Good practice guidance

Guide to corporate finance in the public sector

NAO National Audit Office

September 2022

This guidance describes corporate finance in the public sector through the lens of the National Audit Office's investigations and value for money studies involving government transactions, organisations and functions. It contains key questions to support scrutiny of corporate finance activities by senior decision-makers informed by case studies drawn from our published reports and supported by references to additional government guidance.

We are the UK's independent public spending watchdog

INSIGHT

Contents

The National Audit Office (NAO) scrutinises public spending for Parliament and is independent of government and the civil service. We help Parliament hold government to account and we use our insights to help people who manage and govern public bodies improve public services. The Comptroller and Auditor General (C&AG), Gareth Davies, is an Officer of the House of Commons and leads the NAO. We audit the financial accounts of departments and other public bodies. We also examine and report on the value for money of how public money has been spent. In 2021, the NAO's work led to a positive financial impact through reduced costs, improved service delivery, or other benefits to citizens, of £874 million.

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Introduction

Government and the wider public sector have used corporate finance techniques to support and implement a range of policy objectives, particularly the government response to the global financial crisis and the COVID-19 pandemic. Corporate finance includes asset sales and related transactions, infrastructure and project financing, taxpayer-funded rescues and long-term financial management.

While there can be sound reasons for using corporate finance, it is important to understand the risks and benefits to public finance of its use. Corporate finance arrangements affect the government balance sheet and therefore government's ability to fund its activities.

Corporate finance is a complex and specialist topic. We have examined corporate finance transactions and the organisations performing these activities for more than 35 years. Our work shows that there are many factors that senior leaders must consider to ensure that public bodies manage the risks and benefits to taxpayers when using corporate finance techniques.

This guide brings together insights gained from carrying out work on corporate finance. It is not a technical 'how to' manual. It sets out useful questions, case examples and links to further resources to help decision-makers scrutinise planned or ongoing corporate finance activities.

The guide is for senior leaders responsible for overseeing corporate finance activities. It will also be useful to anyone engaged in or supporting corporate finance activities across the public sector.

About the guide

We identified 14 themes from our reports, and grouped them around three areas to consider when deciding and using corporate finance in the public sector:

1. Understanding the **principles and concepts** for determining whether to use corporate finance and which approaches to take. This section is relevant for all those considering using corporate finance.
2. Exploring the risks and opportunities of using particular **organisations and functions** to achieve your objectives.
3. Deciding on the most appropriate **transaction** to achieve value for money for taxpayers.

The guide sets out why each of the 14 themes is important, key questions to ask, case examples illustrating findings related to each theme from our work, and links to further resources.

Evidence base

The guide draws from our experience of reporting on 139 studies, examining corporate finance activities covering more than 35 years and across a broad range of government sectors. We tested our themes, insights and questions with a wide range of stakeholders in government, professional bodies and corporate finance advisers.

How to use this guide

This guide comprises 14 themes grouped into three areas to consider when using corporate finance techniques in the public sector:

1 Principles and concepts

2 Organisations and functions

3 Transactions

The first area is relevant for all those considering using corporate finance. It helps with the scrutiny of the **principles and concepts** for determining whether to use corporate finance and which approaches to take. Our work shows that for corporate finance activities to be successful, organisations need to have considered the underlying principles and concepts, and have the right organisational arrangements in place to support the delivery of the objective.

The next two areas explore the risks and opportunities around the various **organisations and functions**, and **transactions**, that can be used to achieve the objectives.

In **Part One** of this guide, we set out the key high-level questions senior leaders should consider when scrutinising corporate finance techniques.

In **Part Two**, we share our insights on each of the 14 themes. We set out some questions you may wish to use or consider as you develop your approach. We also include case examples and other useful resources.

Part Three provides some further resources, including information to help with understanding balance sheet accounting and implications; and additional information to support the principles and concepts.

Principles and concepts

- Analysis and evaluation
- Valuation and investment appraisal
- Government balance sheet and accounting
- Capability and advisers
- Governance and stewardship

Organisations and functions

- Companies
- Joint ventures
- Government financial institutions
- Commercial functions and regulators

Transactions

- Asset sales and privatisations
- Acquisitions and investments
- Lending
- Financial guarantees
- Private finance

List of case studies in this guide

Each section of our detailed guidance on pages 9 to 39 is supported by two case studies. We have developed these case studies from our published reports to provide context for the descriptions and questions that we have set out in each section.

	Section	Case study 1	Case study 2
Principles and concepts	Analysis and evaluation	First sale of shares in Royal Bank of Scotland	Thames tideway tunnel early review of potential risks to value for money
	Valuation and investment appraisal	The sale of Eurostar	The Privatisation of Royal Mail
	Government balance sheet and accounting	Evaluating the government balance sheet: borrowing	The sale of student loans
	Capability and advisers	Specialist skills in the civil service	Commercial skills for complex government projects
	Governance and stewardship	Investigation into supply chain finance in the NHS	The Ministry of Defence's arrangement with Annington Property Limited
Organisations and functions	Companies	Companies in government	The Motability Scheme
	Joint ventures	Spinning out MyCSP as a mutual joint venture	Shared Service Centres
	Government financial institutions	British Business Bank	The Green Investment Bank
	Commercial functions and regulators	The adult social care market in England	The economic regulation of the water sector
Transactions	Asset sales and privatisations	The £13 billion sale of Northern Rock assets	The first sale of shares in Lloyds Banking Group The return of Lloyds Banking Group to private ownership
	Acquisitions and investments	Local Authority Investment in Commercial Property	Venture capital support to small businesses
	Lending	Investigation into the Department of Energy & Climate Change's loans to the Green Deal Finance Company	Help to Buy: Equity loan scheme – progress review
	Financial guarantees	Investigation into the Bounce Back Loan Scheme The Bounce Back Loan Scheme: an update	UK Guarantees scheme for infrastructure
	Private finance	Hinkley Point C	The choice of finance for capital investment

Principles and concepts

These questions help with the scrutiny of the principles and concepts for deciding whether to use corporate finance and, if so, which approaches to take.

- What approach and methods has the team used to analyse and evaluate the corporate finance technique(s)? How has the team assessed the risks and expectations of return? How will the analysis/evaluation be monitored and kept up-to-date throughout the organisation or transaction's lifecycle?
- What are the key drivers of the valuation and investment appraisal? Has an independent expert produced the valuation using a range of appropriate methods?
- How does the relevant government balance sheet and financial reporting implications of the proposed transaction or organisational arrangement affect the overall merits of the policy?
- Does the organisation have the appropriate capability and advisory team in place to deliver the intended policy objectives?
- Will in-house experts provide capability, or does the organisation need external consultants, or a mixture of in-house and external experts? Has the team mapped out the expertise it requires?
- What governance and stewardship principles does the organisation need to apply, and how do these relate to relevant guidelines or requirements from public sector financial management?
- How has the organisation identified and addressed any potential conflicts of interest?
- Have these underlying principles been used to decide the organisational or functional model and the selection of a transaction?

Further information

Analysis and evaluation

Valuation and investment appraisal

Government balance sheet and accounting

Capability and advisers

Governance and stewardship

Organisations and functions

These questions help with the consideration of the risks and opportunities of using different organisations or functions to deliver the objective.

- What is the purpose of the organisation or company and how will its strategy achieve these aims?
- What approvals are needed by the organisation to establish a government company or joint venture, and has the organisation received these?
- What alternatives has the team considered to establishing a government-owned company and how has it considered value for money in looking at other options?
- What is the commercial model for generating income and how will the company be financed?
- What risks and opportunities do the new organisation expose the taxpayer to and how will these be managed?
- What skills and capabilities are needed to achieve the aims of the approach or to select an organisation or function type? How will these skills and capability be sourced and appointed?
- What return on investment is required for the approach to meet its aims? What are the success criteria, and will performance be measured and monitored?
- What process has the parent body used to identify and select a joint venture partner? What due diligence has it done?
- What regulation applies to the products or services that will be performed, for example financial services regulation, and how will the organisation comply with these regulations? For example, it could obtain an exemption, or manage regulatory risk.
- How has the parent body considered what governance arrangements it will need to oversee the creation and performance of a new company or joint venture?
- What is the strategy for exiting or transitioning from the organisation/model, or for deciding that it should continue in its existing form?

Further information

Companies

Joint ventures

Government financial institutions

Commercial functions and regulators

Transactions

These questions help with the decision on the most appropriate transaction to apply, including considering how it will ensure it is value for money for the taxpayer.

- What is the reason for the transaction? Is it based on a strong business case – using appropriate principles and concepts (see page 6)?
- Is the transaction a reaction to an external event that requires urgent response by government, and how does this affect the department's approach to delivery?
- Are the plans and judgements surrounding the transaction designed in a way that decision-makers can understand?
- What are the plans for implementing the transaction? How has the organisation considered the factors relevant to the transaction, such as market conditions or the benefits of competitive tension, and incorporated these into the preparation and timing of the transaction?
- Does the organisation have the necessary approvals to proceed with the transaction at the given time?
- Who is implementing the transaction? What support do they need and what are the plans for accessing the relevant in-house expertise and external advice?
- How has the team assessed risk and return? What is the organisation's risk appetite?
- How will risks be managed and mitigated? How will returns be used?
- What market benchmarks or pricing information has the team used, and what assurances can it provide that it used the most appropriate information?
- What internal factors influence the timing and speed of the transactions, and what influence does the transaction team have over them?
- What external factors have the most significant implications for the success or failure of the proposed transaction?
- How will lessons from this process be gathered and used to improve future transactions?

Further information

Asset sales and privatisations
Acquisitions and investments
Lending
Financial guarantees
Private finance

Analysis and evaluation

To be successful, organisations should apply best practice in analysing and evaluating potential corporate finance techniques.

Analysis is the process of examining data and information about a corporate finance technique, to assess its performance and to recommend improvements or stopping the approach.

Evaluation involves understanding how an intervention is being or has been implemented; what effects it had, for whom and why; comparing what happens with what was expected under Business As Usual; and identifying what can be improved, estimating overall impacts and cost-effectiveness.[1]

Some analysis and evaluation techniques include: cash-flow modelling, applying discount rates and using appropriate assumptions to make decisions to protect taxpayers' funds. Page 44 of this guide also contains example ratios that can be used for assessing the financial viability of companies and suppliers involved in public sector commercial activities.

Relevant government guidance

The Green book – Chapter 2 Introduction to appraisal and evaluation, Chapter 8 Monitoring and evaluation

Government Functional Standard GovS 010: Analysis – The functional standard sets expectations for the planning and undertaking of analysis to support decision-making

Government Analysis Function Career Framework – This document describes some of the skills and experience required in analytical roles

The Magenta Book – Guidance on what to consider when designing an evaluation

1 Source: Green Book: chapter 8.

Questions to ask based on lessons from NAO reports

Basis

- What are the objectives of the analysis/evaluation?
- Has the analysis identified a strategy to achieve the policy objective?
- What skills are needed to complete the analysis/evaluation, and are they available?
- How have the interests of all stakeholders been considered in the analysis/evaluation?

Approach

- How does the analysis/evaluation support senior leaders to make effective judgements and decisions?
- How has the analysis/evaluation addressed the principles of ethics, environmental, social and governance considerations, and equality, diversity and inclusion?
- What markets, financial models or other conditions to help achieve value for money has the analysis/evaluation identified?
- How has the team ensured it has used appropriate methodologies and metrics?

Risk

- Have relevant stakeholders been identified? Do they understand the policy objective? Have the risks to achieving the objective been identified and mitigated?
- Do those analysing/evaluating the outcomes understand the task they have been asked to carry out?
- How has the team considered the costs and risks of any corporate finance technique to consumers and/or taxpayers?

Review

- What analytical/evaluative techniques is the organisation planning to use to assess the outcomes of the corporate finance technique against the policy objective, and are they appropriate to the risks?
- What strategies are in place to deal with unexpected challenges, or changes to the plans or methodology?
- Do reviewers have the skills to complete an effective review and to make appropriate judgements?

Analysis and evaluation

First sale of shares in Royal Bank of Scotland (June 2017)

Example of using appropriate techniques to return a shareholding to the private sector over time.

To maintain financial stability at the height of the financial crisis, the government injected a total of £45.5 billion into the Royal Bank of Scotland (RBS) between October 2008 and December 2009.

UK Financial Investments (UKFI) reviewed all disposal options and chose the most appropriate one to sell the shares. UKFI's advisers conducted a comprehensive valuation on a timely basis before the sale. They used appropriate methodologies for the banking sector as well as tailored methodologies to reflect RBS's ongoing restructuring activity.

UKFI and its advisers received no indications of interest from a strategic investor to buy a stake in RBS. In the absence of such a buyer, UKFI reviewed the disposal options via the public markets. It concluded that an accelerated book-build was the most appropriate option to achieve the £2 billion sale announced in the 2015 Summer Budget at the lowest possible discount and execution risk. The windows of opportunity for a sale were restricted by regulatory and reputational considerations. UKFI chose the August 2015 sale window as market conditions were good, and potential investors were supportive.

Thames Tideway Tunnel: early review of potential risks to value for money (June 2014)

Example of evaluating risk and return in the early phases of a major infrastructure project.

The Thames Tideway Tunnel is a project to build a large sewer running under the River Thames for 25 kilometres from Acton in the West to Abbey Mills in the East. The tunnel was the government's preferred solution to the problem of spills from London's sewers into the tidal part of the River Thames.

The government identified four significant risks to this project: scale; construction; management; and regulation. In order to help Thames Water manage these risks and reduce any potential impact on consumers or taxpayers, the government worked with Ofwat and Thames Water to develop a bespoke approach to managing the project's risks, which involved the formation of an infrastructure provider to be licensed and regulated by Ofwat.

This review examined potential risks and set out what we expect good practice to look like in six areas we believed to be most critical to achieving value for money for consumers and taxpayers: setting clear project objectives; appraising the options; choosing the right delivery model; managing taxpayer risks; managing project costs and risks; and setting the right charge for consumers.

Other relevant NAO reports

Financial modelling in government

The £13 billion sale of former Northern Rock assets

The Bounce Back Loan Scheme: an update

The Green Investment Bank

Hinkley Point C

Valuation and investment appraisal

Valuation is the process of determining or quantifying the worth of a business, asset or liability by an expert or professional valuer.

Investment appraisal is the analysis done to consider the profitability of an investment over the life of an asset and taking into account the affordability and strategic fit.[2]

Both activities support decisions around whether, and which, corporate finance approach to take, and how to report on the technique used. Experts use a variety of approaches which are underpinned by assumptions, professional judgement, and by assessing wider economic issues. The quality of valuation processes may impact on sale proceeds, so it is important that those using or scrutinising corporate finance activities understand the methods used.

We set out some examples of valuation techniques that have been covered in some of our reports on page 45.

Relevant government guidance

The Green Book – chapter 6 – valuation of costs and benefits and Green Book supplementary guidance: asset valuation

HMT asset sale disclosure guidance

Value for money of public sector assets – Annex A: Valuation of corporate and financial assets and the treatment of risk

Pension Protection Fund – provides valuation guidance for pension funds

HM Treasury's review of quality assurance of government analytical models

HM Treasury's Aqua Book (2015)

Office for Statistics Regulation Quality Assurance of Administrative Data

The government's Uncertainty Toolkit for Analysts in Government

2 Association for project management.

Questions to ask based on lessons from NAO reports

Basis

- What is the purpose of the valuation, and how will it be used?
- Is it clear what is being valued, for example shares, debt, property, other assets or liabilities?
- What are the circumstances of the valuation (for example, is it in normal circumstances, or under exceptional conditions?) and how has the valuer taken that into account?

Approach

- Who is performing the valuation, what experience and qualifications do they have and are they independent of the organisation or transaction?
- Are there observable market benchmarks to support the valuation (for example, share prices from recognised exchanges, prices paid in similar transactions) and how has the valuer taken them into account?
- What different valuation methods have been used to develop a plausible range, and to select the most appropriate result?

Risk

- What adjustments have been made to the valuation and by whom, for example, for illiquidity, to reflect risk, relative influence/control, size, one-off/exceptional circumstances?
- For discounted cash flow valuations, how was the cost of capital derived, and how have underlying cash flow forecasts been tested for reliability?
- What adjustments have been made for the capital structure and balance sheet items including cash, debt and liabilities such as pensions?

Review

- Has the team prepared a sensitivity analysis to consider the effect of varying key assumptions, and what does it show?
- What independent review has there been of the valuation or appraisal, for example by peers or independent reviewers?

Valuation and investment appraisal

The sale of Eurostar (November 2015)

Shows the benefits of using a range of valuation methods and determining market price using a conventional sale process, enabling the government to fully exit its investment.

Eurostar commenced passenger rail services via the Channel Tunnel in 1994. Eurostar was incorporated in 2010 as a UK company jointly owned by the UK government (40% stake) and the national rail operators of France, SNCF (55% stake) and Belgium, SNCB (5% stake).

The UK government had held its minority shareholding as a financial investment. The shareholders agreed to run a competitive sale process for the stake. The sale timetable was tight with little room for contingency because of the intention to agree a deal before the 2015 General Election.

Valuations were used to assess whether offers received were fair and exceeded the value of retaining the shares. Additional assurance from an independent expert was used alongside the valuations prepared by the government and its financial adviser. The project team noted that it would be unlikely to recommend that a sale below the independent adviser's valuation would represent value for money. Ministerial submissions provided valuation ranges and underlying assumptions. Sensitivity analysis considered how alternative assumptions might affect bid levels.

The Privatisation of Royal Mail (April 2014)

Shows the benefits of using a range of valuation methods and determining a market price through an initial public offering, placing the majority of the company in private sector ownership.

In October 2013, the government sold 60% of its shares in Royal Mail plc to private investors via an initial public offering (IPO) on the London Stock Exchange. This generated proceeds of £2 billion. The privatisation implemented the final recommendation of two government reviews by Richard Hooper CBE (2008 and 2010) on securing an affordable, sustainable universal postal service.

The Department for Business, Innovation & Skills (the Department) targeted a majority sale to achieve its policy objectives. Having explored a range of options, an IPO was the Department's preferred method of introducing private capital. The timing of the sale was relatively inflexible and took place under conditions of considerable uncertainty.

The Department sought to understand the value to the taxpayer of both keeping and selling Royal Mail in order to achieve maximum value. The Department estimated that the value of retaining the whole of Royal Mail in public ownership was less than £1 billion. Valuing the company was difficult as its shares were not traded so there was no observable share price. The approach applied by the independent corporate finance adviser was based on a number of different methodologies including in particular a dividend yield approach and earnings multiples.

Other relevant NAO reports

The Sale of the Married Quarters Estate

The £13 billion sale of former Northern Rock assets

Framework to review models

Other useful resources

International Valuation Standards Council (IVSC) – International Valuation Standards

The Royal Institute of Chartered Surveyors – valuation standards

Government balance sheet and accounting

When deciding on what organisations and functions or transactions to use for corporate finance activities, it is crucial to consider how these will be accounted for.

The nature of the corporate finance arrangement will determine the accounting treatment. Therefore, legal and finance teams will need to work together to ensure that the drafting of the arrangement does not have unintended financial reporting consequences.

In this section, we explain the relationship between the various government balance sheet accounting measures. We also set out the principles of accounting for government borrowing included in statistical measures and departmental accounts, and the resulting risks government has to manage.

The way in which the government presents its balance sheet can change – for example, in response to new accounting standards.

Further details on the effect of corporate finance activities on the balance sheet and the importance of different approaches to measuring and reporting are set out in Part Three of this guide, pages 40 to 43.

Relevant government guidance

Managing Public Money – para 4.13 – Transparency

ONS classification process

Government Financial Reporting Manual

OBR fiscal outlook report and OBR fiscal risks report

Exploring-the-UK-governments-contingent-liabilities

Questions to ask based on lessons from NAO reports

Departmental financial reporting and accounting standards

- Has appropriate accounting advice been sought to determine the financial reporting implications for transactions and balances?
- Does the treatment and accounting of assets and liabilities on the balance sheet promote transparency and support good decision-making?
- Does the activity create a contingent liability, or longer-term exposure and has relevant guidance been applied?

Quantification

- Is there an observable market value to support the valuation of assets and liabilities? If not, what benchmarks or estimates are used to determine the value?
- What is the likelihood of the decision and balance sheet implications exposing the taxpayer to significant risk?

National debt and statistical measures

- What is the classification of the economic unit/instrument from a national statistics perspective?
- How will the transaction or arrangement affect the national accounts (see pages 40 to 41 for further information on national and departmental accounts)?
- How would changes to the accounting treatment affect the policy (for example, bringing onto the government balance sheet what was previously excluded)?

Review

- Have appropriate authorities (including HM Treasury) considered existing assets and liabilities before providing new funding for the new venture?
- Where contingent liabilities have been identified, has the Contingent Liability Central Capability team at UK Government Investments been consulted to support with managing the risks that government is exposed to across its portfolio?

Government balance sheet and accounting

Evaluating the government balance sheet: borrowing (November 2017)

Helps to explain the principles of accounting for government borrowing included in statistical measures and departmental accounts, and the risks government has to manage.

The government's fiscal policy and targets for debt and borrowing were based on its preferred statistical National Accounts measures of public sector net debt (PSND) and public sector net borrowing (PSNB). However, alternative measures which serve different purposes such as public sector net financial liabilities (PSNFL) were introduced by HM Treasury to provide a more comprehensive view of the balance sheet. PSNFL is more complete than PSND and includes all financial assets and liabilities in the National Accounts.

Managing the public finances has become more difficult since the financial crisis and as the government has used its balance sheet to pursue its policy objectives. The scale and concentration of the government's assets in the banking, housing and student finance sectors expose asset values to volatility in the economy. Inherent difficulties in measuring some of these assets and liabilities and their impact on cash flows, along with the challenges of estimating the likelihood and timing of liabilities crystallising, make it more difficult for the government to forecast its borrowing needs accurately. At the same time, delays to large financial asset sales or the profile of contingent liabilities, which may crystallise in the event of an economic shock, could mean significant increases in the government's borrowing needs.

The sale of student loans (July 2018)

Helps to explain the relationship between the various government balance sheet accounting measures, in relation to higher education funding.

From 1990, successive governments allowed universities and higher education providers to charge fees to students. Over time they also introduced a system of student loans. As a result, the government's student loan portfolio expanded rapidly.

In 2013, the government decided to sell a portion of the student loans that were issued before 2012. Due to the different accounting frameworks, the National Accounts and Departmental accounts present the sale differently. The impact of the sale on government's overall financial position depends on the balance sheet measure chosen.

Selling student loans reduced public sector net debt (PSND) in direct proportion to the sale proceeds. However, this measure did not take into consideration that the sale resulted in the forfeiture of future receipts from student loan repayments. By contrast public sector net financial liabilities (PSNFL) increased by £1.8 billion as a result of the sale, because the transaction reduced the estimated value of outstanding loans by the estimated impairment of loans expected never to be repaid.

Departmental Accounts apply International Accounting Standards and assume that not all loans will be repaid. The Department for Education reported the shortfall between proceeds and carrying value, which meant that the transaction had an adverse effect on its financial position and performance.[3]

Other relevant NAO reports

Evaluating the government balance sheet: provisions, contingent liabilities and guarantees

Evaluating the government balance sheet: pensions

Other useful resources

IFRS – Conceptual Framework for Financial Reporting

Information hub – for members of the government finance function

3 Statistical National Accounts measures (PSND, PSNB and PSNFL) as set out above are further described on pages 40 to 41.

Capability and advisers

Due to the complex and specialist nature of corporate finance, it is important that organisations using or planning to use corporate finance have the right level of capability to do so. This means having access to the relevant knowledge and experience to make appropriate judgements and put in place the processes to support them.

Central government has developed functions to grow its professional and functional expertise to deliver complex transactions and policies. Government supplements in-house capability by appointing external advisers to support decision-makers, where this is needed.

Relevant government guidance

Managing Public Money – chapter 7 – working with others

Government Corporate Finance Profession Competency Framework

Government Functional Standard GovS 010: Analysis – The function standard sets expectations for the planning and undertaking of analysis to support decision-making

Government Analysis Function Career Framework – This document describes some of the skills and experience required in analytical roles

Questions to ask based on lessons from NAO reports

In-house delivery

- What assessment has been performed to identify the skills required and to ensure that the proposed team has the range of professional expertise and diversity to deliver a successful outcome?
- What arrangements are in place to maintain the knowledge and resources needed to provide monitoring or longer-term support following the initial phase of the transaction or deal activity?
- Does the team have access to relevant sources of information and data from within the department or elsewhere (for example, financial markets data) necessary to complete the activity?
- What processes are in place to ensure those involved in the activity are independent and impartial? For example, processes to make sure they declare conflicts of interest immediately, that conflicts are resolved quickly, and to ensure independence is maintained throughout the engagement.

Central capability and specialist functions

- Have the relevant centres of expertise (for example HM Treasury, UK Government Investments, or the Infrastructure and Projects Authority) been consulted and engaged at the appropriate stage?

External advisers

- Why is external advice required?
- Have external advisers been appointed using appropriate procurement methods?
- How has value for money for taxpayers been considered in the advisers' costs and incentive structures?
- How have the advisers demonstrated relevant experience and regulatory approval to provide advice?

Capability and advisers

Specialist skills in the civil service (July 2020)

Examines the need for developing specialist capability within government and the progress made so far.

The report noted that the government had made progress in developing specialist skills and cross-government functions that support development of these skills. The Cabinet Office's 'blueprint' exercise in 2018 set consistent expectations for its 14 specialist functions and introduced more regularised reporting from functions on their performance, costs and benefits.

The functions were established as an important part of government's efforts to tackle issues and themes that cut across departments. They were intended to coordinate and combine knowledge and insight to tackle cross-government issues. This type of working could also support the development of cross-cutting or transferable capabilities that move across traditional professional or functional boundaries.

In 2018, the Cabinet Office introduced a performance measurement team to monitor the functions' work more closely. The team aimed to make performance reporting more consistent by setting clear requirements for all functions to report to it on their key performance measures. Functions had articulated the skills their people needed to become specialists in government, demonstrating a more structured approach to identifying specialist skills requirements, with the development of people standards, frameworks for professional accreditation and tailored training programmes suitable across all grades.

The report focused on examining four functions and found that while most collected data on the number of people trained through their academies, they did not generally collect data on the impact and benefits of their current training offer.

Commercial skills for complex government projects (November 2009)

Supports the growing importance of skills and clear guidance for commercial and corporate finance activities, a trend which has continued since.

Government had long been aware of the need to improve its commercial skills, and the challenges stemming from an increase in the number and complexity of the contracts that the government had entered into. The growth in both the sophistication and number of different models used by government to contract with the private sector increased the need for awareness of the pros and cons of each approach.

The growing use of private finance to support programmes within local authorities, under central government oversight, resulted in scarce commercial skills in the public sector having to be stretched across a larger number of projects.

The report noted that to achieve value for money, the government needed to ensure projects were being delivered by project teams with the required commercial skills, giving them the ability to interact on equal and professional terms with the private sector. Projects also needed to be led and governed by commercially aware senior civil servants and departmental boards.

Other relevant NAO reports

Lessons from PFI and other projects

Use of consultants and temporary labour

Conflicts of interest

Governance and stewardship

It is crucial that organisations that use corporate finance techniques have appropriate oversight over the complex processes that corporate finance often requires. Corporate finance requires meaningful collaboration between the private and public sectors on governance and stewardship to safeguard taxpayers' funds.

Governance is the system of processes and interactions determined by law or organisational procedures to support the judgements, decision-making and accountability of organisations and their leadership.

Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries, leading to sustainable benefits for the economy, the environment and society.

We have set out our expectations of ethical standards and considerations for how business should be conducted on page 46 to further support governance and stewardship arrangements.

Relevant government guidance

Corporate governance code for central government departments 2017

Companies Act 2006 – particularly sections 170 – 179 on the duties of a company director

Managing public money (MPM) – paragraph 4.1.2 of MPM requires all central government departments to be guided by the Corporate Governance Code

Tailored Reviews: Guidance on reviews of public bodies

The Seven Principles of Public Life

Questions to ask based on lessons from NAO reports

Rationale

- What are the key features of the organisation's business plan?
- What board arrangement is appropriate to support effective decision-making over the life of the organisation?
- What are the terms of reference for those charged with governance and stewardship, and how do these consider the interests of the taxpayer?

Implementation

- What codes of good practice on governance and stewardship have been adopted and can these be demonstrated?
- Is there a code of ethics for relevant parties (for example board members)?

Risk

- How will the appointment process ensure directors are suitably qualified – with the right skills, experience, independence and diversity to meet the organisational requirements?
- What is the process for ensuring that members are provided with sufficient and timely information to support decision-making?
- Have potential conflicts of interest been taken into consideration when appointing those responsible for governance and stewardship?

Review

- What assurance processes are in place for reviewing the effectiveness of governance arrangements periodically?

Governance and stewardship

Investigation into supply chain finance in the NHS (October 2021)

Demonstrates the need for central oversight of novel corporate finance techniques and the management of potential conflicts of interest.

Greensill Capital was involved in delivering two supply chain finance arrangements to the NHS. The Department was not able to provide evidence of any review of a potential conflict of interest in relation to the appointment of the subcontractor.

The Pharmacy Earlier Payment Scheme (PEPS) was introduced by government in 2013 in order to improve cashflow to community pharmacies for the reimbursement of dispensing prescriptions. The Department of Health & Social Care (the Department) assumed that the NHS could achieve savings of £100 million per year in pharmaceutical supplies through supply chain finance but it was unable to provide evidence of realised benefits.

In July 2020, the scheme was revised to enable pharmacies to obtain funds at the beginning of each month, prior to dispensing prescriptions, thereby introducing a higher risk to the lender in the event of a pharmacy failing. The Department did not produce a business case for this change to PEPS because it considered that there were no taxpayer implications associated with the change to risk. The failure of Greensill Capital (the subcontractor) in March 2021 resulted in the Department stepping in to instruct NHS Business Services Authority (NHSBSA) to reimburse pharmacies. Therefore, NHSBSA made payments in advance of need, which *Managing Public Money* states should only occur in "exceptional circumstances". HM Treasury provided approval for the monthly payments to pharmacies, which resulted in an increase in cash requirements of £144 million.

The Ministry of Defence's arrangement with Annington Property Limited (January 2018)

Shows the need for effective oversight of long-term agreements.

The Ministry of Defence (MOD or the Department) entered into a sale and leaseback arrangement with Annington Property Limited, involving the sale of the majority of its married quarters estate. The MOD thereby committed itself to paying rental bills of hundreds of millions of pounds each year stretching into the foreseeable future.

The deal did not generate the improvements in the management of the estate that the families who live in the properties would have hoped for. Meanwhile, the steep increase in house prices meant that the Department had lost out on billions of pounds worth of increases in asset values, while Annington made a significantly higher return on its investment than expected.

The report noted that, at that stage, the Department did not properly manage the risks and responsibilities that it retained, including maintenance and quality, vacancy rates and management costs. The Department and Annington had not worked together to generate greater value from the estate.

The Department faced a challenge to prepare for rent negotiations on an equal footing with Annington, based on proper resourcing, accurate information, and a robust negotiating strategy.

Other relevant NAO reports

- The Nuclear Decommissioning Authority's Magnox contract
- Local authority governance
- Improving operational delivery in government: A good practice guide for senior leaders
- Framework to review programmes
- Lessons from PFI and other projects
- Academies and maintained schools: Oversight and intervention
- Round-up for Audit Committees

Other useful resources

- The UK Corporate Governance Code
- The UK Stewardship Code
- OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 Edition

Companies

Government departments and public bodies have created and own a number of companies which are classified as public bodies but take a distinct legal form and may be described as 'public corporations' as set out in Managing Public Money.

The most common legal form is a limited liability company incorporated and registered under the Companies Act 2006. Companies in government also use other arrangements, such as limited by guarantee, formed by Royal Charter.

Companies may operate at arm's length from government and apply a range of commercial strategies to achieve a particular objective for government, including generating profits or commercial returns. Departmental accounting officers and the directors of government-owned companies are responsible for achieving value for money for taxpayers and the proper delivery of public services through such companies.

Relevant government guidance

Public Bodies Handbook – Part 2. The Approvals Process for the Creation of New Arm's-Length Bodies: Guidance for Departments

UK government arm's-length bodies: the case for them in specialised delivery and how to optimise their use

Partnerships between departments and arm's length bodies – Code of Good Practice

Code of conduct for board members of public bodies

Public Bodies Review Programme

Companies Act 2006, section 172

Managing Public Money (Para A7.7)

Questions to ask based on lessons from NAO reports

Rationale

- What is the purpose, business model and strategy of the company?
- Why does it need to be established as a company?
- What approvals are needed to form the company, and have they been received?
- Who has reviewed and/or amended the articles of association to make sure that they are appropriate?
- Who is the shareholder, for example, is it in the name of the Secretary of State?

Governance

- Who will lead the company and how will they be chosen and appointed?
- What corporate governance arrangements apply to the company, including its board structure?
- Who is responsible for stewardship on behalf of taxpayers and do they have the appropriate powers to make relevant decisions?

Performance

- What are the financial reporting and audit arrangements?
- How will performance be measured and monitored?

Outcomes

- How does the company plan to generate shareholder value, for example, through dividends and distribution, financial engineering, capital appreciation, or sale and how will this benefit taxpayers?

Review/exit

- What arrangement has been made to review whether the company is a going concern?
- Has the need for follow-on funding or financial support been considered from the outset?
- What determines whether, and how long, the company should remain in public ownership?

Companies

Companies in government (December 2015)

Highlights how many companies have been incorporated by government departments and maps their ownership and classification as public bodies.

The 17 central government departments in existence at the date of this report owned or controlled at least 218 companies (excluding company subsidiaries or academy trusts). The number of companies increased by at least 66 between 2010 and 2014. There was no set approval process for forming a company in government and no central guidance on when a company was the most appropriate form of new body.

Public bodies were categorised or classified by the Cabinet Office according to their function and characteristics rather than legal form. A public body (also known as an arm's-length body) is sponsored by a central government department and operates within the terms of a framework document agreed with the department. A public body is accountable through the accounting officer to the Secretary of State for the department and then to Parliament.

Government controlled companies are companies limited by shares or guarantee where government is a member and/or where it exerts control by being able to appoint, approve or remove directors; providing funding, with rights of control over how that funding is spent; own a share conferring special rights; or able to set or constrain corporate policy.

Companies in government which are incorporated under the Companies Act 2006 have equivalent legal status whether they are in the public sector or in the private sector.

The Motability scheme (December 2018)

Shows an example of the relationship between a policy objective and its delivery, and the structure and financial arrangements of the provider company.

The Motability scheme enabled eligible people to choose to exchange mobility allowances paid by government for the lease of a new car, powered wheelchair or scooter. In 2017-18, overall customer satisfaction with the scheme was 99%. The scheme's customers represented 36% of all eligible individuals.

Two organisations delivered the scheme: Motability (a charity) and Motability Operations Limited (a public limited company, owned by four shareholder banks). Motability's governors had often exceeded recommended tenure limits, and there was insufficient consideration of diversity in appointing them. Motability has limited formal influence over Motability Operations' executive remuneration arrangements.

Motability benefited from certain tax concessions associated with the direct transfer of the mobility components of qualifying allowances from the government. Government also directly transferred customer allowances to Motability Operations, reducing the company's exposure to customer credit risk. Government support also contributed to scale, which facilitated substantial discounts from manufacturers. Motability Operations chose a more prudent risk management approach than other car leasing companies, despite its overall business risk being lower owing to the competitive advantages afforded through government support. Motability Operations made cash donations to Motability to support its operations.

From 2008 to 2017, Motability Operations profit was almost double the planned level, mainly due to an underestimate in the value of cars, which meant that its customers were charged more than necessary to cover depreciation.

Other relevant NAO reports

Department for International Development: investing through CDC

The creation and sale of Northern Rock

Joint ventures

Joint ventures are companies whose shares are owned partly by a government department or public authority, and partly by another organisation, such as a private sector contractor. There are risks and benefits to shared ownership which should be considered as part of the role of directors and how government sets up corporate governance.

To make sure joint ventures work well, the ventures' corporate governance and stewardship arrangements should coordinate with the owning department's oversight and accountability requirements.

Relevant government guidance

Joint Ventures: a guidance note for public sector bodies forming joint ventures with the private sector

Public Bodies Handbook – Part 1. Classification Of Public Bodies: Guidance for Departments

Cabinet Office Appointments Guidance

Public Bodies Handbook – Part 2. The Approvals Process for the Creation of New Arm's-Length Bodies: Guidance for Departments – see page 6

Code of conduct for board members of public bodies

Questions to ask based on lessons from NAO reports

Rationale

- What is the purpose, business model and strategy of the joint venture and have alternatives been considered?
- What process did the team use to identify, select and perform due diligence on the joint venture partner?
- How do the founding documents, including the articles of association, reflect the specific objectives and purposes of the company?

Governance

- Has each party's share of ownership of the joint venture been determined based on an independent valuation of contribution of assets and liabilities?
- What are the governance arrangements, and how are non-executive director appointments related to the participation or ownership of each shareholder?
- Are there other matters that need to be set out in a shareholder agreement or framework document – for example, strategic priorities, commercial objectives, or dispute resolution?
- What forms of control or influence does the department have and how does this affect how the Office for National Statistics classifies the joint venture?

Performance

- What are the joint venture's financial and commercial objectives?
- How will performance be measured and monitored?

Outcomes

- On what basis will the joint venture be awarded future commercial business with the public sector?
- What process will the department use to identify when the joint venture has achieved its planned outcomes?

Review/exit

- Have potential future equity funding rounds and their effects on each owner's share of the joint venture been considered?
- What is the process for exiting the joint venture?

Joint ventures

Spinning-out MyCSP as a mutual joint venture (September 2013)

Supports the importance of a strong business case for a joint venture with defined requirements.

MyCSP is the organisation that administers civil service pensions for 1.5 million public sector employees. It was created as a mutual joint venture by the Cabinet Office selling 40% of MyCSP to a private sector pensions administration provider, and transferring for nil consideration 25% of the newly formed company to its employees, with the shares being held in trust. The Department retained the remaining 35%.

The government decided to spin-out the organisation into a mutual joint venture to get private sector investment and expertise, and improve employee engagement. However, it was not explicit about the cost of alternative options and the business case contained a relatively high degree of assumed data.

In response to audit committee concerns, the Department put in place four key stakeholder tests that the transaction had to pass before it could proceed. Each test had a senior responsible officer and clear approvals processes and accountabilities. The tests covered the interests of government, MyCSP, the taxpayer, and current and future pensioners.

Shared service centres (May 2016)

Demonstrates the importance of commercial expertise and having a clear approach to strategic priorities and commercial objectives.

As part of the government's shared service centres plan, staff in several departments joined Shared Services Connected Limited (SSCL), a new joint venture company (75% owned by Steria and 25% owned by the Cabinet Office).

Savings were significantly less than forecast. By June 2016, savings from SSCL were £64 million at investment costs of £61 million, including £25 million paid by SSCL customers to develop a single operating platform to replace individual departmental systems.

The report noted that there was no evidence of a risk assessment for introducing the single operating platform into the procurement and SSCL reported that it was unable to undertake sufficient due diligence on this aspect of the contract.

Lack of department understanding about costs resulted in misunderstandings and some departments lacked a detailed analysis of the differences between their own processes and those of the shared service centre. SSCL had to bear the costs of maintaining its customers' legacy systems and did not achieve the efficiencies expected because it was not able to offshore work to the extent it had planned.

Other relevant NAO reports

Disposal of public land for new homes

Companies in government

Dr Foster Intelligence: A joint venture between the Information Centre and Dr Foster LLP

Framework-to-review-programmes-2019 update

Department for International Development: investing through CDC

Government financial institutions

Government financial institutions in this context are public sector bodies created by government to perform corporate finance activities that achieve policy objectives such as economic stimulus, regional development, sustainability, decarbonisation, or specific sector strategies.

For example, during the 2008-09 global financial crisis the government's ownership of banks and private sector financial institutions increased. We have examined how the government has sought to return these assets to private sector ownership.

The Office for National Statistics' process of classifying organisations between public and private sectors has also resulted in some public corporations with significant corporate finance activities being newly recognised as public sector bodies.

Relevant government guidance

Government Corporate Finance Professional Competency Framework – competency 4: Corporate Governance and Regulation

FCA Handbook

FCA Senior Managers and Certification Regime

Questions to ask based on lessons from NAO reports

Rationale

- What is the policy objective and rationale for establishing the institution and what is the supporting economic analysis and business case?
- What analysis has the team carried out on the effects of any intervention and the impact of subsidies on competition?

Governance

- What are the roles and responsibilities of the department, and any relevant government sponsorship team, and are these clearly set out in governing documents?
- Are the roles and responsibilities of the management team running the institution (for example chief executive officer and accounting officer) and the board defined clearly?

Performance

- For publicly owned banks, are commercial and non-commercial activities, and the rates and terms on which products are offered, defined clearly?
- What economic return is the institution expected to achieve and how has this been determined? How will performance be measured and monitored?
- How is the institution funded and are the initial and ongoing needs secured over the expected lifetime?
- Does the institution have its own permanent balance sheet for its investments?

Outcomes

- Is the impact of the institution or its policies on government's objectives clear and measurable?

Review/exit

- What plans are in place to deal with unexpected future challenges and the government's exit from the institution?

Government financial institutions

British Business Bank (February 2020)

An example of government financial institution.

The government formally launched the British Business Bank (the Bank) in 2014 to address signs of weakness in the UK small and medium-sized enterprise (SME) finance market. SMEs are a major part of the UK economy, accounting for 60% of private sector employment and 52% of private sector turnover.

The Bank was formed as a company wholly owned by government. The Department for Business, Energy & Industrial Strategy (the Department) was the sole shareholder and had a policy responsibility for business and enterprise. UK Government Investments (UKGI) managed the shareholding in the Bank on behalf of the Department.

The Department gave the Bank operational independence, within a framework of accountability and governance requirements. The Bank has had to strengthen its governance and operational procedures in response to pressures from its rapid growth.

While the Bank's costs had increased more than threefold since launch, they were broadly comparable with organisations undertaking similar activities.

The Bank undertook good-quality evaluations, albeit of a relatively small part of its activities, to assess how products were working. The Bank estimated that its products achieved benefit-cost ratios of between 2.8:1 and 11.3:1, compared to an expectation at launch that overall the Bank would generate at least 5:1. The Bank and government also developed a high-level framework that provides greater flexibility to support SMEs during a potential economic downturn.

The Green Investment Bank (December 2017)

An example of a government financial institution.

In 2011, government estimated that the UK needed to double green investment. In October 2012, the government established the UK Green Investment Bank plc (GIB) to invest in green projects. This responded to market failures affecting the flow of investment. GIB was structured as a public company to give it sufficient freedom to pursue the intended objectives.

By March 2017, GIB had invested in 100 projects, committing £3.4 billion of its own capital. It had attracted £8.6 billion of private capital, equating to around £2.50 for every £1 invested. The Department for Business, Energy & Industrial Strategy (the Department) and GIB commissioned an independent evaluation which concluded in August 2015 that GIB was addressing market failures: in offshore wind (where GIB had committed around 46% of its capital); and waste and bioenergy (where it had committed around 34% of its capital). The government decided in June 2015 that further public funding was not affordable, and announced it was considering plans to sell all or part of GIB.

In March 2016 it launched a process to sell GIB into private ownership. In October 2016 the Department entered an exclusivity period with a Macquarie Group-led consortium. The sale formally completed in August 2017 with Macquarie paying £1.6 billion and government retaining a stake in a small number of assets it valued at around £132 million.

Other relevant NAO reports

Financial institutions landscape

The creation of the UK Infrastructure Bank

Commercial functions and regulators

Commercial functions within organisations and regulators across a range of industry sectors, use corporate finance techniques to safeguard the delivery of public services by private sector companies and to protect consumers and service users. Commercial staff and regulators also monitor commercial performance with a focus on the financial viability of commercial providers in order to safeguard the security of supply.

Relevant government guidance

Better regulation framework – Department for Business, Energy & Industrial Strategy guide for government officials

Regulators' Code – A framework for how regulators should engage with those they regulate

Assessing and monitoring the economic and financial standing of bidders and suppliers – guidance note

Questions to ask based on lessons from NAO reports

Commercial functions

- Has the department established what a service or supply should cost, including an estimate for a reasonable rate of return or profit for commercial suppliers?
- How has the department considered whether its requirements can be met by third sector providers (not for profit) alongside, or as an alternative to, for-profit suppliers?
- What arrangements are in place to assess the financial health of suppliers before appointing a supplier and entering a commercial agreement? See Part Three on page 44 for types of ratios to support the assessment of financial health.
- Does the department have appropriate management information and access rights to supplier information, for example open book access?
- How will the department monitor financial performance of suppliers, to identify potential warning signs, for example, excess or insufficient returns?
- What sensitivity analysis and stress testing has been performed to consider risks to supply or service continuity?
- What contingency plans has the department made in order to maintain security of supply if a supplier fails?

Regulators

- How has the department established the requirement for regulation?
- Has relevant approval been obtained for the proposed approach?
- What governance and sponsorship arrangements should be in place between the department and regulator to make sure responsibilities and accountabilities are clear?
- Does the regulator have access to the information required to achieve its regulatory objective, both from those it regulates and any other third-party information it may need?
- How will the sponsoring department measure and monitor the performance of the regulator?

Commercial function and regulators

The adult social care market in England (March 2021)

Provides insights into the cost of delivering public services through private contractors, and the benefits of understanding the financial resilience and performance of key suppliers.

Adult social care covers social work, personal care and practical support for adults with a physical disability, a learning disability, or physical or mental illness, as well as support for their carer. In 2019-20, local authorities spent a net £16.5 billion on care.

There were around 14,800 registered organisations providing care across 25,800 locations at the date of the report. Local authorities are required to ensure a diverse market with sufficient high-quality services for adults to choose from. Nearly all local authorities and stakeholders we spoke to told us that these market-shaping responsibilities were clear but their ability to do so varied.

The Care Quality Commission (CQC) regulates care providers. CQC had a six-stage process for oversight, and it had a statutory duty to notify relevant local authorities if it believed that a provider was likely to fail and service cessation was likely. Significant numbers of large providers were not financially resilient. The collapse of Southern Cross in 2011 highlighted the need for government to develop a system to address serious provider failure. Since 2015, CQC has overseen the financial sustainability of around 65 difficult-to-replace care providers, representing around 30% of the overall care market by number of beds.

The economic regulation of the water sector (October 2015)

Explains how regulators apply corporate finance techniques to establish a fair rate of return that incentivises and rewards private sector owners of public services.

The English water industry was privatised in 1989. In 2015 there were 18 large regional independently run private companies. Water companies are monopoly suppliers to households. Ofwat regulates the sector and limits prices companies can charge.

Ofwat's primary duties are to protect consumer interests and ensure that water companies properly carry out their functions. Ofwat's price limit (updated every five years) promoted substantial service and efficiency gains to the benefit of consumers, while maintaining a stable and attractive climate for investors. Allowing companies to keep the difference between the price limit and actual costs gave them an incentive to make efficiency savings.

When setting price limits for 2010 to 2015, Ofwat assumed higher borrowing costs for companies than they actually incurred, because interest rates fell. In March 2013, Ofwat challenged companies to share some of the gains linked to low tax, low borrowing costs and high inflation. It estimated that companies shared £435 million with consumers between 2010 and 2015, but this was far below the total windfall gains.

Ofwat established strong regulatory protections which reduced the likelihood of company financial failure and its impact on services if it does occur. However, the information gathered by Ofwat to understand the corporate and financial resilience of the sector to external shocks was limited.

Other relevant NAO reports

Departmental Overview 2020-21: Regulation

Improving operational delivery in government: A good practice guide for senior leaders

Principles of effective regulation

The Rural Broadband Programme

Helping over-indebted consumers

Overseeing financial sustainability in the further education sector

Regulating the financial sustainability of higher education providers in England

The energy supplier market

Good practice guidance: Managing the commercial lifecycle

Asset sales and privatisations

Government uses asset sales and privatisatons to transfer a business or service to the private sector to raise proceeds or recover taxpayer support. The types of assets sold vary significantly and could range from a stake in a private or public company, to financial loans due to government. They can be categorised as private (between government and a single investor after a competitive sales process) and public (which follows Stock Exchange rules).

In general, it is government policy to sell assets where there is no policy or strategic rationale to retain them. Such sales raise cash to support public finances and aim to introduce private sector leadership and incentives into commercial enterprises. Phases of privatisations and asset sales occurred in the 1990s and after the financial crisis in 2008-09, during which government's intervention led it to buy stakes in financial institutions, many of which it later sold.

Assets sales and privatisations require government to assess the options available to enable it to achieve the policy objective, and to plan its approach, including assessing market conditions and the timing of the sale.

Relevant government guidance

Green Book – Chapter 6: Valuation of Costs and Benefits and Green Book supplementary guidance: asset valuation

HMT asset sale disclosure guidance

Value for money of public sector assets – Annex A: Valuation of corporate and financial assets and the treatment of risk

HM Treasury guide to developing the project business case – 6. Planning the scheme and preparing the Outline Business Case

Asset sale disclosures: guidance for government – sets out the process for disclosing the impacts of the sale

Questions to ask based on lessons from NAO reports

Rationale

- What is the asset, and are the rationale and objectives for the transaction clear?
- Have wider government objectives been considered when setting the objective for the sale, and has the organisation assessed alternative options?
- How does the timing of the transaction potentially affect the impact on the taxpayer/public finances? Is this the right time to do the transaction?
- Does the department or organisation responsible for the transaction have the appropriate governance processes in place to monitor the transaction, and manage any potential subsequent commitments and risks?

Implementation

- What method has been chosen to conduct the transaction, how has it been tested, and what alternative options have been considered?
- Is there a competitive market for the asset and does the chosen transaction method ensure competitive tension?

Risk

- Is the information and data available on the asset for sale sufficient for investors to assess its value and the impact of a sale?
- Do the people conducting the transaction (and managing any subsequent events) have the appropriate skills and capability?
- Are appropriate safeguards in place with respect to market/price sensitive information?

Price and monitoring

- What assumptions is the government's valuation of the asset or business based on, what are the key drivers and have any adjustments been made to the valuation?
- Is the valuation based on multiple valuation approaches, assessed against Key Performance Indicators linked to the transaction's objective and based on quality data? (See page 45 for additional information on valuation and investment appraisal).

Review and exit

- Are the financial, fiscal and accounting impacts of the transaction clear and can the benefits to the taxpayer be assessed?

Asset sales and privatisations

The £13 billion sale of former Northern Rock assets (July 2016)

Sets out the stages of the first transaction to find a private sector buyer for a novel category of financial asset.

Northern Rock was nationalised in 2018 because it was unable to fund itself during the global financial crisis. Government established UK Asset Resolution (UKAR) in 2010 to facilitate the orderly management of Northern Rock's assets.

Government policy was to return these assets to the private sector as quickly as possible, while demonstrating value for money on a case-by-case basis. When the government sells income-generating assets like UKAR's, there is an impact on public finances. Selling reduced public sector net debt in the short term but it also surrendered a future income stream, which would increase the deficit. Holding assets to maturity might maximise financial returns but comes with risks, for example borrowers may default.

Government sold a £13 billion asset portfolio of mortgages and unsecured loans and private sector debt. It represented the government's largest-ever financial asset sale. Government carried out this complex transaction professionally within a tight timeframe during benign market conditions. It considered a wide range of options for asset disposal, but at the point of choosing a sales structure it had not fully assessed the value of those alternatives. Some alternatives may have achieved higher proceeds at the expense of slower balance sheet reduction and increased market and execution risk. Once UKAR had decided on the structure of the sale, the sales process achieved competitive tension. This resulted in a price above the par value of the assets and the government's valuation.[4]

4 Par value (also referred to as the nominal or face value) is the value of the outstanding loans without any adjustment for expected losses.

Asset sales and privatisations

The return of Lloyds to the private sector (part 1 and part 2) (December 2013 and December 2018)

Sets out the how government prepared for running a programme of asset sales to generate cash proceeds from the sale of shares traded on the public market.

In late 2008, the government purchased £20 billion of shares in Lloyds Banking Group (Lloyds) to maintain financial stability. In September 2013, UK Financial Investments (UKFI) oversaw the sale of just over 15% stake for £3.2 billion.

UKFI decided the best transaction option was to sell the first tranche of shares over a 12 to 48 hour period. UKFI received no expressions of interest from other banks. Selling all the shares at once was too large for a single sale at a competitive price. A sale involving retail investors was considered too risky.

Where shares are already trading on the Stock Exchange, we expect departments to protect value by: maintaining confidentiality ahead of any sale; maximising competitive tension among potential purchasers; and setting a price which reflects demand and ensures a stable price for the shares in trading after the sale. The sale was at a smaller discount to the market price than seen in similar sales. Following the sale, the price held steady, lending support to UKFI's decisions on timing and pricing. Following a competitive procurement exercise and negotiations, UKFI secured agreements with the book-runners that it would not be charged a fee.

A simple comparison of the price at which the shares were bought with the sale price for the first tranche indicated a gain of £120 million. Taking account of the cost of borrowing the money to buy the shares indicated a shortfall of £230 million. Following further sales, Lloyds returned to full private ownership in May 2017. Overall proceeds from share sales and dividends received was approximately £900 million more than government paid for the shares, excluding financing costs.

Other relevant NAO reports

Network Rail's sale of the railway arches

The first sale of shares in Royal Bank of Scotland

The work of the directors-general of telecommunications, gas supply, water services and electricity supply

Guide for audit and risk committees on financial reporting and management during Covid-19

Acquisitions and investments

Local authorities may choose to invest in various classes of assets, including shares in companies or commercial property, to generate income or capital gain. Managing Public Money explains that government may also do so in order to deliver policy objectives, although it is not allowed to do so solely for commercial reasons.

We have examined direct equity stakes in companies (for example, a start-up, early stage company or an established business), indirect equity holdings in a portfolio of ventures (for example, via a fund managed by a professional investor), and ownership of an income generating asset (for example, commercial property).

Organisations will need to effectively manage any acquisition or investment over its life cycle, in order to achieve its objective.

Relevant government guidance and other references

Guidance on local government investments – sets out definitions and principles for local authorities

Managing Public Money, HM Treasury, particularly section 7.14

Other useful resources

UK Stewardship Code, Financial Reporting Council

Questions to ask based on lessons from NAO reports

Rationale

- What is the nature of the acquisition or investment, for example an asset, equity stake, loan or other financial instrument?
- What is the policy rationale and objective supporting it, and what business case and approval process supports it?

Implementation

- How will the organisation fund the investment, and has it considered the opportunity cost as part of its wider obligations?
- How will the investment be classified for National Accounts and departmental financial reporting purposes?

Risk

- What risk assessment and due diligence will the organisation conduct before proceeding?
- How does the anticipated return on the investment compensate for the risk?

Pricing

- How are market conditions factored into the timing of the investment decision?
- How will the organisation establish the valuation and price at the point of investment, for example, through a competitive bidding process, or as a result of some kind of managed process or transaction?

Monitoring and management

- What governance arrangements are in place and does the organisation have the skills and capacity needed at each stage of the process?
- For equity ownership, what is the overall shareholder composition and what shareholder rights does the organisation have?

Review and exit

- Have exit options been considered at the outset and prepared for appropriately and in a timely fashion?

Acquisitions and investments

Local Authority Investment in Commercial Property (February 2020)

Describes how local authorities have invested in commercial property as a means of generating income, and highlights some of the potential risks.

In response to substantial falls in funding since 2010-11, local authorities reduced spending on services. Some authorities have also sought to offset funding reductions by generating new income through a range of strategies, including a rapid expansion in the acquisition of commercial property, often funded by borrowing.

Local authorities acquire commercial property for a variety of reasons, but yield is currently an important factor. Local authorities are subject to a prudential framework, including powers and duties created by legislation and a set of statutory codes and guidance to which they must have regard.

Buying commercial property can deliver benefits including income generation and local regeneration. As with all investments, there are risks. Risks associated with the acquisition of commercial property include 'specific risk' associated with each individual property such as the length of the lease or the financial strength of the tenant.

Local authorities also face 'systematic risk', which reflects movements in market values and rent levels. Systematic risk is apparent in the performance of the retail sector with the shift to online sales, among other factors, leading to growth in vacancy and void rates. The implications of these risks, should they materialise, will depend on the level of exposure of authorities' finances to their property portfolios, and the capacity of their governance to mitigate these risks.

Venture capital support to small businesses (December 2009)

Considers government's oversight of its investments, alongside private sector organisations, to support small to medium-sized enterprise (SMEs) and companies with high-growth potential.

Between 2000 and 2009, the Department for Business, Innovation & Skills (the Department) placed around £338 million in a series of venture capital funds aimed at supporting SMEs. Other equity investors contributed a further £438 million, making a total of £776 million. The Department aimed to stimulate economic growth and productivity and developed aims for each fund but there were not clear, measurable objectives or priorities.

Start-up companies are risky due to initial negative cash flows and high failure rates. Equity is the usual financing choice because limited collateral and trading income mean that loans are not usually available. The funds were administered by private sector fund managers who made the investment decisions, provided expertise to help companies grow and managed the portfolio of investments over the cycle of the funds' lives. Fund managers' fees were comparable to the wider venture capital industry but over the lifecycle of the funds, depending on the eventual returns achieved, this was potentially an expensive form of business support.

This report reviewed the interim financial performance of funds more than five years old, as the venture capital industry considered it was reasonable to begin to evaluate the financial performance of funds from this point. As the Department's funds held a significant number of investments, the final performance of the funds at the end of their lives was uncertain. The Department had published minimal fund performance information. In the absence of a measurement framework and given the poor performance of the early funds at that date, the programme could not demonstrate value for money.

Other relevant NAO reports

Evaluating the government balance sheet: financial assets and investments

PFI and PF2

Equity investment in privately financed projects

Companies in Government

Help to Buy: Equity Loan scheme progress review

Lending

Sometimes government lends money to eligible recipients, who must repay the loan and usually pay an interest charge on their borrowing. The terms and conditions of a loan may vary according to the individual circumstances of the borrower, or a policy may provide a standard set of terms and conditions for all borrowing. To establish a market price in order to avoid providing a subsidy, the interest rate and other price-related elements of the loan may need to be compared or benchmarked in comparison with similar instruments in the financial markets (for example, bond markets). This can be challenging when there is limited market data available to establish a price.

A range of factors influence the overall effectiveness of government lending activities. For example, setting robust eligibility and affordability criteria to support lending decisions; managing the lender and borrower relationship; and having an ongoing monitoring and review process to manage risks – including those resulting from fraud, default and recovery.

Relevant government guidance

Government Functional Standard – GovS 014: Debt

Subsidy Control legislation

Guidance on the UK's international subsidy control commitments

Questions to ask based on lessons from NAO reports

Rationale

- Why did government introduce the scheme?
- Who are the intended recipients of the loan?
- What can the borrower spend the loan on?

Implementation

- How was the loan agreement designed and did a relevant professional review it?
- Who issued the loan? For example, did the government issue it directly to the borrower, or was it part of a fund that makes multiple loans?

Risk

- How did the organisation approve the loan scheme, and carry out due diligence?
- What risk assessment did the organisation conduct on the borrower and whether the borrower can afford the loan? Are there any other relevant counterparties?
- How did the organisation assess the likelihood and timing of repayment by the borrower?

Pricing

- What are the terms of the loan on which pricing is based?
- Does the pricing of the loan represent a subsidy? Is the interest rate lower than the market rate?

Monitoring and collection

- Who is responsible and what are the processes for monitoring the loan, collecting interest and repayments and administering borrower accounts?
- What governance arrangements are in place?
- Are there clear principles for how to decide on any actions to delay or enforce repayments?

Review and exit

- What is the performance with respect to recovery and repayment of loans?
- What determines when and whether to stop lending?

Lending

Investigation into the Department of Energy & Climate Change's loans to the Green Deal Finance Company (April 2016)

Sets out some of the factors to consider when developing a scheme to support private sector lending to help achieve a policy objective.

The Green Deal Finance Company was founded by government and private sector investors in 2012. This not-for-profit company provided finance to Green Deal providers, which made Green Deal loans to consumers. The government provided a stakeholder loan of £25 million alongside other private capital, to the finance company to cover its early costs. The stakeholder loans were the most junior set of investments in the finance company. It accrued interest at 14% to compensate for the risk of non-payment.

Government's business case assumed the finance company would be self-financing once the value of the consumer loans arranged was between £450 million and £500 million. The Department of Energy & Climate Change (the Department) predicted that the finance company would start repaying the stakeholder loan when the value of consumer loans reached approximately £600 million. Government's business case asserted there was no realistic risk of insolvency and the risk that the stakeholder loan would need to be written off would only materialise in an "extreme downside scenario". The finance company had accumulated operating losses of £45.5 million by December 2014 including set-up costs. This was because demand for Green Deal loans fell short of initial expectations and only £23.7 million Green Deal loans were issued.

Overall, government lent £48.5 million to the finance company. In 2015 the Secretary of State terminated financial support, bringing the Green Deal to a halt. The government fully impaired the £25 million stakeholder loan and £5.6 million of interest accrued on it, because it did not expect to recover any of this loan. It expected around half of the other loans to be repaid.

Help to Buy: Equity Loan scheme – progress review (June 2019)

Demonstrates the importance of clear and measurable objectives for lending.

The government launched the Help to Buy: Equity Loan scheme in 2013 to address a fall in property sales following the financial crisis and the tightening of regulations affecting mortgage availability. The objectives were to support supply and demand for new-build housing and stimulate economic growth. Government expected to support around 352,000 property purchases by March 2021 via loans totalling around £22 billion. It expected to recover its investment in the medium term and make a positive return overall, although it recognised its exposure to significant market risk.

By December 2018, around 211,000 loans amounting to £11.7 billion had been issued. Between April 2013 and September 2018, 38% of all new-build property sales were supported by loans through the scheme, representing around 4% of all housing purchases. The annual number of new-build property sales increased by 70% over five years. The Ministry of Housing, Communities & Local Government found that around 60% of buyers could have bought a property without the support of Help to Buy. The scheme has supported five of the six largest developers in England to increase the number of properties they sold year on year, thereby contributing to higher profits.

The scheme achieved the short-term benefits it set out to, but its overall value for money will only be known when we can observe its longer-term effects on the property market and the net return, or cost, to the taxpayer when the very substantial portfolio of loans has been repaid.

Other relevant NAO reports

Investigation into the Culture Recovery Fund

Investigation into the Bounce Back Loan Scheme

The sale of student loans

Financial guarantees

A financial guarantee is a legal promise or agreement made by a public body (the guarantor) to a private sector lender (for example, a bank) to cover a borrower's debt or other liabilities should the borrower fail to repay the debt or fulfil the contractual obligation. Government has used guarantees as a policy instrument to support private sector lending to a range of recipients, for example business owners. Issuing a guarantee does not involve up-front taxpayer funding, but it does create a potential financial outflow should the guarantee be called.

Risks, subsidies and subsidy control considerations all affect the price of guarantees. Departments and public bodies should consider the accounting treatment of a guarantee carefully to ensure it is disclosed appropriately in the annual accounts. It may also need HM Treasury or Parliamentary approval, such as through the Contingent Liability Approval Framework.

Relevant government guidance

Managing Public Money – 5.9 External borrowing

Government as insurer of last resort: managing contingent liabilities in the public sector

HMRC Corporate Finance Manual – CFM31100 – Loan relationships: what are loan relationships: guarantees and loan relationships

The mortgage guarantee scheme

Contingent Liability Approval Framework

CLCC Guidance – Estimating losses for Guarantees and Indemnities

Questions to ask based on lessons from NAO reports

Rationale

- Why did government introduce the scheme? For example, is it to respond to a market failure?

Implementation

- What is the design of the guarantee, including its eligibility and application criteria?

Risk

- Have HM Treasury and those responsible for managing contingent liabilities reviewed and approved the scheme?
- Have people with appropriate accounting expertise considered the accounting treatment for these guarantees?

Pricing

- What techniques have been used for establishing a market price, is this based on benchmark data?
- Is a policy pricing mechanism in place to generate a commercial income (for example from charging a premium in return for the guarantee), or has it been set at a level that represents a subsidy (below market price or no charge)?

Monitoring

- Who is responsible for monitoring risk throughout the life of the guarantee (which may survive long after cessation of issuance of new guarantees)?
- What is the overall limit/funding envelope for the guarantee – is this the determinant of how long the scheme runs for (for instance, until the money runs out)?
- Who administers claims and how does the flow of payments work?

Review and exit

- How concentrated/diversified is the portfolio of guarantees? Does the existence of a diversified portfolio represent a reduction of risk?
- How does government seek to monitor the operation of the scheme?
- What review arrangements are in place to evaluate the effectiveness of the scheme?

Financial guarantees

Investigation into the Bounce Back Loan Scheme and The Bounce Back Loan Scheme: an update (October 2020 and December 2021)

Supports the assessment of the implications of a guarantee scheme design and the subsequent expected recovery of loans, and taxpayer exposure to risk.

The Bounce Back Loan Scheme provided small and medium-sized enterprises (SMEs) with loans of up to £50,000, or a maximum of 25% of annual turnover, during the COVID-19 pandemic. Loans were provided by banks and building societies directly to businesses, who were expected to repay the loan in full. Government provided lenders with a 100% guarantee against the loans (both capital and interest). This means if the borrower does not repay the loan, government will step in and repay the lender.

The loans had a fixed interest rate of 2.5% and a maximum length of 10 years. In the first year, government paid the interest – making it interest-free for the borrower. By September 2021, the scheme guaranteed 1.5 million business loans worth £47 billion. Government recognised the taxpayer risks of prioritising speed.

The Department for Business, Energy & Industrial Strategy's (the Department's) Accounting Officer sought and received a Ministerial Direction on the grounds that the spending proposal would breach HM Treasury rules on regularity, propriety, value for money and feasibility. The Department's counter-fraud strategy evolved over time but lacked clear governance at the outset and sufficient resources. The Department estimated that by 31 March 2021, 11% of loans worth £4.9 billion were fraudulent but this estimate was highly uncertain.

Government departments introduced 13 additional counter-fraud measures, but most came too late to prevent fraud and were focused instead on detection. In March 2021, the Department estimated that 37% of loans worth £17 billion may not be repaid, although this estimate was highly uncertain.

Financial guarantees

UK Guarantees scheme for infrastructure (January 2015)

Supports the assessment of the costs and benefits of government financing guarantees to improve access to sources of private finance.

Government responded to the reduction in lending to infrastructure projects following the 2008 financial crisis by issuing financing guarantees to projects including energy, transport, health, education, courts, prisons and housing. It initially identified 50 projects that might benefit from a guarantee and received more than 200 enquiries. The scheme had a limit of £40 billion of guaranteed lending but risks were not evenly distributed. By December 2014, guarantees were issued to seven projects with a value of £1.7 billion (excluding interest).

Government established governance processes, developed documentation and recruited commercial specialists to administer guarantees. Before guarantees were issued, government assessed risk and performed commercial due diligence.

Government set a fee for each project that ensured the borrower paid a market-oriented cost for finance because the guarantees were not intended to provide subsidies. Government charged the borrower (the infrastructure project) the fee to compensate the taxpayer for the risk that the project is unable to repay debt and interest, triggering the guarantee. The fee was paid over the life of the loan; however, once the guarantee had been issued the fee cannot change.

Government published a pricing practice note setting out how to choose market benchmarks with a similar risk rating and duration. It recommended using a combination of four methods: market price of commercial guarantees; bank debt in the same or similar transaction; market prices for corporate and project bond prices; and market prices for credit default swaps.[5]

Other relevant NAO reports

Investigation into the British Business Bank's accreditation of Greensill Capital

Review of the Thames Tideway Tunnel

5 In June 2021, the administration and responsibility for the UK Guarantees scheme moved to the UK Infrastructure Bank, where guarantees will be considered if they meet the Bank's mandate and investment principles.

Private finance

The UK developed the concept of public private partnerships (PPPs) for public services projects. Through partnership with the private sector, PPPs sought to deliver efficient, cost-effective public services while minimising financial risk. Private finance initiative (PFI) contracts are a form of PPP used in the UK since the 1990s. PFI is a way to finance and provide public sector infrastructure and capital equipment projects, such as roads, hospitals and schools.

As of 2020, there were more than 700 operational PFI contracts in place in the UK with a capital value of £57 billion. They involve setting up a new private finance company, called a special purpose vehicle (SPV). The SPV finances, builds, maintains and operates the assets over the contract term, usually 25 to 30 years. During the contract term, the public sector organisation makes payments, known as a unitary charge, to the SPV which covers debt repayment, financing costs, maintenance and any other services provided. Private finance may be funded by bond issuance, bank lending or equity issuance. In 2012 the NAO reported that through competition, PFI contracts were generally priced based on an expected return to investors of between 12% and 15%.

Climate change risk and green finance

In addition to more traditional private finance activities, in July 2019, the government launched the Green Finance Strategy. The strategy aims to support the UK's economic policy for strong, sustainable and balanced growth. Futher information is available at Green finance.

Other useful resources

United Kingdom Public Investment Management Assessment – IMF, September 2022

Questions to ask based on lessons from NAO reports

Rationale

- How well is the required return on investment, its expense and the use of private finance understood and evaluated, for example, using a shadow bid model?
- How well has the organisation specified the benefits, which are expected to compensate for the higher cost relative to public finance? Benefits can include private management, expertise and commercial incentives.
- Does the organisation consider that it will have the capacity within its budget to fund the construction of the asset when construction commences?

Implementation

- How well does the organisation understand the regulated asset bases, and return on capital allowances?
- How clear are the roles and responsibilities of each party?
- How transparent is data on the cost of debt?

Risk

- Does the organisation understand any explicit and implicit transfers of risk onto taxpayers or consumers?

Price

- How have costs and accompanying schedules been reviewed and audited?
- Have complex derivatives been accounted for appropriately?

Monitoring

- Is there enough information available to make informed decisions on how to manage ongoing private finance arrangements?

Review and exit

- How has the organisation prepared for the end of the agreement?

Private finance

Hinkley Point C (June 2017)

Outlines some of the factors government considered in a major capital investment, and the mechanisms for allocating risk and return.

This report assessed the government's case for supporting the construction of Hinkley Point C nuclear power station (HPC). HPC was to be the first new nuclear power station built in the UK since 1995, with capacity to generate around 7% of Great Britain's anticipated electricity requirement from the mid-2020s. Government hoped that the successful conclusion to the HPC deal would help to generate wider investor confidence and pave the way for other nuclear projects.

The government agreed a four-part deal to support the project. The main element was a 'contract for difference' (CfD). A CfD offered greater certainty and stability of revenues by setting a 'strike price' that the developer receives for a set period. HPC would receive top-up payments if the market price was lower than £92.50 per mega-watt hour (in 2012 prices), which would be paid ultimately by electricity bill-payers. Conversely, payments will flow in the opposite direction if wholesale prices rise above the strike price.

The cost of handling nuclear waste and decommissioning the plant once it stops generating electricity was addressed by an agreement to set aside a proportion of revenues, up to £7.3 billion (in 2016 prices). Government also explored a financing guarantee to support HPC to issue bonds and underwrote a compensation arrangement if a future government policy change resulted in the shutdown of HPC.

The Department for Business, Energy & Industrial Strategy subjected the deal to four value-for-money tests: that the return to HPC's investors was fair; that HPC is cost-competitive with other options for generating power; that it brought net societal benefits by reducing the cost of the electricity system; and that it was affordable for electricity consumers. The government's case for proceeding with the deal was also subject to wider strategic, deliverability and affordability considerations.

Relevant government guidance

PFI/PPP finance guidance

Preparing for PFI contract expiry

Managing the risks of PFI contract expiry

Infrastructure and Projects Authority: assurance review toolkit

Private finance

The choice of finance for capital investment (March 2015)

Sets out some of the factors public sector organisations considered when looking at financing infrastructure projects using public and/or private finance.

In the 50 years to 2015, public sector gross investment (PSGI) fell as a proportion of gross domestic product (GDP), in part due to the transfer and sale of assets to the private sector. Capital investment by privatised companies is not included in PSGI. In the 15 years to 2015, government capital investment increased, with a peak in 2010 which coincided with a stimulus and a decline lasting five years due to constraints.

Several factors affect central government capital investment, including budgeting, project appraisal, procurement, finance and accounting treatment. The report commented on the relative flexibility, transparency and other attributes of different financing choices, including its cost. It did not evaluate individual investment decisions.

Some public bodies (for example, local authorities) can borrow via the Public Works Loan Board, from banks or issue bonds. If a government department wants to finance a large capital investment with public finance it will seek HM Treasury approval. Government requires that a decision to use public or private capital to finance a particular investment be supported by a value-for-money assessment.

Private finance has been used to deliver a wide range of capital projects for the public sector. When departments procure assets using private finance, they typically sign long-term contracts to maintain and service the asset alongside repayment of the original investment with interest. This can ensure that the asset is maintained to contractually agreed standards.

Reporting for public expenditure statistics, budgets and financial accounts is affected by whether public or private finance is used. About 90% of privately financed capital investment is not recorded as public spending when the investment takes place and so does not impact departmental capital budgets. By contrast, publicly financed investment is always included as capital spending in public expenditure statistics and budgets.

Other relevant NAO reports

Managing PFI assets and services as contracts end

Investigation into the rescue of Carillion's PFI hospital contracts

UK Guarantees scheme for infrastructure

PFI in housing

Understanding balance sheet accounting implications

Further information on National Accounts and the Whole of Government Accounts

To understand how government borrowings (or debt) and the outlay of cash (for example through interventions in times of crisis) affect the government balance sheet and overall accounts, it is useful to compare their presentation on the National Accounts and the Whole of Government Accounts.

National Accounts are the core accounts for the UK economy as a whole. They comprise individual sectors (sector accounts) and satellite accounts that cover activities linked to the economy. The National Accounts framework brings units and transactions together to provide a simple and understandable description of production, income, consumption, accumulation and wealth. The Office for National Statistics also publishes accounts for the regions, subregions and local areas of the UK.

The Whole of Government Accounts (WGA) consolidates the audited accounts of more than 10,000 organisations across the UK public sector – including those of central government departments, non-departmental public bodies, public corporations, local authorities, the National Health Service, academy schools and the devolved administrations. WGA is based on International Financial Reporting Standards (IFRS), interpreted and adapted for the public sector context through the government financial reporting manual (FReM). Therefore, it is prepared on a similar financial reporting basis to the private sector with the NAO as the group auditor providing the necessary assurance over its reliability. The benefits of WGA are that it provides a complete picture of the government's financial position, the future consequences of decisions already taken and financial commitments already entered into (for example pensions, and the Private Finance Initiative).

There are various statistical measures available in the National Accounts providing a complementary perspective of the health of the government's balance sheet (as presented in the WGA).

The graphic on page 41 shows a comparison of National Accounts and WGA measures. The 2019-20 WGA notes that over the 11 years that the WGA has been published, the overall trend of the National Accounts PSND and the WGA net liabilities has generally been similar. There was a divergence for 2016-17 and 2017-18. This is because pension liabilities increased in value that year, which affects WGA net liabilities but not National Accounts PSND.

The Public Sector Net Debt (PSND) comprises government borrowings less liquid financial assets (such as bank deposits and foreign exchange reserves). PSND excluding the public sector banks is the government's preferred measure of fiscal health as it is consistent with the internationally agreed National Accounts framework. Public Sector Net Financial Liabilities expands on PSND to include all financial assets, such as loans, derivatives and equity investments.

Public Sector Net Worth is thought to be the most comprehensive measure derived from National Accounts as it compares the government's debt with all of its assets, including physical assets used to deliver services such as infrastructure, hospitals and schools and non-financial assets.

WGA net liabilities is more comprehensive than PSND and includes non-financial assets and public sector pensions liabilities, provisions and PFI contracts.

Understanding balance sheet accounting implications

Further information on National Accounts and the Whole of Government Accounts

Comparison of National Accounts and WGA measures

National Accounts measures			WGA
Public Sector Net Debt	**Public Sector Net Financial Liabilities**	**Public Sector Net Worth[1]**	**WGA Net Liabilities**
		Non-financial assets	Non-financial assets
	Illiquid financial assets	Illiquid financial assets	Illiquid financial assets
Liquid financial assets	Liquid financial assets	Liquid financial assets	Liquid financial assets
Assets			
Liabilities			
Government borrowing	Government borrowing	Government borrowing	Government borrowing
	Other financial liabilities	Other financial liabilities	Other financial liabilities
	Funded public sector pensions	Funded public sector pensions	Funded public sector pensions
		Unfunded public sector pensions[1]	Unfunded public sector pensions
		PFI contracts[1]	PFI contracts
			Provisions

Note

1 Unfunded public sector pensions and PFI contracts will be included in the Government Financial Statistics Manual measure of PSNW, but not in the European Statistics Agency 2010 based measure.

Source: Whole of Government Accounts 2019-20

Understanding balance sheet accounting implications

Financial statements and reporting

It is important that due consideration is given to how corporate finance activities and arrangements will be accounted for as part of assessing what organisations or functions and transactions will be used to achieve the desired objective. We set out below some of the relevant reporting and accounting standards applicable to some of the corporate finance activities we have reviewed over the years. A number will apply to public bodies undertaking corporate finance activities.

International Financial Reporting Standards (IFRS) are a single set of accounting standards for all countries and all sectors. Accounting standards are authoritative statements of how particular types of transaction and other events should be reflected in financial statements. The UK government interprets and adapts IFRS for the public sector context through the Government Financial Reporting Manual (FReM), which sets out how corporate finance transactions are reported. IFRS and the FReM are subjected to periodic reviews which can affect accounting treatment, including the presentation of various assets, financial instruments and liabilities in departmental accounts, and the relevant disclosures or notes that accompany the financial statements.

Other financial reporting considerations

The financial reporting system of any organisation is important for providing fundamental information to stakeholders – including the leadership of organisations, company directors, shareholders, employees, advisers, competitors, governments, taxpayers and the general public. The Annual Report and Accounts provides an account of an organisation's activities over the year for which the report is based and includes highlights of key programmes and the progress the organisation and its leaders have made in meeting the organisation's objectives. It is important to note that the accounting for transactions is determined by the detail of an arrangement, and legal and finance teams will need to work together to ensure that the drafting of an arrangement does not have unintended financial reporting consequences.

Understanding balance sheet accounting implications

Financial statements and reporting

Financial reporting and accounting standards relevant for financial instruments and corporate finance in general include:

IFRS 7 Financial Instruments: Disclosure

IFRS 9 Financial Instruments

IFRS 10 Consolidated Financial Statements

IFRS 11 Joint Arrangements

IFRS 12 Disclosure of Interests in Other Entities

IFRS 13 Fair Value Measurement

IFRS 16 Leases

IAS 1 Presentation of Financial Statements

IAS 19 Employee Benefits

IAS 28 Investment in Associates and Joint Ventures

IAS 32 Financial Instruments: Presentation

IAS 37 Provisions Contingent Liabilities and Contingent Assets

IAS 39 Financial Instruments: Recognition & Measurement

All other reporting standards are available at IFRS.org – IFRS Standards Navigator

Other relevant guidance:

Standards and Guidance for Auditors

Government Financial Reporting Manual (FReM) – this guidance is updated each financial year

Government Functional Standard GovS 006: Finance

Standards for Investment Reporting

Additional information to support the principles and concepts

1/3

Analysis and evaluation

Types of ratio to assess financial viability

Proper analysis and evaluation of corporate finance activities and arrangements support good risk management and decision-making. There are a number of techniques – including the use of ratios that can be used to assess the financial viability of companies and monitor the economic and financial standing of suppliers engaged in providing corporate finance and other commercial activities in the public sector. These techniques form part of a wider strategy to maintain a healthy market and safeguard public funds.

Ratio type	Useful for	Source of information
Turnover Ratio	Assessing whether there is reliance on one contract.	Turnover/revenue from the profit and loss account.
Operating Margin Ratio	Measuring a company's profitability. A higher figure suggests the business may be more sustainable.	Profit and loss account.
Free Cash Flow to Net Debt Ratio	Measuring a company's leverage. A low ratio indicates a potential issue with the company's ability to service its existing debt.	Net cash flow from operating activities obtained from the face of the cash flow statement. Net debt from balance sheet and notes in the balance sheet.
Net Debt to Earnings before interest, taxes, depreciation & amortisation (EBITDA) Ratio	Measuring an entity's ability to service its debt.	EBIT from the face of profit and loss account. Depreciation and amortisation from the operating profit note.
Net Debt + Net Pension Deficit to EBITDA Ratio	Measuring the scale of an entity's debt and pension deficit relative to its size.	Pension deficit is shown on the face of the balance sheet.
Net Interest Paid Cover Ratio	Measuring how easily an entity can service interest on its debt from its profits.	Interest received and interest paid are on the face of the profit and loss account.
Acid Ratio	Measuring an entity's ability to meet its short-term liabilities as and when they fall due.	Current assets, inventories and current liabilities from the face of the balance sheet.
Net Asset Value	Measuring whether an entity's assets exceed its liabilities and its overall solvency. Negative net asset value may suggest that the entity is less sustainable if its performance worsens.	Net asset value is on the face of the balance sheet.
Group Exposure Ratio	Measuring the level of exposure of the entity to other entities within the group.	Balances owed by group undertakings from notes to the accounts. Fixed assets and current assets from the face of the balance sheet.

Source: Assessing and monitoring the economic and financial standing of suppliers (Government Commercial Function)

Additional information to support the principles and concepts

Valuation and investment appraisal

Types of valuation techniques

Investors and companies use a range of valuation techniques to support decision-making for corporate finance. Here we set out some examples of techniques we have examined to support asset sales and privatisations.

Type of valuation	What it means	Factors to consider from NAO reports	References
Intrinsic valuations, which examine the value of an asset or business based on its projected cash-flow without comparing it to any other assets or businesses			
Equity value	The value of assets to its owners/shareholders. For listed companies this is the number of shares times the price of the shares. For unlisted companies, it can be estimated by using discounted cash flows, or relative valuations and reflecting the net debt position of the asset.	The ability of the market to absorb the planned sale may affect the sale price of shares. Existing market conditions may affect the disposal options available.	The first sale of shares in Royal Bank of Scotland
Firm value	The value of all the financial capital which finances the asset. This includes the equity value plus all outstanding debt less any cash.	The capital structure is the mix of debt and equity used by a company to fund its operations. A good capital structure, in line with comparable companies, should ensure the company is using funds effectively.	The Privatisation of Royal Mail
Discounted cash flows	Based on the concept of net present value, this valuation methodology uses estimated future earnings from the asset and an estimate of the riskiness of these earnings.	The assumptions underlying the estimated future earning/cash flows and any potential adjustments. Key business risks, for example volume or price assumptions. Estimate of the risk and calculation of the discount rate, particularly where there are few precedents or comparators available.	Network Rail's sale of railway arches The sale of student loans
Relative valuations, which examine the value of an asset or business based on the value of its peers, and helps to establish a current market value			
Trading multiples	Estimating the value of an asset by comparing it to the performance of comparable assets.	Selecting the appropriate metric for the industry. Selecting comparable assets. Making adjustments to comparator assets to better reflect the asset being considered.	The Privatisation of Royal Mail The first sale of shares in Royal Bank of Scotland
Transaction multiples	Estimating the value of an asset by comparing it to similar asset sales.	Selecting the appropriate metric for the industry. Selecting comparable assets. Making adjustments to comparator assets to better reflect the asset being considered.	The sale of Eurostar

Additional information to support the principles and concepts

Ethical standards and business conduct

The governance and stewardship arrangements for corporate finance activities should be supported by good ethical standards and appropriate considerations for how business is conducted. Senior decision-makers may wish to ask their managers and teams about how these considerations have been incorporated into the underlying principles and concepts for public sector corporate finance activities. We have set out below our expectation of some of the areas for consideration:

Ethical standards	Environmental, Social and Governance	Equality, Diversity and Inclusion
Ethical standards are guiding principles that govern behaviour. They help professionals conduct business with honesty and integrity for the benefit of all stakeholders. Setting out and applying ethical standards are a necessary part of winning trust and building confidence in public service markets, as well as promoting social responsibility. Commissioners and providers of corporate finance should be explicit with each other and the public as to the standards expected. In sectors such as auditing, banking and finance, there are rules and regulations (or codes) that govern how they conduct their roles. Other organisations voluntarily set their own code of ethics for their employees. The seven principles of public life (selflessness, integrity, objectivity, accountability, openness, honesty, leadership) apply to those delivering public services in any sector. We would expect government to consider commercial organisations' approach to these principles as part of its decision process in working with them.	The British Business Bank defines Environmental, Social and Governance (ESG) as "a collective term for a business's impact on the environment and society as well as how robust and transparent its governance is in terms of company leadership, executive pay, audits, internal controls and shareholder rights." It measures how a business integrates environmental, social and governance practices into operations, as well as the business model, its impact and its sustainability. Government has committed to considering social value as part of its approach in procurement and other activities. The British Business Bank has more information on each of the elements, as does HM Treasury's Greening Finance: A Roadmap to Sustainable Investing. Source: What is ESG? A guide for businesses (British Business Bank)	Equality, Diversity and Inclusion (ED&I) practices encourage equal treatment of all stakeholders, with dignity and fair access to resources and opportunities. ED&I principles are based on the premise that employing and engaging with people who have a range of different backgrounds, experiences and ideas will increase creativity and lead to better problem-solving and decision-making. The government has committed to a civil service that can attract, retain and invest in talent wherever it is found. This will include having a diverse workforce and culture of openness and inclusivity, as a means of delivering better outcomes for the public. These principles can also be applied more widely, including when considering commercial activities and organisations within the corporate finance arrangements. Professional bodies have highlighted the benefits of sourcing from a more diverse supply chain and some departments have developed their own strategies for doing so.
Further guidance: Ethical Standards for Providers of Public Services – guidance Financial Reporting Council – Revised Ethical Standard 2019	**Further guidance:** TNFD – Taskforce on Nature-related Financial Disclosures Climate-related financial disclosures for companies and limited liability partnerships (LLPs)	**Further guidance:** How to source diverse suppliers (CIPD) Civil Service Diversity and Inclusion Strategy: 2022 to 2025 Equality Act 2010: guidance Equality Framework for Local Government 2021

Other relevant NAO work

We have set out below other NAO reports that support some of the themes covered in this guide. We work across all central government departments and a range of other public sector bodies. We have good knowledge of the challenges facing government, and our audit work gives us a unique perspective on how these challenges are being met. This birds-eye view means we often see recurring issues across government. We also see innovations or successful ways of working that could be applied more widely.

NAO publication	Why it is useful
Good practice guidance: managing the commercial lifecycle (July 2021) reflects upon findings and recommendations drawn from 209 NAO reports concerning 350 commercial arrangements published over the past 20 years – including recent examinations of commercial activities triggered in response to the global pandemic. We also published an audit framework (April 2022) setting out how we structure our reviews of commercial and procurement activities.	It provides the structure and good practice for preparing, delivering and managing the procurement of goods and services (including activities relating to corporate finance) in government.
Evaluating government spending (December 2021) examined government's progress in developing and using evaluation evidence across government. We also published an audit framework in April 2022 to support accounting officers and other reviewers to assess evaluation arrangements.	All corporate finance activities and projects require evaluation at all levels – including those to support the understanding of the objectives, decisions on financing methods, delivery techniques, measuring and reporting on outcomes.
Evaluating the government balance sheet: financial assets and investments (June 2016) examined the Whole of Government Accounts balance sheet, showing the financial impact of the government's decisions and the effect they might have on public finances for many years to come.	The report highlighted the most significant strategic issues and financial risks that the government was facing, and showed how the balance sheet demonstrates the financial risks faced by government. It was part of a series of reports exploring major risks to public finance in the Whole of Government Accounts, including Evaluating the government balance sheet: provisions, contingent liabilities and guarantees.
Good practice guidance: Fraud and Error (March 2021) highlights how to: measure fraud and error; put effective counter-fraud and error controls in place; and detect and pursue overpayments to protect the taxpayer's interest.	This document supports organisations to adopt good practices to help mitigate and minimise the risk of fraud and error when embarking on a corporate finance activity.
Principles of effective regulation (May 2021) sets out the broad principles of effective regulation (covering the design, operation and learning cycle) and it is intended to complement existing government guidance on regulatory matters including those on appraising proposed regulatory measures. The publication aligns with our expectations of ensuring that policies and regulatory matters concerning corporate finance activities are designed and implemented effectively to achieve the desired outcomes. The Institute of Chartered Accountants in England and Wales has also published information describing some common corporate finance scenarios. It highlights whether these activities are regulated or not and if so, whether an organisation needs Financial Services Authority (FSA) authorisation, a Designated Professional Body (DPB) licence, or are unregulated and so no authorisation or licence is needed.	Corporate finance activities require effective regulation to ensure consistency. These documents provides helpful ways to think about structuring regulation.

Glossary of key terms

1/2

Key term	Definition
Asset	A present economic resource controlled by an entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.
Balance sheet	A summary of the financial position of an organisation or government at a particular date in time (a snapshot) – covering its total assets and liabilities which helps to establish an estimate of the authority's net worth.
Capital employed	Total assets less current liabilities.
Classification	This is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes.
Contingent liability	A commitment of the UK government should it be needed; no money has changed hands and therefore no liability is recognised on the balance sheet.
Cost of capital	The cost of raising funds which is sometimes expressed as an annual percentage rate.
Debt	Simply defined, this is an arrangement between borrower and lender. A capital sum is borrowed from the lender on the condition that the amount borrowed is paid back in full either at a later date, multiple dates or over a period of time. Interest is accrued on the debt and the business's repayment usually has an element of capital repayment and interest.
Environmental, social and governance (ESG)	A group of terms used to describe an organisation's impact on the environment and society; the robustness and transparency of its governance in relation to its leadership, executive pay, audits, internal controls, and if applicable, shareholder rights.
Equality, diversity and inclusion (ED&I)	Practices which encourage equal treatment of all stakeholders, with dignity and fair access to resources and opportunities.
Equity	The residual interest in the assets of an entity after deducting all its liabilities.
Ethics	Guiding principles that govern behaviour, designed to assist professionals to conduct business with honesty and integrity for the benefit of all stakeholders.
Fair value	This is the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date.
Financial Instruments	Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

NAO reports covering particular sectors or themes can be accessed via our website using the publication search function shown below:

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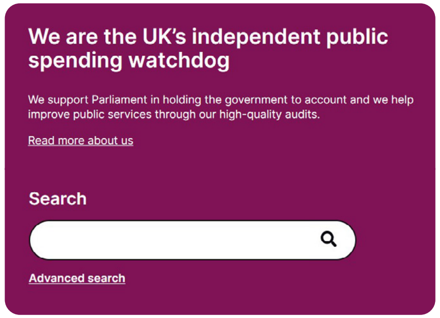

Glossary of key terms

Key term	Definition
Governance	A system that provides a framework for managing organisations and identifies who can make decisions, who has the authority to act on behalf of the organisation and who is accountable for how an organisation and its people behave and perform.
Guarantee	A legal promise or agreement made by one party (the guarantor) to a lender to cover a borrower's debt or other liabilities (for example, contractual performance) should the borrower fail to repay the debt or fulfil the contractual obligation.
Financial reporting and International Financial Reporting Standards	Financial reporting is the presentation of information containing the financial performance, the financial position, changes in equity and cash flows of an authority covering a specified period of time. Central government departments adopted International Financial Reporting Standards (IFRSs) from the 2009-10 financial year through the Government Financial Reporting Manual (referred to as the FReM).
Joint venture	Companies whose shares are owned partly by a government department or public authority, and partly by another organisation, for example, private sector contractor.
Liability	A present obligation of the entity to transfer an economic resource as a result of past events.
Loan	Amount borrowed and usually requires the borrower to pay an interest charge on their borrowing, and to repay the debt.
Return on capital employed	The proportion of operating profit relative to the capital employed.

Our methodology and approach

Our aim

Using corporate finance to implement and manage government policy and interventions affects the government balance sheet and, therefore, government's ability to fund its activities. This guide is designed to help readers understand the risks and benefits to public finance of using corporate finance techniques. The guidance brings together insights from our analysis of NAO's past reports to support some of the consideration of corporate finance risks and benefits. The guide also reflects insights from our consultation with stakeholders between January and July 2022.

Analysis of previous work

We used the team's knowledge and key word searches on the NAO's back catalogue of publications to identify reports which mentioned corporate finance or applicable types of organisations or techniques. We identified 139 reports covering our response to government's corporate finance activities between 1985 and 2022 and we reviewed the findings and recommendations from these reports to identify good practice. Our team included professionals with extensive corporate finance experience, who applied judgement to the review of our past work to identify the 14 themes. We tested these themes with stakeholders and identified areas where additional information would be helpful. We then used the combination of the team's knowledge, government guidance, the reviewed material and stakeholder input to draw out the most important questions for each of those themes.

Consultation

We consulted a range of stakeholders in both the public and private sectors to identify current and emerging best practice in corporate finance. We have considered and incorporated appropriate feedback from our stakeholder engagement in developing this guide.

Our stakeholder contacts in the private sector included banking officials, corporate finance consultants, audit and accountancy firms, professional accountancy and investment bodies. In the public sector, we engaged with central and local government, the Office for Budget Responsibility and the UK Regulators Network. We met and exchanged ideas with various HM Treasury and UK Government Investments staff with specialisms in the treatment and accounting of government balance sheet arrangements and government corporate finance activities.

Case studies

We identified 28 case studies (two case studies for each of the 14 themes – although the Lloyds bank case study for asset sales and privatisation, and the Bounce Back Loans case study for financial guarantees each draw on two reports) which would provide illustrative examples to support each of the themes. We recognise that the case studies could be used across multiple themes but we selected the 28 case studies based on our judgement of those most suited to the theme being discussed. Our case studies reference findings at the time of reporting and, therefore, do not recognise changes implemented or actions taken by government since our publication.

Review of additional resources

We have reviewed and referenced a range of guidance issued by government and relevant professional bodies to help provide additional support and reference materials for users of this guide. Our consultation highlighted additional guidance which we have reviewed and judged to be relevant for supporting some of the key themes identified in this guide.

Stakeholders consulted during fieldwork

Category	Details
Central government, public bodies and specialist groups	HM Treasury; Office for Budget Responsibility; UK Regulators Network; UK Government Investments; Government Corporate Finance Profession
Professional membership organisations	Chartered Institute for Securities & Investment; The Chartered Institute of Public Finance & Accountancy; Institute of Chartered Accountants in England & Wales; Association of Chartered Certified Accountants; The Investments Association; Members of the Government Corporate Finance Profession; Representation from the Local Government Association
Advisers to government	A number of professional advisers (including those with specialisms in banking and investment) and audit and accountancy firms