HM Treasury

Certificate and Report of the Comptroller and Auditor General: Whole of Government Accounts 2009-10

This is an extract from the Certificate and Report of the Comptroller and Auditor General on the Whole of Government Accounts 2009-10 published by HM Treasury on 29th November 2011 (HC 1601)

This report has been prepared under Section 11 of the Government Resources and Accounts Act 2000

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Comptroller and Auditor General
National Audit Office

31st October 2011

THE CERTIFICATE OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSE OF COMMONS

I certify that I have audited the financial statements of the Whole of Government (the Account) for the year ended 31 March 2010 under the Government Resources and Accounts Act 2000. These comprise the Consolidated Statement of Revenue and Expenditure, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Taxpayers' Equity, the Consolidated Cash Flow Statement, the related notes and Annexes 1 to 4. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for the preparation of a consolidated account for a group of entities each of which appears to HM Treasury to exercise functions of a public nature, or to be entirely or substantially funded from public money , which presents a true and fair view of the state of affairs of the whole of government and of its net deficit, changes in taxpayers equity and cash flows for the year then ended. My responsibility is to examine the accounts with a view to satisfying myself that they present a true and fair view. I have audited the accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by HM Treasury; and the overall presentation of the financial statements.

Basis for qualification on accounts

Qualification arising from disagreements on the definition and application of the Account boundary

The Government Resources and Accounts Act 2000 (the Act) requires HM Treasury to produce a set of accounts for a group of bodies which appears to HM Treasury to exercise functions of a public nature, or to be entirely or substantially funded from public money. The Act also states that the Accounts should present a true and fair view and conform to generally accepted accounting practice subject to such adaptations as are necessary in the context. HM Treasury has adopted a framework for these Accounts which is based on International Financial Reporting Standards adapted for the public sector context.

However, in Note 1.21.1 to these Accounts, HM Treasury defines the accounting boundary for the Account by reference to those bodies classified as being in the public sector by the Office for National Statistics. I consider that it would be more appropriate to assess the accounting boundary with reference to the accounting standards[1]**.** By applying such accounting standards, I consider that the Account should include Network Rail.

I also consider that HM Treasury's accounting policy has not been applied consistently in 2009-10 as a number of significant bodies[2] have not been included in the Accounts, even though they are classified by Office for National Statistics as being in the public sector and which I also consider should be included in the Accounts in line with applicable accounting standards.

Although I cannot quantify the effect of these omissions on the Accounts with certainty as I do not have information needed to identify the transactions that would have to be eliminated to provide a consolidated view, the most significant impact could be on the Account's Statement of Financial Position. The exclusion of the following categories of bodies could affect this Statement. To illustrate the potential impact:

- Network Rail which has gross assets of £41.7 billion and gross liabilities of £35.7 billion;

- Publicly-owned banks which have gross assets by £2,862.1 billion and gross liabilities of £2,720.9 billion; and

- Other bodies, such as the Bank of England, which have estimated gross assets of £263.3 billion and gross liabilities of £250.1 billion.

[1] IAS 27 - Consolidated and Separate Financial Statements
[2] The significant bodies excluded are listed in Figure 12 in my Report.

Qualification arising from disagreement relating to inconsistent application of accounting policies

HM Treasury's accounting policies state that the Accounts are prepared on an International Financial Reporting Standards (IFRS) basis, as adapted or interpreted for the public sector context[3]. A number of bodies consolidated in these Accounts do not adopt the same framework under which these Accounts are prepared. These bodies fall under the following categories:

- Bodies in the local government sector follow the Local Government Statement of Recommended Practice (SORP) for 2009-10, which is based on UK Generally Accepted Accounting Practice (UK GAAP); and

- Bodies that do not apply the Government Financial Reporting Manual but do apply IFRS, UK GAAP, the Charities SORP or NHS Manuals, where appropriate.

Accounting standards require that, where the effect of such inconsistent accounting policies are material, adjustments should be made on consolidation. HM Treasury has not been able to fully quantify the impact of the different accounting frameworks or accounting policies on the Accounts but it is material in some areas. An example of the use of different accounting policies is where infrastructure assets included in the Accounts are not valued on a consistent basis. Assets held by local government bodies are valued at historic cost, whereas those held by central government bodies are valued at depreciated replacement cost. HM Treasury's estimate of the understatement of assets due to the differences in valuation between historic cost and depreciated replacement cost for local government assets could be at least £200 billion (Note 14.1 to the Accounts).

Qualification arising from limitation in audit scope due to lack of evidence supporting the completeness of the elimination of intra-government transactions and balances

Accounting standards require that balances and transactions held and made between bodies consolidated into these Accounts shall be eliminated in full. HM Treasury has a process in place to identify intra-government balances and transactions between bodies consolidated into the Accounts, and most balances and transactions have been eliminated. However, there remains material values of intra-government transactions and balances which have not been eliminated and the effect of not adjusting for these could lead to a potential overstatement of up to £17.0 billion in gross income and expenditure and up to £6.8 billion in gross assets and liabilities.

[3] This framework is set out in the Government Financial reporting Manual (FReM)

I have reviewed the impact of this uncertainty and have assessed that the maximum uncertainty resides within the gross figures in the individual primary statements rather than on the net deficit or net liabilities. The totals reported for the net deficit and the net liabilities are subject to a maximum uncertainty of some £3.2 billion. There is also uncertainty about whether there are amounts which both bodies involved in a relationship have not declared, leading to further overstatement.

Qualification arising from disagreement in the accounting for 3G licences

In April 2000, the government issued licences to access the 3G telecommunications spectrum. Each licence was awarded for 20 years and the total raised was £22.5 billion. This was recognised as £22.5 billion income in 2000-01. I consider that it would be more appropriate to recognise this income in the Accounts over the life of the licences as the licence holders have the right to access the spectrum for 20 years and the government has an ongoing obligation to ensure that the spectrum remains available to licence holders. The impact of this difference is that income would be £1.1 billion greater; liabilities would be £11.4 billion greater; and the value of the general fund would be £11.4 billion less.

Qualification arising from disagreement and limitation in audit scope from underlying statutory audits of bodies falling within the Accounts

The external auditors of the financial statements of a number of bodies that are consolidated into these Accounts qualified their audit opinion. Of material significance to these Accounts, I qualified the Ministry of Defence's Resource Accounts on two grounds. Firstly, the Ministry has not complied with the Financial Reporting Framework as it has not accounted for the expenditure, assets and liabilities arising from certain contracts in accordance with *International Accounting Standard 17 Leases* as interpreted by *International Financial Reporting Interpretations Committee 4 Determining whether an Arrangement Contains a Lease*. Consequently, the Ministry has omitted a material value of assets and liabilities from its Consolidated Statement of Financial Position as at 31 March 2010. This has also led to a consequential misstatement of the Consolidated Statement of Revenue and Expenditure for 2009-10. I am unable to quantify the impact on the financial statements because the Ministry has not maintained the records or obtained the information required to comply with the relevant accounting standards in this respect.

Secondly, I was unable to obtain sufficient, appropriate audit evidence to support the existence and valuation of certain Ministry inventory and non-current assets which are recorded in the accounts at £6.3 billion and the accuracy and completeness of the associated transactions in the Consolidated Statement of Revenue and Expenditure because the evidence available to me was limited due to a failure to maintain adequate accounting records and supporting evidence to operate adequate stocktaking and asset verification procedures.

Qualified Opinion on Financial Statements

In my opinion, except for the effects of the matters described in the Basis for Qualified Opinion paragraphs above:

- the financial statements give a true and fair view of the state of the affairs of the Whole of Government as at 31 March 2010 and of its net deficit, changes in taxpayers' equity and cash flows for the year then ended; and

- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000.

Emphasis of matter – significant uncertainty

In forming my opinion on the truth and fairness of these Accounts, I have considered the adequacy of the disclosures made in areas where there is significant uncertainty in the values reported in Note 1.21.6 to these Accounts, which concerns the uncertainties inherent in estimating the likely costs of the liabilities of the Nuclear Decommissioning Authority. As explained in the Note, the lengthy timescales, final disposition plans for waste and spent fuel, timing of final site clearance and the confirmation of site end states mean that the ultimate liability will vary as a result of subsequent information and events, and may result in significant adjustment over time to the value of the provision, which currently stands at £45.1 billion.

Opinion on other matters

In my opinion, the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I report by exception

For those areas, in respect of my limitation in scope qualifications above:

- the financial statements are not in agreement with the accounting records or returns; and

- I have not received all of the information and explanations I require for my audit.

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- returns adequate for my audit have not been received from component bodies not visited by my staff; or

- the Statement on Internal Control does not reflect compliance with HM Treasury's guidance.

Report

My Report on pages 8 to 43 includes more details of these matters.

Amyas C E Morse
Comptroller and Auditor General
31st October 2011

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Summary

1 This report provides my assessment of the first audited *Whole of Government Accounts* (WGA) for 2009-10. It covers the extent to which the WGA has met HM Treasury's aims to help Parliament and the public understand and scrutinise how taxpayers' money is spent (**Part 1**), and the reasons why I qualified my audit opinion (**Part 2**).

2 The publication of the first WGA is an important step in the Treasury's efforts to increase transparency in its management of public finances.

3 The development of WGA in the UK can be traced back to 1995, when the Committee of Public Accounts concluded that audited whole of government accounts would allow the public and Parliament to see more clearly how taxes have been spent, and what assets and liabilities were held on their behalf by government.[4] The Treasury accepted the Committee's recommendation to carry out further research.[5] In 1998 the Treasury confirmed its aim, in a scoping study, to prepare whole of government accounts.[6] Parliament made this a statutory requirement when it passed the Government Resources and Accounts Act 2000,[7] with a Statutory Instrument in March 2010 providing for the implementation of the first and subsequent WGAs.[8]

4 The Treasury, which is responsible for preparing the accounts, currently has five objectives for the WGA, to:

- improve **transparency** by providing more public data using standard accounting conventions to enable a wider range of users to interpret them;
- increase **accountability** and confidence in the data by publishing accounts that have been audited by the National Audit Office;
- provide more **complete** data for the public sector than existing sources, such as the *National Accounts* prepared by the Office for National Statistics;
- use WGAs to encourage public bodies to prepare their accounts consistently, so data are **comparable**; and
- provide **complementary** and complete information on the government's capital and long-term financial position, income, spending and cash flow to support long-term fiscal analysis and decision making.

[4] Committee of Public Accounts *Resource Accounting And Budgeting In Government*, Fifteenth Report 1994-95, HC 407 Session 1994-95.
[5] Treasury Minute on the Fifteenth Report from the Committee of Public Accounts 1994-95, Resource Accounting and Budgeting in Government, CM 2990.
[6] http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/media/E/B/wga_scopingstudy.pdf
[7] www.legislation.gov.uk/ukpga/2000/20/contents/made
[8] www.legislation.gov.uk/uksi/2010/570/pdfs/uksi_20100570_en.pdf

Key findings

5 The publication of WGA 2009-10 is a major landmark in improving transparency in how government manages public finances. This WGA is the first and most comprehensive audited account of what the UK government spends and receives, and what it owns and owes. Its ambition significantly exceeds that of similar accounts published by other countries as it includes the accounts of central government, the devolved administrations, local government, the health service and public corporations.

6 WGAs can help Parliament hold the Treasury, as the government ministry with overall responsibility for public spending, to account. The publication of the first audited WGA has not altered the existing framework for managing public money, and accounting standards do not require the WGA to include targets or forecasts against which performance can be measured. However, the WGA for 2009-10 marks a substantial improvement as it gives Parliament and the public additional information, all in one place, on the government's overall financial position.

7 The WGA 2009-10 does not cover the entire public sector, but it includes a wider range of assets and liabilities than existing sources. The WGA 2009-10 leaves out some organisations, notably the publicly-owned banks, the Bank of England, and Network Rail which, in my view, are owned and controlled by government. It therefore understates the true value of public sector assets and liabilities. However, it complements existing statistical information on public finances, such as the *National Accounts* produced by the Office for National Statistics, by providing combined financial data on a wider range of public assets, liabilities and spending.

8 The WGA 2009-10 provides an overview of spending across the entire public sector and how it is funded. It shows how spending is spread across central and local government, NHS trusts and public corporations, and analyses spending on areas such as benefits, grants and staff costs. It does not show how spending is distributed across policy areas such as defence and education, or analyse spending on different types of goods and service such as consultancy or office accommodation. It also excludes analysis of spending within individual nations or regions. Also, due to gaps in the evidence it received from bodies included in the WGA, the Treasury could not show that it had eliminated all transactions and balances made between these bodies.

9 Differences between accounting policies used by some public sector organisations mean the value of public assets is currently understated. An important difference is between how central and local government account for infrastructure assets, and the Treasury estimates that this resulted in assets being understated by at least £200 billion in WGA 2009-10. Local government organisations are planning to provide the Treasury with additional information from 2012-13 so that the Treasury can align their policies in valuing assets.

10 The WGAs do not show the government's current position, but they can still inform long-term fiscal analysis and decision-making. The time taken to prepare an audited WGA 2009-10 means that it shows the government's financial position some 19 months previously rather than the current position. The Office for Budget Responsibility nevertheless confirmed that it drew on unaudited WGA figures published by the Treasury[9] in July 2011 in its first report on the sustainability of public finances. It is, however, too early to determine how the use of WGAs in fiscal planning will develop.

Conclusion

11 This first WGA, for 2009-10, is the culmination of a project that has spanned more than a decade and is a major landmark in reporting on public finances. It has been prepared in accordance with accounting standards and has been fully and independently audited by the National Audit Office, using auditing standards, and has made a significant advance towards improving scrutiny and transparency.

12 The breadth and scale of the WGA have presented a number of challenges for the Treasury as it compiled these accounts. Some of these have been difficult to resolve and the Comptroller and Auditor General has qualified his audit opinion on the WGA 2009-10 as the WGA has a number of material omissions and misstatements (Part 2 of this report). Except for these qualifications, the WGA 2009-10 gives a true and fair view, based on accounting standards, of the financial affairs of government.

13 The aim of the WGA is to provide robust financial information to help inform debates on the state of the public finances, how effectively government manages these, and to support long-term fiscal analysis and decision-making. It is, however, at this stage too early for me to determine how far the Treasury will achieve these ambitions, given this is the first published WGA.

Recommendations

14 To address potential qualification issues in future WGAs and bring the accounts fully into line with applicable accounting standards, the Treasury should:

- include all bodies that are owned or controlled by government in accordance with accounting standards; and
- improve the accuracy of information by ensuring that it is adjusted for differences between the accounting frameworks and policies used by different parts of government.

[9] *Whole of Government Accounts: Unaudited Summary for the year ended 31st March 2010. July 2011 Cmd 8127*

15 To further strengthen scrutiny of the public finances, the Treasury could improve future WGAs by:

- including additional disclosures that show how public spending is distributed between individual nations or regions within the UK, and spending on different types of goods and services such as consultancy and accommodation;
- adding disclosures analysing spending across the main areas of government such as defence, health and education; and
- helping Parliament and the wider public interpret the data by including budgets and forecasts which, although not required by accounting standards, would provide benchmarks against which results could be compared.

Part One: Achieving the WGA's objectives

16 In this part of my report, I examine:

- the progress that the Treasury has made towards improving transparency;
- how the WGAs can support Parliament and the public in scrutinising how government manages public finances;
- the impact of the Treasury excluding some government-controlled bodies;
- the additional information that the accounts give on the public finances;
- where the analysis of spending in the WGA is limited and where there are inconsistencies in accounting frameworks; and
- the time taken to prepare the accounts.

WGA 2009-10 is an important milestone in improving transparency and accountability

17 The 2009-10 WGA is an important milestone for the Treasury in its ambition to improve the transparency of public finances. This process started with the production of individual central government departmental accounts on a resource, rather than cash, basis from 1999-2000. Much of the information contained in the WGA is already available in around 1,500 individual published accounts that were consolidated into the WGA.[10] However, consolidating the assets, liabilities, income and spending of these bodies gives, for the first time and in one place, an audited accounts-based view of what the UK public sector owns and owes, and what it earns and spends (**Figure 1**).

18 Other countries have published consolidated financial statements that show the overall financial position and performance of central government, but the UK WGA is more ambitious as it also includes local government bodies (**Figure 2**). The differences in scope, as well as timing and accounting frameworks, mean that the UK WGA cannot be compared directly with equivalent accounts prepared by other governments.

[10] The individual accounts designated for inclusion are listed in Annex 1 of the WGA.

Figure 1

Key elements of the *Whole of Government Accounts 2009-10*

	Description	Examples	Value in WGA 2009-10 (£bn)
Assets	Resources controlled by government from which future benefits can be generated	Gold reserves, student loans, the national road network, military equipment	1,207.5
Liabilities	Obligations on government arising from past transactions or events	Deficit on the public sector pension schemes, gilt-edged stock, future cost of decommissioning existing nuclear facilities	(2,419.3)
Net liability	The difference between what the government owned and what it owed at the end of the financial year		(1,211.8)
Revenue	Income received from government activities	Taxation, rental from local government housing, funding received from the EU	582.0
Expenditure	The cost of running government and providing public services	Benefits payments, staff costs, grants, depreciation, contributions to the EU	(665.7)
Net financing cost	Costs recognised in relation to the funding of government activities	Investment revenue, interest paid on gilts, interest on pension scheme liabilities	(80.5)
Net loss on the sale of assets			(0.3)
Net deficit for the year	The shortfall between operating revenue and expenses (including finance costs) during the year		(164.5)

Source: National Audit Office analysis of WGA 2009-10.

19 The WGAs put the financial position of individual parts of government within the context of the public sector's overall financial position. For example, WGA 2009-10 shows that as at 31 March 2010:

- military equipment accounted for just over 5 per cent of the total £708.0 billion net book value of all government property, plant and equipment;[11]
- government has provided for irrecoverable debts of some £20.3 billion, of which around £10.9 billion relate to the risk of non-payment of tax;[12]
- the provision to cover the cost of nuclear decommissioning accounted for 56 per cent of the total £101.6 billion provision for meeting future liabilities arising from previous activities;[13] and
- NHS (UK) accounted for 29 per cent of the total net public service pension liability of £1,132.3 billion.[14]

[11] WGA note 14.1.
[12] WGA note 17.
[13] WGA note 25.
[14] WGA note 27.3.

Figure 2

The UK's WGA has a wider scope than similar accounts produced by other countries

	UK	France	USA	Australia	New Zealand	Canada
First published account, and audit opinion	2009-10 Qualified	2006 Qualified	1996-97 Disclaimed	1996-97 Qualified	1991-92 Unqualified	More than 30 years ago[3]
Latest available account (year end)	31 March 2010	31 December 2010	30 September 2010	30 June 2010	30 June 2011	31 March 2011
Audit opinion	Qualified	Qualified	Disclaimed	Unqualified	Unqualified	Unqualified
Published (months after year-end)	19	7	3	6	4	7
Accounts included	c. 1,500[4]	Not reported	149	203	156	Not reported
Examples of bodies in scope of accounts	Central and local government, health sector, public corporations	Central government, Head of State	Office of the President, Federal government and its agencies, Supreme Court	Central government, Parliament, courts	Central government Crown bodies, Courts, Parliament	Central government, Crown corporations
Examples of bodies outside scope	Parliament Crown Estate	Local government, rail companies	State and other local government nationalised companies	State and other local government	Local government	Province territory and other local government
Results from latest available account						
	(£ bn)	**(€ bn)**	**(US$ bn)**	**(AUS$ bn)**	**(NZ$ bn)**	**(CA$ bn)**
Assets	1,207.5	891.2	2,883.8	377.2	245.2	370.5
Liabilities	(2,419.3)	(1,647.7)	(16,356.6)	(430.1)	(164.3)	(920.9)
Net liability	**(1,211.8)**	**(756.5)**	**(13,472.8)**	**(52.9)**	**80.9**	**(550.4)**
Revenue	582.0	253.9	2,215.7	301.3	86.5	237.1
Expenditure	(746.5)	(365.9)	(4,296.0)	(360.4)	(100.0)	(270.5)
Net deficit for the year	**(164.5)**	**(112.0)**	**(2,080.3)**	**(59.1)**	**(13.5)**	**(33.4)**

NOTES

1. Figures from different countries are not directly comparable because they are stated in different currencies, the accounts have different scope, are prepared according to different accounting standards and at different points in time.
2. Expenditure includes finance costs.
3. Canada's accounts have received an unqualified audit opinion for the last 13 years.
4. This number reflects the bodies included in HM Treasury's Designation Order set out in Annex 1 to the WGA and those bodies agreed for inclusion under administrative arrangements.

Source: NAO analysis of latest available audited accounts from listed countries.

The WGA 2009-10 can help Parliament hold the Treasury to account in its role as the UK's Ministry of Finance but it has some limitations

20 As the UK's Ministry of Finance, the Treasury has overall responsibility for the public sector's financial position, public spending, and financial reporting. In presenting the financial position of the whole public sector, the WGA gives Parliament and the public additional information to help them assess the Treasury's delivery of its responsibilities in these areas. The WGA also gives the Treasury the means to improve the consistency of financial reporting across government.

21 The statement of accounting officer's responsibilities and the statement on internal control, included in the WGA, set out the Treasury's responsibilities in preparing the WGA. The Treasury is responsible for making sure that its systems are sufficiently robust to produce a WGA, but it relies on the underlying data provided by those bodies included in the WGA and their own systems of internal control. As the Treasury is not the parent body for this consolidated group, it is not responsible for the individual balances and transactions included in the WGA. In the existing framework, the Treasury delegates accountability for using public resources to the Accounting Officers of individual bodies and to those governing local authorities and other public sector bodies.[15] The WGA does not therefore alter the existing framework for managing public money.

22 As this is the first year of publication, the 2009-10 WGA has no data from the previous year to compare trends, nor does it include targets or budgets for assessing performance. It does, however, provide an initial baseline against which future trends in spending, income, liabilities and assets can be assessed. Including budget information and forecasts in future WGAs could help Parliament and the public interpret trends and understand how the government has used taxpayer resources and how effectively it manages public resources.

23 To provide a reasonable basis for holding government to account, the WGA must present a true and fair view that is free from material misstatement. There are a number of areas where the WGA for 2009-10 does not present a true and fair view of the government's financial position and performance, and I have therefore qualified my audit opinion in a number of important respects. I have set all these out in **Part 2** of this Report but, in summary:

- WGA 2009-10 excludes some government-controlled bodies that in my view should have been included to comply with International Financial Reporting Standards. The main exclusions were the banks that the government owns or partly owns and Network Rail.

[15] Chapter 3 of HM Treasury *Managing Public Money* www.hm-treasury.gov.uk/d/mpm_whole.pdf.

- The accounts of the bodies consolidated into the WGA have not all been prepared under the same accounting framework. For example, local government will not adopt International Financial Reporting Standards until 2010-11.

- The Treasury could not demonstrate that it had removed all transactions and balances between the individual bodies included within the WGA. Removing these intra-government transactions is necessary to show the government's true financial position but, because there were gaps in the information provided to the Treasury, there is a potential overstatement of £17.0 billion in gross income and expenditure, and £6.8 billion in gross assets and liabilities. I estimate that the potential maximum impact on the net annual deficit and net liabilities of the uncertain transactions is £3.2 billion.

- Income for the April 2000 auction of licences to access the 3G telecommunications spectrum has not, in my view, been accounted for in line with accounting standards. The entire £22.5 billion income was recognised in 2000-01 instead of being spread over the 20-year term of the licences.

- The issues raised in my qualification of the Ministry of Defence *Departmental Resource Account 2009-10*, which is included in the WGA, are also material to my opinion on the WGA. I qualified my opinion on the Ministry of Defence *Departmental Resource Account 2010-11* and was able to recognise that the Ministry had addressed a number of issues from the previous year – however, my opinion for 2010-11 will inform my opinion on the next WGA.

WGAs should cover the entire public sector, but some significant entities were excluded from the WGA 2009-10

24 The WGAs should cover the entire public sector, encompassing central government, local authorities, public corporations and all other bodies that exercise public functions or are funded entirely or substantially by public money. Determining which bodies fall within the public sector group can be complex. There is no single controlling entity with legal ownership or economic control of all of the other bodies, and some public sector bodies have statutory, legal or financial independence from the executive arm of government.

25 The Government Resources and Accounts Act 2000 gives the Treasury discretion to determine which bodies should be included in the WGA and requires that the Treasury prepares the WGA so that its presents a true and fair view and conforms to generally accepted accounting standards. The Treasury has adopted the definition of public sector bodies used by the Office for National Statistics in preparing the *National Accounts*. While this definition is appropriate for the *National Accounts*, in my view it is not appropriate for the WGA, which should use definitions based on accounting standards, which Treasury must have regard to in preparing the accounts.[16] By adopting definitions used for the *National Accounts*, instead of accounting standards, the WGA excludes Network Rail, which in my view should be included within the WGA.

26 Additionally, the Treasury has excluded some entities from the WGA even though they were classified as public sector bodies by the Office for National Statistics:[17] The exclusion of bodies that are not responsible to the government,[18] such as Parliament, the National Audit Office, and the Crown Estate, is in line with accounting standards, in that they are not controlled by government. The exclusion of bodies that met the inclusion criteria, but which the Treasury considered too small to warrant the cost of including them into the WGA, was also appropriate as it did not have a material impact on the accounts. These bodies had net assets totalling some £92 million and total spending of £365 million.[19]

27 The following exclusions did not follow accounting standards:

- Bodies where their classification as public sector bodies changed. For example, further education institutions were originally classified as private sector bodies but were retrospectively reclassified as public sector organisations in October 2010. This reclassification was backdated to 1993 (1989 for Northern Ireland institutions).
- Bodies where their classification as public sector bodies is expected to change at some point in the future. For example, the government has committed to returning Royal Bank of Scotland and Lloyds Banking Group to private ownership.
- Bodies where the Treasury has not been able to arrange for their consolidation in 2009-10. In some cases, the Treasury expects to include such entities in future years' WGAs. This class includes the government's wholly owned banks (Northern Rock (Asset Management) and Bradford & Bingley), the Bank of England (which the Treasury intends to include from 2010-11), and Directly Operated Railways (which the Treasury intends to include from 2011-12).

In these cases, the Treasury's departure from the relevant accounting standards means that, in my view, assets and liabilities reported in the WGA are materially understated. **Figure 12** in Part 2 sets out the potential financial impact in more detail.

[16] Government Resources and Accounts Act 2000, section 9(5)a.
[17] WGA Annex 1 lists the entities that were designated for inclusion and Annex 2 lists bodies that are excluded from the 2009-10 WGA despite meeting the criteria for inclusion.
[18] WGA note 1.21.1.
[19] WGA Annex 3.

The WGA complements existing statistical information on public finances by giving a view based on accounting standards

28 Statistics on the government's financial position are routinely published in the *National Accounts*, monthly *Public Sector Finances Report*, the *Public Expenditure Survey Analysis* and other sources.[20]

29 The WGAs are designed to complement existing statistical information on public finances by providing an account based on International Financial Reporting Standards that are used in the private sector but adapted for use in the public sector. These standards require including a wider range of assets and liabilities than the standards used to prepare the *National Accounts*. The WGA therefore includes:

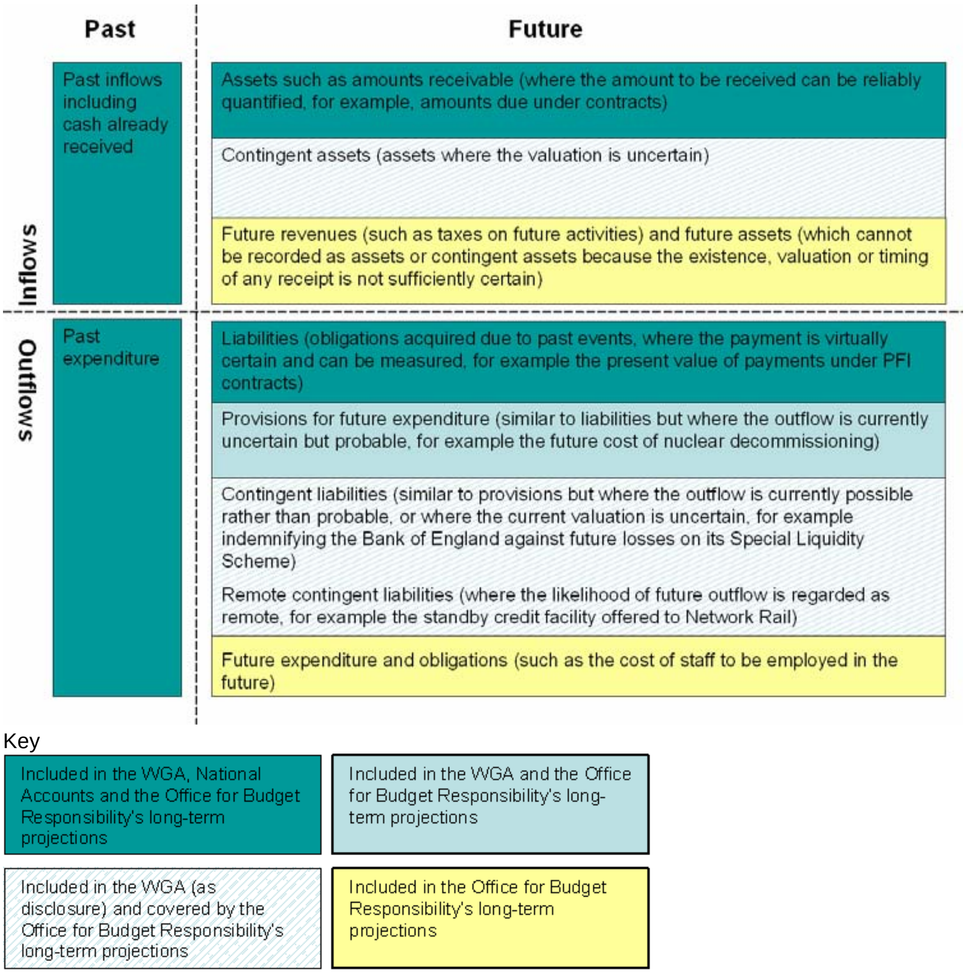
- public service pension assets and liabilities netting to £1,132.3 billion as at 31 March 2010;[21]
- provisions totaling £101.6 billion to cover future spending that will be needed to meet current obligations in areas such as decommissioning legacy nuclear facilities;[22] and
- contingent liabilities (which will only arise if certain future events occur, for example through indemnities provided to the Bank of England) of £206.4 billion.[23]

30 Neither the WGA nor the *National Accounts* reflect the government's future ability to raise taxes or the estimated value of assets or liabilities relating to future events. The Office for Budget Responsibility produces long-term projections of future public sector income and spending as a percentage of the UK's gross domestic product, which are informed by the *National Accounts* and the WGAs (**Figure 3**).

[20] See http://www.hm-treasury.gov.uk/national_statistics.htm
[21] WGA note 27.
[22] WGA note 25.
[23] WGA note 33.2. There are also unquantified contingent liabilities listed in notes 33.3 and 34.2.

Figure 3

The relationship between data in the WGA, *National Accounts* and Office for Budget Responsibility's long-term projections



NOTES

1. Figure shows the inflows and outflows covered by the WGA, the National Accounts, and the Office for Budget Responsibility's long-term projections.
2. The Office for Budget Responsibility's long-term projections do not include future physical assets

Source: National Audit Office analysis.

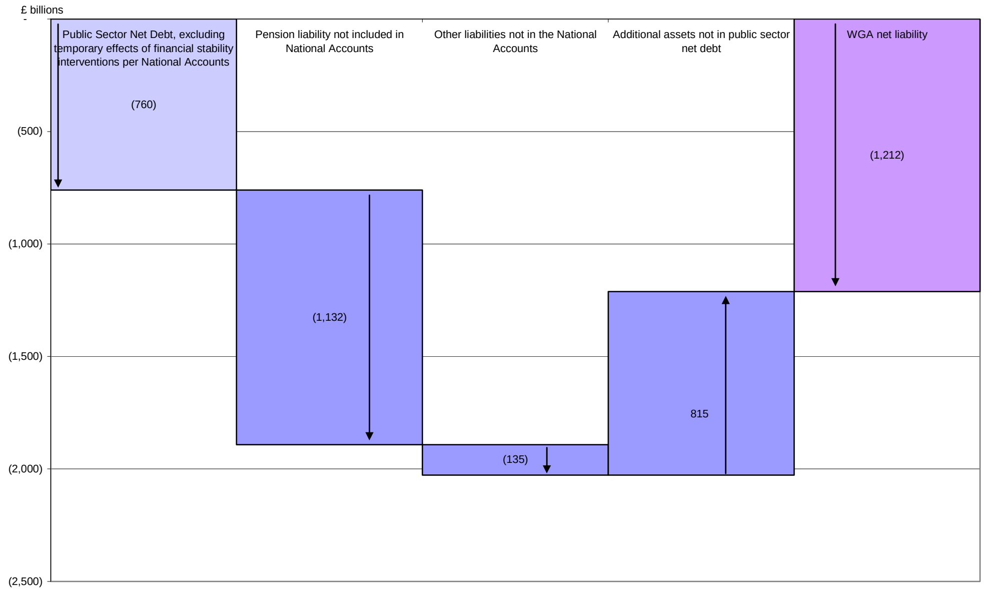
31 The main indicator of the government's financial position that the Treasury uses in its fiscal planning is public sector net debt, as published in the *Public Sector Finances Statistical Bulletin*, a publication based on *National Accounts* produced jointly by the Office for National Statistics and the Treasury.[24] As at 31 March 2010, public sector net debt was £760 billion (using the version of this measure that excludes the temporary effects of financial sector interventions). The nearest

[24] http://www.hm-treasury.gov.uk/national_statistics.htm

accounting equivalent in the WGA is the 'net liability'. The key differences are that the net liability includes pension liabilities, provisions for future spending that will be needed to meet current obligations, PFI liabilities which are not included in the *National Accounts*, and assets that are reported in the *National Accounts* but not included in the net debt figure. Reflecting this wider scope, the net liability in the WGA was 59 per cent higher at £1.2 trillion than public sector net debt (**Figure 4**).[25] The net liability represents the difference between the public sector's £2.4 trillion liabilities and its £1.2 trillion assets as recorded in the 2009-10 WGA.

Figure 4

WGA and Public Sector Finances measure of the public sector debt as at 31 March 2010 (£ billions)



NOTES

1. The measure of public sector net debt used excludes the temporary effects of the financial stability interventions.

2. The adjustment of £815 billion additional assets includes assets that are reported in the *National Accounts* but excluded from the calculation of the public sector net debt, using statistical reporting standards.

3. The £135 billion represents liabilities included in the WGA but not in the *National Accounts.* It consists of £102 billion of provisions for future expenditure, £23 billion liabilities under PFI contracts and £10 billion other differences.

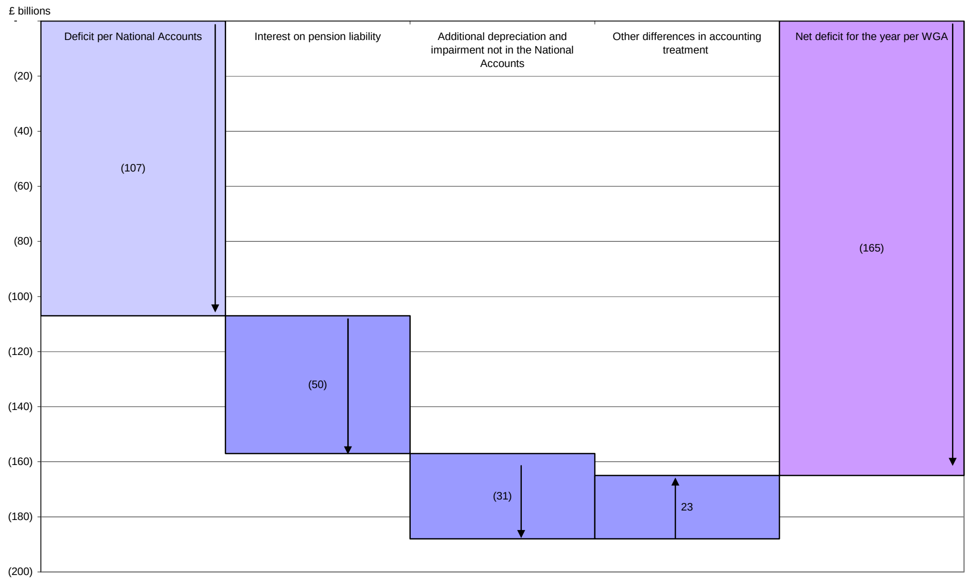
Source: Treasury reconciliation of net liabilities in the WGA to public sector net debt in the *Public Sector Finances Statistical Bulletin*.

32 The public sector current deficit in the *Public Sector Finances Statistical Bulletin* was £107 billion in 2009-10 (excluding financial interventions). The nearest equivalent in the WGA is the net deficit for the year. This is the public sector equivalent of a private sector company making a loss in a single year and, at £164.5 billion in 2009-10, was more than 50 per cent higher than the equivalent measure used in the *Public Sector Finances Statistical Bulletin* (**Figure 5**).

[25] A trillion is one thousand billion (1,000,000,000,000).

Figure 5

Comparing the WGA and Public Sector Finances measure of the annual deficit for 2009-10 (£ billions)



Source: Treasury reconciliation of the deficit in the WGA to the deficit in the *Public Sector Finances Statistical Bulletin*.

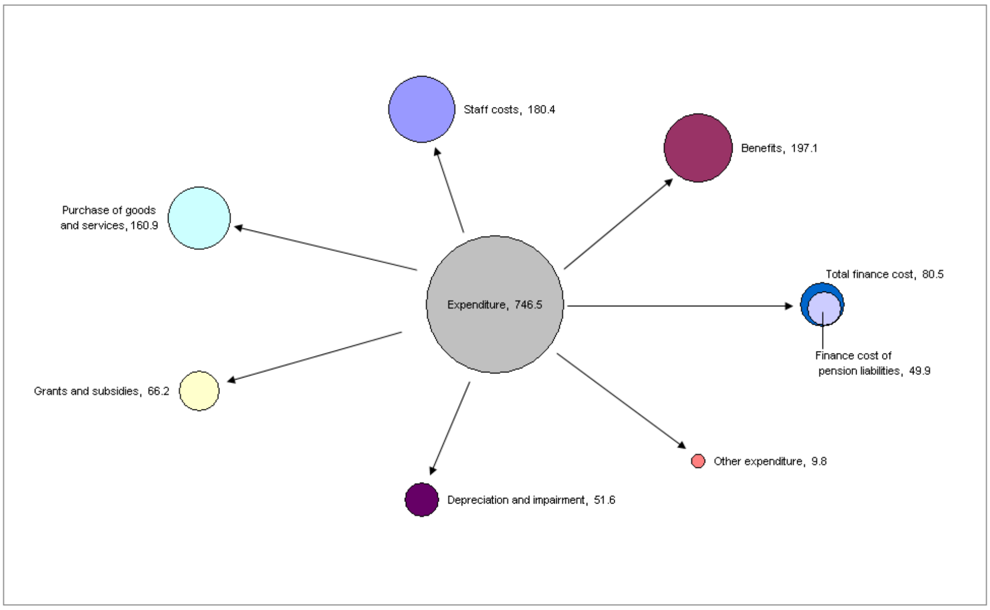
The WGA shows what total public spending was in 2009-10, but does not provide a detailed analysis of where it was spent

33 The WGA shows that in 2009-10, the public sector spent £746.5 billion. It shows how this spending was distributed across central government, NHS trusts, local government and public corporations.[26] It also analyses the distribution of spend by type, which shows that the largest components were state benefits (£197.1 billion), staff costs (£180.4 billion) and the purchase of goods and services (£160.9 billion) (**Figure 6**).

[26] WGA note 2.

Figure 6

Government spending in 2009-10 (£ billions)



NOTES

1 Total expenditure is net of items which are netted off expenditure in the WGA, which includes intra-government transactions removed, the release of provisions no longer required, investment revenue, and expected return on pension assets.

Source: WGA, Consolidated statement of revenue and expenditure.

34 By excluding any analyses of spending across the main policy areas of government such as defence, health and education, which are examined in the *National Accounts* and the *Public Expenditure Statistical Analyses,* the WGA 2009-10 does not fully comply with requirements for segmental reporting under International Financial Reporting Standards. This could limit Parliament and the public's understanding of how, and where, public resources have been used or the reasons for trends over time. There are additional areas where, although not required by accounting standards, the WGA 2009-10 could have provided more analysis to support transparency and scrutiny:

- it could show spending within individual nations or regions;
- it could provide the same level of detail disclosed in the accounts of those bodies covered by the WGA. For example, *Note 8: Expenditure on purchases of goods and services*, provides an analysis by government sector rather than by type of spending such as consultancy, accommodation costs, staff training or charges under PFI arrangements; and

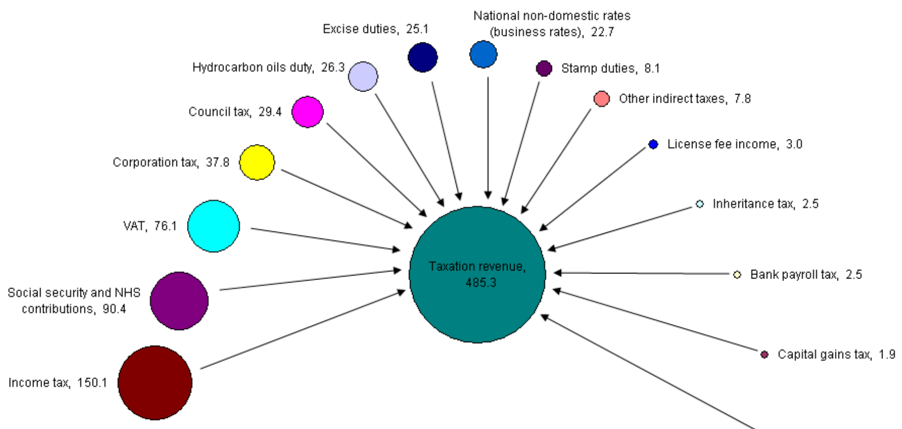
- it could show the major flows of funds betweens particular government sectors and bodies, for example the grants paid by central government departments to local authorities.

The WGA gives a full account of revenue from taxation and details of government borrowings

35 The government funds its activities through a combination of income (mainly taxation) and borrowing. The WGA shows that the revenue from each of the main taxes and duties totalled £485.3 billion in 2009-10 (**Figure 7**), which was 34.5 per cent of gross domestic product.

Figure 7

Taxation revenues in 2009-10 (£ billions)



NOTES

1. Figures differ from those reported in the accounts of HM Revenue & Customs because £107.2 billion of transactions with other WGA bodies have been removed. This includes public sector employers' national insurance contributions.

2. Bank payroll tax is included within income tax in the WGA.

Source: National Audit Office analysis of WGA note 3.

36 The WGA gives a figure of £965.6 billion for total outstanding central government borrowing[27] consisting of £803.8 billion of gilts, £63.0 billion of Treasury bills and £98.8 billion of National Savings & Investment products. The WGA also shows other liabilities have been incurred to fund the public sector's activities, including:

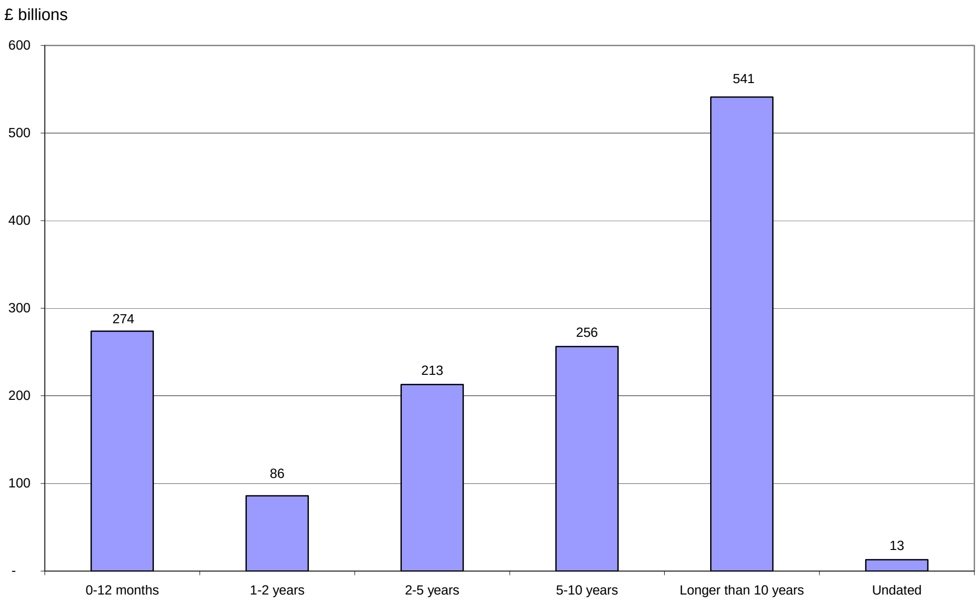
[27] WGA note 24.

- £31.0 billion of bank and other borrowings, including those held by local authorities;[28]
- £18.1 billion of liabilities created by money market operations[29] used to meet the Government's cash requirement;[30] and
- overdrawn bank accounts of £2.6 billion held at the Office of the Paymaster General.[31]

37 As debts come to the end of their term, the original amount must be repaid. As at 31 March 2010, financial liabilities (debts) held by the Treasury, Debt Management Office, the National Loans Fund and the Exchange Equalisation Account of £273.9 billion were due in 2010-11 (**Figure 8**). This total includes £39.1 billion gilts and all £63.0 billion Treasury Bills issued during 2009-10. Other bodies, such as local government, do not provide details of when debts are due in their WGA returns.

Figure 8

Maturity profile of financial liabilities



NOTES

1. Undiscounted financial liabilities held by HM Treasury, Debt Management Account, National Loans Fund, and the Exchange Equalisation Account

Source: WGA note 36.5.3.

[28] WGA note 23.
[29] Sale and repurchase agreements where a bank sells securities to the public sector for later repurchase.
[30] WGA note 26.
[31] WGA note 20.

Not all public bodies in the WGA use the same accounting framework, but the Treasury is addressing this

38 One of the aims of the WGA is to encourage public bodies to align accounting policies, to support direct comparisons between organisations. The chosen accounting framework for the WGA is the International Financial Reporting Standards adapted for the public sector. [32] Where individual accounts use different accounting frameworks, the data in these accounts should be adjusted by the Treasury, where there are material inconsistencies, so that the WGA can be prepared on a consistent basis.

39 Local government organisations did not prepare their 2009-10 accounts in line with International Financial Reporting Standards. The Treasury did not adjust the data supplied by local government to take account of this. This should improve for 2010-11 when local government organisations are preparing their 2010-11 accounts in line with International Financial Reporting Standards.

40 Using the same financial reporting standards would improve the quality of data in the WGA, although in some instances those standards allow a choice of accounting treatments. For example, local government organisations value infrastructure assets, such as local road networks, at their original cost rather than their replacement cost, as required by the central government accounting framework. The Treasury estimates that this resulted in the value of such assets in the WGA being understated by at least £200 billion (86 per cent).[33] Local government organisations do not expect to be able to provide a valuation of their infrastructure assets on a basis consistent with central government until 2012-13. Different approaches may be appropriate for the accounts of individual public bodies but, for the WGA, a common accounting treatment should be used for consistent financial reporting.

41 The Treasury has not been able to fully quantify the impact of the different accounting frameworks or policies on the WGA. However, the most significant impact is expected to be limited to certain areas of the accounts, such as assets. Therefore, the information currently presented in the WGA is still useful to give a view of the public sector and is broadly on the same basis on which large private-sector companies report.

WGA may inform fiscal planning by providing a range of information on the government's financial position

42 The WGA is consistent with accounting standards in only including information that can be reliably estimated, and excluding the value of revenue, liabilities and assets arising from future transactions or events that are too uncertain to include. For example, pension liabilities for the past service of public sector employees can be reliably estimated and are included in the WGA, but the cost of future service by

[32] The Government Financial Reporting Manual (FReM)
[33] WGA note 14.1.

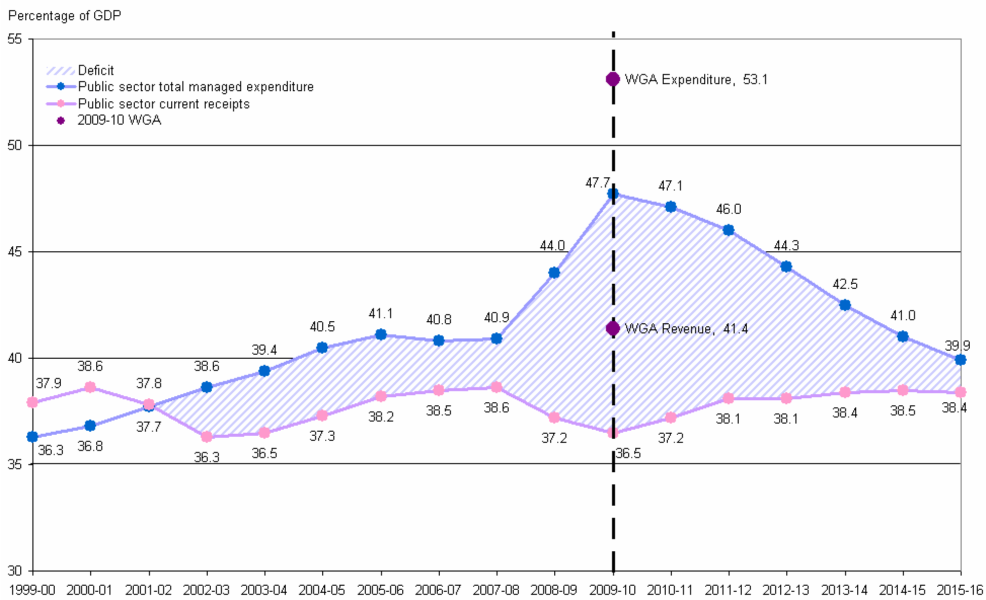
current or future employees is less certain and is therefore excluded. The WGA also excludes the present value of future tax revenues for the same reasons. As a set of accounts, WGAs can *inform* long-term fiscal analysis and decision-making, but they are not designed to *measure* the government's long-term position.

43 It is too early to say how the WGA will actually be used to inform the preparation of longer-term fiscal projections in practice. However, the Office for Budget Responsibility, a non-departmental public body established under the Budget Responsibility and National Audit Act 2011, confirmed that it drew on the unaudited WGA published by the Treasury in July 2011[34] in preparing its first annual report on the sustainability of the public finances.[35] **Figure 9** shows the Office for Budget Responsibility's forecast of how the public deficit will change over the next few years.

[34] www.hm-treasury.gov.uk/press_78_11.htm
[35] Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2011. http://budgetresponsibility.independent.gov.uk/wordpress/docs/FSR2011.pdf

Figure 9

The Office for Budget Responsibility has forecast that the public deficit will reduce as a percentage of gross domestic product, mainly through reducing spending



NOTES

1. Figure shows actual spending and receipts up to 2009-10, which the Office for Budget Responsibility sourced from the Treasury's *Public Sector Finance's databank*, and forecasts up to 2015-16.

Source: Office for Budget Responsibility, *Economic and Fiscal Outlook* March 2011, http://budgetresponsibility.independent.gov.uk/wordpress/docs/economic_and_fiscal_outlook_23032011.pdf and supplementary tables http://budgetresponsibility.independent.gov.uk/pubs/obr_fiscal_supplementary_tables1.xls ; and WGA 2009-10

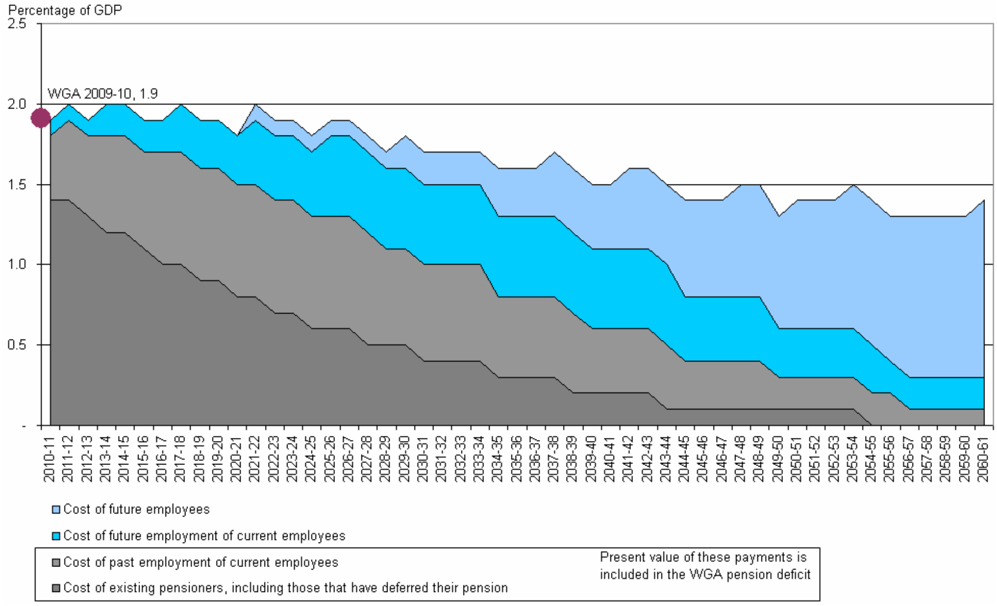
44 The Office for Budget Responsibility considers that the WGA is more complete than the *National Accounts*, but the additional information included in the WGA is subject to greater uncertainty. The uncertainties include the impact of varying the discount rates used to calculate the present value of future liabilities. For example, the net public service pension liability in WGA increased by 41 per cent to £1,132.3 billion between March 2009 and March 2010 largely as a result of changes to the discount rate.[36] The June 2010 budget announced that the inflation assumption will be based on the Consumer Prices Index (CPI) instead of the Retail Prices Index (RPI). This development is likely to reduce the pension liability and finance cost of the pension in future years' WGA, and it will change cash payments from 2011-12. Against this background, the Office for Budget Responsibility's long-term projection is for a fall in

[36] WGA note 1.21.5 shows that while general government, including central government and the NHS, used a discount rate of 1.8 per cent rate based on corporate bonds, local government used higher discount rates of between 5.5 and 5.8 per cent (nominal), set according to the judgement of each local authority. A higher discount results in a reduced liability. Pension liability figures from WGA note 27.2.

future pension payments over the next few decades to 1.4 per cent of gross domestic product by 2060-61, which shows that the increase in pensions liabilities reported in WGA 2009-10 must be put in a wider context (**Figure 10**).

Figure 10

Pension costs, for future service and future new entrants, are an important part of the long-term financial position of the public sector



NOTES

1. Figure shows the Office for Budget Responsibility's July 2011 long-term projections for future public service pension payments as a percentage of gross domestic product.

2. The WGA pension liability does not include future payments for future service by current or future employees, in accordance with International Financial Reporting Standards.

3. Note 27.2 to the 2009-10 WGA shows payments of £26.9 billion on the unfunded schemes (1.9 per cent of 2009-10 gross domestic product). This does not include any payment on the funded schemes, which are netted off the scheme assets.

Source: Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2011.

The time taken to prepare the WGA may limit how far it meets its objectives

45 To publish audited WGAs is a significant undertaking for the Treasury, requiring co-ordinating and consolidating some 1,500 accounts and removing transactions between them. The Treasury planned on publishing the first set of audited accounts for the 2005-06 financial year by 2006, and took a further five years to achieve this (**Figure 11**). The delay mostly reflected the Treasury widening the scope of the unpublished WGA from central to local government organisations from 2004-05, and central government adopting the International Financial Reporting Standards, adapted for the public sector, from 2009-10.

Figure 11

The development of public financial reporting since 1995

1995	In May 1995, the Committee of Public Accounts recommend that a WGA be produced for central government. July 1995 White Paper proposes Government produces its accounts on a resource, rather than cash, basis.
1998	March 1998 *Code for fiscal stability* requires Government to produce a WGA.[37] Treasury publishes a scoping study in July 1998 which proposes publishing an audited WGA covering 2005-06 by 2006.
2000	Central Government publish audited accounts for 1999-00 on a resource basis. Government Resources and Accounts Act 2000 establishes a requirement to publish an audited WGA, but does not set a specific date to start.
2003	First dry-run WGA produced but not published. It covers only central government and relates to the 2001-02 financial year. The intention is to publish this Central Government Account from 2003-04 and then to extend the scope to the entire public sector. December 2003 Pre-Budget Report proposes publishing the full WGA starting with 2006-07.
2004	Scope of the 2004-05 dry-run WGA is extended to cover the entire public sector.
2007	March 2007 Budget announces that central and local government will adopt International Financial Reporting Standards for the 2008-09 accounts, and proposes that WGA for 2008-09 will be the first published.
2008	March 2008 Budget delays adopting the International Financial Reporting Standards and publishing the WGA by one year so that 2009-10 will be the first account published.
2010	March 2010 Statutory Instrument (legislation) specifies that WGA must be published by 31 December 2011. Central Government publish audited accounts for 2009-10 under International Financial Reporting Standards.

Source: National Audit Office

46 The 2009-10 accounts were published some nineteen months after the end of the financial period to which they relate. However, this was the first WGA that would be fully audited and the legislation foresaw that initial timetables would need to allow time to produce and audit an account of sufficient quality and depth.

47 The Treasury originally planned to publish the WGA 2009-10 in Spring 2011. This timetable proved to be unrealistic as the breadth and scale of the task were greater than the Treasury had initially anticipated. The Treasury is reliant on the data it receives from each of the bodies consolidated within the WGA and it needed to undertake more work than planned so that this data was of sufficient quality for WGA purposes. Additionally, although the Treasury had produced "dry run" accounts over the previous seven years, and had feedback from the National Audit Office following

[37] http://archive.treasury.gov.uk/pub/html/docs/fpp/1998/code/cfs.pdf

its review of each of these accounts, these accounts were incomplete and work was not drawn to a final conclusion. In bringing the WGA for 2009-10 to such a conclusion, there was additional work that had to be incorporated into the project plan covering the need to:

- produce good quality draft accounts;
- remove intra-group transactions and balances, within acceptable limits, and give sufficient and robust evidence to support the resulting adjustments;
- compile certain statements and figures within the account, such as those within the cash flow statement and where opening balances were included; and
- resolve a large number of issues and adjustments arising from the external audit process.

48 Publishing the WGA more quickly and efficiently would help decision-makers by providing more timely and comprehensive information. The Treasury has identified[38] actions to help address, or partly address, a number of the issues I have identified in my report, namely:

- including additional bodies into the WGA;
- addressing inconsistencies around PFI reporting, which will improve disclosing existing commitments;
- improving the consistency of the WGA by ensuring that all local government data is reported using the International Financial Reporting Standards from 2010-11; and
- adopting depreciated replacement cost for valuing highways infrastructure assets by local authorities by 2012-13.

49 The Treasury could take further steps to help to strengthen preparing the WGA by:

- reviewing its accounting policies for the accounting treatments that have led me to qualify my audit opinion, for example, on the WGA boundary;
- assessing differences in accounting frameworks and ensuring that the WGA can be produced consistently and within a common accounting framework;

[38] WGA Annex 5

- considering whether it should seek additional powers to ensure that bodies to be consolidated into the WGA comply with the instructions for preparing the WGA returns in order to strengthen the quality and depth of information they provide; and

- considering how the process for identifying and agreeing intra-group transactions and balances could be improved.

50 In taking forward some of the issues above, it is important that the Treasury engages with bodies being consolidated into the WGA so that potential issues can be identified and resolved earlier in the process.

51 One example of where the Treasury will need to take more action is in relation to the inclusion of Academies. Academies have a 31 August year-end, so they have compiled their returns from a five month pro-rata of the audited accounts for the period to 31 August 2009, together with unaudited data to reflect subsequent activity to March 2010. Not all Academies submitted returns, and a small number of them were excluded as the Department for Education considered the financial data to be of poor quality. The Department was not able to substantiate the omitted figures for Academies or the reasonableness of their pro-rata of 2008-09 figures, and I estimate that this resulted in omissions of some £0.2 billion expenditure and £0.3 billion assets. The value of unaudited data included within WGA from the individual Academy returns for the period to March 2010 is £1.2 billion of expenditure and £2.2 billion of assets.

52 The Academy sector is expected to grow. In 2009-10 there were 181 Academies included in the WGA, and, by 1 October 2011, there are 1,350[39] Academies. The Treasury must continue to work with the Department for Education to put effective mechanisms in place so that they have more robust data to include in the WGA, and the impact this will have on future WGAs will be determined by the extent to which the uncertainties experienced with the 2009-10 data are addressed in returns for subsequent years.

[39] Department for Education. http://www.education.gov.uk/schools/leadership/typesofschools/academies/b0069811/open-academies-and-academy-projects-in-development

Part Two: Qualifying the Comptroller and Auditor General's audit opinion

Introduction

53 As highlighted in Part 1 of my report, the breadth and scale of the WGA have presented a number of challenges for the Treasury as it compiled this account. A number of these have been difficult to resolve for this first year and, as a result, have led me to qualify my audit opinion. This part of my report explains why I have qualified my audit opinion on the 2009-10 WGA.

My obligations as auditor

54 Under the Government Resources and Accounts Act 2000, I am required to examine and certify the WGA. International Standards on Auditing (UK and Ireland) require me to obtain sufficient evidence to allow me to give reasonable assurance that the WGA is free from material misstatement. In forming my opinion I examine, on a test basis, evidence supporting the disclosures in the financial statements and assess the significant estimates and judgements made in preparing them. I also consider whether the accounting policies are appropriate, consistently applied and adequately disclosed.

Qualified opinion owing to multiple disagreements and limitation of scope of my audit

55 I have qualified my opinion on the WGA 2009-10 because in a number of important areas, the WGA does not comply with International Financial Reporting Standards as adapted for the public sector context, [40] and this has had a material effect on the figures presented. My qualifications relate to:

- the definition of public bodies that the Treasury has used to determine the boundary of the WGA;
- the inconsistent application of accounting standards;
- how the Treasury has accounted for income from the sale of 3G licences; and
- the qualification of the audit opinion of an account that is included in the WGA.

56 I have also limited the scope of my opinion on the WGA 2009-10 because of the following issues, which meant I was unable to obtain sufficient and appropriate audit evidence to base my opinion in certain areas:

[40] The Government Financial Reporting Manual (FReM)

- there was a lack of evidence to support the completeness of the intra-government adjustments to remove transactions and balances between the bodies included in the WGA; and

- issues arose within the audit opinions of an account included in the WGA where auditors have limited the scope of their audit.

Qualified audit opinion relating to the WGA boundary

57 I have qualified my opinion because, in my view, the Treasury has not complied with applicable accounting standards in determining which bodies to include in the WGA. Significant assets and liabilities have therefore been left out of the financial statements.

58 I cannot quantify the impact of this on the WGA with certainty, as I do not have information needed to identify the transactions that would have to be removed to provide a consolidated view. However, for illustrative purposes, I have examined the impact of adding the gross assets, liabilities, income and spending published in the individual accounts of public sector bodies that the Treasury did not include in the WGA. Although these figures are only illustrative, they demonstrate that the exclusions represent a material omission from the WGA (**Figure 12**).

Accounting policies

59 The definition of the whole of government boundary, and applying this definition, determines the content of the WGA. The Government Resources and Accounts Act 2000[41] allows the Treasury to define the WGA boundary. The Treasury has adopted the classifications of public bodies used by the Office for National Statistics in preparing the *National Accounts.*[42]

60 The Act also requires that the Treasury prepares the WGA so that they "*present a true and fair view and conform to generally accepted accounting practice subject to such adaptations as are necessary in the context*". The Treasury has established a framework[43] to support this requirement which is based on International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board. The *National Accounts* are based on the statistical standards set out in the European System of National and Regional Accounts 1995 (ESA 95). Financial statements and the *National Accounts* are each prepared for different purposes and are not therefore alternative views on the same issue - they can legitimately lead to different conclusions.

[41] Section 9, Government Resources and Accounts Act 2000.
[42] WGA note 1.21.1.
[43] The Government Financial Reporting Manual (FReM).

Figure 12

Gross accounts figures from bodies that have been excluded from WGA as compared to the total figures in the WGA (for illustrative purposes)

	Revenue (£bn)	Expenditure (£bn)	Net deficit for the year (£bn)	Assets (£bn)	Liabilities (£bn)	Net liability (£bn)
Figures in the WGA	**582.0**	**(746.5)**	**(164.5)**	**1,207.5**	**(2,419.3)**	**(1,211.8)**
Total values of the entities which have been excluded from the WGA	**108.4**	**(108.7)**	**(0.3)**	**3,167.1**	**(3,006.7)**	**160.4**
Made up of:						
Network Rail Ltd	5.7	(5.4)	0.3	41.7	(35.7)	6.0
State-owned banks (temporary ownership): Lloyds Banking Group plc and Royal Bank of Scotland Group plc	97.5	(96.8)	0.7	2,723.7	(2,585.0)	138.7
State-owned banks (longer-term ownership): Northern Rock (Asset Management) plc, Bradford & Bingley plc and Dunfermline Building Society	1.8	(2.2)	(0.4)	138.4	(135.9)	2.5
Financial Services sector: Bank of England, Financial Services Authority and the Financial Services Compensation Scheme	1.3	(1.1)	0.2	243.5	(239.4)	4.1
Education sector: Further Education Institutions	-	-	-	12.6	(5.5)	7.1
Transport sector: London & Continental Railways Ltd, Tube Lines Ltd, and Directly Operated Railways Ltd	1.8	(3.1)	(1.3)	6.4	(5.2)	1.2
Other: NHS non-independent charities, and London Councils	0.3	(0.1)	0.2	0.8	0.0	0.8

NOTES

1. The additional bodies have been treated as if they had always been entirely owned by the public sector. In particular, for Royal Bank of Scotland and Lloyds Banking Group, no account has been taken of the residual private sector shareholdings. This means that a portion of the net deficit for the year and the net liability that is attributable to the remaining private sector shareholders has not been distinguished between that attributable to the public sector. This will overstate the quoted figures for the net liability and net deficit for the year.
2. Not all bodies have a March year-end: some of the figures relate to December 2010 (the banks) or February 2010 (the Bank of England).
3. To avoid double counting with the results of the Treasury and the Bank of England, no adjustment is made for the Bank of England Asset Purchase Facility Fund, because as at 28 February 2010 its £200 billion assets consisted mainly of £192.8 billion of gilts issued by the Treasury, £1.8 billion receivable from the Treasury and £3.8 billion cash deposited with the Bank of England and its £200 billion liabilities is entirely funding provided by the Bank of England.
4. No amounts are included for Northern Rock plc as these are already included through other accounts.
5. No amounts have been included for income and spending of Further Education Institutions because the majority of their operations are funded through government grants, which are included in WGA note 9. Their assets and liabilities have been estimated from data provided by the Higher Education Funding Council for England.
6. The adjustment for the NHS Charities has been estimated by the Department of Health from 2007-08 Charity Commission data.

Source: National Audit Office analysis of WGA note 37 and published accounts.

61 In my view, the most appropriate basis to apply when compiling a set of financial statements would be the criteria set in the accounting standards. The Government Resources and Accounts Act requires the Treasury to prepare accounts for a group of bodies, *each of which appears to the Treasury to exercise functions of a public nature, or to be entirely or substantially funded from public money*. In describing the boundary for *National Accounts*, adopted by the Treasury for WGA, the statistical standards require including bodies that the Office for National Statistics has classified as 'public sector'. Public sector bodies are those where government has control over determining their general corporate policy. Accounting standards, however, require including bodies that are subject to government control, and define control as "the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities".[44]

62 As a consequence of the Treasury adopting statistical, rather than accounting, standards when it comes to defining 'control', the WGA excludes Network Rail Ltd, a company limited by guarantee with the Department for Transport acting as one of the guarantors. Under accounting standards, Network Rail would be classified as being part of the public sector as the government's interest in the company is akin to an equity shareholder's interest. The government effectively gives security to the providers of debt finance to Network Rail and is acting as the lender of last resort in the event of financial difficulties. The government is the party bearing the risk that would normally be borne by equity capital if Network Rail were an equity-based company.[45] The Treasury, by excluding Network Rail, which had net assets of £6.0 billion at 31 March 2010, did not comply with the accounting standards that in my view prevail.

63 The Treasury has also not applied its own criteria consistently. As paragraph 26 and 27 highlights, there are a number of bodies that fall within both statistical and accounting definitions of government 'control' but have not been included in the WGA. These are set out in Annex 2 to the WGA and include:

- bodies that are not controlled by government, such as Parliament;
- a number of small bodies that have not been consolidated on the basis of size (Annex 3 to the WGA); and
- other bodies that are partly or wholly owned by the government, such as the Bank of England and Royal Bank of Scotland (**Figure 12**).

64 I consider it appropriate to exclude those bodies that are not controlled by the government, as this treatment meets with accounting standards. I also consider that it is acceptable to exclude the small bodies as they do not represent a significant

[44] IAS 27 – *Consolidated and Separate Financial Statements*.
[45] See Network Rail NAO ONS Joint Statement, www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/na-classifications/network-rail/ons---national-audit-office--nao--joint-statement-on-network-rail.pdf.

exclusion from the WGA. However, by adopting generally accepted accounting standards, I consider that the bodies listed in **Figure 12**, where the government has the ability to control their activities, should be included in the WGA.

Actions by the Treasury

65 The Treasury set out in Annex 5 actions it intends to take to include further bodies into future WGAs. For 2010-11, it intends to include the Bank of England and London & Continental Railways Ltd. It aims to include Directly Operated Railways Ltd from 2011-12. It also intends to complete plans for the consolidation of Bradford & Bingley plc and Northern Rock (Asset Management) plc by the end of 2012-13 and will consider the status of other public sector entities not currently included in the WGA. However, the qualification of my opinion on this matter is likely to remain until all significant government-controlled entities, including Network Rail Ltd, are included in line with the accounting standards.

Recommendation for further action

66 The Treasury should review its criteria for including bodies in the WGA.

Qualification arising from disagreement relating to the inconsistent application of accounting policies

67 I have qualified my opinion because of the impact of the inconsistent application of accounting policies. This arises as the statutory accounts of the bodies included in the WGA were prepared on different bases and the Treasury did not make adjustments for these differences when consolidating these bodies.

The WGA accounting framework

68 The accounting framework that WGA must follow is set out in the Government Financial Reporting Manual which applies International Financial Reporting Standards, as adapted for the public sector context. However, for 2009-10, some of the bodies included in the WGA prepared their accounts based on accounting frameworks that did not fully comply with the requirements of the Government Financial Reporting Manual.[46]

69 Under accounting standards,[47] the Treasury should identify the impact of the different frameworks and make appropriate adjustments to the WGA, where material, so that the WGA is prepared on the same basis. The Treasury has not undertaken a full assessment of these differences and has made no adjustments for differences in accounting policies. Without this assessment, I do not have the information to fully quantify the effect of this limitation.

[46] Annex 4 to WGA
[47] IAS 27 – *Consolidated and Separate Financial Statements*

70 The Treasury has identified one area of material misstatement in the WGA due to differences between the accounting policies of central and local government. The accounting framework used by local government requires local authorities to value their infrastructure assets using historic cost, but central government values assets at their depreciated replacement cost in line with the requirements of the Government Financial Reporting Manual[48]. The Treasury estimates that this difference in accounting treatment has resulted in an understatement of asset value of at least £200 billion[49].

Recommendations for further action

71 The Treasury should fully assess the extent of differences in accounting frameworks adopted by all the sectors in the WGA and make all the adjustments that are required to bring the accounts into line.

72 From 2010-11, the local government sector will adopt a revised framework that will follow International Financial Reporting Standards. Although this will bring this sector's accounting framework more in line with that of central government, the Treasury will still need to consider any remaining differences in accounting treatments. The complexities involved in moving the accounting for infrastructure assets from historic cost to depreciated replacement cost mean that this information will not be available until 2012-13. Until accounting frameworks are applied consistently, the qualification of my audit opinion will remain.

Qualification arising from limitation in audit scope due to lack of evidence supporting the completeness of the elimination of intra-government transactions and balances

73 I have limited the scope of my opinion concerning the lack of evidence about the completeness and accuracy of removing intra-government transactions and balances, when the WGA was prepared.

Accounting requirements

74 The WGA is a consolidated account which is prepared by including the financial activities of around 1,500 government controlled bodies. Transactions and balances between these bodies are removed so that income, expenditure, assets and liabilities are not overstated between bodies within the group, as required by accounting standards.[50]

[48] As required under paragraphs 6.2.10 to 6.2.18 of the Government Financial Reporting Manual
[49] WGA note 14.1: The best proxy available for depreciated replacement cost is the calculated asset value used by the Office for National Statistics from their perpetual inventory model reflected in the *National Accounts*. The 2010 *National Accounts* estimated the value of the road network at £248 billion as at 31 December 2009, implying a likely understatement of at least £200 billion.
[50] IAS 27 – *Consolidated and Separate Financial Statements*, paragraph 20.

75 To present a true and fair picture of the financial position and financial results of government, it is important that the removal of these intra-government transactions and balances are complete and accurate.

76 The Treasury collects information from each of the bodies in the WGA through specifically designed WGA information packs. Each body completes and submits these packs, which will have been audited by their external auditor, either directly to the Treasury or via a sub-consolidating body.

77 Within these packs, bodies must identify and report all intra-government balances, transactions, income and expenses that are over £1 million and the relevant counterparty. Examples of such transactions are where a central government department gives grants to local government, such as the Revenue Support Grant. With this information, the Treasury matches these balances and transaction streams and removes them from the WGA. The scale of this task is challenging and, as part of the preparation of the WGA for 2009-10, the Treasury removed significant values of transactions and balances (**Figure 13**).

Figure 13

Value of transactions removed from the WGA

	Gross value (£ bn)	Transactions removed (£ bn)	Net Value (£ bn)	Balance removed (%)
Income	964	382	582	39.6
Expenditure	1,200	453	747	37.8
Net cost for the year	236	N/A	165	N/A
Assets	1,737	529	1,208	30.5
Liabilities	2,652	232	2,420	8.7
Net liabilities	915	N/A	1,212	N/A

Source: National Audit Office analysis of WGA note 2.

78 I have considered the approach that the Treasury has taken in removing these intra-government transactions and balances during 2009-10. There is a process for bodies included in the WGA to identify these intra-government balances and for some level of agreement process to take place. However, there is a material residual uncertainty over some of the figures in the financial statements because the removal of transactions and balances is potentially incomplete and inaccurate. This uncertainty arises where:

- either of the entities declare different intra-government transactions or balances (requiring an assumption to be made as to the correct amount to remove); or
- where only one entity declares an intra-government transaction or balance (a particular issue between central and local government bodies); or

- where neither body declares an intra-government transaction or balance.

79 Using available evidence, I have estimated the level of uncertainty as being up to £17.0 billion in gross income and expenditure and up to £6.8 billion in gross assets and liabilities (**Figure 14**). I have reviewed the impact of the uncertain transactions on the financial statements and have concluded that the uncertainty mainly resides within the gross figures in the primary statements (between income and spending and separately between assets and liabilities). There are, however, some transactions which are not confined solely to one statement, such as grant-in-aid expenditure and grant-in-aid financing within reserves. This means that the potential impact of the uneliminated intra-government transactions and balances on the annual deficit and net liabilities is not likely to be zero. I estimate that the potential maximum impact of the uncertain transactions in Figure 14 could be up to £3.2 billion, which represents a possible misclassification between the annual deficit and net liabilities.

80 It is the significance of the estimated level of gross uncertainty within the statements, and the potential gross overstatement of income, expenditure, assets and liabilities, which has led me to qualify my opinion rather than the potential impact on the annual deficit or net liabilities.

Figure 14

Sources of uncertainty about transactions removed and the impact on the financial statements

	Sources of uncertainty			
	Entities declaring different intra-government transactions or balances (£bn)	**Only one entity declares an intra-government transaction or balance (£bn)**	**Neither entity within an expected relationship declares an intra-government transaction or balance[51] (£bn)**	**Impact on the financial statements (potential overstatement) (£bn)**
Consolidated statement of revenue and expenditure	3.7	7.3	6.0	17.0
Consolidated statement of financial position	1.2	5.1	0.5	6.8

Source: National Audit Office analysis.

[51] Calculated with reference to transaction streams and balances that are expected to be fully removed.

Recommendations for further action

81 The Treasury needs to undertake further work to reduce the uncertainties in removing intra-government transactions and balances in future years. It needs to enhance the process so that bodies in the WGA provide more robust information about their transactions and balances with other bodies, and to better identify relevant counterparties. From 2011-12, the process to widen the resource accounting boundaries for central government departments (under the Clear Line of Sight project) could also lead to more intra-government transactions and balances being removed from the accounts of individual bodies. Removing more intra-government transactions would allow the Treasury to reduce the uncertainties I have identified.

82 If the Treasury can strengthen its process and get better information to reduce the level of uncertainties within acceptable levels, I may be able to remove this qualification in future years.

Qualification arising from disagreement in the accounting for 3G licences

83 I have qualified my opinion because I consider that the Treasury has not complied with accounting requirements regarding accounting for the income from the sale of 3G licences in April 2000. The impact of this on the 2009-10 WGA is that income is understated by £1.1 billion, liabilities are understated by £11.4 billion and the general fund is understated by £11.4 billion.

Accounting requirements

84 In April 2000, the government sold five licences for using the electromagnetic spectrum for third generation mobile phone services (3G). They sold the licences in auction and raised some £22.5 billion. All licences were paid for at this date and receipts were surrendered by the Radiocommunications Agency in full to the Consolidated Fund. The accounts of the Consolidated Fund are prepared on a cash basis and this particular receipt was properly accounted for in its 2000-01 financial statements.

85 In my view, income arising from this auction has been accounted for incorrectly in the WGA. Following accounting standards,[52] as licence holders have the right to access the spectrum for 20 years and there is an ongoing performance obligation to maintain the airwaves, a more correct accounting treatment would be to recognise this income over 20 years rather than in the first year.

86 The Treasury does not agree with this view and, as disclosed in Note 1.21.3 to the WGA, believes that there are no additional performance obligations. Therefore, the

[52] IAS 18 – *Revenue*

Treasury has not adjusted the WGA for this transaction and I have qualified my opinion based on my disagreement of this material issue.

Recommendations for further action

87 The Treasury should, in my view, adjust the WGA for this transaction and, where there are future transactions of this nature, account for them in line with the accounting standards.

Qualification arising from disagreement and limitation in audit scope from underlying statutory audits of bodies in the WGA

88 Where the external auditors of bodies in the WGA qualify their opinions on the statutory accounts, I am required to consider the impact of these qualifications on my opinion on the WGA. In 2009-10, external auditors qualified their opinions of some 29 accounts (Annex 1 to the WGA).

89 The most significant of these relates to the *Departmental Resource Accounts* of the Ministry of Defence where I qualified my audit opinion. Given they also have a material impact on WGA, I have also qualified my opinion on the WGA. More details of my qualification can be found in my audit opinion and within the Ministry's own annual accounts.[53]

90 I will assess the impact of any qualifications on the statutory accounts for the 2010-11 audit of WGA. However, due to aspects of the Ministry of Defence qualification remaining, it is likely that this qualification will remain in place.

Other issues on which I have not qualified my opinion

91 There are a number of other issues that I wish to draw attention to, although I have not qualified my opinion about these issues:

- I have included an emphasis of matter paragraph in my audit opinion for one account that is significant to the WGA, highlighting an area that is significantly uncertain in the values reported. This value has been calculated based on reasonable assumptions, but could change with future events. This relates to the uncertainties in estimating costs of the liabilities of the Nuclear Decommissioning Authority.

- The external auditor of some 16 bodies included in the WGA, qualified their audit opinions owing to the material existence of irregular spending; that is using resources not in accordance with Parliamentary intentions. Of these, two are of significance to the WGA. These cover error and fraud in benefit payments and tax credit payments. These irregularities lead me to qualify my regularity opinion on

[53] www.mod.uk/NR/rdonlyres/F10E990E-C296-48B1-9838-B3006C1F8DCB/0/mod_ra0910.pdf

the resource accounts of the Department for Work and Pensions since 1988-89 and the trust statement of HMRC since 2003-04. Because the scope of my audit of the WGA, which is set out in the Government Resources and Accounts Act 2000, does not require me to provide an opinion on regularity, irregular transactions do not lead to a qualification of my audit opinion on the WGA.

Amyas C E Morse
Comptroller and Auditor General
31st October 2011

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