17 July 2013

HM Treasury: Certificate and Report of the Comptroller and Auditor General

Whole of Government Accounts 2011-12

This is an extract from the Certificate and Report of the Comptroller and Auditor General on the Whole of Government Accounts 2011-12

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

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15 July 2013

Contents

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 Accounts (the Account) for the year ended 31 March 2012 under the Government Resources and Accounts Act 2000. These comprise the Consolidated Statements of Revenue and Expenditure, Comprehensive Income, Financial Position, 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. My responsibility is to audit, certify and report on the accounts with a view to satisfying myself that they present a true and fair view. 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 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, Performance Report, Governance Statement, Remuneration Report and Comparison to National Accounts 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 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 Account 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 Account should include Network Rail.

I also consider that HM Treasury's accounting policy has not been applied consistently in 2011-12 as a number of significant bodies[2] have not been included in the Accounts, even though they are classified by the 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.

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 Account's Statement of Financial Position. The exclusion of the following categories of bodies could affect this Statement, illustrating the potential impact:

- Network Rail which has gross assets of £47.8 billion and gross liabilities of £39.3 billion;
- Publicly-owned banks which have gross assets £2,572.8 billion and gross liabilities of £2,445.5 billion; and
- Other bodies which have estimated gross assets of £18.9 billion and gross liabilities of £6.1 billion.

Qualification arising from disagreement relating to inconsistent application of accounting policies

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. These bodies fall under the following categories:

- Bodies in the local government sector follow the Code of Practice on Local

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

[2] The significant bodies excluded are listed in Figure 17 in my Report.

[3] This framework is set out in the Government Financial Reporting Manual.

Authority Accounting in the UK for 2011-12;

- Bodies that follow either pure IFRS or UK GAAP;
- Bodies that follow the Charities Statement Of Recommended Practice; and
- Bodies that follow the NHS reporting framework.

Under accounting standards, the Treasury should identify the impact of the different frameworks and make appropriate adjustments to the WGA, where material, so that the Account is prepared consistently in accordance with the relevant financial reporting framework.[4] The Treasury has undertaken an assessment of these differences and identified one material inconsistency, but has not been able to adjust for this in 2011-12. This inconsistency 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 between historic cost and depreciated replacement cost for local government assets could be at least £200 billion.[5] I do not have the information to fully quantify the effect of this limitation.

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 £1.3 billion greater; liabilities would be £9.0 billion greater (£10.3 billion in 2010-11); and the value of the general fund would be £9.0 billion less (£10.3 billion in 2010-11).

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 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 a material value of intra-government transactions and balances which have not been eliminated. The effect of not adjusting for these could lead to a potential overstatement of up to £16 billion (£22.6 billion in 2010-11) in gross income and expenditure and up to £5.1 billion (£10.4 billion in 2010-

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

[5] Note 14 to the WGA

11) 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 expenditure for the year or net liabilities. The totals reported for the net expenditure for the year and the net liabilities are subject to a maximum uncertainty of some £1.0 billion (£2.9 billion in 2010-11). 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 limitation of 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 three areas of uncertainty:

- local authority maintained schools' assets, which are estimated to be up to £26 billion of assets from voluntary aided and foundation schools and £8.5 billion assets from voluntary controlled schools have been omitted from these Accounts.
- local authorities transferred land and buildings with a book value of £6.5 billion to academies in 2011-12 with the academies recording additions of land and buildings of some £12.3 billion. The Treasury and the Education Funding Agency commissioned an exercise to value the academies' estates. The subsequent audit of the exercise found that not all land and buildings on academy sites should be included in the academies' accounts and the Agency was unable to demonstrate that the risks and rewards of ownership had been transferred in all cases. There is, therefore, insufficient evidence for me to establish the correct value of the assets that should be included within the Accounts.
- I have also been unable to obtain sufficient assurance from my audit that the data submitted by the academies is representative of the income and expenditure incurred in 2011-12.

Qualification arising from disagreement and limitation of 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 the Resource Accounts of the Ministry of Defence and the Cabinet Office: Civil Superannuation.

- **Ministry of Defence Resource Accounts**: Firstly, the Ministry has not complied with the relevant 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 2011 and 31 March 2012. This has also led to a consequential misstatement of the Account's Consolidated Statement of Revenue and Expenditure for 2010-11 and 2011-12. 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, in respect of the valuation of inventory (£3 billion) and certain non-current assets in the form of capital spares (£7 billion) recorded in the financial statements, the evidence available to me was limited due to the Department having failed to perform an adequate impairment review on a systematic basis. Consequently I was unable to obtain sufficient, appropriate audit evidence to support the valuation of £10 billion in the Statement of Financial Position and assess the completeness and accuracy of the associated transactions in the Statement of Comprehensive Net Expenditure. I have also been unable to obtain sufficient, appropriate audit evidence for the corresponding figures for 2010-11, which were also subject to this qualification.

- **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 scope of my audit was limited because 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 in the evidence to support the accuracy of benefits awarded in the year to 31 March 2012 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 valuation of the pension liability.

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 Accounts as at 31 March 2012 and of its net expenditure 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 – inherent 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, the lengthy timescales, final disposition plans for waste and spent fuel, timing of final site clearance and the confirmation of site end states mean that the ultimate liability will vary as a result of subsequent information and events, and may result in significant adjustment over time to the value of the provision, which currently stands at £52.9 billion (£49.1 billion in 2010-11).

Opinion on other matters

In my opinion, the information given in the Foreword and the Performance Report 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 on audit scope referred to in the basis for qualified opinion paragraphs above:

- 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 Governance Statement does not reflect compliance with HM Treasury's guidance.

My Report on pages 9 to 50 includes more details of the matters leading to my qualified opinion.

Amyas C E Morse
Comptroller and Auditor General

15 July 2013

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The Report of the Comptroller and Auditor General to the House of Commons

Summary

1 The Whole of Government Accounts (WGA) is a single set of accounts consolidating the financial activities of the UK public sector. The WGA for 2011-12 is the third such set of accounts to be published by HM Treasury.

Scope of this report

2 The purpose of my Report is to highlight key areas of the WGA of interest and to supplement these with broader observations to aid its interpretation. These observations are drawn from my work on the WGA and from my other work across the UK's public sector. My Report covers:

- In **Part 1**, I explain the key figures in the 2011-12 WGA and provide further insight into the Government's finances.
- In **Part 2**, I set out how the WGA is meeting its objectives, how it is being used so far and why I qualified my audit opinion on the 2011-12 WGA.

Key findings

3 The WGA shows the UK public sector's overall financial position, as defined by accounting standards. In 2011-12, the WGA deficit[6] (the difference between expenditure and income) decreased by £11 billion to £185 billion, once the 2010-11 position is adjusted to take into account the £126 billion gain arising from reducing the indexation rate used for public sector pensions and a £24 billion reduction in the value of social housing.

4 The financial positions in the WGA can be compared to those produced by the Office for National Statistics which, in turn, are used by Government for fiscal management purposes. The WGA deficit is more than the current deficit, and WGA net liabilities are more than the Public Sector Net Debt. Chapter 1 sets out the relationship between the WGA positions and those produced by the Office for National

[6] The 2011-12 WGA describes the WGA Deficit as "Net Expenditure for the Year". In previous years, it was termed "Net Deficit for the Year".

Statistics. The figures differ because the WGA goes further than these other measures by including long term obligations which occurred during the year but which will not be paid until some point in the future, for example, pension liabilities. The WGA also highlights categories of expenditure that are within the direct control of bodies included in the WGA and those that are based on external factors, such as pension and provision discount rates.

5 The WGA shows that the government's measures to reduce the deficit are beginning to have an impact. Direct expenditure has fallen from £663.3 billion in 2010-11 to £647.8 billion in 2011-12. This is the first full year of the Government's debt reduction plan and the WGA will continue to report on progress. However, the Government will need to take continued steps in order to make longer term and more sustainable savings.

6 The 2011-12 WGA is a true and fair account of the use of public resources, but my opinion remains qualified in certain aspects. My audit opinion on the 2011-12 WGA is similar to that for 2010-11, although the Treasury has made some improvements. My audit revealed significant issues with the quality and consistency of the data included in the WGA and some bodies, such as Network Rail, remain excluded from the WGA even though accounting standards require their inclusion.

7 The Treasury has again bought forward its publication of the WGA but, for it to be used more effectively, it needs to be produced faster. The 2011-12 WGA was published some 16 months after the financial year to which it relates. This is an improvement and is a significant milestone in achieving the Treasury's medium term goal of delivering the WGA within nine months of the year end.

8 The lack of detail in parts of the WGA continues to inhibit its usefulness and the underlying data is not yet good enough to allow improvements to be made. For example, the 2011-12 WGA does not breakdown expenditure by function or show how this is distributed across the UK's nations. The Treasury's current system, which is to be replaced, was not designed to collect this data.

Conclusions

9 As I concluded last year, 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. The Treasury continues to make improvements to the WGA so that it can meet all of its original objectives and is now beginning to address some of my qualifications. But, for the WGA to meet its full potential, the Treasury must do more before I can remove my qualifications.

Recommendations

10 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:

- **Ensure the profile of the WGA is raised within government and is used more effectively to help decision making.** The Treasury has started to take steps to do this, including for the 2013 Spending Round, but it needs to ensure this is embedded in all cross-government decision making.
- **Continue to improve the production process so that the WGA can be published quicker**.
- **Do more to remove my qualifications.** Until I am able to remove my current qualifications, the WGA cannot fully meet its objectives.
- **Improve data collection so that information in the WGA can become more detailed and be of greater use to its readers.** Whilst the WGA meets the requirements of the accounting standards, the WGA could add value by including more detail over government spending.

Part One: The UK Government's Financial Position

The Whole of Government Accounts

1.1 The Whole of Government Accounts (WGA) is a single set of audited accounts consolidating the financial activities of most of the UK public sector. The WGA sets out what the public sector owns (assets), owes (liabilities), spends (expenditure) and receives (revenue). The WGA portrays the public sector as a single corporate entity. This means that all transactions and balances between different parts of the public sector should be eliminated to avoid double counting them.

1.2 HM Treasury compiles the WGA and has overall responsibility for delivering it as a “true and fair” representation of the financial position and performance of the whole of government. The WGA is based on International Financial Reporting Standards adapted for use by the public sector. 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 estimates that the 2011-12 WGA includes around 3,000 bodies.[7] To be included in the WGA, a body must exercise functions of a public nature and be accountable to, or be otherwise controlled by the UK Government. This definition includes central and local government, public corporations such as the Bank of England but not independent public sector organisations such as Parliament, the Crown Estate or the National Audit Office. 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 2**).

[7] The 2011-12 WGA includes information from 3,076 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. For example, the Department of Health consolidates 256 hospitals and the Consolidated Academies account consolidates 1,623 Academies. In addition, Annex 2 and 3 to the WGA show some 460 bodies that should have been consolidated (e.g. four banks, Network Rail, 86 trust ports and 344 further education colleges) but have not been.

The purpose of my Report

1.4 The Treasury has provided a comprehensive commentary on the WGA in their Foreword and Performance Report. The purpose of my Report is not to duplicate what is already in this commentary but to highlight key areas of interest and to supplement this with our broader observations to aid the WGA's interpretation. These observations are drawn from my work on the WGA and from my other work across the UK's public sector.

1.5 **Figure 1** shows the key elements within the 2011-12 WGA and this Part of my Report highlights:

- **the financial position of the UK public sector as reported in the WGA** (paragraphs 1.6 to 1.9);
- **the WGA Deficit,** including the impact of actions taken by the Government so far to reduce the deficit (paragraphs 1.10 to 1.19);
- **Expenditure**, including the impact of payroll initiatives and losses (paragraphs 1.20 to 1.29);
- **Liabilities**, including Government borrowing (paragraphs 1.30 to 1.53); and
- **Assets** (paragraphs 1.54 to 1.62).

The financial position of the UK Public Sector

1.6 Statistics on the government's financial position are routinely published in the *National Accounts*, monthly *Public Sector Finances Report*, the *Public Expenditure Survey Analysis* and other sources. These produce two main measures which HM Treasury use for fiscal management which are the *current deficit* and *public sector net debt*.

1.7 I highlighted in my first Report for 2009-10[8], that the WGA complements the existing statistical information on public finances by giving a view based on accounting standards. These standards require the inclusion of a wider range of public assets, liabilities and expenditure than those used to prepare the *National Accounts*. The Treasury have set out the key differences between the two approaches in **Chapter 3** and their impact in reporting the public sector's financial position.

1.8 Chapter 3 compares the financial position as recorded in the WGA and the equivalent using the fiscal definitions. **Figure 2** shows these positions for the Government's Deficit and **Figure 3** shows these for the Net Liability. Between 2009-10 and 2011-12, the Deficit as shown in the WGA has fluctuated (paragraph 1.10)

[8] Whole of Government Accounts 2009-10, Session 2010-12, HC 1601, November 2011, paragraphs 7.29 to 7.33.

whereas the Current Deficit fell year on year. The WGA also shows that the Net Liability has fluctuated over the same time period whereas the Public Sector Net Debt has increased.

Figure 1

Key elements of the Whole of Government Accounts 2011-12

	Description	Examples	2009-10	2010-11	2011-12
Assets	Resources controlled by government from which future benefits can be generated	Offices, student loans, the national road network, military equipment.	1,249.5	1,234.3	1,267.6
Liabilities	Obligations on government arising from past transactions or events	Unfunded elements of public sector pension schemes, gilt-edged stock, future cost of decommissioning existing nuclear facilities.	(2,477.4)	(2,420.0)	(2,614.6)
Net Liability	**The difference between what the public sector owned and what it owed at the end of the financial year**		**(1,227.9)**	**(1,185.7)**	**(1,347.0)**
Revenue	Income received from government activities	Taxation, rental from local government housing, funding received from the EU.	583.4	614.0	616.6
Direct Expenditure	The costs of running government and providing public services	Benefit payments, staff costs, grants, depreciation, contributions to the EU.	(619.5)	(663.3)	(647.8)
Other Operating Expenditure	Items subject to revaluations based on external factors	Pension scheme costs and impairment of assets.	(47.7)	38.4	(67.3)
Net financing cost	The cost of funding government's activities	Investment revenue, interest paid on gilts, interest on pension scheme liabilities.	(78.9)	(83.5)	(86.8)
WGA Net Expenditure for the year	**The difference between all the public sector's expenditure and its income (WGA Deficit)**		**(162.7)**	**(94.4)**	**(185.3)**

All figures in £ billions

The balance sheet figures for 2010-11 have been restated so that they are comparable with the 2011-12 WGA. This reduced the net liability by £7.7 billion.

The figures for 2009-10 were restated last year to make them comparable with the original figures for 2010-11 but have not been further restated for comparability with 2011-12. This reduced net expenditure for the year by £1.8 billion and increased the net liability £16.1 billion.

Source: NAO analysis of WGA 2011-12 and 2010-11

Figure 2

Measures of the Government's Deficit

	2009-10	2010-11	2011-12
WGA Net Expenditure	163	94	185
Current Deficit as reported by the Office for National Statistics	109	101	90

All amounts in £ billion

Source: Paragraph 3.5 of the WGA

Figure 3

Measures of the Government's Net Liability

	2009-10	2010-11	2011-12
WGA Net Liability	1,228	1,186	1,347
Public Sector Net Debt as reported by the Office for National Statistics	828	1,005	1,106

All amounts in £ billion

Source: Paragraph 3.5 of the WGA

1.9 The WGA will, in time, allow the reader to see how the UK Government is reducing the deficit. With three years of WGA now available, the reader can begin to see trends develop, but is not yet able to identify long-term trends as, for example, large one-off items in any one year can make identifying trends difficult.

The WGA Deficit

1.10 The WGA shows that the WGA Deficit[9], the shortfall between income and expenditure as defined by accounting standards, was £185.3 billion (**Figure 1**). This compares to £94.4 billion reported in 2010-11. This difference was largely due to the impact of two non-recurrent items in 2010-11:

- the Government changed the indexation rate used for public sector pensions from RPI to CPI, which created a one-off gain of £126 billion; and
- a one-off impairment to council housing, which increased the 2010-11 expenditure by £24 billion.

[9] The 2011-12 WGA describes the WGA Deficit as "Net Expenditure for the Year". In previous years, it was termed "Net Deficit for the Year".

1.11 The Treasury classifies expenditure as that which is direct expenditure of Government, and that which is subject to revaluation, usually based on external factors such as changes in discount rates for pensions reflecting market yields on corporate bonds and the value of shares in the banks owned by the public sector at the balance sheet date. Direct expenditure is similar to the definition of spending used by the Office for National Statistics to calculate the fiscal deficit. Direct expenditure has decreased from £663.3 billion in 2010-11 to £647.8 billion in 2011-12 (**Figures 1 and 4**) due to:

- staff costs (excluding pension scheme costs) decreased by 2 per cent from £152 billion in 2009-10 to £148.9 billion in 2011-12; and
- purchases of goods and services decreased 5.5 per cent from £160.9 billion in 2009-10 to £152 billion in 2011-12.

1.12 Figure 1 also shows that revenue has risen each year, whereas components within expenditure and indirectly controlled expenditure have increased or decreased largely because of one-off factors. These include:

- Revenues have increased from £614.0 billion in 2010-11 to £616.6 billion in 2011-12. Tax revenues increased from £485.3 billion in 2009-10 to £523.7 billion in 2011-12, largely due to the increase in the rate of value added tax, which raised an additional £21.7 billion.
- There were increases in expenditure on benefits from £197.1 billion in 2009-10 to £209.7 billion in 2011-12, with the largest increase (some £6.7 billion) due to the state retirement pension.
- Other operating expenditure, relating to impairment of assets and pension scheme costs, changed from a £38.4 billion gain to a loss of £67.3 billion.
- Financing cost, investment revenue, interest on pension liability and gains and losses on assets increased from £83.5 billion to £86.8 billion.

Measures to reduce the deficit

1.13 Against this background, the Government has introduced measures to reduce the deficit:

- those proposed in key fiscal statements such as the Budget and the 2013 Spending Round for 2015-16; and
- actions taken by the Cabinet Office's Efficiency and Reform Group and the Government Property Unit.

1.14 Most recently, the Chancellor presented the 2013 Spending Round to the House of Commons on 26 June. This set out how government spending in the year

2015-16 will be divided between departments and confirmed that the Total Managed Expenditure in 2015-16 will be £744.7 billion.[10] In total, the Departmental Expenditure Limit for all departments will be reduced by 2.8 per cent in real terms compared to 2014-15. However, the National Health Service, schools and international development budgets will be protected, meaning that the reductions have fallen across the other departments. The total reductions announced of £11.5 billion for 2015-16 are in addition to the previously made Budget announcements.

1.15 The 2013 Spending Round also set out proposals for further changes which may impact upon the deficit. A welfare cap will be applied from April 2015 and will be set every year in the budget. The welfare cap will include housing benefit, tax credits, disability benefits and pensioner benefits but will not include the state pension. It is too early to state the impact that this will have on the deficit.

1.16 The departmental spending reductions announced in successive Budgets and Spending Rounds will be delivered by departments. The Efficiency and Reform Group (ERG) was set up in May 2010 to help central government achieve cost reductions by encouraging improved efficiency and wider reform, and exerting a stronger central oversight of department's spending.

1.17 The ERG reported savings of £5.5 billion in 2011-12. These savings contribute to a £15 billion reduction in central government spending in 2011-12 compared to 2009-10.[11] ERG has subsequently reported a further increase, taking the savings to £10 billion in 2012-13. The savings are a mix of one-off and sustainable benefits to the taxpayer. They include changes to public service pension schemes, restrictions on employing consultants and temporary staff, the monitoring of the recruitment of permanent staff, central control over procurement of common goods and services and review of major ICT and other projects.

1.18 In April 2013, I reported that one-off savings and cost avoidance are valuable but do not deliver the same long-term benefits as sustainable savings given that short-term savings will need to be replicated by new savings in 2014-15.[11]

1.19 The Government Property Unit is part of the Cabinet Office's Efficiency and Reform Group. Its aim is to maximise the value obtained from the central government estate. It claims to have raised £1 billion from the sale of surplus property and land owned by central government between the start of June 2010 and the end of February 2013.[12] Despite the size of the reported savings, the figures may be recognised over a number of years which will not make a visible impact on the WGA's Net Expenditure.

[10] HM Treasury, 2013 Budget, Session 2012-13, HC 1033, March 2013, Table 2.3, page 68

[11] Comptroller and Auditor General, *The Efficiency and Reform Group*, Session 2012-13, HC 956, National Audit Office, April 2013

[12] Cabinet Office, 13 March 2013. https://www.gov.uk/government/news/government-raises-1-billion-for-public-purse-by-exiting-unused-assets accessed on 28 May 2013

For example, the £62.5 million generated from the Department for International Development's move to Whitehall in February 2013 will be realised at around £10 million per year.[13]

Expenditure

1.20 The WGA shows that public sector expenditure, finance costs and pension scheme revaluations totalled £822.5 billion[14] in 2011-12, of which 25 per cent related to benefit payments and 18 per cent to staff costs (**Figure 4**). Staff costs reduced by £4.1 billion, purchase of goods and services by £7 billion and other expenditure by £3 billion. This was offset by increased spending on social security benefits by £5.7 billion.

Figure 4

Expenditure since 2009-10

Type of expenditure	***WGA Note***	**2009-10**	**2010-11**	**2011-12**
Benefits	*6*	197.1	204.0	209.7
Staff costs (exc. Pension scheme costs)	*7.1*	152.0	153.0	148.9
Purchase of goods and services	*8*	160.9	159.2	152.0
Grants and subsidies	*9*	66.2	68.4	61.6
Depreciation and amortisation	*10*	25.1	27.4	27.6
Impairment of receivables	*10*	7.2	5.5	4.8
Provision expense	*25*	-17.0	18.3	17.4
Other expenditure	*11*	28.0	27.5	25.8
Direct expenditure (per Table 2.2 of the WGA)		**619.5**	**663.3**	**647.8**
Impairments and revaluations of non-financial assets	*10*	18.7	41.7	13.4
Impairments of financial assets	*10*	0.6	5.8	18.6
Pension scheme costs: current service costs	*7.1*	27.5	40.4	34.6
Pension scheme costs: losses on settlement & curtailment	*7.1*	0.2	-0.3	-0.3
Pension past service costs	*7.2*	0.7	-126	1
Total expenditure (per Table 2.2 of the WGA)		**667.2**	**624.9**	**715.1**
Finance costs	*13*	33.1	40.5	42.3
Interest on pension schemes	*27*	58.9	60.8	64.8
Net loss on disposal of assets	*n/a*	1.2	3.6	0.3
Total expenditure in WGA		**760.4**	**729.8**	**822.5**

All amounts in £ billion

Source: NAO analysis of WGA 2011-12 and 2010-11, in particular Table 2.2 in Chapter 2 to WGA 2011-12.

[13] Cabinet Office, State of the Estate in 2012, May 2013 https://www.gov.uk/government/publications/state-of-the-estate-in-2012 accessed on 28 May 2013

[14] The revenue and expenditure elements of Net Finance Costs in the WGA have been allocated to Revenue and Expenditure in Figures 1 and 4.

Purchases of Goods and Services and Other

1.21 The WGA does not include detailed information on expenditure on '*purchases of goods and services*' of £152.0 billion and '*other expenditure*' of £25.8 billion.[15] These costs represent the day to day activities. The absence of detailed information in the WGA does not allow the reader to analyse these areas, although the presentation does not depart from accounting standards. For example, it is not currently possible to see what the public sector spent on consultancy, accommodation and subscriptions to international bodies. However, from my analysis of the WGA's supporting data, I have been able to provide further insight on such subscriptions which, together with other payments to international bodies and countries which are recorded elsewhere in the WGA, account for some £13.3 billion, and is a significant element of public expenditure and an important means by which the government discharges its international obligations (**Box 1**).

Box 1: International expenditure in 2011-12

The Government took part in various international activities costing around £13.3 billion in 2011-12. These can be grouped into three areas: grants to the EU; international aid; and subscriptions to international organisations. In 2011-12, the Government paid:

Grants to the EU: The UK contributed some **£12.2 billion** to the EU, of which some £5.0 billion was received back from the EU (Note 9 to the WGA). Of this £5.0 billion, some £4.6 billion (Note 5) was granted by the Government as co-managed funding for EU approved projects in the UK, including subsidies to farmers (Note 9).

International Aid: **£5.3 billion** in grants to developing countries (Note 9 of the WGA)

International Subscriptions: **£0.8 billion** for international subscriptions, the costs of which are included within 'Other expenditure' (Note 11 to the WGA):

	£ million
North Atlantic Treaty Organisation (NATO)	197.4
European Space Agency	199.9
United Nations (UN)	98.1
European Organisation for Nuclear Research (CERN)	102.2
European Southern Observatory	27.9
Council of Europe	26.5
World Health Organisation	19.5
International Atomic Energy Agency	21.1
Organisation for Economic Co-operation and Development	12.5
European Meteorological Infrastructure	11.1
World Trade Organisation	6.3
Interpol	2.8
World Meteorological Organisation	2.4
Other	33.4
Total	**761.1**

Source: NAO analysis of accounts consolidated into the WGA 2011-12.

[15] Notes 8 and 11 of the WGA respectively

Staff costs

1.22 After social security benefits, the public sector spends most on staff with costs of £183 billion (Note 7.1 to the WGA). Staff costs reduced by £10 billion in 2011-12 due to falling pension scheme costs (£6 billion), primarily due to a change in the discount rate, and salaries and wages (£4 billion) mainly because government employed 22,145 (0.5 per cent) fewer people (paragraph 1.23) and the freezing of public sector pay (paragraph 1.25). Reduced staff costs were off-set by £2.7 billion of redundancy packages, which will result in lower staff costs in the longer term.

Reductions in staff numbers

1.23 The public sector has made some 108,234 redundancies in 2011-12 (Note 7.4 to the WGA). Overall, this has led to 22,145 less full-time equivalent staff (Note 7.3 to the WGA). Note 7 of the WGA also shows that central government (including the NHS) increased its staff numbers, but this was because some 168,495 staff working in Academies were reclassified from local to central government. Adjusting for this transfer, the WGA figures indicate that local government would have increased its staff numbers and the majority of staff reductions were being made in central government (dotted lines in **Figure 5**).

1.24 Changes to the Civil Service Compensation Scheme have reduced the average cost of early departures in central government departments between 2010-11 and 2011-12[16] and the NAO estimated that departure costs would be recovered through reduced costs within 15 months, except for staff nearing retirement.[17] The average cost of government exit packages was £25,047 (**Figure 6**).

Impact of the public sector pay freeze on staff costs

1.25 The government introduced a public sector pay freeze but it did not prevent average pay from increasing. In June 2010, the Chancellor of the Exchequer announced to Parliament a two year pay freeze starting in 2011-12. The freeze did not apply to public sector workers earning less than £21,000 a year (who received an increase of at least £250 a year[18]) and the freeze did not prevent many public sector workers receiving pay rises due to automatic pay progressions written into their contracts (for example teachers, police and some civil servants). Pay systems involving progression exist for around a half to two thirds of the public sector workforce. Automatic time served progression exists for around 20-25 per cent of the Civil Service. The actual number receiving increments will depend on how many have

[16] Comptroller & Auditor General, The Efficiency and Reform Group, Session 2012-13, HC 956, April 2013.

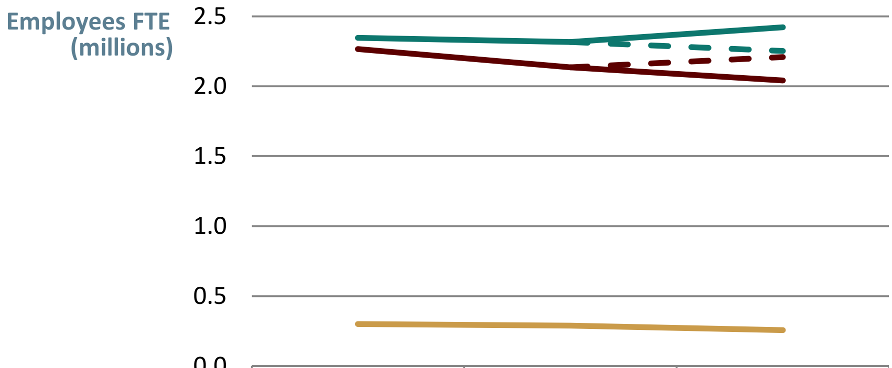
[17] Comptroller & Auditor General, Managing early departures in central government, Session 2010–2012, HC 1795, March 2012.

[18] HM Treasury, Budget Statement 2010, Session 2010-12, HC 61, 22 June 2010, paragraph 2.18.

reached the top of their pay scales. The ONS estimates that the average pay rise for the public sector is 1.3 per cent in 2011-12 (**Figure 7**).

Figure 5

Staff numbers since 2009-10

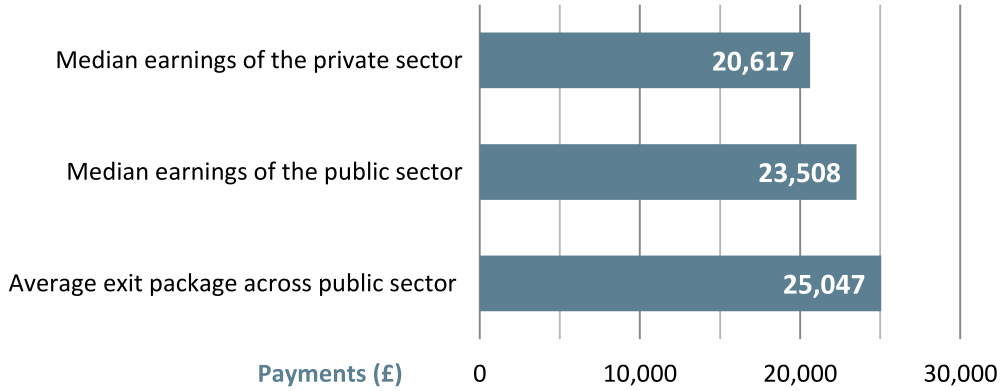


	2009-10	2010-11	2011-12
Central government	2,345,408	2,316,023	2,421,154
Central government exc. Academies		2,316,023	2,252,659
Local government	2,266,834	2,135,666	2,040,846
Local government inc. Academies		2,135,666	2,209,341
Public corporations	299,126	289,597	257,141
Total	4,911,368	4,741,286	4,719,141

Source: NAO analysis of WGA 2011-12 and 2010-11

Figure 6

Public sector exit packages compared to median earnings



Source: WGA 2011-12, Remuneration Report and Note 7.4

1.26 In the 2013 Spending Round, the Chancellor announced that the government would put in place plans to end automatic time-served pay progression in the civil service, excluding those in place for the armed forces, by 2015-16. In addition, substantial reforms to progression pay will be taken forward or are already underway for teachers, the health service, prisons and the police.

Figure 7

Average annual pay rises

	Public Sector	**Private Sector**
2011-12	+ 1.3 %	+ 0.3 %
2012-13	+ 1.4 %	+ 0.8 %

Source: Office for National Statistics, Statistical bulletin: Labour Market Statistics: Earnings. May 2012 and 2013

Estimated Losses and Fraud

1.27 The size and complexity of the types of expenditure managed by the public sector sometimes means that monies are not always applied to their intended purpose and, in the case of revenues, not fully collected. Although the amounts involved are relatively small compared with the total amount spent and received by the public sector, they do represent significant sums of public money and, in recognition of this, the Government established the *Fraud, Error and Debt Taskforce* in 2010 to help coordinate action across Government and the wider public sector to focus on efficiently and effectively reducing fraud and error loss in the public sector.

1.28 The WGA includes the impacts of fraud, error, negligence and loss (**Figure 8**). For example, the Comptroller and Auditor General has highlighted the levels of estimated overpayments of benefits due to fraud and error as part of his audits of the accounts produced by HMRC and the Department for Work and Pensions. In addition, central government departments have disclosed in their financial statements losses that they have incurred[19] - twenty of the most significant government departments reported actual losses in their accounts of some £1.1 billion, which includes categories such as inventory write offs, payments made with no benefit gained, and debts no longer being pursued. Figures for local government and public corporations are not available because these bodies are not required to disclose their losses as they do not prepare their accounts in line with the Government’s Financial Reporting Manual.

[19] HM Treasury, Managing Public Money, October 2007. Annex 4.10

Figure 8

Losses from Fraud, Error, Negligence and Debt Management

	Total	Fraud	Debt management	Error	Other
Tax write-offs [a,b]	**7,018**	-	7,018	-	-
Benefits fraud and error [c,f]	**3,654**	1,100	-	2,554	-
Clinical negligence [d,e]	**1,377**	-	-	1,377	-
Write-offs [f]	**594**	-	574	-	20
Other losses [f]	**514**	-	-	413	101
Total	**13,157**	1,100	7,592	4,344	121

All figures in £ million

Sources:

a. HMRC, Annual Report and Accounts 2011-12, Session 2012-13, HC 38, June 2012, pages 115 and 145.

b. Television Licence Fee Trust Statement 2011-12, Session 2012-13, HC 383, July 2012, page 19

c. The Comptroller and Auditor General, Report on the Department for Work & Pensions Accounts 2011-12, July 2012.

d. NHS Litigation Authority Annual Report and Accounts 2011-12, Session 2012-13, HC 215, June 2012.

e. Welsh Government Consolidated Accounts 2011-2012, July 2012

f. NAO analysis of losses in the losses and special payments notes of 20 of the most significant departments in central government, including the devolved nations, excluding HMRC losses which are recorded under (a.).

1.29 As well as fraud and losses that are disclosed in the accounts of public sector bodies, other sources provide estimated information on the potential impact on the revenues and costs of the public sector:

- **Fraud:** The National Fraud Authority estimates fraud in the public sector to be £20.6 billion.[20] Although any estimate of fraud will always be subject to uncertainty, the Authority considers that fraud is more accurately measured in the public sector than other sectors.[21] The types of public sector fraud that the Authority identified can be classified as: tax fraud (£14 billion); procurement fraud (£2.3 billion); benefit fraud (£2.3 billion, including £1.1 billion reported in Figure 8); grants fraud (£0.5 billion), payroll and pension fraud (£0.4 billion), television licence fee fraud (£0.2 billion) and council tax fraud (£0.1 billion).

[20] National Fraud Authority, Annual Fraud Indicator, June 2013

[21] The National Fraud Authority estimates fraud in the public sector to be £20.6 billion compared to £21.2 billion in the private sector, £9.1 billion to individuals and £0.15 billion in the charity sector.[20]

- **Tax Gap:** This is the difference between the hypothetical amount of tax due, based on data on economic activity, and that amount that the Government expects to collect. This theoretical asset to the government is the additional amount of tax that would be due if every business and individual complied exactly with tax law as interpreted by HMRC. The most recent estimate of the tax gap relates to 2010-11 and shows a total tax gap of £32 billion.[22]

Government liabilities

1.30 As highlighted in Chapter 1, the measure of net liability as recorded in the WGA differs from the Government's fiscal measure, Public Sector Net Debt (PSND). The WGA is wider in scope than the PSND as it includes additional areas such as property, plant and equipment, and public service pension liabilities.

1.31 The WGA shows that all types of Government liability increased between March 2011 and March 2012 (**Figure 9**). The WGA shows liabilities of £2.6 trillion, including Government financing and borrowing commitments of £965.5 billion (paragraphs 1.32 to 1.34), commitments of £1,008 billion for public service pensions (paragraphs 1.35 to 1.37); £113 billion of provisions for likely future expenses due to past events (paragraphs 1.38 to 1.47) and £154 billion of trade payables. The WGA also shows £262 billion of contingent liabilities (paragraphs 1.48 to 1.51).

Government borrowing

1.32 Government financing and borrowing grew from £908 billion in March 2011 to £965 billion in March 2012 (Note 24 to the WGA). This represents the total amount of borrowing accumulated by government over time. The £965 billion consisted of gilt-edged securities (£788 billion of debt issued to the market), Treasury bills (£74 billion of short-term financing) and National Savings & Investment products (£103 billion).

Figure 9

WGA Liabilities since 31 March 2010

	31 March 2010	**31 March 2011**	**31 March 2012**
Public service pensions	1,134.7	961.0	1,007.8
Borrowing and financing	781.8	908.2	965.5
Other financial liabilities	312.6	295.4	373.2
Trade and other payables	146.1	148.4	154.8
Provisions	102.2	107.0	113.3
Total	**2,477.4**	**2,420.0**	**2,614.6**

Source: NAO analysis of WGA 2011-12 and 2010-11

[22] HM Revenue and Customs, *Measuring Tax Gaps, 2012*, October 2012.

1.33 The increase in borrowing has mainly been driven by additional gilts issued to fund payments that could not be met from taxation revenues. This increase in borrowing has led to a corresponding increase in the cost of borrowing of £1.1 billion since 2010-11 to £37 billion in the year ended 31 March 2012 (Note 13 to the WGA).

1.34 The £965 billion is the total amount borrowed by central government and other liabilities have also been incurred to fund the activities of government as a whole. In addition to the £965 billion shown in Note 24 to the WGA, borrowings by local authorities totalled £33 billion (contained within Bank and other borrowings in Note 26 to the WGA), government owes £36 billion for assets and services purchased using the Private Finance Initiative, and a further £217 billion held by the Bank of England to finance the re-purchase of gilts by the Bank of England's Asset Purchase Facility Fund in support of the policy of quantitative easing (contained within Deposits by Banks in Note 26). The consolidation of quantitative easing into WGA does not reduce the overall liabilities because gilts are exchanged for central bank reserves. These aggregate to some £1.25 trillion at the end of March 2012. I have commented on the emerging effectiveness of quantitative easing in my Report on the 2012-13 HM Treasury Departmental Accounts.[23]

The public sector pension liability

1.35 The largest liability recorded in the WGA is the public sector pension liability of £1,008 billion (Note 27 to the WGA). The increase of £47 billion in 2011-12 is largely driven by changes in actuarial assumptions over the long term cost of meeting the pension commitments. Actuarial assumptions used in calculating the public pension liability include the rate of increase of salaries and pension inflation as well as the discount rate.

1.36 The Government has introduced various reforms to manage the pension liability. Central government employee pension contributions were increased by an average 3.2 per cent over a three year period starting in 2012-13 (intended to save £2.8 billion in 2014-15[24]). The Public Service Pensions Act 2013 will introduce new pension schemes from April 2015 which will provide members with pensions based on their average career earnings instead of final salary. The Act will increase the age when public sector workers start to receive their pension to the same age as when the state pension is paid, except for police, fire service and armed forces personnel for whom a pension age of 60 has been proposed.

1.37 As I highlighted in my report on the 2010-11 WGA, the Office for Budget Responsibility estimates that these measures will reduce the cost of public sector

[23] HM Treasury, Annual Report and Accounts 2012-13, Session 2013-14, HC 34, July 2013.

[24] Written Ministerial statement, Cabinet Office, 26 March 2012, Minister for the Cabinet Office, Paymaster General: Principal Civil Service Pension Scheme – Increase to member contributions, Rt Hon Francis Maude http://www.civilservice.gov.uk/pensions/reform/contribution-increases accessed on 19 June 2013

pensions from around the current 1.5 per cent of GDP to 1 per cent of GDP by 2061-62.[25]

Provisions

1.38 The second largest category of liabilities in the WGA are the provisions for costs the Government expects to have to meet at some point in the future arising from past events. The main provisions are nuclear decommissioning (£64.3 billion) clinical negligence (£19.4 billion) and other provisions (£29.6 billion). **Figure 10** shows that the overall provisions figure continued to increase over the three years of the WGA.

The provision for nuclear decommissioning

1.39 The WGA (Note 25 to the WGA) shows provisions of £64.3 billion relating to the estimated cost of decommissioning and cleaning up the civil and military nuclear estate. Of this figure, some £52.9 billion is in respect of the nuclear facilities owned by the Nuclear Decommissioning Authority.[26]

1.40 The increase in the nuclear decommissioning provision in 2011-12 is partly due to the impact of inflation, some changes to site programmes and a further £2.5 billion increase due to changes made by the Government over its preferred option for the re-use of civil stocks of plutonium. My report on the financial statements of the Nuclear Decommissioning Authority for 2012-13 includes a more up to date position and its sensitivity to changes in the discount rate.[27]

1.41 The Energy Act 2008 requires the operator of new nuclear power stations to provide secure financing arrangements to meet the full costs of decommissioning and their full share of the costs of waste disposal before nuclear-related construction can begin. In March 2013, the Government announced that Hinkley Point C will be the first nuclear project that will be decommissioned using private sector finances.[28]

The provision for clinical negligence

1.42 The WGA (Note 25 to the WGA) includes a provision of £19.4 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

[25] Office for Budget Responsibility, Fiscal Sustainability Report, July 2012.

[26] Nuclear Decommissioning Authority, Annual Accounts 2011-12, Session 2012-13, HC 355, July 2012.

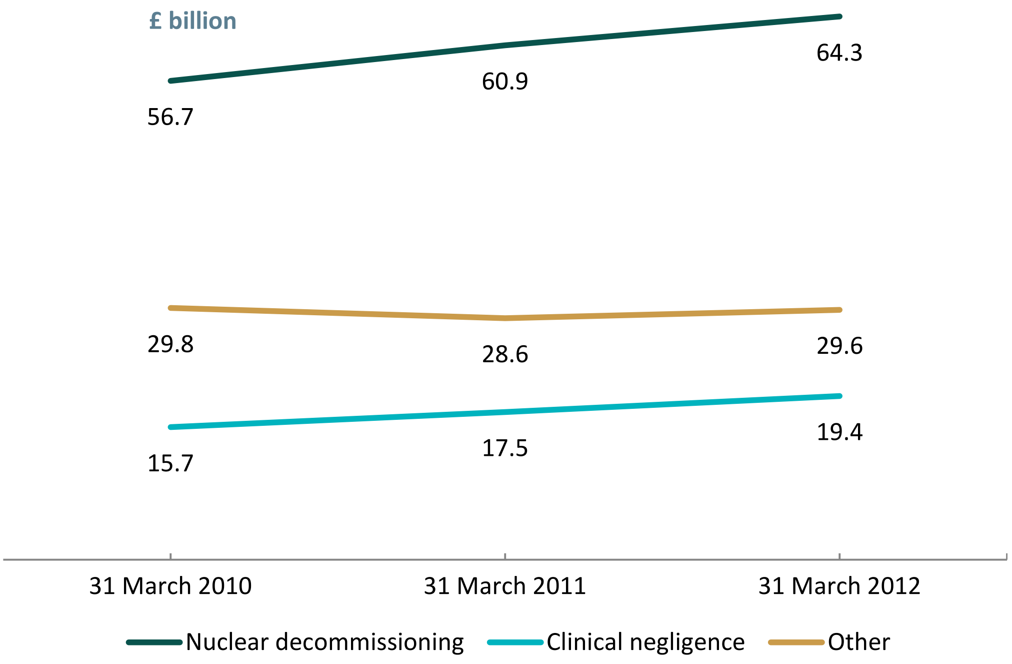
[27] Nuclear Decommissioning Authority, Annual Accounts 2012-13, Session 2013-14, HC236, June 2013.

[28] EDF Energy, Hinkley Point C - An Opportunity to Power the Future, http://www.edfenergy.com/about-us/energy-generation/new-nuclear/hinkley-point-c/book/book/files/assets/basic-html/page12.html accessed on 12 June 2013.

and settling a claim can also take many years, depending on the complexity and circumstances of the case.

Figure 10

Provisions since 31 March 2010



Source: NAO analysis of WGA 2011-12 and 2010-11

1.43 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 for English NHS bodies. The NHS Litigation Authority has increased its total provision for all claims of negligence from £9.2 billion at 31 March 2007 to £23 billion at 31 March 2013.[29]

Other types of provision

1.44 The visibility of provisions for clinical negligence and nuclear decommissioning has allowed for wider consideration of their management. The narrative to Note 25 of WGA does not provide a breakdown of the £29.6 billion of other provisions although these figures are disclosed in their originating financial statements. **Figure 11** provides a more detailed breakdown of other provisions which shows that individual provisions largely remain constant.

[29] NHS Litigation Authority, Annual Report and Accounts 2012-13, Session 2013-14, HC 527, July 2013.

Figure 11

Details of Other Provisions

March 2011	March 2012	Responsible party	Description
2.7	3.9	DWP	DWP makes provision for potential payments under the Financial Assistance Scheme. The Scheme was announced in 2004 to provide assistance to members of defined benefit occupational schemes that were underfunded and where the employers became insolvent between January 1997 and April 2005. Schemes that became insolvent after April 2005 may be covered by the Pension Protection Fund.
3.4	3.3	DECC	The Coal Authority provides for compensating coal workers for injuries, litigation costs and ensuring the safety of abandoned coalmines.
4.4	2.1	HMRC	HMRC takes legal advice for legal disputes, recognising a provision if it believes the case will result in a probable loss to the Government. As these often involve complex tax cases, the amount settled may be different than the amount provided for, and the case may take many years to resolve.
1.6	1.3	Various	Employee early departure costs.
1.5	1.3	Treasury	Compensation of Equitable Life policy holders for the failure of regulation.
13.6	**11.8**		
16.1	17.8		Others provisions individually less than £1 billion. For example, £0.7bn has been provided for Injury claims by NHS staff injured in the course of their duties.
29.7	**29.6**		**Total other provisions**

All figures in £ billions

Source: NAO analysis of 2011-12 WGA data and Accounts of the responsible parties referred to.

Discount rates and assumptions have a significant impact on the value of long term liabilities

1.45 Accounting standards require liabilities due a long time in the future to be valued at the present value of future payments, discounted at a rate reflecting the time value of money. As I highlighted in my Report on the 2010-11 WGA[30], changes in the discount rate used would therefore impact on the value of the liabilities presented in the WGA. A higher discount rate results in a lower liability and vice versa.

1.46 As in previous years, the Treasury changed the discount rate for provisions so it was more closely aligned to market conditions. 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'.[31] This means the value of the pension liability and the cost recognised will fluctuate based on market prices. For the public sector pension liability, 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'. This means that the value of the pension liability and the cost recognised in any year will fluctuate based on market prices.

1.47 The WGA does not provide a sensitivity analysis to show readers the impact of potential changes to the assumptions used for long term liabilities (for example, changes in discount rates for provisions; and for pensions: performance of bond and stock markets). The WGA refers readers to the underlying accounts to understand how these figures are based upon changes to assumptions.

Contingent liabilities

1.48 According to accounting standards, a contingent liability is a possible obligation that depends on the outcome of a future event, or a present obligation where payment is not probable (less likely than a provision) or the amount cannot be measured reliably. The Government has £100.8 billion of contingent liabilities at 31 March 2012 that meet this definition (**Figure 12**). This type of contingent liability has increased from £49.5 billion at 31 March 2011 because of new or increases to existing liabilities, for example:

- £29.7 billion that the UK may have to contribute to the European Investment Bank under European legislation which was treated as a remote contingent liability in 2010-11;
- £20 billion for oil field decommissioning that may reduce Petroleum Tax revenues;

[30] Comptroller and Auditor General, Report on the Whole of Government Account 2010-11, October 2012

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

- £14.5 billion for HMRC legal proceedings;
- £9.9 billion that the Export Credits Guarantee Department guarantees exporters of goods and services and overseas investors from the UK against loss; and
- £8.5 billion for clinical negligence (which is considered less likely to be payable than the £17.5 billion provided for).

1.49 Parliament also requests sight of certain contingent liabilities that are considered to have a remote chance of occurring. The Government has £160.3 billion of contingent liabilities at 31 March 2012 that meet this definition, a reduction of £170.2 billion from 31 March 2011. The reduction has been mainly caused by reduced credit guarantee scheme obligations (£91 billion), the change in treatment of the potential contribution to the European Investment Bank from a remote contingent liability to a contingent liability (£29.7 billion) and reduction to the value of assets covered by the asset protection scheme (£56 billion). These reductions have been offset by some increases across the other remote contingent liabilities to arrive at the net reduction.

1.50 Remote contingent liabilities have reduced by a further £78.9 billion since 31 March 2012 due to the closure of the Asset Protection Scheme and Credit Guarantee Schemes in October 2012, without any claims being made upon them.

1.51 As well as the £261 billion of contingent liabilities that the Government can quantify[32], the Government has some contingent liabilities that it cannot estimate. These are described in Notes 32.3 and 33.2 of the WGA, and include indemnities in relation to financial stability interventions, reinsurance arising from acts of terrorism, and life insurance for Ministry of Defence service personnel.

[32] £261 billion is the total of £100.8 billion that meet accounting standard requirements (paragraph 1.48), plus £160.3 billion that Parliament requests sight of (paragraph 1.49).

Figure 12

The Profile of Public Sector Liabilities

Likelihood of the public sector having to make a payment (and accounting treatment)			31 March 2010	31 March 2011	31 March 2012
Certain	On balance sheet	Payables, borrowing and pensions	2,375.2	2,313.0	2,501.3
Probable	On balance sheet	Provisions	102.2	107.0	113.3
Possible	Off balance sheet	Contingent Liabilities for accounting standards	41.4	49.5	100.8
Remote	Off balance sheet	Contingent Liabilities for Parliament	434.0	330.5	160.3
Total			**2,952.8**	**2,800.0**	**2,875.7**

All figures in £ billions

Source: NAO analysis of WGA 2011-12 and 2010-11

Other liabilities and commitments

1.52 In addition to the Government's liabilities and provisions the Government has non-cancellable contractual commitments which it is obliged to pay when the obligating event has occurred. The Government had non-cancellable contractual commitments totalling £272.7 billion at the end of March 2012, which is £10 billion less than in March 2011 (**Figure 13**).

1.53 The WGA does not include any liability or commitment for future benefits such as the State Pension scheme as citizens are only entitled to a payment if they meet certain criteria on the date that payment would be due. As the Government is able to adjust these criteria, there is no obligation or commitment to pay current recipients. The WGA therefore recognises state pension scheme payments as benefit expenditure when it is incurred, and that expenditure is funded from future tax revenues. In 2011-12, the total state pension payment was £78.1 billion (Note 6 to the WGA). The Office for National Statistics has estimated the total State Pension Scheme liability at £3.8 trillion, which will be met from future taxation.[33]

[33] Office for National Statistics, Pensions in the National accounts – A fuller picture of the UK's funded and unfunded pension obligations, 27 April 2012. http://www.ons.gov.uk/ons/rel/pensions/pensions-in-the-national-accounts/uk-national-accounts-supplementary-table-on-pensions--2010-/art-mainarticle.html accessed 21 June 2013

Figure 13

Total Commitments

Type of Commitment (*WGA note reference*)	**31 March 2010**	**31 March 2011**	**31 March 2012**
PFI (*30*)	131.5	144.6	149.4
Capital (*28*)	51.3	44.0	37.7
Operating Leases (*29.1*)	19.7	21.9	20.9
Finance Leases (*29.2*)	6.7	6.6	5.3
Other (*31*)	68.2	65.8	59.4
Total	**277.4**	**282.9**	**272.7**

All figures in £ billions

Source: NAO analysis of WGA 2011-12 and 2010-11

Government assets

1.54 The Government owns £1,268 billion of assets of which the largest category of £745 billion is property, plant and equipment (Note 14 to the WGA) (**Figure 14**).

Figure 14

Assets since 31 March 2010

	31 March 2010	**31 March 2011**	**31 March 2012**
Property, plant and equipment	712.8	714.0	745.1
Gold, cash and other financial assets	274.2	254.6	278.7
Trade and other receivables	139.4	145.1	141.9
Equity investment in the public sector banks	61.1	59.5	40.8
Intangible assets	36.3	34.8	35.0
Other physical assets	25.7	26.3	26.1
Total	**1,249.5**	**1,234.3**	**1,267.6**

All figures in £ billions

Source: NAO analysis of WGA 2011-12 and 2010-11

Property plant and equipment

1.55 The largest increase is to property, plant and equipment which includes assets acquired using the private finance initiative. At 31 March 2012, £39 billion or 5.2 per cent of property, plant and equipment had been procured through PFI and this proportion has increased slightly from £35.3 billion or 5.0 per cent at 31 March 2011 (Note 14.3 to the WGA). In the same period, the Government's contractual commitments to pay for PFI schemes have increased from £144.6 billion at 31 March 2011 to £149.4 billion at 31 March 2012 (Note 30.1 to the WGA).

Equity investments in public sector banks

1.56 Equity investment in the public sector banks reduced by £19 billion (Note 18 to the WGA) reflecting the fall in the share prices of Lloyds and Royal Bank of Scotland (as considered in my Report on HM Treasury's 2011-12 Resource Account[34]).

1.57 Since March 2012, the share prices of both the Royal Bank of Scotland and Lloyds Banking Group have increased which will lead to an increase in the value reported under 'Equity investments in the public sector banks' of £ 3.8 billion.[35] This increase will be reported as a gain and consequently a reduction in Net Expenditure in the 2012-13 WGA. While the Government remains committed to returning both banks to private ownership, a formal timetable for disposal has not yet been announced.

1.58 A Parliamentary Commission on Banking Standards was established in July 2012 to consider and report on the professional standards and culture of the banking sector and lessons to be learned about corporate governance, transparency and conflicts of interest, and their implications for regulation and for Government policy. The Commission's final report was published in June 2013 and the Chancellor of the Exchequer announced on 19 June 2013 that the Treasury will introduce amendments to legislation arising out of the Commission's work and consider further the recommendation that RBS should be split into a "good bank/bad bank". The Chancellor also announced that the Treasury was actively considering how to sell the shareholding in Lloyds Banking Group.

Trade and other receivables

1.59 Tax is the largest revenue source for the government but there will always be a period between revenue being earned by individuals and companies and cash being collected. Tax revenue is estimated from the expected level of taxable activity, and in 2011-12 the WGA shows £85.2 billion future taxation was accrued (Note 17 to the WGA). 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 2012.

1.60 Note 17 to the WGA also shows a total of £26 billion of unpaid taxation owed to the Government as at 31 March 2012 and **Figure 15** shows how HMRC has managed their component of this debt in 2011-12. HMRC collected £37.9 billion of the £62.9 billion it managed during 2011-12 and wrote off £4.2 billion. Both of these figures are an improvement on the previous year.

1.61 As part of its policy of improving tax collection, the Government has signed a number of international agreements that will allow it to pursue those organisations and individuals who attempt to escape paying taxes by placing their funds overseas. On 6 October 2011, the UK and Swiss governments signed an agreement to tackle

[34] HM Treasury, Annual Report and Accounts 2011-12, Session 2012-13, HC 46, July 2012.

[35] HM Treasury, Annual Report and Accounts 2012-13, Session 2013-14, HC 34, July 2013.

offshore tax evasion. The agreement aims to settle the past tax liabilities of UK individuals who hold Swiss assets through a one-off payment covering liabilities and will also establish a new withholding tax to collect future amounts due.[36] Agreements have also been signed with the British Crown dependencies (Jersey, Guernsey and the Isle of Man) and most British overseas territories including the British Virgin Islands, the Cayman Islands, Anguilla, Montserrat and the Turks and Caicos Islands.[37]

Figure 15

The collection of debt from tax in 2011-12 and 2010-11

	2011-12	**2010-11**
Tax debt as at 1 April	15.0	17.9
Tax debt becoming due in the year	47.9	45.1
	62.9	**63**
Amounts collected	-37.9	-33.3
Amounts written off	-4.2	-4.7
Amounts remitted	-1.0	-0.8
Amendments, cancellations and other	-6.5	-9.2
Tax debt as at 31 March	**13.3**	**15**

All figures in £ billions. The tax debt is that element of tax debt under active management.

The £1 billion remitted in 2011-12 is in respect of debts that HMRC believed it could not collect cost effectively
Amounts remitted and written off (£5.2 billion in 2011-12) are part of the £7.1 billion tax write off figure in Figure 8.

The £1.9 billion difference is due to write offs in benefits and BBC licence fees.

Source: HMRC, Annual Report and Accounts 2011-12, Session 2012-13, HC 38, June 2012

Sale of assets

1.62 The Government disposed of two significant assets in 2011-12:

- Northern Rock plc was sold to Virgin Money at the end of 2011 incurring a loss of £527 million, of which £212 million was recognised as an impairment last year, and £315 million is recognised as a loss on sale within the 2011-12 WGA.[38] Further proceeds of £73 million were received in 2012-13.

- The Government sold the Horserace Totalisator Board (The Tote) to Betfred plc in June 2011 for £265 million. The Tote received £3.6 billion annually in 2010-11 from bets placed and spent the same figure in administrative overheads and winnings. Its sale, only three months into the year, accounts for some of the year on year variance shown in the WGA within sales of goods and services and other expenditure in the public corporation sector.

[36] HMRC Trust Statement, Annual Report and Accounts 2011-12, Session 2012-13, HC 38, June 2012

[37] HM Treasury, Chancellor welcomes huge step forward in global fight against tax evasion, 2 May 2013
https://www.gov.uk/government/news/chancellor-welcomes-huge-step-forward-in-global-fight-against-tax-evasion

[38] Comptroller & Auditor General, The creation and sale of Northern Rock plc, Session 2012-13, HC 20, National Audit Office, May 2012; Comptroller & Auditor General, Report on HM Treasury's Annual Report &Accounts 2011-12, July 2012.

Part Two: Meeting the WGA's Objectives

2.1 This part of my Report examines how the Treasury is meeting its objectives for the WGA, the use that is being made of the WGA, and explains why I have qualified my Audit Opinion on the 2011-12 WGA and the actions taken by the Treasury to address the issues identified in my Report on the 2010-11 WGA.[39]

HM Treasury’s objectives for the WGA

2.2 HM Treasury set the following objectives for the WGA to:

- **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 existing sources, such as the National Accounts prepared by the Office for National Statistics;
- use WGA to 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.

2.3 The Treasury is making good progress in meeting their objectives but there is still work to be done before the Treasury can assert that it has fully met its objectives (**Figure 16**).

Transparency

2.4 The WGA is based on accounting standards, specifically International Financial Reporting Standards adapted for use by the public sector, and so is based on standard accounting conventions. The WGA is presented in a format that is readily recognisable and is an accessible set of financial statements. The Management Commentary presented alongside the accounts provides insight into the key figures within the WGA and highlights key drivers in the public finances. In June 2013, the

[39] Comptroller and Auditor General, Report on the Whole of Government Account 2010-11, October 2012

Treasury began to consult the users and potential users of the WGA to get a clearer understanding of what the WGA could contain to aid users in making informed decisions.[40]

2.5 I consider that the WGA aids the transparency of public finances and improvements the Treasury plans to take forward have the potential to enhance this objective further.

Figure 16

HM Treasury's original objectives for WGA

Objective	Status	Progress
Transparency	Met	Improving
Accountability and confidence	Partly met	Improving
Completeness	Not yet met	No change
Consistency and comparability	Partly met	Improving
Complementary	Met	Improving

Source: National Audit Office

Accountability and confidence

2.6 This is the third year that I have audited the WGA and I have been able to report to Parliament that these accounts are a 'true and fair' presentation of the finances of the whole of government, although I have qualified my opinion on certain matters. In addition, the Committee of Public Accounts have taken an active interest in the use the Treasury is making of the WGA, and how it is exerting its role as the UK's Ministry of Finance in holding underlying bodies to account for the spending decisions they make. As the WGA becomes more mature, its users will be able to have increased confidence in the data presented to them.

2.7 The Treasury is taking action to allow me to remove my qualifications though more needs to be done before I will be able to remove these entirely.

Completeness

2.8 The WGA provides more information than is currently available from other sources, such as that presented by the Office for National Statistics. However, I conclude that the WGA is not yet complete as the government define the WGA's

[40] HM Treasury, Central government annual reports and accounts: consultation on simplifying and streamlining the presentation of annual reports and accounts, June 2013

boundary by reference to statistical, rather than accounting, standards leading to a number of government owned and controlled entities not being included, for example Network Rail. I have qualified my opinion on the 2011-12 WGA (paragraph 2.24) as a result and it is this that impacts on my assessment of the Treasury meeting this objective.

Consistency and Comparability

2.9 The WGA is presenting annual data that allows users to begin to compare the government's results over a number of years and on a consistent basis. Underlying bodies are also presenting their accounts on a more consistent basis, for example, local authorities have compiled their accounts on the same accounting basis as central government since 2010-11.

2.10 Although more needs to be done to ensure underlying data is presented on a more consistent basis (such as valuing the local authority infrastructure assets on the same basis as that applied by central government, paragraphs 2.31 to 2.37, and removing more intra-group transactions and balances, paragraphs 2.44 to 2.53), I consider that the Treasury has made good progress in meeting this objective.

Complementary information

2.11 Notwithstanding the boundary and the completeness of the WGA, the WGA does provide more complete information on the government's capital and long term financial position which complements other data prepared by the Treasury and other bodies, such as that produced by the Office for Budget Responsibility.

Timeliness

2.12 The original objectives set by the Treasury did not include timeliness. However, financial information must be presented on a timely basis to remain relevant for external accountability purposes and for internal decision-making. Delays in producing a robust and good quality WGA also limits the speed at which improvements can be made, for example, by the time 2010-11 WGA was completed, work was already underway on the 2011-12 WGA. Improving the WGA will take more than one year.

2.13 The 2011-12 WGA has been published earlier than in the past two years (some 3.5 months earlier than last year) and this is in line with the Treasury's ambitions. The Treasury plans to publish the 2012-13 WGA within the same timeframe as the 2011-12 WGA to allow it to fully implement a new IT system supporting the WGA and make further improvements. They are also considering the viability, in the longer term, of delivering future WGAs within nine months of the financial year end.

The WGA is beginning to be used

2.14 The Treasury provided guidance for their spending teams in March 2013 on how to use the WGA to inform spending decisions in the 2013 Spending Round. The Treasury has engaged with its spending teams, providing training on the WGA and its uses. The most significant use in the 2013 Spending Round was to highlight how the WGA can inform better asset management. The Treasury is looking to promote further the use of WGA data to assess the impact of policy changes on the Governments long term financial position and to improve the management of debt.

2.15 The WGA continues to be used by the Office for Budget Responsibility to help it form a baseline for their projections of future government spending and receipts, but is not the main source of their projections.

2.16 The Department for Communities and Local Government published an unaudited version of the 2010-11 WGA in April 2013 covering the English local government sector. This publication provides more segmental analysis on English local government activity than is currently shown in the WGA, though it is not designed to meet the requirements needed for a “true and fair” set of financial statements. The 2010-11 version allowed readers to see the impact of adopting International Financial Reporting Standards on the English local government sector.

International developments and the WGA

2.17 I highlighted in my Report on the first WGA[41], covering 2009-10, that the UK's WGA was more ambitious in scope than those produced by other key countries. While other nations produce consolidated accounts of government activity, the scope, measurement and timing of each consolidated account varies, which does not permit meaningful comparison between nations. The UK’s National Accounts produced by the Office for National Statistics, using internationally agreed economic and statistic standards, can be compared to those of other nations, but these are not audited and do not present as complete a picture as required by accounting standards.

2.18 In March 2013, the European Commission published a report calling for the alignment of public sector accounting standards in Member States based around International Public Sector Accounting Standards (IPSAS).

2.19 The UK Government’s accounting framework is based upon International Financial Reporting Standards (IFRS) adapted for public sector differences. IPSAS follow a similar logic, taking the IFRS as a starting point and adjusting them to the public sector specificities. Adjustments include recognising the concept of service potential in addition to economic benefits, rules on non-exchange transactions (for example grants) and disclosures comparing actual outturn against budget.

[41] Comptroller & Auditor General, Report on the Whole of Government Accounts 2009-10, November 2011

Qualifying the Comptroller and Auditor General's Audit Opinion

My obligations as auditor

2.20 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.

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

2.21 I have qualified my opinion on the 2011-12 WGA because in a number of significant areas, the WGA does not comply with International Financial Reporting Standards as adapted for the public sector context, and this has 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; and
- How the Treasury has accounted for income from the sale of 3G licences.

2.22 I have also limited the scope of my opinion on the 2011-12 WGA because of the following issues which meant I was unable to obtain sufficient and appropriate audit evidence on which to base my opinion:

- 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 arising within the audit opinions of material accounts included in the WGA where auditors have limited the scope of their audit.

Qualified audit opinion relating to the WGA boundary

2.23 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 income and expenditure, assets and liabilities have therefore been left out of the financial statements.

2.24 I cannot quantify the impact of this on the WGA with certainty, as I do not have the 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 expenditure 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 material omissions from the WGA (**Figure 17**).

Accounting requirements

2.25 In my previous Reports[42], I noted that in determining the boundary for the whole of government, the Treasury has adopted the classifications of public bodies used by the Office for National Statistics, rather than apply accounting standards which 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]

2.26 As a consequence of the Treasury adopting statistical, rather than accounting, standards when it comes to defining 'control', the WGA excludes Network Rail Ltd, which had net assets of £8.5 billion as at 31 March 2012 (£7.7 billion as at 31 March 2011). The Treasury has also not applied its own criteria consistently as 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[44] 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[45]; and
- other bodies that are partly or wholly owned by the Government, such as the Royal Bank of Scotland (**Figure 17**).

2.27 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 standards, I consider that the bodies listed in **Figure 17**, where the Government has the ability to control their activities, should be included in the WGA.

Actions taken by the Treasury since 2010-11

2.28 The Treasury has made some progress in addressing the issues which have led to my qualifications. The introduction of the Clear Line of Sight initiative in 2011-12 has now led to more bodies being included in the WGA, such as the Financial Services Compensation Scheme and public railway companies (apart from Network Rail). The Treasury also plans to include UK Asset Resolution Ltd from 2013-14

[42] Comptroller & Auditor General, Report on the Whole of Government Accounts 2009-10, November 2011
Comptroller & Auditor General, Report on the Whole of Government Accounts 2010-11, October 2012

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

[44] Annex 2 to the WGA

[45] Annex 3 to the WGA

which will bring both Northern Rock (Asset Management) and Bradford and Bingley into the WGA.

Figure 17

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

	Income	Expenditure	Impact on Net Expenditure	Assets	Liabilities	Impact on the net liability
2010-11 WGA (before restatement)	614.0	(708.4)	(94.4)	1,227.7	(2,421.1)	(1,193.4)
Total values of entities excluded from 2010-11 WGA	**85.4**	**(85.5)**	**(0.1)**	**2,654.7**	**(2,510.3)**	**144.4**
2011-12 WGA	616.6	(801.9)	(185.3)	1,267.6	(2,614.6)	(1,347.0)
Total values of entities excluded from 2011-12 WGA	**64.7**	**(67.1)**	**(2.4)**	**2,639.5**	**(2,490.9)**	**144.0**
2011-12 figures consist of:						
Network Rail Ltd	6.0	(5.2)	0.8	47.8	(39.3)	8.5
State-owned banks (temporary ownership)[1]	55.7	(60.4)	(4.7)	2,477.4	(2,354.7)	122.7
State-owned banks (longer-term ownership)[2]	1.8	(0.6)	1.2	95.4	(90.8)	4.6
of which already included in WGA	-	-	-	-	-	(4.6)
Financial services sector[3]	0.5	(0.5)	-	0.3	(0.3)	-
Further education institutions[4]	-	-	-	14.9	(5.4)	9.5
Transport sector[5]	0.3	(0.3)	-	1.3	(0.3)	1.0
Other[6]	0.4	(0.1)	0.3	2.4	(0.1)	2.3

NOTES

All figures in £ billions

1. Lloyds Banking Group plc and Royal Bank of Scotland Group plc.
2. Northern Rock (Asset Management) plc and Bradford & Bingley plc. Will be fully consolidated in the WGA from 2013-14. The net asset position is included in the WGA (Note 18: Equity investment in Public Sector Banks).
3. Financial Services Authority
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 Skills Funding Agency and relate to 2010-11.
5. Trust Ports - figures have been estimated from available accounts for year-ended 31 December 2011.
6. NHS non-independent charities and London Councils. The figures for NHS charities have been estimated by the

Department of Health from 2010-11 Charity Commission data.

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.

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.

Not all bodies have a March year-end, e.g. figures for the banks relate to the year ending 31 December 2011.

Source: NAO analysis of Note 37 to the WGA and published accounts.

Recommendations for further action

2.29 I continue to recommend that the Treasury should review its criteria for including bodies within the WGA. In addition, the Treasury should review changes in the control government exerts over English further education institutions following the passing of the Education Act 2011 and conclude whether this means this sector should now be included in the WGA under accounting standards.

2.30 The qualification of my opinion on this matter is likely to remain until all significant government controlled entities are included in line with accounting standards.

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

2.31 I have qualified my opinion because of the impact of the inconsistent application of the financial reporting framework.

The WGA accounting framework

2.32 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 2011-12, some of the bodies included in the WGA prepared their accounts based on accounting frameworks that are inconsistent with the requirements of the Government Financial Reporting Manual.[46]

2.33 Under accounting standards, the Treasury should identify the impact of the different frameworks and make appropriate adjustments to the WGA, where material, so that the WGA is prepared consistently in accordance with the financial reporting framework.[47] The Treasury has undertaken an assessment of these differences and identified one material inconsistency, but has not been able to adjust for this in 2011-12. I do not have the information to fully quantify the effect of this limitation.

2.34 The one area of material misstatement identified 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

[46] Annex 4 to the WGA

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

replacement cost in line with the requirements of the Government Financial Reporting Manual.[48] The Treasury estimates that this difference in accounting treatment has resulted in an understatement of asset value of at least £200 billion.[49]

Actions taken by the Treasury since 2010-11

2.35 The Chartered Institute of Public Finance and Accountancy (CIPFA) updates the *Code of Practice on Local Authority Accounting* annually. The Treasury has been working with CIPFA to move towards changing this Code so that depreciated replacement cost, rather than historic cost, can be applied as a basis to value infrastructure assets in local authorities own statutory accounts. The Treasury has been collecting draft data, which has been used to inform its discussions with the standards setters. The complexity involved in local government bodies changing the basis for accounting for infrastructure assets is significant because of the range of assets involved and their specialised nature. The Treasury has requested depreciated replacement cost data from local authorities as part of its 2012-13 WGA data collection exercise.

Recommendations for further action

2.36 The Treasury should continue to support CIPFA in helping local authorities to develop the quality of the data to support this change in valuation basis. It should also work closely with local authority standards setters in its considerations of the basis of valuing such assets for their own statutory accounts. It should also take steps to ensure that the data collected is sufficiently robust to be considered complete, reliable and auditable.

2.37 Should local government be able to make a successful transition to depreciated replacement cost for its highways infrastructure assets, which includes providing complete, robust, consistent and auditable data, I may be able to remove my qualification in this area in future years.

Qualification arising from disagreement in the accounting for 3G licences

2.38 I have qualified my opinion because I consider that the Treasury has not complied with the requirements for accounting for income from the sale of 3G licences in April 2000. The impact of this on the 2011-12 WGA is that income is understated by £1.3 billion, deferred income is understated by £9.0 billion (£10.3 billion in 2010-11) and the General Fund is overstated by £9.0 billion (£10.3 billion in 2010-11).

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

[49] 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 local government infrastructure assets at £266 billion as at 31 December 2011, implying a likely understatement of at least £200 billion.

Accounting requirements

2.39 In April 2000, the Government raised some £22.5 billion from the sale of five licences for the electromagnetic spectrum for third generation mobile phone services. Telecommunications companies paid for the licences in full in 2000 and the Consolidated Fund accounted for these proceeds on a cash basis in its 2000-01 account.

2.40 The accounting standard for revenue recognition requires income to be matched to expenditure.[50] Licence holders have the right to access the spectrum for 20 years and there is an on-going cost on the Government to maintain the airwaves. Therefore the correct accounting treatment is to recognise this income over the licence period rather than treat it all as income in the first year. The Treasury does not agree with this view and, as disclosed in Note 1 to the WGA, believes that there are no more 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.

2.41 The balance of deferred income at 31 March 2011 was some £10.3 billion and therefore it has fallen by some £1.3 billion in the current reporting period. The issue therefore has a decreasing quantitative impact on the Account.

Recommendations for further action

2.42 This qualification will have increased relevance for the 2012-13 WGA as, following the auction of 4G licences in January 2013, 4G licences with a value of £2.4 billion have been awarded with an initial right to access the spectrum for 20 years. All licences were paid for in 2012-13 and receipts were surrendered in full to the Consolidated Fund.

2.43 The Treasury should, in my view, adjust the WGA for the 3G transaction in line with accounting standards. It should also consider the appropriate accounting treatment for the 4G licences that were auctioned in 2012-13.

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

2.44 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, between bodies included in the WGA.

[50] *International Accounting Standard 18 – Revenue*

Accounting requirements

2.45 The WGA is a consolidated account which is prepared by including the financial activities of around 3,000 government controlled bodies. Transactions and balances 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.

2.46 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.

2.47 The Treasury collects information from each of the bodies in the WGA on all intra-government transactions that are over £1 million with details of the relevant counter-party. The Treasury uses this data to match balances and transaction streams and removes them from the WGA. The scale of this task is challenging and the value of the transactions the Treasury eliminated in the preparation of the 2011-12 WGA presented for audit is significant (**Figure 18**).

Figure 18

Value of transactions removed from the financial statements

	Gross value	Transactions	Net value	Balance removed
Income	994	372	622	38%
Expenditure	1,243	436	807	35%
Net Expenditure for the year	249		185	
Assets	1,953	685	1,268	35%
Liabilities	3,269	655	2,615	20%
Net liabilities	2,687		1,347	

Gross and net values are in £ billions

Source: NAO analysis of WGA 2011-12 (Note 2)

2.48 Despite the work by the Treasury, there remains material uncertainty over some of the figures in the financial statements because the removal of these transactions and balances is potentially incomplete and inaccurate. This uncertainty arises where:

- 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.

2.49 Using the available evidence, I have estimated the level of uncertainty as being up to £16 billion (£22.6 billion in 2010-11) in gross income and expenditure and up to £5.1 billion (£10.4 billion in 2010-11) in gross assets and liabilities (**Figure 19**). The estimated errors reside mainly within individual primary statements. However, I estimate the maximum impact of these uncertain transactions on Net Expenditure reported in the Account could be up to £1 billion (£2.9 billion in 2010-11) (**Figure 19**).

2.50 I have qualified my opinion because of the significance of the estimated level of gross uncertainty, and therefore the potential gross overstatement of income, expenditure, assets and liabilities (rather than the potential impact on Net Expenditure or net liabilities).

2.51 Local government bodies make up the largest contribution to overall uncertainty:

- local government bodies are involved in £6.8 billion of the £10.4 billion error that can be linked to specific entities in the Consolidated Statement of Revenue and Expenditure;
- local government bodies are involved in £3.2 billion of the £4.9 billion error that can be linked to specific entities in the Consolidated Statement of Financial Position.

Figure 19

Sources of uncertainty about transactions removed and the impact on the financial statements

	Statement of Revenue & Expenditure	Statement of Financial Position
Entities declaring different intra-government transactions or balances	4.9	1.0
Only one entity declares an intra-government transaction or balance	5.5	3.9
Subtotal of errors that can be linked to specific entities	**10.4**	**4.9**
Neither entity within an expected relationship declares an intra-government transaction or balance	5.6	0.2
Impact on the financial statements (potential overstatement)	**16.0**	**5.1**

All figures in £ billions; Source: NAO analysis of WGA 2011-12

Actions taken by the Treasury since 2010-11

2.52 There has been a significant improvement in the elimination of counter-party transactions since I last reported on WGA, with the level of error falling in 2011-12 compared with the previous year. The Treasury has been proactive in encouraging bodies to agree intra-group transactions and as a result of its Clear Line of Sight initiative, the degree of departmental scrutiny of intra-departmental group transactions has increased. The Treasury also carried out extensive work on balances as part of its preparation of the WGA which has aided the elimination process.

Recommendations for further action

2.53 The Treasury should undertake further work to reduce the uncertainties in removing intra-government transactions. As local government is the largest sector of the remaining error, I recommend that further work is concentrated in this area, such as formal agreement of balances. If the Treasury can reduce the level of error sufficiently, I may be able to remove this qualification in future years.

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

2.54 I have qualified my opinion in respect to local authority maintained school assets because not all school assets are included in the WGA.

2.55 All local authority maintained schools are classified by the Office for National Statistics as public sector and hence fall within the Treasury's definition for inclusion within the WGA. Taking an approach based on accounting standards[51], I 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 can exert over such schools.

2.56 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 that not all schools were included within local authority accounts.[52]

2.57 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 assets controlled by schools 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 allow me to conclude that the assets of foundation, voluntary aided and voluntary controlled schools are all included within the WGA.

2.58 Based on the estimates I do have, the omissions are material to the WGA. **Figure 20** shows that up to £26 billion (2010-11: £32.5 billion) of assets used by voluntary aided and foundation schools and £8.5 billion (2010-11: £9.0 billion) of

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

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

assets used by voluntary controlled schools may have been omitted from the accounts.

Figure 20

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

	Voluntary aided and foundation schools (not included in WGA)		**Voluntary controlled schools (may or may not be included in WGA)**	
	Number	**Amount (£m)**	**Number**	**Amount (£m)**
Primary Schools	4154	12,462	2458	7,374
Secondary Schools	900	13,500	78	1,170
Total	**5,054**	**25,962**	**2,536**	**8,544**

Estimates as at January 2012 based on typical carrying value of £3 million for primary schools and £15 million for secondary schools as estimated by CIPFA. 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.
FRAB (108) 11: Consideration of the code of practice on Local Authority Accounting 2011/12 and 2012/13 http://www.hm-treasury.gov.uk/d/frab108_11.pdf and Tables 15 a and 15b of the schools, pupils and their characteristics https://www.gov.uk/government/publications/schools-pupils-and-their-characteristics-january-2012

2.59 In addition to the above, the value of land and buildings brought into the academy accounts (at £12.3 billion) does not agree to the book value of assets disposed from local authorities' accounts (£6.5 billion). Some of this difference relates to new buildings provided to Academies from the private and third sectors on establishing the academy under private finance arrangements. The Treasury has not provided me with sufficient evidence for me to confirm these values nor have I received sufficient evidence over the Academies' land and buildings opening balances.

Actions taken by the Treasury since 2010-11

2.60 For 2011-12, the Treasury amended the returns local authorities are required to submit to it to include numbers and valuations of land and buildings for local authority maintained schools that are not included in the local authorities' balance sheets. However, this information is not audited and I have been unable to obtain sufficient assurance that this information is accurate and complete.

2.61 The Treasury is working with CIPFA in leading a working group to understand the definitions of public sector control following revised group accounting standards, which are expected to come into force from 1 April 2014, in the context of public sector schools.

2.62 For 2011-12, I concluded that the population of buildings within academies' reported assets included some properties which academies may not own. I therefore believe that the values of academy assets are likely to be overvalued but I am unable to conclude on the extent of the overstatement of assets.

2.63 The Treasury has made progress on the academies issue since I last reported as all but 42 Academies (out of 1,665 as at 31 March 2012) are now included within the WGA. However, I have been unable to obtain sufficient assurance that the data submitted by Academies is representative of the income and expenditure they incurred in 2011-12.

2.64 For 2012-13, academies will be consolidated into the Department for Education. The Education Funding Agency will be carrying out further work to prove that the Academies' accounts, which have an August year end, are a suitable proxy for the information required to be consolidated into the WGA, with its March year end. There were 1,665 academies operating on 31 March 2012, with 3,128 operating on 1 July 2013. The quality issues with underlying data are increasing in importance as the population affected increases until the sector stabilises in size and composition.

Recommendations for further action

2.65 The Treasury should undertake work to ensure that the data collected relating to local authority maintained schools in the first year of implementation is sufficiently robust to be considered true and fair. Once sufficient robust data is available in support of the completeness and valuation of voluntary aided, voluntary controlled and foundation schools I may be able to remove my qualification in future years.

2.66 I recommend that the Treasury continues to work with the Education Funding Agency to make the Agency's consolidation methodology robust so that there is adequate information to support the account balances.

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

2.67 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 2011-12, external auditors qualified their opinions of some 24 accounts (23 accounts in 2010-11).

2.68 The most significant of these qualifications relate to the resource accounts of the Ministry of Defence and the Cabinet Office: Civil Superannuation for 2011-12. Given these accounts have a material impact on the WGA, I have also qualified my opinion on the WGA.

2.69 Further details can be found in my audit opinions and within the annual accounts of the Ministry of Defence and Cabinet Office: Civil Superannuation.[53]

[53] Ministry of Defence Annual Report and Accounts 2011-12, Session 2012-13, HC 62, December 2012. Cabinet Office: Civil Superannuation Accounts 2011-12, Session 2012-13, HC 600, January 2013.

Activity since WGA 2010-11

2.70 Progress is being made by both departments to improve their systems for capturing and reporting robust information. I have, though, qualified my opinion on the 2012-13 Ministry of Defence's accounts[54] and I will report on the progress the Cabinet Office has made during 2012-13 in addressing my qualification once I have completed my audit.

Recommendations for further action

2.71 The Treasury should consider how it can support both the Ministry of Defence and the Cabinet Office to help remove these long standing qualifications.

Other issues on which I have not qualified my opinion

2.72 There are two 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 certificate relating to the uncertainties in estimating costs of the liabilities of the Nuclear Decommissioning Authority. This value has been calculated based on reasonable assumptions, but could change with future events.
- The external auditor of some 30 accounts (22 in 2010-11) included in the WGA, qualified their audit opinions owing to the material existence of irregular spending;[55] that is, using resources not in accordance with Parliamentary intentions. Of these, two are of significance to the WGA and cover error and fraud in benefit payments and tax credit payments. These irregularities have led me to qualify my regularity opinion on the 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

15 July 2013

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[54] Ministry of Defence Annual Report and Accounts 2012-13, Session 2013-14, HC 38, July 2013.

[55] Included in this number are four accounts qualified on a ‘true and fair’ basis as explained in paragraph 2.67.