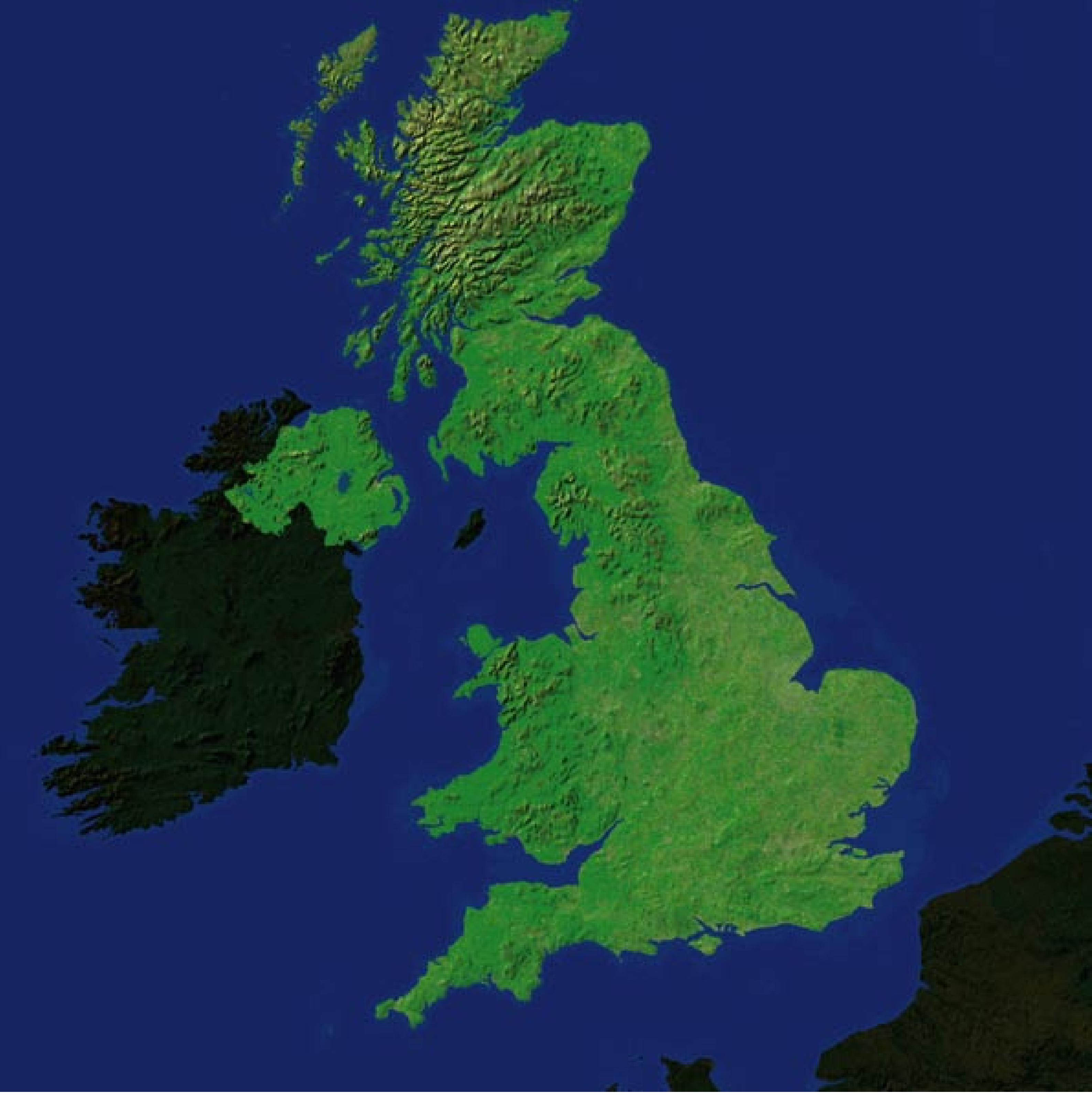

National Audit Office

FINANCIAL AUDITING AND REPORTING

General Report of the Comptroller and Auditor General 2004-05

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 1015 Session 2005-2006 | 31 March 2006

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 800 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.

FINANCIAL AUDITING AND REPORTING

General Report of the Comptroller and Auditor General 2004-05

Ordered by the House of Commons to be printed on 28 March 2006

LONDON: The Stationery Office
£9.25

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This report has been prepared for presentation to the House of Commons under Section 6(4) and Section 7(3)(c) of the Government Resources and Accounts Act 2000.

John Bourn
Comptroller and Auditor General
National Audit Office

24 March 2006

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

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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 2005 to 31 January 2006.

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 progress departments have continued to make in improving the quality and timeliness of accounts submitted for audit. I have qualified my opinions on the resource accounts of two departments compared with a total of four in the prior year.

However, 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 an increasing 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 pleased that during 2005 we were able to assist in a Treasury led department by department review of the effectiveness of financial management within central government. My senior staff responsible for the audit of each department are discussing with departments' senior management how we can contribute to the achievement of the action plans arising out the reviews.

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 improve continually in this area. Whilst significant progress has been made there is still more that might be done in some departments to demonstrate that they have made effective risk management a central part of their day to day management processes. 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 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 is, for the audits of 2005-06 accounts, conducting its work in accordance with International Standards on Auditing (UK and Ireland), in line with the timetable for the adoption of these 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 spheres. Part 3 of this report therefore explores the benefits that our mainstream financial audit work provides beyond its primary objective of providing independent assurance, information and advice to Parliament on the proper accounting and use of public resources. It also considers some of the additional areas of work involving the Office's financial auditors that benefit individual audited bodies, the wider central government sector, Parliament, members of the public and the wider interests of the United Kingdom.

John Bourn

Comptroller and Auditor General

24 March 2006

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 2005 to 31 January 2006 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 undertakes, 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 approximately 500 accounts per year, incorporating total expenditure and revenue of approximately £800 billion.

4 All financial audits for 2004-05 accounts were 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 A major 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.

Quality and Timeliness of Accounts

8 During 2004-05, departments generally continued to make good progress in response to the challenges of resource accounting and, for the most part, 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 two sets of departmental resource accounts, compared to four accounts in the prior year;
- The number of accounts qualified in relation to truth and fairness fell from two accounts to one;
- The number of accounts qualified in relation to regularity fell from two accounts to one.

9 Nevertheless there was a significant setback in that one department's account presented such fundamental problems that the Comptroller and Auditor General had to issue a 'disclaimer of opinion' due to the lack of audit evidence such that he could not reach an opinion on the truth and fairness of the account.

10 Thus whilst the great 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.

11 In general, departments continue to make good progress in improving the timeliness of accounts submission. This was reflected in the fact that over 85% of departmental resource accounts had been submitted for audit by October 2005 and that twenty-five departments were able to lay their accounts before Parliament's summer recess. But there remain a small number of departments who struggle to meet the statutory timetable for submitting accounts to the Comptroller and Auditor General for audit by 30 November and six departments failed to meet this deadline. This compares unfavourably to the prior year, in which only two departments failed to adhere to the timetable.

12 The Treasury aim to accelerate the preparation and audit of accounts, with the intention that all resource accounts from 2005-06 onwards should be laid before Parliament by the Summer Recess. Most departments have continued to make progress towards meeting this target, although a large number will need to make further significant effort if they are to meet that timetable. 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 decision making 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.

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 reservations over Tax Credits, satisfactory, and provided overall assurance that adequate regulations and procedures had been framed by the Inland Revenue, HM Customs and Excise and the Driver and Vehicle Licensing Agency ('DVLA') to secure an effective check over the assessment, collection and allocation of tax.

14 The Comptroller and Auditor General continued to note reservations concerning Tax Credits errors, and this led to a further qualification of his audit opinion on the Inland Revenue's Trust Statement account for 2004-05. In July 2005, the Department produced interim findings which indicated that it had overpaid £460 million (around 3.4 per cent by value) because of claimant error and fraud in 2003-04. That error rate was likely to increase as the Department's work continued and there is no evidence to suggest that the level of error would have fallen significantly from 2003-04 to 2004-05. The Comptroller and Auditor General concluded that these levels of error were unacceptably high and qualified his audit opinion on the Inland Revenue Trust Statement account.

15 The Trust Statement accounts produced by the Inland Revenue and HM Customs and Excise were on an accruals basis for the first time in 2004-05. These accounts include estimates and forecasts of taxes collectable in 2004-05, as well as amounts collected. The Comptroller and Auditor General concluded that there whilst there was some uncertainty relating to the forecast of certain elements of tax accruals for Income Tax Self Assessment and Corporation Tax, for which taxpayer returns were not due until after the Trust Statement was finalised, there was adequate disclosure of the range of uncertainty so that his opinion did not require qualification in respect of this matter. DVLA currently record taxation on a receipts and payments basis, but intend to produce an accruals based account for 2005-06.

16 HM Revenue and Customs (HMRC) was established in April 2005 by the Commissioners for Revenue and Customs Act which brought together most of the functions of the Inland Revenue and HM Customs and Excise.

17 The Comptroller and Auditor General's audit of public debt and reserves accounts was conducted satisfactorily, building on the reporting timetable gains made in 2003-04. Work is ongoing to advance further the reporting timetable for the Consolidated Fund and National Loans Fund accounts, with the aim of achieving completion prior to Parliament's summer recess in 2007-08.

Whole of Government Accounts

18 The Chancellor's Pre-Budget Report confirmed the Government's decision to proceed with the publication of Whole of Government Accounts (WGA), and good progress continues to be made on this significant project. Throughout the period, the National Audit Office has continued to work closely with Treasury on the central government sub-consolidation. Significant advances have been made in terms of data quality, in specific areas such as accounting for taxation income and Central Funds on an accruals basis, and calculating pension scheme liabilities. Improvements have also been made in the timeliness of the consolidation process.

19 The need for further improvements in both timeliness and data quality still remain however, and the National Audit Office continues to work closely with the Treasury to address these issues. At the same time work has begun to incorporate local government, health and public corporations in the consolidation process with 2004-05 being the first of two dry-run years of WGA prior to the envisaged publication of WGA balance sheet information for the 2006-07 financial year. The National Audit Office is currently establishing working protocols to deal with the added logistical challenges of adding a thousand new bodies to the consolidation process, while at the same time helping to address a number of technical challenges such as the need to converge different accounting policies.

20 WGA will make available for the first time comprehensive, audited public sector information based upon generally accepted accounting principles. This will support enhanced policy formulation and resource allocation, and should contribute significantly to fiscal management. The National Audit Office will continue its commitment to working with Treasury and other bodies across the public sector to support this significant initiative and contribute to the success of a project that will also increase the accountability and transparency of the whole public sector to Parliament and the wider public alike.

Looking Forward

21 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 Company Law Reform Bill proposes to change UK legislation to enable the Comptroller and Auditor General to audit government owned companies, as proposed in Lord Sharman's report. The National Audit Office is consulting with the Institute of Chartered Accountants in England and Wales, the Department of Trade and Industry and the Treasury on the practical arrangements that will be necessary to put this into effect once the new provisions become law.

22 International Accounting Standards have been mandatory for European Union listed companies in their group financial statements from 1 January 2005. The Treasury has decided that the implementation of international accounting standards in the central government sector should follow United Kingdom Accounting Standards as they converge with international standards. There is currently some debate on how and when such convergence should be achieved, but it remains likely that there will be a major change in accounting standards in the next few years. The National Audit Office will work with the Treasury and the Financial Reporting Advisory Board to ensure the appropriate application of international accounting standards 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.

23 Another major development in financial reporting for the central government sector that will affect 2005-06 accounts is the requirement for a more extensive 'Management Commentary' statement, broadly following the guidelines set out in the Accounting Standards Board's Reporting Statement: Operating and Financial Review. National Audit Office financial audit teams will review the content of their audited bodies' new style Management Commentaries for consistency with the rest of the annual report and accounts and their own knowledge of the client.

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 continues 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's reports in recent years on risk management have stressed the importance for departments of embedding risk management within their day to day general management processes. At the individual entity level our risk based financial audit methodology enables our financial audit teams to make specific recommendations to their client bodies on improving internal control frameworks and risk management to put this into practice.

26 A well functioning audit committee is key to achieving good corporate governance and ensuring that risk management processes receive the attention that they deserve. It is an important part of the role of the National Audit Office's senior line financial audit staff to support their clients' audit committees, and the Office has been developing a range of guidance and tools to assist public sector audit committees. This includes a self assessment toolkit for audit committees to allow them 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 Office 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 continues. In July the Treasury introduced a Governance Code for Central Government along the lines of the Combined Code applicable to listed companies in the private sector. And it is currently revising its Audit Committee Handbook for central government bodies. The National Audit Office intends to continue to play its full part in ensuring the success of these and other initiatives.

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 have assisted the Treasury in a department by department review of the effectiveness of financial management within central government. There are now a number of pieces of work underway or planned by senior National Audit Office staff responsible for the financial audits of departments to assist in carrying forward the action plans arising from the reviews.

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 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.

PART ONE
Financial Audit

Introduction

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. This section of the report summarises the results and conclusions of financial audits undertaken over the twelve months from 1 February 2005 to 31 January 2006. A summary of all accounts audited by the Comptroller and Auditor General is included at Appendix 2 to this report.

1.2 The Comptroller and Auditor General will express an opinion on the financial statements of the bodies for which he is the appointed auditor, reporting whether in his opinion the financial statements give a true and fair view of the financial position of the entity and have been properly prepared in accordance with the relevant statute and Treasury directions made thereunder. This includes examining how well the management of audited bodies meet their responsibilities for keeping appropriate and accurate financial records.

1.3 The Comptroller and Auditor General will also report his opinion as to whether the transactions contained within the financial statements are regular in that they have been undertaken in accordance with relevant legislation, other regulations issued by Ministers, and with Parliamentary and Treasury authority.

1.4 The Comptroller and Auditor General will draw to the attention of Parliament, by way of a qualified audit opinion and an accompanying published report on the accounts, significant matters relating to poor financial control or matters having an impact on public expenditure. Reports on other matters believed to be of significant interest to Parliament may also be published without qualifying the opinion on the financial statements.

1.5 The Office has a number of internal procedures to ensure the maintenance of high quality in our financial audit work in line with the requirements of the Auditing Practices Board's engagement standards, in particular International Standard on Quality Control no. 1. And, as is normal practice for the major audit firms, our financial audit practice is also subject to annual review by an independent monitoring body, the Quality Assurance Directorate of the Institute of Chartered Accountants in England and Wales, who evaluate our compliance with the profession's Audit Regulations.

1.6 The Audit of Receipts of Revenue and Public Debt and Reserves is discussed at paragraphs 1.37 to 1.87 below. The other side of the equation – where and how the money is spent – forms the other major area of the National Audit Office's financial audit work, whether such expenditure is directly via the major departments of state or their agencies, executive non-departmental public bodies or grants to other organisations. Departments submit initial estimates of their expenditure requirements early in the relevant financial year (main supply estimates) adjusted, if necessary by revised estimates later in the year (spring and winter supplementary estimates).

1.7 After the end of the relevant financial year each department submits a 'Resource Account' for audit. Resource accounts comprise financial statements similar to those found in commercial accounts but also including a summary comparing planned expenditure with the actual outturn. In the period covered by this report the Comptroller and Auditor General qualified his opinion on only two sets of departmental resource accounts. This was a decrease over the previous year, indicating that, in general, standards of financial control in departments are improving. An analysis of qualified departmental resource accounts is provided in **Figure 1**, while a full list of qualified opinions is included in Appendix 3 of this report.

1.8 While the accuracy of financial statements is essential to the Parliamentary control of government expenditure, timely reporting is equally important. Therefore, this part of the report also comments upon progress made by departments in submitting high quality accounts, on a more timely basis to the Comptroller and Auditor General for audit, as well as commenting on key developments in the area of faster financial closing.

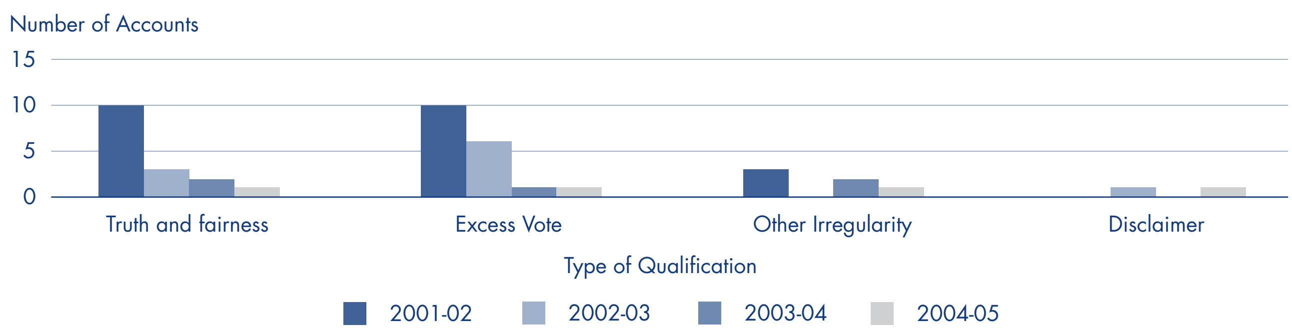
1.9 The remainder of this part of the report provides a commentary on some significant aspects of the Comptroller and Auditor General's current financial audit responsibilities and some key developments impacting on those responsibilities going forward.

Departmental Resource Accounts – Qualified Opinions

1.10 In general the quality of accounts submitted to the Comptroller and Auditor General for audit during the period covered by this report continued the pattern of improvement shown in recent years. Qualified opinions were issued on only two sets of departmental resource accounts compared to four qualifications in the prior year. Figure 1 illustrates the year on year decrease in qualifications and compares the number of qualifications by type for each year for the last four years.

1.11 The Department for Work and Pensions resource account was subject to a qualification on three separate grounds; the substantial level of estimated losses and fraud in benefit payments (regularity); material inconsistencies over the completeness, existence and accuracy of amounts recorded in the accounts for benefit overpayment balances and a significant limitation in the audit evidence available to support Social Fund Loan balances (limitations of scope); and finally, that in one area the department had expended more resources than had been authorised by Parliament in its supply estimate (excess vote). Resource based supply estimates were introduced for 2001-02 accounts onwards and as a result departmental resource accounts can be qualified on the grounds of an Excess Vote. Such excesses, however small, are irregular and result in a qualified opinion. They require retrospective parliamentary authority in a subsequent Appropriation Act.

1 Number of Qualifications by Type: Resource Accounts



1.12 The Home Office resource account was subject to a 'disclaimer of opinion'. A disclaimed opinion is expressed when the auditor is prevented from obtaining sufficient audit evidence to express an unqualified opinion and the effect of that is so material or pervasive that the auditor is, accordingly, unable to express an opinion on the financial statements. The Home Office had not maintained complete financial books and records during the year and as a result was unable to deliver its accounts for audit by the statutory timetable. The Comptroller and Auditor General concluded also that, because the Home Office failed to deliver its accounts for audit by the statutory timetable and because of the fundamental nature of the problems encountered, he could not reach an opinion on the truth and fairness of the Home Office's accounts.

1.13 The implementation of a new accounting system contributed to the late delivery of the Home Office's accounts. The difficulties encountered in the transfer and cleansing of data, and the fact that staff were not trained to use the accounting system, meant that the Department could not use data from its new accounting system effectively to produce a cogent set of accounts to the required statutory timetable. The National Audit Office will be working with the Home Office to strengthen its financial control framework and to improve its financial statements' preparation processes.

1.14 While the vast majority of departmental resource accounts continued to receive an unqualified audit opinion, the fact that true and fair qualifications and disclaimed opinions still occur is indicative of weaknesses in departmental financial control – weaknesses that compromise the ability of the departments concerned to provide sound accountability to Parliament. Those departments need to continue to improve their financial controls so as to remove the causes of the qualifications as soon as possible, and the National Audit Office will continue to work with them in recommending control improvements.

1.15 The National Audit Office will also continue to work with departments to improve their ability to effectively manage and budget for their resource consumption and where necessary, to implement improvements and enhancements to their financial systems. These skills will allow departments to adopt a more sophisticated approach to Estimate setting and monitoring and serve to fully embed accruals based financial management. In this regard the National Audit Office is also pleased to have participated in the Treasury's department by department review of the effectiveness of financial management. This included an assessment of the planning and budgeting processes in place at each department and an Action Plan has been derived for each department to be taken forward between Treasury and the department. Part 3 of this report provides further details of this work and how senior National Audit Office staff are helping departmental boards to achieve these action plans.

Other Entities – Qualified Opinions

1.16 In the period covered by this report the Comptroller and Auditor General qualified his opinion on a further eleven sets of accounts. A full list of these qualified opinions is included in Appendix 3 of this report.

1.17 The eleven qualifications include the 2004-05 accounts of the Advisory, Conciliation & Arbitration Service (ACAS). The Service's accounts were qualified as a result of severance payments which had been made to six employees, totalling £61,000, but for which Treasury approval had not been sought. The severance payments were in excess of that which the entity was contractually obliged to pay and as a result were considered novel and contentious. A subsequent request for retrospective approval was declined by the Treasury on the basis that they did not consider the payments to represent value for money for the taxpayer and therefore had approval been sought at the outset it would have been declined. The payments were therefore considered to be 'irregular'.

1.18 The National Audit Office conducted further investigation into the extent and frequency of ex-gratia compensation payments across central government. As a result of this work a number of such payments were highlighted and retrospective approval subsequently sought by the entities concerned. Whilst Treasury approval was granted in these instances, the National Audit Office investigations prompted the issue of further guidance by the Treasury to all government departments and their sponsored entities. The guidance highlighted that central government departments and their sponsored bodies should have appropriate personnel procedures in place which treat special severance payments in excess of statutory or contractual entitlement as exceptional and that such payments must only be offered with Treasury approval.

1.19 In forming his audit opinion on the Community Fund accounts for 2004-05, the Comptroller and Auditor General was required to confirm that, in all material respects, the income and expenditure of the Fund had been applied to the purposes intended by Parliament, i.e. that they were regular. In September 2004 the Community Fund, which now operates under the name Big Lottery Fund, identified a number of irregularities in certain grant applications. The Fund, police and Charity Commission initiated extensive investigations into potentially fraudulent applications by a number of community groups and a number of arrests have been made. The investigations continue into the nature and extent of the potential fraud. The payments made by the Fund on the basis of fraudulent or potentially fraudulent applications in the 2004-05 financial year totalled £770,000. This expenditure was not in accordance with Parliamentary intention and the audit opinion was qualified accordingly.

1.20 The scope of the Comptroller and Auditor General's audit opinion (including regularity) on the NHS Pensions Agency Administration Accounts was limited as a result of insufficient audit evidence to support a material balance relating to grant award payments made to students studying towards careers in the National Health Service.

1.21 The Northern Ireland Police Board accounts for 2004-05 showed that the entity had a bank overdraft as at the 31st March 2005. The legislation under which the entity was established prohibits borrowing and therefore the underlying transaction that created this overdraft was considered irregular, and the audit opinion was qualified accordingly.

1.22 The Ordnance Survey accounts for 2004-05 were qualified as a result of an on-going disagreement over the accounting treatment adopted in respect of the National Geographic database. The Comptroller and Auditor General considers that the data held in the database should be capitalised and recorded on the balance sheet. The Agency, however, considers that the data does not meet the conditions for capitalisation.

1.23 The Social Fund accounts in respect of both 2003-04 and 2004-05 were qualified during the period. The scope of the Comptroller and Auditor General's audit opinion (including regularity) on the Social Fund was limited as a result of the Department for Work and Pensions being unable to provide adequate supporting evidence to support a number of benefit awards to members of the public.

1.24 The Child Support Agency's Client Funds Accounts for 2004-05 were qualified as a result of material errors identified in both the amounts due and the amounts received from non-resident parents and in subsequent payments over to the parent with care or the Secretary of State. This was largely due to combinations of errors made in 2004-05 and earlier years, including errors in the underlying maintenance assessments.

1.25 The National Treatment Agency is a Special Health Authority. Under Section 97 of the National Health Service Act 1977, these bodies have a statutory financial duty to ensure that the use of their resources in a financial year does not exceed the amount specified for them in relation to that year by the Secretary of State. Separate limits are set for revenue and capital resources. Failure to keep expenditure within agreed capital and revenue resource limits will result in a qualification of the regularity opinion. The National Treatment Agency breached its resource limit in 2004-05.

1.26 The scope of the Comptroller and Auditor General's audit opinion on the Ministry of Defence Police and Guard Agency was limited in respect of the prior year comparative figures. The Agency was established by the combination of an existing agency, the Ministry of Defence Police, with a part of the Ministry of Defence operating as the Ministry of Defence Guard Service on 1 April 2004. It was not possible to identify the prior year comparative element relating to the transferred functions relating to the Ministry of Defence Guard Service and as a result the account was qualified.

1.27 Further details on the audit and subsequent qualification of the Inland Revenue Trust Statement 2004-05 are included at paragraph 1.54 below.

Conclusion

1.28 Nearly all departments and the other public bodies falling within the Comptroller and Auditor General's remit are producing unqualified accounts, but 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. Whilst there is no consistent pattern to the qualifications they are nevertheless indicative of weaknesses in internal control which may impinge upon a body's ability to provide sound accountability to Parliament.

Departmental Resource Accounts – Timeliness for Rendering Accounts for Audit

1.29 Accurate reporting of departmental performance is only a part of ensuring Parliamentary accountability: equally important is the need for timely reporting of government expenditure to Parliament. To facilitate this, departments must ensure that the financial statements for which they are responsible are prepared and submitted for audit on a timely basis.

Performance in Period

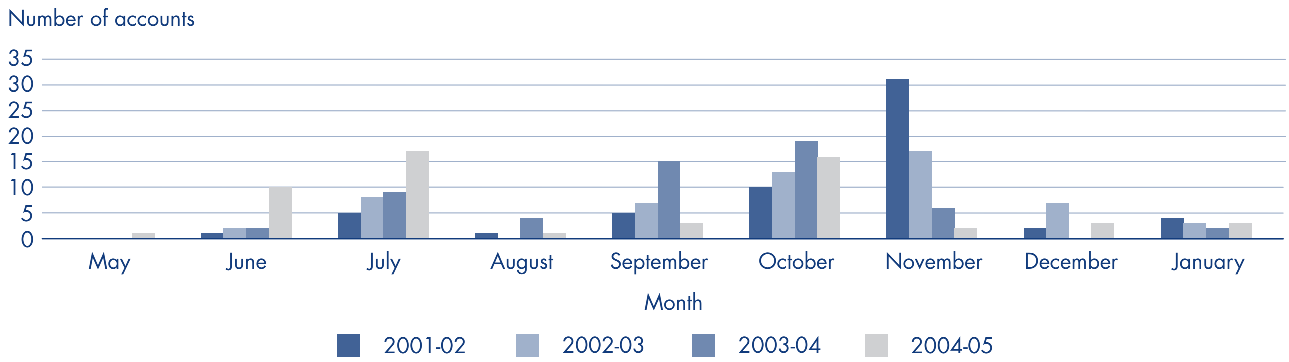
1.30 Previous reports have commented upon the timeliness of accounts: namely whether departments had met the statutory requirement to submit accounts for audit by 30 November following the financial year ended the previous 31 March. **Figure 2** shows departments' performance in delivering signed accounts for audit over the last four years.

1.31 In general, departments continue to make good progress in improving the timeliness of accounts submission. For example, by October 2005, 87 per cent of resource accounts had been submitted for audit, compared to the prior year position of 84 per cent. A small number of departments, however, continue to struggle to meet the statutory timetable of 30 November, and six departments actually missed this statutory deadline. However, all accounts were laid before the House of Commons by the deadline of 31 January 2005.

Faster Financial Closing

1.32 The Treasury's initiative to accelerate the production and audit of resource accounts, has as an intention that for the reporting year 2005-06 and subsequent years all departmental resource accounts will be laid before Parliament before the Summer Recess. This replicates the timetable that already applies to the accounts of departments' Executive Agencies. The impetus for this initiative stems from calls by the Committee of Public Accounts for faster accounts closure and from a desire to mirror what is accepted as general commercial best practice. Moreover, the accelerated timetable will be necessary to allow Whole of Government Accounts to be produced in a timely fashion. Further detail on Whole of Government Accounts is given later in this section of the Report.

2 Delivery of signed resource accounts



1.33 The plan for 2005-06 accounts to be laid by Summer Recess, along with the actual results for the previous three years, is illustrated in **Figure 3**.

1.34 Figure 3 shows that departments have made further progress towards meeting the faster closing agenda. In 2005, twenty-five departments were able to lay their 2004-05 accounts to a pre-recess timetable. This is an improvement on the prior year when only eleven resource accounts met the recess deadline. Other improvements have been secured with a number of larger departments continuing to make good progress in accelerating their accounts production process. However, the graph indicates that a large number of departments consider the move towards the faster closing of accounts to be a heavily end-loaded process and as a result some fifteen departments will need to accelerate their accounts production process by over three months in 2005-06 in order to meet the Treasury timetable. Achievement of the proposed accelerated timetable will require significant effort by these departments.

1.35 Fundamental to the success of faster closing is the recognition that the accounts production process is not merely a year end activity. Robust, accurate and timely financial information is key to improved resource planning and should be something that departments produce and utilise throughout the financial year. Indeed, departments should not view the faster closing initiative in isolation, but should consider it as an outcome within the context of wider improvements in financial management across central government in general.

1.36 The Comptroller and Auditor General fully welcomes the steps which the Treasury is taking to speed up the delivery of accounts and is wholly committed to a partnership with the departments to help achieve this. Part 3 of this report provides further detail of his work in this area.

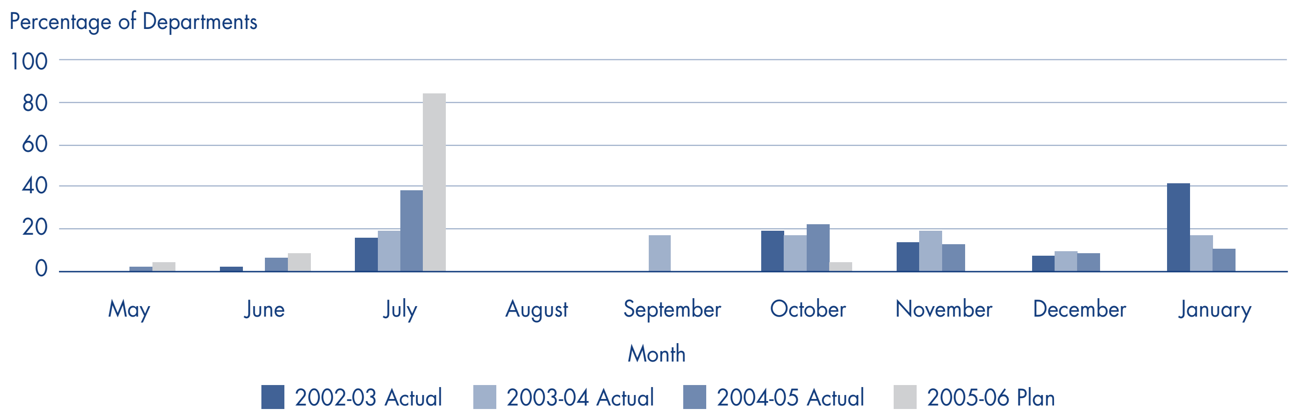
Audit of Receipts of Revenue

Introduction

1.37 In 2004-05, the Inland Revenue collected some £257 billion, including National Insurance Contributions and HM Customs and Excise collected net revenue of some £121 billion. The Inland Revenue paid out £15.8 billion in Tax Credits. The Driver Vehicle Licensing Agency (DVLA) collected net revenue of £4.7 billion from Vehicle Excise Duty (VED). Overall this represents approximately 90 per cent of central government revenue for the year.

1.38 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 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 and, together with a report on the resource accounts of the Department concerned, report to the House of Commons.

3 Timetable of Laying of Accounts



1.39 In accordance with the directions given by the Treasury, the Inland Revenue and HM Customs and Excise prepare financial statements of taxes collected on an accruals basis, including estimates and forecasts of taxes collectible, as well as amounts collected. The DVLA currently record taxation on a receipts and payments basis, but intend to produce an accruals based account for 2005-06. The Comptroller and Auditor General concluded that there was uncertainty relating to certain elements of tax accruals in the Inland Revenue Trust Statement, although his opinion was not qualified in respect of this matter (see paragraphs 1.70 and 1.71 below). The Comptroller and Auditor General continued to note reservations concerning Tax Credits errors, and this led to a further qualification of his audit opinion on the Inland Revenue's Trust Statement for 2004-05 (see paragraph 1.54 below). The Comptroller and Auditor General also audits the Inland Revenue and HM Customs and Excise Resource Accounts, both of which received unqualified opinions in 2004-05.

1.40 HM Revenue and Customs (HMRC) was established in April 2005 by the Commissioners for Revenue and Customs Act which brought together most of the functions of the Inland Revenue and HM Customs and Excise.

HM Customs and Excise

1.41 The Comptroller and Auditor General's published Standard Report, presented to Parliament with the Accounts of HM Customs and Excise (HC 447 2005-06) detailed the main outcome of the work carried out by the National Audit Office. This report covered the Department's management of Value Added Tax debt and the strategy implemented by HM Customs and Excise to tackle tobacco fraud. Other suggestions for further improvements in controls were notified to the Department in management letters.

1.42 Subject to the issues outlined in his Standard Report the Comptroller and Auditor General was satisfied that his work in 2004-05 gave him assurance that Customs and Excise's regulations and procedures provided an effective check over the assessment, collection and allocation of tax. He was also able to provide an unqualified opinion on the Department's Trust Statement.

VAT debt management

1.43 HMRC is responsible for the collection of gross VAT receipts of more than £125 billion each year. The Comptroller and Auditor General's Standard Report for 2001-02 noted a rapid rise in debt levels and weaknesses in IT systems which resulted in poor management information and impaired performance. The 2004-05 Standard Report examined how the Department's arrangements for managing VAT debt have developed since then.

1.44 Debt management makes an important contribution to the delivery of the Department's Public Service Agreement (PSA) target to reduce VAT losses to no more than 12 per cent by March 2006. In responding to this challenge, the Department has significantly improved its collection rates for recoverable debt, and steadily reduced the level of outstanding debt available for collection.

1.45 The Comptroller and Auditor General noted that the use of legacy IT systems continues to provide major problems. Many of the legacy systems on which the Department relies were due for replacement or upgrade as part of an e-Business solution. However, ongoing work to make improvements to legacy systems had to undergo continual re-evaluation and prioritisation.

1.46 In May 2002, key systems failed to reconcile by £300 million. This meant that £300 million of outstanding debt was not passed to debt management units for monitoring or collection. Since then the unreconciled difference has grown, and by March 2005 stood at approximately £900 million. The Department has established that most of this balance represents debt not likely to be immediately recoverable as it relates to fraud cases under investigation, and assessments made by the Department against which traders have appealed. Of the total £900 million, about £35 million of this accrued debt should have been pursued and, although the Department is now taking action in respect of this debt, delays in starting recovery action may make collection more difficult.

The Tobacco Strategy

1.47 Tobacco Duty fraud has been the source of annual revenue losses estimated to exceed £2.5 billion since the late 1990s. The strategic response developed by HM Customs and Excise to combat this fraud was set out in its March 2000 publication Tackling Tobacco Smuggling. The aim of the strategy was first to slow the growth in, and then to cut the level of tobacco fraud.

1.48 Over the lifetime of the strategy, the market share for illicit cigarettes has fallen from an estimated 21 per cent in 2000-01 to an estimated 16 percent in 2003-04. Unlike previous years, the Department has decided not to publish a provisional estimate for the illicit share of the cigarette market for 2004-05 as it no longer considers the provisional data from the Office for National Statistics to be sufficiently reliable. Estimated reductions in the level of cigarette fraud were most pronounced in the first two years of the strategy, and have been consolidated in subsequent years. In order to fulfill its new Public Service Agreement commitment of a 13 per cent illicit market share by the end of March 2008, the Department is considering ways to refocus the strategy to reflect the constantly changing nature of fraud.

1.49 The Department's success in reducing the illicit market share for cigarettes has resulted in organised criminal gangs becoming ever more sophisticated in their methods. It has also led to displacement from genuine UK brands towards counterfeit tobacco products.

1.50 The Comptroller and Auditor General noted that the Department needs to ensure that the resources deployed to deal with tobacco fraud continue to be appropriate to achieve ever more challenging targets. Resource decisions should take account of the full range of indicators available given the timing and uncertainties of the annual fraud estimates. The Department also needs to enhance the current fraud estimates to reflect total risks to tobacco revenue. Work to establish a Public Service Agreement type target to reduce fraud relating to hand rolling tobacco will help to address this.

1.51 The Comptroller and Auditor General noted that the Department has established an effective model for ensuring cooperation across traditional work streams to reduce the level of tobacco fraud. The Department is constantly seeking ways to improve delivery, including a significant reorganisation of the tobacco intelligence teams during 2004-05. Implementation of the conclusions of the Department's review of the deployment of overseas intelligence staff will provide assurance that that network is appropriately resourced and properly located to address all relevant risks.

1.52 The work the Department has undertaken with the tobacco manufacturers has successfully restricted the availability to smugglers of genuine UK tobacco products. The Department is looking to enhance its relationship with the tobacco manufacturers to ensure greater control of legitimate supply chains and introduce further measures to address the problem of counterfeit product.

Inland Revenue

1.53 The Comptroller and Auditor General's published Standard Report, presented to Parliament with the Accounts of the Inland Revenue (HC 446 2005-06) details the outcome of the main work carried out by the National Audit Office. This report covered Tax Credits, the management of Corporation Tax by the Large Business Office and certain other issues including significant and widespread errors in Pay As You Earn Income Tax. Other suggestions for further improvements in controls were notified to the Department in management letters.

1.54 The Comptroller and Auditor General continued to note reservations concerning Tax Credits errors, and this led to a further qualification of his audit opinion on the Inland Revenue's Trust Statement account for 2004-05. In July 2005, the Department produced interim findings which indicated that it had overpaid £460 million (around 3.4 per cent by value) because of claimant error and fraud in 2003-04. That error rate was likely to increase as the Department's work continued and there is no evidence to suggest that the level of error would have fallen significantly from 2003-04 to 2004-05. The Comptroller and Auditor General concluded that these levels of error were unacceptably high and qualified his audit opinion on the Inland Revenue Trust Statement account.

1.55 Whilst recognising that no tax collection system can ensure that all those who have a tax liability comply with their obligations, the National Audit Office's work in 2004-05 provided overall assurance that the Inland Revenue's regulations and procedures continued to provide an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out, subject to reservations about Tax Credits and certain other matters discussed below.

Child and Working Tax Credits – Error and Fraud

1.56 A Departmental exercise in 2000-01 indicated that it had overpaid some 10 to 14 per cent by value of the former tax credits because of claimant error or fraud. Whilst the design of the new Tax Credits and supporting systems are very different from the former tax credits and should have reduced the risk of error and fraud, the Department had no evidence that error rates had in fact fallen. The Comptroller and Auditor therefore qualified his audit opinion on the Trust Statement accounts for 2002-03 and 2003-04.

1.57 The Department is undertaking work to provide more information on the level of fraud and error. This examination involves a full check of 4,700 randomly selected claimants. This exercise is not due to be completed until Spring 2006. In July 2005 the Department produced interim findings which indicated that it had overpaid £460 million (around 3.4 per cent by value) because of claimant error and fraud in 2003-04. The Department believes that these interim results are subject to a wide margin of error because they are based on work that had been completed by May 2005 and it is likely that these cases were more compliant. The final results are likely to show an increase in the proportion of cases involving claimant fraud and error. Whilst this work suggests that the level of error is lower than with the former tax credits, the Comptroller and Auditor concluded that it remained unacceptably high and there is no evidence to suggest that the level of error would have fallen significantly from 2003-04 to 2004-05. Consequently, the Comptroller and Auditor General qualified his audit opinion on the 2004-05 Trust Statement account.

1.58 The Comptroller and Auditor General reported that there was evidence that Tax Credits have been targeted by organised criminals, particularly where they can make claims over the internet without proving identity. He concluded that the Department will need to maintain compliance work to ensure that confidence in the fairness of the schemes is not undermined by unacceptable levels of unjustified claims. The Department closed the tax credits internet facility in December 2005 because it had identified attempts to defraud the tax credits system.

Child and Working Tax Credits – Overpayments

1.59 Tax credit awards are initially based on the claimant's income for the preceding tax year. They are finalised after the end of the year when the Department asks claimants to confirm their circumstances, including their actual income for the previous year. Underpayments are paid as a lump sum and the Department seeks recovery of overpayments.

1.60 The Department estimated that overpayments for 2003-04 awards were £2.2 billion. This was mainly because family income had increased by more than £2,500 compared with the income declared at the time of the original application for Tax Credits (increases below this amount are disregarded). The final entitlement to tax credits in 2003-04 would have been about £800 million lower without the £2,500 'disregard'.

1.61 The Comptroller and Auditor General noted that some £391 million of these overpayments was recovered in 2004-05. The Department also wrote off some £95 million of overpayments. It further considered that some £481 million to be irrecoverable because claimants successfully contended that they could not repay because of hardship, or because the Department had difficulty in tracing claimants no longer entitled to receive Tax Credits. Full recovery of the remaining 2003-04 overpayments is expected to take at least five years.

1.62 The Department estimated that overpayments for 2004-05 awards were likely to be similar to those for 2003-04 and it made a provision of £480 million for doubtful debts in respect of overpayments for 2004-05.

Large Business Office management of Corporation Tax

1.63 The Large Business Office (LBO) handled the tax affairs of some 800 large entities and employers which generated some £18.4 billion of tax in 2004-05. The Comptroller and Auditor General noted that the complexity and sophistication of tax management in the large business sectors, including European Union and other international dimensions, pose some of the most difficult and potentially costly challenges for the Department, both in terms of administration cost and loss of revenue.

1.64 The LBO generated an additional tax yield of some £2.1 billion in respect of 2004-05 – primarily from the examination of specific tax issues. The Comptroller and Auditor General noted that good quality and prompt tax risk assessments are essential to achieving the best deployment of the Department's resources and the most effective compliance effort. For some years the LBO had been developing sector specialist knowledge and structures to improve tax risk identification. The Department recognised that there was significant development work to do before sector-based approaches to risk assessment became fully effective. The Comptroller and Auditor General noted that the compilation of data and calculation of financial ratios used in tax risk assessments were largely manual, time consuming and resource intensive, and not eased by the data being supplied by corporate taxpayers mainly in hard copy format rather than electronically.

1.65 In 2004, the Department launched a project called "Better Data for Corporation Tax". This was intended to achieve a step change in the effectiveness of compliance work through better use of management information to improve the targeting and effectiveness of enquiry work in the LBO. There were also important initiatives in internal quality assurance of Corporation Tax case work, management and structural reorganisations, employment of specialists, and new compliance processes with some customers. These initiatives are continuing within the integration plans for the new Department.

1.66 The LBO was integrated with the Customs and Excise equivalent in April 2005 to form the Large Business Service of HM Revenue and Customs and Excise, with a mission to "make a substantial contribution to financing the UK's future by closing the tax gap". The Comptroller and Auditor General noted that the management by large businesses of their tax affairs will continue to pose a challenge to the Department and that it must continue to modernise its work on Corporation Tax within the large business sectors. The Department needs to ensure that its various initiatives enable it to match the sophistication of large businesses with equivalent Departmental expertise and methods.

Pay As You Earn Income Tax (PAYE)

1.67 The Comptroller and Auditor General reported on significant and widespread errors in PAYE, which meant that around £575 million per annum of tax due was not being pursued by the Department and taxpayers were not being advised of around £295 million per annum potentially repayable to them. The main cause was the Department's failure to finalise and calculate correctly tax liabilities where people had more than one source of employment income.

Creation of HM Revenue and Customs

1.68 HM Revenue and Customs (HMRC) brought together most of the functions of the Inland Revenue and HM Customs and Excise from 18 April 2005. The Comptroller and Auditor General noted that integration offers the opportunity for the new Department to adopt a more effective approach to taxpayer compliance across all tax streams. The Department reviewed the effect of the integration on its compliance strategy and sought to develop a better understanding of the tax gap and other measures to help taxpayers comply with their obligations. The Comptroller and Auditor General also commented on the risks involved in the integration of two large departments, including risks that existing work priorities could be disrupted.

Accruals Based Accounts for Revenue Receipts

1.69 The Inland Revenue and Customs and Excise prepared accounts of revenue receipts on an accruals basis for the first time in 2004-05. As a result of this change from cash based accounting, the Inland Revenue and HM Customs and Excise had to estimate tax due at the year end, but not paid or payable. These accounts therefore include estimates and forecasts of taxes in respect of 2004-05 that will become enforceable liabilities in due course.

1.70 The Comptroller and Auditor General noted that there was uncertainty with certain elements of tax accruals on the Inland Revenue Trust Statement. For some taxes the Revenue had a reasonably firm basis for the estimate but for Income Tax Self Assessment and Corporation Tax the taxpayer returns were not due until after the Trust Statement was finalised. The Department forecast that the amounts due at 31 March 2005 were £15.4 billion for Income Tax Self Assessment and £12.1 billion for Corporation Tax. The Department based these forecasts on patterns of receipts of revenue and tax returns in previous years, assumptions about the rate of growth in the economy and profitability in the sectors most affected by Income Tax Self Assessment.

1.71 The Department could not determine precisely the uncertainty in these forecasts, but considered that the combined accrual of £27.5 billion should be regarded as subject to uncertainty of up to £2.5 billion in either direction. The Comptroller and Auditor General therefore concluded that there was uncertainty with these elements of tax accruals. This matter was adequately disclosed in the Trust Statement and the Comptroller and Auditor General's opinion was not qualified in respect of this matter.

1.72 DVLA intend to produce an accruals based Vehicle Excise Duty (VED) account for 2005-06. The account will show the proportion of VED paid where the duty period runs into the following financial year. This will be shown as deferred income in the balance sheet as at 31 March 2006.

Audit of Public Debt and Reserves

Introduction

1.73 The Comptroller and Auditor General's audit of debt and reserves involves the examination of a number of areas including central government receipts, payments and borrowing via the Consolidated Fund and National Loans Fund, debt and cash management through the Debt Management Account, the operations of the Commissioners for the Reduction of the National Debt and the Public Works Loan Board, and the management of foreign exchange reserves through the Exchange Equalisation Account.

The Consolidated Fund and the National Loans Fund

1.74 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 through the annual Consolidated Fund Act and Appropriation Acts;
- Standing services – these are payments for services that 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 budget of the European Union.

1.75 The 2004-05 accounts show that total receipts and payments into and out of the Consolidated Fund were over £352 billion, including gross receipts of £159 billion and £121 billion from the Inland Revenue and Customs and Excise respectively. Payments for supply services came to £326 billion while the total for standing services was £26 billion.

1.76 The National Loans Fund is the Government's principal borrowing account. 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 to meet government debt obligations, for example, gilt coupon and redemption payments.

1.77 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.

1.78 The 2004-05 accounts for the National Loans Fund show that at 31 March 2005 the Government's net liabilities through National Loans Fund borrowing were £455 billion, compared to £413 billion at the end of the previous financial year. In total, the Fund's liabilities were £531 billion, and included £377 billion in long term borrowing through gilt-edged stock, £67 billion borrowed in the retail savings market by National Savings and Investments, and a further £51 billion financed through the Debt Management Account and its money market borrowing operations. The Fund's assets were £76 billion, and included £42 billion advanced to the Public Works Loan Board to finance loans to local authorities and a further £20 billion advanced to the Debt Management Office to finance its debt and cash management activities. The 2004-05 accounts also show that the total cost of financing the Government's borrowing through the Fund of £27 billion was offset partly by income from lending operations of £5 billion and other income of £2 billion.

1.79 Both the Consolidated Fund and the National Loans Fund are operated by the Treasury. However, except for transfers between the two funds, the Treasury can only make issues from them with the authority of the Comptroller and Auditor General. During 2004-05, the Treasury introduced a new payments system for the Consolidated Fund and National Loans Fund. The new system requires on-line authorisation for payments from the Funds from the National Audit Office before payments can be made. HM Treasury and the National Audit Office managed the transition to the new system successfully, ensuring that controls and procedures in place continued to meet the duties of the Comptroller and Auditor General, whilst also securing operational benefits.

1.80 Following the Government's announcement in July 2004 of the transfer of the administrative and registration functions for gilts from the Bank of England to Computershare Investor Services plc, the National Audit Office carried out a review of the service migration process. The findings from the review indicated that the process was running smoothly. The transfer to Computershare Investor Services plc took place in December 2004 as scheduled.

Debt and Cash Management

1.81 The Debt Management Office is an executive agency of the Treasury that exists to support the government's debt management 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. The Debt Management Office is also responsible 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.

1.82 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 activities. At 31 March 2005, the Account held £62 billion in assets, for example – debt securities and loans, for the purpose of debt and cash management.

1.83 The Debt Management Office also administers functions relating to the Commissioners for the Reduction of the National Debt and the Public Works Loans Board. The main function of the Commissioners for the Reduction of the National Debt is to invest funds on behalf of certain government entities. Financial statements are prepared for each investment fund and these are audited by the Comptroller and Auditor General.

1.84 At 31 March 2005, the Commissioners controlled funds with a market value of some £37 billion. This included £28 billion, £5 billion and £3 billion on behalf of the National Insurance Fund, Court Funds (England and Wales) and the National Lottery Distribution Fund respectively. The financial statements for 2004-05 were certified with unqualified audit opinions.

1.85 The Public Works Loans Board considers loan applications from local authorities and other prescribed bodies and, where loans are made, collects the repayments. The 2004-05 accounts show that the Public Works Loans Board had loans outstanding of £42 billion at 31 March 2005, about the same amount as at the end of the previous financial year. The accounts also show that the Board's income from interest receipts and premiums amounted to £3 billion in 2004-05.

Foreign Exchange Reserves

1.86 The management of the United Kingdom's foreign exchange reserves is reported through the Exchange Equalisation Account. The reserves comprise 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.

1.87 As at 31 March 2005, the Account held total assets of £25 billion including some £19 billion of debt securities, £2 billion of loans and advances to banks and £2 billion of gold. The 2004-05 financial statements for the Exchange Equalisation Account were certified with an unqualified audit opinion by the Comptroller and Auditor General.

Whole of Government Accounts

Introduction

1.88 The Chancellor's 2005 Pre-Budget Report and the associated document 'Delivering the benefits of accruals accounting for the public sector' confirmed the Government's decision to proceed with the publication of Whole of Government Accounts (WGA), beginning with the publication of balance sheet information for the year ending 31 March 2007.

1.89 WGA will be commercial-style group accounts for the whole of the public sector, prepared by the Treasury and audited by the Comptroller and Auditor General. The main aim of the Treasury's WGA programme is the provision of better quality financial information on the Government as a whole, underpinning the decisions of government fiscal planners, helping with policy formulation and resource allocation, and improving the accountability of government to Parliament and the wider public.

1.90 The WGA programme builds upon preliminary central government sub- consolidations for the financial years 2001-02 and 2002-03 and a more complete central government consolidation process for the financial year 2003-04, all of which have been subject to National Audit Office dry-run audit procedures. Although this process has been valuable in identifying learning points regarding the timeliness of the consolidation process and issues concerning the quality of data, the government has decided to focus preparations for publication on whole of government data.

1.91 The extension of the WGA project to include local authorities, health trusts and public corporations within the accounting boundary has begun, with the 2004-05 financial year representing the first dry-run. This will be built upon in 2005-06 with a second dry-run which will be subject to a full dry-run audit, drawing on the work of auditors other than the Comptroller and Auditor General. This represents a major project, adding over a thousand bodies to the consolidation process and will require the convergence of accounting policies and timetables.

Results of the central government sub-consolidation process

1.92 The WGA programme has been designed with clearly defined "milestones" intended to identify and make necessary changes regarding accounting policies, systems and procedures in a progressive, manageable way. The initial stage in this process was to concentrate on a central government sub-consolidation encompassing the devolved administrations, central government departments and agencies, funds and non-departmental public bodies (NDPBs).

1.93 HM Treasury have been engaged in the central government sub-consolidation process for the financial years 2001-02 to 2003-04, and the central government sub-consolidation will continue to be a key element of the extension of the programme to the WGA dry-run stage. The three years to date have been marked by significant progress in a number of key areas including:

- The ability to produce robust figures for the major taxation income streams on an accruals basis;
- Recognising the assets and liabilities of the Central Funds on a full accruals basis;
- Compiling and validating pension schemes' liabilities in order to meet the implementation of FRS17 across the central government sector;
- An incremental improvement in the delivery of consolidation returns by audited bodies within the accelerating timeframes set by Treasury; and
- An incremental improvement in the ability of audited bodies to identify transactions and balances with other bodies within the sub-consolidation boundary.

1.94 Any dry run process is intended to identify issues and lessons to be learned however, and while there has been general improvement, there are a number of significant issues still to be addressed:

- Despite improvements in the timeliness of submissions, too many bodies still fail to deliver within the timeframes set by Treasury. This is a significant issue as, to be relevant and useful for fiscal management, consolidated data has to be timely. Addressing this issue appropriately will become more relevant as Treasury continues to accelerate its timetable.
- Despite improvements, a number of bodies still have difficulty in identifying transactions and balances with other bodies within the sub-consolidation boundary, and further work needs to be carried out in establishing systems to identify these items throughout the financial year. This issue is of importance to ensure that the overall picture of government finances is not unduly distorted through the inclusion of internal balances and transactions that should have been eliminated, and will become more significant with the move to WGA and the large increase in the number of bodies included within the accounting boundary.
- Improvements in the data relating to scheme membership in some unfunded occupational pension schemes will be necessary to provide certainty as to the accuracy and completeness of the liabilities of those schemes.
- Further work needs to be undertaken regarding the presentation and valuation of financial instruments and the wider disclosure of Central Funds to reflect Government's management of its financial resources, taking into account significant developments in international accounting standards.
- A number of minor taxation revenue streams still have to be calculated on an accruals basis.

1.95 The National Audit Office and Treasury continue to work together to address these and other issues relevant to the central government sub consolidation, while at the same time identifying how the lessons learnt can inform the extension to WGA. In addition, Treasury plan to use the next two years to further develop the links between the GAAP-based information and the fiscal indicators that are contained in the National Accounts, so that GAAP-based information makes a more direct contribution towards fiscal policy.

The move to Whole of Government Accounts

1.96 Work on the extension of the project to WGA has begun, and the Treasury and the National Audit Office are currently engaged on the first WGA dry-run for the 2004-05 financial year. The move to WGA will add significant extra work and complexity to the consolidation process and will entail the addition of nearly one thousand new bodies (in excess of six hundred local authorities, over three hundred NHS and Foundation Trusts, and approximately sixty Public Corporations including trading funds) to the consolidation process.

1.97 The logistical challenges of data collection, compilation and audit are significant. Many of the bodies to be included within WGA are not audited by the Comptroller and Auditor General, and as such he will need to rely on the work of other auditors. Building upon working protocols already established with Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office as part of the central government sub-consolidation, the National Audit Office is working closely with the Audit Commission and its appointed auditors (for local government and National Health Service trusts) and private firms (for public corporations and foundation trusts) to determine the scope of their work and reporting protocols.

1.98 There are a number of other significant issues that will need to be addressed as part of the wider WGA project, including:

- the convergence of different accounting policies, for example the different methods of accounting for fixed assets used by local authorities when compared to the rest of the public sector, and ensuring consistency of Private Finance Initiative accounting across the various WGA sectors; and
- finalisation of the bodies to be included.

1.99 The National Audit Office will be actively involved at all stages of the WGA process and will strive to ensure that the responses to the challenges faced adequately balance the costs of additional audit work with the need to protect the robustness of the Comptroller and Auditor General's audit opinion.

Conclusion

1.100 The move to WGA is a significant one that will have many advantages. Comprehensive, audited public sector financial information based on UK Generally Accepted Accounting Principles (UK GAAP) will be available for the first time, and will contribute significantly to policy formulation and resource allocation, and will raise the quality of debate on the public finances. The Comptroller and Auditor General remains committed to working with the Treasury and other bodies across the public sector in making a success of the WGA project and, in so doing, increasing the accountability and transparency of the whole public sector, to the benefit of Parliament and the wider public.

Looking Forward

Lord Sharman's review

1.101 In February 2001 Lord Sharman published his review of Audit and Accountability for Central Government, to recommend suitable audit and accountability arrangements for central government in the 21st century. The Government response to the review was published in March 2002.

1.102 Among the recommendations of the review was that the Comptroller and Auditor General should be appointed statutory auditor of all non-departmental public bodies (NDPBs), and that he should be given statutory access to a variety of private sector bodies in receipt of public funds where previously this depended on negotiated agreement or conventions. Ultimately, the Comptroller and Auditor General should be able to audit non-departmental public bodies that are companies and companies which are subsidiaries of non-departmental public bodies.

1.103 The Treasury has now made seven orders since 2003 under the Government Resources and Accounts Act 2000 (GRAA) extending the Comptroller and Auditor General's statutory rights of access to the bodies listed in Lord Sharman's report, as well as transferring the audits of a number of non-departmental public bodies and special health authorities.

1.104 Further to Lord Sharman's recommendation that the Comptroller and Auditor General should be able to audit government owned companies, the Company Law Reform Bill, currently being scrutinised in Parliament, promises to make the changes to UK legislation that are needed to put this into effect. The National Audit Office is in discussion with the Institute of Chartered Accountants in England and Wales, the Department of Trade and Industry and the Treasury on the practical arrangements that will be necessary to put this into effect once the new provisions become law.

International Accounting Standards

1.105 International Accounting Standards have been mandatory for European Union listed companies in their group financial statements from 1 January 2005. The Treasury has decided that the implementation of international accounting standards in central government should follow United Kingdom Accounting Standards as they converge with international standards. There is currently some debate on how and when such convergence should be achieved, but it remains likely that there will be a major change in accounting standards in the next few years. The Financial Reporting Advisory Board, on which the National Audit Office is represented, and Treasury will have to consider how these should be applied or adapted for use in the government sector. The impact of this is addressed in Part 3 of this report.

Management Commentaries

1.106 Another major development in financial reporting for the central government sector that will affect 2005-06 accounts is the requirement for a more extensive 'Management Commentary', broadly following the guidelines set out in the Accounting Standards Board's Reporting Statement: Operating and Financial Review. National Audit Office financial audit teams will review the content of their audited bodies' new style Management Commentaries for consistency with the rest of the annual report and accounts and their own knowledge of the client.

1.107 The objective of the Accounting Standards Board's guidance is that the Operating and Financial Review should be a balanced and comprehensive analysis of the development and performance of the business of the entity during the financial year; the position of the entity at the end of the year; the main trends and factors underlying the development, performance and position of the business of the entity during the financial year; and the main trends and factors which are likely to affect the entity's future development, performance and position, prepared so as to assist stakeholders to assess the strategies adopted by the entity and the potential for those strategies to succeed. However, the Accounting Standards Board's guidance is not directly applicable to the central government sector, and its application will need to be tailored to reflect the fact that public sector bodies have to provide information to a range of stakeholders for different purposes and that accountability - or stewardship - is a key consideration (rather than the decision to invest in a company as in the private sector).

PART TWO
Corporate Governance

Introduction

2.1 In recent years, both the public and private sectors 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, the Treasury requires 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 with their financial statements.

2.2 The Comptroller and Auditor General fully supports the steps taken to improve the risk management capacity of central government bodies. Today's public service delivery environment constantly presents new risks to the provision of public services, and robust risk management can help departments respond effectively and avoid failures in service delivery. Well managed risk taking also presents opportunities to deliver better public services, make more reliable decisions, improve efficiency and support innovation. The announcement in the Government's July 2004 Spending Review of its intention to achieve savings of £21.5 billion a year, staff reductions of 84,000 in support functions by 2008 and sales of £30 billion of assets by 2010 makes effective risk management even more critical. If these targets are to be successfully met whilst also meeting Public Service Agreements risks will need to be successfully managed.

The implementation of risk management across Central Government

2.3 In August 2000, the Comptroller and Auditor General commented that properly planned and managed risk taking by government departments can promote innovation and lead to improved value for money for taxpayers[1]. Partly in response to this report Departments were considering how best to devise and implement effective risk management strategies.

2.4 In 2004, the Comptroller and Auditor General looked again at the progress departments have made and published a follow-up report[2]. This report was based on a survey of the main Whitehall departments, focus groups of departmental risk managers, comparisons with private sector organisations, academic research, case studies of five departments and the work of National Audit Office financial auditors in relation to their review of departmental Statements on Internal Control. The Comptroller and Auditor General reported that departments had made good progress in embedding risk management, providing staff with greater access to training and guidance on risk management, and building a common understanding of risks they face. He noted that progress had been made particularly in defining risk objectives, having processes to report changes in risks and in regarding risk as an opportunity as well as a threat.

1 *Supporting Innovation: Managing Risk in Government Departments* – HC 864 1999-2000.
2 *Managing Risks to Improve Public Services* – HC 1078-I 2003-2004.

2.5 The Comptroller and Auditor General highlighted a number of areas where more needs to be done. Only one quarter of the departments surveyed by the National Audit Office were confident that they had established an overall view about their exposure to risk. The management of working relationships with partner organisations needs to be strengthened, particularly where there are complex delivery networks or where clarity is lacking about which delivery organisation is responsible for different risks. More progress is needed to embed risk management in the day to day activities of departments, particularly by making sure that there is a sufficient critical mass of staff with well developed skills and expertise to manage risk effectively.

2.6 The report identified five key aspects of risk management which, if more widely applied, could contribute to better public services and increased efficiency:

- Sufficient time, resource, and top level commitment needs to be devoted to handling risks;
- Responsibility and accountability for risks need to be clear and subject to scrutiny and robust challenge;
- Judgements about risks need to be based on reliable, timely and up to date information;
- Risk management needs to be applied throughout departments' delivery networks;
- Departments need to continue to develop their understanding of the common risks they share and work together to manage them.

2.7 Overall, while significant progress has been made by departments to improve their risk management, the Comptroller and Auditor General concluded that they have further to go to demonstrate that they have made effective risk management a central part of their day to day general management processes in a way that can fully deliver improved performance and other benefits. They need to continue to develop their ability to take risks and innovate, to keep projects and programmes on track, to handle complex service delivery networks, and to be ready to respond to unexpected events.

2.8 In July 2005 the Treasury introduced a Governance Code for Central Government along the lines of the Combined Code applicable to listed companies in the private sector. Departments were asked to apply the code principles flexibly in the context of their own circumstances. The code requires the board of each department to give a clear account of how far it has complied with key aspects of the code, including an explanation of why any alternative approach has been chosen (for example, overriding legal constraints). This report on the department's corporate governance will form part of the material accompanying its resource accounts for 2005-06, and the National Audit Office's financial audit teams will review these reports.

Corporate Governance and Risk Management – the role of the National Audit Office

2.9 The National Audit Office continues to work closely with audited bodies and their Audit and Risk Committees in assisting in the development of corporate governance arrangements and, more broadly, risk management procedures. As well as contributing to enhanced disclosures in Statements on Internal Control, auditors have given active support, encouragement and advice to help audited bodies to develop underlying internal control procedures.

2.10 The National Audit Office's financial audit methodology is a risk-based approach, involving explicit 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 leaves the auditors well placed to make recommendations for improvements to the client's internal control framework, including its approach to risk management.

2.11 On a more strategic level, the National Audit Office has continued to participate in various events to aid clients and their audit committees in developing their corporate governance arrangements. For example, the National Audit Office was pleased to provide speakers for the Treasury's Managing Risks to Improve Public Services Conference in February 2005 aimed primarily at central government audit committee members.

2.12 The National Audit Office regard well functioning audit committees as a key to achieving good corporate governance and consequently have been developing a range of guidance and tools to assist public sector audit committees. A key output in this regard has been the development of a self-assessment toolkit for audit committees. This uses externally facilitated meetings to help the chairs of all the bodies in the same departmental family to address common strategic issues.

2.13 The National Audit Office also contributes to the continuing development of advice in the audit of corporate governance through participation in such bodies as the Public Audit Forum, the Auditing Practices Board and the International Organisation of Supreme Audit Institutions (INTOSAI). Representatives of the National Audit Office served on the working group that developed the new INTOSAI Standard on Internal Control which was published in November 2004 and are part of the working group that is producing an addendum to the guidance to take account of international developments in matters such as enterprise risk management.

2.14 The National Audit Office is also well placed to identify good practice in specific areas within its client base and to share that good practice across wider audiences. In this regard, the National Audit Office recently undertook a review of corporate governance of Sponsored Bodies, paying particular attention to the risks to corporate governance of progressing departmental objectives and deliveries through Executive Agencies and Non-Departmental Public Bodies.

2.15 This review considered how effective corporate governance of sponsorship arrangements in the public sector can be achieved, the specific issues that arise from sponsorship arrangements and how these can best be integrated within the overall corporate governance arrangements of sponsors and sponsored bodies. The National Audit Office looked at the variety of sponsorship structures in place and developed a model of the essential dynamics of an effective sponsorship relationship. The review[3] included a framework of key questions and suggested action points for sponsor departments and their sponsored bodies to consider when reviewing the effectiveness of sponsorship arrangements.

Corporate Governance – Future Developments

2.16 The two year Risk Programme, launched by the Prime Minister in 2002 and led by the Treasury, was established to give focus and drive to departments in the development of plans and frameworks designed to make effective risk management a reality. The Programme came to an end in December 2004 and, following the C&AG's report on Managing Risks to Improve Public Services which highlighted that it is critical for departments to build on the momentum achieved to date, the National Audit Office jointly hosted with the Treasury a conference in February 2005 to provide further stimulus for departments to maintain their efforts to fully embed risk management in their day to day activities.

2.17 The Conference was aimed at members of the Public Accounts Committee (PAC) and Accounting Officers of all Government Departments and agencies. It provided an opportunity to take stock of progress in improving risk management across government, and discuss what specific further improvements are needed in light of the Treasury's cross Departmental Risk Programme, the Comptroller and Auditor General's own Report on risk management, and the PAC's subsequent conclusions to further improve risk management and encourage well managed risk taking.

2.18 The Treasury is currently revising the 'Audit Committee Handbook'. This is to reflect the evolving role of audit committees in the central government sector and the modified governance arrangements envisaged by the Central Government Code for Corporate Governance. The revision will also give greater consideration to the role of audit committees in executive non-departmental public bodies. The National Audit Office has been involved in the initial discussions on the revision of the handbook and will comment on the formal consultation draft which is expected to be released in Spring 2006.

3 *Corporate Governance of Sponsored Bodies*: a review by the National Audit Office, November 2004.

PART THREE
Adding Value

Introduction

3.1 The range of financial audit work undertaken by the National Audit Office continues to evolve and this part of the report describes the additional audit services provided by the National Audit Office. The recent developments in this area reflect the commitment on behalf of the Comptroller and Auditor General to further contribute to the improvement of financial management and effective financial control across the United Kingdom central government sector.

3.2 This contribution can be made in many ways, most directly by reporting to the audited body on issues identified through the audit process and added value work. This role is supplemented through the direct secondment of National Audit Office staff to government bodies, and advice given on accounting treatments and developments. In addition, active participation by staff in relevant external bodies and organisations helps shape the auditing and accounting framework for the central government sector, at the same time as influencing the wider United Kingdom and international environment that central government operates within.

Reporting to the Audited Body

3.3 The primary objective of the National Audit Office's financial audit is to provide independent assurance, information and advice to Parliament on the proper accounting and use of public resources. A subsidiary, but nevertheless important, objective is to assist audited bodies to improve their financial and risk management.

3.4 As part of the audit process, National Audit office staff assess the adequacy of a body's accounting systems and financial controls to the extent necessary to form an opinion on the accounts. In undertaking this work, they are able to offer constructive advice to the audited body where they identify weaknesses in the design, operation or application of these systems and controls, and to recommend potential improvements that could be made to the effectiveness or efficiency of the body's operations.

Management Letters

3.5 Throughout the course of an audit National Audit Office staff provide advice – often orally – to their audit clients. And at the end of the audit the National Audit Office formally raises the more significant issues in a management letter to each audited body. The management letter reports the results of the audit, informs the client of the internal control and financial management weaknesses that have been identified as a result of the audit work, and makes recommendations on how those controls and management procedures may be improved. It will also comment, where necessary, on the client's accounts production process and make recommendations to improve the quality and timeliness of the draft accounts produced for audit.

3.6 The overall results of the Comptroller and Auditor General's financial audit work in the period covered by this report indicate that, in general, the standards of financial control in audited bodies remains high. However, the Comptroller and Auditor General has made a number of recommendations for improvements to the majority of clients' control environments and accounting processes.

3.7 Whilst the recommendations raised are tailored to the particular circumstances of each client, a number of common themes emerged during the audit of the 2004-05 accounts. Many of the observations and recommendations referred to actions required to improve the speed and accuracy with which accounts are produced in order to facilitate the faster closing initiative. One management letter, in a comment that will apply to many audited bodies, noted that "the demands presented by the Faster Closing timetable for 2005-06 require re-engineering of the accounts preparation and audit process".

3.8 A common response to this need is a 'hard close' – preparation of complete and accurate interim accounts at, for example, two or three months before the year end as well as high quality year end accounts. Other points raised in this regard were the need to ensure adequate resourcing of the finance and accounting functions; the development of embedded in-year processes; better management of consolidation processes; and enhanced project management of the accounts preparation process. Underpinning all these proposals is the need for the continued, and in some cases enhanced, involvement of senior client management.

3.9 Overlapping the issues raised under the umbrella of faster closing there were a number of other common themes in the management letters, including recommendations to:

- improve the evidence for and review of disclosures in the accounts presented for audit to avoid inconsistent, incomplete and omitted disclosures;
- clarify the legislative authority for certain areas of expenditure;
- institute, and develop controls over, reconciliations of various sets of data – particularly of payroll and personnel records – to strengthen financial control of key balances;
- emphasise the need for comprehensive identification and appropriate calculation of accruals;
- encourage progress in complying with Whole of Government Accounts reporting requirements and meeting the reporting deadlines;
- enhance budgetary forecasting, control and reporting capabilities;
- develop the management of relationships with departments' sponsored Non-Departmental Public Bodies, and with contractors for outsourced accounting functions, to ensure the appropriate level of control and monitoring; and
- continue to improve the control and accounting of balance sheet items, in particular fixed asset accounting and provisions.

3.10 Audited bodies are generally proactive in implementing recommendations raised by the Comptroller and Auditor General, though in some cases recommendations arising from the previous year's financial audit are ongoing or have as yet only been partially actioned. The Comptroller and Auditor General continues to work with clients, and where relevant their audit committees, to follow up and review the process of implementation of his recommendations.

Financial Impacts

3.11 Our financial audit approach is designed to provide us with the robust, risk-based means of providing the Comptroller and Auditor General with assurance to allow him to give his opinion on the financial statements and to recommend process and financial management improvements. However, securing financial impacts as a result of our work is also important.

3.12 These impacts, which are agreed with the department to which we have made recommendations, demonstrate the benefit of our work in terms of savings to the United Kingdom taxpayer. Currently our work overall generates savings of £8 for every £1 that we cost, although from 2007, the Comptroller and Auditor General has made a commitment to Parliament that this ratio will increase to £9 for every £1 that we cost.

3.13 In order to achieve this, we have been working on a series of initiatives to enhance the impact of our work. For the calendar year 2005, the £8 target has already been met and is likely to be exceeded. Both the number and value of the impacts arising from our financial audit work is increasing with estimated impacts of £120 million from 2005.

3.14 Examples of financial impacts generated are detailed in the table below:

Financial Impacts Generated as a Result of Financial Audit Work on 2004-05 Accounts

1 An impact of £8.4 million arising from using a model to predict expected payments, as part of audit certification work. During our audit we developed a methodology to predict the payments due to third parties. This work revealed significant overpayments. The department used this work to agree recoveries of £8.4 million.

2 We worked with a client to establish whether their controls over the payment of training allowances to eligible individuals were sufficient to ensure that the allowance was stopped as soon as any individuals ceased to attend the relevant training. This revealed the absence of a full audit trail and an estimated £7 million of overpaid allowances in 2004-05 that could be pursued for potential recovery.

Added Value Assignments

3.15 The Comptroller and Auditor General supplements his annual audit of accounts by a selective programme of project work – the Good Governance Programme. Often, the timescale and tight focus of financial audit prevents the National Audit Office from examining emerging findings in the depth or detail that they, or the client, might like in order to identify how improvements might best be delivered. Good Governance projects offer an opportunity to go beyond the process of 'holding to account' towards more explicitly helping organisations to improve.

3.16 These projects are discrete assignments which examine specific issues in greater depth. The programme of work is designed to enhance the quality of service provided to Parliament and audited bodies by examining key issues of propriety, governance and financial management. It also provides an opportunity to improve financial management and secure efficiency gains that are not essential parts of the financial audit certification process. The main criteria of this work however, is that the assignments are designed to focus on issues where the Comptroller and Auditor General feels he can 'add value' to the audited body.

3.17 The identification of such assignments can arise from a number of sources: as part of the risk analysis that informs the audit planning approach; as a response to a weakness identified as part of the financial audit process; in response to concerns raised by Audit Committees or management; or to address concerns raised by Members of Parliament regarding the propriety or economy of particular areas of public expenditure.

3.18 As well as using such assignments to improve financial management and promote beneficial change for individual clients, the Good Governance programme offers the Comptroller and Auditor General the opportunity to perform central government wide reviews focussed on specific areas of governance or financial management with the aim of identifying and disseminating good practice. In addition, the programme facilitates the communication of areas of good practice identified at one client across the relevant departmental family or the wider central government sector as appropriate.

3.19 The results of assignments will be communicated to the audited body by various means; such as presentations, workshops or internal reports to management. Some assignments may lead to the publication of findings particularly where issues of wider application are identified.

3.20 Audited bodies have been very receptive to the assignments performed to date, and have implemented a variety of improvements in their controls and governance structures as a result of the work.

Examples of Areas Covered by Added Value Assignments Related to Financial Audit Work on 2004-05 accounts

1 An independent examination of best practice in delivering services to end-users for a major department

The National Audit Office examined recent developments and consulted with sector experts in a specific area of service delivery. As a result of the work undertaken, the National Audit Office highlighted a number of areas of good practice and common pitfalls to be avoided that would contribute to improving service delivery without increases in cost.

2 A review of the controls and processes operating in the Financial Service Centre used by a major agency

The National Audit Office assessed the controls and processes operating at the Financial Service Centre used by a major agency in light of a significant change in senior staff and procedures. This review resulted in a number of significant recommendations being made, which aided the Centre in improving its standards to enable them to match the benchmark standard seen in the private sector.

3 Facilitated Workshops with the Audit Committees of a number of clients

The National Audit Office has been invited to aid Audit Committees at a number of clients by facilitating their annual self assessments. In one example the National Audit Office reviewed the action plans and papers of an Audit Committee and held meetings with the members and senior management. As a result of this the Audit Committee was presented with an action plan which has improved the effectiveness of its oversight function.

4 A joint audit of debt collection at a major department

The National Audit Office undertook, with colleagues from the Departmental Internal Audit team, a joint audit of debt management and collection procedures. As a result of the work undertaken, the National Audit Office made a number of recommendations covering all aspects of the debt management process, which if implemented should result in a significant increase in annual recoveries.

National Audit Office Contribution to Faster Closing

3.21 Part 1 of this report referred to the Treasury's 'Faster Closing' initiative within the context of commenting upon the timeliness of departments rendering accounts for audit. Departments have made progress in working to improve the speed of delivery of their accounts, but significant improvements will be needed of a number of departments if they are to meet the accelerated timetable and lay their 2005-06 resource accounts before Parliament by 25th July 2006, the provisional date for the start of the Summer Recess. Twenty-five departments were able to meet the summer recess timetable for their 2004-05 accounts but a large portion of the remainder will need to accelerate their accounts production process by more than 90 days if they are to meet pre-recess timetable for 2005-06.

3.22 The Comptroller and Auditor General has worked continually with both Treasury and audited bodies in addressing the challenges which are posed by faster closing. The National Audit Office issued guidance to departments on faster accounts closure through the publication of the booklet, 'Ready, Steady, Go' which aims to highlight best practice in both the public and private sectors in meeting the challenges of faster accounts closure. A companion publication to 'Ready, Steady, Go' has also been issued, which provides updated, practical guidance for those involved in the preparation of resource accounts. Previously, National Audit Office staff were directly involved in consultation on the Treasury's guidance booklet for departments 'Managing Resources – Faster Closing' and staff have continued to participate in various seminars to help promote the faster closing message to departments.

3.23 As part of the Comptroller and Auditor General's on-going commitment to the initiative, National Audit Office staff have liaised closely with Treasury during the year to review progress against timetable. We will continue to work closely with Treasury to monitor progress as we approach the summer recess in 2006.

3.24 The Comptroller and Auditor General is committed to ensuring that the faster closing plans implemented by departments accurately reflect their current capabilities. To this end, recent revisions to the National Audit Office's financial audit methodology are designed to contribute directly to improvements in these capabilities. Faster Closing will depend not only on a more sophisticated year end process, but upon sound financial management operated by departments throughout the financial year. The production of robust and accurate financial information must be a monthly discipline that is not performed for its own sake, but which directly contributes to the financial monitoring and effective management of government departments. This in turn will lead to further efficiencies in the audit process, allowing the Comptroller and Auditor General to undertake large amounts of his audit work before the financial year end, hence further contributing to the accelerated certification timetable.

3.25 The National Audit Office provided further training to financial audit staff during the year to support the initiative and facilitate the adoption of 'hard close' audits under which the major part of the audit testing is undertaken before the end of the accounting period. This is only feasible where departments have a robust management accounts function and are able to produce timely and complete financial statements.

National Audit Office Contribution to the Efficiency Agenda

3.26 The Comptroller and Auditor General has always been highly supportive of initiatives designed to improve efficiency within central government. The drive for efficiency has gained a new impetus from the review led by Sir Peter Gershon, the then Head of the Office of Government Commerce, of public sector efficiency which aimed to release major resources into frontline services by reducing bureaucracy and undertaking activities more efficiently. The review recognised the key role that financial management has to play in the efficient use of resources and the delivery of efficiency programmes.

3.27 The National Audit Office has established an efficiency 'centre of excellence' to draw together and raise the profile of the existing work on efficiency within the Office and to take forward the further development of the National Audit Ofice's approach to assessing organisational efficiency. An early output has been the publication of a cross cutting report in February 2006, 'Progress in improving government efficiency' (HC 802-I 2005-06) which assesses progress in achieving efficiency gains and is supplemented by a survey of good practice drawn from public, voluntary and private sectors and from overseas.

3.28 Following the Gershon Review, the government announced, in the July 2004 Spending Review, that all departments would have professional Finance Directors reporting to the Permanent Secretary with a seat on the Departmental Board by December 2006.

3.29 The Treasury have also conducted a department-by-department review of the effectiveness of financial management, led by Mary Keegan. These reviews began in late 2004 with the largest spending programmes followed by a second phase of reviews in 2005. Issues such as accountability structures, planning and budgeting, production and use of financial information and the effectiveness and efficiency of the finance function were considered. The Deputy Comptroller and Auditor General was a member of the steering group and a senior National Audit Office representative sat on each of the review teams.

3.30 An Action Plan has been derived for each department to be taken forward between Treasury and the department. Senior National Audit Office staff responsible for the audit of each department have assessed the Action Plans and other findings from the reviews against the Office's current and proposed work plans and have discussed with the senior management of the department how we can contribute to achievement against the Action Plan. A number of pieces of work have resulted or are planned in areas such as the development of self assessment tools and workshops to assist board members in reviewing risks in financial management and governance systems, reviews to identify areas for improvement in financial forecasting and in-year monitoring systems, and the development of project plans to help departments to improve the timeliness of their annual financial reporting. At a corporate level, National Audit Office staff are continuing discussions with the Treasury as to how the Office can contribute to any cross-cutting action that they decide to take.

3.31 The Comptroller and Auditor General warmly welcomes these measures designed to improve the level of skills, experience and effectiveness in financial management. National Audit Office staff will continue to work closely with Finance Directors and other senior finance staff to provide advice and assistance where possible in improving the contribution of the finance function to financial management across departments.

3.32 The 2004 Spending Review also introduced departmental efficiency targets. These were supplemented with a wide range of initiatives designed to cut administrative cost and achieve efficiency gains across the public sector totalling £21.5 billion a year by 2007-08.

3.33 As part of this initiative, we have recently completed three reviews of service delivery chain efficiency jointly with the Audit Commission. This joint approach has allowed a unique view of the way PSA targets are designed and delivered to inform and contribute to Whitehall and the wider public sector's thinking as they approach Spending Review 2007. The three reports looked at childhood obesity, housing markets (the affordability and availability of housing) and the provision of bus services. A separate generic report highlighting principles of good practice has also been published. We have also provided joint assessments with the Audit Commission of efficiency measurement proposals for 18 main government departments as set out in their Efficiency Technical Notes.

Departmental Capability Reviews

3.34 Last October, Sir Gus O'Donnell, the Cabinet Secretary, announced before the Public Administration Committee, the launch of Departmental Capability Reviews. These will assess how well equipped Departments are to meet delivery challenges and also to provide targeted support to meet any improvements required. The reviews will examine the strategic and leadership capabilities of departments, how well they run human resources, IT and financial management and how well they engage with their key stakeholders, partners and the public.

3.35 The National Audit Office has seconded a Director to work on these reviews, and also considers that its own work on capability issues might provide a valuable contribution. The Comptroller and Auditor General has written to the Cabinet Secretary with some recommendations on capability issues.

National Audit Office support to the agenda of the United Kingdom Presidency of the European Union

3.36 During 2005, the European Commission developed a 'roadmap' designed to move the European Union towards a clear audit certificate (known as a positive Statement of Assurance). The roadmap was published in June 2005, just prior to the start of the United Kingdom's Presidency of the European Union for the latter half of 2005. The National Audit Office provided support to the United Kingdom Presidency to help develop the roadmap. Specifically, we worked with the Treasury to analyse the Commission's proposals. This analysis informed a meeting of an expert panel in September 2005 which met to discuss the proposals. The expert panel was supported by three working groups, one of which we chaired jointly with the Commission.

3.37 Following the publication of the European Council's conclusions on the roadmap, the European Commission published an Action Plan designed fill the gaps between the current system of internal controls and that proposed by the Commission. One action relates directly to the work of state audit institutions (SAIs) like the National Audit Office, suggesting that Member States should invite their Parliaments to ask their SAIs for audit and assurance on European Union funding. We are currently considering how to take that forward.

Working with the Audit Commission

3.38 The National Audit Office have had close contacts with the Audit Commission for a number of years and both bodies consult regularly on common issues. On specific financial audit matters joint discussions have been held over Whole of Government Accounts, the Comptroller and Auditor General's audits of national NHS accounts (where, for example, we will be using Audit Commission Auditors to audit most Special Health Authorities over the next two to three years), our work with the Department of Health in its faster closure of accounts agenda and our access to the Registered Social Landlords.

3.39 There are an increasing number of initiatives either recently completed or currently underway to work more closely together. These aim to maximise the benefits of each body's respective knowledge and experience, and reduce the risk of duplication. For example, in addition to the three delivery chain studies, in June 2005 we published a joint report on Financial Management in the NHS to accompany the National Audit Office's work on the NHS Summarised Accounts. And in May 2005 we held a joint meeting of the two bodies' management committees.

Working with Internal Audit

3.40 The internal audit function operates as a service to the management of each audited body by measuring and evaluating the effectiveness of its internal control systems, while also performing an increasingly important role in risk management procedures. Internal audit therefore constitutes an important part of the systems of control within each organisation. To be most effective, internal auditors should be afforded the appropriate independence from management, reporting directly to the Accounting Officer and the body's Audit or similar corporate governance Committee.

3.41 The Comptroller and Auditor General considers the work of internal audit and seeks wherever possible to take assurance from its work. This reliance, facilitated by regular liaison and collaboration, provides audit cost savings to the audited body by reducing the overall audit burden.

Secondments to Audit Clients

3.42 The National Audit Office has an active programme of secondments to client organisations. This is an important aspect of our support for other organisations. It has benefits for the individual, for the Office and for the host organisation. Such arrangements provide opportunities for the secondee to gain a greater understanding of the operating environment of the client, while at the same time enabling them to contribute to the quality of financial management at the organisation concerned by using their skills and experience to encourage change.

3.43 The NAO also supports a series of inward secondments from partner organisations and clients. These provide the NAO with external expertise and experience, encouraging cross fertilisation of ideas, techniques and approaches. Inward secondments also provide training and experience to staff from other state audit institutions e.g. the Netherlands, Australia and New Zealand, as well as UK organisations.

3.44 There are currently 25 National Audit Office staff on secondment to a range of domestic and overseas organisations. These include House of Commons Select Committees and the House of Commons Scrutiny Unit, the Department for International Development and the Foreign and Commonwealth Office. Overseas organisations benefiting from the Office's experience include the North Atlantic Treaty Organisation, the European Commission and the Office of the Auditor General in New Zealand.

Representation on Professional Bodies

3.45 The Comptroller and Auditor General and staff from the National Audit Office also continue their participation in the development of new accounting and auditing guidance through active participation on a number of professional bodies, while also continuing to work with those bodies tasked with strengthening oversight within the profession.

3.46 The Comptroller and Auditor General is the Chairman of the Professional Oversight Board for Accountancy. He also has observer status on the Financial Reporting Council and is a member of the Financial Reporting Review Panel.

3.47 National Audit Office staff sit on a number of committees, such as the Institute of Chartered Accountants in England and Wales' Public Sector Audit Committee and the Chartered Institute of Public Finance and Accounting's Accounting and Auditing Standards Panel. The National Audit Office has representation on the Auditing Practices Board's Public Sector Sub Committee and the Public Audit Forum and a member of staff has been seconded to the Accounting Standards Board.

3.48 In addition to fulfilling its duties to Parliament, the National Audit Office seeks to play a full part in the development of public sector audit around the world on behalf of the United Kingdom. The Comptroller and Audit General is currently a member of the United Nations Panel of External Auditors, a member of the Governing Board of the International Organisation of Supreme Audit Institutions (INTOSAI) and a member of the Contact Committee of the European Court of Auditors. He also has observer status on the Governing Board of the European Organisation of Supreme Audit Institutions.

3.49 A member of National Audit Office senior management board has been appointed chair of the Public Sector Committee of the Federation des Expert Comptables Europeans. The Committee promotes the exchange and acceptance of international best practice in public sector auditing and its members include all member states of the European Union, as well as Norway and Switzerland. In addition, National Audit Office staff are active on a number INTOSAI bodies, such as the Auditing Standards Sub-Committee and the Internal Control Standards Sub-Committee.

Contribution to National and International Accounting and Auditing Developments

3.50 An important aspect of the role of the Comptroller and Auditor General is to contribute towards the shaping of accounting and auditing best practice within the central government sector. This role also extends to the wider public sector, as well as to the national and international context within which central government bodies operate. This is achieved through the provision of direct advice to client bodies, through the shaping of accounting developments in general, and through active participation in a range of professional bodies.

International Accounting Standards

3.51 From 1 January 2005 listed companies in the European Union member states have been required to adopt European Commission endorsed International Accounting Standards (IAS) issued by the International Accounting Standards Board in their group financial statements. In addition to European Union member states, over 70 other countries permit or require the use of IAS by some or all or their domestic listed companies, or have announced plans to do so. In the United Kingdom, the Department of Trade and Industry has decided that listed companies may adopt IAS in their individual accounts as well as their group accounts from 2005 onwards and that non-listed companies can choose to adopt IAS if they wish.

3.52 In order to minimise the inconsistency and disruption arising from the concurrent use of two sets of accounting standards, the Accounting Standards Board (ASB) intends to bring United Kingdom accounting standards into close convergence with international accounting standards over the next few years. However there has been some debate recently regarding new international accounting standards and the complexities of converging UK and international standards on a piecemeal basis. It is possible that the body of international accounting standards will be adopted on a 'big bang' basis in 2009.

3.53 Almost all of the 500 or so central government accounts that the Comptroller and Auditor General audits are prepared in accordance with United Kingdom Generally Accepted Accounting Practice, which includes adherence to accounting standards, adapted as necessary by the Treasury to be meaningful in the central government context. The Treasury consider that generally accepted accounting practice could be met by either international or existing United Kingdom standards but have decided that the government sector should broadly follow the ASB timetable for convergence rather than the European 2005 deadline for listed companies. There is thus likely to be a major change in accounting standards over the next few years and the Financial Reporting Advisory Board[4], on which the National Audit Office is represented, and Treasury will have to consider how these should be applied or adapted for use in the government sector. In this respect various difficult issues surrounding the implementation of international standards dealing with financial instruments have already arisen for consideration by the Financial Reporting Advisory Board.

International Auditing Standards

3.54 The National Audit Office, along with auditors in the private sector, is complying with International Standards on Auditing (UK and Ireland) (ISAs(UK and Ireland)) for audits of accounting periods commencing on or after 15 December 2004. These standards will therefore be applied to the audit of our 2005-06 accounts. The National Audit Office adopts a risk based approach to audit and

4 The Financial Reporting and Advisory Board is an independent body that advises on the application of financial reporting principles and standards for government. The membership of the Board reflects the relevant spread of interests, as well as ensuring its independence and accounting expertise.

a comprehensive understanding of the activities of a client forms the cornerstone of all National Audit Office audits. ISAs (UK and Ireland) build upon this approach and the National Audit Office has reflected the additional requirements arising from the implementation of the standards into the Office's audit methodology. The key changes reflect developments in the audit approach to the assessment of fraud and its place in the risk assessment; and the placement of the risk assessment of fraud at the very centre of the planning process. All financial audit staff have received comprehensive training on ISAs (UK and Ireland).

3.55 The National Audit Office continues to work with standard setters to ensure that the requirements of the central government sector are fully reflected in any revisions of auditing standards. For example, a number of National Audit Office staff are members of International Auditing and Assurance Standards Board task forces and provide a public sector perspective to the revision of existing ISAs. The National Audit Office is also represented on the Institute of Chartered Accountants in England and Wales' International Standards on Auditing Implementation Sub-Committee

3.56 The Auditing Practices Board's Practice Note 10 'Audit of Financial Statements of Public Sector Entities' has been revised to reflect the new ISAs (UK and Ireland), and the new version was published on the 25th January 2006. The Practice Note provides additional guidance to auditors of public sector entities. This work was undertaken by a working party of the Auditing Practices Board's Public Sector Sub-Committee which was chaired by a representative of the National Audit Office.

Provision of Accounting Advice

3.57 The provision of accounting advice to audited bodies is an important aspect of financial audit, to help meet the requirements of resource accounting. Government bodies have to exercise judgement in deciding upon the accounting treatment for assets, liabilities and financial transactions, and the Comptroller and Auditor General is responsible for advising on such treatments and for concluding on the appropriateness of the accounting judgements made by the bodies concerned. Looking forward, it is anticipated that the implementation of International Accounting Standards will give rise to a significant number of enquires and requests for assistance.

3.58 During the period covered by this report, the Comptroller and Auditor General assisted the management of audited bodies by providing technical advice on a range of issues. An important area of advice continues to be the accounting issues surrounding complex transactions such as the private finance initiative.

Accounting for Complex Transactions – The private finance initiative and off balance sheet financing

3.59 Public private partnerships, and more specifically the private finance initiative (PFI), remain a major method of infrastructure procurement in central government, in local government and the health service. The Comptroller and Auditor General continues to carry out a wide range of value for money audit work on PFI and associated matters. The use of PFI deals also raises significant issues of accounting judgement in terms of how transaction streams and assets should be treated in the accounts of government bodies.

3.60 Obtaining good quality services at value for money should, of course, be the major incentive of PFI deals. But in addition to that objective, there are also more practical incentives for public sector bodies to structure projects so that the assets (and the corresponding liability to pay for the asset) are not recorded on their balance sheet. This has been particularly the case in the local authority and health sectors. For instance, in the local authority sector, 'PFI credits' allowing projects to go forward have been conditional upon the local authority obtaining off balance sheet status for the project. These incentives may present a temptation to public sector bodies not only to diverge from good accounting practice, but also to structure contracts so as to achieve off balance sheet treatment rather than the best possible value for money.

3.61 For those public sector bodies audited by the Comptroller and Auditor General, he works closely with the body concerned to ensure that the accounting treatment for individual projects is appropriate, and he has made it clear to departments that where he considers that the liabilities arising from off-balance sheet 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.

3.62 But, in the light of budgetary pressures, and notwithstanding the guidance on PFI accounting from both the Accounting Standards Board (Financial Reporting Standard No 5 (FRS 5), Application Note F) and the Treasury (PFI Taskforce Technical Note No 1), it is clear that differing interpretations of the accounting guidance have been applied to projects in different parts of the public sector. Thus a number of new buildings or refurbishments of buildings in other parts of the public sector which the Comptroller and Auditor General would have expected to have been accounted for on the relevant public sector body's balance sheet have not been so accounted for. This will have an impact on Whole of Government Accounts incorporating the local government and health sectors.

3.63 It is also apparent that a number of property assets built under PFI, such as a number of PFI schools and hospitals, 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 and at the behest of the Financial Reporting Advisory Board, the Comptroller and Auditor General has worked with the Treasury and the other UK public sector audit agencies to investigate the factors behind the seemingly inconsistent treatments and to consider whether changes to the guidance are necessary.

3.64 These issues are not new and the Comptroller and Auditor General has previously brought attention to them in his General Reports for 2001-02, 2002-03 and 2003-04, and the Financial Reporting Advisory Board has expressed similar concerns in its last three annual reports. And they will come into sharper focus as we move towards the production and eventual publication of Whole of Government Accounts. It is disappointing, therefore, to report that there seems to have been little visible progress in the revision of the relevant Treasury accounting guidance or the lessening of the incentives that lead public sector bodies to seek off balance sheet status for their projects. While there is ongoing work at the International Standards Board's International Financial Reporting Interpretations Committee to develop some guidance for PFI-type contracts that may provide some principles that can be applied in this area, that work is fairly limited in scope and is intended for the private sector operators rather than the public sector purchasers.

Correspondence with Members of Parliament and members of the public

3.65 The Comptroller and Auditor General receives a wide range of correspondence from MPs and members of the public. Some letters require significant amounts of detailed research, but for straightforward cases he aims to reply to MPs within fifteen working days and to members of the public within a month. The Office also receives a number of requests for information under the Freedom of Information Act which came into effect on 1 January 2005. Ninety-nine Freedom of Information requests were received in 2005, and replies were sent to the vast majority within a twenty day deadline.

3.66 The C&AG is also designated (section 43F of the Employment Rights Act 1996, as amended by the Public Interest Disclosure Act 1998) as a 'prescribed person' to whom 'whistleblowing' disclosures may be made by employees suspecting malpractice in the workplace where they reasonably believe that the allegations made are substantially true. He is responsible for receiving disclosures in areas which fall under his jurisdiction. Schedule 2 to the Public Interest Disclosure (Prescribed Persons) (Amendment) Order 2003, made under the Act, defines his remit as 'the proper conduct of public business, value for money, fraud and corruption in relation to the provision of centrally-funded public services'. The Office hosts a dedicated telephone line for whistleblowers, the number for which is publicised on the Office website.

APPENDIX ONE

Outturn of all Resource Accounts 2004-05

This summary records the outturn for Resources Accounts as follows:

Resources	**Gross expenditure**	**£000**	**£000**
	Estimates:		
	Original Estimates	390,495,245	
	Supplementary etc. Estimates	16,711,951	
			407,207,196
	Actual		391,836,743
	Saving		15,370,453
	Appropriations in Aid		
	Authorised:		
	Original Estimates	42,003,876	
	Supplementary etc. Estimates	2,901,578	
			44,905,454
	Applied		43,981,177
	Deficiency		924,277
	Net Expenditure		
	Estimates:		
	Original Estimates	348,491,369	
	Supplementary etc. Estimates	13,810,373	
			362,301,742
	Actual		347,855,566
	Saving		14,446,176
Cash	**Net Expenditure**		
	Estimates:		
	Original Estimates	326,136,312	
	Supplementary etc. Estimates	13,695,713	
			339,832,025
	Actual		325,372,584
	Saving		14,459,441

Consolidated Fund Extra Receipts Consolidated Fund Extra Receipts Surrenderable recorded in the Resource Accounts amount to £11,005,046,000.

APPENDIX TWO

Accounts audited by the Comptroller and Auditor General

Type of account (2003-04 figures in brackets)	**Number audited**	**Opinion qualified**[1]
Resource Accounts[2]	55	2
	(56)	(4)
Executive Agency[3]	80	1
	(87)	(0)
Other UK accounts audited under statute or by agreement[4]	393	10
	(416)	(13)
Total 2004-05	528	13
Total 2003-04	559	17

NOTES

1 Appendix 3 provides details of the accounts qualified.

2 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.

The total of 55 resource accounts includes the House of Lords Resource Account. This is a non-statutory account which is laid in the House of Lords.

3 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.

4 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.

APPENDIX THREE

Accounts qualified by the Comptroller and Auditor General

Resource Accounts 2004-05

Department for Work and Pensions	Limitation of Scope
	Regularity
	Excess Vote
Home Office	Disclaimer

Other Accounts Qualified

Social Fund 2003-04

Social Fund 2004-05

Inland Revenue Trust Statement 2004-05

Ordnance Survey 2004-05

Advisory, Conciliation & Advisory Service (ACAS) 2004-05

Community Fund 2004-05

MOD Police and Guard Agency 2004-05

Child Support Agency: Client Funds Account 2004-05

National Treatment Agency 2004-05

NHS Pensions Agency Administration Account 2004-05

Northern Ireland Policing Board 2004-05

Printed in the UK for the Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
186425 03/06 7333