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H M TREASURY

GUIDE TO EXPENDITURE WORK IN THE TREASURY

FRANCHISING AND PRIVATE FINANCE PROPOSALS

Note by the Secretary

Amendments to the Guide will be issued from time to time as policy and practice in the areas covered by the Guide change. The first agreed amendments reflecting the Treasury's attitude towards franchising and private finance proposals are attached.

Please remove and destroy existing Sections 7, 11, 15 and 31 and substitute the attached revisions.

J W HARVEY

EXPENDITURE, PUBLIC EXPENDITURE, OTHER EXPENDITURE, VOTED EXPENDITURE: WHAT ARE THEY?

The descriptive labels and definitions of expenditure numbers are bewilderingly complicated at first sight. This Section tells you how and where to find all the precision and detail that you need about what expenditure is.

2. If you have come back to expenditure work, or have moved to a new area of it, it reminds you to bring yourself up-to-date and to learn any aspects that are special to the new job.

Public expenditure is defined in the White Paper

3. 'Public expenditure' is spending covered by the annual public expenditure Survey (PES) and the public expenditure White Paper (PEWP). In broad terms, it is what the public sector as a whole (central government, local authorities and public corporations) spends in the world outside the public sector. In detail it is much more complicated.

4. A narrative definition is brought up-to-date each year in explanatory and technical notes of PEWP, usually its Part 6.

5. The definition of expenditure used in the PEWP (known as the 'planning total') is closely related to the system of national accounts run by the Central Statistical Office. This means that it is relatively easy to relate the PEWP numbers to statistics about the economy as a whole. Work is in hand to make it even easier, following an internal Treasury study in 1984-85 - the Review of Public Expenditure Classifications (REPEC).

The FIS Procedures Manual for classification codes

6. The detailed classification codes used to identify each unit of expenditure by the department spending the money (spending authority) the object of the spending (functional programme) and type of purchase (economic/national accounts category) is in the Treasury's Financial Information System Procedures Manual, Part A.

Other expenditure

7. 'Other' expenditure is government expenditure not directly featuring in PES and PEWP though it often helps to finance expenditure that is dealt with in them. For example, rate support grant (RSG) paid to local authorities is an example of 'other' expenditure. This is because it is a financing transaction between central and local government. What public expenditure includes is what the local authorities spend, partly financed by such grants. Note, however, that government finance to nationalised industries and many other public corporations does score as public expenditure, because of the different nature of the control process.

8. Other expenditure is often referred to as 'non-Survey' or 'non-public' expenditure. This provides such simple contrasts as 'public' and 'non-public'; though it can seem odd to refer to 'voted, non-public expenditure' (of which RSG is an example).

Voted expenditure and the Summary and Guide (S and G)

9. Voted expenditure is financed by money authorised by Parliament for departments. Supply Estimates are presented to Parliament each year to get this authority. You will realise straightaway that voted expenditure in Supply Estimates includes both 'public expenditure' (but not all of it) and 'other' expenditure. RSG is paid from voted money.

10. Voted spending is also classified by functional programme and economic or national accounts category as well as by vote and subhead (which implies a classification by department). The extra codes needed for monitoring actual spending for votes in the APEX system (see Sections 8 and 25) are also included in the FIS Procedures Manual Part A.

11. A summary list of all votes, and key particulars of each, is included in the annual Summary and Guide to Supply Estimates (S and G, formerly called the Chief Secretary's Memorandum) published with the Estimates booklets on Budget day.

Comparing the coverage of PES and Estimates

12. A simplified diagram of how the coverage of public expenditure compares with the coverage of votes is included in the first section 'Supply Estimates and public expenditure' of the Summary and Guide.

The computer as a dictionary

13. The computerised data bases described in Section 8 store all the definitions of all existing types of spending : so if you want to check how a particular item is defined/classified, ask the computer.

People to help you

14. You should be able to learn a lot from your immediate colleagues in your division - depending on how long they have been in post.

15. In case of doubt, or to check a point beyond their knowledge, ask GEP3. There will be a member of its Data Unit working on what is now spent in your area of spending. GEP3, Branch B helps with classification points.

16. On **new proposals, always check in good time what the classifications should be with Branch B of GEP3.** They, with colleagues in the Central Statistical Office, are responsible for the integrity of classification systems and you must heed their guidance.

17. Remember that one of the oldest tricks that departments try is to get some proposal classified as outside the definition of public expenditure and hence outside the controls of the Survey. There are two different sorts of things to watch out for . First , it may not be right to net proposed "charges" (see section 23) off in PES; they may have to be scored as revenue on the other side of the public sector accounts.

18. Secondly , sometimes departments come up with unusual ways of financing a project which may appear to take it outside the definitions of public expenditure. For example , obtaining some equipment on a hire purchase or leasing agreement helps spread the payments; but the equipment still has to be bought on day one and , as far as the economy is concerned, the public sector may as well have bought it outright. Other proposals involve the private sector investing in projects with some form of government guarantee or indemnity; again , this is little different from the public sector doing the investing. Sometimes proposals simply involve the swapping of assets with the private sector (financial or physical assets) which has no real effect on the economy; but it reduces recorded public expenditure , giving the department room for spending somewhere else. These schemes are often thought up just because they avoid public expenditure controls ; and they are often more expensive than the more straight forward or conventional route. There are therefore rules against them or at least about their careful handling. (The rules are summarised in an internal guidance note circulated by GEP2 on 18 October 1985; a longer paper was sent to departments by the 2PS in May 1985. These papers and the related "Ryrie Rules" are available from GEP2).

19. If you are suspicious of a scheme proposed by a department , get advice from GEP2 or PSE (or PE2 if a nationalised industry is involved) , and from GEP3 on the classification. Ask TOA if there is a potential problem of propriety..

eferences

1. The written sources described are all in your division. If you need extra copies ask the Library for the White Paper and the Summary and Guide; and Committee Section for the FIS Manual.

THE PUBLIC EXPENDITURE SURVEY: WHO TAKES PART IN THE TREASURY AND THE MAIN STAGES

In the Treasury the public expenditure Survey (PES) starts around Budget time. It starts earlier in spending departments. The key decisions are announced in the Government's Autumn Statement (late in October or early in November) and work on the public expenditure White Paper takes over. This Section outlines how the Survey is conducted in the Treasury. Each stage is clearly defined and directed.

Who takes part

2. Your **Second Permanent Secretary (2PS)** directs operations within the framework of objectives set by Ministers.

3. All members of the public expenditure sector are involved (see Section 3 on Organisation). **Each expenditure division** deals with its own departments.

4. The **General Expenditure Policy (GEP)** Group steers and co-ordinates to ensure that the specific groups and divisions act as parts of a whole - urging one to be tougher, and, much less often, another to be less draconian - assembles the annual Survey Report and prepares the overall submissions to Ministers and papers for Cabinet.

5. **GEP3** monitor the data base of cash figures. **SCS** division provides computing services to both GEP and specific expenditure divisions.

6. While the main Survey is proceeding, **PE Group** are managing the annual **Investment and Financing Review (IFR)** of the **nationalised industries** and **LG Group** is managing the survey in respect of the Government's plans for **current spending by local authorities** (their capital spending is handled in the main Survey). These feed into the main Survey. Their special features are noted in Sections 14 and 15.

Survey guidelines

7. Each Survey starts by the Treasury issuing guidelines for its conduct and for preparing the Survey Report. **GEP** initiates them. They are discussed in draft with specific expenditure divisions and (informally) with the Principal Finance Officers of some departments and submitted to the Chief Secretary for approval. He seeks concurrence from Cabinet colleagues. Finally, usually in April, they are issued as working instructions to all departments as PESC and PESC(WM) papers (see Acronyms).

8. Typical sideheadings are:

- Aims and objectives of the Survey Report
- Timetable (detailed in an Annex)
- Additional bids and offsetting savings
- Options for spending reductions
- Value for money.

Special features are highlighted, such as the introduction of separate targets for the running costs of each department (see Section 21).

9. If the Survey is current, study a copy. If you start your new job in the Winter, find time to read the Guidelines for the latest Survey as part of your self-training for the next one.

Constructing the baseline

10. The baseline is the set of detailed figures that the Survey will confirm or change. This makes it important that the figures should be unambiguous and a genuine baseline for all changes. Later in the Survey, the Ministerial negotiations are always about changes - up or down - from the baseline.

11. Baseline figures for the first two years stay close to the cash plans in the previous public expenditure White Paper - the end-product of the previous Survey. The rules for such differences as are permitted are in the Guidelines.

12. Initial figures for the new final year are generated by the Treasury computer as a percentage change from the White Paper's final year applied to all (or nearly all) programmes.

13. Your spending department may ask if it may re-arrange some of its planned spending between items. The rules are annexed to the Guidelines.

Compiling the survey report

14. Detailed in-house guidance on handling this stage - about the Treasury's objectives, the style of the report, even arrangements for typing - is discussed with divisions before being finalised. Sometimes the 2PS adds a note to the Grade 3s in charge of expenditure groups stressing key Treasury objectives. One Treasury aim at this stage is to garner material that can be deployed later to put the Chief Secretary in the best negotiating position in his bilaterals with each spending colleague.

15. The Survey report assembles the background factual material about:

- The baseline

- Spending departments' additional bids

- Reduced requirements

- Offsetting savings offered

- Value for money

- And special analyses.

Each expenditure division vets the draft chapter(s) provided by its spending department(s). The aim is to probe the strength of their bids; encourage more or bigger savings; propose additional cuts in plans (you can require the spending department to cost what your ideas would save on its programme); and end up with a clear text that meets instructions. In practice it is not usually possible to alter departments' figures much at this stage: the point is to test them and begin to set up the Treasury's negotiating position.

16. Material on policy options for reductions is kept separate from the more available Survey report. Some of it may be politically sensitive.

Cabinet's decisions on strategy and target totals

17. By late June the Survey report is circulated as background material to Ministers and the Treasury has the lists of possible options for reductions in plans. GEP then takes the lead in putting together the Treasury assessment of the 'Survey pressures' - the strength of the bids for more and the prospects for cuts elsewhere. This judgment is balanced against the Chancellor's strategy for taxation and the latest macro-economic forecasts, to establish the Treasury line. The Chief Secretary then puts a paper to Cabinet proposing what the 'planning total' for public expenditure should be for each year of the Survey.

18. GEP group continues to be the focal point for this paper. It is usually prepared at some speed, in consultation with the Central Unit and others in the Treasury.

Bidding letters to departments

19. Each bidding letter has a common element prepared by GEP group, which reminds Ministers of the overall position. This element is given to expenditure divisions with any necessary instructions. Expenditure divisions then complete the letters for the Chief Secretary to send, one to each spending Minister, setting out what the Treasury wants to discuss with him. They are issued by the end of July to provide the agendas for the Chief Secretary's bilaterals with spending Ministers which usually start early in September.

Briefing for bilateral negotiations

20. In this phase, the task is to give the Chief Secretary the ammunition he needs. Good briefing for the Chief Secretary is vital for his bilateral negotiations. A standard format has been developed which all expenditure divisions are expected to use so that he knows where to look for what he wants.

21. All the knowledge in your division needs to be brought to bear: make sure that in the press of business you do not lose sight of useful ammunition (including debating points) that your colleagues may have gleaned.

22. Another lesson of experience is the need to have agreed in advance with the spending department just what numbers will be in front of both Ministers to lessen the chance of their getting at cross-purposes and losing precious time and energy. Your spending department will not necessarily be trying to make your task easy and you may have to make an effort to get them to agree common ground in advance.

23. A good way of doing this is to meet with your opposite numbers before the Ministerial bilateral to make sure that what should be common ground is so. Try to clear away minor differences and sound out negotiating positions.

24. Beware the last minute new proposal; or hitches in the normal flow of information. Beware also of "savings" that are really statistical or financial devices aimed at getting around public expenditure controls (see Section 7).

25. On the substance of the briefing, the better you and your division know your spending department and its doings, the more cogent the arguments and the more telling the examples for the briefs.

Bilaterals

26. The Chief Secretary is normally supported by your 2PS or his deputy, the appropriate head of specific expenditure group (or the head of division), a representative of GEP and a minute-writer (probably a Principal) from the expenditure division. The visiting Minister has his team. An agreed record is prepared.

27. The Treasury tries very hard to settle all matters in these bilaterals but sometimes there has to be recourse to a wider group of Ministers.

Final decisions

28. The form of the final stage varies. An ad hoc group of Ministers may be set up. In recent years such groups have been nicknamed the Star Chamber, recalling the court revived by Henry VII after the Wars of the Roses to curb the powers of the barons. Its conclusions are reported to Cabinet, with any disputes still outstanding.

The Autumn Statement

29. Once the final decisions have been taken or endorsed by Cabinet, there is a rush and press of activity to finalise the brief announcements in the Autumn Statement and prepare all the detailed briefing nevertheless needed in connection with it. GEP takes the lead and specifies what is needed from expenditure divisions.

30. Meanwhile, instructions for compiling the public expenditure White Paper are in hand and departments and expenditure divisions are busy on text and numbers - see Section 13.

References

1. Copies of all the documents referred to in this Section are in your division.

NATIONALISED INDUSTRIES, THE INVESTMENT AND FINANCING REVIEW (IFR), EFLs AND IN-YEAR MONITORING

The nationalised industries, as part of the public sector, are covered by the public expenditure Survey and in-year monitoring but because of their nature are treated separately. This Section outlines the Public Enterprises (PE) Group's work on the annual investment and financing review (IFR) of the industries, on monitoring the resulting external financing limits (EFLs) which are a form of cash limit; and on changing EFLs, if it becomes necessary. It complements Sections 10- 13 on the public expenditure Survey, Section 25 on Monitoring and Section 29 on operating cash limits. It is derived from much fuller guidance prepared by PE Group for its staff. Members of PE Group should put a copy of that into this Guide in place of this Section.

PE Group works with sponsor departments

2. Each nationalised industry has a sponsor department: for example, the Department of Transport for British Rail and the Department of Energy for the National Coal Board. The relevant Secretary of State is responsible to Parliament for his industries. PE Group work through these sponsor departments. They have relatively little direct access to the industries.

The investment and financing review (IFR), EFRs and EFLs

3. The purpose and conduct of the annual investment and financing review (IFR) closely resembles that of the Survey. Much of the guidance in Sections 10-13 applies.

4. Nationalised industries' external finance rather than their total expenditure counts towards the public expenditure planning total (PEPT). An industry's external finance requirement (EFR) is the finance it needs from outside the business: in broad terms it is the difference between capital requirements and net funds generated by the business. This external finance includes government finance to the industries (subsidies, grants and loans), any borrowing from UK capital markets and overseas, and the capital value of assets they lease.

5. For an individual industry, access to external finance is controlled by an annual external financing limit (EFL). EFLs serve the same purpose as cash limits in public expenditure control. EFLs are determined in the annual IFR.

6. Sometimes industries or departments propose novel financial arrangements, aimed at taking a project outside the definitions of the planning total, thereby avoiding EFL control. In many cases, these arrangements are often more expensive than the conventional financing route, but the statistical change has no real economic effect (see section 7). There are therefore rules against them, or at least about their careful handling. If you are suspicious of a proposal , consult PE2.

Who takes part

7. All members of the PE Group are involved in the IFR. Each branch deals with its own industries through the sponsor departments. PE2 steers and co-ordinates. GEP group are consulted throughout to keep the IFR in step with the Survey and PE complete Position Reports (see Section 27).

Main stages of the IFR

8. The normal sequence of the IFR is:

1 - the head of PE Group writes to sponsor departments in January commissioning basic data and giving outline guidelines and timetable;

2 - by late April, sponsor departments return IFR tables, after preliminary scrutiny of the information provided by each industry. Each industry makes its own economic assumptions;

3 - in late April/early May, a more detailed letter commissions draft texts about each industry's bids for external financing for three years ahead;

4 - by-end May, PE receive draft texts from sponsor departments. Much of the material focuses on deviations proposed by the industries from the detailed breakdown of the external financing limits agreed at the end of the previous IFR (which provides the baselines for the first two years of the current IFR). The baseline for the third year is, like the main Survey baseline, computer-generated;

5 - by late-June, PE has vetted the draft texts. PE2 has prepared the introduction and tables and has assembled the IFR report as background material for Treasury Ministers and Ministers in charge of sponsor departments;

6 - in July, a Cabinet Committee discussion serves the same function as the July Cabinet on the Survey. A paper by the Chief Secretary, drafted by PE Group, is circulated to the relevant Ministers inviting them to endorse his recommendations on aggregate target figures to be achieved and, in financial terms, the main potential areas for savings (eg reducing current costs, improving profitability, increasing tariffs, reducing working capital, lower investment). There is liaison with GEP at all stages;

7 - following the meeting, the head of PE Group normally writes to sponsor departments seeking revised bids to reflect any changes in trading conditions and the thrust of Ministers' overall targets for nationalised industries finance over the IFR Survey period. PE staff discuss with their opposite numbers in sponsor departments how best to identify and achieve any necessary reductions, to prepare for the Chief Secretary's bilaterals with sponsor Ministers;

8 - PE prepares a bidding letter for the Chief Secretary to send to each sponsor Minister shortly before his bilateral meeting, setting out the Treasury's proposals for his industries' EFRs. For the bilateral meeting, a general brief by PE2 sets out the background and PE branches provide material specific to each industry, setting out the baseline; bid figures; explanations of bids and the Treasury's recommendations for specific savings to be sought as well as an overall acceptable outcome for each industry;

9 - sometimes there is recourse to a wider group of Ministers when agreement cannot be reached bilaterally;

10 - individual EFLs for the coming year are announced in the Autumn Statement. External finance figures for the following 2 years may be given but only in aggregate.

PE work for the White Paper

9. PE commissions material for the separate part of the public expenditure White Paper on the nationalised industries. This includes a detailed breakdown of EFLs agreed in the IFR. PE2 co-ordinates production, prepares tables and an introductory summary and, in conjunction with appropriate PE branches, edits the individual industry sections. They pass the finished material to GEP1 which handles printing and publication arrangements for the White Paper as a whole. PE2 also co-ordinates general and specific briefing on nationalised industries for the briefs GEP1 assembles for use at and after publication.

Treatment of privatised industries

10. An industry's EFR continues to be included in the public expenditure planning total until it is privatised. Stylised assumptions may need to be made in the IFR and the PEWP if it is expected that an industry will be privatised in the Survey period. This is decided case by case.

Corporate Plans

11. In addition to the IFR, there is a programme for comprehensive annual assessments, by Ministers, of each industry's plans and performance, including a corporate plan submitted annually and normally spanning 3-5 years. These plans summarise developments since the preceding plan and describe and quantify, as far as possible, expected business developments. An industry's plan should be consistent with strategic objectives agreed by the sponsor Ministers and the industry, as well as any collective Ministerial decisions.

12. The aim of these corporate planning procedures is to give the Government a measure of control over the industries as businesses, leaving the IFR as the means by which their public expenditure impact is regulated. PE Group's ambition is to complete corporate plan work each year in time to inform the IFR.

13. Guidelines on the objectives, content and timing of corporate plan and performance reviews were summarised in a letter from the Chancellor of the Exchequer to the Secretary of State for Trade and Industry and other colleagues on 19 December 1983.

In-year monitoring of nationalised industries

14. PE monitor nationalised industries' performance closely during the year.

The monthly funds flow statement

15. Most industries submit a monthly funds flow statement (MFFS) to the appropriate sponsor department within four weeks of its end. The sponsor department checks it and forwards copies to PE.

Nationalised industries financial information system

16. PE2 has a computerised system, the nationalised industries financial information system (NIFIS) to hold this information and all the data needed for the IFR and the PEWP. For in-year monitoring it contains profiles for each significant element of cash flow and types of external finance with which the actuals are compared.

Reviews by Ministers

17. Ministers collectively review industries' financial performance every three months on the basis of the information provided by the MFFS, focussing upon estimates of overall outturn for external finance, investment expenditure and borrowing.

18. Information in the MFFS is also used for PE Group's inputs to the Treasury's macro-economic and PSBR forecasting exercises.

In-year changes to EFLs

19. Each industry is expected to keep within its external financing limit (EFL). An undershoot, resulting eg from a better than expected trading performance, is welcome. An overshoot is a serious matter.

20. If it appears, perhaps through an MFFS return, that an industry may overshoot its EFL, the cause is immediately questioned through the sponsor department. The presumption is that the industry will take remedial action to keep within the EFL.

21. If adequate corrective action of a kind acceptable to the Government cannot be taken, Ministers may raise the EFL. The sponsor Minister normally writes to the Chief Secretary to make the case for an EFL increase. The PE branch concerned advises the Chief Secretary on the justification for an increase, clearing the draft submission with GEP2 as any addition to an EFL forms a claim on the Reserve (see Section 26), unless acceptable offsetting savings are offered elsewhere in the department's programme. An increase in the EFL has to be announced in a PQ by the departmental Secretary of State.

22. EFLs can also be reduced, if circumstances warrant. A formal reduction is most likely to be made when the sum in question is substantial and the change in need develops early in the financial year so that there would be a significant loss of control if the full EFL remained available.

The ring fence round nationalised industries in departmental programmes

23. Nationalised industry external finance is ring-fenced from spending on other departmental programmes. It would be wrong for a department to be able to spend more on its programmes simply because, for example, unexpectedly better trading conditions were resulting in an undershoot on the EFL of a nationalised industry that it sponsored.

EFLs and end-year flexibility

24. There is an end-year flexibility scheme for nationalised industries. Because an industry may experience difficulties in keeping its financing requirements within a particular figure by a particular day, it may be allowed to exceed its EFL at the year end through increasing short term borrowing by a sum within 1 per cent of forecast turnover plus fixed asset expenditure. This facility is intended to cater for short-term factors which would rapidly be self-correcting or which could be offset within a few months. It is available only in the last three months of the financial year.

25. The PE branch concerned must confirm in each case that it is appropriate to let the industry use the facility and, in particular, that the prospective overshoot could not reasonably have been foreseen earlier and remedial action taken.

26. The amount involved is agreed with the sponsor department. A corresponding reduction is made and announced in the EFL for the following year.

27. Further detail on the setting and operation of EFLs is given in a Written Answer from the Chancellor to Sir William Clark MP (Hansard, 4 August 1980).

WHAT THE TREASURY IS LOOKING FOR IN SPECIFIC EXPENDITURE PROPOSALS

The formal position is that only the Treasury can approve the spending of money authorised by Parliament. In practice, the Treasury delegates many spending decisions to departments, on the understanding that they will keep within agreed terms and conditions. This Section outlines three reasons why the Treasury sees proposals in advance and introduces other, more technical, Sections about specific decisions. They are also relevant to following Sections about aspects of financial management.

Is the proposal novel or contentious?

2. Expenditure which does not have Treasury authority is not properly chargeable to a department's appropriation account (that is the account of what it has spent, audited by the National Audit Office - Section 46). The phrase "novel or contentious" has been used for a long time as a catch-all for the kind of proposals which should be referred to the Treasury for this reason (see, for example, Government Accounting B78, B103 and M9). The spending department has to decide whether it has the delegated authority to go ahead. Usually it plays safe.

3. Occasionally a department may submit such a proposal in the hope of shifting the responsibility for going ahead on to the Treasury. Take care not to be taken for a ride.

Will the proposal put pressure on control totals, now or later?

4. The Treasury anyway has a wider perspective, across all government spending, than any one department can have. So it should be actively involved in specific decisions which may commit a significant amount of taxpayer's money, now or over a run of years, or which could set a potentially expensive precedent or cause repercussions in other departments. In all these ways the Treasury's room for manoeuvre in subsequent public expenditure Surveys would be reduced.

5. Beware too of proposals for expenditure on public sector-type activities which the departments claim are outside the definition of public expenditure. Departments often think up schemes , eg novel ways of financing , which are geared precisely at trying to avoid public expenditure controls (see Section 7). Such schemes may add to the cost of a project: there are therefore rules against them , or at least about their careful handling. If you are suspicious of a scheme proposed by a department , get advice n from GEP2 or PSE (or PE2 if a nationalised industry is involved), and GEP3 on the public expenditure classification.

What standard of planning and appraisal does the proposal show?

6. Oversight of your spending department's internal management and performance means that you need to see some cases (sometimes picked at random) to test how well it is planning, appraising and evaluating its proposals. This will be specially true when objectives are fuzzy. (See Sections 4 and 5 on the Treasury's role in relation to spending departments and on Delegating authority to a department).

References

1. There is a copy of Government Accounting in your division. If you need an extra copy of the Sections revised in 1985, ask Committee Section.