WGA0004

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Introduction

1. I welcome the opportunity to submit this memorandum to the Committee in response to its call for evidence (Committee of Public Accounts, 2024) ahead of its annual meeting with the Treasury about the UK Whole of Government Accounts (WGA) scheduled for 15 May 2024. My memorandum has four sections after this Introduction:
   a) Praise for the Treasury's WGA team for publishing WGA 2021-22 on 26 March 2024, in accordance with the recovery plan timetable
   b) Suggestions for improving submission rates of entity accounts
   c) Criticism of the Treasury's decision in WGA 2021-22 to strip out the numerical reconciliations in Annex A between the WGA and national accounts income statement and balance sheet which were a feature of all 12 prior WGAs
   d) Suggestions as to other topics which the Committee might raise with the Treasury at the formal meeting on 15 May.

   The full usefulness of the UK's WGA will only be derived when attention can be turned away from WGA timeliness and missing data towards the incremental information content of the WGA (Bradley et al., 2023b).

Congratulations to Treasury WGA Team

2. The Treasury, particularly its WGA Team, should be congratulated on hitting the delivery target for WGA 2021-22, having surmounted obstacles beyond their control. Timeliness is a vital attribute of government financial reporting and the WGA consolidating over 10,000 entity accounts means that its timeliness is hostage to audit delays and non-submissions to OSCAR 2. Further progress is expected, with WGA 2022-23 scheduled for November 2024. This approach will incur continuing audit qualifications but I support this trade-off.

3. My view is that the Treasury made the correct decisions with regard to:

a) Accepting that further delays to WGA 2021-22, resulting from waiting for more delayed accounts to be audited and submitted, would have been unwise. It was better to accept the inevitable deterioration in WGA accounts' quality, remembering that timeliness itself is a vital component of quality

b) Explaining throughout the Performance Report the Treasury's best estimates of the scale of missing and/or unreliable data, something that will be a continuing feature of the next few WGAs because the local audit crisis in England will take years to fully purge (Bradley et al., 2023a; Department for Levelling Up, Housing and Communities, 2024).

Suggestions on how to increase OSCAR 2 submission rates

4. At the 8 June 2022 Committee hearing there was much discussion about the significant contribution of technical problems with OSCAR 2 to the delayed WGA 2019-20 (Committee of Public Accounts, 2022b). It is pleasing that these operational problems with OSCAR 2 seem to have been resolved.

5. From outside government, it is difficult to know the relative importance of factors that led to 178 entities not submitting data for WGA 2021-22. The local audit crisis in England is one continuing factor, with only 1% of audited accounts having been published by the administrative deadline of 30 September 2023, with a cumulative backlog of 918 (Public Sector Audit Appointments, 2023). The combination of damaged local authority financial reporting capacity and the dysfunctional local audit market in England have been large contributory factors. However, I believe that there

Number of missing entities

1.15 A summary of the number of entities which did not submit data for 2021-22 is as follows:

Sector	Number of bodies 2021-22	2020-21
UK central government	0	3
Scottish central government	14	17
Total central government	**14**	**20**
English local government	146	118
Scottish local government	10	9
Welsh local government	1	1
Total local government	**157**	**128**
Public corporations	**7**	**7**
Total	**178**	**155**

is a behavioural dimension to non-submission to OSCAR 2 that is important and could be addressed relatively quickly (see paragraphs 6-9 below).

6. The table above is imported from WGA 2021-22 (Treasury, 2024, page 19). It is striking that all UK, Welsh and Northern Ireland central government bodies submitted data for 2021-22 whereas 14 Scottish central government bodies did not. There were 146 missing submissions from English local authorities and similar bodies, 10 from Scotland and 1 from Wales, with none missing from Northern Ireland. The vital point here is that the local audit crisis only affects England, so there must be other factors at work.

7. To illustrate this point, I have checked the date on the audit certificate of those Scottish local authority bodies listed as 2021-22 non-submitters in the web Annex 2 on the [gov.uk page for WGA 2021-22](). All 10 have 2021-22 audit certificates dated not later than 21 April 2023. OSCAR 2 was not closed for 2021-22 submissions until 21 August 2023, so all these bodies could have submitted audited data. Under the *Government Resources and Accounts Act 2000*, the Treasury may designate a body for inclusion in the WGA, unless its activities relate entirely to Scotland. The Scottish Government makes separate administrative arrangements for bodies in Scotland to provide data in line with Treasury requirements, but these have not been fully effective for WGA 2021-22.

8. In my memorandum to the Committee on WGA 2020-21 (Heald, 2023b), I suggested that some of the non-submissions might arise from the Treasury's increase of the threshold for auditor assurance of WGA submissions from £500 million to £2 billion. It is in the public domain that only 10 councils were above that threshold but the number above the earlier threshold is not in the public domain. The Committee raised this matter with the Treasury and was told that the matter would be kept under review (Committee of Public Accounts 2023, Question 5). My assumption is that the intention of the change was to lessen the burden on auditors at a time when local audit in England faced systemic crisis. However, the termination of auditor involvement may have been taken as a signal that WGA submissions were now less of a priority at a time when local authority financial reporting capacity was under severe strain. Without knowledge of how many local authorities had previously required auditor assurance – only the Treasury and the National Audit Office (NAO) will know – it is impossible to assess the importance of this factor. It is possible that auditor expertise from multiple audit assignments had previously helped local authorities to make their WGA submissions. The Treasury could check whether there has been a deterioration in WGA submission rates from those authorities above the previous threshold but below the current threshold.

9. It is inevitable that missing local authority WGA submissions will continue to be a problem for WGA 2022-23 and probably for later years. Notwithstanding the systemic backlog of local audit opinions in England, it seems possible that, as shown for Scotland in paragraph 7 above, there are councils where the problem is non-submission to OSCAR 2 rather than not having audited accounts from which to extract the required data.

Dropping of WGA to national accounts reconciliations from Annex A of WGA 2021-22

10. The Treasury has dropped from Annex A the balance sheet and income statement reconciliations between Public Sector Net Debt (PSND) and WGA Net Liabilities and between Public Sector Current Budget Deficit and WGA Net Expenditure. All that is left in Annex A is a narrative exposition of differences between the national accounts and WGA, accompanied by some graphics showing that the numbers and trends are different. These reconciliations have been valuable features of all 12 WGAs before WGA 2021-22 and provided data for my research team's 2023 journal article on the under-realized potential usefulness of the WGA (Bradley et al., 2023b, Table 2 reproduced below).

11. The Treasury has been aware of our research since I gave a presentation on 8 March 2023 (Heald, 2023a) to its User and Preparer Advisory Group, of which I am a member. When there subsequently appeared in WGA 2020-21 (Treasury 2023) a massive residual item (£1,663 million, labelled "Other adjustments including eliminations") in the balance sheet reconciliation, I sought explanation from the Treasury and raised this in my memorandum on WGA 2020-21 to the Committee because this residual item had previously been small (see Table 2 from Bradley et al., 2023b, reproduced below).

12. If the Treasury had stated in WGA 2021-22 that the reconciliations had been dropped from Annex A because of operational difficulties in getting them right in the time available before scheduled publication, I would have supported temporary omission provided there was an explicit commitment to restore them as soon as possible. Annex A is outside the WGA audit conducted by the NAO but provides valuable information.

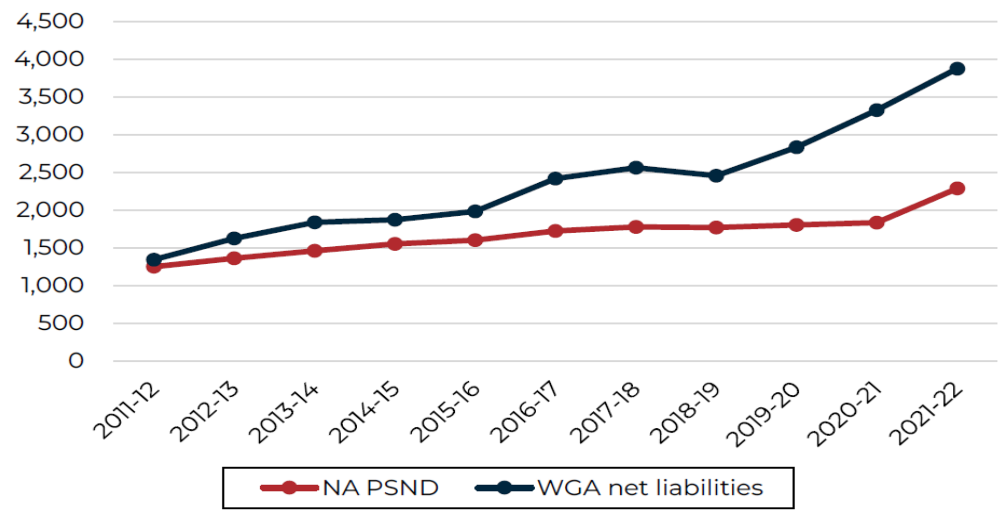
13. Regrettably, the Treasury seems to have decided that dropping the reconciliations is permanent. Given that the Treasury often says that it wants user engagement, it is odd messaging to respond to user questions about data that have existed for all 12 previous years of WGA by permanently dropping those data. If an important reconciliation does not work, the appropriate response would be to get it right in future, not to dispose of it.

Table 2: WGA Net Liabilities compared with Public Sector Net Debt, 2009-10 to 2020-21, £bn

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Public Sector Net Debt, £bn	**828**	**1,005**	**1,106**	**1,299**	**1,458**	**1,554**	**1,603**	**1,727**	**1,779**	**1,774**	**1,806**	**1,835**
Add liabilities not recognized in national accounts:												
Net public sector pensions liability	1,135	961	1,006	1,172	1,303	1,493	1,425	1,835	1,865	1,894	2,190	2,306
Provisions	102	108	113	131	155	175	306	322	422	311	375	366
PFI contracts	25	27	31	32	33	33	33	33	33	32	31	27
Adjust assets measured differently in national accounts:												
Asset Purchase Facility Fund				-44	-46	-49	-50	-127	-200	-194	-181	-1,557
Unamortized premia on gilts	13	15	23	31	29	35	38	51	54	56	62	62
UK Asset Resolution net impact on net debt	-59	-94	-83	-83	-74	-50	-30	-24	-10	-2	-1	5
Add assets and liabilities excluded from measure of PSND:												
Property, plant and equipment		-710	-745	-747	-812	-1,076	-1,120	-1,168	-1,208	-1,268	-1,313	-1,270
Investment property		-13	-13	-12	-14	-15	-16	-18	-20	-23	-24	-17
Intangible assets		-34	-35	-35	-32	-32	-33	-35	-36	-37	-40	-41
Tangible and intangible fixed assets	-769											
Trade and other receivables		-40	-35	-35	-37	-35	-37	-49	-42	-41	-45	-43
Prepayments and accrued income		-77	-81	-77	-80	-78	-87	-91	-103	-108	-88	-79
Inventories		-12	-11	-12	-12	-11	-10	-9	-10	-10	-11	-15
Investments	-11	-17	-17	-27	-23	-73	-50	-51	-52	-53	-33	-41
Trade and other payables		51	50	48	47	49	51	51	53	51	56	44
Accruals and deferred income		37	41	39	44	54	55	59	62	61	66	81
Deduct liabilities not yet recognised in WGA												
Network Rail				-34								
Housing associations				-	-56	-60	-67	-70		0	0	0
Other adjustments												
Other adjustments including eliminations	-27	-16		-15	-43	-39	-25	-15	-22	13	-16	1,663
Inadequate data to match classification structure												
Payables and receivables	-9											
Net taxation and duties due		-5	-3	-3								
WGA Net Liabilities, £bn	**1,228**	**1,186**	**1,347**	**1,628**	**1,840**	**1,875**	**1,986**	**2,421**	**2,565**	**2,456**	**2,834**	**3,326**

Source: Bradley et al. (2023b).

Chart 5.B: National Accounts (NA) PSND and WGA net liabilities (£ billion per financial year)



Source: HM Treasury and ONS data

14. On the basis of what I presently know, I believe that:
    a) the Treasury has lost expertise in the relationship between IFRS-based government financial reporting and national accounts
    b) the delays in WGA preparation, which have been largely outside the control of the Treasury, have diverted attention from Annex A
    c) substantive changes in the nature of public sector activity, including complex financial transactions substituting for direct production, have complicated both IFRS-based financial reporting and national accounts
    d) Quantitative Easing undertaken by the Bank of England through the operation of the Asset Purchase Facility Fund has brought complications, including that the WGA shows gilt purchases at fair value whereas the national accounts record gilt purchases at nominal value.
15. Those Treasury officials who conceived of the WGA as an important feature of the introduction of accruals accounting to central government understood that national accounts would always feature more prominently in public debate and debt market attention because of (a) speed of production, and (b) international comparability. A realistic long-term target for WGA publication might be within 12 months of the reporting date. The WGA's benefit in terms of fiscal transparency comes from its greater comprehensiveness than national accounts. The WGA shows more adverse trends in recent years than do national accounts, as is illustrated above in Chart 5.B from WGA 2021-22 (Treasury, 2024, Annex A, p. 279). The cumulative upwards divergence of WGA Net Liabilities from PSND since 2011-12 is striking, and worrying given that WGA Net Liabilities is both the broader and less manipulable measure.

16. Having two different measurement systems applied to the same economic phenomena gives insights into the strengths and weaknesses of both. That is why the Annex A reconciliations are invaluable for fiscal transparency. As shown in the balance sheet reconciliation above, WGA Net Liabilities include important liabilities not in PSND (Net Public Sector Pensions Liability, Provisions and Private Finance Initiative (PFI) contracts) and shows earlier arbitrage of standards (Network Rail and housing associations). Because fiscal targets focus on PSND, games are played around statistical definitions, with these being much easier to track in retrospect when there are Annex A reconciliations.

Redirecting attention away from WGA delays and missing data to substantive issues

17. Recent annual Committee oral evidence sessions with the Treasury have perhaps inevitably been dominated by the topics of delays and missing data. Now that the Treasury is in the process of gradually reducing delays and has established an approach to explaining the effects of missing data, I hope that more time will be available at these annual sessions to focus on the under-realized potential of the WGA. The WGA provides a more pessimistic take on UK fiscal sustainability, the Treasury graphic reproduced above being one illustration. Two of the most important issues are the effects of discount rates applied to Liabilities and Provisions (included in the WGA but generally excluded from the national accounts) and Contingent Liabilities (disclosed in the notes to the WGA). My concerns relate both to technical matters including the effects of discounting and to the temptations facing governments to circumvent their own fiscal rules and to arbitrage accounting standards.

18. WGA 2021-22 makes frequent reference to discount rates and changes in them. My understanding is that the Treasury's methodology for setting discount rates for liabilities and provisions in compliance with IFRS has not changed but that the numbers generated by the application of that methodology have changed because of market changes during a period of economic volatility without precedence in the WGA. Increases in WGA liabilities and provisions will arise because of new economic events or measurement changes. Moreover, IFRS-based measurement differs from national accounts measurement, for example in the case of public service pension liabilities where the ONS follows Eurostat's (2020, p. 40) prescribed discount rate of 2% plus the inflation target, which stays in place for multiple years. This is motivated by the search for international comparability and to avoid countries reducing their reported pension liabilities by using higher discount rates. This national-accounts practice contrasts with much lower IFRS-based discount rates, sometimes negative and regularly updated, used in the WGA. It

is very important to learn to what extent Chart 5.B above is affected by such different measurement practices.

19. Regarding Contingent Liabilities, Philip Hammond, Chancellor of the Exchequer (2016-19), who officially abandoned the PFI in 2018, stated: “I had already discovered, and my successor would have spotted the joys of contingent liabilities in public accounting. You can offer any number of guarantees but don’t use public money” (Davis, 2022, p. 107). There are examples of similar cynicism reported in Hood et al.’s (2023, p. 251) study of the Treasury’s public expenditure management from 1993 to 2015, including reference to the old Treasury joke that “there is no fiscal crisis that cannot be tackled by swingeing classification changes” (p. 251). In an era of diminished trust in government, widespread cynicism is damaging. Heald and Hodges (2018) noted that government guarantees can be a useful instrument of public policy but that their potential would be undermined if misused. More generally, the WGA provides users with the opportunity to watch the IFRS-based public sector balance sheet and has stimulated greater interest in national accounts’ measures of public sector net worth.

Conclusion

20. I believe that the WGA is a valuable innovation in UK public sector financial reporting, and that the Committee’s annual meeting with the Treasury provides a focal point and which helps to bring the WGA to the attention of a wider user group. I concur with the Committee’s statement that “The Whole of Government Accounts (WGA) is a unique document which provides the most complete and accurate picture available of UK public sector finances” (Committee of Public Accounts, 2022a). The way in which the financial troubles of Thames Water are being reported in the media solely in terms of how much an emergency nationalisation would add to PSND, said to be £15.6 billion, illustrates that the benefits of the WGA picture have not sufficiently permeated public discussion. So much focus on the PSND as fiscal target invites distortion and misunderstanding.

21. I recommend that the Committee asks the Treasury to investigate whether the phenomenon of entities with audited accounts in ample time not submitting to OSCAR 2 extends beyond Scottish local government. Without auditor engagement this may have slipped down the priorities of stressed-out finance departments.

22. I recommend that the Committee asks the Treasury to resolve the problems which have emerged in relation to the reconciliation tables in Annex A, and to resume publication as soon as possible. Having such reconciliations provides insights into how government financial reporting and

national accounts treat the same economic events on their own measurement systems. A succession of economic shocks has further weakened UK fiscal sustainability going into a period when fiscal decisions will be politically difficult and Parliament will be seeking fiscal transparency.

23. I recommend that the Committee asks the Treasury whether the faster growth of WGA Net Liabilities over that of PSND in recent years represents a build-up of additional public sector liabilities or whether it is driven mainly by different financial valuation practices, particularly discounting, between the WGA and the national accounts.

Glasgow, 1 May 2024

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