CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL

MAY, 2016

HM Treasury

Whole of Government Accounts

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

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Certificate of the Comptroller and Auditor General

I certify that I have audited the financial statements of the Whole of Government Accounts (the Account) for the year ended 31 March 2015 under the Government Resources and Accounts Act 2000. These comprise the consolidated statements of: revenue and expenditure, comprehensive expenditure, financial position and changes in taxpayers' equity; cash flow statement; the related notes; and Annexes 1 to 5. 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 consolidated accounts for a group of entities each of which appears to HM Treasury (the 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 the Treasury; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the overview; comparison to national accounts; governance statement; and remuneration report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. 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 accounting boundary

The Government Resources and Accounts Act 2000 (the Act) requires the Treasury to produce a set of accounts for a group of bodies which appears to the 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. The Treasury has adopted a framework for the accounts which is based on International Financial Reporting Standards adapted for the public sector context.

However, in Note 1.3 to this Account, the Treasury defines the accounting boundary for the accounts by reference to those bodies classified as being in the public sector by the Office for National Statistics. I consider that it would be more appropriate to assess the accounting boundary with reference to the accounting standards.

I also consider that the Treasury's accounting policy has not been applied consistently in 2014-15 as a number of significant bodies, including Royal Bank of Scotland, 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.

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

- Royal Bank of Scotland which has gross assets £1,050.8 billion and gross liabilities of £990.6 billion; and
- other bodies which have estimated gross assets of £16.6 billion and gross liabilities of £5.9 billion.

Qualification arising from disagreement relating to inconsistent application of accounting policies

The Treasury's accounting policies state that the WGA is prepared on an International Financial Reporting Standards (IFRS) basis, as adapted or interpreted for the public sector context. A number of bodies consolidated in the WGA do not adopt the same framework under which the accounts are prepared. These bodies fall under the following categories:

- bodies in the local government sector follow the Code of Practice on Local Authority Accounting in the UK for 2014-15;
- bodies that follow either pure IFRS or UK GAAP; and
- bodies that follow the Charities Statement of Recommended Practice.

Accounting standards require that, where the effect of such inconsistent accounting policies is material, adjustments should be made on consolidation. The Treasury has not provided a full analysis of these differences, although Annex 4 to the accounts does list some of these, and it has not been able to quantify fully the impact of the different accounting frameworks or accounting policies on the WGA but it is material in some areas. The most significant example of the use of different accounting policies is where assets included in the WGA are not valued on a consistent basis, for example assets held by local authorities and infrastructure assets held by Network Rail.

Assets held by local authorities are valued at historic cost and the infrastructure assets held by Network Rail are valued on a discounted cash flow basis, whereas those held by central government bodies are valued at depreciated replacement cost. The Treasury's estimate of the understatement of assets due to the difference in valuation between historic cost and depreciated replacement cost for local authority assets could be at least £244 billion (Note 13 to the accounts). There is currently no reliable estimate for the Network Rail infrastructure figure as this is still to be completed as part of Network Rail's consolidation into the Department for Transport's 2015-16 accounts.

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

The external auditors of the financial statements of a number of bodies that are consolidated into these accounts qualified their audit opinion. Of these, two are of material significance to these accounts, qualifications of the accounts of the Ministry of Defence and the Department for Education.

- **Ministry of Defence accounts:** The Ministry of Defence does not hold records to enable compliance with the financial reporting framework and account for the expenditure, assets and liabilities arising from certain contracts in accordance with International Accounting Standard 17, Leases. Consequently, I have concluded that the Ministry of Defence has omitted a material value of leased assets and lease liabilities from its statement of financial position as at 31 March 2013, 31 March 2014 and 31 March 2015. This has also led to a material misstatement of the statement of comprehensive net expenditure for 2013-14 and 2014-15 and statement of parliamentary supply for 2013-14 and 2014-15. I am unable to quantify the impact on the financial statements because the Ministry of Defence has not maintained the records or obtained the information required to comply with International Financial Reporting Standards in this respect.

- **Department for Education accounts:** The Department has recognised academy trust land and buildings of £33 billion in its statement of financial position. The audit evidence available to me was limited in respect of this balance because the departmental group was unable to demonstrate that these all met the recognition criteria for non-current assets under International Accounting Standard 16 Property, Plant and Equipment. Finally, I qualified my audit opinion in 2013-14 because I identified a material level of misstatement and uncertainty in the group financial statements. In addition, I have identified a material level of misstatements in the 2014-15 group financial statements that also relate to 2013-14. Therefore, I have qualified my opinion on the comparative figures in the group financial statements.

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

Accounting standards require that balances and transactions held and made between bodies consolidated into these accounts shall be eliminated in full. The Treasury has a process in place to identify intra-government balances and transactions between bodies consolidated into the accounts, and most balances and transactions have been eliminated. However, there remains material values of intra-government transactions and balances which have not been eliminated and the effect of not adjusting for these could lead to a potential overstatement of up to £6.5 billion (£7.3 billion in 2013-14) in gross income and expenditure within the consolidated statement of revenue and expenditure.

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 2015 and of its net deficit 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 – nuclear decommissioning provisions

In forming my opinion on the truth and fairness of these financial statements, I have considered the adequacy of the disclosures made in areas where there is significant uncertainty in the values reported in Note 1.22.5 to the financial statements, 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 £82.9 billion (£77.4 billion in 2013-14).

Opinion on other matters

In my opinion, the information given in the overview; comparison to national accounts; remuneration report; and governance statement, 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 the Treasury's guidance.

My report includes more details of the matters leading to my qualified opinion.

Sir Amyas C E Morse
Comptroller and Auditor General
23 May 2016

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

Report of the Comptroller and Auditor General

Summary

1 The Whole of Government Accounts (WGA), published by HM Treasury (the Treasury), is a single set of accounts consolidating the financial activities of over 6,000 organisations with the aim of providing an overview of the financial performance and position of the UK public sector.

2 It is the largest consolidation of public sector accounts by any country, and includes both central and local government bodies as well as public corporations such as the Bank of England, but does not include independent public sector organisations such as Parliament, the Crown Estate or the National Audit Office. (Annexes 2 and 3 sets out entities that have not been consolidated into the WGA).

3 The WGA for 2014-15 is the sixth such set of audited accounts. Since the 2009-10 WGA was first published in October 2011, the Treasury has made significant improvements to not only data quality and the account consolidation processes, but also to the disclosures and commentary published alongside the accounts.

Scope of my financial audit

4 The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of my opinion which reports whether the financial statements are accurate, prepared fairly and accord with an applicable financial reporting framework. Under the Government Resources and Accounts Act 2000, I am required to audit, certify and report on the WGA.

5 I apply the concept of materiality both in planning and performing my audit, and in evaluating the effect of misstatements on my audit and on the financial statements. This approach recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement or irregularity. A matter is material if its omission or misstatement would reasonably influence the decisions of users of the financial statements.

6 My audit approach is risk based, informed by my understanding of the government's activities and my assessment of the risks associated with the WGA. This focusses my audit on the areas of highest risk, such as those affected by significant accounting estimates or management judgement. In this context, risk solely relates to the risk of material misstatement in the presentation of the financial statements, so a business or operational risk, on its own, is not sufficient to be considered a significant risk, although there may be overlap between the two.

7 The main risks for my audit of the WGA relate to the areas of past qualification, which are set out below. These relate to three broad areas: the boundary of the WGA and its application; areas of inconsistency and disagreement over accounting treatments; and the quality of the data that forms the accounts. I am also required to consider the following by International Standards on Auditing:

- The risk of material fraud arising from the approach to recognising revenue - which I addressed via my understanding and assessment of the approach that government has to recognising the main revenue streams via my audit of HM Revenue and Customs; and
- The risk of management using its influence to override the embedded controls that support the production of the accounts and manipulate the financial results within the WGA. This risk is a particular challenge for the WGA, due to the range of figures that constitute the accounts and level of adjustments that the Treasury processes to produce the consolidated figures. I addressed this via my audit of these adjustments and through my assessment of how the transactions streams and balances within the underlying accounts that form the WGA are reflected within the consolidated financial statements.

8 My audit opinion on the financial statements considers the truth and fairness of the presentation of the WGA but does not consider whether the activities presented in the WGA represent value for money. I have statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy and exercise these functions through my programme of value for money reports.

Key findings

9 The WGA shows the UK public sector's overall financial position as defined by accounting standards. In 2014-15, the WGA net expenditure (the shortfall between income and expenditure) increased by £6.3 billion, to £152.0 billion. This is due to an £8.4 billion increase in the estimated costs of provisions, which mainly relates to an increase in the liabilities for nuclear and oil and gas field decommissioning; a £7.5 billion increase in net interest on pension scheme liabilities; and the impact of the triple lock policy on state pensions of £3.6 billion. These costs are offset by an increase in overall revenues from £652.9 billion to £659.3 billion, which is largely due to an increase in Value Added Tax. Within net expenditure wages and salaries are broadly stable at £148.3 billion compared to £148.2 billion, in the light of staff numbers falling by 20,346.

10 The government's net liabilities (the shortfall between assets and liabilities) increased to £2,103.2 billion from £1,840.6 billion, which is mainly due to increases in pension liabilities of £190.2 billion and government borrowing of £78.4 billion.

11 The 2014-15 WGA is an accurate reflection of the use of public resources,

but my opinion remains qualified. I have been able to remove two of my long-standing qualifications of the WGA relating to the recognition of local authority school assets and 3G and 4G spectrum income; and have reduced the extent of my qualification relating to the accuracy and completeness of intra government eliminations. This represents significant progress in the 2014-15 accounts. The Treasury has put in place measures that may enable me to remove my qualification relating to the inconsistent accounting treatments across the WGA over the next four years. However, my qualifications relating to the boundary of the WGA; and the underlying qualifications in the Ministry of Defence and Department for Education; are likely to remain for the foreseeable future.

12 The Treasury has continued to improve the accounts production process for 2014-15, but significant challenges remain in meeting its target of publishing the accounts within nine months of the year-end. The Department for Education, a significant component for WGA, extended its deadline for laying its 2014-15 accounts before Parliament, and I did not certify the accounts until the 7 April 2016. It is an achievement on the part of the Treasury that despite this delay I was able to certify the WGA 2014-15 on 23 May 2016. This is in part due to improvements to the accounts production process including the Treasury increasing the number of validation checks in the data collection process to address recurring data collection issues, and introducing a more efficient grant elimination methodology.

13 Due to the nature of the WGA, the Treasury is dependent on good quality, timely data from component bodies in order to publish the accounts in an appropriate timeframe. Delayed consolidation returns from significant components, such as government departments, impact on the Treasury's ability to achieve target publication dates and improve upon the timeliness of WGA. The submission of poor quality or incomplete data requires additional Treasury resources to cleanse the data and to manually identify eliminations of material intra-government transactions and balances. As the Treasury works to further reduce the value of unsupported eliminations and the removal of my related qualification; and seeks to accelerate the timetable, it will require significant component bodies to submit high quality consolidation returns in a timely manner.

14 The WGA is a comprehensive record of the use of public resources, but the **Treasury should look to develop the comparative financial disclosures to improve the ability to evaluate the trends in the figures and assess performance in the achievement of its financial strategy for government.** The WGA consolidates the financial activities of over 6,000 organisations across the public sector and shows the overall public sector financial position. However it remains difficult for the reader of the accounts to assess the progress, or otherwise, in consolidating the public finances.

15 The Treasury is taking steps to make disclosures more detailed and transparent, but more needs to be done in this regard. I reported in 2013-14 that the lack of detail in parts of the WGA continues to inhibit its usefulness and this remains the case. For example, there remains limited information on the purchase of goods and services by government or the distribution of public spending across the regions or the main areas of government activities. As devolution continues and the process of managing the government's deficit progresses, these disclosures will be increasingly relevant and useful to the ability to analyse the management of the public finances.

16 The WGA provides a unique perspective of the government's portfolio of assets and liabilities. The WGA provides comprehensive information on the full inventory of the government's assets, liabilities and financial risks that is not available from any other source and, together with the ongoing impact of the government's financial performance, forms the country's overall net worth. The disclosures that support this portfolio view of assets and liabilities need to be improved however, to enable comparative performance to be judged more fully and to provide clarity as to the underlying risks that exist across the portfolio.

17 The WGA is being used to help manage the public finances, and the Treasury has increased the impact and profile of the accounts. The Office for Budget Responsibility and the Institute for Fiscal Studies use the WGA in their reports on the management of the public finances, and the data collected for Public Corporations is shared with the Office of National Statistics every year to feed into the annual National Statistics publication. The comprehensive nature of the accounts and their reach across the public sector, provides the opportunity for the Treasury to link financial policy and performance and explain its approach to managing the government's overall finances.

Recommendations

18 Although responsibility for the underlying transactions lies with the various bodies included in the WGA, my recommendations are aimed at the Treasury, because of its overarching responsibilities for the management of the public finances and the preparation of the WGA. The Treasury should:

- **Continue its work in improving the quality and timeliness of data within the WGA.** In cases of late or erroneous data, the Treasury should set out an action plan for ensuring improvements are made with the relevant component bodies. I recommend that the Treasury agrees with such component bodies an action plan for improving the data; and an appropriately senior responsible officer tasked with improving the timeliness and quality of problematic WGA submissions.

- **Build on developments in financial management and reporting across government to remove the inconsistencies in accounting approach and policies.** Eliminating the major inconsistencies in asset valuation and ownership; liability recognition; and the application of the boundary of the WGA, would improve the usefulness of the WGA by providing a stable base within the numbers upon which to analyse the government's financial position and performance. Where other organisations or component bodies are instrumental in making progress with the removal of the residual inconsistencies, such as CIPFA or government departments, the Treasury should agree the necessary steps with those bodies that will ensure that progress is made.

- **Enhance the disclosures that support the financial information in the WGA, to enable the reader to better assess the profile of spend across government.** The Treasury should improve the disclosures in the WGA on the purchases of goods and services; and the regional and functional allocation of spending, assets and liabilities.

- **Develop the disclosures regarding its portfolio of assets and liabilities more fully, to enable a more accurate understanding of the underlying drivers of the movements in the government's net financial position**. This would enable users of the accounts to understand the extent to which the government's overall financial position has changed due to policy or financial performance; and the impact of external factors such as discount rates and accounting adjustments on the government's overall net liabilities.

- **Continue to raise the profile of** the **WGA within government and embed it into the routine monitoring of the risks to public finances.** As fiscal consolidation continues, the Treasury should seek to provide greater insight into progress and the risks and potential impact of the programme through use of the trend data available through the WGA.

Part One

The context for my audit of the Whole of Government Accounts

The Whole of Government Accounts

1.1 The Whole of Government Accounts (WGA) plays a key role in the Treasury's overarching framework to improve public financial management and Parliamentary accountability. The WGA is being used by those within and outside of the Treasury to inform decisions which affect public finances. As such, improvements to the quality and timeliness of the WGA help to increase its value to the Treasury in its management of public finances and improves accountability to Parliament and the public.

The wider picture

1.2 The WGA, which is underpinned by accruals based financial statements under a common framework, is increasingly being seen as best practice around the world. The International Monetary Fund is promoting the adoption of accruals based accounting methodologies, and the development of comprehensive statements of accounts for developed countries as a mechanism for ensuring transparency and greater accuracy in the presentation and management of the public finances.[1] The UK is among the most advanced countries in this regard and the WGA is a uniquely comprehensive product; as it is the only set of consolidated country accounts that includes both central and local government activities.

Understanding public financial performance

1.3 The WGA forms a key part of the mechanisms for understanding the government's financial performance. Together with the statistical framework that is published in the National Accounts by the Office of National Statistics, and the Office for Budget Responsibility's forecasts of economic performance and the public finances; the WGA provides a mechanism for holding government to account for its long term financial performance.

1.4 The Treasury uses two major measures for fiscal management: Curr*ent Deficit* and *Public Sector Net Debt*. These statistics and a number of others on the government's financial position are routinely published in the *National Accounts,* in the monthly *Public Sector Finances Report*, and in the *Public Expenditure Statistical Analyses* and other sources. Therefore, they provide an up-to-date, current and independent view of the government's financial performance.

[1] http://www.imf.org/external/pubs/ft/wp/2016/wp1695.pdf

1.5 The WGA provides a broader view of public finances based on International Financial Reporting Standards (IFRS), the system of accounts used internationally by the private sector, as adapted and interpreted for the public sector context. The Treasury sets out the key differences between the Current Deficit and Public Sector Net Debt and the WGA financial position in **Chapter 2** to the WGA. The WGA provides a comprehensive and independently audited view of the assets and liabilities owned and managed by the government; and a detailed record of financial performance, enabling analysis of the Treasury's management of the public finances and the financial implications of the application of government policy.

1.6 The Office for Budget Responsibility publishes regular independent forecasts of economic and financial performance. In particular it publishes an annual assessment of financial risk to the public finances in its Fiscal Sustainability Report.[2] This combines an analysis of the balance sheet financial information presented in the National Accounts and the WGA; and projections of long term government spending to assess the overall sustainability of the public finances in the long term.

The WGA's role in the management of the public finances

1.7 The WGA is one part of a wider set of processes that the Treasury uses to manage the public finances. In the main, financial management in government centres on the fiscal frameworks; budgeting and spending; and on the annual process of estimating departmental spending and reporting outturn against that budget. While these frameworks were initially designed for different purposes than the WGA, they are nevertheless connected and in many cases draw on the same data, such as departments' monthly reports submitted into the Treasury's public spending database, OSCAR.

1.8 The WGA helps to manage the longer-term risks to the government's assets and liabilities that do not feature as prominently in the other management frameworks that instead focus on government spending, cash requirements or an individual, rather than holistic view of financial assets and liabilities.

1.9 The WGA provides a unique standpoint that cannot be matched by any of the other financial management frameworks in government, which is the ability to assess the full portfolios of assets and liabilities that the government holds. While the information in the WGA is incomplete in this regard, as demonstrated by the qualifications on the accounting boundary and the inconsistent accounting frameworks that are set out in Part 2 of this report; there is no more comprehensive record of what the government owns, owes and is committed to than the WGA. This portfolio perspective is becoming increasingly valuable as it facilitates an understanding of the various mechanisms the government deploys to assess the risks to and manage its portfolio positions and their relative performance.

1.10 I will shortly publish a series of reports which build on this portfolio level view and explore some of the major risks to public finances highlighted in the WGA. These

[2] http://budgetresponsibility.org.uk/fsr/fiscal-sustainability-report-june-2015/

reports will examine how the significant risks to the balance sheet have changed in recent years and considers how government currently manages them. Specifically, these reports focus on government's pension liabilities; its financial assets; and provisions, contingent liabilities and guarantees. I will also be carrying out work evaluating government's infrastructure assets and government debt in 2016-17.

1.11 There are still elements of government's activities that lack detail in the WGA. For example, Note 8 to the WGA, which shows expenditure on the purchases of goods and services by government, does not provide further analysis as to how funds have been spent, such as on consultancy and accommodation. The WGA also does not include additional disclosures showing how public spending is distributed between individual regions or nations across the UK or across the main areas of government, such as defence, health and education. This lack of granularity within the WGA does not help the reader assess the full impact of the government's current and future deficit reduction measures.

1.12 Following the introduction of OSCAR to support the WGA in 2012-13, the Treasury has captured transactions in a greater level of detail. However, due to inconsistencies in the reporting of underlying data from component bodies, it is yet to be confident enough in the data to disclose more information on spend within the WGA and the Treasury needs to work with these bodies to improve its quality. This process will become increasingly important and relevant as consolidation of the public finances continues and more spending is devolved to local administrations.

How the WGA is being used

1.13 I have previously recommended that the profile of the WGA should be raised within government and for it to be used more effectively to help decision making. In its report on the 2012-13 WGA, the Committee of Public Accounts also recommended that the Treasury sets out how it will ensure that the government makes better use of the WGA to inform decisions.

1.14 The WGA is being used across government in the following ways:

- The data collected for Public Corporations is shared with the Office of National Statistics every year to feed into the annual national statistics publication.
- WGA is being used to assess the public sector fixed asset base with a view to identifying areas for scrutiny and rationalisation.
- WGA is the only place that reconciles accounting information to the National Accounts adding to the transparency of public finances.

1.15 The Treasury has started to take steps to embed the role of the WGA, and its underlying data, in helping to inform further areas of focus and financial risk management. Now the WGA is in its sixth year of publication, the Treasury has useful trend data which it is able to share with others within and outside of the Treasury. Specifically, the Treasury highlighted the main changes and improvements to WGA as being:

- The consolidation of the assets and liabilities of Network Rail and the Pension Protection Fund;
- The reporting of Cabinet Office cross government fraud, error and debt data for the first time;
- Significant progress in removing the current qualifications of my audit opinion;
- Progress towards the implementation of a consistent accounting policy for highways infrastructure assets by 2016-17;
- Improvements in academy schools data, particularly in respect of the valuation of fixed assets; and
- The development a simplified and streamlined WGA as part of the government agenda to make public sector accounts more accessible.

1.16 Outside of government, the WGA has been utilised by a number of professional bodies.

- Institute for Chartered Accountants of England and Wales (ICAEW) - The ICAEW published analysis of the 2013-14 WGA and its outputs during the year, to support its briefing for the 2015 budget in the lead up to the 2015 general election. [3]
- The Institute for Fiscal Studies (IFS) – The IFS published an analysis of the WGA in the Green Budget for 2016, which supported its analysis of the budget and its deliverability.[4]
- The International Monetary Fund (IMF) – The IMF published an analysis of the use of consolidated financial accounts in developed countries and the role that they can play in supporting transparency, accountability and effective management.[5]

The Whole of Government Accounts view of 2014-15

1.17 The key messages within the 2014-15 WGA relate to the major trends in income and expenditure across government; the net liability position; the presentation of the risks to the public finances; and the disclosure of the extent of fraud and error across the whole of government. These are set out below.

Trends in income and expenditure

1.18 The 2014-15 WGA shows the financial impact of the government's major fiscal consolidation and growth programmes. This demonstrates the contribution a

[3] https://www.icaew.com/~/media/corporate/files/about%20icaew/what%20we%20do/policy/public%20policy/icaew%20wga%202013-14%20presentation%202015-03-26.ashx
[4] http://www.ifs.org.uk/publications/8129
[5] http://www.imf.org/external/pubs/ft/wp/2016/wp1695.pdf

comprehensive picture of the government's finances can make to the transparency agenda and in demonstrating the overall impact of the ongoing fiscal consolidation.

1.19 There are a number of areas where economic growth and fiscal consolidation measures can be seen within the WGA: net and total expenditure; increases in taxation revenue; revisions to the social security benefits regime under the control of the Department for Work and Pensions; and changes in the employment profile in the public sector, as described below.

Net and total expenditure

1.20 The WGA shows that net expenditure, the shortfall between income and expenditure as defined by accounting standards, was £152.0 billion in 2014-15. This represents an increase of £6.3 billion or 4% compared to the 2013-14 figure of £145.7 billion.

1.21 Total expenditure has increased during 2014-15 by 2.1% from £718.4 billion to £733.9 billion. This £15.5 billion rise is due to an increase in benefits expenditure, as noted below; a £7.5 billion increase in net interest on pension scheme liabilities; a £5.5 billion increase in the liability for nuclear decommissioning; a £4.4 billion increase in pre-existing HM Revenue and Customs (HMRC) provisions for losses in tax revenue relating to North Sea oil and gas decommissioning; a £2.7 billion increase in clinical negligence provisions; and £1.8 billion increase in outstanding legal claims in relation to disputed taxes. This is offset by an increase in total revenue of £6.4 billion.

Taxation revenue

1.22 The WGA shows an increase in the government's revenue arising from taxation of 2% from £555.8 billion to £566.7 billion. This is in contrast to a 6% increase in taxation revenue shown in the 2013-14 WGA, and in comparison to economic growth during 2014-15 of 4.3% in nominal terms[6].

1.23 The increase in 2014-15 mainly arises from a 5% increase in VAT receipts, from £108.2 billion to £113.9 billion, reflecting growth in the automotive and manufacturing sectors and business services. Following on from a rise of 6% in 2013-14, income tax receipts increased by 0.6%, or £1 billion, to £163.1 billion in 2014-15. Capital Gains Tax also rose by £1.8 billion to £5.7 billion.

1.24 Whilst the majority of other taxation lines saw only small fluctuations in both absolute and proportional terms, two major streams saw decreases: council tax receipts fell from £28.5 billion to £28.2 billion, whilst National Insurance Contributions dropped by £0.1 billion to £97.2 billion.

Social security benefits

1.25 Expenditure on social security benefits increased during the year by 2%, or £4.3 billion, from £213.4 billion to £217.7 billion. This follows a reduction reported in the

[6] http://www.bankofengland.co.uk/publications/Documents/inflationreport/2015/aug.pdf

previous year, where the total social security benefits fell in the WGA, from £215 billion to £213.4 billion.

1.26 The largest change in social security benefits is a 4% increase in state pension payments, which increased by £3.6 billion to £88.6 billion due to the government's triple lock policy where the state pension rises every year by the highest of price inflation, earnings growth or 2.5%.

1.27 Employment support allowance increased by 18.7%, rising from £10.9 billion to £13.4 billion, as take up of the allowance increases as it replaces income support and incapacity benefit, both of which fell by £0.7 billion and £1 billion respectively.

Public sector wages and salaries

1.28 Public sector wages and salaries have increased by £0.1 billion, from £148.2 billion to £148.3 billion. This is broadly in line with the government's policy on pay restraint across the public sector.

1.29 Overall staff numbers within the public sector have fallen by 20,346 to 4.43 million, representing a 0.5% reduction.

1.30 During 2014-15 there were 63,708 compensation packages arising from staff leaving the public sector, at a total cost of £1.5 billion and an average cost of £23,544. These figures represent a reduction on those disclosed in the 2013-14 WGA, where 72,445 compensation packages were paid at a total cost of some £1.8 billion and an average cost of £24,846.

Trends in the WGA net liability position

1.31 In 2014-15 the government's net liability position increased by £262.6 billion, to £2,103.2 billion. This is largely due to increases in public sector pension liabilities of £190.2 billion and government borrowing of £78.4 billion.

1.32 Public sector pensions have increased due to actuarial assumptions, current service costs and financing costs, offset by payments made in year.

1.33 Government borrowing financed mainly by the issuance of government gilts has increased to £1,174.5 billion from £1,096.1 billion during 2014-15, but the costs of financing this debt fell by £4.1 billion to £27.6 billion. The reduction in interest costs is due primarily to the impact of lower inflation rates on the uplifting of the nominal repayable for index-linked gilts. Therefore, the cost of financing this debt overall has fallen to 2.4% from 2.9% in 2013-14. The level of government debt will rise again in 2015-16, reflecting the continuing deficit in the public sector finances which is likely to be in place until the end of the current parliamentary session.

Risks to the government's finances

1.34 The WGA shows the most complete picture of the potential risks to the government's finances, through the disclosure of contingent liabilities, guarantees and letters of comfort. The overall potential exposure to additional liabilities rose during the year to £76.4 billion from £63.8 billion. The most significant increases in potential liabilities arose in HM Revenue and Customs where taxes subject to challenge increased from £29.2 billion in 2013-14 to £35.6 billion in 2014-15; and the Department of Health, where potential clinical negligence claims have increased from £11.9 billion in 2013-14 to £14.0 billion in 2014-15.

1.35 The WGA also discloses a range of unquantifiable contingent liabilities in note 31.3. These relate to: regional development funds; health trusts and private sector companies engaged in health care; risks arising from the transport of nuclear matter; and government guarantees to British Telecom's pension liabilities.

Highlighting the extent of fraud and error across the whole of government

1.36 The Committee of Public Accounts recommended in its reports on the 2011-12 and 2012-13 WGAs that government should report cross-government figures within the WGA which would show the impact of its counter-loss activities.[7] Although the WGA included the financial impact of fraud, error and loss through the consolidation of central government accounts, it did not state explicitly the aggregate figure across government.

1.37 The Treasury has implemented this recommendation, and in the 2014-15 WGA discloses that during 2014-15 fraud and error reported to the Cabinet Office by central government departments (excluding benefits, tax credits and local government) was analysed and agreed with departments at £72.9 million.

Production of the 2014-15 Whole of Government Accounts

1.38 Since the inception of WGA, the Treasury has focused on improving the quality of the data feeding into the accounts, removing the qualifications to the audit opinion, and improving the timeliness of publication.

1.39 In March 2015, the Treasury made the significant step of publishing the 2013-14 WGA within a calendar year of the reporting date. Given the scale and complexity of the consolidation, this represented an achievement. However in the production and publication of the 2014-15 accounts, the Treasury has faced delays in the delivery of underlying data within the Department for Education, as outlined below, which has resulted in publication once more falling back to over a year after the reporting year-end.

Department for Education

1.40 The Department for Education (DfE) group reported total expenditure of £59 billion in 2014-15, which represents a significant component of the WGA and data that is essential to the production of complete accounts. Some £41 billion of DfE

[7] Committee of Public Accounts, *Whole of Government Accounts 2011-12*, HC 667, Thirty-second Report of Session 2013–14, 12 December 2013

expenditure relates to capital and resource grants, the majority of which are to educational bodies and local authorities. Information relating to these payments is required by the Treasury to identify transactions to be eliminated in the WGA in order to provide an accurate consolidated view of the government's finances.

1.41 During 2014-15 the DfE faced increasing challenges in consolidating the growing number of academies and used a statutory instrument laid under Section 22 of the Government Resources and Accounts Act 2000 to extend the deadline for laying its accounts before Parliament. The 2014-15 DfE accounts were then certified on the 7 April 2016, and I again qualified my opinion on a number of issues including material levels of misstatement and uncertainty, limitations in the evidence available to me to evaluate academy trust land and buildings, and a number of breaches of parliamentary spending totals. This delay impacted on the Treasury's ability to produce a complete WGA.

1.42 The 2014-15 WGA was certified some 7 weeks after the certification of the DfE annual report and accounts. The Treasury was able to achieve this because of the improvements it has made to its consolidation and accounts production processes, including increasing the number of validation checks in the data collection packs to address recurring data collection issues, and using its analytical review process to ensure the quality and integrity of reported balances.

Progress in the removal of qualifications to the Whole of Government Accounts

1.43 The WGA has been qualified since its inception on multiple grounds. The qualifications have fallen into six categories: inconsistent application of the judgements on the boundary of the WGA; inconsistent accounting treatments; material qualification of the underlying accounts that feed into the WGA; incomplete inventory and valuation of local authority school assets; disagreements on accounting judgements; and incomplete information on the elimination of transactions within the WGA to produce an accurate reflection of the transactions that are external to government.

1.44 For 2014-15, I have been able to remove two of these qualifications, local authority schools assets and the disagreement on the accounting treatment for 3G and 4G spectrum licence income; and reduce the extent of a third, the completeness of intragroup transactions, as set out below. This represents a significant move forward for the WGA this year. Progress in addressing the remaining qualifications is set out in part 2 of this report.

Schools assets

1.45 For each WGA up to and including 2013-14, I qualified my audit opinion in respect to a limitation of scope on the completeness and valuation of local authority maintained school assets.

1.46 All local authority maintained schools are classified by the ONS as public sector and fall within Treasury's definition for inclusion within WGA. Such schools were only included in the WGA if they had been consolidated into the financial statements of individual local authorities. A number of schools, namely voluntary aided, voluntary controlled and foundation schools, were correctly excluded from local authority accounts, but remained under the control of government and therefore should be included within the WGA. My previous qualification arose from the Treasury being unable to value the assets of the schools that were not consolidated into local authority accounts, but were nevertheless under the government's control. In 2013-14, I estimated the omission as high as £21.8 billion of assets from voluntary aided and foundation schools, and £7.7 billion from voluntary controlled schools.

1.47 To address this issue in the 2014-15 WGA, the Treasury engaged with the CIPFA Local Authority Accounting Code Board (CIPFA/LASAAC) to amend the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which is the basis for local authorities to produce their financial statements.

1.48 The amended Code sets out that local authorities control schools as entities under the Code's definition of control. Following the application of this amendment, school or local authority controlled assets are either recognised directly or consolidated into the local authority financial statements as the local authority consolidates the schools' transactions.

1.49 As these assets have been brought onto the government balance sheet in the 2014-15 WGA, I am able to remove the qualification in my audit report relating to the completeness and valuation of school assets.

3G and 4G spectrum licence income

1.50 In April 2000, the government raised £22.5 billion from the sale of licences for the electromagnetic spectrum for third generation mobile phone services. The Treasury accounted for the proceeds on a cash basis in its 2000-01 accounts. In February 2013, the government raised a further £2.4 billion from the sale of fourth generation services and similarly accounted for it a cash basis in 2012-13.

1.51 In my previous reports, I qualified the WGA on the basis that I concluded that a more appropriate accounting treatment would be to recognise this income over the licence period rather than treat it all as income in the first year.

1.52 During 2014-15, the Treasury reviewed its accounting treatment in the light of the principles of the new accounting standard 'IFRS15 – revenue recognition', expected to be adopted in 2018. In applying this set of criteria to the licence income, the Treasury judged that the standard indicates that the income should be spread over the lifetime of the contract.

1.53 The Treasury's approach and my judgement now align, and this qualification to my audit opinion has now been removed.

Continued reduction of unsupported eliminations adjustments

1.54 The Treasury has continued to make good progress in the identification and resolution of intra-government transactions and balances. During the year, the Treasury also revised its eliminations methodology for grants to a top down approach, maintaining the same level of assurance, but delivering process efficiency savings.

1.55 The balance of unsupported eliminations has now fallen to an estimated £6.5 billion (£7.3 billion in 2013-14) in the statement of revenue and expenditure and £2.6 billion (£2.2 billion in 2013-14) in the statement of financial position; and the Treasury has improved the feedback given to entities regarding counter-party mismatches. The level of unsupported eliminations is discussed further in Part 2, where I discuss qualifications to my audit opinion on the 2014-15 WGA. Following the stabilisation of the unsupported eliminations in the statement of financial position over the last two years, I have concluded that I am able to remove this element of the qualification.

Part Two

Qualifications of the Comptroller and Auditor General's audit opinion

Summary

2.1 This part of my report explains why I have qualified my Audit Opinion on the 2014-15 WGA. It also provides details of the progress the Treasury has made in respect of each qualification since my last report.

2.2 This is the sixth year that I have audited the WGA and I have been able to report to Parliament that these accounts are an accurate presentation of the whole of government's financial position, although I have always qualified my opinion.

2.3 The Treasury continues to make good progress in moving towards resolving the qualification issues I have raised. As set out in Part 1 of this report, I have removed two qualifications this year, the completeness and valuation of local authority schools; and the accounting disagreement over the recognition of 3G and 4G spectrum licence income. I have also reduced the extent of my limitation of scope regarding the completeness of intra government adjustments, which now focuses on the impact on the revenue and expenditure account only.

My obligations as auditor

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

2.5 Due to the number of component bodies making up the WGA, my audit is dependent upon the work of component auditors to provide me with assurance over the accuracy of data submitted as part of the consolidation process. I send detailed instructions over the type and scope of procedures that I require to be performed to all component auditors, supplemented by training on my audit requirements where requested. I also carry out assurance work on all of the significant component audits, together with a sample of non-significant components.

Materiality

2.6 As noted above, the concept of materiality recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement. I consider a matter to be material if its omission or misstatement would reasonably influence the decisions of users of the financial statements. I consider the primary users of this account to be Parliament but I recognise that the financial statements will be of general interest to others.

2.7 I calculate a materiality level before the financial statements are produced to assess the risks of material misstatement and to plan the nature, timing and extent of our audit procedures. The appropriateness of the materially is considered throughout the audit and adjusted as required.

2.8 The choice of materiality requires professional judgement and, for the financial statements as a whole, I set this at £8 billion for 2014-15 which is approximately 1% of gross expenditure, although I give consideration to other benchmarks in the financial statements when setting materiality. Materiality is not only a pure quantitative measure, but also includes a qualitative aspect and my opinion is not solely based on total error being under the materiality level.

2.9 There are specific figures within the WGA which need to be disclosed in a clear and understandable way. Should there be any error in these figures, I consider the impact that these would have on the users of the financial statements even if the error is below the materiality level.

2.10 I agreed with the Treasury Audit Committee that I would report to it all corrected and uncorrected misstatements identified through my audit in excess of £100 million as well as any differences below that threshold which in my view warranted reporting on qualitative grounds.

2.11 The expenditure base for WGA may reduce in future years as public sector spending constraints continue and this could mean that my materiality level will also reduce in line with this reduced expenditure.

Qualified opinion owing to disagreements and limitations of scope in my audit

2.12 I have qualified my opinion on the 2014-15 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.

2.13 My qualifications relate to:

- the definition of public bodies that the Treasury has used to determine the boundary of the WGA; and

- the inconsistent application of accounting standards.

2.14 I have also limited the scope of my opinion on the 2014-15 WGA because of the following issues which meant I was unable to obtain sufficient and appropriate audit evidence on which to base my opinion in certain areas:

- material issues arising within the audit opinions of accounts included in the WGA where component auditors have limited the scope of their audit; and

- the lack of evidence to support the completeness of the intra government adjustments to remove transactions between the bodies included in the revenue and expenditure account of the WGA.

Qualified audit opinion relating to the WGA boundary

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

2.16 I cannot quantify the impact of this on the WGA with certainty, as I do not have information needed to identify the transactions that would have to be eliminated 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 1**).

Financial reporting requirements

2.17 In my previous Reports[8], I have 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 (ONS), rather than apply accounting standards which require including bodies that are subject to government control and that define control as 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'.[9]

2.18 As a consequence of the Treasury adopting statistical, rather than accounting, standards when it comes to defining 'control', the WGA excludes a number of significant bodies. The Treasury has also not applied its own criteria consistently as

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[8] Comptroller and Auditor General, Report on the Whole of Government Accounts 2012-13, June 2014

Comptroller and Auditor General, Report on the Whole of Government Accounts 2011-12, July 2013

Comptroller and Auditor General, Report on the Whole of Government Accounts 2010-11, October 2012

Comptroller and Auditor General, Report on the Whole of Government Accounts 2009-10, November 2011

[9] *International* Financial Reporting Standard 10 – *Consolidated Financial Statements*.

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[10]. These 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[11]; and
- other bodies that are partly or wholly owned by the government, such as the Royal Bank of Scotland.

2.19 I consider it appropriate to exclude those bodies that are not controlled by the government, as this treatment meets with accounting standards; and 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 where the government has the ability to control their activities; the Royal Bank of Scotland, further education institutions and trust ports, as listed in **Figure 1**, should be included in the WGA.

Figure 1

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

	Revenue	Expenditure	Impact on net expenditure	Assets	Liabilities	Impact on net liability
2014-15 WGA	659.3	811.3	(152.0)	1,455.3	(3,558.5)	(2,103.2)
Total values of entities excluded from 2014-15 WGA	**18.7**	**(16.2)**	**2.5**	**1,067.4**	**(996.5)**	**70.9**
2014-15 figures consist of:						
State-owned banks (Royal Bank of Scotland)	18.2	(15.8)	2.4	1,050.8	(990.6)	60.2
Further education institutions	-	-		14.9	(5.4)	9.5
Trust Ports	0.4	(0.3)	0.1	1.4	(0.4)	1.0
Other4	0.1	(0.1)	-	0.3	(0.1)	0.2

[10] Annex 2 to the WGA
[11] Annex 3 to the WGA

NOTES

1. Royal Bank of Scotland only. Note that the holding in Lloyds Banking Group fell from 24.9% to 21.8% during 2014-15, and has been accounted for in the HM Treasury accounts and the WGA as an equity investment.
2. 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 (covering England only) for 2010-11.
3. Trust Ports - figures have been estimated from available accounts for year-ended 31 December 2014.
4. London Councils and other minor bodies.
5. The bodies have been treated as if they had always been entirely owned by the public sector. In particular, for Royal Bank of Scotland, no account has been taken of the residual private sector shareholdings.
6. Not all bodies have a March year-end, e.g. figures for the banks relate to the year ending 31 December 2014.
7. All figures are in £ billions.

Source: NAO analysis of Note 36 to the WGA and published accounts.

Progress since 2013-14

2.20 There has been progress in including the appropriate bodies in the 2014-15 WGA as Network Rail has been brought into the figures for the first time. The ONS reclassified Network Rail as a public sector body from September 2014 and it has been consolidated in WGA for the first time with effect from 1 April 2014. The 2014-15 WGA accounts therefore include the transactions and opening and closing balances from Network Rail for the current year and have restated the balances for 2013-14 accordingly.

2.21 The position of the remaining elements of the qualification is as follows

- **Royal Bank of Scotland**: As at the date of this report the government's ownership of the Royal Bank of Scotland continued to exceed the generally accepted threshold of control. The Treasury continue to account for its holding of 62 percent of voting share capital (equivalent to 79 percent of total share capital) as an equity investment.

- **Further education institutions**: In my Reports on the WGAs for 2011-12 [12] and 2010-11[13], I recommended that the Treasury should review its criteria for including bodies within the WGA, taking into account changes in the control government exerts over English further education institutions following the passage of the Education Act 2011. The Treasury continue to exclude English institutions from the WGA as the ONS determined that these bodies fall outside of the public sector following the 2011 Act[14]. However, under accounting standards, there remains in my view sufficient government control to warrant their inclusion.

  In addition, there are national differences across the United Kingdom. The further

[12] C&AG's Report within Whole of Government Accounts 2011-12, HC531, July 2013, Paragraph 2.29.
[13] C&AG's Report within Whole of Government Accounts 2010-11, HC687, October 2012, Box 6, paragraph 7.69.
[14] http://www.ons.gov.uk/ons/rel/na-classification/national-accounts-sector-classification/classification-update---may-2012/reclassification-of-further-education-corporations-and-sixth-form-colleges-in-england---article.html#tab-Executive-Summary

education institutions in Northern Ireland, Scotland and Wales remain excluded from the WGA, despite these being designated by the ONS as falling within the public sector. However, the Treasury is reviewing the position of these bodies and is considering the possibility, subject to any future legislative changes, of including these bodies in future years.

- **Trust Ports**: The Treasury is considering the status of Trust Ports with a view to bringing them within the 2015-16 WGA.

Recommendations for further action

2.22 I reiterate my previous recommendations that the Treasury should change its criteria for including bodies within the WGA. However, despite the government's controlling shareholding in Royal Bank of Scotland, which means I need to include it within the qualification on technical ground, I support the Treasury's exclusion of Royal Bank of Scotland from the WGA as its scale and the nature of its activities would distort the reflection of government's core activities within the financial statements.

2.23 Although the Treasury continues to make progress in consolidating more bodies into the WGA, my qualification on this matter is likely to remain until all significant government controlled entities are included in line with accounting standards. As a result, I am unlikely to exclude the technical qualification on the WGA boundary until the government sells a significant proportion of its shareholding in the Royal Bank of Scotland.

Qualification arising from disagreement relating to the inconsistent application of accounting policies

2.24 I have qualified my opinion due to the impact of the inconsistent application of accounting policies.

2.25 The financial reporting 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 2014-15, some of the bodies included in the WGA prepared their accounts based on accounting frameworks that are inconsistent with the requirements of the Financial Reporting Manual.[15]

2.26 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 on the same basis.[16] I do not have the information to fully quantify the effect of all inconsistencies that exist as a result of inconsistent financial reporting frameworks, however the issues outlined below all constitute material inconsistencies currently found within the 2014-15 WGA.

[15] Annex 4 to the WGA
[16] *International Accounting Standard 27 – Consolidated and Separate Financial Statements*

Local government infrastructure valuation

2.27 Material misstatement in the WGA arises from differences between the financial reporting frameworks used by local government, which requires local authorities to value their infrastructure assets using historic cost, and central government which values assets at their depreciated replacement cost, in line with the requirements of the government Financial Reporting Manual.

2.28 Local authority infrastructure assets consist primarily of local highways infrastructure but also of other assets such as coastal defences, airports and light rail, including the London underground network.

2.29 The Treasury notes that the 2014 National Accounts estimates the value of the road network at £306.6 billion (2013: £291.8 billion) as at 31 December 2014. On this basis, road infrastructure assets alone are likely to be understated by in excess of £244 billion.

Progress since 2013-14

2.30 In my Report on the 2013-14 WGA, I recommended that the Treasury should continue to support the Chartered Institute of Public Finance and Accountancy (CIPFA) in considering the basis of valuing assets and take steps to ensure that data collected is considered reliable.

2.31 CIPFA plans that the Code of Practice on Local Authority Accounting will be amended to require local authorities to account for their highways infrastructure assets using depreciated replacement cost accounting in their own financial statements from 2016-17. This timeframe is set so that local authorities can prepare and collect accurate information in 2015-16 as opening balances for 2016-17. This is currently on track to be completed for inclusion in the 2016-17 WGA.

Network Rail asset valuation

2.32 The ONS reclassified Network Rail as a public sector body from September 2014 and it has been consolidated in WGA for the first time with effect from 1 April 2014. The 2014-15 WGA, therefore, includes a valuation of the railway network carried in the balance sheet at its fair value. As there is no active market in railway infrastructure assets, Network Rail has derived the fair value of the network using income from the regulated asset base (RAB) as a proxy for discounted cash flows.

2.33 However, upon consolidation into government and the Department for Transport’s (DfT) accounts, an income-based valuation model for the rail infrastructure is not appropriate in light of the substance of DfT’s wide-ranging role in the rail economy and the requirements of the government’s Financial Reporting Manual.

2.34 All parties have agreed to prepare the rail network valuation on a depreciation replacement cost basis in the DfT's 2015-16 accounts. However, an audited depreciated replacement cost of the rail network was not available for the publication of the 2014-15 WGA. Therefore, I have not been able to quantify the misstatement arising from this accounting policy inconsistency.

Recommendations for further action

2.35 The Treasury should continue its work with CIPFA to ensure that the planned changes to the Code of Practice on Local Authority Accounting remain on track and that it is able to take prompt action should there be early indications that the data collected by local authorities is not complete, robust, reliable or auditable. Treasury should also put in place plans to obtain depreciated replacement cost values for the remaining non-highways infrastructure assets.

2.36 Treasury should support and advise Network Rail and the Department for Transport where appropriate in delivering a robust and reasonable valuation of the Rail Network.

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

2.37 Where the external auditors of bodies in the WGA qualify their opinions on the statutory financial statements, I am required to consider the impact of these 'true and fair' qualifications on my opinion on the WGA. In 2014-15, external auditors qualified their opinions of 6 accounts (4 accounts in 2013-14).

2.38 The most significant of these qualifications relate to the departmental accounts of the Ministry of Defence and Department for Education for 2014-15. Given the significance of these qualifications, I have also qualified my opinion on the WGA.

2.39 Further details can be found in my audit opinions and within the annual accounts of the Department for Education[17] and the Ministry of Defence[18] .

Progress since 2013-14

Ministry of Defence

2.40 In the 2014-15 Ministry of Defence annual report and accounts, the Ministry states that it has conducted a review of its most significant contract arrangements and has identified a number of lease type arrangements which are not currently recognised and cannot be accurately quantified.

2.41 The Ministry has, in agreement with the Treasury, decided not to obtain more detailed information on its leases on the grounds that doing so would not represent value for money. In 2014-15, the Ministry confirmed that it is possible to account for existing contracts in compliance with IAS 17, but this would create significant challenges for the Ministry.

2.42 Consequently, no conclusion can be drawn as to whether the existing contracts represent leases and the financial impact of the omission of potential assets and liabilities cannot be determined with sufficient accuracy. This decision will have an

[17] Department for Education Annual Report and Accounts 2014-15, HC 46 April 2016.
[18] Ministry of Defence Annual Report and Accounts 2014-15, HC 32, July 2015

ongoing impact on the audit opinion I am able to provide on the financial statements for the foreseeable future.

Department for Education

2.43 The 2014-15 Department for Education (DfE) accounts were qualified on the basis of incomplete and inaccurate valuation of academies' land and buildings assets.

2.44 In 2014-15, the number of academies continued to increase from 3,905 to 4,580, but the DfE has not addressed the difficulty in maintaining oversight over them. As a result the scope of this issue has grown to £33 billion during the year and is likely to continue to be a source of continued qualification within the WGA until there are changes in the oversight and accountability regime for academies.

Recommendations for further action

2.45 I recommend that the Treasury should work with the Ministry of Defence as it considers further work in respect of the application of lease accounting to its new contracts, and monitor progress in this area with the aim of removing this qualification as current contracts expire and are replaced.

2.46 I recommend that particular attention is given to the Department for Education over the issues it faces in respect to the accuracy and timeliness of academies data, as these weaknesses illustrate the lack of accountability within the oversight arrangements and is likely to result in further qualification in the upcoming years until a resolution is found. In seeking to resolve this issue, the Treasury should seek to ensure the primacy of Parliamentary accountability over the academies is addressed, as well as its ability to assess and manage spend.

2.47 In addition, the Treasury should work with the Department for Education to seek to improve the timeliness of information that is submitted to support the WGA, as this was a source of delay in the production of the 2014-15 accounts, and is likely to be so in future years.

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

2.48 I have limited the scope of my opinion because of the lack of evidence supporting the completeness and accuracy of the elimination of intra-government transactions and balances, between bodies included in the WGA.

Financial reporting requirements

2.49 The WGA is a consolidated account which is prepared by including the financial activities of over 6,000 government controlled entities. Transactions and balances between these are removed so that income, expenditure, assets and liabilities are not overstated between bodies within the group, as required by accounting standards. 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 is complete and accurate.

2.50 The Treasury collects information from each of the bodies in the WGA on all intra-government transactions and with details of the relevant counter-party. The Treasury uses this data to match balances and transaction streams and removes them from the WGA. Despite the work by the Treasury, there remains a material residual uncertainty over the figures in the financial statements because the removal of these transactions and balances is 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.

2.51 Using the available evidence, I have estimated the level of uncertainty as being up to £6.5 billion (£7.3 billion in 2013-14) in gross income and expenditure and up to £2.6 billion (£2.2 billion in 2013-14) in gross assets and liabilities (**Figure 2**). The estimated errors reside mainly within the individual primary statements.

Figure 2

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	3.2	1.4
Only one entity declares an intra-government transaction or balance	1.9	0.9
Subtotal of errors that can be linked to specific entities	**5.1**	**2.3**
Neither entity within an expected relationship declares an intra-government transaction or balance	1.4	0.3
Impact on the financial statements (potential overstatement)	**6.5**	**2.6**

NOTES

All figures in £ billions

Source: NAO analysis of WGA 2014-15

2.52 It is the significance of the estimated level of uncertainty within the statement of revenue and expenditure, and the potential gross overstatement of income and expenditure which has led me to qualify my opinion, rather than the potential impact on the annual deficit in the statement of financial position.

Progress since 2013-14

2.53 This level of error, although material in context due to the impact on the disclosure of key income and expenditure lines, is showing a positive downward trend (**Figure 3**). As a result of the stabilisation of the error, I have been able to focus my qualification on the gross numbers in the statement of revenue and expenditure and conclude that there is no material uncertainty regarding the statement of financial position.

Figure 3

Level of potential overstatement in the WGA

	2014-15	**2013-14**	**2012-13**	**2011-12**	**2010-11**
Statement of revenue and expenditure	6.5	7.3	9.1	16.0	22.6
Statement of financial position	2.6	2.2	3.7	5.1	10.4

All figures in £ billions

Source: NAO analysis of WGA 2014-15

2.54 In my report on the 2013-14 WGA, I recommended that the Treasury should undertake further work to reduce the uncertainties in the elimination of intra-government transactions and balances and I also recommended that further work be concentrated on the area of local government.

2.55 The Treasury has taken a number of actions which have contributed to the reduction of the error in 2013-14. The Treasury has sought to maximise the benefits of the introduction of a change in IT systems by amending its data collection tools with the aim of improving the accuracy of the initial data received in the preparation of the WGA. It also seconded staff with sector expertise to help identify errors within the data returns and reduced the threshold at which it would investigate potential imbalances. The Treasury also used other available data from central government sources to review the data it had received.

Recommendations for further action

2.56 The Treasury has made significant progress in reducing the elimination error over the last three years and I have been able to reduce the scope of my qualification as a result.

2.57 However, with such an extensive body of components preparing information, some error in the initial data preparation is almost inevitable and it is possible that the level of error cannot be reduced much further under the current method of collation and preparation. I recommend that Treasury carries out a review of the structure and process of data collection in order to determine areas of potential weakness and also to consider alternative methods of proving counter party balances in those areas which are either onerous to prove or are prone to error. If the Treasury can reduce the level of error to the point that it does not have the potential to distort the key figures in the revenue and expenditure account, then I may be able to remove the remaining element of this qualification.

Other issues on which I have not qualified my opinion

2.58 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 opinion for one account that is significant to the WGA. This relates 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 18 accounts[19] (17 in 2013-14) included in the WGA qualified their audit opinions owing to the existence of material irregular transactions; that is not using resources 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 financial statements of the Department for Work and Pensions[20] and HM Revenue and Customs[21]. 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
23 May 2016

National Audit Office
157-197 Buckingham Palace Road
Victoria
London SW1 W9SP

[19] Included in this number are four accounts qualified on a 'true and fair' basis.
[20] Department for Work and Pensions Annual Report and Accounts 2014-15, Session 2015-16, HC31, 16 July 2015
[21] HM Revenue and Customs Annual Report and Accounts 2014-15, Session 2015-16, HC18, 16 July 2015