, which excludes minority interests from the consolidated statements, the entity concept includes them and, furthermore, does not treat them differently from the controlling (parent company) interests. This is because the minority shareholders are considered to be co-shareholders with the parent company shareholders: both provide part of the capital of the economic entity.10

3.2. Specific UK public sector context

3.2.1. Defining the parent—the government department

Under the RAB proposals, the department is analogous to the parent company in the private sector context (i.e. the entity which has control over other entities and is required to produce consolidated statements). However, there is no clear cut definition of a government department, in statute or elsewhere, though there are some departments with a statutory basis (e.g. the Inland Revenue and the offices of the utility regulators). Government offices and departments own their establishment and organisation, together with any powers they possess and duties they perform, partly to the Royal Prerogative and partly to Parliament (Bradley and Ewing, 1997). The meaning of the term 'department' depends on the particular context in which it is used; indeed, different official lists produce variable numbers of government departments (McLean and Clifford, 1996). Jordan (1994:44) concluded:

'The [search] for an understanding of the organisation of British Government is best made by seeking historical explanations of particular arrangements than for a set of principles that underpin the complexity. Not only is the subject of Government lost in a fog, we have no reliable and accessible model or maps to help us through.'

However, this 'disorder' (Jordan, 1994:11) acquires more practical importance when a govern-

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10 For comprehensive discussion of the different concepts of consolidation, see Moomiz (1951), Walker (1976), Parker (1977), FASB (1991) and Taylor (1996).

11 The Australian standard (AAS 29), which also uses the government department in the reporting entity, defines it as 'a government controlled entity, created pursuant to administrative arrangements or otherwise designated as a government department by the government which controls it' (AARF, 1992, para. 8).
Department is defined to be the parent for the purposes of RA.

The extension of UK GAAP to central government, notably the construction of balance sheets, renders these ambiguities more salient than under cash accounting (Head and Georgiou, 1995). Lacking definitive guidance, the Treasury has adopted the existing parliamentary voting and reporting arrangements as the starting point for DRAs. At present, 65 DRAs (59 plus six for Northern Ireland departments) are envisaged (Treasury, 1996). The Treasury's suggestion that the configuration of accounting entities would be an appropriate subject for consultation between departments and their select committees jars with the extension of (the increasingly rule-based) UK GAAP to central government. Successive UK governments have restructured the shape of central government for a complex mixture of motives, including improving the effectiveness of the machinery of government and making work for would-be ministers. The implementation of RAB is unlikely to alter such political realities. However, there are substantial political implications for how such mergers and demergers of departments will be accounted for, and the demands on information systems for data about shuffled components, so that a reasonable level of data comparability over time can be secured.

3.2.2. Area of consolidation

Sensitivity to the prerogatives spelled out in successive editions of the 'bible' of parliamentary procedure, Erskine May (Boulton et al., 1989; Limon, McKay et al., 1997), led the Treasury to adopt a consultative, consensus-seeking style in its dealings with Parliament on the RAB project. This has differed markedly from Treasury practice concerning public expenditure planning, where fundamental changes are often sprung without warning (Head, 1995). However, the Treasury has proved unyielding in its view that the area of consolidation for DRAs should be highly restrictive. The adjustment in the departmental boundary between the 1994 Green Paper and the 1995 White Paper was a limited technical one, conceding nothing of substance to those who argued during the consultation phase for more extensive consolidation.12 While there has been much emphasis upon the benefits of applying UK GAAP to central government (Likerman, 1995), the area for consolidation was determined as a firm policy decision by the Treasury, long before FRAB had been conceived of, still less constituted.

The Treasury's prescription of the area of consolidation is reminiscent of the ways in which the Accounts Directions of Executive NDPBs have sometimes been used; namely, prescribing accounting treatments which conflict with UK GAAP and arguably with statutory requirements in the relevant primary legislation to follow 'best commercial practice'. The principal substantive argument used for restricting consolidation has been that Executive NDPBs, nationalised industries and local authorities are 'constitutionally independent bodies' and that ownership of assets and liabilities is not vested in the department (Treasury, 1994: para. 2.22). This is a surprising argument in that consolidation in the private sector has been about piercing the 'veil of incorporation'. A subsidiary argument used by the Treasury has been that the departmental boundary defined in the proposed way would correspond to the responsibilities of the Department's Principal Accounting Officer. Irrespective of these arguments, it is clear that the Treasury's requirements concerning the area of consolidation are in conflict with UK GAAP, and they also differ from the Australian standard (AAS 29) that requires departments to consolidate all entities which they control.13 Control of an entity is defined in AAS 29 as:

'...the capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in pursing the objectives of the controlling entity' (AARF: 1993, para. 8).

3.2.3. Measures of control in the public sector

In the private sector, control is inextricably linked to the operation of various kinds of ownership rights, whereas everything is much fuzzier in the public sector. Behaviour in the public sector is more difficult to predict, not least because there is much more scope for decisions to be contested. There is a huge political science literature on the nature and ambiguities of control: see, for example, Dunsire (1985) and Wirth (1985). Given the definition of the department as the reporting entity, it is beyond the scope of this paper to fully explore the concept of control in the public sector. Such a pursuit would most probably lead the discussion away from departmental reporting and back to the issue of Whole-of-Government Accounts. The focus here is with the concept of control as relevant to the specific and more limited

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12 CIPFA (1995: para. 2.24-27) considered that the application of FRS 2 would 'confirm the "exclusion" of the nationalised industries, public corporations and local authorities from departments' resource accounts', but suggested that National Health Service bodies and non-Executive NDPBs should be brought within the scope of the DRA.

13 'The general purpose financial report of the government department shall encompass all entities controlled by the government department' (AARF, 1993: para. 24).
purpose of determining those entities controlled by the department.

In the private sector, subsidiaries have a legal identity deriving from incorporation under the Companies Acts, while public sector bodies are frequently incorporated pursuant to Acts of Parliament. Though it is customary to speak of assets being vested in a Crown body, it is not customary in the UK to speak of one Crown body having an ownership interest in another Crown body: this limits the easy transfer of the commercial analogy of looking to ownership as an indicator of control.

In order to establish what constitutes control in a public sector context, crucial questions must be addressed about the nature of relationships between a department and its NDPBs, and between those NDPBs and the quasi-public sector bodies—classified to the private sector by the Office for National Statistics—which actually undertake much service delivery. In the context of extensive purchaser-provider separation, the Treasury may liken purchaser-provider relationships to commercial relationships in the market sector, as, for instance, between Marks & Spencer plc and textile firms for which it is the dominant purchaser. It is therefore necessary to explore the nature of the relationships between, for example, the Department of the Environment, Transport & Regions and the Housing Corporation and housing associations; and between the Department for Education and Employment and the Higher Education Funding Council for England (HEFCE) and Higher Education Institutions (HEIs).

One indicator of control is the right of the relevant Secretary of State to appoint the majority of members of the board, which is the case with the Housing Corporation and HEFCE, but not with housing associations or HEIs. The Companies Act 1989 and FRS 2 set out criteria to indicate that a company is the subsidiary of another company; these include that the parent:

'(a) holds a majority of voting rights in it or
(b) is a member and has the right to appoint or remove a majority of its board of directors or
(c) has the right to exercise dominant influence over the undertaking' (FRS 2, para. 14: ASB, 1992).

Condition (a) is of modest relevance only; UK public sector organisations are rarely constituted as companies with shareholdings and therefore there is no parallel to membership. Regarding (b), there is a trend in certain policy areas (e.g. higher education and research) for ministers to abrogate this power of appointing a majority of board members. Regarding (c), the mechanisms in the private sector for exercising dominant influence would be by provisions in the articles of association of the controlled undertaking, or a written control contract which has been authorised in the memorandum or articles of association of the controlled undertaking and which does not breach any law.

It is a characteristic feature of NPM that public service delivery increasingly takes place through entities outside the departmental boundary, establishing relationships with departments or funding/purchasing bodies which Sizer (1992: 29) has characterised as 'vertical quasi-integration'. After the implementation of NPM reforms, control is frequently exercised through contracting and funding mechanisms.14

Figure 3 reproduces the entries in Figure 2 relating to the NHS and NDPBs/public corporations, extends the diagram to show the relevance of the quasi-public sector and introduces the issue of public employee pension schemes. Beyond the DRA, there is a constellation of 'moons' which themselves may have 'satellites'. Quite often, the core department will feed moons which in turn feed satellites, with the payments being described as grants or as contractual payments for output. Three cases will now be considered for the insights they bring into the difficulty of operationalising control and accounting for transactions across the boundary. They raise the question as to whether organisations which are fiscally dependent upon a department should be regarded as controlled by that department, and draw attention to the opportunities for off-balance sheet financing which occur when fiscally dependent organisations are excluded from the area of consolidation.

The first case to be discussed with reference to Figure 3 concerns the NHS. The assets and liabilities of about 550 NHS Trusts are outside the relevant DRAs.15 When NHS Trusts finance capital

14 Insights can be gained from US experience in relation to the regulation of state and local governments, which is undertaken by the Government Accounting Standards Board (GASB). In particular, GASB 14 uses 'fiscal dependence' as a test for financial accountability, which it takes as the criterion for determining the boundary of the reporting entity. The definition of the reporting entity is based primarily on the notion of financial accountability. A primary government is financially accountable for the organisations that make up its legal entity. It is also financially accountable for legally separate organisations if its officials appoint a voting majority of an organisation’s governing body and either it is able to impose its will on that organisation or there is a potential for the organisation to provide financial benefits to, or to impose specific burdens on, the primary government. A primary government may also be financially accountable for governmental organisations that are fiscally dependent on it’ (GASB, 1991, summary on unnumbered page). Walker (1995) also emphasised fiscal dependence as a criterion for consolidation in his paper informed by Australian experience.

15 The NHS is managed separately in each of the four territories of the UK, so that four DRAs will be involved: Department of Health; Scottish Office; Northern Ireland Department of Health and Social Services; and Welsh Office. An additional complication is that the NHS is now a devolved function in Scotland, Wales and Northern Ireland.
asset acquisition through the Private Finance Initiative (PFI), the assets are owned, financed and operated by private sector consortia. At present, only a minute part of the NHS functions in this way, though there are plans for a massive extension of this model. A number of questions arise about the nature of the contracts between organisations within the DRA (NHS purchasers) and public sector bodies outside the DRA (NHS Trusts), and again between NHS Trusts and PFI consortia. In particular, the (potentially extensive) borrowing of such consortia would be a form of off-balance sheet finance for the public sector. If NHS Trusts had themselves been allowed to bor-
row from the private sector, this would have been outside the Public Sector Borrowing Requirement (as public corporations they are outside general government). The reconfiguration of public service delivery through NPM reforms has therefore accentuated the importance of mapping commitments which arise from contractual mechanisms such as the PFI.\textsuperscript{16} Borrowing by PFI consortia is classified as private borrowing. This is unsettled territory in terms of accounting treatments. The July 1997 issue of the Resource Accounting Manual postponed discussion of the treatment of PFI schemes until Treasury guidance was available. Subsequently, ASB (1997, 1998) has published its standard (FRS 5A), which would bring more assets on-balance sheet than the Treasury's interim guidance (Treasury, 1997). At the time of writing, it remains unclear whether the Treasury will mandate compliance with FRS 5A.

The second case highlighted by Figure 3 occurs when the department funds NDPBs outside the DRA. These then feed organisations (technically private, but best viewed as quasi-public because of their overwhelming dependence on public funds) which may then enter into contracts with PFI consortia which finance, own and operate assets. Four examples can be cited, relating to: HEIs; non-local authority social housing; economic development including training; and tourist promotion. The Scottish Office (parent department) funds the Scottish Higher Education Funding Council (Executive NDPB which is outside the DRA but within general government), which funds HEIs (technically private, though really quasi-public), which build residences and teaching buildings through PFI contracts (Livingston, 1997). The Scottish Office also funds Scottish Homes (Executive NDPB which is outside the DRA and is also a public corporation), which funds housing associations (technically private, though really quasi-public), which borrow on the security of the full value of their highly subsidised assets. Similarly, the Scottish Tourist Board (Executive NDPB), funded by the Scottish Office, itself funds the network of Area Tourist Boards (ATBs), which are statutory bodies established under the Local Government (Scotland) Act 1994. In none of these three examples is there consolidation of the service delivery organisations with the funders. The fourth example is the exception; the Scottish Office funds Highlands & Islands Enterprise (HIE) (Executive NDPB which is outside the DRA and is also a public corporation), which in turn funds Local Enterprise Companies (LECs), which are companies limited by guarantee. The financial relationships between HIE and its LECs have attracted an untypical level of media and political attention.

Sectoral consolidation is found in Highlands & Islands Enterprise Network Accounts 1995–96 (Comptroller & Auditor General, 1996), which from that year are required to be produced in accordance with Section 227 of the Companies Act 1985, exemption having previously been granted through a Treasury-approved Accounts Direction (Scottish Office, 1992). This sectoral consolidation is entirely outside the general government boundary. The stricter terms of FRS 2, compared to those of SSAP 14, in terms of allowing exclusion from the area of consolidation, reinforced the Companies Act requirement and led to audit qualifications in 1992-93, 1993-94 and 1994-95 for the non-consolidation of LECs, whereas there had been no qualification in 1991-92 (HIE's first accounting year). In essence, the audit qualification was a challenge to the Accounts Direction. Following the issuing of a new Accounts Direction (Scottish Office, 1996), HIE fully complies with FRS 2. A consequence of these developments is that there are Balance Sheets for HIE and for the HIE network, but an Income & Expenditure Account and Cash Flow Statement only for the HIE network. This occurs despite the fact that HIE is within the public sector and the LECs are in the private sector for national accounts purposes.

The third case highlighted by Figure 3 concerns the relationship between public and quasi-public bodies and the pension funds established for their employees. These may be funded schemes (in which case the concern is whether they are in deficit), or notional schemes (in which case the Exchequer is directly or indirectly liable to pay the pensions when these become due). The employees of departments are likely to be in notional pension funds; in recent years, departments have each year been charged with an amount equal to the employer cost of the future benefits accrued by employees in post in that year. However, the Civil Service Superannuation Scheme is a liability of the government as a whole, not of individual departments. These liabilities are therefore excluded from DRAs, though the Treasury has promised that 'scheme statements' will be presented to Parliament. A Public Accounts Committee (1996) hearing on the chronic mismanagement of the notional Teachers' Superannuation Scheme (England and Wales) revealed, almost in passing (Richard, 1996), that a funded scheme would need to stand at £70 bn—the equivalent of 23.4% of GGE(X)\textsuperscript{17} in 1995–96. Even in the case of funded schemes, the financial cost of downsizing public organisations is frequently met in part by early retirement packages involving charges on the pension fund. In

\textsuperscript{16} Mooney (1951: 24) cited the private sector example of Bethlehem Steel which consolidated Cambria Iron Company, in which it owned no shares but had leased all its assets under a 999-year lease.

\textsuperscript{17} GGE(X) is the public expenditure aggregate which the Treasury (1998) targets for macroeconomic policy.
such cases, it will be the quasi-public bodies which are legally liable for outstanding liabilities, though their heavy dependence on public funds puts the Exchequer at risk.

Taking Figures 2 and 3 together, there are six boundaries of importance:

(a) the departmental boundary for the DRA (as defined by the Treasury);
(b) the 'government' boundary (as would be defined by the unconstrained application of UK GAAP);
(c) the central government boundary as defined by the Treasury in accordance with the internationally prescribed System of National Accounts 1993 (SNA) (Inter-Secretariat Working Group on National Accounts, 1993) and its EU variant, the European System of Accounts 1995 (Eurostat, 1996);
(d) the general government boundary (as defined on the above national accounts basis);
(e) the relevant boundary as defined for the purposes of the Maastricht Treaty and used to monitor compliance with the Excessive Deficits Protocol (Office for National Statistics, 1997);
and
(f) the fuzzy boundary of the public plus quasi-public sector.

Except in the case of boundary (f), this listing uses terms in a strict technical sense, following SNA and UK GAAP. A practical difficulty is that much public discussion uses terms like 'government' and 'public sector' in ways which are, deliberately or unintentionally, lacking in precision. Although this paper is primarily concerned with boundary (a), the macro-fiscal context and public policy framework mean that the importance of these wider boundaries must not be neglected.

It is evident from the above that multiple scorekeeping systems will cause confusion and may be exploited for purposes of creative accounting. Examples, including the PFI and private borrowing by housing associations, have already been discussed. Two topical examples complete this section. First, the Education and Employment Committee (1997: para. 33) of the House of Commons has made a proposal designed to 'resolve' the accounting difficulty that student loans will count against the PSBR. Instead of the government itself borrowing, HEIs would borrow through a not-for-profit trust, with the 'bad debt provisions' being 'underwritten' by the Treasury. There are several examples, both in the Committee's report and in the accompanying evidence volume, of how lobbies linked to spending departments will 'pick and choose' between accounting rules. Having welcomed RA (and urged its advanced implementation concerning student loans), the Report then intriguingly claimed it an advan-

tage that 'the cost of meeting the bad debt provi-
sion would be many years down the line' (paras. 31 and 33).

Second, two reports commissioned by the Chartered Institute of Housing have argued the case for establishing local housing companies as a mechanism for taking local authority borrowing for council housing outside the PSBR (Hawksworth and Wilcox, 1995; Radcliffe, Hawksworth and Glan-
ville, 1996). One of the arguments advanced is that this would put local authorities on to the same basis as housing associations. Whatever the substantive merits of these two cases, neither lobby affects to know of other good causes which might also benefit from creative accounting!

4. Conclusions

This investigation of consolidation issues, seemingly highly technical and narrow in focus, raises a number of issues of fundamental principle, both about accounting as applied to government and about the meaning of concepts widely appealed to in discussions of government, such as accountability, control and transparency. The topic therefore has both substantive importance ('seeing the whole picture') and procedural importance (restricting the area of consolidation was a Treasury decision pre-dating the establishment of FRAB). Moreover, this paper has cast light upon some of the ways in which the government sector is relevantly different from the private sector when accruals accounting is in operation.

First, the idea of control is substantially more difficult to operationalise. Moreover, pursuit of the idea of control may raise conflicts with other principles, such as accountability. If interpreted in terms of fiscal dependence, the criterion of control might lead to a vastly expanded area of consolidation in UK government, embracing both separately elected local authorities and even those parts of the quasi-public sector which most observers would regard as primarily private in character. Whereas appeal to GAAP provides a welcome safeguard against manipulation by preparers, such anchoring should not inhibit the search for styles of government financial reporting which address user needs and reflect institutional context (International Federation of Accountants—Public Sector Committee, 1998; Office of the Auditor General of Canada and United States General Accounting Office, 1986). In particular, the application of UK GAAP to government confronts problems originating from the way in which government confers unrequited benefits (e.g. capital grants to finance asset acquisition) outside the departmental and general government boundaries, thereby creating a new asset which it does not own but over whose use it may retain substantial influence. In some cases, extending the area of consol-
idation based on the notion of control would resolve this problem, yet there would also be cases when the resulting asset is genuinely privately controlled.

Second, problems arise as to the appropriate methods of accounting for transactions across the DRA boundary, especially when this has been drawn in a restrictive manner. One of the most obvious effects of NPM reforms has been to further fragment the machinery of government and confer private sector status on various activities, thereby heightening the importance of accounting as a mechanism for portraying the broader picture. The full implications for the Treasury of having established FRAB, with direct links to ASB through overlapping membership, may not have been digested. In particular, the Treasury has always valued its control of public expenditure definitions as a device for policy presentation and obfuscation. Notwithstanding current rhetoric about transparency, this seems unlikely to change. It therefore seems likely that its current conflict with ASB over the PFI will be replicated on other issues (Broadbent and Laughlin, 1999), especially when ‘doing good by stealth’ (much-needed hospitals) clashes with ‘honest accounting’ (off-balance sheet finance). These issues concerning accounting regulation raise the possibility that it is indeed the adoption of an accruals basis for government accounting which is forcing into the open irrational or hitherto tacit understandings about the machinery of government.

Third, there is a surprising lack of disclosure requirements concerning the relationship of the consolidated entity with entities (e.g. NDPBs) which are excluded from the area of consolidation. The rather unique and complex nature of these relationships deserves full disclosure in the Notes to the DRA. Such disclosure would enhance the transparency of a department’s financial affairs, allowing report users to produce, if they wish, ‘home-made’ consolidations. What makes disclosure particularly important is that there are inevitably problems attached to the interpretation of government financial statements, whether consolidated or not. Obvious among these are that liabilities (e.g. unfunded pensions) are much more under the discretionary control of government than would ever be the case for private sector decision-makers. Moreover, future tax revenues (which will be the means of meeting these liabilities as they mature) are not capitalised, thereby aggravating the difficulty of interpreting the ‘General Fund’. One of the greatest concerns is that the DRA, defined as the reporting entity, is ‘evacuated’ of both assets and liabilities, which are then transferred ‘outside’.
### Appendix: Glossary of UK terminology

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tbody>
<tr>
<td>Appropriation Account</td>
<td>The end-of-year cash-based account which compares amounts authorised by Parliament in Supply Estimates with actual cash payments made and receipts brought to account and explains any substantial differences. One is prepared for each Vote.</td>
</tr>
<tr>
<td>Control Total</td>
<td>From 1993–94 to 1998–99, the Treasury has focused upon this control aggregate, in order to deliver its objectives for the broader—but less directly controllable—GGEx(X). The Control Total excludes cyclical social security, privatisation proceeds, central government debt interest and miscellaneous accounting adjustments.</td>
</tr>
<tr>
<td>Departmental Resource Account (DRA)</td>
<td>The accruals-based consolidated account for each department, prepared in conformity with the Resource Accounting Manual, scheduled to replace the Appropriation Account as from 2001–02.</td>
</tr>
<tr>
<td>Executive agencies</td>
<td>Launched in 1988 as the ‘Next Steps’ programme, much of central government activity is conducted through executive agencies which are intended to have greater managerial autonomy. They are all self-accounting, and many have moved from cash to accruals in advance of their parent departments. Most are on-Vote (i.e. all their expenditure and income appears in the relevant Estimate line) but some have trading fund status (with only their external financing from the department being voted). In the national accounts, trading funds are treated as public corporations.</td>
</tr>
<tr>
<td>General Fund</td>
<td>In a department’s accounts the balance on the General Fund represents its total assets less liabilities to the extent that it is not represented by other reserves.</td>
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<tr>
<td>GGEx(X)</td>
<td>General Government Expenditure (GGEx) is drawn from the national accounts which are prepared by the Office for National Statistics. However, as its macro-fiscal control target, the Treasury has focused for some years on a variant, known as GGEx(X). This is defined as: GGEx + privatisation proceeds − general government interest and dividend receipts − lottery expenditure.</td>
</tr>
<tr>
<td>Non-Departmental Public Bodies (NDPBs)</td>
<td>This is a heterogeneous category of government organisations, which the Cabinet Office categorises into three types: Executive etc., advisory and tribunals.</td>
</tr>
<tr>
<td>Public Expenditure Survey (PES)</td>
<td>The annual review of public expenditure plans, for three years ahead, which has been conducted on broadly comparable lines since the 1960s. However the incoming Labour government in May 1997 abolished the 1997 and 1998 PES rounds, substituting instead the Comprehensive Spending Review which fixed the new control aggregates for three years ahead. The first resource-based survey will be conducted in 2008, for the years 2001–02, 2002–03 and 2003–04.</td>
</tr>
<tr>
<td>Resource Accounting</td>
<td>The application of accruals accounting to central government; more specifically, the adoption of accounting standards as applicable to private sector companies, though subject to modifications devised by the Treasury in the light of particular circumstances in the central government sector.</td>
</tr>
<tr>
<td>Resource Budgeting</td>
<td>Resource Budgeting covers planning and controlling public expenditure on a resource accounting basis.</td>
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<tr>
<td>Supply</td>
<td>Money voted by Parliament annually on the basis of departments’ estimates of payments and receipts likely to arise in the year, to meet the services shown in Estimates. Estimates are statements presented to the House of Commons of the estimated expenditure of departments which ask for the necessary funds to be voted. An individual Supply Estimate is called a Vote because the procedure by which Parliament authorises expenditure is to vote Supply.</td>
</tr>
<tr>
<td>Total Managed Expenditure</td>
<td>As from 1999–2000, there is a new control framework, albeit still on a cash basis. Total Managed Expenditure consists of Departmental Expenditure Limits (set firmly for three years ahead) and annually managed expenditure (whose composition is still reviewed annually). As from 2001–02, these aggregates will be recast in both resource and financing requirement (mostly cash) terms.</td>
</tr>
<tr>
<td>UK generally accepted accounting practice (GAAP)</td>
<td>The accounting and disclosure requirements of the Companies Act 1985 and pronouncements by the Accounting Standards Board (principally accounting standards and Urgent Issues Task Force abstracts), supplemented by accumulated professional judgement.</td>
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</table>
References


