

# National Lottery Distribution Fund Investment Account 2012-13

# National Lottery Distribution Fund Investment Account 2012-13

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

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# Commissioners for the Reduction of the National Debt

## Foreword

### Introduction

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

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

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

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

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

The resources used to deliver CRND's objectives are accounted for within the United Kingdom Debt Management Office's (DMO) agency vote and reported in the DMO Report and Accounts 2012-13. The cost of managing the NLDFIA is recharged to the Department for Culture, Media and Sport; in 2012-13, this amounted to £114,000 (2011-12: £115,000).

### Commissioners for the Reduction of the National Debt

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

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

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

## Audit arrangements

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

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

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

## Management Commentary

### Results for 2012-13

During 2012-13, the NLDFIA made a surplus for the year of £27 million (2011-12: £12 million). The increase of £15 million was primarily due to a profit on disposal of £18 million that arose from UK Government gilt-edged securities.

The NLDFIA's comprehensive income for the year was £10 million (2011-12: £31 million), the decrease of £21 million was primarily due to a decrease of £19 million in fair value gains on UK Government gilt-edged securities.

The NLDFIA continued to invest in demand deposits with the Debt Management Account and National Loans Fund, and in UK Government gilt-edged securities, in order to best protect its capital and access to liquidity. The NLDFIA sold its holdings of UK Government gilt-edged securities during the year resulting in a profit on disposal of £18 million. As at 31 March 2013 the total value of investments held by the NLDFIA was £1,496 million (31 March 2012: £1,279 million).

### Date of authorisation for issue

The Secretary and Comptroller General authorised these financial statements for issue on 28 June 2013.

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

27 June 2013

## Statement of Secretary and Comptroller General's responsibilities

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

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

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

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

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

## Governance Statement

### Scope of responsibility

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

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

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

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

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

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

### Managing Board

The Secretary and Comptroller General was supported during 2012-2013 by the DMO Managing Board (the Board) which, in addition to the Secretary and Comptroller General, is comprised of:

Robert Stheeman – DMO Chief Executive and Accounting Officer

Jim Juffs – Chief Operating Officer

Joanne Perez – Joint Head of Policy and Markets

Sam Beckett (resigned July 2012) – Non-executive HM Treasury representative

James Richardson (appointed July 2012) – Non-executive HM Treasury representative

Brian Larkman

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

Brian Duffin

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

Non-executive directors are appointed by the DMO Accounting Officer following a formal process and have fixed terms defined in their contracts of service. Sam Beckett resigned from the Board in July 2012 and was replaced as HM Treasury's representative by James Richardson. James was appointed by the DMO Accounting Officer in accordance with the DMO's Framework Document. All non-executive Board members receive an induction on joining and have access to additional information and training where it is considered necessary for the effective discharge of their duties.

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

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

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

### 2012-2013 Board activities

Board meetings were held throughout 2012-2013 and covered regular agenda items, including risk management, staffing and progress against the operational business plan.

Board attendance is outlined in the table below:

	Possible	Actual
Robert Stheeman	8	8
Jo Whelan	8	7
Jim Juffs	8	8
Joanne Perez	8	8
Sam Beckett (resigned July 2012)	2	1
James Richardson (appointed July 2012)	6	5
Brian Larkman	8	7
Brian Duffin	8	8

### Audit Committee

The Secretary and Comptroller General was supported during 2012-2013 by the Audit Committee on matters relating to risk, internal control and governance. The members of the Audit Committee during 2012-13 were:

Brian Larkman (Chair)

Brian Duffin

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

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

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

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

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

- Business continuity planning, especially with regard to the Olympics period;
- Anti-money laundering controls;
- Anti-fraud controls;
- Regulatory compliance;
- Risk management and financial control;
- Implementation of audit recommendations;
- External and internal financial reporting; and
- Information systems security.

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

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

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

The Fund Management Committee reviews CRND activity relating to the performance of the government funds under management, including any reporting on compliance activities undertaken in relation to the funds. In addition to regular agenda items the Committee has been monitoring the progress of updating the Memoranda of Understanding for a number of the funds.

The Fund Management Committee met four times in 2012-13.

#### **Business Delivery Committee**

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

The Business Delivery Committee met regularly (typically weekly) throughout 2012-13.

## Risk Committees

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

### Risk management and internal control

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

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

### The risk and control framework

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

#### First line of defence:

Day-to-day management of risk is the responsibility of management staff within business areas. The DMO fosters a risk aware culture and encourages all members of staff, including Board members to identify new risks and changes in previously identified risks, so that these may be assessed and so that appropriate mitigating actions may be put in place.

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

#### Second line of defence:

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

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

#### Credit and Market Risk Committee

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

### **Operational Risk Committee**

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

The ORC has advised the DMO Accounting Officer and the Board, during the year, on significant operational risk concerns, significant risk issues and trends as well as actions to mitigate such risks. The Committee has focused this year on further developing business continuity planning, including operational planning for the Olympic period, improving data security arrangements and extending the scope of the DMO's internal compliance testing programme. ORC met eight times during 2012-13.

### **Controls Group**

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

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

During the year the Controls Group review work has included reviewing the processes in place to control the introduction of IT changes as well as specific CRND reconciliation items.

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

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

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

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

### Third line of defence

The DMO's Internal Audit function provides the DMO Accounting Officer with independent and objective assurance on the overall effectiveness of the Agency's system of internal control. It does this through a risk based work programme which is approved by the Audit Committee at the start of each year. All audits make a series of recommendations which, once agreed by management, are monitored for implementation. In 2012 Internal Audit conducted a review of CRND concluding that there is a satisfactory level of control over managing and processing transactions. The function is independent of the DMO's trading activities and operations and has a direct reporting line to the DMO Accounting Officer. The work of Internal Audit includes assessing the effectiveness of both control design and control performance. With its independence and overall remit, Internal Audit provides a third line of defence against the risks that might prevent the DMO delivering its objectives.

### Risk policies and procedures

The DMO's risk policies reflect the high level standards and requirements which determine the way in which risks are managed and controlled. The DMO Accounting Officer, with the support of the Board, ensures that policies are regularly reviewed to reflect any changes in the DMO's operations and/or best practice. In 2012 this included revisions to the Information Security Policy, the Confidentiality and Official Information Policy and the Telephone Use and Recording Policy.

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

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

### Risk profile

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

Principal risks and uncertainties	Mitigation and management
<b>IT Systems and infrastructure</b>	
<p>CRND relies on a number of IT and communications systems to conduct its operations effectively and efficiently.</p> <p>A number of the operational systems and services on which CRND relies are provided or supported by third party suppliers.</p>	<p>The DMO has put in place structured business continuity arrangements to ensure it is able to continue market operations in the event of an internal or external incident that threatens business operations. These arrangements extend to cover CRND.</p> <p>The DMO's Business Continuity Plan (BCP) including Disaster Recovery (DR) and other arrangements are subject to continuous programme of testing, review and update. During 2012 the DMO ensured a thorough programme of DR testing was carried out, and that BCP arrangements to support auctions were undertaken during the year with teams working from the DR site during auctions. Assessment of business continuity needs is a specific requirement for new projects and major business initiatives, including those related to or affecting CRND.</p> <p>The DMO is represented on the Public Finance Business Continuity Management Group and played an active part in the Group's contingency planning for the Olympics in 2012. In addition the DMO also conducted an in house DR exercise as part of its contingency planning for the Olympic period.</p> <p>To mitigate the risk of failure of a key third party the DMO undertakes a corporate risk assessment of each potential supplier in order to assess financial strength and operational capacity. The DMO has dedicated relationship managers who meet regularly with key suppliers and monitor performance against agreed SLAs.</p>
<b>Transaction processing</b>	
<p>CRND relies on its operational processes to successfully execute a significant number of high value transactions on a daily basis. Reliance on the accurate execution of processes exposes CRND to operational risk arising from process breakdown and human error.</p>	<p>A key component of CRND's control framework is the segregation of duties to ensure independent checking and reconciliation, and to avoid concentration of key activities or related controls in individuals or small groups of staff. In particular, segregation of duties takes place between front and back office activities. In addition during 2012-13 the DMO continued to enhance its management information around trading activity and strengthened its reconciliation processes and controls.</p> <p>All teams, including CRND, have documented procedures for their main activities and there are clearly defined authorisation levels for committing the DMO externally.</p> <p>The RMU conducts regular control and compliance testing of CRND activities, providing the executive sub-committee of the Board with assurance on the effectiveness of operational controls and compliance with relevant Financial Services Authority rules in the dealing and settlement areas.</p> <p>The DMO also maintains a strong audit and control environment which includes a well embedded incident reporting procedure which extends to cover CRND. This promotes early identification and resolution of risk incidents and provides visibility to the DMO Accounting Officer and Board.</p> <p>DMO recruitment policies help ensure that individuals with the appropriate level of skill and experience are appointed at all levels within the organisation. This helps mitigate the level of human error resulting in process failures.</p>

<b>People risk</b>	
<p>The DMO, including CRND, relies on maintaining a sufficiently skilled workforce at all levels of the organisation in order to operate effectively and efficiently, and to deliver its strategic objectives.</p> <p>The DMO is exposed to an increased risk of operational failure if it is unable to compete for, and retain, sufficiently skilled staff over time. Competition for skilled staff is generally against employers from the private financial services sector which is not subject to public sector remuneration policies and which have historically offered higher remuneration than either the private sector in general or the public sector.</p>	<p>The DMO's Training and Development policy aims to ensure that its staff have the right skills to meet its objectives.</p> <p>The DMO has a formal recruitment and selection process to help ensure vacancies are filled quickly by appropriately skilled candidates.</p> <p>The DMO has put in place a formal performance appraisal process and all staff are given clear and achievable objectives. Where appropriate, staff are encouraged to engage in activities which promote development and the DMO provides regular training opportunities and support for professional studies to enhance the skills base of its employees. The DMO also provides cross-training for different roles to help improve staffing flexibility and reduce turnover pressure.</p> <p>Salaries are reviewed annually, taking account of benchmarks derived from equivalent private sector pay levels. In addition the DMO has a policy to recognise those staff who have performed well in their roles through the payment of one off performance related awards. Any awards are assessed annually by the DMO Pay Committee and are determined by individual performance and criteria associated with the DMO's performance management process and are aligned to the policy for public sector pay.</p> <p>A Staff Council has met regularly throughout the year and enabled an open exchange of ideas and views between management and staff representatives and has been an effective conduit for wider communication and consultation with all staff.</p> <p>On an annual basis DMO staff take part in the Civil Service employee engagement survey and any issues raised, including mitigating action if required, will be considered by the DMO Accounting Officer and Board.</p> <p>The DMO was reaccredited as an Investor in People in 2011.</p>
<b>IT and data security</b>	
<p>Through its activities the DMO gathers, disseminates and maintains sensitive information including market sensitive information and personal data about staff and market participants. The DMO seeks to ensure the highest standards of data protection and information management.</p> <p>The DMO is exposed to risk of an external attack on its IT systems and infrastructure.</p>	<p>The DMO continues to work to maintain the required level of protective security covering physical, personnel and information security. In 2012 the DMO experienced a breach of its data handling policies. Although no personal data was affected and there was no consequential impact from this lapse, the DMO's information security policies and controls were fully reviewed and enhancements introduced. These included strengthening the processes for the induction of new staff and raising the level of awareness of information security issues for existing staff.</p> <p>In addition the DMO has a project underway to enhance system logging and improve control of system access rights.</p> <p>Risks to data and information held by the DMO are owned and managed by designated Information Asset Owners. The DMO has a Senior Information Risk Owner (SIRO) who is responsible for the information risk policy and the assessment of information risks. The SIRO is a member of the Board and provides advice to Board members on the management of information risk.</p> <p>The DMO has put in place several layers to defend against external attack and its infrastructure undergoes an annual penetration test to ensure the control environment is robust. These tests are undertaken by specialists and form part of the assessment against the CESG requirements which is a condition for continuing connection to the GSI Convergence Framework (GCF).</p>

## Review of effectiveness

I have reviewed the effectiveness of the system of internal control and confirm that an ongoing process designed to identify, evaluate and prioritise risks to the achievement of CRND's aims and objectives has been in place throughout 2012-13. This review included an assessment of any material risk and control issues identified and reported during the relevant period.

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

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

In 2012-13, no ministerial directions were given and no material conflicts of interest have been noted by the Board or Audit Committee members in the Register of Interests.

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

*Jo Whelan* 27 June 2013  
Secretary and Comptroller General  
to the Commissioners for the Reduction of the National Debt

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

I certify that I have audited the financial statements of the National Lottery Distribution Fund Investment Account for the year ended 31 March 2013 under the National Lottery etc. Act 1993. The financial statements comprise: the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Client Funds and the related notes. These financial statements have been prepared under the accounting policies set out within them.

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

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

My responsibility is to audit, certify and report on the financial statements in accordance with the National Lottery etc. Act 1993. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

## Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the National Lottery Distribution Fund Investment Account's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Secretary and Comptroller General; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the Foreword, Management Commentary and Governance Statement, to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

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

### **Opinion on regularity**

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

### **Opinion on the financial statements**

In my opinion:

- the financial statements give a true and fair view of the state of the National Lottery Distribution Fund Investment Account's affairs as at 31 March 2013 and of the surplus for the year then ended; and
- the financial statements have been properly prepared in accordance with the National Lottery etc. Act 1993 and the HM Treasury directions issued thereunder.

### **Opinion on other matters**

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

### **Matters on which I report by exception**

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

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

### **Report**

I have no observations to make on these financial statements.

*Amyas C E Morse*  
Comptroller and Auditor General

28 June 2013

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

## Income Statement for the year ended 31 March 2013

	Notes	<b>2013</b> <b>£000</b>	2012 £000
Interest income	2	<b>9,418</b>	12,064
Other gains	3	<b>17,634</b>	–
<b>Surplus for the year</b>		<b><u>27,052</u></b>	<u>12,064</u>

## Statement of Comprehensive Income for the year ended 31 March 2013

	<b>2013</b> <b>£000</b>	2012 £000
<b>Surplus for the year</b>	<b>27,052</b>	12,064
Other comprehensive income:		
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	<b>938</b>	18,809
Realised gains on UK Government gilt-edged securities classified as available-for-sale transferred to the income statement	<b>(17,634)</b>	–
<b>Total comprehensive income for the year</b>	<b><u>10,356</u></b>	<u>30,873</u>

*The notes on pages 21 to 23 form part of these accounts.*

## Statement of Financial Position as at 31 March 2013

	Notes	2013 £000	2012 £000
<b>Assets</b>			
Demand deposits with the Debt Management Account & the National Loans Fund		<b>1,495,598</b>	992,791
UK Government gilt-edged securities classified as available-for-sale	4	–	285,916
<b>Total</b>		<b><u>1,495,598</u></b>	<b><u>1,278,707</u></b>
<b>Client Funds</b>			
NLDF funds		<b><u>1,495,598</u></b>	<b><u>1,278,707</u></b>
<b>Total</b>		<b><u>1,495,598</u></b>	<b><u>1,278,707</u></b>

*Jo Whelan* 27 June 2013  
 Secretary and Comptroller General  
 to the Commissioners for the Reduction of the National Debt

*The notes on pages 21 to 23 form part of these accounts.*

## Statement of Cash Flows for the year ended 31 March 2013

	<b>2013</b>	2012
	<b>£000</b>	£000
<b>Operating activities</b>		
Interest received on demand deposits	<b>6,045</b>	5,609
(Increase)/decrease in demand deposits	<b>(502,598)</b>	111,067
<b>Net cash flow (used in)/from operating activities</b>	<b>(496,553)</b>	116,676
<b>Investing activities</b>		
Interest received on UK Government gilt-edged securities classified as available-for-sale	<b>2,754</b>	5,426
Sales of UK Government gilt-edged securities classified as available-for-sale	<b>289,963</b>	–
Purchases of UK Government gilt-edged securities classified as available-for-sale	<b>(2,699)</b>	(5,371)
<b>Net cash from investing activities</b>	<b>290,018</b>	55
<b>Financing activities</b>		
Funds received from NLDF	<b>1,889,210</b>	1,663,266
Funds paid to NLDF	<b>(1,682,675)</b>	(1,779,997)
<b>Net cash from/(used in) financing activities</b>	<b>206,535</b>	(116,731)
<b>Increase/(decrease) in cash</b>	<b>–</b>	<b>–</b>

*The notes on pages 21 to 23 form part of these accounts.*

## Statement of Changes in Client Funds for the year ended 31 March 2013

	NLDF funds (excluding revaluation reserve) £000	Revaluation reserve £000	Total NLDF funds £000
<b>At 1 April 2011</b>	<b>1,366,678</b>	<b>(2,113)</b>	<b>1,364,565</b>
Surplus for the year	12,064	–	12,064
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	–	18,809	18,809
Funds received from NLDF	1,663,266	–	1,663,266
Funds paid to NLDF	(1,779,997)	–	(1,779,997)
<b>At 31 March 2012</b>	<b>1,262,011</b>	<b>16,696</b>	<b>1,278,707</b>
Surplus for the year	27,052	–	27,052
Realised gains transferred to income statement on disposal of UK Government gilt-edged securities classified as available-for-sale	–	(17,634)	(17,634)
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	–	938	938
Funds received from NLDF	1,889,210	–	1,889,210
Funds paid to NLDF	(1,682,675)	–	(1,682,675)
<b>At 31 March 2013</b>	<b>1,495,598</b>	<b>–</b>	<b>1,495,598</b>

*The notes on pages 21 to 23 form part of these accounts.*

# Notes to the Accounts for the year ended 31 March 2013

## 1 Accounting policies

### 1.1 Basis of preparation

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

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

Certain IFRS have been issued or revised, but are not yet effective, and will be applied in subsequent reporting periods. These are:

- IAS 1 Presentation of Financial Statements, which has been revised. Application is required for reporting periods beginning on or after 1 July 2012. Earlier application is permitted. The NLDFA expects to apply these revisions to IAS 1 in 2013-14. The application of these revisions, which relate to presentation of items in the income statement based on their potential to be reclassified, is not expected to impact the presentation of information in the NLDFA.
- IFRS 13 Fair Value Measurement, which has been issued. Application is required for reporting periods beginning on or after 1 January 2013. Earlier application is permitted. The NLDFA expects to apply IFRS 13 in 2013-14. The application of IFRS 13 is not expected to materially change the valuation or disclosure of transactions or balances in the NLDFA.
- IAS 1 Presentation of Financial Statements, which has been revised as part of the IASB's annual improvements process. Application is required for reporting periods beginning on or after 1 January 2013. Earlier application is permitted. The NLDFA expects to apply these revisions to IAS 1 in 2013-14. The application of these revisions to IAS 1 do not materially change the minimum requirements for comparative information and are expected to have an immaterial impact on the NLDFA.
- IFRS 9 Financial Instruments, which will replace IAS 39. Application is required for reporting periods beginning on or after 1 January 2015. Earlier application is permitted. The NLDFA expects to apply IFRS 9 in 2015-16. The application of IFRS 9 is not expected to impact on the reporting of financial instruments in the NLDFA.

## 1.2 Assets

### a Demand deposits

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

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

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

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

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

## 1.3 Income recognition

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

## 1.4 Administrative costs

Administrative costs are accounted for in the DMO Report and Accounts 2012-13 and a recovery is made from the Department for Culture, Media and Sport.

## 2 Interest income

	<b>2013</b>	2012
	<b>£000</b>	£000
UK Government gilt-edged securities classified as available-for-sale	<b>3,165</b>	6,477
Demand deposits with the Debt Management Account and the National Loans Fund	<b>6,253</b>	5,587
	<b>9,418</b>	12,064

## 3 Other gains

	<b>2013</b>	2012
	<b>£000</b>	£000
Profit on disposal of UK Government gilt-edged securities classified as available-for-sale	<b>17,634</b>	–
	<b>17,634</b>	–

#### 4 UK Government gilt-edged securities classified as available-for-sale

	2013	2013	2012	2012
	Nominal	Fair value	Nominal	Fair value
Maturity analysis	£000	£000	£000	£000
Due within one – five years				
Non marketable	-	-	266,036	279,217
Marketable	-	-	3,841	4,031
Due in more than five years				
Marketable	-	-	2,192	2,668
	<u>-</u>	<u>-</u>	<u>272,069</u>	<u>285,916</u>

#### 5 Risk

##### 5.1 Credit risk

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

As at 31 March 2013, the investments of the NLDFIA comprised deposits with either the Debt Management Account or the National Loans Fund. These deposits were considered to have no exposure to credit risk because both were obligations of HM Government.

##### 5.2 Market risk

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

The interest returns on deposits are closely linked to the official Bank Rate.

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

##### 5.3 Liquidity risk

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

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

#### 6 Related party transactions

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

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

During the year, the NLDFIA had a significant number of material transactions with the NLDF due to the NLDF receiving funds from the National Lottery for investment. During the year, the NLDF deposited £207 million (net of withdrawals) with the NLDFIA (2011-12: net withdrawal of £117 million).

## Appendix

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

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

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

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

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

23 March 2012

For further information about the National Audit Office please contact:

National Audit Office  
Press Office  
157-197 Buckingham Palace Road  
Victoria  
London  
SW1W 9SP  
Tel: 020 7798 7400  
Email: [enquiries@nao.gsi.gov.uk](mailto:enquiries@nao.gsi.gov.uk)

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