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Public Finance Scrutiny Unit

Access to funding from the United Kingdom Reserve

Paper 3 of 5

As part of the five-part series on the Draft Budget 2015-16, this Briefing Paper describes the mechanisms through which the Northern Ireland Executive is able to gain access to additional temporary funding from the United Kingdom Reserve. To establish context, the Paper first explains the duty placed on the Executive and its departments to control expenditure and to contain pressures. Such information establishes the circumstances in which Reserve funding may be accessed.

Key points

- The Executive (including its departments) is expected to maintain a balanced budget. This is central to the prevailing financial arrangements under current devolution: those arrangements establish rules – the Public Finance Framework – that inform decisions made by the Executive about the budget, amongst other things; and thereby facilitate the Executive's delivery of effective government.

- At present, the rules do not require the Executive to maintain Departmental Unallocated Provision as contingency.

- In usual circumstances, the rules require the Executive to absorb expenditure pressures by making relevant reductions and reallocations as it determines to be appropriate, following consideration of relevant facts, including competing needs, priorities and scarce resources, as well as the rules surrounding public expenditure and finance.

- In exceptional circumstances, the rules allow for the Executive to access to the UK Reserve under specified terms and conditions, including repayment in the subsequent year.

- Moreover, the rules afford Treasury discretionary power to impose penalties if it finds that the Executive has seriously mismanaged its finances. However, it appears that the Executive may avoid such penalties if it successfully accesses the UK Reserve and complies with terms and conditions specified by Treasury.

Introduction

This Briefing Paper is the third in a five-part series that covers key issues arising out of the Draft Budget 2015-16. The series is not intended to exhaustively address the full implications of the proposals: much of the detail that will inform impact is still to follow in terms of how each department will implement the proposals. Also, the timetable for the Assembly to scrutinise and debate the Draft Budget is extremely tight.

With these two factors in mind, and the desire to facilitate Members' participation in the Assembly's on-going discussions and deliberations about the Draft Budget 2015-16, the series addresses key issues that appear to have raised particular interest. The series complements the Lines of Questioning Briefing (NIAR 753-14, dated 4 November 2014) by the Public Finance Scrutiny Unit (PFSU) within the Research and Library Service (RaISe).

This Briefing Paper aims to support the Assembly's consideration of the Executive's current 2015-16 budgetary proposals. The Paper explains key rules under the prevailing Public Finance Framework in Northern Ireland (i.e. the financial arrangements under current devolution), which relate to public expenditure control, and access to the United Kingdom (UK) Reserve. It also provides important background information to facilitate readers' understanding of the fifth Briefing Paper in the series *Draft Budget 2015-16: reliance on the discretion of the Treasury* (NIAR 771-14,).

The paper is structured in the following way:

- Section 1 starts by explaining UK Treasury's conditions if Northern Ireland accesses the UK Reserve during 2014-15;
- Section 2 sets out terminology to avoid potential for confusion;
- Section 3 draws on key rules arising from UK Treasury and Department of Finance and Personnel policies and guidance concerning the Executive's responsibilities relating to control of expenditure;
- Section 4 provides detail on key rules set out in UK Treasury policies and guidance and legislation, which relate to accessing the UK Reserve;
- Section 5 seeks to explore what would happen if the Executive did not successfully access the UK Reserve; and,
- Section 6 sets out concluding remarks.

1. Access to the Reserve - conditions

On 13 October 2014, the Minister of Finance and Personnel made a statement to the Assembly in which he announced that the Executive has been allowed to gain "*temporary access*" to the United Kingdom (UK) Reserve "*to draw down £100.0 million to assist the Executive in 2014-15,*" if certain conditions are met.[1] These conditions were outlined in the Chancellor's letter dated 9 October (appended to this Paper). They include:[2]

- The Executive's full implementation of the 4.4% baseline reductions as indicated in June Monitoring, which was agreed by the Executive on 31 July 2014;
- The Executive's agreement to a credible 2015-16 budget plan before the end of October 2014; and,
- Further reductions to the Executive's DEL if there is no progress on Northern Ireland's welfare reform legislation.

[1]Statement to the Assembly, 13 October 2014, available online at: http://www.dfpni.gov.uk/statement-on-october-monitoring-round-2014-15.pdf (accessed 15 October 2014) (see page 3)
[2] Statement to the Assembly, 13 October 2014, available online at: http://www.dfpni.gov.uk/statement-on-october-monitoring-round-2014-15.pdf (accessed 15 October 2014) (see page 3)

2. UK Reserve

A number of official publications refer to the 'Reserve' in different ways. It is variously called the 'UK Reserve', the 'National Reserve' and the 'Treasury Reserve'.

Throughout this Paper the term 'UK Reserve' is used, which is defined by the Department of Finance and Personnel (DFP) as:

> *For the entire UK, there is a small centrally held DEL Reserve controlled by HM Treasury. Support from the Reserve is available only for genuinely unforeseeable contingencies which the Executive cannot be expected to manage within the NI DEL.*[3]

[3]DFP (2012) 'Public Expenditure Terminology', available online at: http://www.dfpni.gov.uk/ced-public-expenditure-terminology.pdf (accessed 16 October 2014) (see page 69)

3. Control of public expenditure

This section highlights key elements of the rules that are relevant to departmental budgeting in Northern Ireland for the control of public expenditure. Collectively, these rules help to establish the parameters within which budgets are set and managed by the Executive (including departments) under the prevailing devolution arrangements.

Significantly the rules also include the Treasury's discretionary power, e.g., to provide financial assistance in exceptional circumstances, such as following an Executive's failure to control expenditure within its specified totals.

For ease of presentation, the rules are outlined using the source from which they arise, but not in any particular order of significance.

3.1. The applicability of UK Treasury policies to Northern Ireland

When explaining the rules in this area, first to highlight is the UK Treasury's discretionary power. Section 67 of the Northern Ireland Act 1998 provides that:

> *The Treasury may require the Northern Ireland Ministers and departments to provide, within such period as the Treasury may specify, such information, in such form and prepared in such manner, as the Treasury may specify.*[4]

The above informs the application of all rules under the financial arrangements of current devolution.

3.2. The UK Treasury's Statement of Funding Policy

The Treasury's publication *Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy* is the keystone of the current Public Finance Framework (the Framework) governing the public expenditure system in Northern Ireland and the other devolved administrations. The *Statement of Funding Policy* is usually revised and updated alongside UK Spending Reviews.

At a high level, the Framework establishes the requirement that the Executive is to manage its financial position within the limits that are set during UK Spending Reviews:

> *The Departmental Expenditure Limits set firm, multi-year plans. United Kingdom Government Departments and* ***devolved administrations must live within these plans and absorb unforeseen pressures****. The devolved administrations must ensure they introduce suitable arrangements for the planning and control of public expenditure on devolved services to achieve this. Thus the presumption is that*

[4] http://www.legislation.gov.uk/ukpga/1998/47/part/VI

departments and the devolved administrations will contain pressures on their budget by re-allocating priorities, seeking offsetting savings and, where appropriate, using unspent entitlements from the preceding year.[5] [emphasis added]

Crucially in the context of this Paper, the cited passage emphasises the need for the Executive to contain expenditure pressures within its budget, rather than to seek additional resources from the UK government. In particular, the duty is placed on the Executive to introduce "suitable arrangements" for the control of public expenditure.

The cited passage underpins the high-level principles set out earlier in the *Statement of Funding Policy*:

The UK Government and the devolved administrations have shared interests including:

[…]

- *Maintaining and improving the disciplined management of the public finances.*[6]

Further to the above, one of the 'key principles' for management of UK public finances, which is set out in *the Statement of Funding Policy,* is "*discipline: the system of devolved finance is subject to overall UK macroeconomic and fiscal policy*".[7]

This principle is important because it serves as a reminder that Northern Ireland's public finances under current devolution are ultimately under the remit of the UK government. This point is underlined later in the *Statement of Funding Policy*:

…the devolved administrations' budgets continue to be determined within the framework of public expenditure control and budgeting guidance in the [UK].[8]

Another 'key principle' of the *Statement of Funding Policy* is:

…autonomy: each administration has fiscal responsibilities and freedoms to match its executive and legislative powers ***within the terms of the***

[5]HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 27)
[6]HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 5)
[7]HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 6)
[8]HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 6)

> ***devolution settlements and UK-wide spending framework**.*[9] [emphasis added]

Finally, relevant to the current context, the *Statement of Funding Policy* states:

> *..the presumption is that departments and the devolved administrations will contain pressures on their budget by re-allocating priorities, seeking offsetting savings and, where appropriate, using unspent entitlements from the preceding year, not through in-year access to the DEL Reserve. The establishment of Departmental Unallocated Provisions is encouraged for this purpose.*[10]

'Departmental Unallocated Provision' (DUP) is in effect a contingency fund held for the purposes of meeting emerging and unanticipated expenditure pressures. At present, however, DUP is not held in Northern Ireland, as noted in DFP's advice on 9 May 2012 to the Committee for Finance and Personnel that the Executive is not required to hold DUP:

> *The Improving Spending Control document places considerable emphasis on risk management and contingency arrangements. In particular, there is now a requirement for Whitehall departments to identify 5 per cent of their budget that could be reprioritised to fund unforeseen financial pressures. [T]he Executive operates, uniquely within the UK, the in-year monitoring process which can successfully address unforeseen pressures.* ***HM Treasury has confirmed that the requirement to set out such explicit financial contingency plans does not apply to Northern Ireland.***[11]

This enables the Executive to do **precisely the opposite:** overcommit resources in an attempt to minimise end of year underspends.

[9] HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 6)

[10] HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 27)

[11] DFP reference CFP112/11-15

The level of overcommitment at recent Monitoring Rounds is shown in Table 1.

Table 1	Overcommitment (£m)	
Monitoring Round	Resource	Capital
October 2014-15	25.0	n/a*
June 2014-15	0.0	38.6
January 2013-14	24.8	(0.3)
October 2013-14	19.4	8.0
June 2013-14	16.8	10.5
January 2012-13	8.0	0.0
October 2012-13	14.6	10.3

* at the time of writing, the full October 2014-15 had not been agreed by the Executive and capital remained to be determined.

In the current circumstances, the Executive's practice of overcommitment gives rise to an issue for scrutiny.

Scrutiny point: with hindsight, would it have been more prudent in terms of efficient and effective management of expenditure pressures, if the Executive had held Departmental Unallocated Provision rather than overcommitting?

3.3. The UK Treasury's Budgeting Guidance

Another publication serves - in part - to underpin the *Statement of Funding Policy*, i.e. the Treasury's *Consolidated Budgeting Guidance,* which is revised and updated annually. The latest version explains the need for departments (and by extension the devolved administrations) to manage their activities, and the resources that support them:

> *…programmes need to be managed to maximise effectiveness, efficiency and economy in the use of public funds. For programmes in DEL that is well understood. Because DEL programmes compete for resources within a fixed envelope departments are under a clear pressure to review programmes, re prioritise and pursue efficiency measures.*[12]

The above-cited passage again highlights the responsibility placed on departments to live within a fixed budgetary limit, and to do so by managing programmes through review, reprioritisation and efficiencies.

[12]HMT (2014) 'Consolidated Budgeting Guidance 2014-15' available online at: https://www.gov.uk/government/publications/consolidated-budgeting-guidance-2014-to-2015/consolidated-budgeting-guidance-2014-to-2015 (accessed 24 September 2014)

Consolidated Budgeting Guidance also emphasises that compliance should not only be with the *letter* of the guidance, but also with its *spirit*:

> *Sometimes departments' or public bodies' consultants offer them suggestions for ways round the spending control framework. We have no interest in such schemes. Departments are asked to go with the spirit of the spending control framework. If a transaction is clearly just a way round the letter of the rules, then departments should follow the spirit of the rules.*[13]

3.4. Managing Public Money Northern Ireland

At the devolved level, the DFP publication *Managing Public Money Northern Ireland* sets out principles of public financial management. In particular, it states:

> *Resources are provided by central [i.e. the UK] government and hence it is expected that the public sector in Northern Ireland will operate within the broad framework established by HM Treasury.*[14]

Importantly, this highlights recognition at the Northern Ireland level that, even where specific Treasury policies may not apply to the letter in Northern Ireland, there is a general expectation that the spirit of the policies is taken into consideration.

The above-cited passage serves to reinforce the relevance of the rules Treasury policies noted above.

3.5. DFP's 2014-15 In-year Monitoring Guidelines

Also at the devolved level, a further DFP publication, the *In-year Monitoring Guidelines*, explains the duty placed on departments not to exceed their budgetary limits.

The In-year Monitoring process operated by the Executive is non-statutory. DFP develops the rules for the operation of the process, and updates these as necessary.

The underlying purpose of the In-year Monitoring process is to facilitate DFP's corporate aim to "*help the Executive secure the most appropriate and effective use of resources and services for the benefit of the community*".[15]

The 2014-15 version of the In-year Monitoring Guidelines states:

> *The process is not intended to facilitate the re-opening of the agreed Budget position and **departments must treat all allocations set in the***

[13]HMT (2014) 'Consolidated Budgeting Guidance 2014-15' available online at: https://www.gov.uk/government/publications/consolidated-budgeting-guidance-2014-to-2015/consolidated-budgeting-guidance-2014-to-2015 (accessed 24 September 2014) (see page 4)
[14]DFP (2008) 'Managing Public Money Northern Ireland' available online at: http://www.dfpni.gov.uk/index/finance/afmd/afmd-key-guidance/afmd-mpmni/mpmni_chapters.pdf (accessed 26 September 2014) (see page 3)
[15]DFP Corporate Plan 2012-15, available online at: http://www.dfpni.gov.uk/dfp-corp-plan-12-15-and-oper-plan-12-13.pdf

> ***course of the Budget process as ceilings, and should seek to manage their activities to contain spending within those ceilings, unless and until any increase is agreed by the Executive.***[16]

The cited passage is important in the context of this Paper, because it explicitly establishes that **departments work on the basis of agreed budgets.** In other words, **they must not plan on the assumption that bids will be met through the In-year Monitoring process.**

In practice, the rules are issued as guidance, and if departments do not comply, **DFP has no formal authority to compel them to do so.** Nevertheless, the above sub-sections guide public expenditure control in Northern Ireland.

[16] http://www.dfpni.gov.uk/in-year-monitoring-of-public-expenditure-2014-15-guidelines.pdf (accessed 23 September 2014) (see page 5)

4. Access to the UK Reserve

This section first sets out key provisions in relation to accessing the UK Reserve. It then highlights the current context in which the Executive has sought access to the UK Reserve, including its efforts to contain expenditure through reallocation and redistribution.

4.1. UK Reserve claims

As noted above, DELs set firm, multi-year plans and the Executive must live within these plans and absorb unforeseen pressures. In the Treasury's *Statement of Funding Policy,* however, there is provision in "*exceptional circumstances*" for the Executive to access the UK Reserve, through the Secretary of State, on a case-by-case basis and specifically where:

> ***1.*** *a United Kingdom department is granted access to the Reserve to enable it to meet exceptional pressures on a spending programme. If a devolved administration has a comparable programme and establishes that it faces similar exceptional pressures, unforeseen at the time spending plans were settled, it will have the opportunity to make its case on access to the Reserve which will be considered. There is no automatic application of the Barnett Formula to Reserve claims by departments of the United Kingdom Government. Reserve claims paid to a devolved administration may be higher or lower than a population share depending on the circumstances of the claim or other pressures facing the United Kingdom Government; and*
>
> ***2.*** *Scotland, Wales or Northern Ireland faces exceptional and unforeseen domestic costs which cannot reasonably be absorbed within existing budgets without a major dislocation of existing services. Access to the Reserve may also be considered for Northern Ireland in accordance with the specific agreement reached for the devolution of policing and justice issues.*[17]

Simply stated, paragraph 2 (above) seems to allow access to the UK Reserve if exceptional expenditure pressures would significantly affect existing provision of services.

The *Statement of Funding Policy* further qualifies such access, stating Treasury treats devolved administrations' access claims just like UK departments:

> *Reserve claims on behalf of the devolved administrations will be judged by the same criteria as claims for United Kingdom departments (including*

[17] HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 27)

exceptionally any future year consequences) and devolution will not lessen in any way the basis of entitlement of the Scottish and Northern Ireland Executives and the Welsh Assembly to access to the Reserve.[18]

Moreover, in the case of Northern Ireland, it specifies that:

Access to the Reserve may also be considered for Northern Ireland in accordance with the specific agreement reached for the devolution of policing and justice issues.[19]

At the very least, the cited passage demonstrates that the particular security-related circumstances of Northern Ireland may be taken into account when determining access to the UK Reserve.

Unfortunately, apart from the Northern Ireland security-related provision, the *Statement of Funding Policy* does not specify criteria that devolved administrations could rely on to make claims on the UK Reserve, nor criteria that the Treasury uses when assessing such claims. Instead, as noted in section 3.2, the *Statement* guides public expenditure control at a high level.

For further information on Reserve claims, one has to look to other Treasury policies, which are noted in the below sub-sections.

4.1.2. Other Treasury policies

Improving Spending Control

In April 2012, the Treasury published a policy called *Improving Spending Control*, which includes a section on the UK Reserve. The policy states:

The last Spending Review reduced the size of the Reserve to ensure that the maximum possible resources could be allocated to government priorities. As a result, the Treasury has had to take steps to tighten the rules around access to the Reserve, ensuring it is spent on genuinely unforeseen, unaffordable and unavoidable pressures, or certain special cases of expenditure that would otherwise be difficult to manage, as agreed with the Chief Secretary. In the Consolidated Budgeting Guidance, the Government sets out that support from the Reserve must be repaid the

[18] HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf

[19] HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 27)

> *following year by means of a reduction in the Department's DEL and will preclude carrying forward an underspend through Budget Exchange.*[20]

The above passage reinforces the requirement that claims on the UK Reserve be for unforeseen, unaffordable and unavoidable reasons. It also highlights that repayment is achieved through reduction in the subsequent year's DEL. Importantly, it also states that **if UK Reserve funding is provided, the ability of the Executive to use the Budget Exchange Scheme to manage year-end underspends will be removed (see below).**

Improving Spending Control contains a further provision in relation to the criteria for assessing claims on the UK Reserve:

> *The process for assessing Reserve claims will take account of the department's or devolved administration's capability and past performance. This will include an assessment of the amount of Reserve funding allocated in the past, the number of Reserve applications received, and any cases where Reserve funding has been allocated and gone unspent in previous years.*[21]

In other words, the Executive's track record in financial management is relevant. In this context, it is noteworthy that on 5 October 2012, DFP stated in a letter to the Committee for Finance and Personnel that:

> *The Northern Ireland Executive has not in the past accessed the Reserve on its own accord in order to seek funding for unforeseen pressures. The only past Reserve claim has occurred where an unforeseen pressure was common across the Devolved Administrations and Whitehall (e.g. student loan subsidy).*[22]

Consequently, it is reasonable to infer that in the present context the Executive successfully demonstrated that it had not previously had to rely on assistance from the UK Reserve, in order to meet its expenditure commitments. This appears to establish that **the present financial difficulties are unprecedented in UK-Executive financial relations.**

In addition to the above, *Improving Spending Control* contains other provisions which appear to be relevant to claims on the UK Reserve. The policy states:

[20] HMT (2012) 'Improving Spending Control' available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220648/improving_spending_control.pdf (accessed 17 October 2014) (see page 15)
[21] HMT (2012) 'Improving Spending Control' available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220648/improving_spending_control.pdf (accessed 17 October 2014) (see page 15)
[22] DFP reference MISC77/11-15

> *Particular conditions and/or penalties will be applied to Reserve claims that relate to failures of financial management or are inappropriate.*[23]

On 9 May 2012, however, DFP informed the Committee for Finance and Personnel that the publication of *Improving Spending Control*:

> *…has no significant **new** implications for Northern Ireland. It reiterates spending control arrangements that the Executive already adheres to and where there are some changes outlined within the publication, these do not apply to Northern Ireland.*[24] [emphasis added]

The above-cited passage may therefore imply that the Treasury's ability to apply penalties does not arise from *Improving Spending Control,* but instead was a reiteration of an established, pre-existing element of spending control arrangements. Section 5 below contains more information on penalties.

Finally, *Improving Spending Control* states:

> *All additional funding from the Exchequer should be presumed to be a Reserve claim, except where agreed as part of the Budget Exchange system or explicitly stated otherwise in writing by the Chief Secretary [of the Treasury].*[25]

The implication of this cited passage is that, no matter what any request might be called (e.g. whether named a 'loan' or 'facility'), *de facto* it is a claim upon the UK Reserve.

The Budget Exchange Scheme

The *Budget Exchange Scheme* is a mechanism that allows departments to carry forward DEL underspends from one year to the next. The limits on the Budget Exchange Scheme that apply to Northern Ireland amount to 0.6% of resource DEL and 1.5% of capital DEL.[26]

Consolidated Budgeting Guidance

Finally, *Consolidated Budgeting Guidance* gives more detail on the rules for accessing the UK Reserve:

> *Departments that think they might require support from the Reserve should contact their Treasury spending team early so that alternative courses of*

[23] HMT (2012) 'Improving Spending Control' available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220648/improving_spending_control.pdf (accessed 17 October 2014) (see page 15)
[24] DFP reference CFP112/11-15
[25] HMT (2012) 'Improving Spending Control' available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220648/improving_spending_control.pdf (accessed 17 October 2014) (see page 15)
[26] https://www.gov.uk/government/news/alexander-announces-new-budget-flexibility-for-devolved-administrations

action can be fully discussed while there is still time to put them into effect. Departments' proposals should set out:

- *the size of the pressure*
- *the cause of the pressure and why it was unforeseen*
- *the offsetting actions that have been taken and could be taken to manage the pressure and to absorb it, including cutting costs, cutting inefficiencies, cutting unnecessary programmes and cutting lower priority budgets*
- *the residual pressure, split into capital and resource, and the administration costs and programme elements*
- *the corrective actions they mean to take if support from the Reserve is agreed, as regards the substance of the policy, improved financial management, and paying back the amount provided*

The drawdown of funding from the Reserve is subject to an assessment of need, realism and affordability at the time at which the funds are released.[27]

Simply stated, the above-quoted guidance calls for early, proactive departmental (Executive) action that demonstrates understanding of the pressure and how to efficiently and effectively redress it.

4.2. The Executive's efforts to contain expenditure

It has been noted in the preceding sections of this Briefing Paper that the Treasury requires the Executive to balance its budget and to absorb expenditure pressures.

The Assembly voted on 9 March 2011 to approve the four-year spending allocations set out in *Budget 2011-15,*[28] in line with the Spending Review 2010 settlement. These allocations have subsequently been modified on five specific occasions and beyond the routine Monitoring Rounds:

- Capital budgets were realigned in February 2012;[29]
- There was a further realignment of 2013-14 and 2014-15 budget allocations in January 2013;[30]
- A further capital realignment was conducted in October 2013 for the 2014-15 year;[31]

[27] HMT (2014) 'Consolidated Budgeting Guidance 2014-15' available online at: https://www.gov.uk/government/publications/consolidated-budgeting-guidance-2014-to-2015/consolidated-budgeting-guidance-2014-to-2015 (accessed 24 September 2014) (see page 9)
[28] Official Report http://archive.niassembly.gov.uk/record/reports2010/110309.htm#a4
[29] Official Report http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-11-12/14-February-2012/#a1
[30] Official Report http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-12-13/22-January-2013/
[31] Official Report http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Reports-13-14/21-October-2013/

- Resource DEL baselines for most departments were reduced in the June 2014-15 Monitoring Round;[32] and,
- Resource DEL baselines for most departments were again reduced in the October 2014-15 Monitoring Round.[33]

These redistributive exercises may perhaps be regarded as evidence that the Executive has not simply ignored emerging financial pressures, but instead has repeatedly sought to proactively redress them through the In-year Monitoring process. Despite these efforts, a number of unresolved political issues remain, notably the implementation of Welfare Reform. This was highlighted in the Minister of Finance and Personnel's statement to the Assembly on 13 October 2014:

> *Since June, it has become apparent that a number of departments face inescapable pressures that cannot be addressed from within their existing Resource DEL allocations. These pressures are in addition to the costs of not implementing Welfare Reform.*
>
> *My officials have scrutinised departmental pressures and it has been determined that £125.0 million of these are genuinely inescapable, with many involving legal or contractual commitments. Failure to address these departmental pressures and the cost of not implementing Welfare Reform through the in-year monitoring process would increase the risk that the Executive would breach its HM Treasury control total on Resource expenditure.*[34]

The following sub-section examines whether the Executive had any alternatives to seeking access to the UK Reserve.

[32] Written Statement by the Minister of Finance and Personnel http://www.niassembly.gov.uk/Assembly-Business/Official-Report/Written-Ministerial-Statements/Department-of-Finance-and-Personnel--2013-14-Provisional-Outturn2014-15-June-Monitoring-Round/

[33] Statement to the Assembly, 13 October 2014, available online at: http://www.dfpni.gov.uk/statement-on-october-monitoring-round-2014-15.pdf (accessed 15 October 2014) (see Annex B)

[34] Statement to the Assembly, 13 October 2014, available online at: http://www.dfpni.gov.uk/statement-on-october-monitoring-round-2014-15.pdf (accessed 15 October 2014) (see page 2)

5. Alternative funding

The Executive is not permitted to borrow for purposes of funding resource expenditure.[35] In any case, the *Statement of Funding Policy* provides that "*any increases in borrowing must be offset by reductions in other spending.*"[36] So, even if borrowing increases were achievable, it would not represent an alternative means of addressing the expenditure pressures. Rather, it is envisioned that borrowing would be used alongside it.

So what alternative could the Executive consider under the current financial arrangements under devolution? It could have chosen to do nothing and simply breach the control totals for 2014-15. It appears that the consequences of such a breach could result in penalties, as the *Statement of Funding Policy* states:

> *Breaches in DELs which materialise at the end of the year would be viewed by the United Kingdom Government as serious mismanagement on the part of the devolved administration and the presumption would be that the following year's DEL and grant to the devolved administration would be reduced by an amount equivalent to the breach.*[37]

On the face of it, the apparent effect of the above would be a DEL reduction for 2015-16, due to serious financial mismanagement resulting in a breach. It also could result in **additional penalties** imposed by Treasury.

It appears that the issue of penalties is the material difference between the above and the consequences that would be expected to follow a Northern Ireland claim on the UK Reserve. The breach would result in additional penalties: permitted access to the Reserve apparently would not, as noted in the statement of the Minister of Finance and Personnel on 13 October 2014:

> *The consequences of breaching the block grant would have been multiple and would have been grave.*
>
> *Not only would HM Treasury have removed the total of our overspend which would have been in the range of £200.0 million to £300.0 million from next year's Budget, **there was the prospect of an additional penalty heaped on top**. Issues that are important to this Assembly like the ongoing discussions on the devolution of corporation tax powers would have ceased, and the flexibilities we are seeking for the continued funding*

[35]The prevailing devolution legislation in the UK (*Scotland Act 1998*[35], *Northern Ireland Act 1998*[35] and *Government of Wales Act 2006*[35]) empowers UK devolved governments to borrow to manage short term cash flow, and for capital investment purposes under the Reinvestment and Reform Initiative (RRI).

[36]HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 21)

[37]HMT (2010) 'Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy' available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf (accessed 24 September 2014) (see page 29)

> *of the proposed Community Safety College at Desertcreat would not have materialised.* ***It was also possible that HM Treasury wouldn't have even tolerated us heading towards an overspend and could have stepped in before year-end and begun to manage our access to cash on a day-to-day basis****. In the inevitable discussions with Treasury that would have followed a breach,* ***I am certain that we could not have escaped without the Treasury spotlight being shone on our so-called 'super-parity' measures****. Mr Speaker, each of those possible negative consequences have been avoided as a result of this agreement.*[38] [emphasis added]

Another critical difference between the two – i.e. a breach due to serious financial mismanagement as opposed to agreed access to the UK Reserve – is that the former could result in '…*Treasury stepping in before year-end and …manag[ing] [Northern Ireland's] access to cash on a day-to-day basis…'*.

It remains unclear from the currently available information precisely as to which provision the Treasury would rely on to 'step in'. In this context however, it may be worth noting that section 58 of the Northern Ireland Act 1998 provides:

> *The Secretary of State shall from time to time make payments into the Consolidated Fund of Northern Ireland out of money provided by Parliament of such amounts as he may determine.*[39]

The reference in section 58 to the Secretary of State making a determination on the flow of money from the UK Parliament to the Northern Ireland Consolidated Fund may be relevant.

In the event that the Draft Budget is not approved by the Assembly, it would be prudent to establish the application of section 58.

Scrutiny points: is section 58 of the Northern Ireland Act 1998 applicable if the Draft Budget is not approved?

What are the reasonably foreseeable consequences of the Treasury managing the Executive's access to cash on a day-to-day basis if the Draft Budget is not approved?

In light of the information presented throughout this section, the Executive appears to have had no option but to seek additional funding from the UK government - through accessing the UK Reserve - in order to make-up the anticipated shortfall for 2014-15. It appears the Executive's failure to act could have resulted in a breach of the control limits and resulted in punitive financial consequences.

[38]Statement to the Assembly, 13 October 2014, available online at: http://www.dfpni.gov.uk/statement-on-october-monitoring-round-2014-15.pdf (accessed 15 October 2014) (see page 6)
[39]http://www.legislation.gov.uk/ukpga/1998/47/section/58

6. Concluding remarks

This Paper has set out key elements of the Public Finance Framework of current devolution that relate to the Executive's access to the UK Reserve. It is clear that the combination of statutory provisions and policies under the Framework provide the Treasury with a significant degree of discretion.

This will be highlighted if the Executive gains access to the Reserve and the UK Treasury subsequently reduces Northern Ireland's DEL for 2015-16 by up to £100 million. However, in the event that the Draft Budget were not approved, the Executive accessing the Reserve would no longer be the issue. Rather, the focus would shift onto what action Treasury would take under the Public Finance Framework, raising issues such as:

- How would Treasury step in and manage Northern Ireland's access to cash on a daily basis?
- What other Treasury-imposed consequences would flow from a failure to agree a Budget?

Appendix

HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

9 October 2014

Dear Peter,

Thank you for your letter of 7 October setting out the budgetary position. It is a matter of some concern that the Northern Ireland Executive finds itself in this position.

The Statement of Funding Policy is clear that Departmental Expenditure Limits set firm, multi-year spending allocations, and like UK Government departments, each devolved administration is expected to live within these plans. The presumption that the Northern Ireland Executive should contain pressures within existing budgets by re-allocating priorities and seeking offsetting savings is also well established.

I appreciate that, alongside the deputy First Minister and other Ministers in the Executive, you took steps in relation to the June Monitoring Round to deal with some of the pressures.

You have indicated that even with that action and further planned re-allocations, the Executive will be unable to live within its 2014/15 budgets. You have suggested that the Executive be provided with a 'facility' of between £100m and £150m to cover emerging pressures which on current assessments you believe are inescapable.

Such an arrangement is effectively a call on the DEL Reserve. I am prepared to permit access to the Reserve of up to £100m this year, with the following conditions:

- The Executive need to fully implement the budget changes agreed in the June monitoring round and the indicative further reductions and reallocations highlighted at that stage.
- Access to the Reserve of up to £100m will be permitted if the Executive remains unable to identify other ways of further managing and minimising the pressures identified.
- Firm revised Northern Ireland departmental allocations for the remainder of 2014/15 will need to be agreed on that basis.
- An amount equivalent to the level of the Reserve access you ultimately require in 2014/15, up to £100m, will be deducted from the Executive's control total for 2015/16, in line with the arrangements set out in the Statement of Funding Policy.
- Amendments to the NI Executive's DEL control totals to be processed at the Supplementary Estimates round which related to forgone AME savings due to the

failure to progress welfare reform remain as set out in the Chief Secretary's earlier correspondence: -£87m in 2014/15; and -£114m in 2015/16.

- The Executive will need to agree with the Treasury, before the end of October 2014, a credible plan for a balanced 2015/16 budget which reflects these allocations.
- We will need to assess in-year 2014/15 progress on an ongoing basis to ensure that departmental plans remain deliverable; and develop a shared understanding of the medium-term sustainability of the Executive's spending. This will need to include, over the coming weeks, an assessment of the 2015/16 position.
- Access to the Reserve is only granted exceptionally, and there can be no expectation that further access will be available in future years.

I trust that these terms are acceptable. I am copying this letter to the Chief Secretary and the Secretary of State for Northern Ireland.

George Osborne.

GEORGE OSBORNE