

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.



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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.