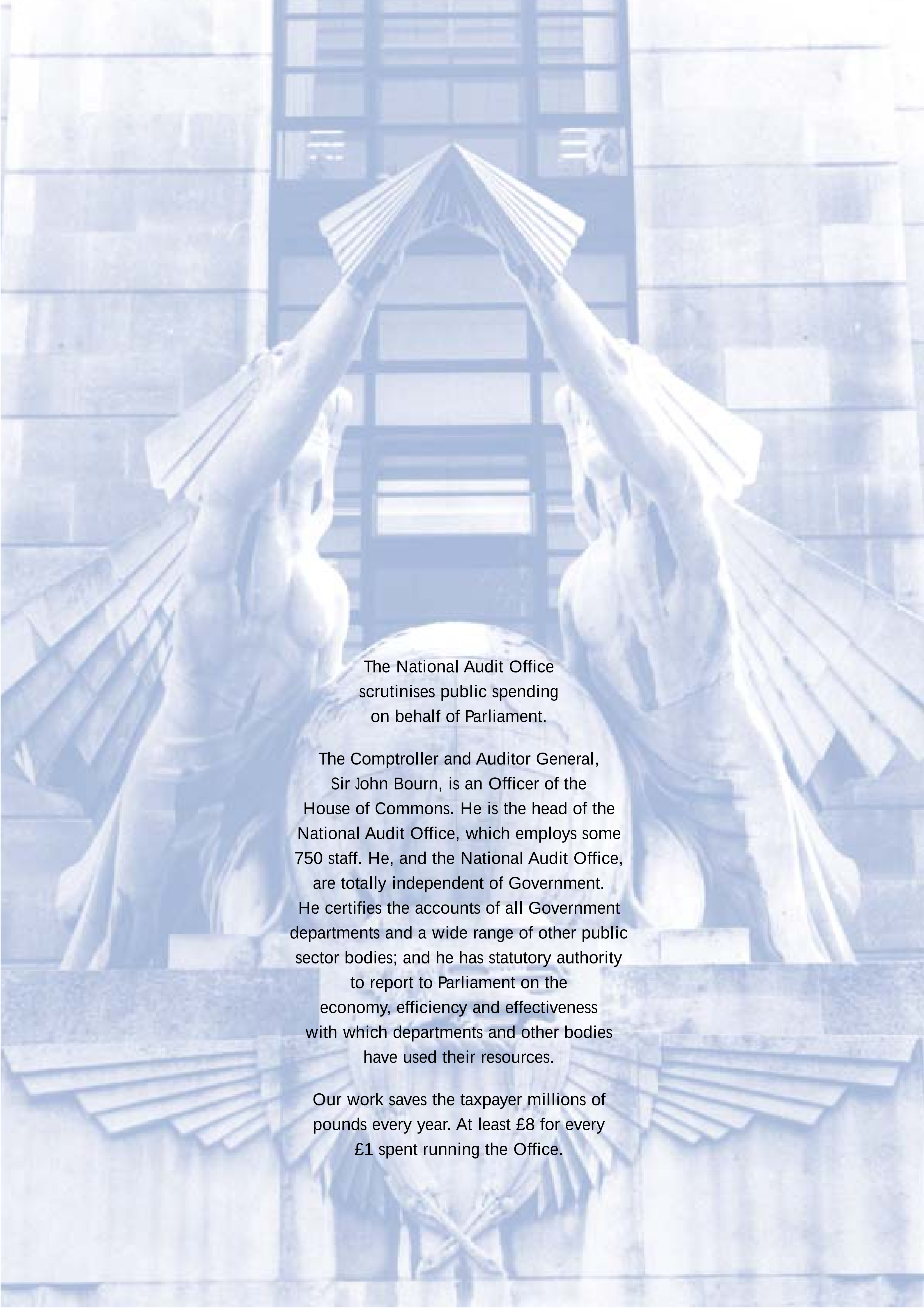
NATIONAL AUDIT OFFICE

Financial Auditing and Reporting

General Report of the Comptroller & Auditor General 2001-02

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HC 517 Session 2002-2003: 26 March 2003



The National Audit Office scrutinises public spending on behalf of Parliament.

The Comptroller and Auditor General, Sir John Bourn, is an Officer of the House of Commons. He is the head of the National Audit Office, which employs some 750 staff. He, and the National Audit Office, are totally independent of Government. He certifies the accounts of all Government departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

Our work saves the taxpayer millions of pounds every year. At least £8 for every £1 spent running the Office.

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John Bourn
Comptroller and Auditor General

National Audit Office
17 March 2003

This report can be found on the National Audit Office web site at www.nao.gov.uk

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executive summary

1 My General Report to Parliament summarises the results of financial audit work undertaken by the National Audit Office over the twelve months from 1 February 2002 to 31 January 2003 and highlights key issues arising from it. In my report, I comment upon developments in financial management across government, and highlight those few instances where the accounts rendered by central government bodies have not, in my opinion, provided a true and fair presentation of financial information, or where funds have not been spent for the purposes intended by Parliament. I also raise other issues relating to financial management and financial reporting which may be of interest to Parliament.

2 In the first year in which resource based accounting and supply has wholly superseded cash based appropriation accounts and estimates as the main Parliamentary control over public expenditure, I report on the progress made in adopting resource accounting, and identify areas in which further work is required. My report also provides me with an opportunity to comment on the progress made by audited bodies in the central government public sector in embedding risk management systems and other best corporate governance practice and in developing systems to enable the future compilation of whole of government accounts.

Financial Management and Financial Reporting

3 I certified over 550 sets of financial statements during 2002-03 relating to (Westminster) central government revenues, expenditure, public debt and reserves. In addition to expressing an opinion on whether the statements gave a true and fair view of the income and expenditure of central government bodies, I also examined the regularity and propriety of transactions, to provide Parliament with assurances that public funds had been spent in accordance with parliamentary intention.

4 While I found that in many organisations the quality of accounting and financial management was improving, I remain concerned at the time taken by many bodies to prepare and render accounts for audit, particularly at departmental level. Accounts that are not rendered until some months after the year end date are of reduced usefulness and will, in the longer term, impact on the timeliness of whole of government accounts. In this regard, I am pleased to welcome the initiatives which the Treasury is proposing to advance the timetables against which accounts are required to be submitted and audited. This may prove challenging for some departments, and any advances in the timetable should not be at the expense of the underlying quality of the accounts produced, but there is a very real scope for improvement in this area.

Resource Accounting and Resource-Based Parliamentary Supply

5 Resource accounts and estimates have entirely replaced cash based appropriation accounts as the prime basis for Parliamentary control and government accountability. I am pleased to be able to report that all departmental resource accounts for 2001-02 were audited and laid before Parliament by the statutory deadline of 31 January 2003. This contrasts with both 1999-2000 and 2000-01, when a number of major departments required dispensations from Treasury allowing audited accounts to be laid after the statutory deadline. In addition I was also able to complete my audit of the non-statutory accounts of the House of Commons and the House of Lords by 31 January 2003. Overall this represents a significant and welcome improvement, reflecting the considerable efforts of departments, HM Treasury and the National Audit Office.

6 But while departments have continued to make progress in producing quality accounts in line with the statutory timetable, for a significant minority there remains more to be done both in terms of the timeliness of submission and the quality of accounts rendered. In a number of departments there is an over-reliance on too few key personnel and a lack of technically competent supporting staff. Some departments have still to develop the accruals-based management information systems required to embed both resource budgeting and resource accounting into routine financial management.

7 In 2001-02 I qualified my opinion on more resource accounts than the previous year (sixteen compared to nine in 2000-01). In fact the number of qualifications relating to the truth and fairness of the accounts dropped, reflecting an improvement in the quality of accounts presented for audit. But for the first time in 2001-02, breaches by departments of their approved allocations of either cash or resources, resulting in 'Excess Votes' and automatic qualification of my opinion, came into play for resource accounts. Prior to 2001-02, excesses were recognised only in appropriation accounts. More detail on this is provided within part 2 of this report and also in the 7th and 8th Reports of the Public Accounts Committee (HC504 and 504, 2002-03).

Corporate Governance

8 Organisations across the central government sector continue to work towards the Treasury's target for them to have in place a full, embedded system of risk management and internal control for the 2003-04 financial year. Many organisations are ahead of this timetable and have recognised the real benefits which integrated and pro-active risk management can bring.

9 Accounting Officers are required to report progress in a 'Statement on Internal Control', with their annual accounts, which is subject to my review. I also work closely with audited bodies to advise on the development of their corporate governance arrangements and risk management processes. I wholeheartedly support the developing use of risk management, and have been clear in stating my support and the support of the National Audit Office for well thought through risk-taking.

10 The recommendations contained in the recent reports on non-executive directors (the Higgs report) and on audit committees (the Smith report) should serve to further strengthen the corporate governance framework. Though aimed primarily at the listed company sector, these reports have clear resonances for the central government sector. I welcome these reports and will work with colleagues at the Treasury and audited bodies to see that their recommendations are taken forward in our sector.

Regulation of the auditing profession

11 I was a member of the Department of Trade and Industry's Co-ordinating Group on Audit and Accountancy Issues which was set up to consider the regulatory arrangements in place in the United Kingdom for statutory audit and financial reporting. The Group issued its final report in January 2003.

12 I welcome the recommendations made by the Co-ordinating Group and by accompanying reports which aim to ensure a robust regulatory framework for the audit and accountancy profession. I and the National Audit Office are committed to playing an active role in the development of the new arrangements.

Looking forward

13 The range of financial audit work which I and the National Audit Office carry out continues to change. I look forward to the further implementation of the recommendations set out in Lord Sharman's report into audit and accountability in central government to widen my responsibilities, particularly in terms of facilitating my appointment as the external auditor of all non-departmental public bodies, and formalising in statute my rights of access to private sector organisations in receipt of public funds. Once these recommendations are implemented, I will be better placed to discharge my responsibilities to Parliament in scrutinising the expenditure and income of government bodies.

14 My role and that of the National Audit Office, both in providing independent assurance to Parliament on audited bodies' financial statements and use of resources, and in providing an efficient and effective audit service to the bodies themselves, is crucial. This is particularly the case at a time when, following the introduction of resource accounting, government bodies are increasingly required to exercise judgement in deciding upon the accounting treatment for assets, liabilities and financial transactions. As the external auditor it is my responsibility to advise on accounting treatments, and also to consider, in reaching my opinion on the financial statements whether I concur with the material accounting judgements made by government bodies. If I consider an accounting treatment to be inappropriate, and conclude that it could lead to a material misstatement of the accounts, then I qualify my opinion on that account.

15 The National Audit Office will continue its active participation in the development of new guidance, through taking an active role in bodies such as the Public Audit Forum and the Auditing Practices Board. We will also continue to work with those bodies tasked with strengthening oversight within the profession. The input of the National Audit Office into the work of such bodies is another way in which the assurance provided to Parliament from the Office's financial audit work can be enhanced, through the development of appropriate auditing and accounting guidance for the central government sector, and by ensuring that the accounting and auditing regime within the UK is robust.

16 And the National Audit Office will continue to play its prominent role in the development of the accounting framework for the central government sector. The projected adoption of International Accounting Standards across the European Community by 2005 could also have significant implications for this framework, as set out in the Resource Accounting Manual. Any required changes will need to be assessed by the Financial Reporting Advisory Board to the Treasury, on which the National Audit Office is represented.

John Bourn
Comptroller and Auditor General

17 March 2003

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Part 1

Financial management and reporting

1.1 The Comptroller and Auditor General is the appointed auditor of all government departments, executive agencies, and a wide range of other public bodies.

1.2 As well as expressing an opinion on the financial statements of the bodies for which he is the appointed auditor, the Comptroller and Auditor General examines how well the management of audited bodies meet their responsibilities for the keeping of appropriate and accurate financial records, following generally accepted accounting practice as adapted in the public sector context and set out in accounting guidance issued by the Treasury, and for ensuring that public funds are spent in accordance with Parliamentary intention.

1.3 The Comptroller and Auditor General will draw to the attention of Parliament, by way of a qualified audit opinion, a report on accounts or both, matters which he feels warrants Parliament's attention. During the period covered by this report the Comptroller and Auditor General qualified his audit opinion on thirty two sets of accounts rendered to him. This was a slight increase over the preceding year. A full list of qualified opinions is included in this report at Appendix 3 of this report. A list of reports on accounts issued is included at Appendix 4.

1.4 A significant proportion of the qualified opinions issued during 2002-03 related to departmental resource accounts. These are dealt with in more detail in the following part of this report.

1.5 The remainder of this part of the report provides a commentary on some of the key themes arising out of the National Audit Office's financial audit work over the last year, under the following headings:

- The preparation of financial statements and faster financial closing;
- The private finance initiative, off balance sheet financing and contingent liabilities.
- Addressing future challenges - harmonisation with international accounting standards;

The preparation of financial statements and faster financial closing

1.6 To allow the timely and accurate reporting of government expenditure to Parliament, Accounting Officers should ensure that the financial statements for which they are responsible are prepared and rendered for audit on a timely basis, and that the accounts are subject to an appropriate level of internal quality review which will allow for their audit without requiring a significant number of amendments.

1.7 The Treasury have developed proposals for accelerating the timetable for finalising departmental resource accounts. We are pleased to welcome the Treasury's initiative in this area, and comment more fully on these proposals in part 2 of this report. The need to prepare and render accounts is not, though, simply an issue for departments. Executive agencies are required to present their accounts for audit under the same statutory timetable as for resource accounts (by 30 November following the financial year ending 31 March), but there is a presumption that these accounts will be audited and laid before Parliament in advance of the summer recess. During the period covered by this report 63 of 89 executive agency accounts met this deadline, with a further 14 audited and laid before 30 November. By 31 January 2003, 85 of the 89 accounts had been audited and laid before Parliament.

1.8 Although departments and other audited bodies have made considerable progress in working to improve the speed of delivery of their accounts, there remain a number of problems which must be addressed if bodies are to improve their delivery of accounts to the timetables envisaged by the Treasury. A key problem continues to be the reliance of audited bodies on a small number of technically qualified staff to carry out their accounts preparation. And in spite of investment in accounting systems, many audited bodies continue to rely heavily on management information systems which were designed to operate on a cash basis in year, meaning the production of year end financial statements is reliant on a disproportionate level of manual effort at the year end.

Accounting for complex transactions - the private finance initiative, off balance sheet financing and contingent liabilities

1.9 In recent years, government bodies have developed a range of different means by which to procure or provide services and capital assets. Chief amongst these has been the development of the Private Finance Initiative (PFI). I continue to carry out a wide range of value for money audit work on PFI and associated matters. And the use of PFI deals and other similar transactions also raises issues of accounting judgement in terms of how transactions streams and assets should be treated in the accounts of government bodies.

1.10 A range of guidance is in place to assist government bodies in reaching their view as to the most appropriate accounting treatment for a complex transaction such as a PFI deal. It is important that government bodies follow this guidance and ensure that they adopt an appropriate accounting treatment and that the resulting assets and liabilities are correctly recorded.

1.11 The National Audit Office works closely with audited bodies to ensure that the accounting treatment adopted for individual projects is appropriate, and the Comptroller and Auditor General has made clear to departments that where he considers that the liabilities arising from financing arrangements are not correctly reflected in the financial statements of the bodies that he audits then he will qualify his opinion and report to Parliament accordingly. He has not yet had the need to do so.

1.12 The Comptroller and Auditor General also seeks to ensure that any contingent liabilities arising under such arrangements are properly disclosed so that Parliament is made aware of all significant potential liabilities.

1.13 One particular case that arose last year was that of Network Rail, and the question of whether its assets and liabilities should fall to be accounted for on the consolidated balance sheet of the Strategic Rail Authority (a public sector body). The Office for National Statistics concluded that, for the purposes of the statistically based National Accounts, Network Rail should be classified as a private sector body and its borrowings not included as government borrowing. The Comptroller and Auditor General concluded that, under UK Generally Accepted Accounting Practice accounting conventions, Network Rail should be treated as a public sector body under the auspices of the Strategic Rail Authority, and its assets and liabilities included in full on the SRA's consolidated balance sheet.

1.14 The Comptroller and Auditor General and the National Statistician issued a joint statement explaining the different bases on which they had reached their judgements. The statement made clear that the financial statements of central government bodies and the National Accounts are each prepared for different purposes and under different sources of guidance.

1.15 Notwithstanding the guidance on accounting for PFI programmes provided by the Accounting Standards Board and the Treasury, the National Audit Office has noted some apparent inconsistencies in accounting treatments applied to projects in different parts of the public sector. This may have an impact on Whole of Government Accounts incorporating the local authority and health sectors.

1.16 It is apparent that the property assets built under a number of PFI deals have been accounted for on neither the public sector body's balance sheet or that of the 'special purpose vehicle' of the consortium delivering the project. While there may be valid reasons of accounting and judgement for this in some cases, it is a cause for concern. The Accounting Standards Board is leading a project for the International Accounting Standards Board on accounting for service concessions. One of the issues being considered is the extent to which it is appropriate to use a components-based methodology which would address the issue.

1.17 The National Audit Office is committed to working with the other UK audit agencies who participate in the Public Audit Forum to ensure that, so far as is possible, a consistent approach to the accounting for such complex transactions is taken across the entire public sector, in line with the prevailing guidance.

Addressing future challenges - harmonisation with International accounting standards

1.18 The European Union has stated its intention that, from 1 January 2005, the accounts of all publicly listed companies should be prepared in accordance with International Accounting Standards (IAS). The Accounting Standards Board has already expressed its intention that in future UK Accounting Standards and UK Generally Accepted Accounting Practice (UKGAAP) will be harmonised with international standards.

1.19 The Treasury has been involved in consultations about the applicability of IAS to the UK public sector, but has not yet publicly commented on its intentions for the UK public sector. It is waiting for the outcome of the Department for Trade and Industry consultation on the extent of the application of IAS to the corporate sector. The Financial Reporting Advisory Board to the Treasury, on which the National Audit Office is represented, will be responsible for advising on any interpretation of UKGAAP as revised for the government sector context.

1.20 Any decision to harmonise with International Standards could have significant implications for balance sheet accounting policies, particularly those applying to the valuation of certain assets and liabilities, where some of the principles within IAS and UK Financial Reporting Standards differ.

1.21 The convergence of UK and International Accounting Standards, if adopted within the public sector will have major ramifications. The National Audit Office will work closely with the Treasury, the Financial Reporting Advisory Board, and with audited bodies to ensure that future changes to UK accounting standards which are subsequently incorporated within the government financial reporting framework can be applied by audited bodies with a minimum of disruption.


Waco
Stories

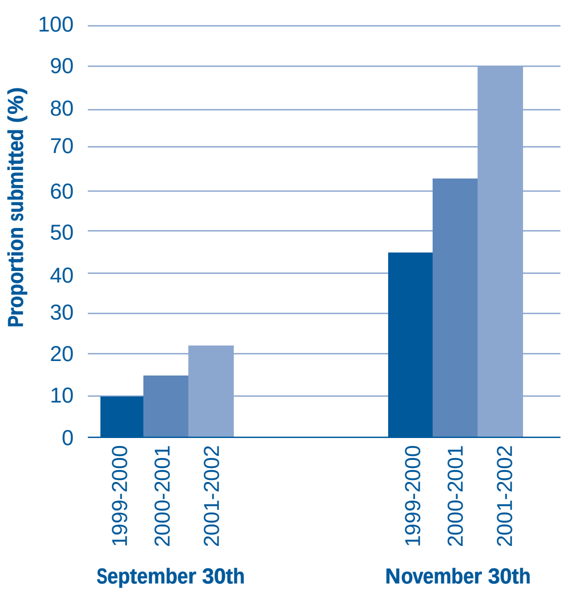
Part 2

Resource accounting and resource-based Parliamentary supply

2.1 Resource accounting is a commercial style of financial reporting which has been introduced across the whole of central government. 'Accruals-based' resource accounts are prepared by each government department to show its expenditure and income as it is incurred or earned rather than when amounts are paid or received. The accounts also show departments' assets and liabilities so that amounts owed or owing are disclosed, as well as capital assets such as buildings and longer term liabilities. And the accounts continue to show overall cash flows. Resource accounts thus provide a much fuller picture of departments' financial activity than the simple receipts and payments or 'cash based' system they replace.

2.2 Resource accounts became particularly significant in 2001-02 when they wholly replaced the former cash based Appropriation Accounts. This followed an unpublished 'dry run' for 1998-99 and two further years of published parallel running. In 2001-02, for the first time, resource accounts became the means by which departments accounted for their 'Supply' - the amounts Parliament had authorised them to spend. 2001-02 also marked the introduction of 'resource based' Supply. Under this new system, Parliament authorises and sets limits on departmental expenditure on two bases rather than one. It authorises amounts for 'resource consumption' (being current expenditure on an accruals basis) as well as the 'cash' required to meet all the department's needs - capital as well as current. And for the first time the accounts have been prepared under the Government Resources and Accounts Act 2000 which was passed to make the changes possible.

1 **Date of submission of signed Resource Accounts 1999-2000 to 2001-02**



2.3 In all, resource accounts for 2001-02 were the culmination of more than five years of preparation, dry running and parallel running to prepare for the new system.

Past progress

2.4 In my 2000-01 General Report I reported on the progress that departments had made in their resource accounts for 1999-2000 and 2000-01, the two full parallel run years. I commented on the timeliness of the accounts - as to whether departments had met the statutory requirement to render accounts for audit by 30 November following the financial year ended the previous 31 March. I also commented on the quality of the accounts, as evidenced by the number that gained clear audit opinions and those that did not. As foreshadowed in that report I provided, in May 2002, a memorandum to the Committee of Public Accounts providing further information about progress, including a more detailed analysis of findings from the 2000-01 accounts.

2.5 Following from those earlier observations, this report focuses on the position departments have reached for 2001-02 and considers what the future holds.

2.6 **Figure 1** shows departments' performance in delivering signed accounts for audit over the 3 years to 2001-02. For 2001-02, 90 per cent of accounts (53 out of 59) were delivered by the statutory deadline of

30 November. Three of the remaining six accounts were parliamentary accounts not bound by the statutory timetable. All six outstanding accounts were delivered by the following January and all departments' accounts were audited and laid before the House of Commons by the statutory date of 31 January.

2.7 By contrast, only 60 per cent of accounts for the previous year had been delivered by 30 November. And 5 accounts for that year - and 10 for the year before - had not been laid before the House until February or March, the departments having been released from the statutory obligation by a Treasury dispensation. This was necessary because of the departments' inability to deliver their accounts for audit in time.

2.8 Overall, therefore, with only a very few exceptions, the improvements in meeting the statutory requirement for delivering accounts for audit have been significant and sustained. Full compliance with the statutory timetable was very nearly achieved for 2001-02 and the laying of all departments' accounts by the due date was achieved, notwithstanding the few late deliveries for audit.

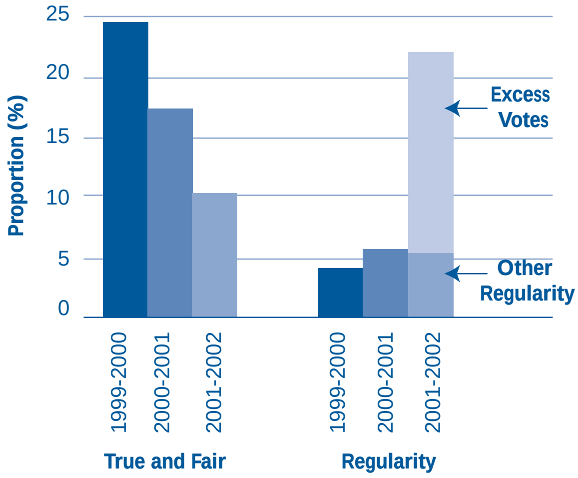
Truth and fairness

2.9 The quality of accounts also further improved for 2001-02. This is shown in **Figure 2** by the decreasing proportion of accounts for which the audit opinion relating to truth and fairness was qualified. Of the 59 accounts for 2001-02, 53 (90 per cent) received a clear audit opinion. The opinion on the truth and fairness of the remaining 6 accounts was qualified. In each case this was because insufficient audit evidence could be obtained regarding one or more specified elements of the accounts (for example, amounts relating to the consumption of stocks or fixed assets). The scope of the audit opinion was accordingly limited in this regard.

2.10 By contrast, the numbers of opinions qualified in respect of truth and fairness for 1999-2000 and 2000-01 were 12 and 9 respectively. Some of the qualifications were also far more severe. 3 of the former and 2 of the latter opinions were 'disclaimed' (in effect, a 'non-opinion') because the lack of audit evidence was so pervasive or material.

2.11 The truth and fairness of the accounts, as represented by the results for 2001-02, has therefore significantly improved to the point where the great majority of departments' accounts provide sound accountability to Parliament. This is vital if Parliament is to retain its control of government expenditure. The six departments that received qualified audit opinions on their accounts for 2001-02 will need to continue to improve so as to remove the causes as soon as possible.

2 Qualified Accounts



Regularity

2.12 As indicated by figure 2**,** there was however in 2001-02 a substantial increase in the proportion of accounts where the separately-expressed audit opinion on the 'regularity' of expenditure was qualified. In 2001-02 the regularity opinion on thirteen accounts was qualified. This increase from 3 in 2000-01 was caused wholly by departments breaching expenditure limits set by Parliament through 'Supply'. Such excesses - however small - are irregular and result in a qualified opinion. They require retrospective parliamentary authority through an 'Excess Vote'. Ten departments' accounts were qualified on such grounds.

2.13 Qualification of the audit opinion on grounds of an 'Excess Vote' came into play only from 2001-02, when resource accounts first assumed the role of accounting for Supply. Prior to that, such excesses were recognised only in Appropriation Accounts. Comparison with details of qualified opinions in previous years should therefore reflect this. The number of qualifications arising from Excess Votes in the 2001-02 resource accounts was nonetheless about twice the average number of such qualifications over recent years in Appropriation Accounts. Much of the reason for this was the nature and novelty of the new resource-based Supply system, in which departments are set limits on the consumption of resources as well as cash. Six of the qualifications were in respect of a breach of resource limits, one in respect of cash, and three in respect of both.

2.14 The remaining 3 regularity qualifications in 2001-02 (3 in 2000-01 and 2 in 1999-2000) all arose from error or insufficient evidence to confirm that certain expenditures had been materially in accordance with the relevant legislation or regulations.

2.15 In the case of Excess Votes, they do indicate in some cases a need for better resource planning, greater understanding of the resource consequences of decisions - particularly those that do not have immediate cash consequences, and improved financial systems that provide information for monitoring the consumption of resources as well as cash. In some cases the excess has clearly been attributable at least in part to the continued reliance on essentially cash-based financial systems.

2.16 Further details on the Excess Vote qualifications is set out in the Committee of Public Accounts 7th and 8th reports of 2002-03 (HC 503 and 504 of 2002-03).

Treasury proposals for accelerating the production of resource accounts

2.17 The Treasury proposes to accelerate the production and audit of resource accounts. Its ultimate intention is that accounts should be laid before Parliament before the Summer Recess. Such a timetable already applies to the accounts of departments' Executive Agencies. The aim is to achieve this on a timetable aligned to the production of Whole of Government Accounts. The Treasury has sought proposals from each department for a timetable for achieving this. To assist in the process the Treasury, in consultation with the NAO, prepared a 'Faster Closing' booklet which helps identify how departments may close off their books and prepare their accounts more rapidly. The ability of departments to finalise accounts, and submit them for audit within a much shorter timetable is important if whole of government accounts are to be produced sufficiently quickly after the end of the financial year, that they will provide timely and valuable information to Parliament and to other users.

2.18 The NAO also participated in writing the Public Audit Forum paper 'The Whole Truth: Or why Accruals Accounting Means Better Management', published in 2002. This included benchmarks against which departments might assess the extent to which they have implemented the systems necessary for such improvement, and examples of good practice.

2.19 The NAO is pleased to welcome the steps which the Treasury is taking to speed up the delivery of accounts. It is wholly committed to a partnership with departments to help achieve this. Success will critically depend on departments implementing improvements to their financial systems. A key concern expressed by the Committee of Public Accounts and shared by the NAO is whether such acceleration can be made without risk to the quality of accounts presented for audit and to Parliament.

2.20 There may also be some doubt as to the pace of acceleration and there are certainly challenges for the larger more complex departments to deliver their accounts to the timetable proposed by the Treasury. As well as performance against the statutory submission deadline of 30 November, figure 1 above shows the extent to which departments were able to submit their accounts for audit by the end of September. This was a target date set administratively by the Treasury, to reflect the expectations of the Public Accounts Committee in relation to Appropriation Accounts. The figure shows that by 2001-02 less than a quarter of departments were achieving that target. In the main, such departments were the smaller, less complex ones.

2.21 The NAO will therefore be concerned to see that the plans being made by departments, for what is a very much more radical acceleration, reflect their present capabilities. NAO will also want to see that, as necessary, the plans include enhancements to financial systems and recognise that acceleration depends on achieving them. Such enhancements will also be a pre-requisite for the risk-based and systems-based audit that is already the NAO's preferred approach. This will be vital if the faster audit implied by the acceleration is to be achieved.

Conclusions

2.22 2001-02 represented a watershed for resource accounting and resource based Supply. Its outcome was a test of whether the new system was indeed sufficiently reliable to be the new basis for parliamentary control of expenditure. The test has very largely been satisfied. A few departments still have more to do to prepare accounts for which there is sufficient audit evidence to conclude that the accounts provide a true and fair view in all areas. But the scale of such areas is diminishing and those departments are making progress. Although nearly all departments are producing unqualified accounts, there are nevertheless indications from the numbers of Excess Votes that some underlying systems and management controls are still, in essence, cash based. Such systems and management will need to be further developed if the Treasury's proposals to accelerate the production of accounts are to be achieved.

Whole of Government Accounts

2.23 The Government Resources and Accounts Act 2000 also places a requirement on the Government to prepare consolidated accounts for the public sector - Whole of Government Accounts (WGA). WGA will be commercial-style accounts, prepared using UK Generally Accepted Accounting Practice (GAAP), modified only as necessary for the needs of the public sector.

2.24 The main aim of WGA is the provision of better quality financial information on the activities and position of government as a whole, underpinning the decisions of government fiscal planners, and improving the accountability of government to Parliament and the wider public.

2.25 WGA will be produced in stages, starting with Central Government Accounts (CGA), made up of departments, central funds, the devolved administrations and non-departmental public bodies. The first published CGA will be for the year ending 31 March 2004, with dry run accounts being prepared for each of the two preceding years commencing 2001-02. The extension from CGA to WGA depends on a Ministerial decision expected later in 2003. Subject to that decision, current plans are for the Whole of Government Accounts to be published from 2005-06 onwards, comprising the bodies within CGA plus local authorities, National Health Service Trusts, trading funds and public corporations (for example, the British Broadcasting Corporation and the Post Office Group). As with CGA, the approach to WGA is likely to include a period of dry run accounts preceding publication.

2.26 The Comptroller and Auditor General is the auditor of CGA and WGA. In forming his overall opinion on the accounts, he will rely on assurances given by the auditors of the departments, funds and non-departmental public bodies included within the consolidation. As well as National Audit Office staff, those auditors include Audit Scotland, the Northern Ireland Audit Office, the Audit Commission and private sector firms. The National Audit Office's strategy for the audit of Central Government Accounts aims to integrate the CGA work with the audit of the statutory accounts of each body, so as to make most efficient use of audit resources while minimising the extra time and costs that the production of CGA adds to the audit process. The NAO and the Treasury are also encouraging departments to think of preparations for CGA as integral to their year end accounts work. The strategy is available at http://www.nao.gov.uk/guidance/wga/wga_index.htm.

2.27 The Treasury's Whole of Government Accounts Team is implementing CGA via a project plan (the "Milestones" strategy). In the past year, the WGA Team has made substantial progress on essential development stages such as the implementation of the consolidation system and the alignment of accounting policies. Consistency of accounting policies within government should be beneficial in itself, by improving comparability and contributing to the fair and efficient use of resources.

2.28 While departments have been publishing resource accounts since 1999-2000, other significant areas of the governments' finances are still prepared on a cash or less than full accruals basis. The WGA programme is one of the drivers of key developments, described in the following paragraphs, to bring all central government finances onto a full accruals basis.

Recognising taxation income on the accruals basis

2.29 The Trust statements currently produced by the Inland Revenue and Customs & Excise and referred to in Section 4 of this report, record taxation revenue on a receipts and payments basis. These departments are working towards recognising taxation income on an accruals basis when it becomes receivable, rather than when it is received. Accruals based information should

- allow more meaningful year on year comparisons, by removing the effect of short term timing differences in receipts and payments;
- by being more consistent with the basis of recognition of expenditure, allow a more meaningful measure of the government's current surplus or deficit;
- allow a better assessment of the revenue departments' performance in collecting amounts due; and
- show more clearly the effect of changes in law and regulations, for example a tribunal decision that creates a liability to repay tax previously collected.

2.30 Neither Customs nor the Inland Revenue currently have management information systems that capture tax receivable on an accruals basis, although Customs and Excise are currently working on an accruals based Trust Statement on a dry run basis. The practical issues raised by the move to accruals accounting vary across the different tax streams. VAT, PAYE and National Insurance contributions, for example, are reported to and collected by the revenue departments on a frequent basis and matching the revenue to the appropriate accounting period should present relatively few difficulties. The main problems with accruals accounting for taxation revenue lie with corporation tax and the higher rate and self-assessed elements of income tax, where the amount due from the taxpayer for the accounting year ending 31 March may not be reportable until 10 months or more after the year end.

2.31 The Inland Revenue proposes in the short to medium term to use statistical estimation techniques for the measurement of revenue receivable but not collected or notified at the balance sheet date. However, as the Inland Revenue and Customs and Excise recognise, the long term solution is for management information systems to capture information at the level of individual taxpayers that is, first, useful for management on a frequent basis and, second, generates the figures needed for the statutory accounts. Both departments are considering how best to improve their management information systems, with a view to reducing significantly the reliance on statistical estimation techniques.

Pension liabilities of government employees

2.32 Most government employees are members of final salary pension schemes. Currently, the pension liabilities of the main schemes are revalued by the Government Actuary's Department (GAD) every three to five years. The Actuary's Report, stating the most recent valuation, is attached to the scheme accounts, but the liability is not shown on the schemes' balance sheets. Therefore movements in the liability, resulting for example from changes in the benefits promised or changes in the assumptions about life expectancy or inflation, are not readily apparent to Parliament and other users of the scheme accounts. The liabilities are unaudited, as the Actuary's Report is outside the scope of the audit opinion.

2.33 Public sector pension schemes are funded by taxation rather than investments, so their sustainability is not vulnerable to market volatility to the same extent as private sector final salary schemes. However, the schemes do represent some of the government's largest commitments - the latest actuarial valuations of the liabilities of the unfunded public sector pension schemes total £350 billion - so it is important that up to date and reliable information on those commitments is available.

2.34 The Treasury WGA Team is co-ordinating the adoption by the schemes of Financial Reporting Standard 17, through a working group made up of the WGA Team, the managers of the schemes, the Government Actuary and the National Audit Office. By 2003-04, the scheme accounts will recognise pension liabilities on their balance sheets and explain the movements on the liability and the assumptions underpinning the valuation. The consolidated movements and position on all the schemes will be shown in CGA. These developments should in due course deliver improved accounting information at departmental level, as well as at the Whole of Government Accounts level, with potentially significant benefits for departmental management.

2.35 The National Audit Office has reported to Treasury on the two Central Government Accounts Milestones completed up to the date of this report, and will report additionally to the Committee of Public Accounts on the completion of the audit of Milestone 3, the (unpublished) 2001-02 dry run audit.

Part 3

Corporate governance

Introduction

3.1 In recent years, both the public sector and the private sector have seen the development of systematic 'risk management' arrangements, as a basis for ensuring the effective delivery of organisations' objectives. In the central government sector, in December 2000, the Treasury issued 'Dear Accounting Officer' (DAO) letter 13/00 (Corporate Governance: Statement on Internal Control). The letter set out Treasury's requirements for Accounting Officers in all central government public bodies to maintain, and review, a sound system of risk management and internal control, and to attest to their compliance with Treasury's requirements through the publication of a Statement on Internal Control in their financial statements.

3.2 In previous years, the Comptroller and Auditor General has reported on the progress made by audited bodies in meeting the requirements of improved internal financial control, and he has reported that the majority of audited bodies are able to meet these requirements. In setting its current guidance, the Treasury was fully aware that given the size and complexity of many central government bodies, a move to meet the requirements of a full Statement on Internal Control was likely to prove more challenging. In recognition of this, Treasury allowed for a gradual timetable of implementation, which whilst encouraging full compliance with the requirements of the DAO at the earliest possible date, did not make full compliance compulsory until the financial year 2003-04.

3.3 In considering the progress made by bodies developing their corporate governance and risk management arrangements, and in 2001-02 in publishing Statements on Internal Control, the Comptroller and Auditor General focused his attention on:

- the implementation of internal control and risk management procedures across central government;
- disclosures within Statements on Internal Control;
- the role of the National Audit Office in promoting corporate governance; and
- future developments within corporate governance likely to impact upon central government.

The implementation of internal control and risk management procedures across central government

3.4 The size and complexity of many central government organisations has resulted in a mixed response to the requirement to make the transition to a full Statement on Internal Control. Generally, the smaller and less complex an organisation, the easier it has been for an organisation to implement the necessary control procedures. A number of Non-Departmental Public Bodies have already reported full implementation in 2001-02. At Departmental level, full compliance has proved difficult. Across the central government population as a whole, approximately one quarter of all organisations disclosed that they have the necessary procedures in place.

3.5 For those organisations which have not achieved full compliance in 2001-02, most have made reasonable progress in introducing necessary control frameworks. The first step in the process is the identification of risk, and most organisations have responded by performing risk assessments, producing risk registers, and prioritising these risks in terms of the likely impact on key business objectives. Where further progress needs to be made however, is in the design of control procedures to deal with these risks and the implementation of ongoing procedures to monitor how these risks are managed in practice. This is often a difficult and time consuming process, and the majority of bodies which have yet to fully develop such arrangements envisage that it will take them until the 2003-04 financial year to have fully implemented the necessary internal control procedures.

3.6 It is important to note the benefits to audited bodies of this whole development - it is not simply a matter of complying with a set of central regulations or procedures. There is now a more general recognition that good corporate governance and effective risk management lie at the heart of achieving organisational objectives. Considerable challenges do remain; the process of risk management is an ongoing one, needing constant attention and refinement. It is in helping central government organisations to meet these challenges that the National Audit Office has a key role to play. It will continue to review audited bodies' arrangements, and provide appropriate advice to assist them to meet these challenges.

Disclosures within Statements on Internal Control

3.7 The Comptroller and Auditor General found that all of the bodies he audits required by the Treasury to produce a Statement on Internal Control for 2001-02 did so, confirming that the Accounting Officer had developed, or was developing, internal controls, and that these controls were subjected to a process of review. He also found that the specific disclosure requirements of the Treasury guidance had all been met, although a number of statements would have benefited from further elaboration in terms of making clear the Accounting Officer's boundary of accountability. In instances where full implementation had not yet been achieved, some statements would have benefited from a more explicit description of the proposed implementation timetable. However, such instances were fairly isolated.

3.8 Where significant weaknesses or gaps in control have arisen, these have generally been disclosed by the relevant Accounting Officer in their statement. As a result, the reader of the account can be assured that the statement given by the Accounting Officer is an accurate reflection of the system of internal controls in place.

3.9 The wording and format of a large number of Statements on Internal Control were strikingly similar. There was limited evidence of tailoring to reflect the specific requirements of the reporting entity, and a number of audited bodies placed undue reliance on the pro forma examples included in the Treasury guidance. Some statements lacked specific comment on the operational and risk context within which the audited body operated, and in many cases failed to give specific examples of the particular controls operated. Instead, there was an undue concentration on the general mechanisms of risk management.

3.10 The Treasury are currently considering the development of enhanced guidance on SICs to encourage more informative disclosures from departmental accounting officers. Revised guidance, though, will not, of itself, bring about improvements, either in disclosures or, crucially, in the systems of internal control which underpin departmental arrangements. The following paragraphs set out the role which the National Audit Office sees for itself in promoting enhanced risk management and corporate governance arrangements.

Corporate governance and risk management - the role of the National Audit Office

3.11 The National Audit Office supports the developing use of risk management and has been explicit in stating its support for well thought through risk taking (Managing Innovation: Risk Management in Government Departments HC864 1999-2000). Auditors continue to work closely with audited bodies and their Audit and Risk Committees in assisting in the development of both corporate governance arrangements and, more broadly, risk management procedures. As well as contributing to disclosure issues in Statements on Internal Control, there has been active support, encouragement and advice to help audited bodies to develop underlying internal control procedures. The National Audit Office's financial audit methodology is a risk-based approach, involving analysis of the audited body's business, the risks that it faces and how those risks are managed. This provides a sound basis for consideration of the Statement on Internal Control. And it also provides opportunities to make recommendations for improvements to the client's internal control framework.

3.12 On a more strategic level, the National Audit Office has participated in the development of Treasury and Cabinet Office initiatives, and continues to work with Treasury on how best to adapt the Turnbull recommendations for application in the public sector. In addition, the National Audit Office is contributing to the continuing development of advice in the audit of corporate governance through its participation in such bodies as the Public Audit Forum, the Auditing Practices Board, and the Risk Management Steering Group, the latter bringing together the Treasury, Cabinet Office and departmental representatives to engender cohesion between the various government-wide initiatives which come under the umbrella of corporate governance and risk management.

Corporate governance - future developments

3.13 The high profile corporate collapses in the United States have brought in their wake a renewed awareness of the importance of the corporate governance arrangements in place within organisations, and of the role played, in particular, by non-executive directors (NED's) and Audit Committees. In the UK, reports have recently been published in both these areas, bringing forward recommendations with regard to the role of the non-executive director (the "Higgs Report"), and the Audit Committee (the "Smith Report").

3.14 Though the impetus for the production of these reports stemmed primarily from corporate collapses in the private sector, their conclusions and recommendations apply in many cases equally to the public sector. The central government sector has seen the development in recent years of a much more active role for the Audit Committee and, by extension, much greater involvement for non-executive directors. Accountability structures in the central government sector differ from those in the private sector, with responsibility tending to be vested in the hands of a single individual (the Accounting Officer) rather than a Board. Nevertheless, the National Audit Office's experience is that the influence of external non-executive input, both as a source of valuable advice and as a means of holding both management and the external auditors to account, has proved extremely effective.

3.15 Both the Higgs and Smith reports contain valuable recommendations to embed and strengthen these developments. Going beyond simply the role of NEDs and Audit Committees, they cover a diverse range of issues, including the recruitment, training and remuneration of NEDs, and the membership, procedures and resources of Audit Committees. The National Audit Office is committed to working with the Treasury and with audited bodies to ensure that the key recommendations contained within the reports are reflected in the way in which NEDs and Audit Committees operate in the central government sector.

Part 4

Audit of receipts of revenue

Introduction

4.1 In 2001-02, HM Customs and Excise collected net revenue of £104.9 billion, and the Inland Revenue £148.9 billion.

4.2 Under Section 2 of the Exchequer and Audit Departments Act 1921, the Comptroller and Auditor General is required to examine the accounts of the receipts of revenue on behalf of the House of Commons, to ascertain whether adequate regulations and procedures have been framed to secure an effective check on the assessment, collection and proper allocation of revenue. He also examines whether such regulations and procedures are being duly carried out. In addition, he is required to carry out any such examination as he thinks fit with respect to the correctness of sums brought to account and, together with a report on the resource accounts of the Department concerned, report to the House of Commons.

4.3 In accordance with directions given by the Treasury, HM Customs and Excise and the Inland Revenue prepare financial statements of revenue receipts and payments which are laid before Parliament. The Comptroller and Auditor General audits these financial statements and issued an unqualified opinion on each Department's accounts for 2001-02.

HM Customs and Excise

4.4 During 2001-02 the National Audit Office examined both new and existing systems for the assessment and collection of revenue, and certain of Customs' associated information technology systems. The NAO's coverage included:

- examinations of Customs' internal controls, including the development of governance arrangements;
- reviews of quality assurance work and other checks carried out by the Department on the tax systems;
- periodic in-depth reviews of existing systems and significant changes to them, and evaluation of new systems;
- reviews of Customs' computer installations, networks and specific information technology applications; and
- test examinations of individual transactions and balances.

4.5 The Comptroller and Auditor General's report for 2001-2002 covered:

- Business Continuity Planning and Money Laundering, including Customs' response to internal and external threat;
- Customs' work in collecting the right revenue at the right time;
- The resolution of VAT disputes with traders through the reconsiderations and appeals processes;
- The VAT IT systems;
- Debt management; and
- The custody and disposal of seized goods.

Subject to the factors outlined in his report, the Comptroller and Auditor General was satisfied that his work in 2001-02 gave him assurance that Customs' regulations and procedures provided an effective check over the assessment, collection and allocation of tax.

4.6 In addition, the Comptroller and Auditor General was able to provide an unqualified audit opinion on the Department's Resource Account and Trust Statement for 2001-02 (Cm 5671). However, as with last year, he included a report on the Trust Statement regarding the possibility of VAT repayments being made to potential perpetrators of Missing Trader Fraud. He noted that Customs are withholding suspect VAT Repayments and recommended that the Department continue this practice, whilst causing the least disruption possible to genuine trade.

4.7 The outcome of his work on Customs is reported in more detail in their annual report (Cm 5671, December 2002).

Inland Revenue

4.8 During 2001-02 the Comptroller and Auditor General examined both new and existing systems. The new systems examined were those for the management of debts and tax returns and the Children's Tax Credit. Reviews of existing systems included aspects of Pay As You Earn (PAYE), Corporation Tax and the Working Families' and Disabled Person's Tax Credits and the Inland Revenue's management of risk associated with their information technology infrastructure.

4.9 Subject to recognising that it is not possible to secure full tax payer compliance, and other specific matters in the Comptroller and Auditor General's report, the work of the National Audit Office provided assurance that the department's regulations and procedures continued to provide and effective check over the assessment, collection and allocation of tax. The Comptroller and Auditor General's audit opinion on the department's Trust Statement for 2001-02 records that he was also satisfied that the sums brought to account were properly presented in the Trust Statement. His report on the department's Resource Accounts (HC 71) covers his main findings on the Statement of Internal Control, Tax Credits and Debt Management.

4.10 The Accounting Officer's Statement on Internal Control complies with Treasury requirements and describes a number of control mechanisms and initiatives. It sets out some areas where continuing development of control arrangements is needed during 2002-03. The Comptroller and Auditor General welcomed the department's emphasis on improved management information which should help better target effort and demonstrate achievement.

Tax Credits

4.11 The Comptroller and Auditor General has examined tax credits in previous years and it was again found that the department has had problems in reconciling the amount of tax credit paid via employers with that actually authorised by the department. A special reconciliation exercise will be needed again for 2002-03. It is important that the department is learning lessons from their experiences of current tax credits so as to minimise similar problems in the new tax credit schemes that are due to operate from April 2003. The Comptroller and Auditor General drew attention to the importance of transitional arrangements, management of information on changes in circumstance, development and use of management information and the need to build controls into the new arrangements.

Debt Management

4.12 The department's Receivable Management Service is a major new business stream that is taking a number of initiatives to transform tax collection and debt management. The Comptroller and Auditor General noted the importance of extending the initiatives to all tax streams and to all classes of debt. He recommended that the department should continue to develop management information capable of demonstrating much more comprehensively the achievements of the department, particularly in debt management and tax collection.

Other Reports on the work of Customs and Excise and the Inland Revenue

4.13 The Comptroller and Auditor General also examines the economy, efficiency and effectiveness with which HM Customs and Excise and the Inland Revenue have used their resources under Section 6 of the National Audit Office Act 1983. The results of these value for money examinations are published in separate reports to the House of Commons under Section 9 of that Act. During 2001-02 the Comptroller and Auditor General has reported on:

- Income Tax Self Assessment (HC 56, Session 2001-02)
- Losses to the Revenue from Frauds on Alcohol Duty (HC 178, Session 2001-02);
- NIRS 2: Contract Extension (HC 355, Session 2001-02)
- e-Revenue (HC 492, Session 2001-02);
- The Misuse and Smuggling of Hydrocarbon Oil (HC 614, Session 2001-02);
- Government on the Web - part 2 Dealing with Business HM Customs and Excise (HC 764, Session 2001-02).
- Tackling fraud against the Inland Revenue (HC 429, Session 2002-03)

Driver and Vehicle Licensing Agency

4.14 This is the first year that the Trust Statement (formerly known as the 'Motor Tax Account') has been published. Formerly the Motor Tax Account was prepared by the Agency for submission to the Treasury but was not formally audited. The Comptroller and Auditor General is now required to formally audit the Trust Statement and report his opinion on the account to Parliament, along with any observations on the revenue collection and management systems.

4.15 Gross revenues from Vehicle Excise Duty (VED) for the United Kingdom totalled £4,884 million in 2001-02.

Electronic Collection of Vehicle Excise Duty

4.16 The Agency has rapidly expanded schemes for the collection of Vehicle Excise Duty by electronic means. These methods included the Automated First Registration and Licensing (AFRL) scheme, enabling motor dealers to register and tax new vehicles electronically, and the system used by large fleet operators who are able to re-license their vehicles by electronic data interchange. The levels of Vehicle Excise Duty collected by electronic means have continued to increase annually reaching nearly £340 million in 2001-02.

Vehicle Excise Duty Evasion

4.17 The evasion of vehicle excise duty remains a problem that the Agency continues to take very seriously. Estimated Annual Loss of Revenue amounted to around £81 million. For Northern Ireland, the estimated net loss of revenue in 2001-02 was some £11.5 million.

Measures to tackle VED evasion

4.18 The Agency addresses the problem of vehicle excise duty evasion through a variety of enforcement activities. These include wheelclamping, the follow up of offence reports from the police and traffic wardens, Statutory Off-Road Notifications (SORN) and, more recently, the introduction of Automatic Number Plate Reading (ANPR) equipment. The well-publicised threat of vehicle clamping, impoundment and disposal continues to be a most effective inducement in encouraging vehicle excise duty evaders to license their vehicles. As a direct result of both widespread publicity and police enforcement action during 2001-02, the Agency estimates that over 305,000 motorists voluntarily re-licensed their vehicles generating additional revenue of some £40 million. In the six months from its national launch in October 2001 to 31 March 2002, the ANPR project resulted in 440 out of court settlements and 94 successful prosecutions. The number of British Police forces using ANPR systems to detect unlicensed vehicles rose from 15 to 29 during 2001-02.

Reform of Vehicle Excise Duty on Lorries

4.19 The Agency received additional government funding in both 2000-01 and 2001-02 in respect of the interim rates and rebate scheme for Vehicle Excise Duty payable on Heavy Goods Vehicles. These rates represented a 50 per cent reduction in the face value of license discs issued to hauliers. Some 322,000 discs were issued at the reduced rate during the interim period to 30 November 2001, at a total cost to the Exchequer of around £283 million. On 1 December 2001, new rates reduced the number of tax classes from more than 130 to just seven bands, with further deductions for vehicles with low pollution rates. During the period December 2000 to March 2002 the Agency made rebate payments valued at almost £235 million to more than 132,000 HGV keepers who met the criteria of the rebate scheme. Around 19,500 of these rebates were made using the bank automated payment scheme, a method which is both quicker, cheaper and more secure than cheque payment methods.

Agricultural & Concessionary Measures

4.20 In his March 2001 Budget the Chancellor announced, with immediate effect, the abolition of VED on tractors and other concessionary vehicles. This initiative affected around 255,000 vehicles in the United Kingdom and necessitated the payment of rebates to vehicle keepers by the Agency. As the individual rebate payments were generally of low value (averaging less than £20 each) and since there were relatively few vehicle keeper changes, the Treasury agreed that the Agency could pay refunds directly to the registered keeper without the need to issue and process rebate application forms.

Closure of the rebate schemes

4.21 No formal closure date was written into the enabling legislation for the various rebate schemes, leaving the Agency with no statutory basis on which to bring the schemes to an end. As at 31 March 2002, a total of one million rebate applications remained outstanding pending the return of signed declarations by vehicle keepers, and residual applications under the schemes will be dealt with as they arise.

Part 5

Audit of Public Debt and Reserves

Introduction

5.1 The Comptroller and Auditor General's audit of debt and reserves encompasses examinations of a range of activities including central government receipts, payments and borrowing via the Consolidated Fund and National Loans Fund, debt and cash management through the Debt Management Account and the management of foreign exchange reserves by the Exchange Equalisation Account.

Consolidated Fund and the National Loans Fund

5.2 The Consolidated Fund is the government's account at the Bank of England through which the vast majority of central government receipts, (for example tax receipts), and payments flow. Payments from the Consolidated Fund fall into two broad categories:

- Supply services - these are issues required to meet government expenditure. Parliament provides amounts of money to government departments each financial year under the powers of annual Consolidated Fund Acts and Appropriation Acts.
- Standing services - these are payments for services which Parliament has decided should be made directly from the Consolidated Fund and are not subject to annual authorisation by Parliament, for example, Civil List payments and payments to the European Union.

5.3 The National Loans Fund is the primary account through which the government's borrowing flows. It is also an important source of finance for government lending. Money borrowed by the government, for example through the issue of gilts, flows into the National Loans Fund, together with interest and principal repayments on loan finance made available from the Fund to public corporations and local authorities. In addition to making loans, money flows out of the National Loans Fund through servicing the cost of government debt, for example, gilt coupon and redemption payments. The Consolidated Fund and the National Loans Fund are closely linked. The Consolidated Fund is balanced on a daily basis via a payment from, or transfer to, the National Loans Fund.

5.4 The Consolidated Fund and the National Loans Fund are operated by the Treasury. However, except for transfers between the two, the Treasury can only make issues out of the funds with the authority of the Comptroller and Auditor General. In practice, the Treasury sends a "credit requisition" to the Comptroller and Auditor General on each business day. The requisition shows why the issue is needed and the relevant statutory authority. Once the Comptroller and Auditor General has checked the credit requisition and is content with the proposed issue, a "credit" for the relevant amount is sent to the Bank of England, who can then make the payments required on direction from the Treasury.

5.5 In addition to the credit process, Parliamentary accountability is exercised through the preparation and audit of annual accounts. Section 21(1) of the National Loans Act 1968 requires the Treasury to prepare accounts of payments into and out of the Consolidated Fund and the National Loans Fund for each financial year and in such form as the Treasury may prescribe. Section 21(2) of the Act, provides for the Comptroller and Audit General to examine, certify and report on the accounts and lay copies of them, together with his report, before each House of Parliament.

5.6 The audits of the 2001-02 accounts of the Consolidated Fund and National Loans Fund were conducted satisfactorily and unqualified audit opinions were provided by the Comptroller and Auditor General. Total receipts and payments into and out of the Consolidated Fund amounted to £295 billion, including gross receipts of £149 billion and £105 billion from the Inland Revenue and Customs and Excise respectively. Payments for supply services came to £272 billion while the total for standing services was £20 billion. Total receipts and payments into and out of the National Loans Fund were £681 billion, including the daily transfers back and forward of Consolidated Fund surpluses and deficits and other government daily balances at the Bank of England.

5.7 The accounts of the Consolidated Fund and the National Loans Fund are supported through the preparation and presentation to Parliament of additional Supplementary Statements in accordance with section 21(3) of the National Loans Act 1968. The Act requires the Treasury to prepare in such a form as it may determine, statements containing additional information regarding the transactions, assets and liabilities of the Consolidated Fund and the National Loans Fund. The statements are categorised as "A-Tables" or "B-Tables". A-Tables are audited by the Comptroller and Auditor General by agreement with the Treasury. B-Tables are not audited.

5.8 The 2001-02 Supplementary Statements audited by the Comptroller and Auditor General received an unqualified audit opinion. These included "Table A1 - Summary of Central Government Transactions Contributing to the Central Government Net Cash Requirement" and "Table A2 - Summary Reconciliation of the Central Government Net Cash Requirement and the Change in the Nominal National Debt". Table A1 illustrates the components of the Central Government Net Cash Requirement. This is the measure of the government's need to raise cash through borrowing or running down its liquid financial assets. For 2001-02, the Central Government Net Cash Requirement was £2.8 billion. Table A2 shows how the Central Government Net Cash Requirement is reconciled to the change in the nominal National Debt as represented by the gross nominal liabilities of the National Loans Fund. In 2001-02, there was an increase in the nominal National Debt of £8.6 billion.

5.9 The Treasury is developing an accruals based account for the National Loans Fund and plans to have this in place for the financial year 2003-04. The production of a National Loans Fund account on an accruals basis provides an opportunity to enhance Parliamentary accountability through the provision of information on the transactions, assets and liabilities of the Fund in a single document. The National Audit Office is working closely with the Treasury to facilitate this transition.

Debt and Cash Management

5.10 The Debt Management Office was established as an executive agency of the Treasury on 1 April 1998 to support the government's debt management policy objective - to minimise over the long term the cost of meeting the government's financing needs, taking into account risk, whilst ensuring that debt management policy is consistent with the objectives of monetary policy.

5.11 On 3 April 2000, the Debt Management Office also assumed responsibility for managing the government's daily cash requirement - to offset, through its market operations, the expected cash flow into or out of the National Loans Fund, in a cost effective manner and taking account of risk.

5.12 The Finance Act 1998 provided for the creation of the Debt Management Account and this was established by order on 15 November 1999. The Debt Management Account facilitates the management and reporting of the activities of the Debt Management Office in pursuit of its debt and cash management objectives.

5.13 The Debt Management Account 2001-02 was given an unqualified audit opinion by the Comptroller and Auditor General. At 31 March 2002, the Account held £20 billion in assets, mainly in debt securities and loans, for the purpose of debt and cash management.

Foreign Exchange Reserves

5.14 The management of the bulk of the United Kingdom's foreign exchange reserves is reported through the Exchange Equalisation Account. The reserves are comprised of holdings of gold, foreign currencies and International Monetary Fund Special Drawing Rights. The Exchange Equalisation Account is controlled by the Treasury, although day to day management and operation of the Account is performed on behalf of the Treasury by the Bank of England.

5.15 The Exchange Equalisation Account 2001-02 was given an unqualified audit opinion by the Comptroller and Auditor General. As at 31 March 2002, the Account held total assets of £27 billion including £16 billion of debt securities, £4 billion of loans and advances to banks, and £2 billion of gold.

Other reports on public debt and reserves

5.16 The Comptroller and Auditor General reported on the sale of part of the United Kingdom gold reserves and reported to the House of Commons (HC 86 2000-01).

Appendix 1 Accounts audited by the Comptroller and Auditor General

Type of account (2000-01 figures in brackets)	Number audited	Opinion qualified [1]	Opinion not qualified but report attached [2]
Appropriation Account [3]	0	0	0
	(85)	(8)	(3)
Resource Accounts[4]	64	20	1
	(57)	(13)	(0)
Executive Agency [5]	89	1	0
	(90)	(3)	(0)
National Loans Fund	12	0	0
	(19)	(0)	(0)
Other UK accounts audited under statute or by agreement [6]	399	11	5
	(275)	(5)	(4)
Total 2001-02	564	32	6
Total 2000-01	527	29	7

NOTES

1. Appendix 3 provides details of the accounts qualified.
2. Appendix 4 lists reports issued by the Comptroller and Auditor General on financial audit matters.
3. Appropriation accounts are the accounts of the expenditure and receipts of government departments and are produced on a cash basis. Appropriation accounts ceased to be produced after 2000-01.
4. Resource accounting is an accruals-based form of financial reporting that has been introduced in all government departments, and is the prime means of managing and reporting government expenditure and maintaining Parliamentary control. Resource accounts comprise financial statements similar to those found in commercial accounts but additionally include a statement designed for Parliamentary reporting purposes and a further statement analysing income and expenditure by objectives.
5. Executive Agencies have been established to undertake operational functions of departments. They are required to produce financial statements on an accruals basis and in compliance with the requirements of the Companies Acts; the Resource Accounting Manual issued by the Treasury and generally accepted accounting practices, insofar as these are appropriate.
6. The Comptroller and Auditor General also undertakes the audit of a large number of other accounts whether under statute or by agreement. These include investment accounts, stewardship accounts, charity and pension fund accounts as well as receipts and payments and accruals accounts covering a variety of other activities and purposes. The significant increase in the number of accounts audited is due to the completion of 120 Education Action Zone audits during the reporting period.

Appendix 2 Outturn against all supply estimates

Outturn of all Resource Accounts

This summary records the outturn for Resources Accounts as follows:

		£000	£000
Resources	**Gross expenditure**		
	Estimates:		
	Original Estimates	295,087,898	
	Supplementary etc. Estimates	20,533,153	
			315,621,051
	Actual		307,500,256
	Saving		8,120,795
	Appropriations in Aid		
	Authorised:		
	Original Estimates	24,779,675	
	Supplementary etc. Estimates	6,220,481	
			31,000,156
	Applied		29,600,349
	Deficiency		1,399,807
	Net Expenditure		
	Estimates:		
	Original Estimates	270,308,223	
	Supplementary etc. Estimates	14,312,672	
			284,620,895
	Actual		277,899,907
	Saving		6,720,988
Cash	**Net Expenditure**		
	Estimates:		
	Original Estimates	265,163,109	
	Supplementary etc. Estimates	15,458,781	
			280,621,890
	Actual		269,437,300
	Saving		11,184,590

Consolidated Fund Extra Receipts Consolidated Fund Extra Receipts Surrenderable recorded in the Resource Accounts amount to £8,481,147,344.70.

Actual Outturn The actual net resource outturn is £277,899,902,895.40 and the actual net cash outturn is £284,437,297,508.64.

Appendix 3 Accounts qualified by the Comptroller and Auditor General

Resource Accounts 2000-01

Security and Intelligence Agencies	Limitation of Scope
Ministry of Agriculture, Fisheries and Food	Disclaimer
Northern Ireland Office	Disclaimer
Home Office	Limitation of Scope

Resource Accounts 2001-02

Ministry of Defence	Limitation of Scope
	Excess Vote
Office for National Statistics	Limitation of Scope
Department for Environment, Food, and Rural Affairs	Limitation of Scope
Department for Work Pensions	Limitation of Scope
	Regularity
Home Office	Limitation of Scope
	Regularity
Department for Education and Skills	Regularity
Department for Transport, Local Government and the Regions	Excess Vote
Teachers Pension Scheme	Excess Vote
Royal Mint	Excess Vote
Foreign and Commonwealth Office	Excess Vote
Charity Commission	Excess Vote
Serious Fraud Office	Excess Vote
Department for Culture, Media and Sport	Excess Vote
Postal Services Commission	Excess Vote
Northern Ireland Office	Excess Vote
Security and Intelligence Agencies	Limitation of Scope

Appendix 3 Accounts qualified by the Comptroller and Auditor General

Other Accounts qualified

National Gallery 2001-02

Human Fertilisation and Embryology Authority 2001-02

Child Support Agency Client Funds Account 2001-02

Driver and Vehicle Licensing Agency Trust Statement 2001-02

Ordnance Survey 2001-02

Security Facilities Executive Agency 1997-98

Plymouth Education Action Zone 1999-2000

Plymouth Education Action Zone 2000-01

Camborne Education Action Zone 1999-2000

Camborne Education Action Zone 2000-01

Withernsea Education Action Zone 2001-02

National Insurance Fund (Northern Ireland) 1999-2000

Appendix 4 Reports of the Comptroller and Auditor General

NHS (England) Summarised Accounts 2000-01

Cabinet Office Resource Account 2000-01

Northern Ireland Police Service 2000-01

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