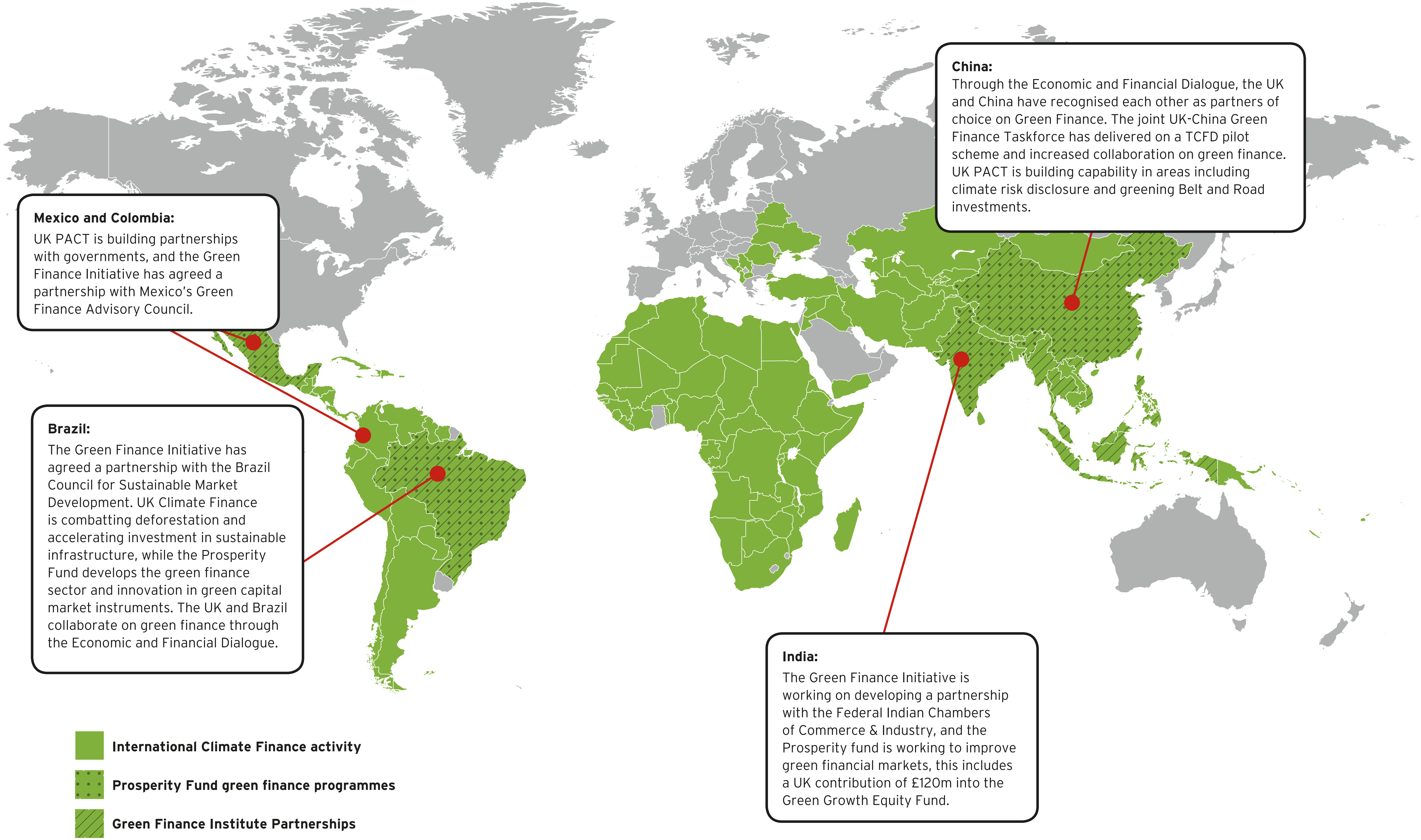
**Figure 4 – UK's climate investments and green finance partnerships**



The Government's ambition is for the UK to remain a leader in developing innovative green finance products and services and climate-related data and analytics. Our approach to doing this has four elements:

- Creating effective regulatory and policy frameworks and encouraging common standards to correct market failures and promote consistency, clarity, and best practice;
- Promoting dialogue between government, regulators, academia, and the financial sector to understand and identify challenges and opportunities;
- Enhancing climate and environmental data and analytics to reduce information asymmetries and foster transparency; and
- Developing policies to promote the adoption and mainstreaming of green finance products and services.

## Creating effective frameworks and encouraging common standards

Building on the UK's reputation for quality regulation in financial services and thought leadership in climate policy, the Government recognises the importance of fostering a policy and regulatory environment that stimulates innovation and encourages investment in the real economy. As set out in the first two chapters, the Government is committed to enacting forward-looking and transparent real economy policies and building robust green financial market frameworks and common standards.

## Promoting dialogue to support innovation

The bulk of expertise in green finance sits within the private sector and over the past few years we have consistently worked in collaboration with industry in developing policy. Fostering a dialogue between the public and private sector is important to enable the sharing of expertise, building momentum around new innovations, and to understand, identify, and respond to challenges and opportunities.

At the request of the Government, the City of London's Green Finance Initiative was established in 2016, bringing together financial sector leaders, academics, and the civil society into a market development group. Subsequently, HM Treasury and the Department for Business, Energy and Industrial Strategy (BEIS) jointly convened the Green Finance Taskforce, composed of leading experts on green finance to work with their industry peers to provide a series of recommendations on how to accelerate the growth of green finance. The GFI will build on these examples of public-private collaboration, as shown above.

There is also a constant dialogue between the UK regulators and industry. For example, as referred to in Chapter 1, the Financial Conduct Authority and the Prudential Regulation Authority have established a Climate Financial Risk Forum to build capacity and share best practice across financial regulators and the private sector on green finance. The forum brings together senior representatives from banking, insurance, and asset management. One of the forum's four working groups is specifically focused on innovation[86].

The Government has also supported dialogues with regulators, other governments and the private sector on topics of innovation in financial services. For instance, the Sustainable Finance Study Group, co-chaired by the Bank of England and People's Bank of China on behalf of the UK and China, fostered discussion on the potential of green securitisation, venture capital, and digital technologies leading to ways to mobilise capital for the transition to a greener economy. HM Treasury officials, regulators, financial institutions, and academics also took part in roundtables in Beijing and Hong Kong in Spring 2019 to discuss ways to operationalise green asset-backed securities as well as the benefits and risks associated with transferring green securitised loans to institutional investors in the debt capital markets.





## Enhancing climate and environmental data and analytics

Governments, regulators, academia, civil society and the private sector all have a key role to play in developing and promoting access to environmental and climate-related financial data and analytics. This should help investors make better informed decisions and stimulate the development of new financial products, including green Fintech, unlocked from enhanced data availability, analytics and understanding of potential applications.

The UK Government already provides a wealth of publicly available environmental and climate-related data, building on its reputation for publishing and using open data for accountability, innovation, and social impact[87]. For example, the Government and publicly funded entities are already showing leadership in the collection, management, and analysis on physical climate-related data, energy and greenhouse gas emission-related data. For further detail on the UK's public data sources and relevant institutions pertaining to climate-related risk analysis please see Annex B.

The Government is also committed to enhancing the quality, coverage and use of geospatial data across all sectors of the economy, including the financial sector – which is also in the remit of the Geospatial Commission formed in April 2018. Earth observation, combined with artificial intelligence (AI), has the potential to transform the availability of data in our financial system and change how risks, opportunities and impacts are measured and managed by financial institutions. The UK already has world-leading capabilities in both.

We welcome recent developments including:

- The Alan Turing Institute (the UK's national institute for data science and AI) which, in support of the AI and Data Grand Challenge, has established a Sustainable Finance Interest Group to bring together researchers to support financial institutions and regulators to integrate AI and geospatial data into financial services, and analyse the performance of sustainable investments;
- The Spatial Finance Initiative (SFI) which was established in 2019 by The Alan Turing Institute, Satellite Applications Catapult, the GFI, and the University of Oxford Sustainable Finance Programme to mainstream the use of geospatial data and analysis in financial decision-making globally[88]; and
- The work of the public-private partnership Space for Climate – aimed at creating a seamless supply chain of reliable and quality assured data ready to translate into climate services including those needed by the finance sector.

In line with the Green Finance Taskforce recommendations, the Government recognises there is a need for further innovation and coordination in data availability, comparability and aggregation, as well as a better understanding of existing datasets and potential applications within the financial sector. That is why:

- **The Government is working with UK Reseach and Innovation (UKRI) to explore options for future research funding to reduce information asymmetries and promote transparency in the availability and application of climate risk information**. The Natural Environment Research Council (NERC) and Innovate UK, which are part of UKRI, are working together to deliver a research and innovation programme. This will develop improved information and analytics on climate and environmental hazards, as well as vulnerability and exposures to support the financial sector and other corporates. Further details will be announced later this year.
- **The Government will work with the GFI to**

**explore the use of climate analytics and data to support mission-led coalitions (see Chapter 2), and to mobilise green investment.**

- **The Geospatial Commission, together with other Government backed organisations (e.g. UK Research & Innovation, NERC, the UK Space Agency, The Satellite Applications Catapult, The Alan Turing Institute), and the Spatial Finance Initiative, will explore how to accelerate UK efforts to secure and support the adoption of geospatial datasets required to green the global financial system.**

These actions will help promote the mainstreaming of green finance products and services, and support green fintech.

## Promoting the adoption and mainstreaming of green finance products and services

The UK Government recognises the importance of enacting policies that foster innovation in green finance and the mainstreaming of new products and services. This includes creating an environment that allows innovation to flourish and promotes best practice – building on the LSEG's leadership in mainstreaming new green products, as shown in the Case Study below – as well as through direct incentives to stimulate innovation across asset classes and industry sectors.

### Case Study – the London Stock Exchange Group: Innovation in Capital Markets

London Stock Exchange Group (LSEG) has taken a range of steps to support investors and issuers in the transition to a low-carbon and sustainable economy. It has developed a comprehensive sustainable finance and investment offering and continues to innovate in support of market needs.

LSEG was the first major exchange in the world to launch a dedicated green bond segment back in 2015. It now has over 100 active Green and sustainable bonds listed on its markets by issuers including corporates, municipalities, sovereigns and multilateral development banks from 16 countries, which have raised more than $29 billion in 12 currencies.

Renewable energy funds are another important structure to drive capital to the green economy. Listed green funds have been a success story at the LSEG, with 11 renewable funds, in addition to others focused on energy storage, energy efficiency and environmental technologies, collectively worth over $9 billion. The market for Yieldcos is also gaining traction with 12 renewable Yieldcos currently on the LSEG with a market capitalisation of £7.6 billion.

LSEG's index and analytics business, FTSE Russell has been active in the global index space since 2001 when the FTSE4Good Index Series was launched and currently has approximately $16 trillion benchmarked to its indexes. Its data and analytics tools support many of the world's largest asset owners as they look to integrate ESG into their investment strategies.

There has also been a significant uptake in Exchange Traded Funds (ETFs), with 64 ESG ETFs with a total value of $5.1 billion (as of Nov 2018) – up 45% compared to the previous year. 80% of professional investors expect investment into ESG ETFs to grow over the next five years, with 20% expecting a dramatic rise in interest.

We welcome the launch of the FCA's Green Fintech Challenge in October 2018, building on its pioneering regulatory Sandbox service and Innovation hub, to help businesses test innovative propositions in the market with real consumers. The Green Fintech Challenge aims to support firms that require specific regulatory support in developing innovative green solutions to assist the UK's transition to a greener economy. The initiative offers a range of support services for the successful applicant depending on the individual needs and maturity of the firm, including a dedicated Innovate Adviser, authorisation support, live market resting in the sandbox, and formal and informal guidance. Applications closed in January and the first nine successful applicants were announced in April this year[89].

The UK Government is also committed to supporting financial innovation that can encourage the decarbonisation of the UK housing sector – a key contributor to UK carbon emissions. That is why:

- **We are launching a £5 million Green Home Finance Innovation Fund** to pilot over 18 months green home finance products that have sustainable business models, will incentivise energy efficiency retrofit, and are supported and promoted effectively by the lender. The pilots will test the extent to which green finance products are attractive to consumers, drive energy efficiency works and can be self-sustaining.

Government policies in this area need to be focused on securing additionality by addressing existing barriers to the adoption and mainstreaming of green finance products and services. In this context, the Government has been carefully considering the call to issue a sovereign green bond.

Green bonds have demonstrated significant growth in recent years, and the Government recognises the importance for this broader growth to continue. At present the Government does not plan to issue a sovereign green bond, given the absence of significant barriers to market for corporate issuances in the UK. In addition, the Government does not consider a sovereign green bond to be value for money compared to the core gilt programme, which remains the most stable and cost-effective way of raising finance to fund day-to-day government activities (including existing and new green expenditure). This owes to the strength of investor demand for gilts, the well-established nature and size of the market, as well as the fact that gilts can be built up to benchmark sizes across a range of maturities, resulting in a highly liquid market and diverse investor base.

The Government remains open to the introduction of new debt financing instruments but would need to be satisfied that any new instrument would meet value for money criteria, enjoy strong and sustained demand in the long-term and be consistent with the wider fiscal objectives of government. The Government continues to monitor the case for a sovereign green bond and will keep this under review. Meanwhile, the Government has already set out plans for significant investments in clean and resilient growth as outlined in Chapter 2.

# Building Capabilities and Skills

As green finance continues to establish itself in the mainstream, there will be an increasing need for the UK and global financial services industries and related sectors to develop the capabilities of their workforce with relevant education and training in green finance principles and practice. As a leading global financial centre and with a world-renowned network of universities and Chartered professional bodies, the UK is strategically placed to establish and promote global professional and educational standards for green finance. Our aim is for the UK to consolidate its reputation as the home of the green finance professional and to capture the commercial opportunities arising from the global demand for training and qualifications in green finance.

## Working with professional bodies

UK-based professional bodies are already leading the world in embedding green finance into programmes of initial and continuing professional development, as the examples below demonstrate. Such programmes are designed to ensure that finance practitioners have the necessary skills and expertise needed to understand climate science, integrate environmental factors into financial risk analysis and investment decision-making, seize opportunities in green finance and help align private sector finance with the transition to a clean and resilient economy.

For example, in 2018, the Chartered Banking Institute launched the new Green Finance Certificate – subsequently adopted by the Chartered Institute for Securities and Investment – and CFA UK has recently launched an ESG Investing certificate. In a similar vein, work is underway in a wide range of UK-based professional bodies to raise awareness of the financial risks from climate change and embed green and sustainable finance principles and practice.

**Building on this work, the Government in collaboration with a working group of professional bodies and the GFI has developed a Green Finance Education Charter.**

Global initiatives such as the Global Research Alliance for Sustainable Finance and Investment – created in 2017 by a network of global research universities to promote multi-disciplinary academic research on sustainable finance, are also advancing the agenda.

## Training for the Public Sector

While green finance capability in Government has grown significantly in recent years, developing green finance skills in the public sector continues to be important. That is why:

- **The Government has been working closely with the University of Oxford to create a short course for UK government policy officials to provide foundational knowledge on green finance**. This has been trialled by UK policy and trade officials across 30 different High Commissions, Embassies, Consulates, and Missions across North America, Latin America, Southeast Asia, and Australasia from December 2018 to June 2019. Financial and Professional services teams in the Department for International Trade have also trained staff in UK embassies and consulates globally on Green Finance; and
- **The Government will be strengthening its training for the public sector by organising a public-sector conference on green finance, to take place on 17 October 2019.**

The conference will aim to co-ordinate efforts on green finance policy across central and local government, showcase work and successes, provide a forum to discuss emerging topics, and provide opportunities for peer learning and exposure to latest practices on green finance.

### Box 8 – Green Finance Education Charter

On 14 May, Government together with the Green Finance Initiative hosted a roundtable for CEOs of professional finance and accounting bodies to discuss how they could lead the drive to develop appropriate programmes of initial and continuing professional development to build the capability and capacity of the banking, finance and professional services sectors to mainstream green finance.

Following the roundtable, the Government, a working group of professional bodies, and the GFI have developed a charter that commits professional bodies to taking prompt action to identify and address gaps in the development of green finance knowledge and skills, and engage members on the risks and opportunities climate change and environmental challenges present to their professions. The Charter will be launched at the Green Finance Summit in July 2019, with a wide range of UK-based professional bodies expected to sign up to the Charter by the end of the year.

Going forward the new GFI will work with UK-based professional bodies to help build skills and capabilities in green finance.

## Building Consumer Awareness and Demand

As green finance becomes increasingly mainstream, there will be a growing demand for retail products such as green mortgages. Improved consumer awareness and understanding of how their money is invested will give individuals greater agency in choosing these financial products. This will help stimulate demand for green products and create a feedback loop with greater innovation in the UK green finance sector. Crowdfunding options and retail investment platforms are already leading the way and tapping into this nascent market.

While the Government's Green Finance Strategy has mainly sought to address the role of Government, regulators, financial institutions and industry in growing green finance, we fully recognise the vital role of individuals in driving demand for green financial products and services and delivering the UK's environmental objectives. That is why the first Green GB Week in October 2018 was aimed at engaging consumers on Clean Growth issues, including green finance through events, media and campaigns. We also welcome the Mayor of London's Climate Action Week in July this year, and the second Green GB Week in November will provide further opportunities for Government to reach new audiences with its messages[90].

The UK Government is taking forward a range of broader activities to engage with individuals and make it easier for them to invest in line with their values. The Department for International Development (DFID) and the Department for Digital, Culture, Media and Sport (DCMS) are leading a number of cross-government initiatives to make progress on this agenda. These include the Taskforce on Growing a Culture of Social Impact Investing in the UK, support for the new independent Impact Investing Institute (see Next Steps below for more details), and the Investing for a Better World project.

The 'Investing in a Better World[91]' project, sometimes called The National Conversation on Investing in the Global Goals, aims to better understand the public's views on ethical, responsible and impactful investment practices. Its research will help industry understand the shape and scope of UK customer demand for responsible and impactful investment, in order to support sustainable investment in the developing world and help deliver the Global Goals, a set of 17 goals agreed by world leaders at the UN to end poverty and protect the environment.

To achieve this, the Government is running a nationally representative survey of 6,000 people on their values, awareness, interest, and barriers to action. This will result in a comprehensive, statistically valid view on how the UK public thinks about responsible investment. Interim results will be available for the UN High Level Political Forum in July, where the UK will also present its Voluntary National Review on its progress against achieving the Sustainable Development Goals domestically.

DFID has also run a series of events to raise awareness and to work with industry to support more product development so that people have more opportunities to invest in line with their values. The findings of this work will be publicly available after the UN General Assembly in September. We will consider the findings as we implement the Green Finance Strategy, working closely with the GFI and the Impact Investing Institute.



# Next Steps

This Strategy sets out the actions we will take in the coming years to accelerate the growth of green finance, both at home and overseas, and use this to drive economic growth in the real economy at a time of huge change and opportunity. The Strategy supports the UK's economic policy for strong, sustainable and balanced growth and delivery of our modern Industrial Strategy. It also helps to ensure the UK remains at the forefront of global efforts to fight climate change and protect our environment while strengthening the competitiveness of the UK's financial services sector.

The Strategy comes at an important time for the UK's climate leadership following our setting of a net zero emissions target and ahead of UN Global Climate Action Week in September and COP26 next year. The Government will continue to work closely with the private sector as we deliver our strategy, building on the work of the Green Finance Taskforce through the establishment of the Green Finance Institute, and we will seek opportunities to further strengthen our approach.

As part of this, we will explore linkages to related issues, such as delivering a just transition and accelerating social impact investing.

## Delivering a just transition

The transition to a clean, low carbon economy can help give us towns and cities with cleaner air and warmer homes with lower bills while growing our economy and supporting new jobs in emerging low carbon industries. Already there are almost 400,000 jobs in low carbon businesses and their supply chains in the UK.

But as our economy changes it is vital we make sure that this growth is inclusive, benefitting people across the UK, supporting workers as industries transform and ensuring the costs as well as the benefits are shared fairly, protecting consumers, workers and businesses. This is why alongside our announcement of legislating for net zero, we also announced that HM Treasury will be conducting a review into the costs of decarbonisation, including how to achieve this transition in a way that works for households, businesses and public finances, and the implications for UK competitiveness. Over the summer we will publish our Energy White Paper that will aim to bring down energy bills and recently we've also developed sector deals on nuclear, offshore wind and automotive that will create green-collar jobs across the country and support the UK's other world class sectors to take part in this transition. For example the UK's expertise in the North Sea from oil and gas is now part of a growing offshore wind supply chain.

## Capturing synergies with the impact investment agenda

Impact Investment is investment with the intention to generate a positive, measurable impact on society and the environment alongside a financial return. It is an important complement to green finance and together they have the potential to address some of the most pressing social and environmental challenges in the UK and internationally. The UK has seen significant growth in the impact investment market over the last two decades supported by a number of pioneering government initiatives. Big Society Capital was established in 2012, with funding made available from dormant bank accounts, to act as a market champion and as a wholesaler of capital for voluntary community and social enterprise organisations committed to social or environmental impact. The Social Impact Investment Taskforce of 2013, launched as part of the UK's presidency of the G8, created a network of National Advisory Boards for each member state to drive impact investing.

In 2016, Government set up an independent Advisory Group chaired by Dame Elizabeth Corley (former Chief Executive and Vice-Chair at Allianz Global Investors) to answer the question: "How can the providers of savings, pensions and investments engage with individuals to enable them to support more easily the things they care about through their savings and investment choices?" Their report, 'Growing a Culture of Social Impact Investing in the UK'[92], made far-ranging recommendations for government, regulators and industry. In March 2018, the Prime Minister commissioned an industry taskforce to progress the recommendations in the report. The Taskforce published their final report in June this year.

This Taskforce has been closely aligned with the Green Finance Taskforce in working to promote a more sustainable future for our planet and people. Key areas of collaboration identified include: the role of innovative technology; effective tax relief regimes, consistent reporting principles and innovation of financial instruments and structures to leverage incremental capital. We will continue to explore green finance synergies with impact investing initiatives in the UK, including as we seek to support the establishment of a new Impact Investing Institute (see Box 9).

## Reviewing progress

The Strategy sets out an ambitious approach that will require strong collective action to deliver. We also recognise the systemic changes required will not happen overnight.

To quote Bank of England Governor Mark Carney in the context of breaking the 'Tragedy of Horizon'; 'the task is large, the window of opportunity is short, and the stakes are existential'[93].

To ensure we meet the challenge, we will:

- Specifically review progress on greening the UK's financial system, including implementation of the TCFD recommendations, by the end of 2020, as outlined in Chapter 1; and
- Conduct a formal review of progress against the ambitions and plans across all three chapters of this Strategy in 2022.

### Box 9 – A new Impact Investing Institute

The Impact Investing Institute, announced in June, is being established to accelerate the growth and improve the effectiveness of the UK impact investing market. It brings together the UK National Advisory Board on Impact Investing (UK NAB) and the Implementation Taskforce for Growing a Culture of Social Impact Investing in the UK (Implementation Taskforce) and will be led by their chairs, Sir Harvey McGrath (former Chair of Man Group and Chair of Big Society Capital) and Dame Elizabeth Corley (former Chief Executive and Vice-Chair at Allianz Global Investors). The Institute will combine the energy, supporter base and achievements of these two groups to provide a focal point for the UK impact investing market and accelerate the potential for finance to improve people's lives at home and in developing countries.

The Institute has broad backing across the financial services and social sector, and will be supported by private firms and foundations alongside the Department for Digital, Culture, Media and Sport (DCMS), the Department for International Development (DFID) and the City of London Corporation. It will work with government as well as regulators and other policy makers to drive thought leadership and innovation. One such body is the new GFI, which will champion green finance in the UK and abroad. Both Institutes will identify areas where there are common themes and opportunities for joint working.





## Annex A – Prosperity Funding and UK PACT Programmes supporting green finance market development

**India:** India's Prosperity Fund programme will work in partnership with government and regulators in India to help develop a green finance market. The programme aims to improve financial market regulations, promote innovation in green finance instruments / taxonomies, and mobilise green finance. £120million of prosperity funding has also been used to support the Green Growth Equity Fund (GGEF), which aims to crowd in private sector investment to finance green infrastructure projects. Further programming used UK expertise to support the issuance of green bonds, resulting in an Indian public sector company committing $4 billion to finance vital clean energy infrastructure in India. This commenced with a first tranche of $300 million worth of green 'masala' bonds issued on the London Stock Exchange.

**Mexico**: The Energy strand of the Mexico Prosperity Programme aims to develop the skills of men and women, businesses, and government institutions to support Mexico's transition to a low carbon economy. Likewise, prosperity funded indicative activities as part of the Financial Services Agile Programming Fund will seek to complement efforts to catalyse green finance in Mexico through capacity building, policy recommendations, and market guidelines (including, but not limited to, a taxonomy for green projects).

UK PACT in Mexico spans across several sectors, with a strong focus on green finance. As well as work on renewable energy, climate policy, waste and sustainable transport, UK PACT works closely with the Mexican Government to increase access to green finance at a national and sub-national level. The programme focuses on harmonising guidelines and standards; improving pipeline development and increasing innovation in green finance products and green finance policy design. Projects include: capacity building work with key institutions; supporting a green finance hub; mobilising green finance for the development of smart cities and infrastructure and developing green bonds.

**Brazil**: The Green Finance strand of Brazil's Prosperity Fund programme aims to mobilise private finance and support effective allocation of government resources to leverage private investment into sustainable infrastructure. This will be achieved by developing Brazil's green finance sector and using UK expertise to develop new capital markets instruments for sustainable infrastructure. It complements the energy strand of the Brazil programme which supports the transition to a low carbon economy.

**Colombia:** UK PACT in Colombia works to directly influence the growth and development of green finance flows and local and international capital markets. The programme works in partnership with the government in several priority areas for green finance, including unlocking finance flows and mobilising investment, asset-owner information disclosure to promote transparency, a green bond roadmap and a climate finance accelerator.

**China**: The energy and low carbon strand of the China Prosperity programme aims to reduce global emissions by accelerating China's low carbon energy transition, capitalising on UK energy and low carbon expertise. The programme will focus on clean technology policy and regulation, thereby supporting the transition away from unabated coal; fundamental energy system reforms; and enhancing China's engagement with international energy and climate governance structures.

The first UK PACT projects in China strengthen collaboration between the UK and China on green finance, building on the priorities highlighted by the UK and Chinese governments in their EFDs (see Case Study in Chapter 1).

**Indonesia**: Under the Indonesia Renewable Energy Programme there is a focus on increasing green finance flows into Indonesia's renewable energy sector through technical assistance and capacity building.

**Association of Southeast Asian Nations (ASEAN)**: The ASEAN Low Carbon Energy Programme will strengthen policy and regulatory frameworks for green finance and energy efficiency; facilitate greater investment in low carbon technologies, including improved green finance flows; increase innovation and knowledge transfer in energy efficiency and low carbon technologies; and facilitate more efficient use of energy in target countries.

## Annex B - UK Public Sector Climate-related Data Ecosystem

### Physical environmental data

- **Flood map data:** The Environment Agency publish a wide range of flood risk information, including maps, as open data, for example, the 'Risk of Flooding from Rivers and the Sea' and 'Risk of Flooding from Surface Water' and related datasets[94]. Not all this information considers the effects of climate change directly, but may still give an idea of what increased flood risk looks like.
- From 2024 the quality and range of flood risk information available will improve when the new national flood risk assessment is published. This information will consider a range of climate change scenarios in line with UK Climate Projections (UKCP18), supporting planning activities seeking resilience to future climates.
- **The UK Climate Projections (UKCP18)**: Launched by DEFRA last year, these Met Office projections (funded by DEFRA and BEIS) provide the most up-to-date assessment of how the climate of the UK may change over the 21st century. UKCP18 is the first major update to the UK's national climate change projections for nearly 10 years, and the suite of products includes global and regional scenarios. Government will make use of UKCP18 to inform its adaptation and mitigation planning and decision-making, and the Projections will also help businesses and individuals to take action to improve resilience.
- **Environmental change**: In May 2019 the government published an outcome indicator framework for measuring environmental change pertinent to the goals of the 25 Year Environment Plan. This framework of 66 indicators acts guides readers to many of the available data sets that can inform them about key aspects of environmental change, including factors related to climate resilience.
- **UK Research and Innovation (UKRI)** Strategic Priorities Fund, the Natural Environment Research Council and the Met Office, alongside the Engineering and Physical Sciences Research Council (EPSRC), the Economic and Social Research Council (ESRC) and the Arts and Humanities Research Council (AHRC), have launched a UK Climate Resilience Programme (£18.7 million), aimed at bringing together fragmented climate research and promoting multi – and inter-disciplinary climate risk and adaptation research[95];
- **The Centre for Environmental Data Analysis** (CEDA) serves the environmental science community through provision of a long term data archive, a data intensive supercomputer (JASMIN), and participation in a host of relevant research projects, for example by providing access to UKCP18 datasets. CEDA is primarily funded by NERC (based within RAL Space, a department of the Science and Technology Facilities Council), provides state of the art data storage, through three data centres, and data processing facilities to support environmental science, further environmental data archival practices, and develop and deploy new technologies to enhance access to data. The CEDA data archive is part of a family of NERC data centres that together form the NERC Environmental Data Service.
- **Defra's Environment Analysis Unit** is developing a new online resource that will make the evidence base on natural capital more accessible to non-specialists. This resource will synthesise and signpost a very wide range of published valuation and natural capital evidence, guidance, tools and applications to support analysts and decision-makers to better value and account for natural capital in England. An initial version will be launched during 2019, and improved versions are planned to be developed as this area evolves.
- **The UK hosts the European Space Agency Climate Change Office. This runs the Climate Change Initiative (CCI+).** The European Space Agency (ESA) Climate Change Initiative (CCI), is a programme whose aim is to provide stable, long-term, satellite-based Essential Climate Variable data products for climate modellers and researchers. This can be achieved by realising the full potential of the long-term Earth Observation (EO) archives that ESA, together with its member states, has established over the last 30 years, as a significant and timely contributions to the ECV databases required by United Nations Framework Convention on Climate Change (UNFCCC). The activities of the programme are undertaken across Europe with the UK leading many of the science areas.
- The adoption of the UK-led Traceable Radiometry Underpinning Terrestrial and Helio-Studies (TRUTHs) mission as a European Space Agency Earthwatch Mission. Proposed by the National Physical Laboratory, TRUTHS is a small to medium size EO operational mission aiming to enhance our ability to estimate the Earth radiation through direct measurements and to enhance interoperability and performance of the global earth observing system, through cross-calibration with other satellites.

### Energy and GHG- emissions- related data

- **National Atmospheric Emissions Inventory** (funded by BEIS, DEFRA, The Welsh Government, The Scottish Government and Northern Ireland's Department of Agriculture, Environment and Rural Affairs) provides estimates of emissions to the atmosphere from UK sources such as cars, trucks, power stations and industrial plants and land use. Free and open access data is available on gov.uk to support companies in reporting emissions Including conversions factors to calculate emissions from metrics such as energy use;
- **Energy Performance Certificate (EPC) data:** MHCLG will seek to publish an update to the EPC data available through the Open Data Communities website and commit to regularly update this data to support lenders in driving energy efficiency by evaluating the EPC performance of their lending portfolios, to improve the energy efficiency of buildings within lenders' portfolios. We will also consider how this data could be made available on a "live" basis as part of updating the EPC Register platform.
- **The UK is a mission partner on MicroCarb, the first European mission to measure carbon. The UK Space Agency is working with the French Space Agency CNES on various parts of the hardware and the development of the algorithms with world experts from University of Leicester and University of Edinburgh.**

### Geospatial Data

- The Geospatial Commission was formed in April 2018 as an independent expert committee to advise government on the most productive and economically valuable uses of geospatial data and to deliver beneficial changes. The Commission is looking to publish a National Geospatial

Strategy at the end of this financial year 19/20. Their activities over the coming year are framed within two pillars, the first focusing on unlocking the potential of geospatial data in key areas across the private and public sectors and the second growing the geospatial ecosystem through activities focusing on data improvement, building skills to use geospatial data and the adoption of technology and innovation. 'An Initial analysis of the Potential Geospatial Economic Opportunity,' published by Cabinet Office in 2018, shows a potential economic value of £6 billion to £11 billion per annum from high-value use cases, not including the financial sector itself.

- The UK Space Agency (UKSA) leads on civil space policy. The UK has world-leading satellite EO capability, from developing and building missions to managing and exploiting data and creating trusted applications and services. The UK's vision by 2040 is to maximise the potential of EO – for the economy, science and society – by providing the quality-assured data required to underpin mass market and business applications, cutting-edge science, and the development of effective and efficient policy and operational decision making. Our priorities include maximising the opportunities in international partnerships, investing in global innovation and growth through research and innovation, and positioning EO as a fundamental infrastructure and tool underpinning industrial strategy, policy and societal needs.
- The UKSA works on climate services through the Space for Climate partnership – a public-private-academic partnership working collaboratively to ensure a seamless supply chain for climate data from space. Our collective ambition is that the UK leads the world in trusted climate expertise and products. The UKSA is seeking to chair CEOS (the Committee on Earth Observation Satellites) in 2023/24. CEOS ensures international coordination of civil space-based EO programmes and promotes exchange of data to optimize societal benefit and inform decision making for securing a prosperous and sustainable future for humankind.
- The UK is home to a third of Europe's total AI companies and twice as many as any other European country (MMC Ventures, 2019). The AI and Data Grand Challenge's AI sector deal – agreed last year- [96] established of a strong partnership between business, academia and government. £300 million has been allocated by the EPSRC to fund research related to 'data science and AI' complementing the new centres for doctoral training mentioned above.

# Endnotes

1 The Presidency of the 26th Conference of the Parties (COP26) to the United Nations Framework Convention on Climate Change

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**Annex 22  Managing Public Money**

HM Treasury

# Managing Public Money

May 2021

HM Treasury

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May 2021

This publication is available at: www.gov.uk/official-documents.

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# Contents

# Foreword

## about this document

i. This document updates the version published in 2007. Like the original, it sets out the main principles for dealing with resources in UK public sector organisations Some of the specifics, especially those in the annexes, relate to England rather than the devolved administrations, which have their own detailed rulebooks. But the same basic principles generally apply in all parts of the UK public sector, with adjustments for context.

ii. The key themes also remain. They are the fiduciary duties of those handling public resources to work to high standards of probity; and the need for the public sector to work in harmony with parliament.

iii. While these principles are invariant, the advice in this document cannot stand forever. The law, business practices, and public expectations all change. So public sector organisations can and should innovate in carrying out their responsibilities, using new technology and adopting good business practice. Throughout parliament always expects the government and its public servants to meet the ethical standards in this document and to operate transparently.

iv. As before, the main text of the document is intended to be timeless. The Treasury will revise the annexes from time to time as the need arises. All the text is available freely on the gov.uk website.

v. Above all, nothing in this document should discourage the application of sheer common sense.

# Chapter 1

# Responsibilities

The relationship between the government, acting on behalf of the Crown, and parliament, representing the public, is central to how public resources are managed. Ministers implement government policies, and deliver public services, through public servants; but are able to do so only where parliament grants the right to raise, commit and spend resources. It falls to the Treasury to respect and secure the rights of both government and parliament in this process.

## 1.1 Managing public money: principles

1.1.1 The principles for managing public resources run through many diverse organisations delivering public services in the UK. The requirements for the different kinds of body reflect their duties, responsibilities and public expectations. The demanding standards expected of public services are set out in box 1.1.

**Box 1.1: standards expected of all public services**

| | | | | |
|---|---|---|---|---|
| honesty | impartiality | openness | accountability | accuracy |
| fairness | integrity | transparency | objectivity | reliability |

carried out

in the spirit of, as well as to the letter of, the law

in the public interest

to high ethical standards

achieving value for money

1.1.2 The principles in this handbook complement the guidance on good governance in the *Corporate Governance Code*[1] applying to central government departments. Some of the detail applies to England only, or just to departments of state. There is separate guidance for the devolved administrations. Where restrictions apply, they are identified.

1.1.3 Much of this document is about meeting the expectations of parliament. These disciplines also deliver accountability to the general public, on whose behalf parliament operates. The methods of delivery used should evolve as technology permits. Public services should carry on their businesses and account for their

[1] The Corporate Governance Code – see https://www.gov.uk/government/publications/corporate-governance-code-for-central-government-departments

stewardship of public resources in ways appropriate to their duties and context and conducive to efficiency.

## 1.2 Ministers

1.2.1 In the absence of a written constitution, the powers used to deploy public resources are a blend of common law, primary and secondary legislation, parliamentary procedure, the duties of ministers, and other long-standing practices. This mix may of course change from time to time.

1.2.2 As the *Corporate Governance Code* makes clear, the minister in charge of a department is responsible for its policy and business as part of the broad sweep of government policy determined in Cabinet. They:

- determines the policies of the departmental group;
- chairs the departmental board;
- allocates responsibilities among the ministers in the department;
- chooses which areas of business to delegate to officials, and on what conditions;
- looks to the department's accounting officer (see chapter 3) to delegate within the department to deliver the minister's decisions and to support the minister in making policy decisions and handling public funds; and
- also has general oversight of other bodies on whose behalf they may answer in parliament, including the department's arms length bodies (ALBs).

1.2.3 The *Ministerial Code*[2] requires ministers to heed the advice of their accounting officers about the proper conduct of public business. See section 3.4 for how the minister may direct the accounting officer to proceed with a policy if a point of this kind cannot be resolved.

1.2.4 The minister in charge of a department may delegate defined areas of its business, or of its parliamentary work, to their junior ministers. Ministers have wide powers to make policies and to instruct officials.

1.2.5 Only ministers can propose legislation to parliament to raise public revenue through taxation, or to use public funds to pursue their policy objectives. Specific primary legislation is normally required to spend public funds (see section 2.1). Similarly, taxes may be collected, and public funds may be drawn, only with parliamentary authority; and only as parliament has authorised.

1.2.6 It is not normally acceptable for a private sector organisation to be granted powers to raise taxes, nor to distribute their proceeds. Parliament expects these responsibilities to fall to ministers, using public sector organisations.

1.2.7 The House of Commons (and not the House of Lords) enjoys the financial privilege to make decisions on these matters.

[2] https://www.gov.uk/government/publications/ministerial-code

## 1.3 Parliament

1.3.1 Parliament approves the legislation which empowers ministers to carry out their policies. It also allows finance for services when it approves each year's Estimates. See the *Estimates Manual*[3] for more.

1.3.2 From time to time parliament may examine government activity. Select committees examine policies, expenditure, administration and service delivery in defined areas. The Committee of Public Accounts (PAC - see section 3.5) examines financial accounts, scrutinises value for money and generally holds the government and its public servants to account for the quality of their past administration.

## 1.4 The Treasury

1.4.1 Parliament looks to the Treasury to make sure that:

- departments use their powers only as it has intended; and
- revenue is raised, and the resources so raised spent, only within the agreed limits.

1.4.2 Hence it falls to the Treasury to:

- set the ground rules for the administration of public money; and
- account to parliament for doing so.

1.4.3 This document sets out how the Treasury seeks to meet these parliamentary expectations. The key requirements are regularity, propriety, value for money and feasibility (see box 3.2). The Treasury:

- designs and runs the financial planning system[4] and oversees the operation of the agreed multiyear budgets to meet ministers' fiscal policy objectives;
- oversees the operation of the Estimates through which departments obtain authority to spend year by year;
- sets the standards to which central government organisations publish annual reports and accounts in the *Financial Reporting Manual* (*FReM*). This adapts International Financial Reporting Standards (IFRS) to take account of the public sector context;
- sets Accounts Directions for the different kinds of central government organisations whose accounts are laid in parliament; and
- may also work through the Cabinet Office to set certain standards applicable across central government, for example functional standards[5].

3 https://www.gov.uk/government/publications/supply-estimates-guidance-manual

4 See the Consolidated Budgeting Guidance for more - https://www.gov.uk/government/publications/consolidated-budgeting-guidance

5 See Functional Standards - GOV.UK (www.gov.uk).

## 1.5 Departments

1.5.1 Within the standards expected by parliament, and subject to the overall control and direction of their ministers, departments have considerable freedom about how they organise, direct and manage the resources at their disposal. It is for the accounting officer in each department, acting within ministers' instructions, and supported by their boards, to control and account for the department's business.

1.5.2 A departmental board, chaired by the senior minister, leads each department. Boards can bring to bear skills and experiences from elsewhere in, and outside of, the public sector (see section 4.1).

1.5.3 Within each department, there should be adequate delegations, controls and reporting arrangements to provide assurance to the board, the accounting officer[6] and ultimately ministers about what is being achieved, to what standards and with what effect. These arrangements should provide timely and prompt management information to enable plans to be adjusted as necessary. Similarly ministers should have enough evidence about the impact of their policies to decide whether to continue, modify or end them. This is discussed further in chapter 4.

1.5.4 In supporting ministers, civil servants should provide politically impartial advice. Should they be asked to carry out duties which appear incompatible with this obligation, the accounting officer should take the matter up with the minister concerned (see also the *Civil Service Code*[7]).

1.5.5 Departments often operate with and through a variety of partners to deliver their ministers' policies. It is important that these relationships operate in the public interest: see chapter 7.

## 1.6 The Comptroller and Auditor General

1.6.1 Supported by the National Audit Office (NAO), the Comptroller and Auditor General (C&AG) operates independently to help parliament scrutinise how public funds have been used in practice. Further information about the role of the NAO is available on their website[8] and in annex 1.1.

1.6.2 The C&AG provides parliament with two sorts of audit:

- financial audit of the accounts of departments and ALBs, covering:
  - assurance that accounts have been properly prepared and are free of material misstatements[9]; and
  - confirmation that the underlying transactions have appropriate parliamentary authority;
- value for money reports assessing the economy, efficiency and effectiveness with which public money has been deployed in selected areas of public business. A programme of these reviews covers a variety

6 If there is a change of Accounting Officer in the course of the year, the Accounting Officer in place at the year end takes responsibility for the whole year's accounts, using assurances as necessary.

7 http://www.civilservice.gov.uk/about/values

8 The NAO website address is http://www.nao.org.uk

9 See Audit Practice Note 10 of the Audit Practices Board on the FRC website at Http://www.frc.org.uk

of subjects over a period, taking account of the risks to value for money and parliament's interests.

1.6.3 The C&AG has a general right to inspect the books of a wide variety of public organisations to further these investigations. When the NAO investigates any public sector organisation, it should get full cooperation in provision of papers and other oversight. It is good practice to draw the NAO's attention to the confidentiality of any sensitive documents provided in this process. It is then for the independent C&AG to judge what material can be published in the public interest.

1.6.4 In addition, the C&AG publishes other independent reports to parliament. The PAC (see section 3.5) may hold hearings to examine evidence on any of these reports and on other related matters.

# Chapter 2

# Use of Public Funds

This chapter explains the process for parliamentary authorisation of public resources. Parliament consents in principle to the use of public funds through legislation to enable specified policies. It then approves use of public resources to carry out those policies year by year by approving Estimates. Only rarely can lesser authority suffice. At the close of each financial year, parliament expects a clear account of the use of the public funds it has authorised. Parliament expects the Treasury to oversee the operation of these controls. The PAC may investigate specific issues further.

- Ministers have very broad powers to control and direct their departments. In general, they may do anything that legislation does not prohibit or limit, including using common law powers to administer their operations or continue business as usual.
- Ministers also need parliamentary authority for use of public funds before each year's expenditure can take place. The full list of requirements is set out in box 2.1.

Box 2.1: requirements for use of public funds

- budget cover in the collectively agreed multi-year budgets
- with a few exceptions[1], parliamentary authorisation for each year's drawdown of funds through an Estimate, which is then approved as a Supply and Appropriation Act (see section 2.2)
- adequate Treasury consents (see section 2.3)
- assurance that the proposed expenditure is regular and proper (section 2.4)
- sufficient specific legal powers - though see section 2.5 for some limited exceptions

2.1.1 The Treasury runs the control process because parliament expects the Treasury to control public expenditure as part of fiscal policy. The primary means through which the Treasury controls public expenditure is multi-year budgets, agreed collectively at spending reviews. The *Consolidated Budgeting Guidance* sets out the rules for their use. (See also chapter 4).

[1] See section 5.3

## 2.2 Using the Estimate

2.2.1 The requirements in box 2.1 are to some extent interrelated. The accounting officer of a department (see also chapter 3) is responsible for ensuring that:

2.2.2 the Estimate(s) presented to parliament for the department's annual expenditure (consolidating its ALBs) are within the statutory powers and within the government's expenditure plans; and

2.2.3 use of resources is within the ambit of the vote and consistent with the Estimate(s)-

and must answer to parliament for stewardship of these responsibilities.

## 2.3 Treasury consents

2.3.1 Departments also need Treasury consent before undertaking expenditure or making commitments which could lead to expenditure (see annex 2.1). Usually the Treasury agrees some general approvals for each department subject to delegated limits and/or exclusions.

2.3.2 Some common approaches to setting delegations are shown in box 2.2 and are discussed further in annex 2.2. It is good practice to review delegations from time to time to make sure that they remain up to date and appropriate. Delegations can be tightened or loosened at reviews, depending on experience.

> Box 2.2: examples of approaches to delegated authorities
>
> - objective criteria for exceptions requiring specific Treasury scrutiny or approval
> - a sampling mechanism to allow specimen cases to be examined
> - a lower limit above which certain kinds of projects must achieve specific consent

2.3.3 In turn departments should agree with each of their arm's length bodies (ALBs - the public sector organisations they sponsor or finance) a similar set of delegations appropriate to their business[2] (see also chapter 7).

2.3.4 There is an important category of expenditure commitments for which the Treasury cannot delegate responsibility. It is transactions which set precedents, are novel, contentious or could cause repercussions elsewhere in the public sector. Box 2.3 gives examples. Treasury consent to such transactions should always be obtained before proceeding, even if the amounts in question lie within the delegated limits.

2 Delegations to ALBs should never be greater than the delegated limits agreed between the Treasury and the sponsor department.

Box 2.3: examples of transactions requiring explicit Treasury consent

- extra statutory payments similar to but outside statutory schemes
- ephemeral ex gratia payment schemes, eg payments to compensate for official errors
- special severance payments, eg compromise agreements in excess of contractual commitments
- non-standard payments in kind
- unusual financial transactions, eg imposing lasting commitments or using tax avoidance
- unusual schemes or policies using novel techniques

2.3.5 It is improper for a public sector organisation to spend or make commitments outside the agreed delegations. The Treasury may subsequently agree to give retrospective consent, but only if the expenditure in question would have been agreed if permission had been sought at the right time.

2.3.6 Sometimes legislation calls for explicit Treasury consent, eg for large or critical projects. There are also Whitehall wide controls on key progress points for the very largest projects.[3] In such cases it is unlawful to proceed without Treasury consent - and Treasury consent cannot be given retrospectively.

## 2.4 Regularity and propriety

2.4.1 The concepts of regularity and propriety, fundamental to the right use of public funds, are set out in box 2.4. The term *regularity and propriety* is often used to convey the idea of probity and ethics in the use of public funds – that is, delivering public sector values in the round, encompassing the qualities summarised in box 1.1. Supporting this concept are the Seven Principles of Public Life - the *Nolan principles*[4] - which apply to the public sector at large. In striving to meet these standards, central government departments should give a lead to the partners with which they work.

Box 2.4: regularity and propriety

**Regularity:** compliant with the relevant legislation and wider legal principles such as subsidy control and procurement law, delegated authorities and following the guidance in this document.

**Propriety:** meeting high standards of public conduct, including robust governance and the relevant parliamentary expectations, especially transparency.

2.4.2 Each departmental accounting officer should make sure that ministers in their department appreciate:

- the importance of operating with regularity and propriety; and

3 Through the Major Projects Authority, [http://www.cabinetoffice.gov.uk/content/major-projects-authority], using powers delegated by the Treasury

4 http://www.public-standards.gov.uk/

the need for efficiency, economy, effectiveness and prudence in the administration of public resources, to secure value for public money[5].

2.4.3 Should a minister seek a course of action which the accounting officer cannot reconcile with any aspect of these requirements, they should seek instructions in writing from the minister before proceeding (see chapter 3).

2.4.4 Should departments need to resolve an issue about regularity or propriety, they should consult the relevant Treasury spending team. Similarly, ALBs should consult their sponsor departments about such issues, and the department concerned may in turn consult the Treasury.

2.4.5 Neither improper nor irregular expenditure achieves the standards that parliament expects. So any such expenditure must be noted in the department's annual report and accounts. If the discrepancy is material it can result in a qualification to the accounts. When any expenditure of this kind comes to light, it should be drawn to the attention of both the NAO and the Treasury. The immediate follow up action is to identify the source of any systematic problems so that there is no recurrence. The PAC may also call the accounting officer to explain the matter at a public hearing.

## 2.5 Securing adequate legal authority

2.5.1 Parliament usually authorises spending on a specific policy or service by approving bespoke legislation setting out in some detail how it should work. It is not normally acceptable to use a royal charter as an alternative to primary legislation, for this approach robs parliament of its expectations for control and accountability. Departments should ensure that both they and their ALBs have adequate legal cover for any specific actions they undertake.

2.5.2 The Treasury takes this requirement seriously. It is fundamental to the trust and understanding between the government and parliament on which management of the public finances is founded. In the Concordat of 1932 (see annex 2.3), the Treasury undertook that departments would not spend without adequate legal authority.

2.5.3 There are some general exceptions. These kinds of expenditure do not require specific legislation in order to avoid burdening parliamentary time:

- routine matters covered by common law (the main examples are in box 2.5);
- a very limited range of Consolidated Fund Standing Services (see section 5.3);

2.5.4 Projects or services which are modest or temporary (see box 2.6). This exception cannot be used to plug a gap in spending authority before specific legislation for an ongoing service is passed. The temporary services derogation only applies to initiatives lasting no more than two years in total, and it is therefore important to note that this does not provide a two-year grace period for spending on a new, ongoing service before specific legislation is required.

[5] A more detailed description of value for money is at annex 4.4

Box 2.5: expenditure which may rely on a Supply and Appropriation Act

- routine administration costs: employment costs, rent, cleaning etc
- lease agreements, eg for photocopiers, lifts
- contractual obligations to purchase goods or services (eg where single year contracts might be bad value)
- expenditure using prerogative powers such as defence of the realm and international treaty obligations

In all the three cases in paragraph 2.5.3, departments may rely on the sole authority of a Supply and Appropriation Act (the culmination of the Estimates process) without the need for specific legal authority, provided that the other conditions in box 2.1 are met.

Box 2.6: modest or temporary expenditure which may rely on a Supply and Appropriation Act

either services or initiatives lasting no more than two years, eg a pilot study or one off intervention

or expenditure of no more than £1.75m a year (amount adjusted from time to time)

provided that there is no specific legislation covering these matters before parliament and existing statutory restrictions are respected.

These conditions are demanding. Treasury consent is required before they may be relied on.

## 2.6 New services

2.6.1 When ministers decide on a new activity, all the conditions in box 2.1 must be met before it can begin. In practical terms this means that most significant new policies which are intended to persist require specific primary legislation.

Sometimes ministers want to start early on a new policy which is intended to continue but whose enabling legislation has not yet secured royal assent. It may be possible to make limited preparation for delivery of the new service before royal assent, but to do so it will usually be necessary to consider borrowing from the Contingencies Fund (see annex 2.4). Access to this Fund is controlled by the Treasury, subject to the conditions in box 2.7. Specific Treasury consent is always required.

Box 2.7: conditions for access to the contingencies fund (see also annex 2.4)

- the proposed expenditure must be urgent and in the public interest, ie with wider benefits to outweigh the convention of awaiting parliamentary authority (political imperative is not enough)
- the relevant bill must have successfully passed second reading in the House of Commons
- the legislation must be certain, or virtually certain, to pass into law with no substantive change in the near future, and usually within the financial year
- the department responsible must explain clearly to parliament what is to take place, why, and by when matters should be placed on a normal footing.

# Chapter 3

# Accounting Officers

This chapter sets out the personal responsibilities of all accounting officers in central government. Essentially accounting officers must be able to assure parliament and the public of high standards of probity in the management of public funds. This chapter is drawn to the attention of all accounting officers when they are appointed.

3.1.1 Each organisation in central government – department, agency, trading fund, NHS body, NDPB or arm's length body – must have an accounting officer. This person is usually its senior official. The accounting officer in an organisation should be supported by a board structured in line with the *Corporate Governance Code*.

3.1.2 Formally the accounting officer in a public sector organisation is the person who parliament calls to account for stewardship of its resources. The standards the accounting officer is expected to deliver are summarised in box 3.1. The equivalent senior business managers of other public sector organisations are expected to deliver equivalent standards.

## 3.2 Appointment of accounting officers

3.2.1 The Treasury appoints the permanent head of each central government department to be its accounting officer. Where there are several accounting officers in a department, the permanent head is the principal accounting officer.

3.2.2 Within departments, the Treasury also appoints the chief executive of each trading fund as its accounting officer.

3.2.3 In turn the principal accounting officer of each department normally appoints the permanent heads:

- of its executive agencies, as agency accounting officers for their agencies; and
- of other ALBs (including all NDPBs), as accounting officers for these bodies; and
- at their discretion, additional accounting officers for defined part(s) of the department's business.

## 3.3 Special responsibilities of accounting officers

**Box 3.1: standards expected of the accounting officer's organisation**

Acting within the authority of the minister(s) to whom they are responsible, the accounting officer should ensure that the organisation, and any ALBs it sponsors, operates effectively and to a high standard of probity. The organisation should:

governance

- have a governance structure which transmits, delegates, implements and enforces decisions
- Have trustworthy internal controls to safeguard, channel and record resources as intended
- Work cooperatively with partners in the public interest
- Operate with propriety and regularity in all its transactions
- Treat its customers and business counterparties fairly, honestly and with integrity
- Offer appropriate redress for failure to meet agreed customer standards
- Give timely, transparent and realistic accounts of its business and decisions, underpinning public confidence;

Decision-making

- Support its ministers with clear, well reasoned, timely and impartial advice
- Make all its decisions in line with the strategy, aims and objectives of the organisation set by ministers and/or in legislation
- Take a balanced view of the organisation's approach to managing opportunity and risk
- Impose no more than proportionate and defensible burdens on business;

Financial management

- Use its resources efficiently, economically and effectively, avoiding waste and extravagance
- Plan to use its resources on an affordable and sustainable path, within agreed limits
- Carry out procurement and project appraisal objectively and fairly, using cost benefit analysis and generally seeking good value for the Exchequer as a whole
- Use management information systems to gain assurance about value for money and the quality of delivery and so make timely adjustments
- Avoid over defining detail and imposing undue compliance costs, either internally or on its customers and stakeholders
- Have practical documented arrangements for controlling or working in partnership with other organisations, as appropriate
- Use internal and external audit to improve its internal controls and performance.

3.3.1 It is important that each accounting officer takes personal responsibility for ensuring that the organisation they manages delivers the standards in box 3.1. In particular, the accounting officer must personally sign: the accounts; the annual report the governance statement (see annex 3.1); and having been satisfied that they have been properly prepared to reflect the business of the organisation, must personally approve: voted budget limits; and the associated Estimates Memorandum.

3.3.2 The accounting officer of a corporate arm's length body should arrange for a board member to sign the accounts as well as signing them himself or herself, if (unusually) they are not a member of the board.

3.3.3 There are several other areas where accounting officers should take personal responsibility:

- *regularity and propriety* (see box 2.4), including securing Treasury approval for any expenditure outside the normal delegations or outside the subheads of Estimates;
- *affordability and sustainability*: respecting agreed budgets and avoiding unaffordable longer term commitments, taking a proportionate view about other demands for resources;
- *value for money*: ensuring that the organisation's procurement, projects and processes are systematically evaluated to provide confidence about suitability, effectiveness, prudence, quality, good value judged for the Exchequer as a whole, not just for the accounting officer's organisation (eg using the Green Book[1] to evaluate alternatives);
- *control:* the accounting officer should personally approve and confirm their agreement to all Cabinet Committee papers and major project or policy initiatives before they proceed;
- management of *opportunity and risk* to achieve the right balance commensurate with the institution's business and risk appetite;
- *learning from experience*, both using internal feedback (eg through managing projects and programmes using techniques such as PRINCE2), and from right across the public sector; and
- accounting accurately for the organisation's *financial position* and *transactions*: to ensure that its published financial information is transparent and up to date; and that the organisation's efficiency in the use of resources is tracked and recorded

3.3.4 In the case of principal accounting officers, these responsibilities apply to the business of the whole departmental group.

## 3.4 Advice to ministers

3.4.1 Each departmental accounting officer should take care to bring to the attention of the minister(s) to whom they are responsible any conflict between the minister's instructions and their duties. The accounting officer cannot simply accept the minister's aims or policy without examination. There is no set form for registering objections, though the accounting officer should be specific about their

[1] to https://www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

nature. The acid test is whether the accounting officer could justify the proposed activity if asked to defend it.

3.4.2 Accounting officers should routinely scrutinise significant policy proposals or plans to start or vary major projects and then assess whether they measure up to the standards in box 3.1 so that they can identify any discrepancy[2]. The accounting officer should draw any such problems to the attention of the responsible minister to see whether they can be resolved.

3.4.3 If the minister decides to continue with a course the accounting officer has advised against, the accounting officer should ask for a formal written direction to proceed. An oral direction should be confirmed in writing quickly. Examples of where this procedure is appropriate are in box 3.2.

> Box 3.2: when accounting officers should seek a direction
>
> - **Regularity**: (see Chapter 2) if a proposal is outside statutory powers, parliamentary authority or Treasury delegations; or incompatible with the agreed spending budgets.
> - **Propriety**: if a proposal would breach parliamentary control procedures or expectations.
> - **Value for money**: if an alternative proposal, or doing nothing, would deliver better value, eg a cheaper, higher quality or more effective outcome for the Exchequer as a whole.
> - **Feasibility**: where there is a significant doubt about whether the proposal can be implemented accurately, sustainably, or to the intended timetable.

3.4.4 Directions of this kind are rare. It is good practice for accounting officers to discuss the matter with the Treasury if time permits. The ultimate judgement in each case must lie with the accounting officer personally.

3.4.5 When a direction is made, the accounting officer should:

- copy the relevant papers to the C&AG and the TOA promptly. The C&AG will normally draw the matter to the attention of the PAC, who will attach no blame to the accounting officer;
- follow the minister's direction without further ado;
- if asked, explain the minister's course of action. This respects ministers' rights to frank advice, while protecting the quality of internal debate;
- arrange for the existence of the direction to be published, no later than in the next report and accounts, unless the matter must be kept confidential.

## 3.5 Public Accounts Committee

3.5.1 The PAC may hold public hearings on the accounts of central government organisations laid in parliament (see section 1.6). In practice most PAC hearings focus on NAO value for money studies. NAO seeks to agree the text of these reports

2 The Treasury or the chair of the relevant Cabinet Committee may also ask for the accounting officer's assessment of any novel proposal.

with the accounting officer(s) concerned so there is a clear undisputed evidence base for PAC scrutiny.

3.5.2 When a hearing is scheduled, the PAC normally invites the accounting officer(s) of the relevant institution(s) to attend as witness(es). An accounting officer may be accompanied by appropriate officials. Where it is appropriate, and the PAC agrees, an accounting officer may send a substitute. The PAC may also invite other witnesses who may not be public servants to give insight into the background of the subject in hand.

3.5.3 In answering questions, the accounting officer should take responsibility for the organisation's business, even if it was delegated or if the events in question happened before they was appointed accounting officer. In response to specific PAC or Select Committee requests, previous accounting officers may also attend relevant PAC hearings. Recalls of this kind should be assessed case by case, depending on the circumstances. They are acceptable if the business in issue was fairly recent, and where the former accounting officer has had an opportunity to comment before publication on any NAO report which the PAC is to investigate.

3.5.4 The PAC expects witnesses to give clear, accurate and complete evidence. If evidence is sensitive, witnesses may ask to give it in private. Witnesses may offer supplementary notes if the information sought is not to hand at the meeting. Any such notes should be provided within one week unless the PAC is willing to grant an extension. They should do so without delay.

3.5.5 The TOA (or an alternate) attends all PAC hearings. This enables the PAC to explore any more general issues arising out of the hearing.

## 3.6 When the accounting officer is not available

3.6.1 Each public sector organisation must have an accounting officer available for advice or decision as necessary at short notice.

3.6.2 When the accounting officer is absent and cannot readily be contacted, another senior official should deputise. If a significant absence is planned, the accounting officer may invite the Treasury (or the sponsor department, as the case may be) to appoint a temporary acting accounting officer.

## 3.7 Conflicts of interest

3.7.1 Sometimes an accounting officer faces an actual or potential conflict of interest. There must be no doubt that the accounting officer meets the standards described in box 3.1 without divided loyalties. Possible ways of managing this issue include:

- For a minor conflict, declaring the conflict and arranging for someone other than the accounting officer to make a decision on the issue(s) in question;
- For a significant but temporary conflict, inviting the treasury (or the sponsor department, as the case may be) to appoint an interim accounting officer for the period of the conflict of interest; or
- For serious and lasting conflicts, resignation.

## 3.8 Arm's length bodies

3.8.1 The responsibilities of accounting officers in departments and in arm's length bodies (ALBs) are essentially similar. Accounting officers in ALBs must also take account of their special responsibilities and powers. In particular, they must respect the legislation (or equivalent) establishing the organisation and terms of the framework document agreed with the sponsor department. See chapter 7 for more.

3.8.2 The framework document (or equivalent) agreed between an ALB and its sponsor always provides for the sponsor department to exercise meaningful oversight of the ALB's strategy and performance, pay arrangements and/or major financial transactions, eg by monthly returns, standard delegations and exception reporting. The sponsor department's accounts consolidate those of its ALBs so its accounting officer must be satisfied that the consolidated accounts are accurate and not misleading.

3.8.3 Overall, the accounting officer of a sponsor department should make arrangements to satisfy himself or herself that that the ALB has systems adequate to meet the standards in box 3.1. Similarly, the accounting officer of an ALB with a subsidiary should have meaningful oversight of the subsidiary. It is not acceptable to establish ALBs, or subsidiaries to ALBs, in order to avoid or weaken parliamentary scrutiny.

3.8.4 Exceptionally, the accounting officer of a sponsor department may need to intervene if an ALB drifts significantly off track, eg if its budget is threatened, its systems are badly defective or it falls into disrepute. This may include replacing some or all of the leaders of the ALB, possibly even its accounting officer.

3.8.5 There are sensitivities about the role of the accounting officer in an ALB which is governed by an independent fiduciary board, eg a charity or company. The ALB's accounting officer, who will normally be a member of the board, must take care that their personal legal responsibilities do not conflict with their duties as a board member. In particular, the accounting officer should vote against any proposal which appears to cause such a conflict; it is not sufficient to abstain.

3.8.6 Moreover, if the chair or board of such an ALB is minded to instruct its accounting officer to carry out a course inconsistent with the standards in box 3.1, then the accounting officer should make their reservations clear, preferably in writing. If the board is still minded to proceed, the ALB accounting officer should then:

- ask the accounting officer of the sponsor department to consider intervening to resolve the difference of view, preferably in writing;
- if the board's decision stands, seek its written direction to carry it out, asking the sponsor department to inform the Treasury;
- proceed to implement without delay; and
- follow the routine in paragraph 3.4.5.

3.8.7 This process is similar to what happens in departments (see section 3.4), allowing for the special position of the organisation's board, which is often appointed under statute.

## 3.9 In the round

3.9.1 It is not realistic to set firm rules for every aspect of the business with which an accounting officer may deal. Sometimes the accounting officer may need to take a principled decision on the facts in circumstances with no precedents. Should that happen, the accounting officer should be guided by the standards in box 3.1 in assessing whether there is a case for seeking a direction for any of the factors in box 3.2. It is essential that accounting officers seek good outcomes for the Exchequer as a whole, respecting the key principles of transparency and parliamentary approval for management of public resources.

3.9.2 Where time permits, the Treasury stands ready to help accounting officers think such issues through. It is good practice to document decisions where the accounting officer has had to strike difficult judgements, especially where they break new ground.

# Chapter 4

# Governance and Management

**Public sector organisations should have good quality internal governance and sound financial management. Appropriate delegation of responsibilities and effective mechanisms for internal reporting should ensure that performance can be kept on track. Good practice should be followed in procuring and managing resources and assets; hiring and managing staff; and deterring waste, fraud and other malpractice. Central government departments have some specific responsibilities for reporting, including to parliament.**

4.1.1 Each public sector organisation should establish governance arrangements appropriate to its business, scale and culture. The structure should combine efficient decision making with accountability and transparency.

4.1.2 In doing so, central government departments should be guided by the *Corporate Governance Code*[3] . Each public sector organisation needs clear leadership, normally provided by a board. Box 4.1 sets out best practice for departmental boards.

**Box 4.1: best practice for boards in central government departments**

- chaired by the department's most senior minister, with junior ministers as members
- comparable numbers of official and non-executive members, including a lead non-executive and a professionally qualified finance director (see annex 4.1)
- meeting at least quarterly
- sets the department's strategy to implement ministers' policy decisions
- leads the department's business and determines its culture
- ensures good management of the department's resources – financial, assets, people
- decides risk appetite and monitors emerging threats and opportunities
- steers performance to keep it on track using regularly updated information about progress
- keeps an overview of its ALBs' activities

4.1.3 It is good practice for ALBs to use similar principles. In many ALBs some structural features, such as board composition, derive from statute but considerable discretion may remain. In some organisations it is usual, or found valuable, for the board to include members with designated responsibility or expertise, eg for regional affairs or for specialist professional skills.

4.1.4 In order to carry out its responsibilities each board needs to decide, and document, how it will operate. Box 4.2 outlines the key decisions. It is not

[3] https://www.gov.uk/government/publications/corporate-governance-code-for-central-government-departmentsfor both the code and the good practice guidance

exhaustive. Once agreed, the working rules should be reviewed from time to time to keep them relevant. Boards should challenge themselves to improve their working methods, so that their processes can achieve and maintain good modern business practice.

**Box 4.2: key decisions for boards**

- mission and objectives
- delegations and arrangements for reporting performance
- procedures and processes for business decision making
- scrutiny, challenge and control of significant policies, initiatives and projects
- risk appetite and risk control procedures, eg maintaining and reviewing a risk register
- control and management of associated ALBs and other partnerships
- arrangements for refreshing the board
- arrangements for reviewing the board's own performance
- accountability – to the general public, to staff and other stakeholders (see section 4.13)
- how the insights of non-executives can be harnessed
- how often the board's working rules will be reviewed

## 4.2 Working methods

4.2.1 The accounting officer of each organisation is accountable to parliament for the quality of the administration that they leads. The administrative standards expected are set out in the *Civil Service Code*[4] and the Ombudsman's *Principles of Public Administration*[5]. They allow considerable flexibility to fit with each organisation's obligations and culture. It is against these standards that failure to deliver is assessed.

4.2.2 Another fundamental concept is the Treasury's leadership position in managing public expenditure, and setting the rules under which departments and their ALBs should deploy the assets, people and other resources under their control. In turn each public sector organisation should have robust and effective systems for their internal management. Box 4.3 outlines the key decisions each organisation needs to make.

4.2.3 To help the Treasury carry out this task properly:

- departments should provide the Treasury with accurate and timely information about in-year developments - their expenditure, performance against objectives and evolution of risk (eg serious unforeseen events or discovery of fraud);
- ALBs should provide their sponsor departments with similar information; and

[4] http://www.civilservice.gov.uk/about/values

[5] http://www.ombudsman.org.uk/improving-public-service/ombudsmansprinciples

- the established mechanisms for controlling and reporting public expenditure, including Treasury support or approval where necessary, should be respected.

4.2.4 In particular, departments should consult the Treasury (and ALBs their sponsor departments) at an early stage about proposals to undertake unusual transactions or financing techniques. This applies especially to any transactions which may have wider implications elsewhere in the public sector (see paragraph 2.3.4 and box 2.3).

4.2.5 Working with the accounting officer, the finance director of each public sector organisation has special responsibility for seeing that the standards described in this chapter are respected. Annex 4.1.sets this out in more detail.

**Box 4.3: essentials of effective internal decision making**

choice

- active management of the portfolio of risks and opportunities
- appraisal of alternative courses of action using the techniques in the *Green Book*, and including assessment of feasibility to achieve value for money
- where appropriate, use of models (see annex 4.2) or pilot studies to provide evidence on which to make decisions among policy or project choices
- active steering of initiatives, eg reviews to take stock at critical points of projects

operation

- appropriate internal delegations, with a single senior responsible officer (SRO) for each significant project or initiative, and a single senior person leading each end to end process
- prompt, regular and meaningful management information on costs (including unit costs), efficiency, quality and performance against targets to track progress and value for money
- proportionate administration and enforcement mechanisms, without unnecessary complexity
- use of feedback from internal and external audit and elsewhere to improve performance
- regular risk monitoring, to track performance and experience and make adjustments in response

afterwards

- mechanisms to evaluate policy, project and programme outputs and outcomes, including whether to continue, adjust or end any continuing activities
- arrangements to draw out and propagate lessons from experience

## 4.3 Opportunity and risk

4.3.1 Embedded in each public sector organisation's internal systems there should be arrangements for recognising, tracking and managing its opportunities and risks. Each organisation's governing body should make a considered choice about its desired risk appetite, taking account of its legal obligations, ministers' policy decisions, its business objectives, and public expectations of what it should deliver.

This can mean that different organisations take different approaches to the same opportunities or risks.

4.3.2 There should be a regular discipline of reappraising the opportunities and risks facing the organisation since both alter with time and circumstances, as indeed may the chosen responses. This process should avoid excessive caution, since it can be as damaging as unsuitable risk taking. The assessment should normally include:

- maintaining a risk register, covering identified risks and contingent risks from horizon scanning;
- reputational risks, since poor performance could undermine the credibility, and ultimately the creditworthiness, of the Exchequer as a whole;
- consideration of the dangers of maintaining the status quo;
- plans for disaster recovery;
- appraisal of end to end risks in critical processes and other significant activities.

4.3.3 In making decisions about how to manage and control opportunity and risk, audit evidence and other assurance processes can usefully inform choice. Audit, including internal audit, can provide specific, objective and well-informed assurance and insight to help an organisation evaluate its effectiveness in achieving its objectives. It is good practice for the audit committee to advise the governing board of a public sector organisation on its key decisions on governance and managing opportunities and risks. It is also a good discipline for this process to include evaluating progress in implementing PAC recommendations, where they have been accepted.

4.3.4 In turn the board should support the accounting officer in drawing up the governance statement, which forms part of each organisation's annual accounts. See annex 3.1. Further guidance about managing risks is in annex 4.3 and the Orange Book.

## 4.4 Insurance

4.4.1 In the private sector risk is often managed by taking out insurance. In central government it is generally not good value for money to do so. This is because the public sector has a wide and diverse asset portfolio; a reliable income through its ability to raise revenue through taxation; and access to borrowed funds more cheaply than any in the private sector. In addition commercial providers of insurance also have to meet their own costs and profit margins. Hence the public purse is uniquely able to finance restitution of damaged assets or deal with other risks, even very large ones. If the government insured risk, public services would cost more.

4.4.2 However, there are some limited circumstances in which it is appropriate for public sector organisations to insure. They include legal obligations[6], and occasions

[6] Eg ALBs should insure vehicles where the Road Traffic Act requires it

where commercial insurance would provide value for money[7]. Further information about insurance generally is in annex 4.4.

## 4.5 Control of public expenditure

4.5.1 The Treasury coordinates a system through which departments are allocated budget control totals for their public expenditure. Each department's allocation covers its own spending and that of its associated ALBs. Within the agreed totals, it has considerable discretion over setting priorities to deliver the public services for which it is responsible.

4.5.2 Each public sector organisation should run efficient systems for managing payments (see box 4.4). It should also keep its use of public resources within the agreed budgets, take the limits into account when entering into commitments, and generally ensure that its spending profile is sustainable.

4.5.3 Any major project, programme or initiative should be led by a senior responsible owner (SRO). It is good practice to aim for continuity in such appointments[8].

**Box 4.4: essentials of systems for committing and paying funds**

- Selection of projects after appraisal of the alternatives (see the *Green Book*), including the central clearance processes for larger commitments.
- Open competition to select suppliers from a diverse range, preferably specifying outcomes rather than specific products, to achieve value for money (see annexes 4.6 and 4.7).
- Where feasible, procurement through multi-purchaser arrangements, shared services and/or standard contracts to drive down prices.
- Effective internal controls to authorise acquisition of goods or services (including vetting new suppliers), within any legal constraints.
- Separation of authorisation and payment, with appropriate controls, including validation and recording, at each step to provide a clear audit trail.
- Checks that the goods or services acquired have been supplied in accordance with the relevant contract(s) or agreement(s) before paying for them.
- Payment terms chosen or negotiated to provide good value.
- Accurate payment of invoices: once and on time, avoiding lateness penalties (see annex 4.8).
- A balance of preventive and detective controls to tackle and deter fraud, corruption and other malpractice (see annex 4.9).
- Integrated systems to generate automatic audit trails which can be used to generate accounts and which both internal and external auditors can readily check.
- Periodic reviews to benefit from experience, improve value for money or to implement developments in good practice.

[7] Eg where private sector contractors take out single-site insurance policies because they are cheaper than each individual party insuring themselves separately.

[8] See annex 4.5.

## 4.6 Receipts

4.6.1 Public sector organisations should have arrangements for identifying, collecting and recording all amounts due to them promptly and in full. Outstanding amounts should be followed up diligently. Key features of internal systems of control are suggested in box 4.5.

4.6.2 Public sector organisations should take care to track and enforce debts promptly. The presumption should be in favour of recovery unless it is uneconomic to do so.

Box 4.5: essential features of systems for collecting sums due

- Adequate records to enable claims to be made and pursued in full.
- Routines to prevent unauthorised deletions and amendments to claims.
- Credit management systems to manage and pursue amounts outstanding.
- Controls to prevent diversion of funds and other frauds.
- Clear lines of responsibility for making decisions about pressing claims increasingly more firmly, and for deciding on any abatement or abandonment of claims which may be merited.
- Arrangements for deciding upon and reporting any write-offs (see annex 4.10). Audit trails which can readily be checked and reported upon both internally and externally.

## 4.7 Non-standard financial transactions

4.7.1 From time to time public sector organisations may find it makes sense to carry out transactions outside the usual planned range, eg:

- **write-offs** of unrecoverable debts or overpayments;
- recognising **losses** of stocks or other assets;
- **long term loans** or **gifts** of assets.

4.7.2 In each case it is important to deal with the issue in the public interest, with due regard for probity and value for money. Annexes 4.10 to 4.12 set out what is expected when such transactions take place in central government, including notifying parliament.

4.7.3 Where an organisation discovers an underpayment, the deficit should be made good as soon as is practicable and in full. If there has been a lapse of time, for example caused by legal action to establish the correct position, it may be appropriate to consider paying interest, depending on the nature of the commitment to the payee and taking into account the reputation of the organisation and value for money for the Exchequer as a whole (see also section 4.11).

4.7.4 Similarly, public sector organisations may have reason to carry out current transactions which would not normally be planned for. These might be:

- extra contractual payments to service providers;

- extra-statutory payments to claimants (where a similar statutory scheme exists);
- ex gratia payments to customers (where no established scheme exists); or
- severance payments to employees leaving before retirement or before the end of their contract and involving payments above what the relevant pension scheme allows.

4.7.5 Again it is important that these payments are made in the public interest, objectively and without favouritism. The disciplines parliament expects of central government entities are set out in annex 4.13, which explains the notification procedure to be followed for larger one-off transactions of this kind. The steps to be considered when setting up statutory or extra-statutory compensation schemes are discussed in annex 4.14.

## 4.8 Unusual circumstances

4.8.1 Sometimes public sector organisations face dilemmas in meeting their commitments. They may have a legal or business obligation which would be uneconomic or inappropriate to carry out assiduously to the letter. In such cases it can be justifiable to seek a pragmatic, just and transparent alternative approach, appropriately reported to parliament in the organisation's annual accounts. One-off schemes of this kind are always novel and so require Treasury approval, not least because they may also require legislation or have to rest on the authority of a Supply and Appropriation Act (see section 2.5). Box 4.6 suggests precedented examples.

**Box 4.6: examples of one-off pragmatic schemes**

- A court ruling could mean that a public sector organisation owed each of a large number of people a very small sum of money. The cost of setting up and operating an accurate payment scheme might exceed the total amount due. The organisation could instead make a one-off payment of equivalent value to a charity representing the recipient group.
- A dispute with a contractor might conclude that the contractor owed a public sector organisation an amount too big for it to meet in a single year while staying solvent. The customer might instead agree more favourable payment terms, with appropriate safeguards, if this arrangement provides better value for money.

## 4.9 Staff

4.9.1 Each public sector organisation should have sufficient staff with the skills and expertise to manage its business efficiently and effectively. The span of skills required should match the organisation's objectives, responsibilities and resources, balancing professional, practical or operational skills and policy makers, and recognising the value of each discipline. Succession and disaster planning should ensure that the organisation can cope robustly with changes in the resources available, including unforeseen disruption.

4.9.2 Public sector organisations should seek to be fair, honest and considerate employers. Some desirable characteristics are suggested in box 4.7.

Box 4.7: public sector organisations as good employers

- selection designed to value and make good use of talent and potential of all kinds
- fairness, integrity, honesty, impartiality and objectivity
- professionalism in the relevant disciplines, always including finance
- arrangements to make sure that staff are loaded cost effectively
- management techniques balancing incentives to improve and disciplines for poor performance
- diversity valued and personal privacy respected
- mechanisms to support efficient working practices, both normally and under pressure
- arrangements for whistleblowers to identify problems privately without repercussions.

4.9.3 Similarly public sector employers have a right to expect good standards of conduct from their employees. The qualities and standards expected of civil servants are set out in the *Civil Service Code*. Other public sector employees should strive for similar standards, appropriate to their context.

## 4.10 Assets

4.10.1 All public sector organisations own or use a range of assets. Each organisation needs to devise an appropriate asset management strategy to define how it acquires, maintains, tracks, deploys and disposes of the various kinds of assets it uses. Annex 4.15 discusses how to set up and use such a strategy.

4.10.2 It is good practice for public sector organisations to take stock of their assets from time to time and consider afresh whether they are being used efficiently and deliver value for public funds. If there is irreducible spare capacity there may be scope to use part of it for other government activities, or to exploit it commercially for non-statutory business.

## 4.11 Standards of service

4.11.1 Poor quality public services are not acceptable. Public sector organisations should define what their customers, business counterparties and other stakeholders can expect of them.

4.11.2 Standards can be expressed in a number of ways. Examples include guidelines (eg response times), targets (eg take-up rates) or a collection of customer rights in a charter. Even where standards are not set explicitly, they may sometimes be inferred from the way the provider organisation carries out its responsibilities; so it is normally better to express them directly.

4.11.3 Whatever standards are set, they should be defined in a measurable way, with plans for recording performance, so that delivery can be readily gauged. It is good practice to use customer feedback, including from complaints, to reassess from time to time whether standards or their proxies (milestones, targets, outcomes) remain appropriate and meaningful.

4.11.4 Where public sector organisations fail to meet their standards, or where they fall short of reasonable behaviour, it may be appropriate to consider offering remedies. These can take a variety of forms, including apologies, restitution (eg supplying a missing licence) or, in more serious cases, financial payments. Decisions about financial remedies – which should not be offered routinely - should include taking account of the legal rights of the other party or parties and the impact on the organisation's future business.

4.11.5 Any such payments, whether statutory or ex gratia, should follow good practice (see section 4.13). Since schemes of financial redress often set precedents or have implications elsewhere, they should be cleared with the Treasury before commitments are made, just as with any other public expenditure out of the normal pattern (see sections 2.1 to 2.4).

## 4.12 Complaints

4.12.1 Those public sector organisations which deal with customers directly should strive to achieve clear, accurate and reliable standards for the products and services they provide. It is good practice to arrange for complaints about performance to be reviewed by an independent organisation such as an ombudsman.

4.12.2 Often such review processes are statutory. The activities of central government departments and the NHS are open to review by the PHSO[9], whose *Principles of Good Complaints Handling*[10] sets out generic advice on complaints handling and administration of redress (see also annex 4.14). After investigation of cases of specific complaint, the PHSO can rule on whether injustice or hardship can be attributed to maladministration or service failure, and may recommend remedies, either for individual cases or for groups of similar cases. If departments decline to follow the PHSO's advice, they should lay a memorandum in parliament explaining why.

## 4.13 Transparency

4.13.1 All public sector organisations should operate as openly as is compatible with the requirements of their business. In line with the statutory public rights[11], they should make available timely information about their services, standards and performance. This material should strike a careful balance between protecting confidentiality and open disclosure in the public interest.

4.13.2 All public sector organisations should adopt a publication scheme routinely offering information about the organisation's activities. They should also publish regular information about their plans, performance and use of public resources.

4.13.3 The published information should be in sufficient detail, and be sufficiently regular, to enable users and other stakeholders to hold the organisation and its ministers to account. Benchmarks can help local users to evaluate local performance more easily.

4.13.4 The primary document of record for central government departments is the report and accounts, which should consolidate information about the relevant ALBs. It should include a governance statement (see annex 3.1).

9 http://www.ombudsman.org.uk/

10 http://www.ombudsman.org.uk/improving-public-service/ombudsmansprinciples

11 Eg Freedom of information act 2000, Data protection act 1998, Environment information regulations 2004 and the Re-use of public sector information regulations 2005.

4.13.5 In addition, the Treasury is responsible for publishing certain aggregate information about use of public resources, for example Whole of Government Accounts (WGA) consolidating all central and local government organisations' accounts and comparisons of outturn with budgets. The Office for National Statistics (ONS) also uses input from data gathered by the Treasury to publish the national accounts.

4.13.6 In certain areas of public business it is also important or desirable to provide adequate public access to physical assets. Unnecessary or disproportionate restrictions should be avoided. Managed properly, this can be a valuable mechanism to promote inclusion and enhance public accountability.

## 4.14 Dealing with initiatives

4.14.1 Public sector organisations need to integrate all the advice in this handbook when introducing new policies or planning projects. Each is unique and will need bespoke treatment. The checklist in box 4.8 brings the different factors together. It applies directly to central government organisations but the principles will be of value elsewhere.

### Box 4.8: factors to consider when planning policies or projects

**design**

- Has the proposal been evaluated against alternative options, including doing nothing?
- Should there be pilot testing before full roll out?
- Are the controls agreed and documented clearly? Have the risks and opportunities been considered systematically? Is the change process resilient to shocks? What contingencies might arise?
- Is the intended intervention proportionate to the identified need?
- What standards should be achieved? How will performance be tracked and assessed? Could the proposal be simplified without loss of function?
- If partner(s) are involved, is the allocation of responsibilities appropriate?
- Will the proposal be efficient, effective and offer good value for money?
- Is the policy sustainable in the broadest sense? Should it have a sunset clause?
- Does the planned activity meet high standards of probity, integrity and honesty?
- Will the proposal deliver the desired outcome to time and cost?
- Does the accounting officer assess the initiative as compatible with the public sector standards?

**control**

- What prior agreement is required, if any?
- How will internal governance and delegation work? Will it be effective? Is it transparent? Should there be an SRO?
- Is there adequate legislation? If not, what is needed to make the action lawful?
- How will the proposal be financed? Is there budget and Estimate cover? Is it appropriate to charge to help finance the service? Are charges set within the law?
- Is the proposed action within the department's delegated authorities?
- What financial techniques will be used to manage rollout, implementation and operation?
- Are project and programme management techniques likely to be useful?
- How will the intended new arrangements be monitored and efficiency measured?
- How will feedback be used to improve outcomes?
- Does the design inhibit misuse and counter fraud? What safeguards are needed?
- Has the risk of fraud been assessed to help inform policy or project design?
- How will the associated risks be tracked and the responses adjusted?
- What intervention will be possible if things go off track?
- Would it be possible to recover from a disaster promptly?

**accountability**

- How should parliament be told of the proposal and kept informed of progress?
- What targets will be used? Are they sufficiently stretching?
- Is public access called for? How?
- Is the policy or service fair and impartial?
- Will its administration be open, transparent and accessible?
- Should there be customer standards? How are complaints used to improve performance?
- Should there be arrangements for redress after poor delivery?
- Is enforcement required? If so, is it proportionate?
- Is an appeal mechanism needed?
- Is regulation called for?

**learning lessons**

- What audit arrangements (internal and external) are intended?
- What information about the activity will be published? How and how often?
- When and how will the policy or project be evaluated to assess its cost and benefits and to determine whether it should continue, be adjusted, replaced or ceased?

# Chapter 5
# Funding

This chapter explores the means by which central government organisations may obtain funds in order to finance public expenditure. The Treasury operates disciplines to respect parliament's concern to prevent unauthorised expenditure.

5.1.1 Most public expenditure is financed from centrally agreed multi-year budgets administered by the Treasury, which oversees departments' use of their budget allocations. In the main, departments have considerable discretion about how they distribute these budget allocations, which are expressed net of relevant income. The main source of receipts to be netted off is fees and charges (see chapter 6).

5.1.2 The Treasury oversees and directs the rules that departments should respect in managing their budgets. Departments are expected to live within their allocations for each financial year, with some limited exceptions, eg for certain demand led services. The budgeting framework is explained in the *Consolidated Budgeting Guidance,* which is refreshed each year.

## 5.2 Grants

5.2.1 Each central government department decides how much of its budget provision it should cascade to its ALBs in each year of the multi-year agreement. Departments may pay them grants (for specific purposes) and grants-in-aid (unspecific support) to finance their spending; though it is the net spending of the ALB that scores in the departmental budget. Annex 5.1 explains more about grants.

5.2.2 Budgets and Estimates plan net spending and include all spending of ALBs however it is financed. In general it is sensible to consider arrangements for protecting the Exchequer interest through clawback of specific grants should the purposes for which they are agreed not materialise (annex 5.2).

## 5.3 Estimates

5.3.1 The multiyear departmental budgets agreed collectively among ministers do not of themselves confer authority to spend or commit resources. Parliamentary agreement, usually through the Supply Estimate process, is also essential (see box 2.1).

5.3.2 Departmental Estimates are put to parliament covering one financial year at a time, in the spring. Each covers the net expenditure of a department and its ALBs (ie all spending in budgets and any voted spend outside of budgets). For the year ahead, the provision sought should be taut and realistic, without padding. The *Supply and Estimates Guidance Manual* has more detail.

5.3.3 Before the summer recess, the provision sought in the Estimate is formally authorised in a Supply and Appropriation Act, which sets net expenditure limits for the year. The Act is then the legal authority for public expenditure within the ambit of the Estimate. The ambit itemises a specific range of permitted activities and income streams for the year.

5.3.4 Within a financial year, there is some scope for transferring (through virement) provision from one section or subhead to another within any of the control limits in the same Estimate. There is scope for adjusting Estimate provision through a Supplementary Estimate late in the year if circumstances change. A Supplementary Estimate should show all movements between sections, even if they would otherwise have been dealt with through virement.

5.3.5 Departmental Select Committees may examine departmental witnesses on the plans contained in Estimates. Usually such hearings take place after Estimates are laid in parliament but before they are voted into law.

5.3.6 If there is underspending against Estimate provision in one year, it cannot automatically be carried forward to a later year. If a department wants to spend resources it did not consume in a previous year, it needs Treasury approval and must also obtain fresh parliamentary authority to spend in the year(s) concerned.

5.3.7 Like budgets, Estimates are set net of income. But parliament needs to be made aware of receipts since Estimates authorise gross expenditure, normally using statutory powers. Annex 5.3 explains more about of types of receipt. Chapter 6 contains guidance about setting and adjusting fees and charges.

5.3.8 Occasionally an Estimate sets a negative limit for permitted resources. This happens if income is expected to exceed the relevant gross expenditure. Similarly a Supplementary Estimate can be negative if provision for spending is to fall within a given year.

5.3.9 A department's Estimate for a year includes all spending within its agreed budget for that year, as well as any voted non-budget spending. Not all of this amount requires voted parliamentary approval since some items, such as Consolidated Fund Standing Services, are paid direct from the Consolidated Fund. Hence only the voted parts of the Estimate requiring parliamentary approval appear in the Supply and Appropriation Act. Of course the disciplines on public funds (box 3.1) apply to all the activities described in the Estimate and accounts whether within the Act or not.

## 5.4 Excess Votes

5.4.1 Accounting officers have an important role in overseeing the integrity of the Estimates for which they are responsible. In particular, accounting officers are responsible for ensuring that Estimates are in good order (see section 2.2).

5.4.2 The Treasury presents parliament each year with a Statement of Excesses to request retrospective authority for any unauthorised resources consumed above the relevant limits or outside the ambit of the Estimate. Parliament takes these excesses seriously. The PAC or departmental select committee may call witnesses to account in person or ask for a written explanation.

5.4.3 The Statement of Excesses includes two kinds of excess:

- spending above the amount provided in an Estimate; and
- irregular expenditure outside the ambit, eg on an unauthorised service.

5.4.4 Parliament usually regards the latter as particularly unsatisfactory because it means that the department concerned has flouted parliament's intentions[12] and may have defective systems of control. The auditor may identify such excesses as spending not covered by statutory powers, even if the total amount spent does not exceed the voted limit.

5.4.5 Expenditure in excess of provision on an activity agreed by parliament is also to be avoided since the authority of a Supply and Appropriation Act is just as essential as specific statutory authority (box 2.1). It is possible, with Treasury agreement, to raise the amount in an Estimate during the course of the year in a Supplementary. But otherwise accounting officers should reduce, reprioritise or postpone use of resources to keep within the provision parliament has agreed for the year.

## 5.5 Commitments

5.5.1 Parliament is not bound[13] to honour ministers' commitments unless and until there are statutory powers to meet them and it authorises public funds to finance them (through an Estimate) in a given year. This discipline is especially important when ministers plan a new service.

5.5.2 Because commitments can evolve into spending, they should always be scrutinised and appraised as stringently as proposals for consumption (box 4.8 may help). Some departments may agree with the Treasury blanket authority for defined and limited ranges of non-statutory commitments, eg indemnities for board members and commitments taken on the normal course of business. All other non statutory commitments are novel, contentious or repercussive, so Treasury approval is always essential before they are undertaken.

5.5.3 Public sector organisations should give parliament prompt and timely notice of any significant new commitments, whether using existing statutory powers or to be honoured through future legislation. Non statutory contingent liabilities (above a specified threshold) should always be notified in this way. The process is set out in annex 5.4.

12 Ie has breached the Concordat – see annex 2.3

13 Under the Concordat

Box 5.1: contingent liabilities: notifying parliament

- Parliament should be notified of uncertain liabilities in a meaningful way without spurious accuracy. It is good practice to notify parliament if a previously notified liability changes significantly, or can be clarified, eg if the timing can be firmed up.
- If a contingent liability affects several departments but cannot confidently be allocated among them, the relevant ministers should inform parliament in a pragmatic way. A single statement may well suffice.
- If, exceptionally, a new liability needs to remain confidential, the minister should inform the chairs of the relevant select committee and the PAC; then inform parliament openly when the need for confidentiality lifts.
- Ministers should inform parliament if an ALB assumes a contingent liability which it could not absorb within its own resources, since the risk ultimately lies with the sponsor department's budget.

5.5.4 The general rule is to err on the side of caution in keeping parliament informed of emerging contingent liabilities. It is impossible to generalise about every possible set of circumstances but some guidance is in box 5.1.

## 5.6 Tax

5.6.1 Public sector organisations should not engage in, or connive at, tax evasion, tax avoidance or tax planning. If a public sector organisation were to obtain financial advantage by moderating the tax paid by a contractor, supplier or other counterparty, it would usually mean that the Exchequer as a whole would be worse off – thus conflicting with the accounting officer's duties (section 3.3). Thus artificial tax avoidance schemes should normally be rejected. It should be standard practice to consult HMRC[14] about transactions involving non-standard approaches to tax before going ahead.

5.6.2 There is of course no problem with using tax advisers to help meet normal legitimate requirements of carrying on public business. These include administration of VAT, PAYE and NICs, where expert help can be useful and efficient.

5.6.3 Proposals to create new taxes in order to assign their proceeds to new spending proposals are rarely acceptable. Decisions on tax are for Treasury ministers, who are reluctant to compromise their future fiscal freedom to make decision.

## 5.7 Public dividend capital

5.7.1 Certain public sector businesses, notably trading funds and certain Health Trusts, are set up with public dividend capital (PDC) in lieu of equity. Like equity, PDC should be serviced, though not necessarily at a constant rate.

5.7.2 PDC is not a soft option. In view of the risk it carries, it should deliver a rate of return comparable to commercial equity investments carrying a similar level of risk. There is scope for the return to vary to reflect market conditions and investment

14 HMRC customer relationship manager or customer co-ordinator

patterns; but persistent underperformance against the agreed rate of return should not be tolerated.

5.7.3 A department needs specific statutory power to issue PDC, together with supply cover to pay it out of the Consolidated Fund. Sometimes instead of a specific issue of PDC, the legislation establishing (or financially reconstructing) a public sector business deems an issue of PDC to the new business. Dividends on PDC, and any repayments of PDC, are paid to the sponsor department of the business.

5.7.4 Further information about the use of PDC can be found in Consolidated Budgeting guidance.[15]

## 5.8 Borrowing by public sector organisations

5.8.1 Some public sector organisations, eg certain trading funds, are partly financed through loans provided through the sponsor department's Estimate; or from the National Loans Fund (NLF). In these cases Treasury consent and specific legal powers are always required. Limits and other conditions are common. See annex 5.5 for more.

5.8.2 NLF and Voted loans can only be made if there is reasonable expectation that the loan will be serviced and repaid promptly. Similarly, when ALBs borrow, their sponsor departments explicitly stand behind them and so should scrutinise borrowers' creditworthiness, not just relying on their track records, in order to satisfy themselves that such loans are sound. For NLF loans, if timely repayment could not realistically be expected, the loan would be unlawful.

5.8.3 Should a department become aware of concerns about the security of outstanding loans (either its own or an ALB's), it should warn the Treasury promptly and consider what action it can take to reduce or otherwise mitigate any potential loss. If a loan becomes irrecoverable, remedial treatment should be agreed with the Treasury and then notified to parliament.

5.8.4 The NLF cannot make a loss. So the interest rates charged on NLF loans, whether fixed or variable, must be higher than the rates at which the NLF could raise funds for a similar period. Early repayment is sometimes possible, eg if the borrower has windfall receipts, but never simply to refinance on terms more favourable to the borrower because a fee is charged to match the Exchequer costs when a loan ends early. This is because the NLF finances the amount outstanding using money market instruments sold at the time the loan was made, and must continue to service those instruments. So the Exchequer as a whole would make a loss if the NLF offered cheaper replacement loans.

5.8.5 While NLF loans are repaid to the NLF, voted loans are repaid to the Consolidated Fund. The treatment of repayments and interest payments in Estimates and accounts is discussed in the *Consolidated Budgeting Guidance*, the *Estimate Manual* and the FReM. The Treasury accounts for NLF transactions in the NLF's accounts. Any proposed write-offs must be notified to parliament after obtaining Treasury agreement: see annex 5.5

[15] https://www.gov.uk/government/publications/consolidated-budgeting-guidance-2021-to-2022

## 5.9 External borrowing

5.9.1 Public sector organisations may borrow from private sector sources only if the transaction delivers better value for money for the Exchequer as a whole. Because non-government lenders face higher costs, in practice it is usually difficult to satisfy this condition unless efficiency gains arise in the delivery of a project (eg PFI). Treasury agreement to any such borrowing, including by ALBs, is also essential. Nevertheless it can sometimes be expedient for public sector bodies to borrow short term, for example by overdraft.

5.9.2 When a sponsor department's ALB borrows, the department should normally arrange to guarantee the loan to secure a fine rate. This is not always possible, eg when a guarantee would rank as a state aid (see annex 4.7). A department which guarantees a loan normally[16] needs a specific statutory power as well as Estimate provision. On exceptional occasions temporary non-statutory loans may be possible.

5.9.3 The case for a guarantee should be scrutinised as thoroughly as if indeed a loan were made. Since guarantees always entail entering into contingent liabilities, parliament must be notified when a loan guarantee is given, using the reporting procedures in annex 5.4.

5.9.4 Occasionally there is a case for an ALB to borrow in foreign currency in its own name rather than the government's. Because this can affect the credit standing of the government as a sovereign borrower, and may well cost more, it is essential to consult the Treasury beforehand. The same principles apply to the borrowing of any bodies, such as subsidiaries, for which a department's ALBs are responsible.

## 5.10 Multiple sources of funding

5.10.1 Sometimes public sector organisations derive funding from more than one source. Examples of funding other than voted funds include national insurance contributions (which are dedicated to the National Insurance Fund), lottery funding and charitable funding. All of these alternatives usually come with specific conditions attached.

5.10.2 Organisations in this position should segregate and account separately for the different streams of funding so that they can apply the relevant terms and conditions to each. In particular, where a source of funding is designated to a particular purpose, it is rarely appropriate to use another instead. In those circumstances switching is novel and contentious and thus requires Treasury approval.

5.10.3 When there is doubt about how to handle multiple streams of funding, it is good practice to consult the Treasury.

## 5.11 Cash management

5.11.1 The various organisations in central government together handle very large flows of public funds. At the end of each working day, the Exchequer must either borrow from the money market or place funds on deposit with the money market,

16 The Concordat applies here in just the same way as to spending – see annex 2.3

depending on the net position reached after balancing outflows to finance expenditure against inflows from taxes and other sources.

5.11.2 So there is considerable advantage to be gained for the Exchequer as a whole by minimising this net position. In practice this means gathering balances together at the end of each working day. In aggregate all these accounts make up the Exchequer Pyramid, managed by the Treasury. Most funds are held with the Government Banking Service.

5.11.3 It is essential for central government organisations to minimise the balances in their own accounts with commercial banks. Were each to retain a significant sum in its own account with such banks, the amount of net government borrowing outstanding on any given day would be appreciably higher, adding to interest costs and hence worsening the fiscal balance.

5.11.4 Each central government organisation should establish a policy for its use of banking services. See annex 5.6 for guidance. Sponsor departments should also make sure that their ALBs are aware of the importance of managing this aspect of their business efficiently and effectively (see box 7.2).

## 5.12 Other financing techniques

5.12.1 Depending on its circumstances, purposes and risk profile, a public sector organisation may consider using financial instruments provided by the commercial markets. Among these techniques are foreign currency transactions and various hedging instruments designed to control or limit business risks, for example those arising out of known requirements for specific future purchases of market priced commodities. Mundane possibilities are use of credit or debit cards, in order to secure faster settlements.

5.12.2 As with making decisions about other policies and projects, an organisation considering using unfamiliar financing techniques should evaluate them carefully, especially to assess value for money. The checklists in boxes 4.5 and 4.6 have reminders of factors that may need to be considered. As such transaction(s) are almost always novel, contentious or repercussive, it is essential to consult the Treasury.

5.12.3 Any organisation using a new or non-standard technique should ensure that it has the competence to manage, control and track its use and any resulting financial exposures, which may vary with time. In particular, departments should consult the Treasury before using derivatives for the first time (and ALBs their sponsoring departments).

5.12.4 When assessing an unfamiliar financing technique, it is important to remember that providers of finance and complex financial instruments intend to profit from their business. And providers' costs of finance are always inferior to the UK government's cost of borrowing. So it is usually right to be cautious about any novel techniques. The Treasury will always refuse proposals to speculate. Offers which appear too good to be true usually are.

5.12.5 As with managing other business, parliament may ask accounting officers to justify any decisions about use of financial transactions, especially if with hindsight they have not achieved good value for money.

# Chapter 6

# Fees, charges and levies

Charges for services provided by public sector organisations normally pass on the full cost of providing them. There is scope for charging more or less than this provided that ministers choose to do so, parliament consents and there is full disclosure. Public sector organisations may also supply commercial services on commercial terms designed to work in fair competition with private sector providers. Parliament expects proper controls over how, when and at what level charges may be levied.

6.1.1 Certain public goods and services are financed by charges rather than from general taxation. This can be a rational way to allocate resources because it signals to consumers that public services have real economic costs. Charging can thus help prevent waste through badly targeted consumption. It can also make comparisons with private sector services easier, promote competition, develop markets and generally promote financially sound behaviour in the public sector.

6.1.2 There are unavoidable reasons why policy on charging is important:

- charges substitute for taxation (or, in the short term, borrowing) as a means of government finance. Decisions on charging policy should therefore be made with the same care, and to similar standards, as those on taxation;
- for this reason, parliament expects to consider legislation on whether charges should be levied; how they should be structured; and on charge levels;
- international standards[1] determine how income from charges is classified in the national accounts. Certain charges are treated as taxes.

6.1.3 As in other areas of managing public funds, parliament expects the Treasury to make sure that its interests are respected, including pursuit of efficiency and avoidance of waste or extravagance. Because Estimates and budgets are shown net of income, special effort is required to give parliament information about both gross and net costs, and about the sources and amounts of income.

## 6.2 Basic principle

6.2.1 The standard approach is to set charges to recover full costs. Cost should be calculated on an accruals basis, including overheads, depreciation (eg for start up or improvement costs) and the cost of capital. Annex 6.1 sets out how to do this.

[1] The Treasury and public accounts follow classification decisions taken by the Office for National Statistics, an independent organisation which is guided by the international standards set out in the European System of Accounts

6.2.2 This approach is simply intended to make sure that the government neither profits at the expense of consumers nor makes a loss for taxpayers to subsidise. It requires honesty about the policy objectives and rigorous transparency in the public interest.

6.2.3 As elsewhere, organisations supplying public services should always seek to control their costs so that public money is used efficiently and effectively. The impact of lower costs should normally be passed on to consumers in lower charges. Success in reducing costs is no excuse for avoiding the principles in this guidance.

6.2.4 This chapter applies to all fees and charges set by ministers and by an extensive range of public bodies: departments, trading funds, NDPBs, the NHS, non-devolved services in Scotland, Wales and Northern Ireland, and most public corporations. Departments should be able to satisfy themselves that their ALBs can deliver the financial objectives for the services they charge for. This chapter also applies when one public organisation supplies another with goods or services; and to certain statutory local authority charges set by ministers.

## 6.3 Setting a charge: standard practice

6.3.1 When a charge for a public service is to be made, it is normally necessary to rely on powers in primary legislation. The legislation should be designed so that ministers decide, or have significant influence over, both the structure of the charge and its level. It is common to frame primary legislation in general terms, using secondary legislation to settle detail.

6.3.2 Treasury consent is required for all proposals to extend or vary charging schemes. This holds even if the primary legislation does not call for it, or the delegated authorities within which the organisation operates would otherwise allow it.

6.3.3 It is sometimes possible to rely on secondary legislation rather than primary to determine charges:

- an order under s56 of the Finance Act 1973;
- restructuring of charges can sometimes be achieved by an order under s102 of the Finance (no 2) Act 1987 (see box 6.1).

Box 6.1: restructuring charges using S.102

- A s102 order can extend or vary powers in existing primary legislation.
- It can permit restructuring by specifying factors to be taken into account when setting fees.
- Explicit prior Treasury consent is always essential.

But

- A s102 order cannot create a power for new charges where no primary legislation exists.
- Nor can it lift restrictions in (or in any other way undermine) primary legislation.
- Parliament is usually sceptical because s102 substitutes secondary for primary legislation.

6.3.4 When deciding the level of a charge, it is important to define:.

- the range(s) of services for which a charge is to be made;
- how any categories of service are to be differentiated, if at all, in setting charges.

6.3.5 The standard approach is that the same charge should apply to all users of a defined category of service, so recovering full costs for that category of service. Different charges may be set for objectively different categories of service costing different amounts to provide. Box 6.2 shows how this can work.

> **Box 6.2: how different charges can apply to different categories of service**
>
> Different categories could be recognised by:
>
> - distinguishing supply differences, eg in person, by post or online
> - priorities, eg where a quicker service costs more
> - quality, eg charging more for a premium service with more features
> - recognising structural differences, where it costs more to supply some consumers.

6.3.6 However, different groups of customers should not be charged different amounts for a service costing the same, eg charging firms more than individuals. Similarly, cross subsidies are not standard practice, eg charging large businesses more than small ones where the cost of supply is the same.

6.3.7 Charges within and among central government organisations should normally also be at full cost, including the standard cost of capital. Any different approach would cause one party to make a profit or loss not planned in budgets agreed by ministers collectively; while the customer organisation(s) would conversely face charges higher or lower than full costs. A number of objectionable consequences might flow from this. For instance, a question of state aid could arise; or private sector consumers of the customer organisation might be charged distorted fees.

6.3.8 Shared services (box 6.3) are a special case of charging within the public sector.

> **Box 6.3: shared services**
>
> It is often possible to make economies of scale by arranging for several public service organisations to join together to deliver services cheaper, eg by using their joint purchasing power. One organisation supplies the other(s). Since all the parties should lower their costs, the accounting officer of each organisation should have no difficulty in recognising improved value for money for the Exchequer as a whole and so justify going ahead.
>
> Public sector organisations supplying (or improving) shared services should consult the Treasury at an early stage of planning. Typically supplier organisations face the cost of setting up provision on a larger scale than they need for their own use. As with setting up any new service, plans in budgets should amortise initial costs so that they can be recovered over an appropriate period from the start of the service. More detail on shared services is in section 7.5.
>
> It is not acceptable for supplier organisations to plan to profit from, or subsidise, supply to customer organisations in the public sector. Nor is it acceptable for accounting officers to resist shared services just because the impact on their own organisation is not perceived to be favourable.

## 6.4 Setting a charge: non-standard approaches

6.4.1 Ministers' policy objectives for a service where a charge is levied may not fit the standard model in section 6.3. In such cases it may be possible to deliver the policy objective in another way. Some ways of doing this are described below. Explicit Treasury consent, and often formal legal authority, is always required for such variations. It is desirable to consult the Treasury at an early stage to make sure that the intended strategy can be delivered.

### Charging below cost

6.4.2 Where ministers decide to charge less than full cost, there should be an agreed plan to achieve full cost recovery within a reasonable period. Each case needs to be evaluated on its merits and obtain Treasury clearance. If the subsidy is intended to last, this decision should be documented and periodically reconsidered.

### Charging above cost

6.4.3 ONS normally classifies charges higher than the cost of provision, or not clearly related to a service to the charge payer, as taxes. Such charges always call for explicit ministerial decision as well as specific statutory authority. The Treasury does not automatically allow departments to budget for net expenditure associated with above cost charges. Netting off, or netting off up to full costs, may be agreed in certain instances, considering each case on its merits.

6.4.4 Sometimes when a change of this kind is classified as a tax, departments also propose to assign its revenue. The Treasury always treat such proposals with caution (see 5.6.3).

### Cross subsidies

6.4.5 Cross subsidies always involve a mixture of overcharging and undercharging, even if the net effect is to recover full costs for the service as a whole. So cross subsidised charges are normally classified as taxes. They always call for explicit ministerial decision and parliamentary approval through either primary legislation or a s102 order.

### Information services

6.4.6 In the public interest, information may be provided free or at low charge. This approach recognises the value of helping the general public obtain the data they require to function in the modern world. There are some exceptions - see annex 6.2.

## 6.5 Levies

6.5.1 Compulsory levies, eg payments for licences awarded by statutory regulators, or duties to finance industry specific research foundations, are normally classified as taxation. Such levies may be justified in the wider public interest, not because they provide a direct beneficial service to those who pay them. Depending on the circumstances, the Treasury may allow regulators to retain the fees charged if this approach is efficient and in the public interest.

6.5.2 As with other fees and charges, levies should be designed to recover full costs. If the legislation permits, the charge can cover the costs of the statutory body, eg a regulator could recover the cost of registration to provide a licence and of associated supervision. It may be appropriate to charge different levies to different kinds of licensees, depending on the cost of providing different kinds of licences (see box 6.2).

## 6.6 Commercial services

6.6.1 Some public sector services are discretionary, ie no statute underpins them. Services of this kind are often supplied into competitive markets, though sometimes the public sector supplier has a monopoly or other natural advantage.

6.6.2 Charges for these services should be set at a commercial rate. The rate should deliver a commercial return on the use of the public resources deployed in supplying the service. So the financial target should be in line with market practice, using a risk weighted rate of return on capital relevant to the sector concerned. The rate of return used in pricing calculations for sales into commercial markets should be:

- for sales into commercial markets, in line with competitors' assessment of their business risk, rising to higher rates for more risky activities; or
- where a public sector body supplies another, or operates in a market without competitors, the standard rate for the cost of capital (see annex 6.1).

6.6.3 If a publicly provided commercial service does not deliver its target rate of return, outstanding deficits should be recovered, eg by adjusting charges. Any objective short of achieving the target rate of return calls for ministerial agreement, and should be cleared with the Treasury. But discretionary services should never undermine the supplier organisation's public duties, including its financial objective(s).

6.6.4 It is important for public suppliers of commercial services to respect competition law. Otherwise public services using resources acquired with public funds might disturb or distort the fair operation of the market, especially where the public sector provider might be in a dominant position: see annex 6.3.

## 6.7 Disclosure

6.7.1 It is important that parliament is fully informed about use of charges. Each year the annual report of the charging organisation should give:

- the amounts charged
- full costs and unit costs
- total income received
- the nature and extent of any subsidies and/or overcharging
- the financial objectives and how far they have been met.

6.7.2 To keep parliament properly informed, Estimates should display details of expected income from charges. The Estimates Manual explains how the controls work.

6.7.3 The FReM sets out the information public sector organisations should publish in their accounts. It should include analysis of income.

## 6.8 Taking stock

6.8.1 As with any other use of public resources, it is important to monitor performance so that the undertaking can be adjusted as necessary to stay on track. It is good practice to review the service routinely at least once a year, to check, and if appropriate revise, the charging level. At intervals, a more fundamental review is usually appropriate, eg on a timetable compatible with the dynamics of the service. Box 6.4 suggests some issues to examine.

**Box 6.4: reviewing a public service for which a charge is made**

- Is it still right for a public sector body to use public resources to supply the service?
- Are there any related services for which there might be a case for charging?
- Does the business structure still make sense? Are the assets used for the service adequate?
- How can efficiency and effectiveness be improved so that charges can be lower or offer better value?
- Is the financial objective right?
- For a statutory (or other public sector) service, if full costs are not recovered, why not?
- For a commercial service, does the target rate of return still reflect market rates?
- Is it still appropriate to net off against costs any agreed charges above cost?
- Is there scope to secure economies of scale by developing a shared service?
- What developments might change the business climate?
- Do any discretionary services remain a good fit for the business model and wider objectives?
- Should any underused assets be redeployed, used to make a commercial return, or sold?
- Would another business model (eg licensing, contracting out, privatising) be better?

# Chapter 7

# Working with others

It often makes sense for public sector organisations to work with partners to deliver public services. This chapter outlines how sponsor departments should keep track of their ALBs, and where necessary control their activities. It is important that the public interest and the need to keep parliament informed are given priority in setting up and operating these relationships.

## 7.1 The case for working in partnership

7.1.1 Public sector organisations may be able to deliver public services more successfully if they work with another body. Central government departments may find it advantageous to delegate certain functions to ALBs that can be free to concentrate on them without conflict of interest. Or it may be helpful to harness the expertise of a commercial or civil society sector organisation with skills and leverage not available to the public sector.

7.1.2 Any such relationship inevitably entails tensions as well as opportunities. The autonomy of each organisation needs to be buttressed by sufficient accountability to give parliament and the public confidence that public resources are used wisely.

7.1.3 It can be important that an ALB is demonstrably independent. This in itself does not determine the ALB's form or structure. Independence is achieved by specifying how the ALB is to operate. Functional independence is compatible with financial oversight by the ALB's parent department and with accountability.

7.1.4 It is generally helpful to deal with any potential conflicts head on by deciding at the outset how the relationship(s) between the parties should work. The key issues to tackle are set out in box 7.1.

**Box 7.1: Issues for partnerships with public sector members**

- The decision to engage with a partner should rest on evaluation of a business case assessed against a number of alternatives, including doing nothing.
- Conflicts of interest should be identified so that handling strategies can be agreed, eg by establishing early warning processes or safeguards.
- The cultural fit of the partners should be close enough to give each confidence to trust the other.
- Accountability for use of public funds should not be weakened.

The terms of engagement, including governance, should be documented in a framework agreement or equivalent (see box 7.2).

## 7.2 Setting up new arm's length bodies

7.2.1 When a sponsor department sets up a new ALB, the nature of the new body should be decided early in the process. It is sensible for the functions of the new body to help determine this choice. Annex 7.1 offers advice and sources of guidance on setting up a new ALB and compares the characteristics of agencies, non-departmental public bodies (NDPBs) and non-ministerial departments (NMDs). Departments should consult the Treasury and the Cabinet Office about making the choice.

7.2.2 In general, each new ALB should have a specific purpose, distinct from its parent department. There should be clear perceived advantage in establishing a new organisation, such as separating implementation from policy making; demonstrating the integrity of independent assessment; establishing a specialist identity for a professional skill; or introducing a measure of commercial discipline. It is sensible to be sceptical about setting up a new ALB, since it will often add to costs.

7.2.3 ALBs cannot be given authority to make decisions proper to ministers, nor to perform functions proper to sponsor departments. Only rarely is a non-ministerial department the right choice as NMDs have limited accountability to parliament[2]. Nor is it acceptable to use a royal charter to establish a public sector body since such arrangements deny parliament control and accountability.

7.2.4 A sponsor department cannot relinquish all responsibility for the business of its ALBs by delegation. It should have oversight arrangements appropriate to the importance, quality and range of the ALB's business. Normally new, large, experimental or innovative ALBs need more attention from the sponsor than established or small ALBs doing familiar or low risk business. And the sponsor department always needs sufficient reserve powers to reconstitute the management of each ALB should events require it (see section 3.8). .

7.2.5 The sponsor department should plan carefully to make sure that its oversight arrangements and the internal governance of any new ALB are designed to work together harmoniously without unnecessary intrusion. The ALB also needs effective internal controls and budgetary discipline so that it can live within its budget allocation and deliver its objectives. And the sponsor department must have sufficient assurance to be able to consolidate its ALBs' accounts with its own.

7.2.6 There is a good deal of flexibility about form and structure. It may be expedient, for example, to set up an organisation which is eventually to be sold as a Companies Act company. Or certain NDPBs may operate most effectively when constituted as charities. Mutual structures can also be attractive. Innovation often makes sense. The standard models are all capable of a good deal of customisation.

7.2.7 If the PAC decides to investigate an ALB, the accounting officers of both the ALB and its sponsor department should expect to be called as witnesses. The PAC will seek to be satisfied that the sponsor's oversight is adequate.

## 7.3 What to clarify

7.3.1 When documenting an agreement with a partner, public sector organisations should analyse the relationship and consider how it might evolve. The framework document (or equivalent) should then be kept up to date as the partnership develops. Box 7.2 contains terms which should always be considered for inclusion. The list is not exhaustive.

2 The sponsor department also has less control as each NMD has its own budget, Estimate and annual accounts. So if a ministerial department transfers work to an NMD, there is a greater risk of excess votes in each.

### Box 7.2: framework terms for partnership agreements

**purpose**

- The aims of the relationship and its working remit.
- Its standards, key objectives and targets.

**governance and accountability**

- The legal relationship, including any financial or other limits.
- Any statutory requirements relating to the functions of the partnership.
- The governance of any ALB: its board structure, how its members are appointed (and disappointed). How the partnership should work, eg regular meetings of senior people.
- The extent to which any department is responsible to parliament for the conduct of a partner (essential for partnerships between departments and ALBs).
- Any other important features of the sponsorship role of the public sector partner, eg acting as intelligent shareholder or consulting third parties.
- How any relationships with departments other than the sponsor should operate.
- Any arrangements for regular reporting on performance to the public and/or parliament.
- Plans for any evolution (eg into a mutual) after a period of ALB status.
- Any arrangements for successor activity, eg establishing similar partnerships elsewhere.

**decision making**

- How strategic decisions about the future of the partnership will be made, with timetable, terms for intervention, break points, dispute resolution procedures, termination process.
- How the chain of responsibility should work, eg stewardship reporting, keeping track of efficiency, risk assessment, project appraisal, management of interdependencies.
- How the partnership will identify, manage and track opportunities and risks.
- The status of the staff; and how they are to be hired, managed and remunerated.
- How any professional input (eg medical, scientific) is to be managed and quality assured.
- Arrangements for taking stock of performance and learning lessons from it.
- Arrangements for intervention when necessary.

**financial management**

- The financial relationship of the partners, eg:
    - Any founding capital (including assets, goods, financial sums or other valuables)
    - Any periodic grants and their terms
    - How the partnership's corporate plan and annual target(s) are to be agreed
    - How asset management and capital projects are to be decided and managed
    - How cashflow is to be managed, and current expenditure financed
    - The distribution of income and profit flows
    - Any financial targets, eg Return on capital employed (roce)
    - How any charges to customers or users are to be set
    - Any agreed limits on the partnership's business.
- Monitoring, financial reporting, regular liaison and any other tracking arrangements.
- Internal and external audit arrangements, with any relevant accounts directions.
- Arrangements for consolidation of accounts (essential for ALBs)

7.3.2 In framing founding documentation, the partners should adopt a proportionate approach. Parliament expects that public funds will be used in a way that gives reasonable assurance that public resources will be used to deliver the intended objectives.

7.3.3 In this process the aim should be to put the accounting officers of the parties in a position to take a well informed view on the current status of the relationship, enabling timely adjustments to be made as necessary. It is good practice to develop structured arrangements for regular dialogue between the parties to avoid misunderstandings and surprises.

7.3.4 Further advice about framework documents is in annex 7.2. It is important that such documents fit the business to which they relate (rather than following precedent or copying a standard model).

## 7.4 Agencies

7.4.1 Each agency is either part of a central government department or a department in its own right. Agencies are intended to bring professionalism and customer focus to the management and delivery of central government services, operating with a degree of independence from the centre of their home departments. Some are also trading funds (see section 7.8).

7.4.2 Each agency is established with a framework document on the lines sketched out in box 7.2. With the exception of those agencies which are trading funds (see section 7.8), they are normally funded through public expenditure supplied by Estimates. Departments should consult the Treasury and Cabinet Office about the preparation of their framework documents.

## 7.5 Departments working together

7.5.1 To promote better delivery and enhance efficiency, departments often find it useful to work with other government departments (or ALBs). This can make sense where responsibilities overlap, or both operate in the same geographical areas or with the same client groups - arrangements loosely categorised as joined up government. Such arrangements can offer opportunities for departments to reduce costs overall while each partner plays to its strengths.

7.5.2 Such relationships can be constituted in a number of different ways. Some models are sketched in box 7.3. The list is not exhaustive.

**Box 7.3: examples of joined up activities in central government**

- one partner can act as lead provider selling services (such as IT, HR, finance functions) to other(s) as customers, operating under service level agreement(s)
- cost sharing arrangements for common services (eg in a single building), allocated in line with an indicator such as numbers of staff employed or areas of office space occupied
- joint procurement using a collaborative protocol
- a joint venture project with its own governance, eg an agency or wholly owned company, selling services to a number of organisations, some or all of which may be public sector
- an outsourced service, delivering to several public sector customers

7.5.3 Shared services often need funding to set up infrastructure, eg to procure IT. This could be agreed in a spending review, or customers could buy in to the partnership by transferring budget provision to the lead provider. Each of the accounting officers involved should be satisfied that the project offers value for money for the Exchequer as a whole. The provider's charges should be at cost, following the standard fees and charges rules (see chapter 6).

7.5.4 In any joint activity, there must be a single accounting officer so that the lines of responsibility are clear. If the PAC decides to investigate, the accounting officers of each of the participants should expect to be summoned as witnesses.

## 7.6 Non-departmental public bodies

7.6.1 Non-departmental public bodies (NDPBs) may take a number of legal forms, including corporates and charities. Most executive NDPBs have a bespoke structure set out in legislation or its equivalent (eg a Royal Charter[3]). This may specify in some detail what task(s) the NDPB is to perform, what its powers are, and how it should be financed. Sometimes primary legislation contains powers for secondary legislation to set or vary the detail of the NDPB's structure. Annex 7.1 has links to more about NDPBs.

7.6.2 Each NDPB is a special purpose body charged with responsibility for part of the process of government. Each has a sponsor department with general oversight of its activity. The sponsor department's report and accounts consolidates its NDPBs' financial performance.

7.6.3 NDPBs show considerable variety of structures and working methods, with scope for innovation and customisation. Some NDPBs may also need to work with other organisations as well as with their sponsor. All this should be documented in the framework document (see annex 7.2).

7.6.4 NDPBs' sources of finance vary according to their constitution and function. Box 7.4 shows the main options available.

[3] This route is no longer used - see Section 2.5.

Box 7.4: sources of finance for NDPBs

- specific conditional grant(s) from the sponsor department (and/or other departments)
- general (less conditional) grant-in-aid from the sponsor department
- income from charges for any goods or services the NDPB may sell
- income from other dedicated sources, eg lottery funding
- public dividend capital

7.6.5 In practice NDPBs always operate with some independence and are not under day-to-day ministerial control. Nevertheless, ministers are ultimately accountable to parliament for NDPBs' efficiency and effectiveness. This is because ministers: are responsible for NDPBs' founding legislation; have influence over NDPBs' strategic direction; (usually) appoint their boards; and retain the ultimate sanction of winding up unsatisfactory NDPBs.

## 7.7 Public corporations

7.7.1 Some departments own controlling shareholdings in public corporations or Companies Act companies, perhaps (but not necessarily) as a step toward disposal. Public corporations' powers are usually defined in statute; but otherwise all the disciplines of corporate legislation apply. The Shareholder Executive, which specialises in strategic management of corporates, may be a good way of managing departments' responsibilities as shareholders.

7.7.2 Sponsor departments should define any contractual relationship with a corporate in a framework document adapted to suit the corporate context while delivering public sector disciplines. The financial performance expected should give the shareholder department a fair return on the public funds invested in the business. Box 7.5 offers suggestions. This approach may also be appropriate for a trading fund, especially if it is to become a Companies Act company in time.

7.7.3 A shareholder department may also use a company it owns as a contractor or supplier of goods or services. It is a good discipline to separate decisions about the company's commercial performance from its contractual commitments, so avoiding confusion about objectives. So there should be clear arm's length contracts between the company and its customer departments defining the customer-supplier relationship(s).

Box 7.5: outline terms for a relationship with a public corporation

- the shareholder's strategic vision for the business, including the rationale for public ownership and the public sector remit of the business
- the capital structure of the business and the agreed dividend regime, with suitable incentives for business performance
- the business objectives the enterprise is expected to meet, balancing policy, customer, shareholder and any regulatory interests
- the department's rights and duties as shareholder, including:
  - governance of the business
  - procedure for appointments (and disappointments)
  - financial and performance monitoring
  - any necessary approvals processes
  - the circumstances of, and rights upon, intervention
- details of any other relationships with any other parts of government

## 7.8 Trading funds

7.8.1 All trading funds are established under the Trading Funds Act 1973. Their activities are not consolidated with their sponsor departments' business. They must finance their operations from trading activity.

7.8.2 Each trading fund is set up through an order subject to affirmative resolution. Before an order can be laid in parliament, the Treasury needs to be satisfied that a proposed trading fund can satisfy the statutory requirement that its business plan is sustainable without additional funding in the medium term. A period of shadow operation as a pilot trading fund may help inform this assessment.

7.8.3 Each trading fund must be financed primarily from its trading income. In particular, each trading fund is expected to generate a financial return commensurate with the risk of the business in which it is engaged. In practice this means the target rate of return should be no lower than its cost of capital. The actual return achieved may vary a little from one year to the next, reflecting the market in which the trading fund operates.

7.8.4 The possible sources of capital for trading funds are shown in box 7.6. They are designed to give trading funds freedom from the discipline of annual Estimate funding. The actual mix for a given trading fund must be agreed with the sponsor department (if there is one) and with the Treasury, subject to any agreed limits, eg on borrowing.

7.8.5 Further detail about trading funds is in annex 7.3. Guidance on setting charges for the goods and services trading funds sell is in chapter 6.

Box 7.6: sources of capital for trading funds

- public dividend capital (equivalent to equity, bearing dividends - see annex 7.4)
- reserves built up from trading surpluses
- long or short term borrowing (either voted from a sponsor department or borrowed from the National Loans Fund if the trading fund is a department in its own right)
- temporary subsidy from a sponsor department, voted in Estimates
- finance leases

## 7.9 Non-ministerial departments

7.9.1 A very few central government organisations are non-ministerial departments (NMDs). It is important that there is some clear rationale for this status in each case.

7.9.2 NMDs do not answer directly to any government minister. They have their own accounting officers, their own Estimates and annual reports, and settle their budgets directly with the Treasury. However, some ministerial department must maintain a watching brief over each NMD so that a minister of that department can answer for the NMD's business in parliament; and if necessary take action to adjust the legislation under which it operates. A framework document should define such a relationship.

7.9.3 This limited degree of parliamentary accountability must be carefully justified. It can be suitable for a public sector organisation with professional duties where ministerial input would be inappropriate or detrimental to its integrity. But the need for independence is rarely enough to justify NMD status. It is possible to craft arrangements for NDPBs which confer robust independence. Where this is possible it provides better parliamentary accountability, and so is to be preferred.

## 7.10 Local government

7.10.1 A number of central government departments make significant grants to local authorities. Some of these are specific (ring fenced). Most are not, allowing local authorities to set out their own priorities.

7.10.2 Nevertheless parliament expects assurances that such decentralised funds are used appropriately, ie that they are spent with economy, efficiency and effectiveness, and not wasted nor misused. The quality of the assurance available differs from that expected of central government organisations because local authorities' prime accountability is to their electorates.

7.10.3 For these relationships a framework document is not usually the most fruitful approach. Instead. Central government departments should draw up an annual account of how their accounting officers assure themselves that grants to local government are distributed and spent appropriately; and how underperformance can be dealt with. This account forms part of the governance statement in the report and accounts of each department affected (see annex 3.1).

7.10.4 Similar considerations apply to the NHS and centrally funded schools.

## 7.11 Innovative structures

7.11.1 Sometimes central government departments have objectives which more easily fit into bespoke structures suited to the business in hand, or to longer range plans for the future of the business. Such structures might, for example, include various types of mutual or partnership.

7.11.2 Proposals of this kind are by definition novel and thus require explicit Treasury consent. In each case, proposals are judged on their merits against the standard public sector principles after examining the alternatives, taking account of any relevant experience. The Treasury will always need to understand why one of the existing structures will not serve: eg the NDPB format has considerable elasticity in practice.  Boxes 4.8 and 7.2 may help with this analysis.

## 7.12 Outsourcing

7.12.1 Public sector organisations often find it satisfactory and cost effective to outsource some services or functions rather than provide them internally. Candidates have included cleaning, security, catering and IT support. A wider range of services is potentially suitable for this treatment. Innovative approaches should be explored constructively.

7.12.2 The first step in setting up any outsourcing agreement should be to specify the service(s) to be provided and the length of contract to be sought. At that stage it is usually desirable to draw up an outline business case to help evaluate whether outsourcing makes financial and operational sense. Any decision to outsource should then be made to achieve value for money for the Exchequer as a whole.

7.12.3 It is good practice to arrange some form of competition for all outsourcing, as for other kinds of procurement. If services are likely to be required at short notice - for example legal services for advice on opportunities, threats or other business pressures which emerge with little warning - it is good practice to arrange a competition to establish a standing panel of providers whose members can be called upon to deal with rapidly emerging needs.

7.12.4 Contracting out does not dissolve responsibility. Public sector organisations using a contractor should set in place systems to track and manage performance under the contract. It may be appropriate to plan for penalties for disruption and/or failure if the contractor cannot deliver. The PAC may need to be satisfied that the arrangements for contracting out entail sufficient accountability for the use of public funds.

## 7.13 Private finance

7.13.1 Where properly constructed and managed, public sector organisations can use private finance arrangements to construct assets and/or deliver services with good value for money. Structured arrangements where the private sector puts its own funds at risk can help deliver projects on time and within budget.

7.13.2 It is important to carry out a rigorous value for money analysis to determine whether these benefits are likely to exceed the additional cost of using private finance. Contracting organisations should also make sure that they are able to afford such arrangements over their working lifetimes, taking account, as far as possible, of the risk of difficult future financial environments. It is not good practice to embark on a private finance arrangement if it is dependent on other separate financial transactions taking place during the project's lifetime

7.13.3 Procurement using private finance is a flexible, versatile and often effective technique, so it should be considered carefully as a procurement option. Contracts should normally be built up using standard terms and guidance published by the Treasury (see Annex 7.4). Departure from standard guidance needs to be approved by the Treasury.

## 7.14 Commercial activity

7.14.1 When public bodies have assets which are not fully used but are to be retained, it is good practice to consider exploiting the spare capacity to generate a commercial return in the public interest. This is essentially part of good asset management.

7.14.2 Any kind of public sector asset can and should be considered. Candidates include both physical and intangible assets, for example land, buildings, equipment, software and intellectual property (see annex 4.15). A great variety of business models is possible.

7.14.3 Such commercial services always go beyond the public sector supplier's core duties. Because these assets concerned have been acquired with public funds, it is important that services are priced fairly: see chapter 6. It is also important to respect the rules on state aids: see annex 4.7. Central government organisations should work through the checklist at box 7.7.

Box 7.7: planning commercial exploitation of existing assets

- define the service to be provided
- establish that any necessary vires and (if necessary) Estimate provision exist
- identify any prospective business partners and run a selection process
- if the proposed activity is novel, contentious, or likely to set a precedent elsewhere, obtain Treasury approval
- take account of the normal requirements for propriety, regularity and value for money

7.14.4 While it makes sense to make full use of assets acquired with public resources, such activity should not squeeze out, or risk damaging, a public sector organisation's main objectives and activities. Similarly, it is not acceptable to acquire assets just for the purpose of engaging in, or extending, commercial activity. If a public sector supplier's commercial activity demands further investment to keep it viable, reappraisal is usually appropriate. This should consider alternatives such as selling the business, licensing it, bringing in private sector capital, or seeking other way(s) of exploiting the underused potential in the assets or business.

7.14.5 It is a matter of judgement when departments should inform parliament of the existence, or growth, of significant commercial ventures. It is good practice to consult the Treasury in good time on this point so that parliament can be kept properly informed and not misled.

## 7.15 Working with civil society bodies

7.15.1 Central government organisations may find they can deliver their objectives effectively through relationships with civil society bodies: ie charities, social, voluntary or community institutions, mutual organisation, social enterprises or other not-for-profit organisations. Such partnerships can achieve more than either the public or the civil society sector can deliver alone. For example, using a civil society sector organisation can provide better insight into demand for, and suitable means of delivery of public services.

7.15.2 It is good practice to plan relationships with civil society partners through a framework document, as with other partnerships. Some guidelines on how these relationships can work well in harmony with policy and spending decisions are in the Civil Society Compact[4].

7.15.3 In this kind of relationship a public sector organisation may fund activities, make grants, lend assets, or arrange other transfers to a civil society sector body performing or facilitating delivery of services. It is desirable to build in safeguards to ensure that resources are used as intended (see annex 5.2). This gives parliament confidence that voted resources are used for the purposes it has approved.

7.15.4 The safeguards to be applied should be agreed at the start of the relationship. Customisation in nearly always essential. It is often right to require clawback, ie to agree terms in which public sector donors reclaim the proceeds if former publicly owned assets are sold.

[4] https://www.gov.uk/government/publications/compact-the-agreement-between-government-and-the-voluntary-community-sector

# Annex 1.1

# The Comptroller and Auditor General

Supported by staff of the National Audit Office (NAO), the Comptroller and Auditor General (C&AG) is the independent auditor of nearly all central government institutions. Using extensive statutory rights of access to records, the C&AG provides direct advice and assurance to Parliament.

A1.1.1 The C&AG is an officer of the House of Commons appointed by The Queen. They are responsible for the audit of most central government institutions. This work is carried out under his or her direction by NAO staff (see www.nao.org.uk) or by contracting out. NAO is in the public sector but independent of central government.

A1.1.2 The C&AG is appointed for a single non-renewable term of ten years; and can only be removed from office by The Queen on an address of both Houses of Parliament. The NAO's statutory board advises and supports the C&AG – for example, on the NAO's strategic direction and the associated resource requirements. Audit related decisions such as which examinations to perform and the specific audit and reporting approach, are matters solely for the independent C&AG to decide.

A1.1.3 The NAO is financed by an Estimate submitted jointly by the C&AG and the NAO chair to the Public Accounts Commission (TPAC), a committee of the House of Commons. NAO's expenditure may include discretionary activities permitted under statute if approved by NAO's board and subsequently by TPAC through its scrutiny of the NAO's Estimate.

## Audit

A1.1.4 In order to carry out financial audit work, the C&AG has extensive statutory rights of access to information held by a wide range of public sector organisations. This material is also required to compile Whole of Government Accounts, and extends to the records of many contractors and recipients of grants. The C&AG also has a right to obtain information about, and explanations of, any of this evidence.

A1.1.5 The C&AG is responsible for the financial audit of virtually all central government organisations, providing an audit opinion on their annual financial and reporting to Parliament. The C&AG may be appointed the auditor of government companies as a requirement of statute or on an 'agreement' basis with an individual entity as necessary. Financial audits are carried out in accordance with International Standards on Auditing (UK and Ireland).

A1.1.6 In addition, the C&AG may carry out audits of particular areas of central government expenditure to establish whether public funds have been used economically, efficiently and effectively. Selection of these value for money (vfm) examinations - having taken account of any proposals made by the Committee of

Public Accounts - is entirely at the C&AG's discretion, as is the manner in which they are carried out and reported. The C&AG has the same level of access for vfm examinations as for financial audit. Central government bodies must ensure that such access is provided for within the terms and conditions of contracts and agreements with third party contractors, sub-contractors and grant recipients.

A1.1.7 In the event of the C&AG requiring access to sensitive documents to inform his work – for example, policy papers such as Cabinet, or Cabinet Committee, papers – then public sector organisations should cooperate with NAO requests for access to such information, irrespective of its classification or other sensitivity. It is important to work closely with NAO to explain fully any publication sensitivities that may exist. While the final decision about the contents of his or her reports must rest with the C&AG, such close working ensures sensitivities can be properly taken into account as the report content is finalised.

A1.1.8 The Public Accounts Committee (PAC) may decide to invite witnesses to discuss the findings of-both financial audits and vfm examinations. The PAC may also initiate other hearings on related matters.

## The Comptroller function

A1.1.9 An important part of the C&AG's responsibilities is oversight of payments from the Consolidated Fund and the National Loans Fund. In response to requests from the Treasury, NAO staff establish that the sums paid out of these funds each business day are made in accordance with legislation. Once the authorisations (credits) are given, the Treasury may make drawings from these funds to finance the Exchequer's commitments.

# Annex 2.1
# Treasury approval of legislation

This annex sets out how departments should clear proposed legislation with the Treasury where there are financial implications, either for expenditure or raising revenue. More detailed guidance on the preparation of legislation and the legislative process should be sought from departmental parliamentary clerks.

## Consulting the Treasury

A2.1.1 When preparing legislation, departments must consult the Treasury:

- before any proposals for legislation with financial implications are submitted to ministers collectively for policy approval;
- about any provisions included in legislation with financial and public service manpower implications;
- on the terms of Money Resolutions and Explanatory Notes; and
- subsequently about any changes that are proposed to the agreed financial provisions, eg during the legislation's passage through Parliament.

A2.1.2 Departments should make sure that they achieve Treasury agreement early in the process and in any event before drafting instructions to Parliamentary Counsel are prepared.

## Treasury consent

A2.1.3 All legislation with a financial dimension should provide for specific Treasury consents to any key changes in the implementation of the powers it contains. Examples of such triggers, all requiring ministerial decisions, are in box A2.1A. Treasury consent is required to protect the authority of the Chancellor of the Exchequer in matters of finance or establishment.

A2.1.4 In principle, the Chancellor's authority is protected by:

- the doctrine of the collective responsibility of ministers;
- the need for Treasury approval of Estimates before they are presented to Parliament and before resources consumed or expenditure incurred can be charged on the Consolidated Fund;

but providing for statutory consent avoids any danger that the Chancellor might be committed to legislation he or she would not have agreed.

## Money resolutions

A2.1.5 A money resolution is required[1] for legislation which creates a charge upon public funds, either by way of new resource expenditure or by remission of debt. Further advice on money resolutions should be sought from Parliamentary Clerks.

A2.1.6 The responsible department should clear the draft with the Treasury at official level. When agreed, the Treasury will arrange for a copy initialled by the Financial Secretary to be returned to Counsel.

### Box A2.1A: examples of legislation matters which require explicit Treasury approval

- as a direct charge (a Consolidated Fund standing service), or
- indirectly, ie "out of monies to be provided by Parliament" (through Estimates):

- expenditure proposals affecting public expenditure as defined in the current public expenditure planning total, eg rates of grant

- contingent liabilities, including powers to issue indemnities or to give guarantees

- loans taken from the National Loans Fund (NLF)- provisions for writing off NLF debt

- use of public dividend capital (PDC)- provisions involving the assets and liabilities of the CF and NLF- borrowing powers

- fees and charges, including changes in coverage

- the form of government accounts and associated audit requirements

- public service manpower

- pay and conditions (eg superannuation and early severance terms) of civil servants pay and conditions of board members of statutory organisations

- creation of (or alteration to) new statutory bodies and related financial arrangements

- provisions affecting grant recipients, including grants in aid

- provisions on audit usually giving the C&AG right of access

## Ways and Means resolutions

A2.1.7 A ways and means resolution is required in the House of Commons where legislation directs the payment of money raised from the public to the Consolidated Fund (this technically constitutes the raising of money for the Crown to spend). Some legislation may require both a money resolution and a ways and means resolution.

A2.1.8 Departments should clear ways and means resolutions with the Treasury. Further advice should be sought from parliamentary clerks.

## Explanatory Notes

A2.1.9 Except for finance, consolidation and tax law rewrite bills, departments should prepare explanatory notes for all government bills. The main items to be covered are set out in box  A2.1B. Guidance on preparation is on the Cabinet Office website[2].

[1] By virtue of Standing Order 49 of the House of Commons

[2] https://www.gov.uk/government/publications/guide-to-making-legislation

### Box A2.1B: Legislation authorising expenditure: explanatory notes

1. Financial effects of the legislation:

- Estimates of expenditure expected to fall on

  - the Consolidated Fund (CF), distinguishing between Consolidated Fund standing services and

  - charges to be met from Supply Estimates; or the National Loans Fund (NLF)

- Estimates of any other financial consequences for total public expenditure (i.e. in addition to costs which would fall on the CF or NLF) as defined in the current public-expenditure planning total;
- Estimates of any effects on local government expenditure

2. Effects of the legislation on public service manpower:

- Forecasts of any changes (or postponement of changes) to staff numbers in government departments expected to result from the legislation;
- Forecasts of the likely effects to other public service manpower levels, for example in non-departmental public bodies and local authorities.

# Annex 2.2

# Delegated authorities

> **This annex expands on the requirement for departments to obtain Treasury consent to their public expenditure and the process of delegated authorities.**

A2.2.1 Treasury approval for expenditure is one aspect of the convention that Parliament expects the Treasury to control all other departments in matters of finance and public expenditure. Accounting officers are responsible (see first bullet of paragraph 3.3.3) for ensuring that prior Treasury approval is obtained in all cases where it is needed.

A2.2.2 The need for Treasury approval embraces all the ways in which departments might make public commitments to expenditure, not just Estimates or legislation, important as they are. Box A2.2A identifies the main ways in which the need can arise. It may not be exhaustive.

A2.2.3 Treasury approval:

- must be confirmed in writing, even where initially given orally;
- cannot be implied in the absence of a reply;
- must be sought in good time to allow reasonable consideration before decisions are required.

A2.2.4 Departmental ministers should be made aware when Treasury consent is required in addition to their own.

### Box A2.2A: where Treasury approval is required

- public statements or other commitments to use of public resources beyond the agreed budget plans
- guarantees, indemnities or letters of comfort creating contingent liabilities
- any proposals outside the department's delegated limits
- all expenditure which is novel, contentious or repercussive, irrespective of size, even if it appears to offer value for money taken in isolation
- where legislation requires it
- fees and charges

Where Treasury approval has been overlooked, the case should immediately be brought to the Treasury's attention.

## Delegation

A2.2.5 Formally, Treasury consent is required for all expenditure or resource commitments. In practice, the Treasury delegates to departments' authority to enter into commitments and to spend within predefined limits without specific prior approval from the Treasury (but see A.2.2.12 for exceptions). Delegated authorities may also allow departments to enter into commitments to spend (eg contingent liabilities) and to deal with special transactions (such as some write-offs) without prior approval.

A2.2.6 Such delegated authorities strike a balance between the Treasury's need for control in order to fulfil its responsibilities to Parliament and the department's freedom to manage within its agreed budget limits and Parliamentary provision.

A2.2.7 Departments should not take general Treasury approval of an Estimate as approval for specific proposals outside delegated limits even if provision for them is included in the Estimate.

A2.2.8 The Treasury may also work through the Cabinet Office to set certain expenditure controls applicable across central government[1].

## Setting delegated authorities

A2.2.9 While the standard terms for inclusion in delegated authorities are set out in box A2.2B, HMT has produced a single template delegation letter which must be used to set delegated limits for central government departments and ALBs. Departments should appreciate that delegated authorities for certain kinds of expenditure can be modified or removed entirely if the Treasury is not satisfied that the department is using them responsibly.

A2.2.10 In establishing delegated authorities, the Treasury will:

- agree with the department how it will take spending decisions (e.g. criteria and/or techniques for investment appraisal, project management and later evaluation);
- establish a mechanism for checking the quality of the department's decision-taking (e.g. by reviewing cases above a specified limit, or giving full delegation but requiring a schedule of completed cases of which a sample may be examined subsequently); and
- encourage delegation of authority within the department to promote effective financial management. In general, authority should be delegated to the point where decisions can be taken most efficiently. It is for the accounting officer to determine how authority should be delegated to individual managers.

### Box A2.2B: standard terms for delegated authorities

- a clear description of each item delegated

[1] https://www.gov.uk/government/collections/cabinet-office-controls

- the extent of each delegation, usually in financial terms, but potentially also in qualitative terms, eg all items of a certain kind to require approval
- any relevant authorities, eg the enabling legislation or letter from a Treasury minister
- the relevant budget provision
- the relevant section of the department's Estimate
- any effective dates
- arrangements for review. HMT requires that delegated authority limits be reviewed annually.

A2.2.11 In turn departments should agree delegated authorities with their arm's length bodies, making use of the template delegated authority letter. Delegations to ALBs should be no greater than departments' own delegated authorities. Departments must seek HMT approval for the delegated authorities they agree with their ALBs.

A2.2.12 There are some areas of expenditure and resource commitments which the Treasury cannot delegate: see box A.2.2C.

Box A2.2C: where authority is never delegated

- items which are novel, contentious or repercussive, even if within delegated limits
- items which could exceed the agreed budget and Estimate limits
- contractual commitments to significant spending in future years for which plans have not been set
- items requiring primary legislation (eg to write off NLF debt or PDC)
- any item which could set a potentially expensive precedent
- where Treasury consent is a specific requirement of legislation

A2.2.13 Strictly, the Treasury cannot delegate its power of approval where there is a statutory requirement for Treasury approval. But in practice it can be acceptable to set detailed and objective criteria where Treasury approval can be deemed without specific examination of each case. This may be appropriate to avoid a great deal of detailed case-by-case assessment. The Treasury may ask for intermittent sampling to check that this arrangement is operating satisfactorily.

## Failure to obtain Treasury authority

A2.2.14 All expenditure which falls outside a department's delegated authority and has not been approved by the Treasury, is irregular. It cannot be charged to departmental Estimates. Similarly, any resources committed or expenditure incurred in breach of a condition attached to Treasury approval is irregular.

A2.2.15 Where resource consumption or expenditure is irregular, the Treasury may be prepared to give retrospective approval if it is satisfied that:

- it would have granted approval had it been approached properly in the first place; and
- the department is taking steps to ensure that there is no recurrence.

Requests for retrospective approval should follow the same format as requests submitted on time.

A2.2.16 If the Treasury does not give retrospective approval or authorise write-off of irregular expenditure, the department must inform the NAO. The Treasury may also draw the matter to the attention of the responsible accounting officer. The C&AG may then qualify his or her opinion on the account and the PAC may decide to hold an oral hearing. In the case of voted expenditure, the Treasury will present an excess vote to Parliament to regularise the situation.

A2.2.17 It is unlawful to commit resources or incur expenditure without Treasury consent, where such consent is required by statute. In such cases retrospective consent cannot confer legality. Such consumption cannot, therefore, be regularised.

A2.2.18 In cases of unlawful expenditure, the responsible accounting officer must note the department's accounts accordingly and notify the NAO. It will then be for the C&AG to decide whether to report on the matter to Parliament with the relevant accounts and whether to draw it to the attention of the PAC.

A2.2.19 The C&AG and the Treasury cooperate closely on questions of authority for expenditure. The C&AG may bring a department's attention to any cases where the department:

- has ignored or wrongly interpreted a Treasury ruling;
- is attempting to rely on a mistaken delegated authority, eg where the delegation has been changed or where consent was given orally only;
- has committed resources or incurred expenditure which the Treasury might not have approved had it been consulted.

A2.2.20 Departments should bring such cases to the attention of the Treasury, indicating clearly the NAO interest. The Treasury and NAO keep each other in touch with such cases.

# Annex 2.3

# PAC Concordat of 1932

A2.3.1 The PAC has had long standing concerns about how the government gains authority from Parliament for each area of spending.

A2.3.2 In the mid 19th century it became customary for governments to gain Parliamentary authority for some areas of expenditure simply by use of the Contingencies Fund, without troubling to obtain specific powers for them. Shortly after its formation in 1862, the PAC protested about this practice, partly because it involved less stringent audit. It urged that the Contingencies Fund should be used only for in-year funding of pressing needs, and that all continuing and other substantive spending should be submitted to the Estimates process with due itemisation.

A2.3.3 By 1885 the PAC had become concerned that the authority of the Estimate and its successor Appropriation Act was not really sufficient either:

> "… cannot accept the view in a legal, still less in a financial, sense that the distinct terms of an Act of Parliament may be properly overridden by a Supplementary Estimate supported by the Appropriation Act … this matter … is one of great importance from a constitutional point of view ..."

A2.3.4 While the Treasury agreed in principle, the practice did not die out because in 1908 the PAC again complained:

> "… while it is undoubtedly within the discretion of Parliament to override the provisions of an existing statute by a vote in Supply confirmed by the Appropriation Act, it is desirable in the interests of financial regularity and constitutional consistency that such a procedure should be resorted to as rarely as possible, and only to meet a temporary emergency".

A2.3.5 The PAC reverted to the issue in 1930 and again in 1932, citing a number of cases involving various departments. It was concerned to specify how far an annual Appropriation Act could be regarded as sufficient authority for the exercise of functions by a government department in cases where no other specific statutory authority exists. It took the view that:

> "… where it is desired that continuing functions should be exercised by a government department, particularly where such functions may involve financial liabilities extending beyond a given financial year, it is proper, subject to certain recognised exceptions, that the powers and duties to be exercised should be defined by specific statute".

A2.3.6 In reply, the Treasury Minute said:

"… while it is competent to Parliament, by means of an annual vote embodied in the Appropriation Acts, in effect to extend powers specifically limited by statute, constitutional propriety requires that such extensions should be regularised at the earliest possible date by amending legislation, unless they are of a purely emergency or non-continuing character".

"… while … the Executive Government must continue to be allowed a certain measure of discretion in asking Parliament to exercise a power which undoubtedly belongs to it, they agree that practice should normally accord with the view expressed by the Committee that, where it is desired that continuing functions should be exercised by a government department (particularly where such functions involve financial liabilities extending beyond a given year) it is proper that the powers and duties to be exercised should be defined by specific statute. The Treasury will, for their part, continue to aim at the observance of this principle".

A2.3.7 With this Concordat, the matter still lies.

A2.3.8 Use of the Supply and Appropriation Acts as authority for expenditure is discussed in annex 2.4.

# Annex 2.4

# New services

A2.4.1 Chapter 2 (box 2.1) sets out the essential conditions for authorisation of public spending. New services are exceptions, ie services for which parliament would normally expect to provide authorising legislation but has not yet done so. They can include altering the way in which an existing service is delivered as well as services not previously delivered.

## When the Supply and Appropriation Act suffices

A2.4.2 Notwithstanding the general rules ion box 2.1, in some circumstances it is not necessary to have specific enabling legislation in place. Parliament accepts that agreement to the Estimate[1] is sufficient authority for the kinds of expenditure listed in boxes 2.5 or 2.6. The content of these boxes is reproduced in box A2.4A. They can all be considered part of business as usual.

**Box A2.4A: Expenditure parliament accepts may rest on a Supply and Appropriations Act**

- routine administration costs: employment costs, rent, cleaning etc;
- lease agreements, eg for photocopiers;
- expenditure using prerogative powers, notably defence of the realm and international treaty obligations;
- temporary services or continuing services of low cost, provided that there is no specific legislation covering these matters before parliament and existing statutory restrictions are respected, specifically
    - initiatives lasting no more than two years, eg a pilot study or one off intervention; or
    - expenditure of no more than £1.75m a year (amount adjusted from time to time).

A2.4.3 It is important not to exceed these limits. The Treasury has agreed in the Concordat (see annex 2.3) to seek to make sure they are respected. So departments should consult the Treasury before relying upon them.

## Anticipating a bill

A2.4.4 In addition, parliament is prepared to accept that departments may undertake certain preparatory work while a bill is under consideration and before royal assent. Examples are listed in box A2.4B.

[1] Which becomes a Supply and Appropriation Act once it has been through its parliamentary stages