

FINANCIAL AUDITING AND REPORTING

General Report of the
Comptroller and Auditor General 2003-04

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FOREWORD



It gives me great pleasure to present my General Report to Parliament, summarising the results of the financial audit work undertaken on my behalf by the National Audit Office over the twelve months from 1 February 2004 to 31 January 2005.

My financial audit work enables me to provide independent assurance that the annual financial statements of United Kingdom central government bodies are properly prepared and that the income and expenditure have been applied for the purposes intended by Parliament.

Overall, I consider that the standards of accountability and probity remain high. In this report I highlight my view of the good progress departments have continued to make in meeting the challenge of resource accounting and in improving the quality of accounts submitted for audit. As evidence of this, I issued qualified opinions on only four sets of departmental resource accounts compared with a total of eight in the prior year.

Good progress has also been made by departments in improving the timeliness of accounts submission. However, I consider that in order to meet the challenge of the Treasury's faster closing initiative, to accelerate the production and audit of resource accounts so as to lay audited accounts within four months of the year end, many departments still have much work to do. The aim of faster closing is to provide Parliament with more timely financial information and I am fully committed to a partnership with departments to help achieve this.

I am pleased to note that, following the Gershon Review, there is now general recognition of the key role that financial management has to play in the efficient use of resources and in the delivery of efficiency programmes. In this respect, I warmly welcome the steps being taken by the Treasury and departments to improve the professionalism of the finance function, not least the decision that, from December 2006, all departments will have qualified accountants as board level finance directors. I am also particularly pleased to be assisting the Treasury in the major department by department review of the effectiveness of financial management within central government.

I also comment upon developments in corporate governance and risk management across government and the work that the National Audit Office continues to undertake to assist government bodies to continually improve in this area. Robust risk management can help departments avoid failures in service delivery and also presents opportunities to deliver better public services, make more reliable decisions, improve efficiency and support innovation. I therefore fully support the steps taken to improve the risk management capacity of government bodies.

I am pleased to report that significant progress has been made by departments to improve their risk management capabilities. However, I consider that it is critical for departments to build on the momentum achieved to date as many have further to go to demonstrate that they have made effective risk management a central part of their day to day management processes in a way that can fully deliver improved performance and other benefits. In this respect I was pleased to recently host a joint conference with the Treasury for Accounting Officers of all government departments and their agencies to provide further stimulus for departments to maintain their efforts to fully develop and embed their risk management procedures.

I aim to continue to provide an efficient and effective audit service to central government bodies and other stakeholders and to provide independent assurance and comfort to Parliament and the people of the United Kingdom. In doing so I am conscious of the need to ensure that the methodologies employed by the National Audit Office continue to reflect best practice and the current thinking of the wider auditing profession. In this regard I am pleased to report that the National Audit Office will conduct their work in accordance with International Standards on Auditing in line with the timetable for the adoption of the Standards in the private sector.

In conducting my work I am mindful of the need to provide 'added value' advice to audited bodies as well as influencing developments in auditing, accounting and financial management within the wider national and international profession. Therefore, I also include in this report details of the additional services provided arising from my financial audit responsibilities.

John Bourn

Comptroller and Auditor General

11 March 2005

EXECUTIVE SUMMARY



1 This report to Parliament summarises the results of financial audit work undertaken by the National Audit Office over the twelve months from 1 February 2004 to 31 January 2005 and highlights key issues arising from that work.

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

3 The National Audit Office undertake, under the direction of the Comptroller and Auditor General, the detailed financial audit work necessary to support his duties and statutory responsibilities. In total, the Comptroller and Auditor General audits over 550 accounts per year, incorporating total expenditure and revenue of approximately £700 billion.

4 All financial audits are conducted in accordance with UK Auditing Standards issued by the Auditing Practices Board which require an opinion as to whether the accounts are free from material misstatement and show a true and fair view. The audit opinion also requires confirmation that the transactions in the accounts comply with appropriate Parliamentary authority – known as the “regularity” opinion. Audit procedures also have regard to the propriety with which public funds have been handled and the manner in which public business has been conducted.

5 In reporting the results of audit examinations, this report focuses upon the Comptroller and Auditor General’s audits of the receipts of revenue and of public debt and reserves, as well as commenting upon progress made by audited bodies in developing systems to enable faster financial reporting and the future compilation of whole of government accounts. It also comments on the progress made by audited bodies in embedding risk management systems and other best practice within corporate governance.

6 An increasingly important aspect of the work of the Comptroller and Auditor General is his commitment to contribute towards improvements in financial management and control across central government. Consequently, this report also provides a summary of the various other services provided by the Comptroller and Auditor General arising from his financial audit work designed to add value to audited bodies.

7 This report does not deal with the value for money (VFM) audit work of the National Audit Office which supports the production of the Comptroller and Auditor General’s published VFM reports. Details of the VFM reports published in the period covered by this report can be found on the National Audit Office web site at www.nao.org.uk.

Financial Audit

Quality and Timeliness of Accounts

8 During 2003-04, departments continued to make good progress in response to the challenges of resource accounting, and the quality of accounts submitted to the Comptroller and Auditor General for audit continued the pattern of improvement noted in recent years:

- Qualified opinions were issued on only four sets of departmental resource accounts, comparing favourably with a total of eight accounts from the prior year.
- The number of accounts qualified in relation to truth and fairness fell from three accounts to two.
- The nature of qualifications was less severe than in previous years as no opinions were 'disclaimed' because of a lack of audit evidence.
- The number of accounts qualified in respect of regularity was halved.

9 However, whilst the majority of departments and other public bodies falling within the Comptroller and Auditor General's remit are producing unqualified accounts, a small number 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 and that the underlying transactions are regular in all areas.

10 In general, departments continue to make good progress in improving the timeliness of accounts submission. This was reflected in the fact that over 80 per cent of accounts had been submitted for audit by October 2004. There remain a small number of departments who struggle to meet the statutory timetable of 30 November and two departments failed to meet this deadline. This compares favourably with the prior year, in which eleven departments failed to adhere to the timetable.

11 The Treasury aim to accelerate the accounts process, with the ultimate intention being that all resource accounts from 2005-06 onwards should be laid before Parliament by the Summer Recess. Departments continue to make steady but slow progress towards meeting this

agenda. Fundamental to the success of faster closing will be the recognition that the accounts production process is not merely a year end activity. Robust, accurate and timely financial information is pivotal to improved resource planning and should be something that departments produce and utilise throughout the financial year. The National Audit Office will continue to work with audited bodies to help achieve the aims of better financial management and timelier external financial reporting.

Implementation of a New Standard for Accounting for Retirement Benefit

12 Financial Reporting Standard 17 was implemented for the first time in the central government sector in 2003-04. This was in accordance with the original implementation timetable stipulated by the Accounting Standards Board. The standard was adapted for use in the central government sector and as a result the major unfunded central government pension schemes have recognised over £360 billion of pension liabilities in their balance sheet for the first time.

The Audit of Receipts of Revenue and Public Debt and Reserves

13 The Comptroller and Auditor General's audit of receipts of revenue was, with the exception of concerns over tax credit application errors, satisfactory, and gave assurance that regulations and procedures employed by HM Customs and Excise ('Customs'), the Inland Revenue ('Revenue') and the Driver and Vehicle Licensing Agency ('DVLA') provided an effective check over the assessment, collection and allocation of tax.

14 The Comptroller and Auditor General continued to note major reservations concerning tax credit application errors, and this led to a further qualification of his audit opinion on the Revenue's trust statement for 2003-04. In 2000-01, the Revenue had identified tax credit applicant error rates of 10-14 per cent by value, equivalent to overpayments of £510-£710 million per year. While improved controls in the new tax credit system are planned to reduce the incidence of such overpayments, the Revenue will not know the effect these controls have had on the error rates until an ongoing review is completed in July 2005.

15 The Trust Statements produced by Customs, Revenue, and the DVLA currently record taxation on a receipts and payments basis, although for 2004-05 statements will be produced on an accruals basis. Customs have already been producing a dry-run accruals statement since 2002-03. The National Audit Office will continue to work with each organisation to help implement and embed the changes required to produce true and fair accruals accounts for revenue, which are required for the production of Whole of Government Accounts.

16 The Comptroller and Auditor General's audit of public debt and reserves was conducted satisfactorily, and benefited greatly from a general acceleration in the reporting timetable.

17 The National Audit Office's work on the audit of public debt and reserves has seen significant developments during 2003-04. The accounts of the National Loans Fund, investment accounts prepared by the Commissioners for the Reduction of the National Debt, and the financial statements of the Public Works Loan Board have been prepared on an accruals basis for the first time. In addition, the format of the Consolidated Fund financial statements has been revised in response to developments in central government accounts. While these developments have been challenging, they reflect an ongoing desire to bring greater transparency and accountability to a complex area.

18 Advances in the audit timetable of debt and reserves continue to be made, for example - the Exchange Equalisation Account was certified by the Comptroller and Auditor General some four months earlier than last year.

Whole of Government Accounts

19 Good progress continues to be made towards the publication of Whole of Government Accounts (WGA). The Treasury prepared dry run Central Government Accounts (CGA) for 2002-03, which were reviewed by the National Audit Office, and these built upon the experience of the first dry run with significant advances being made since 2001-02.

20 These advances have been important as the Treasury move towards preparing the first published CGA for 2003-04 which will be audited by the Comptroller and Auditor General. While a precise publication timetable has yet to be determined, good progress has been made, and the National Audit Office continue to work closely with the Treasury to address the resolution of issues identified from the dry run process.

21 CGA is an interim, albeit important, step towards the publication of WGA, and running in parallel with the CGA process the Treasury and the National Audit Office have commenced work on planning the first dry run WGA for 2004-05. The move to WGA presents new logistic and technical challenges, and the National Audit Office are committed to helping address those issues while consulting on a suitable approach to dealing with the WGA consolidation.

Looking Forward

22 The scope of financial audit work carried out by the Comptroller and Auditor General and National Audit Office continues to evolve. Further progress has been made in implementing the recommendations of Lord Sharman's report into audit and accountability in central government. The European Commission and the Department of Trade and Industry have accepted that there is no barrier in principle to the Comptroller and Auditor General auditing government owned companies, as proposed in Lord Sharman's report. The National Audit Office are consulting with the relevant parties to determine what legislative changes would be required to facilitate this development.

23 International Accounting Standards (IAS) are mandatory for EU listed companies in their group financial statements from 1 January 2005. The Treasury have decided that the implementation of accounting standards will follow UK Accounting Standards as they converge with international standards. There will thus be major changes in accounting standards over the next few years. The National Audit Office will work with the Financial Reporting Advisory Board to ensure the appropriate application of IAS to central government bodies. More generally, the National Audit Office will continue to play a prominent role in the development of the accounting framework at both a national and international level thereby reflecting the arena in which central government bodies operate.

Corporate Governance

24 Properly planned and managed risk taking by government departments can promote innovation and lead to improved value for money for tax payers. The National Audit Office continue to work closely with audited bodies and their Audit and Risk Committees in assisting the development of corporate governance arrangements and, more broadly, risk management procedures.

25 The Comptroller and Auditor General followed up his previous report on risk management by looking at the progress made by departments in embedding risk management. This concluded that whilst significant progress has been made by departments, many must undertake further work to demonstrate that they have made effective risk management a central part of their day to day general management processes.

26 The National Audit Office is well placed to identify good practice in specific areas within its client base and to share that good practice across a wider audience. A well functioning audit committee is key to achieving good corporate governance and consequently, the National Audit Office have been developing a range of guidance and tools to assist public sector audit committees. This guidance has included an award winning self assessment toolkit for audit committees. This will allow audit committees to assess their performance against best practice.

27 On a more strategic level, the Comptroller and Auditor General and his staff continue to influence the development of risk management, through participation in such bodies as the Public Audit Forum, the Auditing Practices Board and the International Organisation of Supreme Audit Institutions. In addition, National Audit Staff have attended various events to aid clients and audit committees in developing corporate governance.

28 The development of corporate governance in the central government sector is on-going and considerable work remains to be completed. The Treasury have recently undertaken a review of the corporate governance framework in central government. It is intended that this will facilitate a Governance Code for the sector. The National Audit Office have actively contributed to this review and will continue to work with the Treasury to provide further stimulus for departments to maintain their efforts to fully embed risk management in their day to day activities.

Adding Value: Other Financial Audit Work

29 The overall results of the Comptroller and Auditor General's financial audit work indicated that, in general, standards remained high. However, the Comptroller and Auditor General was able to contribute to improvements in the effective financial management and financial control within the bodies which the National Audit Office audits. This contribution was made in a number of ways; most directly, by the provision of a management letter at the end of the audit process or as a result of the recommendations arising from good governance projects.

30 The Comptroller and Auditor General has always been highly supportive of the need to improve efficiency within central government. The efficiency agenda has gained new impetus following the publication of the Gershon Review in July 2004 and there is now greater awareness of the key role that financial management has to play in the effective use of resources and in delivering efficiency programmes. The Comptroller and Auditor General and his staff fully support the steps being taken to professionalise the finance function in departments and are assisting the Treasury in a department by department review of the effectiveness of financial management within central government.

31 The Comptroller and Auditor General and staff from the National Audit Office continue to contribute towards the shaping of accounting and auditing best practice through active participation on a number of professional bodies. The Comptroller and Auditor General continues as Chairman of the Review Board and is Chairman of the Professional Oversight Board for Accountancy. National Audit Office staff are represented on committees and working groups of bodies such as the Accounting Standards Board, the Institute of Chartered Accountants in England and Wales, the Treasury, the Public Audit Forum, the Chartered Institute of Public Finance and Accountancy, and the International Auditing and Assurance Standards Board. In addition to this, staff continue to contribute to the debate on issues which are key to the central government sector, most notably the accounting treatment of Private Finance Initiative projects.