

Appendix III

Views on Whole of Government Accounts: Professor David Heald, University of Aberdeen

Under Resource Accounting and Budgeting (RAB) two forms of consolidation will be undertaken but another will not. The Departmental Resource Account (DRA) of each department will consolidate organisations falling within the relevant departmental boundary. Moreover, organisations outside the departmental boundary will continue to follow the current standard FRS2 in relation to any subsidiaries. However RAB will not involve the creation of a “super departmental” resource account, consolidating DRAs. The topic of consolidation within the public sector can be shown to be of substantive importance for anyone seeking the “whole picture” and it is possible to identify reasons for more systematic public sector financial consolidation.

The onset of RAB will be likely to lead to more and more pressure to consolidate DRAs and additional information to produce a Whole of Government Account (WGA). In addition, it is likely to be difficult to avoid the introduction of a consolidated government account for macro-economic reasons. A commitment has been given, subject to the outcome of the scoping study, to produce consolidated Central Government accounts along with a less firm commitment to widen the scope of the consolidation beyond Central Government as part of the recent fiscal policy announcements made by Treasury Ministers. In addition, it is likely that benefits would be derived from the production of a WGA because it would lead to improved public accountability and transparency and would inform micro-economic decision making.

It is worth noting that New Zealand has already produced a WGA, thus setting a precedent for others to consider. The New Zealand WGA involves the consolidation of all government bodies on a line-by-line basis, and the consolidation of all central government interests outside the general government boundary on an equity basis. Local authorities are excluded from the New Zealand financial statements, so that the term “WGA”, though widely used, is rather misleading (note that in terms of both expenditure and functions, local government is much less important in New Zealand than in the UK). The UK will need to ensure that the data contained in the WGA are as reliable as possible, and that misinterpretations are avoided, particularly given the links to the macro-economic agenda and fiscal policy decisions.

Given that UK GAAP is being extended to central government and that there is a possibility that a WGA will be produced based on UK GAAP, then it is useful to consider the relevance of private sector experience with consolidation. 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. The decisive criterion for consolidation under UK GAAP is that of control and not that of ownership. Consolidation brings together the financial results of the parent and all subsidiaries, thereby eliminating an opportunity for income smoothing through timely dividend payments from subsidiaries to the parent. Therefore it is vitally important to define the boundary of the entity to be consolidated, which may be difficult given the complexity of government structure. It would be possible to contend that UK government is the ultimate parent of all UK government entities, which would suggest that consolidation should go beyond the New Zealand style of WGA to include local authorities. This would be likely to be highly contentious because of the constitutionally separate status of local authorities.

It is important to consider how the government sector differs from the private sector when accruals accounting is in operation. First, the idea of control is substantially more difficult to operationalise. Second, some liabilities (eg unfunded pensions) are much more under the discretionary control of government than would ever be the case for private sector decision-makers. Moreover, the 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". Third, the application of UK GAAP to government confronts problems originating from the way in which government confers unrequited benefits (eg capital grants to finance asset acquisition) outside the departmental and general government boundaries, thereby creating a new asset but one which it does not own but over whose use it may retain substantial control. In some cases, extending the area of consolidation based on the notion of control would resolve this problem. However, there will also be cases where the resulting asset is genuinely privately controlled.

A judgement concerning the balance between consolidation and disclosure, and how the two can most effectively be combined, needs to be made. Applying "control" as the criterion would lead to a vastly expanded area of consolidation in the UK, embracing both local authorities and even those parts of the quasi public sector which most observers would regard as primarily private in character. The issue becomes more sharply focussed in a federal system, such as in Australia where Whole of Government has the meaning of Whole of Jurisdiction (ie Commonwealth, six States and two Territories). When looking at net worth, it is always relevant to ask "whose net worth?". Across the complex structure of units

and tiers of government there might be marked variations in fiscal probity and health. Whereas appeal to UK GAAP provides a welcome safeguard against manipulation by preparers, such anchoring should not inhibit the search for a style of WGA which addresses both user needs and reflects the institutional context.

My overall conclusion would be that a WGA is a key “next step” in the UK’s financial management reform agenda. It would, in my opinion, be sensible to demonstrate that a Central Government consolidation could be successfully achieved and produce useful data before moving further and widening the scope of the consolidation to include other public sector bodies including local authorities.

An extended exposition of my views is available in the paper “*Consolidation principles and practices for the UK government sector*” co-authored with George Georgiou (mimeo, March 1998).

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