HM Treasury

Whole of Government Accounts June 2018

Whole of Government Accounts:

year ended 31 March 2017

HC 1091

June 2018

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Presented to the House of Commons pursuant to section 11 of the Government Resources and Accounts Act 2000

Ordered by the House of Commons to be printed on 28 June 2018

HC 1091

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ISBN 978-1-5286-0568-7

CCS0618905468 06/18

Printed on paper containing 75% recycled fibre content minimum

Printed in the UK by the APS Group on behalf of the Controller of Her Majesty's Stationery Office

Contents

Chapter 1	Overview and performance analysis	3
	Overview	3
	Report on assets and liabilities	15
	Report on income and expenditure	37
	Other key matters	49
	EU withdrawal	54
	Events since 31 March 2017	55
Chapter 2	Statement of Accounting Officer's responsibilities	57
Chapter 3	Governance statement	59
	Scope of Accounting Officer's responsibility	59
	The WGA governance framework	60
	Improvements in preparing WGA	60
	How WGA is being used	61
	Review of effectiveness	62
	Assurance in making this judgement	64
	HM Treasury's role in managing financial risk	64
	Information and data handling	65
	Disclosure of information to auditors	65
Chapter 4	Remuneration and staff report	66
	Remuneration report	66

	Staff report	68
Chapter 5	Financial statements	72
	Statement of Revenue and Expenditure	73
	Statement of Comprehensive Income and Expenditure	73
	Statement of Financial Position	74
	Statement of Changes in Taxpayers Equity	76
	Statement of Cash Flows	77
	Notes to the accounts	78
Chapter 6	Certificate and Report of the Comptroller and Auditor General to the House of Commons	150
Annex A	Comparison to the National Accounts	175

Chapter 1
Overview and performance analysis

Overview

Introduction

1.1 The Whole of Government Accounts (WGA) are financial statements prepared in accordance with International Financial Reporting Standards (IFRS). WGA reports on the financial performance and position of the whole of the UK public sector through a statement of revenue and expenditure (or income statement), a statement of financial position (or balance sheet), a statement of cash flows and a statement of comprehensive income and expenditure (other recognised gains and losses), together with associated notes providing additional detail and analysis.

1.2 WGA consolidates the audited accounts of over 7,000 organisations across the UK public sector including central government departments, local authorities, devolved administrations, the NHS, academy schools and public corporations. It is a uniquely comprehensive product as it is the only set of consolidated public sector accounts in the world that includes central government, arm's length bodies of central government, devolved administrations, the central bank and local government organisations.

1.3 The WGA boundary is similar to the concept of a group under generally accepted accounting practice, but is based on control criteria used by the Office for National Statistics (ONS) to define the classification. There has been no significant change to the WGA boundary during the year under review. When changes to the WGA boundary occur, the entire dataset is not retrospectively adjusted, therefore this will have an impact on the year on year comparability of information in the charts provided in this chapter.

1.4 The amounts reported in WGA are different from those reported in the National Accounts, the statistical reporting framework used by the government for budgeting, reporting and financial analysis. National Accounts are prepared using the ESA10 framework, which is set by the European Commission. WGA is prepared using IFRS, as interpreted for the UK public sector by the Financial Reporting Advisory Board.

1.5 Chart 1.A illustrates the scope of National Accounts measures for financial position and the balance sheet position reported in WGA. As WGA includes assets and liabilities not reported within the National Accounts, it provides a more complete picture of the government's financial position. By incorporating long-term liabilities, such as the pension entitlements of public sector employees or liabilities incurred under Private Finance Initiative (PFI)

contracts, WGA provides more information about the future consequences of decisions already taken and financial commitments already entered into.

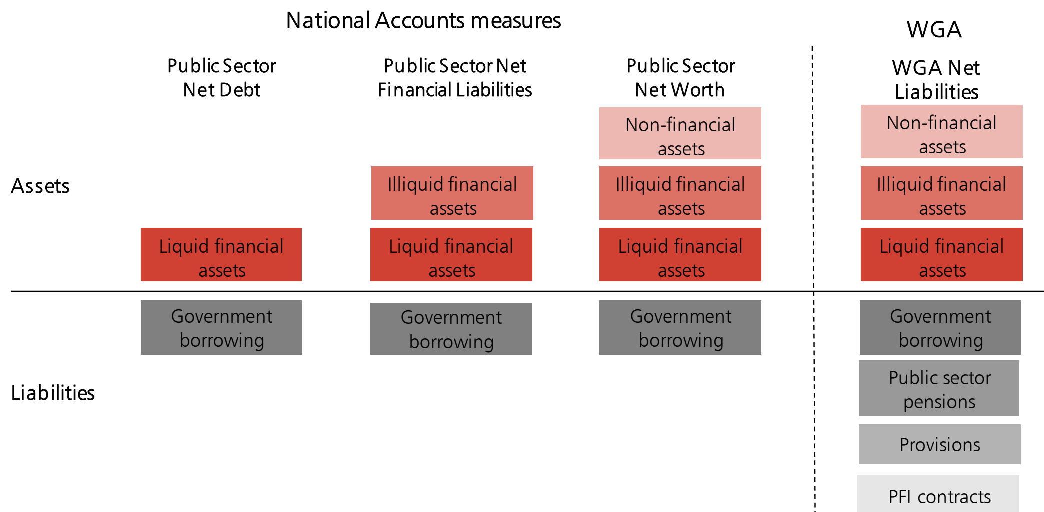
1.6 Information on improvements in preparing the WGA and how the data is being used can be found in the Governance statement in Chapter 3.

WGA and the National Accounts

1.7 In looking at the fiscal picture, there are various statistical measures available in the National Accounts providing a complementary perspective of the health of the government's balance sheet. Public Sector Net Debt (PSND) comprises government borrowings less liquid financial assets (such as bank deposits and foreign exchange reserves). PSND excluding the public sector banks is the government's preferred measure of fiscal health as it is consistent with the internationally agreed National Accounts framework. Public Sector Net Financial Liabilities expands on PSND to include all financial assets, such as loans, derivatives and equity investments. The most comprehensive measure derived from National Accounts is Public Sector Net Worth which compares the government's debt with all of its assets, including physical assets used to deliver services such as infrastructure, offices, hospitals and schools.

1.8 To get WGA net liabilities we include non-financial assets and public sector pensions liabilities, provisions and PFI contracts. Annex A to the account includes further explanations of the differences between the WGA and National Accounts.

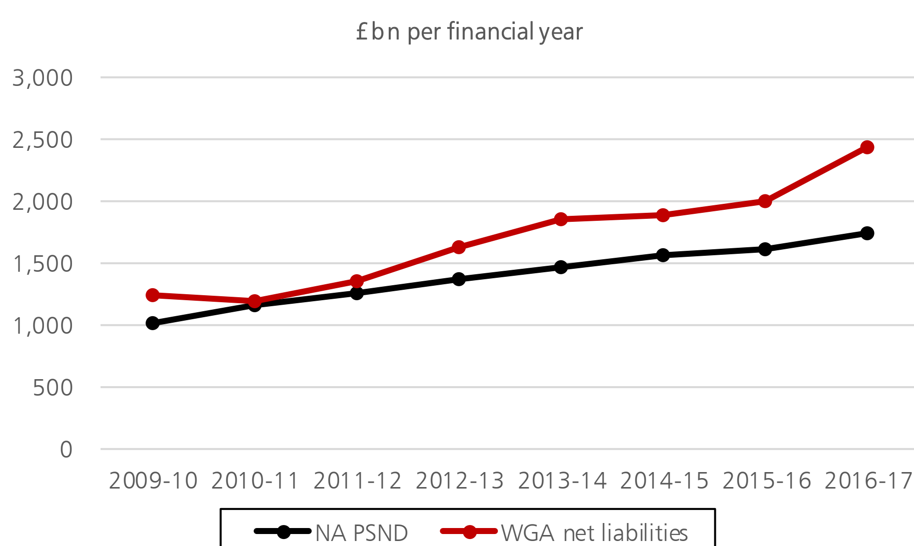
Chart 1.A: Comparison of National Accounts and WGA measures



1.9 When considering the affordability of long-term liabilities, the government additionally considers the future cash flows and how sustainable they are, often expressed as a percentage of Gross Domestic Product (GDP). Further information on the profile and affordability of long-term liabilities, including provisions and public sector pensions, is included in the report on assets and liabilities later in this Chapter and in the Office for Budget Responsibility (OBR) Fiscal Sustainability Reports.[1] In October 2015 Parliament approved a revised Charter for Budget Responsibility that required OBR to produce a Fiscal Risks Report every two years. The government has to respond within a year of publication. The first Fiscal Risks Report was published in July 2017 and the government is due to respond this summer.[2]

Asset and liability trends

Chart 1.B: National Accounts (NA) PSND and WGA net liabilities

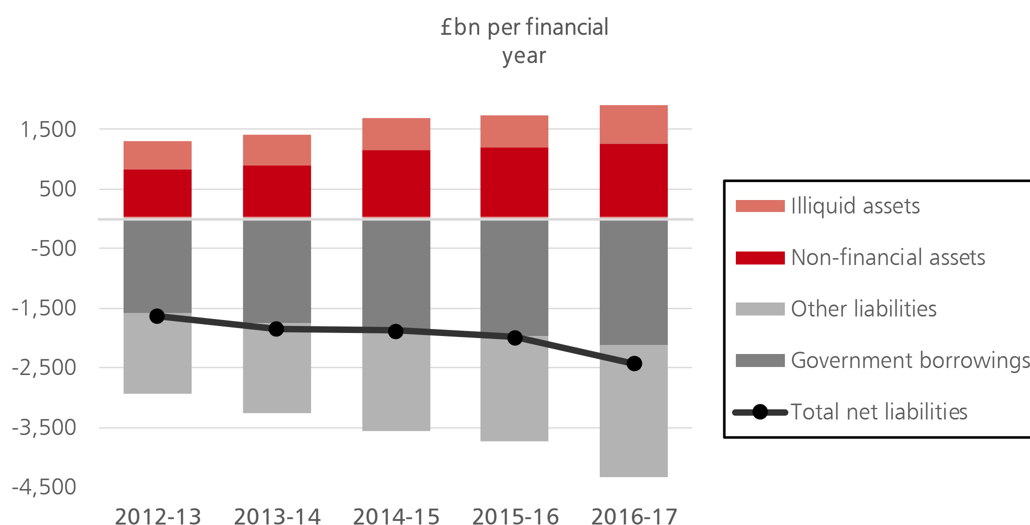


1.10 Over the 8-year time series that the WGA has been published, the overall trend of the National Accounts PSND and the WGA net liabilities has generally been similar. There was a divergence for 2016-17. This is because pension liabilities have increased in value, which affects WGA net liabilities but not National Accounts PSND.

1 http://budgetresponsibility.org.uk/fsr/fiscal-sustainability-report-january-2017/

2 http://obr.uk/frr/fiscal-risk-report-july-2017/

Chart 1.C: Asset and liability trends



1.11 The public sector balance sheet has expanded significantly over the last 5 years. In part, this is due to government borrowing increasing to fund in-year deficits and capital investment. This is reflected in the increase in PSND excluding public sector banks from £1.2 trillion in March 2011 (76% of GDP) to £1.7 trillion in March 2017 (86.6% of GDP).[3]

1.12 Similarly, other liabilities have increased from £1.6 trillion in 2012-13 to £2.4 trillion in 2016-17 leading to an overall increase in liabilities of around 48%. Of the £0.8 trillion increase over this period, £0.1 trillion was due to a change in discount rates for certain provisions between 2014-15 and 2015-16. A further £0.4 trillion is due a change in discount rate for public sector pensions between 2015-16 an 2016-17. A further £0.2 trillion is due to increases in public sector pension liabilities and provisions that are not related to the discount rate.

1.13 Changes in discount rates have a significant impact on these liabilities because they are discharged over a long period of time. The public sector pension liability reflects payments that will need to be made for decades to come, and the nuclear provision will be paid out until 2137. The discount rate changes do not affect the amount of cash that, over time, will be paid to discharge these liabilities. However, it does affect the way they are valued in present day money.

1.14 The government launched a Balance Sheet Review at Autumn Budget 2017 to make more effective use of assets and liabilities, looking at areas such as estates optimisation, improving the return on investments, and reducing the cost of liabilities. The Review will help to release resources for further investment in public services and improve the sustainability of the public finances. The government will update on progress of the review at Budget 2018.

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3 https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/bulletins/publicsectorfinances/mar2017

Box 1.A: Why are liabilities so much higher than assets?

WGA has a net liability position of over £2.4 trillion on the balance sheet. The value of liabilities (£4.3 trillion) is much higher than the value of assets (£1.9 trillion) due to accounting rules around the recognition of liabilities compared to the accounting rules around the recognition of assets and income.

This has a particular impact on WGA government borrowing (£1.3 trillion), provisions (£0.3 trillion) and pensions liabilities (£1.8 trillion), which together make up nearly 80% of the total liabilities balance.

The accounting rules WGA follows require the full liability to be recognised on the WGA Statement of Financial position. Some of these liabilities are due to be paid over a number of years, decades and (in the case of the nuclear provision) over a century.However, only a small portion of the liability falls due to be paid each year.

Tax revenues collected in that year contribute to paying down these liabilities. The accounting rules do not allow for this future tax revenue to be recognised as an asset. Therefore, WGA includes the full value of certain future commitments, but not the income that will be generated to pay those liabilities as they fall due.

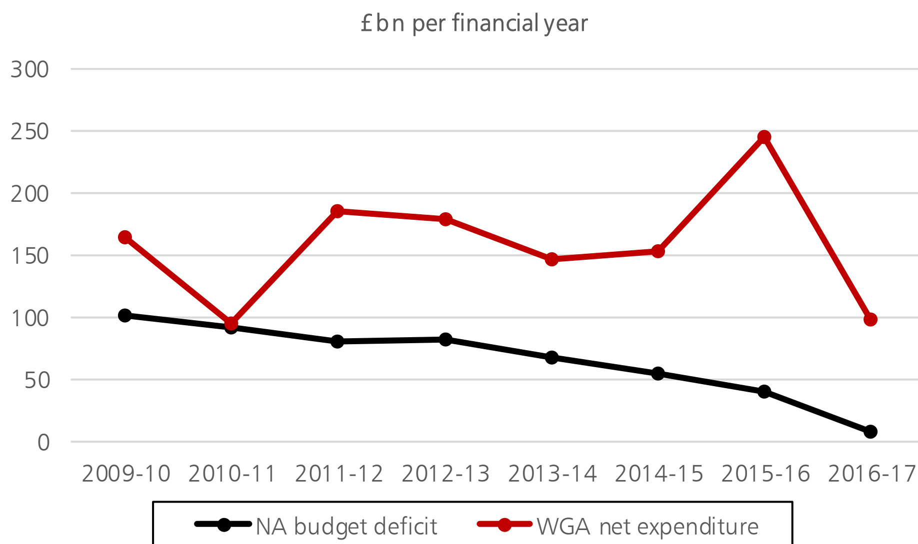
The OBR provides further analysis of the sustainability of the public finances in the Fiscal Sustainability Reports.[4] Their approach is to:

- look at the fiscal impact of past public sector activity, as reflected in the assets and liabilities that it has accumulated on its balance sheet
- secondly, look at the potential impact of future public sector activity, by projecting how spending and revenues may evolve over the next 50 years – and the impact this would have on PSND

4 http://obr.uk/fsr/fiscal-sustainability-report-january-2017/

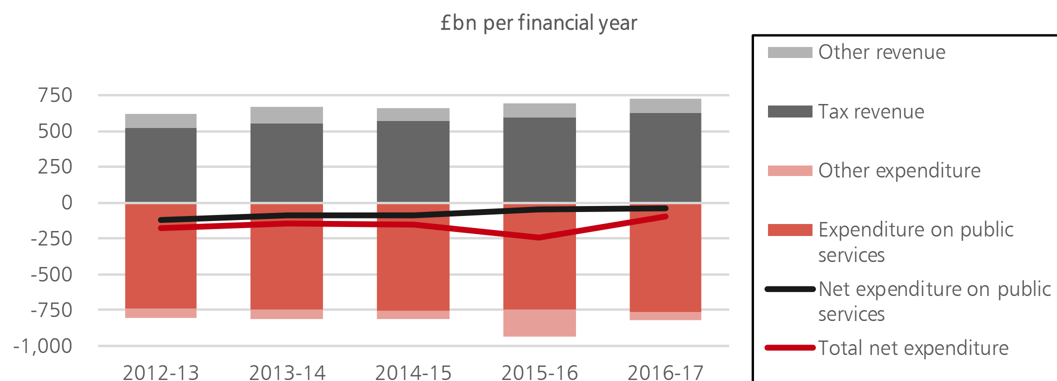
Income and expenditure trends

Chart 1.D: National Accounts (NA) Public sector current budget deficit and WGA net expenditure



1.15 Over the 8-year time series the NA current budget deficit has been steadily reducing. The WGA net expenditure series over the same period has shown greater volatility, mainly due to the expenditure for financing government's long-term liabilities which are included in the WGA but not in the National Accounts. The financing costs of long term liabilities is affected significantly by changes to the discount rates used to discount future cash flows. This had a particular impact in 2015-16, as there was a change in discount rates for certain provisions that impacted financing costs for that year by £125.2 billion.

Chart 1.E: Income and expenditure trends



1.16 Over the last 5 years the expenditure on public services as recorded in WGA has remained stable at around £749 billion. This is because increased expenditure on social protection and health has been offset by lower levels of impairments and by lower levels of new provisions (as opposed to valuation changes for existing liabilities).

1.17 Over the same period revenue has increased from £620.7 billion to £720.8 billion, primarily as a result of an increase in tax revenue of £103.7 billion. This means that net expenditure on public services in WGA has decreased by 67% from £118.7 billion to £39.9 billion in 2016-17.

1.18 WGA also includes expenditure for financing government's long-term liabilities which are not included in National Accounts.

1.19 WGA discloses expenditure in the categories as required by the accounting standards, for example staff costs. An alternative breakdown of public expenditure would be to split expenditure based on the services that are being delivered, such as health or transport.

1.20 The main data source for the alternative breakdown of public expenditure by objective or outcome is the Public Expenditure Statistical Analyses (PESA).[5] PESA is the yearly HM Treasury statistical release covering all UK public sector spending, largely based on the same data as the National Accounts. It brings together recent outturn data, estimates for the latest year, and spending plans for the rest of the current spending review period.

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5 https://www.gov.uk/government/statistics/public-expenditure-statistical-analyses-2017

Table 1.A: Public services expenditure breakdown - Functional

Function	2016-17 £bn	% of total	2015-16 £bn	2014-15 £bn	2013-14 £bn	2012-13 £bn
Social protection	264.3	37%	265.0	260.9	254.0	253.4
Health	144.3	20%	138.5	134.1	129.4	124.3
Education	87.2	12%	84.8	85.1	84.9	84.0
Defence	37.0	5%	36.6	36.7	36.4	36.3
Public order and safety	30.1	4%	30.2	30.5	29.6	31.3
Transport	29.6	4%	27.8	22.0	20.9	20.3
Other economic affairs	17.5	3%	17.0	17.9	18.9	16.5
Environment protection	11.3	2%	11.6	11.6	11.2	10.7
Housing and community amenities	10.6	1%	10.0	10.4	10.0	10.1
Recreation, culture and religion	11.6	2%	10.9	12.4	11.4	12.7
General public services	22.9	3%	21.6	21.9	20.9	18.9
Debt interest	39.4	6%	37.5	37.0	40.1	40.7
EU transactions	4.7	1%	7.7	6.2	7.2	6.7
Public services expenditure on services[a]	710.5	100%	699.2	686.7	674.8	666.0
Add: Depreciation and impairment	47.1		42.7	45.4	51.0	51.1
Add: Increase in provisions	18.6		9.2	26.0	19.5	29.0
Accounting adjustments	(15.5)		(8.9)	(6.8)	3.6	(5.2)
WGA expenditure on public services	760.7		742.2	751.3	748.9	740.9

a Public Expenditure Statistical Analyses 2017 table 4.2 (tables may not cast due to rounding)

1.21 PESA is prepared on a different basis than WGA, therefore figures do not align precisely. PESA shows that expenditure on public services has increased over the last 5 years, driven by increases in expenditure on social protection and health.

1.22 The largest element of expenditure on public services is social protection. This incorporates social security benefits (the largest element of expenditure within WGA) and broader expenditure on social protection such as social care. This expenditure is captured through staff costs, purchase of goods and services and other lines within WGA based on the type of expenditure incurred to deliver social protection.

1.23 Another useful source of information is the Country and Regional Analysis (CRA).[6] The CRA is an annual HM Treasury publication which presents statistical estimates for the allocation of identifiable expenditure between the UK countries and 9 English regions. A comparison with WGA expenditure on public services is included in table 1.C.

Table 1.B: Public services expenditure breakdown – Country and Regional

Region	2016-17 £bn	% of total	2015-16 £bn	2014-15 £bn	2013-14 £bn	2012-13 £bn
English Regions:						
North East	25.5	4%	25.2	24.7	24.5	24.2
North West	68.1	10%	67.6	66.2	64.4	64.5
Yorkshire and The Humber	47.8	7%	47.5	46.6	45.5	45.1
East Midlands	39.1	6%	38.5	38.0	36.8	36.3
West Midlands	51.3	7%	50.0	50.0	48.3	47.8
East	50.0	7%	49.4	48.1	46.2	45.2
London	89.6	13%	87.4	85.1	83.7	82.5
South East	73.2	10%	70.8	69.0	67.5	65.7
South West	47.2	7%	46.0	45.3	43.9	42.7
Scotland	57.6	8%	56.3	55.1	54.2	54.0
Wales	31.4	4%	31.0	30.6	30.1	29.6
Northern Ireland	20.6	3%	20.2	20.3	20.0	19.6
Outside UK	24.2	3%	25.6	26.9	26.7	25.1
Non-identifiable expenditure[a]	85.6	11%	84.9	81.1	83.4	83.4
Public sector expenditure on services per CRA[b]	711.1	100%	700.3	687.2	675.1	665.8
Add: Depreciation and impairment	47.1		42.7	45.4	51.0	51.1
Add: Increase in provisions	18.6		9.2	26.0	19.5	29.0
Accounting adjustments	(16.1)		(10.0)	(7.3)	3.3	(5.0)
WGA expenditure on public services	760.7		742.2	751.3	748.9	740.9

a Includes the effect of financial sector interventions

b Country and Regional Analysis 2017 table A.1

Please note tables may not cast due to rounding

6 https://www.gov.uk/government/statistics/country-and-regional-analysis-2017

1.24 The CRA also provides information on total identifiable expenditure on services per head, by country and region, as included in the table below:

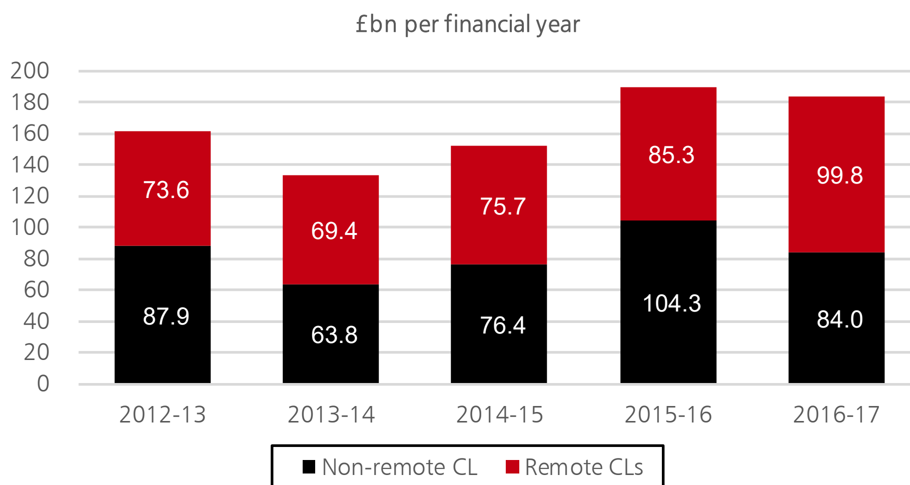
Table 1.C: Total identifiable expenditure on services by country and region, per head 2012-13 to 2016-17

£ per head outturn	2016-17	2015-16	2014-15	2013-14	2012-13
North East	9,680	9,585	9,451	9,377	9,284
North West	9,429	9,419	9,275	9,073	9,102
Yorkshire and the Humber	8,810	8,804	8,701	8,523	8,490
East Midlands	8,282	8,231	8,202	8,003	7,943
West Midlands	8,846	8,702	8,754	8,505	8,476
East	8,155	8,126	8,000	7,765	7,651
London	10,192	10,074	9,964	9,941	9,933
South East	8,111	7,913	7,776	7,677	7,532
South West	8,549	8,403	8,356	8,155	8,004
England	8,898	8,803	8,711	8,554	8,488
Scotland	10,651	10,478	10,308	10,169	10,155
Wales	10,076	9,994	9,908	9,770	9,614
Northern Ireland	11,042	10,921	11,048	10,920	10,773
UK identifiable expenditure per CRA[a]	9,159	9,058	8,967	8,814	8,747

a Country and Regional Analysis 2017 table A.2

Contingent liability trends

Chart 1.F: Quantifiable contingent liabilities: Non-remote and remote



1.25 The public sector's exposure to quantifiable contingent liabilities has increased over the last 5 years, mainly due the rise in contingent liabilities relating to clinical negligence.

1.26 In addition to the quantifiable contingent liabilities mentioned above, the government entered into contingent liabilities where the size of the liability could either not be determined with reasonable certainty or to quantify it would jeopardise the outcome of any legal proceedings. The details of the most significant non-quantifiable contingent liabilities are included in notes 29 and 30 to the financial statements.

1.27 HM Treasury has enhanced its approach to the management and scrutiny of contingent liabilities through the creation of stricter controls for approving new contingent liabilities. The department published the new contingent liability framework in July 2017.[7] Each contingent liability that goes through the process is assessed on the basis of several factors. These include the rationale for the intervention (including relative to alternative options), the duration and size of the government's exposure as a result of the contingent liability, the causes that may lead to the contingent liability crystallising, the expected loss associated with the liability, whether crystallisation would be affordable, and whether the governance arrangements in place to manage the risks associated with the contingent liability are robust. While the framework covers new contingent liabilities, the existing stock, including those in Chart 1.F, are being evaluated as part of the recently announced Balance Sheet Review.

1.28 Individual departments also announced policies that will impact on contingent liabilities, for example the Department of Health and Social Care's new maternity strategy.

[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/635939/contingent_liability_approval_framework_guidance.pdf

Other sources of information

1.29 In addition to WGA, further information is published by HM Treasury and others on the public finances as viewed using the National Accounts framework:

- PESA and CRA publications provide retrospective and forward looking analyses of public expenditure. They include an analysis of public expenditure by function, country and region. The information in PESA and CRA can therefore be used to understand the profile of spend across government
- the OBR's Fiscal Sustainability Report sets out long-term projections for spending, revenue and financial transactions, and assesses whether they imply a sustainable path for public sector debt[8]
- the OBR's Fiscal Risks Report reviews a wide range of risks from the economy and financial system, to tax revenues, public spending and the balance sheet and also includes a fiscal stress test.[9] The government will respond to the Fiscal Risks Report setting out its approach to managing these risks
- Annex A to WGA reconciles WGA figures to Public Sector Net Debt and the current budget deficit. It also explains the differences between WGA and National Accounts frameworks

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8 http://obr.uk/fsr/fiscal-sustainability-report-january-2017/

9 http://obr.uk/frr/fiscal-risk-report-july-2017/

Report on assets and liabilities

Assets

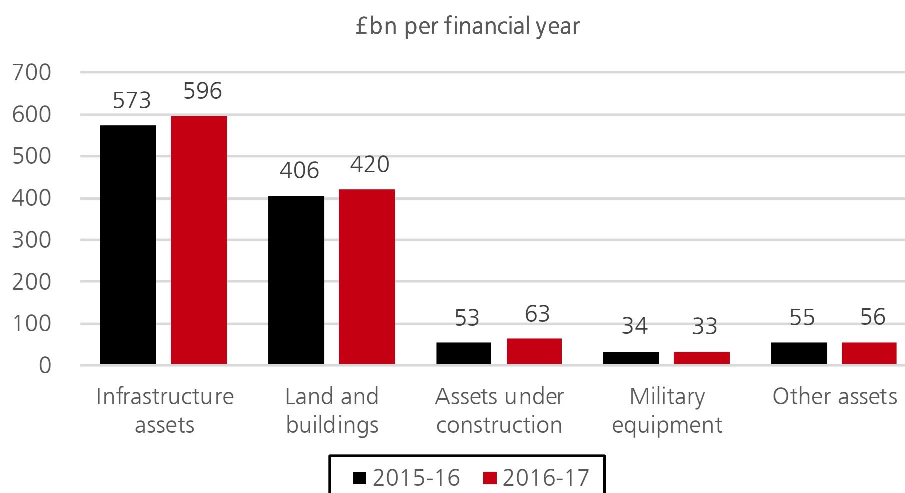
What are the most significant assets owned and controlled by government?

The most significant assets owned and controlled by government are **property, plant and equipment** (which includes land and buildings, infrastructure and military equipment), **financial assets** (which includes the investment in the public sector banks) and **trade receivables.**

		2016-17 £bn	2015-16 £bn
Property, plant and equipment	Note 12	1,167.6	1,120.2
Other financial assets	Note 16	458.9	373.0
Trade and other receivables	Note 15	173.2	154.7
Other assets	Notes 13, 14, 17, 18 (incl. gold and assets held for sale)	103.3	94.5
Total assets		1,903.0	1,742.4

Property, Plant and equipment

Chart 1.G: Types of property, plant and equipment



1.30 Overall, the value of government's property, plant and equipment increased by £47.5 billion or 4% in 2016-17. The most significant components of the government's property, plant and equipment are infrastructure assets and land and buildings which are reviewed in table 1.D.

Infrastructure assets

Table 1.D: Breakdown of infrastructure assets

Held by	2016-17 £bn	2015-16 £bn
Network Rail	288.9	280.1
Department for Transport	117.4	113.3
Scottish Water	56.3	52.2
Northern Ireland Department for Infrastructure	25.6	24.5
Scottish Government Strategic Road Network	17.7	17.1
Welsh Government	15.6	14.8
Other	6.0	5.5
Total central government and public corporations	527.5	507.5
Transport for London	18.6	18.2
Highways infrastructure and other local government assets	49.5	46.9
Total local government	68.1	65.1
Total infrastructure assets	595.6	572.6

1.31 The value of the government's infrastructure assets increased in value by 4% in 2016-17. Table 1.D provides a further breakdown of the government's infrastructure assets. The most significant movements related to upwards revaluation of the rail network and strategic road network.

Box 1.B: The strategic road network and rail network

- The strategic road network (£114.2 billion) and the rail network (£288.9 billion) are the most valuable infrastructure assets in WGA. The Department for Transport is ultimately responsible for these assets
- The strategic road network is approximately 4,300 miles of motorways and all-purpose trunk roads which carry around a third of all traffic.[10] The rail network carried 66 billion passenger-kilometres and 17.2 billion net tonnes of freight[11]
- In 2016-17 road network maintenance costs totalled £0.5 billion, with rail network maintenance totalling £0.8 billion.[10] Other roads are under local authority or private ownership

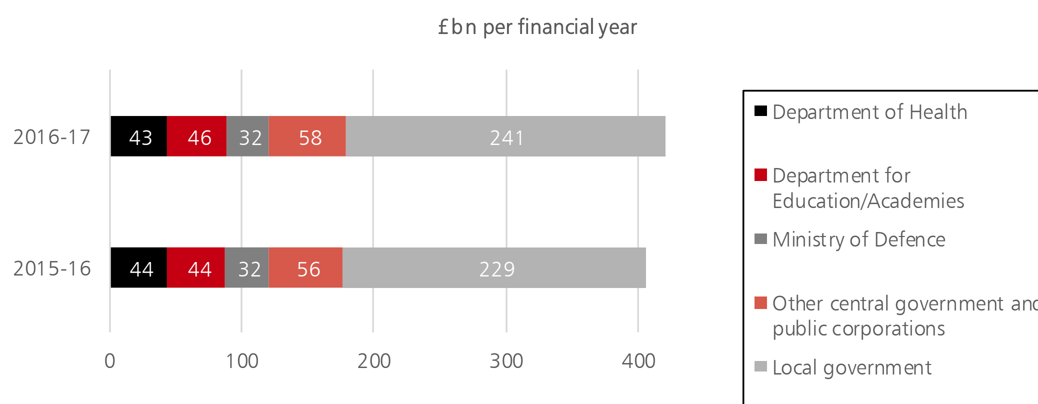
[10] https://www.gov.uk/government/publications/dft-annual-report-and-accounts-2016-to-2017

[11] https://www.networkrail.co.uk/who-we-are/publications-resources/regulatory-and-licensing/annual-report/

1.32 Central government and public corporations value their infrastructure assets at depreciated replacement cost. Local government on the other hand, values their assets, of which highways infrastructure is the most significant, based on historical cost. The differences in valuation method means that local authority infrastructure assets are likely to be understated by at least £52.8 billion and therefore the local government share of infrastructure appears disproportionately small. Further information on the differences in valuation are included in the critical accounting policies in Note 2 to the accounts.

Land and buildings

Chart 1.H: Breakdown of government's estate

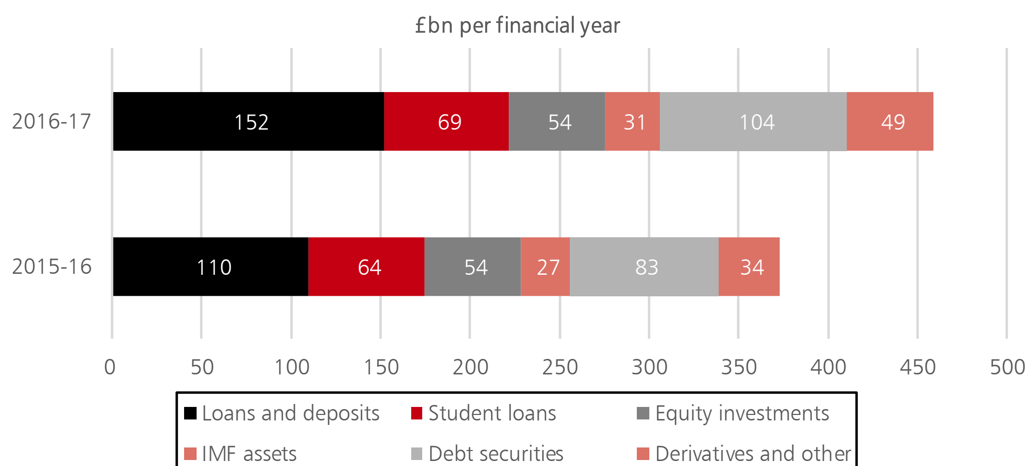


1.33 The value of land, buildings and dwellings owned by government has increased by 3% compared to 2015-16. This movement is driven by a number of entities undertaking a periodic revaluation of assets as well as building additions across the whole of English local government.

1.34 The government is establishing a new executive agency to own and manage central government property, allowing it to better identify opportunities to obtain the best value for money for taxpayers. This new body, known as the Government Property Agency, will implement a commercially-driven approach to asset management and drive better strategic oversight and management of the estate. It launched on 1 April 2018.

Other financial assets

Chart 1.I: Breakdown of other financial assets by type



1.35 As the chart shows, the government holds a range of financial assets. Some are held as part of the government's normal operations to manage cash and foreign exchange risks. Others were acquired to support specific policy objectives. For example, student loans are provided to support access to education and loans and equity investments were acquired during the financial crisis to support financial stability.

1.36 The government's policy is to sell assets where it is value for money to do so and where there is no policy reason to continue to own them. Selling assets gives headroom for the government to invest in other policies with greater economic or social returns and reduces fiscal pressures.

1.37 To support this policy, the government set up UK Government Investments (UKGI) in April 2016, as a centre of excellence in corporate finance and corporate governance. The government company brings together the functions of the Shareholder Executive and UK Financial Investments under a single holding company and is managed by an independent board.

1.38 UKGI has three objectives: prepare and execute all significant corporate asset sales by the UK government; advise on other major corporate finance matters, including all major UK government financial interventions into corporate structures and on major UK government corporate finance negotiations; and act as a shareholder for and lead establishment of UK government arms-length bodies, as required and in line with HMT priorities.

1.39 Achievements in 2016-17 for UKGI include the sale of the Green Investment Bank which completed in August 2017 and working across Whitehall to coordinate the government's response to special situations, most notably in the steel industry.

1.40 Information on significant sales after 31 March 2017 have been included in Note 32: Events after the reporting period.

Loans and deposits

1.41 Loans and deposits increased by £42.2 billion or 38% in 2016-17. This is due to the sale of UKAR's Bradford and Bingley mortgage assets (which reduced loans by £15.8 billion: £11.8 billion from the sale and £4.0 billion from mortgage redemptions and repayments), offset by the new Term Funding Scheme (TFS) loans at the Bank of England (which increased loans by £55.1 billion).

Student loans

1.42 The carrying value of student loans held by government increased by £5.0 billion or 8% in 2016-17. This increase is mostly due to new loans issued which amounted to £5.6 billion net of impairment.

1.43 The value of student loans held by government in the WGA at 31 March 2017 reflects an estimate of the present cost of subsidising interest on loans over the life of the loan (interest subsidy impairment) and an estimate of the future cost of policy write offs as not all of the loans issued will be recoverable due to the repayment terms offered (policy write off impairment). The carrying value of England only student loans, which makes up almost 90% of all student loans, was 69% of the face value of these loans. Further information on the valuation of student loans is included in the critical accounting policies in Note 2 to the accounts.

1.44 The accounting treatment of student loans in the WGA is in line with IFRS to ensure the balance sheet reflects the fair value of an asset. The National Accounts are prepared in line with ESA210 and accordingly student loans are recorded differently for National Accounts purposes. Specifically, the student loans are represented at their face value and show write-offs when they occur. The impairment of student loans is also assessed annually and upfront within the Department for Education's accounts. The Budgeting system explicitly includes the value of the impairment (as the RAB charge) and this is assessed against the target impairment.

1.45 In summary, the National Accounts, Departmental Accounts (as well as the WGA), and the Budgeting system provide complementary information and they are all used to inform policy and fiscal decisions.

1.46 In December 2017, the government concluded the first sale of part of the English income-contingent student loan book, raising £1.7 billion for the Exchequer. The sale of the student book is a part of the government's aim to sell publicly-owned assets in a way that secures good value for money for taxpayers and reduce fiscal pressures.

Debt securities

1.47 The government increased its holdings of foreign currency reserves during the year leading to an increase of £21.0 billion (25%) in debt securities. £76.8 billion of the total balance is held by the Exchange Equalisation Account.

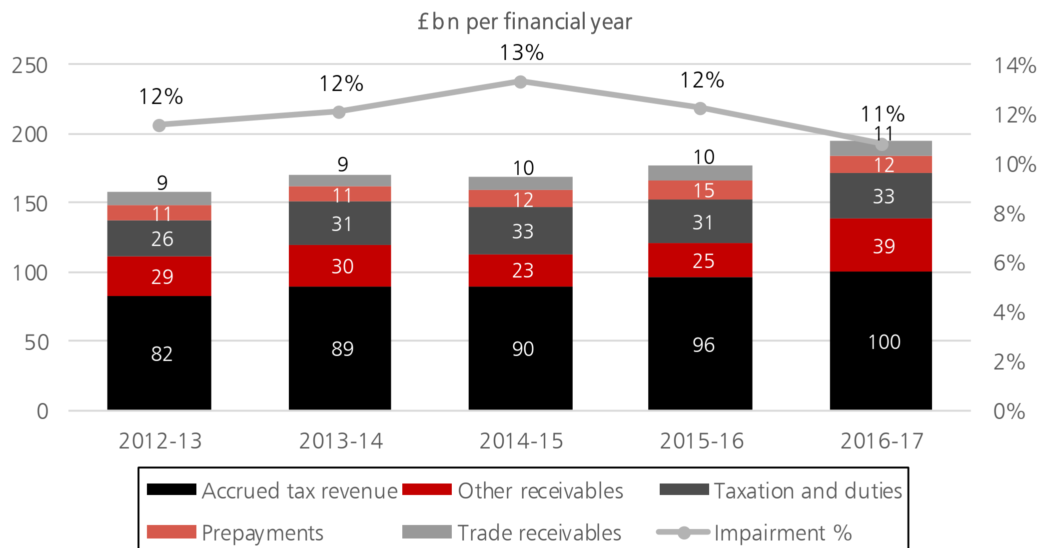
Equity investments

1.48 The value of the government's shares in Lloyds and the Royal Bank of Scotland (RBS) decreased by £1.9 billion compared to 2015-16. This was due to a sale of £3.5 billion of shares on Lloyds, partially offset by a fair value increase of £1.6 billion to RBS shares.

1.49 The government remains committed to returning RBS, an asset taken on in the financial crisis, to the private sector in a way that will maximise value for money for the taxpayer.

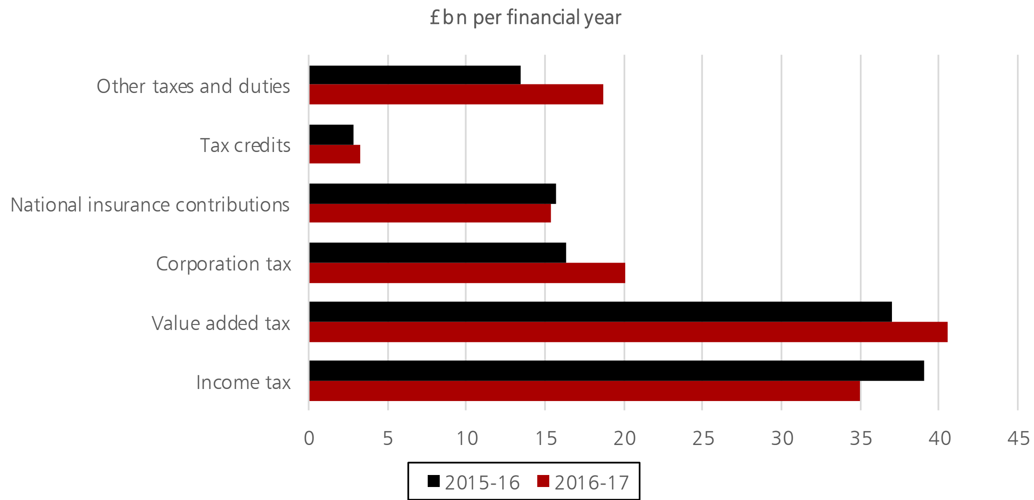
Trade and other receivables

Chart 1.J: Breakdown of receivables by type



1.50 Receivables have increased by 24% over the last 5 years, while the impairment percentage has reduced from 12% to 11%. The most significant receivables held by government relate to taxation income. Accrued and receivable tax revenue of £132.8 billion is broken down in the Chart 1.K.

Chart 1.K: Breakdown of 2016-17 accrued tax revenue and taxation and duties (before impairment)



Source: HMRC 2016-17 trust statement[12]

1.51 Impairments to tax receivables amount to £6.4 billion. This is estimated based on HMRC's analysis of existing receivables and historical trends in debt recovery, losses, discharges, amendments and cancellations. Each year HMRC review and enhance the impairments methodology based on the latest management information available to ensure a robust estimation process. This year the impairment balance has reduced from £6.9 billion to £6.4 billion.

1.52 For further information on management of debt owed to government refer to paragraphs 1.153 to 1.155 of Chapter 1.

12 https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2016-to-2017

Liabilities

What liabilities does government have?

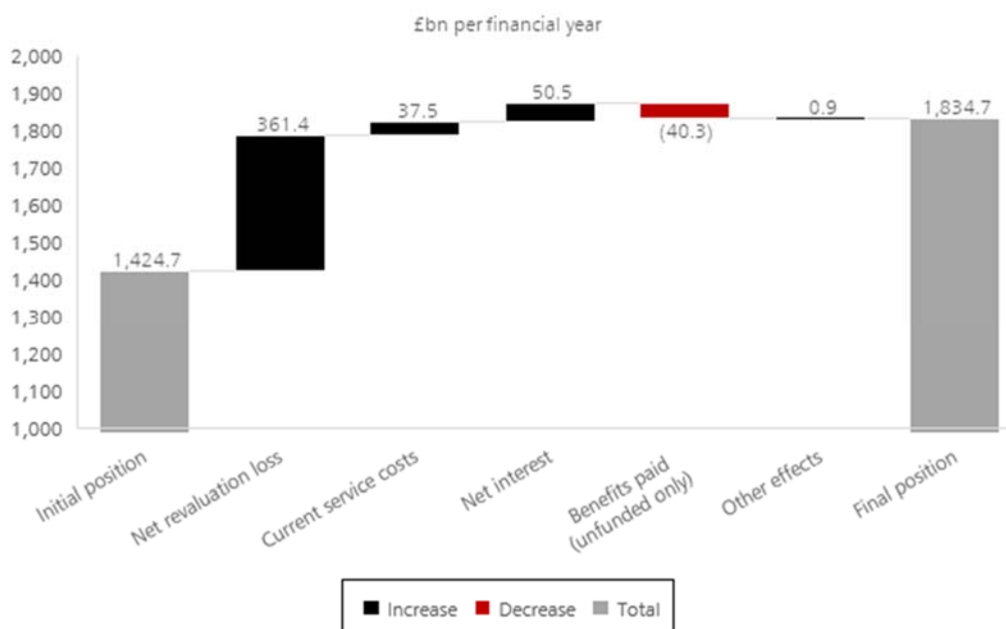
Government borrowings comprises long-term borrowing in the form of gilt-edged securities (gilts), and National Savings and Investments (NS&I) products and short-term borrowing in the form of Treasury bills. The government also has **public sector pension liabilities** and **provisions** which will be paid out in future years.

		2016-17 £bn	2015-16 £bn
Public sector pension schemes	Note 24	1,834.7	1,424.7
Government borrowings	Note 20	1,289.0	1,260.6
Other financial liabilities	Note 21	692.2	557.4
Provisions	Note 22	322.2	305.5
Trade and other payables	Note 19	185.6	180.2
Total liabilities		4,323.7	3,728.4

Public sector pensions

1.53 At £1,834.7 billion, the largest liability in the 2016-17 WGA is the liability in respect of public sector pension schemes. This has increased by £410.0 billion (29%) from 2015-16 largely due to the change in discount rate, which is reflected within the net revaluation loss in Chart 1.L.

Chart 1.L: Change in the net public sector pension liability



Discount rate changes

1.54 The main cause of the change in this liability each year is the annual change to the discount rate used to measure the liability - the "discount rate net of the consumer price index (CPI)". This discount rate is used because the value placed on the liability each year is based upon commitments from the

schemes to make future benefit payments, which are generally indexed with CPI, discounted back to today's terms.

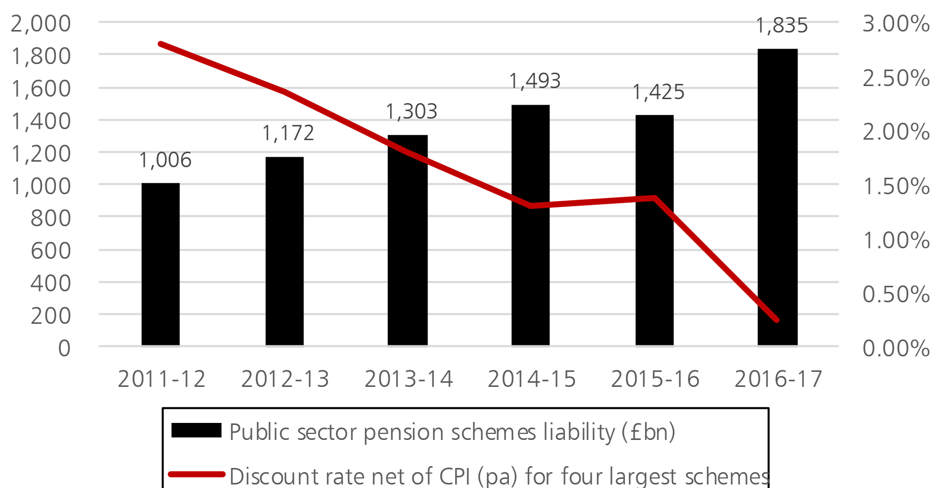
1.55 This discount rate generally has a significant impact on the liability because many of the benefit payments the schemes expect to make fall decades into the future, and so a small change in the (per annum) discount rate has a large impact on the liability.

1.56 WGA is prepared in accordance with international accounting standards, which prescribe that the discount rate for pension liabilities should be based on the real yield on corporate bonds. Therefore, the discount rate changes each year to reflect changes in these real yields. An increase in the discount rate lowers the liability because future benefit payments are discounted by a higher amount.

1.57 Over three quarters of the public sector pension schemes liability relates to 4 of the largest (unfunded) schemes - those for the armed forces, civil service, teachers and the NHS. Chart 1.M illustrates how the trend in the discount rate for these schemes compares with the trend in the public sector pension schemes liability over recent years. It shows that the large decrease in the discount rate over 2016-17 corresponds with a rise in the liability, similar to the trend from 2011 to 2015 where three smaller reductions in the discount rate corresponded to three smaller increases in the liability. Conversely, the much smaller increase in the discount rate over 2015-16 corresponds with a small drop in the liability.

1.58 The discount rate for the year 2017-18 (for the central government schemes) has been set at 0.10% pa (a small decrease from 0.24% pa)[13] with individual entities currently preparing their 2017-18 resource accounts. We therefore anticipate an increase of perhaps around £50 billion in the reported public sector pension scheme liability when the 2017-18 WGA is published next year, solely as a result of this change in the discount rate.

Chart 1.M: Discount rate trend



[13] Local government accounts (including local government police and fire accounts) use a different discount rate set by the actuary.

Underlying drivers of the public sector pensions liability

1.59 Annual changes in the discount rate drive changes in the public sector pension liability, but setting aside future CPI growth, the discount rate does not affect the future benefits payable.

1.60 As the liability represents commitments to make future benefit payments to both current and historic workforces the underlying drivers of the liability (besides the discount rate) are the assumptions for CPI growth and salary growth (which affect how much an individual is expected to receive), life expectancy (how long payments are expected to be made for) and workforce size (the number of people expected to receive payments).

1.61 These drivers influence the liability in a variety of ways:

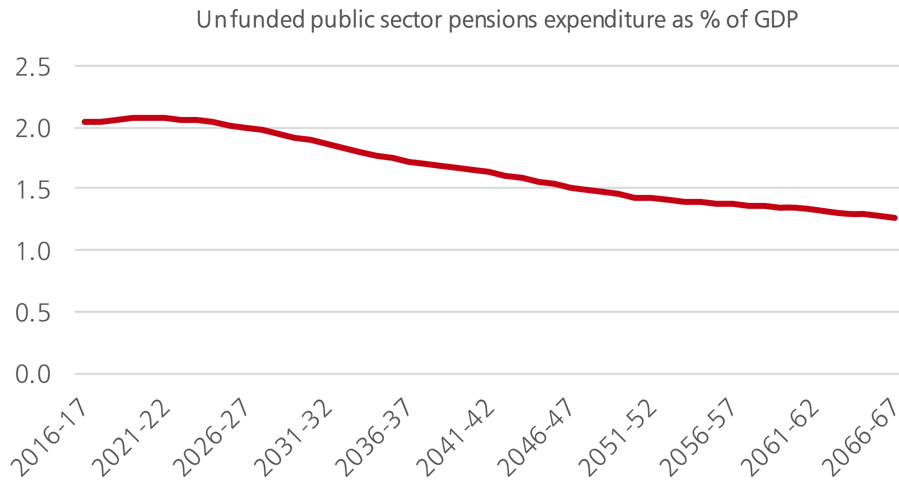
- "Gradual changes" in workforce size over many years (e.g. a reducing civil service or growing health service) can cause trends in the liability as a larger or smaller value is added to the liability each year to reflect the additional pension promised to the workforce for their service that year
- "Step changes" in the liability can occur when the assumptions or data are updated, such as the publication of the ONS population projections used to set life expectancy assumptions. Moving from ONS 2012 to ONS 2014 life expectancy assumptions reduced liabilities by around 2% and may have contributed around £25 billion to the decrease in 2015-16 WGA liabilities
- "Fluctuations" are also caused by changes in the assumptions for salary and CPI growth which, like the discount rate, are set using prescribed accounting standards

1.62 When observed events differ from previous assumptions this can also cause fluctuations in the liability, but these are typically much smaller than those described above. For example, lower salary growth or more deaths over the accounting year than expected can both lead to a reduction in the liability.

Affordability of public sector pensions

1.63 The public sector pension liability given in the accounts is driven by the discount rate adopted, which in turn is driven by bond yields as prescribed by international accounting standards. As the discount rate has no bearing on the future benefits payable, the government focuses on other measures to assess the affordability of the public sector pension schemes and to manage the associated fiscal risks. For example, when monitoring the fiscal implications of the schemes the government considers the OBR's long-term projections of public sector pension scheme expenditure published in their Fiscal Sustainability Reports, which looks at the future benefits payable as a percentage of GDP. Chart 1.N shows the most recent such projection made in the January 2017 Fiscal Sustainability Report.

Chart 1.N: Unfunded public sector pensions expenditure as a percentage of GDP



1.64 This chart shows that spending on unfunded public service pensions is projected to fall gradually from around 2% of GDP to below 1.5% of GDP over the next 50 years. There are various reasons for this fall – including the impact of both historic and recent reforms.

1.65 In recent years, to address the fiscal pressures that will result from an ageing population, to rebalance taxpayer and member contributions and to ensure that the schemes are sustainable, the government has implemented a package of public sector pension scheme reforms to reduce their costs. These reforms included ending final salary pension schemes, aligning normal pension age with the state pension age, increasing member contribution rates and changing indexation arrangements from the RPI to the CPI.

1.66 These reforms built on the more historic reforms implemented midway through the 2000's, the effects of which will also emerge over future decades. With the exception of the police, firefighters and armed forces the reforms set out in the Public Service Pensions Act 2013 generally increased the normal pension age from 60 to 65. The reforms also changed the way benefits accrue and introduced retirement lump sum options to bring more consistency across all the schemes.

1.67 To manage the fiscal risks associated with the public sector pension schemes, alongside the reforms, the government introduced a link between state pension age and life expectancy (which helps manage the risk of increasing costs due to increasing life expectancy, due to the alignment of normal pension age in public sector pension schemes to state pension age) as well as a mechanism to cap the cost of each of the reformed pension schemes. This mechanism is embedded within the regular valuations of the schemes (used to set the schemes' employer contribution rates), which take place on a four year cycle (or three year for the local government pension schemes).[14]

[14] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/289366/public_service_pensions_actuarial_valuations_130314.pdf

Differences between pension liability figures in valuations and accounts

1.68 Although they both reflect the same future benefit payments, the pension liability figures in the regular public sector pension scheme valuations differ from those in the scheme accounts (which are collated to form the WGA). There are two general causes for these differences; firstly, different financial assumptions are used, and secondly, timing practicalities cause differences.

1.69 The valuations of the pension schemes use a different discount rate and different assumptions for CPI and salary growth (known collectively as the "financial assumptions") to the accounts and, as explained above, this causes differences in the liability figures. The financial assumptions used in the accounts are based on market conditions close to the effective date of the accounts, while the valuations use more stable financial assumptions including a discount rate (known as the SCAPE rate) linked to the OBR's expected rate of long-term GDP growth, which is reviewed at least every five years.

1.70 Most other differences in liability figures not caused by different financial assumptions relate to the different timing cycles which apply to accounts (annual) or valuations (every three or four years).

1.71 Calculations for the valuations are based on detailed membership data (which can take up to a year to collect and verify) and demographic assumptions (non-financial assumptions such as when members retire or leave service) set by ministers with input from the Government Actuary Department (GAD) and the scheme's advisory boards. The process of completing valuations generally takes a few years.

1.72 Since the accounts are required on an annual basis they don't use new detailed data or demographic assumptions every year. Instead the latest calculations (often from a previous valuation) are rated up or down to reflect the latest "whole scheme" data (e.g. current total payroll and total pensions in payment etc.) The refreshed data and demographic assumptions from valuations typically feed into accounts up to a few years later so that accounts and valuations for a given year generally use different data and demographic assumptions, even when these are set under the same processes.

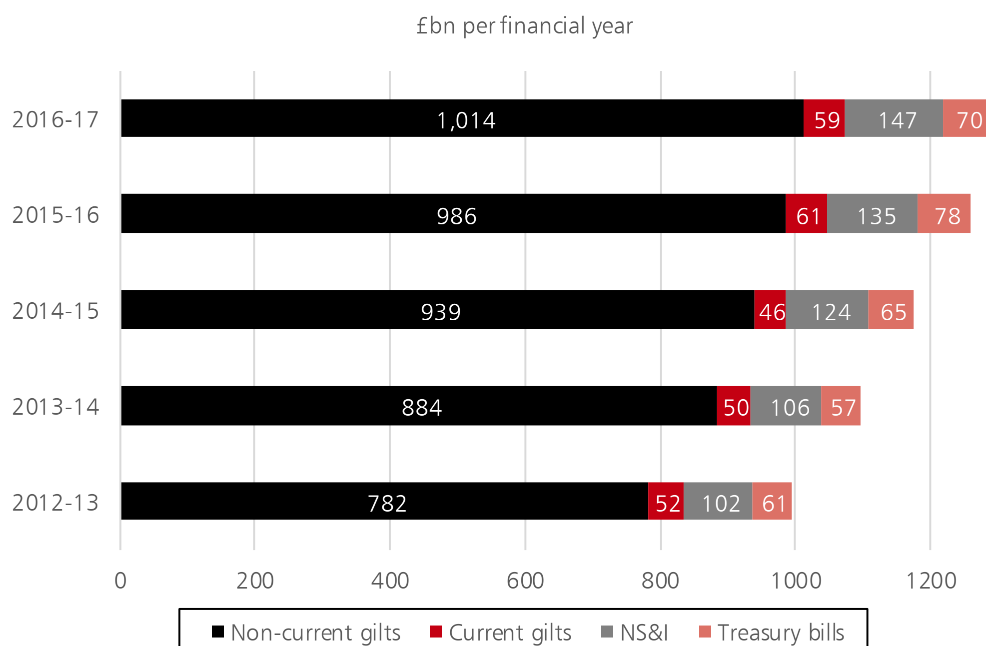
1.73 In assessing the value of future pension liabilities, it is sensible to look at all the information available – the statutory accounts, the OBR forecasts of benefit expenditure as a proportion of GDP as well as the scheme valuations – as no single measure gives the complete picture. Accounts must use international accounting standards common to all accounts, allowing for easier comparison, and use a discount rate that illustrates the amount required that, were it invested in low risk bonds, would be expected to meet the promised benefit payments. Scheme valuations provide a more long-term but less frequent view on the position, often with more up-to-date data, and use a discount rate based on expected long-term GDP growth. The OBR forecasts, however, provide year-by-year expected cashflows rather than a single liability figure and demonstrate the affordability of public sector pension payments in the context of overall public finances allowing for both short-term and long-term expected GDP growth.

Sensitivity to changes in key assumptions

1.74 Note 24 to the accounts includes a table which shows the approximate sensitivity of the unfunded liability to changes in key assumptions. The sensitivity will be broadly similar for the gross liability of the funded schemes.

Government borrowings

Chart 1.O: Long term trends in government borrowing



1.75 The total nominal value of central government wholesale debt (excluding government holdings) as at 31 March 2017 was £1,289.0 billion, up from £1,260.6 billion as at 31 March 2016. The market value weighted average maturity of the portfolio, net of holdings in the DMO increased in 2016-17, from 16.7 years[15] to 17.9 years.[16]

1.76 When setting strategy for government borrowing, a number of risks are taken into account. These include interest rate risks, refinancing risk, inflation risk, liquidity risk and execution risk. Maintaining the relatively long average maturity of government debt was part of an expressed objective to mitigate refinancing risk. Details of the government's debt management strategy and financing plans for 2016-17 were set out in the 'Debt management report 2016-17', HM Treasury, March 2016.[17]

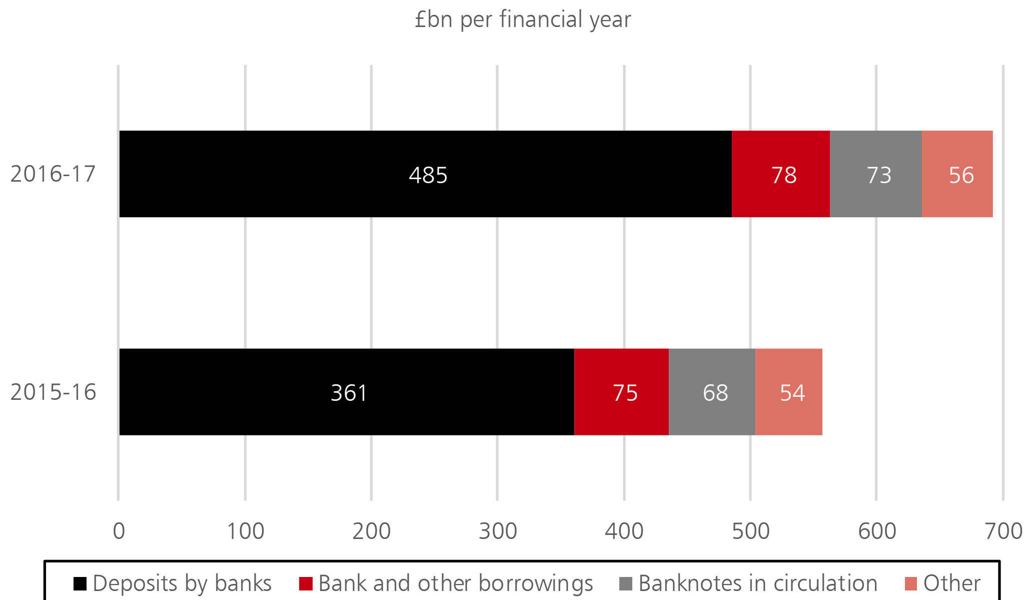
15 https://www.dmo.gov.uk/media/14653/jan-mar16.pdf

16 https://www.dmo.gov.uk/media/15025/jan-mar17.pdf

17 https://www.gov.uk/government/publications/debt-management-report-2016-to-2017

Other financial liabilities

Chart 1.P: Breakdown of other financial liabilities by type



Deposits by banks

1.77 Deposits by banks increased by £124.2 billion (34%), mainly due to an increase in the Bank of England's sterling deposits repayable on demand. The majority of deposits repayable on demand comprise of reserves accounts held at the Bank of England. Reserves accounts are sterling current accounts for banks and building societies. They are the most liquid asset a bank or building society can hold and are the ultimate means of settlement between banks and building societies.

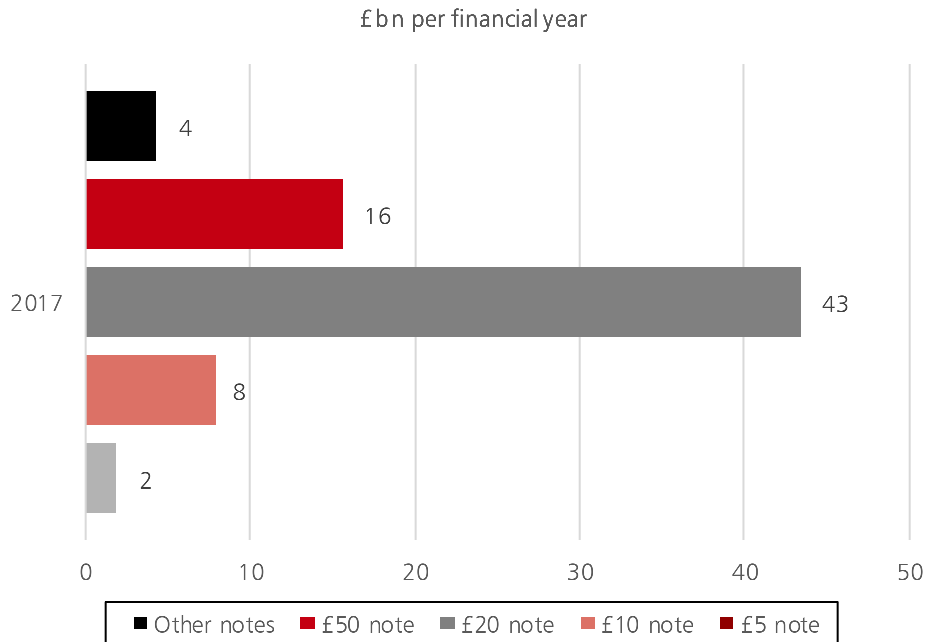
1.78 The supply and rate of remuneration of reserves are part of the framework that keeps market interest rates in line with the Bank Rate. All reserves balances are currently remunerated at Bank Rate.

Bank and other borrowings

1.79 Bank and other borrowings are made up of a number of different bonds and other financial liabilities. The most significant of these relates to Network Rail with £25.8 billion (2015-16: £29.3 billion) of bonds issued under the Debt Issuance Programme. These are bonds issued by Network Rail to finance investment in the rail network. Debt issued under this scheme is guaranteed by the government. The remainder relates to the government's commitment to the International Monetary Fund (IMF) (£17.9 billion) and borrowing by local government.

Banknotes in circulation

Chart 1.Q: Composition of bank notes in circulation



Source: Bank of England Issue Department accounts 2016-17[18]

1.80 Bank notes in circulation increased by 8% to £73.2 billion in 2016-17 and the composition is detailed in Chart 1.Q above.

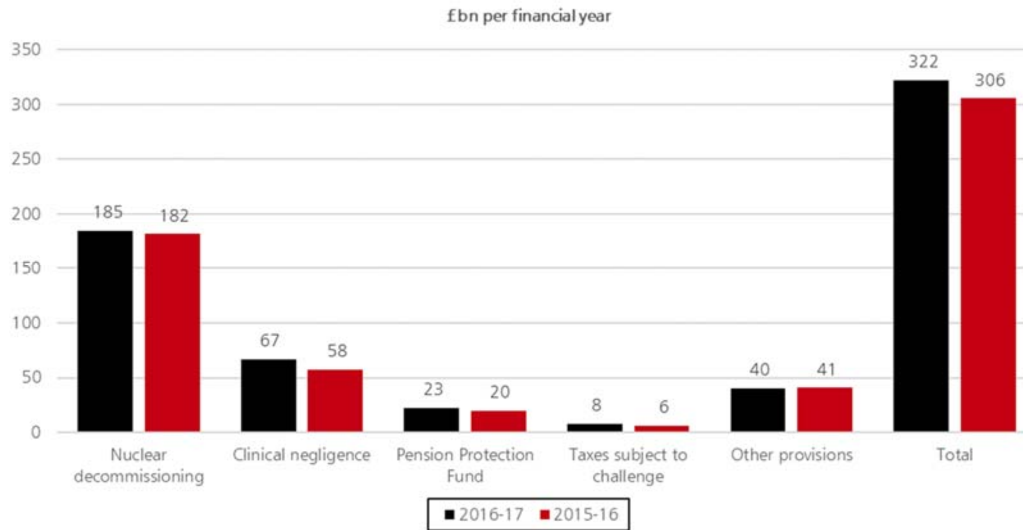
1.81 For accounting purposes coins are treated differently to bank notes as coins are treated as a contingent liability which is disclosed in the accounts of the Consolidated Fund. As at 31 March 2017 the total contingent liability for coins was £4.9 billion (2015-16: £4.6 billion). More information can be found in the accounts of the consolidated fund.[19]

[18] https://www.bankofengland.co.uk/annual-report/2017- Please note that other notes include higher value notes used as banking for the note issues of banks in Scotland and Northern Ireland

[19] https://www.gov.uk/government/publications/consolidated-fund-account-2016-to-2017

Provisions

Chart 1.R: Movement in types of provisions



1.82 The total provisions have increased by 5% to £322.2 billion in 2016-17, mainly due to the increase in the provision relating to clinical negligence. This increase is largely driven by changes in future expenditure.

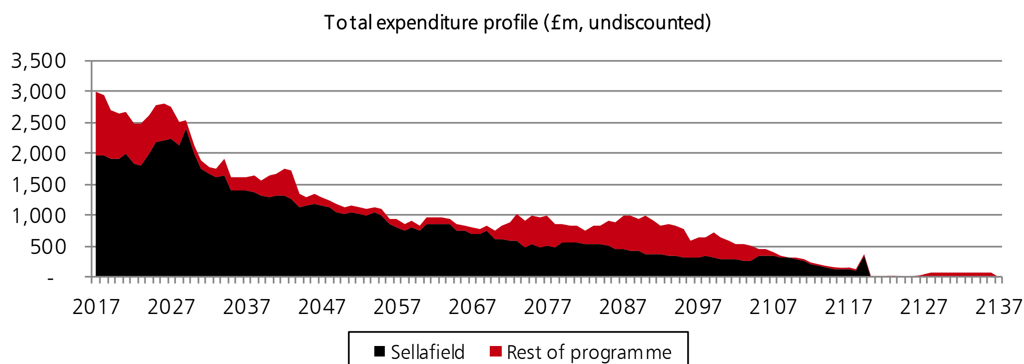
1.83 In 2015-16 the changes in the discount rate (see box 1.D Discount rates on page 47) for provisions resulting in an increase of £125.2 billion, mainly due to the change in the long term discount rate. In 2016-17 there was no change to the long term discount rate and the effect of the changes in short and medium discount rates led to an increase of £10.6 billion. The long term discount rate is updated as part of the Spending Review, and therefore the next update is expected in 2019.

Nuclear decommissioning

1.84 The provision for nuclear decommissioning increased by £3.2 billion, from £181.7 billion in 2015-16 to £184.9 billion in 2016-17.

1.85 Chart 1.S illustrates the expected profile of payouts by the Nuclear Decommissioning Authority (NDA) which total £118.5 billion before discounting and £163.5 billion after discounting, and makes up the largest portion of the total provision of £184.8 billion. The remaining nuclear decommissioning provision of £21.3 billion is held by other bodies, including the Nuclear Liabilities Fund and the Ministry of Defence.

Chart 1.S: Nuclear decommissioning provision: expenditure profile for future years on NDA provision



1.86 The largest element of the government's nuclear decommissioning provision relates to Sellafield which comprises £119.9 billion of the £184.9 billion nuclear decommissioning provision. From 1 April 2016, the ownership of the organisation responsible for managing and operating Sellafield on behalf of the NDA transferred from the private sector to the public sector. This new model enables better planning for the uncertainty that is inherent in handling such a complex site and provides benefits for managing long-term outcomes which extend beyond 2120. The aim is to increase the pace of progress, improve performance, including making use of partnerships with the private sector, and ensure a continued focus on the long-term clean-up mission. The future direction for Sellafield is set out in the Transformation plan.[20]

1.87 The NDA continues to pursue opportunities to both manage and reduce nuclear decommissioning costs through, for example:

- Consolidating storage of nuclear waste and materials in a few sites across the country (rather than have stores on every nuclear site)
- Investing in technology to deal with difficult decommissioning challenges e.g. robotics to cut material in confined spaces
- Clearing old cold-war era nuclear waste stores which are expensive to maintain safely and replacing them with better, modern facilities
- Reviewing end-state standards which determine the extent of long term remediation work required at each site

Clinical negligence

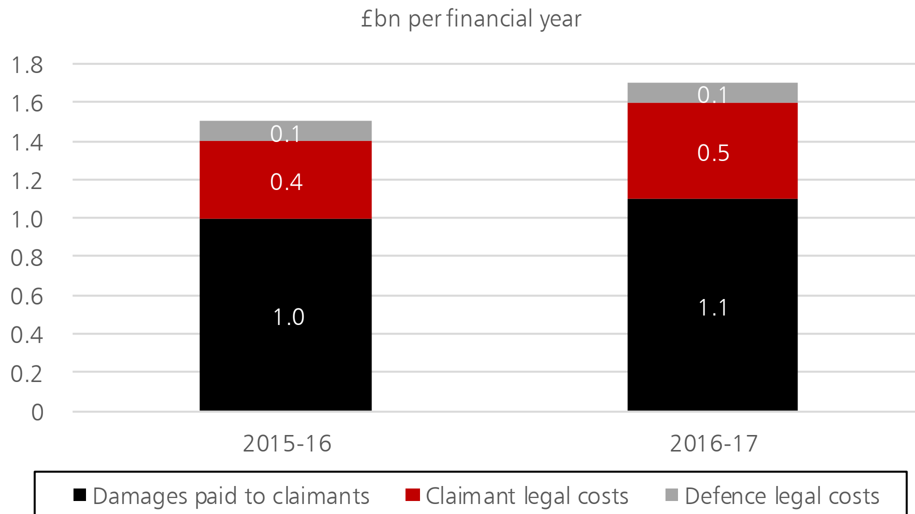
1.88 The provision for clinical negligence increased by £9.0 billion, from £57.6 billion in 2015-16 to £66.6 billion in 2016-17. £7.7 billion of this increase is an increase in expected future payouts (which increases the provision) and there were £1.9 billion of payouts made in year (which reduces the provision). There was also a £5.2 billion increase due to changes in the discount rates, and a £1.8 billion reduction due to provisions not required which were written back. In addition to the provisions recognised on the balance sheet, an amount of £36.5 billion (2015-16: £26.7 billion) in

[20] https://www.gov.uk/government/publications/transformation-plan

contingent liabilities relating to claims that are disclosed as contingent liabilities. These are claims where payment is not deemed likely.

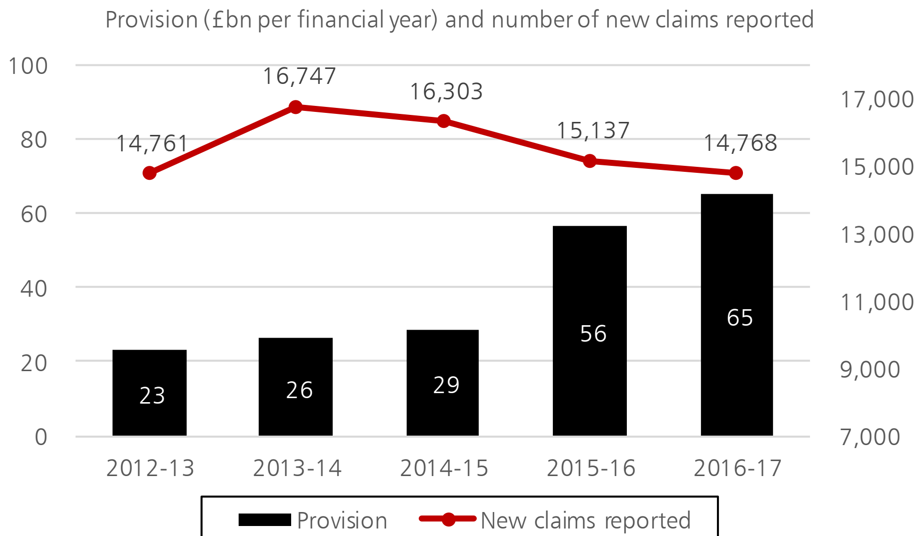
1.89 Chart 1.T shows the composition of payments of £1.7 billion (2015-16: £1.5 billion) made by NHS resolution in 2016-17.

Chart 1.T: NHS resolution payouts in year



Source: NHS Resolution 2016-17 accounts

Chart 1.U: NHS Resolution provision for clinical negligence and number of new claims reported



1.90 NHS Resolution manages clinical and non-clinical claims against the NHS in England and in 2016-17 they recorded a 2.5% decrease in the number of new clinical claims reported compared to the prior year (2016-17: 10,686 claims, 2015-16: 10,965). In addition 4,082 non-clinical claims were received compared to 4,172 in 2015-16. Although the volume of new claims has decreased, the overall value of claims and corresponding provision has increased. The highest value of clinical claims received in 2016-17 was from the speciality area of obstetrics, continuing a year-on-year trend. NHS

Resolution manages £64.7 billion of the £66.7 billion clinical negligence balance.

1.91 The Government continues to focus on actions to reduce patient harm, including harm to users of maternity services. In November 2017, the Government announced plans for a refreshed Maternity Safety Strategy which brought forward from 2030 to 2025 the existing ambition to halve rates of stillbirths, neonatal and maternal deaths, and brain injuries occurring during or soon after birth. This included standardisation of investigating cases of stillbirth, early neonatal death and severe brain injury so that the NHS learns as quickly as possible from what went wrong and shares the learning to prevent future tragedies.

1.92 The Department of Health has also consulted in January 2017 for a mandatory system of fixed recoverable costs for clinical negligence claims below £25,000. As set out in DHSC's consultation response, government has now asked the Civil Justice Council (CJC) to devise a bespoke process and propose a grid of costs; CJC's working group is expected to report later in 2018.

1.93 The rising costs of clinical negligence claims has been considered by the National Audit Office and the Public Accounts Committee, who challenged Government to set out, by September 2018, a coordinated strategy to manage the growth in the costs of clinical negligence. Development of the Strategy is underway.

1.94 In 2015-16 the Government implemented the Statutory Duty of Candour which requires NHS and independent health providers to give accurate, truthful and prompt information when mistakes are made and treatment does not go to plan, including apologising to the patient and offering further support.

1.95 In March 2017 the personal injury discount rate (PIDR) was in accordance with the current framework for setting the rate, with the Ministry of Justice (MoJ) simultaneously announcing a review of the framework. Following this review, including a consultation in 2017, the Civil Liability Bill covering PIDR as well as whiplash reforms was introduced into the House of Lords in March 2018.

1.96 The Lord Chancellor's announcement of the March 2017 change lowered the discount rate return from 2.5% to minus 0.75%, as the current framework is based on returns on the lowest risk investments - an investment portfolio containing only Index Linked Gilts -which had changed over the preceding years.

1.97 Clinical negligence provisions increase each year as additions to the provision from new claims are higher than settlements of old claims, many of which will be settled over a period of several decades.

Box 1.C: Personal Injury Discount Rate (PIDR)

What is PIDR?

The Government Actuary's Department defines the PIDR in the following way: Claimants in personal injury cases may be awarded damages for future losses, for example loss of earnings or future care costs. Damages may be awarded as a stream of payments, as a lump sum or a combination of the two. The PIDR is used to calculate the lump sum that should be payable such that, allowing for investment returns, it represents the value that the claimant would expect to need to replicate the losses.[21]

How is PIDR determined?

The current PIDR is determined in line with the principles set out in law. This states that the claimant should neither be under or overcompensated. The current PIDR is based on the yield on index linked gilts, as these are judged to be very low risk investments.

The PIDR was determined by the Lord Chancellor, acting in accordance with powers under the Damages Act 1996. However, on 30 March 2017 the Ministry of Justice announced a review of the framework under which the rate is set.

Following consultation in September 2017 on a new framework for setting the rate, the Civil Liability Bill covering both PIDR and whiplash reforms was introduced into the House of Lords in March 2018. The key change that the PIDR proposals make is to change the basis for setting the rate to reflect more closely how claimants actually invest their money - in low risk diversified portfolios, instead of in Index-linked Gilts alone. The new framework would also ensure that the rate is reviewed regularly, and involve an expert panel in the reviews.

How has PIDR changed over the last year?

The PIDR changed in March 2017. This affected the provisions recognised as at 31 March 2017. The PIDR changed from 2.5% to minus 0.75%.

What do the changes mean for net expenditure?

A negative discount rate increases the value of provisions recognised in NHS Resolution by £4.7 billion and increases the amount of an individual's payment. This increase also impacts net expenditure.

[21] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/643137/Technical_Bulletin_Personal_Injury_Discount_Rate.pdf

Pension Protection Fund (PPF)

1.98 The PPF provision relates to liabilities to pay compensation to members and claims from pension schemes. The PPF retains the assets of the pension plans it rescues and generates investment growth to support the obligations it acquires. At 31 March 2017, it had net investments of £28.7 billion, £6.1 billion in excess of its liabilities.

1.99 The PPF is funded by a levy on eligible pension schemes, the assets on schemes that transfer to the PPF, recovery of assets from insolvent employers, and income from assets that they hold. In 2016-17, the PPF generated £0.6 billion in levy income (2015-16: £0.6 billion).

1.100 PPF paid £0.7 billion in compensation in 2016-17, with total PPF compensation paid to date rising to £3.0 billion as at 31 March 2017.

Taxes subject to challenge

1.101 Disputes are a normal feature of tax administration, and the vast majority are resolved without the need for litigation. However, HMRC is committed to fighting cases where they believe tax liabilities are due and they have a reasonable chance of success. At 31 March 2017, HMRC's legal claims provisions were £7.8 billion (2015-16: £5.9 billion). Provisions cover cases where the department believes that a settlement payment is likely, having taken legal and other specialist advice. As well as the amounts recognised in the provision, there is a further £18.7 billion (2015-16: £49.1 billion) in contingent liabilities disclosed in the HMRC trust statement. These reflect case where the likelihood of payment is not high enough to allow for a provision to be recognised.

1.102 Decisions in large and sensitive cases are taken within formal published governance procedures involving senior HMRC tax professionals and informed by legal advice.[22] HMRC tracks and report to HM Treasury on cases and issues with significant tax at risk.

1.103 After March 2017 there has been a number of positive judgements for HMRC in cases with significant revenue risk. In a long-running litigation action Littlewoods were contesting compound interest on VAT which was overpaid from 1973 to 2004. The claim was for £1.2 billion, in addition to £268 million statutory interest paid and £205 million VAT reimbursed. HMRC was also exposed to a substantial amount of follower claims with over £17 billion of tax at risk. On 1 November 2017, the Supreme Court ruled in favour of HMRC on the Littlewoods case.

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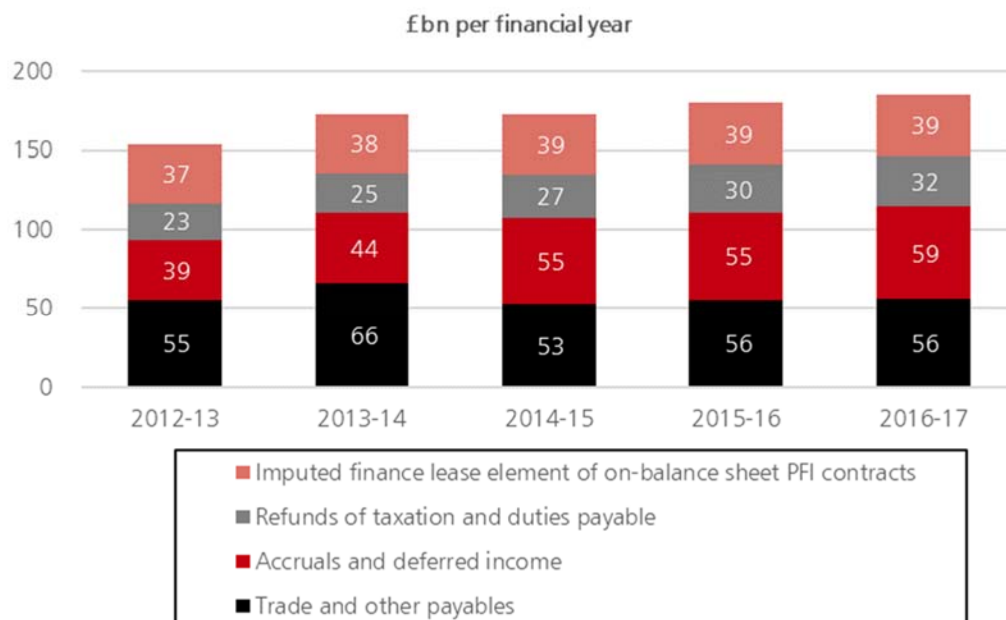
22 https://www.gov.uk/government/publications/litigation-and-settlement-strategy-lss

Trade and other payables

Chart 1.V: Breakdown of payables by type



1.104 Trade and other payables (such as refunds of taxation and duties due) will fluctuate naturally based on underlying expenditure and activity. Since 2012-13 trade and other payables have increased by 21%. Payables have increased by 3% (£5.4 billion) from 2015-16 to 2016-17, consistent with the 2% increase in total expenditure on public services.

1.105 Government is a significant purchaser of goods and services from the private sector, with the 2016-17 WGA showing total purchases of goods and services of £194.8 billion. Prompt payment of suppliers is therefore important, especially when government works with small and medium suppliers, to support the economy. Central government aims to pay 80% of undisputed invoices within five days, with all undisputed invoices paid within 30 days.[23]

[23] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/418724/PPN_05-15_Prompt_Payment_Policy_and_Reporting_of_Performance.pdf

Report on income and expenditure

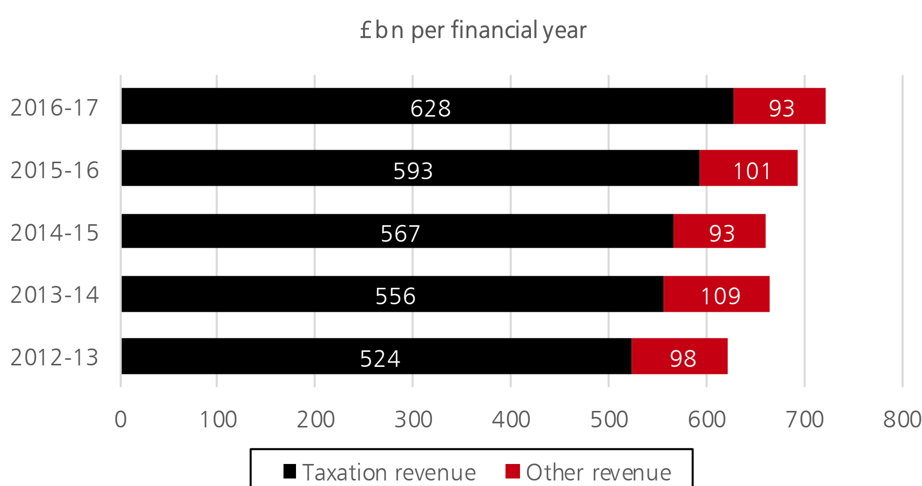
Income

What does government receive from taxes and other income?

The primary source of revenue is **taxation**, making up 87% of total public sector income.

		2016-17 £bn	2015-16 £bn
Taxation revenue	Note 4	628.1	592.6
Other revenue	Note 5	92.7	101.3
Total public services revenue		720.8	693.9

Chart 1.W: Income trends



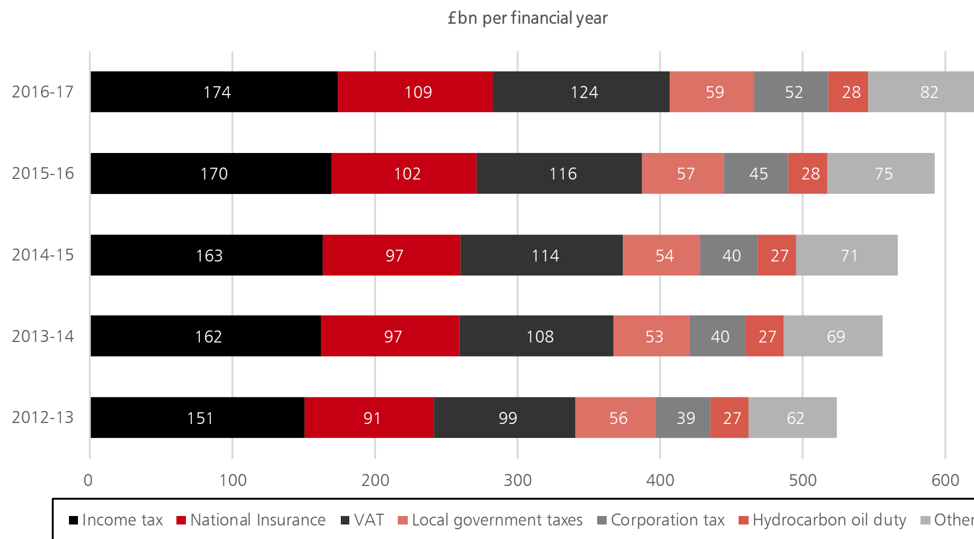
1.106 Over the last 5 years there has been a 16% increase in the total revenue from public services which is analysed in further detail below.

Tax revenue

1.107 The forecasted tax receipts for 2016-17 as set out in the 2016 Summer Budget were £665 billion and the outturn reported by the OBR was £672.2 billion.[24] This is higher than the taxation reported in WGA. The WGA balance is lower as National Insurance Contributions, Value Added Tax (VAT) and business rates paid by the public sector are eliminated and certain levies are included within other revenue. Chart 1.X and the text below is therefore based on the eliminated balance.

24 http://obr.uk/docs/dlm_uploads/Forecast-Evaluation-Report-2017_Web-Accessible.pdf

Chart 1.X: Breakdown of tax revenue by type



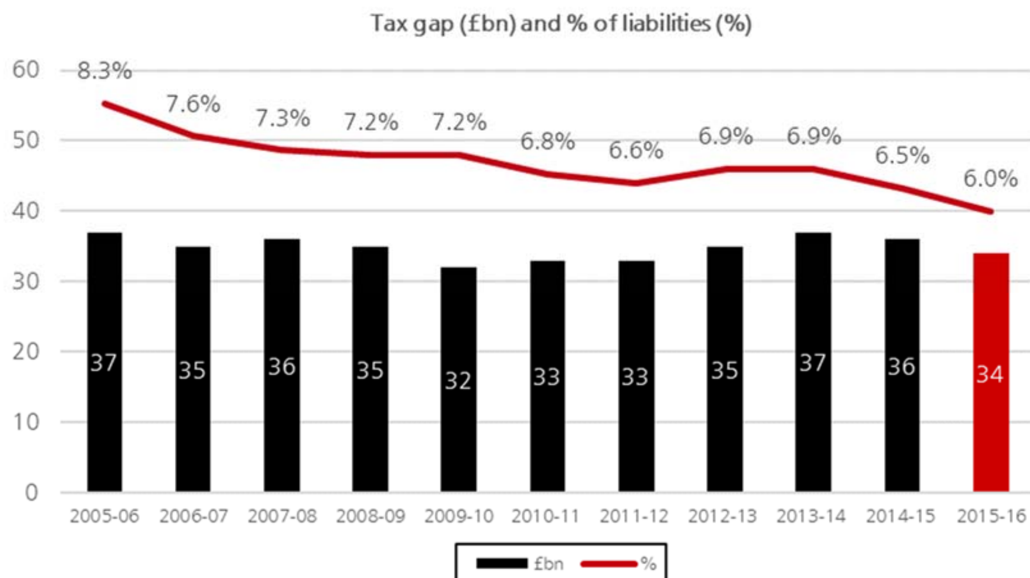
1.108 Taxation revenue increased by 6% compared to the prior year, primarily due to an increase in the overall level of activity in the economy:

- Income tax (28% of tax revenue), and National Insurance Contributions (17% of tax revenue) increased by 3% and 6% respectively, due to higher levels of employment and higher wages
- VAT (20% of tax revenue) increased by 7%, due to increases in receipts for the automotive, business services and utilities sectors as well as higher household spending
- Corporation Tax (8% of tax revenue) increased by 16%
- Hydrocarbon oils (4% of tax revenue) increased by 1%, due to the reduction of pump prices increasing the amounts purchased
- Council Tax and National Non-Domestic Rates (10% of tax revenue) increased by 4% and 3% respectively
- Other taxes (13% of the tax revenue) increased by 9%, partly due to increases in the bank levy and inheritance tax

1.109 A number of other taxes, including stamp taxes, alcohol and tobacco duties, Capital Gains Tax, Inheritance Tax and Air Passenger Duty, accounted for the remaining 13%.

Tax gap and compliance revenues

Chart 1.Y: Tax gap and percentage of theoretical tax liabilities



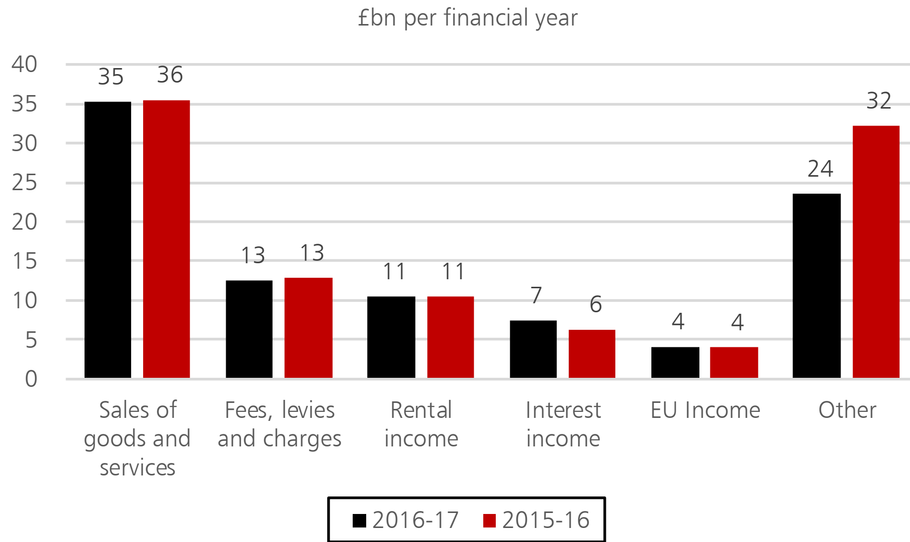
1.110 The tax gap is the difference between the amount of tax that should in theory be collected by HMRC against what is actually collected. HMRC publish an estimate of the tax gap each year. For 2015-16, the latest year that data is available, the tax gap is estimated to be at £34 billion which is 6.0% of theoretical tax liabilities.[25]

1.111 The UK tax gap is one of the lowest in the world and the chart above shows how it has remained at a consistently low level for a decade. There is still an overall downward trend in the tax gap from 8.3% in 2005-06 to 6.0% in 2015-16.

25 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/655097/HMRC-measuring-tax-gaps-2017.pdf

Other revenue

Chart 1.Z: Other revenue



1.112 Government provides a number of services for which it charges a fee. As well as this, income is recovered through penalties and fines and a variety of other sources. Further breakdowns are provided in Note 5 to the accounts.

1.113 In 2016-17 the total other revenue decreased to £92.7 billion compared to £101.3 billion in 2015-16. In 2015-16 there was a significant profit on disposal of assets of £6.3 billion, which became a loss on disposal of £2.1 billion in 2016-17. £6.2 billion of the 2015-16 profit and £1.1 billion of the 2016-17 loss was generated by HM Treasury, due to their sale of shares in Lloyds banking group and RBS shares. These shares were bought to ensure financial stability at the height of the financial crisis and not to make a profit. Of an initial intervention of £20.3 billion, £21.2 billion was returned to the taxpayer through share sales and dividends.

1.114 EU income is mostly recognised in the accounts of the Department for Environment, Food and Rural Affairs (DEFRA).

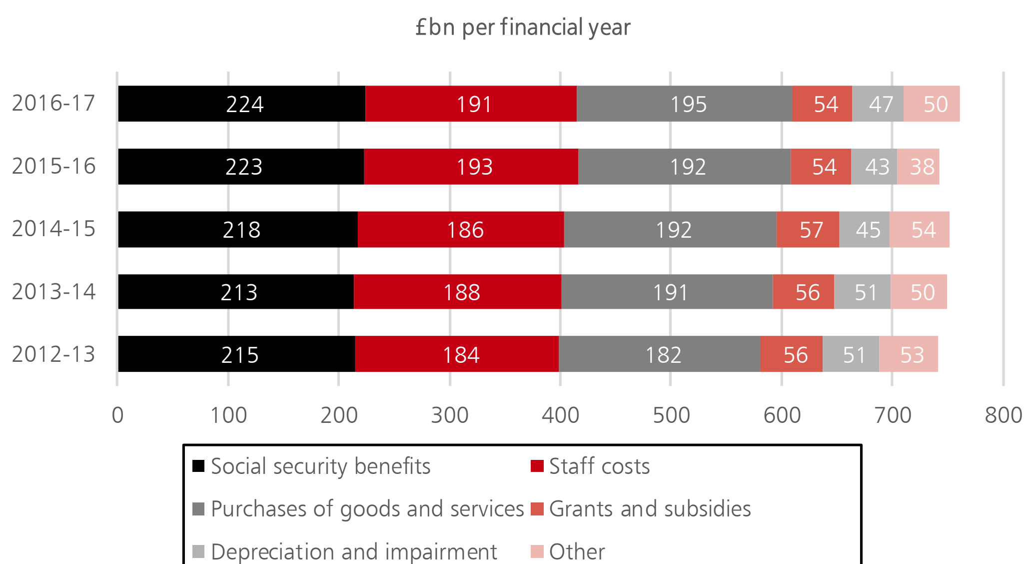
Expenditure

What does government spend on providing services and running costs?

The most significant elements of expenditure were **social security benefit payments**, **goods and services** purchased to meet operational requirements, and the **cost of employing staff** in the public sector.

		2016-17 £bn	2015-16 £bn
Social security benefits	Note 6	223.7	222.5
Staff costs	Note 7	191.1	193.3
Purchase of goods and services	Note 8	194.8	192.1
Other operating expenditure	Notes 9 and 10	100.7	96.8
Interest costs on government borrowing	Note 11	31.8	28.3
Increase in provisions	Note 22	18.6	9.2
Total expenditure on public services		760.7	742.2

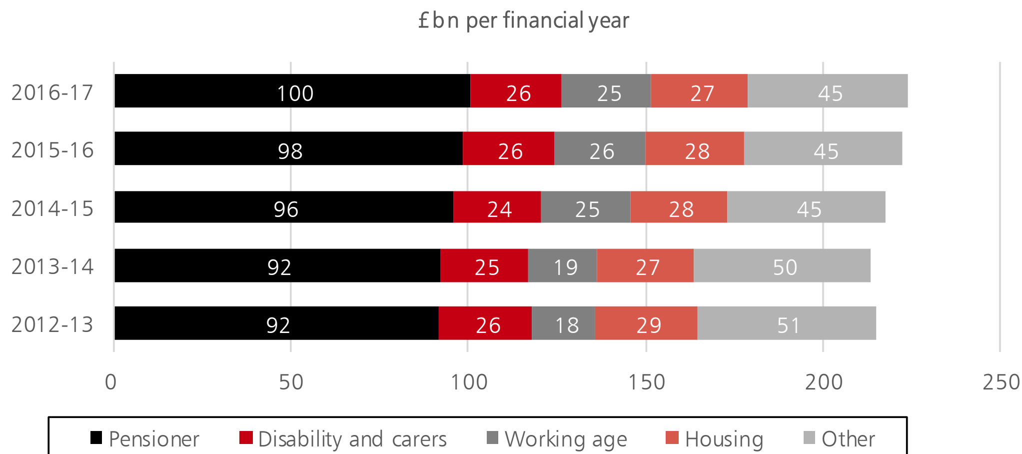
Chart 1.AA: Expenditure trends



1.115 Total expenditure on public services has increased by 3% over the last 5 years.

Social security benefits

Chart 1.BB: Breakdown of social security benefits



1.116 Government spending on social security benefits increased by 1% in 2016-17 compared with 2015-16.

1.117 Increases in pensioner benefit spending reflect both demographic trends and the government's policy of increasing state pensions every year by the highest of price inflation, earnings growth, or 2.5% (the 'triple lock').

1.118 The rising prevalence of mental health conditions and learning difficulties, particularly at younger ages, has been an important driver of the rising disability benefits caseload and the rising proportion of incapacity benefit claimants that are being placed in the support group of Employment and Support Allowance (which is more expensive to the exchequer than the alternative work-related activity group).

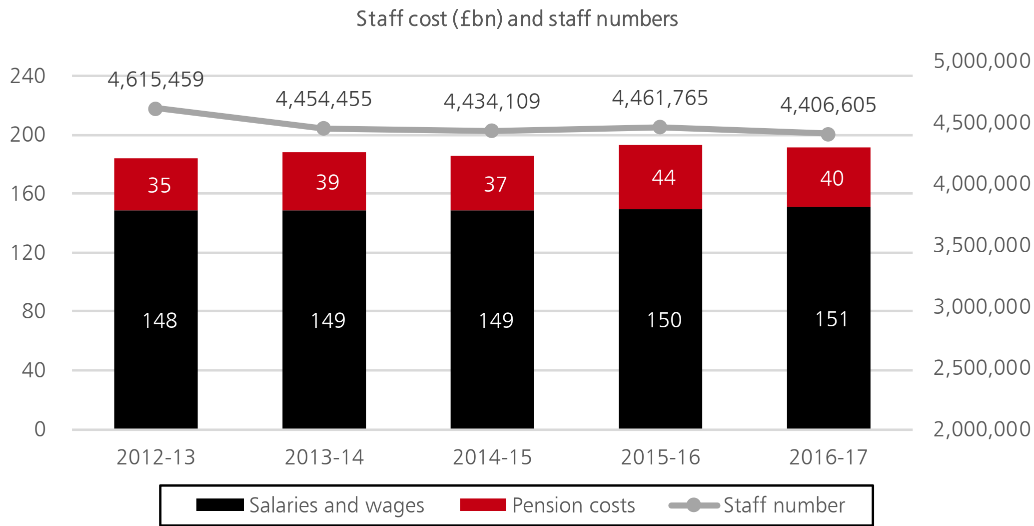
1.119 The two largest areas of spending, employment and support allowance (and its predecessor incapacity benefit) and the personal independence payment (and its predecessor disability living allowance) are the subject of ongoing reforms.

1.120 The overall increase in social security benefit spending in 2016-17 was consistent with the longer term trend on benefit expenditure as set out in Chart 1.BB. There has been a £8.7 billion (4%) increase in benefit expenditure over the past 5 years.

1.121 The government is also reforming the working age welfare system with the introduction of Universal Credit (UC). UC is designed to ensure that work always pays and Department for Work and Pensions (DWP) evidence suggests it is already yielding positive results: study showing UC claimants are 4 percentage points more likely to be in work within 6 months than equivalent Jobseeker's Allowance claimants.

Staff costs

Chart 1.CC: Staff costs and staff numbers trends



1.122 Staff costs comprises expenditure on salaries and wages of £151.0 billion (2015-16: £149.6 billion) and expenditure on pensions of £40.1 billion (2015-16: £43.7 billion).

1.123 Salaries and wages have shown a slight increase of 1% or £1.4 billion in comparison to 2015-16. The 1% public sector pay policy continued to apply in 2016-17. As a result of this policy the overall cost of salaries and wages have remained relatively stable over the last five years.

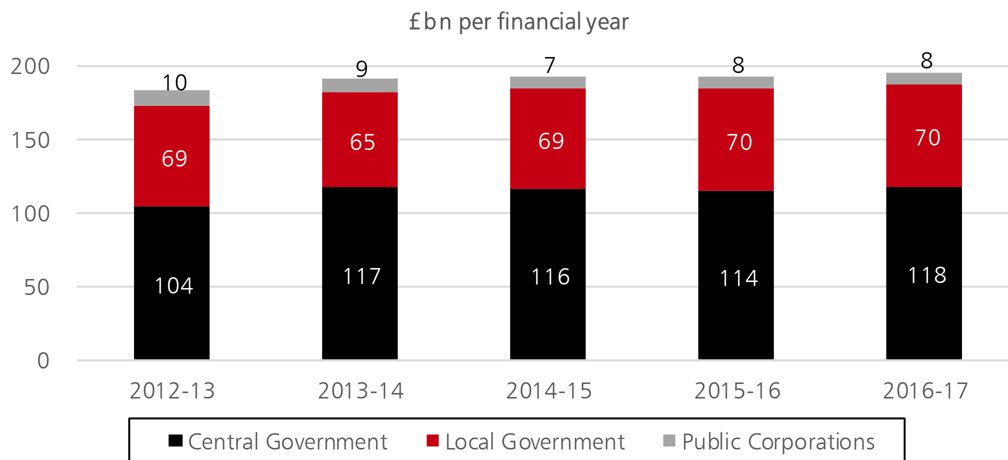
1.124 In September 2017 the government announced a more flexible approach to public sector pay to apply in 2018-19, where this can be justified on the grounds of affordability, recruitment and retention, or in return for improvements to public sector productivity.

1.125 Further details on staff costs and numbers are included in the Remuneration and staff report in Chapter 4.

Purchase of goods and services

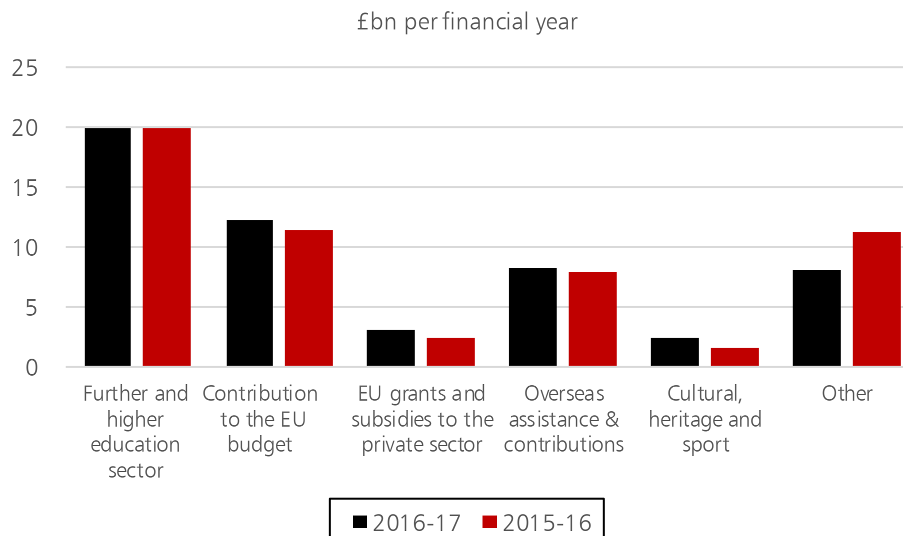
1.126 Purchases of goods and services has increased slightly by £2.7 billion, or 1.4%, from 2015-16 to 2016-17. One of the challenges with WGA is getting a more in-depth breakdown of this balance as the level of detail provided by bodies included in the consolidation is very variable. Along with the timing of the account, this is a key area for development in future years. This year's WGA includes an analysis of total expenditure on public services by objective or outcome as well as country and region in the Overview to this chapter. It also includes a segmental analysis of purchase of goods and services in Note 3 to the accounts.

Chart 1.DD: Segmental analysis of purchase of goods and services



Grants and subsidies

Chart 1.EE: Grant expenditure



1.127 WGA excludes grants paid by bodies within WGA to other bodies within WGA (for example a grant from a central government department to a local authority would be excluded). Further and higher education (which are classified as private sector by ONS and therefore outside of the WGA boundary) institutions are the largest recipients of grants, followed by net contributions to the EU.

Interest costs on government borrowing

1.128 The cost of servicing government debt increased by £3.5 billion or 12%, whilst at the same time the stock of government debt increased by £28.4 billion or 2%. The effective interest rate in 2016-17 was 2.5%, which is slightly higher than the 2015-16 rate of 2.3%.

1.129 Debt interest costs as a share of total receipts increased from 4.1% in 2015-16 to 4.4% in 2016-17. The interest costs exclude interest that is paid on gilts held by the Bank of England as part of its quantitative easing programme. Interest paid on debt held by the Bank of England is eliminated on consolidation as both parties to the transaction are within the WGA boundary. This reduces interest costs recognised in WGA by around a third.

Financing long-term liabilities

What does government pay to finance its long-term liabilities?

The government recognises expenditure when estimating the value of liabilities which will be paid in the future.

		2016-17 £bn	2015-16 £bn
Provision financing costs	Note 11	9.3	127.9
Pension financing costs	Note 11	50.5	52.1
Other finance expense	Note 11	8.5	7.4
Total financing costs of long-term liabilities		68.3	187.4

Valuing long term liabilities

1.130 Some of the government's operations result in liabilities that are very long-term and will involve cash outflows over decades to come. Examples include the costs of carrying out nuclear decommissioning and the costs of public sector pensions. The amount that will be paid out to settle these liabilities is uncertain, yet WGA must present a single number in the accounts as a best estimate. Estimating the amount that will be paid out involves a number of assumptions, the most significant of which are described in the critical accounting policies in Note 2 to the accounts.

The effect of the discount rate

1.131 The discount rate for pensions is updated annually by HM Treasury. In 2016-17 the rate net of CPI decreased from 1.37% to 0.24% reflecting reduced yields on corporate bonds and increased market expectations of inflation. The £424.7 billion revaluation loss on pensions was primarily caused by the impact of the reduction in discount rate while other changes in assumptions contributed much smaller.

1.132 A significant impact of financing pensions in WGA is the effect of unwinding the discount each year as the future stream of payouts gets a year closer. For provisions, this effect is relatively modest however for pensions the effect is much more significant and resulted in £50.5 billion of expenditure in 2016-17 (2015-16: £52.1 billion).

1.133 In 2015-16, the long-term provisions discount rate was updated by HM Treasury for the first time since 2003-04 and decreased from 2.2% to negative 0.8%. This increased the value of the existing provisions in today's prices by £125.2 billion without impacting the amount that the government actually expects to pay to settle its provisions. The long-term discount rate was not updated in 2016-17 and the next update is expected to be 2019.

1.134 Box 1.D on the following page provides more information on discount rates while the liabilities section of the report on assets and liabilities provides further information on the affordability of long term liabilities.

Box 1.D: Discount rates

What is discounting?

Government accounting follows IFRS.

In general, IFRS tries to measure assets and liabilities at exit values, which is the price at which the asset could be sold or a liability could be settled at today. To estimate this, expected future cash flows that will be earned from assets or paid out to meet liabilities are discounted to reflect the time value of money for investors.

Future cash flows are discounted because cash received today can be used to buy low risk assets that earn a return and mature when the money is needed for payment. The discount rates used are adjusted for inflation.

Any changes to the discount rate affect the value of assets and liabilities on the balance sheet even though the estimates of future cash flows are unchanged.

How are discount rates determined?

Public sector pensions

IFRS requires that pension liabilities are discounted based on the yields of high quality corporate bonds. For unfunded schemes the discount rate is set by HM Treasury using an index of corporate bond yields, with an adjustment to reflect that pensions are uprated by the CPI and not the RPI. For funded schemes the discount rate is determined by the actuaries for individual schemes using a market rate for high quality corporate bonds.

Provisions

Provisions are discounted at a risk-free rate, which is taken to mean the return on government gilts adjusted for inflation. Three rates are set by HM Treasury to reflect different maturities - short, medium and long term. Short and medium term rates are updated annually. The long term rate was updated in 2015-16 following the Spending Review.

Student loans

Future cash flows are discounted at the government's long term cost of borrowing. The rate is updated at each Spending Review.

How have discount rates changed over the last year?

The applicable discount rates are set out below. With the exception of local government rates for pensions, they have all been adjusted for inflation:

	Central government %		Local government %	
Section	2016-17	2015-16	2016-17	2015-16
Public sector pensions	0.24	1.37	2.4 - 3.6 nominal	2.7 - 4.0 nominal
Provisions:				
Short term	-2.70	-1.55	-2.70	-1.55
Medium term	-1.95	-1.00	-1.95	-1.00
Long term	-0.80	-0.80	-0.80	-0.80
Student loans	0.70	0.70	-	-

What do the changes mean for net expenditure?

Public sector pensions

The large decrease in the discount rate has the effect of increasing the pension's liability and significantly contributed to the loss on revaluation which is recognised in Other Comprehensive Income.

The only effect on net expenditure is an expense for unwinding the discount as all future cash flows are one year closer to payment. In 2016-17 this discount rate unwind resulted in an expense of £50.5 billion.

Provisions

The decreases in the short and medium term discount rates resulted in the value of future payouts in today's prices increasing by £10.6 billion. This has been recognised within net expenditure.

Student loans

There was no change in the applicable discount rate and therefore no impact on net expenditure.

Other key matters

Contingent liabilities

What contingent liabilities does government have?

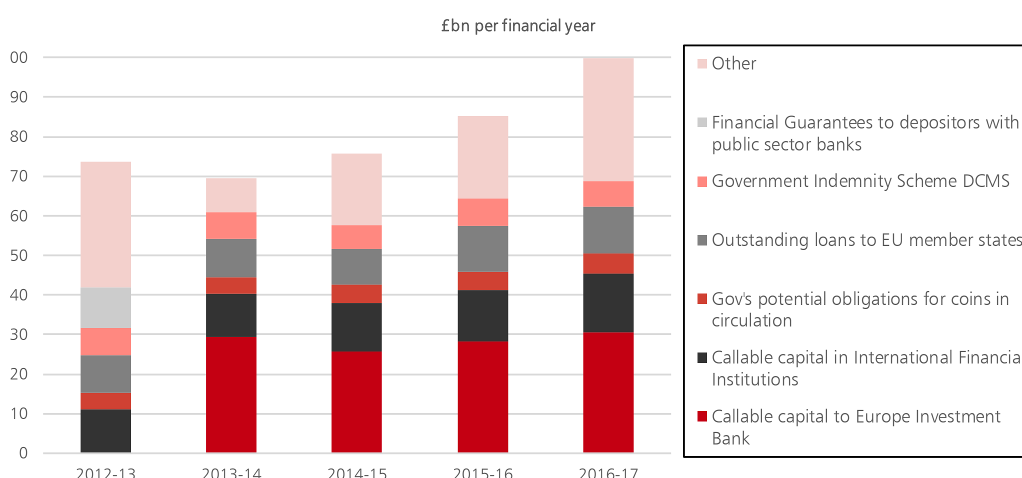
The government has quantifiable and non-quantifiable contingent liabilities and these are classified as remote and non-remote (disclosed under IAS37).

		2016-17 £bn	2015-16 £bn
Contingent liabilities disclosed under IAS37	Note 29	84.0	104.3
Remote contingent liabilities reported to Parliament	Note 30	99.8	85.3
Total quantifiable contingent liabilities		183.8	189.6

1.135 In the past five years, total quantifiable contingent liabilities (remote and non-remote) have increased from £161.5 billion in 2012-13 to £183.8 billion in 2016-17, driven by a rise of £26.2 billion in the remote contingent liabilities. The same period has seen a fall of £3.9 billion in the non-remote contingent liabilities, which are more likely to crystallise.

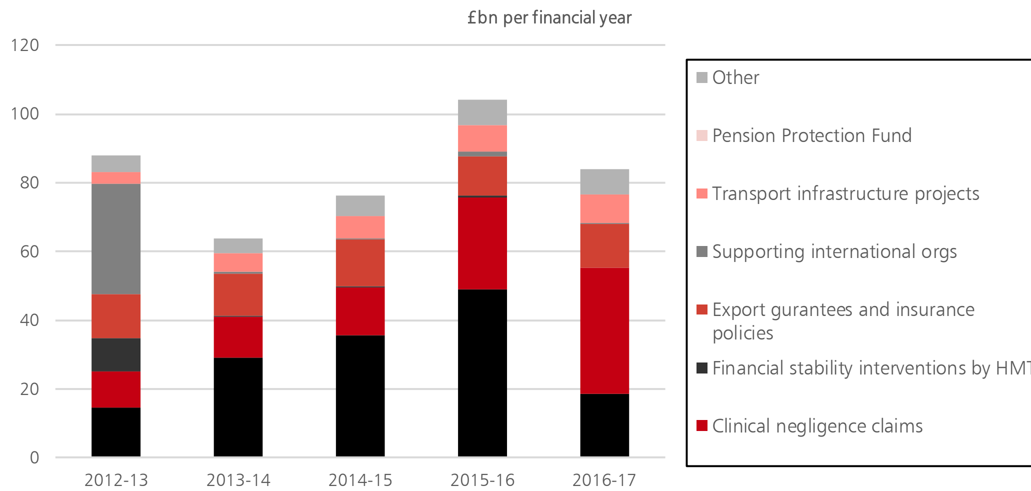
1.136 The 36% increase in remote contingent liabilities over the past 5 years is mainly the result of the potential liability relating to the callable capital to the European Investment Bank (2016-17: £30.5 billion), which moved from a non-remote contingent liability to a remote contingent liability in 2013-14 as the likelihood of member states being called upon to pay the remaining capital was judged to be remote.

Chart 1.FF: Remote contingent liabilities by type



1.137 In non-remote contingent liabilities, the decrease due to the reclassification mentioned above, was offset by the increases in contingent liabilities relating to clinical negligence claims and taxes subject to challenge as can be seen in Chart 1.GG.

Chart 1.GG: Non-remote contingent liabilities by type



1.138 Where the time value of money is material, contingent liabilities which are required to be disclosed under the terms of the accounting standards are stated at discounted amounts. The changes in the long term discount rate and the Personal Injury Discount Rate have been the main contributing factor in the £26.0 billion (37%) increase in the clinical negligence contingent liabilities over the period shown.

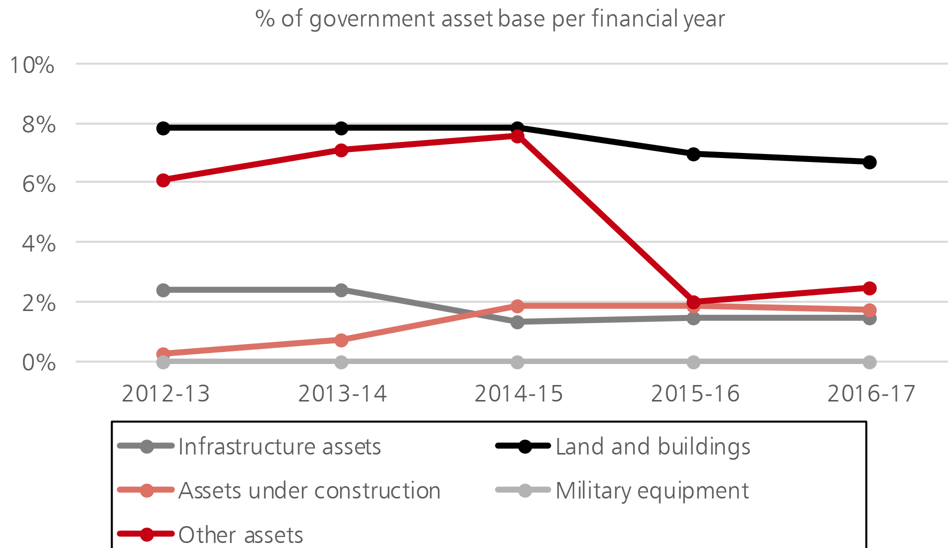
1.139 The level of contingent liabilities relating to taxes subject to challenges has fluctuated significantly over the period and overall increased by £4.2 billion (29%) since 2012-13. The fluctuations are due to the revision and reclassification of estimates for cases currently in litigation, taking into account court decisions during the year and interest that would be payable on final settlements.

1.140 In addition to the quantifiable contingent liabilities, the government has entered into a number of contingent liabilities where the size of the liability could either not be determined with reasonable certainty or to quantify it would jeopardise the outcome of any legal proceedings. The details of the most significant non-quantifiable contingent liabilities are included in notes 29 and 30 to the financial statements.

PFI

1.141 PFI was introduced to bring private sector investment into public infrastructure. PFI assets make up a small but important part of the government's asset base.

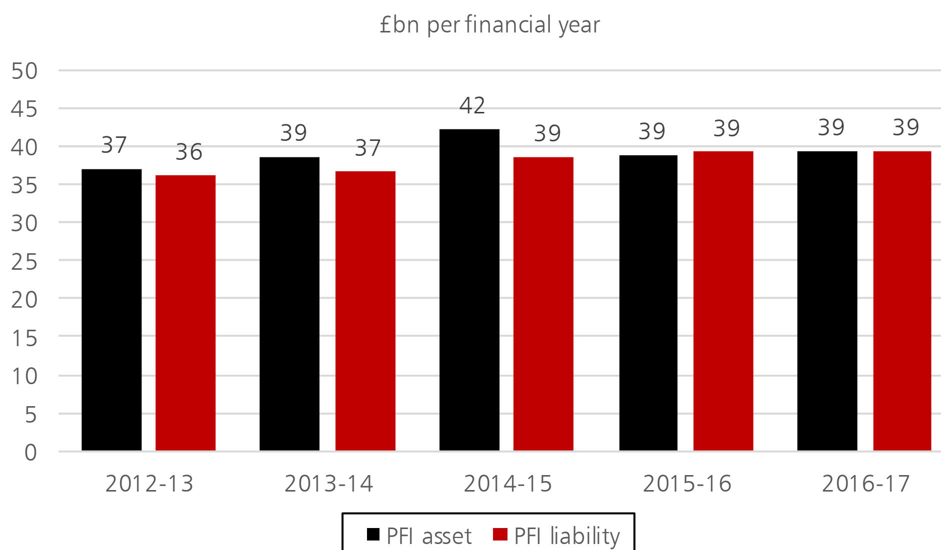
Chart 1.HH: PFI assets as a percentage of the government asset base



1.142 PFI assets are paid for in instalments. The charge covers the cost of the asset, an interest charge to reflect the financing of the asset, and a service charge for ongoing maintenance and use of the asset. At the end of the term the ownership of the asset reverts to government.

1.143 The asset is counterbalanced by a liability on the Statement of Financial Position. This reflects the financing for the asset. Chart 1.II shows total PFI assets and liabilities recognised in WGA.

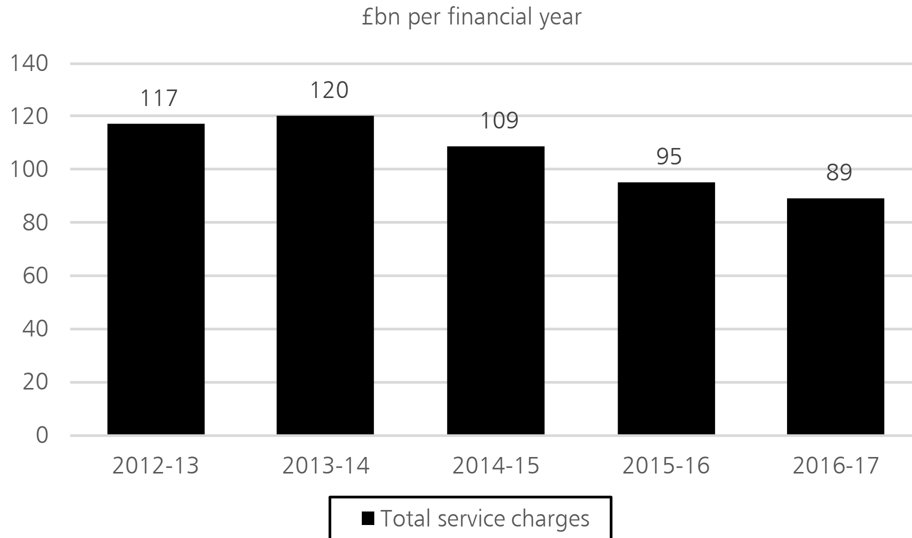
Chart 1.II: PFI assets and liabilities



1.144 The third aspect of PFI contracts are service charges. These are the costs of maintaining the purchased assets and are recognised as they fall due.

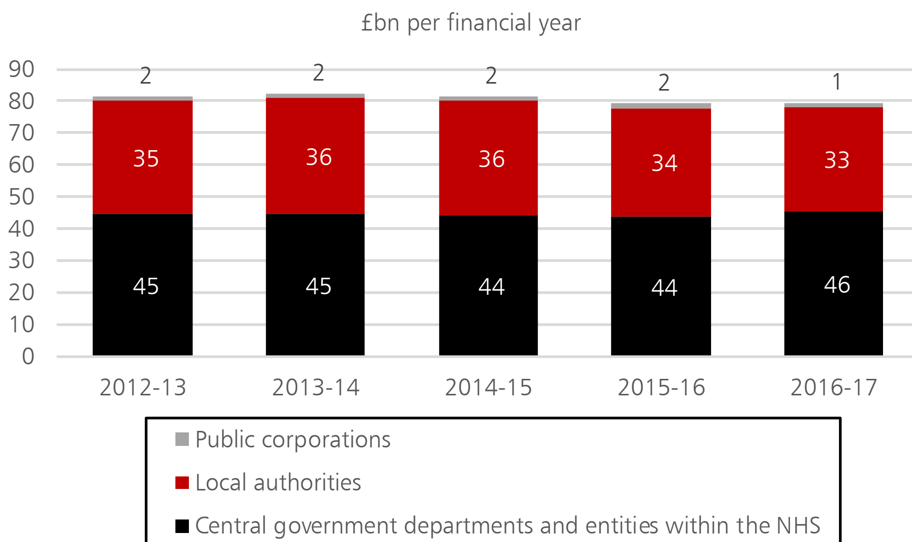
However, WGA discloses the total commitment as these costs represent a contractual commitment. They are not recognised on the Statement of Financial Position because the services that trigger these payments have not been delivered yet.

Chart 1.JJ: PFI service charge commitments



1.145 PFI contracts are used throughout government. The split between central government (including NHS), local government and public corporations is given Chart 1.KK.

Chart 1.KK: Split of PFI obligations by sector



1.146 Since 2012, the government has used PF2 instead of PFI. PF2 is considered for new capital projects and is used where it presents good value for money and where it is appropriate. The PF2 model has improved transparency, reduced procurement times and improved the flexibility of private finance contracts. So far, it has been used for 6 schemes with a capital value of around £1.0 billion.

1.147 The 2017 summary data reported in the Private Finance Initiative and Private Finance 2 report indicates that as at 31 March 2017, there were 715 current PFI and PF2 projects. 699 projects were Operational and 16 were in construction. Of these projects 631 were signed before May 2010 and have a capital value of £50.6 billion (86% of the total). There are only 4 PF2 projects in the portfolio.[26]

Fraud, error and debt

Fraud and error in the welfare system

Table 1.E: Reported rates of fraud and error

		2016-17	2015-16	2014-15	2013-14	2012-13
DWP	Overpayments as a percentage of benefit payments	2.0%	1.9%	1.8%	2.1%	2.1%
	Net overpayments after recoveries have been offset	1.4%	1.2%	1.2%	1.5%	1.6%
HMRC	Fraud and error as a percentage of finalised personal tax credits entitlement	X[a]	5.5%	4.8%	4.7%	5.3%

a 2016-17 data not available at time WGA was prepared

1.148 Overpayments of Welfare and Tax Credits are considerable components in the measurement of fraud and error expense within central government. Overpayments of Welfare are predominantly from means-tested benefits administered by DWP; Tax Credits are administered by HMRC.

1.149 Levels of fraud within DWP and HMRC rose in 2016-17. DWP saw a rise from 1.9% to 2.0% of fraud and error overpayments which reflects a monetary value of around £3.6 billion. Recoveries by the department and local authority during the same period were around 0.4% which reflects a monetary value of around £1.1 billion.

1.150 DWP's long term fraud, error and debt strategy reveals new focus on some critical commitments for success in areas of empowerment for claimants, internal promotion, robust interventions, risk based approaches, optimal use of own data and the shaping of the organisation.

1.151 HMRC have accounted a rise in fraud and error value from 4.8% in 2014-15 to 5.5% in 2015-16 reflecting a monetary value of £1.6 billion of expenditure (2014-15: 4.8% of expenditure or £1.4 billion).

26 https://www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2017-summary-data

1.152 HMRC will continue to develop insight into the different error and fraud risk groups, using a range of data sources to select the right cases for action, sharing their Prevent and Respond agenda and delivering large scale checks on those cases where HMRC believe the award could be wrong.

Management of debt owed to government

1.153 Government's trade and other receivables totalled £173.2 billion as at 31 March 2017 and a more detailed breakdown of this balance can be found in Note 15 to the financial statements. The majority of debt is paid on time and at the reporting date an estimated £22.5 billion was overdue. Around 99% of overdue debt is held by HMRC, DWP and the Ministry of Justice. Debt owed to these departments includes overdue tax liabilities, benefit or tax credits overpayments, outstanding fines and court confiscation orders. Government losses from write offs and remissions totalled around £4.5 billion.

1.154 The government is implementing a cross-government debt management strategy, which sets out a more consistent and strategic approach to debt management. One example of this is the transfer of tax credits debt from HMRC to DWP for claimants who have moved to Universal Credit. Government is also starting to develop a Debt Centre of Excellence, to improve the quality outcomes for government debt management and collection, build resilience across government, and to ensure the efficient use of scarce resources.

1.155 Debt is an asset that can depreciate over time. The benefit of good debt management is that it can maximise the value of the asset. The Debt Market Integrator (DMI) is a procurement-free way to increase government debt management capacity and capability through private sector engagement. The DMI is a joint venture company that manages debt collection agencies, analytics providers and the enforcement and litigation agencies on behalf of government.

EU withdrawal

1.156 On 29 March 2017 the UK government submitted notification to leave the EU in accordance with Article 50 of the Treaty on European Union (Article 50). Negotiations are underway and on 19 March 2018 the UK and EU negotiators published a draft withdrawal agreement, which translated the Joint Report on progress during the first phase of negotiations into a draft legal text.

1.157 Information on the EU exit and its effects on the WGA have been included in Note 30: Remote contingent liabilities reported to parliament and Note 31: Events after the reporting period in the notes to the accounts.

1.158 HM Treasury is working with all departments to establish their funding requirements to effectively prepare for EU Exit. At Budget 2018 the Chancellor announced £3.0 billion of additional funding. Over £1.5 billion of this was allocated to government departments for EU exit preparatory work

for 2018-19. Details of this were set out to Parliament by the Chief Secretary to the Treasury.[27]

Box 1.E: EU Withdrawal: the financial settlement

The UK formally notified the EU of its intention to leave the Union by triggering Article 50 on 29 March 2017. The terms on which the UK will leave, including any financial settlement payable by the UK towards commitments and liabilities that the EU entered into when the UK was a member state, will be determined by the withdrawal agreement under Article 50 and become legally binding when ratified. The negotiations are ongoing.

On 8 December 2017, the UK and EU negotiators published a Joint Report on progress during the first phase of the negotiations. The report covered the components of the financial settlement and the principles for their valuation. In January 2018, the Chancellor of Exchequer wrote to the Treasury Select Committee outlining the details of the agreement in the Joint Report and setting out a reasonable central estimate of the value of the settlement of £35-39bn (€40-45bn).

On 19 March 2018, the UK and EU negotiators published a draft withdrawal agreement, which translated the Joint Report into a draft legal text.

On 20 April 2018, the National Audit Office published a report on the financial settlement. The NAO's report assessed the reasonableness of this estimate and identified issues for the Treasury to consider in managing the risks attached to the settlement.

Events since 31 March 2017

1.159 Since the accounts of the individual entities that form WGA were prepared, there have been a number of events that could have a bearing on the Statement of Financial Position as at 31 March 2017. These events are shown in Note 32 to the accounts.

James Bowler

Accounting Officer

19 June 2018

[27] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-03-13/HCWS540/

Chapter 2

Statement of Accounting Officer's responsibilities

2.1 Under section 9 of the Government Resources and Accounts Act 2000 (the GRAA), HM Treasury is required to prepare, for each financial year, a consolidated set of accounts for a group of entities, each of which appears to HM Treasury:

- to exercise functions of a public nature
- to be entirely or substantially funded from public money

2.2 The account is prepared on an accruals basis and in accordance with the GRAA and the 2016-17 Government Financial Reporting Manual (FReM) which applies EU adopted International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector. The accounts must give a true and fair view of the whole of government's finances.

2.3 In preparing the accounts, the Accounting Officer is required to comply with the requirements of the FReM, and in particular to:

- observe the relevant accounting and disclosure requirements and apply suitable accounting policies on a consistent basis
- make judgements and estimates on a reasonable basis, including those judgements involved in consolidating accounting information provided by different sectors
- state whether applicable accounting standards, as set out in the FReM, have been followed, and disclose and explain any material departures in the accounts
- prepare the accounts on a going concern basis

2.4 In addition to these responsibilities, and specifically with regard to Whole of Government Accounts (WGA), the Accounting Officer is responsible for:

- drawing up WGA in accordance with the GRAA
- ensuring that WGA complies with the FReM and generally accepted accounting practice
- agreeing the process of producing WGA and for ensuring that relevant data are collected and accurately and appropriately processed
- ensuring that there is an appropriate control environment for the production of WGA

2.5 The responsibilities of an Accounting Officer are set out in Managing Public Money published by HM Treasury and include the need for efficiency, economy, effectiveness, and prudence in the administration of public resources to deliver value for money.[1]

2.6 The WGA Accounting Officer is responsible for signing the WGA Governance statement. When signing the Governance statement, the WGA Accounting Officer places reliance on the assurances made for each individual entity by the Accounting Officer or their equivalent, as documented through the Governance statement for those bodies.

1 http://www.hm-treasury.gov.uk/psr_mpm_index.htm

Chapter 3

Governance statement

Scope of Accounting Officer's responsibility

3.1 As Accounting Officer, I am responsible for maintaining a governance framework to support the efficient and effective production and audit of the Whole of Government Accounts (WGA). The framework is designed to minimise the risks to the process of preparing and publishing the consolidated accounts. The accounts of individual entities consolidated within WGA are subject to their own governance frameworks including Accounting Officer or equivalent controls.

3.2 The framework is intended to manage risk to a reasonable level rather than to eliminate all risk of failure to the consolidation and preparation process. It provides reasonable, but not absolute, assurance of effectiveness. The governance framework is based on an ongoing process, designed to identify and prioritise the risks, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently.

3.3 Publication of WGA is managed within HM Treasury's overall risk management framework, which is set out in the department's annual report and accounts.[1] The Deputy Director for Government Financial Reporting is responsible on a day-to-day basis for managing risk and for ensuring that the activities necessary for the production of these accounts are properly planned, resourced and performed.

3.4 In producing WGA, I must rely on the accounting officer (or equivalent) of each entity to manage their own risks. In some instances, the risks from underlying accounts may have a significant impact on the WGA consolidation and preparation process. The major risks identified from the underlying accounts are set out in paragraphs 3.15 and 3.16. The key risks in the preparation of WGA include:

- inaccuracies in entities' WGA returns, resulting in materially misstated balances
- failure to provide data or delays in the submission of WGA returns
- non-elimination of intra-group transaction streams and balances, resulting in materially misstated figures in the accounts

[1] https://www.gov.uk/government/collections/hmt-annual-report

3.5 HM Treasury has put in place a risk management framework to manage the key risks to the WGA consolidation and preparation process. This includes maintenance and regular review of a risk register to assist in identifying and implementing mitigating actions. HM Treasury also maintains a control and validation framework to define the controls over the preparation of the accounts and to monitor the effectiveness and completeness of the controls in place.

3.6 The WGA governance framework has been in place for the year ended 31 March 2017 which this account reports on and the full period of account preparation up to the date of approval. The governance accords with HM Treasury guidance, including the 'Corporate Governance in Central Government: Code of Good Practice', to the extent that it is deemed relevant and practical. The control and validation framework was provided to the HM Treasury Group Audit and Risk Committee who confirmed it provided a good basis of assurance.

The WGA governance framework

3.7 I receive support and assurance on the management of risks in a number of ways:

- the HM Treasury Group Audit and Risk Committee, chaired by a non-executive member and supported by the Treasury's internal audit function, reviews the department's approach to internal control and provides independent advice, with oversight of financial reporting and risk management activities associated with WGA. The effectiveness of the Audit and Risk Committee is assessed in the HM Treasury Annual Report and Accounts

- as well as the internal framework of governance and risk management, the WGA is subject to external audit provided by the Comptroller & Auditor General, supported by staff from the National Audit Office (NAO). The Comptroller & Auditor General is independent, and reports his findings on the accounts to Parliament. More information about the respective responsibility of the auditor and preparer can be found in the Comptroller & Auditor General's audit certificate in Chapter 6. The Comptroller & Auditor General and his staff have access to all HM Treasury papers and attend HM Treasury's Audit and Risk Committee

Improvements in preparing WGA

3.8 For the 2016-17 year, we have focussed on making the following improvements to the publication:

- Including a country and regional breakdown of public services expenditure in Chapter 1, using the Country and Regional Analysis (CRA) publication by HM Treasury and comparing to the WGA expenditure on public services

- Taking a more risk based approach to Chapter 1 to ensure that information is provided on the most significant risks to government and what we are doing to manage these risks

- Including information on **EU exit**, particularly on the financial settlement and additional spending agreed with departments.

3.9 Part of the challenge of producing such a comprehensive consolidation as WGA is the time it takes to receive audited returns covering over 7,000 organisations and to consolidate these returns into an accurate and understandable format. The Treasury will continue to work with stakeholders in central and local government and the NAO to deliver progressive improvements in the timing of future publications and will aim to produce the 2018-19 WGA by January 2020. This relies on planned changes to the local authority statutory deadline in England and the Academies reporting framework enabling the Department for Education to publish accounts by July in line with the rest of central government. However, the nature of WGA means that any delays to any significant components lead to delays with the overall delivery of WGA.

3.10 WGA is based on International Financial Reporting Standards (IFRS), the method of accounting used internationally by the private sector. WGA is independently audited by the NAO. As can be expected from a consolidation of this scale, WGA has received audit qualifications each year since it was first produced. The Treasury is making steady progress in removing them and in the last three publications, three qualification areas have been removed.

How WGA is being used

3.11 WGA is now an established product, and it is used to support decision making and manage risks more effectively. Some examples are:

- the government launched a Balance Sheet Review at Autumn Budget 2017 to make more effective use of assets and liabilities, looking at areas such as estates optimisation, improving the return on investments, and reducing the cost of liabilities. WGA data was used to inform the scoping exercise for this Balance Sheet Review

- HM Treasury has enhanced its approach to the management and scrutiny of contingent liabilities through the creation of stricter controls for approving new contingent liabilities. The department published the new contingent liability framework in July 2017.[2] WGA was used as a source of data to help build the case for implementing the new framework

- the Office for Budget Responsibility (OBR) independently reports on the future sustainability of the public finances in its Fiscal Sustainability Report[3] and Fiscal Risks Report[4], drawing on the data published in WGA

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2 https://www.gov.uk/government/publications/contingent-liability-approval-framework

3 http://obr.uk/fsr/fiscal-sustainability-report-january-2017/

4 http://obr.uk/frr/fiscal-risk-report-july-2017/

- the Office for National Statistics (ONS) used WGA data on pensions as comparison when preparing their publication on 'Pensions in the national accounts, a fuller picture of the UK's funded and unfunded pension obligations: 2010 to 2015'[5]

3.12 Publication of WGA also supports the government transparency agenda to make more public data available. In their 2016 evaluation of the UK, the International Monetary Fund highlighted the strength of the UK's reporting, concluding that WGA and the government's other fiscal reports place the UK at the forefront of fiscal reporting practices worldwide. [6]

3.13 WGA is independently audited giving both Parliament and the outside world greater confidence in the figures, and supports effective scrutiny by Parliament through the Public Accounts Committee. The most recent report from the Public Accounts Committee on 'Government Borrowing and the Whole of Government Accounts' was published in January 2018.[7]

Review of effectiveness

3.14 The 2016-17 WGA has been qualified as a result of qualifications in underlying accounts and as a result of issues relating to the boundary, non coterminous year ends and accounting policies applied by the Treasury when carrying out the WGA consolidation.

Addressing significant governance issues in underlying accounts

3.15 The underlying accounts and WGA data submissions show significant governance issues in a small number of entities that have resulted in audit qualifications. These weaknesses are the responsibility of the relevant accounting officer (or equivalent) and cannot be managed by the WGA Accounting Officer. Internal control weaknesses that led to qualifications (other than regularity) are also considered for their impact on WGA.

3.16 Those qualifications that are material to WGA are summarised below:

- the Ministry of Defence has not applied IFRIC 4 'Determining whether an Arrangement Contains a Lease' to all of its contracts. It is believed that a limited number of significant, largely single source contracts, particularly strategic procurement arrangements with key contractors, would meet the IFRIC 4 definition of containing a lease if they were reviewed against IFRIC 4; and that some of these leases would meet the definition of a finance lease per IAS 17 'Leases'. The impact on the financial statements of not applying IFRIC 4 is that contractors' assets held under finance leases and the associated liabilities have been excluded from the Statement of Financial Position. Consequently, the Comptroller & Auditor-General qualified his opinion on the accounts of the Ministry of Defence on the basis that a material value of leased assets and liabilities were omitted from its Statement of Financial Position

[5] https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/articles/pensionsinthenationalaccountsafullerpictureoftheuksfundedandunfundedpensionobligations/2010to2015

[6] https://www.imf.org/en/Publications/CR/Issues/2016/12/31/United-Kingdom-Fiscal-Transparency-Evaluation-44395

[7] https://publications.parliament.uk/pa/cm201719/cmselect/cmpubacc/463/46302.htm

- The **Department for Education (DfE)** received a qualified opinion on the sector annual report and accounts (SARA) for the year ended 31 August 2016 as result of a material level of error identified in the academy trust land and buildings. This was the first year of preparation of the SARA and further details are provided in paragraph 3.17 below

- both the **Department of Work and Pensions** and **HM Revenue and Customs' Trust statement** accounts received qualified audit opinions due to the level of fraud and error being material to the overall audit opinion on the regularity of the accounts

Addressing significant governance issues in the WGA consolidation process

3.17 The qualifications which arise from the consolidation process are those relating to the boundary, accounting policies and non-coterminous year ends and are summarised below:

- The **boundary** qualification will remain as long as the Royal Bank of Scotland (RBS) is in public ownership

- The qualification on **inconsistent accounting policies** mainly relates to different methods used in valuing infrastructure assets. The largest difference remaining is the valuation of the local authority road network. The Treasury is working with the body which sets accounting standards for local authorities on a plan to obtain this information

- DfE agreed new financial reporting arrangements for the Academies sector with the Treasury and Parliament. In terms of these arrangements DFE will henceforth prepare a SARA for the academic year from 1 September to 31 August each year. This is different to the financial reporting period for government departments, which is from 1 April to 31 March each year

  DfE prepared the first SARA for the reporting period from 1 September 2015 to 31 August 2016.[8] For WGA consolidation purposes the SARA information for the academic year ended 31 August 2016 was used without modification. An attempt was not made to convert this to a 31 March 2017 year end using estimates, as was done in previous years when the academies sector was consolidated first into the DfE accounts and then into WGA. There is therefore a misalignment between the data for Academies in WGA, and the rest of the bodies consolidated in the account. This misalignment gives rise to a qualification on the **non-coterminous year ends**. The most material balances affected by this qualification are property, plant and equipment (specifically land and buildings) and the net public sector pension liability

  Although Treasury agreed to prepare the 2016-17 WGA using unadjusted SARA data, this decision applies to 2016-17 only. We will continue to work together with DFE to explore ways to either obtain or create data for the Academies sector that matches the financial year of the rest of WGA.

8 https://www.gov.uk/government/publications/academies-consolidated-annual-report-and-accounts-2015-to-2016

3.18 Further details on the qualification matters noted above are included in the critical accounting policies in note 2 to the accounts

3.19 We have been able to maintain the balances and transactions between consolidated bodies not eliminated in full on the same level as the prior year. Further improvements will be made as experience of producing and using WGA grows. These will focus on improving the accuracy of the data collected at the local level to minimise the corrective work in the centre. Plans are being developed to increase the speed of account production to within 9 months of the year end.

3.20 I have assessed the WGA compliance with the Corporate Governance in Central Government Departments Code of Good Practice. I believe that we comply with the provisions of the Code that are relevant to my responsibilities to prepare WGA.

3.21 I am satisfied that effective remedial action is being taken to address the remaining control issues and that action taken so far is beginning to yield positive results. However, some improvements may take several years to implement fully. In part, this is because lessons are being learned after the accounts of the previous year have been completed. I have procedures in place to monitor the progress being made to tackle these weaknesses.

Assurance in making this judgement

3.22 I have considered the evidence that supports this governance statement and I am assured that the Treasury has a strong framework of controls to support the production of WGA.

HM Treasury's role in managing financial risk

3.23 In addition to the WGA governance framework, HM Treasury also has a role in managing the government's financial risk more widely, although this is outside the responsibility of the WGA Accounting Officer. Financial risk is managed in a number of ways, including:

- the Managing Public Money framework – this provides departments with guidance and sets out requirements on how to handle public funds properly
- Spending Reviews – the process through which spending is allocated to areas of government activity including public services, social security, and administration costs, according to the government's priorities. Spending Reviews set firm and fixed spending budgets over several years for each department
- the budget and estimates process for central government departments - the government uses the annual budgeting system to plan and control public expenditure. The Treasury presents estimates of budgetary plans to Parliament to obtain the statutory authority to consume resources and spend cash. The budgetary system has two main objectives:
  - to support the achievement of macro-economic stability by ensuring that public expenditure is controlled in support of the government's fiscal framework

  - to provide good incentives for departments to manage spending well so as to provide high quality public services that offer value for money for the taxpayer

- the Treasury sets the financial reporting framework for central government and works with the other relevant authorities such as CIPFA, Local Authority (Scotland) Accounts Advisory Committee (LASAAC) for financial reporting across government and the Financial Reporting Advisory Board, to set best practice accounting standards
- the Treasury spending teams provide strategic challenge to, and monitoring of, departments' spending on an ongoing basis
- the Treasury's Fiscal Group is responsible for ensuring the sustainability of the public finances over the short, medium and long term, including management of key financial assets and liabilities on the public sector balance sheet
- the OBR published its first Fiscal Risks Report (FRR) in July 2017, as required by the Charter of Budget Responsibility. The Government will respond formally to the FRR within a year, as required by the Charter. The response will set out the government's approach to managing the key risks to the public finances identified by the OBR

Information and data handling

3.24 In preparing WGA, HM Treasury does not collect any personal data from WGA entities. WGA data collected from WGA entities are held on HM Treasury's Online System for Central Accounting and Reporting (OSCAR) database. Data will be published on the gov.uk website as part of a scheduled release of OSCAR data at intervals.

Disclosure of information to auditors

3.25 As Accounting Officer, I confirm that there is no relevant audit information of which the NAO is unaware. I have taken all the necessary steps to make myself aware of any relevant audit information and to establish that the NAO is aware of that information.

3.26 I confirm that this annual report and accounts 2016-17 is, as a whole, fair, balanced and understandable. I take personal responsibility for the annual report and accounts, including the judgements required for determining that it is fair, balanced and understandable.

James Bowler

Accounting Officer

19 June 2018

Chapter 4

Remuneration and staff report

Remuneration report

4.1 Remuneration reports produced by Whole of Government Accounts (WGA) entities contain information about senior employees' salaries, bonuses, benefits in kind and pension entitlement, but a similar report for WGA would require publishing details of senior employees for over 7,000 entities. This remuneration report therefore does not follow the same format as the remuneration reports of WGA entities. Instead it sets out the government's policy on public sector pay, summarises the remuneration arrangements of the main public sector workforces and includes some statistics on pay across the public sector.

Government policy on public sector pay

4.2 The 1% pay award which operated in 2016-17 is an average that applies to an organisation or workforce, rather than each individual. This means that organisations are free to distribute the award among staff based on their own requirements. Employers may decide to allocate more of their pay award to specific parts of its workforce provided the average increase in the annual award for the organisation's total pay remit is in line with the pay policy. The policy of pay restraint operates across the public sector, in particular to the Pay Review Body workforces, the Civil Service and associated bodies. However, the government does not control pay in public corporations or local government. For local government, the Local Government Association announced that the majority of employees will receive an uplift of 1% in April 2016 and April 2017.

Remuneration in main public sector workforces

Pay review bodies

4.3 For much of the public sector, pay awards are set by the government after receiving advice from the independent pay review bodies. Each year the review bodies take evidence from interested parties, including government departments, employers, trade unions and staff associations, carry out their own independent research, and then formulate recommendations on the remuneration of their particular workforce. The government then decides whether to accept, reject or stage the pay awards recommended by the review bodies.

4.4 The pay review bodies are:

- National Health Service (NHS) Pay Review Body – covering all NHS staff, excluding doctors, dentists and very senior managers
- Review Body on Doctors' and Dentists' Remuneration – covering hospital doctors and dentists, public and community health doctors, ophthalmic medical practitioners, general medical practitioners, general dental practitioners, and community dental and dental public health staff
- School Teachers' Review Body – covering school teachers in England and Wales
- Armed Forces' Pay Review Body – covering members of the Naval, Military and Air Forces of the Crown up to and including the rank of Brigadier (one star) or equivalent
- Prison Service Pay Review Body – covering prison staff in England, Wales and Northern Ireland and includes governors and other operational managers, principal and senior officer grades, and prison officer and support grades
- Senior Salaries Review Body – covering senior civil servants, members of the judiciary, senior officers in the armed forces, senior police, very senior managers in the NHS and police and crime commissioners
- the National Crime Agency (NCA) Remuneration Review Body – covering all NCA officers in the UK
- Police Remuneration Review Body – covering police officers in England and Wales

4.5 Pay for those working in NHS Foundation Trusts and academy schools is a matter for those organisations. However, in practice, the majority of these organisations choose to follow the relevant Pay Review Body recommendation.

Civil service pay policy

4.6 Pay policy for civil servants below the Senior Civil Service is delegated to departments, within overall parameters set out in the Civil Service Pay Guidance. The Guidance sets out the pay parameters within which pay awards can be made by Departments, and it is then for departments to agree their individual settlement with the trade unions, within those parameters.[1] These arrangements also cover many non-departmental public bodies where staff are not civil servants.

[1] https://www.gov.uk/government/publications/civil-service-pay-guidance-2016-to-2017/civil-service-pay-guidance-2016-to-2017

The devolved administrations

4.7 Where civil servants work for the devolved administrations, pay is a matter for these administrations. Reports on pay related matters affecting the devolved bodies may be sent to the First Ministers of the Scottish Parliament and The National Assembly for Wales, and the Presiding Officer of the Northern Ireland Assembly. Where civil servants work in UK departments, but are based in the devolved countries, and in instances such as the armed forces, pay is a matter for the UK government.

Local government[2]

4.8 Pay for local government workers is a matter for local government to determine. In practice, the pay and conditions for the vast majority of the local government workforce is set by the National Joint Council (NJC) for local government services. The NJC is a negotiating body comprising trade unions and employers. It sets a national pay scale, but it is for individual authorities to decide where to place employees on that scale or whether to opt out completely from that pay framework.

Staff report

Staff costs (audited)

Table 4.A: Staff costs

	Permanently employed staff £bn	Others £bn	2016-17 Total £bn	2015-16 Total £bn
Salaries and wages	139.8	11.2	151.0	149.6
Pension scheme costs: current service costs (net of employees' contributions)	37.5	-	37.5	40.2
Pension scheme costs: past service costs	0.6	-	0.6	1.4
Pension scheme costs: losses on settlements and curtailments	(0.2)	-	(0.2)	(0.4)
Expenditure on external pension schemes	2.2	-	2.2	2.5
Total staff costs	179.9	11.2	191.1	193.3

4.9 **Salaries and wages** increased by £1.4 billion to £151.0 billion in 2016-17. Expenditure on NHS salaries and wages increased by £886 million as a result of an increase in staff numbers. The remaining increase in salary costs was

[2] Details of local government pay in England and Wales are available from the Local Government Association (LGA), which publishes an annual local government earnings survey on its website: www.local.gov.uk. An overview of English local government pay and workforce figures is published annually by the Department for Communities and Local Government in their report 'Local Government Financial Statistics England' available on its website: https://www.gov.uk/government/organisations/department-for-communities-and-local-government. Details of remuneration by local authority are available in their individual accounts and online.

driven by other sectors such as the increasing staff numbers associated with Academy Schools.

4.10 'Others' included the cost of ministers, special advisers, temporary and contract staff. The cost of the salaries of ministers was £5.6 million (2015-16: £5.9 million) and the cost of special advisers was £9.5 million (2015-16: £8.9 million). The ministerial salary only includes the additional element on top of the basic salary of an MP.

4.11 **Pension scheme costs** decreased by £3.3 billion in 2016-17 to £37.9 billion. These costs included expenses such as current service costs, past service costs, enhancements, gains or losses on settlements and curtailments. Further details are included in note 24 to the accounts.

Median earnings

4.12 Median earnings across the public sector for the financial year 2016-17 for all employees with a comparative to the private sector are shown below.

Table 4.B: Median earnings

	Median earnings 2016-17 £	**Median earnings 2015-16 £**	**Median earnings 2014-15 £**
Central government civil service[3]	25,900	25,350	24,980
Local government[4]	-	-	20,194
Public sector[5]	24,965	24,977	24,686
Private sector[5]	23,044	22,492	21,703

Average number of persons employed

Table 4.C: Average number of full-time equivalent (FTE) persons employed during the year

	Permanently employed staff	Others	2016-17 Total	2015-16 Total
Central government (including health)	2,507,602	182,028	2,689,630	2,660,976
Local government	1,556,725	54,764	1,611,489	1,689,854
Non-financial public corporations	81,313	21,239	102,552	108,194
Financial public corporations	2,934	-	2,934	2,741
Total	4,148,574	258,031	4,406,605	4,461,765

[3] ONS Statistical Bulletin, Civil Service Statistics, 2017, 2016 and 2015 (www.ons.gov.uk)

[4] Local Government Earnings Survey, Summary 2014-15 (http://www.local.gov.uk); data unavailable for 2015-16 and 2016-17 as publication discontinued.

[5] Table 13.7a, Annual Survey of Hours and Earnings, 2017 (Provisional), 2016 (Revised) and 2015 (Revised), ONS (www.ons.gov.uk)

Table 4.D: Central government breakdown

	2016-17 **Total**	2015-16 **Total**
Health sector	1,399,452	1,380,598
Academy schools	385,992	367,129
Other	904,186	913,249
Total central government (including health)	2,689,630	2,660,976

Civil Service and other compensation schemes - exit packages

Table 4.E: Exit package cost band 2016-17

	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band	Total Cost £bn
<£10,000	2,593	4,409	7,002	0.1
£10,000-£50,000	10,945	28,161	39,106	0.6
£50,000-£100,000	669	3,616	4,285	0.3
>£100,000	555	1,077	1,632	0.2
Total	14,762	37,263	52,025	1.2

Table 4.F: Exit package cost band 2015-16

	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band	Total Cost £bn
<£10,000	2,455	4,382	6,837	0.1
£10,000-£50,000	12,478	35,435	47,913	0.9
£50,000-£100,000	781	4,658	5,439	0.3
>£100,000	297	1,490	1,787	0.2
Total	16,011	45,965	61,976	1.5

4.13 The majority of these payments are made within the terms and conditions of exit schemes under the relevant remuneration framework. The government has committed to introducing two measures on public sector compensation: a cap on all public sector exit payments at £95,000; and a 'clawback' of redundancy compensation when a highly-paid individual returns to the public sector shortly after receiving an exit payment.

James Bowler

Accounting Officer

19 June 2018

Chapter 5

Financial statements

Statement of Revenue and Expenditure

For the year ended 31 March 2017

	Note	2016-17 £bn	2015-16 £bn
Taxation revenue	4	(628.1)	(592.6)
Other revenue	5	(92.7)	(101.3)
Total public services revenue		(720.8)	(693.9)
Social security benefits	6	223.7	222.5
Staff costs	7	191.1	193.3
Purchase of goods and services	8	194.8	192.1
Grants and subsidies	9	53.6	54.1
Depreciation and impairment	10	47.1	42.7
Interest costs on government borrowing	11	31.8	28.3
Increase in provisions	22	18.6	9.2
Total expenditure on public services		760.7	742.2
Net expenditure on public services		39.9	48.3
Financing costs of long-term liabilities, including discounting	11	68.3	187.4
Revaluation of financial assets and liabilities		(10.4)	8.1
Net expenditure for the year		97.8	243.8

Statement of Comprehensive Income and Expenditure

For the year ended 31 March 2017

	Note	2016-17 £bn	2015-16 £bn
Net expenditure for the year		97.8	243.8
Other comprehensive income and expenditure:			
Net (gain)/loss on:			
Revaluation of property, plant and equipment		(37.7)	(31.0)
Revaluation of intangible assets		(1.3)	(0.3)
Revaluation of available for sale financial assets		(1.4)	0.4
Revaluation of pension scheme liabilities		361.4	(123.0)
Other comprehensive income and expenditure		321.0	(153.9)
Total comprehensive expenditure for the year		418.8	89.9

Statement of Financial Position

As at 31 March 2017

	Note	2016-17 £bn	2015-16 £bn
Non-current assets			
Property, plant and equipment	12	1,167.6	1,120.2
Investment property	13	18.2	15.8
Intangible assets	14	34.5	33.0
Trade and other receivables	15	15.2	14.4
Other financial assets	16	205.7	208.8
		1,441.2	1,392.2
Current assets			
Inventories	17	9.2	9.6
Trade and other receivables	15	158.0	140.3
Other financial assets	16	253.2	164.2
Cash and cash equivalents	18	28.3	25.8
Gold holdings		9.9	8.6
Assets held for sale		3.2	1.7
		461.8	350.2
Total assets		1,903.0	1,742.4
Current liabilities			
Trade and other payables	19	(122.5)	(114.7)
Government borrowings	20	(275.5)	(274.2)
Other financial liabilities	21	(584.9)	(452.5)
Provisions	22	(15.6)	(14.7)
		(998.5)	(856.1)
Non-current liabilities			
Trade and other payables	19	(63.1)	(65.5)
Government borrowings	20	(1,013.5)	(986.4)
Other financial liabilities	21	(107.3)	(104.9)
Provisions	22	(306.6)	(290.8)
Net public sector pension liability	24	(1,834.7)	(1,424.7)
		(3,325.2)	(2,872.3)
Total liabilities		(4,323.7)	(3,728.4)
Net liabilities		(2,420.7)	(1,986.0)

	Note	2016-17 £bn	2015-16 £bn
Financed by taxpayers' equity:			
General reserve		(2,948.1)	(2,504.4)
Revaluation reserve		482.4	514.5
Other reserves		45.0	3.9
Total liabilities to be funded by future revenues		(2,420.7)	(1,986.0)

The financial statements and supporting notes on pages 78 to 149 and annex A were approved by James Bowler as the Accounting Officer for WGA on 19 June 2018.

James Bowler
Accounting Officer
19 June 2018

Statement of Changes in Taxpayers Equity

As at 31 March 2017

	General reserve £bn	Revaluation reserve £bn	Other reserves £bn	Total £bn
At 1 April 2015	(2,379.7)	501.0	3.5	(1,875.2)
Net expenditure for the year ended 31 March 2016	(243.8)	-	-	(243.8)
Net gain/(loss) on:				
Revaluation of property, plant and equipment	-	31.0	-	31.0
Revaluation of intangible assets	-	0.3	-	0.3
Revaluation of available for sale financial assets	-	(0.4)	-	(0.4)
Revaluation of pension scheme liabilities	123.0	-	-	123.0
Other reserves movements including transfers	(3.9)	(17.4)	0.4	(20.9)
Balance at 31 March 2016	(2,504.4)	514.5	3.9	(1,986.0)
Net expenditure for the year ended 31 March 2017	(97.8)	-	-	(97.8)
Net gain/(loss) on:				
Revaluation of property, plant and equipment	-	37.7	-	37.7
Revaluation of intangible assets	-	1.3	-	1.3
Revaluation of available for sale financial assets	-	1.4	-	1.4
Revaluation of pension scheme liabilities	(361.4)	-	-	(361.4)
Other reserves movements including transfers	15.5	(72.5)	41.1	(15.9)
Balance at 31 March 2017	(2,948.1)	482.4	45.0	(2,420.7)

The general reserve includes the pension reserves. The revaluation reserve includes assets available-for-sale. Other reserves include the hedging reserve and reserves restricted for specific purposes.

Statement of Cash Flows

For the year ended 31 March 2017

	Note	2016-17 £bn	2015-16 £bn
Cash flows from operating activities			
Net operating expenditure	SoRE	(39.9)	(48.3)
Adjustments for non-cash transactions		139.7	115.9
(Increase)/decrease in inventories		0.7	1.9
(Increase)/decrease in trade and other receivables		(22.1)	(6.3)
Increase/(decrease) in trade and other payables		3.4	9.5
Use of provisions		(12.1)	(8.9)
Net cash inflow/(outflow) from operating activities		69.7	63.8
Cash flows from capital expenditure and financial investment			
Purchase of non-financial assets		(57.7)	(55.4)
Proceeds from disposal of non-financial assets		1.3	2.7
Net cash inflow/(outflow) from purchase and disposal of financial assets and liabilities		3.0	(10.6)
Net cash inflow/(outflow) from capital expenditure and financial investment		(53.4)	(63.3)
Cash flows from financing activities			
Interest received		7.4	6.3
Financing costs of long-term liabilities, including discounting		(35.8)	(31.0)
Finance charges paid on finance leases and PFI contracts		(4.4)	(4.7)
Net Borrowings		19.0	27.9
Net cash inflow/(outflow) from financing activities		(13.8)	(1.5)
Net increase/(decrease) in cash and cash equivalents	18	2.5	(1.0)
Cash and cash equivalents at the beginning of the year	18	25.8	26.8
Cash and cash equivalents at the end of the year	18	28.3	25.8

Notes to the accounts

Note 1. Statement of accounting policies

1.1 Basis of preparation

The financial statements have been prepared in accordance with the 'Government Resources and Accounts Act 2000' (GRAA) and International Financial Reporting Standards (IFRS), as adapted and interpreted by the Financial Reporting Manual (FReM). A number of public bodies consolidated into these financial statements do not follow the FReM. For example, local authorities follow the IFRS-based Code of Practice on Local Authority Accounting. Adjustments are made on consolidation to harmonise accounting policies where material and any exceptions are noted in these accounting policies.

In adopting the going concern basis for preparing the financial statements, the Accounting Officer has considered the Government's power to set tax rates to meet its funding requirements as well as controls over public spending which ensure that the government will continue to exercise its functions.

1.2 Accounting convention

The financial statements have been prepared under the historical cost convention, modified where appropriate to account for the revaluation of certain assets and liabilities as set out in these accounting policies.

1.3 Basis of consolidation

The financial statements consolidate a group of entities that appears to HM Treasury to exercise functions of a public nature, or to be entirely or substantially funded from public money. This group includes central government departments, non-departmental public bodies, public corporations, local authorities, the National Health Service and the devolved administrations. The Whole of Government Accounts (WGA) boundary is compared to the Office for National Statistics (ONS) classification of the public sector to ensure the accounts are consistent and comparable to other measures of financial performance, such as the National Accounts.

There are areas where the boundary diverges from the ONS classification, most significantly the exclusion of Royal Bank of Scotland (RBS), and further details are provided in the critical accounting policies in note 2. A list of all the entities consolidated in the financial statements is published on gov.uk.

1.4 Accounting standards in issue but not yet effective

The following new standards have been issued but are not yet effective:

IFRS 9 'Financial Instruments' was issued in July 2014, effective for periods beginning on or after 1 January 2018. IFRS 9 will replace IAS 39 'Financial Instruments: Recognition and Measurement'. IFRS 9 introduces new requirements for the classification and measurement approach to all types of financial assets but carries forward unchanged almost all of the accounting requirements in IAS 39 for financial liabilities. IFRS 9 introduces a forward-looking 'expected-loss' impairment model, which will result in earlier recognition of expected credit losses, and a simplified model for hedge accounting to more closely align the accounting

treatment with risk management activities. WGA will be most affected by the new impairment model and changes to disclosure requirements for financial instruments.

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014, effective for periods beginning on or after 1 January 2018. IFRS 15 will replace IAS 18 'Revenue Recognition' and IAS 11 'Construction Contracts'. The standard establishes a principles based approach for revenue recognition and is based on the concept of recognising revenue for obligations only when they are satisfied and the control of goods or services is transferred. It also introduces more extensive disclosure requirements. For WGA, IFRS 15 will impact the accounting and disclosure of revenue other than taxation, and in particular there may be an impact on the timing of revenue recognition.

IFRS 16 'Leases' was issued in January 2016, effective for periods beginning on or after 1 January 2019, but has yet to be endorsed by the EU. IFRS 16 will replace IAS 17 'Leases'. IFRS 16 largely removes the distinction between operating and finance leases for lessees by introducing a single lessee accounting model that requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. This is a significant change in lessee accounting and will increase the leased assets and lease liabilities recognised on the balance sheet within WGA.

It is not possible to quantify the effect that these new standards will have on WGA as it will be dependent on the impact in each underlying account.

1.5 Foreign Currency

Transactions that are denominated in a foreign currency are translated into sterling at the rate of exchange ruling on the date of each transaction, except where rates do not fluctuate significantly. In this case, an average rate for the period is used. Monetary assets and liabilities denominated in foreign currency at the financial year end are translated at the rates ruling at that date. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies, are recognised in the Statement of Revenue and Expenditure, except when deferred in equity as qualifying cash flow hedges.

1.6 Revenue

Taxation revenue

Taxes and duties are measured at the fair value of the consideration received or receivable net of repayments. Revenue is recognised when a taxable event has occurred, the revenue can be measured reliably, and it is probable that the associated economic benefits from the taxable event will flow to the government. No revenue is recognised if there are significant uncertainties regarding recovery of the taxes and duties due.

Revenues are deemed to accrue evenly over the period for which they are due. Taxes and duties are accounted for on an accruals basis, except for stamp duty and National Insurance Classes 1A, 1B and 3. These are accounted for on a cash basis and do not have a material impact on the accounts. In addition, some repayments are accounted for on a cash basis.

Taxable events for the material tax streams are as follows:

Revenue type	Revenue recognition point
Income tax	Earning of assessable income during the taxation period
Social security	Earning of income on which National Insurance is payable
Corporation tax	Earning of assessable profit during the taxation period
Value Added Tax	Undertaking of taxable activity during the taxation period
Other excise duties	Date of production, date of import or movement of goods out of a duty suspended regime
Stamp duty	When property or shares are purchased
Council Tax	Residency in, or ownership or tenancy of, a chargeable dwelling for any period in the financial year
National Non-Domestic rates	Occupation or ownership of a relevant non-domestic property for any period in the financial year

Income tax excludes tax credits which are recognised separately as an expense.

The tax gap is not recognised in these financial statements. The tax gap is the difference between the amount of tax that should, in theory, be collected if all individuals complied with both the letter and spirit of the law, and what is actually collected. It comprises of the revenue that is lost through non-payment, use of avoidance schemes, interpretation of tax effect of complex transactions, error, failure to take reasonable care, evasion, the hidden economy and organised criminal attack. Information on the size of the tax gap is included in Chapter 1.

Other revenue

Revenue from the sale of goods and services is measured at the fair value of the consideration received or receivable, and is recognised when the goods or services are provided. Income from the European Union (EU) in respect of supported projects is recognised at the point that the expenditure on those projects is recognised. Grants and similar financing for capital items, to the extent that they have not been eliminated on consolidation, are recognised immediately in the Statement of Revenue and Expenditure unless it is likely that the grant will need to be repaid, in which case the grant is deferred in the Statement of Financial Position.

1.7 Expenditure

Social security benefits

Social security benefits are statutory entitlements payable to private individuals and households, including the state pension. Social security benefits are accounted for as expenditure in the period to which they relate.

Social security benefits include tax credits, which are recognised in the year in which claims are assessed and awards authorised. Where under or overpayments are identified, either during the award year or subsequently, adjustments are made to expenditure.

Staff costs

Staff costs include salaries and wages, the costs of pensions and other employee benefits. Staff costs that can be attributed directly to the construction of an asset have been capitalised. Average staff numbers include staff engaged on capital projects.

Public sector pension scheme costs include current service costs and past service costs, both of which are explained in further detail in accounting policy note 1.19.

Grants and subsidies

Grants and subsidies are recorded as expenditure during the period that the underlying event or activity giving entitlement to the grant occurs. Entitlement to a grant varies according to the details of individual schemes and the terms of the offers made. Unpaid and unclaimed grants are charged to the Statement of Revenue and Expenditure on the basis of estimates of claims not received and are included in accruals in the Statement of Financial Position.

Interest costs

Interest costs on government borrowing are determined using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. The majority of government's borrowings are at fixed interest rates. For variable rate borrowings the current rate applicable to that product is used and this treatment is also applied to index-linked borrowings. Gilts with the same maturity and coupon rate are sometimes issued in separate tranches and may have a different effective interest rate due to market conditions. However, once issued, gilts with the same maturity and coupon rate are indistinguishable from each other and so are accounted for as one issue using a weighted average effective interest rate.

1.8 Property, plant and equipment

Property, plant and equipment is initially recognised at cost and subsequently valued based on current value in existing use. For non-specialised assets, such as offices, this is the market value based on its current use less depreciation. For specialised assets, including the road and rail network held by central government, this is replacement cost less depreciation. However, road network assets held by local government and Scottish Water infrastructure assets are valued at historical cost less depreciation. Further details on the accounting estimates involved in valuing infrastructure assets are included in the critical accounting policies in Note 2.

Land and buildings are usually professionally valued at 5 year intervals or when material changes are known to have arisen, and are subject to annual internal reviews. Gains on revaluation are taken to the revaluation reserve. Losses on revaluation for a particular asset are debited to the revaluation reserve if gains for that asset have been previously recorded, otherwise the full amount is charged to the Statement of Revenue and Expenditure.

Assets under construction are measured at cost less any recognised impairment loss, and are not depreciated. Heritage assets and community assets are either not capitalised, or included at cost or a token value and are not revalued.

Military equipment comprises non-current assets used by the military for which there is no civilian use. It includes items such as tanks, fighter aircraft and warships. It is initially recognised as a tangible non-current asset at its direct purchase or production cost, and is then depreciated over its useful economic life. In all other respects, it is treated in the same way as other non-current asset categories. Development expenditure on military equipment, which meets the capitalisation criteria, is capitalised as an intangible asset.

1.9 Investment properties

Investment properties comprise of land or buildings held for rental revenue or for capital appreciation. Investment properties are measured initially at cost and are subsequently measured at fair value. Gains or losses arising from a change in fair value or disposal are recognised in the Statement of Revenue and Expenditure.

1.10 Intangible assets

Intangible assets are recognised if it is probable that they will result in future economic benefits to the government and if their cost can be measured reliably. Intangible assets are initially recognised at cost and subsequently valued based on current value in existing use. Where no active market exists, intangible assets are revalued using indices or another suitable model.

1.11 Depreciation and amortisation

Depreciation or amortisation is charged to write down the cost or valuation of an asset to its residual value over its estimated useful economic life. Residual values and useful economic lives are reviewed annually. Assets acquired through finance leases or Private Finance Initiative contracts are depreciated over the shorter of the lease term and the estimated useful life. Any impairment in value in addition to depreciation is recognised immediately in the Statement of Revenue and Expenditure.

The depreciation period varies based on the estimate made by each WGA entity of the useful economic life of their assets. Generally, property, plant and equipment are depreciated over the following timescales:

Type	Period
Scottish water infrastructure	Up to 150 years
Road and rail network	Up to 100 years
Freehold land	Not depreciated
Buildings	Up to 60 years
Assets under construction	Not depreciated
Military equipment	Up to 35 years
Plant and machinery	Up to 30 years
Transport equipment	Up to 50 years
IT equipment	Up to 10 years
Furniture and fittings	Up to 20 years
Investment properties	Not depreciated

Intangible assets are typically amortised over the following timescales:

Type	Period
Military equipment	Up to 35 years
Development expenditure	Up to 35 years
Other intangible assets	Up to 15 years

1.12 Inventories

Inventories are valued at the lower of cost and net realisable value with the exception of inventory held by the Ministry of Defence. The Ministry of Defence hold inventory at current cost based on replacement purchase price or estimated through indexation. Where there is no expectation of consumption or sale in the ordinary course of business, the value is impaired to reduce it to net realisable value.

1.13 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and current balances with banks and other financial institutions. They are readily convertible to known amounts of cash, and are subject to insignificant risk of changes in value and have an original maturity of three months or less. The carrying amount of these assets approximates their fair value. Bank overdraft amounts are included within trade and other payables in the Statement of Financial Position.

1.14 Gold holdings

Gold is valued at fair value based on the sterling equivalent of the London Bullion Market Association dollar denominated spot bid price at the reporting date. Changes in fair value are recognised in the Statement of Revenue and Expenditure.

1.15 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently at amortised cost. The value of receivables is shown after an allowance for irrecoverable debts. Changes in the carrying amount of the allowance, for example as a result of increases in bad debts, are recognised in the Statement of Revenue and Expenditure.

1.16 Leases

Leases in which a significant proportion of the risks and rewards of ownership are transferred to government are finance leases and the leased assets are treated as if they had been purchased. The corresponding liability to the leasing company is shown as a finance lease liability and the accounts distinguish between payments of interest and capital.

All other leases are operating leases and the costs in respect of operating leases are recognised in the Statement of Revenue and Expenditure on a straight-line basis.

The Ministry of Defence has not applied IFRIC 4 'Determining whether an Arrangement Contains a Lease' to all of its contracts. Further information regarding this departure from FReM can be found in paragraph 3.16 in Chapter 3 Governance statement.

1.17 Private Finance Initiatives (PFI)

PFI contracts in which the government controls or regulates what services the private sector operator must provide with the assets, and controls any significant residual interest in the asset at the end of the contract, are recorded on the government's balance sheet as if they had been purchased. The corresponding liability to the PFI operator is recognised as a PFI liability and the accounts distinguish between payments of interest, capital and charges for services.

If the above conditions are not met, then the private sector provider recognises the asset and all payments are recognised as charges for services.

A number of WGA entities have PFI contracts which should not be recognised on the Statement of Financial Position because, under IFRIC 12, the private sector contractor was, on balance, considered to have greater control over the use of the asset. WGA entities reported off-balance sheet contracts in their accounts in different ways in 2016-17, as the accounting standards allow flexibility as to how to present the information. Therefore, it is not possible to provide a summary of all PFI contracts in this account. Included in Note 27 is a list of the most material PFI contracts that have been reported.

1.18 Provisions

Provisions are recognised when the government has a present obligation as a result of a past event and it is probable that the government will be required to settle that obligation. Provisions are measured at the best estimate of the expenditure required to settle the present obligation at the reporting date and are discounted to present value where the time value of money is material.

Where some or all of the expenditure required to settle a provision is expected to be recovered from a third party, the recoverable amount is treated as an asset. The net provision expense after deducting expected recoveries from third parties is recognised in the Statement of Revenue and Expenditure.

1.19 Pension liabilities

The pension liability relates to public sector pension liabilities for current and former government employees, plus a small component for other approved organisations that qualify for membership of these government schemes. The government operates both defined benefit and defined contribution pension schemes. The defined benefit pension schemes are either funded (meaning that the scheme is a separate entity, which receives contributions and invests them to fund pension payments) or unfunded (meaning that there is no separate fund and the government is directly liable to fund pension payments as they fall due). The pension liability excludes the state pension paid to the general public which is included within overall expenditure and recorded as welfare spend.

For defined benefit pension schemes, the difference between the fair value of scheme assets (if any) and the present value of the scheme liability is recognised as a net asset or liability on the Statement of Financial Position. The scheme liability is calculated by discounting expected future benefit payments back to the reporting date using a discount rate based on high quality corporate bonds, usually interpreted as corporate bonds with a credit rating of AA. The expected future benefit payments are calculated allowing for pensionable service to the reporting date, future increases to benefits in accordance with scheme rules (known as the projected unit method) and projections of earnings for current employees up to the date of retirement, leaving service or earlier death. The pension liability is therefore an estimate of the amount of money that would need to be invested in high quality corporate bonds at the reporting date to cover all the expected future benefit payments accrued up to the reporting date.

Current service costs are the increase in the present value of the scheme liabilities arising from current members' service over the year. They are determined by the individual scheme actuaries and were calculated using the discount rate at the start of the year.

Past service costs are changes in the present value of the scheme liabilities related to employee service in prior periods arising in the current period as a result of the introduction, change, or improvement to retirement benefits. These also include any gains or losses in relation to events defined as settlements or curtailments.

Pension financing costs are the increase during the period in the present value of the scheme liabilities because the benefits are one period closer to settlement. The financing cost is based on the discount rate (including inflation) at the start of the year and is calculated on the gross liability of unfunded schemes (which is shown gross) and the net liability of funded schemes (i.e. net of assets).

The actuarial gains and losses on revaluation reflect three elements:

- The first of these elements is the change in the underlying assumptions used by the actuaries to determine the value of scheme liabilities. This includes financial assumptions, mortality rates and projected salary increases

- The second element relates to where in-year experience differs from assumptions previously used to determine the liabilities. For example, pension increases and general salary growth were different to that assumed in the previous accounts, or if more members resigned than expected
- The third element relates to funded schemes and reflects differences between the asset returns experienced in-year and the interest on the assets included in the Statement of Revenue and Expenditure

The current service costs, any past service costs, including those arising from settlements or curtailments, and pension financing costs are recognised as an increase in the pension liability and are charged to the Statement of Revenue and Expenditure. The gain or loss on revaluation of pension scheme assets and liabilities is recognised in the Statement of Other Comprehensive Income and Expenditure.

Payments to defined contribution pension schemes are recognised in the Statement of Revenue and Expenditure as they fall due.

1.20 Financial Instruments

Financial assets

Depending on the purpose for which a financial asset is held or acquired it is classified as one of the following: at fair value through profit or loss, held-to-maturity investments, loans and receivables or available-for-sale assets.

Fair value through profit or loss	Financial assets held for trading or designated as at fair value through profit or loss. Derivatives are also classified as held for trading unless they are designated as hedges. Assets are recognised initially at fair value and transaction costs are expensed. Gains and losses arising from change in fair value are recognised in the Statement of Revenue and Expenditure.
Held-to-maturity investments	Non-derivative financial assets with fixed or determinable payments and fixed maturity, where there is a positive intention and ability to hold to maturity. Assets are recognised initially at fair value and subsequently at amortised cost with annual assessments for impairment.
Loans and receivables	Non-derivative financial assets with fixed or determinable payments that are not traded in an active market. Assets are recognised at fair value and subsequently at amortised cost using the effective interest rate method with annual assessments for impairment.
Available-for-sale assets	Non-derivative financial assets classified as 'available-for-sale' or not classified in any of the other three categories of financial assets. Assets are initially measured at fair value including transaction costs and gains or losses arising from changes in fair value are recognised in the Statement of Other Comprehensive Income and Expenditure.

The table below summarises the accounting treatment for government's financial assets:

Financial asset	Category used
Trade and other receivables	Loans and receivables
Debt securities	Fair value through profit or loss
Loans and deposits	Loans and receivables or held to maturity investments
Student loans	Loans and receivables
Equity investments	Available-for-sale or fair value through profit or loss
International Monetary Fund (IMF) quota subscription	Loans and receivables
IMF Special Drawing Rights holdings	Fair value through profit or loss

Financial liabilities

The majority of the government's financial liabilities are classified at amortised cost. The only exceptions are deposits by banks and debt securities which can also be classified at fair value through profit or loss and IMF Special Drawing Rights allocation which are classified at fair value through profit or loss.

1.21 Contingent liabilities and contingent assets

Contingent liabilities and contingent assets are not recognised as liabilities or assets in the Statement of Financial Position, but are disclosed in the notes to the accounts. A contingent liability is a possible obligation arising either from past events whose existence will be confirmed only by uncertain future events, or a present obligation arising from past events which is not recognised because either an outflow of economic benefit is not probable or the amount of the obligation cannot be reliably measured. A contingent asset is a possible asset whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the entity. Where the time value of money is material, the contingent liabilities and assets are stated at discounted amounts.

Note 2. Critical accounting estimates and judgements

2.1 WGA boundary

The GRAA requires HM Treasury to prepare WGA for "a group of bodies each of which appears to HM Treasury (a) to exercise functions of a public nature, or (b) to be entirely or substantially funded from public money".

In complying with the GRAA, HM Treasury has made a judgement to base the consolidation boundary on entities classified to the public sector by the ONS. This has the benefit of aligning the boundary of WGA to the boundary for National Accounts and increases the usefulness of WGA as a tool for understanding the public finances.

The immaterial exceptions to this policy are:

- WGA excludes a small number of entities such as the National Audit Office and Audit Scotland that are accountable to their respective parliaments or assemblies rather than an executive arm of the government, and therefore do not form part of government
- minor entities are excluded on the basis that they are too small to have any material impact on WGA. The criteria used for minor bodies in 2016-17 was that they had to have gross expenditure, income, assets and liabilities of less than £10.0 million. For example, this includes some district councils

The material exceptions to this policy are housing associations and RBS:

Housing associations

Housing associations were classified to the public sector on 30 October 2015 by the ONS. The government is implementing a package to deregulate housing associations and return them to the private sector. The ONS reclassified Housing Associations to the private sector in November 2017. The ONS and WGA treatment will therefore align for future years.

Royal Bank of Scotland (RBS)

RBS is recognised as an investment of government rather than being consolidated. This is on the basis that the scale of RBS would dwarf other aspects of WGA, distorting the accounts and making it difficult to determine trends. It would also be very technically challenging to consolidate RBS due to the differences in accounting policies and year-end. The government does not intend to retain its shares in RBS for the long-term, and has started to sell its holding, which makes the time and cost of consolidation less worthwhile.

The following table sets out the estimated effect of excluding RBS from the consolidation. It is based on RBS's financial results for the year ended 31 December 2016. It does not include an estimate of the changes required to align the year-end or accounting policies.

	Revenue £bn	Expenditure £bn	Net expenditure £bn	Assets £bn	Liabilities £bn	Net liabilities £bn
2016-17 WGA	720.8	(818.6)	(97.8)	1,903.0	(4,323.7)	(2,420.7)
2016 RBS	15.1	(20.4)	(5.3)	798.7	(749.3)	49.4
Eliminations	(2.7)	2.7	-	(81.2)	81.2	-
WGA plus RBS	733.2	(836.3)	(103.1)	2,620.5	(4,991.8)	(2,371.3)

2.2 Taxation revenue

Taxation revenue is recognised in the period in which the event that generates the revenue occurs. Some of the accrued revenue receivable figures and other items are subject to statistical estimation of forecasts, as tax returns and tax payments can be filed at a later date. Due to the areas of uncertainty involved, actual outcomes could differ from the estimates used. HM Treasury believe that the levels of variation are acceptable and HM Revenue and Customs (HMRC) estimate that any total understatement or overstatement is unlikely to exceed £5.0 billion, which does not significantly impact the reported position and is less than 1% of total revenue reported in the Statement of Revenue and Expenditure.

2.3 Valuation of infrastructure assets

Road network assets held by local authorities are currently valued at historical cost less depreciation, which is a departure from the requirements of the FREM. Local authorities have been working towards implementing a valuation based on replacement cost less depreciation although it is uncertain whether this method of accounting will be adopted in the Code of Practice on Local Authority Accounting. In the meantime, the best proxy available for depreciated replacement cost is the calculated asset value used by the ONS in the National Accounts. The 2017 National Accounts estimated the value of the road network at £121.0 billion (2015-16: £114.4 billion) as at 31 December 2016.[1] Infrastructure assets are likely to be understated by at least £52.8 billion. The ONS valuation does not include the value of land, which would be included within a replacement cost valuation. Therefore the understatement will be significantly higher than the difference between historic cost and ONS valuation. Further information regarding this departure from FReM can also be found in paragraph 3.17 in Chapter 3 Governance statement.

The rest of the road network and the whole of the rail network is held by central government and valued at replacement cost less depreciation. The value reflects the cost of constructing a modern equivalent asset on a greenfield sites, adjusted to reflect the current condition of the asset. Full valuations are carried out every 5 years and indices are used in interim periods.

[1] UK National Accounts, The Blue Book, 2017, Table 9.9 ‘Other Structures’

2.4 Student loans

Student loans are held at amortised cost, with the gross value of the loans issued being discounted to net present value using the effective interest rate. The effective interest rate used is the higher of the rate intrinsic to the instrument and the real long term discount rate set by HM Treasury to approximate government's cost of borrowing. As student loans will not be fully repaid the higher of the two rates is the real long term discount rate, which for 2016-17 was RPI plus 0.7% (2015-16: RPI plus 0.7%).

The net present value calculation also takes into account an estimate of the value of student loans which will not be repaid because of the policy decisions made by the government for the loans to be written off in certain circumstances such as death, disability or the age of the student. This estimate is sensitive to assumptions on borrowers' earnings which are based on latest forecasts from the Office for Budget Responsibility.

The method for determining the carrying value of the student loan book in the accounts is set by the FReM and is likely to be higher than the amount that they could be sold for. This is because the discount rate used by a market investor in valuing the future cash flows would likely be higher given that the investment is more risky than gilts.

2.5 Public sector pension liability

The assessment of the pension liabilities requires various assumptions about future unknowns in order to determine the expected future benefit payments. These assumptions include life expectancy, employee turnover rates, projections of price inflation and projections of earnings for current employees. A discount rate is then required to discount the future benefit payments to produce a net present value.

The key financial assumptions used by the actuaries of government pension schemes to determine the 2016-17 and 2015-16 WGA pension liabilities are set out below:

	2016-17 Unfunded central government[2] %	2016-17 Unfunded local government[3] %	2016-17 Funded local government %	2015-16 Unfunded central government %	2015-16 Unfunded local government %	2015-16 Funded local government %
Rate of increase in salaries[4]	4.55	1.0-5.1	1.0-4.4	4.2	1.0-4.7	0.9-4.3
Rate of increase in pensions in payment[5]	2.55	1.0-4.4	2.0-3.5	2.2	0.9-3.0	1.7-3.5
Discount rate – real[6]	0.24	-	-	1.37	-	-
Discount rate – Nominal	2.8	1.7-10.0	2.4-3.6	3.6	2.3-10.6	2.7-4.0
Price inflation assumption	2.55	1.0-3.6	1.5-3.7	2.2	0.9-3.4	1.7-3.5

2.6 Provision for nuclear decommissioning

Nuclear Decommissioning Authority's (NDA's) nuclear decommissioning provision forms the bulk of the overall government provision for nuclear decommissioning and represents the best estimate of the costs of decommissioning plant, land, buildings and equipment on their designated nuclear licenced sites to return them to pre-agreed end states in accordance with the Authority's published strategy. NDA's programme of work will take until at least 2137. The estimate is necessarily based on assumptions regarding processes and methods likely to be used to discharge the obligations, reflecting a combination of latest available technical knowledge, requirements of the existing regulatory regime, government policy and commercial agreements. Given the very long timescale involved and the complexity of the plants and material being handled, considerable uncertainty remains in the estimates of future costs, particularly in later years. The estimate is updated to reflect changed circumstances and more recent knowledge and changed assumptions; as a result, material adjustments could be made to the carrying amount of the nuclear decommissioning provision and related assets and liabilities in the future. The principal assumptions and sensitivities around the cost estimates were reviewed and updated by NDA management as at 31 March 2017.

[2] Central government unfunded schemes includes the Principal Civil Service Pensions Scheme (PCSPS), NHS pension schemes, armed forces pensions schemes and teachers' pension schemes

[3] Local government includes the local government pension schemes, police pension schemes and firefighters' pension scheme, with the exception of the police and fire schemes in Northern Ireland as they are administered by central government

[4] Rate of increase in salaries is shown inclusive of the inflation assumption but does not include promotional salary increases

[5] Rate of increase of pensions in payment will depend upon the underlying measure of inflation and whether there are any upper or lower limits on the rate of increase

[6] The discount rate for central government unfunded schemes are set by HM Treasury

2.7 Provision for clinical negligence

The clinical negligence provision requires the directors of the NHS Litigation Authority to make judgements, estimates and assumptions to value the liability. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. They are reviewed annually by the NHS Litigation Authority, supported by its actuaries the Government Actuary's Department.

Known reported claims are individually valued using likely costs to resolve the claim and probability factors to take account of the potential of a successful defence. Whilst incurred but not reported claims are valued using actuarial models to predict likely values. Due to the long-term nature of the liabilities and the assumptions on which the estimate of the provision is based, some uncertainty about the value of the liability remains.

2.8 Non-coterminous year ends

WGA consolidates a wide variety of organisations. All bodies, barring the exceptions discussed below, use a year end to 31 March. Where the impact of different year ends is material, HM Treasury is required by the accounting standards to make adjustments to align the component's submission to the WGA year end.

The following WGA components have different financial year ends where the impact is judged by HM Treasury to be immaterial:

- Commonwealth Development Corporation - year end of 31 December 2016
- Manchester Policing and Crime Commissioner - year end of 7 May 2017
- Northern Ireland FE colleges - year end of 31 July 2017
- Channel 4 - year end of 31 December 2016

The following WGA components have different financial year ends where the impact is judged by HM Treasury to be material:

Bank of England

The three Bank of England entities in WGA (Bank of England Banking Department, Bank of England Issue Department and Bank of England Asset Purchase Facility Fund Limited) have a year end of 28 February 2017. An adjustment was made by HM Treasury to ensure that corporate bond assets and financial assets under the Term Funding Scheme (held on the Bank of England Asset Purchase Facility Fund Limited balance sheet) were valued as at 31 March 2017.

Academies sector

The Academies sector annual report and accounts has a year end to 31 August 2016. The account is compiled and published by the Department for Education. The Department was unable to estimate, to a material level of accuracy, the adjustments required to reflect their financial position and performance to 31 March. WGA therefore reflects the Academies sector to 31 August 2016, with no adjustments made. The main impact of this misalignment is in property, plant and equipment (where academies report net book value of £48.2 billion) and pension liabilities

(where academies report a pension deficit of £7.4 billion). The academies sector is also subject to a qualification on the basis of accuracy and completeness of land and buildings valuation. More details can be found in the Comptroller and Auditor General's certificate and report in chapter 6.

2.9 Contracts for difference (CfDs)

CfDs are a mechanism used to support investment in UK green energy projects. CfDs have been established as a contract between the 'Generator' and the Low Carbon Contracts Company (LCCC), a company wholly owned by the government and consolidated within the Department for Business, Energy and Industrial Strategy. WGA includes a number of CfDs on the Statement of Financial Position. In addition to the recognised contracts, there is a contract for Hinkley Point C that has not been recognised but is disclosed. The valuation for CfDs is dependent on a number of assumptions including:

- Changes to discount rate
- Proportion of electricity lost as it passes from the generator to the supplier
- Start date of the contract
- Inflation
- Forecast future wholesale electricity prices
- Installed capacity of the project as reflected in the contract
- The actual power output of the project compared to its rated installed capacity (known as the load factor)

Further details on the assumptions can be found in Note 9 (Derivative Financial Instruments) of the 2016-17 accounts of the Department for Business, Energy and Industrial Strategy.[7]

[7] https://www.gov.uk/government/publications/beis-annual-report-and-accounts-2016-to-2017

Note 3. Segmental reporting

Segmental reporting 2016-17

	Central government £bn	Local government £bn	Public corporations £bn	Whole of Government £bn
Taxation revenue	(573.2)	(54.7)	(0.2)	(628.1)
Other revenue	(47.5)	(34.7)	(10.5)	(92.7)
Total public services revenue	(620.7)	(89.4)	(10.7)	(720.8)
Social security benefits	196.2	26.8	0.7	223.7
Staff costs	123.5	62.7	4.9	191.1
Purchase of goods and services	117.6	69.6	7.6	194.8
Interest cost on government borrowing	31.8	-	-	31.8
Increase in provisions	15.4	0.5	2.7	18.6
Other expenditure	88.8	10.5	1.4	100.7
Total expenditure on public services	573.3	170.1	17.3	760.7
Net expenditure on public services	(47.4)	80.7	6.6	39.9
Financing costs of long-term liabilities, including discounting	56.4	10.5	1.4	68.3
Net loss on revaluations and disposals of assets and liabilities	(6.1)	(0.3)	(4.0)	(10.4)
Net expenditure/(revenue) for the year	2.9	90.9	4.0	97.8
Property, plant and equipment	742.4	353.6	71.6	1,167.6
Other non-current assets	216.7	26.3	30.6	273.6
Current assets	313.1	38.4	110.3	461.8
Total assets	1,272.2	418.3	212.5	1903.0
Current government borrowings	(275.5)	-		(275.5)
Other current liabilities	(166.2)	(28.9)	(527.9)	(723.0)
Non-current government borrowings	(1,013.5)	-	-	(1,013.5)
Provisions non-current	(282.5)	(2.0)	(22.1)	(306.6)
Net public sector pension liability	(1,548.2)	(285.4)	(1.1)	(1,834.7)
Other non-current liabilities	(102.0)	(43.0)	(25.4)	(170.4)
Total liabilities	(3,387.9)	(359.3)	(576.5)	(4,323.7)
Net assets/(liabilities)	(2,115.7)	59.0	(364.0)	(2,420.7)

WGA uses the same classification of sectors of government as the ONS.

Central government comprises government departments, the devolved administrations of Scotland, Wales and Northern Ireland, non-departmental public bodies, entities in the National Health Service, the pension liability for all teachers included within the Teachers' Pension Scheme and certain local government functions in Northern Ireland and Scotland, such as police, education and social services, which are carried out by central departments. Central government also includes academy schools. The share of central government expenditure has been increasing over time as schools convert and transfer out of the local government sector.

Local government comprises all local authorities, police and crime commissioners, fire and rescue authorities, national park authorities and waste disposal authorities in England and Wales and local authorities in Northern Ireland and Scotland.

Public corporations comprise organisations which generate more than 50% of their income from the sale of goods and services, for example the British Broadcasting Corporation, Bank of England and Driver & Vehicle Standards Agency.

The remuneration and staff report in Chapter 4 provides a breakdown of staff numbers by sector.

Segmental reporting 2015-16

	Central government £bn	Local government £bn	Public corporations £bn	Whole of Government £bn
Taxation revenue	(539.7)	(52.7)	(0.2)	(592.6)
Other revenue	(51.9)	(39.4)	(10.0)	(101.3)
Total public services revenue	(591.6)	(92.1)	(10.2)	(693.9)
Social security benefits	194.4	27.4	0.7	222.5
Staff costs	123.9	64.5	4.9	193.3
Purchase of goods and services	114.0	70.3	7.8	192.1
Interest cost on government borrowing	28.3	-	-	28.3
Increase in provisions	8.1	0.5	0.6	9.2
Other expenditure	81.6	13.3	1.9	96.8
Total expenditure on public services	550.3	176.0	15.9	742.2
Net expenditure on public services	(41.3)	83.9	5.7	48.3
Financing costs of long-term liabilities, including discounting	174.5	11.0	1.9	187.4
Net loss on revaluations and disposals of assets and liabilities	8.8	(0.8)	0.1	8.1
Net expenditure/(revenue) for the year	142.0	94.1	7.7	243.8
Property, plant and equipment	713.2	336.5	70.5	1,120.2
Other non-current assets	221.5	23.1	27.4	272.0
Current assets	260.2	40.0	50.0	350.2
Total assets	1,194.9	399.6	147.9	1,742.4
Current government borrowings	(274.2)	-	-	(274.2)
Other current liabilities	(144.3)	(26.2)	(411.4)	(581.9)
Non-current government borrowings	(986.4)	-	-	(986.4)
Provisions non-current	(270.0)	(2.2)	(18.6)	(290.8)
Net public sector pension liability	(1,188.3)	(235.8)	(0.6)	(1,424.7)
Other non-current liabilities	(107.0)	(40.9)	(22.5)	(170.4)
Total liabilities	(2,970.2)	(305.1)	(453.1)	(3,728.4)
Net assets/(liabilities)	(1,775.3)	94.5	(305.2)	(1,986.0)

Note 4. Taxation revenue

	2016-17 £bn	% of total	2015-16 £bn	% of total
Income Tax	173.8	28%	169.5	29%
National Insurance Contributions (NIC)	108.6	17%	102.1	17%
Value Added Tax (VAT)	124.4	20%	116.1	20%
Corporation Tax	52.4	8%	45.2	8%
Hydrocarbon oils duty	28.0	4%	27.7	5%
Excise duty	26.8	4%	26.4	4%
Stamp taxes	15.9	3%	14.8	2%
Capital gains tax	8.4	1%	7.3	1%
Other taxes and duties	30.8	5%	26.6	4%
Central government taxation revenue	569.1	90%	535.7	90%
Council Tax	30.8	5%	29.6	5%
National Non-Domestic Rates (NNDR)	28.2	5%	27.3	5%
Local government taxation revenue	59.0	10%	56.9	10%
Total taxation revenue	628.1	100%	592.6	100%

There has been an increase of 6% in total tax revenue in 2016-17:

Income tax increased by 3% compared to 2015-16. This increase was largely due to growth in the economy, leading to higher levels of employment and higher wages.

NICs increased by 6% compared to 2015-16. The increase is due to the growth in the economy which has led to higher levels of employment and growth in wages.

VAT increased by 7% compared to 2015-16, influenced by higher oil prices, which led to significant increases in receipts for the gas, mining and oil sectors. There was also strong growth in the construction and pharmaceutical sectors.

Corporation Tax increased by 16% compared to 2015-16.

Hydrocarbon oils increased by 1% compared to 2015-16.

Excise Duties includes duties on tobacco, alcohol, customs and vehicles. Overall, Excise duties increased by 2% compared to 2015-16 which reflects various changes in habits and duty rates. There were increases in duty rates for alcohol alongside a slight increase in consumer purchases for home consumption. Tobacco duty however reduced due to the fall in cigarette consumption.

Stamp Taxes are taxes related to the purchase of property or shares. Overall, stamp taxes increased by 7% compared to 2015-16, mainly driven by the introduction of higher rate for additional properties. This was also helped by continuing increase in property prices, in both the residential and commercial sectors.

Council Tax income has increased by 4% compared to 2015-16, due to an increase in the average tax rate of 1.1% and an increase in the tax base, i.e. the number of taxable dwellings.

NNDR are collected by local authorities from those that occupy a non-domestic property, based upon valuations set by the Valuation Office Agency. The total income from NNDR rose by 3% compared to 2015-16.

Note 5. Other revenue

	2016-17 £bn	2015-16 £bn
Sale of goods and services	35.2	35.5
Fees, levies and charges	12.5	12.8
Rental income	10.5	10.5
Interest income	7.4	6.3
Net (loss)/profit on sale of assets	(2.1)	6.3
EU income	4.1	4.0
Private sector contributions to local services	2.7	3.1
Pension scheme income	2.6	2.5
NHS related income	3.1	2.6
Train operator franchise income	1.9	1.8
Deferred income	1.6	1.6
Licence income	1.7	1.6
Grants from private sector	1.6	1.4
CRC allowances sales and EU emissions trading scheme	1.1	1.1
Charitable income	0.9	1.0
Pensions other	0.5	0.8
Recoveries and recharges	0.5	0.4
Miscellaneous operating revenue	6.9	8.0
Total other revenue	92.7	101.3

The most significant source of revenue, after taxation, for government is the **sale of goods and services** analysed below:

	2016-17 £bn	2015-16 £bn
Services provided by local authorities	17.9	18.4
Public corporations	7.0	7.0
Highways and transport services provided by TfL	4.5	4.4
Central government	4.0	3.9
NHS	1.8	1.8
Total sale of goods and services	35.2	35.5

Services provided by local authorities include social care, planning and development, cultural and leisure provision and environmental services. Services provided by public corporations include the supply of waste services, water services and advertising. Services provided by central government include waste management and electricity generation.

Fees, levies and charges include fees and charges to recover the full cost of providing services and levies. The most significant sources are analysed below:

	2016-17 £bn	2015-16 £bn
Transport / passenger rail services	2.6	2.2
Visa, immigration and passport	1.7	1.8
Levies	1.8	1.8
Court fines and penalties	1.0	1.7
NHS fees and charges (dental, prescription and other)	1.9	1.5
Other fines and penalties	0.2	0.9
Other	3.3	2.9
Total fees, levies and charges	12.5	12.8

Rental income from local government housing relates to rents and related costs collected from local government council tenants.

EU income comprises funding received by WGA entities for projects supported wholly or partly by the EU. Much of this funding was passed onto third parties, including agricultural subsidies payments to farmers. The increase is mostly driven by the Department for Environment, Food & Rural Affairs.

Pension scheme income relates to employer contributions from organisations which participate in public sector pension schemes but are not themselves consolidated within the WGA boundary. Examples included GPs and charity hospices that contributed to the NHS pension scheme; higher and further education institutions and independent teaching establishments that contributed to the Teachers' Pension Scheme. It also includes non-WGA entities such as the National Audit Office, Wales

Audit Office and Electoral Commission that contribute to the Principal Civil Service Pension Scheme. Employer contributions from bodies within WGA totalled £18.0 billion (2015-16: £15.9 billion) of which £15.4 billion (2015-16: £13.4 billion) have been eliminated on consolidation. Employee contributions totalled £8.5 billion (2015-16: £8.3 billion), this was netted of against current service costs in staff costs in compliance with the FReM.

Pensions other includes transfers in from other schemes.

Note 6. Social security benefits

	2016-17 £bn	% of total	2015-16 £bn	% of total
State pension	93.8	42%	91.5	41%
Pension credit	6.0	3%	6.2	3%
TV licences for the over 75's	0.6	0%	0.6	0%
Pensioner benefits	100.4	45%	98.3	44%
Disability lving allowance	12.5	6%	14.3	6%
Attendance allowance	5.7	3%	5.7	3%
Personal independence payment	5.1	2%	3.0	1%
Carer's allowance	2.8	1%	2.7	1%
Disability and carer's benefits	26.1	12%	25.7	11%
Employment and support allowance	15.6	7%	15.0	7%
Jobseeker's allowance	2.0	1%	2.4	1%
Income support	2.5	1%	2.9	1%
Statutory sick pay and maternity pay	2.2	1%	2.5	1%
Other working age benefits	2.8	1%	3.0	1%
Working age benefits	25.1	11%	25.8	11%
Tax credits	30.5	14%	31.3	14%
Child benefit	11.7	5%	11.7	5%
Other benefits administered by HMRC	42.2	19%	43.0	19%
Housing benefit	27.4	12%	28.0	14%
Other benefits	2.5	1%	1.7	1%
Total social security benefits	223.7	100%	222.5	100%

Spending on **total social security benefits** increased by 1% compared with 2015-16, with the increase being mainly due to the annual uprating of the State Pension.

The **State pension** at £93.8 billion is the largest benefit and accounted for 42% of total social security benefit spending. Overall, just under half of benefit spending goes to pensioner benefits (45%). The 'triple lock' uprating policy gave an above inflation increase in 2016-17, meaning spending increased in real terms.

Benefits paid in support for **Disability and carer's benefit** were £26.1 billion, an increase of £0.4 billion from 2015-16.

Working age benefits of £25.1 billion went to people of all ages on low incomes, to protect them from poverty and improve their life chances.

Tax credits of £30.5 billion (2015-16: £31.3 billion) consists of personal tax credit and corporation tax reliefs. This amount has decreased due to a reduction of personal tax credits.

Housing benefit decreased by 2% in 2016-17. This is a benefit paid to assist people with their rent if they are on a low income. It can pay all or part of the rent, depending on the individual's circumstance. The benefit is administered and paid by local authorities, which are then reimbursed by DWP. The DWP recovered over £1.3 billion of debt in 2016-17, which is consistent with the prior year.

DWP publishes statistical summaries every quarter.[8] The summary that aligns closest to the financial year 2016-17 was the summary published in November 2017. This analysed data as at May 2017. There were 20 million claimants in total, with 13 million of those being of state pension age, and 6.8 million being working age.

Fraud and error

As the welfare system is funded by taxpayers, it is of paramount importance that government seeks to make accurate payments to claimants who are entitled to them. The departments responsible for benefit payments continue to work hard to reduce fraud and error. Refer to Chapter 1 for further information.

8 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/659423/dwp-quarterly-benefit-stats-summary-november-2017.pdf

Note 7. Staff costs and numbers

	Permanently employed staff £bn	Others £bn	2016-17 Total £bn	2015-16 Total £bn
Salaries and wages	139.8	11.2	151.0	149.6
Pension scheme costs: current service costs (net of employees' contributions)	37.5	-	37.5	40.2
Pension scheme costs: past service costs	0.6	-	0.6	1.4
Pension scheme costs: losses on settlements and curtailments	(0.2)	-	(0.2)	(0.4)
Expenditure on external pension schemes	2.2	-	2.2	2.5
Total staff costs	179.9	11.2	191.1	193.3

Full details of staff costs and number of staff employed can be found in the remuneration and staff report in Chapter 4 and in the segmental analysis in Note 3 of Chapter 5.

Note 8. Purchase of goods and services

	2016-17 £bn	2015-16 £bn
Central government	117.6	114.0
Local government	69.6	70.3
Public corporations	7.6	7.8
Total purchases of goods and services	194.8	192.1

The Department of Health reported the largest expenditure on purchases of goods and services of £65.8 billion (2015-16: £64.8 billion). Other departments that reported large expenditure include HMRC, Ministry of Defence and Scottish Government. Further information on overall expenditure on public services can be found in the performance analysis in Chapter 1.

Note 9. Grants and subsidies

	2016-17 £bn	2015-16 £bn
Further and higher education sector	19.8	19.9
Contribution to the EU budget	12.2	11.3
EU grants and subsidies to the private sector	3.0	2.3
Overseas assistance and contributions	8.2	7.8
Cultural, heritage and sport	2.3	1.6
Transport	0.8	0.9
Housing	0.3	0.4
Scottish Government private sector grants	2.6	2.8
Welsh grants	1.4	2.2
Other grants and subsidies	3.0	4.9
Total grants and subsidies	53.6	54.1

Further and higher education grants are paid to colleges and universities.

The UK's **contribution to the EU budget** is the amount payable to the EU after the UK's rebate has been applied.

EU grants and subsidies to the private sector relate to projects which have been approved and funded by the EU but are administered by government, such as agricultural support. The EU reimburses the UK for this expenditure and the corresponding income is included in Note 5.

Overseas assistance and contributions includes contributions made by the Department for International Development to reduce poverty in developing countries; the majority of payments are made to multilateral organisations and non-government organisations in support of the Single Departmental Plan and UK's Aid Strategy. The Government is committed to spending 0.7% of the gross national income on international development.

Housing grants and subsidies covers a range of initiatives to improve the supply and quality of housing. Expenditure includes grants made to housing associations and other bodies to invest in affordable housing, Help to Buy and private market investment.

Scottish Government provides a range of grants to deliver their policies as reported in the portfolio outturn statements in their consolidated accounts.

Welsh Government provides a range of grant schemes to deliver their policies and create a fairer, more prosperous Wales. This includes funding to businesses and third sector organisations in order to improve the economy, encompassing a wide range of activities such as business start-ups, regeneration, energy saving initiatives, training and tourism.

Note 10. Depreciation and impairment

	Note	2016-17 £bn	2015-16 £bn
Depreciation of property, plant and equipment	12	29.0	29.8
Amortisation of intangible assets	14	3.5	3.6
Impairments and revaluations		14.6	9.3
Total depreciation and impairment		47.1	42.7

Impairments refers to the impairment of property, plant and equipment, intangible assets, trade receivables, financial assets and revaluation expenditure.

Note 11. Finance expense

	2016-17 £bn	2015-16 £bn
Interest on gilts	29.0	25.5
National Savings and Investment products	2.3	2.1
Treasury bills	0.4	0.5
Bank deposits and other	0.1	0.2
Total interest costs on government borrowing	31.8	28.3

Interest costs on government borrowing comprised interest on gilts, National Savings and Investment products, bank deposits and treasury bills. It excludes interest paid on gilts held by the Bank of England as part of its quantitative easing programme.

	Note	2016-17 £bn	2015-16 £bn
Pension financing costs	24	50.5	52.1
Provision financing costs	22	9.3	127.9
Other finance expense		8.5	7.4
Total financing costs of long-term liabilities		68.3	187.4

Pension financing costs and **provision financing costs** relate mainly to changes in the discounting of future liabilities to produce an estimate of their value today, rather than a change to the actual amount expected to be paid out. An explanation of discounting and discount rates is included in the performance analysis in Chapter 1 and further details are included in notes 22 and 24.

Other finance expense includes £4.4 billion (2015-16: £4.7 billion) of financing costs from PFI and finance leases. Further details on obligations under finance leases and PFI contracts are included in notes 26 and 27.

Note 12. Property, plant and equipment

Property, plant and equipment 2016-17

	Infrastructure assets	Land and buildings	Assets under construction	Military equipment	Other assets	Total
	£bn	£bn	£bn	£bn	£bn	£bn
Cost of valuation:						
At 1 April 2016	766.1	453.7	53.3	75.1	107.2	1,455.4
Additions	4.9	10.3	31.1	0.4	4.8	51.5
Revaluations and impairments	22.8	7.2	(3.3)	1.8	1.7	30.2
Reclassifications and transfers	5.1	5.6	(17.8)	0.6	2.1	(4.4)
Disposals	(0.3)	(7.7)	(0.2)	(2.2)	(4.5)	(14.9)
At 31 March 2017	798.6	469.1	63.1	75.7	111.3	1,517.8
Depreciation:						
At 1 April 2016	(193.5)	(47.8)	-	(41.3)	(52.6)	(335.2)
Charged in year	(8.8)	(10.8)	-	(2.9)	(6.5)	(29.0)
Revaluations and impairments	(1.1)	3.6	-	(1.1)	(0.3)	1.1
Reclassifications and transfers	0.1	0.7	-	1.1	0.3	2.2
Disposals	0.3	4.8	-	1.6	4.0	10.7
At 31 March 2017	(203.0)	(49.5)	-	(42.6)	(55.1)	(350.2)
Carrying amount at 31 March 2016	572.6	405.9	53.3	33.8	54.6	1,120.2
Carrying amount at 31 March 2017	595.6	419.6	63.1	33.1	56.2	1,167.6
Asset financing:						
Owned	587.0	384.6	61.9	33.1	50.8	1,117.4
Finance leased	-	6.8	0.1	-	4.0	10.9
On balance sheet PFI contracts	8.6	28.2	1.1	-	1.4	39.3
Carrying amount at 31 March 2017	595.6	419.6	63.1	33.1	56.2	1,167.6

Infrastructure assets include the:

- railway network held by Network Rail of £288.9 billion (2015-16: £280.1 billion)
- strategic road network assets held by the Highways England of £114.2 billion (2015-16: £110.0 billion)
- highways network asset held by local authorities of £68.1 billion (2015-16: £65.1 billion)

- networked assets held by Scottish Water of £56.3 billion (2015-16: £52.2 billion)

The value of infrastructure assets has increased by £22.9 billion during 2016-17 reflecting new additions, indexation adjustments and the completion of assets under construction. These included investments in the rail and road networks by the Department for Transport and investment in transport infrastructure by Transport for London. Further information on the valuation of infrastructure assets is included in the critical accounting policies in ote 2.

Land and buildings increased by £13.9 billion overall. The most significant revaluation related to land and buildings held by the Ministry of Defence, amounting to £1.7 billion.

Reclassifications and transfers include assets reclassified between assets under construction to other types of assets, transfers to and from intangible assets and transfers to and from operating expenditure or reserves. Of the £18.0 billion outflow from assets under construction, £3.5 billion relates to the Ministry of Defence. This is made up mainly of £1.0 billion into transport equipment and £0.6 billion transferred into military equipment. Other large reclassifications and transfers under assets under construction include £3.4 billion relating to the completion of infrastructure within the Department for Transport.

Other assets consist of:

	Plant and machinery	Transport equipment	IT equipment	Furniture, fittings and other	Total other assets
	£bn	£bn	£bn	£bn	£bn
Carrying amount at 31 March 2016	17.5	14.9	5.3	16.9	54.6
Carrying amount at 31 March 2017	18.3	15.5	5.1	17.3	56.2

Property, plant and equipment 2015-16

	Infrastructure assets £bn	Land and buildings £bn	Assets under construction £bn	Military equipment £bn	Other assets £bn	Total £bn
Cost of valuation:						
At 1 April 2015	748.0	427.4	48.8	71.3	105.1	1,400.6
Additions	5.1	10.1	29.7	3.0	3.2	51.1
Revaluations and impairments	6.5	16.5	(3.2)	0.9	(0.2)	20.5
Reclassifications and transfers	7.4	6.7	(21.8)	2.5	3.6	(1.6)
Disposals	(0.9)	(7.0)	(0.2)	(2.6)	(4.5)	(15.2)
At 31 March 2016	766.1	453.7	53.3	75.1	107.2	1455.4
Depreciation:						
At 1 April 2015	(186.8)	(47.5)	-	(39.5)	(51.0)	(324.8)
Charged in year	(9.1)	(11.0)	-	(3.4)	(6.3)	(29.8)
Revaluations and impairments	1.9	3.2	-	(0.5)	0.4	5.0
Reclassifications and transfers	(0.3)	0.9	-	-	0.4	1.0
Disposals	0.8	6.6	-	2.1	3.9	13.4
At 31 March 2016	(193.5)	(47.8)	-	(41.3)	(52.6)	(335.2)
Carrying amount at 31 March 2015	561.2	379.9	48.8	31.8	54.1	1,075.8
Carrying amount at 31 March 2016	572.6	405.9	53.3	33.8	54.6	1,120.2
Asset financing:						
Owned	564.3	371.0	52.3	33.8	49.4	1,070.8
Finance leased	-	6.5	-	-	4.1	10.6
On balance sheet PFI contracts	8.3	28.4	1.0	-	1.1	38.8
Carrying amount at 31 March 2016	572.6	405.9	53.3	33.8	54.6	1,120.2

Note 13. Investment properties

	2016-17 £bn	2015-16 £bn
As at 1 April	15.8	14.9
Additions	2.3	0.6
Revaluations and impairments	0.4	0.7
Disposals	(0.3)	(0.4)
As at 31 March	18.2	15.8

Investment properties comprise mainly of land and buildings owned by local authorities. They provide rental income for the funding of services, as part of a financial strategy to minimise the use of general reserves to meet ongoing expenditure.

Note 14. Intangible assets

Intangible assets 2016-17

	Military equipment £bn	Development expenditure £bn	Software £bn	Licences and other £bn	Total £bn
Cost or valuation:					
At 1 April 2016	32.0	11.3	8.3	10.3	61.9
Additions	2.0	0.7	0.2	1.0	3.9
Revaluations and impairments	0.9	0.2	0.1	0.1	1.3
Reclassifications	0.6	(0.8)	0.5	0.1	0.3
Disposals	(0.2)	(0.1)	(0.6)	(1.7)	(2.6)
At 31 March 2017	35.3	11.3	8.5	9.8	64.9
Amortisation:					
At 1 April 2016	(11.4)	(4.8)	(5.7)	(7.0)	(28.9)
Charged in year	(0.9)	(0.5)	(0.7)	(1.4)	(3.5)
Revaluations and impairments	(0.4)	(0.1)	(0.1)	0.0	(0.6)
Reclassifications	0.0	0.0	(0.1)	0.2	0.1
Disposals	0.2	0.1	0.6	1.6	2.5
At 31 March 2017	(12.5)	(5.3)	(6.0)	(6.6)	(30.4)
Carrying amount at 31 March 2016	20.5	6.5	2.6	3.3	33.0
Carrying amount at 31 March 2017	22.8	6.0	2.5	3.2	34.5

Military equipment primarily covers the development of new equipment and the improvement of the effectiveness and capability of existing military equipment. The Ministry of Defence's 2016-17 Annual Report and Accounts includes details of intangible assets with a carrying amount greater than £0.5 billion, the most significant of which is the ongoing development costs for the Typhoon Airframe which in 2016-17 amounted to £5.3 billion (2015-16: £5.4 billion).[9]

Intangible assets 2015-16

	Military equipment £bn	Development expenditure £bn	Software £bn	Licences and other £bn	Total £bn
Cost or valuation:					
At 1 April 2015	30.3	11.0	7.7	11.0	60.0
Additions	1.8	0.7	0.2	0.9	3.6
Revaluations and impairments	0.3	-	0.1	-	0.4
Reclassifications	(0.1)	(0.1)	0.5	-	0.3
Disposals	(0.4)	(0.3)	(0.2)	(1.4)	(2.3)
At 31 March 2016	31.9	11.3	8.3	10.5	62.0
Amortisation:					
At 1 April 2015	(10.6)	(4.4)	(5.1)	(7.5)	(27.6)
Charged in year	(0.9)	(0.5)	(0.7)	(1.5)	(3.6)
Revaluations and impairments	(0.2)	-	(0.1)	(0.1)	(0.4)
Reclassifications	-	-	-	0.3	0.3
Disposals	0.3	0.2	0.2	1.6	2.3
At 31 March 2016	(11.4)	(4.7)	(5.7)	(7.2)	(29.0)
Carrying amount at 31 March 2015	19.7	6.6	2.6	3.5	32.4
Carrying amount at 31 March 2016	20.5	6.6	2.6	3.3	33.0

9 https://www.gov.uk/government/publications/ministry-of-defence-annual-report-and-accounts-2016-to-2017

Note 15. Trade and other receivables

	2016-17 £bn	2015-16 £bn
Non-current:		
Taxation and duties due	5.2	5.0
Trade receivables	0.9	0.8
Other receivables	9.4	9.4
Prepayments and accrued revenue	1.1	1.1
Welfare overpayments	2.0	2.1
Total before impairment	18.6	18.4
Less: provision for impairment of receivables	(3.4)	(4.0)
Total non-current trade and other receivables	15.2	14.4
Current:		
Accrued tax revenue receivable	99.6	95.6
Taxation and duties receivable	28.0	26.0
Trade receivables	9.7	8.9
Other receivables	24.3	10.8
Prepayments and accrued revenue	10.9	13.6
Welfare overpayments	0.4	0.4
Court fines	2.7	2.5
Total before impairment	175.6	157.8
Less: provision for impairment of receivables	(17.6)	(17.5)
Total current trade and other receivables	158.0	140.3
Total trade and other receivables	173.2	154.7

Accrued tax revenue receivable represents amounts of taxes and duties relating to 2016-17 that were not yet due or received from taxpayers at time of HMRC publication, where these have not been included in taxation and duties due and collection is reasonably certain. The increase is broadly in line with the increase in tax revenue for 2016-17.

Taxation and duties receivables represent all taxpayer liabilities that have been established, irrespective of whether due or overdue, for which payments have not been received at the HMRC Statement of Financial Position date.

Other receivables include £11.4 billion for the sale of UKAR's Bradford and Bingley mortgage assets.

The provision for impairment of receivables is analysed below:

	Non-current £bn	Current £bn	2016-17 £bn	2015-16 £bn
Taxation and duties due	2.4	8.4	10.8	11.2
Welfare payments	1.0	0.2	1.2	1.2
Court fines	-	2.1	2.1	1.9
Other trade and other receivables	-	6.9	6.9	7.2
Total provision for impairment of receivables	3.4	17.6	21.1	21.5

Note 16. Other financial assets

	2016-17 £bn	2015-16 £bn
Non-current:		
Loans and deposits	32.3	48.3
Student loans	66.7	62.0
Equity investments	52.7	53.5
IMF quota subscription	22.0	19.7
Derivatives and other financial assets	32.0	25.3
Total non-current other financial assets	205.7	208.8
Current:		
Debt securities	104.2	83.2
Loans and deposits	119.7	61.5
Student loans	2.7	2.4
Equity investments	1.1	0.9
IMF Special Drawing Rights	9.0	7.2
Derivatives and other financial assets	16.5	9.0
Total current other financial assets	253.2	164.2
Total other financial assets	458.9	373.0

Loans and deposits increased by £42.2 billion. This is partly due to the sale of a portfolio of UKAR's Bradford and Bingley mortgage assets of £11.8 billion with a further £4.0 billion of mortgage redemptions and repayments, offset by an increase of £55.1 billion due to the Term Funding Scheme (TFS) loan scheme at the Bank of England. These are cash loans made to eligible participants, financed by the issuance of central bank reserves. These loans are secured against eligible collateral. More

detail on this scheme can be found in the 2016-17 accounts of the Bank of England Asset Purchase Facility Fund Limited.[10] Loans and deposits consists of:

	Non-current £bn	Current £bn	2016-17 £bn	2015-16 £bn
Loans	28.5	58.0	86.5	47.8
Deposits	3.8	10.9	14.7	18.2
Repurchase agreements	-	50.8	50.8	43.8
Total loans and deposits	32.3	119.7	152.0	109.8

Loans include £19.5 billion of mortgage loans by UKAR:

	2016-17 £bn	2015-16 £bn
Residential mortgages	18.9	34.7
Commercial loans	0.3	0.4
Unsecured loans	0.3	0.4
Total mortgage loans	19.5	35.5

Deposits mainly consist of deposits made by local government at commercial institutions of £12.8 billion.

Repurchase agreements increased by 16% and are funds advanced to banks (or bank subsidiaries) and central clearing counterparties under reverse repurchase agreements where securities were held as collateral and returned when the funds are repaid. Reverse sale and repurchase agreements were valued daily and depending on whether the value of the collateral rose or fell, collateral was returned to the provider of collateral, or additional securities requested from the provider of collateral. Further details are available in the 2016-17 accounts of the Exchange Equalisation Account,[11] Debt Management Office,[12] and Bank of England.[13]

Student loans are valued at the gross value of the loans issued discounted to net present value using the effective interest rate method and adjusted to take into account an estimate of the value of student loans which will not be repaid because of policy reasons, such as age of the student or loan.

[10] https://www.bankofengland.co.uk/asset-purchase-facility/2017/2016-17

[11] https://www.gov.uk/government/publications/exchange-equalisation-accounts-2016-to-2017

[12] https://www.gov.uk/government/publications/uk-debt-management-office-annual-report-and-accounts-2016-to-2017

[13] https://www.bankofengland.co.uk/annual-report/2017

The value of student loans assets has increased year on year and the movement is analysed below:

	2016-17 £bn	2015-16 £bn
As at 1 April	64.4	48.5
New loans issued (net of impairment)	5.6	10.2
Interest	2.0	1.2
Repayments	(2.6)	(2.1)
Effect of change in discount rate	-	7.2
Impairment adjustments	-	(0.6)
As at 31 March	69.4	64.4

The **equity investments** held by the government are set out below:

	2016-17 £bn	2015-16 £bn
RBS	20.4	18.8
Lloyds Banking Group	0.9	4.4
European Investment Bank	9.1	8.1
Other	23.4	23.1
Total equity investments	53.8	54.4

The value of RBS ordinary shares increased by £1.6 billion due to market gains. Lloyds Banking Group ordinary shares decreased by £3.5 billion primarily due to share sales. Further details regarding these equity investments can be found in the 2016-17 accounts of HM Treasury. The increase in value of the government's shareholding in the European Investment Bank is as a result of exchange rate movements during 2016-17 and an increase in the European Investment Bank's net assets.

The **IMF quota subscription** and **Special Drawing Rights (SDRs)** relate to the UK's investments in the IMF. On becoming a member of IMF in 1944, the UK was required to pay a quota subscription to the IMF in a mixture of SDRs, the IMF's unit of account, and other widely accepted currencies. The UK's quota subscription of 20,155 million SDRs was equivalent to £21.9 billion at 31 March 2017, an increase of £2.2 billion compared to the prior year.

Debt securities primarily relate to securities issued or guaranteed by the governments of the United States, Euro-area countries and Japan which are used to manage the government's foreign currency reserves. The government increased its holdings of foreign currency reserves during the year.

Derivatives and other financial assets include derivatives and other investments.

Note 17. Inventories

	Raw materials and consumables	Other	2016-17 Total	2015-16 Total
	£bn	£bn	£bn	£bn
As at 1 April	6.5	3.1	9.6	11.3
Additions	10.6	1.6	12.2	12.0
Disposals	(10.4)	(1.8)	(12.2)	(13.4)
Write-offs	(0.5)	(0.1)	(0.6)	(0.3)
Revaluation	0.2	(0.0)	0.2	0.0
As at 31 March	6.4	2.8	9.2	9.6

Raw materials and consumables includes £4.6 billion (2015-16: £4.6 billion) of supplies and spares for immediate and potential use by the Ministry of Defence.

Note 18. Cash and cash equivalents

	2016-17	2015-16
	£bn	£bn
Balance at 1 April	25.8	26.8
Net change in cash and cash equivalent balances	2.5	(1.0)
Balance at 31 March	28.3	25.8
The following balances at 31 March were held at:		
Government Banking Service	(3.2)	(3.5)
Commercial banks and cash in hand	14.9	15.4
Short term investments	16.6	13.9
Balance at 31 March	28.3	25.8

Note 19. Trade and other payables

	2016-17 £bn	2015-16 £bn
Non-current:		
Trade and other payables	9.5	11.4
Accruals and deferred income	11.3	11.9
Imputed finance lease element of on-balance sheet PFI contracts	37.7	37.5
Obligations under finance leases	4.6	4.7
Total current trade and other payables	63.1	65.5
Current:		
Trade and other payables	41.4	39.3
Accruals and deferred income	47.5	43.2
Refunds of taxation and duties payable	31.7	30.2
Imputed finance lease element of on-balance sheet PFI contracts	1.6	1.7
Obligations under finance leases	0.3	0.3
Total non-current trade and other payables	122.5	114.7
Total trade and other payables	185.6	180.2

Trade and other payables and **accruals and deferred income** were held across a wide range of public sector entities and relate to both day-to-day business delivery costs and other financial obligations.

Refunds of taxation and other duties payable relates mainly to council tax and business rates owed to the taxpayer and to amounts due to VAT traders where their claim was received after the end of the year and amounts in respect of corporation tax, income tax and other small taxes expected to be repayable by HMRC pending finalisation of taxpayer liabilities.

Further information on **obligations under finance leases** can be found in Note 26 while further information on **PFI commitments** can be found in Note 27.

Note 20. Government borrowings

	2016-17 £bn	2015-16 £bn
Non-current:		
Gilts	1,013.5	986.4
Total non-current government borrowings	1,013.5	986.4
Current:		
National Savings and Investment products (NS&I)	146.9	135.1
Treasury bills	69.6	78.3
Gilts	59.0	60.8
Total current government borrowings	275.5	274.2
Total government borrowings	1,289.0	1,260.6

The increase in total government borrowing is mainly due to additional gilts issued by the Debt Management Office (DMO) and a significant inflow from Premium bonds, Index Linked Savings Certificates and Income Bonds for NS&I products. Further information on the government's financial risk, including liquidity and funding risk, is included in Note 23.

NS&I products are a range of secure savings and investments offered to the public, that are backed by the Exchequer. They provide the government with a source for financing public spending. Further details of these products, and NS&I's 2016-17 accounts, can be found on the NS&I website.[14]

Treasury bills are issued by the Debt Management Account and, along with other money market operations, are used by the DMO to meet the government's daily cash requirements. Further details on these operations can be found in the Debt management report 2016-17, HM Treasury, March 2016.[15]

Gilts are UK government sterling denominated listed bonds that are fixed rate or index-linked with the return linked to movements in the Retail Price Index. As the government's debt manager, the DMO sells gilts to the market to ensure sufficient funding is available to meet the government's financial commitments. Gilts held by public sector entities are eliminated on consolidation and removed from the balance above, with the exception of gilts held by funded public sector pension schemes. Further details regarding gilts are available in the 2016-17 debt management report and the 2016-17 accounts of the National Loans Fund.[16]

14 https://nsandi-corporate.com/sites/default/files/2018-05/annual-report-2016-17-complete-website-version_0.pdf

15 https://www.gov.uk/government/publications/debt-management-report-2016-to-2017

16 https://www.gov.uk/government/publications/national-loans-fund-account-2016-to-2017

Note 21. Other financial liabilities

	2016-17 £bn	2015-16 £bn
Non-current:		
Deposits by banks	3.8	3.5
Bank and other borrowings	68.4	66.0
Debt securities	5.0	6.5
Derivatives	29.4	28.0
Financial Guarantees	0.3	0.3
Other financial liabilities	0.4	0.6
Total non-current other financial liabilities	107.3	104.9
Current:		
Deposits by banks	481.2	357.3
Banknotes in circulation	73.2	67.8
Bank and other borrowings	9.4	9.0
IMF Special Drawing Rights liability	11.0	9.9
Debt securities	1.4	3.2
Derivatives	8.7	5.2
Financial Guarantees	-	0.1
Total current other financial liabilities	584.9	452.5
Total other financial liabilities	692.2	557.4

Deposits by banks comprise mainly £469.1 billion of deposits, held primarily by the Bank of England, and £14.8 billion of reverse sale and repurchase agreements (reverse repo). Reverse sale and repurchase agreements are where an entity purchases securities and agrees to sell them back at a specified time and price. Securities pledged by an entity as collateral via reverse repo remain on its own Statement of Financial Position.

The 34% increase in current deposits by banks in 2016-17 is largely due to a rise in Bank of England sterling deposits repayable on demand. Banks and building societies hold reserves accounts (sterling current accounts) with the Bank of England, as the ultimate means of settling transactions. Banks and building societies are free to choose the level of reserves which they hold within their reserves accounts. Further information on these deposits can be found in the 2016-17 accounts of the Bank of England.[17]

[17] https://www.bankofengland.co.uk/annual-report/2017

Banknotes in circulation are issued by the Bank of England. The 8% increase in 2016-17 continues the trend of increasing demand for banknotes year on year. The Bank of England is responsible for maintaining confidence in the currency, by meeting demand with good-quality banknotes that the public can readily exchange.

Bank and other borrowings reflects loans and overdrafts. The largest component in this category relates to £25.8 billion of Network Rail long term debt.

International Monetary Fund (IMF) Special Drawings Rights (SDRs) has increased 11% in 2016-17. This comprises a liability to the IMF for those SDRs that were allocated when the UK became a participant in the SDR agreement and that have been allocated subsequently. A corresponding asset of £9.0 billion for the UK's actual holdings of SDRs is included in Note 16.

Debt securities comprise securitised notes and covered bonds issued by HM Treasury group and Bank of England to securitise loans to customers and to raise unsecured medium term funding.

Significant derivatives include a £12.3 billion balance held by the Department for Business, Energy and Industrial Strategy (formerly held by the Department of Energy and Climate Change) relating to contracts for difference. These are a mechanism used to support investment in low carbon generation projects, involving contracts with future generators of low carbon energy. Due to uncertainties in future electricity prices, it is not possible to quantify with certainty the settlement of these liabilities, or the impact on future financial results. The carrying value of £12.3 billion does not include unamortised deferred "day 1 liabilities" of £19.1 billion. The government entered into a contract for the Hinkley Point C (HPC) facility in 2016-17. The fair value of the HPC CfD is estimated as £28.8 billion as at 31 March 2017. The Contract for Difference related to HPC is not recorded on the balance sheet, partly due to the uncertainty of estimating wholesale energy prices to the end of the contract (2060). More details on the valuation of this contract can be found in Note 9 of the 2016-17 accounts for BEIS[18] and in Note 23 of WGA.

Other significant derivatives of £14.5 billion relate to the Pension Protection Fund and are mainly interest rate swaps, options, credit default swaps and forward foreign exchange contracts to support liability-driven investment.

[18] https://www.gov.uk/government/publications/beis-annual-report-and-accounts-2016-to-2017

Note 22. Provisions for liabilities and charges

Provision for liabilities and charges

	Nuclear decommissioning £bn	Clinical negligence £bn	Other provisions £bn	2016-17 Total £bn	2015-16 Total £bn
At 1 April	181.7	57.6	66.2	305.5	175.3
Provisions utilised in year	(3.1)	(1.9)	(7.1)	(12.1)	(8.9)
Increase in expected future pay-outs	2.8	7.7	16.1	26.6	16.9
Change in discount rate	4.9	5.2	0.5	10.6	125.2
Discount rate unwind	(1.3)	(0.2)	0.2	(1.3)	2.7
Provisions not required written back	(1.2)	(1.8)	(3.4)	(6.4)	(5.6)
Transfers to payables	1.1	(0.0)	(1.8)	(0.7)	(0.1)
At 31 March	184.9	66.6	70.7	322.2	305.5

Provision movement

	2016-17 £bn	2015-16 £bn
Amounts included in the Statement of Revenue and Expenditure:		
Increase in provisions	18.6	9.2
Provision expense in cost to public services	18.6	9.2
Discount rate changes	10.6	125.2
Discount rate unwind	(1.3)	2.7
Provision financing costs	9.3	127.9
Total expenditure recognised in the Statement of Revenue and Expenditure	27.9	137.1
Amounts included in the Statement of Financial Position	1.2	2.0
Provisions utilised in year	(12.1)	(8.9)
Total provision movement	17.0	130.2

Provision profile

	Nuclear decommissioning £bn	Clinical negligence £bn	Other provisions £bn	2016-17 Total £bn	2015-16 Total £bn
Within one year	3.9	3.3	8.4	15.6	14.7
Between one and five years	13.5	15.7	21.2	50.4	44.0
Thereafter	167.5	47.6	41.1	256.2	246.8
Total provision liability	184.9	66.6	70.7	322.2	305.5
Current provisions	3.9	3.3	8.4	15.6	14.7
Non-current provisions	181.0	63.3	62.3	306.6	290.8

The **total provision liability** has increased by £17.0 billion as at 31 March 2017. Of this, £10.6 billion was due to a change in the discount rates used to calculate their values in today's prices. Further information on discounting is included in the performance analysis in Chapter 1.

Each year the government reviews its obligations against all provisions and reviews the assumptions and judgements used to estimate the value of each provision. The estimates can be subject to significant revision if new information becomes available. Further information on the significant assumptions used in valuing the provisions for nuclear decommissioning and clinical negligence is included in the critical accounting policies in Note 2.

The **provision for nuclear decommissioning** represents the best estimate of the cost in today's prices of decommissioning the plant, land, buildings and equipment on each designated nuclear licenced site and returning them to pre-agreed end states. This programme of work is forecast to take at least until 2137 to complete.

The provision increased by £2.2 billion in 2016-17, largely as a result of the change in the discount rate used to produce a discounted present value.

Some expenditure is recoverable from third parties under commercial agreements. In these cases, expenditure in the Statement of Revenue and Expenditure is shown net of changes in the amount recoverable from third parties. The amount of recoverable costs included in the provision as at 31 March 2017 was £4.9 billion (2015-16: £5.0 billion).

The largest element of the provision relates to the Sellafield site which is the largest, most hazardous site that remains the government's highest priority for clean-up. Further information on the approach that the government is taking to manage its nuclear liabilities is included in the performance analysis in Chapter 1.

In respect of the Nuclear Liabilities Fund, assets of £9.2 billion have been recognised in the Statement of Financial Position but these assets can only be used in respect of nuclear decommissioning costs.

The provision for nuclear decommissioning was subject to an emphasis of matter on uncertainties inherent in the provisions relating to the costs of dealing with nuclear decommissioning in the Audit Opinion of the Comptroller & Auditor General.

Further details are available in the 2016-17 accounts of the Nuclear Decommissioning Authority.[19]

The **provision for clinical negligence** represents the value in today's prices of the cost of claims arising from harm that occurred up to 31 March 2017. As many claims are not paid out immediately but instead involve payments over many years, the liability includes determined claims as well as claims that are considered likely to be determined in the claimant's favour.

The provision increased by £9.0 billion in 2016-17, largely as a result of the change in the Personal Injury Discount Rate (PIDR). The NHS Litigation Authority (now NHS Resolution) manage claims against the NHS in England and they recorded a 2.5% decrease in the number of new clinical claims reported compared to the prior year (2016-17: 10,686 claims, 2015-16: 10,965 claims). Even though there was a 2.5% decrease in the number of new claims, the value of the provision has increased.

Further information on the actions being taken by government on clinical negligence is included in the performance analysis in Chapter 1.

Other provisions included a wide range of provisions across all parts of the public sector. These include provisions in relation to: injury benefits, medical costs, criminal injuries compensation, legal costs, compulsory purchases, concessionary fuel allowance to ex-miners, mine water treatment, public safety and subsidence, subsidence pumping stations and tip management, claims in respect of structural damage and diminution of value of properties affected by transport schemes, and compensation payments for termination of employment. The most significant provisions included in this balance are:

- £22.7 billion (2015-16: £19.5 billion) held by the Pension Protection Fund relating to liabilities to pay compensation to members and claims from pension schemes. The Pension Protection Fund retains the assets of the pension plans it rescues and generates investment growth to support the obligations it acquires. At 31 March 2017, it had net investments of £28.7 billion, £6.1 billion in excess of its liabilities[20]
- £7.3 billion (2015-16: £7.2 billion) held by the Department for Work and Pensions (DWP) for the Financial Assistance Scheme (FAS). FAS provides assistance to members of defined benefit occupational pension schemes that were wound up under-funded when their employers became insolvent during the period 1 January 1997 to 5 April 2005. The FAS provision is held to provide for liabilities arising from any FAS qualifying schemes once the assets from such schemes have transferred to government
- £6.4 billion (2015-16: £6.9 billion) held by HMRC relating to the repayment of tax receipts resulting from oil and gas field decommissioning, over the period 2017-18 to 2045-46. Since 2015-16, HMRC have made improvements to its forecasting model allowing for the use of more reliable administration data resulting in a smaller provision requirement. Through the use of new data and a revised methodology,

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[19] https://www.gov.uk/government/publications/nuclear-decommissioning-authority-annual-report-and-accounts-2016-to-2017

[20] https://www.gov.uk/government/publications/pension-protection-fund-annual-report-and-accounts-2015-to-2016

the Oil and Gas Authority have increased their estimate of the industry's costs for decommissioning the UK/UK Continental Shelf (UKCS). The net impact of these two changes is a reduction to this year's provision balance resulting in some provision being written back

- £7.8 billion (2015-16: £5.9 billion) held by HMRC relating to a number of legal and other disputes

Note 23. Financial instruments

This financial instruments note has two parts. The first part provides information on the significance of financial instruments on the government's balance sheet. The second part provides information about the nature and extent of risks arising from financial instruments and what the government does to manage these risks.

Financial assets by category 2016-17

	Note	Cash and cash equivalents	Loans and receivables	Held to maturity investments	Available for sale assets	Designated as fair value	Held for trading at fair value	2016-17 Total
		£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and cash equivalents	18	28.3	-	-	-	-	-	28.3
Trade and other receivables	15	-	173.2	-	-	-	-	173.2
Debt securities	16	-	-	-	-	-	104.2	104.2
Loans and deposits	16	-	85.0	2.7	-	-	64.3	152.0
Student loans	16	-	69.4	-	-	-	-	69.4
Equity investments	16	-	-	-	43.8	9.5	0.5	53.8
IMF quota subscription	16	-	22.0	-	-	-	-	22.0
IMF Special Drawing Rights	16	-	-	-	-	-	9.0	9.0
Other	16	-	2.0	8.3	12.2	0.3	25.7	48.5
Total financial assets		28.3	351.6	11	56	9.8	203.7	660.4

Financial assets by category 2015-16

	Note	Cash and cash equivalents	Loans and receivables	Held to maturity investments	Available for sale assets	Designated as fair value	Held for trading at fair value	2015-16 Total
		£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and cash equivalents	18	25.8	-	-	-	-	-	25.8
Trade and other receivables	15	-	154.7	-	-	-	-	154.7
Debt securities	16	-	-	-	6.8	18.7	57.7	83.2
Loans and deposits	16	-	99.1	1.9	-	-	8.8	109.8
Student loans	16	-	64.4	-	-	-	-	64.4
Equity investments	16	-	-	-	44.5	5.4	4.5	54.4
IMF quota subscription	16	-	19.7	-	-	-	-	19.7
IMF Special Drawing Rights	16	-	-	-	-	-	7.2	7.2
Other	16	-	1.8	1.2	7.6	2.3	21.4	34.3
Total financial assets		25.8	339.7	3.1	58.9	26.4	99.6	553.5

Financial liabilities by category 2016-17

	Note	Carried at amortised cost	Designated at fair value	Held for trading at fair value	2016-17 Total
		£bn	£bn	£bn	£bn
Trade and other payables	19	185.6	-	-	185.6
Government borrowings	20	1,289.0	-	-	1,289.0
Deposits by banks	21	458.3	3.4	23.3	485.0
Banknotes in circulation	21	73.2	-	-	73.2
Bank and other borrowings	21	77.8	-	-	77.8
Derivatives	21	-	2.6	35.5	38.1
Debt securities	21	-	6.4	-	6.4
IMF Special Drawing Rights liability	21	-	-	11.0	11.0
Financial Guarantees	21	0.3	-	-	0.3
Other	21	0.4	-	-	0.4
Total financial liabilities		2,084.6	12.4	69.8	2,166.8

Financial liabilities by category 2015-16

	Note	Carried at amortised cost	Designated at fair value	Held for trading at fair value	2015-16 Total
		£bn	£bn	£bn	£bn
Trade and other payables	19	180.2	-	-	180.2
Government borrowings	20	1,260.6	-	-	1,260.6
Deposits by banks	21	334.0	3.5	23.3	360.8
Banknotes in circulation	21	67.8	-	-	67.8
Bank and other borrowings	21	75.0	-	-	75.0
Derivatives	21	-	14.6	18.6	33.2
Debt securities	21	9.7	-	-	9.7
IMF Special Drawing Rights liability	21	-	-	9.9	9.9
Financial Guarantees	21	0.4	-	-	0.4
Other	21	0.6	-	-	0.6
Total financial liabilities		1,928.3	18.1	51.8	1,998.2

In most cases the value of assets and liabilities shown on the balance sheet either equals or is a reasonable approximation of fair value. The main exceptions are government borrowings and the Contracts for Differences (CfD) liability (included in derivatives in the table above). Gilt-edged securities have a carrying amount of £1,072.5 billion (2015-16: £1,047.2 billion) and a fair value of £1,398.6 billion (2015-16: £1,276.3 billion), reflecting the higher amount that investors are willing to pay in order to secure a certain level of interest payment. The CfD liability has a carrying value of £12.3 billion (2015-16: £12.6 billion) and a fair value of £31.4 billion (2015-16: £30.6 billion). The difference of £19.1 billion relates to a 'day one' loss from when the contracts were first entered into and is required by accounting standards to be deferred. This additional liability will be gradually recognised in the financial statements over the contract lifetime.

The government entered into the Hinkley Point C contract for difference on 29 September 2016. The fair value of the CfD liability is valued at £28.8 billion. This valuation required an estimate of wholesale electricity prices to 2060. There is significant estimation uncertainty with electricity prices past 2040. Due to this uncertainty, the CfD for Hinkley Point C is not recognised on the Statement of Financial Position. Further details can be found in the BEIS annual report and accounts for 2016-17.[21]

The government also has gold holdings which are treated as being similar to a financial asset and, as such, reported at fair value based on the sterling equivalent of the London Bullion Market association dollar denominated spot bid price as at 31 March 2017. During 2016-17 the price of gold rose from £860 to £996 an ounce, an increase of 16%, giving rise to a revaluation gain of £1.4 billion. During 2015-16 the price of gold rose from £799 to £860 an ounce, an increase of 8%, giving rise to a revaluation gain of £0.6 billion.

Fair value hierarchy

Assets and liabilities carried at fair value are valued using a 'fair value hierarchy' which gives highest priority to quoted prices in active markets for identical instruments (level 1 inputs), second priority to valuation techniques based on observable inputs (level 2) and lowest priority to valuation techniques using unobservable inputs. Where valuation techniques are based on unobservable inputs (level 3) then the appropriate valuation technique is chosen, including use of discounting of future cash flows and the use of the net asset values underlying the unquoted equity investment. The table below summarises asset and liability fair values based on the valuation technique used.

21 https://www.gov.uk/government/publications/beis-annual-report-and-accounts-2016-to-2017

Fair value hierarchy 2016-17

	Level 1 £bn	Level 2 £bn	Level 3 £bn	2016-17 Total £bn
Financial assets at fair value:				
Debt securities	94.2	8.5	1.5	104.2
Equity investments	29.6	1.1	23.1	53.8
IMF Special Drawing Rights	9.0	-	-	9.0
Loans and deposits	-	64.3	-	64.3
Other	5.5	28.2	4.5	38.2
Financial liabilities at fair value:				
Deposits by banks	(0.6)	(26.1)	-	(26.7)
IMF SDR allocation	(11.0)	-	-	(11.0)
Other	(6.6)	(25.5)	(12.4)	(44.5)

Fair value hierarchy 2015-16

	Level 1 £bn	Level 2 £bn	Level 3 £bn	2015-16 Total £bn
Financial assets at fair value:				
Debt securities	76.1	6.7	0.4	83.2
Equity investments	41.0	2.4	11.0	54.4
IMF Special Drawing Rights	7.2	-	-	7.2
Loans and deposits	-	8.8	-	8.8
Other	3.7	24.4	3.2	31.3
Financial liabilities at fair value:				
Deposits by banks	(10.1)	(16.7)	-	(26.8)
IMF SDR allocation	(9.9)	-	-	(9.9)
Other	(0.8)	(19.3)	(13.1)	(33.2)

The most significant individual level 3 liability balance is the CfD contracts which uses a discounted cash flow methodology. Further details can be found in the annual report and accounts of the Department for Business, Energy and Industrial Strategy. Another significant level 3 asset is the investment in the European Investment Bank (EIB). The valuation of this asset changes based on the movement in the EIB's net assets and changes due to exchange rate movements. Further details can be found in the accounts of the Consolidated Fund.[22]

[22] https://www.gov.uk/government/publications/consolidated-fund-account-2016-to-2017

Liquidity and funding risk

The government's objective when funding its operations is to minimise, over the long term, the costs of meeting the government's financing needs, taking into account risk, while ensuring that debt management policy is consistent with the aims of monetary policy.

Each year, the government assesses the costs and risks associated with different possible patterns of debt issuance taking into account the most up-to-date evidence and information about market conditions and demand for debt instruments. This information is used to set the Debt Management Office's (DMO's) financing remit which is published alongside the Budget and updated during the year to reflect changes to government's cash requirements.

Refinancing risk is the risk that the government will need to roll over high levels of debt continuously, or that redemptions will be concentrated in particular years. This risk is mitigated by taking decisions which spread gilt issuance along the maturity spectrum. The issuance profile used in 2016-17 is summarised below:

	Short conventional (0-7 years)	Medium conventional (7-15 years)	Long conventional (over 15 years)	Index linked	Unallocated
2016-17 debt issuance %[a]	26	20	30	25	0

a Figures may not sum due to rounding

The government's cash management objective is to ensure that sufficient funds are always available to meet any net daily cash shortfall and, on any day when there is a net cash surplus, to ensure this is used to the best advantage. HM Treasury and the DMO work together to achieve this. The Treasury is responsible for daily forecasts of net flows into or out of the Exchequer. Its objective is to provide the DMO with timely and accurate forecasts of the expected net cash position over time. The DMO then carry out market transactions to either fund or place the net cash positions in order to minimise the costs of cash management while operating within the risk appetite approved by ministers.

In 2016-17 the DMO carried out its cash management objective primarily through market instruments and Treasury bill sales. The DMO operates within agreed risk limits and the main market instruments used are sterling-denominated repurchase agreements and reverse repurchase agreements. The following balances were held by the DMO as at 31 March 2017:

- £32.2 billion (2015-16:£19.6 billion) of secured lending under reverse sale and repurchase agreements and recognised as loans and deposits
- £17.8 (2015-16: £7.5 billion) of liabilities where government has sold securities and agrees to buy them back at a specified time and price

For further details see the DMA's 2016-17 annual report and accounts.[23]

[23] https://www.gov.uk/government/publications/uk-debt-management-office-annual-report-and-accounts-2016-to-2017

Local authorities adopt independent liquidity risk management, and this is done within a statutory framework. Local authorities are required by the Local Government Finance Act 1992 to provide a balanced budget, which ensures sufficient funds are raised to cover annual expenditure. Medium term plans generally set targets for liquidity ratios, which are approved as part of the annual budget setting process. To manage liquidity risk, local authorities can access borrowings from the money markets to cover any day to day cash flow need and can access longer term funds from financial institutions or from the government's Public Works Loan Board. Balances between the Public Works Loan Board and Local Authorities are eliminated on consolidation in WGA.

Interest rate risk

At present, annual debt management decisions are made in the context of an elevated level of debt relative to gross domestic product (GDP) and fiscal consolidation. As a result, subject to cost-effective financing, the government has decided to maintain a relatively high proportion of fixed-rate exposure at a relatively long average maturity in the debt portfolio to limit exposure to interest rate volatility. The government is exposed to cash flow interest rate risk on its remaining floating-rate investments and borrowings.

The most significant floating rate investments and borrowings are index-linked gilts and NS&I products, debt issued by Network Rail and student loans. Other central government departments do not invest or access funds from commercial sources, so have negligible exposure to interest rate risk.

Index-linked gilts expose the government to both interest rate risk and inflation risk whereby interest and redemption amounts paid on index-linked gilts vary monthly in line with changes in RPI. If interest rates were to increase by 100 basis points, then this would increase government's borrowing costs by £530 million and if RPI were to increase by 100 basis points then government's borrowing costs would rise by £4.3 billion. An element of this would be eliminated within the government boundary.

Network Rail has a combination of fixed, floating, index-linked debt issuances. Like with the government's gilt portfolio, this gives rise to interest rate risk and inflation risk. If interest rates were to increase by 100 basis points, then this would increase Network Rail's borrowing costs by £0.7 billion (2015-16: £1.2 billion) and if RPI were to increase by 100 basis points then Network Rail's borrowing costs would rise by £0.2 billion (2015-16: £0.2 billion).

The interest rate on pre-2012 student loans is the lower of RPI and the Bank of England base rate plus 1%. The amount of interest repayable is therefore subject to fluctuations in base rates and RPI. The impact of the interest rate risk for student loan issued under the pre-2012 scheme is factored into the carrying value as the student loan repayment model calculates the impact of interest rate on expected future cash flows. There is inherent risk in forecasting the amount of interest payable and if the UK experiences base rates that are lower than RPI the future cash flows will be impaired further. It would require a change in RPI of 2.8% to increase or decrease the value of the pre-2012 loan book by 1%. The same change in the post 2012 undergraduate full time loan book would require a 4.2% change in RPI.

Counterparty risk

The categories where the main counterparty risk are found are: debt securities (£104.2 billion), loans and deposits (£151.9 billion), student loans (£69.4 billion) and IMF balances (£31.0 billion).

The majority of **debt securities** (£76.8 billion, 2015-16: £69.0 billion) are held in the EEA, and comprise the UK's official holding of international reserves. The Government holds foreign currency reserves on a precautionary basis to meet current policy objectives to regulate the exchange value of sterling and any potential future changes in policy.

Foreign currency assets inevitably carry some element of credit risk. In order to keep this risk at a low level, the government predominantly invests in securities issued or guaranteed by the national governments of the United States, Euro-area countries and Japan. The EEA debt securities are held at an equivalent external rating of AA and above (£73.1 billion, 2015-16: £64.5 billion) and A to AA (£3.7 billion, 2015-16: £4.5 billion) and were held within Europe (£34.5 billion, 2015-16: £31.5 billion), North America (£40.0 billion, 2015-16: £34.4 billion), and Asia-Pacific (£2.3 billion, 2015-16: £3.1 billion). Further details on the government's credit risk management of foreign currency reserves can be found in the annual report and accounts of the EEA.[24]

Other significant financial assets include those lent under the Funding for Lending Scheme (FLS). Under FLS participating banks and building societies can until January 2018 borrow Treasury Bills from the Bank of England in exchange for eligible collateral. The aim of the FLS is to increase the supply of credit to the real economy by incentivising Banks and other financial institutions to boost their lending to UK households and businesses. The FLS has contributed to a fall in bank funding costs.

The NLF issues Treasury Bills for sale to the Debt Management Account (DMA) which makes them available to be borrowed by the Bank of England. As at 31 March 2017, on an amortised cost basis, £75.1 billion (2015-16: £86.4 billion) of Treasury Bills issued to the DMA by the NLF for the FLS were outstanding; further details are available from the accounts of both the National Loans Fund[25] and the Bank of England.[26]

Loans and deposits mainly comprise of mortgages made by UKAR (£19.5 billion, 2015-16 £35.5 billion) which are not rated, and reverse sale and repurchase agreements (£50.8 billion, 2015-16 £43.8 billion). £55.1 billion of the loan balance is made up of TFS loans made by the bank of England Asset Purchase Facility Fund.

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24 https://www.gov.uk/government/publications/exchange-equalisation-accounts-2016-to-2017

25 https://www.gov.uk/government/publications/national-loans-fund-account-2016-to-2017

26 https://www.gov.uk/government/publications/national-loans-fund-account-2016-to-2017

The impact of credit risk on UKAR's loan book is shown by the following table of allowances for mark-downs of impaired assets.

	Balance sheet value £bn	2016-17 Provision £bn	Balance sheet value £bn	2015-16 Provision £bn
Loans secured on residential property	18.8	0.6	34.7	0.7
Other secured loans	0.3	0.1	0.4	0.1
Unsecured personal loans	0.3	0.1	0.4	0.1
Total UKAR loans	19.4	0.8	35.5	0.9

For more details on disclosures relating to UKAR, please refer to the accounts of HM Treasury.[27] The balance on residential mortgages reduced by £15.8 billion due to the sale of UKAR's Bradford and Bingley mortgage assets which had a carrying value of £11.8 billion and repayments of £4.0 billion.

Reverse sale and repurchase agreements are mainly entered into by the Bank of England, DMA, and EEA. Exposures to credit risk are fully collateralised and assets held as collateral are revalued daily. The government returns collateral to the provider of collateral, or requests additional collateral, depending on whether the value of collateral has risen or fallen. Details on collateral held under these agreements can be found in the accounts of the entities above.

The government intentionally takes on counterparty risk through **student loans**. Eligible students can get loans regardless of their credit rating in order to support the policy aim of encouraging students to enter higher and further education. There is no obligation to repay the loan until the borrower's income reaches a certain income threshold and there are other circumstances when the loan will be written off, for example based on the age of the student. Therefore, even though most repayments are collected by HMRC as part of the tax collection process, not all of the loans will be repaid.

Of the total student loans provided by government (£69.3, 2015-16: £64.4 billion), the Department for Education holds £61.4 billion. In 2016-17 responsibility for Student loans moved from Department for Business, Innovation and Skills to Department for Education. The face value of the loan book was £88.8 billion compared to a balance sheet value of £61.3 billion (2015-16: face value of £75.8 billion compared to a balance sheet value of £56.6 billion). The impact of credit risk and policy decisions on repayment conditions on these loans are shown by the following table of allowances for mark-downs of impaired assets:

27 https://www.gov.uk/government/collections/hmt-annual-report

	Balance sheet value £bn	2016-17 Provision £bn	Balance sheet value £bn	2015-16 Provision £bn
Pre-2012 higher education loans	29.7	13.1	33.7	10.8
Post 2012 higher education loans	31.6	14.4	23.0	7.9
Total student loans held by Department for Education[a]	61.3	27.5	56.9	18.8

A 2015-16 balances were held by the Department for Business, Innovation and Skills

The table above shows that the overall level of impairment increased in 2016-17. The repayment threshold for post 2012 loans is frozen at £21,000. The pre-2012 repayment threshold is set as £17,495. The loans are based on complex models, which a series of assumptions including the latest OBR short and long term forecasts for RPI, base rates and earnings growth. The valuation of the student loan books is uncertain as they are highly dependent on macroeconomic circumstances and graduate earnings over the next 30 years, as well as a number of other complex assumptions, for around five million borrowers.

Balances with the IMF are made up of the IMF quota subscription (£22.0 billion, 2015-16: £19.7 billion) and IMF SDRs (£9.0 billion, 2015-16: £7.2 billion). SDRs are an international reserve asset created by the IMF. SDRs represent a claim to currency held by IMF member countries for which they may be exchanged. The government's holdings result from SDR allocations made by the IMF, any subsequent purchases and sales of SDRs from or to other IMF members and fair value changes.

The largest balance within **other financial instruments** is derivatives (£17.5 billion, 2015-16: £16.5 billion). Of the derivative balance the largest individual material balances are with the Pension Protection Fund (PPF) (£13.5 billion, 2015-16: £12.5 billion), and EEA (£2.1 billion, 2015-16: £1.6 billion). The PPF manage the risks associated with this by using counterparties rated at least A- (or subject to increased collateral) and are subject to overall exposure limits. The EEA manage the risks associated with this by counterparty and issuer limits and collateralisation. Further details can be found in the PPF[28] and EEA accounts.

In providing liquidity via the Term Funding Scheme **(TFS)** the Bank of England Asset Purchase Facility manages credit risk by ensuring that exposures are fully collateralised (with appropriate haircuts) by a wide range of collateral. The collateral can include mortgage-backed securities, covered bonds backed by mortgages or public sector securities, or portfolios of loans in unsecuritised form. The collateral must meet published eligibility criteria. A summary of eligible criteria is available on the Bank of England website, and further details can be found in the Bank of England Asset Purchase Facility Fund accounts.[29]

28 http://www.pensionprotectionfund.org.uk/DocumentLibrary/Documents/PPF_Annual_Report_2016_17.pdf

29 https://www.bankofengland.co.uk/asset-purchase-facility/2017/2016-17

Foreign exchange rate risk

The government is mainly exposed to foreign exchange risk on the UK's official holdings of international reserves ('the Official Reserves'). Foreign currency reserves are held on a precautionary basis that could be used, when necessary, to regulate the exchange value of sterling, and is the mechanism through which any UK government exchange rate intervention would be conducted, for example in the event of any unexpected shocks.

The Official Reserves comprise two components: reserves that are hedged for currency and interest rate risk ('the hedged reserves'), and the remaining reserves which are unhedged for currency and interest rate risk ('the unhedged reserves'). The Official Reserves comprises assets held by the Exchange Equalisation Account (EEA) consisting of the UK's reserves of gold, foreign currency assets, and IMF SDRs, and assets held in the National Loan Fund (NLF) comprising the UK's Reserve Tranche Position at the IMF and lending to the IMF.

The Treasury has appointed the Bank of England to act as its agent in the day-to-day management of the EEA in accordance with an agreed framework and to manage the foreign currency assets and liabilities associated with the reserves of the NLF.[30] The Bank of England monitors and controls market risk primarily by using a Value at Risk (VaR) model, which estimates a loss level that will not be exceeded at a specified confidence level, over a defined period of time, that losses will not exceed the VaR figure in 99 out of a 100 two-week periods.

The Bank reports the VaR on a benchmark reserve on a six-monthly basis. The values of the benchmark reserves are based on market-to-market prices at the end of the period.

Benchmark reserves

	$ Millions 2017	$ Millions 2016
Hedged reserves		
VaR as at 31 March	109	102
Unhedged Reserves		
VaR as at 31 March	2,246	1,237

In addition to foreign currency reserves, the government is exposed to foreign exchange risk through the UK's transactions with the **IMF**. The UK's quota subscription and lending to the IMF are both denominated in SDR and are subject to valuation adjustments by the IMF. The UK's liabilities to the IMF, although denominated in sterling, are also subject to valuation adjustments by the IMF.

Investments in financial institutions primarily relates to the value of the UK's capital investment in the European Investment Bank (EIB) of £9.1 billion (2015-16: £8.1 billion) as based on the UK's share of the EIB's net assets in euros. Therefore, the

[30] An annual Service Level Agreement between the Treasury and the Bank of England, a summary is included in a Treasury report entitled 'Management of the Official Reserves' available at https://www.gov.uk/government/publications/management-of-the-official-reserves.

government is exposed to foreign exchange rate risk on the fair value of this equity investment.

Price Risk

The Government is exposed to price risk on its shareholdings in RBS and Lloyds Banking Group. The fair value of these UK listed shares fluctuates as a result of changes in market prices. Market prices for a particular share may fluctuate due to factors specific to the individual share or its issuer, or factors affecting all shares traded in the market. The UK Financial Investments Limited (a wholly-owned subsidiary of HM Treasury) is responsible for the development and execution of an investment strategy for disposing of the investments in RBS and Lloyds Banking Group in an orderly and active way, within the context of protecting and creating value for the taxpayer.

Note 24. Public sector pensions

Pension liabilities

The public sector pension liabilities are summarised in the following table with figures separated out for each of the Principal bodies with schemes. The table also shows the percentage change in the net liabilities between 2015-16 and 2016-17.

	Scheme liabilities £bn	Scheme assets £bn	2016-17 Net liabilities £bn	2015-16 Net liabilities £bn	Change in scheme liabilities %
Unfunded schemes					
NHS (UK)	591.8	-	591.8	443.8	33.3
Teachers (UK)	398.3	-	398.3	311.9	27.7
Civil Service (UK)	257.0	-	257.0	205.8	24.9
Armed Forces	191.8	-	191.8	145.2	32.1
Police (UK)	157.5	-	157.5	130.3	20.9
Royal Mail	46.8	-	46.8	38.3	22.2
Fire (UK)	31.0	-	31.0	26.0	19.2
Other unfunded	22.8	-	22.8	19.1	19.4
	1,697.0	-	1,697.0	1,320.4	28.5
Funded schemes					
Local government (UK)	363.8	(246.1)	117.7	92.0	27.9
Other funded	93.1	(73.1)	20.0	12.3	61.8
	456.9	(319.2)	137.7	104.3	31.9
Total	2,153.9	(319.2)	1,834.7	1,424.7	28.8

The Local Government Pensions Scheme (LGPS) is the largest funded scheme. The LGPS (England and Wales) consists of 90 separately administered funds, with the LGPS (Scotland) having a further 11 funds. The individual local authority employers that contributed to these funds recognised their proportion of the scheme liabilities in their statement of accounts. The local government funded schemes balance disclosed above includes the portion of the pension liability of the LGPS that was reported in the financial accounts of the individual local authority employers.

Other unfunded schemes include schemes within the UK Atomic Energy Authority (UKAEA Pension Scheme) £8.3 billion (2015-16: £6.7 billion); and the Research Councils (RCPS) £5.2 billion (2015-16: £4.2 billion).

Other funded schemes comprise largely balances reported by Academy schools in the Local Government Pension Scheme £7.4 billion (2015-16: £4.0 billion), Department for Transport - including Network Rail £4.7 billion (2015-16: £ 3.1 billion); Ministry of Justice £1.7 billion (2015-16: £1.3 billion); and BBC £1.1 billion (2015-16: £1.0 billion). It also includes other LGPS liabilities for bodies within the WGA boundary which are not local authorities.

In addition to updates provided in annual accounts, public sector pension schemes carry out periodic full actuarial valuations which are used to set employer contribution rates. The last full published actuarial valuations for a majority of the unfunded pension schemes were carried out as at 31 March 2012, which set the employer contribution rates for a 4-year period from 1 April 2015.

Increase in pension liabilities

The table below breaks down the changes in the present value of gross scheme liabilities over the financial year.

	Unfunded £bn	Funded £bn	Total £bn
Gross liability at 1 April 2016	1,320.4	370.3	1,690.7
Current service costs (net of participants' contribution)	28.4	9.1	37.5
Past service costs	0.4	0.2	0.6
Settlements/curtailments	(0.1)	(0.6)	(0.7)
Interest on scheme liabilities	47.2	12.9	60.1
Contribution by scheme participants	9.1	2.1	11.2
(Gains)/Losses on revaluation:			
Experience gains and losses arising on liabilities	(20.3)	0.9	(19.4)
Changes in assumptions underlying the value of liabilities	352.0	72.7	424.7
Benefits paid	(40.3)	(11.9)	(52.2)
Transfers in/(out)	0.2	1.2	1.4
Gross liability at 31 March 2017	1,697.0	456.9	2,153.9

Overall, the net public sector pension liability increased by £409.9 billion during the year. This is broken down as follows:

	2016-17 £bn	2015-16 £bn
Net liability at 1 April	1,424.7	1,493.3
Net (gains)/losses on revaluation	361.4	(123.0)
Current service costs (net of participants' contributions)	37.5	40.2
Net interest costs	50.5	52.1
Unfunded schemes benefits paid	(40.3)	(40.0)
Past service costs	0.6	1.4
Net settlements/curtailments	(0.2)	(0.4)
Contribution by unfunded scheme participants	9.1	8.9
Contribution by funded scheme employers	(8.6)	(8.4)
Net transfers in/(out)	-	0.6
Net liability at 31 March	1,834.7	1,424.7

As summarised in the above tables, the change in the net pension liability is largely dictated by four factors:

- the revaluation gain or loss, which at this year end increases the liability but last year decreased the liability
- the current service costs which increase the liability
- the net interest costs which increase the liability
- the benefits paid from the unfunded schemes which reduce the liability

This volatility in the **revaluation gain or loss** is predominantly due to the change in assumptions, in particular the discount rate net of inflation and demographic assumptions. The discount rate for central government schemes is determined by those responsible for the management of the individual pension funds and is based on yields of high quality (AA) corporate bonds. The return on corporate bonds is only used to discount the future benefit payments to the present day, therefore whilst movement in the assumption has a significant impact on the liability figure in the accounts from year to year, as shown by the sensitivity analysis, it does not influence the level of benefits received by the members.

The key financial assumptions are shown in Note 2.5 and show that, for the central government unfunded schemes, the (net of CPI) discount rate decreased from 1.37% in 31 March 2016 to 0.24% in 31 March 2017. The decrease in discount rate increases the present value of liabilities. This actuarial loss from the discount rate change is recognised in other comprehensive income rather than against net expenditure.

The table below shows the approximate sensitivity of the unfunded liability to changes in key assumptions. The sensitivity will be broadly similar for the gross liability of the funded schemes.

	% change	£bn change
Increasing the assumption by 0.5% a year:		
Discount rate	(11%)	(187)
Rate of increase in pensions	9%	153
Increasing assumed life expectancy in retirement by 1 year	3%	51

The **current service cost** is an estimate made by scheme actuaries of the benefit earned by employees in the year. The majority of the unfunded schemes were reformed. Over the long term this is expected to reduce the current service cost compared to the position if the reforms had not taken place.

The **net interest cost** reflects the increase in the present value of the pension liability during the year because the benefits are one period closer to settlement. The financing cost is based on the discount rate (including inflation) at the start of the year and is calculated on the net liability. The expense from unwinding the discount rate is recognised against net expenditure.

Pension assets

Funded pension schemes hold the following assets:

	Local government £bn	Other funded £bn	2016-17 Total £bn	2015-16 Total £bn
Equity investments	154.5	31.0	185.5	145.0
Bonds	37.7	19.7	57.4	44.9
Other	53.9	22.4	76.3	76.1
Total market value	246.1	73.1	319.2	266.0

The 'other' balance consisted of property, cash and other alternative assets, such as hedge funds and private equity, diversified growth funds, or infrastructure investments, which have varying levels of performance.

Increase in pension assets

The table below breaks down the increase in the fair value of funded scheme assets over the financial year.

	2016-17 £bn
Gross assets at 1 April	266.0
Interest on scheme assets	9.6
Actual return less interest on scheme assets	43.9
Contributions by employers	8.5
Contributions by scheme participants	2.2
Benefits paid	(11.9)
Assets distributed on settlements	(0.5)
Transfers in/out	1.4
Gross assets at 31 March	319.2

Amounts recognised in the financial statements

Amounts recognised in the Statement of Revenue and Expenditure are as follows:

	Unfunded £bn	Funded (net) £bn	2016-17 Total £bn	2015-16 Total £bn
Current service cost	28.4	9.1	37.5	40.2
Past service cost	0.4	0.2	0.6	1.4
Settlements/curtailments	(0.1)	(0.1)	(0.2)	(0.4)
Net financing cost	47.2	3.3	50.5	52.1
Total recognised in the Statement of Revenue and Expenditure	75.9	12.5	88.4	93.3

Amounts recognised in the Statement of Other Comprehensive Income are as follows:

	2016-17 £bn	2015-16 £bn
Actual return less expected return on scheme assets	(43.9)	5.3
Experience gains and losses arising on liabilities	(19.4)	(27.2)
Changes in assumptions underlying the value of liabilities	424.7	(101.1)
(Gain)/loss on revaluation of (net) liabilities	361.4	(123.0)

The actual return on the assets was slightly lower than the interest on the assets over the year 2016-17 (the interest is determined based on the discount rate applicable at the start of the year).

Note 25. Capital commitments

Capital commitments comprise future commitments to capital expenditure that are contracted for, but not provided for in the financial statements. Capital commitments for the acquisition of property, plant and equipment, loans and investments for capital projects and intangible assets for which no provision has been made in these financial statements amounted to £53.0 billion (2015-16: £48.4 billion).

The most significant capital commitments included those reported by the Ministry of Defence of £21.1 billion (2015-16: £19.1 billion), Department of Transport of £5.1 billion (2015-16: £3.9 billion), Transport for London of £2.9 billion (2015-16: £4.1 billion) and Department for Education of £2.9 billion (2015-16: £3.3 billion). No other individual capital commitments exceeded £3.0 billion.

Note 26. Commitments under leases

Operating leases

Total future minimum lease payments under operating leases are given in the table below analysed according to the period in which the lease expires.

	2016-17 £bn	2015-16 £bn
Obligations under operating leases comprised:		
Total payments within one year	2.3	2.6
Total payments between one and five years	6.0	6.2
Total payments thereafter	9.7	9.4
Total future minimum lease payments under operating leases	18.0	18.2

The most significant operating leases included Department of Health of £2.7 billion (2015-16: £2.8 billion), Ministry of Justice of £1.6 billion (2015-16: £1.8 billion), Transport for London of £1.3 billion (2015-16: £1.0 billion), Academies of £1.0 billion and Department for Transport of £1.0 billion (2015-16: £1.2 billion).

Finance leases

Total future minimum lease payments under finance leases are given in the table below, analysed according to the period in which the lease expires.

	2016-17 £bn	2015-16 £bn
Obligations under finance leases comprised:		
Total payments within one year	0.6	0.6
Total payments between one and five years	1.8	1.9
Total payments thereafter	21.6	21.9
Total	24.0	24.4
Less interest element	(18.8)	(19.5)
Total present value of obligations	5.2	4.9

The most significant finance lease relates to a land and buildings lease entered into by the Ministry of Defence of £1.7 billion (2015-16: £1.7 billion) to provide homes for service personnel and their families.

Note 27. Commitments under Private Finance Initiative (PFI) contracts

PFI contracts recognised on the Statement of Financial Position

PFI assets are recognised on the Statement of Financial Position where the government controls or regulates the services, to whom they are provided, the price, and any significant residual interest in the asset at the end of the contract.

The net book value of PFI assets included in the Statement of Financial Position was £39.3 billion (2015-16: £38.8 billion) as at 31 March 2017. The PFI liability for the present value of capital amounts payable was £39.3 billion (2015-16: £39.2 billion).

The net present value of future obligation of £42.8 billion excluding service charges was different from the liability recognised on the Statement of Financial Position of £39.3 billion for a number of reasons. Some WGA entities included costs such as contingent rents and lifecycle replacement costs in future obligations but not in the liability figure. Some WGA entities also reported future obligations but had not recognised a liability in their accounts as the related PFI asset had not yet been commissioned.

The substance of these contracts is that the government has a number of finance leases which comprise two elements: imputed finance lease charges and service charges.

Details of the imputed finance lease charges are given in the table below:

	2016-17 £bn	2015-16 £bn
Obligations for future periods arise in the following periods:		
No later than one year	4.7	4.6
Later than one year and not later than five years	17.8	17.0
Later than five years	56.8	57.7
	79.3	79.3
Less interest charges allocated to future periods	(36.5)	(38.8)
Net present value of obligations	42.8	40.5

Details of the minimum service charge are given in the table below:

	2016-17 £bn	2015-16 £bn
Obligations for future periods arise in the following periods:		
No later than one year	5.9	5.5
Later than one year and not later than five years	19.6	19.3
Later than five years	63.8	70.4
Total service charges	89.3	95.2

Future obligations arising 'later than 5 years' may arise for another 30 to 40 years, depending on the individual contract.

The PFI obligations by segment of government were:

	2016-17 £bn	2015-16 £bn
Central government departments and entities within the NHS	45.5	43.8
Local authorities	32.7	34.0
Public corporations	1.0	1.5
Gross present value of future finance lease obligations	79.2	79.3

Details of all of the government's PFI schemes are published on the gov.uk website.[31]

PFI contracts not recognised on the Statement of Financial Position

During the 2016-17 financial year, a number of WGA entities had PFI contracts which were not recognised on the Statement of Financial Position because the private sector contractor was, on balance, considered to have greater control over the use of the asset.

31 https://www.gov.uk/government/publications/private-finance-initiative-and-private-finance-2-projects-2017-summary-data

HM Treasury has considered whether assets not recognised on the Statement of Financial Position of any one entity should be consolidated as a shared ownership asset. It concluded that there are none with a significant value that should be included in 2016-17 WGA that are not already consolidated.

Note 28. Other financial commitments

Commitments from other non-cancellable contracts that are not leases or PFI contracts are as follows:

	2016-17 £bn	2015-16 £bn
Financial commitments expiring in future years:		
No later than one year	18.6	13.9
Later than one year and not later than five years	20.6	18.3
Later than five years	4.7	5.4
Total financial commitments	43.9	37.6

The most significant other financial commitments are summarised below:

Entity	Description of commitment	2016-17 £bn	2015-16 £bn
Department of Health	Service contracts for Informatics programmes, formally known as the NHS National Programme of Information Technology, as well as commitments relating to the purchase of childhood and adult vaccines and research and development for improved health care.	5.1	4.8
Ministry of Justice	Commitments in respect to a number of non-cancellable contracts for contracted out services including the management of prisons.	3.2	3.8
BBC	Long term outsourcing arrangements for information technology, finance support and facilities management as well as programme acquisitions and sports rights.	3.5	3.5
Department for Education	Grant funding commitments with higher education institutions and training providers as well as non-cancellable contracts for the previous student loan debt sale and marking key stage tests.	5.4	5.5

Note 29. Contingent liabilities disclosed under IAS 37

Quantifiable contingent liabilities

Total quantifiable contingent liabilities are as follows:

	2016-17 £bn	2015-16 £bn
Export guarantees and insurance policies	12.8	11.6
Clinical negligence	36.5	26.7
Taxes subject to challenge	18.7	49.1
Transport infrastructure projects	8.3	7.6
Other	7.7	9.3
Total quantifiable contingent liabilities	84.0	104.3

Individually significant contingent liabilities with a potential liability of at least £3.0 billion are detailed below:

Entity	Contingent liability	2016-17 £bn	2015-16 £bn
Department for Transport	The Department for Transport supports the delivery of the Crossrail project, and has provided indemnities and assurances to parties carrying risks that they would be unable to bear	5.6	4.5
Export Credits Guarantee Department	The Export Credits Guarantee Department supported exports and investments through issuing and renewing guarantees and insurance policies. It issues guarantees and insurance against loss for, or on behalf of, exporters of goods and services and overseas investors from the UK, and supports the provision of fixed-rate export finance.	12.8	11.7
Department of Health	The Department of Health is the actual or potential defendant in a number of actions regarding alleged clinical negligence. In some cases, costs have been provided for or otherwise charged to the Department's accounts. In other cases, there is a large degree of uncertainty as to the department's liability and amounts involved.	35.3	26.5
HMRC	HMRC is engaged in a number of legal and other disputes which can result in claims by taxpayers against HMRC. This covers a range of cases, including Corporation Tax and VAT.	18.7	49.1

There was a large decrease in contingent liabilities for HMRC, £18.7 billion in 2016-17 (2015-16: £49.1 billion). This is due to revisions of estimates for cases currently in litigation, reduced likelihood of payment for certain cases and cessation of litigation action.

Further information on liabilities arising from clinical negligence and taxes subject to challenge can be found in Note 22 on provisions. In addition, Chapter 1 provides trend information on the government's exposure to quantifiable contingent liabilities.

Non-quantifiable contingent liabilities

Contingent liabilities can also be unquantifiable. The most significant liabilities are detailed below:

Legal claims

Non-quantifiable contingent liabilities have arisen as a result of a number of legal claims, compensation claims and tribunal cases made against a range of WGA entities, for which no reliable estimate of liability could be made.

Commitments in relation to pension scheme deficits

Non-quantifiable contingent liabilities have arisen as a result of commitments made by several WGA entities to provide funding for pension liabilities of individual pension schemes, should those schemes require deficits to be funded.

Contingent liabilities for reinsurance arising from acts of terrorism

Pool Re and Pool Re (Nuclear) are mutual reinsurance companies owned by insurers. They provide insurance cover to industrial and commercial property and nuclear facilities for damage and consequent business interruption arising from terrorist attacks in Great Britain. HM Treasury carries the contingent liability for the risk that the losses incurred by Pool Re or Pool Re (Nuclear) exceed their available resources. These arrangements are set out in the Reinsurance (Acts of Terrorism) Act 1993. Maximum potential liabilities under this arrangement are considered unquantifiable.

Civil nuclear liabilities

The Department for Business, Energy & Industrial Strategy has a range of civil nuclear liabilities arising from both the United Kingdom Atomic Energy Authority and British Nuclear Fuels Limited and obligations under international nuclear agreements and treaties.

Financial Assistance Scheme

Regulations came into force in April 2010 enabling the transfer to government of pension scheme assets that qualify for the Financial Assistance Scheme (FAS), along with their associated pension liabilities. It is estimated that the total value of assets transferred to government will reach £176 million. However, it will not be possible for the Department for Work and Pensions to estimate the impact on the FAS pension liability until all the assets transfer.

Contingent liability in relation to the Channel Tunnel

The Department for Transport has a statutory liability under the Channel Tunnel Act 1987 that if, after termination of the Channel Tunnel concession, it appears to the Secretary of State that the operation of the tunnel will not be resumed in the near future, necessary steps shall be taken to ensure that the land is left in a suitable condition in accordance with the scheme.

Contingent liability in relation to Transport for London

TfL guarantees the payments of certain of its subsidiaries under a number of other service and construction contracts. It guarantees Crossrail Limited's payments to Canary Wharf Properties (Crossrail) Limited under a Development Agreement. It guarantees pension liabilities due to the London Pension Fund Authority from Briggs Marine Contractors Limited in respect of employees working on the Woolwich Ferry. It has guaranteed amounts owed by London Bus Services Limited to the fuel Cells and Hydrogen Joint Undertaking under a Grant agreement for the 3EMOTION Environmentally Friendly, Efficient Electric Motion project. It has guaranteed London Underground Limited's payment obligations as a tenant in respect of an operating lease for the Stratford City Business District. It has also provided an indemnity to Berkeley 55 Limited in respect of future Mayoral CIL payments that Berkeley 55 Limited may be charged in relation to the fit out of the Crossrail station at Woolwich.

Service Life Insurance

The government provides access to life insurance for Ministry of Defence service personnel through Service Life Insurance. Details of the scheme and key features can be found on their website.[32]

Note 30. Remote contingent liabilities reported to Parliament

In addition to the contingent liabilities reported in Note 29, government departments additionally disclose contingent liabilities where the risk of crystallisation is remote. These remote contingent liabilities are not required to be disclosed under accounting standards but are reported here on the basis that guarantees, indemnities and letters of comfort expose the taxpayer to financial risk.

Quantifiable remote contingent liabilities

The potential costs of the government's quantifiable remote contingent liabilities are as follows:

	1 April 2016	Increase in year	Liabilities crystallised in year	Obligations expired in year	31 March 2017
	£bn	£bn	£bn	£bn	£bn
Guarantees	68.8	6.2	-	(1.0)	74.0
Indemnities	16.5	-	-	(2.1)	14.4
Letters of comfort	-	11.4	-	-	11.4
Total	85.3	17.6	-	(3.1)	99.8

32 www.sli365.com.

Individually significant remote contingent liabilities with a potential liability of at least £5.0 billion are detailed below:

Entity	Contingent liability	2016-17 £bn	2015-16 £bn
HM Treasury (Consolidated Fund Account)	The UK is liable for callable capital to the European Investment Bank (EIB). Under Article 5 of the EIB Statute, the Board of Directors may call upon each member state to pay its share of the balance of the subscribed capital should the bank have to meet its obligations.	30.5	28.3
HM Treasury	On 31 March 2017, the Chancellor announced the sale of a portfolio of UKAR's Bradford and Bingley loan book assets. The remote contingent liability covers certain market standard warranties. The crystallisation of any liability is dependent on the occurrence and identification of any defects covered by the fundamental market standard warranties. The maximum potential liability is capped at the sale proceeds of £11.4 billion.	11.4	0
Department for International Development	Contingent liabilities in respect of callable capital on investments in international financial institutions.	15.0	13.0
HM Treasury (Consolidated Fund Account)	This represents the UK's maximum liability from current outstanding loans to EU Member States and Third Countries for which the risk is ultimately borne by the EU Budget. Loans are issued under the following initiatives: the European Financial Stabilisation Mechanism (EFSM); the Balance of Payments Facility; and the Guarantee Fund to Third Countries.	12.0	11.6
Department for Culture, Media and Sport	The Government Indemnity Scheme indemnifies lenders to museums, galleries and other institutions when mounting exhibitions or taking long-term loans for study or display. This figure also includes non-statutory indemnities granted in respect of art on loan from the Royal Collection.	6.5	6.8
Department for Transport	The Department for Transport has contingent liabilities arising from the signing of new, replacement and extended passenger rail franchises agreements, and other agreements to encourage railways investment (£2.8 billion). It also has contingent liabilities for the HS1 concession agreement (£2.4 billion) and potential losses under the Thameslink Rolling Stock contracts (£2.7bn).	7.9	6.7

Non-quantifiable remote contingent liabilities

Remote contingent liabilities can also be unquantifiable. The most significant liabilities are detailed below:

Notification to leave the EU – Article 50

On 29 March 2017 the UK Government submitted its notification to leave the EU in accordance with Article 50. The triggering of Article 50 started a two-year negotiation process between the UK and the EU, during which the UK remains a full member of the EU with all the rights and obligations arising from membership. The negotiations are ongoing and as such have not given rise to any legal or constructive obligation for any components of the Whole of Government Account 2016-17. Further information on the EU withdrawal can be found on page 55.

There are a number of unquantifiable remote contingent liabilities disclosed in individual 2016-17 annual report and accounts of central government bodies reflecting the remote possibility at the reporting date that they may be required to settle any liabilities arising from changes in legislation, regulation and funding arrangements resulting from EU exit on behalf of UK Government.

Regional development banks and funds

The Department for International Development has entered into non-quantifiable contingent liabilities relating to the maintenance of the value of subscriptions paid to the capital stock of regional development banks and funds, such as the African and Asian Development Banks.

National Health Service

The Department of Health has entered into a number of unquantifiable or unlimited contingent liabilities with various health bodies and private companies. There were 19 unquantifiable indemnities. None of these are a contingent liability within the meaning of IAS 37 since the possibility of a transfer of economic benefit in settlement is too remote.

Nuclear matter

Indemnities have been given to UK Atomic Energy Authority (UKAEA) by the Department for Business, Innovation and Skills to cover indemnities given to carriers against certain claims for damage caused by nuclear matter in the course of carriage.

Guarantee to protect British Telecom's pension liabilities

When BT was privatised in 1984, the government gave a guarantee (contained in the Telecommunications Act 1984) in respect of certain liabilities of the privatised company. This guarantee only applies if BT were to enter insolvent winding up and is approximately the size of the BT pension scheme deficit at that point. The latest triennial valuation of the pension scheme as at 30 June 2014 valued the deficit at £7.0 billion.

Note 31. Related party transactions

Related parties in the context of WGA are public sector entities that have not been consolidated into the 2016-17 WGA. The most significant WGA related party is the

Royal Bank of Scotland Group plc. In the course of normal business, WGA entities entered into arms-length banking transactions with this institution, including loans, deposits, reimbursement of related expenses, payment of management fees, interest receipts and dividends. The volume and diversity of these transactions make comprehensive disclosure impractical.

Due to the nature of HM Revenue and Customs' business, it had a large number of transactions relating to taxation income with other public sector entities not within the WGA boundary.

Local government entities had transactions with municipal ports, airports and parish councils, primarily through the provision of funding. They also had transactions with local government pension schemes and record their share of the schemes assets and liabilities in their accounts. Further details are available in the 2016-17 accounts of the individual entities.

The Department for Education, through the Skills Funding Agency, and local authorities, provided funding to further education colleges in England and Wales for research and provision of further education courses. Through the Higher Education Funding Council, it provided funding for research and higher education courses.

On 30 October 2015, the Office for National Statistics (ONS) reclassified some Private Registered Providers of social housing from the private sector to the public sector as non-financial public corporations. The Department for Communities (which was renamed as the Ministry of Housing, Communities and Local Government in January 2018) and Local Government became the sponsor department for these bodies.

Note 32. Events after the reporting period

The following events that have occurred after the reporting period have been identified as significant to WGA. The FReM modifies financial reporting requirements for the purposes of WGA in that the requirement that the financial statements be adjusted for significant transactions or events that occur between the date of the consolidated entity's reporting date and the WGA reporting date do not apply, and therefore all such events are non-adjusting.

Article 50

On 29 March 2017 the UK Government submitted its notification to leave the EU in accordance with Article 50. Since the reporting date the negotiation process was formally launched on 19 June 2017. The UK is scheduled to leave the EU on 29 March 2019, after which an implementation period until 31 December 2020 has been agreed. Until the UK leaves the EU on 29 March 2019, it remains a full member of the EU with full rights and obligations arising from membership (see box 1.E in Chapter 1).

Sales to the private sector

On 31 March 2017, the Chancellor announced the sale of UKAR's Bradford & Bingley mortgage assets. The sale proceeds of £11.4 billion were received by Bradford and Bingley in full on 25 April 2017.

On 17 May 2017, the Treasury sold its remaining Lloyds Banking Group ordinary shares, fully returning Lloyds Bank to the private sector. The proceeds from shares sold after 31 March 2017 were £948 million.

On 17 August 2017, BEIS sold its shareholding of £1.5 billion (value at 31 March 2017) in the Green Investment Bank to the Macquarie Group Limited. At the date of sale the value of the shareholding was £1.6 billion.

In December 2017, DfE completed the first sale of pre-2012 (ICR) Income Contingent Related student loans, generating £1.7 billion of proceeds. The Sale of Student Loans Act (2008) provided the legal basis for completing this sale.

On 5 June 2018 the government sold 7.7% of its shareholding in the Royal Bank of Scotland. This reduces the government's stake from 70.1% to 62.4%. The sale raised £2.5 billion in proceeds and will be reflected in the 2018-19 Whole of Government Accounts.

Grenfell fire

Following the tragic fire at Grenfell Tower in London on 14 June 2017, the Government has confirmed that emergency funding is available in response. The total financial cost of this and other potential legal implications is as yet uncertain.

The NHS is urgently reviewing fire safety arrangements in all hospitals and a small number of hospital buildings have been found to be potentially in need of remedial work. Further testing is on-going across the NHS estate.

Pension Court cases reform

The government is facing legal challenge on the 'transitional protection' offered in the 2013 Public Service Pensions Act to public sector workers within 10 years of normal pension age as at 1 April 2012. Those covered by transitional protection have remained in their existing final salary pension schemes, with all others moved to the reformed career average schemes from 1st April 2015. Five workforces – the judiciary, firefighters, police, Ministry of Defence police and more recently prison officers – have claimed that transitional protection is age discriminatory, and indirectly gender and race, discriminatory. There have now been two Employment Tribunal hearings, with transitional protection found to be unlawful for the judiciary but lawful for firefighters. The government has appealed the ruling for the judiciary

and the claimants have appealed the ruling for firefighters. The Employment Appeal Tribunal issued a ruling in January 2018 which found the government's 2015 reforms to be legitimate, but found the implementation of transitional protection for the judiciary to be unlawful. The appeal submitted by the firefighters has been remitted back to the Employment Tribunal. The government has appealed against the decision made in the ruling for the judiciary, as well as aspects of the decision relating to the firefighters.

Public sector pay

At the Budget 2017, the government confirmed the announcement from September 2017 on a move away from the across the board one percent public sector pay policy, towards a more flexible approach on pay. Final decisions on pay awards will be made incorporating the views of the eight independent Pay Review Bodies, which consider evidence to advise on the pay of public sector workforces. They will report in Spring and Summer 2018, at which point government will consider their recommendations and announce public sector pay awards for each of those workforces.

Liquidation of Carillion

The facilities management and construction company Carillion plc entered into liquidation on 15 January 2018. An Official Receiver was appointed by the courts to oversee the liquidation. In addition, the government has underwritten the Official Receiver's costs so that they were able to maintain public service continuity.

Reclassification of Housing Associations

On 16 November 2017, the Office for National Statistics (ONS) concluded that registered providers of social housing in England are private, market producers and have consequently reclassified them to the private non-financial corporation sector for National Accounts.

Note 33. Prior period adjustments

No prior period adjustments are recognised in the 2016-17 WGA.

Note 34. Date authorised for issue

The financial statements were authorised for issue on 22 June 2018.

Chapter 6

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

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

I certify that I have audited the financial statements of the Whole of Government Accounts (the WGA) for the year ended 31 March 2017 under the Government Resources and Accounts Act 2000. The financial statements comprise the consolidated statements of: Revenue and Expenditure, Comprehensive Income and Expenditure, Financial Position; Changes in Taxpayers' Equity; Cash Flows; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration and Staff Report that is described as having been audited.

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 the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Accounting Officer; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Overview and Performance Analysis, the Statement of Accounting Officer's Responsibilities, the Governance Statement, the Remuneration and Staff report and Annex 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 HM Treasury to produce a set of accounts for a group of bodies which appears to HM Treasury to exercise functions of a public nature or to be entirely or substantially funded from public money. The Act also states that the accounts should present a true and fair view and conform to generally accepted accounting practice, subject to such adaptations as are necessary. HM 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, HM Treasury defines the accounting boundary with 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 HM Treasury's accounting policy has not been applied consistently in 2016-17. A number of significant bodies, including the 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, 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 the information needed to identify the transactions that would have to be eliminated to provide a consolidated view, the most significant impact would be on the Statement of Financial Position. The exclusion of the following categories of bodies could affect this Statement, which illustrates the potential impact:

- Royal Bank of Scotland which, as at 31 December 2016, had gross assets £798.7 billion and gross liabilities of £749.3 billion; and
- other bodies which have estimated gross assets of £16.8 billion and gross liabilities of £12.3 billion.

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

A number of bodies consolidated in the WGA do not adopt the same framework under which the WGA 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;
- 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. HM Treasury has not provided a full analysis of these differences and 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 infrastructure assets held by local authorities.

Infrastructure assets held by local authorities are valued at historical cost, whereas those held by central government bodies are valued at depreciated replacement cost. HM Treasury's estimate of the understatement due to this difference in valuation is that it is as least £52.8bn (Note 2.3 to the accounts). HM Treasury's estimate is based on an independent valuation of local authority infrastructure by the Office for National Statistics in the National Accounts[1], which does not include a valuation of the land associated with the infrastructure. The actual difference between valuation methodologies is, therefore, likely to be significantly higher once the impact of the difference in the valuation of land is considered.

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 the WGA accounts qualified their audit opinion. Of these, two are materially significant to the WGA, arising from 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 adequate 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 2017 and for the relevant comparative figures. This has also led to a material misstatement of the Statement of Comprehensive Net Expenditure for 2016-17 and 2015-16. 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.
- Academies Sector Annual Report and Accounts (SARA): In producing the SARA, which consolidates the financial statements of over 5,500 academies, the Department for Education has recognised academy trust land and buildings of £45 billion in its Statement of Financial Position. The audit evidence available to me was limited in respect of this balance because the Department for Education was unable to demonstrate that these assets all met the recognition criteria for non-current assets under International Accounting Standard 16 Property, Plant and Equipment and had been valued in accordance with the requirements of IAS 16 and HM Treasury guidance. The audit evidence available was also limited in respect

[1] https://www.ons.gov.uk/economy/nationalaccounts/uksectoraccounts/bulletins/nationalbalancesheet/2017estimates

of the equivalent balances reflected in the 31 March 2016 and 31 March 2015 Statements of Financial Position.

Qualification arising from disagreement relating to the consolidation of components with non-coterminous year ends

International Financial Reporting Standard 10 'Consolidated financial statements' (IFRS 10) presumes that, in order to present a true and fair view, the accounting reference date for component bodies consolidated into group accounts should be no more than three months different from the date of the group accounts. Where the accounting reference date is different, IFRS 10 requires that component bodies should prepare, for consolidation purposes, additional financial information as at the same date as the group accounts; or where impracticable to do so, the group accounts should consolidate the component using the most recent financial statements, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the group accounts.

The most recent Academies Sector Annual Report and Accounts (SARA) were prepared by the Department for Education for the year to 31 August 2016. This represents a difference of seven months compared to the accounting reference date of 31 March 2017 for the WGA accounts. In preparing the WGA accounts, HM Treasury have consolidated the SARA for the year to 31 August 2016, with no adjustments processed to reflect the difference in accounting reference dates. No additional financial information was provided by the Department for Education or HM Treasury in support of the adjustments that would have been required.

HM Treasury has not complied with the requirements if IFRS 10 in consolidating the SARA. In my view the extent of non-compliance has resulted in a level of misstatement and uncertaintay which I consider to be material to the WGA and I have, therefore, qualified my opinion in that respect.

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 2017 and of its net expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000.

Emphasis of matter – nuclear decommissioning provisions and Hinkley Point C Contract for Difference (CfD)

Without qualifying my opinion further, I draw attention to the disclosures made in Notes 2.6 and 22 to the financial statements concerning the uncertainties inherent in the provisions relating to the costs of dealing with nuclear decommissioning liability. As set out in these notes, given the complexity and the very long timescales involved, a considerable degree of uncertainty remains over the value of the liabilities. Significant changes to the liabilities could occur as a result of subsequent information and events which are different from the current assumptions adopted.

I also draw attention to the disclosures made in Notes 2.9, 21 and 23 to the financial statements concerning the measurement of liabilities relating to the contract for difference in respect of Hinkley Point C. As these notes describe, the fair value of this liability is highly sensitive to assumptions regarding future prices and volumes, particularly in view of the long timescales involved. As disclosed in Note 23, the uncertainty over the valuation of the Hinkley Point C contract for difference is such that the liability is not considered not meet the recognition criteria set out in the Conceptual Framework for Financial Reporting.

Opinion on other matters

In my opinion:

- the parts of the Remuneration and Staff Report to be audited have been properly prepared in accordance with HM Treasury directions made under the Government Resources and Accounts Act 2000;
- the information given in the Overview and Performance Analysis; Governance Statement; Remuneration and Staff Report; and Annex, 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 and the parts of the Remuneration and Staff Report to be audited are not in agreement with the accounting records or returns; and
- I have not received all of the information and explanations I require for my audit.

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

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

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

Sir Amyas C E Morse
Comptroller and Auditor General
22 June 2018

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Report of the Comptroller and Auditor General

1.The Whole of Government Accounts (WGA) provides the most complete and accurate picture of the financial performance and position of the UK public sector in 2016-17. HM Treasury (the Treasury) consolidates the financial activities of over 7,000 organisations into the WGA. It 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.

2. The WGA is becoming increasingly important to the ongoing management of the public finances, with the Treasury continuing to increase the impact and profile of the accounts. The Office for Budget Responsibility (OBR) and the Institute for Fiscal Studies both draw upon the WGA in their reports on the management and sustainability of the public finances, notably the OBR's first Fiscal Risks Report, published in 2017.[2] In addition, in response to recommendations from the Committee of Public Accounts, the International Monetary Fund (IMF) and the National Audit Office, the Treasury has begun to develop its approach to analysing the public sector balance sheet and evaluating fiscal risk. The Treasury used the WGA to scope its balance sheet review, launched in November 2017, and identify initial opportunities to make more effective use of assets, improve the return from investments and reduce the cost of liabilities. The Treasury plans to provide an update on the review findings in the 2018 Budget.

3. The Treasury has continued to improve the presentation of the 2016-17 WGA, providing better quality analysis of the cross government finances and the main drivers of movements in the accounts. The Treasury has provided trend analysis across key classes of assets, liabilities, income and expenditure with reference to National Account statistical measures such as Public Sector Net Debt and the current budget deficit. In response to recommendations by the Committee of Public Accounts, the Treasury has also included analysis of government spending by function and geographical region based on the annual Public Expenditure Statistical Analyses (PESA); reconciling these measures to WGA expenditure. This should assist users of the accounts in better understanding where the WGA sits in the landscape of wider fiscal measures, and provides a more complete picture of the economic performance and position of the UK public sector.

4. Despite recent improvements, the WGA continues to lack specific detail in key areas that would enable a fuller analysis of the public finances. There remains limited information in the WGA in relation to the purchase of goods and services by government which represents some £194.8 billion of government expenditure. Despite the additional information in the WGA performance report on PESA regional and functional spending, this is based on a statistical data and is not drawn from the extensive and detailed information collected for the WGA consolidation. As the UK exits from the European Union and the process of managing the government's deficit progresses, these disclosures and the underlying data will be increasingly

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2 http://obr.uk/frr/fiscal-risk-report-july-2017/

relevant and useful; and will improve the ability to scrutinise the Treasury's management of the public finances.

5. **The utility of the WGA remains limited by the time it takes to produce and the Treasury has a significant challenge to meet its ultimate aim to publish the accounts within nine months of the year-end.** In recent years, the WGA has been published around thirteen months after the accounting year-end. More timely publication is reliant upon a number of factors, including the receipt of consolidation information from component bodies. From 2017-18, the deadline for publication of the accounts of English Local Authorities has been moved forward from 30 September to 31 July and should, in theory, have a beneficial impact on the overall reporting timetable. Notwithstanding, until the Department for Education is able to produce the SARA earlier in the reporting cycle, the Treasury will not be able to meet its aim of publishing the WGA accounts within nine months of the year-end.

6. **The Treasury has continued to make progress in improving the completeness and accuracy of transactions and balances in the WGA accounts, allowing me to reduce the number of qualifications to my opinion.** The 2016-17 WGA is an accurate reflection of the use of public resources, but my opinion remains qualified in respect of the accounting boundary, the impact of inconsistent accounting policies and certain qualifications flowing from underlying component bodies. Inconsistent accounting treatments related to local government infrastructure remain despite the Treasury working with the local government sector to resolve them. Following sustained improvement by the Treasury, I do not consider either the current or prior year transactions or balances to be materially misstated as a result of issues around the completeness and accuracy of intra-government eliminations. This is the first year since the inception of the WGA accounts that my opinion has not been qualified in that respect.

Recommendations

7. 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 to raise the profile of the WGA within government and embed it into the routine monitoring of the risks to the public finances.** As fiscal policy evolves and the UK exits from the European Union, the Treasury should continue to ensure that it presents consistent data in the WGA. This will provide greater insight into its approach to managing the risks to the public finances; and the government's portfolio of assets, long term liabilities and potential exposures.

- **Continue to improve the quality of data reported within the WGA.** The Treasury should continue to work with component bodies and other relevant stakeholders, for instance the Chartered Institute of Public Finance and Accountancy, to address the underlying issues which give rise to qualification of the WGA accounts. In particular, the Treasury should work with the Department for Education in developing an appropriate, timely approach to the consolidation of academies sector.

- **Set out its plan and timetable for producing the WGA on a more timely basis.** To improve visibility of its plans and provide assurance that planned

improvements are on track, the Treasury should set out its key milestones for publishing the WGA within nine months by January 2020, and routinely report to Parliament and the National Audit Office on progress. Where the timetable is adversely impact by component bodies submitting late or erroneous data, the Treasury should set out an action plan for ensuring improvements are implemented by those component bodies.

- **Ensure that the balance sheet review process has a lasting effect, embedding the best practice it identifies in government's routine decision-making and financial management.** In doing so, the Treasury will need to integrate the results of its balance sheet and fiscal risk analysis with departments' and Treasury oversight functions. The WGA has the potential to become a vital source of information in this control framework, subject to the improvements needed to quality and timeliness described above.

Part One
How the WGA is being used

1.1 The WGA consolidates the accounts of over 7,000 bodies across the public sector to produce an accounts-based picture of the UK's public finances. It is the only set of audited, consolidated accounts in the world that includes the financial performance and position of both central and local government. It includes 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.

1.2 The WGA is underpinned by and supports the government's accruals based budgeting and financial reporting framework and is the most comprehensive record of what the government owes, spends and receives, and is seen as best practice around the world. The International Monetary Fund (IMF) 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.[3] The IMF's evaluation of the UK's fiscal transparency in 2016 credited the WGA's 'wide institutional coverage' of the public sector along with the completeness of its wider balance sheet and reporting of in-year flows with placing the UK 'at the forefront of fiscal reporting practices worldwide'.[4]

1.3 Whilst the timeliness of WGA publication means that government must rely on other, more readily available, information to make decisions in the short term, the WGA forms a key part of the mechanisms for understanding the government's financial performance and position. Together with the statistically based National Accounts produced by the Office for 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. I have published a series of reports which explore some of the major risks to public finances highlighted in the WGA, focussing on the government's pension liabilities[5]; its financial assets[6]; provisions, contingent liabilities and guarantees[7]; and, most recently, government borrowing.[8] These reports examine how the significant risks to the wider government balance sheet have changed in recent years and consider how government currently manages them at the macro level.

1.4 In my 2015-16 Report on the WGA account I recommended that the profile of the WGA should be raised within government and for it to be used more effectively to help decision making. I made similar recommendations in my recent reports on various aspects of the government's balance sheet. In its report on the 2014-15 WGA,[9] the Committee of Public Accounts also recommended that the Treasury sets

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3 http://www.imf.org/external/pubs/ft/wp/2016/wp1695.pdf

4 http://www.imf.org/external/pubs/ft/scr/2016/cr16351.pdf

5 https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-pensions/

6 https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-financial-assets-and-investments/

7 https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-provisions-contingent-liabilities-and-guarantees/

8 https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-borrowing/

9 Committee of Public Accounts The Government Balance Sheet: 19th report of 2016-17 session: HC485

out how it will ensure that the government makes better use of the WGA to inform decisions. In response to these recommendations as well as those of the IMF, the Treasury is increasingly using the WGA to strengthen and inform its approach to analysing the government's balance sheet and evaluating the associated fiscal risks. Since late 2016, it has:

1. Increased its resources for analysing the government's balance sheet; creating a fiscal risks branch as well as a balance sheet analysis branch which are responsible for fiscal risk modelling and stress testing, and bringing together analysis from across the Treasury to support the executive management board's view of risk.

2. Strengthened its budgetary and approvals process around contingent liabilities, increasing the central oversight and risk monitoring of new liabilities.

3. Launched a review of the balance sheet at the 2017 Budget, which the Treasury hopes will realise savings to reinvest in public services in the future. The Treasury used the WGA to scope the review and identify initial opportunities to make more effective use of assets, improve the return from investments and reduce the cost of liabilities. The Treasury is consulting with central government departments on the most significant assets and liabilities before finalising the options. It is expecting to provide an update as part of the 2018 Budget.

1.5 The Treasury's analysis will help to inform its formal response to the Office for Budget Responsibility's Fiscal Risks Report this summer. In October 2015 the UK Parliament approved a revised Charter for Budget Responsibility which requires the OBR to produce a fiscal risks report at least once every two years and for the Government to respond to it formally within a year of publication. In July 2017, the OBR published its first Fiscal Risks Report. As with its established Fiscal Sustainability Reports[10], this report used information from the WGA extensively, particularly when considering significant liabilities where the size, probability or timing is uncertain.[11]

1.6 Outside of government, the WGA is increasingly being used by a number of professional bodies to analyse and comment on the government's financial performance and position and fiscal management, for example:

- The Institute for Fiscal Studies (IFS) – The IFS publishes its Green Budget in the run-up to the Budget statement, in which it discusses key areas likely to be included in the Budget debate. The IFS Green Budget for 2017 included analysis of the WGA carried out by the Institute of Chartered Accountants in England and Wales, which supported its analysis of the budget and its deliverability.[12]

- 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

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10 http://budgetresponsibility.org.uk/fsr/fiscal-sustainability-report-january-2017/

11 http://cdn.obr.uk/July_2017_Fiscal_risks.pdf

12 http://www.ifs.org.uk/publications/8129

effective fiscal management.[13] This paper reported on the progress governments in advanced economies had made in recognising assets and liabilities on their balance sheets. It highlighted the improvements made to WGA disclosures around unfunded pension liabilities, specifically.

1.7 During the year Treasury has also increased its engagement with international stakeholders and other countries' finance ministries. This has included presenting to the Organisation for Economic Co-operation and Development and contributing to the work of the IMF in their mission to improve the transparency of the public finances. The Treasury has also met with administrations from Australia, China and Vietnam to share financial reporting best practice, including implementation of WGA and accruals based accounting.

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

Part Two

Improving the production of the WGA

2.1 The Treasury has continued to improve the quality of the disclosures and narrative commentary in the WGA Overview and Performance Analysis section this year. The Overview and Performance Analysis provides analysis of the major expenditure, income, assets and liabilities. For 2016-17, this analysis also considers the ONS National Statistics data by including trend reporting which compares Public Sector Net Debt with WGA net liabilities, and the budget deficit with WGA net expenditure. In response to recommendations by the Committee of Public Accounts, the Treasury has also included analysis of government spending by geographical region based on their annual Public Expenditure Statistical Analyses (PESA), reconciling these measures to WGA expenditure.

2.2 Drawing together the information from ONS, OBR and the WGA should assist users of the accounts in better understanding where the WGA sits in the landscape of wider fiscal measures, and provides a more complete picture of the UK's economic performance and position. Going forward, the trends in this information will be increasingly important to understanding how government is delivering its fiscal strategy as the number of data points increases over time and the UK exits from the European Union.

2.3 The 2016-17 WGA shows the financial impact of the government's major fiscal policies and growth programmes, demonstrating the contribution a comprehensive accounting standards based picture of the government's finances can make to the transparency and accountability agenda. 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.

2.4 There are still elements of government's activities that lack detail in the WGA. For example, Note 8 to the WGA, which shows expenditure of some £194.8 billion on the purchases of goods and services by government, does not provide further analysis as to how those funds have been spent, such as on consultancy and accommodation. In addition, although the Treasury has again included an analysis of public expenditure by function within the Overview and Performance Analysis section of the WGA and have for 2016-17 also included analysis by region, this is based on PESA statistical data rather than WGA data. The absence of this data within the WGA impacts upon the extent to which a reader of the accounts can evaluate the spend on relevant categories of goods and services, and the balance of government activities in the regions.

Timeliness in producing the Whole of Government Accounts

2.5 The Committee of Public Accounts asked the Treasury to set out how it plans to produce the WGA more quickly. Improving the speed of production of the WGA is crucial to its increasing usefulness. Producing the WGA closer to the reporting date increases the relevance of the numbers and the ability of the government to use the trends in the performance and position to inform its financial strategy and policies. The Treasury has stated its ambition to produce the WGA within nine months by January 2020, however they have not yet set a clear plan for this improvement, or identified specific milestones for delivery.

2.6 The Treasury is reliant on a number of factors to produce the WGA, including the timely receipt of consolidation information from components which depend upon the timely publication of those components' annual accounts. From 2017-18, the deadline for publication of the accounts of English Local Authorities has been moved forward from 30 September to 31 July and should, in theory, have a beneficial impact on the overall reporting timetable.

2.7 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. Since that time, the production and publication of the WGA accounts has once more fallen back to over a year after the reporting date, with the 2016-17 version published in June 2018. The principal reason for the delay in publication of the 2015-16 WGA was the challenge faced by the Department for Education (the Department) in consolidating the results of the academies sector into the Departmental Group accounts.

2.8 For 2016-17 the Department agreed with Parliament and HM Treasury that it could separate academy reporting from its own accounts and, instead, produce a Sector Annual Report and Account (SARA) consolidating the academies and reporting to a 31 August year end. One of the conditions of this agreement was that there would be further work carried out to address the implications of the non-coterminous SARA year end for the WGA accounts. Neither the Treasury nor the Department have undertaken the work required to align the reporting dates and, in preparing the WGA accounts, the Treasury have consolidated the SARA for the year to 31 August 2016, unadjusted.

2.9 Engagement between the Treasury and the Department on how to resolve the issue for WGA purposes was ongoing until January 2018, which was a notable factor in the delays to the planned reporting timetable. In accepting the Department's proposal to submit the unadjusted SARA results for WGA purposes, the WGA Accounting Officer confirmed that this was for 2016-17 only, and re-iterated the need for officials from the Treasury and the Department to work together in identifying and implementing an appropriate solution.

2.10 The Department is not expecting to produce the SARA for the year to 31 August 2017 in time for the 2018 Parliamentary summer recess. The Treasury will need to consider the implications of this and the wider-issue of non-coterminus year ends in preparation of the 2017-18 WGA.

Amyas C E Morse

Comptroller and Auditor General

22 June 2018

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Appendix

Scope of the audit and qualifications of the Comptroller and Auditor General's audit opinion

Summary

1 This part of my report explains my obligations with respect to the audit of the Whole of Government Accounts (WGA); changes to the extent of the qualifications of my Audit Opinion; and why I have qualified my Audit Opinion on the 2016-17 WGA. It also provides details of the progress the Treasury has made in respect of each remaining qualification since my last report.

2 This is the eighth 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.

3 The Treasury continues to make progress towards resolving the qualification issues I have raised. In 2015-16, I removed my qualification in relation to the completeness and accuracy of intra-government eliminations for the first time, however my opinion on the 2014-15 comparatives remained qualified. Following sustained improvement by the Treasury, I do not consider either the current or prior year transactions or balances to be materially misstated as a result of issues around the completeness and accuracy of intra-government eliminations. This is the first year since the inception of the WGA accounts that my opinion has not been qualified in that respect.

My obligations as auditor

4 Under the Government Resources and Accounts Act 2000, I am required to examine, certify and report upon the WGA. International Standards on Auditing (UK and Ireland) require me to obtain sufficient, appropriate 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.

5 Due to the significant number of component bodies which comprise the WGA, my audit necessarily draws upon the work of component auditors to provide me with assurance over the integrity of data submitted by component bodies as part of the consolidation process. I send detailed instructions covering the nature 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

6 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.

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 my audit procedures. The appropriateness of the materially threshold is considered throughout the audit and adjusted as required.

8 The choice of materiality requires professional judgement and, for the financial statements as a whole, I set this at £8 billion for 2016-17 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.

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.

10 I agreed with the Treasury Audit and Risk 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.

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.

Scope of my financial audit

12 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.

13 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.

14 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: inconsistent application

of the judgements on the boundary of the WGA; inconsistent accounting treatments; material non-compliance with the accounting framework and qualification of some of the underlying accounts that are considered to be material to the WGA. 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. For the WGA, my work is focussed on assessing 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 evaluation of how the transactions streams and balances within the underlying accounts that form the WGA are reflected within the consolidated financial statements.

15 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.

Removal of qualifications to the Whole of Government Accounts for 2015-16

16 The WGA has been qualified since its inception on multiple grounds. In 2015-16, I removed my qualification in relation to the completeness and accuracy of intra-government eliminations for the first time, however my opinion on the 2014-15 comparatives remained qualified. Following sustained improvement by the Treasury, I do not consider either the current or prior year transactions or balances to be materially misstated as a result of issues around the completeness and accuracy of intra-government eliminations. This is the first year since the inception of the WGA accounts that my opinion has not been qualified in that respect.

Removal of the unsupported eliminations adjustments qualification

17 The WGA is a consolidated account which is prepared by including the financial activities of over 7,000 government controlled entities. Transactions and balances between these entities are eliminated 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 view of the financial performance and position of government, it is important that the removal of these intra-government transactions and balances is materially complete and accurate.

18 The Treasury collects information from each of the bodies reported in the WGA, covering relevant counter-part details for all intra-government transactions. The Treasury uses this data to match balances and transaction streams and remove them

from the WGA. Despite the work undertaken by the Treasury, there remains uncertainty over the figures in the financial statements because of the difficulty the Treasury faces in accurately removing these transactions and balances. 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.

Using the available evidence, I have estimated the maximum level of uncertainty as being up to £6.5 billion (£7.1 billion in 2015-16) in gross income and expenditure and up to £4.4 billion (£4.4 billion in 2015-16) in gross assets and liabilities.

19 The level of error has reduced steadily since 2010-11, and has stayed at broadly the same level since 2013-14 (**Figure 1**). Whilst the estimated level of uncertainty within the Statement of Financial Position has remained consistent with 2015-16, the uncertainty within the Statement of Revenue and Expenditure has decreased by £0.6 billion. The level has now been broadly stable for four years and below my assessment of materiality which for 2016-17 was defined as £8 billion as set out in paragraph 8 of this appendix.

Figure 1

Level of potential overstatement in the WGA (£ billion)

	2016-17	2015-16	2014-15	2013-14	2012-13	2011-12	2010-11
Statement of Revenue and Expenditure	6.5	7.1	6.5	7.3	9.1	16.0	22.6
Statement of Financial Position	4.4	4.4	2.6	2.2	3.7	5.1	10.4

All figures in £ billions

Source: NAO analysis of WGA 2016-17

20 In order to manage the residual elimination error to immaterial levels, the Treasury has undertaken significant work to improve its analysis of the data, and its approach to removing known sources of error between bodies within the WGA, for example transactions between central and local government. However, with such an extensive body of components preparing information, some error in the data preparation is inevitable and it is possible that the level of error cannot be reduced much further under the current method of collation and preparation of the WGA. This means that the error is unlikely to fall significantly below the level that remains within the 2015-16 WGA.

21 The process of eliminating transactions and balances is made more complicated by the significant level of manual intervention that is required by the Treasury to reach this level. The Treasury, therefore, needs to consider how it can improve the overall process of modelling the transactions between bodies within the WGA and introducing a greater level of automation in the process, to ensure that I am able to continue to provide a clean opinion on the process of eliminating transactions and balances. This will be increasingly important as the Treasury seeks to bring forward the timetable for the publication of WGA in future years.

Qualifications owing to disagreements and limitations of scope in my audit

22 I have qualified my opinion on the 2016-17 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.

23 My qualifications relate to:

- the definition of public bodies that the Treasury has used to determine the boundary of the WGA;
- material non-compliance with the accounting standards stemming from the consolidation of a significant component with a non-coterminous year end;
- the inconsistent application of accounting standards; and
- qualification of some of the underlying accounts that are considered to be material to the WGA.

Qualified audit opinion relating to the WGA boundary

24 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 omitted from the financial statements.

25 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 2).

Financial reporting requirements

26 In my previous Reports[14], I have noted that in determining the boundary for the whole of government, the Treasury has adopted the classifications of public bodies

[14] Comptroller and Auditor General, Report on the Whole of Government Accounts 2015-16, July 2017

Comptroller and Auditor General, Report on the Whole of Government Accounts 2014-15, May 2016

Comptroller and Auditor General, Report on the Whole of Government Accounts 2013-14, March 2015

used by the Office for National Statistics (ONS), rather than apply accounting standards which require the inclusion of 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'.[15]

27 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 there are a number of bodies that fall within both statistical and accounting definitions of government 'control' but have not been included in the WGA. These 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; and
- other bodies that are partly or wholly owned by the government, such as the Royal Bank of Scotland.

28 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, either individually, or in aggregate. In accordance with the accounting framework, I consider that the Royal Bank of Scotland, further education institutions and trust ports, as listed in Figure 2, should be included in the WGA. However, despite the government's controlling shareholding in RBS which means I need to include it within the qualification on technical grounds, I support the Treasury's exclusion of RBS 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.

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

15 International Financial Reporting Standard 10 – Consolidated Financial Statements.

Figure 2

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 the net deficit	Assets	Liabilities	Impact on the net liability
Royal Bank of Scotland	15.1	20.4	(5.3)	798.7	749.3	49.4
Further education institutions	-	-	-	14.1	11.4	2.7
Trust Ports	0.5	0.4	0.1	2.3	0.8	1.5
Other	-	0.2	(0.2)	0.4	0.1	0.3
Total excluding RBS	**0.5**	**0.6**	**(0.1)**	**16.8**	**12.3**	**4.5**
Total	**15.6**	**21**	**(5.4)**	**815.5**	**761.6**	**53.9**

NOTES

1. 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 2015-16.
2. Trust Ports - figures have been estimated from available accounts for year-ended 31 December 2016.
3. London Councils and other minor bodies.
4. The bodies have been treated as if they had always been entirely owned by the public sector. For Royal Bank of Scotland, no account has been taken of the residual private sector shareholdings or intra-government transactions and balances.
5. Not all bodies have a March year-end, e.g. figures for RBS relate to the year ending 31 December 2016.
6. All figures are in £ billions.

Source: NAO analysis of WGA 2016-17 and published accounts.

Progress since 2015-16

29 Treasury have not brought any additional bodies relating to the qualification into the WGA boundary in 2016-17. The position of the 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, quantitative threshold of control. The Treasury held 71 percent of the share capital as an equity investment at 31 March. On 4 June 2018 the government sold 7.7% of its shareholding reducing its stake to 64%.

- Further education institutions: In my Reports on the WGA for 2011-12[16] and 2010-11,[17] I recommended that the Treasury should review its criteria for including bodies within the WGA, taking into account changes in the

[16] C&AG's Report within Whole of Government Accounts 2011-12, HC531, July 2013, Paragraph 2.29.

[17] C&AG's Report within Whole of Government Accounts 2010-11, HC687, October 2012, Box 6, paragraph 7.69.

control government exerts over English further education institutions following the passage of the Education Act 2011. The Treasury continues to exclude English institutions from the WGA as the ONS determined that these bodies fall outside of the public sector following the 2011 Act.[18] However, under accounting standards, there remains in my view sufficient government control to warrant their inclusion.

- Trust Ports: The Treasury is considering the status of Trust Ports with a view to bringing them within the 2017-18 WGA.

30 Although the Treasury continues to make progress in consolidating more bodies into the WGA where appropriate, my qualification on this matter is likely to remain until all significant government controlled entities are included in line with accounting standards.

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

31 I have qualified my opinion due to the impact of the inconsistent application of accounting policies that Treasury have applied in producing the WGA.

32 The financial reporting framework that WGA must follow is set out in the Government Financial Reporting Manual (FReM) which applies International Financial Reporting Standards (IFRS), as adapted for the public sector context. However, for 2016-17, some of the bodies included in the WGA prepared their accounts based on accounting frameworks that are inconsistent with the requirements of the FReM.

33 Under accounting standards, the Treasury should identify the impact of the different frameworks and make appropriate adjustments to the WGA, where material, so that the WGA as a whole is prepared on a consistent basis.[19]

Local government infrastructure valuation

34 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 historical cost, and central government which values assets at their depreciated replacement cost, in line with the requirements of the FReM.

35 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.

36 The Treasury has previously estimated the impact of this inconsistency with reference to a calculation made by the Office for National Statistics (ONS) in its National Accounts[20] estimate, which as at 31 December 2015 valued the Local Authority road network at £322.6 billion (2014: £306.6 billion). In the 2017 National Accounts estimates, the ONS changed its methodology due to requirements from Eurostat to provide estimates of land values separately from the

18 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

19 International Financial Reporting Standard 10 Consolidated Financial Statements

20 Office for National Statistics, The UK national balance sheet: 2016 estimates, Table 9, August 2016

related assets. On this basis, at 31 December 2016, local authority road infrastructure assets, excluding land, were valued by ONS at £121 billion.

37 The value of local government infrastructure already reported in the 2016-17 WGA is £68.2 billion. This means that by using the revised ONS estimate, HM Treasury consider the undervaluation of these assets to be at least £52.8 billion. However, the actual error is likely to be significantly higher as the Treasury estimate does not include the impact of the difference in land values.

Progress since 2015-16

38 In my Report on the 2015-16 WGA I recommended that the Treasury should work with the Chartered Institute of Public Finance and Accounting (CIPFA) to ensure that either the planned changes to the Code of Practice on Local Authority Accounting were brought back on track, or to define an alternative approach to achieving a consistent valuation of infrastructure assets. I also recommended that Treasury put in place plans to obtain depreciated replacement cost valuations of the remaining non-highways infrastructure assets. In March 2017 CIPFA announced that it no longer planned to pursue a revised approach to valuing local authority infrastructure, due to a lack of commitment from government to fund the central costs of producing the valuation.[21] Accordingly, since my Report on 2015-16 WGA, there have been no further developments regarding a revised approached to valuing local authority infrastructure.

39 Key to local authorities producing depreciated replacement cost valuations of their infrastructure network is robust information on: the extent and location of the authorities assets, the current condition of these assets, and up to date costs required to maintain and rebuild the network. This information is also vital to good asset management. The development and recording of this information would benefit local authorities looking to make strategic decisions regarding maintenance and capital investment into their road networks, and help HM Treasury and other government departments such as the Department for Transport to develop a holistic view of the condition of this vital infrastructure across the UK.

40 I therefore re-iterate my previous recommendations that Treasury should work with CIPFA and other government departments where necessary to identify a path forwards, and that Treasury also consider how to obtain depreciated replacement cost valuations for non-highways infrastructure assets.

Qualification arising from disagreement relating to the consolidation of components with non-coterminous year ends

41 I issued an adverse opinion on the Department for Education's (the Department's) accounts between 2013-14 and 2015-16, due to the material level of uncertainty arising from the consolidation of academies with non-coterminous year ends. Whilst the Department's accounts are prepared to a 31 March year end, academies prepare accounts which follow the academic year, being 1 September to 31 August.

42 Between 2012-13 and 2015-16 the Department undertook a number of significant exercises to adjust the outturn reported by academies at 31 August, to present a materially accurate position at 31 March. This work was not considered to

21 http://www.cipfa.org/policy-and-guidance/highways-network-asset-briefing

be sufficiently robust to support an unqualified audit opinion on the Department's accounts.

43 For 2016-17 the Department agreed with HM Treasury and Parliament that it could separate academy reporting from its own accounts and, instead, produce a Sector Annual Report and Account (SARA) consolidating the academies and reporting to a 31 August year end. One of the conditions of this agreement was that there would be further work carried out to address the implications of the non-coterminous SARA year end for the WGA accounts.

44 International Financial Reporting Standard 10 'Consolidated financial statements' (IFRS 10) states that, in order to present a true and fair view, the accounting reference date for component bodies consolidated into group accounts should be no more than three months different from the date of the group accounts. Where the accounting reference date is different, IFRS 10 requires that component bodies should prepare, for consolidation purposes, additional financial information as at the same date as the group accounts; or where impracticable to do so, the group accounts should consolidate the component using the most recent financial statements, adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the group accounts.

45 Neither the Treasury nor the Department have undertaken the work required to align the reporting dates and, in preparing the WGA accounts, the Treasury have consolidated the SARA for the year to 31 August 2016, unadjusted. Accordingly, the Treasury has not complied with the requirements of IFRS 10 in consolidating the SARA. In my view the extent of non-compliance has resulted in a level of misstatement and uncertainty which I consider to be material to the WGA accounts and I have, therefore, qualified my opinion in that respect.

46 The agreement to report the academies sector separately in the SARA did mean that the Department was able to produce its own accounts earlier, with the 2016-17 accounts being published on 19 July 2017 and, without qualification.

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

47 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 2016-17, external auditors qualified their opinions of 3 accounts (4 accounts in 2015-16).

48 The most significant of these qualifications relate to the Ministry of Defence's 2016-17 accounts and the 2015-16 SARA. Given the significance of these qualifications, I have also qualified my opinion on the WGA.

49 Further details can be found in my audit opinions and within the annual accounts of the SARA[22] and the Ministry of Defence.[23]

[22] Academy Schools Sector in England 2015-16, HC 425, 26 October 2017

[23] Ministry of Defence Annual Report and Accounts 2016-17, HC 21, 19 July 2017

Progress since 2015-16

Ministry of Defence

50 In the 2014-15 Ministry of Defence accounts, the Ministry stated that it had conducted a review of its most significant contractual arrangements and had identified a number of lease type arrangements which are not currently recognised and cannot be accurately quantified. 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. This position remains for the 2016-17 accounts and 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. The Ministry has been considering the implications of the new International Financial Reporting Standard 16, Leases (IFRS 16) which is effective from 1 January 2019, and how this may impact upon the accounting treatment for these contracts.

51 This issue will have an ongoing impact on the audit opinion I am able to provide on the accounts for the foreseeable future, and until such time as the Ministry can demonstrate that the accounts are free from material misstatement.

Academies Sector Annual Report and Accounts (SARA)

52 The 2015-16 Academies Sector Annual Report and Accounts (SARA), which has a year end of 31 August 2016, was qualified on the basis of incomplete and inaccurate valuation of academies' land and buildings assets.

53 The audit evidence available to me in respect of these balances was limited because the Department for Education was unable to demonstrate that all of these land and buildings met the recognition criteria for a non-current asset under International Accounting Standard 16 Property, Plant and Equipment (IAS 16) and had been valued in accordance with the requirements of IAS 16 and HM Treasury guidance.

54 In 2015-16, the number of academies continued to increase but the Department for Education has not yet resolved the issues giving rise to the incomplete and inaccurate valuation of academies' land and building assets. As a result, the scope of this issue has grown to £45 billion during the year. Therefore, this is likely to continue to be a source of continued qualification within the WGA until the problems with the accuracy of data and oversight are addressed.

Other issues on which I have not qualified my opinion

55 There are two other issues that I wish to draw attention to, neither of which have led to a qualification of my audit opinion:

- I have included an emphasis of matter paragraph in my audit opinion for two issues that are significant to the WGA. Firstly, there are significant 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. Secondly, there are uncertainties inherent in valuing the Hinkley Point C contract for difference which has resulted in the liability not being recognised on the Statement of Financial Position, as it is not considered to meet the

recognition criteria set out in the Conceptual Framework for Financial Reporting.

- The external auditor of 17 accounts[24] (17 in 2015-16) 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[25] and HM Revenue and Customs[26]. 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.

[24] Included in this number are four accounts qualified on a 'true and fair' basis.

[25] Department for Work and Pensions Annual Report and Accounts 2016-17, HC21, 3 July 2017

[26] HM Revenue and Customs Annual Report and Accounts 2016-17, HC18, 13 July 2017

Annex A

Comparison to the National Accounts

A.1 The numbers reported in WGA are based on accounting standards. Whilst accounting standards provide a comprehensive picture, government typically reports on the public finances using National Accounts rules which apply internationally agreed standards for measuring economic activity. This reporting is carried out by the independent Office for National Statistics (ONS) and is available to a much shorter timescale than WGA.

A.2 Although there are differences between the two frameworks, there is more that is common and the two views can be combined to provide a more complete picture of government's fiscal risk. For example, the Office for Budget Responsibility (OBR) independently assesses the future sustainability of the public finances through its annual Fiscal Sustainability Report and utilises information on long-term liabilities published in WGA.

A.3 The rest of this chapter explains the differences between accounting standards and National Accounts and then provides a reconciliation from WGA to the National Accounts.

Comparison between accounting standards and National Accounts

A.4 The accounting standards followed by WGA are International Financial Reporting Standards (IFRS) and the statistical rules followed by the National Accounts are set out in the European System of Accounts (ESA). Both frameworks have core similarities:

- They are both prepared on an accruals basis (recognition of economic events regardless of when cash transactions occur)
- They each prepare a statement of financial position, income and expenditure analysis and details of other changes
- They both exclude future tax revenue, future assets, and liabilities that will be incurred in the future (such as future benefit and state pension payments).

Comparing WGA expenditure to the Public Sector current budget deficit

A.5 The public sector current budget deficit is an important balance in the fiscal framework. The current budget deficit is the difference in the financial year between accrued current revenue and expenditure as defined in the National Accounts.

A.6 One of the main differences between the current budget deficit used in National Accounts and total expenditure used in WGA is that the National Accounts exclude the financing costs of long-term liabilities as set out in the previous section. Instead, the National Accounts recognise these liabilities when they are due to be paid.

Comparison to Public Sector Net Debt

A.7 Public sector net debt can be defined as the public sector's consolidated gross debt, less its assets that could be readily sold as defined in the National Accounts.

A.8 The difference between the National Accounts and WGA measures of public sector net debt and net liabilities is primarily due to differing treatments of the public sector pension liability, property, plant and equipment and provisions.

Differences between WGA and National Accounts

A.9 The differences between IFRS and ESA in how they recognise and value certain assets, liabilities and items of expenditure are summarised below.

Table A.1: Differences between WGA (IFRS) and National Accounts (ESA)

Area	WGA treatment	National Accounts treatment
Grants to fund capital expenditure	Is recognised as an expense in-year as it doesn't result in an asset for government	Is always capitalised on the basis that it results in an asset in the wider economy
Research and development expenditure	Can be capitalised if it is likely to result in an asset but is frequently recognised as an expense in-year	Is capitalised more frequently on the basis that it is an investment lasting for more than one year
PFI	Most PFI assets and liabilities are recognised on balance sheet after assessing control of the assets. PFI payments are apportioned between repaying debt, paying interest and paying for services	Most PFI assets and liabilities are not recognised on the balance sheet after assessing risks and rewards. Payments under PFI contracts are recognised as a current expense in-year for off balance sheet schemes and a capital expense in-year for on balance sheet schemes.
Depreciation of assets	Is calculated for each asset individually based on its estimated useful economic life and residual value	Is calculated using standard statistical models, high level data and asset life assumptions.
Revaluation and impairment of assets	Assets are revalued as set out in note 1 of the accounts. Assets are assessed annually	Assets are recognised at cost less depreciation and are not revalued. Only impairments

Area	WGA treatment	National Accounts treatment
	for impairment compared to their carrying value	caused by obsolescence or accidental damage are recognised
Profit or loss on sale of assets	Recognised as income or expenditure	Proceeds of sale are recognised but not the profit or loss
Gilts	WGA bodies hold gilts at fair value, these are eliminated out on consolidation and all the remaining gilts are held at amortised cost	Gilts are included based on their redemption price
Public sector pensions	Recognises expenditure when rights accrue to employees, even though payment is not due	Recognises expenditure as it is paid to retirees. The future liability for current employees is not recognised
Provisions	Recognises expenditure when it becomes probable that a payment will be needed as a result of past events	Recognises provisions only when they are settled (i.e. there are actual payments). Amounts expected to be paid out in future as a result of past events are not recognised
Effects of discounting future liabilities	Future cash flows are discounted to estimate the value of the liability. Changes to the cash flows and discount rate are recognised in-year	Not included
Transactions within government	Transactions are eliminated entity-by-entity in a process that takes several months. The residual elimination error is quantified and subject to audit	Transactions are eliminated using a quicker and higher-level approach. The residual elimination error can't be quantified
Asset Purchase Facility	Shows gilt purchases at fair value	Records the gilt purchases at nominal value
UK Asset Resolution (UKAR)	Includes both the liabilities and the assets.	Includes UKAR's own debts to the private sector and exclude their non-liquid financial and other assets
Housing associations	Not included within the WGA boundary	Included in the National Accounts boundary

Reconciliation to Public Sector Net Debt

A.10 Public Sector Net Debt is a measure that is calculated from the National Accounts. The government's preferred measure of Public Sector Net Debt excludes public sector banks. It equals external borrowings less liquid financial assets. The same figures can be compiled from WGA but the total net liabilities recognised within WGA are more extensive than those recognised in Public Sector Net Debt. This is partly because Public Sector Net Debt is only part of the National Accounts balance sheet and partly because WGA recognises additional assets and liabilities which are not included on the National Accounts balance sheet.

Table A.2: Public Sector Net Debt compared to total WGA net liabilities

	2016-17 £bn	2015-16 £bn	2014-15 £bn
Public Sector Net Debt (National Accounts)	1,727	1,603	1,554
Add liabilities not recognised in National Accounts:			
Net public sector pensions liability	1,835	1,425	1,493
Provisions	322	306	175
PFI contracts	33	33	33
Adjust assets measured differently in National Accounts:			
Asset Purchase Facility	(127)	(50)	(49)
Unamortised premia on gilts	51	38	35
UKAR net impact on net debt	(24)	(30)	(50)
Add assets and liabilities excluded from measure of PSND:			
Property, plant and equipment	(1,168)	(1,120)	(1,076)
Investment property	(18)	(16)	(15)
Intangible assets	(35)	(33)	(32)
Trade and other receivables	(49)	(37)	(35)
Prepayments and accrued income	(91)	(87)	(78)
Inventories	(9)	(10)	(11)
Investments	(51)	(50)	(73)
Trade and other payables	51	51	49
Accruals and deferred income	59	55	54
Deduct liabilities not yet recognised in WGA			
Housing associations	(70)	(67)	(60)
Other adjustments including eliminations	(15)	(25)	(39)
Net liabilities (WGA)	2,421	1,986	1,875

A.11 The reconciling amounts included in the table above are calculated as the difference between the value of a balance in WGA and the value of the same balance in the National Accounts. These amounts are therefore not directly comparable to the amounts included in the Financial Statements in Chapter 5.

Reconciliation to Public Sector Current Budget Deficit

A.12 Public Sector Current Budget Deficit is also calculated from the National Accounts and the government's preferred measure excludes public sector banks. Total net expenditure in WGA is higher than the Public Sector Current Budget Deficit primarily because it includes expenditure on long-term liabilities. By comparison, net expenditure on public services in WGA is in line with the Public Sector Current Budget Deficit.

Table A.3: Public sector current budget deficit

	2016-17 £bn	2015-16 £bn	2014-15 £bn
Public sector current budget deficit (National Accounts)[a]	7	39	58
Add expenditure on liabilities excluded from National Accounts:			
Increase in provisions	7	-	18
Adjust expenditure calculated differently from National Accounts:			
Depreciation and amortisation	(10)	(8)	(10)
Impairments and revaluations of assets	15	9	15
Net losses on sale of assets	2	(6)	(2)
Capital grants	9	7	8
Research and development	2	3	3
Other adjustments including eliminations	8	5	2
Net expenditure on public services (WGA)	40	49	92
Financing costs of long-term liabilities, including discounting	68	187	65
Revaluation of financial assets and liabilities	(10)	8	(5)
Total net expenditure (WGA)	98	244	152

a ONS Statistical Bulletin, Public Sector Finances, January 2018

A.13 The reconciling amounts included in the table above are calculated as the difference between the value of a transaction in WGA and the value of the same transaction in the National Accounts. These amounts are therefore not directly comparable to the amounts included in the Financial Statements in Chapter 5.

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CCS0618905468
978-1-5286-0568-7