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FINAL FINDINGS

EDP dialogue visit to the United Kingdom

24-25 January 2013

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INTRODUCTION

In accordance with Council Regulation (EC) No 479/2009 of 25 May 2009 (as amended by Council Regulation (EC) No 679/2010) on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, Eurostat carried out an EDP dialogue visit to the United Kingdom on 24-25 January 2013.

The delegation of Eurostat was headed by Mr François Lequiller, Director of Government Finance Statistics (GFS). Eurostat was also represented by Mr John Verrinder, Mr Martynas Baciulis, Mrs Rasa Jurkoniene and Mr Graham Lock. Representatives of the Directorate General for Economic and Financial Affairs (DG ECFIN) and the European Central Bank (ECB) also participated in the meeting as observers.

The United Kingdom was represented by the Office for National Statistics (ONS), Her Majesty's Treasury (HM Treasury), the Bank of England and the Department for Communities and Local Government.

Eurostat carried out the EDP dialogue visit with the main aims of discussing (1) statistical adjustments made within the recently introduced OSCAR database for departmental expenditure and (2) steps which need to be taken to reduce the significant statistical discrepancy in UK data.

With regard to procedural arrangements, the *Main conclusions and action points* will be sent to the UK authorities for review. Then, within weeks, the *Provisional findings* will be sent to the UK authorities for review. After this, *Final Findings* will be sent to the UK authorities and the Economic and Financial Committee (EFC) and will be published on the website of Eurostat.

Eurostat appreciated the fact that the UK authorities contributed to the smooth organisation of the visit with their open and constructive approach during the meeting as well as with documents provided before and during the visit.

1. STATISTICAL CAPACITY

1.1. Institutional responsibilities

Introduction

Eurostat enquired about formal arrangements of cooperation between the UK authorities, roles of new ONS staff and audit arrangements.

Discussion

As a follow-up to action point 1 from the previous visit in January 2011, the ONS confirmed that its Service Level Agreement (SLA) with HM Treasury had not been reviewed since February 2009. As the two institutions are jointly responsible for the measurement of government deficit and debt (the ONS calculates historical data for past years and HM Treasury provides forecasts for future years), Eurostat underlined the need to update this SLA.

The ONS also confirmed that its SLA with the Bank of England was being reviewed. As part of ongoing quality management work, SLAs might be signed with other data suppliers such as the Department for Communities and Local Government (DCLG), Her Majesty's Revenue & Customs, the Debt Management Office and devolved administrations. Currently, the cooperation between the ONS and DCLG (which provides local government data for England) takes the form of quarterly meetings.

The ONS explained that SLAs are not legally binding but provide references to the existing legal framework.

The ONS informed Eurostat of its recent reorganisation, explaining the functions of Directorate of Collection and Production and the Office of Chief Economic Advisor, and the roles of new staff in the area of Public Sector Finances. An organisation chart and a basic flowchart of compilation of UK Public Sector Accounts were provided for information. Eurostat requested a detailed flowchart of EDP processes.

The UK authorities had confirmed in the past that accounts of all the bodies classified in the General Government sector were audited by various independent bodies. These audits take place immediately after the end of the financial year (March) and audited accounts for central government departments are normally published by the end of July. Local authorities, devolved administrations and other central government bodies generally publish their accounts later in the year with the accounts normally becoming available between July and February of the following year.

The UK authorities explained that external audits of central government entities are carried out by the National Audit Office (NAO) and regional audit offices (Audit Scotland, the Wales Audit Office and the Northern Ireland Audit Office). Until recently the Audit Commission carried out a similar role for local government, but it is being abolished. The ONS and NAO hold regular high-level meetings.

Eurostat welcomed this cooperation in the context of a recent resolution on the Supreme Audit Institutions and enquired about internal control, especially in smaller entities, as required by Directive 2011/85/EU on national fiscal frameworks.

Conclusions

Action 1. The ONS will take steps to update the Memorandum of Understanding between the ONS and HM Treasury by end-2013.

Action 2. A detailed flow chart of EDP processes used in the United Kingdom will be sent to Eurostat by end-June 2013.¹

Action 3. The UK authorities will provide by end-June 2013 a written confirmation of the arrangements for external audit of general government bodies, including who makes these audits and what will happen after the Audit Commission is closed. At the same time a

¹ The UK authorities have since provided initial information. The issue continues to be discussed.

*description of internal audit arrangements in UK general government bodies will be provided.*²

1.2. EDP inventory

Introduction

Discussions focused on the new EDP inventory format.

Discussion

The current UK EDP inventory was last updated in October 2011. The ONS confirmed that there had been no changes since.

The UK authorities are currently working on the new EDP inventory, having grouped the chapters as work packages and identified a leading author for each of them. The UK authorities confirmed the first draft of the new inventory would be delivered at the end of February 2013, in line with indicative planning.

Eurostat recalled that this would be followed by bilateral discussions with the UK authorities and the publication of the new inventory in December 2013. Eurostat also explained that the new EDP inventory format, notably annexes, allowed for timely updates and encouraged the UK authorities to make use of hyperlinks to existing information (for instance, the Public Sector Classification Guide).

Conclusions

Eurostat noted the ongoing work for the completion of the new EDP inventory and underlined the need to update the existing inventory for any major changes in the meantime.

1.3. Data sources

1.3.1. Online System for Central Accounting and Reporting (OSCAR)

Introduction

Eurostat and the UK authorities discussed the transition from the previous Combined On-line Information System (COINS) to OSCAR, statistical adjustments made to OSCAR and the role of the ONS.

Discussion

OSCAR is the HM Treasury database that collects financial information from central government departments and the devolved administrations for the purposes of parliamentary and statistical reporting and spending control. This database replaced COINS with effect from the financial year 2012/13.

² The UK authorities have since provided initial information. The issue continues to be discussed.

As a follow-up to previous action point 3, the ONS confirmed that OSCAR was the source for the data underlying EDP transmissions for central government spending and a small number of receipts and lending transactions (notably, revenue from other sources than Her Majesty's Revenue & Customs).

HM Treasury presented the two phases of the project. One of the main achievements in the first phase (until June 2012) was the introduction of the standard Chart of Accounts which in the future will be extended to the whole General Government sector. In the second phase (until April 2013), the focus will be on additional areas of functionality, such as links to Whole of Government Accounts and reports on Public Private Partnerships.

Eurostat enquired about initial system issues that might lead to revisions in the central government expenditure data. The UK authorities confirmed that no substantial revisions in annual and quarterly data were expected.

HM Treasury also explained four types of statistical adjustments to OSCAR, relating to: (1) conceptual adjustments where there was a difference in treatment between national accounts and HM Treasury budgeting (OSCAR) such as financial intermediation services indirectly measured (FISIM); (2) alternative data sources where the ONS used a data source other than OSCAR, for instance, on capital consumption; (3) corrections of mapping errors (misreporting by departments); and (4) profiling adjustments where monthly data profiles were not plausible.

With reference to documents provided before the visit (a list of monthly adjustments and a full data model for OSCAR, including the Chart of Accounts tab with the mapping to ESA95 categories), Eurostat enquired about the ONS role in making statistical adjustments. The UK authorities explained that, unlike in COINS, adjustments were made on the OSCAR system and so were directly visible to government departments and the ONS. The ONS has limited access to OSCAR and keeps an archive of monthly and quarterly extractions from OSCAR, which are used, respectively, for Public Sector Finances and for quarterly national accounts data, upon which the UK EDP notifications are largely based.

Eurostat noted that a number of adjustments were identical to those discussed as a follow-up to previous action point 1 (adjustments to COINS) in August 2011 and, in some cases, referred to the same outstanding issues. The UK authorities explained that resolution of outstanding issues was linked to ONS revision periods and priority is given to adjustments having potentially large impact.

Conclusions

Eurostat encouraged the UK authorities to describe the system of statistical adjustments to OSCAR in the EDP inventory and to provide clearer meta-data explaining individual adjustments.

1.3.2. Whole of Government Accounts (WGA)

Introduction

Eurostat and the UK authorities discussed the implementation of WGA and a related review of ONS data sources, notably on public corporations and local government.

Discussion

WGA are a consolidated set of financial statements for the UK public sector. They consolidate the audited accounts of over 1,500 organisations across the public sector (including central government departments, local authorities, devolved administrations, the health service, academies and public corporations). WGA are based on International Financial Reporting Standards (IFRS), the system of accounts used internationally by the private sector, as adapted or interpreted for the public sector context.

WGA are different from the national accounts and EDP due to definitional reasons (WGA include liabilities relating to unfunded pension schemes and to certain PPP projects that are statistically considered ‘off-balance sheet’, as well as provisions and contingent liabilities) and due to public sector coverage (including public corporations, except public banks). WGA do include, however, a broad reconciliation of statistical public sector debt and deficit measures with near equivalents within WGA.

As a follow-up to action point 2 from the previous EDP visit, the ONS had provided links to published WGA data. The first audited WGA, for the 2009/10 financial year, were published in November 2011. The next set of WGA (for 2010/11) was published in October 2012. The UK authorities acknowledged that, as a pioneering attempt, WGA attracted a range of qualifications by the Comptroller and Auditor General. The qualification relating to the valuation of schools’ assets was discussed under agenda point 4.1.4. Hospitals and educational institutions.

HM Treasury presented the context and practical challenges relating to the production of WGA. Data for WGA are largely sourced from OSCAR, for central government, and from local authority and public corporations’ accounting systems. At the moment, a standard Chart of Accounts only covers central government bodies.

A link with the statistical discrepancy between non-financial and financial accounts was also discussed. After sharing the experience of other EU Member States, Eurostat encouraged the ONS to compare direct (WGA) and indirect (Bank of England) data sources.

Eurostat noted the plans to use data from the large public corporations on the WGA system for the financial years 2008/09 to 2011/12 in the 2013 Blue Book (main UK annual national accounts publication). The data are supplied directly by the relevant corporations in the form required for the national accounts and so are considered of superior quality to trying to extract the data from published accounts.

Before the visit the ONS explained that the WGA figures for local authorities were on a group basis and so included many subsidiary companies (such as Manchester Airport and London Underground) which ONS classified as public corporations. Therefore, for national accounts purposes, the existing data sources for local authorities are still considered to provide more appropriate coverage than the WGA data. Eurostat encouraged the ONS to check whether differences between WGA and current data sources for local government could be fully explained by consolidation of subsidiaries.

Conclusions

Action 4. *The ONS will undertake a project to compare direct Whole of Government Accounts and indirect Bank of England (counterparty) data for certain financial instruments in general government by end-2014, providing the results to Eurostat.*

1.3.3. Devolved administrations and local government

Introduction

Discussions focused on reporting requirements relating to central government part of the devolved administrations and on local government data, including the data supplied by the devolved administrations and quarterly data. Potential bond issues by UK local authorities and new Scottish borrowing powers were also discussed.

Discussion

In the UK devolution refers to the statutory granting of powers from the UK Parliament to the Scottish Parliament, the National Assembly for Wales and the Northern Ireland Assembly, and to their associated executive bodies: the Scottish Government, the Welsh Government and the Northern Ireland Executive.

The UK authorities confirmed that data for the devolved administrations' spending included in the Central Government sector were collected via OSCAR. Eurostat enquired whether the reporting requirements relating to the devolved administrations were the same as those applicable to government departments in terms of timeliness and detail. The UK authorities confirmed this to be the case.

In preparation for the visit, the ONS provided the timescale for receipt of annual local authority data from the devolved administrations. The ONS explained that data were generally available only for financial years. The only quarterly data received are supplied by the Scottish Government and covers capital expenditure. Generally, estimates are made for the quarterly path for the devolved administrations based on the path recorded for England, for which data are collected by the Department for Communities and Local Government.

A new Quarterly Revenue Outturn form, providing quarterly data on local authority current expenditure for England, was introduced in April 2011. According to the ONS, the data collected so far have shown a virtually flat path during the financial year. This path was adopted for the UK figures, effectively assuming, due to the lack of available data, that the Scottish, Welsh and Northern Irish quarterly paths would follow the same pattern.

The UK authorities confirmed they would discuss with devolved administrations the possibility of introducing similar Quarterly Revenue Outturn forms for Scotland and Wales, and would also look to cross-check local government expenditure data by comparing them to revenues which mainly come from central government grants and locally collected taxes.

Eurostat noted that full annual outturn data for local government were only available for the October EDP notification of the year t+1 and requested a report on the local government source data used in the April EDP notification.

With regard to revisions in local government deficit and debt data in October 2012, the ONS confirmed that this was due to a change in the method used to derive top-up grants for police and fire pensions (for the deficit) and an improvement of source data on loans (for the debt).

According to the UK authorities, the issue of potential bond issues by UK local authorities, to finance infrastructure investment, is now less pertinent following a reduction in rates charged by the central Public Works Loan Board. Eurostat requested to be informed in due course about the potential bond issues by UK local authorities and about the new Scottish borrowing powers under the Scotland Act 2012 (currently subject to consultation).

The issue of local government guarantees was discussed under agenda point 4.3.2.

Conclusions

Action 5. The ONS will provide a report on the availability of local government source data used in the April 2013 notification by end-March 2013.³

2. FOLLOW-UP OF THE JANUARY 2011 VISIT

Introduction

Eurostat and the UK authorities discussed progress made since the previous dialogue visit in January 2011.

Discussion

Out of 25 actions agreed during the previous visit, 15 had been entirely completed. Outstanding actions (of which three were 'in progress' and seven were 'mainly completed') were discussed under the relevant agenda points.

Since the previous visit in January 2011, the UK authorities had implemented the appropriate recording of North-South bodies (previous action 5), confirmed that a quarterly formula was preferable to calculate forecast data for a calendar year (previous action 6), and complied with the Eurostat decision of 2000 in relation to UMTS (previous action 18). The UK authorities also provided more data on capital injections and dividends in the EDP questionnaire and carried out an analysis for possible super-dividends (previous action 23), as well as ensured that military expenditure data were recorded on a delivery basis (previous action 23).

As a follow-up to previous action point 19, the ONS confirmed that local government units recorded EU grants on an accrual basis and that disallowances were recorded as expenditure when the relevant notification is received.

With regard to EU grants retained by government, the ONS provided an extract from OSCAR relating to central government. The ONS has not found evidence of significant retention of grants by central government units. According to the ONS, the most significant amounts are

³ The UK authorities have since provided this information. Eurostat considers this action point to have been completed.

in the Department for Work and Pensions (DWP), relating to funding by the European Social Fund. DWP passes the funds to two other government departments, the Department for Business Innovation and Skills and the Ministry of Justice. The ONS is currently verifying that these two departments pay the funds to bodies outside the Central Government sector.

Eurostat enquired about EU grants potentially retained by local government, and the UK authorities agreed to provide this information after the visit.

Eurostat also underlined that adjustments were necessary not only for grants retained by government, but also for other grants due to timing differences. The UK authorities agreed to confirm the necessary adjustments in financial accounts.

Conclusions

Action 6. The UK authorities will confirm the modalities for the flow of EU grants to local government bodies – seeking a practical example relating to one local authority – and confirm to Eurostat by end-May 2013 if resources from EU funds may accumulate at local government level.⁴

Action 7. The UK authorities will confirm to Eurostat by end-March 2013 if the timing adjustments for EU funds paid to third parties are reflected by entries in financial accounts.⁵

3. FOLLOW-UP OF THE OCTOBER 2012 EDP REPORTING

3.1. EDP table 2

Introduction

Discussion focused on adjustments relating to the transition between the Central Government net cash requirement (CGNCR) and the starting line of EDP table 2A (working balance).

Discussion

The ONS reports an EDP table 2 that is largely empty, owing to the fact that the United Kingdom is managing its public accounts and budget on an accrued basis. As agreed during the previous EDP visit in January 2011, the ONS now regularly provides the reconciliation of CGNCR (cash figures) and the EDP working balance (accrued figures), with each EDP notification. In preparation for the visit, the ONS provided a description of individual adjustments in this reconciliation table.

The “Net lending to private sector and RoW” (ANRH) line represents lending by government and to government which has an impact on net cash requirement but not on net borrowing.

Similarly, the “Net acquisition of UK Company Securities” (ANRS) line represents the acquisition and disposal of equity which has an impact on net cash requirement but not on net

⁴ This action point has not yet been completed.

⁵ The UK authorities have since provided initial information. The issue continues to be discussed.

borrowing. According to the ONS, in recent years the principal components of ANRS were government acquisitions and disposals of equity in the public sector banks, British Nuclear Fuels Ltd, the Nuclear Liability Fund and equity subscription payments to international organisations such as international and regional banks.

The “Accounts receivable/payable” (ANRT) line represents the net position of accounts receivable/payable which leads to differences between the net cash requirement and the net borrowing. The ONS explained that this line differed between Public Sector Finances (PSF) and EDP data presentations because the line in the relevant PSF table included national accounts balancing adjustments which were specifically excluded from the EDP dataset as part of the statistical discrepancy work. As discussed during the October 2012 EDP clarification, the total accounts receivable/payable figures in the reconciliation table should conceptually match the net F.7 position recorded in EDP Table 3B. The ONS continues to investigate the differences, partly explained by the use of different compilation systems (monthly systems are used to produce the PSF bulletin and quarterly systems are used to produce the national accounts and EDP statistics).

The “Adjustment for interest on gilts” (ANRU) line is the same as the line in EDP Table 3B entitled “Difference between interest (D.41) accrued(-) and paid(+)”.

The “Other financial transactions” (ANRV) line is a residual. As explained by ONS in April 2012, this line includes the statistical discrepancy and any differences between cash and accrued flows not already included in the other series (ANRH, ANRS, ANRT and ANRU).

Eurostat enquired about the possibility of using a different (audited) item, and not the (national accounts-based) net borrowing measure, as the starting line (working balance) in EDP table 2A. The UK authorities explained that various net borrowing measures, notably the public sector net borrowing, are the main means of assessing performance against the government’s fiscal targets on a national level, and that cash measures such as CGNCR conceptually are even further removed from the only audited item, departmental resource accounts.

Eurostat underlined that all adjustments in the reconciliation table between CGNCR and the EDP working balance, as well as their links with EDP table 3, should be explained in the EDP inventory. Eurostat also noted the high volatility in the “Other financial transactions” (ANRV) residual line and encouraged the UK authorities to provide greater detail in the reconciliation table.

Conclusions

Action 8. The ONS will complete its work on the reconciliation of other accounts receivable/payable (F.7), and then for loans (F.4) and equity (F.5). The results will be reported to Eurostat by end-September 2013.

Action 9. The ONS will provide greater detail in its reconciliation table between the central government net cash requirement (CGNCR) and the EDP notification working balance, notably splitting “Other financial transactions” and “Accounts receivable/payable” lines

*into their constituent parts, by the October 2013 EDP notification. A pilot table will be sent to Eurostat for comments by end-May 2013.*⁶

3.2. EDP table 3

Introduction

Eurostat and the UK authorities discussed progress made since the previous dialogue visit in January 2011 and a revised adjustment relating to issuances above/below par.

Discussion

The ONS confirmed that no data were currently available to provide a breakdown into increase/reduction of loans (action point 7 from the previous dialogue). It was previously expected that the Flow of Funds project would deliver these disaggregated. The ONS explained that the scope of the Flow of Funds project had changed as a result of its incorporation within the ESA 2010/BPM6 (sixth edition of the Balance of Payments and International Investment Position Manual) programme of work and it was necessary to secure the required data on government loans via a separate exercise.

Much of the currently used net loans data are sourced from the Bank of England, from counterparty banking data. The ONS therefore plans to investigate the possibility to provide the breakdown as part of compliance with action point 4, which looks to compare WGA financial instrument data with that from the Bank of England.

Eurostat requested an update on the results of the ESA10/BPM6, notably as regards data sources for the implementation of the statistical and accounting elements of the Directive 2011/85/EU on national fiscal frameworks.

Since January 2011 the UK authorities had provided a further breakdown of data in part 4 of the EDP questionnaire and confirmed that direct accrual data were used for other accounts payable (previous action point 8). Amounts relating to the allocation of special drawing rights (SDR) by the International Monetary Fund were excluded from EDP tables 3A and 3B (previous action point 10). Allocations of SDRs have no impact on the Maastricht debt. Under ESA95 rules, they should only be recorded as other changes in volume (K.10) of assets in the national accounts and should not appear in EDP tables.

The UK authorities also confirmed that data on financial derivatives are included in EDP table 3 on a net basis in the line for net acquisition of securities other than shares (previous action point 12), ensured that the line for other volume changes in financial liabilities contained no discrepancy/balancing items (previous action point 13), and implemented the revised methodology relating to coupon sold (previous action point 17).

In the October 2013 EDP notification, the ONS significantly revised adjustments in EDP table 3, relating to issuances above/below par. The UK authorities explained that the relevant adjustment line in EDP table 3 had been previously identifying the difference between the cash paid at issuance of a gilt (UK government bond) and the nominal value of the gilts issued. This included some double counting as some of the cash received at issuance related

⁶ The UK authorities have since provided the pilot table.

to accrued interest payments and not a premium or a discount on the price of the gilt. Under the new approach, the change in the nominal value of market holdings of gilts is calculated and compared to the accrued flow of gilt payments, as recorded in net borrowing/lending. The difference between accrued and cash gilt interest payments is then removed (as it is recorded in a separate adjustment line in EDP table 3) and the remainder is recorded in the issuances above/below nominal value line.

Eurostat underlined that, having in mind recent changes and as part of further work on separating out different adjustments relating to gilt issuances, redemptions and interest payments, it might be useful update a one-off questionnaire on the recording of interest in EDP tables.

The recording of interest was further discussed under agenda point 4.2.2.

Conclusions

Action 10. *By end-April 2013 the UK authorities will report to Eurostat on initial work in their task force to investigate data sources for the implementation of the statistical and accounting elements of the Directive 2011/85/EU on national fiscal frameworks.*⁷

Action 11. *Eurostat will immediately provide the UK authorities with a questionnaire on the recording of interest flows in EDP notification tables 2 and 3, and the UK authorities will complete the questionnaire by end-March 2013, as part of the compilation process of the April 2013 EDP notification tables.*⁸

3.3. Statistical discrepancies

Introduction

Discussions focused on two elements of statistical discrepancies: differences between non-financial and financial accounts, and other statistical discrepancies.

Discussion

Following the last EDP visit in January 2011, the UK authorities improved the transparency (previous action points 4 and 13) of the statistical discrepancy reporting by excluding discrepancy/balancing items from other accounts receivable/payable and other volume changes. Statistical discrepancies in the United Kingdom are mainly attributable to central government, but they are also comparatively large for local government.

In response to Eurostat's request to explain the work undertaken since the last EDP reporting in October 2012, the ONS replied that it focused its efforts on other statistical discrepancies for central government, which were driven either by data source differences or missing other economic flows.

⁷ The UK authorities have since provided this information. Eurostat considers this action point to have been completed.

⁸ The UK authorities have since completed the questionnaire provided by Eurostat. The issue continues to be discussed.

According to the ONS, a number of issues were identified and did not require further investigation, notably the incorrect netting off of data from the Debt Management Office, the incorrect recording of accrued interest data for the London Continental Railways' bonds, and the wrong signage in the accounts for short term loans by central government to the Financial Services Compensation Scheme. The ONS identified several other issues but said these needed further investigation before any changes can be implemented: the purchase of London Continental Railways in 2009 that led to a number of instances of debt cancellation and debt assumption, the review of transactions and stocks relating to the Issues Department of the Bank of England Issue Department, and the review of transactions and stocks relating to National Savings liabilities.

The ONS confirmed that, taken together, these corrections would significantly reduce other statistical discrepancies for central government. Eurostat encouraged the ONS to implement the results of this work in the April 2013 EDP reporting and to subsequently address other statistical discrepancies for local government.

The ONS explained that the discrepancy between non-financial and financial accounts would be more difficult to identify, given the accruals data sources used in the UK for the non-financial accounts. However, the ONS is of the opinion that that much of the volatility in this discrepancy over recent years is due to a number of one-off transactions that need to be reviewed, to identify any gaps between the non-financial and financial recording. These one-off transactions include the transfer of the Royal Mail Pension Plan, the reorganisation of the Housing Revenue Account, the sale of British Energy, the reclassifications and restructuring of London Continental Railways, and the interventions in the banking sector.

Eurostat said it would follow-up on the investigation relating to the one-off transactions in the course of forthcoming EDP notifications.

Conclusions

Action 12. Eurostat welcomes the progress made on investigating other statistical discrepancies of UK central government and expects the results of this work to be implemented in the April 2013 EDP notification tables. By the October 2013 EDP notification, the UK authorities will complete an investigation of other statistical discrepancies for local government. Eurostat also underlines the need to continue work on discrepancies between financial and non-financial accounts and will follow this up with the ONS during the course of forthcoming EDP notifications.⁹

3.4. Trade credits

Introduction

Eurostat and the UK authorities discussed the reporting of trade credits data in EDP tables and the implementation of the relevant Eurostat decision of July 2012.

Discussion

⁹ The UK authorities have since provided initial information. The issue continues to be discussed.

Stocks of liabilities in trade credits and advances (AF.71) are reported by EU Member States in EDP table 4. Since October 2012 Eurostat had also published an explanatory note alongside the EDP news release.

So far the data on stocks of trade credits payable, reported by the United Kingdom, have been based on historical estimates. However, during the October 2012 EDP clarification the ONS confirmed that it would be possible to source trade credits data from annual IFRS-based resource accounts of both central government departments and local government bodies. Due to the large number of such bodies, compiling these data would be very time consuming and the ONS is therefore setting up a working party, with HM Treasury and other government departments, to determine the most effective way of collecting these data and other data relating to contingent liabilities.

The UK authorities explained that the UK Whole of Government Accounts' (WGA) balance sheet included figures for total 'trade payables', although the WGA were currently produced with a considerable delay of around 19 months. The latest audited WGA figures showed a total of 'trade payables' of more than GBP 18 billion (around 1% GDP) at end-March 2011.

Eurostat encouraged the UK authorities to provide actual data on central government trade credits in the April 2013 EDP reporting and to continue the work on the availability of local government data.

Eurostat also recalled its July 2012 decision on the statistical recording of some operations related to trade credits incurred by government units. In line with this decision and subject to specific conditions, liabilities in trade credits can be reclassified as loans (AF.4, part of the Maastricht debt) in the cases of restructuring and refinancing via factoring operations. The decision has to be implemented from the April 2013 EDP notification.

According to the ONS, the source of trade credits data (resource accounts) did not identify whether trade credits were factored or restructured, as confirmed in the April 2012 response to a one-off questionnaire on trade credits. The ONS and the Bank of England confirmed that they would be investigating possible data sources in this respect during 2013.

Conclusions

Action 13. *The UK authorities will work towards providing data on stocks of central government trade credits on a financial year basis for the April 2013 EDP notification. Results of planned work on local government trade credits will be reported to Eurostat by end-2013.*¹⁰

Action 14. *The ONS and the Bank of England will investigate available data to apply the 2012 Eurostat decision on trade credits for factoring and restructuring and will inform Eurostat by mid-June 2013 of their findings and their proposals for implementation in the October 2013 EDP notification.*

¹⁰ The UK authorities have since provided the data on stocks of central government trade credits.

4. METHODOLOGICAL ISSUES AND RECORDING OF SPECIFIC GOVERNMENT TRANSACTIONS

4.1. Delimitation of general government

4.1.1. *Green Investment Bank, Big Society Capital and Business Bank*

Introduction

Discussions focused on a general issue of national development banks (NDBs) and three recent UK initiatives in this area: the Green Investment Bank, the Big Society Capital Group and the Business Bank.

Discussion

Eurostat recalled that the issue of NDBs was discussed in the December 2012 meeting of the Financial Accounts Working Group (FAWG). It was notably proposed that: (1) the capital injection test had to be applied to cases of capital injections by government to NDBs, (2) under very specific conditions, a capital injection could be partitioned into financial and non-financial components, (3) the rules applicable to the recording of capital injections into multilateral development banks could not be directly applied in the case of NDBs, and (4) all activities of NDBs performed on behalf of government should be re-routed through government accounts.

Eurostat also recalled previous discussions with the ONS relating to a general issue of financial intermediation. When classifying new financial intermediaries, it is necessary to determine whether their business model is to function as such. In particular, Eurostat would examine if a body could and would raise significant funding from the market after the start-up phase. Other relevant criteria include autonomy of decision making, the possibility of bankruptcy and potential channelling of subsidies or capital grants as a proportion of all activities.

In 2012 the UK government created a Green Investment Bank to attract private funds for the financing of environmental investments. The Green Investment Bank has a capital of GBP 3 billion and is fully-owned by the UK government. The entity does not currently have borrowing powers. The ONS confirmed that the Green Investment Bank had commenced its operations in October 2012 and that it would be classified inside central government (S.1313).

A similar UK government initiative, the Big Society Capital Group, aims to improve access of frontline social organisations to affordable finance. The group is made up of three separate entities: (1) The Big Society Trust (BST), a company limited by guarantee which is the holding company and has the sole object of protecting the social mission of Big Society Capital, (2) Big Society Capital (BSC), a company limited by shares which is the operating company of the group, and (3) The Big Society Foundation, a company limited by guarantee which will be constituted to receive charitable donations and develop grant programmes to support the group's mission.

According to ONS, all three companies are legal entities, and each will have their own boards, different roles, different funding arrangements and would each appear to qualify as

institutional units. BST has a controlling interest in BSC, owning 60% of the equity stake (although it has 80% of the voting rights). Also, BST will be the only member of BSF.

From the UK perspective, the classification of both BSC and BSF into the public or private sector will therefore be determined by whether BST is a public sector or a private sector body. The ONS explained that BST, like all UK companies limited by guarantee, had members and not shareholders. It had eight members (7 of whom were private sector individuals and the eighth was a government appointee), and, for some decisions, 75% of the BST members must be in agreement. The ONS has not yet determined whether this power is sufficient to provide the public sector with control over BST's general corporate policy.

According to the ONS, BST is almost entirely grant funded, as is BSF, so if in the public sector, both these companies will be classified as central government bodies. BSC, if in the public sector, appears to be a borderline financial intermediary. Eurostat recalled, however, that, in the state aid approval of BSC in December 2011, the European Commission had expressed a view that BSC was 'a mere vehicle' channelling funds to the intermediary level.

ONS confirmed that the issue of the classification of the three Big Society Capital Group entities would be resolved by the October 2013 EDP reporting.

In the 2012 Autumn Statement, the UK government announced that it would create a Business Bank, to deploy GBP 1 billion of additional capital. This would enable UK Export Finance (operating name of the Export Credits Guarantee Department, classified as a public non-financial corporation, S.11001) to provide up to GBP 1.5 billion in loans to finance small firms' exports. According to the UK government, the institution would operate on a commercial basis within a strategic framework set by ministers.

The ONS explained that there had been very limited progress on the idea of the Business Bank. The ONS confirmed that it was keeping any developments under review and agreed to inform Eurostat in due course.

Conclusions

Action 15. The ONS will inform Eurostat of its classification conclusions for Big Society Trust and Big Society Capital by end-September 2013.

4.1.2. Network Rail and rail franchises

Introduction

Eurostat and the UK authorities discussed the classification of Network Rail and certain aspects of rail franchises.

Discussion

Network Rail is the owner and operator of most of the rail infrastructure in the United Kingdom (England, Scotland and Wales, but not Northern Ireland and London). It was set up as a company limited by guarantee, a form of UK company where members' liability is limited to a specified amount which is payable under specified circumstances, and where members have no rights to a share in the company's profits or in any surplus on liquidation.

In response to action point 15 from the previous dialogue visit, the ONS confirmed that the degree of UK government's influence and control over Network Rail was not higher than had been before the Railways Act 2005 and that there had been no cases of government interference in appointing the members, the directors or the Membership Selection Panel of Network Rail after March 2003. The ONS said that in the financial years 2009/10 and 2010/11 it is possible that Network Rail might not pass the market test, with the majority of its revenue coming from UK government grants.

Network Rail members (industry members, public member and a special member, the Department for Transport) appoint the board of directors who make the day-to-day decisions. According to the ONS, the members and/or the directors are in control of the general corporate policy of Network Rail which is currently classified as a private non-financial corporation (S.11002).

Eurostat recalled that previous exchange of views with the ONS referred to the classification of Network Rail under ESA95. The ONS was therefore asked to review this classification in light of ESA 2010 (notably, the criteria for government control such as rights under special shares, borrowing from government and control via excessive regulation).

The views on the classification of Network Rail by the ONS and Eurostat under ESA95 guidance were not shared by the UK Comptroller and Auditor General, who believed that Network Rail was controlled by government, bearing the risks that would normally be borne by equity capital. During the visit, Eurostat also recognised that Network Rail had a large amount of debt (guaranteed by government) which increased to around GBP 27 billion (nearly 2% GDP) in the financial year 2011/12 and, according to the annual report published in April 2012, was set to increase to around GBP 33 billion by 2013/14. The guidance contained within ESA 2010 and its implementation provides an opportunity to evaluate Network Rail classification against the new guidance and criteria.

With regard to rail franchises, the discussions focused on minimum revenue guarantees granted to private sector Train Operating Companies. The UK authorities confirmed that, under the new franchise model, it was virtually impossible to receive revenue support in the early years (for example, 80% of the difference between forecasted and actual revenue) and to avoid a premium payment in later years by terminating the contract. Now the UK government would only pay revenue support if the actual GDP growth and official forecasts on which the franchise bid was based differed by several percentage points.

Eurostat recalled its view that, in the case of existence of a minimum revenue guarantee, government should be considered as bearing the majority of the economic risks, and the assets should be recorded on government's balance sheet.

Conclusions

Action 16. Once it has all the necessary methodological elements, the ONS will analyse the classification of Network Rail under ESA 2010 and its accompanying Manual on Government Deficit and Debt (MGDD). This analysis will include one of control – describing the differences between IFRS/IPSAS and ESA 2010 control rules – and also the application of the revised rules on the market/non-market distinction.

4.1.3. Arms Length Management Organisations (ALMOs) and the Housing Revenue Account

Introduction

Eurostat and the UK authorities discussed the classification of Arms Length Management Organisations (ALMOs) and the implications of the Housing Revenue Account reform.

Discussion

In the UK, social housing is provided by local authorities. Each local authority ring-fences its housing activity and compiles a Housing Revenue Account (HRA), which details the relevant income and expenditure. This information allows the market/non-market test to be carried out. The test has traditionally showed that production costs are covered by rental receipts. Therefore, in the UK, local government housing is normally treated as a market activity, and HRAs are classified as public quasi-corporations (public non-financial corporations, S.11001).

In 2002 some UK local authorities started setting up Arms Length Management Organisations (ALMOs), to manage all or part of their housing stock. ALMOs are owned by local authorities, but have an independent legal status and are run independently. Under this system, a local authority retains its housing stock and controls the allocation policy. Until now, management fees charged by ALMOs have been considered as sales. As a result, ALMOs have been classified as public non-financial corporations.

The key issue of management fees charged by ALMOs had been discussed during the previous EDP dialogue visit to the United Kingdom in January 2011. As a follow-up to previous action point 14, the ONS obtained copies of management agreements for two ALMOs. The ONS' tentative conclusion (subject to formal approval by the National Accounts Classification Committee) was that in the first case management fees could not be considered as sales and in the second case they could be. The ONS explained that further work would be undertaken to determine which is type of the management agreements was more common.

Eurostat requested to be informed in due course and expressed a view that, if management fees paid to ALMOs were not sales, ALMOs could possibly be consolidated with HRAs. This would ensure similar statistical treatment of housing activity, whether or not local authorities set up ALMOs.

The United Kingdom also reformed the overall system of local authority housing finance in March 2012, by devolving it to local authorities to manage themselves. In accordance with the Localism Act 2011, the HRA subsidy system in England was abolished and replaced with local government self-financing for council housing.

The ONS explained that the transactions involved in this reform were large and broadly fell into four categories: (1) Local authorities paid GBP 13.4 billion to the Department for Communities and Local Government (DCLG); (2) DCLG paid GBP 5.3 billion mostly to the Public Works Loan Board (PWLB) to discharge local authority debt held by PWLB; (3) DCLG paid a further GBP 1.6 billion to PWLB as payment for the premia on debt discharged

early; and (4) PWLB loaned GBP 12.9 billion to local authorities at a reduced rate (as pre-announced by the government in September 2011).

The first two transactions were treated as capital transfers between central and local government. The third transaction was recorded as an interest receipt by central government and a counterpart interest payment by local government. The fourth transaction was recorded as an increase in local government borrowing from central government (matched by a counterpart cash flow). According to the ONS, the reform had virtually no effect on the overall borrowing by general government, as the transactions took place between general government subsectors.

Eurostat noted the explanations provided by the UK authorities and, due to the complexity and significance of the transactions, requested a flowchart explaining the potential impact on general government deficit and debt. In this context, Eurostat also asked the UK authorities to comment on the statement by the UK Office for Budgetary Responsibility that the HRA reform would “*increase public borrowing more than originally estimated*”.

Conclusions

Action 17. The ONS will provide Eurostat by end-March 2013 with a flow chart explaining the transactions for abolition of the Housing Revenue Account subsidy system, and will explain the potential impact on general government deficit and debt, if any.¹¹

4.1.4. Hospitals and educational institutions

Introduction

Discussions focused on new developments relating to hospitals, notably the bailout fund for National Health Service (NHS) Trusts and potential dissolution of insolvent NHS Trusts, and to central government-controlled schools. The classification of Further Education Colleges and universities was also discussed.

Discussion

All public hospitals in the UK are currently classified inside the Central Government subsector (S.1311). There have been discussions in the past on the classification of Foundation Trusts. However, during the last visit in January 2011 the UK confirmed that Foundation Trust Hospitals are still classified inside general government. Foundation Trusts have more managerial and financial freedom when compared to NHS Trusts, but government is deemed to control the general corporate policy of both types of entities.

Eurostat asked the UK authorities to comment on the new initiative to set up a GBP 1.5 billion bailout fund for NHS Trusts and the potential dissolution of insolvent NHS Trusts under the regime for unsustainable NHS providers, introduced in 2009. Eurostat also recalled reports that the dissolution of one of the NHS Trusts, South London Healthcare, in 2012 would lead to a “write-off” of GBP 150 million of debt.

¹¹ The UK authorities have since provided initial information. The issue continues to be discussed.

The ONS confirmed that it was aware of the new developments and explained that the Department of Health's publically communicated intention to provide support to a small number of NHS Trusts with significant debts was treated as a contingent liability. In addition, as each of NHS trusts are classified in the Central Government sector, any payments to and from these bodies would fall within the central government boundary and would consolidate out for EDP purposes.

The ONS also informed Eurostat of an increased limit relating to private income that could be raised by Foundation Trusts and of NHS Property Services, a new property management entity, the setup of which was apparently similar to the Bundesimmobiliengesellschaft (BIG) case in Austria. Eurostat suggested discussing the issue bilaterally after the visit.

Most of primary and secondary schools in the United Kingdom are classified inside Local Government subsector (S.1313), as they are controlled by the Local Education Authority. However, recently there has been an increase in the number of schools in England, such as academies or free schools, that are directly controlled by central government (Department for Education).

Eurostat recalled concerns, raised by the UK Parliament's Public Accounts Committee, that academies in particular had not been providing all accounting information on expenditure and assets. The ONS explained that this was a question of data sources relating to relatively new entities and undertook to investigate how this could be satisfactorily resolved.

In August 2010 the ONS announced its decision to reclassify reclassified Further Education Colleges (institutions that bridge the gap between schools and universities, as well as offer adult education) to the central government sector (S.1311), moving them from the non-profit institutions serving households sector (NPISH, S.15). Subsequently, the Education Act 2011 amended the powers of government over Further Education Colleges in England. According to the ONS these changes, which came into force in April 2012, were sufficient to remove public sector control and accordingly the English Further Education Colleges were reclassified back to the NPISH sector. Similar bodies in Wales, Scotland and Northern Ireland remain classified inside central government.

The ONS currently records Further Education Colleges in the NPISH sector; that is to say the original reclassification decision to move English Further Education Colleges from the NPISH sector to central government for the period up to March 2012 and Welsh, Scottish and Northern Ireland Further Education Colleges up to the present day has not yet been implemented in either UK national accounts or in Public Sector Finances.

The ONS reported that it is currently reviewing when the classification decision can be implemented across the UK national accounts and public sector finance statistics. Eurostat confirmed with the UK authorities that, when implemented, the reclassification would have virtually no impact on the UK government deficit, as expenditure funded by government was already captured, and fees received directly by the colleges were offset against expenditure in the public finances.

ONS has previously indicated that the current classification of universities is being reviewed, following the introduction of student fees, and that universities (currently classified as NPISH, S.15) could be reclassified as non-financial corporations (S.11). Eurostat requested to be informed in due course.

Conclusions

Action 18. Eurostat takes note of the difficulties encountered in obtaining source information on academies, and asks the UK authorities to investigate how this could be satisfactorily resolved, reporting back to Eurostat by end-2013.

4.1.5. Questionnaire of general government-controlled entities

Introduction

Eurostat and the UK authorities discussed practical issues relating to the completion of the questionnaire on general government-controlled entities.

Discussion

This questionnaire covers non-financial and financial public corporations controlled by government, but not included in the General Government sector. All EU Member States were required to complete the questionnaire on a compulsory basis by end-December 2012. From 2013 onwards, the questionnaire has to be updated by EU Member States on an annual basis.

Eurostat recalled that the two key aspects of the questionnaire were its completeness in terms of entities controlled by government and the correct application of the market/non-market test.

Eurostat noted that the UK questionnaire, provided in December 2012, did not include non-profit institutions serving households (NPISH). The ONS explained that it followed a stricter approach based on ESA95 paragraph 2.87 whereby all government-controlled NPISHs are classified inside general government.

Eurostat also noted that the UK questionnaire had around 170 entries, as compared to around 350 entries in the latest update of the UK Public Sector Classification Guide relating to public corporations alone. The ONS explained that this was due to the fact that the questionnaire included entities at a group level. The ONS gave two reasons for this: (1) it might be very difficult to request data from these entities, as groups could have dozens of subsidiaries, some of them very small, and (2) the sum of stocks of debt at a subsidiary level would not be a good indicator, as a significant part of this debt (notably, intra-group debt) should be consolidated.

Eurostat agreed to reconsider this issue after investigating the practices in other EU Member States.

Conclusions

Action 19. By end-May 2013 Eurostat will consider the treatment of subsidiaries in the Questionnaire on government-controlled entities.¹²

¹² Eurostat has since confirmed that data on subsidiaries should be included in the questionnaire on an unconsolidated basis and considers this action point to have been completed.

4.2. Implementation of accruals principle

4.2.1. Taxes and social contributions

Introduction

Issues discussed by Eurostat and the UK authorities included a change in methodology for the recording of tobacco duties, other accounts receivable/payable relating to taxes and social contributions, new PAYE computer system, Swiss tax agreement and the impact of Directive 2010/45/EU.

Discussion

As a follow-up to action point 16 from the previous visit in January 2011, the ONS now provides more information in the questionnaire on taxes and social contributions and EDP questionnaire table 5.

In the October 2012 EDP notification the ONS informed Eurostat of a new method for the recording of tobacco excise duties, that had been applied back to the financial year 2002/03. A complicated modelling technique for tobacco duties which differed from the accruals methods used by Her Majesty's Revenue & Customs (HMRC) for other similar duties was replaced by the standard accruals methodology.

Eurostat accepted the new approach and recalled that, in line with Regulation (EC) No 2516/2000, "*the methods applied and the possible revisions shall be subject to agreement between each Member State concerned and the Commission (Eurostat)*". The ONS agreed to notify any future changes in advance and to update the questionnaire on taxes and social contributions.

Eurostat noted ONS progress in reconciling transactions and stocks of other accounts receivable/payable (F.79) relating to taxes and social contributions in EDP questionnaire table 5. The ONS explained that remaining inconsistencies related to a historical HMRC source data for stocks and agreed to work on ensuring full consistency.

Eurostat also noted that the ONS reported UK government payables relating to social contributions (D.61) in EDP questionnaire table 5. As such payables are usually limited to prepayments and tax refunds, Eurostat requested more information on the reported data and the accrual method. The ONS confirmed that the data related to National Insurance contributions, and agreed to provide further information after the visit. In the same context, the ONS agreed to confirm the accruals adjustment methods used for National Non-Domestic Rates and Council tax revenues where HMRC accruals data are used.

In June 2009 HMRC introduced a new PAYE computer system relating to the Pay As You Earn (PAYE) withholding income tax and National Insurance contributions. The ONS explained that the system change led to the identification of previous errors in the calculation of income tax liabilities. To rectify the identified errors, HMRC made repayments over the financial years 2010/11 and 2011/12 which related to tax liabilities for earlier years (2003/04 to 2009/10). The ONS accrued these tax payments back to the year in which the tax liability arose. In response to Eurostat's query on the potential impact on other indicators such as

compensation of employees (D.1), the ONS confirmed that D.1 data were also provided by HMRC and no large further changes were expected.

In October 2011 the UK Government and the Swiss Confederation signed a tax agreement relating to assets held by UK residents. Following its entry into effect in April 2012, the agreement will result in four separate payments from the Swiss authorities to the UK government: (1) one-off payments to regularise arrangements in the past; (2) an upfront payment of SFR 500 million; (3) a final withholding tax on interest, dividends and holding gains; and (4) an inheritance tax payable in case of death of a relevant UK resident.

The ONS indicated their intention to treat the one-off payments as capital taxes (D.91), accruing in May 2013. The upfront payment would be treated as a pre-payment, recording a receipt of cash (F.2) by the UK government in the financial accounts, with a counterpart liability in other accounts payable (F.7) in February 2013. The final withholding taxes would be treated as ongoing taxes on income (D.51), accruing as they arise, the inheritance taxes would be treated as ongoing capital taxes (D.91), as they arise.

In line with earlier bilateral discussions, Eurostat accepted the proposed treatment. With regard to the upfront payment, Eurostat requested the final version of the relevant NACC paper, explaining the nature of this payment, and agreed to confirm the time of recording before the actual payment in February 2013.

Eurostat recalled that that Directive 2010/45/EU (to be implemented by end-2012) provided a possibility for the EU Member States to apply a cash accounting scheme for the payment of VAT. Certain companies (depending on their annual turnover) would be able to pay VAT to the competent authority when they receive the payment for supply. This is an optional scheme that should have a positive effect on the cash flow of SMEs and should be limited to the period of economic and financial crisis.

As the directive could have an impact on the recording of government revenue, Eurostat enquired whether its implementation would result in any changes to the method used for recording of VAT revenue. The ONS confirmed that the United Kingdom made use of the optional scheme provided in Directive 2010/45/EU. HMRC was collecting the relevant data but the amounts were insignificant and the data collection had been stopped. Eurostat noted the explanation and thanked the UK authorities for their efforts.

Conclusions

Action 20. The ONS will ensure by the April 2013 EDP notification that data on stocks and flows of taxes and social contributions in EDP questionnaire Table 5 are consistent.¹³

Action 21. The UK authorities will confirm to Eurostat by end-February 2013 the accruals adjustment methods used for National Non-Domestic Rates and Council tax revenues.¹⁴

¹³ The UK authorities have since improved this consistency. Full consistency is expected for the end-September 2013 EDP reporting.

¹⁴ The UK authorities have since provided initial information. The issue continues to be discussed.

Action 22. The UK authorities will confirm to Eurostat by end-February 2013 the reasons for government payables recorded for social contributions, and how accrual of this item is undertaken.¹⁵

Action 23. Eurostat will provide comments on the proposed time of recording of the UK/Swiss tax agreement by mid-February 2013.¹⁶

4.2.2. Interest

Introduction

Discussions focused on interest accrued relating to financial instruments other than bonds and on the seasonality in quarterly series of interest accrued (payable).

Discussion

As a follow-up to action point 16 from the previous visit in January 2011, the ONS confirmed that, in relation to accrued interest, only the data on government bonds was included in EDP table 3.

Progress on other instruments (deposits, loans and repurchase agreements) was originally expected as part of the Flow of Funds project (now incorporated into the wider ESA10/BPM6 programme). The ONS assured, however, that this would not affect progress to review the methodology used in compiling estimates for accrued interest to financial instruments other than bonds. The ONS commenced a review of primary sources, to assess the valuation method for loans and deposits, and expects this review to be completed in mid-2013.

Eurostat noted the ONS assumption that, for financial instruments other than bonds, the difference between interest accrued and paid was not significant, and that the United Kingdom borrowed mainly by issuing bonds. Nevertheless, Eurostat repeated the need for progress in relation to other instruments.

With regard to interest receivable, data on deposit and loan flows are mostly provided by the Bank of England. Eurostat suggested comparing these direct data with information available in OSCAR (chart of accounts) and asked to be informed about the results of this exercise.

The ONS informed Eurostat that data relating to interest on the bonds issued by London Continental Railway were missing from the adjustment for interest accrued/paid in EDP Table 3. This omission will be rectified in the April 2013 EDP reporting.

Eurostat also noted the volatility in quarterly series, with levels of interest accrued (payable) in the second and the fourth quarters of a calendar year consistently exceeding those in the first and the third quarters. The UK authorities were requested to explain the reasons for this and to check whether interest was being accrued correctly.

¹⁵ The UK authorities have since confirmed the reasons for this and made the necessary changes in the end-March 2013 EDP reporting. Eurostat considers this action point to have been completed.

¹⁶ Eurostat has since provided the comments and considers this action point to have been completed.

Conclusions

Action 24. *The UK authorities will examine information available in OSCAR (chart of accounts) on interest accrued (receivable) and compare it with existing sources by end-May 2013. The UK authorities will also explain the reasons for seasonality in quarterly series of interest accrued (payable) by end-March 2013.*¹⁷

4.3. Recording of specific government transactions

4.3.1. Public Private Partnerships

Introduction

Eurostat and the UK authorities discussed a detailed ONS analysis of several PPP projects, the interpretation of the Manual on Government Deficit and Debt (MGDD) and two new initiatives: a new Public Finance Initiative (PFI; a UK national concept which refers to a type of PPPs) model and a new Pension Infrastructure Platform.

Discussion

Until April 2009 UK public sector bodies were reporting PPPs within their resource accounts under the Generally Accepted Accounting Principles (UK GAAP, deemed to be sufficiently close to ESA95/MGDD). Since April 2009 these resource accounts are prepared under International Financial Reporting Standards (IFRS). The move had the effect of removing the original UK GAAP-based data source that ONS relied on for assessing the economic owner of the PPP assets. To compensate for this, UK government departments started reporting new deals on a dual basis: according to their IFRS-based analysis for resource accounts purposes and an MGDD-based analysis for national accounts purposes.

As a follow-up to action point 24 from the previous EDP visit in January 2011, ONS provided a detailed analysis of a pre-IFRS PPP project and two new, post-IFRS projects. For all three projects assessed, the ONS opinion was that the PFI project documentation provided sufficient evidence that both construction risk and availability risk had been transferred to the private sector and, therefore, under ESA95/MGDD guidance these PFI projects should be recorded as on the private partners' balance sheets.

With regard to the pre-IFRS hospital-related PPP project, Eurostat agreed with the ONS analysis and accepted that, in line with the relevant technical guidance by HM Treasury, there was no need to reassess all pre-IFRS PPP contracts for national accounts purposes. Eurostat also agreed with ONS analysis of the two new PPP projects (related to street lighting and highway maintenance). Eurostat accepted the procedure for making a national accounts determination (on-balance or off-balance), described in the HM Treasury's technical guidance. However, the ONS was requested to check not only complex cases referred to it by HM Treasury, but all largest PPP projects above a certain capital value. The ONS agreed to indicate such a threshold after the mission.

¹⁷ The UK authorities have since explained the reasons for seasonality in quarterly series of interest accrued (payable). The comparison of direct and OSCAR data sources relating to interest accrued (receivable) has not yet been completed.

In response to the ONS comment that a number of more recent PFI did not seem to include a high proportion of capital expenditure, Eurostat confirmed that, in the case of existing assets, the expenditure for renovation must represent a major part (more than 50 per cent) of the capital value after the renovation. Eurostat also recalled other PPP-related changes in the latest edition of MGDD (concessions, termination clauses and payments by final users). Eurostat confirmed that PPP-related changes did not apply retroactively and agreed to further clarify this as part the task force to revise MGDD.

Eurostat recalled that more information on PPPs would have to be disclosed under Directive 2011/85/EU on national fiscal frameworks. According to the UK authorities, this should not be an issue in the United Kingdom, as such information was already disclosed in the Whole of Government Accounts. In this context, the ONS was also encouraged to provide more qualitative information on PPP-related guarantees and other risks in EDP questionnaire table 11.

In December 2012, HM Treasury published a revised model for PFIs (known as PF2) along with details of the new standard PFI contracts to be used. The ONS confirmed the intention to analyse the documents on the new PFI arrangements, as they become available later in 2012, and to consider their implications for EDP statistics.

Eurostat also requested to be informed, in due course, about the implications of a new Pension Infrastructure Platform, announced in the 2012 budget. This initiative which will be owned and run by UK pension funds is expected to make initial GBP 2 billion investment in UK infrastructure in 2013. From the initial information, Eurostat understands that there is a link between the Pension Infrastructure Platform and a new UK Guarantees scheme (discussed under agenda point 4.3.2 below), and that UK government might shoulder the risk of building the relevant assets.

Conclusions

Action 25. The ONS will send a proposal to Eurostat for checking the future largest Public Private Partnership (PPP) projects by end-February 2013.¹⁸

Action 26. The ONS will provide qualitative information on PPP-related guarantees and other risks in EDP questionnaire table 11 in the April 2013 notification.¹⁹

Action 27. Eurostat will clarify the retroactive application of changes in the MGDD as part of the task force to revise MGDD.²⁰

¹⁸ The ONS have since sent the proposal. Eurostat considers this action point to have been completed.

¹⁹ The ONS provided the requested qualitative information in the end-March 2013 EDP reporting. Eurostat considers this action point to have been completed.

²⁰ Work in the task force is still ongoing.

4.3.2. Guarantees

Introduction

Eurostat and the UK authorities discussed reporting of guarantees in various questionnaires, guarantees issued by local authorities and the new UK Guarantees scheme.

Discussion

Following the previous EDP visit in January 2011, the ONS provided more data on government guarantees in EDP questionnaire table 9 and verified the sources of existing data (previous action 20). The ONS also confirmed that guarantees could be granted by local government (previous action 21) and provided more information in EDP questionnaire table 8 ((previous action 22).

Eurostat asked the ONS to confirm the source and coverage of data reported in the EDP questionnaire as well as to comment on large stocks of UK government guarantees (averaging 23% GDP over the EDP reporting period). The ONS confirmed that the EDP questionnaire included financial year data on central government guarantees (including those issued by devolved administrations), sourced from resource accounts, whilst large stocks were mainly explained by guarantees granted in the context of the financial crisis. The ONS agreed to provide the relevant split in EDP questionnaire table 9.1.

The ONS also confirmed that there had been no calls on guarantees or debt assumptions since the 2009/10 financial year when guarantees relating to the underground infrastructure project Metronet were called. As calls on standard guarantees might be expected in 2012, Eurostat requested the UK authorities to check the relevant entries in OSCAR (chart of accounts). The ONS confirmed that all currently reported fees related to guarantees issued during the financial crisis, but fees were expected from new guarantee schemes.

Eurostat noted that the stock of public corporations' debt owed to government (i.e. both central government and local government), as reported in the Questionnaire on government-controlled entities, was less than the stock of only central government claims against public corporations, as reported in EDP questionnaire table 8.1. The ONS agreed to check the consistency of the reported data.

Eurostat enquired about the availability of data on guarantees issued by local authorities, which were currently not reported in the EDP questionnaire. The ONS explained that details of guarantees issued by local government bodies were included in the notes to those bodies' resource accounts. The ONS set up a working party, with HM Treasury and other government departments, to determine the most effective way of collecting these data. According to the ONS, information on the most significant guarantees issued by government was included in the Whole of Government Accounts (WGA). However, as guarantees issued by local government were at the smaller end of the scale, they did not appear separately in the WGA.

Eurostat underlined that progress in this area was very important due to new reporting requirements under Directive 2011/85/EU on national fiscal frameworks and encouraged the ONS to provide estimates of guarantees issued by local authorities in the EDP questionnaire.

In 2012 HM Treasury announced a new UK Guarantees scheme, aimed at guaranteeing borrowing for large infrastructure projects. According to the UK authorities, this scheme might be used to guarantee borrowing in respect of two large projects: the redevelopment of Battersea Power Station and the extension to the Northern Line. The ONS agreed to consider EDP implications and inform Eurostat when details become available.

Conclusions

Action 28. *The ONS will provide data on the stock of government guarantees issued to financial corporations in EDP questionnaire table 9.1, and will ensure that the stocks of public corporations' debt owed to government are consistent between EDP questionnaire table 8.1 and the Questionnaire on government-controlled entities in the April 2013 notification.*²¹

Action 29. *When possible the ONS will provide estimates of guarantees issued by local authorities in the comments of EDP questionnaire table 9.1.*

Action 30. *The UK authorities will check OSCAR (chart of accounts) in respect of guarantee calls and debt assumptions and inform Eurostat by end-February 2013.*²²

4.3.3. Financial crisis operations

Introduction

Eurostat and the UK authorities discussed the impacts of the reclassification of two financial defeasance structures to central government as well as initiatives relating to the Bank of England: the Extended Collateral Term Repo Facility, the Funding for Lending Scheme and the Bank of England Asset Purchase Facility Fund.

Discussion

In line with the revised MGDD chapter IV.5 on financial defeasance, the ONS reclassified Northern Rock Asset Management (NRAM) and Bradford & Bingley (B&B) to central government, with effect, from January 2010 and July 2010 (the time when B&B lost its banking licence). The reclassification reduced the UK government deficit for 2010 and 2011 (by 0.06% and 0.05% GDP). The UK government debt increased, respectively, by 3.89% and 2.80% GDP.

Outstanding issues relating to the reclassification, notably the consolidation within central government of all NRAM and B&B transactions and stocks as well as classification of special purpose vehicles (SPVs), are expected to be resolved during 2013. As a follow-up to action point 11 from the previous EDP visit in January 2011, the ONS confirmed that central government assets held at NRAM and B&B consolidated out from 2010 onwards.

²¹ The UK authorities have since provided data on the stock of government guarantees issued to financial corporations and ensured consistency of the stocks of public corporations' debt owed to government. Eurostat considers this action point to have been completed.

²² The UK authorities have since confirmed that there had been no recent guarantee calls or debt assumptions of any substantive value. Eurostat considers this action point to have been completed.

In addition, the ONS confirmed that the liabilities of SPVs were included within the total liabilities of B&B and NRAM (i.e. within UK central government debt), and that the classification of these SPVs would be reviewed in light of the Eurostat's view. Eurostat believes that these SPVs are not institutional units, as they do not have autonomy of decision, and should be consolidated with B&B and NRAM. The issue that some of these SPVs are foreign-based is covered in the MGDD chapter I.6 on government-controlled SPVs. Notably, foreign-based SPVs remain classified in the Rest of the World sector (S.15), mainly for the purposes of Balance of Payments statistics, but their operations are re-routed through the 'originating government'.

Two major financial crisis operations undertaken by the United Kingdom in 2012, the Bank of England Extended Collateral Term Repo Facility (ECTR) and the Bank of England Funding for Lending Scheme (FLS), have already been subject to bilateral discussions between Eurostat and the ONS.

ECTR is a contingency liquidity facility enabling the Bank of England to undertake operations against a much wider range of collateral than is eligible under other facilities. Eurostat and the ONS agreed that ECTR should be treated as a liquidity scheme, with no impact on government debt.

Under FLS, commercial banks can get cheap financing from the Bank of England and then use that to increase the level of loans to the private sector. The scheme will work by the banks borrowing UK treasury bills for up to four years, in return for collateral in the form of loans to the private sector.

Eurostat and the ONS agreed that, based on the available information, FLS meets the criteria of the Eurostat's decision of 2009 on interventions during the financial crisis for being treated as a securities lending transaction, with no impact on government debt. Eurostat underlined, however, this treatment could be reconsidered, if there was evidence that the involvement of HM Treasury extended beyond the oversight of the scheme. The UK authorities confirmed that they were not aware of any further HM Treasury involvement.

In addition, the UK government announced changes to the cash management of the Bank of England Asset Purchase Facility Fund (BEAPFF), a subsidiary of the Bank of England, through which quantitative easing takes place. Under the quantitative easing policy, BEAPFF has purchased gilts on the secondary market. This results in significant, regular interest coupon payments from HM Treasury to BEAPFF. In the longer term, it is possible that HM Treasury will have to pay the Bank of England, under an indemnity that HM Treasury has provided to BEAPFF. This indemnity provides that HM Treasury will cover any loss of the Bank of England that may result from returning the gilts to the market or from other measures taken by BEAPFF.

In November 2012, HM Treasury and the Bank of England jointly announced major changes to the cash management arrangements of BEAPFF, in essence agreeing to transfer excess cash to HM Treasury. It is envisaged that the net coupon income earned by BEAPFF during the 2012-13 financial year will be transferred to HM Treasury during the financial year 2012/13. The excess cash that had accumulated in BEAPFF up to the end of 2011/12 will be drawn down over the course of 2013/14. From 2013/14, the on-going cash surplus will be transferred regularly on a quarterly basis.

The ONS indicated its intention to request a formal ex-ante advice from Eurostat. The request would also cover the treatment of a similar past payment from the Bank of England to HM Treasury relating to the end of the Special Liquidity Scheme. Eurostat agreed to urgently provide such an advice.

Conclusions

Action 31. The ONS will request a Eurostat ex-ante advice on the Bank of England Asset Purchase Facility Fund (BEAPFF) and Eurostat will seek to answer before 21st February 2013.²³

Action 32. The ONS will conclude its investigations of the outstanding issues relating to special purposes entities and the consolidation within central government of transactions and stocks of Northern Rock Asset Management (NRAM) and Bradford & Bingley (B&B) by the October 2013 EDP notification and will inform Eurostat.

4.3.4. London Olympics

Introduction

Discussions focused on the legacy of London 2012 Olympic and Paralympic Games. The Glasgow 2014 Commonwealth Games were also mentioned.

Discussion

The overall cost of London Olympics is estimated to have been GBP 8.9 billion (around GBP 400 million less than expected).

The Olympic Games have been delivered by two UK public sector organisations. The Olympic Delivery Authority was classified to central government (S.1311) and consequently all relevant construction work was recorded as government gross fixed capital formation (P.51). Future sales of assets would be treated as a negative gross fixed capital formation. The ONS confirmed that long-term uses had been agreed for most facilities, except the Olympic Stadium.

The London Organising Committee of the Olympic Games (LOCOG) was initially classified to central government, but was reclassified as a public non-financial corporation (S.11001) from April 2008. At that point significant sponsorship income began to accrue, enabling LOCOG to pass the market test. Ticket revenue was accrued in the third quarter of 2012.

The ONS mentioned that similar structures were planned for the Commonwealth Games, but market/non-market distinction of the bodies involved might be less straightforward.

According to the ONS, much of the post-Olympics work is carried out by the London Legacy Development Corporation, which is classified as a local government body (S.1313). Other

²³ Eurostat provided the ex-ante advice on 19 February 2013 considers this action point to have been completed. The advice is available on the Eurostat website: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/UK-Treatment_of_BEAPFF_and_flows_btwn_Bank_of_England-HM.pdf.

assets used for the Olympic Games have been transferred to other public sector bodies, including the Lee Valley Regional Park (also classified to local government). These transactions were treated as capital transfers in kind (D.92 investment grants) from central government to local government.

From the discussions during the previous EDP visit in January 2011, Eurostat understood that legacy companies would be classified outside general government and asked the ONS to explain the reason for their current classification. The ONS explained that legacy bodies were controlled by the Mayor of London and their remit was broader than initially thought, including such tasks as strategic planning.

Conclusions

Eurostat noted the information provided by the UK authorities.

4.3.5. Planned transactions

Introduction

Eurostat and the UK authorities discussed the auction of mobile spectrum in December 2012, Northern Rock Asset Management repayments, implications of a new Energy Bill and new UK government initiatives such as perpetual bonds and the New Buy scheme.

Discussion

The ONS confirmed that the auction of the fourth generation (4G) mobile phone spectrum commenced in December 2012, with bidders formally declaring their interest. According to the ONS, the results of the auction were expected to be known in February 2013. Eurostat and the ONS agreed that the transaction was likely to be treated as a sale of a non-produced asset, similarly to the sale of the current third generation (3G, UMTS) licences. The 4G licences do not appear to meet the conditions for the special treatment as a rent, notably the contract is of a long-term type, and the total price of the disposal is known.

Northern Rock Asset Management (NRAM) has recently identified a failure to provide all its customers with the full documentation about their loans, as required by the Consumer Credit Act 2008. The ONS explained that, as redress for this failure, NRAM would be refunding all interest payments to customers over the affected period of 2008-2012. The estimated total value of all remediation (either through one-off compensatory payments, or for those customers who still have outstanding loan balances, through the reduction of outstanding loan) is GBP 270 million (0.02% GDP). According to the ONS, the redress being paid by NRAM will be recorded as a current transfer (D.75) from the UK government to households, and for those customers who have outstanding loans, as a simultaneous reduction in the government loan asset/ household loan liability (F.4).

Eurostat and the UK authorities also discussed the implications of a new Energy Bill tabled in November 2012. If adopted, the bill would transform the UK electricity market, by granting a range of new powers to the Department of Energy and Climate Change in exchange for subsidies to generators. The ONS explained that the most relevant aspects were so-called Contracts for Difference (a means to encourage investment in renewable power generation

capacity by reducing electricity price volatility) and a single counterparty body between electricity generators and suppliers.

Eurostat and the ONS agreed to review the issue when details become available. Having in mind links with the similar tax and subsidy schemes (such as the Renewable Energy Obligations Certificate Scheme), Eurostat also agreed to analyse the treatment of imputed taxes in the context of tax burden measures.

Eurostat requested more information on the two initiatives announced in the 2012 UK budget: perpetual bonds and the New Buy scheme.

The UK authorities confirmed that, following a consultation of financial market participants and in the absence of tangible market demand, the UK government decided not to introduce new perpetual gilts.

The New Buy scheme, introduced in England in March 2012, is intended to make mortgages available for people to buy a new home with a 5% deposit. The UK government made a provision to support up to 100,000 households through the scheme. 3.5% of the purchase price would be guaranteed by builders and 5.5% by the UK government. According to the UK authorities, separate schemes were currently being developed in Scotland and Wales.

Eurostat noted the information provided by the UK authorities and requested to be informed in due course.

Conclusions

Action 33. Eurostat will analyse the treatment of imputed taxes in the context of tax burden measures by end-June 2013 and will inform the ONS.²⁴

5. OTHER ISSUES

5.1. ESA95 transmission programme

Introduction

Discussions focused on the issues raised by Eurostat's government finance statistics (GFS) team. Issues relating to the General Lighthouse Authorities were also discussed.

Discussion

With regard to general issues relating to the ESA95 transmission programme, Eurostat noted significant improvements, notably as regards timeliness and completeness, but recalled the need to fully check consistency, growth rates and revisions before reporting the data.

Eurostat also briefly mentioned a number of specific technical issues relating to the latest ESA95 transmission. In particular, the ONS was asked to confirm whether guarantee fees

²⁴ Eurostat is still discussing the issue internally and will inform the ONS of the results when they are available.

received by UK government in its role as a guarantor were recorded as service fees (non-market output (P.131)) and whether recent revisions in tax revenue data were also implemented in the main aggregates and sector accounts. Due to the lack of time, Eurostat and the ONS agreed that technical issues relating to ESA95 table 9 (taxes) and the national tax list would be addressed bilaterally with Eurostat's GFS team after the visit.

The ONS informed Eurostat of ongoing changes relating to the estimation of depreciation of roads, which would affect EDP and ESA reporting. The ONS also reconfirmed its intention to address, in the UK national accounts, the consolidation issues for non-government bodies referred to in a recent pre-infringement letter.

In response to Eurostat's query, the ONS confirmed that it had not yet implemented the decision to classify the General Lighthouse Authorities inside general government (S.13) and to treat the light dues as other taxes on production (D.29).

Conclusions

The ONS agreed to address the technical issues raised by Eurostat after the visit.

5.2. Any other business

Introduction

Discussions focused on the main changes relating to the implementation of ESA 2010, pension reforms and the SDMX (Statistical Data and Metadata Exchange) transmission.

Discussion

Eurostat recalled that EU Member States were expected to transmit their first EDP notification, based on ESA 2010, in September 2014. The UK authorities could not confirm any intentions to start publishing ESA 2010-based data nationally before September 2014, as the relevant timetable had not yet been finalised.

Eurostat also recalled the main changes foreseen in ESA 2010 (relating to sector delimitation, standardised guarantees, military expenditure, transfer of pension obligations, capitalisation of research and development expenditure, and swaps) and enquired about their relevance to the United Kingdom.

The ONS, which has set up a special ESA 2010 implementation group, confirmed that major impact was expected from changes relating to military expenditure and the capitalisation of R&D expenditure, notably in the health sector. In this context, the ONS requested Eurostat to clarify its approach to data sources for the capitalisation of R&D expenditure. Eurostat agreed to discuss the issue internally and informed the ONS about a future questionnaire, to quantify the ESA 2010-related impacts.

With regard to pension reforms, the UK authorities confirmed that no ESA 2010-related changes were expected, apart from the recording of the transfer of the Royal Mail pension scheme to central government in April 2012. As part of a future reform of the pay-as-you-go (PAYG) scheme, only changes in level were expected and not the transfer to a second pillar pension scheme.

In response to technical questions relating to data transmission, Eurostat explained that the SDMX implementation timetable had not yet been finalised for EDP reporting. However, it is expected that EDP data will have to be reported via eDAMIS from end-September 2013.

Conclusions

Action 34. Eurostat will discuss internally the approach to be applied to data sources for capitalisation of research and development and will inform the ONS.

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