National Audit Office

HM Treasury

Certificate and Report of the Comptroller and Auditor General: Whole of Government Accounts 2010-11

This is an extract from the Certificate and Report of the Comptroller and Auditor General on the Whole of Government Accounts 2010-11

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

Amyas Morse
Comptroller and Auditor General
National Audit Office

29 October 2012

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

I certify that I have audited the financial statements of the Whole of Government (the Accounts) for the year ended 31 March 2011 under the Government Resources and Accounts Act 2000. These comprise the Consolidated Statement of Revenue and Expenditure, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Taxpayers' Equity, the Consolidated Cash Flow Statement, the related notes and Annexes 1 to 4. These financial statements have been prepared under the accounting policies set out within them.

Respective responsibilities of the Accounting Officer and auditor

As explained more fully in the Statement of Accounting Officer's Responsibilities, the Accounting Officer is responsible for the preparation of a consolidated account for a group of entities each of which appears to HM Treasury to exercise functions of a public nature, or to be entirely or substantially funded from public money, which presents a true and fair view of the state of affairs of the whole of government and of its net deficit, changes in taxpayers equity and cash flows for the year then ended. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the Whole of Government and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by HM Treasury; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Foreword, Introduction and the Commentary to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

Basis for qualified opinion on the financial statements

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

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

However, in Note 1.22.1 to these Accounts, HM Treasury defines the accounting boundary for the Accounts by reference to those bodies classified as being in the public sector by the Office for National Statistics. I consider that it would be more appropriate to assess the accounting boundary with reference to the accounting standards.[1] By applying such accounting standards, I consider that the Accounts should include Network Rail.

I also consider that HM Treasury's accounting policy has not been applied consistently in 2010-11 as a number of significant bodies[2] have not been included in the Accounts, even though they are classified by Office for National Statistics as being in the public sector and which I also consider should be included in the Accounts in line with applicable accounting standards.

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

- Network Rail, had gross assets of £43.3 billion and gross liabilities of £35.6 billion;
- publicly-owned banks had gross assets by £2,575.3 billion and gross liabilities of £2,446.9 billion; and
- other bodies had estimated gross assets of £36.1 billion and estimated gross liabilities of £27.8 billion.

Qualification arising from disagreement relating to the valuation of local authority infrastructure assets

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

- Bodies in the local government sector follow the *Code of Practice on Local Authority Accounting in the UK* for 2010-11;
- Bodies that follow either pure IFRS or UK GAAP;
- Bodies that follow the *Charities Statement Of Recommended Practice*; and
- Bodies that follow the *NHS Manuals*.

Accounting standards require that, where the effect of such inconsistent accounting policies are material, adjustments should be made on consolidation. HM Treasury has provided an analysis of these differences and have provided evidence that there is one area where there is a material inconsistency for 2010-11.This is where infrastructure assets included in the Accounts are not valued on a consistent basis. Assets held by local government bodies are valued at historic cost, whereas those held by central government bodies are valued at depreciated replacement cost. HM Treasury's estimate of the understatement of assets due to the differences in valuation

---

[1] *International Accounting Standard 27 – Consolidated and Separate Financial Statements*

[2] The significant bodies excluded are listed in Figure 20 in my Report.

[2] The significant bodies excluded are listed in Figure 20 in my Report.

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

between historic cost and depreciated replacement cost for local government assets could be at least £200 billion (Note 14.1 to the Accounts). HM Treasury has not been able to adjust for this inconsistency due to the information not being available from the local government sector at the current time.

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

Accounting standards require that balances and transactions held and made between bodies consolidated into these Accounts shall be eliminated in full. HM Treasury has a process in place to identify intra-government balances and transactions between bodies consolidated into the Accounts, and most balances and transactions have been eliminated. However, there remains material values of intra-government transactions and balances which have not been eliminated and the effect of not adjusting for these could lead to a potential overstatement of up to £22.6 billion (£17.0 billion in 2009-10) in gross income and expenditure and up to £10.4 billion (£6.8 billion in 2009-10) in gross assets and liabilities.

I have reviewed the impact of this uncertainty and have assessed that the maximum uncertainty resides within the gross figures in the individual primary statements rather than on the net deficit or net liabilities. The totals reported for the net deficit and the net liabilities are subject to a maximum uncertainty of some £2.9 billion (£3.2 billion in 2009-10). This information is derived from where only one body has reported an intra-government transaction or balance or there is a mismatch on the amounts reported. There is also uncertainty about whether there are amounts which both bodies involved in a relationship have not reported, leading to further overstatement.

Qualification arising from disagreement in the accounting for 3G licences

In April 2000, the government issued licences to access the 3G telecommunications spectrum. Each licence was awarded for 20 years and the total raised was £22.5 billion. This was recognised as £22.5 billion income in 2000-01. I consider that it would be more appropriate to recognise this income in the Accounts over the life of the licences as the licence holders have the right to access the spectrum for 20 years and the government has an on-going obligation to ensure that the spectrum remains available to licence holders. The impact of this difference is that income would be £1.1 billion greater; liabilities would be £10.3 billion greater (£11.4 billion in 2009-10); and the value of the general fund would be £10.3 billion less (£11.4 billion in 2009-10).

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

The external auditors of the financial statements of a number of bodies that are consolidated into these Accounts qualified their audit opinion. Of these, two are of material significance to these Accounts. I qualified my opinion on the financial statements of the *Ministry of Defence* and *Cabinet Office: Civil Superannuation*.

- **Ministry of Defence Resource Accounts:** Firstly, the Ministry has not complied with the financial reporting framework as it has not accounted for the expenditure, assets and liabilities arising from certain contracts in accordance with *International Accounting Standard 17 – Leases* as interpreted by *International Financial Reporting Interpretations Committee 4 – Determining whether an Arrangement Contains a Lease*. Consequently, the Ministry has omitted a material value of assets and liabilities from its Consolidated Statement of Financial Position as at 31 March 2010 and 31 March 2011. This has also led to a consequential misstatement of the Consolidated Statement of Revenue and Expenditure for 2009-10 and 2010-11. I am unable to quantify the impact on the financial statements because the Ministry has not maintained the records or obtained the information required to comply with the relevant accounting standards in this respect.

Secondly, the evidence available to me from the Ministry was limited due to a failure to maintain adequate accounting records, operate adequate stocktaking and asset verification procedures, and perform sufficient impairment review. Consequently, I was unable to obtain sufficient, appropriate audit evidence to support the accounting for certain inventory and non-current assets (£5.3 billion); and the valuation of a further unquantifiable value of inventory and non-current assets which may require impairment because the associated asset platforms have been taken out of service. I have also been unable to assess the accuracy, occurrence and completeness of the associated transactions in the Consolidated Statement of Revenue and Expenditure.

- **Cabinet Office: Civil Superannuation Resource Accounts**: Under legislation and the governing rules of the Principal Civil Service Pension Scheme, benefits are calculated with reference to an individual's qualifying service and their pensionable pay. The Cabinet Office was unable to provide me with evidence to support some service and salary records and therefore to validate the accuracy of some benefits awarded. The benefits awarded and membership records held by the Scheme are used to calculate the liability for future benefits. Because of the limitation of scope on the accuracy of benefits awarded in the year to 31 March 2011 and a further limitation in the evidence provided to me to support some benefits accrued at the start of the financial year, I have limited the scope of my opinion on the pension liability, which is included in Note 27 to the Accounts.

Qualification arising from limitation in audit scope due to lack of evidence supporting the completeness and valuation of schools' assets included in the Accounts

Local authority maintained schools and academies are required to be included in the Accounts. There is insufficient evidence over the completeness and valuation of assets held by these schools. There are two key areas of uncertainty:

- Firstly, local authority maintained schools' assets, which are estimated to be up to £32.5 billion for voluntary aided and foundation schools, and up to an additional £9.0 billion for voluntary controlled schools,[4] are omitted from these Accounts. The Treasury has not been able to obtain the information to include these assets within the Accounts.

- Secondly, of the 470 academies open as at 31 March 2011, only 275 have been consolidated into the Accounts. Academies have a 31 August year-end and how they have prepared their returns is dependent on when they opened. For the more established academies, which have published accounts, this data is compiled from a five month pro-rata of the audited accounts for the period to 31 August 2010, together with unaudited data to reflect subsequent activity to March 2011. Where academies did not prepare accounts for the period to 31 August 2010, their return was based entirely on unaudited data. Under section 10 of the Government Resources and Accounts Act 2000, bodies that have been designated for inclusion in the WGA are required to arrange for their returns to be audited. The Treasury and the Department for Education have not arranged for the academies' returns to be audited and the review carried out by the Treasury and the

[4] This estimate has been obtained from a paper presented to the Financial Reporting Advisory Board in October 2011 (www.hm-treasury.gov.uk/d/frab108_11.pdf). It is also possible that this estimate includes some assets which are leased from other bodies and may not be controlled by the school, so would not require consolidating into the WGA.

Department for Education did not provide me with sufficient assurance that the data included in the Accounts is accurate and complete. I have reviewed the process for consolidating these returns but was unable to obtain any assurance over the accuracy and completeness of this data. The impact of these issues for academies is:

- some £2.2 billion of income, £1.9 billion of expenditure, assets of £3.5 billion and liabilities of £0.3 billion included in the WGA is unaudited;
- there is an understatement of gross assets in these Accounts estimated to be £2.6 billion arising from the omission of 195 academies; and
- a review of returns submitted by academies estimated a further understatement of assets of approximately £1.4 billion, where insufficient value has been attributed to the assets.

I cannot determine with any reliability the total misstatements arising from these schools' issues, however, the estimates above are based on average values of school assets.

Qualified opinion on financial statements

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

- the financial statements give a true and fair view of the state of the affairs of the Whole of Government as at 31 March 2011 and of its net deficit, changes in taxpayers' equity and cash flows for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000.

Emphasis of matter – significant uncertainty

In forming my opinion on the truth and fairness of these Accounts, I have considered the adequacy of the disclosures made in areas where there is significant uncertainty in the values reported in Note 1.22.6 to these Accounts, which concerns the uncertainties inherent in estimating the likely costs of the liabilities of the Nuclear Decommissioning Authority. As explained in the Note, given the very long timescales involved and the complexity of the plants and materials being handled, a considerable degree of uncertainty remains over the value of the liability for decommissioning nuclear sites designated by the Secretary of State. Significant changes to the liability, which currently stands at £49.2 billion (£45.1 billion in 2009-10), could occur as a result of subsequent information and events which are different from the current assumptions adopted by the Authority.

Opinion on other matters

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

Matters on which I report by exception

In respect solely of the limitations arising from a lack of evidence supporting the completeness of the elimination of intra-government transactions and balances; from underlying statutory audits of bodies falling within the Accounts; and from a lack of evidence supporting the completeness and valuation of schools' assets included in the Accounts:

- the financial statements are not in agreement with the accounting records or returns; and
- I have not received all of the information and explanations I require for my audit.

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

- returns adequate for my audit have not been received from component bodies not visited by my staff; or
- the Statement on Internal Control does not reflect compliance with HM Treasury's guidance.

Report

My Report on pages 8 to 58 includes more details of the qualification of my opinion on the financial statements as well as other matters relating to my audit of the Accounts.

Amyas C E Morse
Comptroller and Auditor General
29 October 2012

National Audit Office
157-197 Buckingham Palace Road
Victoria,
London SW1W 9SP

Contents

Summary	**9**
Part One	**12**
The Whole of Government Accounts	12
Part Two	**35**
Maximising the value of the WGA	35
Part Three	**44**
Qualifying the Comptroller and Auditor General's Audit Opinion	44

Summary

The Whole of Government Accounts

1 The Whole of Government Accounts (WGA) is a single set of accounts consolidating the activities of the UK government. The WGA for 2010-11 is the second such set of accounts to be published, and the first to include comparative information.

2 The Treasury's objectives for the WGA are that it should improve transparency, increase accountability, provide more complete data on public finances than other sources, encourage public bodies to prepare their accounts in a more comparable way, and provide complementary data that can support long-term fiscal analysis and decision making.

Scope of this report

3 This report covers the 2010-11 WGA:

- In **Part 1**, I explain the key figures in the 2010-11 WGA, the key changes since 2009-10, and the insight they give into the government's finances.
- **Part 2** sets out how the WGA has been used so far, and how further improvements are required to maximise the value and use of the WGA.
- In **Part 3**, I explain why I qualified my audit opinion on the 2010-11 WGA.

Key findings

4 The first WGA, for 2009-10, was welcomed by a number of external stakeholders and by Parliament as a potentially powerful tool to improve the management of public resources. The 2010-11 WGA builds on the first set of accounts by including comparative figures. The 2010-11 WGA can be used as a baseline for judging the success of the government's Spending Review and the reduction of the government's deficit. However, the Treasury has still to set out how, in time, it intends to use the WGA to help manage the government's financial position, and associated risks, in its role as the UK's 'Ministry of Finance'.

5 The WGA shows government's overall financial position and performance, and how it is affected by past decisions. Over 2010-11, the government significantly reduced its annual deficit (the difference between expenditure and revenue) from £163 billion to £94 billion, but its overall net liability (the difference between what government owes and what it owns) remained at some £1.2 trillion. The largest reduction in the annual deficit was due to government changing the measure of inflation used to set payments to members of the public sector pension schemes. This change also reduced the public sector pension liability but increases in government borrowing meant that the overall net liability remained, at £1.2 trillion, similar to that reported in the 2009-10 WGA.

6 The 2010-11 WGA is a true and fair account of the use of public resources, but material problems remain and the account is still qualified. My audit opinion on the 2010-11 WGA is similar to my opinion on the 2009-10 WGA but includes an additional qualification over the completeness and valuation of schools' assets within the WGA. My audit again revealed significant issues with the quality and consistency of the data included in the WGA, and some bodies, such as Network Rail, are still excluded from the WGA even though accounting standards clearly require their inclusion. However, apart from the qualification issues, the 2010-11 WGA does comply with accounting standards and does provide the reader with a useful overview of the UK government's financial position.

7 Despite the limited opportunities to make significant changes, the 2010-11 WGA includes improvements over the 2009-10 accounts. When the first WGA covering 2009-10 was published, work on 2010-11 WGA was well underway so there was little opportunity for the Treasury to implement improvements for 2010-11. Despite this, the 2010-11 accounts were improved by adding comparative data, changing accounting standards used by local government to be more consistent with central government, and they include more bodies, such as the Bank of England.

8 For the WGA to be used more, it needs to be produced faster. The 2010-11 WGA was completed some 19 months after the end of the financial year to which it relates. To try and mitigate the delay, the Treasury published an unaudited summary in July 2012 but my audit has since found material error in the unaudited net deficit figure.

9 The lack of detail within some parts of the WGA inhibits its usefulness but the underlying data is not yet good enough to allow improvements to be made. For example, the 2010-11 WGA does not break-down government spending by function, and it does not show how spending is distributed across regions. The Treasury is not yet able to produce more detailed disclosures because it does not collect data at a sufficiently detailed level, as the underlying data is not good enough.

10 The Treasury has overall responsibility for improving the WGA but the individual bodies included in the WGA are responsible for submitting good quality and timely data to the Treasury. The Treasury has not clearly set out the importance of the WGA and consequently government bodies did not always prioritise their WGA submissions. During my audit, I found significant issues with the data prepared by government bodies, particularly in the health and education sectors. This includes instances where transactions between government bodies were not fully understood by the individual bodies.

Conclusion

11 I continue to regard the WGA as a key means through which Parliament and other stakeholders might gain greater insight into the wide range of activities that the government undertakes, scrutinise public finances and hold the government to account. In time, I hope it will provide Treasury with the means to identify key risks to the government's financial position and, with others, act to mitigate these risks. But, although the Treasury made improvements to the 2010-11 WGA, more needs to happen before it reaches this potential. To meets its objectives for the WGA, the Treasury must fix the problems that lead to the qualification of my audit opinion and it must also start to make real use of the WGA.

Recommendations

12 Although responsibility for the underlying transactions lies with the various bodies included in the WGA, my recommendations are all aimed at the Treasury, because it has ultimate responsibility for preparing the WGA. The Treasury should:

a. **Set out how it will use the WGA to manage the government's finances**. It is still early days for the WGA but the Treasury should be more ambitious in its objectives for the WGA. The current objectives are all very narrowly set and are focussed on delivering a set of accounts in compliance with accounting standards. The Treasury continues to make progress on its objectives for the WGA, but must now take action to use the WGA for long term fiscal analysis and decision making.

b. **Do more to remove the qualifications**. The WGA cannot fully meet its objectives until it receives an unqualified audit opinion.

c. **Add additional disclosures to the WGA.** As I have recommended previously, the WGA could be improved by including information about how government spending is distributed amongst its various activities.

d. **Ensure all government bodies take their WGA responsibilities seriously and raise the profile of the WGA across government**. The Treasury should strengthen its guidance to bodies to make clear that their responsibility for financial reporting also extends to the WGA.

e. **Improve the production process so that the WGA can be produced faster and to a higher standard.** The Treasury should provide timely feedback to bodies that submitted poor quality data and consider the introduction of appropriate sanctions for significant problems in quality or timely submission. For example, it should publish details of bodies which failed to produce adequate WGA data. The Treasury should also consider the continued merit of publishing unaudited data.

Part One

The Whole of Government Accounts

1.1 The Whole of Government Accounts (WGA) is a single set of audited accounts consolidating the financial information of the UK government. The WGA sets out what the government owns (assets), owes (liabilities), receives (revenue) and spends (expenditure). The WGA is prepared using accounting standards, specifically International Financial Reporting Standards (IFRS) adapted for use by the public sector. IFRS is an accounting framework used by much of the private sector.

1.2 The Treasury compiles the WGA and has overall responsibility for ensuring it provides a 'true and fair' representation of the financial position and performance of the UK government. While the Treasury is not responsible for the individual transactions underpinning the accounts consolidated into the WGA, it is jointly responsible, along with the bodies included in the WGA, for ensuring that data collection, financial management and reporting are robust.

1.3 The Treasury's objectives for the WGA are that it should:

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

1.4 The Treasury estimates that the 2010-11 WGA includes around 1,500 bodies.[5] To be included in the WGA, a body must do the work of the UK government, be accountable to, or be otherwise controlled by government. This definition includes central and local government, public corporations such as the Royal Mail but not independent public sector organisations such as Parliament, the Crown Estate or the

[5] The 2010-11 WGA includes information from 1,403 individual accounts which are listed in Annex 1 of the WGA. Some bodies publish more than one set of accounts, and some of the accounts already consolidate more than one separate body.

NAO. The Treasury used statistical, rather than accounting, standards to determine which bodies should be included in the WGA, and this departure from accounting standards is one of the reasons I qualified my opinion on the WGA (Part 3).

The financial position of the UK government

1.5 Figure 1 shows the key elements within the 2010-11 WGA and the following paragraphs explain in more detail:

- the net liability (**Figure 2,** paragraphs 1.6 to 1.9);
- the difference between the net liability in the WGA and Public Sector Net Debt (**Figure 3,** paragraphs 1.10 to 1.11); and
- the annual deficit (**Figure 4,** paragraphs 1.12 to 1.14).

Figure 1

Key elements of the Whole of Government Accounts 2010-11

	Description	**Examples**	**2010-11 (£bn)**	**2009-10 restated (£bn)**
Assets	Resources controlled by government from which future benefits can be generated	Offices, student loans, the national road network, military equipment	1,227.7	1,249.5
Liabilities	Obligations on government arising from past transactions or events	Deficit on the public sector pension schemes, gilt-edged stock, future cost of decommissioning existing nuclear facilities	(2,421.1)	(2,477.4)
Net liability	**The difference between what the government owned and what it owed at the end of the financial year**		**(1,193.4)**	**(1,227.9)**
Revenue	Income received from government's activities	Taxation, rental from local government housing, funding received from the EU	614.0	583.4
Expenditure	The cost of running government and providing public services	Benefit payments, staff costs, grants, depreciation, contributions to the EU	(625.2)	(667.5)
Net financing cost	The cost of funding government's activities	Investment revenue, interest paid on gilts, interest on pension scheme liabilities	(83.2)	(78.6)
Net deficit for the year	**The shortfall between revenue and expenses during the year**		**(94.4)**	**(162.7)**

NOTE

1. The figures for 2009-10 have been restated to make them comparable with the 2010-11 WGA. This had a modest impact on the headline figures, for example the net deficit for the year is reduced by £1.8 billion, and the net liability increased by £15.3 billion.

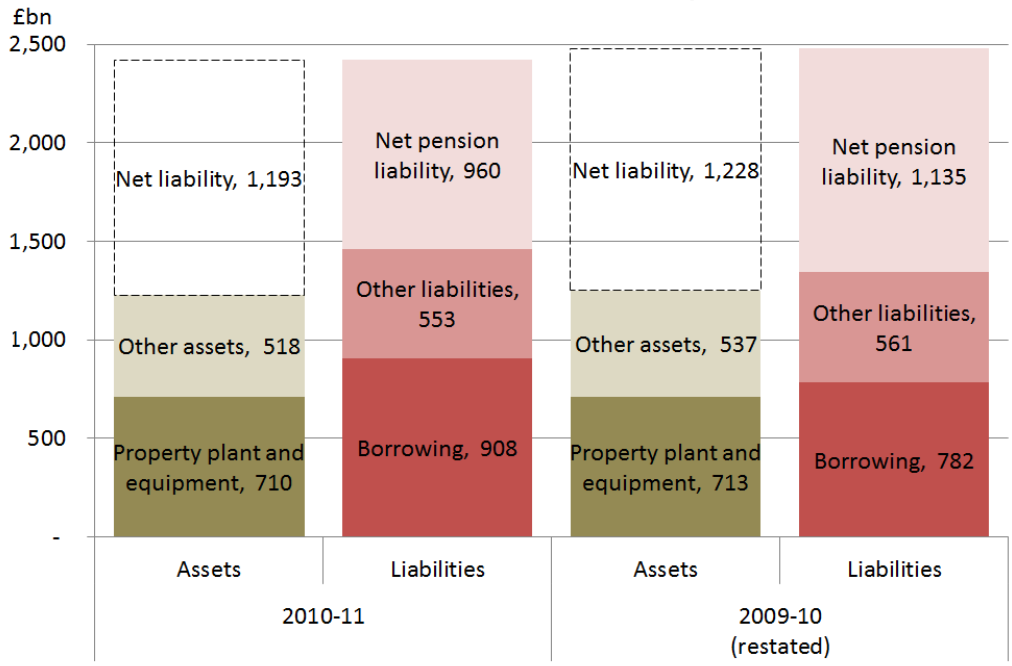
Source: National Audit Office analysis of WGA 2010-11

The net liability

1.6 The net position remains a net liability of £1.2 trillion (**Figure 2**), some 81 per cent of 2010-11 GDP.[6] Over time, the government expects to reduce public sector net debt as reported in the National Accounts, and this may also reduce the net liability reported in the WGA. The 2010-11 WGA provides a baseline against which progress can eventually be judged.

Figure 2

The WGA shows a net liability of £1,193 billion



Source: National Audit Office analysis of WGA Statement of Financial Position

1.7 The WGA shows that government owns £1,228 billion assets. This includes physical assets such as buildings and infrastructure (£710 billion), cash (£23 billion), shares and loans (including those arising from interventions in the financial sector, and student loans) and other financial assets (£223 billion) such as those arising from market operations to meet government's cash requirements.

1.8 Between 31 March 2010 and 31 March 2011, the total value of assets decreased by 2 per cent (£22 billion). This net reduction includes a £5 billion reduction in market value of the government's shares in RBS and Lloyds but is mainly due to a £24 billion reduction in other financial assets, such as those created by central government's cash management operations.

[6] 2010-11 GDP of £1,477 billion as estimated by the ONS as at 24 May 2012. The restated 2009-10 net liability was 87 per cent of 2009-10 GDP on the same basis.

1.9 The WGA shows government liabilities of £2,421 billion as at 31 March 2011. This includes £908 billion of central government borrowing (paragraphs 1.35 to 1.42), a £960 billion liability for public service pensions (paragraphs 1.43 to 1.49), and £108 billion of provisions for likely future expenses due to past events (paragraph 1.50). This does not include contingent liabilities or future obligations such as the state pension scheme (paragraph 1.46) which accounting standards require to be excluded.

1.10 The WGA reports a higher figure for public sector net debt than the Public Sector Finances Statistical Bulletin.[7] The September 2012 Bulletin reported a figure of £910 billion for Public Sector Net Debt[8] as at 31 March 2011 which is broadly comparable to the £1,193 billion net liability in the 2010-11 WGA (**Figure 3**).

Figure 3

The WGA shows a higher measure of net liability than Public Sector Net Debt

NOTES

1. The £150 billion includes £108 billion provisions, £27 billion PFI contracts treated off balance sheet in the National Accounts, and £15 billion other differences in the valuation of gilts
2. The £827 billion includes assets which are reported in the National Accounts but not included in the definition of Public Sector Net Debt. The largest component is £757 billion property plant and equipment which are not included in Public Sector Net Debt because they are illiquid.

Source: HM Treasury

[7] Latest available estimate of March 2011 PSND is available in the September 2012 Bulletin, www.ons.gov.uk/ons/rel/psa/public-sector-finances/sept-2012/stb---september-2012.html

[8] The figure quoted is the version of Public Sector Net Debt which excludes the temporary effects of the financial stability interventions. This is most comparable to the 2010-11 WGA because the banks controlled by the state have not been consolidated into the WGA by the Treasury, and the majority of the support schemes are not on the Statement of Financial Position in the WGA but appear as contingent liabilities.

1.11 The main difference is that some assets and liabilities in the WGA are not included in the definition of Public Sector Net Debt. Both measures include liquid assets and liabilities, but the WGA also includes additional liabilities such as the public sector pension liability and provisions for future expenditure and offsets illiquid assets such as property plant and equipment.

The annual deficit

1.12 The WGA also includes information about the annual deficit, the shortfall between what the government spent and the revenue it received (**Figure 4**). The annual deficit is the equivalent of a company making a loss in a single year. The WGA reports an annual deficit of £94 billion for 2010-11, the deficit for the same period reported in the National Accounts was £104 billion.

Figure 4

Government expenditure continues to exceed revenue

NOTE

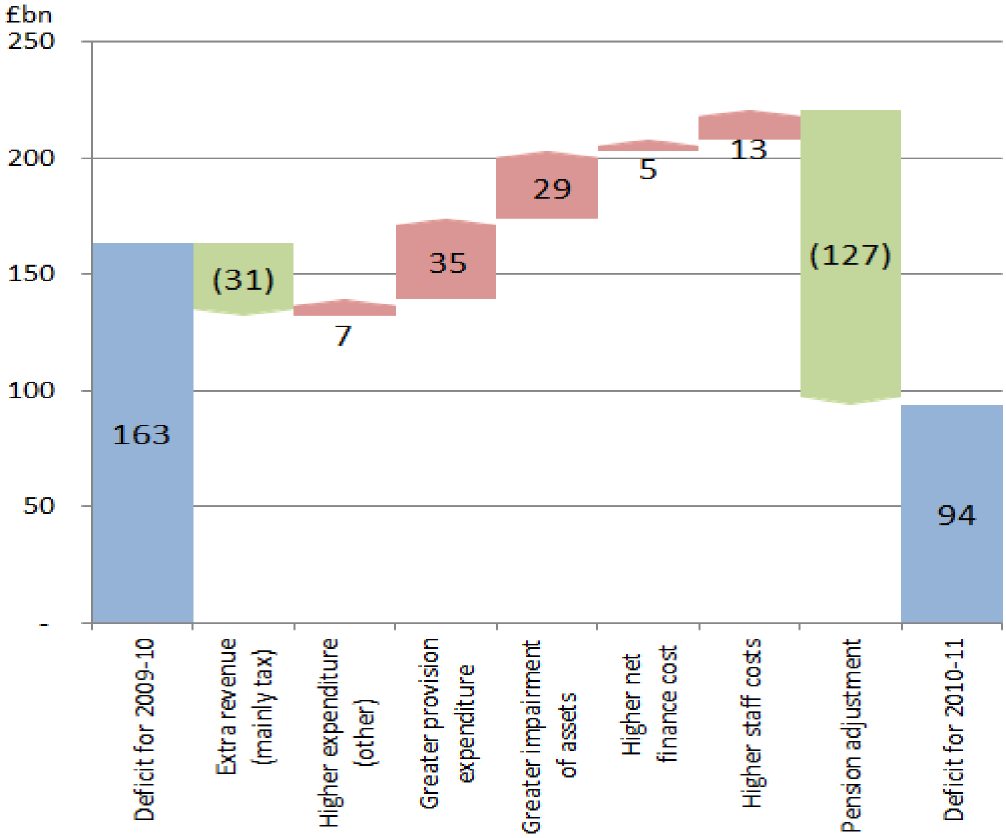
1. The category 'Other' includes costs of grants and subsidies, depreciation and impairment, provision expense and other expenditure. The 2010-11 figure is net of a £126 billion gain due to the pension change (paragraph 1.43) which has been included in the WGA as negative expenditure.

Source: NAO analysis of 2010-11 WGA

1.13 Over 2010-11, the annual deficit fell by £68 billion (42 per cent). Revenue was £31 billion greater in 2010-11, mainly due to increased tax receipts but the largest reduction in the deficit is due to the change to public sector pensions which decreased the deficit by £127 billion (**Figure 5**).

Figure 5

The deficit of £94 billion reported in the 2010-11 WGA is lower than 2009-10, largely due to the change to public sector pension liabilities



NOTES

1. 'Higher expenditure (other)' includes the net increase in expenditure in: grants and subsidies (+£2.2 billion), benefits and social security (+6.9 billion), revaluation of financial assets and liabilities (+£2.4 billion), loss on disposal of assets (+£2.4billion), reduced other expenditure (-£0.5 billion) and reduced purchases of goods and services (-£1.7 billion).
2. The change to public sector pensions (paragraph 1.43) means the deficit is reduced by £127 billion because there was a gain of £126 billion in 2010-11 and in 2009-10, there was a £1 billion cost due to previous changes in the pension rules.
3. The pension adjustment is partially offset by £10.2 billion additional pension expenditure elsewhere in the Accounts: staff costs increased by £12.3 billion due to changes in the pension scheme discount factor, and finance costs were decreased by £2.1 billion due to higher returns from assets in the funded pension schemes.

Source: National Audit Office analysis of the WGA.

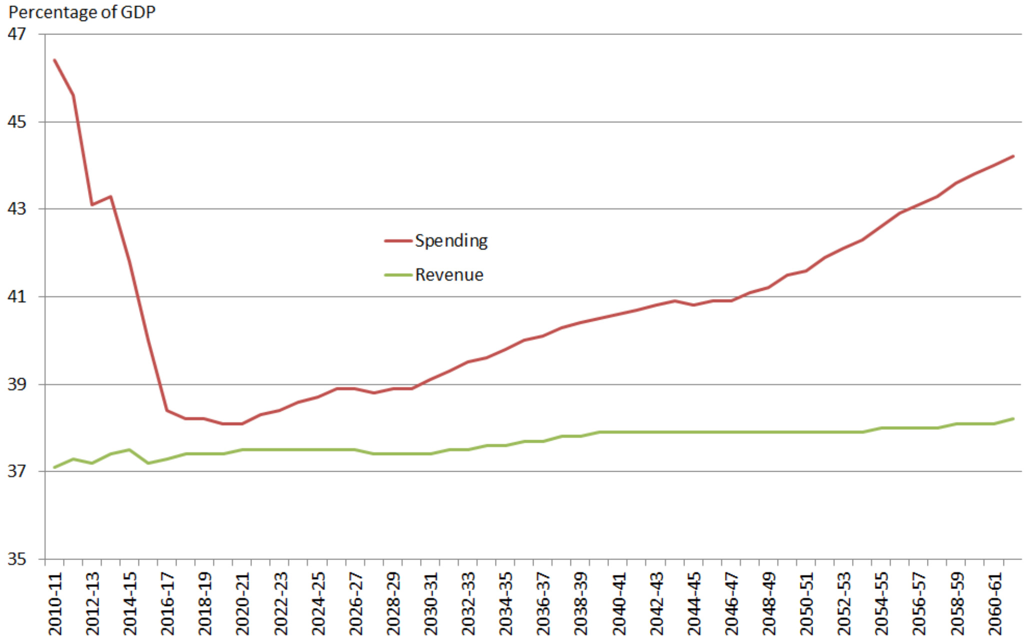
1.14 The Office for Budget Responsibility (OBR) project that the deficit reported in the National Accounts will continue to fall in the short term, but will later increase (**Figure 6**). Its *Fiscal Sustainability Report*[9] stated that 'on current policy we would expect the budget deficit to widen sufficiently over the long-term to put public sector net debt on a continuously rising trajectory as a share of national income. This is clearly

[9] Office for Budget Responsibility, *Fiscal Sustainability Report*, 12 July 2012

unsustainable'. One reason is the requirement to spend more on health as the population ages. The OBR estimated that to return Public Sector Net Debt to the pre-crisis level of 40 per cent of GDP, future governments would need to either reduce spending or increase taxation by around 1 per cent of GDP a year. There are various ways in which the OBR believes this could be achieved, for example as an immediate reduction, or through more gradual reductions over time.

Figure 6

OBR projections of future government spending show the deficit is not controlled over the long-term



NOTE

1. The projections of the deficit in the chart are calculated on the basis of the National Accounts rather than the WGA

Source: Office for Budget Responsibility, *Fiscal Sustainability Report*, July 2012

Using the WGA to understand government finances

1.15 As well as setting out the UK government's financial position, the WGA also provides material that allows the reader to gain greater insight into how, in financial terms, the government manages taxpayer's resources and the key judgements it exercises in accounting for its decisions.

1.16 For example, the 2010-11 WGA is the first year where comparative data is included. In time, this may allow the reader to see trends in the use of public resources. The 2010-11 figures reflect the first year of the implementation of the current Spending Review and, in accounting terms, the WGA provides a baseline against which success can be measured.

1.17 The following sections highlight examples where the WGA brings insight into key financial decisions and the management of financial risk:

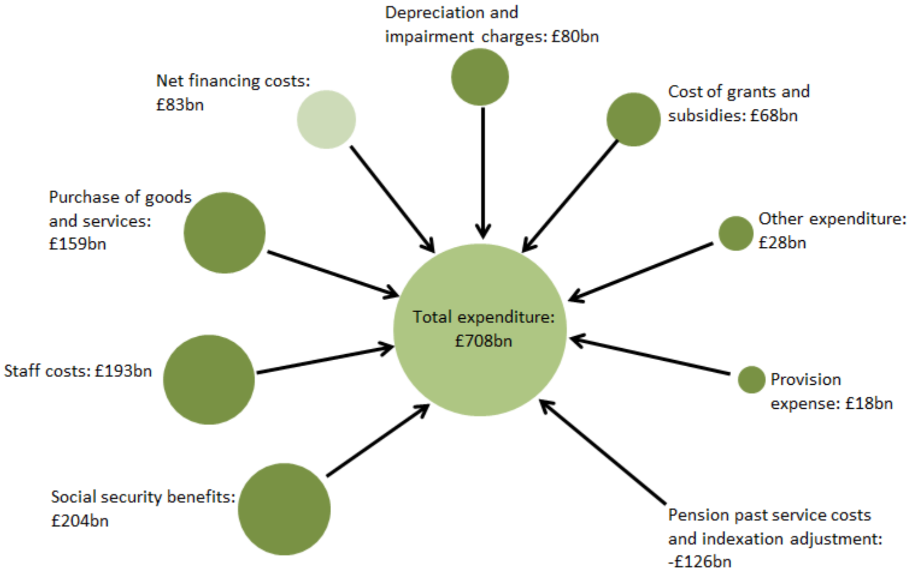
- **The scale of government expenditure** and the emerging impact of payroll and pension policy initiatives (paragraphs 1.18 to 1.19).
- **Government's management of its assets**, including amounts owed from unpaid taxation (paragraphs 1.20 to 1.32).
- **What government is obligated to pay**, including central government borrowing (paragraphs 1.33 to 1.42).
- **Managing the cost of long term commitments** such as public sector pensions and provisions for other liabilities (paragraphs 1.43 to 1.50).

What government spends

1.18 The WGA does not include detailed information on the government's spending. The categories 'Purchase of goods and services' and 'Other expenditure' together accounted for £187 billion (30 per cent) of 2010-11 expenditure. These include essentially all day-to-day activities of government, but the WGA does not give sufficient detail on what is included in these categories to allow analysis of government spending by activity. **Figure 7** shows the level of granularity provided within the WGA but, for example, it is not possible to determine from the WGA what the government spent on accommodation or consultancy.

Figure 7

Expenditure totalled £708 billion in 2010-11



NOTE

1. Figures do not add up to exactly £708 billion due to rounding.

Source: NAO analysis of WGA, statement of income and expenditure

1.19 Total expenditure decreased by 5 per cent, from £746 billion in 2009-10 to £708 billion in 2010-11. The biggest reduction arose from a £126 billion gain due to government's decision to reduce the future cost of public sector pensions (paragraph 1.43). The reduction in expenditure due to the pension change was partially offset by increases in finance costs (£5 billion), depreciation and impairment charges (£29 billion), staff costs (£13 billion, **Box 1**) and social security benefits (£7 billion).

Box 1: Early departure programmes are likely to increase staff costs in the short term

Staff costs include salaries and wages, the costs of pensions and other employee benefits. Note 7.1 to the WGA shows an increase in staff costs of 7 per cent, from £179.7 billion in 2009-10 to £193.1 billion in 2010-11. This increase was largely due to the way current service pension costs were calculated. Over the same period, the average number of full time equivalent staff employed by government (including those working on capital projects) decreased from 4.9 million to 4.7 million, with the greatest decrease being in local government.

The 2010 Spending Review required government departments to make significant administrative cost savings as part of reducing the deficit. Staff costs typically make up around half of administration budgets and almost all departments are planning staff cost reductions, largely through reducing the number of employees. The Cabinet Office estimates that the UK civil service will reduce by around 114,000 full-time equivalent staff (23 per cent) between 2010 and 2015.

Future WGAs are likely to show decreased staff numbers as a result of early departure programmes. As there is a cost associated with early departures, staff costs are likely to increase before they reduce. The NAO has calculated that government departments in England paid an estimated £600 million to release the 17,800 employees who left early under the revised Civil Service Compensation Scheme during the 12 months from its inception on 22 December 2010 and that the time by which the salary and other cost savings pay off the initial costs of these 17,800 departures will be some 11-15 months.

NOTES

1. The UK civil service serves three governments, the national government in Westminster and the governments of Scotland and Wales; the Northern Ireland civil service has been a separate organisation since 1921.
2. These figures include early departures, from government departments and other bodies in England, of staff who are members of the Principal Civil Service Pension Scheme. They do not include early departures from the devolved administrations or from local authorities, the NHS, the police or the armed forces.

Source: Report by the Comptroller and Auditor General*, Cabinet Office: Managing early departures in central government*, HC 1795 Session 2010–2012, 15 March 2012

What government owns

1.20 Where government spending creates resources whose value is to be realised after 31 March 2011, an asset is shown on the Statement of Financial Position.

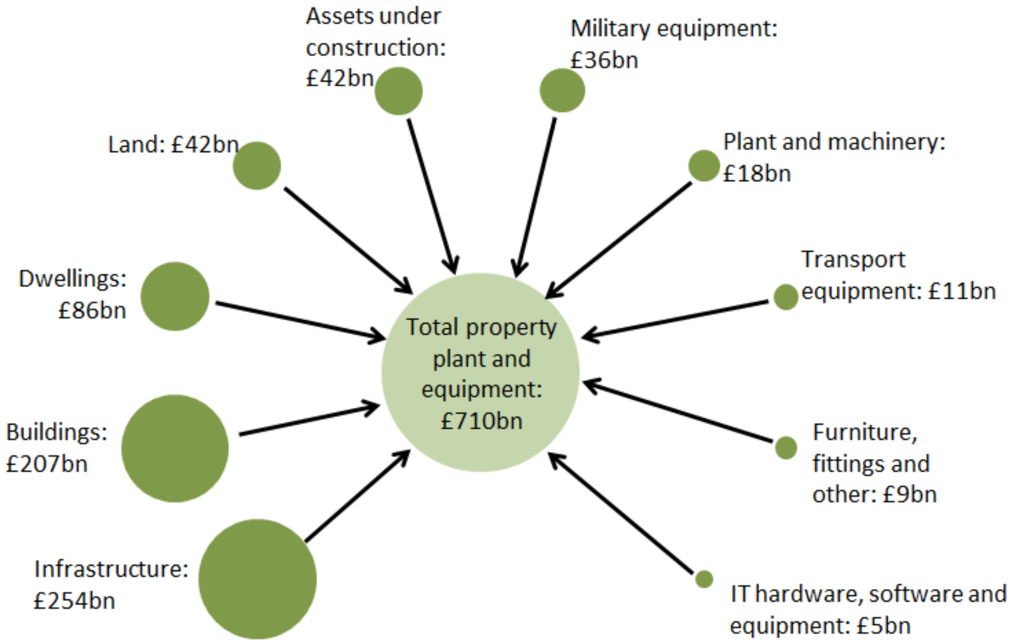
1.21 The WGA shows total assets of £1.2 trillion of which the largest category is £710 billion of tangible items such as property, plant and equipment (**Figure 8**). Changes to the way local authority housing was valued reduced the value of government's assets. In 2010-11 the Department for Communities and Local Government changed the way local authorities calculate the value of local authority housing.[10] The new approach reflects changes in the social housing market between 2005 and 2010 and the additional risk and liability that public sector landlords undertake when compared with the private sector. This reduced the value of

[10] www.communities.gov.uk/documents/housing/pdf/1825886.pdf Chapter 3.4 and Appendix 4

'Dwellings' by £27 billion (to £86 billion), but increases to other categories meant the total reduction in property plant and equipment was just £3 billion over 2010-11.

Figure 8

Property plant and equipment was valued at £710 billion in the 2010-11 WGA



Source: National Audit Office analysis of Note 14 to the WGA

How government manages what it is owed

1.22 Amounts owed to government are recorded as assets. Like any business, government must ensure that these amounts are collected, or make a provision for amounts that are potentially irrecoverable. Note 17 to the WGA shows £165 billion receivable by government of which £19 billion was regarded as potentially irrecoverable as at 31 March 2011.

1.23 The government created the *Fraud, Error and Debt Taskforce* to address its concern over the level of losses due to uncollected amounts. The Taskforce identified total losses to central government of between £7 billion and £8 billion in 2010-11, consisting of the total debt that government had to write off plus the cost of interest on debts owed to government. It also estimated that 95 per cent of the debt owed to government related to uncollected tax, overpaid benefits (including tax credits) and unpaid fines.[11] In response to the Taskforce's findings, the government announced that it would introduce legislation to allow departments to share data.[12]

1.24 Tax is the largest revenue source for the government but there will always be a period between revenue being earned and cash being collected. Tax revenue is estimated from the expected level of taxable activity, and in 2010-11 the WGA shows £85.8 billion future taxation was accrued (Note 17 to the WGA).[13] The period allowed by law for taxpayers to submit a tax return means this accrued revenue was not due to be paid by the taxpayer before 31 March 2011.

1.25 Note 17 to the WGA also shows a total of £27.6 billion of unpaid taxation owed to the government as at 31 March 2011, of which £24.9 billion was owed to HMRC. The £24.9 billion consists of:

- Amounts which were 'overdue' for payment. This amount is known as 'tax debt' and totalled £15 billion as at 31 March 2011. It is this amount which HMRC must actively seek to recover, or write-off.

- Some £9.9 billion of other debt including cases where, as at 31 March 2011, the amount owed had been established but deadline for payment had not passed.

1.26 Figure 9 shows how HMRC managed tax debt in 2010-11. HMRC collected £33 billion of the £63 billion of tax debt it managed during 2010-11 and wrote-off £5.5 billion:

- £4.7 billion was written off when, in HMRC's assessment, there was no practical way to pursue the liability. For example, because the taxpayer could not be traced or had gone bankrupt; and

- £0.8 billion was 'remitted', meaning HMRC judged that it could not recover the debts cost-effectively.

1.27 The figures for uncollected tax do not include any estimate of the tax gap. The tax gap is the difference between the hypothetical amount of tax due, based on data on economic activity, and the amount that government expects to collect. This theoretical asset to the government is the additional amount of tax that would be due if every individual and business complied exactly with tax law as interpreted by HMRC.[14]

---

[11] HM Government, *Tackling Debt Owed to Central Government*: *An interim report of the Fraud, Error and Debt Taskforce*, February 2012

[12] www.cabinetoffice.gov.uk/news/tackling-debt-owed-government-speech-francis-maude, 15 October 2012

[13] As disclosed in Note 1.22.4 to the WGA, accrued revenue receivable and accrued revenue payable for tax at 31 March 2011 are subject to maximum likely uncertainty of £4 billion in either direction.

[14] The Financial Reporting Manual (FReM) defines the tax gap as 'the difference between the hypothetical amount of revenues due, based on data on economic activity, and revenues receivable'. Revenues receivable 'include both the tax yield from compliant taxpayers and estimates of amounts due from non-compliant, but known, taxpayers'. The FReM requires the exclusion of the tax gap from financial statements.

1.28 Government estimates the tax gap for individual tax streams, although the robustness of each estimate varies depending on the type of tax and the frequency with which it is updated.[15] The most recent estimate of the tax gap relates to 2010-11 and shows a total tax gap of £32 billion. This estimate only includes taxes administered by HMRC, for example it does not include any estimate of the level of evasion of business rates.

Figure 9

The collection of debt from tax in 2010-11

	2010-11 restated (£bn)
Tax debt as at 1 April 2010	17.9
Tax debt becoming due in 2010-11	45.1
	63.0
Amounts collected	(33.3)
Amounts written off	(4.7)
Amounts remitted[1]	(0.8)
Amendments, cancellations and other adjustments	(9.2)
Tax debt as at 31 March 2011	15.0

NOTES

1. Tax debt written off where HMRC judged that it could not recover the debt cost-effectively. The figure was restated in HMRC's 2011-12 accounts to remove amounts related to the remission of tax credits.
2. The tax debt balance is included in the receivables balance shown in the Department's Trust Statement account. The receivables balance as at 31 March 2011 was £24.9 billion.
3. "Tax revenue losses" equal to the amounts written off are shown in Note 10 to the WGA

Source: Report by the Comptroller and Auditor General on HM Revenue and Customs 2011-12 Accounts, June 2012

1.29 HMRC is also owed amounts resulting from overpayment of tax credits. At the end of March 2011, the value of personal tax credit debt was £4.7 billion and HMRC made a provision of £3 billion in case of such debt being irrecoverable. HMRC estimated that error and fraud leading to overpayment of tax credits affected between 7.5 and 8.8 per cent of new awards in 2010-11 and cost the taxpayer up to £2.46 billion. HMRC did not meet its target to 'reduce personal tax credit losses due to error and fraud to no more than 5 per cent of the value of finalised entitlement by March 2011' and is investigating why some kinds of error and fraud have increased unexpectedly.

Heritage assets

1.30 Not everything owned by the government is recorded in the WGA, for example, the WGA does not include all information on heritage assets. A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or

[15] HM Revenue and Customs, *Measuring Tax Gaps 2012*, 18 October 2012

environmental qualities that is held and maintained principally for its contribution to knowledge and culture. Government entities hold a significant number of these assets but often do not include their value in their accounts, as allowed by accounting standards.[16] For example, in 2010-11, the National Gallery disclosed in its accounts that it owned 2,314 paintings, of which just 26 items (1 per cent, worth some £133 million) were valued in their accounts.[17]

1.31 Accounting standards also allow heritage assets to be valued at either cost or at their current market value. Where items were obtained a number of years ago, the cost may be significantly lower than the current value of the assets.

1.32 In 2010-11 new accounting standards[18] encouraged holders of heritage assets to value them and to disclose information about assets which had not been valued. However, the majority of government entities did not bring any additional heritage assets into their accounts due to the cost and the inherent difficulty of valuation. While the WGA contains all those heritage assets which have been included in the underlying accounts, the Treasury added an exemption to the accounting framework applicable to the WGA allowing them to exclude any disclosure of heritage assets.[19]

Government's obligations

1.33 On the other side of the balance sheet are the amounts that government owes. The WGA shows liabilities of £2.4 trillion, including government borrowing (paragraphs 1.34 to 1.42), the public sector pension liability (paragraph 1.43 to 1.49) and provisions (paragraph 1.50). The WGA also shows £427 billion of contingent liabilities which mainly relate to the financial stability interventions and were the subject of my Report on HM Treasury's 2010-11 Accounts.[20]

1.34 The WGA does not include every possible obligation on government. The 2010-11 WGA shows the position as at 31 March 2011, so liabilities which are incurred or expected to be incurred through activity after that date are properly excluded. Where liabilities depend on future events, it may not be possible to value them with sufficient accuracy to include them in the WGA.

Government borrowing

1.35 The second largest category of liabilities shown in the WGA is government borrowing. Note 24 to the WGA shows £908 billion consisting of gilt-edged securities (£746 billion of debt issued to the market, **Box 2**), Treasury bills (£64 billion short-term

---

[16] *FRS 30: Heritage Asset* states that where, exceptionally, it is not practicable to obtain a valuation of heritage assets acquired by donation, the reasons why should be stated. Disclosures should also be provided on the nature and extent of significant donations of heritage assets.

[17] National Gallery Accounts 2010-11, www.nationalgallery.org.uk/content/ConMediaFile/17899

[18] *FRS 30: Heritage Assets*.

[19] Chapter 14 of the FReM allows the Treasury to exclude the heritage asset disclosures from the WGA.

[20] www.nao.org.uk/publications/1012/hmt_accounts_2010-2011.aspx

financing) and National Savings & Investments products (£99 billion of savings and investment products, primarily bonds, offered to the public).

1.36 The £908 billion borrowing figure is the total amount borrowed by central government. Other liabilities shown in the WGA were also incurred to fund the activities of government as a whole. For example, in addition to the £908 billion, borrowings by local authorities totalled £32 billion (including £1.5 billion held in overdrawn bank accounts, see Note 23 to the WGA), and cash management activities incurred some £14 billion of liabilities managed through the Exchange Equalisation Account and the Debt Management Office (Note 26.1 to the WGA).

1.37 Central government borrowing increased by £126 billion (16 per cent) in 2010-11. This increase was mainly additional gilts issued to fund cash payments that could not be met from taxation. Because more gilts had been issued, the cost of borrowing (the cost of paying interest on the gilts issued) increased by £5 billion to £36 billion (Note 13 to the WGA), but as a percentage of central government borrowing, the annual cost remained constant, at some 3.9 per cent. The yield[21] on UK gilts is currently low by historical standards.

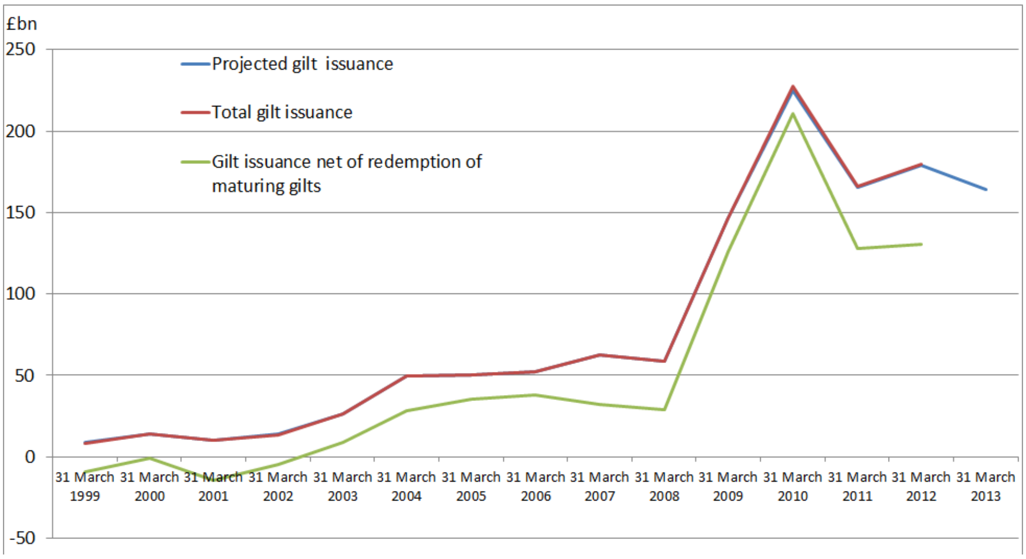
1.38 As at 31 March 2011, there were some £1,059 billion of gilts outstanding but the WGA shows a smaller figure of £746 billion (**Figure 10**). The WGA is not intended to include as liabilities gilts held as assets by entities in the WGA, such as the Bank of England Asset Purchase Facility Fund as part of Quantitative Easing (paragraphs 1.41 to 1.42).

1.39 Some gilts held by WGA entities were not eliminated from the WGA. Funded pension schemes, such as those managed by local authorities and the Royal Mail (**Box 3**), hold gilts as assets as part of their investment policies and these are not eliminated when compiling the WGA. The Treasury believe that not eliminating gilts held by pension schemes gives a better reflection of the future cost of pensions because the gilts are being used to fund the pension liability. Eliminating the gilts would have no net impact on the net liability as the reduction in ‘borrowing’ would be offset by an increase in the public sector pension liability.

[21] The yield is the annualised return that an investor would make from holding a gilt to maturity. Because investors can choose to buy existing gilts instead of new gilts, the yield is a measure of the interest rate that government would need to pay on any new gilt issuance.

Box 2: Gilts

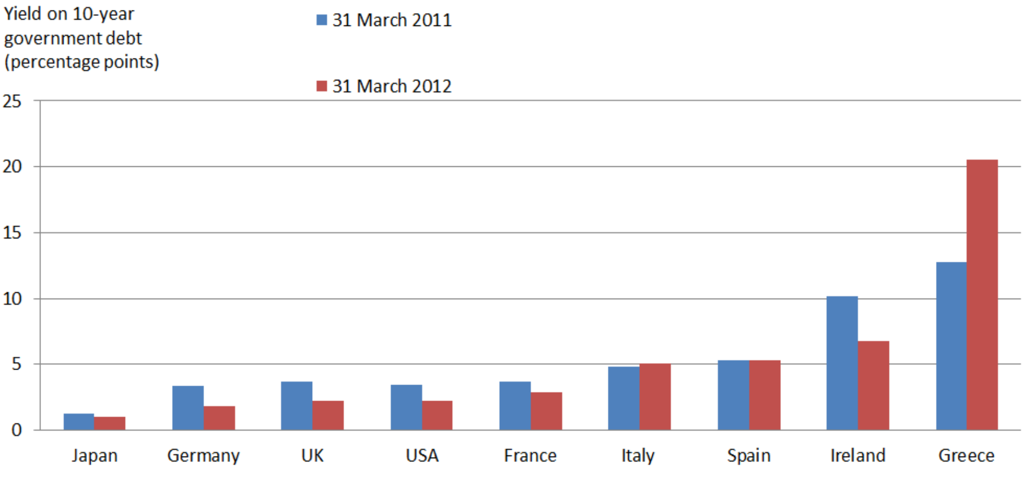
The main component of government borrowing is through gilt-edged securities (gilts). Gilts are debt issued by the UK Debt Management Office (DMO) to cover the projected shortfall between the government's forecast cash expenditure and revenue. Whilst new gilts are being issued each year, gilts are also being repaid. The amount of gilts to be repaid is taken into account when the Treasury sets the total value of gilts for the DMO to issue each year (the DMO's 'debt remit').



Source: NAO analysis of Debt Management Office data

Gilts are issued for a predetermined period of time, over which they pay interest to the holder at a rate defined when the gilt is issued. This rate is generally fixed, but in some cases can be linked to inflation. The rate of interest the government pays on each gilt is set by the DMO based on expected market demand and the yield on existing gilts of similar maturity. The yield is the annualised return that an investor would make from holding a gilt to maturity. Because investors can choose to buy existing gilts instead of new gilts, the yield is a measure of the interest rate that government would need to pay on any new gilt issuance.

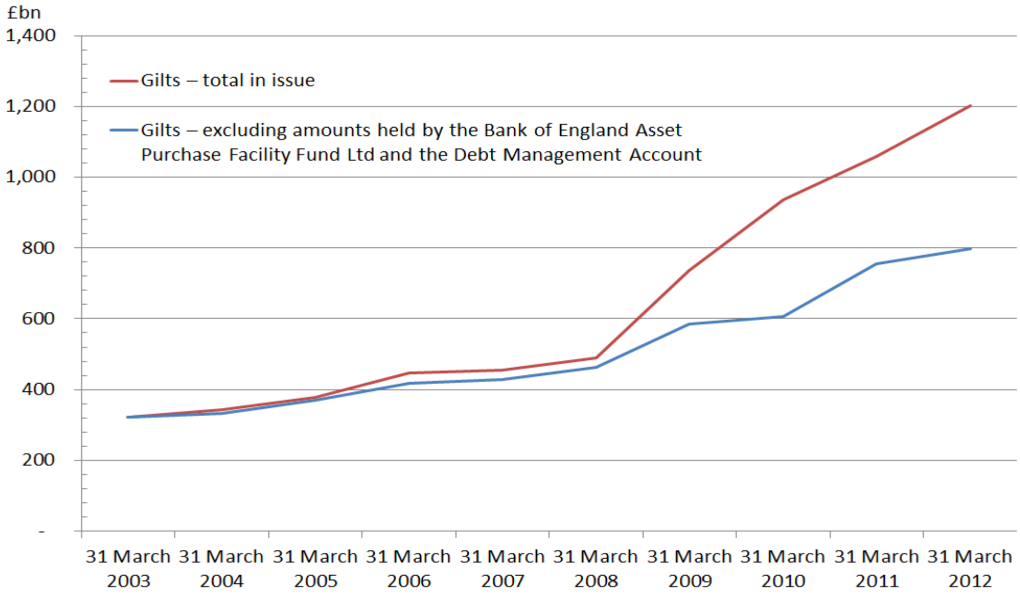
The gilt yield depends on many factors including monetary policy expectations and the relative risk of default associated with UK gilts in comparison to other countries. The yield on UK gilts is currently low in comparison to historical levels and when compared to debt issued by other many countries.



Source: Bloomberg

Figure 10

The increase in gilts since 2003



Source: National Audit Office analysis of National Loans Fund accounts, Debt Management Account, and Bank of England Asset Purchase Facility Fund quarterly statements.

Box 3: Restructuring the Royal Mail pension scheme

The government has been preparing, since late 2010, to privatise the Royal Mail.[22] As part of the restructuring, it will retain the majority of its pension deficit in public ownership. On 1 April 2012, the government transferred the majority of the assets and liabilities held by the Royal Mail's funded defined benefit pension scheme to a new, government owned, scheme. As at 31 March 2012, the Royal Mail scheme held £33.7 billion of assets and £30.8 billion liabilities leading to a pension deficit of £2.9 billion. In March 2012, the European Commission ruled that the Royal Mail must retain £150 million of the net liability to ensure a level of deficit in line with similar UK companies.[23]

The transfer of the scheme will increase the pension liability in the WGA for 2012-13 but will not increase the overall net liability. Accounting standards require that assets held by funded pension schemes are not shown separately but are set against the pension liability. After the transfer, the Royal Mail scheme will become unfunded, and the assets formerly held by the scheme will be shown separately from the related liability. This means that while the net impact of the transfer on the overall net liability within the WGA will be zero, the reported pension liability will increase by the book value of assets reclassified.

On 22 November 2012, the government will cancel the £8.0 billion (nominal value) of gilts formerly held by the Royal Mail scheme. The remaining assets from the original scheme will eventually be sold.

Any profit realised will provide a one-off reduction in the annual deficit reported in the WGA in the year of sale. The government has stated that it will retain the cash proceeds to reduce the borrowing figure reported in the National Accounts.[24]

Source: National Audit Office

[22] www.bis.gov.uk/policies/business-sectors/postal-services/postal-services-bill-2010

[23] ec.europa.eu/competition/state_aid/cases/241549/241549_1324295_215_3.pdf

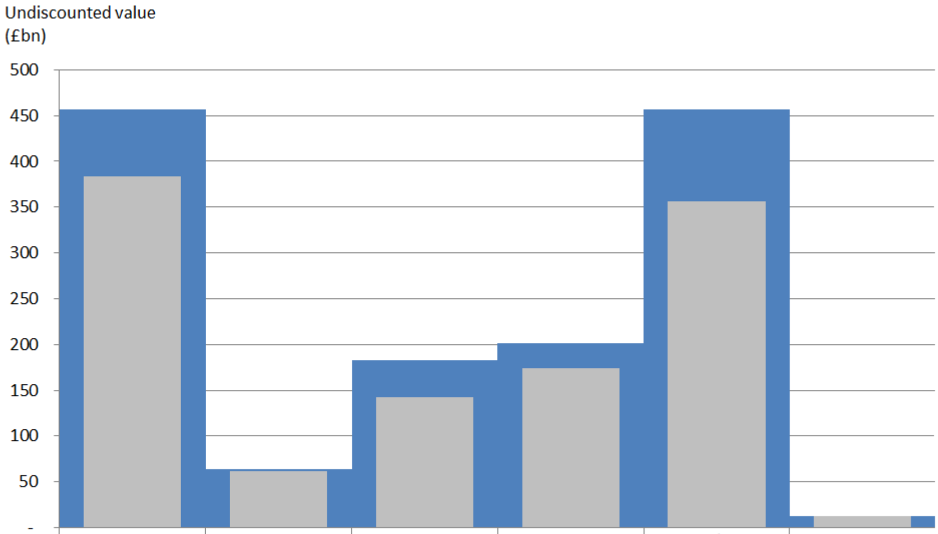
[24] 2012 Budget, cdn.hm-treasury.gov.uk/budget2012_complete.pdf

Repaying the amount borrowed

1.40 Nearly one quarter (£588 billion) of the liabilities on the WGA balance sheet are classed as current, meaning settlement could be required within twelve months of the year-end. It is not necessarily the case that all of these will definitely result in cash outflow, for example, current liabilities include the £52 billion of bank notes issued by the Bank of England. Liabilities that impose a contractual obligation to pay cash and are subject to liquidity risk are shown in **Figure 11** which indicates that the same amount, some £457 billion (undiscounted), is due for repayment after ten years or more as is due within 12 months.

Figure 11

The repayment profile of financial liabilities



	0–12 months	1–2 years	2–5 years	5–10 years	More than 10 years	Undated
2010-11	457	64	183	202	457	13
2009-10	383	62	142	174	357	13

NOTES

1. Figure shows those financial liabilities subject to liquidity risk (undiscounted) at the earliest point at which payment could be contractually required.

Source: National Audit Office analysis of Note 35.5.3 to the 2010-11 WGA

The impact of consolidating Quantitative Easing on borrowing

1.41 The Bank of England operates Quantitative Easing as a monetary policy tool to boost the money supply through the purchase of assets, mainly gilts.[25] The measure is run through the Bank of England Asset Purchase Facility Fund Ltd (BEAPFF), a subsidiary of the Bank of England. The Treasury indemnifies the BEAPFF against any loss and will receive any profits generated by selling the assets back to the market or holding them to maturity (**Figure 12**). As at 31 March 2011, the maximum size of the

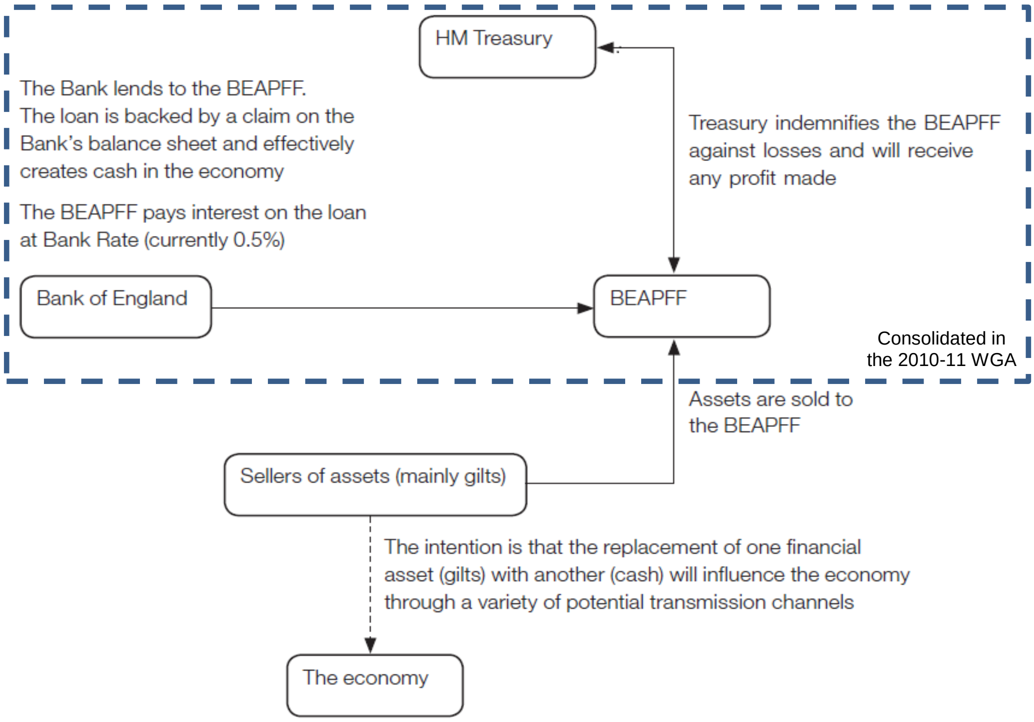
[25] www.bankofengland.co.uk/markets/Documents/money/publications/redbookqe.pdf

programme was £200 billion (increased to £375 billion by July 2012) and the BEAPFF was holding some £184 billion of gilts at that point.

1.42 Consolidating Quantitative Easing does not significantly reduce the overall liabilities of government but it does reduce the number reported as government borrowing. Once intra-government transactions are eliminated, the scheme represents an exchange of gilts (liabilities of the National Loans Fund) for central bank reserves (liabilities of the Bank of England).

Figure 12

The implementation of Quantitative Easing



Source: National Audit Office

The public sector pension liability

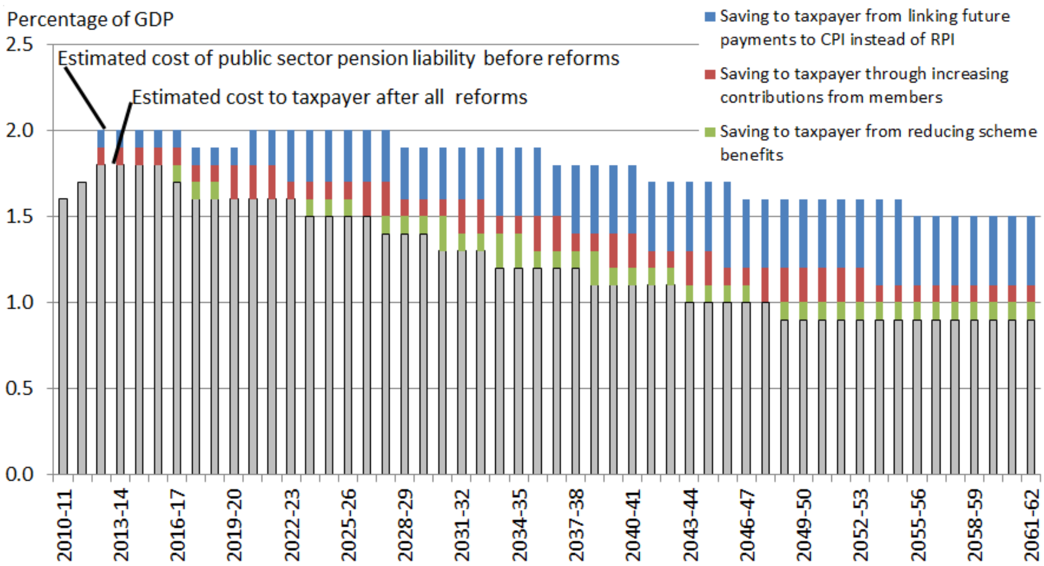
1.43 In the June 2010 Budget, the government reduced the pension liability by changing the measure of inflation used to uprate payments to pensioners to take effect from 1 April 2011. The change, from the Retail Price Index (RPI) to the Consumer Price Index (CPI), reduces the pension liability because the CPI measure is generally lower than RPI.[26] This change also generated a net gain of £126 billion in 2010-11 which reduced the annual deficit (Figure 5).

[26] CPI is derived from a different basket of goods, for example it excludes mortgage costs, and is calculated in a different way. The government believes that a measure excluding mortgage costs is more appropriate for calculating the pension liability because the majority of pensioners will not have a mortgage when they retire. CPI is the measure which the Bank of England attempts to maintain at 2 per cent.

1.44 The government plans further reforms to reduce the cost of public sector pensions. The government introduced *The Public Service Pension Bill* in the House of Commons on 13th September 2012 to consider further reforms to public sector pension schemes following the recommendations of the Independent Public Service Pensions Commission.[27] These reforms include requiring scheme members who are current employees of the government to pay increased contributions into the scheme. The OBR has estimated that these measures, if implemented, will reduce the cost of public sector pensions from around 1.5 per cent to 1 per cent of GDP by 2061-62 (**Figure 13**).

Figure 13

The long-term effects of the reforms to the public sector pension liability reduce its cost



Source: OBR, *Fiscal Sustainability Report*, July 2012

The wider cost of retirement to society

1.45 The cost of funding the retirement of the UK's population falls on the government, individuals and employers. The government is responsible for its own employees' pension payments and also for state pension payments which are paid to eligible citizens when they retire.

1.46 Despite the name, the state pension scheme is more like a social security benefit than a pension scheme. The WGA does not include a liability for the state pension scheme because, unlike public sector workers who have accrued their pension entitlement during the period of employment, citizens are only entitled to a payment under the state pension scheme if they meet certain criteria on the date that payment would be due. The WGA therefore recognises state pension payments as benefit

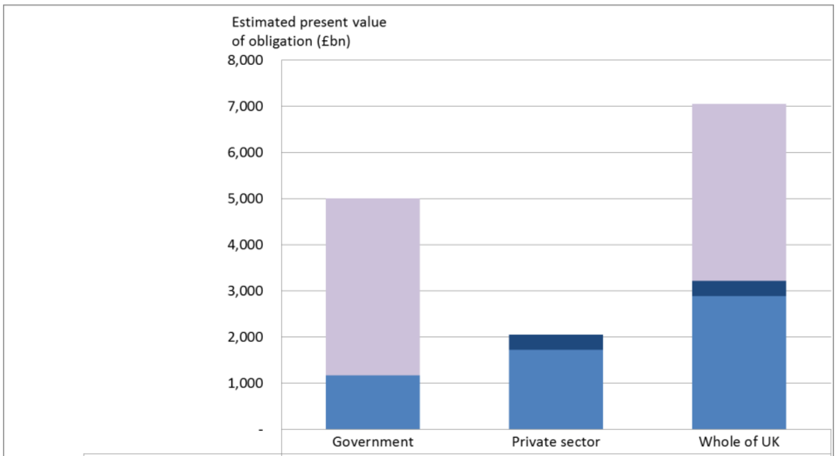
[27] *Independent Public Service Pensions Commission: Final Report* ,March 2011

expenditure when it is incurred. In 2010-11 the total state pension payment was £74 billion, the largest component of social security benefits (Note 6 to the WGA).

1.47 The Office for National Statistics has provided an indication of the £7 trillion cost of retirement (**Figure 14**). They estimate a public sector pension liability of £1.2 trillion and future state pension payments of some £3.8 trillion. The total private sector pension liability, which covers the entirety of the private sector is smaller, some £1.7 trillion.

Figure 14

The government has the majority of the obligation to fund the retirement of the UK's workforce and citizens



	Government	Private sector	Whole of UK
Future state pension costs	3,843	-	3,843
Individual pension schemes	-	326	326
Workplace pension deficits	1,165	1,726	2,891
Total	5,008	2,052	7,060

NOTES

1. Graph shows gross obligations to pay pensions (blue) and future state pension payments (purple). For defined contribution pension schemes the net liability is nil, because the amount to be paid is equal to the value of the assets held. For defined benefit schemes there may, if the scheme is funded, be assets which will be used to fund the payment so the net liability to the pension scheme will be lower. All public sector pension schemes and some private sector schemes are defined benefit schemes
2. The amounts shown for pension schemes is the estimated net present value of future payments (net of future contributions) in respect of pension rights accrued to December 2010. This includes the total remaining pension to be paid to those already retired plus payments for employment, up to December 2010, for those still working. This is the same basis used for the public sector pension liability in the WGA.
3. The WGA figure is most closely comparable to the £1.2 trillion workplace obligation shown under ‘Government’, however the graph shows the liability as at December 2010 using a 5 per cent (nominal) discount rate whereas the WGA reports the figure as at March 2011 using a discount rate based on high quality corporate bonds

Source: National Audit Office analysis of Office for National Statistics data

Valuing the pension liability

1.48 The largest sensitivity in the value of the pension liability is the discount rate used to determine the value of future payments. Accounting standards generally require that liabilities that become due over a long period of time are valued at the present value of the future payments, discounted at a rate reflecting the time value of money. The accounting standard used by the WGA requires the discount rate for pension liabilities to be set 'with reference to market yields at the end of the reporting period on high quality corporate bonds'.[28] This means the value of the pension liability and the cost recognised will fluctuate based on market prices.

1.49 Although the choice of discount rate in the WGA is in line with accounting standards, it does not necessarily reflect the cost of funding the payments. The payments of public sector pensions will be funded through cash raised by taxation and government borrowing, rather than high quality corporate bonds. Applying alternative discount rates would lead to different values for the liability but would not necessarily eliminate the volatility (**Figure 15**). The Treasury has the ability to modify the interpretation of the accounting standard it uses for the WGA but believes corporate bonds are a more appropriate choice.

Figure 15

The effect of the discount rate on the public sector pension liability

	Volatile discount rate	Rate as at 31 March 2011 (%, nominal)
Rate used by central government pension schemes in the 2010-11 WGA	Yes – depends on market and inflation assumption	5.63
Gilt rate (30 year)	Yes – depends on market	4.36
Rate used for long-term provisions in the 2010-11 WGA	No	2.20
Green Book rate (used to appraise public spending across central government, assuming 2 per cent inflation)	No (assuming long-term inflation assumption not modified)	5.57

NOTE

1. A higher discount rate reduces the value of the pension liability because it ascribes a lower value to payments made in the future.

Source: National Audit Office

[28] *International Accounting Standard 19 – Employee Benefits*

Provisions

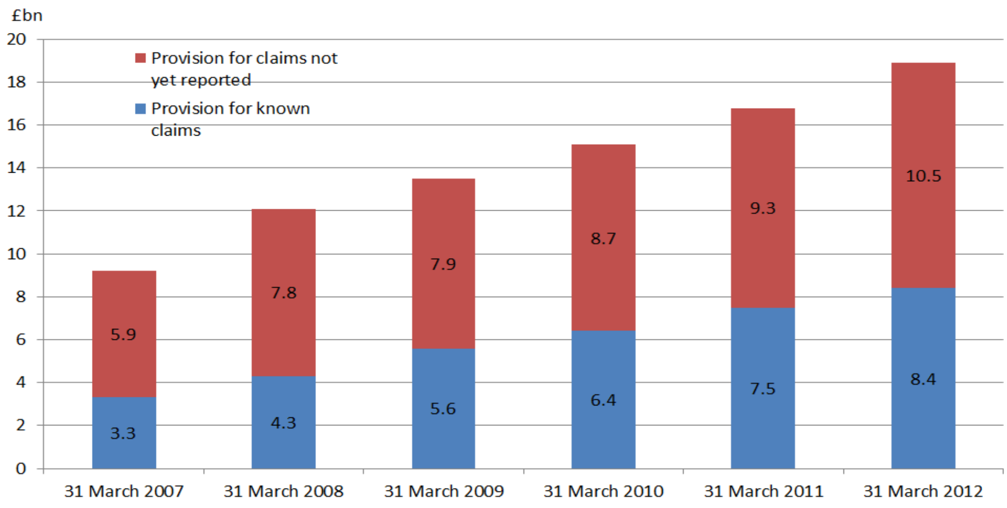
1.50 The other large category of liabilities in the WGA are provisions. The government has provided some £108 billion (Note 25 to the WGA) for costs it expects to have to meet at some point arising from past events. The largest provisions are for claims for clinical negligence (£18 billion, **Box 4**) and the costs of nuclear decommissioning (£61 billion, **Box 5**). The WGA also shows a £30 billion provision for ‘other’ costs which include amounts set aside for redundancies, restructuring and early exit from accommodation leases. Because of inconsistencies in how individual bodies categorised their provisions, reliable disaggregated figures cannot be disclosed in the WGA.

Box 4: Provisions for claims of negligence against the NHS

The WGA (Note 25) includes a provision of £17.5 billion for clinical negligence. Clinical negligence is the term given to a breach of a duty of care by healthcare practitioners in the performance of their duties which has been confirmed by the employing NHS body or through legal process. Claims for clinical negligence are typically long-term liabilities as it can take up to 30 years for claims to be reported and settling a claim can also take many years, depending on the complexity and circumstances of the case.

The largest element of this provision derives from the work of the NHS Litigation Authority which is the body responsible for managing claims of alleged negligence that are made against the NHS in England. The NHS Litigation Authority has increased its total provision for all claims of negligence from £9.2 billion as at 31 March 2007 to £18.9 billion as at 31 March 2012. The Authority also manages claims for non-clinical negligence relating to property expenses and liabilities to third parties however these are typically of a much lower value than claims for clinical negligence. In 2010-11, the Authority spent £863 million on claims for clinical negligence and £48 million on claims for non-clinical negligence.

In 2010-11, the Authority received 8,700 claims of clinical negligence against NHS bodies, up from 6,700 claims in 2009-10. For the first time in 2010-11, claimants were required to notify the Authority of their claim at the same time as notifying the defendant NHS body. The Authority believes that the increase in claims is due to faster reporting as well as more incidents converting to claims. In 2010-11 faster reporting was believed to be the principal factor, however the Authority’s 2011-12 accounts report that it is uncertain to what extent each factor is now driving the change in the total number of claims..



NOTES

1. The chart shows the total provision for all liabilities, clinical and non-clinical. The figures shown are at the net present value of the claims received as calculated by the NHS Litigation Authority at the time of their publication.

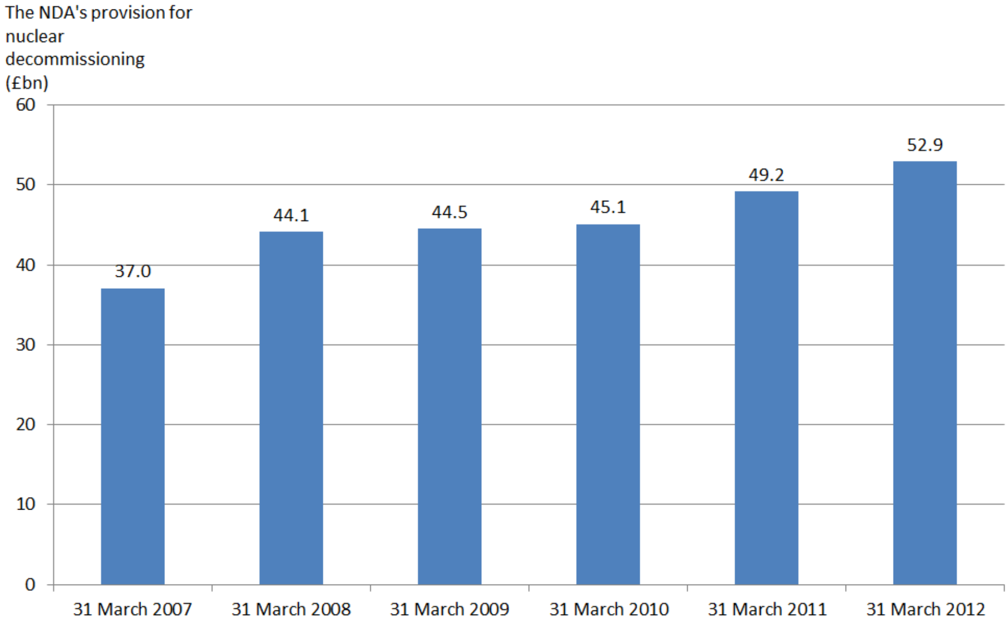
Source: National Audit Office analysis of NHS Litigation Authority accounts

Box 5: The provision for nuclear decommissioning

The WGA (Note 25) shows provisions of £60.9 billion relating to the estimated cost of decommissioning and cleaning up the civil and military nuclear estate. Some £49.2 billion of this relates to the 19 civil nuclear facilities now owned by the Nuclear Decommissioning Authority (NDA). The latest estimate, £52.9 billion as at 31 March 2012, is set out in the NDA's 2011-12 accounts and will be included in the 2011-12 WGA.

The NDA is responsible for operating civil nuclear sites prior to decommissioning, for decommissioning and cleaning up the sites, and for the safe management of all nuclear and non-nuclear waste. In practice, the NDA contracts out the delivery of site programmes (decommissioning, commercial fuel re-processing and commercial electricity generation) through management and operation contracts with five licensed operators called Site Licence Companies, however the responsibility for meeting the costs associated with decommissioning remains with the NDA Group.

Every year, the Group records its best estimate of the cost of decommissioning as a provision in its accounts. In recent years, the provision has increased in value due to inflation, changes in government policy and evolution of the planned decommissioning programme.



NOTES

1. The nuclear provision in the accounts of the NDA is the net present value of the expected costs of nuclear decommissioning.
2. The discount factor, set at 2.2 per cent, set by the Treasury, reflects the time value of money over the very long timescales, over 100 years, over which work will be carried out.

Source: National Audit Office analysis of Nuclear Decommissioning Authority accounts

Part Two

Maximising the value of the WGA

2.1 This part outlines how the first WGA was received and the extent to which it was used. It outlines the improvements the Treasury has made since I last reported and highlights further improvements to make the WGA more useful.

How the 2009-10 WGA was used

2.2 The first WGA was published by the Treasury in November 2011 and was welcomed by parties outside government who saw its potential to aid transparency and accountability and to help the government manage the public finances:

- The International Monetary Fund described the publication of the WGA as 'a valuable new perspective on public finances' and 'a step forward for fiscal transparency'.[29,30]
- Moody's credit rating agency said that the publication of WGA will add further strength to the process of developing the country's long-term fiscal policy objectives.[31]
- The Chartered Institute of Public Finance and Accountancy said the publication of the WGA 'highlights the risks that governments around the world take in managing fiscal policy using National Accounts produced by statistical offices alone rather than complementing them with accounts produced using internationally recognised financial reporting standards'.[32]
- The Institute of Chartered Accountants in England and Wales said the WGA is 'a powerful new tool which Parliament and the public can use to scrutinise public spending, understand our financial obligations and to manage future public debt'.[33]

2.3 The Committee of Public Accounts welcomed the 2009-10 WGA. The Committee stated that 'the WGA will only serve its purpose – telling us what the government

---

[29] www.imf.org/external/pubs/ft/sdn/2012/sdn1202.pdf

[30] www.imf.org/external/pubs/ft/scr/2011/cr11220.pdf

[31] Moody's Weekly Credit Outlook, 18 July 2011.

[32] www.cipfa.org/About-CIPFA/Press-Office/latest-press-releases/UK-Government-Accounts-set-a-new-high-standard

[33] www.icaew.com/en/about-icaew/newsroom/press-releases/2011-press-releases/restoring-confidence-will-be-critical-to-unlocking-business-investment-and-growth

owns, owes, spends and receives – if it is timely and robust' and set out four key principals for managing public finances:[34]

- As the UK's Ministry of Finance, the Treasury is responsible for managing public sector finances and for managing financial risk.
- Timely, reliable and complete information on what the government owes, owns, spends and receives provides the foundation for managing public finances.
- The WGA will help the Treasury to drive change through its management of the public sector's balance sheet.
- Clear performance measures provide a catalyst for identifying and managing risk.

2.4 However, the Treasury itself has not yet made significant use of the WGA, in part because the WGA only had one year of audited data, but also because of the delay in producing the WGA (paragraphs 2.11 to 2.13). The Treasury is examining how it can use the WGA to inform the next Spending Review. It is considering how spending teams might use WGA data to assess the impact of policy changes on government's long term financial position, identify new sources of revenue and improve the management of debt.

2.5 To date, the most extensive use of the WGA has been by the Office for Budget Responsibility (OBR). The OBR used the Treasury's unaudited WGA data[35] to set out the impact of past government activity on the public sector balance sheet, and recognises that the WGA provides additional transparency. The OBR's projections of future government spending and receipts (Figure 6) are not based on the WGA but are created from a bottom-up model which produces figures on the basis of the National Accounts. The government's deficit reduction policy targets the measures reported in the National Accounts rather than the WGA, as there is not yet enough historical WGA data to make future projections.

2.6 The Department for Communities and Local Government published an unaudited version of the 2009-10 WGA covering just the English local government sector[36] (**Figure 16**). This publication provides more segmental analysis on English local government activity than is currently disclosed in the WGA, though it is not designed to be a 'true and fair' set of financial statements. The Department is considering whether to publish a similar document covering 2010-11.

---

[34] Committee of Public Accounts: 67th Report, *Whole of Government Accounts 2009-10,* HC 1696, 7 February 2012

[35] *Whole of Government Accounts: Unaudited Summary for the year ended 31 March 2011,* July 2012

[36] www.communities.gov.uk/localgovernment/localgovernmentfinance/governmentaccounts

Figure 16

Key elements of the financial position and performance of English local government

	2009-10 (£bn, unaudited)
Assets	314
Liabilities	(282)
Net assets	**32**
Total revenue	178
Total expenditure	(184)
Net financing costs and investment income	(13)
Net deficit for the year (£bn)	**(19)**

Source: *WGA: Local Government in England sub-consolidation* for 2009-10

The audit of the WGA revealed problems with its quality

2.7 For stakeholders to gain greater confidence in using the WGA, it needs to be robust. A key measure of 'robustness' of a set of accounts is the opinion provided by the external auditor. Overall, the 2010-11 WGA was a true and fair account of the government's financial position and performance but my audit opinion was qualified. As set out in Part 3 of this Report, I have qualified my opinion on the WGA because:

- **The WGA boundary did not follow accounting standards**. I believe that significant public sector entities such as Network Rail and the public sector owned banks should be included in the WGA, but the Treasury has excluded them. I continue to disagree with the Treasury's exclusion of further education institutions though I am content with its decision to exclude the higher education sector (**Box 6**).
- **The valuation of infrastructure assets was not consistent across the whole of government.** Local authorities valued infrastructure assets at depreciated historical cost whereas central government used depreciated replacement cost, a material inconsistency.
- **There was insufficient evidence that intra-government transactions and balances had been eliminated.** Accounting standards require that all such transactions are eliminated from the WGA.
- **I disagreed with the accounting treatment for the sale of 3G telecommunications licences.** In my opinion, the income from the sale of the licences should have been recognised over the life of the contract.
- **Some of the accounts of the bodies included in the WGA were themselves qualified.** The statutory audit of the Ministry of Defence's Resource Accounts and the Cabinet Office: Civil Superannuation Resource Accounts for 2010-11 resulted in qualified audit opinions, and those qualifications are material to the 2010-11 WGA.

- **I was not provided with sufficient evidence to support the completeness and valuation of assets held by local authority maintained schools and academies.**

2.8 The Treasury published unaudited WGA data[37] before I concluded my audit, and before it had fully completed its preparation work. The unaudited data was published to support the work of the Office for Budget Responsibility (paragraph 2.5). Some of the figures have since changed materially and the errors identified reduced the reported annual deficit from £106 billion to £94 billion (**Figure 17**).

Figure 17

Changes to the unaudited WGA

	Unaudited WGA (£bn)	Change during audit (£bn)	Audited WGA (£bn)
Assets	1,226.4	1.3	1227.7
Liabilities	(2,421.5)	0.4	(2421.1)
Net liability	**(1,195.1)**	**1.7**	**(1,193.4)**
Tax revenue	515.4	-	515.4
Other revenue	95.9	2.7	98.6
Social security benefits	(204.0)	-	(204.0)
Staff costs	(193.1)	-	(193.1)
Other expenditure	(226.0)	(1.8)	(227.8)
Net financing cost and gains and losses on sale of assets	(94.3)	10.8	(83.5)
Net deficit for the year	**(106.1)**	**11.7**	**(94.4)**

NOTES

1. The unaudited publication did not include a cash flow statement or a statement of changes in taxpayer equity.
2. In 2009-10 annual deficit for the year changed by £0.4 billion and the net liability changed by £4.4 billion between the unaudited and audited positions.

Source: National Audit Office

[37] *Whole of Government Accounts: Unaudited Summary for the year ended 31 March 2011*, July 2012

Box 6: Understanding the WGA boundary – further and higher education

The Office for National Statistics (ONS) classifies further education institutions as part of the public sector, making them eligible for consolidation into the WGA. Higher education institutions are judged by the ONS to be part of the private sector and are therefore excluded from the WGA.

The difference in classification arises because, in 2010-11, government had the authority to intervene in the way that further education institutions operate, for example by restricting their ability to borrow money. These powers indicate that government has the ability to control the operating and financial policies of further education institutions. Government does not have equivalent powers to control higher education institutions as those bodies operate under Royal Charter.

The Treasury was unable to collect data from further education institutions in time to consolidate them in the 2010-11 WGA and it does not intend to consolidate them in 2011-12. Government's powers of control over further education institutions will be changed by legislation from 2012-13 onwards and the ONS will no longer regard them as public sector. The Treasury will need to consider whether the change in legislation leads to the inclusion of further education institutions in future years' WGA.

Source: National Audit Office

Responsibility for improving the WGA rests with the Treasury and the bodies included in the WGA

2.9 Overall responsibility for the WGA rests with the WGA Accounting Officer, however all parts of government have a role to play in improving its quality and timeliness. The WGA Accounting Officer is responsible for compiling and producing the WGA, but the data that underpins the WGA is owned by the bodies that are consolidated into the Accounts.

2.10 The Finance Director (or equivalent) of each consolidated body is responsible for the accuracy and timeliness of individual data returns. Not all bodies prioritised the need to prepare robust and timely data for inclusion within the WGA, and WGA requirements are not widely understood throughout the public sector.[38]

The time taken to produce the WGA limits the speed at which improvements can be made

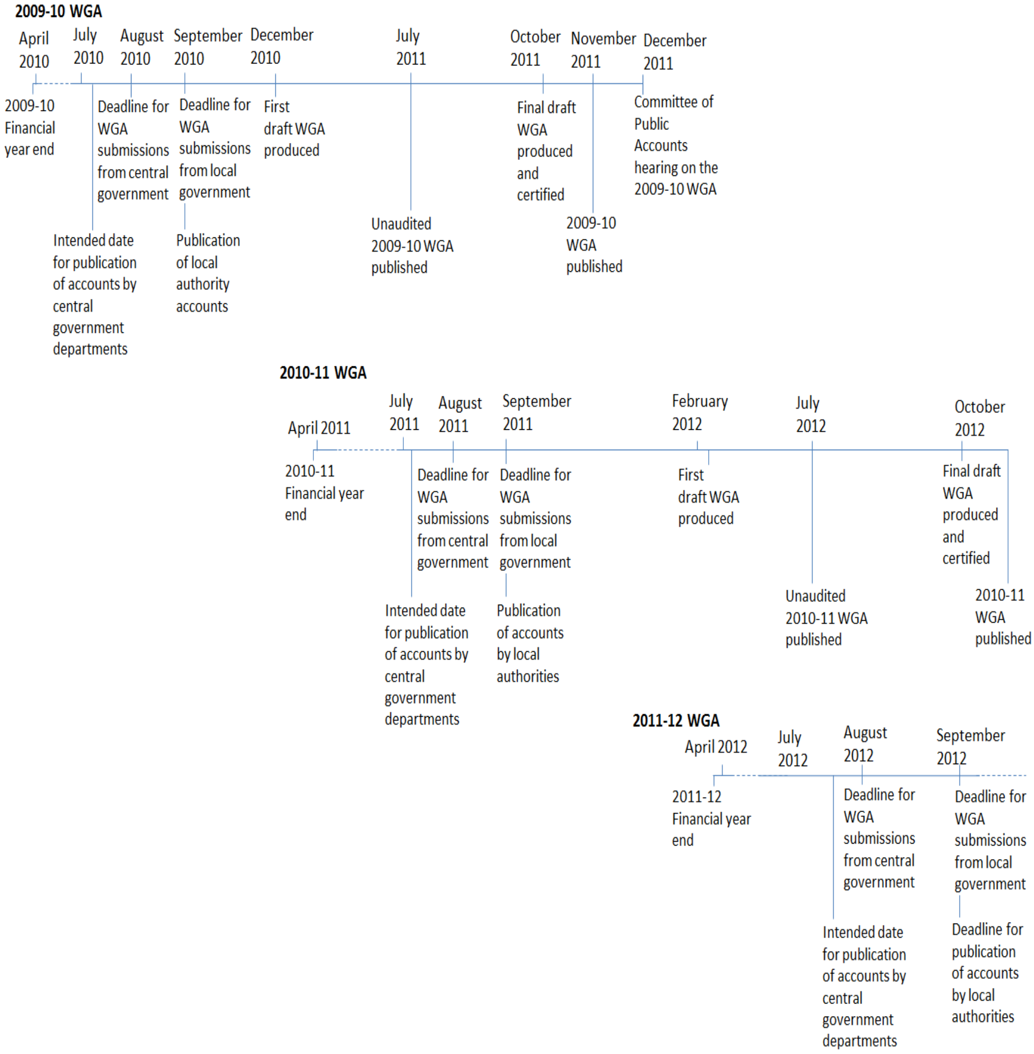
2.11 The 2010-11 WGA was certified in October 2012, some 19 months after the financial year ended. While it takes time to produce a robust and complete WGA, any delay between gathering the data and publishing the WGA reduces its ability to inform government policy.

2.12 The delay in producing the WGA limits the speed at which improvements can be made. Many improvements depend on the right data being collected by the Treasury, but by the time the 2009-10 WGA was completed, work was underway on the 2010-11 WGA and most of the underlying data had already been received by the Treasury Because preparation cycles currently overlap, improving the WGA takes more than one year (**Figure 18**).

[38] Treasury Group Internal Audit, *Review of the Whole of Government Accounts Processes: Final Report*, May 2012

Figure 18

Improving the WGA takes more than one year



Source: National Audit Office

2.13 Despite limited opportunities, the Treasury has taken steps to make the WGA more transparent and complete. The 2010-11 WGA:

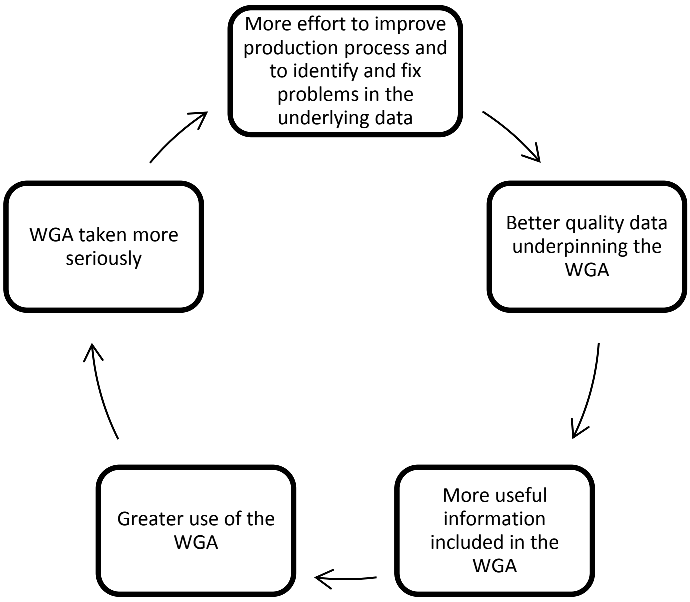
- included comparative data for the first time;
- had greater internal consistency because local government has now adopted International Financial Reporting Standards; and
- consolidated the financial activities of additional bodies, such as the Bank of England.

Improvements need to be made to the process for producing WGA

2.14 The more that improvements are made to the content of the WGA and the process for producing it, the more the WGA is likely to be used, both within government and by external organisations (**Figure 19)**.

Figure 19

Improving the its data and production process could lead to greater use of the WGA



Source: National Audit Office

2.15 Both the Treasury and NAO have identified significant problems in the returns submitted to Treasury by bodies included within the WGA. It takes time for Treasury to fix these problems further delaying the production of the WGA. Such issues include:

- expenditure being incorrectly classified;
- double counting of the same assets in different accounts;
- insufficient identification and disclosure of intra government transactions and balances; and
- poor data being submitted, for example by academies (**Box 7**).

Box 7: Data quality in the academies sector

The increasing size of the academies sector made collecting all its data a challenge.

As at 31 March 2011, there were 470 academies of which 195 were omitted from the WGA. This figure consists of 123 academies which each received less than £5 million funding in 2009-10, 59 which opened in the last two months of 2010-11, and 13 which did not submit returns. There was no attempt by the Treasury or the Department for Education to estimate the impact of these omissions but I estimate that the omission of these academies means assets in the WGA are understated by some £2.1 billion.

For the 275 academies that were included in the WGA, my audit found significant weaknesses in the process for consolidating them. Academies prepared their individual WGA returns but the Department for Education did not put in place arrangements for the returns to be audited. Sufficient review of data quality or reasonableness had not been carried out, by either the Treasury or the Department for Education, to compensate for this lack of audit. More information is included in Part 3 of this Report.

Source: National Audit Office

2.16 Some transactions and balances which should have been eliminated remained in the WGA. To present a true and fair view of government's finances, and to meet the requirements of accounting standards, transactions and balances between government entities need to be eliminated from the WGA.

2.17 The level of un-eliminated transactions and balances, which I estimate to be up to £22.6 billion of income and expenditure and up to £10.4 billion of assets and liabilities, has led me to qualify my audit opinion. Further details are included in Part 3 of this Report and **Box 8** highlights that issues arising within the English health sector were a significant part of this problem.

2.18 Although Treasury established a process to eliminate transactions and balances over £1 million it was not followed consistently. There was a process, within central government only, for different bodies in the WGA to agree transactions above £5 million but there were particular difficulties with the elimination of intra-group transactions and balances between central and local government. For 2011-12, the Treasury has tried to reduce the level of un-eliminated balances by providing feedback to local authorities where they find problems with their data.

Box 8: Eliminating transactions within the health sector

The WGA information for the health sector is consolidated from WGA returns from the three health accounts – the Department for Health Resource Accounts, the NHS Trusts Summarised Accounts and the Foundation Trusts Consolidated Accounts. All of these accounts are big consolidations in their own right and there are significant amounts of business activities between the groups and also with the local government sector. The auditors of all three of these accounts identified material errors and omissions in the intra-government transactions and balances that were reported. This included issues where one party had reported an intra-group transaction or balance but the counter-party had not reported any and where there were significant differences between what each body had reported. The Department for Health has not done sufficient work in 2010-11 to resolve these issues. These errors and omissions made up a significant amount of the elimination uncertainty for which I qualified my opinion on the WGA.

From 2011-12 all these accounts will be consolidated into one account for Department of Health under the clear line of sight initiative (paragraphs 2.19 to 2.20). This will mean that more work will have to be undertaken by the Department of Health to agree the intra-group transactions and balances. The Treasury expects that this will reduce the uncertainty in the consolidated heath accounts, which will in turn reduce the uncertainty within the WGA.

Source: National Audit Office

2.19 From 2011-12, the accounts of non-departmental public bodies and some other arms-length bodies will be consolidated into that of their parent Department under the Treasury's *Clear Line of Sight* initiative. This should improve the WGA process as the Treasury will need to collect data from fewer bodies and more of the work to eliminate intra-government transactions and balances will have been completed during the preparation of each Department's annual accounts.

2.20 The need to consolidate more bodies contributed to two departments publishing their accounts later than the July 2012 Parliamentary recess deadline. Other departments also missed the deadline for other reasons. Delays in finalising the statutory accounts will lead to delays in completing and submitting the related WGA data.

The lack of detail in the WGA inhibits its effectiveness

2.21 As I recommended in my report on the 2009-10 WGA, the Treasury could improve the WGA by including additional disclosures. The 2010-11 WGA does not show how spending is distributed across the main areas of government such as defence, health and education. It does not detail how much was spent on different types of goods and services such as consultancy and accommodation. Nor does it show how public spending is distributed between individual nations or regions within the UK.

2.22 The Treasury currently uses its Combined Online Information System (COINS) to collect WGA data from central government. The system and data is also used for other activities such as producing public expenditure statistics and Supply Estimates for Parliamentary scrutiny. From 2012-13, a new Online System for Central Accounting and Reporting (OSCAR) will replace COINS. The new system is designed to allow a more detailed segmental analysis to be produced, provided the Treasury collects suitable data from component bodies.

2.23 The Treasury plans to introduce a common chart of accounts across central government from April 2014. If successful, this will improve the consistency with which different departments record transactions in their accounts and improve the process for preparing data for the WGA. Currently there are inconsistencies in the way that WGA entities record their transactions, for example, some bodies categorise spending on agency staff as consultancy (part of 'Purchase of goods and services') while others categorise similar spending as part of 'Staff costs'.

Part Three

Qualifying the Comptroller and Auditor General's Audit Opinion

Introduction

3.1 This part of my Report explains why I have qualified my Audit Opinion on the 2010-11 Whole of Government Accounts (WGA) and sets out the actions taken by the Treasury to address the issues identified in my Report on the 2009-10 Accounts. As highlighted in Part 2, it will take some time before a number of issues, which have led me to qualify my Audit Opinion, will be able to be resolved. However, whilst the Treasury has made some progress this year, my qualifications remain.

My obligations as auditor

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

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

3.3 I have qualified my opinion on the WGA 2010-11 because in a number of significant areas, the WGA does not comply with International Financial Reporting Standards as adapted for the public sector context,[39] and this has had a material effect on the figures presented. My qualifications relate to:

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

[39] The Government Financial Reporting Manual (FReM)

3.4 I have also limited the scope of my opinion on the WGA 2010-11 because of the following issues, which meant I was unable to obtain sufficient and appropriate audit evidence to base my opinion in certain areas:

- there was a lack of evidence to support the completeness of the intra-government adjustments to remove transactions and balances between the bodies included in the WGA;
- there was a lack of evidence to support the completeness and accuracy of the value of schools' assets included in the Accounts; and
- issues arose within the audit opinions of two material accounts included in the WGA where auditors have limited the scope of their audits.

Qualified audit opinion relating to the WGA boundary

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

3.6 I cannot quantify the impact of this on the WGA with certainty, as I do not have information needed to identify the transactions that would have to be removed to provide a consolidated view. However, for illustrative purposes, I have examined the impact of adding the gross assets, liabilities, income and spending published in the individual accounts of public sector bodies that the Treasury did not include in the WGA. Although these figures are only illustrative, they demonstrate that the exclusions represent a material omission from the WGA (**Figure 20**).

Accounting policies

3.7 The definition of the whole of government boundary, and applying this definition, determines the content of the WGA. The Government Resources and Accounts Act 2000 allows the Treasury to define the WGA boundary.[40] The Treasury has adopted the classifications of public bodies used by the Office for National Statistics in preparing the National Accounts.[41]

3.8 The Act also requires that the Treasury prepares the WGA so that they 'present a true and fair view and conform to generally accepted accounting practice subject to such adaptations as are necessary in the context'. The Treasury has established a framework[42] to support this requirement which is based on International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board. The National Accounts are based on the statistical standards set out in the European System of National and Regional Accounts 1995 (ESA 95). Financial statements and the National Accounts are each prepared for different purposes and are not therefore

[40] Section 9, Government Resources and Accounts Act 2000.

[41] Note 1.21.1 to the WGA.

[42] The Government Financial Reporting Manual (FReM).

alternative views on the same issue – they can legitimately lead to different conclusions.

Figure 20

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

	Revenue (£bn)	Expenditure (£bn)	Impact on the net deficit (£bn)	Assets (£bn)	Liabilities (£bn)	Impact on the net liability (£bn)
2009-10 WGA (before restatement)	582.0	(746.5)	**(164.5)**	1,207.5	(2,419.3)	**(1,211.8)**
Total values of entities excluded from the 2009-10 WGA	108.4	(108.7)	**(0.3)**	3,167.1	(3,006.7)	**160.4**
2010-11 WGA	**614.0**	**(708.4)**	**(94.4)**	**1,227.7**	**(2,421.1)**	**(1,193.4)**
Total values of entities excluded from the 2010-11 WGA	**85.4**	**(85.5)**	**(0.1)**	**2,654.7**	**(2,510.3)**	**144.4**
2010-11 figures consist of:						
Network Rail Ltd	5.7	(5.4)	**0.3**	43.3	(35.6)	**7.7**
State-owned banks (temporary ownership)[1]	75.4	(77.6)	**(2.2)**	2,463.7	(2,338.8)	**124.9**
State-owned banks (longer-term ownership)[2]	2.1	(0.9)	**1.2**	111.6	(108.1)	**3.5**
Financial services sector[3]	0.9	(0.9)	**0.0**	20.1	(20.2)	**(0.1)**
Further education institutions[4]	-	-	**-**	12.6	(5.5)	**7.1**
Transport sector[5]	1.1	(0.5)	**0.6**	2.8	(1.8)	**1.0**
Other[6]	0.2	(0.2)	**0.0**	0.6	(0.3)	**0.3**

NOTES

1. Lloyds Banking Group plc, Royal Bank of Scotland Group plc and Northern Rock plc.
2. Northern Rock (Asset Management) plc and Bradford & Bingley plc.
3. Financial Services Authority and the Financial Services Compensation Scheme.
4. No amounts have been included for income and spending of Further Education Institutions because the majority of their operations are funded through government grants, which are included in Note 9 to the WGA. Their assets and liabilities have been estimated from data provided by the Higher Education Funding Council for England and relate to 2009-10.
5. Directly Operated Railways Ltd (including East Coast Mainline Ltd), CTRL section 1 Finance plc and Trust Ports. The figures for Trust Ports have been estimated from available accounts for year-ended 31 December 2009.
6. NHS non-independent charities and London councils. The figures for NHS charities have been estimated by the Department of Health from 2007-08 Charity Commission data.
7. The net assets of some of the entities are included in the WGA as equity investments, for example the state-owned banks are included in the accounts of the Treasury.
8. The bodies have been treated as if they had always been entirely owned by the public sector. In particular, for Royal Bank of Scotland and Lloyds Banking Group, no account has been taken of the residual private sector shareholdings.
9. Not all bodies have a March year-end, for example figures for the banks relate to the year ending 31 December 2010.

Source: National Audit Office analysis of Note 36 to the WGA and published accounts

3.9 In my view, the most appropriate basis to apply when compiling a set of financial statements would be the criteria set in the accounting standards. The Government Resources and Accounts Act requires the Treasury to prepare accounts for a group of bodies, each of which appears to the Treasury to exercise functions of a public nature, or to be entirely or substantially funded from public money. In describing the boundary for National Accounts, adopted by the Treasury for WGA, the statistical standards require including bodies that the Office for National Statistics has classified as 'public sector'. Public sector bodies are those where government has control over determining their general corporate policy. Accounting standards, however, require including bodies that are subject to government control, and define control as 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'.[43]

3.10 As a consequence of the Treasury adopting statistical, rather than accounting, standards when it comes to defining 'control', the WGA excludes Network Rail Ltd, a company limited by guarantee with the Department for Transport acting as one of the guarantors. Under accounting standards, Network Rail would be classified as being part of the public sector as the government's interest in the company is akin to an equity shareholder's interest. The government effectively gives security to the providers of debt finance to Network Rail and is acting as the lender of last resort in the event of financial difficulties. The government is the party bearing the risk that would normally be borne by equity capital if Network Rail were an equity-based company.[44] The Treasury, by excluding Network Rail, which had net assets of £7.7 billion at 31 March 2011 (£6.0 billion at 31 March 2010), did not comply with the accounting standards that in my view prevail.

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

- bodies that are not controlled by government, such as Parliament;
- a number of small bodies that have not been consolidated on the basis of size (Annex 3 to the WGA); and
- other bodies that are partly or wholly owned by the government, such as the Royal Bank of Scotland (Figure 20).

3.12 I consider it appropriate to exclude those bodies that are not controlled by the government, as this treatment meets with accounting standards. I also consider that it is acceptable to exclude the small bodies as they do not represent a significant exclusion from the WGA. However, by adopting generally accepted accounting

[43] *International Accounting Standard 27 – Consolidated and Separate Financial Statements*.

[44] *Network Rail NAO ONS Joint Statement*, www.ons.gov.uk/ons/guide-method/classifications/na-classifications/classification-articles/network-rail/ons---national-audit-office--nao--joint-statement-on-network-rail.pdf.

standards, I consider that the bodies listed in Figure 20, where the government has the ability to control their activities, should be included in the WGA.

Actions taken by the Treasury since 2009-10

3.13 In the 2010-11 Accounts, the Treasury has included the Bank of England, Bank of England Asset Purchase Facility Fund and London Continental Railways. The impact of this is included in Note 39 to the WGA.

3.14 The Treasury has set out in Annexes 2 and 5 of the WGA the actions it intends to take to include further bodies into future WGAs. In 2011-12, it intends to include the Financial Services Compensation Scheme and public railway companies (excluding Network Rail). It also intends to consolidate Bradford & Bingley plc and Northern Rock (Asset Management) plc in 2013-14 and will consider the status of other public sector entities not currently included in the WGA.

Recommendation for further action

3.15 The qualification of my opinion on this matter is likely to remain until all significant government-controlled entities, including Network Rail Ltd, are included in line with accounting standards.

3.16 I continue to recommend that the Treasury should review its criteria for including bodies in the WGA.

Qualification arising from disagreement relating to the inconsistent valuation of infrastructure assets

3.17 I have qualified my opinion because of the impact of the inconsistent application of accounting policies. This arises as the statutory accounts of the bodies included in the WGA were prepared on different bases and the Treasury did not make adjustments for the known differences in accounting for infrastructure assets when consolidating these bodies. The Treasury has provided evidence of an assessment of the different accounting frameworks to prove that there were no other material differences.

The WGA accounting framework

3.18 The accounting framework that WGA must follow is set out in the Government Financial Reporting Manual which applies International Financial Reporting Standards (IFRS), as adapted for the public sector context. However, for 2010-11, some of the bodies included in the WGA prepared their accounts based on accounting frameworks that did not fully comply with the requirements of the Government Financial Reporting Manual.[45]

3.19 Under accounting standards,[46] the Treasury should identify the impact of the different frameworks and make appropriate adjustments to the WGA, where material,

[45] Annex 4 to the WGA

[46] *International Accounting Standard 27 – Consolidated and Separate Financial Statements*

so that the WGA is prepared on the same basis. The Treasury has undertaken an assessment of these differences and identified one material inconsistency, but has not been able to adjust for this in 2010-11. I do not have the information to fully quantify the effect of this limitation.

3.20 The one area of material misstatement is due to differences between the accounting policies of central and local government. The accounting framework used by local government requires local authorities to value their infrastructure assets using historic cost, but central government values assets at their depreciated replacement cost in line with the requirements of the Government Financial Reporting Manual.[47] The Treasury estimates that this difference in accounting treatment has resulted in an understatement of asset value of at least £200 billion.[48]

Actions taken by the Treasury since 2009-10

3.21 In 2009-10, I qualified the WGA more widely as the local government sector prepared their accounts on a UK version of the accounting standards. In 2010-11, the local government sector adopted a revised framework which followed International Financial Reporting Standards. This brought this sector's accounting framework more in line with that of central government and the Treasury has provided evidence of consideration of any remaining differences in accounting treatments, which are not material, with the exception of the issue described above for valuing infrastructure assets.

Recommendations for further action

3.22 The Treasury should make the adjustments that are required to bring the accounts into line, where material. The complexities involved in moving the accounting for infrastructure assets from historic cost to depreciated replacement cost mean that this information will not be available until at least 2012-13. Until accounting frameworks are applied consistently, the qualification of my audit opinion will remain.

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

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

Accounting requirements

3.24 The WGA is a consolidated account which is prepared by including the financial activities of around 1,500 government controlled bodies. Transactions and balances

[47] As required under paragraphs 6.2.10 to 6.2.18 of the Government Financial Reporting Manual

[48] Note 14.1 to the WGA: The best proxy available for depreciated replacement cost is the calculated asset value used by the Office for National Statistics from their perpetual inventory model reflected in the *National Accounts*. The 2011 *National Accounts* estimated the value of the road network at £248 billion as at 31 December 2009, implying a likely understatement of at least £200 billion.

between these bodies are removed so that income, expenditure, assets and liabilities are not overstated between bodies within the group, as required by accounting standards.[49]

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

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

3.27 Within these packs, bodies must identify and report all intra-government balances, transactions, income and expenses that are over £1 million and the relevant counterparty. Examples of such transactions are where a central government department gives grants to local government, such as the Revenue Support Grant. With this information, the Treasury matches these balances and transaction streams and removes them from the WGA. The scale of this task is challenging and, as part of the preparation of the WGA for 2010-11, the Treasury removed significant values of transactions and balances (**Figure 21**).

Figure 21

Value of transactions removed from the WGA in 2010-11

	Gross value (£bn)	Transactions removed (£bn)	Net value (£bn)	Balance removed (%)
Income	1,043	411	632	39.4
Expenditure	1,136	428	708	39.2
Net deficit for the year	**151**	**N/A**	**94**	**N/A**
Assets	1,884	656	1,228	34.8
Liabilities	3,026	605	2,421	20.0
Net liabilities	**1,142**	**N/A**	**1,193**	**N/A**

Source: National Audit Office analysis of Note 2 to the WGA.

3.28 I have considered the approach that the Treasury has taken in removing these intra-government transactions and balances during 2010-11. There is a process for bodies included in the WGA to identify these intra-government balances and for some level of agreement process to take place. However, there is a material residual uncertainty over some of the figures in the financial statements because the removal of transactions and balances is potentially incomplete and inaccurate. This uncertainty arises where:

[49] *International Accounting Standard 27 – Consolidated and Separate Financial Statements*, paragraph 20.

- either of the entities declare different intra-government transactions or balances (requiring an assumption to be made as to the correct amount to remove); or
- only one entity declares an intra-government transaction or balance (a particular issue between central and local government bodies); or
- neither body declares an intra-government transaction or balance.

3.29 Using available evidence, I have estimated the level of uncertainty as being up to £22.6 billion (£17.0 billion in 2009-10) in gross income and expenditure and up to £10.4 billion (£6.8 billion in 2009-10) in gross assets and liabilities (**Figure 22**). I have reviewed the impact of the uncertain transactions on the financial statements and have concluded that the uncertainty mainly resides within the gross figures in the primary statements (between income and spending and separately between assets and liabilities). There are, however, some transactions which are not confined solely to one statement, such as grant-in-aid expenditure and grant-in-aid financing within reserves. This means that the potential impact of the un-eliminated intra-government transactions and balances on the annual deficit and net liabilities is not likely to be zero. I estimate that the potential maximum impact of the uncertain transactions in Figure 22 could be up to £2.9 billion (£3.2 billion in 2009-10), which represents a possible misclassification between the annual deficit and net liabilities.

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

Figure 22

Sources of uncertainty about transactions removed and the impact on the financial statements in 2010-11

	Sources of uncertainty			
	Entities declaring different intra-government transactions or balances (£bn)	Only one entity declares an intra-government transaction or balance (£bn)	Neither entity within an expected relationship declares an intra-government transaction or balance[1] (£bn)	Impact on the financial statements (potential overstatement) (£bn)
Consolidated statement of revenue and expenditure	8.0	8.6	6.0	22.6
Consolidated statement of financial position	1.6	7.0	1.8	10.4

NOTES

1. Calculated with reference to transaction streams and balances that are expected to be fully removed.

Source: National Audit Office

Actions taken by the Treasury since 2009-10

3.31 There has not been any significant action taken to address this qualification in 2010-11.

Recommendations for further action

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

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

Qualification arising from disagreement in the accounting for 3G licences

3.34 I have qualified my opinion because I consider that the Treasury has not complied with accounting requirements regarding accounting for the income from the sale of 3G licences in April 2000. The impact of this on the 2010-11 WGA is that income is understated by £1.1 billion, liabilities are understated by £10.3 billion (£11.4 billion in 2009-10) and the general fund is understated by £10.3 billion (£11.4 billion in 2009-10).

Accounting requirements

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

3.36 In my view, income arising from this auction has been accounted for incorrectly in the WGA. Following accounting standards,[50] as licence holders have the right to access the spectrum for 20 years and there is an ongoing performance obligation to maintain the airwaves, a more correct accounting treatment would be to recognise this income over 20 years rather than in the first year.

---

[50] *International Accounting Standard 18 – Revenue*

3.37 The Treasury does not agree with this view and, as disclosed in Note 1.22.3 to the WGA, believes that there are no additional material performance obligations. Therefore, the Treasury has not adjusted the WGA for this transaction and I have qualified my opinion based on my disagreement of this material issue.

Recommendations for further action

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

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

3.39 Where the external auditors of bodies in the WGA qualify their opinions on the statutory accounts, I am required to consider the impact of these 'true and fair' qualifications on my opinion on the WGA. In 2010-11, external auditors qualified their opinions of some 23 accounts (29 accounts in 2009-10, Annex 1 to the WGA).

3.40 The most significant of these qualifications relate to the resource accounts of the Ministry of Defence and the Cabinet Office: Civil Superannuation. Given these accounts have a material impact on the WGA, I have also qualified my opinion on the WGA. Further details can be found in my audit opinions and within the annual accounts of the Ministry of Defence[51] and Cabinet Office: Civil Superannuation[52].

3.41 I will assess the impact of any qualifications on the statutory accounts for the 2011-12 audit of WGA. However, due to aspects of the Ministry of Defence qualification, it is likely that elements of this qualification will remain in place.

3.42 Following qualification of the 2010-11 Civil Superannuation accounts, the Cabinet Office and the pension scheme administrator, MyCSP, attempted to obtain further evidence to support the calculation of benefits paid, but this was insufficient to assure me that there was no material error in the WGA. The 2011-12 accounts are currently being audited.

Qualification arising from limitation in audit scope due to lack of evidence supporting the completeness and accuracy of the values of schools' assets included in the Accounts

3.43 I have qualified my audit opinion because not all school assets are included in the WGA and because of the poor quality of the data submitted by academies, which I consider to be material to the Accounts. I cannot determine with any reliability the total misstatements arising from these schools issues, however, the estimates in the paragraphs below are based on average values of school assets. I estimate that up to £32.5 billion of assets held by voluntary aided and foundation schools, up to a further £9.0 billion of assets held by voluntary controlled schools and some £4.0 billion of

---

[51] www.mod.uk/NR/rdonlyres/E0440EEF-1A7E-4335-B6CD-1CC394FA0AAD/0/mod_ara1011.pdf

[52] www.official-documents.gov.uk/document/hc1011/hc02/0245/0245.pdf

assets held by academies have been omitted from the WGA. In addition, a further £3.5 billion of assets reported in academies' returns was not subject to audit.

Assets held by local authority maintained schools in England and Wales

3.44 All local authority maintained schools are classified by the Office for National Statistics as public sector and hence fall within the Treasury's boundary for inclusion within the WGA. Taking an approach based on accounting standards, [53] I also consider that these schools should be included within the WGA, when taking into account the controls that local authorities and the Secretary of State for Education have the ability to exert over such schools.

3.45 However, such schools have only been included in the WGA if their financial activities were included in the accounts of individual local authorities. A working group, led by the Chartered Institute of Public Finance and Accountancy (CIPFA), reported[54] that not all schools were included within local authority accounts[55] and set out its understanding of how local authorities accounted for the different types of local authority maintained school:

- **Community schools** should be recognised on the balance sheets of local authorities as they are wholly owned by the authority and the authority sets the admission policy and admission numbers.
- **Foundation and voluntary aided schools** should not normally be recognised on the balance sheets of local authorities as the assets are not usually owned by the authority and these schools set their own admissions policies and admission numbers.
- **Voluntary controlled schools** are the most difficult category to determine and the factors are very finely balanced. The non-current assets are not generally owned by the authority, but local authorities are normally responsible for setting the admissions policy and admissions numbers and therefore have some control over the access to economic benefits and service potential inherent in the assets. However, it is not clear that in doing so they have deprived the governors and trustees of this service potential. CIPFA therefore considered that there is not sufficient evidence to override the form of the arrangement and that therefore these assets are not the assets of the local authority.

3.46 The working group further considered that local authorities are likely to have accounted for schools in line with the group's conclusions. Foundation, voluntary aided and community schools have generally been accounted for in line with the conclusions set out above (although there is some evidence that a small number of

---

[53] *International Accounting Standard 27 – Consolidated and Separate Financial Statements*

[54] FRAB (108) 11: Consideration of the Code of Practice on Local Authority Accounting 2011/12 and 2012/13, www.hm-treasury.gov.uk/d/frab108_11.pdf

[55] This is the correct treatment for the local authority accounts and there is no suggestion that the underlying opinions on any of these accounts is compromised.

authorities have recognised all four categories of school on their balance sheet). The treatment of voluntary controlled schools is less clear and would be a decision for the local authority on a case by case basis.

3.47 In considering the impact of this treatment of the local authority maintained schools' sector on the WGA, I have concluded that I have insufficient evidence to support the completeness and accuracy of the value of these schools' assets within the WGA. Although I have sufficient evidence over the treatment of community schools, which are accounted for within local authorities' accounts, I have been presented with no evidence to enable me to conclude that the assets of foundation, voluntary aided and voluntary controlled schools have all been included within the WGA.

3.48 Based on the estimates I do have, the omissions are material to the WGA. **Figure 23** summarises the treatments, showing the number of schools in each category and the estimated value of these schools' buildings. There are up to £32.5 billion of assets excluded from WGA for voluntary aided and foundation schools, with a further potential omission of up to £9.0 billion for voluntary controlled schools.

Figure 23

Estimated net book value of local authority maintained schools, and whether these are included or excluded from the WGA

	Local authority maintained schools				
	Community	**Voluntary aided**	**Voluntary controlled**	**Foundation**	**Total**
Number of primary schools[1]	10,154	3,700	2,507	486	**16,847**
Estimated net book value[2] (£m)	30,462	11,100	7,521	1,458	**50,541**
Number of secondary schools[1]	1,505	521	99	811	**2,936**
Estimated bet book value[2] (£m)	22,575	7,815	1,485	12,165	**44,040**
Total estimated net book value (£m)	**53,037**	**18,915**	**9,006**	**13,623**	**94,581**
Estimated value of schools included in WGA (£m)	53,037	-	-	-	**53,037**
Estimated value of schools not included in WGA (£m)	-	18,915	-	13,623	**32,538**
Estimated value of assets which may or may not be included within the WGA (£m)	-	-	9,006	-	**9,006**

NOTES

1. Estimates as at January 2011 based on a typical carrying value of £3 million for primary schools and £15 million for secondary schools as estimated by CIPFA.
2. These estimates may be overstated as some schools may lease their assets, rather than owning them. There is no information available to take account of this.

Source: FRAB (108) 11: Consideration of the Code of Practice on Local Authority Accounting 2011/12 and 2012/13, www.hm-treasury.gov.uk/d/frab108_11.pdf

Academies

3.49 Academies are all considered to be controlled by government[56] and are required to be consolidated into the WGA. In my Report on the 2009-10 WGA, I highlighted that the information provided by academies was not of adequate quality, was unaudited and was based on assumptions which had not been proven valid. The number of academies has increased from 203 at 31 March 2010 to 470 at 31 March 2011, increasing the significance of this sector to the WGA.

3.50 Of the 470 academies, only 275 have been consolidated into the WGA. Of the 195 academies that have not been consolidated, Ministers at the Department for Education and HM Treasury agreed that 182 would not be asked to submit data for WGA due to the amount of funding they receive (all academies receiving less than £5 million of funding) or the date they opened (those academies opening after 4 January 2011). We estimate that the omission of these academies has resulted in an understatement of gross assets in these Accounts of £2.4 billion. In addition, 13 academies asked to submit data for WGA either made no submission or submitted a return of insufficient quality for it to be included in the WGA. I estimate this resulted in a further understatement of gross assets of £0.2 billion.

3.51 Academies have a 31 August year-end. Where they have submitted data for WGA, these returns are compiled from a five month pro-rata of their audited accounts for the period to 31 August 2010, together with unaudited data to reflect subsequent activity to March 2011. Some academies did not prepare audited accounts for the period to 31 August 2010, and their return was based entirely on unaudited data. Under section 10 of the Government Resources and Accounts Act 2000, bodies that have been designated for inclusion in the WGA are required to arrange for their returns to be audited. The Treasury and the Department for Education agreed not to require academies' returns to be audited and there has been insufficient review by the Treasury and the Department for Education to provide assurance that the data included in the Accounts is accurate and complete. My audit team has reviewed the process for consolidating these returns but were unable to obtain any assurance over the accuracy and completeness of this data.

3.52 As a result, I have been unable to obtain sufficient and appropriate audit evidence on which to base my opinion on this element of the WGA. The value of unaudited data included within WGA from the individual academy returns for the year ended 31 March 2011 is £2.2 billion of income, £1.9 billion of expenditure, assets of £3.5 billion and liabilities of £0.3 billion.

3.53 In reviewing the data submitted from academies' returns which has been included within the WGA, I observed that 122 of the 275 academies reported land and buildings with a value of less than £1 million. I estimate that this could mean that there has been an additional omission of assets with a value of £1.4 billion on the basis that I expect that the majority of academies should recognise school buildings in their

[56] The Office for National Statistics classify academies as public sector and academies are also deemed to be controlled under the accounting standards definition.

accounts. Academies would generally either own their school buildings or they would be rented under long-term leases which are likely to be accounted for as finance leases and capitalised under International Financial Reporting Standards (IFRS). academies produce their accounts under the Charities SORP, and the WGA returns were not adjusted for any differences between this reporting framework and IFRS. One of the key differences is that under IFRS more leases are treated as finance leases, which results in an unquantifiable understatement of WGA assets.

3.54 There are a number of other significant weaknesses in the process for consolidating academies in the WGA:

- The Department for Education does not have a robust process for consolidating academies which resulted in significant adjustments being made to the academies' figures.
- The process was not designed to obtain many of the required disclosures for academies.
- Academy land and buildings are generally transferred from a local authority when a maintained school converts to an academy. However, the Department for Education and the Treasury did not put in place procedures to accurately identify such transfers and ensure consistency between the local authority WGA returns and the information submitted by academies.

Actions taken by the Treasury and Department for Education

3.55 For 2011-12, the Treasury has amended the returns local authorities are required to submit to the Treasury to include numbers and values for local authority maintained schools that are not included in the local authorities' balance sheets. However, this part of the return is not subject to audit. I will review the accuracy and robustness of this data for 2011-12 and beyond.

3.56 The Department for Education is putting in place an alternative approach, which they are now piloting, for 2011-12 that will use available data sources to construct a WGA return for academies as at 31 March 2012. They are developing a framework to collect, validate and adapt this information with a view to submitting data to HM Treasury for the WGA that is, in all material respects, equivalent to the position as at 31 March 2012. This aims to mitigate the impact of academies having their financial year end in August instead of March, but does introduce a level of risk and estimation uncertainty that will require careful management by the Department and flexibility in approach if results prove inadequate or inconclusive.

Recommendations for further action

3.57 The Treasury should undertake further work to develop a more robust methodology for collecting data on numbers and values of schools' assets to ensure that the assets in the WGA are complete, accurate and auditable.

3.58 The academies sector increased significantly in size between 31 March 2011 and 31 March 2012 and is continuing to grow, with 1,660 academies open at 31 March

2012. The Treasury and the Department should continue to work towards putting into place a sustainable methodology for collecting data from academies which will provide a true and fair view of the financial state of the academy sector which is auditable.

Other issues on which I have not qualified my opinion

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

- I have included an emphasis of matter paragraph in my audit opinion for one account that is significant to the WGA, highlighting an area that is significantly uncertain in the values reported. This value has been calculated based on reasonable assumptions, but could change with future events. This relates to the uncertainties in estimating costs of the liabilities of the Nuclear Decommissioning Authority.
- The external auditor of some 22 accounts (16 in 2009-10) included in the WGA, qualified their audit opinions owing to the material existence of irregular spending;[57] that is using resources not in accordance with Parliamentary intentions. Of these, two are of significance to the WGA. These cover error and fraud in benefit payments and tax credit payments. These irregularities lead me to qualify my regularity opinion on the resource accounts of the Department for Work and Pensions since 1988-89 and the trust statement of HM Revenue and Customs since 2003-04. Because the scope of my audit of the WGA, which is set out in the Government Resources and Accounts Act 2000, does not require me to provide an opinion on regularity, irregular transactions do not lead to a qualification of my audit opinion on the WGA.

Amyas C E Morse
Comptroller and Auditor General
29 October 2012

National Audit Office
157–197 Buckingham Palace Road
Victoria
London SW1W 9SP

[57] Included in this number are 10 accounts qualified on a 'true and fair' basis as explained in paragraph 3.39.