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Ms Jocelyn Davies AM  
Chair of the Finance Committee  
National Assembly for Wales  
Cardiff Bay CF99 1NA

Date: 29 February 2016  
Our ref: HVT/0513/fgb  
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Dear Jocelyn

## **WELSH GOVERNMENT DRAFT BUDGET 2016-17 – PRESENTATION**

I am writing in response to your letter of 3 February about the presentation of the Welsh Government's draft budget 2016-17. Specifically, you requested my view 'of whether the presentation of changes in allocations are consistent in terms of how non-recurrent allocations are treated in year-on-year comparisons and whether the use of two separate sets of figures in the narrative document could lead to confusion'.

It is not my normal practice to comment on the presentation of the Welsh Government's budget. As you note in your letter, I did raise a query with the Permanent Secretary on the presentation of in-year additional funding for health in the draft budget 2014-15. The purpose of my correspondence with the Permanent Secretary was primarily one of factual accuracy. At that time, I was intending to publish a future report on health finances, which would have presented a different picture of year-on-year changes to that set out in the draft budget 2014-15.

To respond fully, I have broken your request down into the following questions:

1. Is the Welsh Government's approach 'consistent'?
  - a. With practice elsewhere
  - b. With its own historic practice
2. Is the Welsh Government's approach potentially confusing?

I have annexed to this letter my response on these points. I hope that the Committee finds this useful.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'H. Vaughan Thomas'.

**HUW VAUGHAN THOMAS**  
**AUDITOR GENERAL FOR WALES**

## **ANNEX: WELSH GOVERNMENT DRAFT BUDGET 2016-17 – PRESENTATION**

### **Context**

It is helpful to first set out what the Welsh Government has done with its baseline in the 2016-17 draft budget. By 'baseline' we mean the figures for the financial year before that covered by the draft budget. This baseline is used to compare year-on-year changes in funding allocations. For example, the baseline for 2016-17 would be the budget for 2015-16. In the draft budget 2016-17, the Welsh Government has adjusted both revenue and capital for the baseline financial year 2015-16. For both, the Welsh Government has removed what it describes as 'non-recurrent' allocations. In the case of revenue, these adjustments include funding allocated from reserves and funding allocated for invest-to-save. For capital, the relatively large adjustments relate to funding allocated as part of the Wales Infrastructure Investment Programme (WIIP). The WIIP was introduced in 2012 as a means to better focus capital investment. Under WIIP a significant proportion of capital funding is allocated from the centre to departments to spend on specific projects. The aim is to allocate capital according to need and potential impact, rather than historical trend.

### **Is the Welsh Government's approach consistent?**

#### **Consistent with practice elsewhere?**

Comparison with other parts of the UK is complicated by the fact that each country has developed its own approach to presenting budgets. I have looked at the budget documents for each country. In Scotland there are no adjustments: the baseline used is the budget agreed for that year as set out in the Scottish Government's Budget Act. In Northern Ireland, some adjustments are made to remove non-recurrent allocations to revenue to set an annual baseline. Northern Ireland does not present year-on-year changes to capital. The approach used by the UK Government is complicated. Annual budgets do not appear to include adjustments: the baseline is estimated outturn. However, the UK Government does make adjustments to remove non-recurrent allocations in Departmental baselines as part of a Spending Review. The Minister for Finance and Government Business [wrote](#) to explain these adjustments in June 2013.

Welsh Government officials told us that the adjustments it has made are consistent with the approach taken by the UK Government during a Spending Review. In the 2015-16 Spending Review the adjustments the UK Government made appear to have been relatively small: they account for 0.1% of revenue and 0.6% of the capital baseline. The revenue adjustments the Welsh Government has made in the draft budget 2016-17 documents account for 0.7% of the 2015-16 revenue and 30% of capital baselines in the

2015-16 budget. The reason for the difference in the scale of adjustments in these two cases is that the UK Government capital allocation to departments is largely recurrent and based on historical trends, whereas the WIIP approach means that a significant proportion of capital in Wales is allocated to departments on a time limited basis.

### **Consistent with the Welsh Government's historic practice?**

The approach that the Welsh Government has taken to presenting year-on-year changes has evolved over time, partly in response to requests from the Finance Committee. The approach used for the draft budget 2016-17 is different from the approach taken each year since 2012-13. In draft budgets for 2013-14, 2014-15 and 2015-16, the baseline came from the First Supplementary Budget for the baseline year. No adjustments were made to capital or revenue in the baselines in any of these years. In the 2012-13 draft budget, a small adjustment was made to take out around £9 million non-recurrent revenue funding from the 2011-12 baseline, mostly related to supporting the elections for the National Assembly for Wales. In setting out spending plans for 2015-16 for the first time in the Draft Budget 2014-15, the Welsh Government removed non-recurrent capital allocations made over the period 2011-12 to 2014-15 in Table 4.1 on page 27 of the draft budget narrative document. However, this adjustment was only included in this one table and was not used as part of the main budget tables showing the year-on-year changes.

Although it is a change from recent practice, the approach of removing non-recurrent funding is consistent with the approach the Welsh Government adopted for the 2011-12 draft budget, following the 2010 Spending Review. In the 2011-12 draft budget, the Welsh Government removed non-recurrent capital allocated from the Strategic Capital Investment Fund (which was similar to WIIP). However, the draft 2011-12 budget did not explain that there had been any adjustments. The 2011-12 draft budget documents described the 2010-11 baseline as being the 2010-11 Supplementary Budget, with 'additional MEG to MEG transfers' of funding between departments.

### **Is the Welsh Government's approach potentially confusing?**

In my view, it is not inherently confusing to have both the unadjusted and adjusted year-on-year changes in the draft budget narrative 2016-17. However, I consider that the adjustments could have been better explained. In considering the quality of the budget narrative, I think it important to bear in mind the circumstances under which this draft budget was produced. The UK Government Spending Review was published on 25 November 2015; a month later in the year than the 2010 Spending Review. The Welsh Government published its draft budget and explanatory documents less than two weeks later. That the Welsh Government responded to the Spending Review, developed a detailed draft budget and completed and translated the accompanying documents in under two weeks is a significant achievement.

Looking specifically at the 2016-17 draft budget narrative documents, there is very little explanation of the rationale for the adjustments and the difference between the two sets of figures. The documents do not explain that the Welsh Government has adopted a different approach from that taken in recent years because the draft budget 2016-17 follows a Spending Review. Nor do the documents set out a rationale for why a different approach is required following a Spending Review. The draft 2011-12 budget following the 2010 Spending Review similarly did not set out any rationale for the different approach either. Therefore over time, the fact that the Welsh Government takes a different approach to presenting figures following a Spending Review and what that entails has not been clearly articulated.

Although the budget documents provide little explanation, the Minister's subsequent [letter](#) set out the view that 'if we had not removed the non-recurrent allocations, the budget position for 2015-16 would be artificially inflated and would distort the ability to make like-for-like comparisons'. This explanation suggests that the reasons for the adjustments were concerns over comparability between 2015-16 and 2016-17. I fully understand the concern to make like-for-like comparisons. And I recognise that there were some difficulties with doing that in the draft budget. But the key practical difference in the draft budget 2016-17 compared to previous years was that the Welsh Government had not allocated all of the available capital in line with the WIIP at the time of the draft budget. Therefore, the issue was not that the 2015-16 position would be artificially inflated but that the 2016-17 draft budget figures for departmental capital were understated because WIIP funding had not yet been allocated. Had the WIIP been allocated and included in departmental budgets then the year-on-year changes could have been presented in the same way as recent draft budgets. In my view, the budget narrative and letter could both have explained this issue more clearly.

The appendices of the budget narrative document provide a reconciliation between the 1<sup>st</sup> Supplementary Budget 2015-16 and the baseline. The heading in the tables state 'Adjustments to remove non-recurrent allocations from Reserves'. This would suggest that the Welsh Government is removing funding that was initially held in reserves and then subsequently allocated to departments in the Supplementary Budget. However, as I understand it, the WIIP capital funding listed was not solely allocated from reserves in 2015-16. Some of the capital funding had been allocated to the departments in previous Budgets. Welsh Government officials told us that the reference to reserves reflects that the funding had been allocated centrally. Nonetheless, I consider that the heading could have contributed to confusion.

The broader risk is that the effect of the adjustments to the draft budget potentially painted an overly positive picture of Welsh public finances for 2016-17. I note that much of the media coverage used the adjusted figures to show overall increases for every department other than local government. I myself was surprised to see the reports of

spending increases, given that at the time I was due to publish my report [A Picture of Public Services](#) which showed further spending cuts to 2019-20.

## **Conclusion**

Overall, the Welsh Government's approach of removing non-recurrent allocations could be seen as consistent with what the UK Government does during a Spending Review and is consistent with the approach the Welsh Government took following the 2010 Spending Review. However, the approach was different from the approach taken to presenting changes to budgets over recent years. And in my view, the rationale for using a different approach could have been more clearly explained. There were some complexities involved in presenting year on year changes, particularly to capital, using the approach it had previously adopted of comparing to the Supplementary Budget. However, in my view these complexities were ultimately due to the Welsh Government's decision not to allocate WIIP and to add the funding to reserves. The Committee may wish to explore further with the Welsh Government how it can best explain such complexities through the budget narrative.

In my view, there are benefits in the approach the Welsh Government adopted of being clearer as to recurrent capital baselines. One idea may be for the Welsh Government to present WIIP as a separate budget line. Where the Welsh Government knows how it intends to allocate the WIIP it could include an explanation using the format adopted in the 2014-15 draft budget narrative to show how WIIP funding is being allocated to Departments. This approach would allow a more consistent comparison of the departments' recurrent baselines as well as enabling more transparency and scrutiny of the annual allocation through WIIP. It may also help avoid confusion in future where the Welsh Government has not decided exactly where to allocate WIIP ahead of the draft budget. Instead of recording the funding in reserves, it would have its own budget line which could then be compared year-on-year. The Committee may wish to consider and discuss with the Welsh Government whether adopting this approach would be practical and helpful.