

# National Lottery Distribution Fund Investment Account 2013-14

# National Lottery Distribution Fund Investment Account 2013-14

Presented to Parliament pursuant to Section 33(3) of the National Lottery etc. Act 1993

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# Commissioners for the Reduction of the National Debt

## Foreword

### Introduction

These accounts have been prepared by the Commissioners for the Reduction of the National Debt (CRND) under a direction issued by HM Treasury in accordance with section 33(2) of the National Lottery etc. Act 1993 (the Act).

### Background to the National Lottery Distribution Fund Investment Account

The National Lottery Distribution Fund (NLDF) was established by section 21(1) of the Act. The NLDF is maintained under the control and management of the Secretary of State for Culture, Media and Sport. The purpose of the NLDF is to receive monies generated by the National Lottery for good causes, to allocate these to Distributing Bodies, to invest the funds until such time as they are drawn down by the bodies for payment to approved grant applicants, and to meet its own expenses.

By virtue of section 32(1) of the Act, any money not immediately required for making payments can be transferred to CRND for investment. These monies and the subsequent investments are held in the NLDF Investment Account (NLDFIA). HM Treasury has directed that CRND's investments in respect of the NLDFIA shall be confined to those securities specified in paragraphs 1, 2, 3, 5, 5A, 5B, 9 and 9A of Part II of Schedule 1 to the Trustee Investments Act 1961.

A share of the Lottery proceeds received into the NLDF is allocated to the Distributing Bodies as set out in sections 22 and 23 of the Act (as amended). Until 31 March 2007, income generated by the investments was attributed to the Distributing Bodies in proportion to the share of the balance of the NLDFIA held by each body. However, from 1 April 2012, distribution of the investment income has been on the same basis as lottery proceeds, with expenditure to be split as follows, 20.0 per cent on arts, 20.0 per cent on sport, 20.0 per cent on national heritage, and 40.0 per cent on charities, health, education or the environment.

The resources used to deliver CRND's objectives are accounted for within the United Kingdom Debt Management Office's (DMO) agency vote and reported in the DMO Report and Accounts 2013-14. The CRND's cost of managing the NLDFIA is recharged to the Department for Culture, Media and Sport; in 2013-14, this was £113,000 (2012-2013: £114,000).

### Commissioners for the Reduction of the National Debt

CRND's main function is the investment and management of major Government funds. The investment powers differ from fund to fund.

There are eight Commissioners, but the Secretary and Comptroller General and Assistant Comptroller, who are appointed by and act on behalf of the Commissioners, make the day-to-day decisions. There is no legislation that determines the specific responsibilities of the Secretary and Comptroller General and the Assistant Comptroller. However, in practice the role of the Secretary and Comptroller General is considered analogous to acting as the Accounting Officer for CRND. Therefore, the Secretary and Comptroller General takes responsibility for preparing and signing the accounts on behalf of the Commissioners.

The arrangements made between CRND and the Department for Culture, Media and Sport in respect of the investment service provided by CRND are set out in a Memorandum of Understanding, which describes how CRND intend to achieve the agreed investment objectives.

## Audit arrangements

Section 33(2) of the Act requires the Commissioners to send accounts prepared by them to the Comptroller and Auditor General.

Under section 33(3) of the Act, the Comptroller and Auditor General examines, certifies and reports on the accounts and lays copies of them with his report before each House of Parliament.

The Secretary and Comptroller General confirms that, as far as she is aware, there is no relevant audit information of which the NLDFIA's auditors are unaware, and that she has taken all the steps that she ought to have taken as Secretary and Comptroller General in order to make herself aware of any relevant audit information and to establish that the NLDFIA's auditors are aware of that information.

## Management Commentary

CRND's strategy of investing in the Debt Management Account was maintained through 2013-14. This strategy enabled the NLDFIA to earn a rate of interest very closely correlated with prevailing short-term sterling interest rates, whilst protecting its capital position and access to liquidity at all times.

### Results for 2013-14

During the year, the NLDFIA generated total comprehensive income of £7.8 million (2012-13: £10.4 million). The decrease of £2.6 million was mainly due to the lack of interest income arising from gilts (2012-13: £3.2 million) and the lack of profits on disposal of gilt holdings (2012-13: £0.9 million).

As at 31 March 2014, the total value of investments held by the NLDFIA was £1,571 million (31 March 2013: £1,496 million). This increase was due to a net increase in funding from the NLDF during the year.

### Date of authorisation for issue

The Secretary and Comptroller General authorised these financial statements for issue on 2 July 2014.

*Jo Whelan* 1 July 2014  
Secretary and Comptroller General  
to the Commissioners for the Reduction of the National Debt

## Statement of Secretary and Comptroller General's responsibilities

Section 33(2) of the National Lottery etc. Act 1993 requires the Commissioners to prepare for each financial year a statement of accounts in the form and on the basis set out in the accounts direction. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the NLDFIA, income and expenditure, changes in client funds and cash flows for the financial year.

The Commissioners have appointed the Secretary and Comptroller General to discharge their statutory responsibilities, a role that is analogous to acting as an Accounting Officer. Therefore the Secretary and Comptroller General has responsibility for preparing the annual accounts.

In preparing the accounts, the Secretary and Comptroller General is required to observe the applicable accounting standards and be consistent with the relevant requirements of the Government Financial Reporting Manual (FRM), and in particular to:

- observe the relevant accounts direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going-concern basis.

As the role of the Secretary and Comptroller General is analogous to acting as an Accounting Officer, it is considered that the responsibilities of an Accounting Officer, as set out in *Managing Public Money* published by HM Treasury, apply to the Secretary and Comptroller General. These include responsibility for the propriety and regularity of the public finances for which the Secretary and Comptroller General is answerable, for keeping proper records, and for safeguarding the NLDFIA's assets.



## Governance statement

### Scope of responsibility

As Secretary and Comptroller General of the Commissioners for the Reduction of the National Debt (CRND) I am responsible for ensuring the operation of a sound system of internal control that supports the achievement of CRND's targets, policies and objectives in managing client investment portfolios whilst safeguarding the public funds for which I am accountable, in accordance with the responsibilities assigned to me.

CRND is a separate business entity managed within the control framework of the DMO. While I am responsible for CRND's system of internal control, the Accounting Officer of the DMO is responsible for the wider control framework within which CRND is managed. In discharging my own control responsibilities I take assurance on the continued sound maintenance of the wider control framework from the governance statement for the DMO, although I understand that only reasonable and not absolute assurance can be given that risks have been controlled.

It is also my responsibility to ensure that all CRND fund management activities are conducted with due regard to value for money and operated in line with client instructions. I have put arrangements in place to ensure that there is a proper evaluation of the balance of cost and risk in our operations.

CRND is committed to the highest standards of corporate governance and is guided by the Corporate Governance Code for central government departments (the Code) and the following principles laid down in that Code:

- Parliamentary accountability;
- The role of the Board;
- Board composition;
- Board effectiveness; and
- Risk Management.

CRND does not conduct any part of its business with or through arm's length bodies (ALBs) and therefore has not applied principle six which covers departmental governance arrangements with ALBs.

### Managing Board

The Secretary and Comptroller General was supported during 2013-14 by the DMO Managing Board (the Board) which, in addition to the Secretary and Comptroller General, is comprised of:

Robert Stheeman – DMO Chief Executive and Accounting Officer

Jim Juffs – Chief Operating Officer

Joanne Perez – Joint Head of Policy and Markets

James Richardson – Non-executive HM Treasury representative

Brian Larkman

Non-executive director – Brian Larkman was Global Head of Money Markets at the Royal Bank of Scotland PLC from 2000 to 2001 and Managing Director, Global Money Markets at National Westminster Bank PLC from 1991 to 2000. He was a member of the Regulatory Decisions Committee of the Financial Services Authority until 2006.

Brian Duffin

Non-executive director – Brian Duffin was Chief Executive of Scottish Life from 1999 to 2007 and Executive Director of Royal London Mutual from 2001 to 2007.

Non-executive directors are appointed by the DMO Accounting Officer following a formal process and have fixed terms defined in their contracts of service. All non-executive Board members receive an induction on joining and have access to additional information and training where it is considered necessary for the effective discharge of their duties.

One of the roles of the Board is to advise the Secretary and Comptroller General on any key decisions affecting CRND.

An executive sub-committee of the Board generally meets weekly and supports the Secretary and Comptroller General on operational decisions.

The Board has put in place a formal process to self-evaluate its performance on a regular basis. The Board undertook a self-evaluation of its performance in 2013 and concluded that it has operated effectively in delivering the objectives set out in its Terms of Reference. The Terms of Reference underwent a full review by the Board in 2012.

### 2013-14 Managing Board activities

Board meetings were held throughout 2013-14 and covered regular agenda items, including risk management, staffing and progress against the operational business plan.

Board and Audit Committee attendance is outlined in the table below:

	Managing Board			
	Possible	Actual		
Robert Steeman	8	8		
Jo Whelan	8	8		
Jim Juffs	8	8		
Joanne Perez	8	8	Audit Committee	
James Richardson	8	6	Possible	Actual
Brian Larkman	8	7	4	4
Brian Duffin	8	7	4	4
Caroline Mawhood	NA	NA	4	4

### Audit Committee

The Secretary and Comptroller General was supported during 2013-14 by the Audit Committee on matters relating to risk, internal control and governance. The members of the Audit Committee during 2013-14 were:

Brian Larkman (Chair)

Brian Duffin

Caroline Mawhood – Caroline Mawhood was an Assistant Auditor General at the National Audit Office until 2009 and President of the Chartered Institute of Public Finance and Accountancy for 2008-09. She is a non-executive member of the Audit Committees of the Department of Energy and Climate Change, the Food Standards Agency and the Corporation of London and an independent member of the Audit Progress Committee of the European Commission. She is also the Honorary Treasurer of Breakthrough Breast Cancer charity and a trustee of the Wimbledon Guild charity.

Audit Committee meetings are typically attended by the DMO Accounting Officer, the Secretary and Comptroller General, the Joint Heads of Policy & Markets, the Chief Operating Officer and the Head of Internal Audit.

One of the Audit Committee's objectives is to give assurance to the Secretary and Comptroller General that:

- High quality processes are in place to manage and control risk for the DMO's financial and non-financial activities;
- Overall governance arrangements are appropriate and operating effectively;
- The financial control framework is effective and supported by an appropriate compliance culture;
- External financial reporting is prudent, accurate, timely, appropriate and consistent with relevant guidance;
- Internal financial and management reporting is timely, prudent, appropriate and consistent with external financial reports;
- Whistle blowing arrangements for confidentially raising and investigating concerns over possible improprieties in the conduct of the DMO's business are adequate; and
- Relationships with the National Audit Office (NAO) are effective.

During the period under review the Audit Committee paid particular attention to the following areas:

- Business continuity planning, especially with regard to IT resilience and recoverability;
- Anti-money laundering controls;
- Anti-fraud controls;
- Regulatory compliance;
- Changes in government guidance for audit committees;
- Developing its focus on value for money assessment;
- Risk management and financial control;
- Implementation of audit recommendations;
- External and internal financial reporting; and
- Information systems security.

The Audit Committee covers a regular programme of agenda items, together with other current topics, through an annual schedule of four meetings. All scheduled meetings were held and no additional meetings were deemed necessary.

The Secretary and Comptroller General has also been informed by the following operational committees throughout the period under review:

#### **Fund Management Review Committee**

The Fund Management Review Committee monitors CRND activity relating to the performance of the government funds under management, including any reporting on compliance activities undertaken in relation to the funds.

The Fund Management Committee met four times in 2013-14.

#### **Business Delivery Committee**

The Business Delivery Committee reviews the status of the delivery of DMO's business and work plan as a collective cross functional body, resolving emerging issues in a timely way, and agreeing priorities to ensure the plan stays on track.

The Business Delivery Committee met regularly (typically weekly) throughout 2013-14.

## Risk Committees

The Secretary and Comptroller General is informed by three risk committees covering credit and market risk, operational risk and risk control. More detail on the roles, responsibilities and activities of these committees can be found in the sections below.

### Risk management and internal control

The Secretary and Comptroller General is responsible for maintaining a sound system of internal control that supports the achievement of CRND's targets, policies and objectives in managing client investment portfolios whilst safeguarding the public funds for which she is accountable, in accordance with the responsibilities assigned to her.

CRND is managed within the wider DMO system of internal control which is based upon what the DMO Accounting Officer, with the support of the Board, considers to be appropriate taking account of the DMO's activities, the materiality of risks inherent in those activities and the relative costs and benefits of implementing specific controls to mitigate those risks. The DMO's position differs to that of a commercial organisation in that it must always be in a position to transact the underlying business required to meet its remit. As a result, the risks associated with this activity cannot be avoided and the system of internal control can only provide reasonable assurance against failure to achieve aims and objectives.

### The risk and control framework

The Board has designed and put in place a formal risk management framework covering all the activities conducted and overseen by the DMO. This Framework helps ensure that the DMO Accounting Officer is appropriately informed and advised of any identified risks and also allows the management of risks to be monitored. The risk management framework covers both regular operations and new business initiatives, and evolves as the range and nature of the DMO's activities change. The Framework is supported by a clear 'three lines of defence' model:

#### First line of defence:

Day-to-day management of risk is the responsibility of management staff within business areas. The DMO considers effective risk management to be central to its operations and fosters a risk aware culture in which all members of staff, including Board members, are encouraged to understand and own the risks that are inherent in those operations. In particular the DMO seeks to promote an environment in which staff feel comfortable to identify new risks and changes in previously identified risks, as well as weaknesses so that these may be assessed and appropriate mitigating actions put in place.

Mitigating actions typically include segregation of duties, staff training, clear lines of management delegation and robust business continuity arrangements.

#### Second line of defence:

Oversight of risk is provided by the Board and risk committees, whose role is to provide regular and systematic scrutiny of risk issues which lie within their remit and to support the DMO Accounting Officer in exercising his overall responsibility for risk management.

The DMO considers that the principal risks it faces arise in three broad areas: credit risk, market risk and operational risk. It has established committees to meet regularly to review the changing risk pattern for each of these areas and to set up appropriate responses. The work of these committees is described in more detail below.

#### Credit and Market Risk Committee

The Credit and Market Risk Committee (CMRC) meets on a regular basis, with more frequent meetings held when required, for example during times of market stress. It monitors and reviews the management of market, credit, and liquidity risk. It sets limits across a range of exposures including counterparties, countries, instruments held as collateral as well as setting absolute limits on net daily flows across the DMA. CMRC met nine times during 2013-14.

### **Operational Risk Committee**

The Operational Risk Committee (ORC) meets regularly to monitor operational risks and to review significant risk issues. The ORC is responsible for reviewing risk incidents identified through the DMO's risk incident reporting process, and considering whether planned mitigating action is appropriate. The Committee also reviews and tracks the progress of actions identified by Internal Audit. The Committee's scope includes issues relating to information risk, IT security, business continuity, anti-fraud and key supplier risks.

The ORC has advised the DMO Accounting Officer and the Board, during the year, on significant operational risk concerns, significant risk issues and trends as well as actions to mitigate such risks. The Committee has focused this year on business continuity planning, in particular the resilience of IT infrastructure and improving data security arrangements. The Committee has also focused on work to help ensure continuity of skills in the DMO's technical IT teams to help address ongoing resourcing challenges. ORC met eight times during 2013-14.

### **Controls Group**

The Controls Group meets periodically to review issues affecting the DMO's system of internal control and to analyse material changes to the control environment. The Group recommends actions to management to implement changes where appropriate. The Controls Group consists of representatives from Finance, Risk, Compliance and Internal Audit.

The Controls Group has advised the DMO Accounting Officer, the Board and senior management on any significant risk concerns stemming from the introduction of new business activities as well as risks relating to other change management activities. The Group has also advised the DMO Accounting Officer on suitable mitigating action where appropriate.

During the year the Controls Group review work has covered upgrades to the DMO's IT infrastructure, enhancements in database access controls and systems and project work to improve the DMO's business continuity capacity.

### **Risk Management Unit (RMU)**

The risk committees are supported by the DMO's Risk Management Unit (RMU) which ensures key risk issues arising from these committees are communicated to the DMO Accounting Officer and senior management on a regular basis, with additional ad hoc reporting if an emerging issue requires it. The RMU also supports the formal risk reporting processes with defined outputs, including regular detailed risk reports which are reviewed by the Board and senior management.

As well as supporting the risk committee structure, the RMU provides control advice on risks. As part of the second line of defence the RMU is separate from, and independent of, the DMO's trading operations. The RMU conducts risk analysis and provides market, credit and operational risk capability for the DMO.

The identification, monitoring and mitigation of operational risk is facilitated by the RMU via quarterly consultations with heads of business units and functional teams. Significant risk issues are assessed for materiality and probability of occurrence. New risks, and risks to which exposure is increasing, are highlighted and actions are taken to ensure effective management of all risks. The DMO has Senior Risk Owners (SROs) who undertake a cross-functional moderation process to promote better prioritisation of operational risks across the organisation. The RMU maintains a central exception log to record all risk incidents raised, in order to identify control weaknesses and assign actions to improve controls. Progress against treatment actions is monitored on a regular basis to ensure issues highlighted by internal and external audit, and other identified actions to improve the control environment, are managed and progressed within agreed deadlines.

**Third line of defence:**

The DMO's Internal Audit function provides the DMO Accounting Officer with independent and objective assurance on the overall effectiveness of the system of internal control. It does this through a risk based work programme which is approved by the Audit Committee at the start of each year. All audits make a series of recommendations which, once agreed by management, are monitored for implementation. The function is independent of the DMO's trading activities and operations and has a direct reporting line to the DMO Accounting Officer. The work of Internal Audit includes assessing the effectiveness of both control design and control performance. With its independence and overall remit, Internal Audit provides a third line of defence against the risks that might prevent the DMO delivering its objectives.

**Risk policies and procedures**

The DMO's risk policies reflect the high standards and robust requirements which determine the way in which risks are managed and controlled. The DMO Accounting Officer, with the support of the Board, ensures that policies are regularly reviewed to reflect any changes in the DMO's operations and/or best practice. In 2013-14, this included reviews of the DMO's Personal Dealing Rules as well as its Spreadsheet Management and Contract Management Policies.

Staff are required to signify that they have read and accepted the DMO's rules on personal dealing and the DMO's policy on the use of information systems and technology, and that they are aware of, and will continue to keep up to date with, the DMO's policies on whistle blowing, fraud and anti-money laundering. The DMO ensures that this exercise is undertaken on an annual basis allowing staff to maintain a good level of awareness of the DMO's policies in these areas. All members of staff have job descriptions which include reference to the specific key risks they are expected to manage.

Managers in each business function are responsible for ensuring that the operations within their area are compliant with plans, policies, procedures and legislation.

**Risk profile**

The Secretary and Comptroller General and the DMO Board believe that the principal risks and uncertainties facing CRND are outlined in the table below together with the key actions taken to manage and mitigate them:

Principal risks and uncertainties	Mitigation and management
<b>IT Systems and infrastructure</b>	
<p>CRND relies on a number of IT and communications systems to conduct its operations effectively and efficiently.</p> <p>A number of the operational systems and services on which CRND relies are provided or supported by third party suppliers.</p>	<p>In 2013-14, the DMO completed a major upgrade of its IT infrastructure to ensure that the levels of support for key technology remain robust.</p> <p>The DMO has put in place structured business continuity arrangements to ensure it is able to continue market operations in the event of an internal or external incident that threatens business operations. These arrangements extend to cover CRND. In July 2013, the DMO experienced a disruption to parts of its IT hardware which affected the availability of some of its systems and data. The DMO was able to recover its core systems and data at its disaster recovery (DR) facility with no impact on market operations. Following the incident the DMO launched an external review into the resilience of its IT infrastructure and IT DR capability which resulted in a number of recommendations for action. The DMO has already introduced improvements in response and is working to further strengthen its IT infrastructure in this area.</p> <p>The DMO's Business Continuity Plan (BCP) including disaster recovery arrangements has been revised to take account of lessons learned from the incident noted above. Assessment of business continuity needs is a specific requirement for new projects and major business initiatives, including those related to or affecting CRND.</p> <p>The DMO is represented on the Public Finance Business Continuity Management Group and, in 2013, took part in a major cyber security exercise designed to test the impact of a significant cyber-attack on UK financial institutions and market infrastructure. The DMO participated alongside major banks, market infrastructure providers, city regulators and HM Treasury.</p> <p>To mitigate the risk of failure of a key third party the DMO undertakes a corporate risk assessment of each potential supplier in order to assess financial strength and operational capacity. The DMO has dedicated relationship managers who meet regularly with key suppliers and monitor performance against agreed Service Level Agreements.</p>
<b>Transaction processing</b>	
<p>CRND relies on its operational processes to successfully execute a significant number of high value transactions on a daily basis. Reliance on the accurate execution of processes exposes CRND to operational risk arising from process breakdown and human error.</p>	<p>A key component of CRND's control framework is the segregation of duties to ensure independent checking and reconciliation, and to avoid concentration of key activities or related controls in individuals or small groups of staff. In particular, segregation of duties takes place between front and back office activities.</p> <p>All teams, including CRND, have documented procedures for their main activities and there are clearly defined authorisation levels for committing the DMO externally.</p> <p>The RMU conducts regular control and compliance testing of CRND activities, providing the executive sub-committee of the Board with assurance on the effectiveness of operational controls and compliance with relevant Financial Conduct Authority and Prudential Regulation Authority rules in the dealing and settlement areas.</p> <p>The DMO also maintains a strong audit and control environment which includes a well embedded incident reporting procedure which extends to cover CRND. This promotes early identification and resolution of risk incidents and provides visibility to the DMO Accounting Officer and Board.</p> <p>DMO recruitment policies help ensure that individuals with the appropriate level of skill and experience are appointed at all levels within the organisation. This helps mitigate the level of human error resulting in process failures.</p>

<b>People risk</b>	
<p>The DMO, including CRND, relies on maintaining a sufficiently skilled workforce at all levels of the organisation in order to operate effectively and efficiently, and to deliver its strategic objectives.</p> <p>The DMO is exposed to an increased risk of operational failure if it is unable to compete for, and retain, sufficiently skilled staff over time. Competition for skilled staff is generally against employers from the private financial services sector which is not subject to public sector remuneration policies and which have historically offered higher remuneration than either the private sector in general or the public sector.</p>	<p>The DMO's Training and Development policy aims to ensure that its staff have the right skills to meet its objectives.</p> <p>The DMO has a formal recruitment and selection process to help ensure vacancies are filled quickly by appropriately skilled candidates.</p> <p>The DMO has put in place a formal performance appraisal process and all staff are given clear and achievable objectives. Where appropriate, staff are encouraged to engage in activities which promote development and the DMO provides regular training opportunities and support for professional studies to enhance the skills base of its employees. The DMO also provides cross-training for different roles to help improve staffing flexibility and reduce turnover pressure.</p> <p>Salaries are reviewed annually, taking account of benchmarks derived from equivalent private sector pay levels. In addition, the DMO has a policy to recognise those staff who have performed well in their roles through the payment of one-off performance related awards. Any awards are assessed annually by the DMO Pay Committee, are determined by individual performance and criteria associated with the DMO's performance management process and are aligned to the policy for public sector pay.</p> <p>A Staff Council has met regularly throughout the year and enabled an open exchange of ideas and views between management and staff representatives and has been an effective conduit for wider communication and consultation with all staff.</p> <p>On an annual basis all DMO staff are encouraged to take part in the Civil Service employee engagement survey and any issues raised, including mitigating action if required, will be considered by the DMO Accounting Officer and Board.</p> <p>The DMO is accredited as an Investor in People.</p>



<b>IT and data security</b>	
<p>Through its activities, the DMO gathers, disseminates and maintains sensitive information including market sensitive information and personal data about staff and market participants. The DMO seeks to ensure the highest standards of data protection and information management.</p> <p>The DMO is exposed to risk of an external attack on its IT systems and infrastructure.</p>	<p>The DMO continues to work to maintain the required level of protective security covering physical, personnel and information security and is particularly aware of the growing threat posed by cyber security risk. In 2013 The DMO invited experts from the National Audit Office (NAO) to facilitate a workshop for DMO staff which covered key cyber security risks and control strategies. In addition, in 2013, the DMO assessed its information and data risk exposures to key suppliers and sought assurances on the controls in place to protect sensitive data held by third parties.</p> <p>In November 2013, standard control checks undertaken by the Settlements Team revealed that a small number of records were missing from a specific table in one of the DMO's databases, although the records were still present in other tables within the same database. Further investigation revealed the removal of the records to be an unintended consequence of work on a separate part of the system. The issue was manually corrected and had no impact on the DMO's ability to conduct operations, or its counterparties, with all affected transactions processed and settled on time. In response the DMO has strengthened user access controls for databases and enhanced monitoring of access routes and database changes. Work to further develop the DMO's IT security controls in this area will continue in 2014.</p> <p>Risks to data and information held by the DMO are owned and managed by designated Information Asset Owners. The DMO has a Senior Information Risk Owner (SIRO) who is responsible for the information risk policy and the assessment of information risks. The SIRO is a member of the Board and provides advice to Board members on the management of information risk.</p> <p>The DMO has put in place several layers to defend against external attack and its infrastructure undergoes an annual penetration test to ensure the control environment is robust. The test is undertaken by specialists and form part of the assessment against the Communications Electronics Security Group (CESG) requirements which is a condition for continuing connection to the Public Service Network (PSN). In response to the results of the test undertaken in 2013 the DMO improved security on its core networks and was reaccredited as a member of the PSN.</p>

## Review of effectiveness

I have reviewed the effectiveness of the system of internal control and confirm that an ongoing process designed to identify, evaluate and prioritise risks to the achievement of CRND's aims and objectives has been in place throughout 2013-14. This review included an assessment of any material risk and control issues identified and reported during the relevant period.

My review has been informed by the advice of the risk committees and by the work of the internal auditors and the executive managers within the DMO, who have been delegated responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports.

In my role as Secretary and Comptroller General I have been advised on the implications of the result of my review of the effectiveness of the system of internal control by the Board and the Audit Committee.

In 2013-14, no ministerial directions were given and no material conflicts of interest have been noted by the Board or Audit Committee members in the Register of Interests.

In my opinion, CRND's system of internal control was effective throughout the financial year and remains so on the date I sign this statement.

*Jo Whelan* 1 July 2014  
Secretary and Comptroller General  
to the Commissioners for the Reduction of the National Debt

# The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

I certify that I have audited the financial statements of the National Lottery Distribution Fund Investment Account for the year ended 31 March 2014 under the National Lottery etc. Act 1993. The financial statements comprise: the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Client Funds and the related notes. These financial statements have been prepared under the accounting policies set out within them.

## Respective responsibilities of the Commissioners for the Reduction of National Debt, the Secretary and Comptroller General and the Auditor

As explained more fully in the Statement of Secretary and Comptroller General's Responsibilities, the Commissioners are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. They have appointed the Secretary and Comptroller General to discharge these responsibilities.

My responsibility is to audit, certify and report on the financial statements in accordance with the National Lottery etc. Act 1993. 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 National Lottery Distribution Fund Investment Account's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Secretary and Comptroller General; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Foreword, Management Commentary and Governance Statement, 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.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

## Opinion on regularity

In my opinion, in all material respects, the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

## Opinion on the financial statements

In my opinion:

- the financial statements give a true and fair view of the state of the National Lottery Distribution Fund Investment Account's affairs as at 31 March 2014 and of the surplus for the year then ended; and
- the financial statements have been properly prepared in accordance with the National Lottery etc. Act 1993 and the HM Treasury directions issued thereunder.

**Opinion on other matters**

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

**Matters on which I report by exception**

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

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements are not in agreement with the accounting records or returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

**Report**

I have no observations to make on these financial statements.

*Sir Amyas C E Morse KCB*  
Comptroller and Auditor General

2 July 2014

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

## Income Statement for the year ended 31 March 2014

	Notes	<b>2014</b> <b>£000</b>	2013 £000
Interest income	2	<b>7,758</b>	9,418
Other gains	3	–	17,634
<b>Surplus for the year</b>		<b><u>7,758</u></b>	<b><u>27,052</u></b>

## Statement of Comprehensive Income for the year ended 31 March 2014

	<b>2014</b> <b>£000</b>	2013 £000
<b>Surplus for the year</b>	<b>7,758</b>	27,052
<b>Items that may subsequently be reclassified to income statement</b>		
Gains taken to revaluation reserve on revaluation of investment securities classified as available-for-sale	–	938
<b>Transfers</b>		
Transferred to income statement on disposal of investment securities classified as available-for-sale	–	(17,634)
<b>Total comprehensive income for the year</b>	<b><u>7,758</u></b>	<b><u>10,356</u></b>

*The notes on pages 22 to 24 form part of these accounts.*

## Statement of Financial Position as at 31 March 2014

	<b>2014</b>	2013
	<b>£000</b>	£000
<b>Assets</b>		
Demand deposits with the Debt Management Account and the National Loans Fund	<b>1,571,159</b>	1,495,598
<b>Total</b>	<b><u>1,571,159</u></b>	<u>1,495,598</u>
<b>Client Funds</b>		
NLDF funds	<b>1,571,159</b>	1,495,598
<b>Total</b>	<b><u>1,571,159</u></b>	<u>1,495,598</u>

*The notes on pages 22 to 24 form part of these accounts.*

*Jo Whelan* 1 July 2014  
 Secretary and Comptroller General  
 to the Commissioners for the Reduction of the National Debt

## Statement of Cash Flows for the year ended 31 March 2014

	<b>2014</b>	2013
	<b>£000</b>	£000
<b>Operating activities</b>		
Interest received on deposits with the Debt Management Account and the National Loans Fund	<b>7,779</b>	6,045
Increase in demand deposits with the Debt Management Account and the National Loans Fund	<b>(75,582)</b>	(502,598)
<b>Net cash flow used in operating activities</b>	<b>(67,803)</b>	(496,553)
<b>Investing activities</b>		
Interest received on UK Government gilt-edged securities classified as available-for-sale	-	2,754
Sales of UK Government gilt-edged securities classified as available-for-sale	-	289,963
Purchases of UK Government gilt-edged securities classified as available-for-sale	-	(2,699)
<b>Net cash from investing activities</b>	-	290,018
<b>Financing activities</b>		
Funds received from NLDF	<b>1,711,463</b>	1,889,210
Funds paid to NLDF	<b>(1,643,660)</b>	(1,682,675)
<b>Net cash from financing activities</b>	<b>67,803</b>	206,535
<b>Increase in cash</b>	-	-

*The notes on pages 22 to 24 form part of these accounts.*

## Statement of Changes in Client Funds for the year ended 31 March 2014

	NLDF funds (excluding revaluation reserve) £000	Revaluation reserve £000	Total NLDF funds £000
<b>At 1 April 2012</b>	<b>1,262,011</b>	<b>16,696</b>	<b>1,278,707</b>
Surplus for the year	27,052	–	27,052
Realised gains transferred to income statement on disposal of UK Government gilt-edged securities classified as available-for-sale	–	(17,634)	(17,634)
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	–	938	938
Funds received from NLDF	1,889,210	–	1,889,210
Funds paid to NLDF	(1,682,675)	–	(1,682,675)
<b>At 31 March 2013</b>	<b>1,495,598</b>	<b>–</b>	<b>1,495,598</b>
Surplus for the year	7,758	–	7,758
Funds received from NLDF	1,711,463	–	1,711,463
Funds paid to NLDF	(1,643,660)	–	(1,643,660)
<b>At 31 March 2014</b>	<b>1,571,159</b>	<b>–</b>	<b>1,571,159</b>

*The notes on pages 22 to 24 form part of these accounts.*



# Notes to the accounts for the year ended 31 March 2014

## 1 Accounting policies

### *i Basis of preparation*

These accounts have been prepared in accordance with a direction made by HM Treasury under section 33(2) of the National Lottery etc. Act 1993 in accordance with International Financial Reporting Standards (IFRS) in so far as they are appropriate, and under the historical cost convention and on a going concern basis. In particular, the following standards have been applied:

- IFRS 7 Financial Instruments: Disclosures.
- IFRS 13 Fair Value Measurement.
- IAS 1 Presentation of Financial Statements (revised 2007).
- IAS 7 Statement of cash flows.
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.
- IAS 10 Events After the Reporting Period.
- IAS 18 Revenue.
- IAS 24 Related Party Disclosures.
- IAS 32 Financial Instruments: Presentation.
- IAS 36 Impairment of Assets.
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets.
- IAS 39 Financial Instruments: Recognition and Measurement.

Certain IFRS have been issued or revised, but are not yet effective. Those issues or revisions expected to be relevant in subsequent reporting periods are:

- IAS 24 Related Party Disclosures, which has been revised as part of the IASB's annual improvements process. Application is required for reporting periods beginning on or after 1 July 2014. The NLDFIA expects to apply these revisions to IAS 24 in 2015-16. The application of these revisions, which clarify that entities as well as individuals may be considered as key management personnel and thus may be related parties of the reporting entity, is not expected to alter the disclosure of related parties of the NLDFIA.
- IFRS 9 Financial Instruments, which will replace IAS 39. No application date for IFRS 9 has yet been issued. The content of IFRS 9 has not yet been concluded, but drafts indicate that the application of IFRS 9 is not expected to change the reporting of financial instruments in the NLDFIA.

### *ii Assets*

#### **a Demand deposits**

Deposits with the Debt Management Account and the National Loans Fund are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are therefore treated as loans and receivables measured at amortised cost.

#### **b UK Government gilt-edged securities (gilts)**

In addition to marketable gilts, the NLDFIA may hold non-marketable gilts, which are created for CRND by the National Loans Fund. These are created to ensure there is no market distortion caused by large purchases and sales of gilts by CRND. These gilts mirror exactly the equivalent marketable gilts and are treated as available-for-sale assets.

Assets are classified as available-for-sale where they are expected to be held for an indefinite period of time. However, they may be sold in response to changes in factors such as liquidity needs and interest rate movements.

These gilts are recognised on trade date, when the DMA enters into contractual arrangements with counterparties to purchase securities. Following initial recognition, fair values are re-measured, and gains or losses from changes are recognised in the revaluation reserve until the securities are derecognised, at which point cumulative gains or losses previously recognised in this reserve are recognised as other gains and losses in the income statement.

### *iii Income recognition*

Interest income is recognised using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the instrument.

### *iv Administrative costs*

Administrative costs are accounted for in the DMO Annual Report and Accounts 2013-14 and a recovery is made from the Department for Culture, Media and Sport.

## **2 Interest income**

	<b>2014</b>	2013
	<b>£000</b>	£000
UK Government gilt-edged securities classified as available-for-sale	–	3,165
Demand deposits with the Debt Management Account and the National Loans Fund	<b>7,758</b>	6,253
	<b><u>7,758</u></b>	<u>9,418</u>

## **3 Other gains**

	<b>2014</b>	2013
	<b>£000</b>	£000
Profit on disposal of UK Government gilt-edged securities classified as available-for-sale	–	17,634
	<u>–</u>	<u>17,634</u>

## **4 Risk**

### *i Credit risk*

Credit risk is the risk that a counterparty, or security issuer, will fail to discharge a contractual obligation resulting in financial loss to the NLDFIA.

As at 31 March 2014, the investments of the NLDFIA comprised deposits with either the Debt Management Account or the National Loans Fund. These deposits were considered to have no exposure to credit risk because both were obligations of HM Government.

### *ii Market risk*

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk for the NLDFIA is considered to comprise interest rate risk.

The interest income on the deposits of the NLDFIA were closely linked to the official Bank Rate.

CRND monitored interest rate movements to help inform the NLDF of potential issues and events. The NLDFIA was not subject to active management and thus no formal market risk parameters were in place.

*iii Liquidity risk*

Liquidity risk is the risk that the NLDFIA will encounter difficulty in meeting obligations associated with client withdrawal requests.

Assets held by the NLDFIA were highly liquid to enable all client obligations to be met as they fell due.

**5 Related party transactions**

CRND is a separate entity within the DMO. CRND client mandates are kept distinct from other DMO business.

During the year the NLDFIA had a significant number of material transactions with the Debt Management Account, which is operated by the DMO. CRND's client mandates required the bulk of the funds to be invested in gilts or deposited with the Debt Management Account.

During the year, the NLDFIA had a significant number of material transactions with the NLDF due to the NLDF receiving funds from the National Lottery for investment. During the year, the NLDF deposited £68 million (net of withdrawals) with the NLDFIA (2012-2013: £207 million net deposit).

## Appendix

# National Lottery Distribution Fund (Including Millennium Fund) Investment Account

## Accounts Direction Given by the Treasury in accordance with Section 33 (2) Of The National Lottery, etc Act 1993 (The Act)

- 1 This direction applies to the National Lottery Distribution Fund Investment Account.
- 2 The Commissioners for the Reduction of the National Debt shall prepare accounts for the financial year ended 31 March 2012 and subsequent financial years which give a true and fair view of the state of affairs of the Account at the reporting date, and of its income and cash flows for the year then ended.
- 3 The accounts shall be prepared in accordance with applicable accounting standards, and shall be consistent with relevant requirements of the extant Government Financial Reporting Manual.
- 4 The accounts shall present an income statement, a statement of comprehensive income, a statement of financial position, a statement of cash flows, and a statement of changes in client funds. The statement of financial position shall present assets and liabilities in order of liquidity.
- 5 The notes to the accounts shall include disclosure of assets and liabilities, and of income and expenditure, relating to other central government funds including the National Loans Fund.
- 6 The report shall include:
  - a brief history of the Account, and its statutory background;
  - an outline of the scope of the Account, its relationship to HM Treasury and other central funds, and its management arrangements;
  - a management commentary, including information on financial performance and financial position, which reflects the relationship between the Account and other central funds; and
  - a governance statement.
- 7 This accounts direction shall be reproduced as an appendix to the accounts.

This accounts direction supersedes all previous Directions issued by HM Treasury.

*Chris Wobschall*  
Head, Assurance and Financial Reporting Policy  
Her Majesty's Treasury

23 March 2012

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