HM Treasury

Whole of Government Accounts:

year ended 31 March 2018

HC 2164

May 2019

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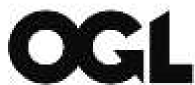

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Chapter 1

Overview and performance analysis

Overview

1.1 The Whole of Government Accounts (WGA) is a uniquely comprehensive view of the Governments financial position and performance. It consolidates the UK public sector, in line with International Financial Reporting Standards.

1.2 The requirement to produce WGA is set out in legislation (the Government Resources and Accounts Act 2000), and every year the Treasury has to prepare a set of accounts, have them audited and lay them in Parliament.

1.3 The headline results in WGA 2017-18 show income of £760.9 billion (2016-17 £720.8 billion), expenditure of £814.8 billion (2016-17 £760.7 billion). After financing costs are taken into account, the net expenditure for WGA is £212.4 billion (2016-17 £97.8 billion). On the Statement of Financial Position, WGA shows total assets of £2,013.8 billion (2016-17 £1,903.0 billion), and liabilities of £4,579.2 billion (2016-17 £4,323.7 billion).

1.4 As well as the income, expenditure, assets and liabilities recognised in WGA, the account includes a number of other liabilities and commitments that are disclosed, but not recognised. These include capital commitments of £54.2 billion (2016-17 £53.0 billion), operating lease commitments of £21.0 billion (£18.0 billion for 2016-17), PFI finance lease commitments of £39.6 billion and service charge commitments of £86.3 billion (2016-17 £42.8 billion and £89.3 billion) and other financial commitments of £48.8 billion (2016-17 £48.1 billion-restated).

1.5 In addition, government enters into a number of contingent liabilities. These are currently not sufficiently likely to occur to warrant recognition on the Statement of Financial Position, but are disclosed. These include £83.7 billion (2016-17 £84.0 billion) of contingent liabilities that are reported under the accounting standards, and a further £108.9 billion (£98.4 billion restated for 2016-17) of remote contingent liabilities. As the chance of these liabilities becoming due is considered remote, the accounting standards do not require their disclosure. However, they are included in the accounts of government departments to provide better transparency of fiscal risks.

1.6 EU exit is one of the most significant issues facing the UK. For the 2017-18 financial year the UK was a full member of the EU. WGA includes information on the UK's relationship with the European Union, and EU exit in paragraphs 1.183 to 1.190.

1.7 The WGA aims to improve transparency of financial reporting, and provide insight for future developments in fiscal risk management. The 2017-18 WGA is made up of the following sections:

- Chapter 1-The performance report- This is an overview of trends of key figures in WGA, contextual information to help clarify what the numbers mean, information on what government is doing to manage some of the risks, and useful background information.
- Chapter 2-Statement of Accounting Officer responsibilities- The Accounting Officer is the senior official responsible for signing off the accounts. This sets out his or her responsibilities in respect of the preparation of the accounts.
- Chapter 3-Governance statement- This section is about the process of preparing WGA, the risks managed in its preparation, and some of the issues encountered with the process.
- Chapter 4-Remuneration and staff report-This section relates to information and policy relating to staff costs.
- Chapter 5-Financial statements- This is a set of accounts, prepared in line with International Standards, as adapted and interpreted for the public sector context.
- Chapter 6- Certificate and Report of the Comptroller and Auditor General- This contains the findings of the audit.
- Annex A-Comparison to the National Accounts-This reconciles key figures in WGA to the National Accounts.

WHAT IS WGA?

Whole of Government Accounts is a unique publication, that puts the UK at the global forefront of fiscal transparency and government financial reporting.

WGA is made up of over 8,000 entities, across the whole public sector including central government departments, local authorities, devolved administrations, the NHS, academy schools and public corporations.

		Public Sector Net Debt	Public Sector Net Financial Liabilities	Public Sector Net Worth	WGA Net Liabilities
Assets				Non-financial assets	Non-financial assets
			Illiquid financial assets	Illiquid financial assets	Illiquid financial assets
		Liquid financial assets	Liquid financial assets	Liquid financial assets	Liquid financial assets
Liabilities		Government borrowing	Government borrowing	Government borrowing	Government borrowing
					Public Sector Pensions
					Provisions
					PFI contracts

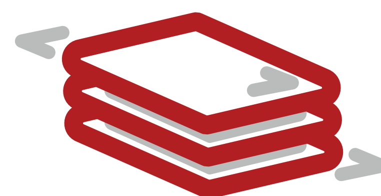
WGA and National Accounts

Day to day management of the public finances uses the National Accounts measures (see chart above).

These measures are less comprehensive than WGA, but are far faster to prepare, and follow international standards that allow comparisons between countries.

Why do we prepare WGA?

Providing a comprehensive picture of the UK's public sector finances is important, and supports government transparency.
Having a picture of long term liabilities helps inform more effective management of fiscal risks.



WGA is independently audited, providing assurance that the figures are prepared in line with International Financial Reporting Standards, as interpreted for the public sector context.

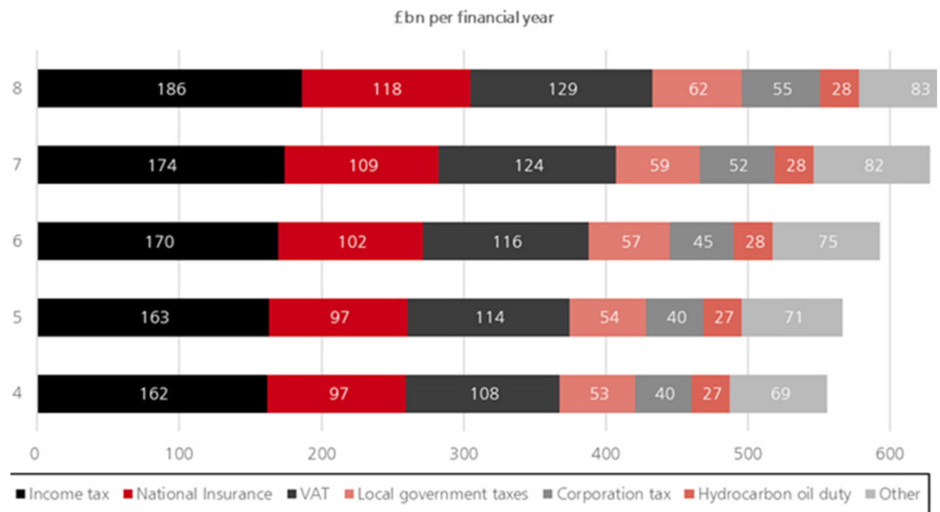
Income

Tax income

Most government expenditure is financed through tax income.

Most tax income is from individuals, with income tax and National Insurance levied on salaries and wages, and VAT and certain duties (such as hydrocarbon oils duties) levied on consumption.

Local taxes are comprised of council taxes and business rates.



WGA income

Income is recognised in WGA in line with the relevant accounting standard. Most income is recognised in the HMRC trust statement, which records most tax revenue collected by central government.

Any income that an organisation is not allowed to keep is passed to the consolidated fund to be redistributed.

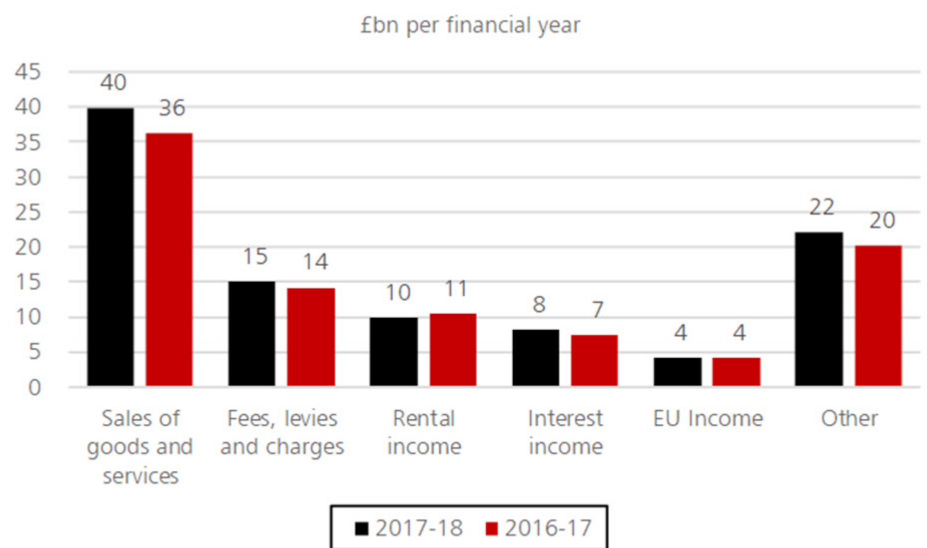
Income source	2017-18 (£bn)	2016-17 (£bn)
Taxation revenue	661.6	628.1
Other income	99.3	92.7
Total income	760.9	720.8

Other income

Government generates other income from a wide variety of sources.

Sales of goods and services is mostly made up of services provided by local authorities (£18.8 billion), with £4.4 billion in income generated by TfL.

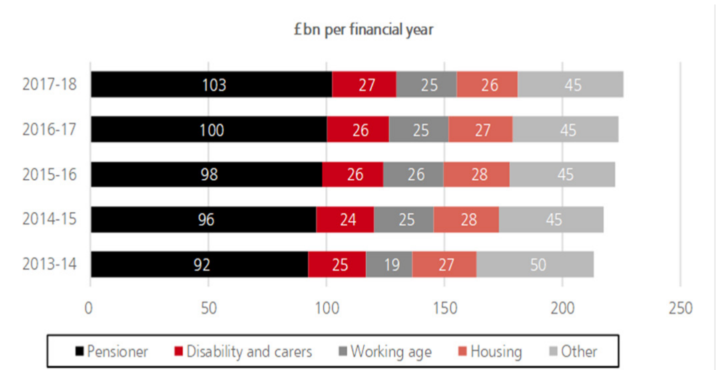
Most EU income (£4.1 billion) is spent by Defra on payments under the Common Agricultural Policy.



Expenditure

Social security

Social security makes up 28% of government expenditure. A significant proportion (43% of total benefits) is made up of the state pension, with 11% made up of housing benefit, 12% paid in disability and carers benefits and 12% paid as working age benefits.



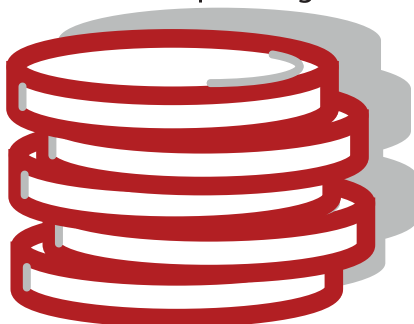
Expenditure type	2017-18 (£bn)	2016-17 (£bn)
Social security	225.9	223.7
Staff costs	215.8	191.1
Purchases	212.2	194.8
Grants and subsidies	51.2	53.6
Debt interest	36.8	31.8
Other	72.9	65.7
Total expenditure on public services	814.8	760.7

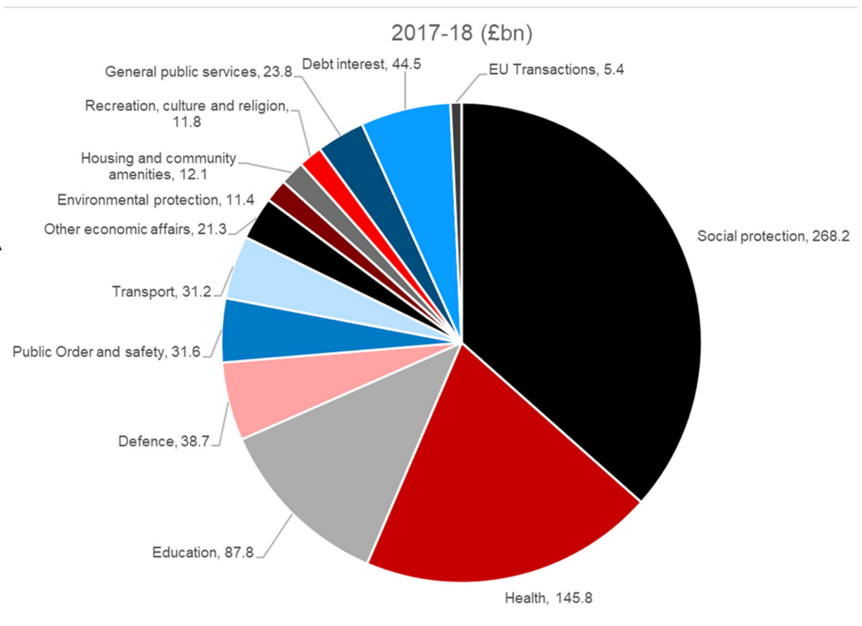
Staff costs

Staff costs comprise a significant proportion of expenditure, with £142.3 billion paid to permanent staff as salaries and wages, and £10.5 billion paid to others. WGA shows 4.4 million full time equivalent persons employed, with 1.5 million employed by the NHS.

Public Expenditure Statistical Analysis

WGA breaks down expenditure on what the money was spent on (for example staff). Treasury also publishes the Public Expenditure Statistical Analysis, which provides more information on public spending. More information can be found in table 1.D and Paragraph 1.136 of the WGA performance report. The chart shows the main areas of spending for 2017-18.





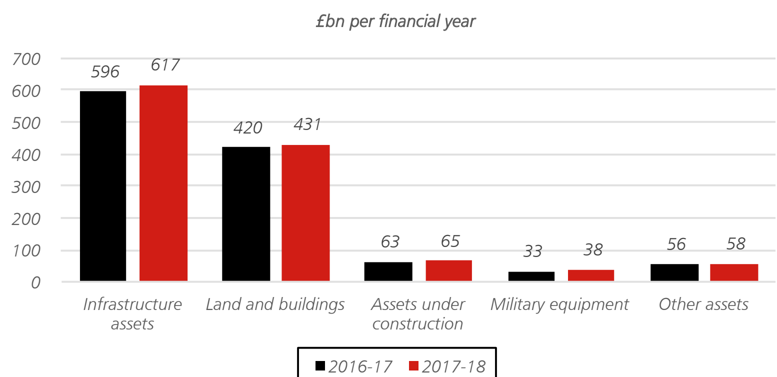
Assets

The most significant assets owned by government are property plant and equipment, financial assets and trade and other receivables.

Asset type	2017-18 (£bn)	2016-17 (£bn)
Property, plant and equipment	1,208.4	1,167.6
Other financial assets	507.6	458.9
Trade and other receivables	179.9	173.2
Other assets	117.9	103.3
Total assets	2,013.8	1,903.0

Property, Plant and Equipment

Property, plant and equipment (PPE) comprises 60% of assets in WGA. The largest components of PPE are land and buildings, and infrastructure assets – which includes the road and rail net-work.



Trade and Other Receivables

The most significant government receivables relate to taxation income.

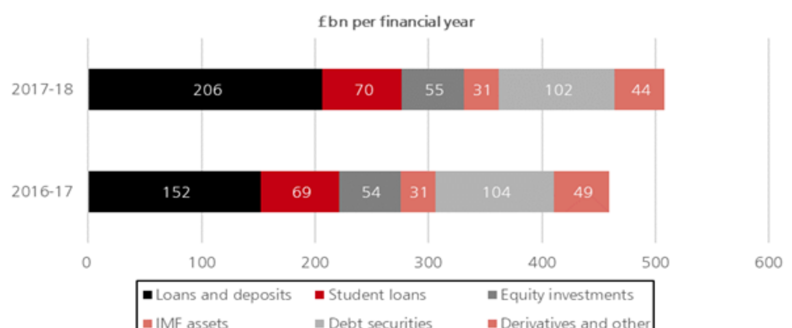
Other Assets

Other types of assets total £117.9 billion and include assets being held for sale, gold, cash and cash equivalents, property held as an investment and intangible assets. The majority of intangible assets are held by the Ministry of Defence and re-late to the development of military equipment.

Other Financial Assets

Other financial assets include loans and de-posits, the student loan book, equity invest-ments and debt securities. Some are held for cash management purposes and others to support specific policy objectives.

Loans and deposits stand at £206.4 billion, increasing this year due to Bank of Eng-land loans issued under the Term Funding Scheme. Equity investments include shares in RBS: a sale of 7.7% of the government's RBS shareholding took place after the reporting date of these accounts.



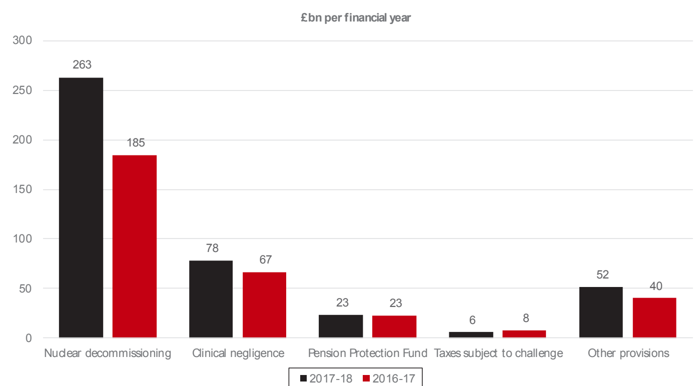
Liabilities

Key government liabilities are the net public sector pension liability, government borrowings, other financial liabilities and provisions.

Liability type	2017-18 (£bn)	2016-17 (£bn)
Public sector pensions	1,865.3	1,834.7
Government borrowings	1,347.4	1,289.0
Other financial liabilities	752.8	692.2
Provisions	422.5	322.2
Trade and other payables	191.2	185.6
Total liabilities	4,579.2	4,323.7

Government borrowings

The primary form of government debt is gilts. Total gilts stand at £1,122 billion. Other components include Treasury Bills and NS&I products.



Public sector pension liability

This is the largest liability within WGA, at £1865.3 billion. Movement in the liability tends to be driven by changes in the discount rate used to calculate the present value of the liability. It's also affected by changes in a range of actuarial assumptions such as on inflation and salary growth, life expectancy and workforce size.

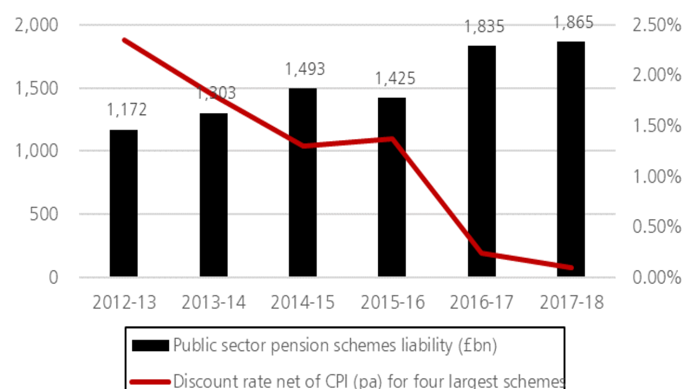
Other financial liabilities and payables

Other financial liabilities include deposits by banks (largely by commercial banks with the Bank of England), banknotes in circulation, a liability to the IMF, and bank and other borrowings.

Payables include capital financing of PFI assets, finance lease payments and other payables.

Provisions

Provisions are liabilities of uncertain timing or amount, but where payment is probable and amounts can be reliably estimated. Key provisions in WGA are those for nuclear decommissioning and clinical negligence. Changes this year in total provisions have been driven by changes to discount rates.



Commitments and contingent liabilities

Types of liability in WGA

The WGA balance sheet shows £4.6 trillion of liabilities.

In addition to these, there are commitments which are not recognised on the balance sheet.

Some of these (such as contingent liabilities) are not recognised because they are not seen as probable to occur.

Others are commitments, where there is a contractual obligation but the triggering event to recognise a liability has yet to occur.

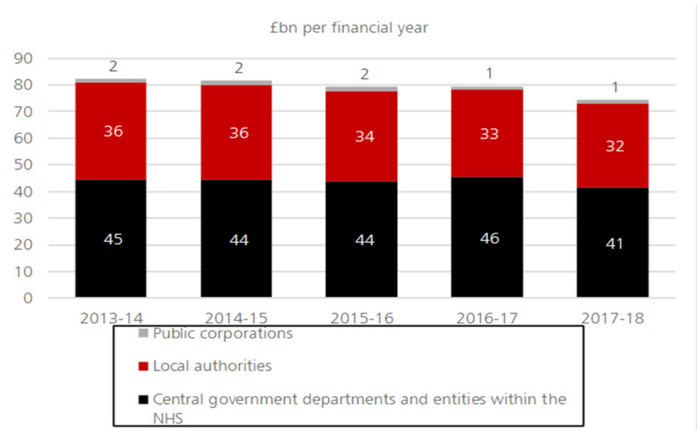
Contingent liabilities

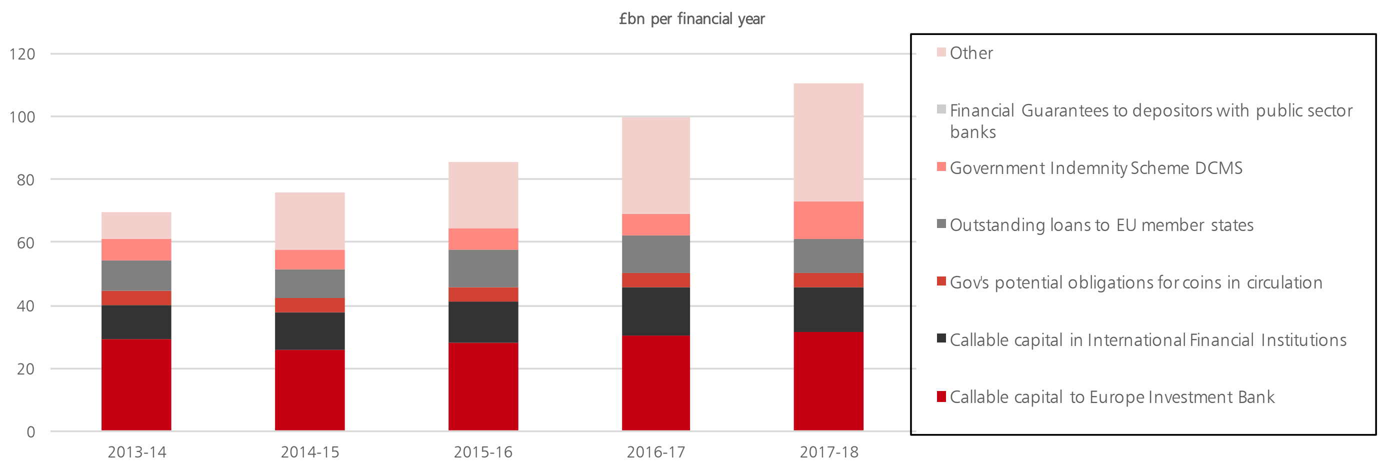
Contingent liabilities are liabilities that are unlikely, and will not crystallise unless a specific event occurs. These include indemnities, guarantees, or clinical negligence liabilities that are not ready to be recognised on the balance sheet.

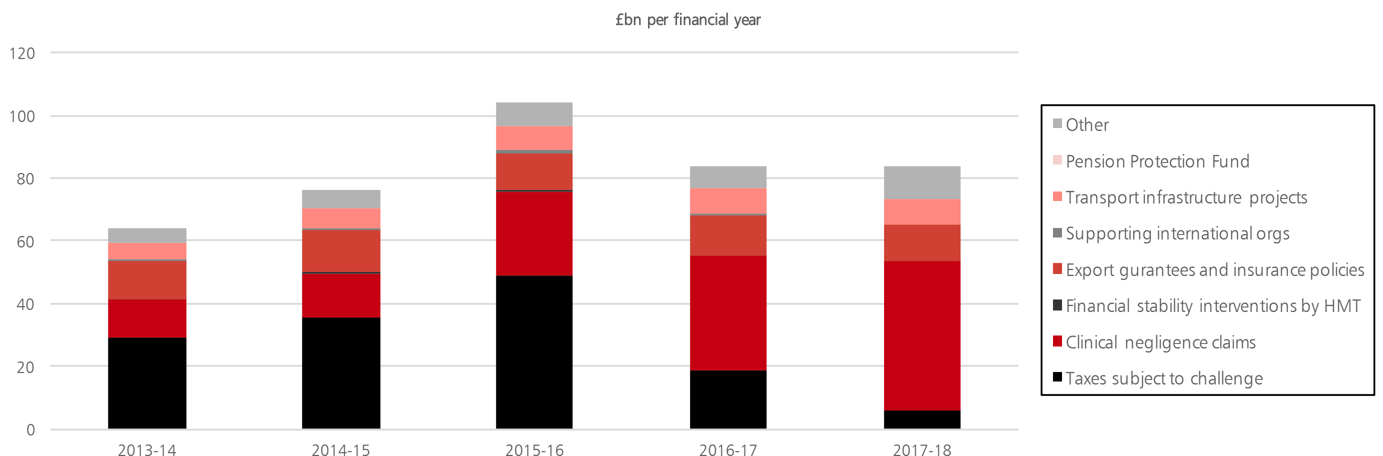
The chart below shows remote contingent liabilities, and the one at the bottom shows non remote contingent liabilities.

Commitments

There are a number of commitments, including £54.2 billion in capital commitments, £21.0 billion in commitments under operating leases, £39.6 billion in PFI finance lease commitments and £48.8 billion in other financial commitments. The chart below shows PFI commitments for different sectors.







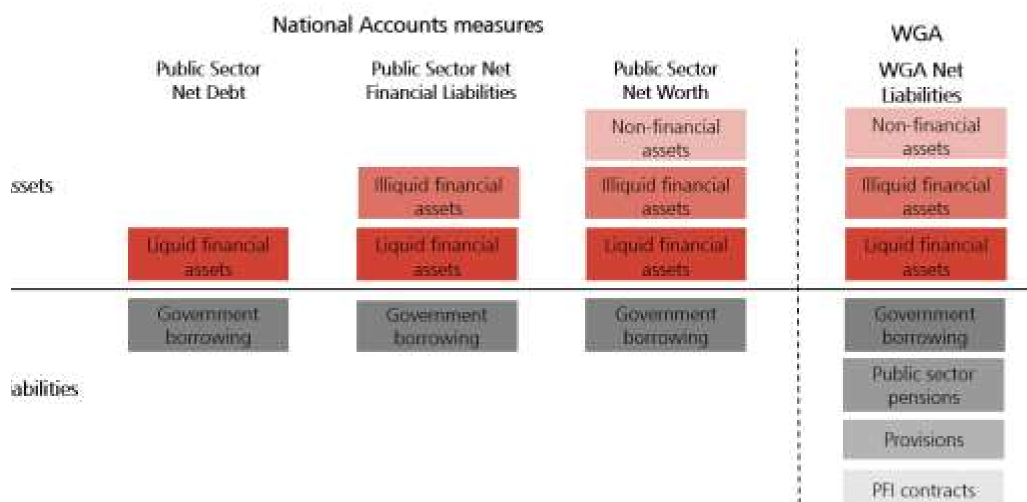
WGA and the National Accounts

1.8 WGA is comprehensive, but not without limitations. Box 1.B provides more information on what is not included in WGA. However, one of the key issues is that published financial statements, including WGA, are not published in a timely enough fashion to allow day to day control of the public finances. In order to understand and control the public finances, the government uses the National Accounts. These are statistical measures that do not include the full range of assets and liabilities that are included in WGA, but are much timelier.

1.9 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.

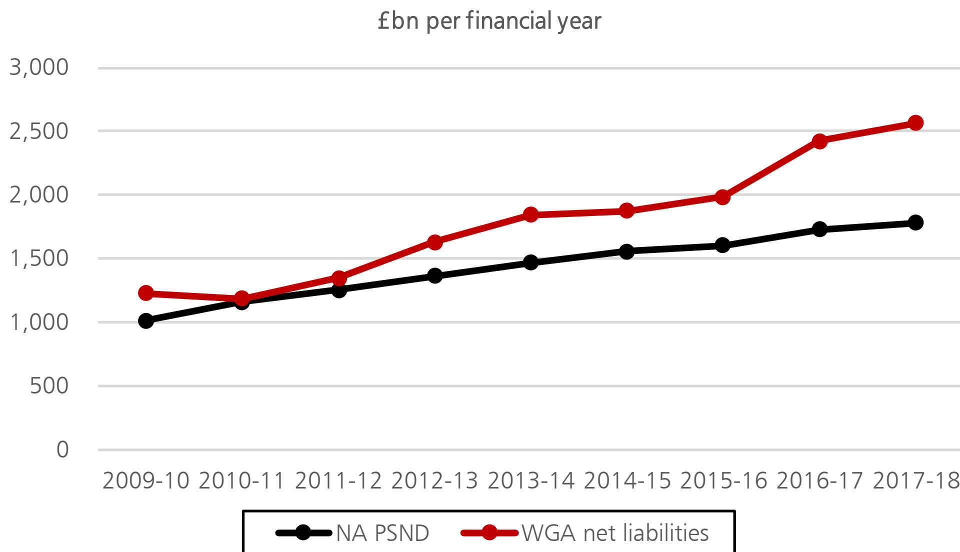
1.10 **WGA Net Liabilities** is more comprehensive than Public Sector Net Debt, including non-financial assets and public sector pensions liabilities, provisions and PFI contracts. Chart 1.A summarises the components of each of the National Accounts measures compared to WGA. Annex A to the account includes further explanations of the differences between the WGA and National Accounts.

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



Source: HM Treasury

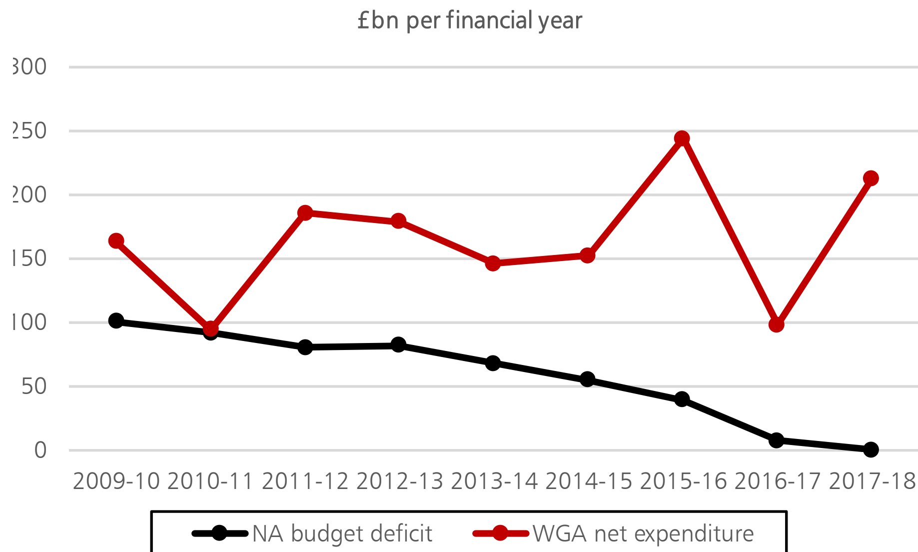
Chart 1.B: National Accounts (NA) PSND and WGA net liabilities



Source: HM Treasury and ONS data

1.11 Over the 9-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 and 2017-18. This is because pension liabilities increased in value that year, which affects WGA net liabilities but not National Accounts PSND.

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



Source: HM Treasury and ONS data

1.12 Over the 9-year time series the National Account 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 and 2017-18, as there was a change in discount rates for certain provisions that impacted financing costs in WGA, but did not affect the National Accounts deficit. Discount rates are one of the main causes for divergence between National Accounts and WGA, and more information can be found in Box 1.K and Annex A.

Box 1.A: Why does government use National Accounts?

The frameworks

WGA is prepared under International Financial Reporting Standards (IFRS). WGA is prepared on a similar basis to the private sector. The standards are interpreted and adapted for the public sector context.).

Public finances use National Accounts rules (European System of National and Regional Accounts) which apply internationally agreed standards for measuring economic activity. Reporting is carried out by the independent Office for National Statistics.

Comparability

There is more that is common than different between the two frameworks, allowing the two views to be combined (for example the use of the accruals accounting concept, production of a balance sheet, and production of an analysis of income and expenditure).

The UK reconciles WGA to the National Accounts to provide transparency.

Benefits of the National Accounts framework

National Accounts reporting is carried out by the Office for National Statistics (ONS) and is available to a much shorter timescale than WGA.

Benefits of the WGA framework

WGA provides a complete picture of the government's financial position and the future consequences of decisions already taken and financial commitments already entered into (for example pensions, PFI). WGA is independently audited.

WGA and the management of fiscal risks

1.14 WGA data has been used by both Treasury and the Office for Budget Responsibility (OBR), as part of a number of publications that seek to better understand and mitigate fiscal risk.

1.15 The **Balance Sheet Review** is led by Treasury. It seeks to embed long term balance sheet management into the spending framework. WGA data was used as part of its scoping, and has supported work as part of the review.

1.16 The Office for Budget Responsibility published the first Fiscal Risks Report (FRR) in July 2017. Government responded to the report in July 2018 by publishing Managing Fiscal Risks (MFR), a report which outlines the steps that the government is taking to mitigate the 57 fiscal risks highlighted by the OBR. WGA data was used as part of the evidence base for the MFR.

1.17 The OBR also published the Fiscal Sustainability Report in July 2018. This set out long term projections for spending, revenue and financial transactions, in order to better understand the underlying drivers of the fiscal position. This report used WGA data.

Box 1.B: What is not included in WGA

Although WGA is a highly comprehensive product, there are some areas that are not included, either because they are outside the accounting standards, would lead to lengthy disclosures that added limited value, or due to limitations in the data collection:

a) WGA does not include a liability for future state pension payments. This is because the payments are only recognised when they fall due, which is on an annual basis. For this reason, future payments for public services are also not recognised,

b) WGA does not recognise an asset for future tax revenue, as the revenue can only be recognised as it falls due.

c) WGA does not include individual remuneration disclosures of public sector employees, including senior employees. This information can be found in the published accounts of individual organisations.

d) WGA cannot currently provide in depth analysis of expenditure, particularly purchases of goods and services. This is because different organisations have different definitions of expenditure categories. Treasury continues to review this area to make improvements, and supplementary information is provided in Table 1.D. Box 1.J includes more information on the challenges of breaking down purchases of goods and services.

e) WGA follows the IFRS definition of Intangible assets. This means that there are strict rules over what can and cannot be recognised on the Statement of Financial Position. There is a broader definition of

intangible assets which encompasses knowledge, techniques and knowhow, which supports broader consideration of public value. More detail on this can be found in paragraph 1.33 to 1.37.

f) More information on some of the limitations around EU Exit disclosures in WGA can be found at paragraphs 1.183 to 1.190.

Report on assets and liabilities

Introduction

1.18 The WGA performance report offers an opportunity to look at the figures in the accounts from a different perspective. The report can use different sources of information to provide broader context.

1.19 The WGA provides a comprehensive and authoritative statement of the public finances. However, the next stage is taking some of the insight gained from WGA and turning it into improved processes that deliver real value to the taxpayer. One of the key ways in which this is being delivered is through the balance sheet review.

The Balance Sheet Review and its impact on future government policy

1.20 The Balance Sheet Review, which launched in Autumn Budget 2017, aims to improve the returns on public sector assets, utilise the asset base more effectively, decrease the cost of the government's liabilities and reduce balance sheet risk (or increase the compensation for bearing such risk). This seeks to release resources for further investment in public services and improve the sustainability of the public finances.

1.21 Budget 2018 provided an interim update on the Review's progress, announcing:

- the retirement of the Private Finance Initiative as a means of financing public infrastructure
- new Asset Sales Disclosure Guidance which aims to increase the transparency on the value for money of asset sales and their impact on the public finances
- action to reduce the government's gilt inflation risk exposure
- the implementation of a new control regime for contingent liabilities;
- a strategy to improve the management of the public sector's knowledge assets
- the announcement of the first-ever geo-spatial Digital National Asset Register to enable better optimisation and commercialisation of public property asset
- new performance management measures and continued central support to improve the recovery of debt owed to government

1.22 The Balance Sheet Review is not an excuse to sell off government assets, although it is government policy to not hold assets for which there is no public policy reason to hold them. Any assets that are sold must represent value for money and serve the public interest. New guidance for government on the disclosure of asset sales, launched by the Treasury in March 2019, describes how government is now required to report the impact of asset sales on the public sector balance sheet to Parliament via a Written Ministerial Statement. This includes disclosing the impacts of a material asset sale on Public Sector Net Borrowing (PSNB), Public Sector Net Debt (PSND),

Public Sector Net Financial Liabilities (PSNFL) and Public Sector Net Liabilities (PSNL) – the WGA accounting balance sheet.

1.23 The Treasury is working to ensure that the Balance Sheet Review has a lasting impact. Treasury is actively engaged with departments to determine how long-term opportunities for strengthening balance sheet management can be taken forward through the upcoming spending review.

1.24 The reforms introduced as a consequence of the Balance Sheet Review aim to deliver permanent improvements in the government's capability, understanding and incentives to improve the management of public sector assets and liabilities, and seek to further strengthen fiscal risk management.

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

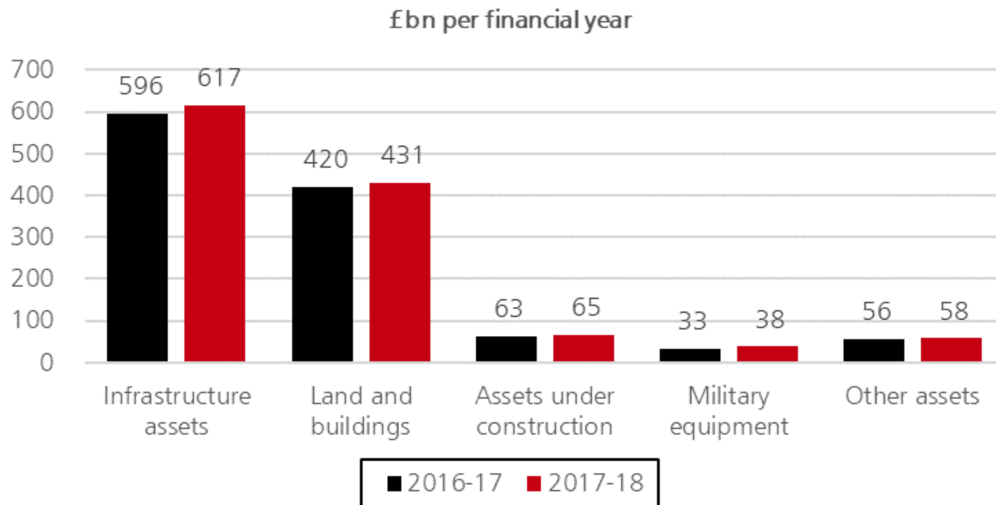
The most significant assets owned and controlled by government are **property, plant and equipment** (which includes land and buildings, infrastructure and military equipment), **financial assets** and **trade receivables.**

	Note	2017-18 £bn	2016-17 £bn
Property, plant and equipment	Note 12	1,208.4	1,167.6
Other financial assets (including loans and deposits, student loans and equity investments)	Note 16	507.6	458.9
Trade and other receivables	Note 15	179.9	173.2
Other assets	Notes 13, 14, 17, 18 (including gold and assets held for sale)	117.9	103.3
Total assets		2,013.8	1,903.0

Assets

Property, Plant and equipment

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



Source: HM Treasury

1.25 Overall, the value of government's property, plant and equipment increased by £40.8 billion or 3.5% in 2017-18. The most significant components of the government's property, plant and equipment are infrastructure assets and land and buildings.

Infrastructure assets

Table 1.A: Breakdown of infrastructure assets

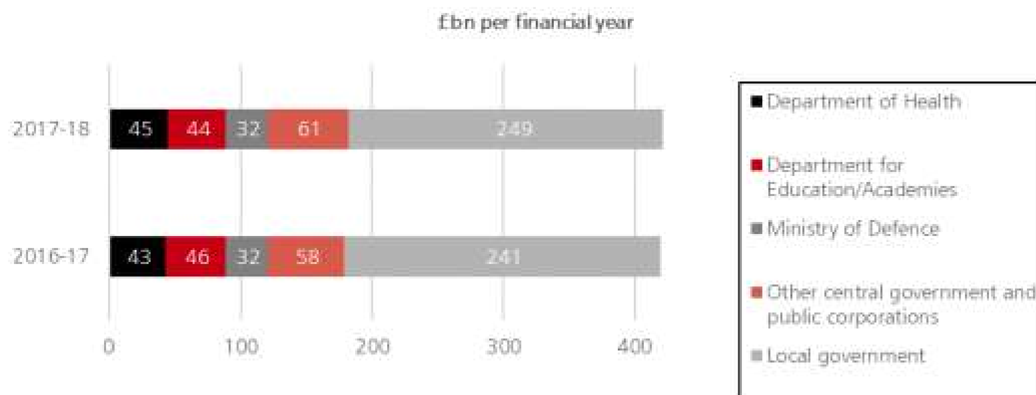
Held by	2017-18 £bn	2016-17 £bn
Network Rail	300.6	288.9
Highways England	119.3	117.4
Scottish Water	59.2	56.3
Northern Ireland Department for Infrastructure	26.8	25.6
Scottish Government Strategic Road Network	19.4	17.7
Welsh Government	16.3	15.6
Other	4.6	6.0
Total central government and public corporations	546.2	527.5
Transport for London	18.7	18.6
Highways infrastructure and other local government assets	51.7	49.5
Total local government	70.4	68.1
Total infrastructure assets	616.6	595.6

1.26 Government's infrastructure assets increased in value by £21 billion or 3.5% in 2017-18. A breakdown of government infrastructure assets by type is shown in the table above. The most significant movements related to Network Rail and Highways England, where new rail and road assets were completed, and existing assets revalued upwards.

1.27 Central government 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 difference in valuation methods means that local authority infrastructure assets are likely to be understated by at least £47.8 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 estimates and judgements in Note 2 to the accounts.

Land and buildings

Chart 1.E: Breakdown of government's estate



Source: HM Treasury

1.28 The value of land, buildings and dwellings owned by government has increased by £11.6 billion or 2.7% in 2017-18. This movement is largely driven by acquisitions of new assets and completion of assets which were under construction. The largest individual increase related to land and buildings held by the Department of Health and Social Care, amounting to £1.4 billion.

Managing the government estate

1.29 Since 2014, the government has disposed of over 1000 properties, raising £2 billion in proceeds and saving £0.3 billion per annum in running costs.

1.30 The Government Property Agency was established on 1 April 2018, just after the reporting date of these accounts. The agency will deliver a more commercial approach to property – reducing operating costs, increasing disposals and driving greater value across departments. The agency plans to bring the government's Whitehall estate onto its balance sheet within the next 5 years.

1.31 A key strand of the agency's work is the Government Hubs programme, creating innovative multi-departmental workplace hubs across the UK. This programme is expected to deliver £2.5 billion of savings over the next 20 years[1].

Box 1.C: Stonehenge in WGA

The government owns many unique cultural assets which you would not see on any private company's asset listing.

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/738217/Government_Strategy_Final_AW_v2.pdf

For instance, **Stonehenge** is a government asset. It was given to the nation by Cecil Chubb in 1918.

Most of our heritage assets are not included in our Statement of Financial Position, or like Stonehenge are valued at close to nil, as the market value would not be a true reflection of the value of the asset to the nation's heritage, or that determining a valuation of these assets would provide limited benefits compared to the costs[2].

Intangible assets

1.32 Intangible assets total £36.0 billion as at 31 March 2018 (£34.5 billion as at 31 March 2017). Intangibles are largely made up of Military equipment (£23.9 billion), capitalised development expenditure (£6.1 billion), software (£2.6 billion) and licences (£3.4 billion).

Getting smart about intellectual property

1.33 The accounting standards determine when an asset can be recognised. For intangible assets a number of criteria need to be met, covering the technical feasibility of what is being developed, the intention to complete the asset, and the ability to reliably measure the expenditure attributable to developing the asset. However, there is a broader definition of intangible assets, that encompass intellectual property, data and other assets which could all be considered as knowledge assets.

1.34 At Budget 2018, as part of the Balance Sheet Review, HM Treasury published a report - 'Getting smart about intellectual property and other intangibles in the public sector'[3]. The report made 10 recommendations to improve the management of intangible or 'knowledge assets' held by the public sector. Knowledge assets include intellectual property, software, data, technological expertise, organisational know-how, and other intellectual resources. These assets are growing in importance as countries see a rising share of employment and value creation coming from the 'knowledge economy'. Among the world's five most valuable companies (Apple, Amazon, Alphabet, Microsoft and Facebook), 95% of their £3.5 trillion of value is in the form of knowledge assets.

1.35 However, most knowledge assets are not recognised by accounting standards. In fact, only 2% (£36.0 billion) of the public sector balance sheet, as reported in the WGA, is attributed to intangible or knowledge assets. A more comprehensive estimate by academics of the total value of the

[2] Note 7 Heritage Assets, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727557/Department_for_Digital__Culture__Media___Sport_Annual_Report_2017-18_Web_Accessible.pdf

[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752003/Getting_smart_about_intellectual_property_and_other_intangibles_in_the_public_sector_-_Budget_2018.pdf

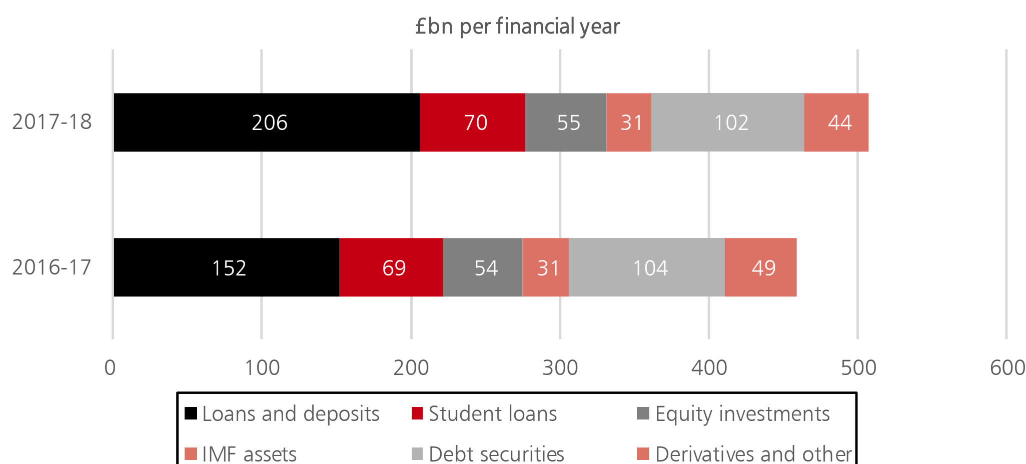
knowledge assets owned by the UK public sector shows that the number has grown strongly in recent years and puts the current figure at £150 billion[3].

1.36 The recommendations of the report include the creation of a central support function; the establishment of specialist knowledge asset networks across the public and private sectors; improvements to the recognition, protection and valuation of knowledge assets; guidance documents detailing good practice; and a package of incentives and investments to reward and drive behaviour.

1.37 Work is now underway to develop these recommendations into an implementation strategy, which will be published in summer 2019. This will put the UK at the forefront of the management of knowledge, using data from the WGA and other sources to improve understanding of public sector assets and inform strategic action in response.

Other financial assets

Chart 1.F: Breakdown of other financial assets



Source: HM Treasury

1.39 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 higher education whilst loans and equity investments were acquired during the financial crisis to support financial stability.

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

1.41 UK Government Investments (UKGI) is 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.

1.42 The government only undertakes sales when UKGI advises it will achieve "fair value"-where the share price accurately reflects the current and future prospects of the bank.

1.43 Information on significant sales after 31 March 2018 have been included in Note 32: Events after the reporting period.

Loans and deposits

1.44 Loans and deposits increased by £54.4 billion in 2017-18. This is largely due to the Bank of England Term Funding Scheme, which at 31 March 2018 stood at £127.0 billion (£55.1 billion at 31 March 2017).

1.45 The Term Funding Scheme (TFS) is a monetary policy tool of the independent Monetary Policy Committee (MPC) and forms part of the Asset Purchase Facility. It was introduced in August 2016 with the aim of supporting the

transmission of the cut in the Bank Rate to lending rates facing households and businesses. The TFS operates by giving loans to commercial banks and building societies against eligible collateral at Bank Rate, charging them a fee of up to 25 basis points more if they reduce their net lending, which provides an incentive to pass on the funding to the broader economy. 62 commercial banks and building societies participated in the TFS. The loans will be repaid over 4 years to February 2022.

1.46 The TFS scheme transferred from the Asset Purchase Facility to the Bank of England in January 2019. Further details can be found in Note 32 of the accounts.

Student loans

1.47 WGA includes student loans of £70.0 billion at 31 March 2018 (2016-17: £69.4 billion). The value of student loans held by government in the WGA at 31 March 2018 reflects an estimate of the present cost of subsidising interest on loans over the life of the loan 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. The table below shows a reconciliation of face value of English student loans (which make up nearly 90% of the value of total loans) to their carrying value in WGA:

Table 1.B: Reconciliation of face value to carrying value of English Student loans

	Total (£ million)
Opening face value of loan book as at 1 April 2017	88,799
Less: Opening value of loan impairments	(27,459)
Opening carrying value of loan book as at 1 April 2017	**61,340**
Fair value of new loans issued	**8,632**
Impairment adjustment to opening loan book	(6,413)
Disposal	(2,584)
Capitalised interest	2,849
Effective interest	(329)
Write-offs	(57)
Repayments	(2,291)
	(8,825)
Carrying value of loan book as at 31 March 2018	61,147
Add back: closing value of loan impairments	40,782
Face value of loan book as at 31 March 2018	**101,929**

Source: DFE 2017-18 accounts

Box 1.D: National Accounts Treatment of student loans

The independent Office for National Statistics (ONS) decides how government's policies are reflected in public finance statistics, following rules set out in the European System of National Accounts 2010 and the Manual on Government Deficit and Debt 2016 (MGDD).

Currently, UK student loans are recorded as conventional loans in the National Accounts and Public Sector Finance. Student loans are different from most other loans government holds, in that they have a high degree of contingency and consequently it is expected a significant amount of the loan will not be paid back. This proportion of capital and accrued interest that will not be paid back is not reflected in the current National Accounts treatment until any unpaid balance is written off at the end of the approximately 30 year repayment period.

The ONS engaged with international statistical organisations and other national statistical institutions on the treatment of student loans, and the revised treatment will be reflected in updated guidance in the MGDD this year and introduced by the ONS in September 2019.

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. 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.

Sale of student loans

1.48 In December 2017, the government concluded the first sale of part of the English income-contingent repayment student loan book, raising £1.7 billion for the Exchequer. This is reflected in the figures disclosed in Note 16 of the accounts.

1.49 In December 2018 the government completed the second sale of pre 2012 student loans, realising proceeds of £1.9 billion. This sale will be reflected in the 2018-19 WGA and accounts of the Department for Education.

Equity investments

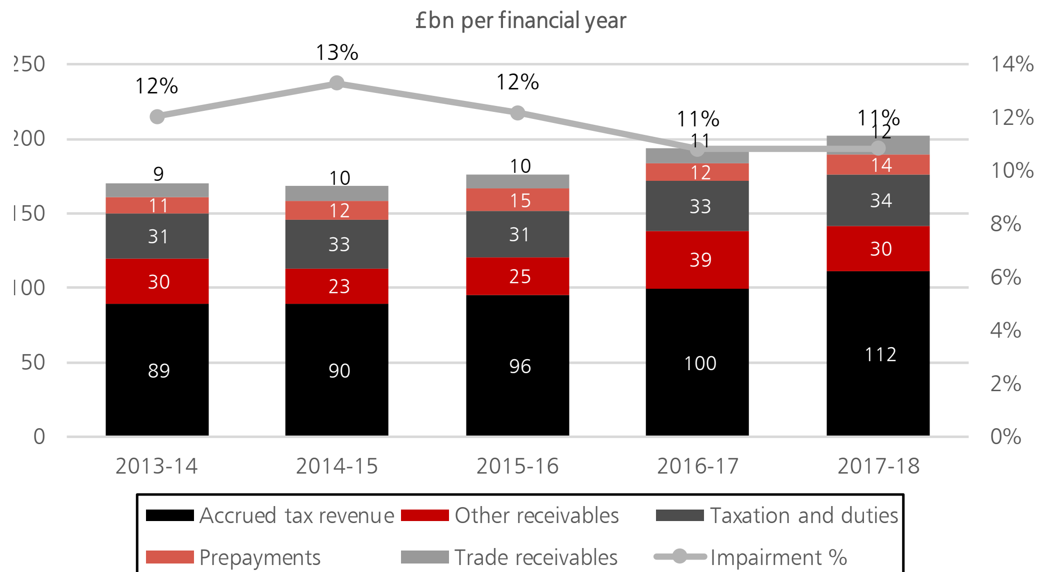
1.50 The government remains committed to returning RBS, an asset taken on in the financial crisis, to the private sector in a way that will maximise value for money for the taxpayer.

1.51 Budget 2018 set out the government's intention to undertake a full disposal of the RBS shareholding by 2023-24, subject to market conditions and achieving value for money.

1.52 On 7 June 2018 government sold £2.5 billion RBS shares, reducing the governments shareholding by 7.7% to 62.4%. This sale will be reflected in the 2018-19 WGA, and the accounts of HM Treasury.

Trade and other receivables

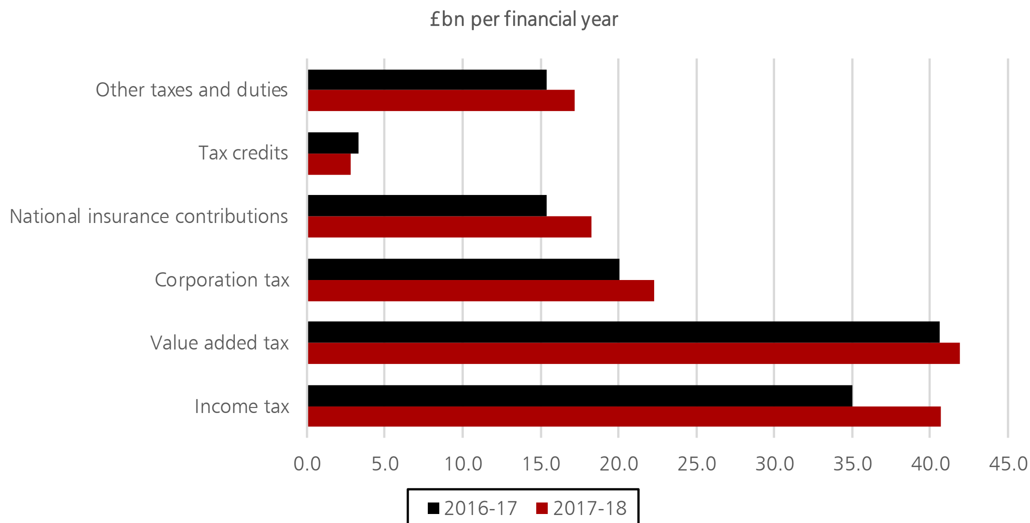
Chart 1.G: Breakdown of receivables by type



Source: HM Treasury

1.53 Receivables have increased by 19% 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 £146.0 billion is broken down in the Chart 1.H.

Chart 1.H: Breakdown of 2017-18 accrued tax revenue and taxation and duties (before impairment)



Source: HMRC 2017-18 trust statement[4]

1.54 Impairments to tax receivables amount to £6.9 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 increased from £6.4 billion to £6.9 billion.

Management of debt owed to government

1.55 Debt is owed by individuals and businesses and comes from a wide range of sources, including overdue tax liabilities, benefit or tax credit overpayments, loans, outstanding fines and penalties and court confiscation orders. Overdue debt is volatile and very much depends on policy decisions. At March 2018, around £23.5 billion of overdue debt was owed to central government (3.3% of revenue generated).

1.56 Government is implementing a Cross Government Debt Management Strategy which outlines the government's aim to create a more consistent strategic approach to debt management. As part of the strategy, government has developed a Debt Standard that sets expectations for the effective management of debt. Government organisations will assess their maturity against the standard and subsequently identify opportunities to further improve efficiency, effectiveness and performance. A Debt Centre of Excellence has also been established to provide a single point of access for debt services across both central and local government.

[4]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/724943/HMRC_Annual_Report_and_Accounts_2017-18__print_.pdf

1.57 Government developed Fairness Principles with the debt advice sector to continually improve how government interacts with people in debt, particularly those in vulnerable circumstances and/or experiencing financial hardship. These are aligned to FCA guidelines on Treating Customers Fairly. The Principles are embedded in the Cross Government Debt Management Strategy and the Debt Standard.

Liabilities

What liabilities does government have?

1.58 Government holds a series of significant liabilities: Government borrowing, public sector pension liabilities, other financial liabilities, payables and provisions.

1.59 The table below provides information on the maturity profile of significant liabilities. As well as the overall maturity of liabilities, it is important to consider the pattern of payments over time. Charts 1.R, 1.L and 1.N provide more information on the payment profiles for the nuclear provision, public sector pensions and gilts respectively. These show significant pressures from these liabilities over the coming 10-20 years. As well as this, the OBR's fiscal sustainability report highlights the demographic and other challenges that will impact the public sector finances in the future:

Table 1.C: Maturity profile of liabilities

Liability	Within one year (£ bn)	After one year (£ bn)	Comment on maturity profile
Payables			
Imputed finance lease element of on-balance sheet PFI contracts	1.6	37.4	PFI contracts are long term projects that involve payments every year. The balance sheet element recorded here reflects the capital financing of the PFI Asset. The Infrastructure and Projects Authority publishes data on existing PFI contracts[a], which includes future payments to be made. According to this data, the final year of payments will be 2049-2050.
Trade and other payables	42.4	9.8	Trade and other payables are generally short term liabilities, with the largest single element being HMRC payables. These figures will fluctuate depending on underlying business activity.
Obligations under finance leases	0.3	4.5	This represents the obligation to pay for assets purchased under finance leases. The largest element of the non-current balance relates to MOD This relates to a leasing arrangement for the provision of homes for service personnel and their families. This contract has over 175 years left to run. This lease is valued at £1.7 billion.
Other payables, accruals and deferred income	82.5	12.7	Accruals, deferred income and other payables are generally short term liabilities, relating to underlying purchases of goods and services.
Borrowings			

Gilts	50.2	1,071.8	Gilts are the main form of government borrowing. At the end of 2017-18 the average time to maturity of gilts is 15.2 years, with 8.2% maturing in the next year. The longest maturity gilt is due to redeem in 2068-69, but the main bulk of gilts are due for redemption before 2040. Gilts are often refinanced when they fall due and are managed by the Debt Management Office (DMO[b]). Chart 1.N shows the gilt redemption profile in more detail.
National Savings and Investment products	156.7	-	NS&I products are offered to the general public and are a form of government borrowing. Because these can be redeemed on short notice, they are considered current liabilities. However, in reality an amount of this will be rolled over multiple years, as savers hold on to their products.
Treasury Bills	68.7	-	£41.7 billion of this amount is due in not more than 3 months, with the rest due between 3 months and 1 year.[c] Treasury bills have a maximum maturity of 364 days and there are weekly tenders, held by DMO.
Other financial liabilities			
Deposits by banks	555.8	2.3	Deposits by banks are mostly made up of deposits of commercial banks with the Bank of England. These will fluctuate depending on the underlying business activity of those financial institutions.
IMF Special Drawing Rights (SDR) Liabilities	10.5	-	The government has a liability to the IMF for SDRs that have been allocated since the UK became a participant in the Special Drawing Rights Agreement. If the UK withdraws from participation or the Agreement is wound up, payment to the IMF would be required at current exchange rates.
Banknotes in circulation	73.3	-	Government maintains a current liability in respect of banknotes in circulation. However, given that there will need to be a supply of cash in the economy, this liability can be considered to not have a maturity, although its value will fluctuate over time depending on the value of notes in circulation. Coins are treated as a contingent liability, and therefore not on the statement of financial position.
Other	14.4	96.5	This figure is mostly made up of bank and other borrowings (£75.5 billion). Of this £23.7 billion relates to obligations for debt issued by Network Rail with a government guarantee.
Provisions for liabilities and charges			

Nuclear decommissioning	3.4	260.0	The nuclear decommissioning provision is the longest term liability within WGA and reflects works to decommission nuclear sites which are not expected to be fully completed until 2137. Chart 1.R shows the planned expenditure profile for this provision.
Clinical negligence	3.3	75.1	Clinical negligence payments are dependent on the outcome of legal processes. Claims for seriously injured patients are usually paid as a lump sum up front and annual payments for the rest of the claimant's life. This means some elements of the liability will last several decades.
Other provisions	9.7	71.0	£23.2 billion of this figure relates to the Pension Protection Fund. This takes on pension liabilities for insolvent employers. The actuarial valuation for these liabilities shows cash flows out to nearly 2088[d].
Public sector pensions			
Public sector pensions liability		1,865.3	Chart 1.L shows unfunded public sector pensions expenditure as a proportion of GDP, showing that there is still a liability past 2066. Given the nature of the liability it is expected that payouts would be made for many decades to come.
Total liabilities	1,072.8	3,506.4	

Source: HM Treasury

a https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/693177/current_projects_as_at_31_March_2017.xlsx

b https://dmo.gov.uk/media/15381/drmr1819.pdf

c https://www.dmo.gov.uk/media/15583/dmodmarep2018.pdf

d https://www.ppf.co.uk/sites/default/files/file-2018-10/annual_report_2017-2018.pdf Page 137

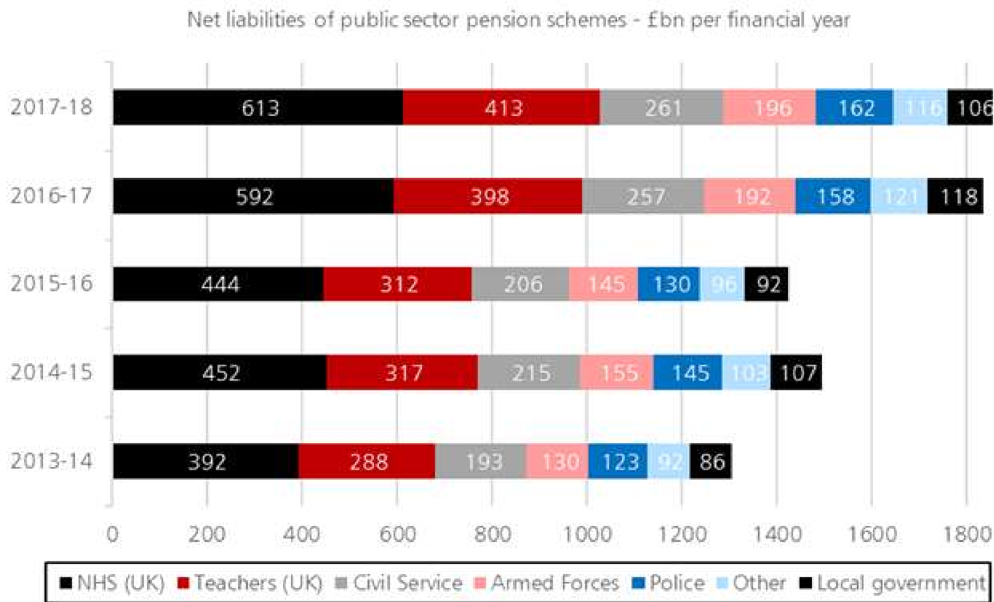
Public sector staff pensions

1.60 At £1,865.3 billion, the net public sector pension liability is the largest liability recorded in the 2017-18 Whole of Government Accounts. The net liability has increased by £30.6 billion or 1.7% in 2017-18. This does not include the state pension, which is disclosed in Note 6 as social security expenditure.

1.61 As shown in Chart 1.I over 75% of the public sector pension scheme liability relates to four central government schemes – NHS, teachers, the civil service and the armed forces.

1.62 The accounting treatment for Pensions is one way of looking at their valuation and affordability. Paragraphs 1.76 to 1.78, as well as Boxes 1.F and 1.G provide more information.

Chart 1.I: Net public sector pension liability by scheme type



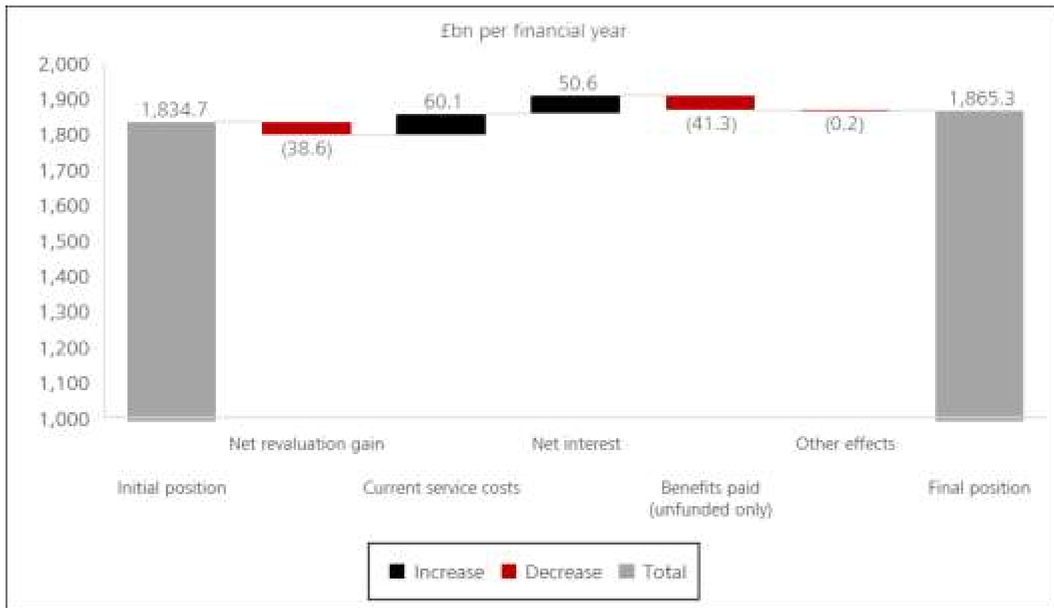
Source: HM Treasury

1.63 The overall change in the liability is shown in Chart 1.J. The net interest cost and the benefits paid out by the unfunded schemes have both changed the overall liability by a similar amount to 2016-17. However, 2016-17 saw a large revaluation loss, whereas in 2017-18 there is a small revaluation gain: this largely reflects changing actuarial assumptions.

1.64 The other factor increasing the 2017-18 liability is the current service costs. The current service cost is calculated by actuaries, and reflects the costs under the accounting assumptions of the benefits earned by employees over the year as a result of their service.

1.65 Since the current service cost depends on the discount rate at the start of the year, rather than the year end, the movement in current service cost reflects the previous years' change in discount rate. In 2017-18, current service costs increased for a number of schemes. However, since the actual rate of employer contributions is determined as part of a funding valuation using different assumptions, changes in current service costs do not affect employer's expenditure.

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



Source: HM Treasury

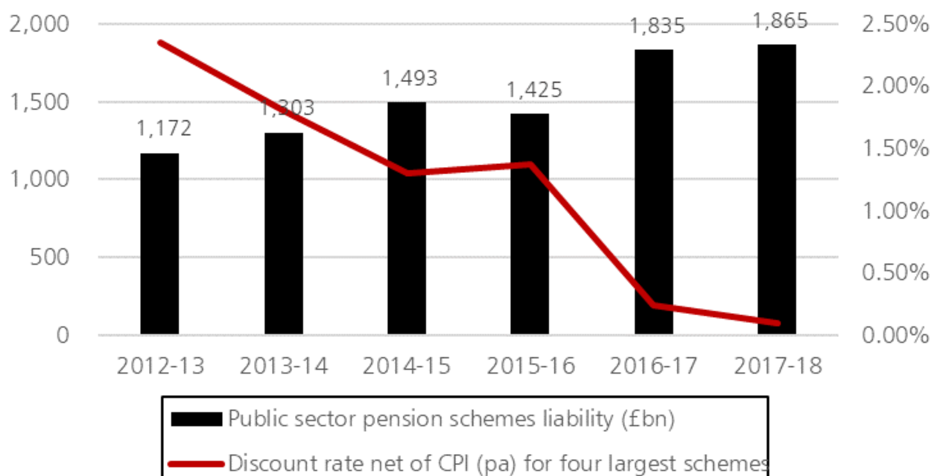
Discount rate changes

1.66 Each year, revisions are made to the discount rate used to calculate the public sector pension liability for accounting purposes. This rate is based on the market yield of corporate bonds net of the consumer price index (CPI).

1.67 The 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. Chart 1.K illustrates how the trend in this discount rate compares with the trend in the public sector pension scheme liability over recent years.

1.68 The discount rate for central government schemes is set by HM Treasury each year.

Chart 1.K: Discount rate trend



Source: HM Treasury

1.69 In 2016-17, the central government discount rate changed from 1.37% to 0.24%. This reflected a reduction in the real yield of corporate bonds. This 1.13% drop in the discount rate led to a significant increase in the 2016-17 net public sector pension liability as shown in WGA. The drop in the discount rate was therefore a key factor in the loss on revaluation shown in the 2016-17 accounts.

1.70 In 2017-18, there was a much smaller reduction to the central government discount rate, from 0.24% to 0.1%. This alone would be expected to cause a loss on revaluation to the pensions liability of around £50 billion. However, the revaluation gain or loss also includes the impact of other actuarial assumptions, as detailed below.

Other factors impacting the public sector pensions liability

1.71 The public sector pensions liability is also impacted by changes in other factors, in addition to the discount rate. These include:

- The assumptions for CPI growth and salary growth which affect how much an individual is expected to receive
- The assumptions for life expectancy which affect the expected term of pension payments
- The assumptions on workforce size which affect the number of people expected to receive pension payments

1.72 Gradual changes in workforce size over many years (e.g. a reducing civil service or growing health service) can cause a gradual shift in the liability, as a larger or smaller value is added to the liability annually to reflect the pension promised to the workforce for their service that year.

1.73 Step changes in the liability can occur when key assumptions or data are updated, such as the ONS publication of population projections which are used to set life expectancy assumptions. Some schemes, including the four largest public sector pension schemes (NHS, Teacher's, Armed Forces, and Civil Service), have moved from using ONS 2014 life expectancy assumptions to ONS 2016 assumptions in 2017-18. The ONS 2016 projections assume lower future life expectancy, compared to the ONS 2014 projections[5]. This change was largely driven by higher observed mortality over 2014 to 2016 than was expected in the previous assumptions. This change in life expectancy assumptions may have reduced the overall pension liability in the 2017-18 WGA by around £75 billion.

1.74 Fluctuations in the liability can be caused by changes in the assumptions for salary and CPI growth, which are set using prescribed accounting standards.

1.75 When observed events differ from previous assumptions this can also cause fluctuations in the liability, but these are typically much smaller than those

[5] See Table 3.2 in https://obr.uk/fsr/fiscal-sustainability-report-july-2018/

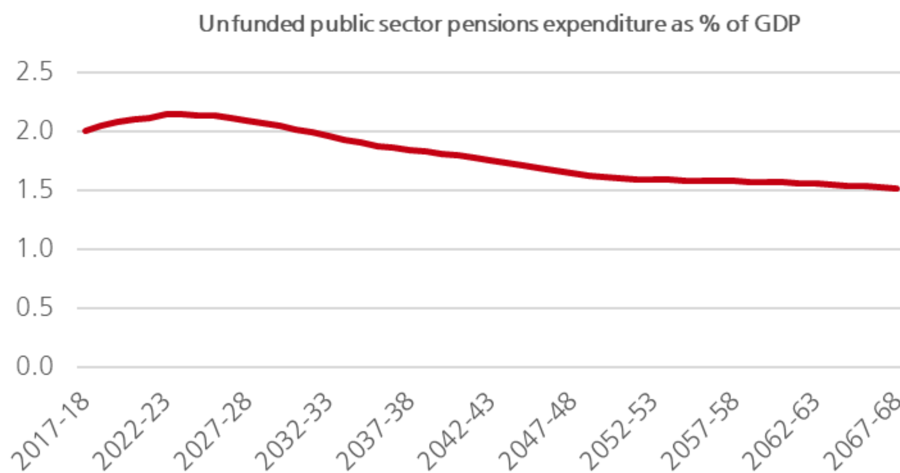
described above. For example, lower salary growth or more deaths over the accounting year than expected can both lead to a reduction in the liability.

Affordability of public sector pensions

1.76 Changes to the discount rate net of CPI drive changes in the public sector pension liability, but do not affect the future benefits payable. Due to this, the government focuses on other measures to assess the affordability of the public sector pension schemes, and manage the associated fiscal risks.

1.77 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, as published in their Fiscal Sustainability Reports. These look at the future expected pension cash flows as a percentage of GDP. Chart 1.L shows the most recent such projection, made in the July 2018 Fiscal Sustainability Report.

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



Source: OBR Fiscal Sustainability Report, Supplementary Data[6]

1.78 This chart shows that spending on unfunded public service pensions is projected to peak in the next few years at around 2.1% of GDP and fall gradually to 1.5% of GDP over the next 50 years. The reasons for this projected fall include the impact of both historic and more recent reforms.

Pension reform

1.79 Around 2015, the government implemented a package of public sector pension reforms to reduce the cost of the schemes. These reforms were set out in the Public Service Pensions Act 2013.The aim of the reforms was to ensure that the schemes are sustainable, to continue to address the fiscal pressures that will result from an ageing population, and to rebalance taxpayer and member contributions. These reforms included ending final salary pension schemes and moving to career average schemes, and aligning

[6] https://obr.uk/fsr/fiscal-sustainability-report-july-2018/

normal pension age with the state pension age (except for firefighters, the police and the armed forces)[7].

1.80 These changes built on previous reforms, the effects of which will also emerge over future decades. These include the change in indexation arrangements from the RPI to the CPI which came into force in 2011, and increasing member contribution rates from 2012[8], as well as more historic reforms introduced in the mid 2000's. These more historic reforms generally increased the normal pension age from 60 to 65, as well as changing the way benefits accrue, and introduced retirement lump sum options to bring more consistency across all the schemes.

1.81 Another measure to manage the fiscal risks of the public sector pension scheme is the introduction of 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 employer contribution rate. However, this element of the valuations was paused in January 2019, until the final impact of a court ruling on part of the 2015 pension reforms becomes more certain (see Box 1.E)[9].

Box 1.E: Legal challenge on transitional protection

As part of the reforms introduced in 2015, employees who were within ten years of their normal retirement age at 1 April 2012 remained in their existing pension schemes rather than moving to the reformed schemes. This is known as transitional protection.

In December 2018, the Court of Appeal ruled that transitional protection arrangements offered to members of the judiciary and to firefighters gave rise to unlawful discrimination. The government is seeking permission to appeal this decision. If permission is refused, the judgement could have implications beyond the two schemes above and for equivalent arrangements in schemes made under the Public Service Pensions Act 2013.Whether the judgement did apply to such other schemes will have to be considered on a scheme by scheme basis.

However, the impact of the litigation is uncertain, it is not possible to quantify the impact, if any, on the pensions liability at this time.

[7] https://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN05768

[8] https://researchbriefings.files.parliament.uk/documents/SN06744/SN06744.pdf

[9] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2019-01-30/HCWS1286/

Box 1.F: How are public sector pension liabilities treated in the National Accounts?

WGA recognises future pension liabilities when the rights accrue to employees, even though payment is not yet due. The National Accounts only recognises expenditure as it is paid out to retirees, and does not recognise a future liability. The expenditure recognised in National Accounts is reduced by the amount received through employer and employee contributions.

Sensitivity to changes in key assumptions

1.82 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.

Box 1.G: Differences between public sector pension liabilities in scheme valuations and WGA

The pension scheme valuations and the scheme accounts which are collated to form WGA both reflect the same future benefit payments, but show different liability figures. There are two main reasons for this difference: differing financial assumptions used, and timing practicalities.

Differing financial assumptions

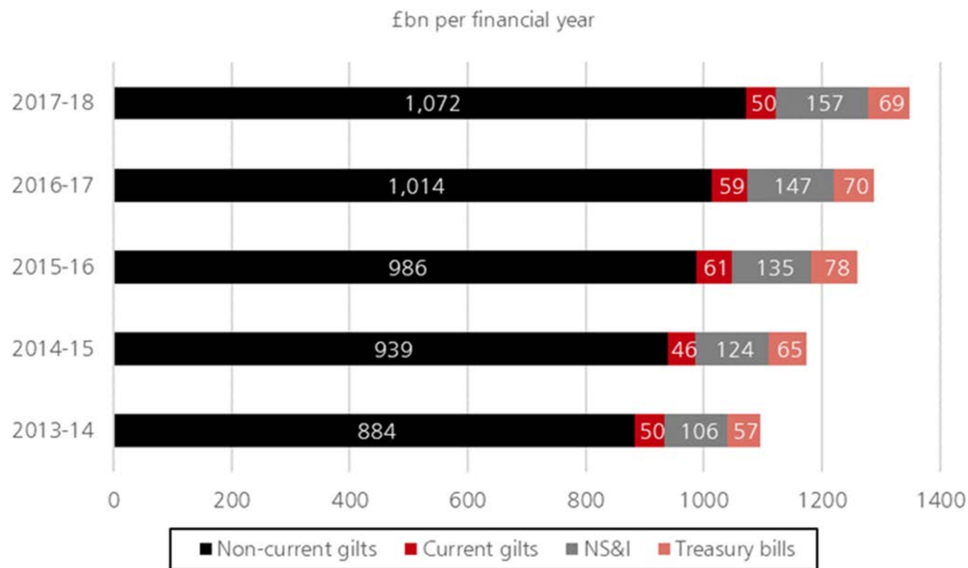
The valuations use a different discount rate, known as the SCAPE rate, that is linked to the OBR's expected rate of long term GDP growth. They also use different assumptions for CPI and salary growth. The assumptions used in the accounts are based on market conditions close to the effective date of the accounts.

Timing practicalities

Valuations take place every 3-4 years. The process takes a few years as valuations are based on detailed membership data, which can take up to a year to collect and verify, and on demographic assumptions which are set to reflect recent data. As accounts are required on an annual basis, they uprate or downrate the latest calculations (often from a previous valuation) to reflect the latest "whole scheme" data. The refreshed data and demographic assumptions from the valuations typically feed into accounts up to a few years later.

Government borrowings

Chart 1.M: Long term trends in government borrowing



Source: HM Treasury

1.83 The total nominal value of central government wholesale debt (excluding government holdings) as at 31 March 2018 was £1,347.4 billion, up from £1,289.0 billion as at 31 March 2017.

1.84 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 are set out in the 'debt management report.'[10]

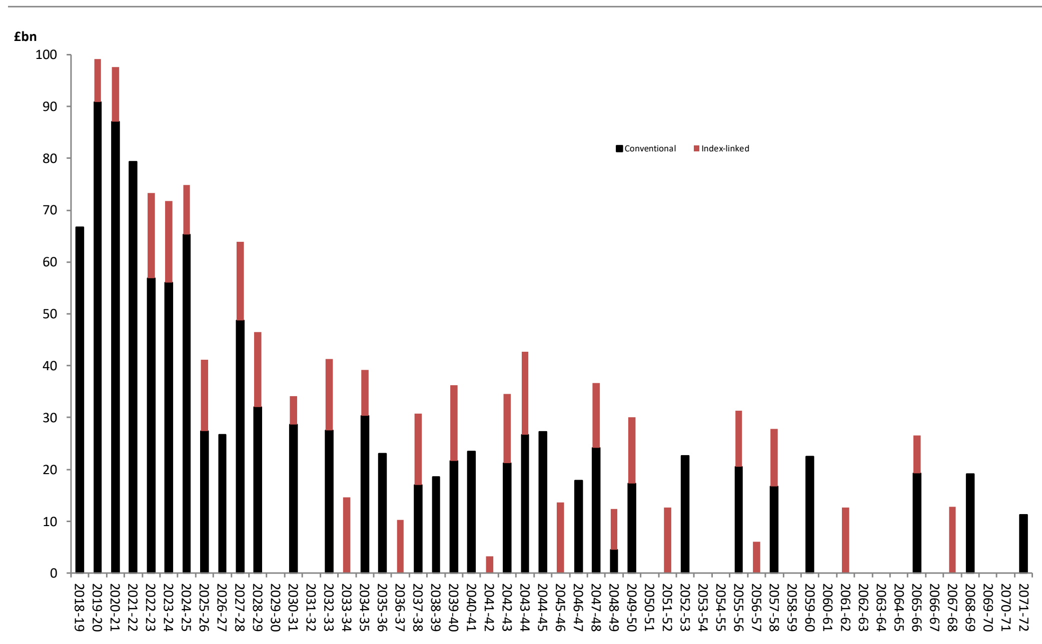
1.85 Gilts are the primary form of government debt. The gilt redemption profile as at 31 December 2018, as disclosed in the DMO debt management report is included in chart 1.N. This shows that some gilts are due for redemption as far in the future as the 2070's, but the bulk are due for redemption before 2040.

1.86 The government issues a mix of fixed coupon (conventional) and index linked gilts. Index linked gilts have their principal and coupon payments adjusted according to the RPI inflation measure. One of the findings of the government's response to the OBR's fiscal risks report was that government

[10] https://www.gov.uk/government/publications/debt-management-report-2018-to-2019

should look to manage the inflation exposure in the debt portfolio by gradually reducing our issuance of index-linked gilts as proportion of total issuance, in line with the reductions planned in 2018-19 and 2019-20[11].

Chart 1.N: Maturity profile of gilts as at December 2018



Source: DMO

1.87 Annex A of WGA reconciles from PSND (the largest constituent liability of which is government borrowing) to the WGA net liabilities position.

Projections of Government debt from the Fiscal Sustainability Report

1.88 The Fiscal Sustainability Report[12] is a valuable tool in improving transparency and risk management. It is not a prediction of what the OBR think will happen – but an illustrative projection of what may happen, if the government did not take action. This provides policy makers and the public with information on how demographic change and other factors may impact the long-run sustainability of the public finances.

1.89 The Fiscal Sustainability Report suggests that the ageing population and health-specific cost pressures will put upward pressure on public spending. Non-interest spending is projected to rise from 36.4% of GDP in 2022-23 to 44.6% by 2067-68. This is largely driven by increases in health spending, the state pension and adult social care. By contrast, demographic factors are expected to have less impact on revenues than on spending. Non-interest

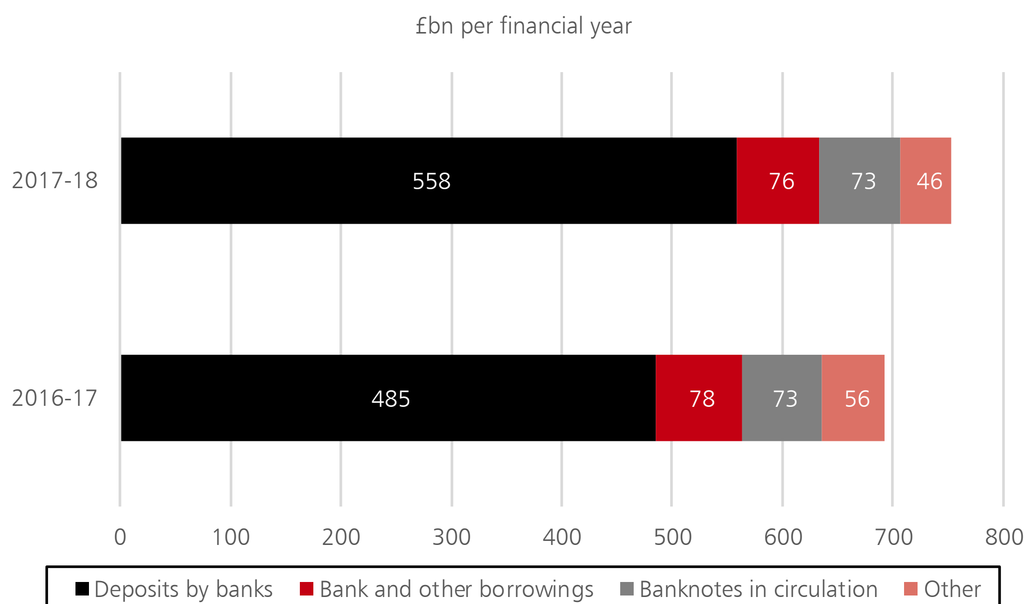
[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785550/debt_management_report_2019-20_final_web.pdf

[12] https://cdn.obr.uk/FSR-July-2018-1.pdf

revenues are projected to be all-but flat across the projection period as a share of GDP.

Other financial liabilities

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



Source: HM Treasury

Deposits by banks

1.90 The majority of deposits by banks relate to funds placed into reserves accounts at the Bank of England by banks and building societies. Reserves accounts are sterling current accounts. They are the most liquid asset a bank or building society can hold, and are the ultimate means of settlement for banks and building societies. All reserves accounts are remunerated at Bank Rate.

1.91 Deposits by banks have increased by £73.1 billion or 15.1% in 2017-18.

Bank and other borrowings

1.92 Bank and other borrowings have decreased by £2.3 billion or 3% in 2017-18. This category of liabilities comprises a number of different bonds, and other financial liabilities such as loans and overdrafts.

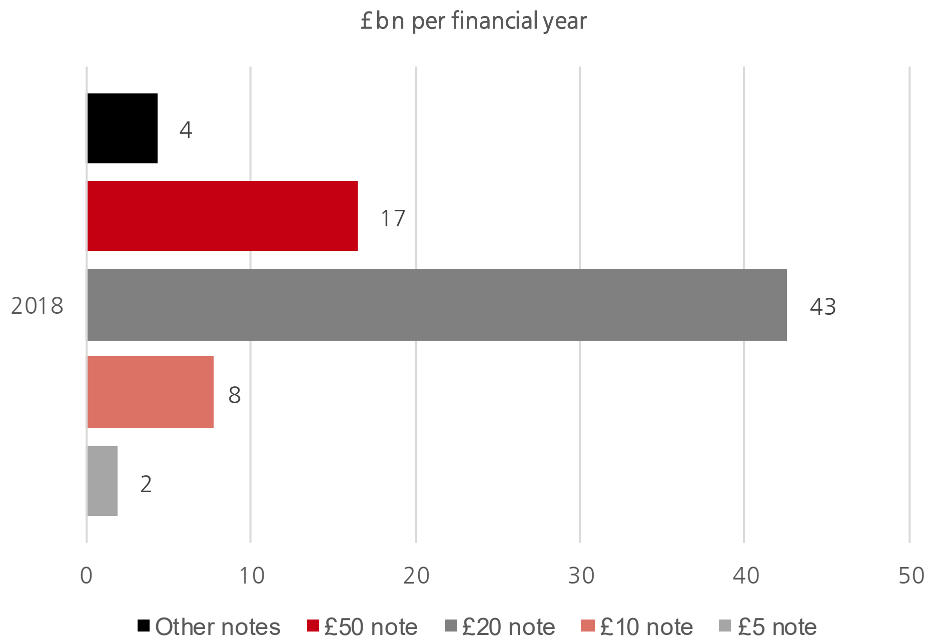
1.93 The most significant item is £23.7 billion (2016-17: £25.3 billion) of long-term debt relating to Network Rail bonds issued under the Debt Issuance program. These bonds were issued to finance investment in the rail network, and are guaranteed by the UK government.

1.94 From the date of Network Rail's formal reclassification to the public sector in 2014, investment funding has been provided in the form of a loan from the Department for Transport. Network Rail does not anticipate issuing further

bonds in the foreseeable future. Network Rail is required to maintain debt levels lower than its Regulatory Asset Base[13].

Banknotes in circulation

Chart 1.P: Composition of banknotes in circulation



Source: Bank of England 2017-18 annual report and accounts[14]

1.95 Banknotes in circulation increased by £0.1 billion to £73.3 billion in 2017-18. The composition of bank notes issued is detailed in the chart above.

1.96 For accounting purposes, coins are treated differently to bank notes. Coins are treated as a contingent liability, rather than a standard liability, and this is disclosed in the accounts of the Consolidated Fund. As at 31 March 2018 the contingent liability for coins stood at £4.6 billion (2016-17: £4.9 billion). The Consolidated Fund has potential liability only in respect of returned and damaged coins, and if coins are redeemed[15].

Government management of other financial liabilities

1.97 As outlined, the largest types of liability in this category are deposits by banks, banknotes in circulation and bank and other borrowings.

[13] Note 25 Funding and Financial Risk Management, https://cdn.networkrail.co.uk/wp-content/uploads/2018/07/NRL-2018-ARA-Full.pdf

[14] https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2018/boe-2018.pdf

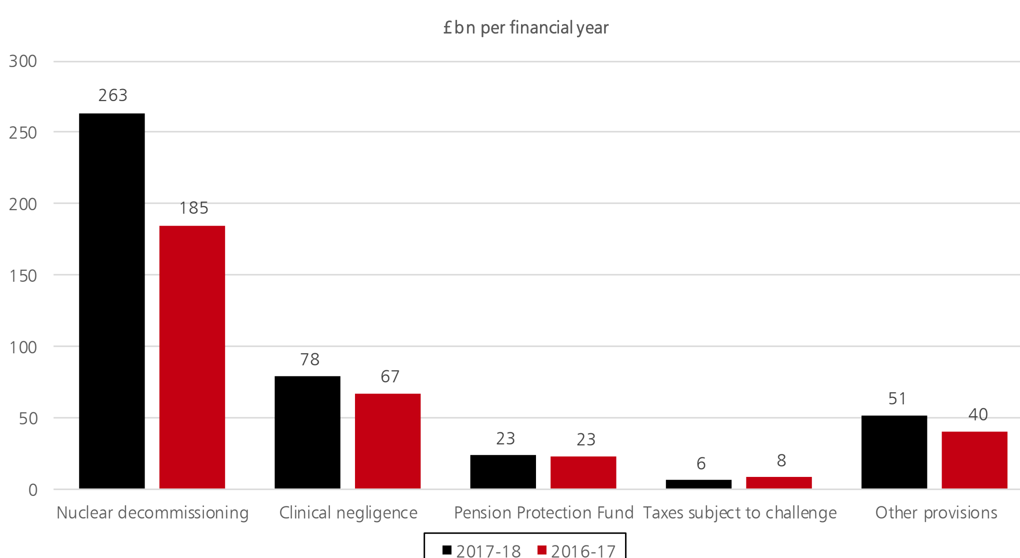
[15] https://www.gov.uk/government/publications/consolidated-fund-account-2017-to-2018

1.98 Deposits by banks and banknotes in circulation relate to the activities of the Bank of England in accepting deposits (mostly from financial institutions) and issuing cash. Both activities are largely demand led. Reserves accounts balances can be varied freely by account holders to meet day to day liquidity needs. Further information about the Bank's reserves accounts scheme can be found in the Bank of England 'Red Book'[16] which sets out its sterling monetary framework.

1.99 To understand how demand for banknotes might change over time, the Bank of England has developed a model based on factors such as nominal consumption, interest rates and exchange rates[17].

Provisions

Chart 1.Q: Movement in types of provisions



Source: HM Treasury

1.100 The total provisions have increased by 31% (or £100.3 billion) to £422.5 billion in 2017-18. £94 billion of the increase in provisions was due to changes in the discount rate. For 2017-18 the real discount rate to be applied to provisions was: Short term, -2.42% (2016-17: -2.70%), Medium term -1.85% (2016-17: -1.95%) and long term -1.56%. (2016-17: -0.80%).

Box 1.H: National accounts treatment of provisions

National accounts treatment of provisions differs from the WGA treatment. For National Accounts, there are no liabilities for future provisions payments. As the provision is utilised, the payments made impact Public Sector Net

16 https://www.bankofengland.co.uk/-/media/boe/files/markets/sterling-monetary-framework/red-book.pdf

17 https://www.bankofengland.co.uk/-/media/boe/files/speech/2017/forcasting-future-banknote-demand.pdf

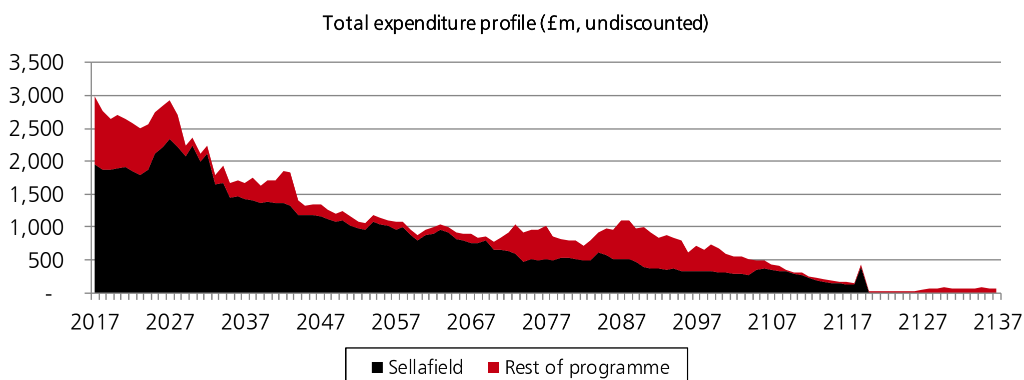
borrowing. In WGA, these payments to discharge the provision are netted off against the balance sheet value to reduce it.

Nuclear decommissioning

1.101 The provision for nuclear decommissioning increased by £78.5 billion, from £184.9 billion in 2016-17 to £263.4 billion in 2017-18. £76.4 billion of this increase is due to the change in discount rates.

1.102 Chart 1.R illustrates the expected profile of payouts by the Nuclear Decommissioning Authority (NDA) which total £120.2 billion before discounting and £233.3 billion (excluding contract loss provisions) after discounting, and makes up the largest portion of the total provision of £263.4 billion. The remaining nuclear decommissioning provision is held by other bodies, including the Nuclear Liabilities Fund and the Ministry of Defence.

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



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

- BEIS and the NDA are seeking more proportionate regulatory control for sites in the final stages of decommissioning and clean-up. In May 2018, BEIS consulted on proposals to regulate these sites in the same way that non-nuclear industrial sites are regulated. Implementation (subject to primary legislation) could achieve significant savings without any reduction in safety.

- The NDA has invested significantly in research and development aimed at reducing the risks and costs of decommissioning, for example by identifying alternative approaches to treating radioactive waste from some of the larger legacy buildings in Sellafield. This is expected to achieve savings by simplifying processes, reducing capital expenditure on treatment facilities and accelerate hazard reduction.

1.104 By law, all new nuclear deals include a Funded Decommissioning Programme (FDP), whereby the developer is required to set aside funds to pay for handling waste and decommissioning. This approach ensures that taxpayer risk is remote and classified as a contingent liability.

Clinical negligence

1.105 The provision for clinical negligence claims increased by £11.8 billion or 17.7% in 2017-18, from £66.6 billion to £78.4 billion. In addition to the clinical negligence provision, £47.3 billion (2016-17: £36.5 billion) is included as a contingent liability for clinical negligence.

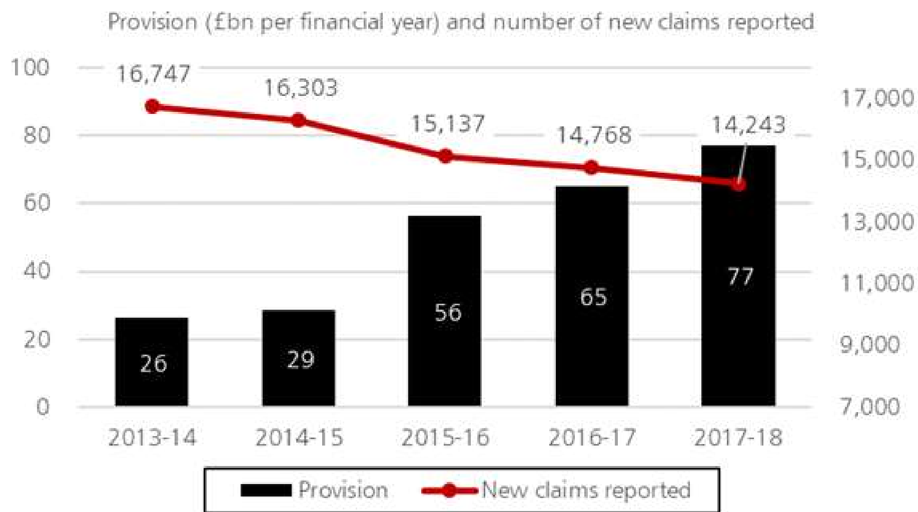
1.106 NHS Resolution makes a provision in its accounts for the likely value of future claims payments, and records contingent liabilities that represent possible additional claims payments to those already provided for. More information on contingent liabilities is included in Notes 29 and 30 to the accounts.

1.107 The majority of the UK government's clinical negligence claims are managed by NHS Resolution, who handle both clinical and non-clinical claims relating to the NHS in England. In 2017-18 it recorded a 0.1% decrease in the number of new clinical claims (2017-18: 10,673, 2016-17: 10,686). The volume of new non-clinical claims also decreased, from 4,082 to 3,570.

1.108 Although the volume of new claims has decreased, the value of these claims has increased[18] as has the overall provision. The provision represents the estimated value of claims in respect to incidents up to 31 March 2018 which have either been received or are expected to be received in the future. Chart 1.S provides further information.

[18] Comparison of 2016-17 accounts Figure 10 https://resolution.nhs.uk/wp-content/uploads/2017/07/NHS-Resolution-Annual-report-and-accounts-2016_17.pdf and 2017-18 accounts Figure 9 https://resolution.nhs.uk/wp-content/uploads/2018/08/NHS-Resolution-Annual-Report-2017-2018.pdf

Chart 1.S: NHS Resolution total provision for clinical and non-clinical negligence claims, and number of new claims reported in year.

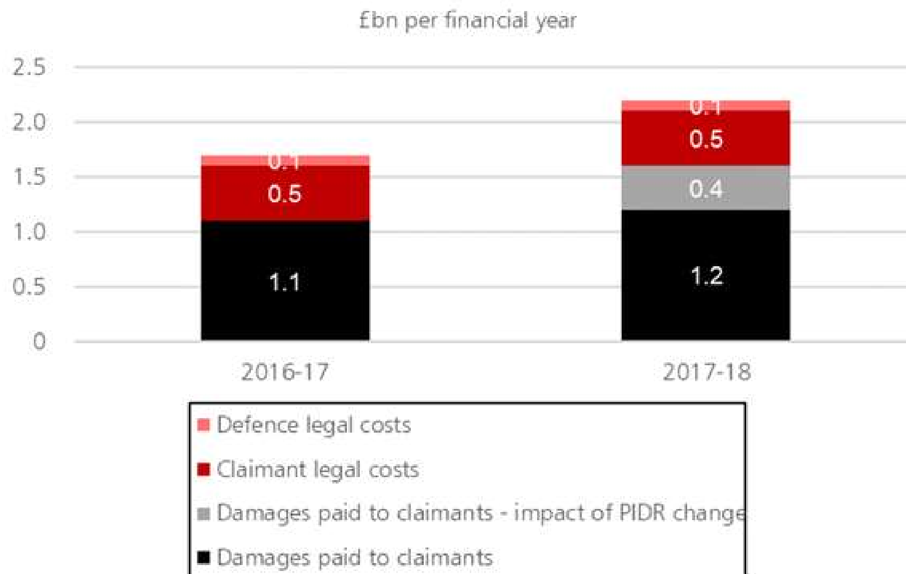


Source: NHS Resolution 2017-18 accounts

1.109 There has been an increase of £0.5 billion in the clinical negligence pay-outs made this year by NHS Resolution. The majority of this increase (£0.4 billion) is due to a change in the Personal Injury Discount Rate (PIDR), which came into force in March 2017. The rate reduced from 2.5% to negative 0.75% which increases the value of lump sum damage payments awarded to successful claimants.

1.110 Chart 1.T below provides a breakdown of the £2.2 billion of pay-outs made by NHS Resolution during 2017-18. The element of the increase in damage payments which is a result of the change in the PIDR is shown separately. Chart 1.S tracks the number of new claims reported (including both clinical and non-clinical claims) and the value of the total provision reported by NHS Resolution over time.

Chart 1.T: NHS Resolution payouts in year



Source: NHS Resolution 2017-18 accounts figure 5[19]

1.111 The provision is an estimate, and is subject to sensitivities in changes in key assumptions. In the NHS Resolution accounts, for the Clinical Negligence Scheme for Trusts (CNST) the accounts estimate a figure of £43.7 billion, with a reasonable upper range of £48.6 billion, and a reasonable lower range £38.0 billion. Further information can be found in the accounts of NHS Resolution.

Government management of clinical negligence

1.112 For claims managed by NHS Resolution, the individual medical specialties with the highest volume of claims received in 2017-18 were Casualty/A&E (13% of claims) Orthopaedic surgery (12% of claims) and Obstetrics (10% of claims). Obstetrics continued to represent the highest value of clinical claims received during 2017-18, at 48% of the total value[20].

1.113 The Department of Health and Social Care (DHSC) continues to focus on actions to reduce patient harm, including harm to users of maternity (obstetrics) services. The NHS Long-Term Plan, published in January 2019, commits to the NHS accelerating action to achieve the National Maternity Safety Ambition to halve rates of stillbirths, neonatal and maternal deaths, and brain injuries occurring during or soon after birth by 2025. The National Patient Safety Director launched a consultation in December 2018 on a proposed safety strategy for the NHS and expects to publish a final version in Spring 2019.

[19] https://resolution.nhs.uk/wp-content/uploads/2018/08/NHS-Resolution-Annual-Report-2017-2018.pdf

[20] See Figures 8 and 9, https://resolution.nhs.uk/wp-content/uploads/2018/08/NHS-Resolution-Annual-Report-2017-2018.pdf

1.114 The rising costs of clinical negligence are a major concern and something government is committed to managing, given that NHS funds spent on clinical negligence are resources not available for front-line care. Building on the NAO report published September 2017 which challenged Government to publish a coordinated strategy, work is underway to explore all the drivers of cost and government expect to bring forward a publication in due course.

1.115 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.

1.116 The Public Accounts Committee and the National Audit Office have both considered the rising cost of clinical negligence claims, and DHSC have committed to publishing a cross-government strategy on managing clinical negligence costs.

1.117 Government is also taking action on lowering the legal costs that lawyers can recover in clinical negligence cases. A Civil Justice Council working group has been set up to consider a bespoke process and propose a grid of costs to introduce fixed costs for clinical negligence claims under £25,000, and is expected to report soon.

1.118 The Ministry of Justice has also brought forward proposals to reform the way the Personal Injury Discount Rate (PIDR) is set. The current negative 0.75% rate is linked to very low risk investment portfolios, whereas the new framework is based on an assumption that claimants would invest in low risk diversified investment portfolios as well as taking into account of the effects of tax, inflation and investment management costs. This will help ensure victims of serious injury are fairly compensated, whilst keeping the costs involved in these cases fair and reasonable. The resultant Civil Liability Bill received Royal Assent in December 2018[21]. Following granting of Royal Assent, the Lord Chancellor must formally consult the Government Actuary and HM Treasury on a new discount rate.

Pension Protection Fund (PPF)

1.119 The Pension Protection Fund (PPF) protects people with a Defined Benefit pension scheme when their employer becomes insolvent, and steps in to take over responsibility for payments.

1.120 The PPF provision relates to liabilities to pay compensation to members, and to potential claims for schemes to enter the PPF or the Fraud Compensation Fund which is also administered by the PPF. The provision stood at £23.2 billion at 31 March 2018 (2016-17: £22.7 billion).

1.121 The PPF is funded by a levy on eligible pension schemes, by taking over the assets of schemes that transfer to the PPF, by recovery of assets from insolvent employers, and by investment income on assets that they hold. In

[21] https://services.parliament.uk/bills/2017-19/civilliability.html

2017-18, the PPF generated £0.5 billion in levy income (2016-17: £0.6 billion).

1.122 PPF paid £1.2 billion of compensation in 2017-18 (2016-17: £0.7 billion), with total PPF compensation paid to date rising to £4.2 billion as at 31 March 2018.

Taxes subject to challenge, and tax repayments relating to oil and gas field decommissioning

1.123 HMRC recognise two separate provisions within their accounts: one relating to legal claims from taxpayers, and another for exchequer liabilities arising from oil and gas infrastructure.

1.124 At 31 March 2018, HMRC's legal claims provision was £5.9 billion (2016-17: £7.8 billion). This relates to legal claims with taxpayers where the department believes that a settlement payment is likely, having taken legal and other specialist advice. HMRC's accounts also disclose a contingent liability in relation to legal claims of £6 billion (2016-17: £18.7 billion). This is in respect of cases where a settlement payment is possible, but not probable. HMRC are committed to fighting cases where they believe tax liabilities are due and they have a reasonable chance of success.

1.125 The oil and gas provision relates to the ability of participators in an oil and gas field to carry back decommissioning losses against previous profits, which can result in a tax repayment becoming due from HMRC. HMRC's oil and gas provision stood at £12.9 billion in 2017-18 (2016-17: £6.4 billion). The increase in the provision is due to the 2017-18 accounts now including a provision for offshore Corporation Tax repayments, which can now be identified and reliably measured following an improvement in forecasting. This is in addition to a provision for Petroleum Revenue Tax repayments.

1.126 Further information is available in HM Revenue and Customs 2017-18 annual report and accounts[22].

[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/724943/HMRC_Annual_Report_and_Accounts_2017-18__print_.pdf

Report on income and expenditure

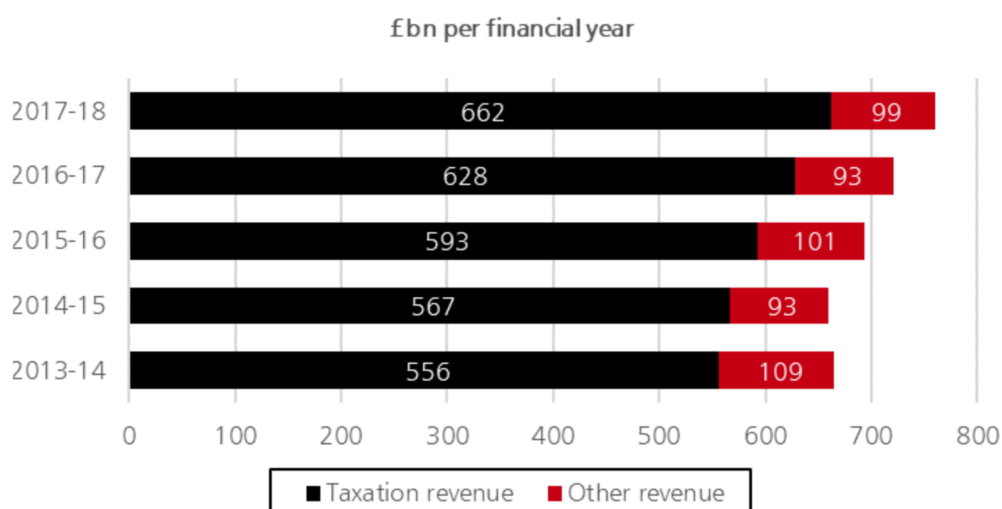
Income

What does government receive from taxes and other income?

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

		2017-18 £bn	2016-17 £bn
Taxation revenue	Note 4	661.6	628.1
Other revenue	Note 5	99.3	92.7
Total public services revenue		760.9	720.8

Chart 1.U: Income trends



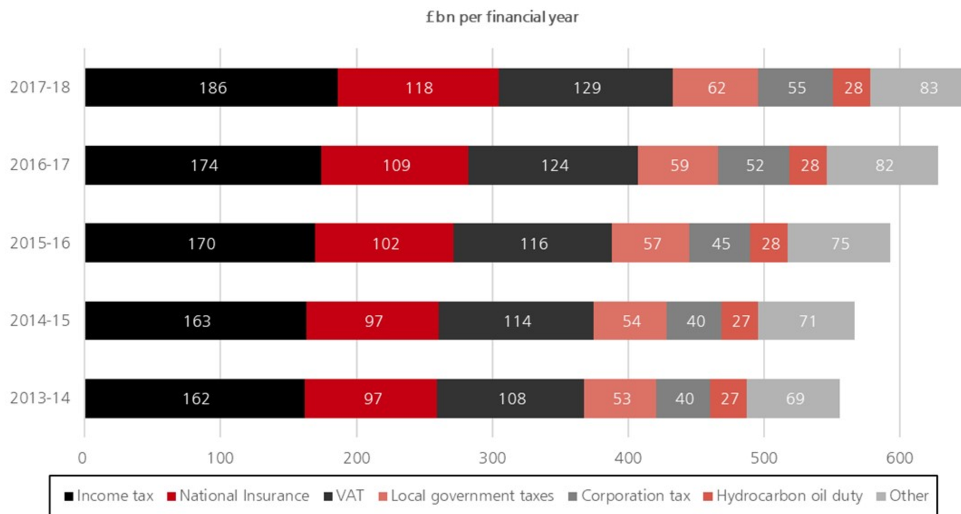
Source: HM Treasury

1.127 Over the last 5 years there has been a 15% increase in the total revenue from public services which is analysed in further detail below.

Tax revenue

1.128 The WGA tax revenue balance is lower than is reported in HMRC and other accounts because 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.V and the text below is therefore based on the eliminated balance.

Chart 1.V: Breakdown of tax revenue by type

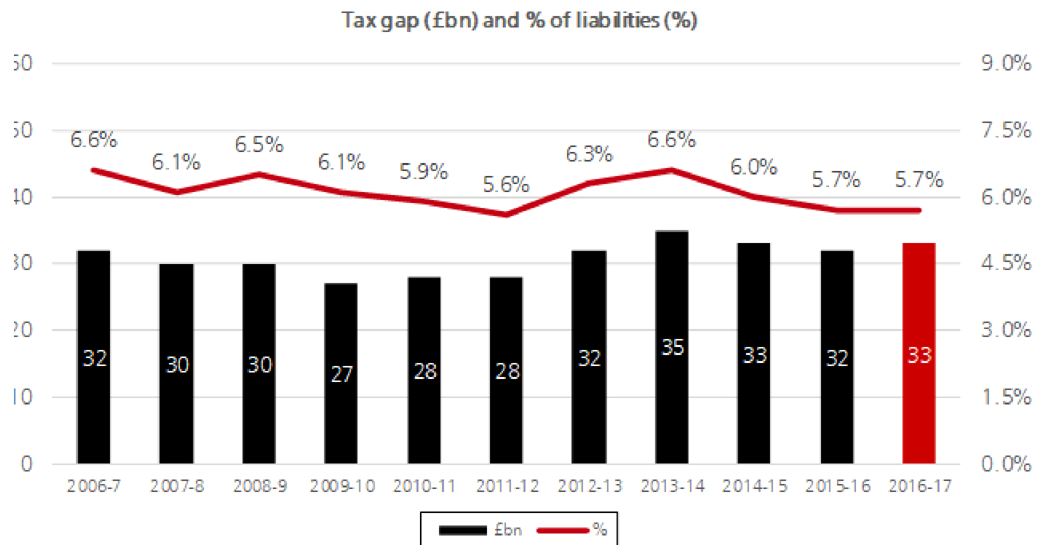


1.129 Taxation revenue increased by 5.3% compared to the prior year, primarily due to an increase in the overall level of activity in the economy. The HMRC trust statement includes a summary of main changes in receipts[23]:

- Income Tax and National Insurance are closely linked to the number of people in employment and wages levels, both of which increased compared to 2016-17.
- VAT increased due to higher receipts in oil, gas and mining and leisure and business sectors.
- Corporation Tax increased due to rising company profits, particularly in the industrial, commercial and finance sectors.

23 Figure 1 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/724943/HMRC_Annual_Report_and_Accounts_2017-18__print_.pdf

Chart 1.W: Tax gap



Source: HMRC 2017-18 Accounts

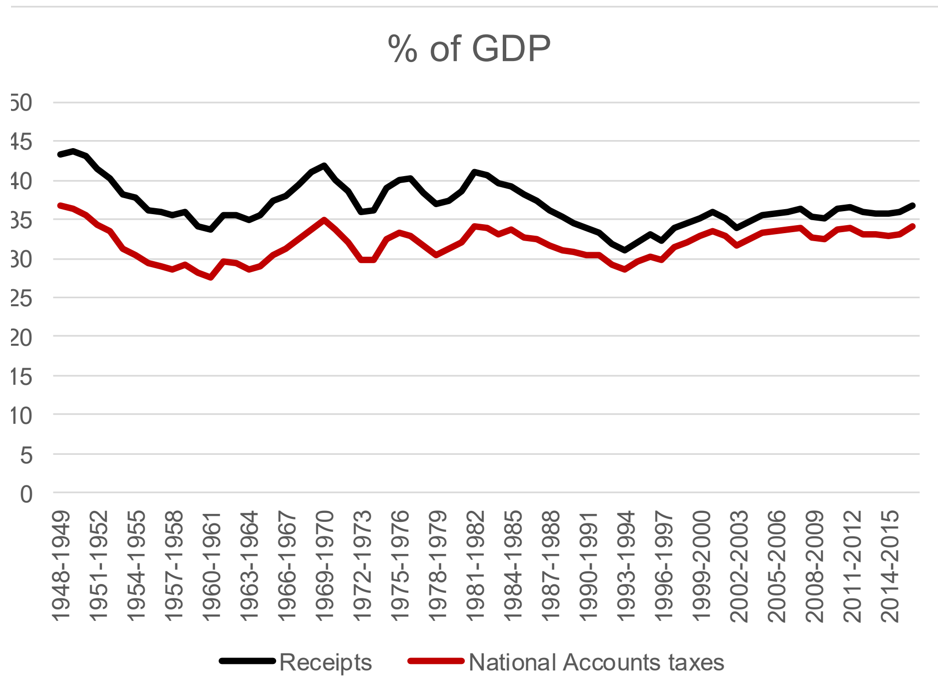
1.130 The tax gap is the difference between the amount of tax that should in theory be collected by HMRC against what is actually collected. HMRC publish an estimate of the tax gap each year. For 2016-17, the latest year that data is available, the tax gap is estimated to be at £33 billion which is 5.7% of theoretical tax liabilities.[24]

1.131 ONS publishes long term statistics showing tax receipts as a percentage of GDP, going back to 1948-49[25]. This is reproduced in chart 1.X This shows that, over this period, the average National Accounts tax receipts over this period is 31.9%.

24 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/715742/HMRC-measuring-tax-gaps-2018.pdf

25 https://obr.uk/box/the-receipts-to-gdp-ratio-since-1986-87/

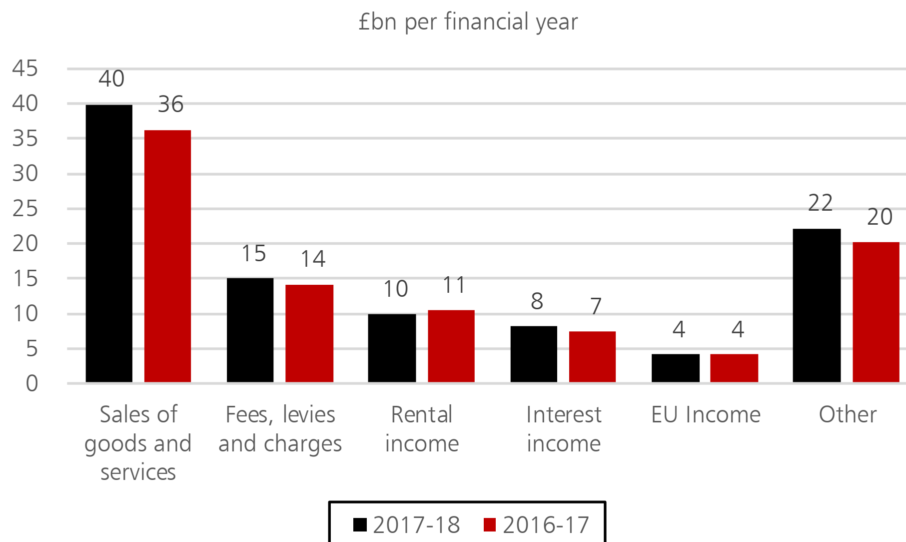
Chart 1.X: Tax receipts as a percentage of GDP



Source: ONS

Other revenue

Chart 1.Y: Other revenue



Source: HM Treasury

1.132 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.

1.133 Of the £39.9 billion of Sales of goods and services, £18.8 billion is generated by local authorities, £7.6 billion is generated by public corporations, and £4.4 billion generated by Transport for London.

1.134 EU income is mostly recognised in the accounts of the Department for Environment, Food and Rural Affairs (DEFRA). More information on where the UK's relationship with the EU is recognised in WGA can be found in paragraphs 1.183 to 1.190

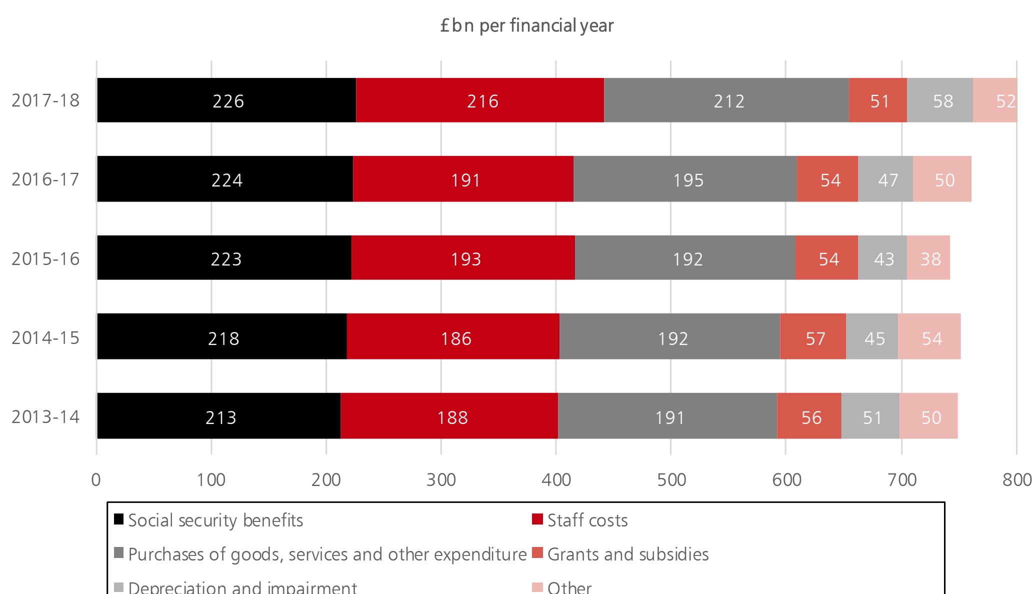
Expenditure

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.

		2017-18 £bn	2016-17 £bn
Social security benefits	Note 6	225.9	223.7
Staff costs	Note 7	215.8	191.1
Purchase goods, services and other expenditure	Note 8	212.2	194.8
Other operating expenditure	Notes 9 and 10	108.9	100.7
Interest costs on government borrowing	Note 11	36.8	31.8
Increase in provisions	Note 22	15.2	18.6
Total expenditure on public services		814.8	760.7

Chart 1.Z: Expenditure trends



Source: HM Treasury

1.135 Total expenditure on public services has increased by 9% over the last 5 years. The largest changes for 2017-18 were an increase of £22.6 billion in current service costs for public sector pensions for the current year (because of a large increase in actuarial valuation in 2016-17), and a one off charge to purchases of other goods, services and other expenditure in the Academies sector for £8.4 billion relating to a one-off derecognition of land and buildings previously recognised in the sector accounts.

Expenditure through a different lens-PESA and CRA

1.136 As well as WGA, the Treasury publishes the Public Expenditure Statistical Analysis (PESA)[26] and the Country and Regional Analysis (CRA)[27].

1.137 These reports are a valuable lens into public expenditure, and provides more detail than WGA expenditure. WGA net expenditure on public services is reconciled to the PESA and CRA figures.

1.138 PESA bases the split of expenditure on classifications derived from the United Nations Classification of the Functions of Government (COFOG). This allows for consistent presentation of expenditure on an international basis.

Table 1.D: Public Expenditure 2012-13 to 2017-18

Function[a]	2017-18 (£bn)	% of total	2016-17 (£bn)	2015-16 (£bn)	2014-15 (£ bn)	2013-14 (£bn)	2012-13 (£bn)
Social protection	268.2	37	265.3	264.8	261.0	253.9	253.4
Health	145.8	20	142.6	138.5	134.1	129.4	124.3
Education	87.8	12	84.9	84.9	85.1	84.7	84.1
Defence	38.7	5	37.1	36.6	36.7	36.4	36.3
Public Order and safety	31.6	4	30.1	30.2	30.5	29.6	31.3
Transport	31.2	4	28.4	27.7	21.8	20.8	20.2
Other economic affairs	21.3	3	20.1	18.8	18.8	20.1	16.5
Environmental protection	11.4	2	11.0	11.6	11.6	11.2	10.7
Housing and community amenities	12.1	2	10.3	9.8	10.3	9.9	10.0
Recreation, culture and religion	11.8	2	11.6	11.4	12.4	11.6	12.7
General public services	23.8	3	23.4	21.6	22.0	21.0	18.9
Debt interest	44.5	6	40.2	38.0	37.4	40.1	40.6
EU Transactions	5.4	1	4.7	7.7	6.2	7.2	6.7
Public services expenditure per PESA	**733.6**	**100**	**709.7**	**701.7**	**687.8**	**675.9**	**665.8**
Add: Depreciation and impairment	57.7		47.1	42.7	45.4	51.0	51.1
Add: Increase in provisions	15.2		18.6	9.2	26.0	19.5	29.0
Accounting adjustments	8.3		(14.7)	(11.4)	(7.9)	2.5	(5.0)
WGA expenditure on public services	814.8		760.7	742.2	751.3	748.9	740.9

Source: Public Expenditure Statistical Analysis 2018 table 4.2

[26] https://www.gov.uk/government/statistics/public-expenditure-statistical-analyses-2018

[27] https://www.gov.uk/government/statistics/country-and-regional-analysis-2018

a Prior year PESA tables are restated every year, but WGA prior year figures are not. Table may not cast due to rounding

Table 1.E: Public services expenditure breakdown-Country and Regional

Region[a]	2017-18 (£bn)	% of total	2016-17 (£bn)	2015-16 (£bn)	2014-15 (£bn)	2013-14 (£bn)	2012-13[b] (£bn)
English Regions:							
North East	25.9	4	25.5	25.3	24.8	24.5	24.2
North West	71.2	10	68.2	67.6	66.3	64.8	64.5
Yorkshire and the Humber	48.9	7	48.0	47.6	46.7	45.5	45.5
East Midlands	40.0	5	39.2	38.6	38.2	36.8	37.0
West Midlands	52.6	7	51.5	50.2	50.2	48.3	48.2
East	51.6	7	49.9	49.6	48.5	46.2	46.6
London	91.6	12	88.5	87.6	84.4	83.7	83.3
South East	75.4	10	73.5	71.1	69.3	67.5	67.8
South West	48.0	7	46.8	45.9	45.3	43.9	42.7
Scotland	59.0	8	57.3	56.2	55.0	54.1	54.0
Wales	32.5	4	31.4	31.0	30.6	30.1	29.6
Northern Ireland	20.9	3	20.5	20.2	20.3	19.9	19.6
Outside UK	26.6	4	25.3	25.7	27.0	26.7	25.1
Non-identifiable expenditure[c]	92.0	12	85.9	85.1	81.1	83.4	83.4
Public sector expenditure on services	**736.0**	**100**	**711.5**	**701.7**	**687.7**	**675.4**	**665.8**
Add: Depreciation and impairment	57.7		47.1	42.7	45.4	51.0	51.1
Add: Increase in provisions	15.2		18.6	9.2	26.0	19.5	29.0
Accounting adjustments	5.9		(16.5)	(11.4)	(7.8)	3.0	(5.0)
WGA expenditure on public services	814.8		760.7	742.2	751.3	748.9	740.9

Source: Country and Regional analysis 2018 table A1

a Table may not cast due to rounding. Prior year figures for CRA are restated, but WGA figures are not

b 2012-13 comparatives are from the 2016-17 CRA, between editions there may have been changes to data classification or regional allocation methodology.

c Includes the impact of financial sector interventions

Box 1.I: Regional WGA data

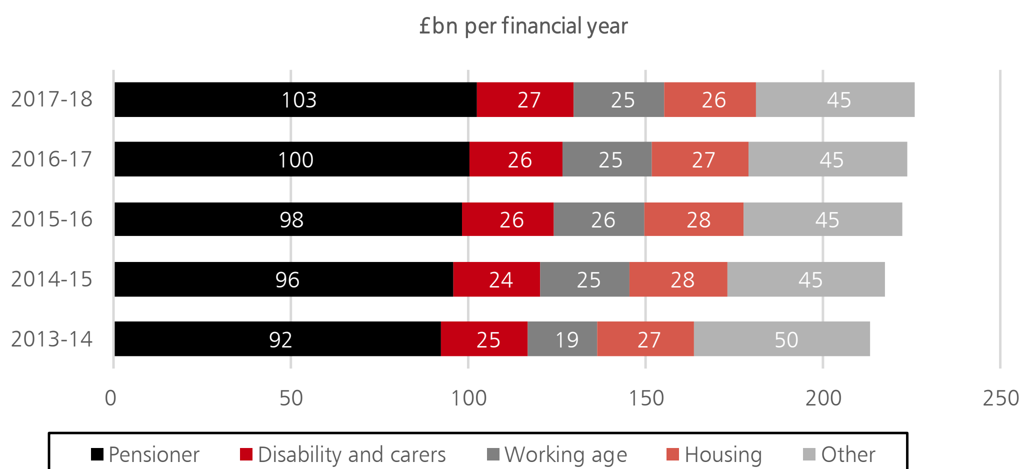
WGA is based on information in the published accounts of underlying entities. These accounts do not consistently provide expenditure on a geographic basis.

In addition, significant balances (such as government borrowings, public sector pensions, or financial assets and liabilities) would be very difficult to split out geographically in a consistent and robust way.

Country and Regional Analysis (CRA) is an established way of providing information relating to distribution of expenditure. Geographical variations in the Country and Regional Analysis are driven by numerous factors, ranging from transportation expenditure to the location of benefit recipients.

Social security benefits

Chart 1.AA: Breakdown of social security benefits



1.139 Government spending on social security benefits increased by 1% in 2017-18 compared with 2016-17.

1.140 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').

1.141 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).

1.142 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. There has been a £12.6 billion (6%) increase in total benefit expenditure over the past 5 years.

1.143 The government's priority remains to deliver Universal Credit in a safe, secure way. As of March 2019, 1.8m are on the Universal Credit caseload.

1.144 At Budget 2018, the government increased the work allowance by £1,000; the amount that 2.4 million households can earn annually before their Universal Credit starts to be withdrawn. This change will make working parents and people with disabilities on Universal Credit up to £630 a year better off. Including this change, because of decisions taken since 2016, Government support for Universal Credit will be over £2.5 billion higher in 2023-24.

Fraud and error in the welfare system

Table 1.F: Reported rates of fraud and error

		2017-18	2016-17	2015-16	2014-15	2013-14
DWP	Overpayments as a percentage of benefit payments	2.2%	2.0%	1.9%	1.8%	2.1%
	Net overpayments after recoveries have been offset	1.6%	1.4%	1.2%	1.2%	1.5%
HMRC	Fraud and error as a percentage of finalised personal tax credits entitlement	Data not available at the time of writing	4.7%[a]	4.8[b]%	4.4[c]%	4.7%

2016-17 Tax Credit figure originally published as 4.9% June 2017 but revised down to 4.7% in April 2019.
2015-16 Tax Credit figure originally published as 5.5% June 2017 but revised down to 4.8%
2014-15 Tax credit figure originally published as 4.8% but revised down to 4.4

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

1.146 Levels of fraud within DWP and HMRC rose in 2017-18. DWP saw a rise from 2.0% to 2.2% of fraud and error overpayments which reflects a monetary value of around £3.8 billion. Recoveries by the department and local authority during the same period were around 0.6% which reflects a monetary value of around £1.1 billion.

1.147 DWP's long-term fraud, error and debt strategy prioritises commitments for success in areas of empowerment for claimants, internal reorganisation, such as the creation of the Risk and Intelligence Service. It has been

recommended they develop risk-based interventions as well as development of digital capabilities and clear metrics to gauge the effectiveness of different programmes to reduce fraud & error.

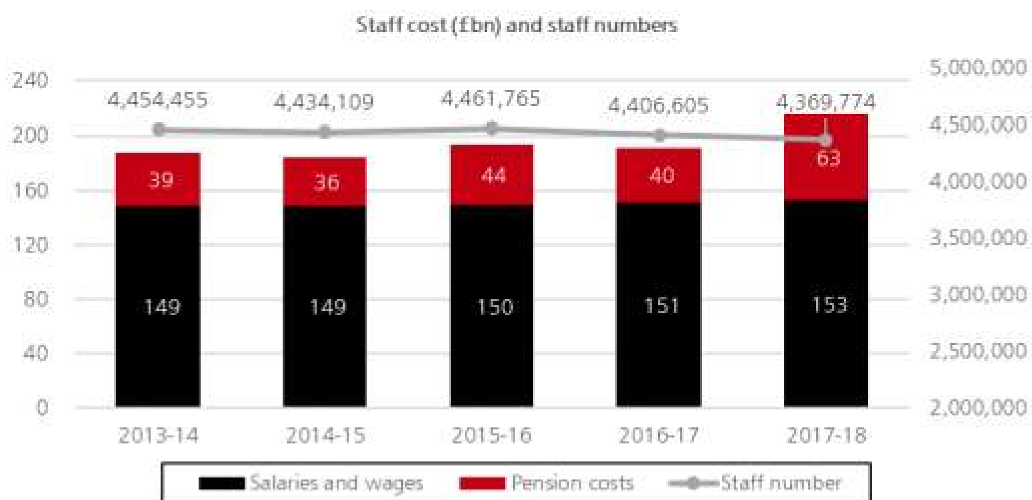
1.148 HMRC have seen a slight fall in error & fraud value from 4.8% in 2015-16 to 4.7% in 2016-17 reflecting a monetary value of £1.3 billion of expenditure which is a small percentage reduction. Expenditure is also falling as claimants are migrated to Universal Credit (2015-16: 4.8% of expenditure was £1.35 billion).

1.149 HMRC have been focusing on 'upstream' data cleansing of cases prior to UC migration. This has included initiatives such as 'nudging' self-employed claimants to accurately report their earnings. They continue to develop insight into the different error and fraud risk groups; this includes proof of concept cross-benefit programmes that are intended to be rolled out as business as usual activity.

1.150 Levels of fraud and error reported for the rest of government (excluding tax & welfare) in 2016-17[28] were £191 million. This is an increase on the previous year, but still well short of the expected level of approximately £2 billion to £20 billion that is suggested by cross government fraud loss measurement exercises[29]. It is therefore the government's stated policy to improve identification of fraud and error across the rest of government.

Staff costs

Chart 1.BB: Staff costs and staff numbers trends



Source: HM Treasury

1.151 Staff costs includes expenditure on salaries and wages, and on pension costs. In 2017-18, the cost of salaries and wages was £152.8 billion (2016-

[28] 2016-17 loss data reported to the Cabinet Office Centre of Expertise for Counter Fraud, via the Consolidated Data Return.

[29] These exercises are generated by the Fraud Measurement and Assurance programme which the Cabinet Office leads on.

17: £151.0 billion) and the pensions cost was £63.0 billion (2016-17: £40.1 billion).

1.152 Salaries and wages have increased by 1.2% since 2016-17. A move away from the previous 1% pay restraint policy was announced in September 2017. A three year pay deal with Agenda for Change staff within the NHS was subsequently agreed, which applies for staff from 1 April 2018[30]. In July 2018, the government also announced pay rises for an additional 1 million public sector workers, to be funded from departmental budgets[31]. These awards ranged from 1.5% to 3.5% for some teachers, for example. Staff costs are therefore likely to increase by greater than 1% in 2018-19.

1.153 Pension costs have increased by 57.4% in 2017-18. This is largely due to a £22.6 billion increase in current service costs compared to the prior year. These costs represent the future benefits estimated to accrue to employees as a result of their services during the year.

1.154 Further details on staff costs and numbers are included in the Remuneration and Staff Report in Chapter 4. Further information on public sector pension costs, and the drivers of changes to these costs, are included in the pension liabilities section of Chapter 1 and in Note 24 to the account.

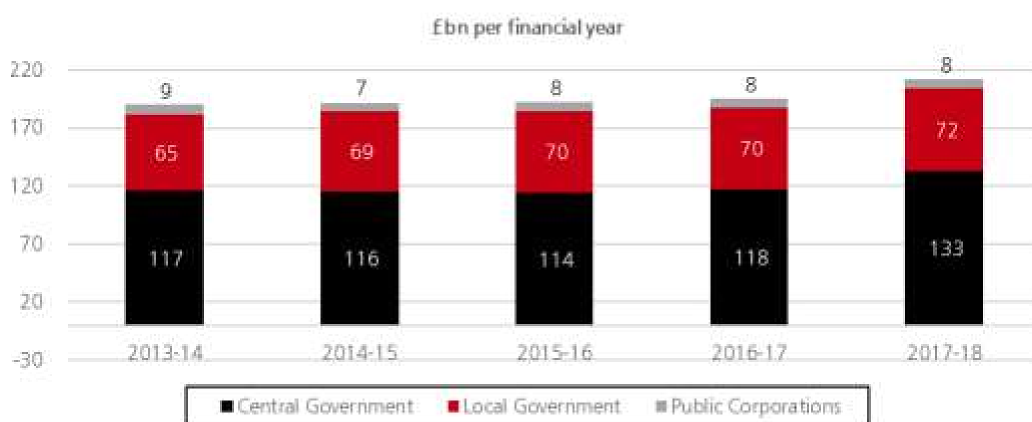
30 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/729958/agenda-for-change-pay-deal-funding-for-2018-to-2019.pdf

31 https://www.gov.uk/government/news/around-one-million-public-sector-workers-to-get-pay-rise

Purchase of goods, services and other expenditure

1.155 Purchases of goods, services and other expenditure increased by £17.4 billion from 2016-17 to 2017-18. £8.4 billion of this increase is due to a one-off charge for derecognising land and buildings from the Academies Sector Annual Report and Account.

Chart 1.CC: Segmental analysis of purchase of goods, services and other expenditure



Box 1.J: Why is it so hard to break down Purchases of Goods and services?

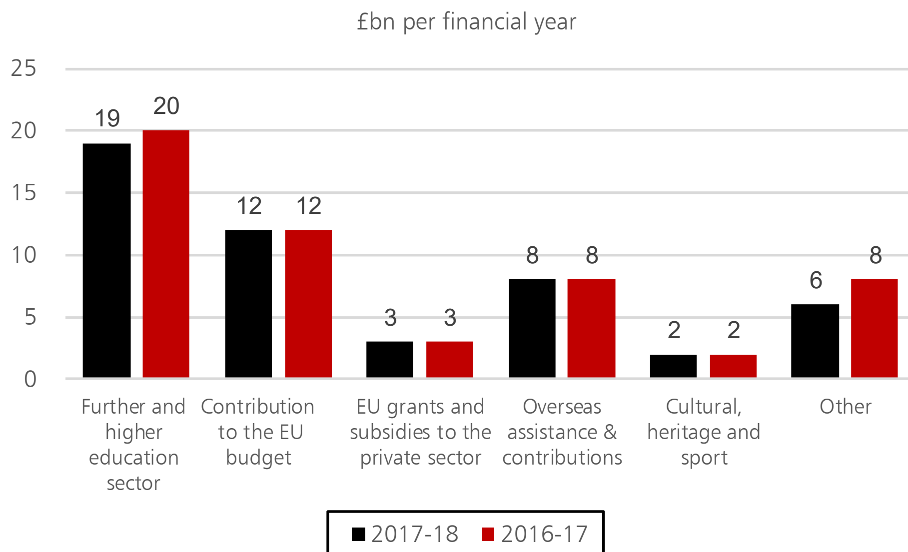
One of the significant challenges of WGA is providing more useful information on purchases of goods and services. There are a number of challenges in providing better information in respect of purchases of goods and services:

1. Accounting Standards do not require specific headings for expenditure, other than they should be materially disaggregated to provide information to users of the accounts. This means that there is greater variation in disclosure in the underlying accounts.
2. Central government and English local government disclose information in different ways. Central government departments tend to disclose expenditure based on the economic category of the expenditure (for example professional services, rent, travel and subsistence). English local government bodies tend to disclose their expenditure based on the purpose of that expenditure (for example, adult social care, transportation, administration costs). Joining these together creates significant challenges for disclosures.
3. Even within central government there will be differing interpretations on the allocation of expenditure. For example, one entity may aggregate legal expenses and professional services into one expenditure category, and another department may split them out. Consistent definitions of these categories is difficult to enforce.

4 Treasury are continuing to review this issue to provide better information wherever possible. Tables 1.D and 1.E provides a breakdown of expenditure using the PESA and CRA methodology.

Grants and subsidies

Chart 1.DD: Grant expenditure



1.156 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 institutions not included in WGA are the largest recipients of grants, followed by net contributions to the EU. More information on how the EU is recognised in WGA can be found in paragraphs 1.183 to 1.190.

Interest costs on government borrowing

1.157 The cost of servicing government debt increased by £5 billion or 16%. Interest costs in WGA are disclosed net of interest relating to gilts held for the purposes of quantitative easing.

1.158 The OBR published an outlook for debt interest spending [32]. This paper noted a number of relevant issues:

- UK public sector debt interest costs is at 2% of GDP, modest by historical standards
- Quantitative Easing has essentially allowed for older fixed term debt to be refinanced using cheaper floating rate debt. If the base rate is increased this could lead to increased debt interest
- The report highlights three risks that could drive interest rates on government debt higher: Faster than expected increase in global real long-term interest rates, earlier sales of the Bank of England's gilt holdings and an increase in the risk premium applied to UK interest rates

1.159 As announced at Budget 2018, the government is taking action to reduce its inflation exposure by looking to reduce the proportion of index-linked gilt issuance in a measured fashion over the medium term.

[32] https://obr.uk/docs/dlm_uploads/The-outlook-for-debt-interest-spending.pdf

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.

		2017-18 £bn	2016-17 £bn
Provision financing costs	Note 11	93.4	9.3
Pension financing costs	Note 11	50.7	50.5
Other finance expense	Note 11	9.6	8.5
Total financing costs of long-term liabilities		153.7	68.3

Valuing long term liabilities

1.160 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

1.161 The main discount rate change that affected the 2017-18 WGA was a change in discount rate for provisions. In particular, the long term discount rate changed from -0.8% to -1.56%. This has a significant effect on very long term provisions, in particular nuclear decommissioning, the Nuclear decommissioning provision increased by £76.4 billion.

1.162 Box 1.K 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.

1.163 In general, discount rates should be positive, meaning that long term liabilities should be worth less when expressed in today's money. This is because often the interest that can be earned on a pound in hand today is more, in the long run, than inflation increasing the value of the liability. However, the choice of rate of return has a key part to play in determining the discount rate. For UK Government provisions, the rate of return is based on the long term return of gilts. This rate has been very low, and in particular lower than the rate of inflation, resulting in negative real rates.

1.164 To address this, Treasury has proposed a new discount rate methodology to apply only to provisions. Treasury issue separate rates for pensions and

financial instruments that are not currently negative, due to differences in how these rates are calculated.

1.165 After discussion with experts and the Financial Reporting Advisory Board, Treasury decided to issue nominal rates for provisions, instead of real rates from 2018-19 onwards. Nominal rates differ from real rates, in that nominal rates do not take account of inflation. Guidance has been provided so provision cash flows can then be separately inflated using OBR CPI forecasts (given this is typically seen as a more reliable indicator of inflation than RPI and more commonly used across the public sector). The nominal rates issued do not factor in the high inflation environment and so are not negative.

Box 1.K: 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 the balance sheet date. 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. This means that essentially a pound today is worth more than a pound in the future, as a pound today can generate income between now and the future.

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

For 2017-18 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 for 2017-18 WGA.

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	2017-18	2016-17	2017-18	2016-17

Public sector pensions	0.10	0.24	2.4-3.4 nominal	2.4 – 3.6 nominal
Provisions:				
Short term	-2.42	-2.70	-2.70	-2.70
Medium term	-1.85	-1.95	-1.95	-1.95
Long term	-1.56	-0.80	-0.80	-0.80
Student loans	0.70	0.70	-	-

What do the changes mean for net expenditure?

Public sector pensions

The decrease in the discount rate has the effect of increasing the pensions liability and 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 2017-18 this discount rate unwind resulted in an expense of £50.6 billion.

Provisions

The changes in discount rate led to a cost to net expenditure of £93.4 billion. £75.1 billion is the increase in nuclear decommissioning provisions, which will be discharged over the next 100+ years.

Student loans

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

Other key matters

Contingent liabilities

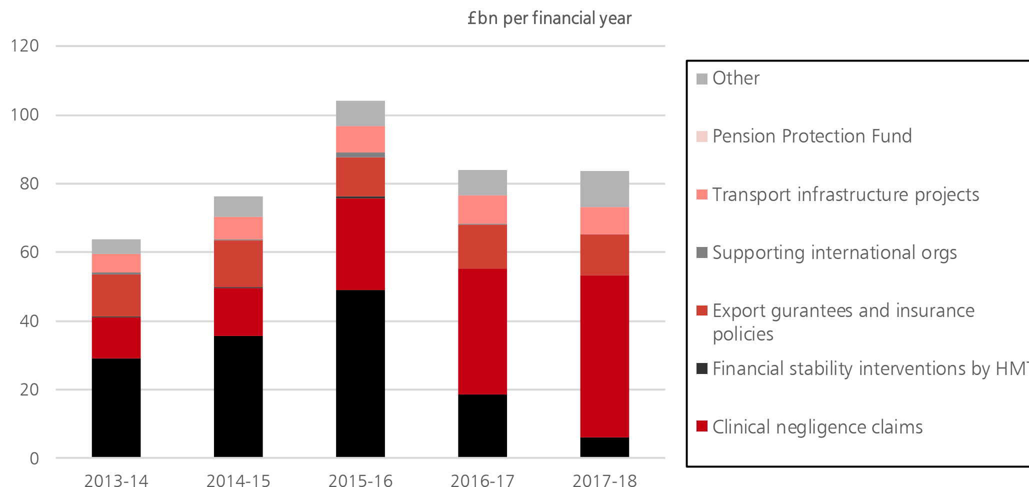
What contingent liabilities does government have?

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

		2017-18 £bn	2016-17 £bn
Non-remote contingent liabilities disclosed under IAS37	Note 29	83.7	84.0
Remote contingent liabilities reported to Parliament	Note 30	108.9	98.4
Total quantifiable contingent liabilities		192.6	182.4

1.166 In the past five years, total quantifiable contingent liabilities (remote and non-remote) have increased from £133.2 billion in 2013-14 to £192.6 billion in 2017-18, driven by a rise of £40.9 billion in the remote contingent liabilities. The same period has seen an increase in non-remote contingent liabilities of £19.9 billion.

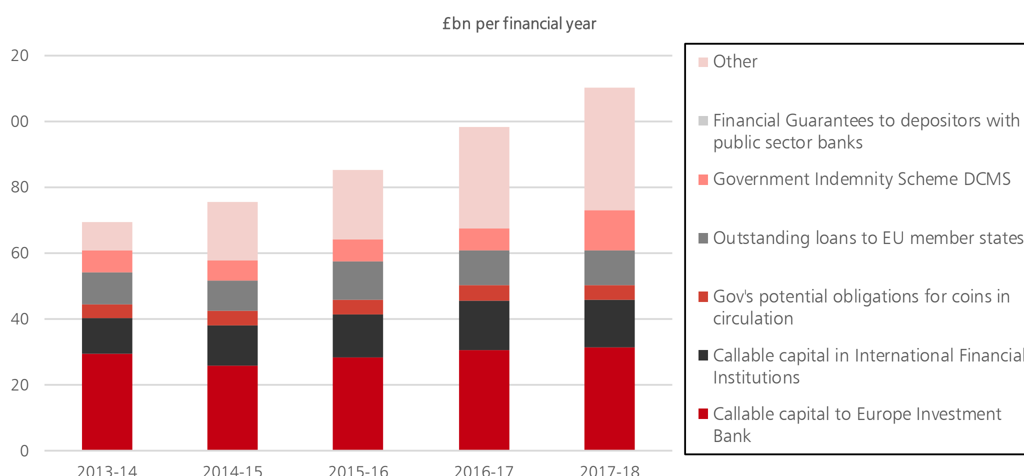
Chart 1.EE: Non-remote contingent liabilities by type



Source: HM Treasury

1.167 In non-remote contingent liabilities, the increase is largely driven by increases in clinical negligence contingent liabilities, which increased from £11.9 billion in 2013-14 to £47.3 billion in 2017-18. A large proportion of this increase occurred due to a change in the discount rate for clinical negligence provisions. Chart 1.EE breaks down non-remote contingent liabilities.

Chart 1.FF: Remote contingent liabilities by type



1.168 Remote contingent liabilities include callable capital for the European Investment Bank of £31.3 billion (£30.5 billion in 2016-17), £14.5 billion (£15.0 billion in 2016-17) for callable capital for investments in international institutions, and £10.6 billion (£10.6 billion restated for 2016-17) for the UK's maximum liability from EU member states and third countries, where loans are backed by the EU budget.

1.169 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.

How is government managing its contingent liabilities

1.170 Contingent liabilities expose the taxpayer to potential future costs. Effective management of these liabilities is vital to managing fiscal risk.

1.171 In 2017, HM Treasury implemented stricter new controls over the issuance of guarantees and other contingent liabilities. The new approvals regime has already been applied to over 80 new contingent liabilities, with over £1.5 billion of new liabilities rejected outright and the vast majority approved more comprehensive information was provided to demonstrate the risk was well understood and managed or after significant modification to reduce exposure.

1.172 The contingent liabilities approval framework requires a written Ministerial statement and Treasury review for new contingent liabilities over £3 million and novel, contentious or repercussive. Departments are required to complete a checklist covering rationale, quantifying exposure and risk, risk management and mitigation. Contingent liabilities too sensitive to disclose publicly (for example if they relate to commercially sensitive negotiations) are notified in writing to the chair of the Public Accounts Committee.

1.173 The Balance Sheet Review is exploring options to further improve the management of contingent liabilities and secure appropriate compensation for the taxpayer when providing guarantees to the private sector.

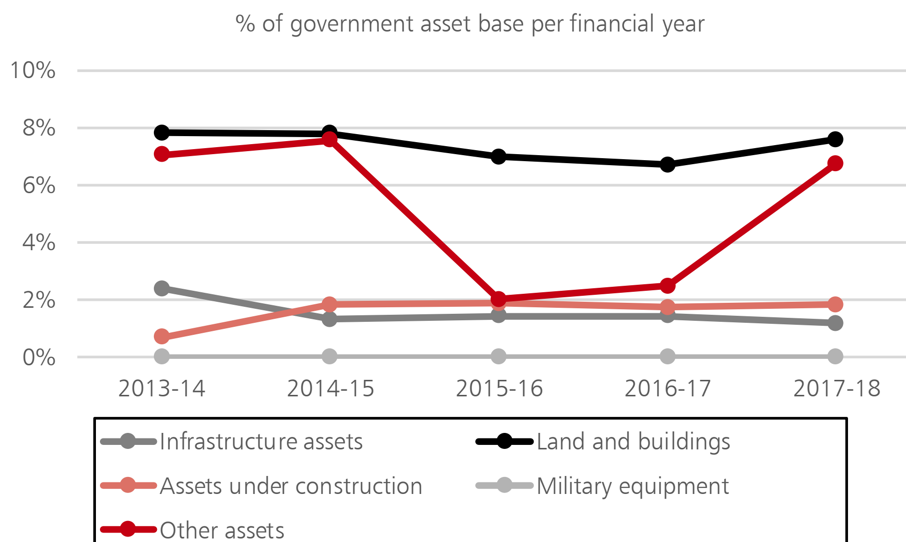
PFI and PF2

1.174 In the UK, government has historically brought private investment into government-funded projects in sectors such as health, education, justice, defence and transport using Public Private Partnerships (PPPs). PPPs are long-term contractual arrangements, usually for the construction and maintenance of an infrastructure asset over 25-30 years.

1.175 Until 2012, the Private Finance Initiative (PFI) was the government's preferred model of PPP. In 2012, PFI was replaced with Private Finance 2 (PF2), in response to widespread concerns about value for money. The 2018 summary data reported in the Private Finance Initiative and Private Finance 2 report indicates that at 31 March 2018, there were 704 current PFI and PF2 projects with a capital value of £57 billion, a reduction from 715 projects with a value of £59 billion at 31 March 2017.

1.176 PFI assets make up a small but important part of the government's asset base.

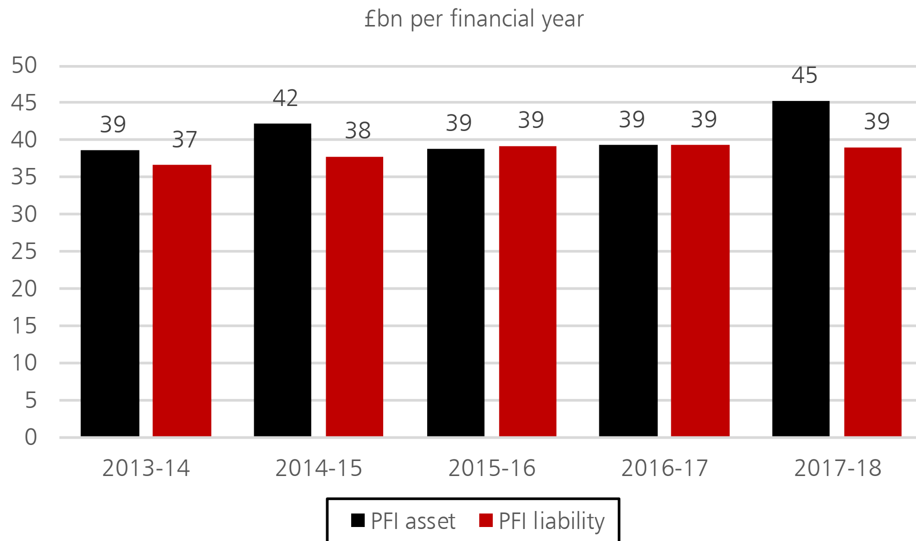
Chart 1.GG: PFI assets as a percentage of the government asset base



1.177 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.

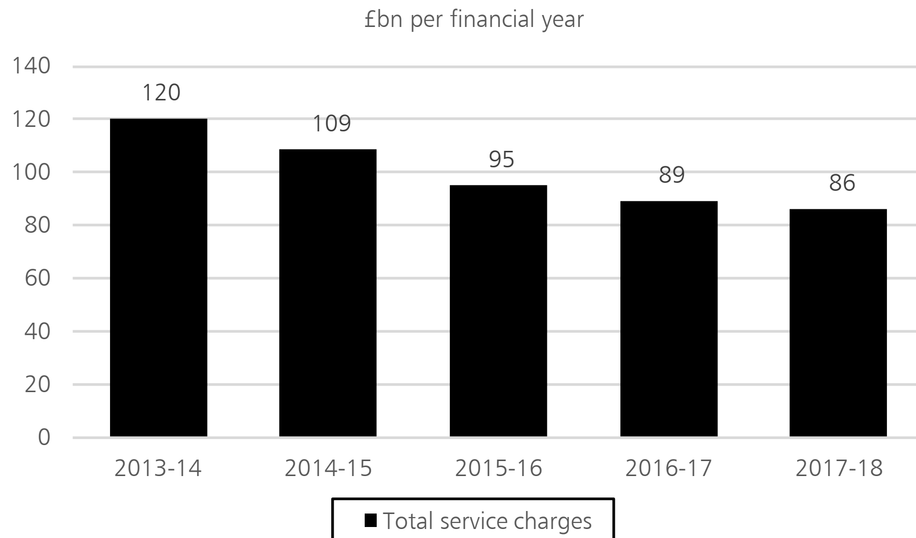
1.178 The asset is counterbalanced by a liability on the Statement of Financial Position. This reflects the financing for the asset. Chart 1.HH shows total PFI assets and liabilities recognised in WGA.

Chart 1.HH: PFI assets and liabilities



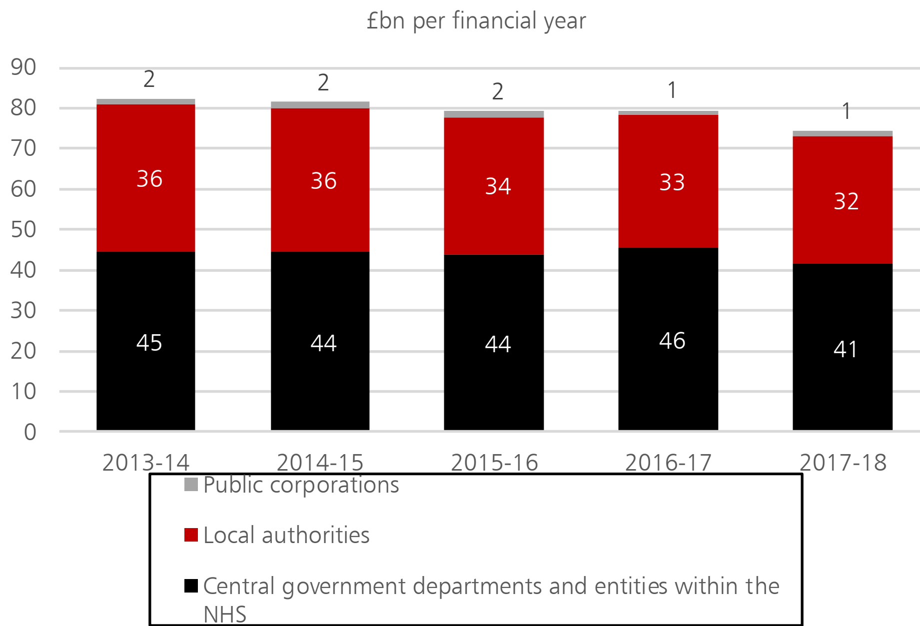
1.179 In addition to assets and liabilities on the Statement of Financial Position, PFI contracts also commit the government to paying service charges. These are the costs of maintaining the purchased assets and are recognised as the services that trigger these payments are delivered. Whilst not recognised as a liability on the Statement of Financial Position, WGA discloses the total contractual commitment.

Chart 1.II: PFI service charge commitments



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

Chart 1.JJ: Split of PFI imputed finance lease obligations by sector



Retiring PF2

1.181 PF2 was used only six times, for projects with a total capital value of around £900 million, comprising only 0.5% public investment over the period 2012 to 2018.

1.182 At Budget 2018, the Chancellor announced that the government would no longer use PF2 for new government projects, recognising that the model created a "fiscal illusion" and a long-term fiscal risk for the taxpayer, inflexibility for public service providers, and operational complexity for public sector contract holders. The Chancellor also confirmed that the government would stand by existing PFI and PF2 contracts, but would seek to improve their management.

EU Exit

The European Union in WGA

1.183 This section explains how the financial relationship between the UK and EU is treated in the WGA. Because these accounts relate to 2017-18, and because of the applicable accounting standards, only some aspects of the relationship (and of the effects of EU Exit) are captured in the accounts. A fuller explanation of the relationship (including the effects of EU Exit) is set out in Annex E of the *European Union Finances 2018: statement on the 2018 EU Budget and measures to counter fraud and financial mismanagement*. In particular this provides more information on the financial settlement. The draft Withdrawal Agreement sets out the financial settlement that was reached between the UK and EU as part of negotiations on the UK's rights and obligations as a departing member state. The financial settlement addresses mutual obligations that arose primarily as a

consequence of the UK's participation in the EU budget, and commitments related to the UK's broader membership of the EU.

1.184 Transactions, balances and commitments between the UK public sector and the European Union are recognised in a number of places in WGA. Please note that transactions between non WGA entities (for example private companies) and the EU will not be recognised in WGA:

- The UK's contribution to the EU budget is recognised as a grant expense. This totalled £12.2 billion for 2017-18 (£12.2 billion for 2016-17). This contribution is paid by the Consolidated Fund, and can be found in Note 9 of WGA
- UK customs duties remitted to the EU (called Traditional Own Resources) are excluded because under the accounting standards the UK government is judged to be acting as the agent of the EU in collecting these revenues. These duties totalled £2.7 billion in 2017-18
- EU grants and subsidies paid by the UK government are also recognised as a grant expense. For 2017-18 this was £3.1 billion (£3.0 billion in 2016-17). This is largely made up of £2.1 billion (£2.2 billion in 2016-17) of grant payments made by the Department for Environment, Food and Rural Affairs (DEFRA). The EU reimburses the UK for this expenditure. This grant payment can be found in Note 9 of WGA
- Income from the EU to reimburse grants and subsidies can be found in Note 5 of the accounts. For 2017-18 this income was £4.1 billion (£4.1 billion for 2016-17). As noted above, this is largely made up of income received by DEFRA to reimburse them for grants and subsidies paid
- The UK's interest in the European Investment Bank is included as a non-current investment in the Consolidated Fund accounts and WGA. The value of this asset in WGA at 31 March 2018 was £9.7 billion (2016-17 £9.1 billion). It is included on the Statement of Financial Position and in Note 16 as an equity investment
- In addition to income, assets and expenditure, there are contingent liabilities held by the UK government that reflect our commitment to the EIB and loans to EU member states and third countries that are ultimately backed by the EU budget. As these are contingent liabilities, no money has changed hands, they represent a commitment of the UK government should it be needed. Therefore, no liability is recognised on the balance sheet, and these amounts do not contribute to the WGA net liabilities figure. In addition, these are considered remote contingent liabilities, meaning they are considered to have a very low chance of occurring. The government's commitment for callable capital under the EIB is £31.3 billion (£30.5 billion in 2016-17), and the UK's maximum liability under loans backed by the EU budget is £10.6 billion (£10.6 billion restated in 2016-17). More information on these can be found in the accounts of the Consolidated Fund, and in Note 30 of WGA

Guarantee of funding

1.185 In July 2018, the UK government announced an extension of its guarantee of EU-funded projects after the UK has left the EU. The guarantee was originally announced in 2016. The guarantee now covers the following:

a) The full Multiannual Financial Framework allocation for structural and investment funds over the 2014-20 period, with payments to beneficiaries made up to the end of 2023

b) The payment of awards where UK organisations successfully bid directly to the European Commission on a competitive basis for EU funding projects while we remain in the EU (i.e. before Exit day), for the lifetime of the project

c) The payment of awards where UK organisations successfully bid to the European Commission on a competitive basis to participate as a 3rd country after Exit, and until the end of 2020, for the lifetime of the project

d) The current level of agricultural funding under CAP pillar 1 until 31 December 2020

1.186 The financial settlement was agreed in principle by both the UK and EU, as set out in the draft Withdrawal Agreement of 25th November 2018. The guarantee will therefore only be called in the event that the Withdrawal Agreement is not ratified in the case of no deal, and UK organisations are unable to access EU funding. If the withdrawal agreement is passed, the guarantee will not be required.

1.187 As a result, a number of departments in WGA will disclose an unquantifiable contingent liability in this respect in their 2018-19 accounts.

What WGA does not include in respect of EU Exit

1.188 There are some areas where WGA may be limited in providing information in respect of EU exit:

WGA will not include liabilities relating to policy or legislative effects on the wider economy, if these effects do not meet the criteria set out in the accounting standards.

- Expenditure on EU exit will be difficult to identify, as much of it will be either expenditure on staff, or purchases of goods and services. In many cases this expenditure will not be extra expenditure, but will come from reprioritisation within departments, which is difficult to capture in accounts
- The effect of EU exit on the economy will not be recognised in WGA
- Any marginal impact on the public finances (e.g. through increased or decreased spending on benefits, increased or decreased borrowing or changes in underlying assumptions that affect valuations) may not be separately identifiable. WGA may recognise specific grant streams, income streams, assets or liabilities, if these are separately identifiable in underlying accounts of WGA bodies, and if this information is material

Impact of the financial settlement on the public finances and government accounts

1.189 The Office for Budget Responsibility publishes its bi-annual Economic and Fiscal Outlook which includes up to date estimates of the cost of the financial settlement. The OBR published forecasts of the financial settlement in March 2018, October 2018 and March 2019. All fell within the Government's central estimate of £35-£39 billion. In March 2018, the OBR estimated that the total cost of the settlement would be €41.4 billion (£37.1 billion). In October, this estimate was increased to €42.2 billion (£38.7 billion). The most recent estimate, from March 2019, saw the estimate fall to €41.8 billion (£37.8 billion).

1.190 The Office for National Statistics will decide how to reflect the actual economic flows under the financial settlement in statistical publications like the National Accounts (Blue Book) and in the Public Sector Finances statistical bulletin, which include a number of key measures of the public sector deficit and debt.

Events since 31 March 2018

1.191 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 2018. These events are shown in Note 32 to the accounts.

James Bowler

Accounting Officer

16 May 2019

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, or
- 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 2017-18 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 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 3.17. 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 2018 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 2017-18 year, we have focussed on making the following improvements to the publication:

- Publishing the accounts more quickly than 2016-17, with publication in May 2019 versus June 2018 for the 2016-17 account.
- Including more information on the differences between National Accounts and WGA treatment for key areas including student loans
- Including information on the maturity profile of liabilities
- Including more information on how fiscal risks are being managed by government.

- Including information on EU-related transactions in WGA

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 8,000 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 March 2020. This relies on a series of factors outside of the control of Treasury, including the publication of statutory accounts of significant components, and the preparation and timely audit of WGA returns.

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.

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 Treasury is working to ensure that the Balance Sheet Review has a long-term impact on the cost-effective management of government assets and liabilities. The Review has already made good progress as reflected in the announcements in the 2018 Autumn Budget. These included the retirement of PFI and PF2 for new projects, reducing inflation risk exposure through gradual reduction of index-linked government debt, and introduction of disclosure requirements for asset sales. These actions are partly based on the insight gained from having a full and comprehensive set of accounts for the public sector

- the Office for Budget Responsibility (OBR) independently reports on the future sustainability of the public finances in its Fiscal Sustainability Report[2] and Fiscal Risks Report[3], drawing on the data published in WGA. In addition, the government responded to the findings of the Fiscal Risk Report in the Managing Fiscal Risks report[4].

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2 https://obr.uk/fsr/fiscal-sustainability-report-july-2018/

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

4 https://www.gov.uk/government/publications/managing-fiscal-risks-government-response-to-the-2017-fiscal-risks-report

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.

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 'Whole of Government Accounts' was published in January 2019.[5]

Review of effectiveness

3.14 The 2017-18 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; 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

- The **Department for Education (DfE)** received a qualified opinion on the sector annual report and accounts (SARA) for the year ended 31 August 2017 as result of a material level uncertainty over the closing revaluation

[5] https://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/inquiries/parliament-2017/inquiry15/

reserve balance and the comparative academy trust land and building values. Further details can be found 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 which will remain as a qualification in the medium term.
- DfE has alternative reporting arrangements for the **Academies** sector as agreed with the Treasury and Parliament. The DfE core department, its agencies and arms length bodies prepare one set of accounts to 31 March. The Academies sector prepare a separate sector account, to a year end of 31 August (known as the Sector Annual Report and Accounts, or SARA). This data creates a non-coterminous year end misalignment with the rest of WGA, and this in turn leads to a qualification to WGA.
- The 2016-17 WGA was the first to be prepared with this new arrangement. Unadjusted data was consolidated, and this led to WGA being qualified. In addition, the valuation of land and buildings was not deemed to be materially true and fair, and was therefore qualified within the SARA itself. This qualification was mirrored in WGA.
- For 2017-18, Treasury has used unadjusted SARA data and is therefore qualified on the basis of **non-coterminous year ends.** However, for the 2017-18 WGA, SARA data was prepared and audited more quickly than for 2016-17. In addition, the SARA data that fed into the 2017-18 WGA was qualified, but the qualification was restricted to the comparatives and opening balance of land and buildings.
- For the 2018-19 WGA cycle, DfE expects to publish the SARA even quicker, and fully resolve the qualification relating to land and buildings. This will have a positive impact on the quality of WGA. Longer term, DfE are aiming to mitigate the impact of the misalignment of year ends, and Treasury is working with them to support this goal. However, it will be important to balance timeliness and cost-effectiveness with any proposed solution.

3.18 Further details on the boundary and accounting treatment of infrastructure assets are included in the critical accounting estimates and judgements 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.

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.

Balancing timeliness, quality and cost effectiveness of data

3.22 While there have been significant improvements in the quality of WGA, the accounts remain qualified. However, three of these qualification issues are partly driven by the same underlying root cause:

- The qualification relating to MOD remains, in part, because it would not be cost effective to review the contracts to identify arrangements that may amount to a lease.
- The qualification relating to highways infrastructure remains, in part, because it would not be cost effective to change accounting valuations within Local Authorities only for the benefit of WGA.
- The qualification relating to Academies non-coterminous year end remains, in part because it would not be cost effective to require separate 31 March returns from the Academies sector

3.23 In preparing WGA, I must balance the timeliness, cost effectiveness and quality of the accounts. Significant financial outlay to provide changes to WGA disclosures has to be carefully considered. While I will continue to improve WGA, it is important to acknowledge that some of the issues outlined above may not have a cost-effective solution. Where I determine this to be the case I will consider how supplementary disclosures or information can be used to improve the quality of the accounts.

Assurance in making this judgement

3.24 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

3.25 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.
- 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 responded in the Managing Fiscal Risks (MFR) report, which was published in July 2018

Information and data handling

3.26 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.

Disclosure of information to auditors

3.27 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.

3.28 I confirm that this annual report and accounts 2017-18 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

16 May 2019

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. A similar report for WGA would require publishing details of senior employees for over 8,000 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 2017-18 was an average that applied to an organisation or workforce, rather than each individual. This means that organisations were free to distribute the award among staff based on their own requirements. Employers could 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 was in line with the pay policy. The policy of pay restraint operated 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.

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, Wales and Northern Ireland.

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.

4.7 The Senior Civil Service (SCS) pay award is set by the government after receiving advice from the Independent Review Body on Senior Salaries (SSRB). Each year the SSRB takes evidence from interested parties, including

[1] https://www.gov.uk/government/publications/civil-service-pay-guidance-2017-to-2018/civil-service-pay-guidance-2017-to-2018

government departments, employers, trade unions and staff associations. It carries out its own independent research, and then formulates a recommendation on the remuneration of the SCS. The government then decides whether to accept, reject or stage the pay award recommended by the SSRB.[2]

2 https://www.gov.uk/government/organisations/review-body-on-senior-salaries

The devolved administrations

4.8 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[3]

4.9 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	Others	2017-18 Total	2016-17 Total
	£bn	£bn	£bn	£bn
Salaries and wages	142.3	10.5	152.8	151.0
Pension scheme costs: current service costs (net of employees' contributions)	60.1	-	60.1	37.5
Pension scheme costs: past service costs	1.3	-	1.3	0.6
Pension scheme costs: losses on settlements and curtailments	(0.4)	-	(0.4)	(0.2)
Expenditure on external pension schemes	2.0	-	2.0	2.2
Total staff costs	205.3	10.5	215.8	191.1

4.10 **Salaries and wages** increased by £1.8 billion to £152.8 billion in 2017-18. Expenditure by the Department of Health and Social Care (which encompasses NHS staff in England) accounted for £1.0 billion of the increase and reflects an increase in staff numbers. The remaining increase was driven

[3] An overview of English local government pay and workforce figures is published annually by the Ministry of Housing, Communities and Local Government in their report 'Local Government Financial Statistics England' available on their website: https://www.gov.uk/government/organisations/ministry-of-housing-communities-and-local-government. Details of remuneration by local authority are available in the authorities individual accounts.

by growth in the Academies sector and smaller increases across central government and the devolved administrations.

4.11 In addition to permanently employed staff, 'others' included the cost of ministers, special advisers, temporary and contract staff. The cost of the salaries of ministers was £5.3 million (2016-17: £5.6 million) and the cost of special advisers was £6.1 million (2016-17: £9.5 million). The ministerial salary only includes the additional element on top of the basic salary of an MP.

4.12 **Pension scheme costs** increased by £22.9 billion in 2017-18 to £63.0 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

4.13 Median earnings across the public sector for the financial year 2017-18 for all employees with a comparative to the private sector are shown below.

Table 4.B: Median earnings

	Median earnings 2017-18 £	Median earnings 2016-17 £
Central government civil service[4]	26,610	25,900
Local government[5]	-	-
Public sector[6]	25,648	24,965
Private sector[6]	23,628	23,044

Average number of persons employed

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

	Permanently employed staff	Others	2017-18 Total	2016-17 Total
Central government (including health)	2,570,124	178,602	2,748,726	2,689,630
Local government	1,464,071	48,712	1,512,783	1,611,489
Non-financial public corporations	81,714	22,183	103,897	102,552
Financial public corporations	4,368	-	4,368	2,934
Total	4,120,277	249,497	4,369,774	4,406,605

[4] ONS Statistical Bulletin, Civil Service Statistics, 2018, 2017 and 2016 (www.ons.gov.uk)

[5] Data was previously sourced from the Local Government Earnings Survey, but this is now unavailable as the publication has been discontinued since 2015-16.

[6] Table 13.7a, Annual Survey of Hours and Earnings, 2018 (Provisional), 2017 (Revised) and 2016 (Revised), ONS (www.ons.gov.uk)

Table 4.D: Central government breakdown

	2017-18 Total	2016-17 (restated) Total
Health sector	1,490,868	1,472,452[a]
Academy schools	433,696	385,992
Northern Ireland and Scotland FE colleges	14,861	14,822
Other	809,301	816,364
Total central government (including health)	2,748,726	2,689,630

a 2016-17 figures were re-presented to make them consistent with 2017-18, in particular moving Northern Ireland health bodies into the 'Health' sector, when they were disclosed in the 'other' sector in the 2016-17 WGA.

Civil Service and other compensation schemes - exit packages

Table 4.E: Exit package cost band 2017-18

	Number of compulsory redundancies	Number of other departures agreed	Total number of exit packages by cost band	Total Cost £bn
<£10,000	2,665	4,660	7,325	-
£10,000-£50,000	10,014	21,340	31,354	0.5
£50,000-£100,000	607	2,294	2,901	0.2
>£100,000	294	1,053	1,347	0.2
Total	13,580	29,347	42,927	0.9

Table 4.F: 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

4.14 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

16 May 2019

Chapter 5

Financial statements

Statement of Revenue and Expenditure

For the year ended 31 March 2018

	Note	2017-18 £bn	2016-17 £bn
Taxation revenue	4	(661.6)	(628.1)
Other revenue	5	(99.3)	(92.7)
Total public services revenue		(760.9)	(720.8)
Social security benefits	6	225.9	223.7
Staff costs	7	215.8	191.1
Purchase of goods, services and other expenditure	8	212.2	194.8
Grants and subsidies	9	51.2	53.6
Depreciation and impairment	10	57.7	47.1
Interest costs on government borrowing	11	36.8	31.8
Increase in provisions	22	15.2	18.6
Total expenditure on public services		814.8	760.7
Net expenditure on public services		53.9	39.9
Financing costs of long-term liabilities, including discounting	11	153.7	68.3
Revaluation of financial assets and liabilities		4.8	(10.4)
Net expenditure for the year		212.4	97.8

Statement of Comprehensive Income and Expenditure

For the year ended 31 March 2018

	Note	2017-18 £bn	2016-17 £bn
Net expenditure for the year		212.4	97.8
Other comprehensive income and expenditure:			
Net (gain)/loss on:			
Revaluation of property, plant and equipment		(37.4)	(37.7)
Revaluation of intangible assets		(0.7)	(1.3)
Revaluation of available for sale financial assets		(1.0)	(1.4)
Revaluation of pension scheme liabilities		(38.6)	361.4
Other comprehensive income and expenditure		(77.7)	321.0
Total comprehensive expenditure for the year		134.7	418.8

Statement of Financial Position

As at 31 March 2018

	Note	2017-18 £bn	2016-17 £bn (restated)
Non-current assets			
Property, plant and equipment	12	1,208.4	1,167.6
Investment property	13	20.0	18.2
Intangible assets	14	36.0	34.5
Trade and other receivables	15	19.1	15.2
Other financial assets	16	323.3	260.8
		1,606.8	1,496.3
Current assets			
Inventories	17	9.9	9.2
Trade and other receivables	15	160.8	158.0
Other financial assets	16	184.3	198.1
Cash and cash equivalents	18	34.3	28.3
Gold holdings		9.4	9.9
Assets held for sale		8.3	3.2
		407.0	406.7
Total assets		2,013.8	1,903.0
Current liabilities			
Trade and other payables	19	(126.8)	(122.5)
Government borrowings	20	(275.6)	(275.5)
Other financial liabilities	21	(654.0)	(584.9)
Provisions	22	(16.4)	(15.6)
		(1,072.8)	(998.5)
Non-current liabilities			
Trade and other payables	19	(64.4)	(63.1)
Government borrowings	20	(1,071.8)	(1,013.5)
Other financial liabilities	21	(98.8)	(107.3)
Provisions	22	(406.1)	(306.6)
Net public sector pension liability	24	(1,865.3)	(1,834.7)
		(3,506.4)	(3,325.2)
Total liabilities		(4,579.2)	(4,323.7)

	Note	2017-18 £bn	2016-17 £bn (restated)
Net liabilities		(2,565.4)	(2,420.7)
Financed by taxpayers' equity:			
General reserve		(3,131.5)	(2,948.1)
Revaluation reserve		562.0	482.4
Other reserves		4.1	45.0
Total liabilities to be funded by future revenues		(2,565.4)	(2,420.7)

2016-17 Other Financial Assets were re-presented to make them consistent with the 2017-18 figures. Further details can be found in Note 16 and Note 1.20.

The financial statements and supporting notes on pages 100 to 180 form part of these accounts.

James Bowler
Accounting Officer
16 May 2019

Statement of Changes in Taxpayers Equity

As at 31 March 2018

	General reserve £bn	Revaluation reserve £bn	Other reserves £bn	Total £bn
At 1 April 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)
Net expenditure for the year ended 31 March 2018	(212.4)	-	-	(212.4)
Net gain/(loss) on:				
Revaluation of property, plant and equipment	-	37.4	-	37.4
Revaluation of intangible assets	-	0.7	-	0.7
Revaluation of available for sale financial assets	-	1.0	-	1.0
Revaluation of pension scheme liabilities	38.6	-	-	38.6
Other reserves movements including transfers	(9.6)	40.5	(40.9)	(10.0)
Balance at 31 March 2018	(3,131.5)	562.0	4.1	(2,565.4)

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 2018

	Note	2017-18 £bn	2016-17 £bn
Cash flows from operating activities			
Net operating expenditure	SoRE	(53.9)	(39.9)
Adjustments for non-cash transactions		183.5	139.7
(Increase)/decrease in inventories		(0.6)	0.7
(Increase)/decrease in trade and other receivables		(7.5)	(22.1)
Increase/(decrease) in trade and other payables		(36.0)	3.4
Use of provisions		(10.1)	(12.1)
Net cash inflow/(outflow) from operating activities		75.4	69.7
Cash flows from capital expenditure and financial investment			
Purchase of non-financial assets		(62.6)	(57.7)
Proceeds from disposal of non-financial assets		3.1	1.3
Net cash inflow/(outflow) from purchase and disposal of financial assets and liabilities		(47.6)	3.0
Net cash inflow/(outflow) from capital expenditure and financial investment		(107.1)	(53.4)
Cash flows from financing activities			
Interest received		8.1	7.4
Financing costs of long-term liabilities, including discounting		(13.7)	(35.8)
Finance charges paid on finance leases and PFI contracts		(4.7)	(4.4)
Net Borrowings		48.0	19.0
Net cash inflow/(outflow) from financing activities		37.7	(13.8)
Net increase/(decrease) in cash and cash equivalents	18	6.0	2.5
Cash and cash equivalents at the beginning of the year	18	28.3	25.8
Cash and cash equivalents at the end of the year	18	34.3	28.3

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 and their agencies, non-departmental public bodies, public corporations (more detail on which can be found below), local authorities, the National Health Service (including NHS trusts and Clinical Commissioning Groups) and the devolved administrations. This includes Academy Schools (which are classified as central government), local policing and crime commissioners and fire and rescue authorities (which are considered local government bodies). 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.

WGA is a highly comprehensive picture of the UK public sector. It is based, in large part, on bodies classified as public sector. This means that it includes all central government departments, their arms length bodies and agencies. It also includes Local government bodies such as councils, Policing and Crime commissioners, combined authorities and transport bodies (such as Transport for London).

WGA also includes public sector bodies from the devolved administrations, Scotland, Wales and Northern Ireland.

WGA includes public corporations, which are companies largely or wholly owned by the taxpayer. WGA includes the following public corporations:

Bank of England

Bank of England Asset Purchase Facility

Bank of England Issue Department

British Council

British Nuclear Fuels Ltd

British Broadcasting Corporation

British Waterways Board

Caledonian Maritime Assets Ltd

Channel Four Television Corporation

Civil Aviation Authority

Commonwealth Development Corporation

Companies House

Covent Garden Markets Authority

Crown Commercial Service

David MacBrayne Ltd

Driver and Vehicle Agency NI (Trading Fund Element only)

FCO Services

Financial Conduct Authority

Financial Ombudsman Services Ltd

Forest Enterprise Agency Scotland

Forest Enterprise England

General Lighthouse Fund

Highlands and Islands Airport

Intellectual Property Office (Patent Office)

Land Registry

London and Continental Railways Limited

Medicines and Healthcare Products Regulatory Agency

Meteorological Office

National Employment Savings Trust Corporation

National Nuclear Laboratory Ltd

Navy, Army and Air Force Institute

NHS Blood and Transplant

NHS Professionals

Northern Ireland Housing Executive

Northern Ireland Transport Holding Company

Northern Ireland Water

Nuclear Liabilities Fund Ltd

Office for Nuclear Regulation

Oil and Pipelines Agency

Ordnance Survey

Pension Protection Fund

Post Office Limited

Queen Elizabeth II Conference Centre

Registers of Scotland

Royal Mint

Scottish Water

UK Hydrographic Office

WGA does not include the Royal Bank of Scotland. Despite it being largely owned by government, it its government's intention to return RBS to the private sector. Including it would distort the disclosures within WGA and reduce the usefulness of the account. The Comptroller and Auditor General has reached the conclusion that this is not in line with the appropriate financial reporting standard, and has therefore qualified his opinion on WGA. WGA also does not include English FE colleges and Trust Ports.

WGA also does not include small bodies (those with assets, liabilities, income and expenditure less than £20 million), and a small number of entities that report directly to the legislature, such as the National Audit Office.

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.

The impact of IFRS 9 is expected to be material to WGA, with financial assets (£507.6 billion) and Trade and Other receivables (£179.9 billion) affected by the change in accounting standards. It is not possible to quantify the impact of any changes at this stage, as this will be dependent on work within individual organisations to assess impairments of their own assets.

IFRS 15 'Revenue from Contracts with Customers' was issued in May 2014, effective for periods beginning on or after 1 January 2018. The impact of IFRS 9 and 15 will be reflected in the 2018-19 WGA. 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 15 is not expected to have a material effect on WGA. The most significantly affected organisation is likely to be the Department for Business, Energy and Industrial strategy, where there is income of around £1 billion from service contracts. This income is mainly from fuel reprocessing, waste and product storage and the transportation of spent fuel, waste and products. Further details can be found in the accounts of the Department.

IFRS 16 'Leases' was issued in January 2016, effective for periods beginning on or after 1 January 2019. The impact of IFRS 16 will be reflected in the 2020-21 WGA. 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 identify the impact of IFRS 16 on WGA at this stage, as it depends on work carried out at individual organisations to identify the impact within their own accounts.

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.

Treatment of Third Resource income due to the EU

The Government Financial Reporting Manual requires that revenues collected on behalf of the EU should be excluded from consolidation. It specifies that these

resources include the Traditional Own Resources, which are customs duties collected by HMRC, sugar levies and the Third Resource. The Third Resource is VAT, based on the application of a uniform rate to a harmonised expenditure base. This income is reflected in the accounts of the Consolidated Fund, where more information can be found. For WGA, the customs duties and sugar levies are excluded from the consolidation.

However, the Third Resource is not excluded from the consolidation. This is because the it is a liability based on a set of assumptions, rather than the UK simply acting as the administrative agent for income it then passes over to the EU, which is the case for customs duties and the sugar levy. Therefore, the treatment in WGA diverges from the treatment set out in the FReM. The total value of this departure is £3.0 billion in 2017-18 (£2.5 billion in 2016-17).

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. These are not included in staff costs, but make up the value of assets recognised in Notes 12 and 14. 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 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 to the extent that 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.

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 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 2017-18, 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.

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 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 changes in the assumptions such as 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, relating to assumptions about general salary and pension increases
- 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.

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: 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.

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

Restatement of loans and deposits

The prior year comparative for 2016-17 has been restated, in line with *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors,* to reclassify loans under the Term Funding Scheme of £55.1 billion as non-current financial assets. These had been previously classified as current financial assets. There is no impact on the net liabilities position for 2016-17.

Financial liabilities

The majority of the government's financial liabilities are classified at amortised cost. The only exceptions are deposits by banks 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 Government Resources and Accounts Act (GRAA) 2000 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 Office for National Statistics (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 exceptions to this policy are:

- WGA excludes a small number of entities such as the National Audit Office, Crown Estate 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. The total impact of excluding these bodies from WGA is estimated to be £1.1 billion of gross expenditure and £17.2 billion of net assets. Some of these amounts would be eliminated on consolidation. Over £14 billion of the net assets not included in WGA are reflected in the Crown Estate.

- 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 2017-18 was that they had to have gross expenditure, income, assets and liabilities of less than £20.0 million (2016-17 £10 million). For example, this includes some district councils. The total impact of excluding minor bodies is estimated to be £0.4 billion of gross expenditure and £0.06 billion of net assets. Some of these amounts would be eliminated on consolidation.

The most significant exception to this policy is the Royal Bank of Scotland (RBS):

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 table below 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 2017. 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
2017-18 WGA	760.9	(814.8)	(53.9)	2,013.8	(4,579.2)	(2,565.4)
2017 RBS	15.2	(13.8)	1.4	738.1	(689.0)	49.1
Eliminations	(2.4)	2.4	-	(116.5)	116.5	-
WGA plus RBS	773.7	(826.2)	(52.5)	2,635.4	(5,151.7)	(2,516.3)

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 £6.0 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 held at historical cost less depreciation, which is different from the valuation basis used by Central government. Local authorities investigated a valuation based on replacement cost less deprecation. However, the body that sets the standards for Local Authority accounts decided that the costs of implementation outweighed the benefits, and decided not to proceed.

The best proxy currently 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 £118.2 billion (2016-17: £121.0 billion) as at 31 December 2017[1] . Infrastructure assets are likely to be understated by at least £47.8 billion. The ONS figure excludes land, and therefore the total error is likely to be larger than the figure stated. Further information regarding this departure from FReM can also be found 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 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, 2018, 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 2017-18 was RPI plus 0.7% (2016-17: 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 2017-18 and 2016-17 WGA pension liabilities are set out below:

	2017-18 Unfunded central government[2] %	2017-18 Unfunded local government[3] %	2017-18 Funded local government %	2016-17 Unfunded central government %	2016-17 Unfunded local government %	2016-17 Funded local government %
Rate of increase in salaries[4]	3.95	1.0-4.3	2.4-4.2	4.55	1.0-5.1	1.0-4.4
Rate of increase in pensions in payment[5]	2.45	1.8-4.3	1.8-3.8	2.55	1.0-4.4	2.0-3.5
Discount rate – real[6]	0.1	-	-	0.24	-	-
Discount rate – Nominal	2.55	1.8-10.0	2.3-3.4	2.8	1.7-10.0	2.4-3.6
Price inflation assumption	2.45	1.00-3.6	1.0-3.8	2.55	1.0-3.6	1.5-3.7

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 2018.

[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 NHS Resolution 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 NHS Resolution, 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. 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.

Table 1.F includes a table setting out the sensitivity of the NHS resolution clinical negligence provision to key underlying assumptions.

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 2017
- Northern Ireland and Scottish FE colleges - year end of 31 July 2017
- Channel 4 - year end of 31 December 2017
- Bank of England – year end to 28 February 2018
- National Physics Laboratory – year end to 31 December 2017
- Navy, Army and Air Force Institute - year end to 28 April 2018
- Northern Ireland Transport Holding Company – year end to 25 March 2018
- British Nuclear Fuels - year end to 30 June 2017

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

Academies sector

The Academies sector annual report and accounts has a year end to 31 August 2017. 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 2017, with no adjustments made. The main impact of this misalignment is in property, plant and equipment

(where academies report net book value of £46.7 billion) and pension liabilities (where academies report a pension deficit of £7.0 billion). The academies sector is also subject to a qualification on the basis of accuracy and completeness of the comparative land and buildings values and on the basis of accuracy of the revaluation reserve balance. 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 in Note 23-Financial instruments. 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 2017-18 accounts of the Department for Business, Energy and Industrial Strategy.[7]

[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725808/BEIS_Web_accessible_Annual_Report_and_Accounts_2017_18.pdf

Note 3. Segmental reporting

Segmental reporting 2017-18

	Central government	Local government	Public corporations	Whole of Government
	£bn	£bn	£bn	£bn
Taxation revenue	(599.2)	(62.2)	(0.2)	(661.6)
Other revenue	(51.4)	(35.4)	(12.5)	(99.3)
Total public services revenue	(650.6)	(97.6)	(12.7)	(760.9)
Social security benefits	200.1	25.2	0.6	225.9
Staff costs	145.0	65.4	5.4	215.8
Purchase of goods, services and other expenditure	132.6	71.8	7.8	212.2
Interest cost on government borrowing	36.8	-	-	36.8
Increase in provisions	13.5	0.8	0.9	15.2
Other expenditure	94.6	12.9	1.4	108.9
Total expenditure on public services	622.6	176.1	16.1	814.8
Net expenditure on public services	(28.0)	78.5	3.4	53.9
Financing costs of long-term liabilities, including discounting	141.4	10.0	2.3	153.7
Net loss on revaluations and disposals of assets and liabilities	5.2	(0.5)	0.1	4.8
Net expenditure/(revenue) for the year	118.6	88.0	5.8	212.4
Property, plant and equipment	761.6	367.8	79.0	1,208.4
Other non-current assets	215.6	31.1	151.7	398.4
Current assets	315.5	38.2	53.3	407.0
Total assets	1,292.7	437.1	284.0	2,013.8
Current government borrowings	(275.6)	-	-	(275.6)
Other current liabilities	(164.1)	(29.1)	(604.0)	(797.2)
Non-current government borrowings	(1,071.8)	-	-	(1,071.8)
Provisions non-current	(381.3)	(2.4)	(22.4)	(406.1)
Net public sector pension liability	(1,589.4)	(275.5)	(0.4)	(1,865.3)
Other non-current liabilities	(101.5)	(45.0)	(16.7)	(163.2)

Total liabilities	(3,583.7)	(352.0)	(643.5)	(4,579.2)
Net assets/(liabilities)	(2,291.0)	85.1	(359.5)	(2,565.4)

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 a range of publicly owned companies, many of which provide services to the general public, including the BBC, Channel 4, Bank of England and Scottish Water.

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

Segmental reporting 2016-17

	Central government	Local government	Public corporations (restated)	Whole of Government
	£bn	£bn	£bn	£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	85.7	328.7
Current assets	313.1	38.4	55.2	406.7[a]
Total assets	1,272.2	418.3	212.5	1,903.0
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)

a 2016-17 Other Financial Assets were re-presented to make them consistent with 2017-18 figures. More details can be found in Note 16.

Note 4. Taxation revenue

	2017-18 £bn	% of total	2016-17 £bn	% of total
Income Tax	186.0	28%	173.8	28%
National Insurance Contributions (NIC)	118.4	18%	108.6	17%
Value Added Tax (VAT)	128.6	19%	124.4	20%
Corporation Tax	55.1	8%	52.4	8%
Hydrocarbon oils duty	27.9	4%	28.0	4%
Excise duty	26.7	4%	26.8	4%
Stamp taxes	17.2	3%	15.9	3%
Capital gains tax	7.8	1%	8.4	1%
Other taxes and duties	31.7	5%	30.8	5%
Central government taxation revenue	599.4	90%	569.1	90%
Council Tax	32.1	5%	30.8	5%
National Non-Domestic Rates (NNDR)	30.1	5%	28.2	5%
Local government taxation revenue	62.2	10%	59.0	10%
Total taxation revenue	661.6	100%	628.1	100%

There has been an increase of 5.3% in total tax revenue in 2017-18:

Other taxes include inheritance tax, gambling duties, air passenger duties, climate change and bank levy. It also includes Insurance Premium tax and the apprenticeship levy.

Note 5. Other revenue

	2017-18 £bn	2016-17 £bn
Sale of goods and services	39.9	36.3
Fees, licences, levies and charges	15.0	14.2
Rental income	9.9	10.5
Interest income	8.1	7.4
Net (loss)/profit on sale of assets	(3.6)	(2.1)
EU income	4.1	4.1
Private sector contributions to local services	3.2	2.7

Pension scheme income	2.5	2.6
NHS related income	5.1	3.1
Grants and charitable income	2.7	2.5
Pensions other	0.4	0.5
Recoveries and recharges	0.4	0.5
Miscellaneous operating revenue	11.6	10.4
Total other revenue	99.3	92.7

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

	2017-18 £bn	2016-17 £bn
Services provided by local authorities	18.8	17.9
Public corporations	7.6	7.0
Highways and transport services provided by TfL	4.4	4.5
Central government	6.0	4.0
NHS	2.0	1.8
CRC allowances and EU emissions trading scheme	1.1	1.1
Total sale of goods and services	39.9	36.3

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

	2017-18 £bn	2016-17 £bn
Transport / passenger rail services	1.0	2.6
Visa, immigration and passport	2.1	1.7
Levies	3.1	1.8
Court fines and penalties	0.9	1.0
NHS fees and charges (dental, prescription and other)	1.8	1.9
Other fines and penalties	0.4	0.2
Licence income	1.6	1.7
Other	4.1	3.3
Total fees, licences, levies and charges	15.0	14.2

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.

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.

Pensions other includes transfers in from other schemes.

Note 6. Social security benefits

	2017-18 £bn	% of total	2016-17 £bn	% of total
State pension	96.1	43%	93.8	42%
Pension credit	5.7	3%	6.0	3%
TV licences for the over 75's	0.7	0%	0.6	0%
Pensioner benefits	102.5	46%	100.4	45%
Disability living allowance	10.5	5%	12.5	6%
Attendance allowance	5.5	2%	5.7	3%
Personal independence payment	8.3	4%	5.1	2%
Carer's allowance	3.0	1%	2.8	1%
Disability and carer's benefits	27.3	12%	26.1	12%
Employment and support allowance	15.7	7%	15.6	7%
Jobseeker's allowance	1.8	1%	2.0	1%
Income support	2.3	1%	2.5	1%
Statutory sick pay and maternity pay	2.4	1%	2.2	1%
Other working age benefits	3.2	2%	2.8	1%
Working age benefits	25.4	12%	25.1	11%
Tax credits	30.1	13%	30.5	14%
Child benefit	11.7	5%	11.7	5%
Other benefits administered by HMRC	41.8	18%	42.2	19%
Housing benefit	25.8	11%	27.4	12%
Other benefits	3.1	1%	2.5	1%
Total social security benefits	225.9	100%	223.7	100%

Spending on **Social Security Benefits** totalled £225.9 billion. This was £2.2 billion more than in 2016-17, mainly due to the annual up-rating of benefits and pensions.

The **State Pension** (including the 'new state pension'), at £96.1 billion, is the largest benefit paid, and accounted for almost half of all spending. State Pension expenditure increased by £2.3 billion due to annual uprating in line with the "triple lock" at 2.5%.

Disability and Carer's Benefits totalled £27.3 billion in 2017-18, an increase of £1.2 billion from the previous year. Most of this increase due to the annual up-rating of benefits. Disability Living Allowance for people aged 16-64 has been replaced for new claimants by PIP since April 2013. In October 2013 DWP also started transferring existing DLA claimants (who were aged between 16 and 64 in April 2013) onto Personal Independence Payment.

A total of £25.4 billion was paid in **Working Age Benefits** to people of all ages on low incomes, to protect them from poverty and improve their life chances.

Tax credits of £30.1 billion consists of personal tax credit and corporation tax reliefs. This amount has decreased by £0.4 in 2017-18 billion due to a reduction in personal tax credits.

Housing Benefit spending was £25.8 billion in 2017-18, down £1.6 billion from 2016-17. This is 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 the Department for Work and Pensions.

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.

Note 7. Staff costs

	Permanently employed staff £bn	Others £bn	2017-18 Total £bn	2016-17 Total £bn
Salaries and wages	142.3	10.5	152.8	151.0
Pension scheme costs: current service costs (net of employees' contributions)	60.1	-	60.1	37.5
Pension scheme costs: past service costs	1.3	-	1.3	0.6
Pension scheme costs: losses on settlements and curtailments	(0.4)	-	(0.4)	(0.2)
Expenditure on external pension schemes	2.0	-	2.0	2.2
Total staff costs	205.3	10.5	215.8	191.1

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, services and other expenditure

	2017-18 £bn	2016-17 £bn
Central government	132.6	117.6
Local government	71.8	69.6
Public corporations	7.8	7.6
Total purchases of goods, services and other expenditure	212.2	194.8

The increase in Purchase of goods, services and other expenditure of £17.4 billion is primarily due to a one-off charge of £8.4 billion. For the 2016/17 Academies consolidated account (which feeds into the 2017-18 WGA) an exercise was undertaken to assess whether all land and buildings were controlled by the academies occupying them. This found that £8.4 billion of land and buildings should not be recognised. Derecognising these has led to a one-off charge. Further details can be found in Note 2 of the Academies Sector Annual Report

Further information on overall expenditure on public services can be found in the performance analysis in Chapter 1.

Note 9. Grants and subsidies

	2017-18 £bn	2016-17 £bn
Further and higher education sector	19.3	19.8
Contribution to the EU budget	12.2	12.2
EU grants and subsidies to the private sector	3.1	3.0
Overseas assistance and contributions	8.2	8.2
Cultural, heritage and sport	2.4	2.3
Transport	1.2	0.8
Scottish Government private sector grants	1.9	2.6
Welsh grants	1.5	1.4
Other grants and subsidies	1.4	3.3
Total grants and subsidies	51.2	53.6

Further and higher education grants are paid to colleges and universities, and includes the funding for Science and Research.

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

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, maritime and fisheries, and funding by region. 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.

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. This is being delivered through the Home Building Fund, the affordable Housing Guarantee Scheme, 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	2017-18 £bn	2016-17 £bn
Depreciation of property, plant and equipment	12	29.8	29.0
Amortisation of intangible assets	14	3.3	3.5
Impairments and revaluations		24.6	14.6
Total depreciation and impairment		57.7	47.1

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

Note 11. Finance expense

	2017-18 £bn	2016-17 £bn
Interest on gilts	33.9	29.0
National Savings and Investment products	2.5	2.3
Treasury bills	0.4	0.4
Bank deposits and other	-	0.1
Total interest costs on government borrowing	36.8	31.8

Interest costs on government borrowing increased overall by £5.0 billion (2016-17: £3.5 billion increase).

	Note	2017-18 £bn	2016-17 £bn
Pension financing costs	24	50.7	50.5
Provision financing costs	22	93.4	9.3
Other finance expense		9.6	8.5
Total financing costs of long-term liabilities		153.7	68.3

Financing costs of long term liabilities increased overall by £85.4 billion due to changes in the discount rate which has significantly increased the cost of provisions across a number of government departments. Discount rates are used to estimate long-term liabilities at current values and do not reflect the amount to be paid out at a future date. Provisions are analysed further in Note 22.

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Note 12. Property, plant and equipment

Property, plant and equipment 2017-18

	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 2017	798.6	469.1	63.1	75.7	111.3	1,517.8
Additions	5.4	11.9	33.3	0.5	4.7	55.8
Revaluations and impairments	15.3	0.4	(2.6)	0.6	0.4	14.1
Reclassifications and transfers	8.7	10.2	(28.3)	5.4	2.6	(1.4)
Disposals	(0.7)	(9.2)	(0.3)	(3.1)	(3.9)	(17.2)
At 31 March 2018	827.3	482.4	65.2	79.1	115.1	1,569.1
Depreciation:						
At 1 April 2017	(203.0)	(49.5)	-	(42.6)	(55.1)	(350.2)
Charged in year	(10.0)	(10.6)	-	(2.9)	(6.3)	(29.8)
Revaluations and impairments	2.0	4.5	-	0.2	0.5	7.2
Reclassifications and transfers	-	1.2	-	0.9	0.3	2.4
Disposals	0.3	3.2	-	3.0	3.2	9.7
At 31 March 2018	(210.7)	(51.2)	-	(41.4)	(57.4)	(360.7)
Carrying amount at 31 March 2017	595.6	419.6	63.1	33.1	56.2	1,167.6
Carrying amount at 31 March 2018	616.6	431.2	65.2	37.7	57.7	1,208.4
Asset financing:						
Owned	609.2	387.9	64.0	37.7	52.6	1,151.4
Finance leased	-	10.5	-	-	1.2	11.7
On balance sheet PFI contracts	7.4	32.8	1.2	-	3.9	45.3
Carrying amount at 31 March 2018	616.6	431.2	65.2	37.7	57.7	1,208.4

Infrastructure assets include the following:

- railway network as reported by the Department for Transport and managed by Network Rail of £300.6 billion (2016-17: £288.9 billion)
- strategic road network assets as reported by the Department of Transport and managed by Highways England of £116.1 billion (2016-17: £114.2 billion)
- highways network assets held by local authorities of £70.4 billion (2016-17: £68.1 billion)
- networked assets held by Scottish Water of £59.2 billion (2016-17: £56.3 billion)

The value of infrastructure assets has increased by £21.0 billion during 2017-18 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 Note 2.

Land and buildings increased by £11.6 billion overall. The most significant increase related to land and buildings held by the Department of Health and Social Care, amounting to £1.4 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 £28.3 billion outflow from assets under construction, £7.5 billion relates to the Ministry of Defence. The main element of this is £5.7 billion for military equipment. Other large reclassifications and transfers under assets under construction include £7.1 billion for the Department for Transport, relating to the completion of infrastructure.

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 2017	18.3	15.5	5.1	17.3	56.2
Carrying amount at 31 March 2018	18.6	15.6	5.1	18.4	57.7

Property, plant and equipment 2016-17

	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 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

Note 13. Investment properties

	2017-18 £bn	2016-17 £bn
As at 1 April	18.2	15.8
Additions	2.7	2.3
Revaluations and impairments	(0.6)	0.4
Disposals	(0.3)	(0.3)
As at 31 March	20.0	18.2

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. Of the £20.0 billion total balance, £18.7 billion sits within the local government sector.

Note 14. Intangible assets

Intangible assets 2017-18

	Military equipment £bn	Development expenditure £bn	Software £bn	Licences and other £bn	Total £bn
Cost or valuation:					
At 1 April 2017	35.3	11.3	8.5	9.8	64.9
Additions	1.9	0.8	0.3	1.2	4.2
Revaluations and impairments	0.4	0.2	0.1	-	0.7
Reclassifications	0.1	(0.3)	0.6	0.1	0.5
Disposals	(0.3)	(0.3)	(0.7)	(0.5)	(1.8)
At 31 March 2018	37.4	11.7	8.8	10.6	68.5
Amortisation:					
At 1 April 2017	(12.5)	(5.3)	(6.0)	(6.6)	(30.4)
Charged in year	(1.0)	(0.5)	(0.8)	(1.0)	(3.3)
Revaluations and impairments	(0.2)	(0.1)	(0.1)	-	(0.4)
Reclassifications	-	-	-	(0.1)	(0.1)
Disposals	0.2	0.3	0.7	0.5	1.7
At 31 March 2018	(13.5)	(5.6)	(6.2)	(7.2)	(32.5)
Carrying amount at 31 March 2017	22.8	6.0	2.5	3.2	34.5
Carrying amount at 31 March 2018	23.9	6.1	2.6	3.4	36.0

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 2017-18 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 2017-18 amounted to £5.4 billion (2016-17: £5.3 billion). More information on intangible assets is provided in Chapter 1.

Intangible assets 2016-17

	Military equipment	Development expenditure	Software	Licences and other	Total
	£bn	£bn	£bn	£bn	£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)	-	(0.6)
Reclassifications	-	-	(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

Note 15. Trade and other receivables

	2017-18 £bn	2016-17 £bn
Non-current:		
Taxation and duties due	5.0	5.2
Trade receivables	1.7	0.9
Other receivables	11.8	9.4
Prepayments and accrued revenue	1.7	1.1
Welfare overpayments	2.0	2.0
Total before impairment	22.2	18.6
Less: provision for impairment of receivables	(3.1)	(3.4)
Total non-current trade and other receivables	19.1	15.2
Current:		
Accrued tax revenue receivable	111.6	99.6
Taxation and duties receivable	29.4	28.0
Trade receivables	10.5	9.7
Other receivables	12.8	24.3
Prepayments and accrued revenue	11.9	10.9
Welfare overpayments	0.4	0.4
Court fines	3.0	2.7
Total before impairment	179.6	175.6
Less: provision for impairment of receivables	(18.8)	(17.6)
Total current trade and other receivables	160.8	158.0
Total trade and other receivables	179.9	173.2

Accrued tax revenue receivable represents amounts of taxes and duties relating to 2017-18 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 2017-18.

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 by HMRC

The provision for impairment of receivables is analysed below:

	Non-current £bn	Current £bn	2017-18 £bn	2016-17 £bn
Taxation and duties due	2.1	8.9	11.0	10.8
Welfare payments	0.8	0.2	1.0	1.2
Court fines	-	2.3	2.3	2.1
Other trade and other receivables	0.2	7.4	7.6	6.9
Total provision for impairment of receivables	3.1	18.8	21.9	21.1

Note 16. Other financial assets

	2017-18 £bn	2016-17 (restated) £bn
Non-current:		
Loans and deposits	153.2	87.4
Student loans	67.4	66.7
Equity investments	53.8	52.7
IMF quota subscription	20.8	22.0
Derivatives and other financial assets	28.1	32.0
Total non-current other financial assets	323.3	260.8
Current:		
Debt securities	101.9	104.2
Loans and deposits	53.2	64.6
Student loans	2.6	2.7
Equity investments	1.0	1.1
IMF Special Drawing Rights	9.9	9.0
Derivatives and other financial assets	15.7	16.5
Total current other financial assets	184.3	198.1
Total other financial assets	507.6	458.9

Loans and deposits increased by £54.4 billion (2016-17: £42.2 billion). This is due to an increase of £72.0 billion due to the Term Funding Scheme at (TFS) at the Bank of England; these are cash loans secured against central bank reserves. More detail on this scheme can be found in the 2017-18 accounts of the Bank of England Asset Purchase Facility Fund Limited. The total balance of TFS loans in WGA was £127.1 billion as at 31 March 2018 (£55.1 billion for 2016-17). 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 2017-18 accounts of the Bank of England Asset Purchase Facility Fund Limited[8] . In the prior year WGA these were disclosed as current loans. However, for 2017-18 these have been reclassified as non-current loans. The prior year figure of £55.1 billion has been restated to reclassify the Term Funding Scheme loans from current to non-current loans and deposits.

This increase was partly offset by a reduction of £5.4 billion, made up of Bradford and Bingley loans moved to Assets Held For Sale.

Loans and deposits comprises:

	Non-current £bn	Current £bn	2017-18 £bn	2016-17 £bn
Loans	149.2	2.4	151.6	86.5
Deposits	4.0	9.1	13.1	14.7
Repurchase agreements	-	41.7	41.7	50.8
Total loans and deposits	153.2	53.2	206.4	152.0

Loans include £11.5 billion (2016-17: £19.5 billion) of mortgage loans by UKAR:

	2017-18 £bn	2016-17 £bn
Residential mortgages	11.0	18.9
Commercial loans	0.2	0.3
Unsecured loans	0.3	0.3
Total mortgage loans	11.5	19.5

Deposits include those made by local government at banks of £11.5 billion (2016-17: £12.8 billion).

Repurchase agreements decreased by 18% (2016-17: 16%). These agreements are funds advanced to banks under reverse repurchase agreements, where securities are held as collateral and returned when the funds are repaid. Further details are available in the 2017-18 Exchange Equalisation Account, Debt Management Account, and Bank of England Account. Repurchase agreements are a form of short term borrowing, where an asset is sold and then agreed to be bought back in the future. A reverse repurchase agreement is the opposite, where an asset is purchased, and an agreement is made to sell it back in the future.

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 age of the loan. More information

[8] https://www.bankofengland.co.uk/-/media/boe/files/asset-purchase-facility/2018/annual-report-2018.pdf?la=en&hash=F5EBCF137CF0DE1EA7EAAB26192F5038E7AA87CA

on the valuation of student loans can be found in paragraph 2.4 of the Accounting policies note.

The value of student loans assets has increased year on year, largely as a result of new loans and interest being higher than repayments and the movement is analysed below:

	2017-18 £bn	2016-17 £bn
As at 1 April	69.4	64.4
New loans issued (net of impairment)	3.2	5.6
Interest	2.7	2.0
Repayments	(2.6)	(2.6)
Effect of change in discount rate	-	-
Impairment adjustments	(2.7)	-
As at 31 March	70.0	69.4

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

	2017-18 £bn	2016-17 £bn
RBS	21.8	20.4
Lloyds Banking Group	-	0.9
European Investment Bank	9.7	9.1
Other	23.3	23.4
Total equity investments	54.8	53.8

The value of RBS ordinary shares increased by £1.4 billion (2016-17: £1.6 billion) due to market gains. HM Treasury sold its remaining Lloyds Banking Group ordinary shares, fully returning Lloyds Bank to the private sector. Further details regarding these equity investments can be found in the 2017-18 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 2017-18 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 £20.8 billion at 31 March 2018, a decrease of £1.2 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's decrease in debt securities of £2.3 billion during the year is primarily due to exchange rate losses as most reserve currencies decrease in value against sterling.

Note 17. Inventories

	Raw materials and consumables £bn	Other £bn	2017-18 Total £bn	2016-17 Total £bn
As at 1 April	6.4	2.8	9.2	9.6
Additions	10.3	4.8	15.1	12.2
Disposals	(10.6)	(3.8)	(14.4)	(12.2)
Write-offs	(0.2)	-	(0.2)	(0.6)
Revaluation and reclassification	0.2	-	0.2	0.2
As at 31 March	6.1	3.8	9.9	9.2

Raw materials and consumables includes £4.3 billion (2016-17 £4.6 billion) of supplies and spares for immediate and potential use by the Ministry of Defence.

Inventories are disclosed as a current asset. However, of this balance £0.4 billion relates to High Speed 2 land and property, which is considered a non-current asset.

Note 18. Cash and cash equivalents

	2017-18 £bn	2016-17 £bn
Balance at 1 April	28.3	25.8
Net change in cash and cash equivalent balances	6.0	2.5
Balance at 31 March	34.3	28.3
The following balances at 31 March were held at:		
Government Banking Service	(3.8)	(3.2)
Commercial banks and cash in hand	18.5	14.9
Short term investments	19.6	16.6
Balance at 31 March	34.3	28.3

Cash and Cash Equivalents increased by £6.0 billion (21%).

Of this, £3.0 billion relates to an increase in Cash held in Commercial Banks by the Exchange Equalisation Account (EEA). The EEA is an account that holds the UK's reserves of gold, foreign currencies and IMF Special Drawing Rights (please see note 21 for more detail on these).

A further £3.0 billion relates to increased Short-Term Investments held by Transport for London, the National Loans Fund and the Bank of England.

Cash held at the government banking service totals negative £3.8 billion. This is made up of positive balances held by government departments as part of the Government Banking Scheme, offset by a negative £23.6 billion which is held by the National Loans Fund. The overall balance is negative due to the way that government undertakes cash management.

Note 19. Trade and other payables

	2017-18 £bn	2016-17 £bn
Non-current:		
Trade and other payables	9.8	9.5
Accruals and deferred income	12.7	11.3
Imputed finance lease element of on-balance sheet PFI contracts	37.4	37.7
Obligations under finance leases	4.5	4.6
Total current trade and other payables	64.4	63.1
Current:		
Trade and other payables	42.4	41.4
Accruals and deferred income	49.2	47.5
Refunds of taxation and duties payable	33.3	31.7
Imputed finance lease element of on-balance sheet PFI contracts	1.6	1.6
Obligations under finance leases	0.3	0.3
Total non-current trade and other payables	126.8	122.5
Total trade and other payables	191.2	185.6

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

	2017-18 £bn	2016-17 £bn
Non-current:		
Gilts	1,071.8	1,013.5
Total non-current government borrowings	1,071.8	1,013.5
Current:		
National Savings and Investment products (NS&I)	156.7	146.9
Treasury bills	68.7	69.6
Gilts	50.2	59.0
Total current government borrowings	275.6	275.5
Total government borrowings	1,347.4	1,289.0

The Government borrows to make up the shortfall between income and expenditure (including any capital expenditure). The National Accounts show a clearer picture of government borrowing used for the financing of deficits, and more detail on this can be found in chapter 1.

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 National Savings & Investments (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 2017-18 accounts, can be found on the NS&I website.[9]

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 2017-18, HM Treasury, March 2017.[10]

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

9 http://nsandi-corporate.com/about-nsi/our-performance/our-annual-report-and-accounts/

10 https://www.gov.uk/government/publications/debt-management-report-2017-to-2018

above, with the exception of gilts held by funded public sector pension schemes. Further details regarding gilts are available in the 2017-18 Debt management report[11] and the 2017-18 accounts of the National Loans Fund.[12]

Note 21. Other financial liabilities

	2017-18 £bn	2016-17 £bn
Non-current:		
Deposits by banks	2.3	3.8
Bank and other borrowings	67.2	68.4
Debt securities	4.5	5.0
Derivatives	24.1	29.4
Financial Guarantees	0.2	0.3
Other financial liabilities	0.5	0.4
Total non-current other financial liabilities	98.8	107.3
Current:		
Deposits by banks	555.8	481.2
Banknotes in circulation	73.3	73.2
Bank and other borrowings	8.3	9.4
IMF Special Drawing Rights liability	10.5	11.0
Debt securities	1.1	1.4
Derivatives	5.0	8.7
Financial Guarantees	-	-
Total current other financial liabilities	654.0	584.9
Total other financial liabilities	752.8	692.2

Deposits by banks mainly consist of deposits held by the Bank of England. The increase of £74.6 billion in current deposits relates to reserves held for banks and building societies, that are repayable on demand, and are the means by which banks and building societies settle transactions.

[11] https://www.gov.uk/government/publications/debt-management-report-2017-to-2018

[12] https://www.gov.uk/government/publications/national-loans-fund-account-2017-to-2018

Banknotes are issued by the Bank of England. In previous years there has been an increasing year on year demand for banknotes. In 2017-18 this trend has stopped and the amount of notes in circulation has remained flat.

Bank and other borrowings reflects loans and overdrafts. One of the largest elements in this category is the £23.7 billion (2016-17: £25.8 billion) of Network Rail long term debt; as reported by the Department for Transport.

The **International Monetary Fund (IMF) Special Drawing Rights (SDRs)** liability has decreased in 2017-18 to £10.5 billion (2016-17: £11.0 billion). This relates to the UK's participation in the Special Drawing Rights Agreement. A corresponding asset of £9.9 billion for the UK's actual holdings of SDRs is included in Note 16.

Derivatives include the £15.8 billion (2016-17: £12.3 billion) liability held by the Department for Business, Energy and Industrial Strategy (BEIS) relating to contracts for difference (CfDs). Contracts for difference are a mechanism used to support investment in UK low carbon energy generation projects. CfDs have been classified as derivatives in accordance with IAS 39 'Financial Instruments: Recognition and Measurement'. For more details see Note 9 of the 2017-18 BEIS accounts.

Other derivatives relate to the Pension Protection Fund of £6.1 billion (2016-17: £14.5 billion) which are mainly interest rate swaps, options, credit default swaps and forward foreign exchange contracts to support liability-driven investment. The liability has reduced by £8.4 billion during 2017-18 due to a decline in the number of positions held.

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.

Note 22. Provisions for liabilities and charges

Provision for liabilities and charges

	Nuclear decommissioning £bn	Clinical negligence £bn	Other provisions £bn	2017-18 Total £bn	2016-17 Total £bn
At 1 April	184.9	66.6	70.7	322.2	305.5
Provisions utilised in year	(3.0)	(2.4)	(4.7)	(10.1)	(12.1)
Increase in expected future pay-outs	6.8	2.5	18.6	27.9	26.6
Change in discount rate	76.4	15.6	2.0	94.0	10.6
Discount rate unwind	(1.3)	0.5	0.2	(0.6)	(1.3)
Provisions not required written back	(0.4)	(3.8)	(5.0)	(9.2)	(6.4)
Transfers to payables	-	(0.6)	(1.1)	(1.7)	(0.7)
At 31 March	263.4	78.4	80.7	422.5	322.2

Provision movement

	2017-18 £bn	2016-17 £bn
Amounts included in the Statement of Revenue and Expenditure:		
Increase in provisions	15.2	18.6
Provision expense in cost to public services	15.2	18.6
Discount rate changes	94.0	10.6
Discount rate unwind	(0.6)	(1.3)
Provision financing costs	93.4	9.3
Total expenditure recognised in the Statement of Revenue and Expenditure	108.6	27.9
Amounts included in the Statement of Financial Position	1.8	1.2
Provisions utilised in year	(10.1)	(12.1)
Total provision movement	100.3	17.0

Provision profile

	Nuclear decommissioning £bn	Clinical negligence £bn	Other provisions £bn	2017-18 Total £bn	2016-17 Total £bn
Within one year	3.4	3.3	9.7	16.4	15.6
Between one and five years	13.3	14.0	21.8	49.1	50.4
Thereafter	246.7	61.1	49.2	357.0	256.2
Total provision liability	263.4	78.4	80.7	422.5	322.2
Current provisions	3.4	3.3	9.7	16.4	15.6
Non-current provisions	260.0	75.1	71.0	406.1	306.6

The total provision liability has increased by £100.3 billion as at 31 March 2018. Of this, £94.0 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 £78.5 billion in 2017-18, £76.4 billion of which is 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 2018 was £5.3 billion (2016-17: £4.9 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 £9.3 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 report of the Comptroller & Auditor General. Further

details are available in the 2017-18 accounts of the Nuclear Decommissioning Authority.

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 2018. 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 £11.8 billion in 2017-18. The increase in the provision due to changes in discount rate was £15.6 billion NHS Resolution manage claims against the NHS in England and they recorded a 0.1% decrease in the number of new clinical claims reported compared to the prior year, with 10,673 new claims in 2017-18 (2016-17: 10,686 claims).

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

Other provisions include 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:

- £23.2 billion (2016-17: £22.7 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 2018, it had £30 billion of assets under management, £6.7 billion in excess of its liabilities
- £7.6 billion (2016-17: £7.3 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
- £12.9 billion (2016-17: £6.4 billion) held by HMRC relating to the repayment of tax receipts resulting from oil and gas field decommissioning, to be paid over the period 2017-18 to 2045-46. The increase in the provision of £6.5 billion is largely explained by a new provision of £6.7 billion identified for tax repayments by HMRC to companies incurring losses from decommissioning expenditure.
- £5.9 billion (2016-17: £7.8 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 2017-18

	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	2017-18 Total
		£bn	£bn	£bn	£bn	£bn	£bn	£bn
Cash and cash equivalents	18	34.3	-	-	-	-	-	34.3
Trade and other receivables	15	-	179.9	-	-	-	-	179.9
Debt securities	16	-	-	-	-	-	101.9	101.9
Loans and deposits	16	-	62.7	2.1	-	-	141.6	206.4
Student loans	16	-	70.0	-	-	-	-	70.0
Equity investments	16	-	-	0.1	45.0	9.1	0.6	54.8
IMF quota subscription	16	-	20.8	-	-	-	-	20.8
IMF Special Drawing Rights	16	-	-	-	-	-	9.9	9.9
Other	16	-	-	4.1	14.3	0.3	25.1	43.8
Total financial assets		34.3	333.4	6.3	59.3	9.4	279.1	721.8

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	11.0	56.0	9.8	203.7	660.4

Financial liabilities by category 2017-18

	Note	Carried at amortised cost	Designated at fair value	Held for trading at fair value	2017-18 Total
		£bn	£bn	£bn	£bn
Trade and other payables	19	191.2	-	-	191.2
Government borrowings	20	1,347.4	-	-	1,347.4
Deposits by banks	21	524.1	2.1	31.9	558.1
Banknotes in circulation	21	73.3	-	-	73.3
Bank and other borrowings	21	75.5	-	-	75.5
Derivatives	21	-	18.2	10.9	29.1
Debt securities	21	-	5.6	-	5.6
IMF Special Drawing Rights liability	21	-	-	10.5	10.5
Financial Guarantees	21	0.2	-	-	0.2
Other	21	0.5	-	-	0.5
Total financial liabilities		2,212.2	25.9	53.3	2,291.4

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

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 in the form of gilt -edged securities and the Contracts for Difference (CfD) liability (included in derivatives in the table above). Gilt-edged securities have a carrying amount of £1,122.0 billion (2016-17: £1,072.5 billion) and a fair value of £1,427.1 billion (2016-17: £1,398.6 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 £15.9 billion (2016-17: £12.3 billion) and a fair value of £39.2 billion (2016-17: £31.4 billion). The difference between the carrying value and the fair value of the on balance sheet CFDs due to the measurement difference relating to day one recognition.

The transaction price for CfDs differ from the fair value at initial recognition measured using a valuation model, mainly because the transaction price is not established in an active market. If there are significant unobservable inputs used in the valuation technique (level 3), the financial instrument is recognised at the transaction price, and any difference between the transaction price and fair value at initial recognition measured using a valuation model is deferred. The most significant components of the increase in fair value of £7.8 billion are the inclusion of separate capture prices for wind and solar technologies, adding £1.6 billion to the liability, and inflation adjustments using the Consumer Price Index adding a further £1.7 billion to the liability.

Both the carrying value and fair value of the CfD liability on the balance sheet exclude the liability for Hinkley Point C. The government entered into the Hinkley Point Contract for Difference on 29 September 2016. The fair value of the CfD liability is valued at £36.6 billion (2016-17: £28.8 billion). This valuation required an estimate of wholesale electricity prices to 2060, but 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 Department for Business, Energy and Industrial Strategy (BEIS) annual report and accounts[13], and in Note 2 of WGA.

The government also has gold holdings which are treated as being similar to a financial asset and are reported at fair value based on the sterling equivalent of the dollar denominated spot bid price as at 31 March 2018. During 2017-18 the price of gold fell from £996 to £943 per ounce, a decrease of 5%, giving rise to a revaluation loss of £0.5 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

13 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725808/BEIS_Web_accessible_Annual_Report_and_Accounts_2017_18.pdf

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.

Fair value hierarchy 2017-18

	Level 1 £bn	Level 2 £bn	Level 3 £bn	2017-18 Total £bn
Financial assets at fair value:				
Debt securities	91.2	8.1	2.6	101.9
Equity investments	31.5	0.6	22.7	54.8
IMF Special Drawing Rights	9.9	-	-	9.9
Loans and deposits	-	141.5	0.1	141.6
Other	3.6	30.6	5.6	39.8
Financial liabilities at fair value:				
Deposits by banks	(1.1)	(32.9)	-	(34.0)
IMF SDR allocation	(10.5)	-	-	(10.5)
Other	(5.8)	(13.0)	(15.9)	(34.7)

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)

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 BEIS. 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.[14]

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 2017-18 is summarised below:

[14] https://www.gov.uk/government/publications/consolidated-fund-account-2017-to-2018

	Short conventional (0-7 years)	Medium conventional (7-15 years)	Long conventional (over 15 years)	Index linked	Unallocated
2017-18 debt issuance %	25	21	29	25	0

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 2017-18 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 2018:

- £22.4 billion (2016-17: £32.2 billion) of secured lending under reverse sale and repurchase agreements and recognised as loans and deposits
- £14.7 billion (2016-17: £17.8 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 2017-18 Debt Management Account (DMA).[15]

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

[15] https://www.gov.uk/government/publications/uk-debt-management-office-annual-report-and-accounts-2017-to-2018

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 the government's borrowing costs by £1.2 billion (2016-17: £0.5 billion) and if RPI were to increase by 100 basis points then the government's borrowing costs would rise by £4.5 billion (2016-17: £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 decrease Network Rail's borrowing costs by £0.3 billion (2016-17: £0.7 billion increase) and if the RPI were to increase by 100 basis points, then Network Rail's borrowing costs would increase by £0.2 billion (2016-17: £0.2 billion increase).

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 2.6% (2016-17: 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 4.0% (2016-17: 4.2%) decrease in RPI to increase the value of the loan book by 1%, and a 3.7% increase in RPI to decrease the value of loan book by 1%.

Counterparty risk

The categories where the main counterparty risk is found are: debt securities (£101.9 billion), loans and deposits (£206.4 billion), student loans (£70.0 billion) and IMF balances (£30.7 billion).

The majority of **debt securities** (£73.6 billion, 2016-17: £76.8 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 Exchange Equalisation Account debt securities are held at an

equivalent external rating of AA and above (£68.9 billion, 2016-17: £74.5 billion restated) and A to AA (£4.6 billion, 2016-17: £2.3 billion restated) and were held within Europe (£30.5 billion, 2016-17: £34.5 billion), North America (£38.5 billion, 2016-17: £40.0 billion), and Asia-Pacific (£4.5 billion, 2016-17: £2.3 billion). Further details on the government's credit risk management of foreign currency reserves can be found in the 2017-18 Exchange Equalisation Account.

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 National Loans Fund 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 2018, on an amortised cost basis, £39.2 billion (2016-17: £75.1 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 and the Bank of England.[16]

Loans and deposits mainly comprise loans designed to provide 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.[17]

As well as this, loans and deposits also includes mortgages made by UKAR (£11.5 billion, 2016-17: £19.4 billion) which are not rated, and reverse sale and repurchase agreements (£41.7 billion, 2016-17: £50.8 billion). £127.1 billion (2016-17: £55.1 billion) of the loan balance is made up of TFS loans made by the bank of England Asset Purchase Facility Fund.

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	2017-18 Provision £bn	Balance sheet value £bn	2016-17 Provision £bn
Loans secured on residential property	11.0	0.3	18.8	0.6
Other secured loans	0.2	-	0.3	0.1
Unsecured personal loans	0.3	0.1	0.3	0.1

16 https://www.gov.uk/government/publications/national-loans-fund-account-2017-to-2018

17 https://www.bankofengland.co.uk/asset-purchase-facility/2018/2017-18

Total UKAR loans	11.5	0.4	19.4	0.8

For more details on disclosures relating to UKAR, please refer to the accounts of HM Treasury[18]. The balance on residential mortgages decreased by £7 billion due to the transfer of £5.4 billion of UKAR's Bradford and Bingley mortgage assets to "Assets Held for Sale", with the balance of the movement consisting of mortgage redemptions and repayments.

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 Bank of England accounts, the DMA and the EEA.

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.

The total balance sheet value of student loans provided by government, including those via the devolved administrations, is £70.0 billion (2016-17: £69.3 billion). The Department for Education, representing English students, holds £61.1 billion (2016-17: £61.4 billion). The face value of the Department for Education's loan book was £101.9 billion (2016-17: £88.8 billion). In December 2017, the government completed the sale of part of the Department for Education's pre-2012 English student loan book. The balance sheet value of the loans sold was £2.6 billion under the existing amortised cost approach, leading to a loss on disposal of £0.9 billion. The impact of credit risk and policy decisions on repayment conditions on all Department for Education student loans are shown by the following table of allowances for mark-downs of impaired assets:

[18] https://www.gov.uk/government/publications/hm-treasury-annual-report-and-accounts-2017-to-2018

	Balance sheet value £bn	2017-18 Provision £bn	Balance sheet value £bn	2016-17 Provision £bn
Pre-2012 higher education loans	26.4	12.4	29.7	13.1
Post 2012 higher education loans	34.7	28.4	31.6	14.4
Total student loans held by Department for Education	61.1	40.8	61.3	27.5

The table above shows that the overall level of impairment increased in 2017-18. This is in part due to the repayment threshold for post 2012 loans being set at £25,000 from April 2018. This means that earnings will need to be higher before loans are repaid, which reduces the amount of repayments. The pre-2012 repayment threshold is set at £17,775. The student loan models use 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 (£20.8 billion, 2016-17: £22.0 billion) and IMF SDRs (£9.9 billion, 2017-18: £9.0 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 (£10.6 billion, 2016-17: £17.5 billion). Of the derivative balance the largest individual material balances are with the Pension Protection Fund (PPF) (£6.1 billion, 2016-17: £14.5 billion), and EEA (£3.0 billion, 2016-17: £2.1 billion). The PPF manage the credit 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 account and EEA.

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. [19] The Bank of England monitors and controls market risk primarily by using a Value at Risk (VaR) model. This estimates a loss level that will not be exceeded at a specified confidence level, over a defined period of time, so that losses will not exceed the VaR figure in 99 out of 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 2018	$ Millions 2017
Hedged reserves		
VaR as at 31 March	107	109
Unhedged Reserves		
VaR as at 31 March	2,685	2,246

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 £9.7 billion (2016-17: £9.1 billion) as based on the UK's share of the EIB's net assets in euros. Therefore, the

[19] 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 shareholding in Royal Bank of Scotland (RBS). 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 in an orderly and active way, within the context of protecting and creating value for the taxpayer.UK Financial Investments ceased to exist as an operating entity on 1 April 2018, for future years, its functions will be carried out by UK Government Investments.

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 2016-17 and 2017-18.

	Scheme liabilities £bn	Scheme assets £bn	2017-18 Net liabilities £bn	2016-17 Net liabilities £bn	Change in scheme liabilities %
Unfunded schemes					
NHS	612.6	-	612.6	591.8	3.5
Teachers	412.9	-	412.9	398.3	3.7
Civil Service	260.9	-	260.9	257.0	1.5
Armed Forces	195.5	-	195.5	191.8	1.9
Police	161.7	-	161.7	157.5	2.7
Royal Mail	46.4	-	46.4	46.8	(0.9)
Fire	29.2	-	29.2	31.0	(5.8)
Other unfunded	22.6	-	22.6	22.8	(0.9)
	1,741.8	-	1,741.8	1,697.0	2.6
Funded schemes					
Local government	359.6	(253.6)	106.0	117.7	(9.9)
Other funded	94.6	(77.1)	17.5	20.0	(12.5)
	454.2	(330.7)	123.5	137.7	(10.3)
Total	2,196.0	(330.7)	1,865.3	1,834.7	1.7

The Local Government Pensions Scheme (LGPS) is the largest funded scheme. The LGPS (England and Wales) consists of 89 separately administered funds, with the LGPS (Scotland) having more than 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) £8.0 billion (2016-17: £8.3 billion); and the Research Councils (RCPS) £5.3 billion (2016-17: £5.2 billion).

Other funded schemes comprise largely of balances reported by Academy schools in the Local Government Pension Scheme £7.0 billion (2016-17: £7.4 billion); Department for Transport - including Network Rail £4.3 billion (2016-17: £4.7 billion); Ministry of Justice £1.6 billion (2016-17: £1.7 billion); and BBC £0.5 billion (2016-17: £1.1 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 actuarial valuations for a majority of the unfunded pension schemes were carried out as at 31 March 2016, which set the employer contribution rates for a 4 year period from 1 April 2019.

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 2017	1,697.0	456.9	2,153.9
Current service costs (net of participants' contribution)	46.5	13.7	60.2
Past service costs	1.2	0.1	1.3
Settlements/curtailments	(0.2)	(0.7)	(0.9)
Interest on scheme liabilities	47.3	11.6	58.9
Contribution by scheme participants	9.3	2.1	11.4
(Gains)/Losses on revaluation:			
Experience (gains) and losses arising on liabilities	5.6	(2.7)	2.9
Changes in assumptions underlying the value of liabilities	(24.2)	(13.2)	(37.4)
Benefits paid	(41.3)	(12.1)	(53.4)
Transfers in/(out)	0.6	(1.5)	(0.9)
Gross liability at 31 March 2018	1,741.8	454.2	2,196.0

Overall, the net public sector pension liability increased by £30.6 billion during the year. This is broken down as follows:

	2017-18 £bn	2016-17 £bn
Net liability at 1 April	1,834.7	1,424.7
Net (gains)/losses on revaluation	(38.6)	361.4
Current service costs (net of participants' contributions)	60.1	37.5
Net interest costs	50.6	50.5
Unfunded schemes benefits paid	(41.3)	(40.3)
Past service costs	1.3	0.6
Net settlements/curtailments	(0.3)	(0.2)
Contribution by unfunded scheme participants	9.3	9.1
Contribution by funded scheme employers	(10.3)	(8.6)
Net transfers in/(out)	(0.2)	-
Net liability at 31 March	1,865.3	1,834.7

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 reduces the liability but last year increased 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 unfunded schemes 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 0.24% in 31 March 2017 to 0.1% in 31 March 2018. The decrease in discount rate increases the present value of liabilities. This actuarial loss from the discount rate is recognised in other comprehensive income rather than against net expenditure. The increase in liability from the change in discount rate was more than offset by other changes in other assumptions, leading to a revaluation gain that reduced the liability.

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	(12%)	(209)
Rate of increase in pensions	8%	139
Rate of increase in Salaries	2%	35
Increasing assumed life expectancy in retirement by 1 year	3%	52

The **current service cost** is an estimate made by scheme actuaries of the benefit earned by employees in the year.

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	Other funded	2017-18 Total	2016-17 Total
	£bn	£bn	£bn	£bn
Equity investments	155.1	30.3	185.4	185.5
Bonds	39.6	22.9	62.5	57.4
Other	58.9	23.9	82.8	76.3
Total market value	253.6	77.1	330.7	319.2

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.

	2017-18 £bn
Gross assets at 1 April	319.2
Interest on scheme assets	8.2
Actual return less interest on scheme assets	4.1
Contributions by employers	10.3
Contributions by scheme participants	2.2
Benefits paid	(12.1)
Assets distributed on settlements	(0.2)
Transfers in/out	(1.0)
Gross assets at 31 March	330.7

	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	Funded (net)	2017-18 Total	2016-17 Total
	£bn	£bn	£bn	£bn
Current service cost	46.4	13.7	60.1	37.5
Past service cost	1.2	0.1	1.3	0.6
Settlements/curtailments	(0.1)	(0.3)	(0.4)	(0.2)
Net financing cost	47.3	3.4	50.7	50.5
Total recognised in the Statement of Revenue and Expenditure	94.8	16.9	111.7	88.4

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

	2017-18	2016-17
	£bn	£bn
Actual return less expected return on scheme assets	(4.1)	(43.9)
Experience gains and losses arising on liabilities	2.9	(19.4)
Changes in assumptions underlying the value of liabilities	(37.4)	424.7
(Gain)/loss on revaluation of (net) liabilities	(38.6)	361.4

The actual return on the assets was significantly higher than the interest on the assets over the year 2017-18 (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 £54.2 billion (2016-17 £53.0 billion).

The most significant capital commitments included those reported by the Ministry of Defence of £22.1 billion (2016-17: £21.1 billion), Department of Transport of £5.7 billion (2016-17: £5.1 billion), Scottish Government of £3.4 billion (2016-17: £2.3 billion) and Department for Education and Academies of £3.3 billion (2016-17: £3.2 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.

	2017-18 £bn	2016-17 £bn
Obligations under operating leases comprised:		
Total payments within one year	2.7	2.3
Total payments between one and five years	7.1	6.0
Total payments thereafter	11.2	9.7
Total future minimum lease payments under operating leases	21.0	18.0

The most significant operating leases included Department of Health and Social Care of £2.8 billion (2016-17: £2.7 billion), HMRC of £1.8 billion (2016-17: £0.6 billion), Ministry of Justice of £1.6 billion (2016-17: £1.6 billion), Department for Work and Pensions of £1.5 billion (2016-17: £0.1 billion) and Transport for London of £1.4 billion (2016-17: £1.3 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.

	2017-18 £bn	2016-17 £bn
Obligations under finance leases comprised:		
Total payments within one year	0.5	0.6
Total payments between one and five years	1.8	1.8
Total payments thereafter	21.3	21.6
Total	23.6	24.0
Less interest element	(18.5)	(18.8)
Total present value of obligations	5.1	5.2

The most significant finance leases relates to a land and buildings lease entered into by the Ministry of Defence of £1.7 billion (2016-17: £1.7 billion.

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 £45.3 billion (2016-17: £39.3 billion) as at 31 March 2018. The PFI liability for the present value of capital amounts payable was £39.0 billion (2016-17: £39.3 billion).

The net present value of future obligation of £39.6 billion excluding service charges was different from the liability recognised on the Statement of Financial Position of £39.0 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:

	2017-18 £bn	2016-17 £bn
Obligations for future periods arise in the following periods:		
No later than one year	4.5	4.7
Later than one year and not later than five years	17.4	17.8
Later than five years	52.3	56.8
	74.2	79.3
Less interest charges allocated to future periods	(34.6)	(36.5)
Net present value of obligations	39.6	42.8

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

	2017-18 £bn	2016-17 £bn
Obligations for future periods arise in the following periods:		
No later than one year	5.4	5.9
Later than one year and not later than five years	19.7	19.6
Later than five years	61.2	63.8
Total service charges	86.3	89.3

The PFI obligations by segment of government were:

	2017-18 £bn	2016-17 £bn
Central government departments and entities within the NHS	41.3	45.5
Local authorities	31.6	32.7
Public corporations	1.3	1.0
Gross present value of future finance lease obligations	74.2	79.2

The net present value of PFI obligations amounts to £39.6 billion for 2017-18, decreasing by £3.2 billon from £42.8 billion in 2016-17. The most significant obligations relate to the Department of Health and Social Care with total obligations of £11.2 billion (2016-17: £11.5 billion).

Total interest charges allocated to future periods of £34.6 billion are disclosed for 2017-18, decreasing by £1.9 billion from £36.5 billion in 2016-17. The most significant balance relates to Department of Health and Social Care, with an interest of £10.6 billion (2016-17: £11.1 billion) due to reduction of PFI obligations year on year.

Total service charges for future periods of £86.3 billion are disclosed but not recognised in the SOCNE or SOFP, decreasing by £3.0 billion from £89.3 billion in

2016-17. The most significant balance relates to Department of Health and Social Care, with a total of £24 billion (2016-17: £23.8 billion). Ministry of Defence accounts for the next significant balance of £11.9 billion (2016-17: £11.8 billion). Department for Transport has a significant decrease in service charges for future periods of £600m from £8.4 billion in 2016-17 to £7.8 billion for 2017-18.

Details of all of the government's PFI schemes are published on the gov.uk website.[20]

PFI contracts not recognised on the Statement of Financial Position

During the 2017-18 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.

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 2017-18 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:

	2017-18 £bn	2016-17 (restated) £bn
Financial commitments expiring in future years:		
No later than one year	17.9	19.4
Later than one year and not later than five years	23.5	22.9
Later than five years	7.4	5.8
Total financial commitments	48.8	48.1[a]

a 2016-17 figures have been restated as MOD did not include data for Other financial commitments for the 2016-17 WGA. 2016-17 comparatives have now been included in the 2017-18 accounts, and therefore the comparatives are restated

The most significant other financial commitments are summarised below:

Entity	Description of commitment	2017-18 £bn	2016-17 (restated) £bn
Department of Health and Social Care	Non cancellable contracts that are not otherwise disclosed.	5.4	5.1

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

Ministry of Justice	Commitments in respect to a number of non-cancellable contracts for contracted out services including the management of prisons.	2.9	3.2
BBC	Long term outsourcing arrangements for information technology, finance support and facilities management as well as programme acquisitions and sports rights.	3.9	3.5
MOD	Other non-cancellable contracts which are not leases or PFI contracts.	4.1	4.2

Note 29. Contingent liabilities disclosed under IAS 37

Quantifiable contingent liabilities

Total quantifiable contingent liabilities are as follows:

	2017-18 £bn	2016-17 £bn
Export guarantees and insurance policies	11.9	12.8
Clinical negligence	47.3	36.5
Taxes subject to challenge	6.0	18.7
Transport infrastructure projects	8.0	8.3
Other	10.5	7.7
Total quantifiable contingent liabilities	83.7	84.0

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

Entity	Contingent liability	2017-18 £bn	2016-17 £bn
Department for International Development	This is made up of a number of contingent liabilities, but the largest is £2.9 billion relating to contributions to international organisations, which have been subject to approval by Parliament, but not yet paid or recognised.	3.5	0.8
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	5.1	5.6
UK Export Finance	UK Export Finance supports 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 supported the provision of fixed-rate export finance. This value is net of reinsurance (gross value before reinsurance is £17.0 billion).	11.9	12.8
Department of Health and Social Care	The Department of Health and Social Care is the actual or potential defendant in a number of actions regarding alleged clinical negligence. £78.4 billion has been recognised as a provision, and the contingent liability reflects cases where there is a large degree of uncertainty as to the department's liability and amounts involved.	46.1	35.3
HMRC	HMRC is engaged in a number of legal and other disputes which can result in claims by taxpayers	6.0	18.7

against HMRC. This covers a range of cases, including Corporation Tax and VAT.

There was a decrease in contingent liabilities for HMRC, £6.0 billion in 2017-18 (2016-17: £18.7 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.

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. Other unquantified contingent liabilities can be found in the 2017-18 accounts of the Ministry of Defence[21].

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.

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 2017 (restated)	Increase in year	Liabilities crystallised in year	Obligations expired in year	31 March 2018
	£bn	£bn	£bn	£bn	£bn
Guarantees	72.6	1.8	-	(5.0)	69.4
Indemnities	14.4	13.7	-	-	28.1
Letters of comfort	11.4	-	-	-	11.4
Total	98.4	15.5	-	(5.0)	108.9

21 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727618/CCS207_CCS0318104056-1_MOD_ARA_2017-18_-_Web_PDF.pdf

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

Entity	Contingent liability	2017-18 £bn	2016-17 (restated) £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.	31.3	30.5
Department for International Development	Contingent liabilities in respect of callable capital on investments in international financial institutions.	14.5	15.0
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. This contingent liability was valued at £12.0 billion in the Consolidated fund 2016-17 accounts, and was subsequently restated to £10.6 billion.	10.6	10.6
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.	12.2	6.5
HM Treasury	On the 31st March 2017, the Chancellor announced the sale of a portfolio of UKAR's Bradford and Bingley loan book assets to Prudential Plc and funds managed by Blackstone. These remote contingent liabilities cover certain fundamental 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	11.4	11.4

	liability is capped at the value of the sale proceeds: £11.4bn.		
Department for Transport	In 2012 the Secretary of State agreed to quantifiable (disclosed) and unquantifiable assurances, warranties, indemnities and potential losses under the Inter City Express Rolling Stock contracts with Agility Consortium and Network Rail. During 2017-18 the Inter City Express Rolling Stock programme met various milestones which allowed some of the assurances relating to force majeure scenarios, to be quantified. Approximately £5.7 billion is the government's maximum liability should the Master and Train Availability and Reliability Agreements be terminated. A further £0.2 billion of the increase relates to indemnities provided the possibility that the Consortium might be unable to secure insurance.	5.9	-

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 2017-18. Further information on the EU withdrawal can be found in Chapter 1.

There are a number of unquantifiable remote contingent liabilities disclosed in individual 2017-18 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 and Social Care 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, Energy and Industrial Strategy 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 2017 valued the deficit at £11.3 billion.

Note 31. Related party transactions

Related parties in the context of WGA are public sector entities that have not been consolidated into the 2017-18 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 2017-18 accounts of the individual entities.

The Department for Education, through the Education and 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.

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.

EU Exit

As at 31 March 2018 the UK remained a full member of the European Union. The UK was due to leave on 29 March 2019, two years after submitting the Article 50 notification. On 21 March 2019 the Article 50 period was extended to 12 April. On 11 April 2019 the government confirmed that the Article 50 period was to be extended further to 31 October, providing the UK participates in European Parliament elections. If a Withdrawal Agreement is ratified by the EU and UK then the UK will leave on the first day of the following month.

More information on the potential impact of EU exit on the public finances is given in paragraph 1.189 and 1.190 in the performance report.

Sales to the private sector

On 26 April 2018 B&B announced that following an open and competitive process it had agreed to sell two separate asset portfolios comprising performing buy-to-let and other residential loans for a total of £5.3 billion. The proceeds contributed to reducing the £4.7 billion balance of the Statutory Debt owed to the Financial Services Compensation Scheme (FSCS), which in turn enabled the repayment by the FSCS of corresponding intra-group debt to HM Treasury.

On 7 June 2018 HM Treasury completed the sale of £2.5 billion RBS shares as part of the government's policy to return the bank to private ownership. This reduced the government's shareholding by 7.7% to 62.4%.

On 27 September 2018 UK Asset Resolution Limited (UKAR) concluded a competitive sales process for the sale of an £860m portfolio of equity release loans to Rothesay Life Plc.

On 4 December 2018 the government completed its sale of part of the older pre-2012 English student loan book for £1.9 billion. The Sale of Student Loans Act (2008) provided the legal basis for completing this sale.

On 02 April 2019, NRAM Ltd (NRAM) part of UK Asset Resolution Limited (UKAR), confirmed that it has agreed to sell two separate portfolios of residential owner-occupied mortgages and unsecured loans to Citi for a total of £4.9 billion.

Creation of UK Research and Innovation

United Kingdom Research and Innovation (UKRI) was formed on 30 March 2018 and began operations on 1 April 2018. UKRI brings together the assets, liabilities and functions of the following organisations into one unified body:

- Arts and Humanities Research Council
- Biotechnology and Biological Sciences Research Council
- Economic and Social Research Council
- Engineering and Physical Sciences Research Council
- Medical Research Council
- Natural Environment Research Council

- Science and Technology Facilities Council
- Innovate UK
- The England-only responsibilities of Higher Education Funding Council for England (HEFCE) in relation to research and knowledge exchange

Bank of England Capital and income framework

On 21 June 2018 HM Treasury and the Bank of England announced reforms to the bank's financial framework to boost transparency, reinforce Bank resilience and independence and strengthen the financial system. It was agreed that the Bank would take the Term Funding Scheme (TFS) onto its own balance sheet from the Bank of England Asset Purchase Facility Fund (BEAPFF), resulting in the end of the Treasury's contingent liability (which is between two WGA bodies and therefore not disclosed directly in the accounts) with respect of losses in the TFS. In the first quarter of 2019 the TFS transferred from the BEAPFF to the Bank's un-indemnified balance sheet. The risks associated with any gains and losses on TFS holdings will now be managed against the Bank's augmented loss-absorbing capital.

Government commitments

As part of our Building Safety Programme, the Government has committed to fully funding the removal and replacement of unsafe cladding by councils and housing associations. The financial cost of this is estimated at £400 million.

In June 2018, the Prime Minister set out a multi-year funding proposal for the NHS, in return for the NHS agreeing a new long-term plan with the Government. The multi-year funding settlement will see increases averaging 3.4% in real terms over the next 5 years, representing an additional £20.5 billion per annum by 2023-24. The Government has now agreed the NHS's Long-Term Plan which sets out the NHS's aspirations and commitments going forwards, with the plan having been published on 7 January 2019.

Public Sector Pay

After lifting the one percent pay cap in 2017, the government announced the biggest pay rise since 2010 for around one million public sector workers across Britain. 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. As part of the usual process, departments will consider recommendations from the independent Pay Review Bodies in Spring and Summer 2019.

Public Sector Pensions

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 1 April 2015. Five workforces – the judiciary, firefighters, police, Ministry of Defence police and prison officers – have claimed that transitional protection is age discriminatory, and indirectly gender and race discriminatory.

In December 2018, the Court of Appeal ruled that transitional protection arrangements offered to members of the judiciary and to firefighters gave rise to unlawful discrimination. The government is seeking permission to appeal this decision. If permission is refused, the judgement could have implications beyond the two schemes above and for equivalent arrangements in schemes made under the Public Service Pensions Act 2013.Whether the judgement did apply to such other schemes will have to be considered on a scheme by scheme basis.

However, the impact of the litigation is uncertain, it is not possible to quantify the impact, if any, on the pensions liability at this time.

Notice of infraction from the European Commission

In March 2018, we received a formal notice of infraction from the European Commission alleging that over the period 2011-2017, the UK did not take adequate steps to prevent losses to the EU budget from customs undervaluation fraud and that €2.7bn of customs duty is owed. Following correspondence between the UK and the Commission, the Commission have referred the case to the European Court of Justice. The government does not agree with the Commission's estimate of evaded duty and does not accept liability, so will be fully contesting the case.

Note 33. Date authorised for issue

The financial statements were authorised for issue on the date of the Comptroller & Auditor General's report.

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

Qualified opinion on financial statements

I certify that I have audited the financial statements of the Whole of Government Accounts (the WGA) for the year ended 31 March 2018 under the Government Resources and Accounts Act 2000. The financial statements comprise: the consolidated Statements of Revenue and Expenditure; Financial Position; Cash Flows; Changes in Taxpayers' Equity; and the related notes, including the significant accounting policies. 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 in that report as having been audited.

In my opinion, except for the effects of the matters described in the basis for qualified opinion section below:

- the financial statements give a true and fair view of the state of the WGA's affairs as at 31 March 2018 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.

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 the accounts, 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 2017-18. 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 2017, had gross assets of £738.1 billion and gross liabilities of £689.0 billion; and
- other bodies which have estimated gross assets of £20.1 billion and gross liabilities of £7.9 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.

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 to 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 2018 and for the relevant comparative figures. This has also led to a material misstatement of the Statement of Comprehensive Net Expenditure for 2017-18 and 2016-17. 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 almost 7,000 academies, the Department for Education has recognised academy trust land and buildings in the Statement of Financial Position with a value of £44 billion as at 31 August 2017, after making an accounting adjustment of £8.4 billion at the year end to correct errors in its records. The Department for Education also reports a revaluation reserve balance of £nil at 31 August 2017 after making an accounting adjustment of £4.6 billion. The audit evidence available to me was limited because the Department for Education, while able to support the 31 August 2017 land and buildings balance, was unable to demonstrate that it would be impracticable to have also corrected comparative balances in accordance with the requirements of International Accounting Standard 8. Nor could the Department for Education support the adjustment of the revaluation reserve under International Accounting Standard 16 Property, Plant and Equipment. As a consequence, the Department for Education was also unable to demonstrate that the associated impairment and gain on revaluation of property, plant and equipment had been correctly calculated.

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 2017. This represents a difference of seven months compared to the accounting reference date of 31 March 2018 for the WGA accounts. In preparing the WGA accounts, HM Treasury has consolidated the SARA for the year to 31 August 2017, 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 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 and I have, therefore, qualified my opinion in that respect.

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 accounts concerning the uncertainties inherent in the provisions relating to the costs of dealing with nuclear decommissioning liabilities. 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 and 23 to the accounts 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 to meet the recognition criteria set out in the Conceptual Framework for Financial Reporting.

Basis of opinions

I conducted my audit in accordance with International Standards on Auditing (ISAs) (UK). My responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of my certificate. Those standards require me and my staff to comply with the Financial Reporting Council's Revised Ethical Standard 2016. I am independent of HM Treasury in accordance with the ethical requirements that are relevant to my audit and the financial statements in the UK. My staff and I have fulfilled our other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Conclusions relating to going concern

I am required to conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the appropriateness of the presentation of the WGA using a going concern basis of accounting. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the entity to cease to continue as a going concern. I have nothing to report in these respects.

Responsibilities of the Accounting Officer for the financial statements

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.

Auditor's responsibilities for the audit of the financial statements

My responsibility is to audit, certify and report on the financial statements in accordance with the Government Resources and Accounts Act 2000.

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. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs (UK), I exercise professional judgment and maintain professional scepticism throughout the audit. I also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HM Treasury's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- obtain sufficient appropriate audit evidence regarding the financial information of the entities within the WGA group to express an opinion on the group financial statements. I am responsible for the direction, supervision and performance of the group audit. I remain solely responsible for my audit opinion.

I communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

Other Information

The Accounting Officer is responsible for the other information. The other information comprises information included in the Overview and Performance Analysis, the Statement of Accounting Officer's Responsibilities, the Governance Statement, the Remuneration and Staff Report and the Annex, other than the parts of the Remuneration and Staff Report described in that report as having been audited, the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon. In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

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 the Government Resources and Accounts Act 2000;
- in the light of the knowledge and understanding of the group and its environment obtained in the course of the audit, I have not identified any material misstatements in the Overview and Performance Analysis, the Statement of Accounting Officer's Responsibilities, the Governance Statement, the Remuneration and Staff Report and the Annex; and
- the information given in the Overview and Performance Analysis, the Statement of Accounting Officer's Responsibilities, the Governance Statement, the Remuneration and Staff Report and the 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

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

- adequate accounting records have not been kept or returns adequate for my audit have not been received from branches not visited by my staff; or
- the financial statements and the parts of the Overview and Performance Analysis, the Statement of Accounting Officer's Responsibilities, the Governance Statement, the Remuneration and Staff Report and the Annex to be audited are not in agreement with the accounting records and returns; or
- I have not received all of the information and explanations I require for my audit; or
- the Governance Statement does not reflect compliance with HM Treasury's guidance.

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

Sir Amyas C E Morse **20 May 2019**

Comptroller and Auditor General

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

Report of the Comptroller and Auditor General

Summary

1 The Whole of Government Accounts (WGA) continues to provide the most complete and accurate picture of the financial performance and position of the UK public sector. The WGA for the year ended 31 March 2018 consolidates the accounts of over 8,000 bodies across the public sector. HM Treasury (the Treasury) first published the WGA for the year ended 31 March 2010.

2 This report considers:

- the progress the Treasury has made in improving the quality of the WGA (**Part One**); and
- the changes in public finances as highlighted through the WGA and the resulting challenges for government (**Part Two**).

Key findings

Improving the quality of the WGA

3 The Treasury has brought forward the publication date of the WGA in response to concerns that the WGA's usefulness is limited by the time it takes to produce. The Treasury published the WGA for the year ended 31 March 2018 in May 2019, a month earlier than in the previous year. The Committee of Public Accounts (the Committee) has raised concerns that the usefulness of the WGA is limited by the time it takes to produce. It has asked the Treasury to provide details of its plans and timetable for publishing the WGA more quickly. The Treasury aims to publish the WGA within nine months of the financial year, but does not expect to achieve this until the WGA for the year ended 31 March 2020 at the earliest.

4 A new IT system to carry out the consolidation is being introduced by the Treasury and will be the key driver to improve the speed of publication. The WGA accounts production process is challenging as it relies on government bodies providing accurate and timely financial information for the Treasury to consolidate. The consolidation requires the Treasury to carry out a detailed review of the financial information between government bodies in order to eliminate transactions and balances between government bodies. This requires manual intervention and is a potential barrier to producing the WGA to a faster timetable. The Treasury is investing in a new IT system to carry out the consolidation and plans to implement this for the WGA for the year ended 31 March 2020. These plans are ambitious and introduce significant risk into the accounts production process. The implementation of a new IT system will need to be informed by a clear understanding of how WGA will be used in the future.

5 Government continues to make progress in improving the underlying financial information that forms the WGA, but further improvement will require the Treasury to carry out a significant programme of work with other government bodies. In the year ended 31 March 2018, the Department for Education improved the valuation and recognition of its land and buildings in the Academies Sector Annual Report and Accounts. The qualifications to my audit opinion that arise from the consolidation of the academies sector and the Ministry of Defence can only be resolved through further work. There has been limited progress in these areas since the publication of the last WGA and the qualifications are likely to remain in place until at least the WGA for the year ended 31 March 2020.

6 The Treasury has included information in response to the needs of its stakeholders, but the insight WGA provides remains limited in some areas. In response to the NAO and the Committee's recommendations to improve its analysis and commentary on key items of the balance sheet, the Treasury has made year-on-year improvements to the 'Overview and performance analysis' section of the WGA, notably around the explanations for changes in the public sector pension liability and provisions. However, the WGA does not yet include disaggregated information about the purchase of goods and services to help users better understand changes in government spending year on year. The Committee has stressed the increasing importance of the WGA for accountability and transparency of the public finances in the future, particularly in enabling the public to understand the longer-term impact of the UK's exit from the European Union on the public finances.

7 Government is already using WGA to enhance decision making but there is more to do to embed the WGA as part of government's routine financial management. The WGA has recently been used to inform the Treasury's balance sheet review and the Office for Budget Responsibility's reports on fiscal sustainability and fiscal risks. However, in 2018, I found that Treasury spending teams' engagement with the balance sheet review had varied and this work had yet to make a difference to the way Treasury monitored risks for departments, which focused mainly on in-year and medium-term spending risks. In response to the Committee's recommendation to encourage the wider use of WGA, the Treasury plans to survey users and readers of the WGA for the year ended 31 March 2018. This will be an important step in understanding how the WGA can be utilised further.

Public spending and challenges for government

8 As the value of government's long-term liabilities continues to rise, risks to affordability will need to be managed effectively. Pensions, provisions and contingent liabilities add pressure to financial sustainability as they represent liabilities that may need funding in future years. The public sector pension liability has risen by almost two-thirds since 2009-10. Currently, the Office for Budget Responsibility (OBR) estimates that the cost of unfunded public sector pensions, expressed as a proportion of GDP, will continue to rise from 2% to 2.1% in the next 10 years before falling to 1.5% by 2067-2068. The inherent uncertainty around the likelihood, timing and size of provisions and contingent liabilities makes them increasingly difficult to manage alongside other spending commitments. The value of provisions has grown by over four times since 2009-10. To help control costs and safeguard the long-term sustainability of the public finances, the government has put in place new controls around contingent liabilities and undertaken pension reforms. The government's pension reforms reduced current and future pension costs, however these reforms are subject to legal challenge and recent changes to employer contribution rates will mean that pension costs rise from April 2019.

9 Government policy is to sell assets where there is no policy reason to hold them, but there is a risk that assets are sold for short-term gain without considering the long-term impact. My reports on the sale of assets such as the Green Investment Bank and student loans have highlighted that the overriding objective was to reduce public sector net debt. While the sales successfully reduced this measure, the sales had less of an impact on the government's broader fiscal measures. In 2019, I reported that Network Rail's sale of the railway arches has delivered value for money in the short-term but the long-term impact on value for money remains to be seen. The Treasury's introduction of asset sales disclosure guidance for government to increase transparency over the impact of sales to Parliament is welcome, though this additional disclosure is not currently included in the WGA for asset sales that occurred in 2017-18. Although the WGA mentions some of the factors that would impact on the value of assets such as student loans, it does not analyse the impact that changes in assumptions have on asset values in the way it does for liabilities.

10 The Treasury is actively managing risks to government borrowing. I have reported that government has so far responded well to its need to increase borrowing since the financial crisis and has done so at relatively low cost. Debt from borrowing was £1,347 billion at 31 March 2018, an increase of 72% compared to 31 March 2010. The Treasury's increased oversight and analysis of fiscal risks and the government's balance sheet has helped it to respond in a challenging environment. Most recently, the Treasury and the Debt Management Office have responded to recommendations from the NAO and the Committee to reduce government's exposure to inflation risk by reducing the proportion of index-linked gilts issued and have continued to lengthen the average maturity of the gilts issued, extending the period of time before it must refinance the portfolio. Nonetheless, the UK's exit from the EU and the eventual unwinding of quantitative easing may create further challenges to cost-effective borrowing.

11 As pressure on the public sector finances increases, there is an opportunity for the government to explain how it is managing these risks in the WGA. The NAO and the Committee continue to report concerns about the impact that reductions in funding and increasing demand for services in areas such as health and local government are having on sustainability, particularly in the absence of agreed long-term funding plans. The balance sheet review and upcoming spending review provide opportunities to ensure departments' planning and spending deliver long-term, sustainable value for money. Currently, the Treasury formally sets out the government's approach to managing fiscal risks highlighted by the OBR every two years. The WGA provides an opportunity for the Treasury to reflect annually on how some of the most significant risks to the public finances are being managed, including the impact of leaving the EU.

Recommendations

a In setting out its plan and timetable for delivering the WGA earlier, the Treasury should review the processes and resources it uses currently to produce the account and reflect both on the elements that are within its control and those that are not, but which it can influence. This might include setting out the time, cost and quality trade-offs it has made and its long-term plans for removing the remaining qualifications.

b The Treasury's plans for improving the quality and timeliness of WGA should be informed by:

- a realistic assessment of the risks to introducing the new IT system and the time it may take to implement; and
- its evaluation of the needs of users of the WGA.

c As recommended previously, the Treasury should examine how it can:

- provide more granular information on government spending, particularly around the purchase of goods and services
- explain the sensitivity of the value of significant assets to changes in assumptions in the way it does for significant liabilities.

d In reflecting on the needs of users of the WGA, the Treasury should:

- consider using the WGA to report on government's management of significant financial risks by way of an annual update to its *Managing fiscal risks* report; and
- continue to refine the disclosures around the impact of leaving the EU.

e The Treasury should ensure that the work of the balance sheet review endures and its analysis of the balance sheet risks and opportunities becomes embedded into government's routine decision-making and financial management processes as well as significant events, such as the planned spending review. The Treasury should use the WGA as a means, alongside its biennial *Managing fiscal risks* report, to demonstrate to the public and Parliament the impact the balance sheet review has had.

Part One

The progress the Treasury has made in improving the quality of the WGA

1.1 The Whole of Government Accounts (WGA) provides the most complete and accurate picture of the financial performance and position of the UK public sector. It is seen as best practice by governments and commentators around the world. 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.

1.2 HM Treasury (the Treasury) produces the WGA by consolidating the accounts of over 8,000 bodies across the public sector to produce a picture of the UK's public finances. It is prepared in accordance with International Financial Reporting Standards (IFRS). 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. The Treasury first published the WGA for the year ended 31 March 2010.

1.3 The Committee of Public Accounts (the Committee) has frequently shown an interest in the WGA, reporting on it seven times since 2012, and has made a range of recommendations. The Treasury has responded to many of these recommendations and continues to develop the process of producing the WGA, the quality of its disclosures, and how it makes use of the information contained within it. As a result, the Committee's recent recommendations have focused more on the usefulness of the WGA and less on how it is produced. However, the Committee continues to stress the importance of publishing the accounts more quickly. This part of my report examines the Treasury's progress in resolving some of the common issues identified by the Committee, including:

- the quality of the information on which the WGA is based;
- the timeliness of the publication of the WGA;
- the usefulness of the information disclosed within the WGA; and
- how government uses the WGA to inform its decision making.

The quality of the information on which the WGA is based

1.4 As in previous years, I have qualified my opinion on the WGA for the year ended 31 March 2018. The basis of my qualified opinion is outlined in the **Appendix** of this report. The Committee has previously expressed concerns about the number of qualifications to my audit opinion of the WGA. In 2012, the Committee asked the Treasury to take a more active role in working with government bodies whose individual accounts have been qualified to resolve the causes of the qualification.[1]

1.5 Since the WGA was first produced the Treasury has made some progress in improving its quality by working to remove some of the qualifications to my audit opinion (**Figure 1**). For example:

- The WGA for the year ended 31 March 2017 was the first published where I did not qualify on the basis of issues relating to the completeness and accuracy of eliminations relating to intra-government transactions and balances disclosed in the accounts.
- The qualification relating to the valuation and recognition of land and buildings in the Academies Sector Annual Report and Accounts (SARA) in the WGA now only applies to the opening balances in the WGA, and not the closing position as at 31 March 2018. This is as a result of the Department for Education's (DfE's) work to improve the valuation and recognition of land and buildings in the SARA. It is not currently expected that any of the balances in the WGA for the year ended 31 March 2019 will be qualified in this regard. More details on qualifications to my WGA opinion are provided in the Appendix of this report.

1.6 The Treasury plans to perform further work to remove some of the qualifications to my audit opinion but expects some of these to continue for the foreseeable future. My longstanding qualification relating to the recognition of leases by the Ministry of Defence (MoD) can only be resolved by the MoD carrying out further work in this area. The Treasury expects this to be resolved through the MoD's work to adopt the new leasing International Financial Reporting Standard, IFRS 16, in the 2020-21 financial year. However, this means the qualification will likely continue until this point. Similarly, the Treasury is working with the DfE to resolve the qualification that arises due to the different financial reporting periods used by the academies sector and the rest of government. The DfE is considering options to resolve this qualification without changing the financial reporting periods of academies (which are aligned with the academic year) and without commissioning additional audited information. The DfE aims to implement a new approach for the WGA for the year ended 31 March 2020. The Treasury therefore expects the current qualification to continue for the WGA for the year ended 31 March 2019.

[1] HC Committee of Public Accounts, *Whole of government accounts 2009-10*, Sixty-seventh Report of Session 2010-12, HC 1696, February 2012.

Figure 1

Issues leading to modifications to the Whole of Government Accounts audit opinion over time

The Treasury has made some progress in improving the quality of the WGA by working to remove some of the qualifications to my audit opinion

Qualification	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Accounting boundary									
Inconsistent accounting policies									
Accounting for 3G and 4G licences									
Completeness and valuation of school assets									
Elimination of intragroup transactions and balances									
Non-coterminous year ends: Department for Education									
Underlying bodies: MoD leases									
Underlying bodies: MoD inventory									
Underlying bodies: civil superannuation benefits									
Underlying bodies: academies land and buildings									

NOTES

1. The shaded areas represent the financial years for which each qualification is relevant.

Source: National Audit Office analysis of WGA audit reports

1.7 Some qualifications would require an unreasonable amount of work to remove or would make the accounts less useful to taxpayers and parliamentarians. My qualification on the accounting boundary is largely due to the absence of the Royal Bank of Scotland (RBS) in the WGA. Despite government having control of RBS by accounting standard definitions, the significant value of RBS assets and liabilities could distort the information provided in the WGA, making it less useful to the user of the accounts. Instead, the government's stake in RBS is accounted for in the WGA as a financial asset that government intends to sell by 2023–24, subject to market conditions and achieving value for money. The qualification in respect of inconsistent accounting policies is driven by local government infrastructure valuation. Local government uses an accounting framework – the Chartered Institute of Public Finance & Accountancy's *Code of Practice on Local Authority Accounting in the United Kingdom* – which is inconsistent with the framework used by the WGA.[2] The Treasury considers that the cost and work required for each local government body to prepare valuations that are consistent with both accounting frameworks would not be appropriate.

The timeliness of the publication of the WGA

1.8 The Treasury typically publishes the WGA around 15 months after the end of the financial year (**Figure 2**). The Committee has repeatedly expressed concern that the time it takes to produce the WGA means that government is not making the most of this valuable resource as a decision-making tool. The Treasury has an ambition to publish the WGA within nine months of the end of the financial year, but it recognises that this relies on it getting the right quality information – on time – from all public bodies, including academies and local government.

1.9 The Treasury met its aim of publishing the WGA within 12 months of the year end for the year ended 31 March 2014. However, it has not been able to keep to this timetable since then. Although the Treasury has continued to work to reduce the amount of time it takes to produce the WGA, publishing the WGA for the year ended 31 March 2018 in May 2019, this was just one month earlier than the previous year and still 14 months after the year end.

1.10 The Treasury intends to further reduce the time it takes to publish the WGA, by developing its internal systems and processes, and by encouraging accounts preparers and auditors across the public sector to deliver audited financial information promptly. The Treasury intends to publish the WGA for the year ended 31 March 2019 by March 2020, less than 12 months after the end of the financial year. This is largely dependent on improvements to the Treasury's existing accounts production process.

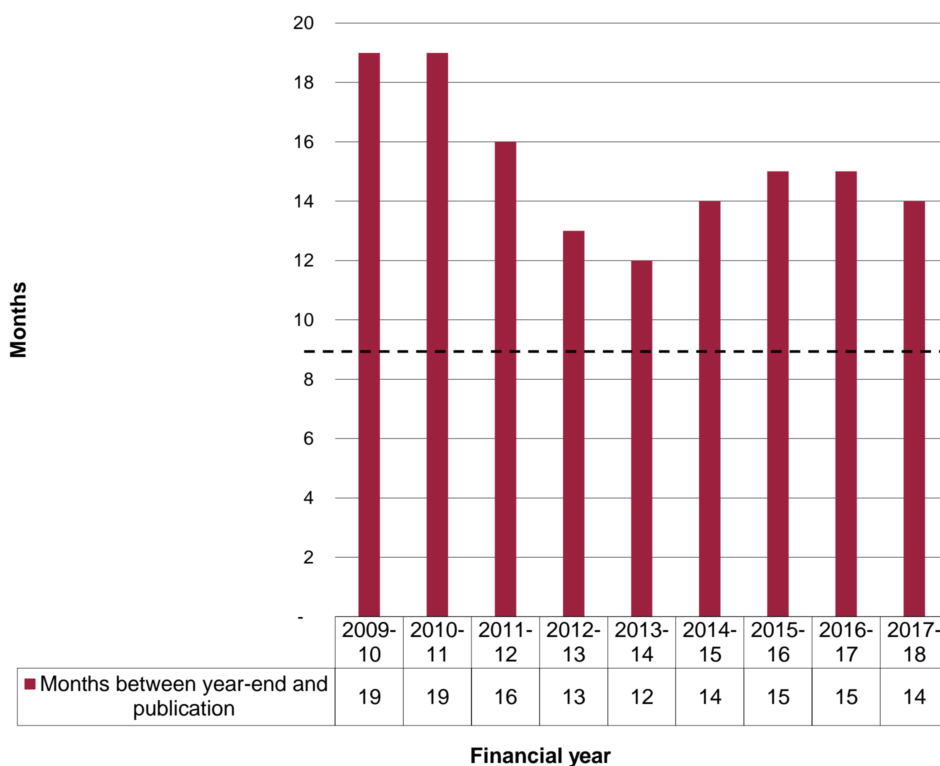
[2] Chartered Institute of Public Finance & Accountancy, *Code of Practice on Local Authority Accounting in the United Kingdom 2017-18*, April 2017.

1.11 The Treasury would like to publish the WGA for the year ended 31 March 2020 by the end of 2020 (around nine months after the end of the financial year) and is investing in a new IT system for consolidating the returns from component bodies to achieve this. The Committee has expressed concern, however, at the Treasury's ambition to bring publication forward by three months in the same year as it is implementing a new IT system.[3] We see significant risk in the planned timetable, particularly as the implementation of a new IT system will need to be informed by a clear understanding of how the WGA will be used in the future.

Figure 2

Timeliness of the Whole of Government Accounts

The Treasury typically publishes the WGA around 15 months after the end of the financial year



	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Months between year-end and publication	19	19	16	13	12	14	15	15	14

Financial year

NOTES

1. Dotted line represents the Treasury's medium-term ambition of publishing the WGA within 9 months of the year end.

Source: National Audit Office analysis of WGA information

[3] HC Committee of Public Accounts, *Whole of Government Accounts*, Seventy-Fourth Report of Session 2017-19, HC 464, January 2019.

The usefulness of information disclosed in the WGA

1.12 In my report on the WGA for the year ended 31 March 2017, I noted that the Treasury had continued to improve the presentation of the WGA, providing better quality analysis of the public finances and the main drivers of movements in the accounts.[4] The WGA now includes analysis of longer-term trends; explains the difference between National Accounts and WGA measures; and includes Public Expenditure Statistical Analyses (PESA) data on UK public sector spending broken down by function and by country and region.

1.13 In response to recommendations of the Committee, the Treasury has included extra information in the 'Overview and performance analysis' section of the WGA for the year ended 31 March 2018. This includes additional information on the maturity profile of government liabilities and more analysis on provisions such as clinical negligence and how government is managing these liabilities.

1.14 However, as noted in my report on the WGA for the year ended 31 March 2017, the WGA continues to lack specific detail in key areas which would enable a fuller analysis of the public finances.[5] Notably there remains little information relating to where government spends its money; some £212.2 billion of spend (Note 8 to the WGA) is classified as simply ‘purchase of goods, services and other expenditure'. Purchases of goods, services and other expenditure by central government accounts for £132.6 billion and has risen by 13% compared with 2016-17. Because the note only provides limited further analysis, neither the public nor Parliament can judge how these funds have been spent or where the increases have arisen. The Treasury has explained to the Committee that it is difficult for it to disaggregate this overall spend, as local government reports expenditure by function (such as adult social care) and central government reports by the nature of the spend (such as professional services).

1.15 The analysis of public expenditure in the 'Overview and performance analysis' section of the WGA that shows expenditure by function and region is based on unaudited PESA statistical data. As reported by the Committee, the PESA analysis included in the commentary to the WGA does not include regional information on assets and liabilities. The Treasury explained to the Committee that to do so would require all public bodies included in the WGA to publish regional information.

1.16 In its report on the WGA for the year ended 31 March 2017 published in early 2019, the Committee concluded that the WGA will be increasingly important to support accountability and aid transparency of the public finances in the future, particularly to help the public understand the longer-term impact of the UK’s exit from the European Union (EU) on the public finances.[6] The Committee also expressed its concern that without additional detail in future, the WGA may not provide the comprehensive information that Parliament and the public expect about the impact of the UK’s exit on the public finances. The Committee recommended that spending relating to the UK’s

[4] HM Treasury, *Whole of Government Accounts: year ended 31 March 2017*, HC 1091, June 2018.
[5] HM Treasury, *Whole of Government Accounts: year ended 31 March 2017*, HC 1091, June 2018.
[6] HC Committee of Public Accounts*, Whole of Government Accounts, Seventy-Fourth Report of Session 2017-19*, HC 464, January 2019.

exit and the future impact on the public finances are transparently disclosed in the WGA.

1.17 In the WGA for the year ended 31 March 2018, the Treasury has included in the 'Overview and performance analysis' a section outlining transactions, balances and commitments between the UK public sector and EU. The Treasury has also explained why there are some areas where the WGA is limited in what it shows about EU exit, such as the impact on the wider economy. However, in its response to the Committee's report in April 2019, the Treasury stated that it would also include additional information, notably the latest information on departmental allocations for spending on EU exit preparation, which is not included in the WGA for the year ended 31 March 2018.[7]

1.18 Looking forward, the Treasury expects that the WGA will need to report on three areas related to EU exit: the amount spent preparing for exit; the financial settlement; and the replacement of EU schemes such as agricultural support. The Committee expects these disclosures to include a comprehensive explanation of the likely impact on the public finances both in the current year and in the future.[8] Although the effects of EU exit on the economy may not be visible in the financial statements of the WGA, parliamentarians and the public may expect the Treasury to use the 'Overview and performance analysis' to report on the wider economic costs and benefits of EU exit.

How the government uses WGA to inform its decision-making

1.19 In my report on the WGA for the year ended 31 March 2017, I described how the Treasury was responding to the recommendations of the NAO, the Committee and the International Monetary Fund (IMF) by increasingly using the WGA to strengthen and inform its approach to analysing the government's balance sheet and evaluating the associated fiscal risks.[9] In particular, it had:

- Increased its resources for analysing the government's balance sheet, and more systematically brought together analysis from across the Treasury to support the executive management board's view of risk.
- Strengthened its budgetary and approvals process around contingent liabilities.
- Launched a review of the government's balance sheet which aims to improve the return on assets and reduce the cost of liabilities. The Treasury used the WGA to set the scope of the review and identify opportunities to get more from government assets and investments and reduce the cost of liabilities. The Committee recommended that the Treasury ensures the review will have a lasting impact.

1.20 Since my last Report, the Treasury has:

[7] HM Treasury, *Treasury Minutes: Government response to the Committee of Public Accounts on the Seventy-Fourth Report from Session 2017-19*, CP 79, April 2019.
[8] HC Committee of Public Accounts, *Whole of Government Accounts, Seventy-Fourth Report of Session 2017-19*, HC 464, January 2019.
[9] HM Treasury, *Whole of Government Accounts: year ended 31 March 2017*, HC 1091, June 2018.

- Committed to surveying users and readers of the WGA, in response to the Committee's recommendation to encourage the wider use of WGA.
- Published its *Managing fiscal risks* report setting out the government's strategies for managing the fiscal risks outlined by the Office for Budget Responsibility (OBR) in 2017 and the responsibilities for managing them. Both the OBR's report and the Treasury's response used the WGA as part of their evidence base.[10]
- The Treasury plans to publish the conclusions of its balance sheet review as part of Spending Review 2019. In my recent report on *Improving government's planning and spending framework* I noted that Treasury spending teams' engagement with the balance sheet review had varied and the work has yet to make a difference to the way spending teams monitor risks for departments, which focused mainly on in-year and medium-term spending risks.[11] I recommended that the Treasury explain how information on the government balance sheet will be used to inform decisions at the planned spending review and to more regularly scrutinise departments' projects, programmes and performance.
- Provided an update on the progress of its balance sheet review at Budget 2018. In it, the Treasury announced it was retiring PF2, the successor to the Private Finance Initiative (PFI), for new projects; reducing inflation exposure by reducing index-linked debt; introducing debt management targets for government departments; and beginning a project focusing on getting more return from intangible assets, such as intellectual property. The balance sheet review will inform the planned spending review.
- Published guidance for government on disclosing the impact of asset sales to Parliament in a more transparent way, including reporting on the sales' impact of on public sector net liabilities – the balance sheet position as reported in the WGA.
- Committed to regular in-year statistical reporting on the whole of the public sector balance sheet in line with the International Monetary Fund's *Government Financial Statistics Manual*. As a result, the coverage of the balance sheet included within the monthly *Public Sector Finances* statistics will be expanded, to include, for example unfunded pension liabilities and reporting on Public Sector Net Financial Liabilities – a broader statistical measure.

[10] HM Treasury, *Managing fiscal risks: government response to the 2017 Fiscal risks report*, Cm 9647, July 2018; Office for Budget Responsibility, *Fiscal risks report*, July 2017.
[11] Comptroller and Auditor General, *Improving government's planning and spending framework*, Session 2017-2019, HC 1679, November 2018.

1.21 The Committee has welcomed the steps the Treasury is taking to strengthen the understanding and management of the government balance sheet but has expressed concerns that unless these actions are embedded in routine financial management, any gains from the review are likely to be short-term.[12] It has stressed the need for the Treasury to ensure that its review has a long-term impact on the cost-effective management of government assets and liabilities. The Committee has asked the Treasury to report to it on how the benefits of the review will be monitored and reported.

[12] HC Committee of Public Accounts, *Government borrowing and the Whole of Government Accounts,* Sixteenth Report of Session 2017-19, HC 463, January 2018; HC Committee of Public Accounts, *Whole of Government Accounts, Seventy-Fourth Report of Session 2017-19*, HC 464, January 2019.

Part Two

Examining the changes and risks to the public finances

2.1 During 2016 and 2017 I published a series of reports that explored some of the major risks to the UK public finances highlighted in the Whole of Government Accounts (WGA). These reports focused on the government's provisions, contingent liabilities and guarantees[13]; pension liabilities[14]; financial assets[15]; and, most recently, government borrowing.[16] These reports examined how the significant risks to the wider government balance sheet have changed in recent years and considered government's approach to managing them.

2.2 Following on from these reports, this part examines how the associated risks and benefits to the UK's public finances shown in the WGA have increased, particularly due to:

- the volatile exposure represented by provisions and contingent liabilities;
- the effect on public finances of pensions;
- increasing spending pressures and long-term financial sustainability issues in the NHS, local authorities and defence as highlighted in my recent reports; and
- the unknown impact of the UK's exit from the European Union (EU).

Provisions, contingent liabilities and guarantees

2.3 Provisions and contingent liabilities are commitments where the size, probability or timing of the cash outflow is uncertain. Some may be a consequence of recurring activities such as providing health care whereas others arise from specific policy decisions. These continue to represent an increasing liability for the government that it must manage alongside other spending commitments.

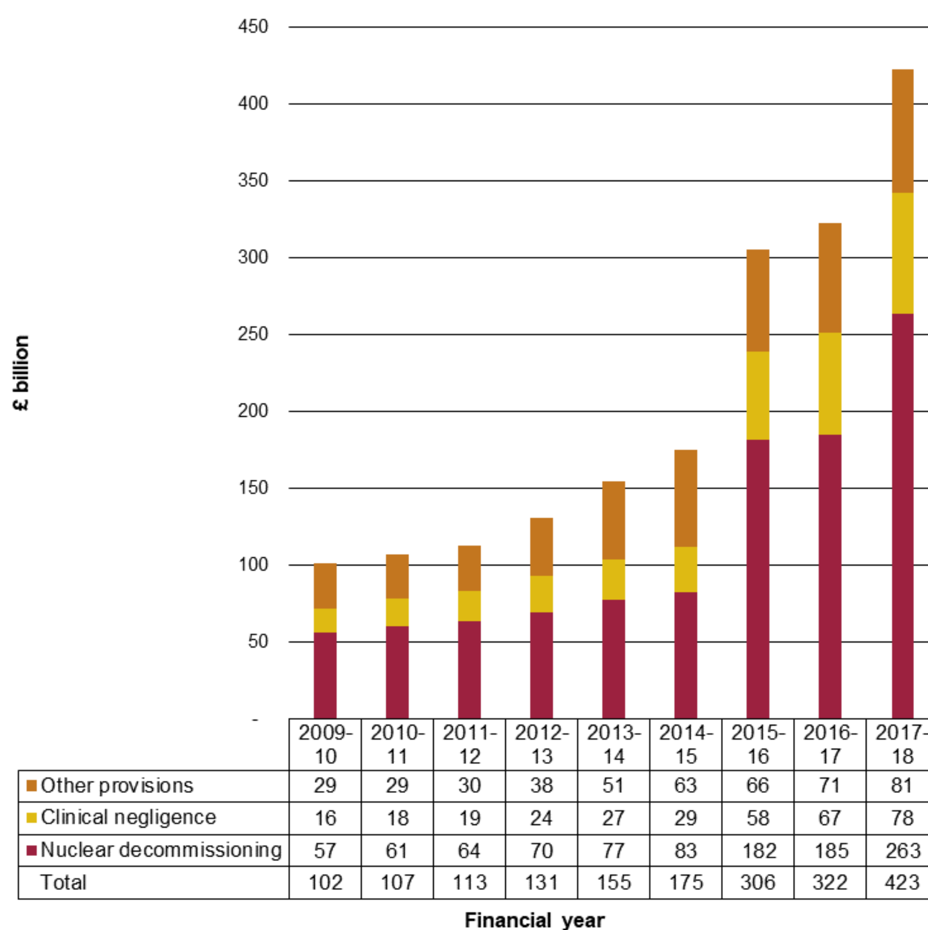
2.4 As at 31 March 2018, provisions and quantifiable contingent liabilities are valued at £423 billion and £84 billion respectively. Combined, this represents 25% of GDP or around £18,600 per UK household. **Figure 3** and **Figure 4** show how provisions and contingent liabilities in the WGA have changed since 2009-10.

[13] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: provisions, contingent liabilities and guarantees*, Session 2016-17, HC 462, National Audit Office, June 2016.
[14] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: pensions*, Session 2016-17, HC 238, National Audit Office, June 2016.
[15] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: financial assets and investments*, Session 2016-17, HC 463, National Audit Office, June 2016.
[16] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: borrowing*, Session 2017-19, HC 526, National Audit Office, November 2017.

Figure 3

Analysis of provisions for liabilities in the Whole of Government Accounts

The value of provisions has grown by over four times since 2009-10, in part due to the effect of changes in the discount rate



	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Other provisions	29	29	30	38	51	63	66	71	81
Clinical negligence	16	18	19	24	27	29	58	67	78
Nuclear decommissioning	57	61	64	70	77	83	182	185	263
Total	102	107	113	131	155	175	306	322	423

NOTES

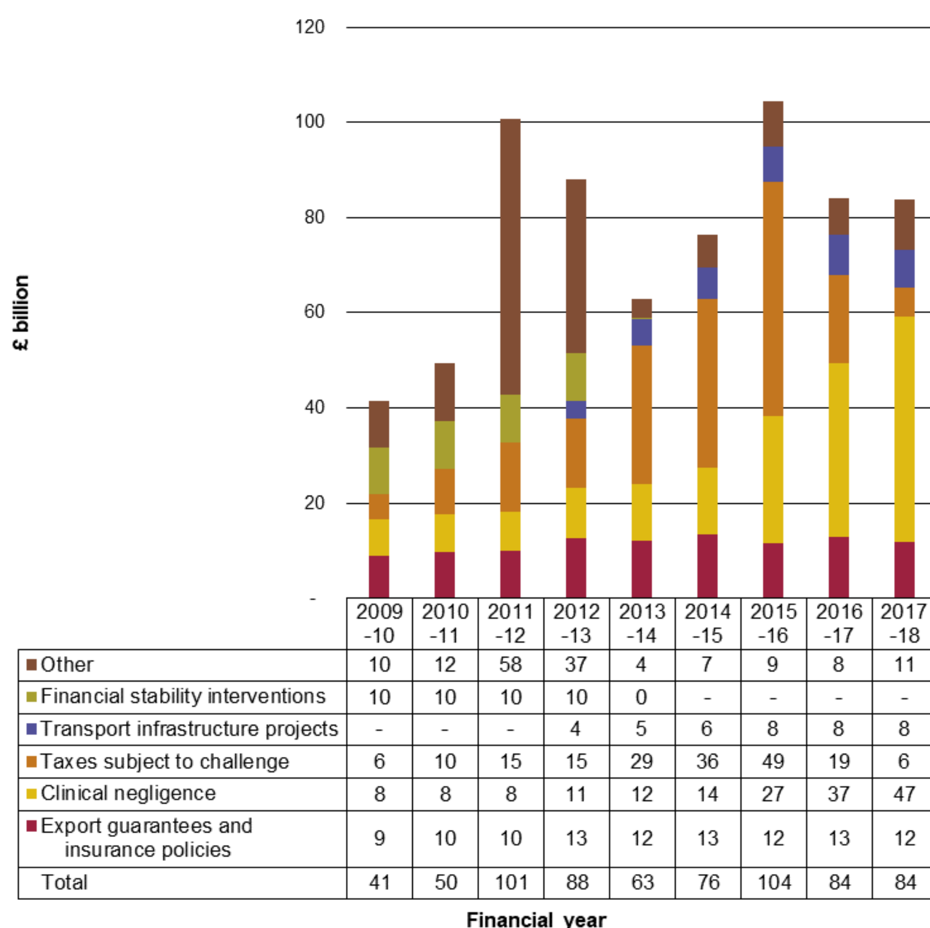
1. Between the 2014-15 and 2015-16 financial years, provisions increased by £131 billion. Of this increase, £125.2 billion relates to a change in the discount rate used to value future cash flows in present terms.
2. Between the 2016-17 and 2017-18 financial years, provisions increased by £100.3 billion. Of this increase, £94 billion relates to a change in the discount rate used to value future cash flows in present terms.
3. Totals may not cast due to rounding.

Source: National Audit Office analysis of WGA information

Figure 4

Analysis of quantifiable contingent liabilities in the Whole of Government Accounts

Contingent liabilities relating to financial stability have fallen but clinical negligence has increased



	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Other	10	12	58	37	4	7	9	8	11
Financial stability interventions	10	10	10	10	0	-	-	-	-
Transport infrastructure projects	-	-	-	4	5	6	8	8	8
Taxes subject to challenge	6	10	15	15	29	36	49	19	6
Clinical negligence	8	8	8	11	12	14	27	37	47
Export guarantees and insurance policies	9	10	10	13	12	13	12	13	12
Total	41	50	101	88	63	76	104	84	84

NOTES

1. 'Transport infrastructure projects' have been a separate category since 2012-13. Before this, these liabilities were included in 'Other'.
2. 'Other' in 2010-11 includes £32.6 billion relating to supporting international organisations and £20 billion relating to loss of tax revenue from oil and gas field decommissioning. In 2012-13, 'Other' includes £21.1 billion relating to supporting international organisations.
3. This analysis excludes quantifiable remote contingent liabilities, valued at £108.9 billion at 31 March 2018.
4. Totals may not cast due to rounding.

Source: National Audit Office analysis of WGA information

2.5 The value of a provision is affected by both the expected future cash flows relating to the liability and the discount rate used to create a present value of these future costs. For example, the government's largest provision relates to the costs of decommissioning nuclear energy sites, which is forecast to continue until at least the year 2137. As at 31 March 2018, the Nuclear Decommissioning Authority (NDA) expects the future cash flows required for nuclear decommissioning to range between £99 billion and £225 billion. The NDA also notes that the nuclear decommissioning provision would increase by £69 billion if the discount rate used to value the liability in today's prices decreased by 0.5%.

2.6 My audit work on bodies such as the NDA and NHS Resolution (which manages most of the UK government's clinical negligence claims) has highlighted the importance of managing the activity that drives these provisions effectively. For example, NHS Resolution estimated that the cost of settling current and future clinical negligence claims stood at £77 billion as at 31 March 2018. In 2017 I reported on government's approach to managing these costs.[17] I found that government's current actions were unlikely to stop the growth in the cost of clinical negligence claims and that an integrated approach was needed across the health and justice systems to tackle the rising cost. The Committee of Public Accounts (the Committee) also concluded that the government has been slow and complacent in responding to clinical negligence and recommended urgent action.[18] Government has since announced it is developing a cross-government strategy to help control these costs.

2.7 Government's understanding of its exposure to risk is always changing and its liabilities can expand rapidly if there is significant economic disruption. To help safeguard the long-term sustainability of the public finances, the Treasury has put in place a control framework for approving, monitoring, and managing contingent liabilities with a maximum exposure of £3 million or more. The Treasury reports that as at the end of March 2019, around 80 new contingent liabilities had been submitted to it for consideration under this framework and that to date it has withheld approval for around £1.5 billion of exposure. The Treasury considers this framework to be important for improving government's understanding of risk, limiting government's exposure in certain areas, and ensuring government charges for taking on risk where appropriate.

[17] Comptroller and Auditor General, *Managing the costs of clinical negligence in trusts*, Session 2017-19, HC 305, September 2017.
[18] HC Committee of Public Accounts, *Managing the costs of clinical negligence in hospital trusts*, Fifth Report of Session 2017-19, HC 397, December 2017.

Pensions

2.8 The net public sector pension liability remains the single largest liability on the government's balance sheet, at £1,865 billion. This represents over 40% of total liabilities on the balance sheet and is equivalent to over £68,000 per UK household and 92% of GDP.

2.9 In recent years, government reforms to pensions have reduced costs in the long term but the total liability has continued to rise. I have previously reported that there is a risk that continued growth in the liability could cause annual pension costs to become unaffordable.[19] There is a limit to the level of pensions that government can afford to pay out annually without either reducing other areas of spending or having to increase taxation or borrowing.

2.10 The net liability has risen by almost two-thirds compared with the liability reported in the WGA for the year ended 31 March 2010. The liability of unfunded public sector pension schemes, which make up over 90% of the total net pension liability, has grown by 72% since the WGA was first published in 2009-10 (**Figure 5**). The discount rate for unfunded pension schemes fell from 1.37% in 2016 to 0.24% in 2017, and was largely responsible for the £410 billion increase in the pension liability between 2015-16 and 2016-17. The net pension liability at 31 March 2018 grew by 2% compared with the previous year as participants in pension schemes earned benefits over the year as a result of their service in 2017-18.

2.11 Instead of the WGA pension liability figure, the Treasury uses the Office for Budget Responsibility's (OBR) forecasts to assess risks to affordability. This is because unfunded pensions will be paid from future tax revenue and therefore depend on long-term economic growth and trends in GDP. Currently, the OBR estimates that the cost of unfunded pensions, expressed as a proportion of GDP, will continue to rise from 2% to 2.1% in the next 10 years, before falling to 1.5% by 2067-2068.[20]

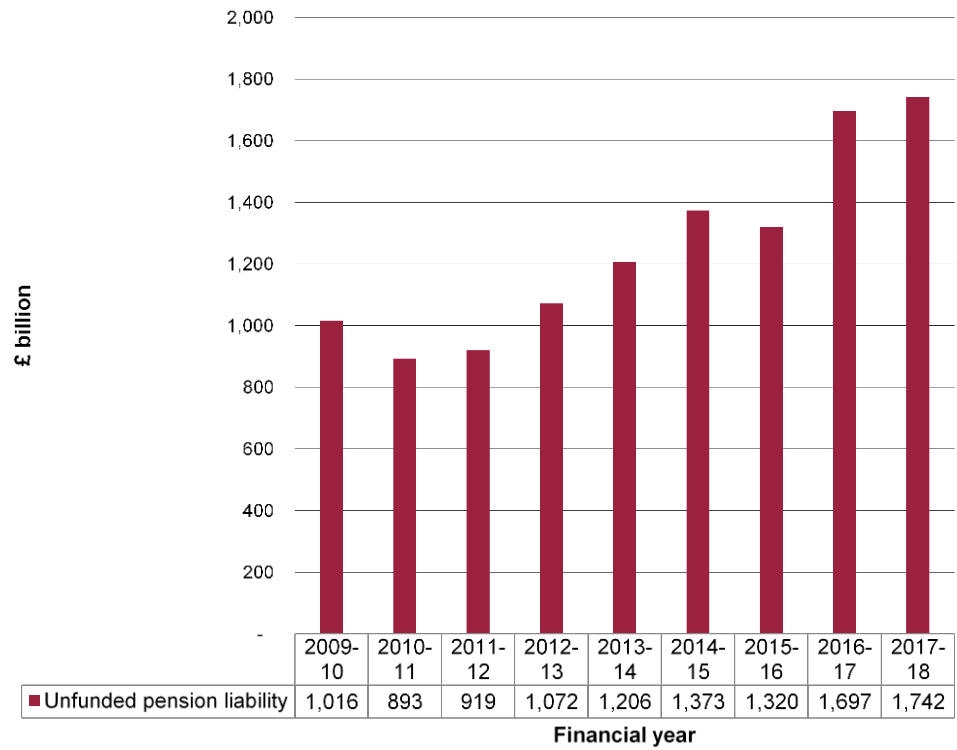
2.12 The state pension is not included in the WGA as a liability because it is a non-contractual commitment funded out of current receipts and is judged to fall outside of financial reporting standards. The government could withdraw or change the benefit in future. However, it still presents a significant long-term risk to the public finances. The OBR recognises that greater spending on the state pension is a specific challenge for government in achieving its broader balanced budget fiscal objectives in 2025-26.[21] It currently forecasts that spending on the state pension will increase by over 26% by 2023-24, due to the number of people in retirement and eligible for government-funded pensions continuing to increase.

[19] Comptroller and Auditor General, *HM Treasury, Evaluating the government balance sheet: pensions*, Session 2016-17, HC 238, National Audit Office, June 2016
[20] Office for Budget Responsibility, *Fiscal sustainability report*, July 2018
[21] Office for Budget Responsibility, *Economic and fiscal outlook*, March 2019

Figure 5

Change in the unfunded public sector pension liability

Unfunded pension liability reported in the Whole of Government Accounts between 2009-10 and 2017-18



	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Unfunded pension liability	1,016	893	919	1,072	1,206	1,373	1,320	1,697	1,742

Source: National Audit Office analysis of WGA information

2.13 In 2016, the NAO and the Committee recommended that the Treasury provide extra analysis and commentary in the WGA on the movement in the pension liability, including the discount rate impact, and how it assesses risks to affordability.[22] Since these recommendations, the Treasury has continued to improve the additional commentary provided in the Overview and Performance Analysis section of the WGA each year:

- The WGA for the year ended 31 March 2016 was the first to include explicit analysis of the impact that changes in the discount rate had on the pension liability and a detailed explanation of how the Treasury assesses the affordability of public sector pensions, with reference to the OBR projections.
- The WGA for the year ended 31 March 2017 included additional information and a chart to illustrate the main drivers of the increase in the liability and additional commentary on reforms made to the state pension and changes in the level of social security benefits paid – including the state pension – to pensioners since 2013-14.
- The WGA for the year ended 31 March 2018 includes an explanation of what isn't included in the WGA and why (in Box 1.B of the commentary), analysis of the pension liability by type of scheme since 2013-14, and an explanation of the effect that changes in other assumptions such as salary growth, workforce growth and life expectancy might have.

2.14 We expect to see an increase in government's pension costs from 2019-20 onwards. At Budget 2018, the Treasury confirmed it was reducing the discount rate used to calculate employer contributions to unfunded pension schemes from 2.8% to 2.4% in line with the OBR's long-term growth forecasts (as at July 2018).[23] This change will increase costs for employers from April 2019, who will have to pay more in contributions. Until the financial year 2019-20, the Treasury has committed to supporting departments that have unforeseen costs because of this change.

2.15 Although the government's pension reforms successfully reduced long-term costs, in December 2018, the Court of Appeal ruled that the 'transitional protection' offered to some members of judicial and firefighter pension schemes as part of reforms made in 2015 amounts to unlawful discrimination. If government's appeal against this ruling is unsuccessful, there will most likely be a material impact on pension liabilities. In December 2018, the potential impact of the judgment was thought to cost the equivalent of around £4 billion per annum. However, the impact of the litigation on all government pension schemes is currently uncertain.

[22] Comptroller and Auditor General, *HM Treasury, Evaluating the government balance sheet: pensions*, Session 2016-17, HC 238, National Audit Office, June 2016; HC Committee of Public Accounts, *The Government Balance Sheet*, Nineteenth Report of Session 2016-17, HC 485, October 2016.
[23] HM Treasury, *Budget 2018*, HC 1629, October 2018.

Financial assets and investments

2.16 Government has a significant and varied portfolio of financial assets, which represent a significant income stream. These assets include those created as a result of specific policy decisions, such as interventions during the financial crisis and loans issued to students to encourage them into higher and further education. As at 31 March 2018, the government's financial assets in the WGA were valued at £551 billion, representing just over a quarter of total assets and equivalent to over £20,000 per UK household and 27% of GDP. Income from the portfolio was £8.1 billion in the year to 31 March 2018, representing a return of 1.5% and, as a source of income, generated £0.3 billion more than capital gains tax. The value of government's financial assets has more than doubled since 2009-10 and grew 11% between 2016-17 and 2017-18 (**Figure 6**).

2.17 Financial assets in the WGA also include assets held for the sole purpose of supporting the government's day-to-day cash management. Government needs to have the right amount of cash available at the right time to fund public services. At 31 March 2018, government bodies held £34.3 billion in cash or cash equivalents (including cash held in bank accounts and short-term investments). This balance represents over a four-fold increase overall since 31 March 2010.

2.18 Around £18.5 billion of the cash balance as at 31 March 2018 was held with commercial banks, outside of the Exchequer. In some cases, there may be good reasons for holding cash in commercial account., However, this balance has grown 24% since March 2017 and has doubled since the WGA was first published. In 2009, I reported that central government bodies were holding more cash in commercial bank accounts than is necessary.[24] I recommended minimising these balances to allow government to manage its cash more efficiently: reducing its borrowing, managing risks more effectively, and accessing better information about when to borrow or invest. We estimate that the £18.5 billion held with commercial banks costs the government up to £0.5 billion annually in additional interest payments than if the cash was held within the Exchequer, though the actual cost would be dependent, among other things, on whether cash is required to be held with commercial banks and the level of interest paid on balances held with commercial banks.[25]

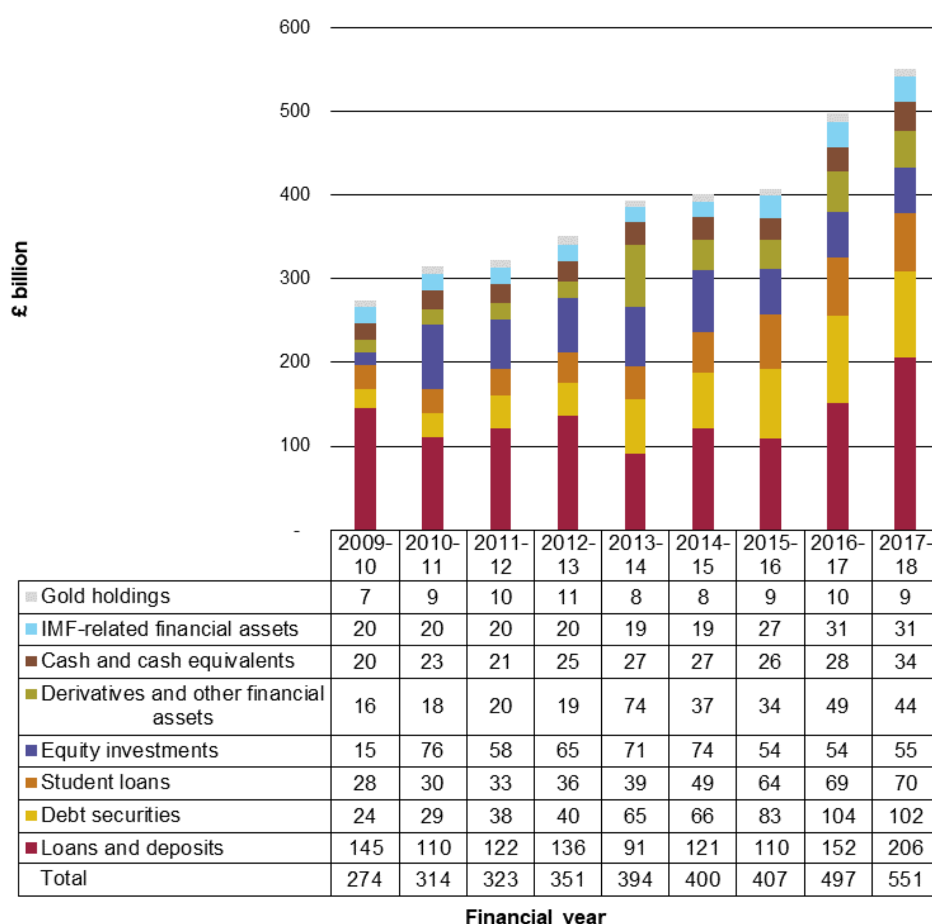
2.19 My report on *Evaluating the government balance sheet: financial assets* highlighted some significant challenges and risks around managing financial assets effectively, particularly valuing the assets, managing legacy assets, and the incentives to hold or sell assets.[26]

[24] Comptroller and Auditor General, HM Treasury, *Government cash management*, Session 2008-09, HC 546, National Audit Office, October 2009.
[25] This rough estimate assumes that all amounts held with commercial banks could be used to reduce the government's borrowing requirement (whereas in some cases this may be inappropriate) and assumes no interest is paid on commercial bank balances.
[26] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: financial assets and investments*, Session 2016-17, HC 463, National Audit Office, June 2016.

Figure 6

Financial assets in the Whole of Government Accounts since 2009-10

Government's significant and varied portfolio of financial assets has more than doubled in value since 2009-10



	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Gold holdings	7	9	10	11	8	8	9	10	9
IMF-related financial assets	20	20	20	20	19	19	27	31	31
Cash and cash equivalents	20	23	21	25	27	27	26	28	34
Derivatives and other financial assets	16	18	20	19	74	37	34	49	44
Equity investments	15	76	58	65	71	74	54	54	55
Student loans	28	30	33	36	39	49	64	69	70
Debt securities	24	29	38	40	65	66	83	104	102
Loans and deposits	145	110	122	136	91	121	110	152	206
Total	274	314	323	351	394	400	407	497	551

NOTES

1. 'Equity investments' include government's stake in the public sector banks following the 2007-08 financial crisis.
2. 'Loans and deposits' include the Bank of England's lending to commercial banks through the Term Funding Scheme. The total balance of Term Funding Scheme loans was £127.1 billion as at 31 March 2018.
3. 'Debt securities' relate primarily to securities that are used to manage the government's foreign currency reserves, through the Exchange Equalisation Account.
4. Totals may not cast due to rounding.

Source: National Audit Office analysis of WGA information

Valuing financial assets

2.20 The bespoke nature of some of government's financial assets, such as the student loan book, means there are few assets to which they can be compared. The value of these assets, which are concentrated in the banking, housing and student finance sectors, means they are particularly exposed to volatility in the economy and movements in the employment market, interest rates and inflation. The value assigned to an asset is important in terms of providing transparency and informing management decisions about whether to hold or sell an asset compared with the future income it might generate. I recommended that disclosures in departmental accounts and the WGA could be enhanced to aid transparency, including providing detail on the risks to the value of the asset holdings; the gain or loss made on asset sales compared to the original costs; and the impact of changes in significant assumptions on the year-on-year movement in the value of assets.[27] The adoption of a new accounting standard for financial instruments (IFRS 9) will change the minimum disclosure required for these assets from the 2018-19 financial year onwards. My recent report on the sale of the first tranche of the student loans book found that government used different assumptions when valuing student loans for financial reporting purposes than when valuing the assets to support the decision to sell them.[28]

Managing legacy assets

2.21 The government's remaining investment in the Royal Bank of Scotland (RBS) nine years after the financial crisis (£21.8 billion at 31 March 2018), illustrates how the nature and scale of the assets taken on by government can affect its ability to sell assets quickly or achieve market prices. While the government is winding down its investments in UK Asset Resolution and sold its remaining Lloyds Banking Group ordinary shares in May 2017, I have stressed the need for a clear and carefully managed plan for exiting from its significant holding in RBS and winding up quantitative easing in the future without disrupting the gilt market.[29] UK Government Investments continues to develop options for disposing of government's 62% stake in RBS. Government aims to fully return its shareholding in RBS to private ownership by 2023-24, subject to market conditions and achieving value for money.

[27] Comptroller and Auditor General, HM Treasury*, Evaluating the government balance sheet: financial assets and investments*, Session 2016-17, HC 463, National Audit Office, June 2016.
[28] Comptroller and Auditor General, Department for Education, HM Treasury, UK Government Investments, *The sale of student loans*, Session 2017-19, HC 1385, National Audit Office, July 2018
[29] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: financial assets and investments*, Session 2016-17, HC 463, National Audit Office, June 2016; Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: borrowing*, Session 2017-19, HC 526, National Audit Office, November 2017.

Short-term incentives to hold or sell assets

2.22 The government's decisions to hold or sell assets could be influenced by short-term incentives. For example, current constraints on public spending could encourage asset sales to make resources available that would otherwise need to come from increased government borrowing or through raising income from taxes or other measures. The exclusion of some significant assets from one of the government's key fiscal measures – public sector net debt (PSND) – could also encourage asset disposals. This is because proceeds from the sale of financial assets and investments generate cash and reduce debt regardless of the profit or loss made on the sale or the income foregone.

2.23 It is government policy to sell public assets, including financial assets, where there is no policy reason to hold them and where value for money can be achieved for the taxpayer. In August 2017, the government sold the UK Green Investment Bank for £1.6 billion. A key objective of the sale of the Green Investment Bank was to declassify it from the public sector balance sheet and reduce public debt. The final sale price of £1.6 billion for the Green Investment Bank was within UK Government Investments' expected valuation range, at the lower end. The sale proceeds reduced PSND by £1.6 billion but reduced public sector net financial liabilities – a broader statistical measure – by considerably less at £201 million. According to the Committee, the objective to reduce public debt was prioritised over the continued delivery of the Bank's green objectives.[30]

2.24 In December 2017, the government completed the first sale of student loans to private investors, raising around £1.7 billion. I found that, in terms of the impact on government's fiscal measures, the objectives for the sale focused on reducing the government's headline debt measure of PSND.[31] Selling student loans for cash reduced PSND by the sale value of £1.7 billion, but increased the broader measure of public sector net financial liabilities by £1.8 billion. It also resulted in a loss of £0.9 billion in the Department for Education's accounts for the year ended 31 March 2018, as the loans had been valued at £2.6 billion on its balance sheet.

[30] HC Committee of Public Accounts, *The sale of the Green Investment Bank*, Twenty-Fifth Report of Session 2017-19, HC 468, March 2018.
[31] Comptroller and Auditor General, Department for Education, HM Treasury, UK Government Investments, *The sale of student loans*, Session 2017-19, HC 1385, National Audit Office, July 2018.

2.25 Amidst indications of significant financial pressure, the incentives for government departments to sell off assets may increase. The Committee has previously highlighted the risk of public bodies selling off assets for short-term gain without considering the longer-term impact on public services or those organisations' long-term sustainability.[32] For example, my recent report on Network Rail's sale of railway arches found that when assessed against the primary sale objective of not prejudicing the safe and sustainable management of the railway infrastructure, it delivered value for money.[33] Yet the long-term value for money will depend on several factors, including how Network Rail manages its ongoing relationship with the leaseholder and the impact of the sale on stakeholders, including tenants, and local economies.

2.26 My reports on the government's balance sheet and recent asset sales, along with those of the Committee, have recommended that government:

- use multiple measures to assess the impact of any potential asset sale on the government's current and future financial liabilities and fully consider the financial impact of the sale on government; and
- enhance disclosures provided in the departmental accounts and WGA to aid transparency around the risks to the value of assets held; the gain or loss made on asset sales compared to the original costs; and the cost of financing.

2.27 In response, to provide greater transparency, the Treasury published guidance for government on the required disclosures of the impact of asset sales on the public finances in March 2019. This requires departments from April 2019, to disclose the impact of an asset sale on a range of fiscal measures and a statement comparing the sale price with government's valuation of the asset at the time of the sale. The WGA 'Overview and performance analysis' does not include this additional disclosure for asset sales made in 2017-18. Although the WGA mentions some of the factors that would impact on the value of assets such as student loans, the disclosures on financial assets are not as comprehensive as those on liabilities. There is scope to do more to highlight the impact of changes in significant assumptions on the year-on-year movement in the value of assets.

[32] HC Committee of Public Accounts, *Improving government*'s *planning and spending*, Seventy-Eighth Report of Session 2017-19, HC 1596, February 2019.
[33] Comptroller and Auditor General, Network Rail, Department for Transport, HM Treasury, *Network Rail's sale of railway arches*, Session 2017-19, HC 2137, May 2019.

Government borrowing and debt

2.28 For the last 17 years, the government's annual spending has exceeded its income. The government funds this budget deficit through borrowing. As a result, government debt has continued to grow, rising to £1,347 billion as at 31 March 2018. This is equivalent to around £49,500 per UK household and 66% of GDP.[34] Government debt on the WGA balance sheet has increased by 72% since the WGA was first published and by 5% compared with 2016-17 (**Figure 7**).

2.29 In November 2017 I reported that government had so far responded well to its need to increase borrowing since the financial crisis and has done so at a relatively low cost (**Figure 8**).[35] The Treasury continues to respond to these challenges through greater oversight and analysis of fiscal risks and the government's balance sheet. In response to recommendations from the NAO and the Committee, the Treasury and the Debt Management Office have begun to mitigate exposure to inflation risk by reducing the proportion of index-linked gilts issued relative to conventional gilts. At a time of historically low interest rates, the government has also continued to lengthen the average maturity of the gilts issued, extending the period of time before it must refinance the portfolio.

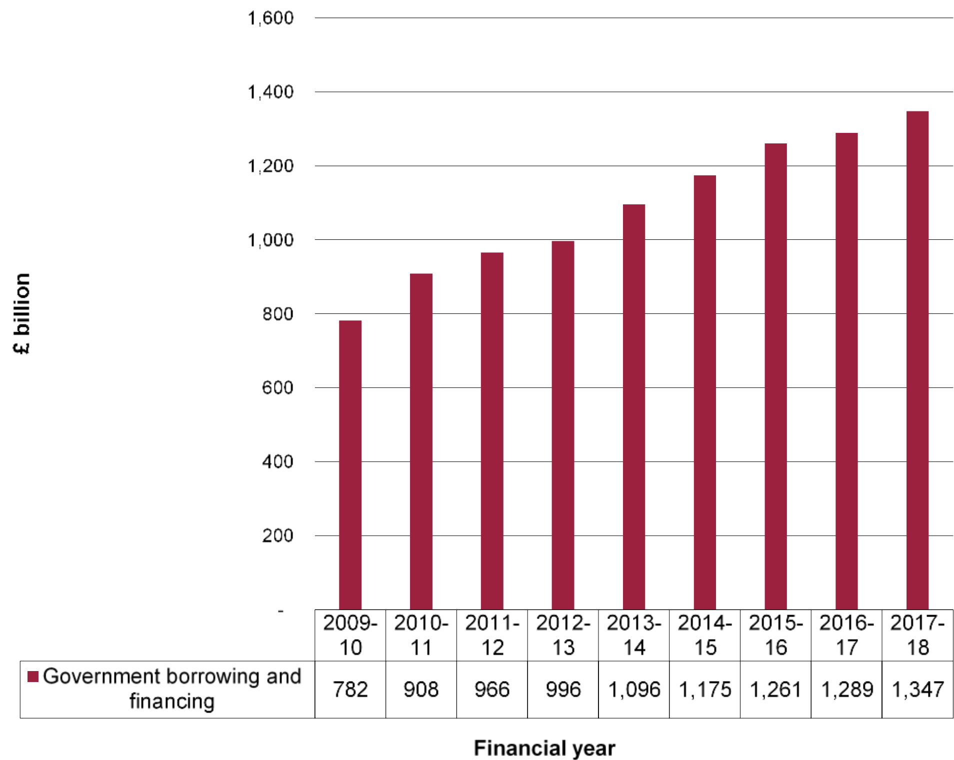
2.30 In addition to these risks, I also noted the risks to the public finances presented by the uncertainty about the UK's exit from the EU and the eventual unwinding of the Bank of England's quantitative easing programme. These risks remain, and it is essential that government continues to manage its ability to borrow cost-effectively during these periods of greater uncertainty.

[34] 'General government gross debt' is the more common statistical measure used to compare government debt to GDP. At the end of the 2017-18 financial year, this was £1,764 billion or equivalent to 85.8% of GDP. The WGA measure is lower as it does not reflect government debt held by the Bank of England and due to the different accounting basis of these two measures.
[35] Comptroller and Auditor General, HM Treasury, *Evaluating the government balance sheet: borrowing*, Session 2017-19, HC 526, National Audit Office, November 2017.

Figure 7

Growth in debt since 2009-10

The stock of government debt has increased by 72% since 2009-10



	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Government borrowing and financing	782	908	966	996	1,096	1,175	1,261	1,289	1,347

Financial year

NOTES

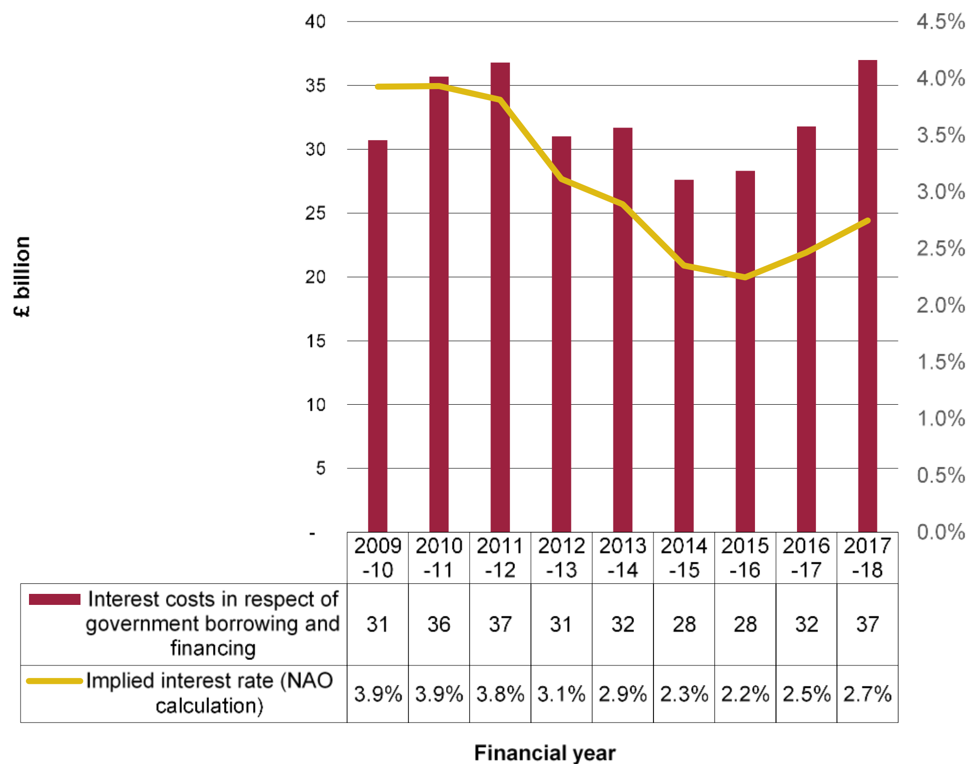
1. This reflects 'government borrowing and financing' in the WGA.

Source: National Audit Office analysis of WGA information

Figure 8

Interest costs and implied interest rate of debt since 2009-10

Government's interest costs fell to 2014-15 and have started to increase



	2009 -10	2010 -11	2011 -12	2012 -13	2013 -14	2014 -15	2015 -16	2016 -17	2017 -18
Interest costs in respect of government borrowing and financing	31	36	37	31	32	28	28	32	37
Implied interest rate (NAO calculation)	3.9%	3.9%	3.8%	3.1%	2.9%	2.3%	2.2%	2.5%	2.7%

NOTES

1. This reflects 'interest costs in respect of government borrowing and financing' in the WGA. This excludes finance charges in respect of finance leases and PFI contracts, and other finance costs.
2. The implied interest rate is calculated by taking the interest costs recognised each year and dividing by the book value of government debt at the end of each year.

Source: National Audit Office analysis of WGA information

Changes in infrastructure financing and capital spending

2.31 At Budget 2018, the government announced that it considered the Private Finance Initiative (PFI) and its successor PF2 to be inflexible and overly complex.[36] In doing this, the Treasury acknowledged the concerns raised by many commentators – including myself and the Committee – about the value for money of these models and the substantial long-term financial commitments they create. It announced that it would no longer use PF2 for new projects and would not seek to replace these models. As yet it is unclear how government might support the financing of significant infrastructure projects in future, nor is it clear how this may impact the public finances.

2.32 In March 2019, in his Spring Statement, the Chancellor announced an Infrastructure Finance Review and consultation.[37] The review will inform the planned 2019 Spending Review and government's response to the first National Infrastructure Assessment. The Infrastructure and Projects Authority currently estimates over £600 billion of public and private investment in infrastructure over the next 10 years. The review will consider the range of tools available to government for supporting private investment, and how they are delivered. In its most recent report on the WGA, the Committee expressed concern about the value for money of some alternative funding models, such as contracts for difference.[38] In response to the Committee's report, the Treasury assured the Committee that proposals involving private finance must demonstrate that they are better value for money than a publicly financed or conventionally procured alternative.[39]

2.33 The Committee has expressed concerns about significant road investment projects – the A303 Stonehenge tunnel and Lower Thames Crossing – which were due to be part-funded through PF2.[40] The Committee is concerned that the Treasury and the Department for Transport lack a clear plan for what will replace PF2 and that this will put pressure on funding already allocated elsewhere, particularly as some road investment projects that should have started before 2020 have been delayed, further reducing the budget for new projects. The Committee remains unconvinced by assurances that the Department and the Treasury are fully committed to these projects without more detail on the alternative funding models that are being developed. It has recommended that they write to the Committee to clearly outline the range of financing structures available to fund the A303 Stonehenge tunnel and Lower Thames Crossing projects, how this will affect the budget of £25.3 billion for Road Investment Strategy 2 (RIS2) funding, the effect on other road projects and how the cost and risk implications of these options will be appraised.

[36] HM Treasury, *Budget 2018*, HC 1629, October 2018.

[37] HM Treasury, Chancellor of the Exchequer, *Spring Statement 2019*, 13 March 2019. Available at: https://www.gov.uk/government/speeches/spring-statement-2019-philip-hammonds-speech

[38] HC Committee of Public Accounts, *Whole of Government Accounts, Seventy-Fourth Report of Session 2017-19*, HC 464, January 2019.

[39] HM Treasury, *Treasury Minutes: Government response to the Committee of Public Accounts on the Seventy-Fourth Report from Session 2017-19*, CP 79, April 2019.

[40] HC Committee of Public Accounts, *Rail management and timetabling*, Eighty-first Report of Session 2017-19, HC 1793, February 2019.

Signs of financial pressure

2.34 The Committee has highlighted concerns about the pressure on departments to meet annual budgets which, along with uncertainty around future funding, can drive decisions that focus on short-term outcomes, like cash injections, which in turn affect longer-term value for money.[41] The Treasury has made progress in understanding and managing long-term fiscal risks and is agreeing longer-term planning horizons for the NHS, defence, infrastructure and capital spending. However, the Committee has highlighted that unless management of government planning and spending are brought together more effectively, the next spending review will not address the problems surrounding the financial sustainability of the public sector. It has recommended that:

- the Treasury and the Cabinet Office require departments to show how their plans and funding bids deliver long-term, sustainable value for money; and
- the Treasury and the Cabinet Office write to the Committee, before the planned spending review, to explain how they will work together, along with functions and departments, to better challenge the realism of departments' plans and the wider effect on sustainable public services.

2.35 My reports, and those of the Committee, examining the financial sustainability of government activity have highlighted increasing signs of financial pressure in several areas of public spending, including the NHS, local authorities and defence. Similarly, the OBR's most recent projections suggest that public finances will come under significant pressure over the longer term, due to an ageing population and pressure on health spending in particular.[42] Assuming no policy changes, the OBR estimates that government will end up spending more as a share of national income on age-related items such as pensions and health care.

NHS

2.36 My report on *Sustainability and transformation in the NHS* in January 2018 set out how the NHS had rebalanced its finances to achieve an overall surplus in 2016-17.[43] Yet some of the measures it used restricted the money available for longer-term transformation. For example, the Department of Health & Social Care transferred £1.2 billion from capital projects to fund day-to-day activities of NHS bodies. A further £1 billion of capital budget was transferred to revenue in 2017-18. Most recently, the Committee has said that the system for funding and financially supporting the NHS focuses too much on short-term survival and cash injections rather than achieving lasting improvement.[44]

[41] HC Committee of Public Accounts, *Improving government's planning and spending*, Seventy-Eighth Report of Session 2017-19, HC 1596, February 2019.
[42] Office for Budget Responsibility, *Fiscal sustainability report*, July 2018.
[43] Comptroller and Auditor General, Department of Health and Social Care, *Sustainability and transformation in the NHS*, Session 2017-19, HC 719, National Audit Office, January 2018.
[44] HC Committee of Public Accounts, *Sustainability and transformation in the NHS*, Twenty-ninth Report of Session 2017–2019, HC 793, April 2018

2.37 I concluded in my 2019 report *NHS financial sustainability*, which covered the year to 31 March 2018, that the growth in waiting lists and slippage in waiting times, and the existence of substantial deficits in some parts of the system (offset by surpluses elsewhere), did not add up to a picture that could be described as sustainable.[45]

2.38 The OBR has highlighted how NHS providers, which account for two-thirds of NHS spending, have been in deficit on average since 2013-14.[46] The pressure on the Department's budget has meant savings have had to be made elsewhere to keep spending within the overall limit set by the Treasury.

2.39 According to the Treasury's *Managing fiscal risks* report – the formal response to the OBR's 2017 *Fiscal risks report* – government has made the NHS its number one spending priority for the next spending review period.[47] In June 2018, the Prime Minister announced an increase in funding for the NHS in England over the next five years to support a 10-year plan for the NHS. This is equivalent to over £20 billion a year more in real terms by 2023-24. The government expects to fund this increase through a combination of lower contributions to the EU, contributions from taxpayers and prioritisation and efficiencies in non-health spending. The full impact of the increase on other government departments will be announced at the planned 2019 Spending Review.

Local authorities

2.40 My report on *Financial sustainability of local authorities* has highlighted real financial pressures on the sector.[48] Government funding to local authorities has fallen substantially since 2010-11, to help meet the government's objective to reduce the deficit. Government funding for local authorities fell by an estimated 49.1% in real terms from 2010-11 to 2017-18, which equates to a 28.6% real terms reduction in spending power (combining government funding and council tax receipts). At the same time, demand for key services has grown. For example, between 2010-11 and 2016-17, the number of households assessed as homeless and entitled to temporary accommodation increased by 33.9%; the number of looked-after children grew by 10.9%; and the estimated number of people in need of care aged 65 and over increased by 14.3%.

[45] Comptroller and Auditor General, Department of Health & Social Care, *NHS financial sustainability*, Session 2017-19, HC 1867, National Audit Office, January 2019.
[46] Office for Budget Responsibility, *Fiscal risks report*, July 2017.
[47] HM Treasury, *Managing fiscal risks: government response to the 2017 Fiscal risks report*, Cm 9647, July 2018; Office for Budget Responsibility, *Fiscal risks report*, July 2017.
[48] Comptroller and Auditor General, Ministry of Housing, Communities & Local Government, *Financial sustainability of local authorities 2018*, Session 2017-19, HC 834, National Audit Office, March 2018.

2.41 In response to multiple, one-off and short-term funding streams, authorities treated capital receipts as revenue income and relied on reserves to balance their books. Spending on discretionary areas such as housing services and highways and transport also fell in real terms, by 45.6% and 37.1% respectively. Financial resilience varies between authorities, with some having substantially lower reserve levels than others. Individual authorities' ability to build up their reserves and the rate at which they have used them varies, but the current pattern of growing overspends on services and dwindling reserves exhibited by an increasing number of authorities is not sustainable over the medium term.

2.42 I have reported that there is no single point within government that monitors the impact of funding reductions across the full range of local authority services on an ongoing basis. The Committee has concluded that the Ministry for Housing, Communities and Local Government does not have a transparent method for assessing financial risk in local authorities and there is no shared definition of what financial sustainability means in practice in the local authority sector.[49] The Committee has also reported serious and ongoing concerns about the impact of central government decisions on the financial sustainability of local services and the lack of incentives for departments to understand the cumulative impact of funding decisions.[50] While the government had to introduce a range of additional short-term funding measures to support the sector, it still lacks a long-term funding plan for local authorities.

Defence

2.43 In 2019, the Committee concluded that the Treasury's requirement for departments to live annually within their means hinders the Ministry of Defence's (MoD) ability to plan for the long-term.[51] The MoD made the case to the Treasury for greater funding flexibility and multi-year settlements for long-term complex programmes. The Committee recommended that the MoD use the planned 2019 Spending Review as an opportunity to explore longer-term budgeting arrangements in certain areas such as nuclear programmes.

2.44 In my November 2018 report on the MoD's equipment plan, I found that it remains unaffordable, with a £7.0 billion difference between expected costs and budget for 2018 to 2028, 84% of which falls in the first four years.[52] If all identified risks were to materialise, the difference could widen to £14.8 billion or more. For the first time, in its 2018 equipment plan, the MoD has set out the affordability risks it faces and its underpinning assumptions. Nonetheless, I considered the MoD's assessment

[49] HC Committee of Public Accounts, *Financial sustainability of local authorities*, Fiftieth Report of Session 2017-19, HC 940, July 2018.
[50] HC Committee of Public Accounts, *Improving government's planning and spending*, Seventy-Eighth Report of Session 2017-19, HC 1596, February 2019.
[51] HC Committee of Public Accounts, *Defence Equipment Plan 2018–28*, Seventy-Seventh Report of Session 2017-19, HC 1519, February 2019.
[52] Comptroller and Auditor General, Ministry of Defence, *The Equipment Plan 2018 to 2028*, Session 2017-19, HC 1621, National Audit Office, November 2018.

to be optimistic and the affordability challenge could increase further over the next 10 years.

2.45 The MoD recognises the trade-off between the short-term decisions needed to ensure that spending stays within its means and longer-term value for money of programmes. During the current period of uncertainty, the MoD has resorted to short-term decision making, increasing the longer-term risks to value for money.

Potential impact of the UK's exit from the EU on public finances

2.46 Government allocated £287 million in 2017-18 to departments in support of their work to prepare for the UK's exit from the EU. Departments may not have spent their total allocation, and may have funded other spending on exit preparations by reprioritising other activities. All spending is included as part of an individual department's accounts and is disclosed in aggregate in the WGA for the year ended 31 March 2018. As explained in paragraph 1.17, the WGA does not identify expenditure on EU-specific activity, including the annual cost of preparing to leave.

2.47 My series of reports on implementing EU exit have noted the scale of the challenge that key departments most affected by exit face. For example, the Department for Environment, Food and Rural Affairs (Defra) estimates that approximately 80% of its areas of responsibility are currently framed by EU legislation and 25% of EU laws apply to its sectors. Defra needs to make major changes to the size and structure of its organisation to provide services and functions to replace those provided by the EU. In 2017-18, Defra recruited more than 1,300 new staff and told Parliament it planned to recruit a further 1,600 during 2018-19. The Treasury approved additional funding for Defra's EU exit programme of £67 million for 2017-18 and a further £310 million for 2018-19.[53]

2.48 The medium- to long-term impact that exiting the EU will have on the economy and public finances is as yet unclear and will depend on the agreement the UK reaches with the EU. For example, different trading relationships would significantly affect economic performance. The government and OBR have both carried out analysis on the potential costs and benefits of withdrawing from the EU. The OBR's provisional analysis, published in November 2016 after the 2016 referendum vote, suggested that EU exit is more likely to weaken the public finances than strengthen them over the medium term, via its effect on the economy and tax revenues.[54] The OBR revised down its forecasts for economic growth as a result. The OBR will revisit this analysis when there is more certainty around the UK's exit from the EU.

[53] Comptroller and Auditor General, Department for Environment, Food & Rural Affairs, *Progress in Implementing EU Exit*, Session 2017-19, HC 1498, National Audit Office, September 2018.
[54] Office for Budget Responsibility, *Economic and fiscal outlook*, November 2016

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 WGA for the year ended 31 March 2018. It also provides details of the progress HM Treasury (the Treasury) has made in respect of each remaining qualification since my last report.

2 This is the ninth year that I have audited the WGA and I have been able to report to Parliament that these accounts are a true and fair presentation of the whole of government's financial position, although I have always qualified my opinion.

3 Although the Treasury continues to make progress towards resolving a number of issues I have raised, I have not been able to remove any of the qualifications to my opinion. However, the qualification relating to the land and property recognition and valuation in the Academies Sector Annual Report and Accounts (SARA) now only applies to the comparative figures disclosed in the accounts and not the closing balances as at 31 August 2017.

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 and 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 materiality 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 2017-18 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 four 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; 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.

Qualifications owing to disagreements and limitations of scope in my audit

16 I have qualified my opinion on the WGA for the year ended 31 March 2018 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.

17 My qualifications relate to:

- the definition of public bodies that the Treasury has used to determine the boundary of the WGA;
- the inconsistent application of accounting standards;
- qualification of some of the underlying accounts that are considered to be material to the WGA; and
- material non-compliance with the accounting standards stemming from the consolidation of a significant component with a non-coterminous year end.

Qualified audit opinion relating to the WGA boundary

18 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.

19 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 9**).

Financial reporting requirements

20 In my previous Reports[55], I have noted that in determining the boundary for the whole of government, the Treasury has adopted the classifications of public bodies used by the Office for National Statistics (ONS), rather than apply accounting standards which require 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'.[56]

21 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 (RBS).

22 I consider it appropriate to exclude those bodies that are not controlled by the government, as this treatment meets with accounting standards. In accordance with the accounting framework, I consider that the bodies listed in **Figure 9**, 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.

[55] Comptroller and Auditor General, Report on the Whole of Government Accounts 2016-17, June 2018
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
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[56] International Financial Reporting Standard 10 – Consolidated Financial Statements.

Figure 9

Figures from bodies that have been excluded from WGA and their impact on the net liability (for illustrative purposes)

	Revenue	Expenditure	Impact on the net deficit	Assets	Liabilities	Impact on the net liability
Royal Bank of Scotland	16.1	14.7	1.4	716.3	689.0	27.3
Further education institutions	1.4	1.7	(0.3)	13.1	2.9	10.2
Other bodies	0.6	0.8	0.2	2.4	1.4	1.0
Bodies which failed to provide WGA returns	2.2	2.1	0.1	4.6	3.5	1.1
Total	**20.3**	**19.3**	**1.4**	**736.4**	**696.8**	**39.6**

NOTES

1. Further education institutions have been estimated from data provided by Skills Funding Agency (covering England only) for 2017-18. Income and expenditure is net of transactions within the WGA group.
2. Other bodies include Trust Ports and other minor bodies. Figures have been estimated from the latest available accounts.
3. 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. The RBS asset value has also been adjusted to reflect that WGA would no longer hold shares in the Bank as an asset on full consolidation.
4. Not all bodies have a March year-end, e.g. figures for RBS relate to the year ending 31 December 2017.
5. All figures are in £ billions.

Source: National Audit Office analysis of WGA 2017-18 and published accounts

23 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

24 I have qualified my opinion due to the impact of the inconsistent application of accounting policies that Treasury has applied in producing the WGA.

25 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 2017-18, some of the bodies included in the WGA prepared their accounts based on accounting frameworks that are inconsistent with the requirements of the FReM.

26 Under accounting standards, the Treasury should identify the impact of the different frameworks and make appropriate adjustments to the WGA, where material, so that the WGA as a whole is prepared on a consistent basis.[57]

27 Material misstatement in the WGA arises from differences between the financial reporting frameworks used by local government and public corporations, which require infrastructure assets to be valued using historical cost, and the requirements of the FReM, which determines that central government should value these assets at their depreciated replacement cost.

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

29 The Treasury estimates the impact of this inconsistency with reference to a calculation made by the Office for National Statistics (ONS) in its National Accounts estimate,[58] which as at 31 December 2017 valued the local authority road network at £118.2 billion (£120 billion in 2016).

30 The value of local government infrastructure already reported in the WGA for the year ended 31 March 2018 is £70.4 billion. The Treasury therefore considers the undervaluation of these assets to be at least £47.8 billion (£52.8 billion in 2016-17).

[57] International Financial Reporting Standard 10 Consolidated Financial Statements
[58] Office for National Statistics, The UK national balance sheet: 2017 estimates, Table 9, August 2018

31 In the 2016 National Accounts estimates, the ONS changed its methodology for calculating the value of the local authority network due to requirements from Eurostat to provide estimates of land values separately from the related assets. Their estimations therefore do not include the valuation of any land underlying the infrastructure assets which would be required to be included in a depreciated replacement cost valuation as prescribed by the FReM. It is therefore likely that the valuation error in the WGA for the year ended 31 March 2018 is significantly higher than the £47.8 billion calculated using data from the current ONS methodology.

32 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 in their road networks, and help the 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.

33 I therefore re-iterate my previous recommendations that the Treasury should work with CIPFA and other government departments where necessary to identify a path forward, and that the Treasury also consider how to obtain depreciated replacement cost valuations for non-highways infrastructure assets.

34 In addition to the misstatement arising from the differences between the valuation of infrastructure in the local and central government settings, the discrepancy also arises between central government and public corporations which follow IFRS rather than the FReM. There are a number of bodies where this discrepancy may be material and these are adjusted by the Treasury. However, we have identified that in the case of Northern Ireland Water Limited, the value of its infrastructure held at the year end has not been adjusted. Whilst it is not possible to determine the precise value of this misstatement, based on bodies of a similar nature and size we estimate that the understatement of infrastructure assets is material to the WGA.

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

35 I issued an adverse opinion on the Department for Education's (DfE'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 DfE's accounts are prepared to a 31 March year end, academies prepare accounts which follow the academic year, being 1 September to 31 August.

36 Between 2012-13 and 2015-16 the DfE 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. The conclusions of that work were not considered to be sufficiently robust to support an unqualified audit opinion on the DfE's accounts.

37 For 2016-17 the DfE agreed with the Treasury and Parliament that it could separate academy reporting from its own accounts and, instead, produce the 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.

38 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.

39 Neither the Treasury nor the DfE have undertaken the work required to align the reporting dates and, in preparing the WGA accounts, the Treasury has consolidated the SARA for the year to 31 August 2017, 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.

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

40 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.

41 The most significant of these qualifications relates to the Ministry of Defence's (MoD's) 2017-18 accounts and the 2016-17 SARA. Given the significance of these qualifications, I have also qualified my opinion on the WGA. Further details can be found in my audit opinions and within the annual accounts of the SARA[59] and the MoD.[60]

Ministry of Defence

42 In the 2014-15 MoD accounts, the MoD 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 MoD 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 accounts for the year ended 31 March 2018 and consequently no conclusion can be drawn as to whether the existing contracts represent leases. This means the financial impact of the omission of potential assets and liabilities cannot be determined with sufficient accuracy.

43 The MoD has been considering the implications of the new International Financial Reporting Standard 16, Leases (IFRS 16) which is being applied by the Treasury in the FReM from 1 April 2020, and how this may impact upon the accounting treatment for these contracts.

44 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 MoD can demonstrate that the accounts are free from material misstatement.

Academies Sector Annual Report and Accounts (SARA)

45 I qualified my opinion on the SARA for the year ended 31 August 2016, because the DfE could not adequately support the recognition and valuation of land and buildings included in those accounts. This resulted in a qualification in the WGA for the year ended 31 March 2017.

46 For the SARA for the year ended 31 August 2017, the DfE has achieved its aim of compiling sufficient evidence to support the recognition and valuation of land and buildings at the year end, 31 August 2017. However, it did not provide further evidence on the comparative land and building values reported in the previous year's SARA.

[59] Academy Schools Sector in England 2016-17, HC 4251701, 6 November 2018
[60] Ministry of Defence Annual Report and Accounts 2017-18, HC 1272, 19 July 2018

47 As a result of the additional evidence provided by the DfE, I have reduced the extent to which my opinion on both SARA and WGA is qualified to only being in relation to the comparative 2016-17 figures published in the WGA for the year ended 31 March 2018.

Other issues on which I have not qualified my opinion

48 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 10 accounts (17 in 2016-17) included in the WGA qualified its 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 & Pensions[61] and HM Revenue & Customs.[62] 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.

[61] Department for Work and Pensions Annual Report and Accounts 2017-18, HC 1108, 28 June 2018
[62] HM Revenue and Customs Annual Report and Accounts 2016-17, HC 1222, 12 July 2018

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.

Area	WGA treatment	National Accounts treatment
Revaluation and impairment of assets	Assets are revalued as set out in note 1 of the accounts. Assets are assessed annually for impairment compared to their carrying value	Assets are recognised at cost less depreciation and are not revalued. Only impairments 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	Not included within National Accounts treatment

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

	2017-18	2016-17	2015-16
	£bn	£bn	£bn
Public Sector Net Debt (National Accounts)	1,779	1,727	1,603
Add liabilities not recognised in National Accounts:			
Net public sector pensions liability	1,865	1,835	1,425
Provisions	422	322	306
PFI contracts	33	33	33
Adjust assets measured differently in national accounts:			
Asset Purchase Facility[a]	(200)	(127)	(50)
Unamortised premia on gilts	54	51	38
UK Asset Resolution (UKAR) net impact on net debt	(10)	(24)	(30)
Add assets and liabilities excluded from measure of PSND:			
Property, plant and equipment	(1,208)	(1,168)	(1,120)
Investment property	(20)	(18)	(16)
Intangible assets	(36)	(35)	(33)
Trade and other receivables	(42)	(49)	(37)
Prepayments and accrued income	(103)	(91)	(87)
Inventories	(10)	(9)	(10)
Investments	(52)	(51)	(50)
Trade and other payables	53	51	51
Accruals and deferred income	62	59	55
Deduct liabilities not yet recognised in WGA			
Housing associations	-	(70)	(67)
Other adjustments including eliminations	(22)	(15)	(25)
Net liabilities (WGA)	2,565	2,421	1,986

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

	2017-18	2016-17	2015-16
	£bn	£bn	£bn
Public sector current budget deficit (National Accounts)	(1)	7	39
Add expenditure on liabilities excluded from National Accounts:			
Increase in provisions	5	7	0
Adjust expenditure calculated differently from National Accounts:			
Depreciation and amortisation	(9)	(10)	(8)
Impairments and revaluations of assets	25	15	9
Net (gains)/Losses on sale of assets	4	2	(6)
Capital grants	9	9	7
Research and development	2	2	3
Other adjustments including eliminations	19	8	5
Net expenditure on public services (WGA)	54	40	49
Financing costs of long-term liabilities, including discounting	154	68	187
Revaluation of financial assets and liabilities	5	(10)	8
Total net expenditure (WGA)	213	98	244

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.

HM Treasury contacts

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If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gov.uk

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