

National Lottery Distribution Fund Investment Account 2011-12

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

National Lottery Distribution Fund Investment Account 2011-12

ORDERED BY THE HOUSE OF COMMONS TO BE PRINTED ON 22 OCTOBER 2012

The National Audit Office scrutinises public spending on behalf of Parliament.

The Comptroller and Auditor General, Amyas Morse,
is an Officer of the House of Commons.
He is the head of the NAO, which employs some 880 staff.
He and the NAO are totally independent of government.

He certifies the accounts of all government departments
and a wide range of other public sector bodies;
and he has statutory authority to report to Parliament
on the economy, efficiency and effectiveness with which departments
and other bodies have used their resources.

Our work led to savings and other efficiency gains worth more than £1 billion in 2010-11.

© Crown copyright 2012

You may reuse this information (excluding logos)
free of charge in any format or medium,
under the terms of the Open Government Licence.

To view this licence, visit
<http://www.nationalarchives.gov.uk/doc/open-government-licence/>
or email psi@nationalarchives.gsi.gov.uk.

Where we have identified any third party copyright information you will need to obtain permission
from the copyright holders concerned.

This publication is available for download at www.official-documents.gov.uk.

ISBN 9780102970647

Contents

	Page
Foreword	2
Management Commentary	4
Statement of Secretary and Comptroller General's responsibilities	5
Governance Statement	6
The Certificate and Report of the Comptroller and Auditor General	15
Income Statement	17
Statement of Comprehensive Income	17
Statement of Financial Position	18
Statement of Cash Flows	19
Statement of Changes in Client Funds	20
Notes to the Accounts for the year ended 31 March 2012	21
Appendix	24

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 of 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, Olympics, Media and Sport. The purpose of 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 Investment Account 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 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 Investment Account held by each body. However, from 1 April 2011, distribution of the investment income has been on the same basis as lottery proceeds, with expenditure to be split as follows, 18.0 per cent on arts, 18.0 per cent on sport, 18.0 per cent on national heritage, and 46.0 per cent on charities, health, education or the environment.

The resources that have been 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 2011-12. The cost of managing the Investment Account is recharged to the Department for Culture, Media and Sport (DCMS); in 2011-12, this amounted to £115,000 (2010-11: £116,000).

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 DCMS 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 Investment Account's auditors are aware of that information. So far as she is aware, there is no relevant audit information of which the Investment Account's auditors are unaware.

Management Commentary

Results for 2011-12

During 2011-12, the Investment Account made a surplus from funds invested of £12.1 million (2010-11: £18.0 million), a decrease on the previous year due to lower average funds on deposit, due to net withdrawals from the fund during the year.

As at 31 March 2012 the total market value of assets held by NLDFIA was £1,279 million (31 March 2011: £1,365 million). NLDFIA has remained largely invested in ultra-short cash instruments, in order to best protect its capital and access to liquidity, however the fund also holds UK Government gilt-edged securities.

Date of authorisation for issue

The Secretary and Comptroller General authorised these financial statements for issue on 16 July 2012.

Jo Whelan 12 July 2012
Secretary and Comptroller General
to the Commissioners for the Reduction of the National Debt

Statement of Secretary and Comptroller General's responsibilities

Section 33(2) of the National Lottery, etc Act 1993 requires the Commissioners to prepare accounts for each financial year in the form and on the basis determined by HM Treasury.

The annual accounts of the NLDF Investment Account are prepared on an accruals basis, as directed by HM Treasury and must give a true and fair view of the financial position of the Investment Account at the year end and of its income and cash flows for the financial year.

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

In preparing accounts an Accounting Officer is required to observe the applicable accounting standards and generally accepted accounting practice in so far as they are relevant to the Account, and apply suitable accounting policies on a consistent basis.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, and for the keeping of proper accounting records, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in *Managing Public Money*.

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.

The 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 2011-12 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 – 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.

Board membership remained unchanged throughout the period under review. Non-executive directors are appointed by the DMO Accounting Officer following a formal process and have fixed terms defined in their contracts of service. HM Treasury's representative 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 they consider it necessary in the discharge of their duties.

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

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

The board has undertaken a formal self evaluation of its performance covering 2011-12. The board concluded that, during the period under review, it has operated effectively in delivering the objectives set out in its terms of reference. Suggestions for minor improvement are being considered and will be implemented where appropriate.

2011-12 Board activities

Board meetings were held throughout 2011-12 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	8
Jim Juffs	8	8
Joanne Perez	8	8
Sam Beckett	8	5
Brian Larkman	8	7
Brian Duffin	8	8

Audit Committee

The Secretary and Comptroller General was supported during 2011-12 by the Audit Committee on matters relating to risk, internal control and governance. The members of the Audit Committee during 2011-2012 were:

Brian Larkman (Chair)
Brian Duffin

Caroline Mawhood – Caroline Mawhood was an Assistant Auditor General at the National Audit Office until 2009 and President of the Chartered Institute of Public Finance and Accountancy for 2008-09. She is a non-executive member of the Audit Committees of the Department of Energy and Climate Change 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.

Audit Committee meetings are typically attended by the DMO Accounting Officer, the Secretary and Comptroller General, the Joint Head of Policy and 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;
- anti-money laundering controls;
- anti-fraud controls;
- staff resourcing;
- risk management and financial control; and
- external and internal financial reporting.

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

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

Fund Management Review Committee

The Fund Management Review Committee 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.

The Fund Management Review Committee met four times in 2011-12.

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 2011-12.

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.

The 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 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 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 twelve 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 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, reviewing trading controls and improving the data quality and reliability of the DMO website. ORC met eight times during the year.

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 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 Accounting Officer on suitable mitigating action where appropriate.

During the year the Controls Group review work has included improvements in cash forecasting and trade settlement processing, and changes to banking arrangements for CRND funds.

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 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 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. The function is independent of the DMO's trading activities and operations and has a direct reporting line to the 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 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 2011 this included broadening the scope of certain DMO policies to cover requirements introduced by the Bribery Act.

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 board believe that the principal risks and uncertainties facing the 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
IT Systems and infrastructure	
<p>The 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 the CRND relies are provided or supported by third party suppliers.</p>	<p>In line with good practice the DMO has put in place comprehensive business continuity arrangements to ensure it is able to continue market operations in the event of an internal or external incident that threatens business as usual activity. These arrangements extend to cover CRND.</p> <p>The DMO's Business Continuity Plan (BCP) including Disaster Recovery (DR) and other arrangements is subject to continual review and update. The DMO ensured a programme of DR testing was carried out in 2011, and that BCP arrangements to support auctions were observed during the year, with teams working from the DR site during auction sessions. Assessment of business continuity requirements is a specific requirement for new projects and major business initiatives.</p> <p>The DMO recruited a dedicated business continuity specialist in 2011 to help enhance and promote planning across the organisation.</p> <p>The DMO is represented on the Public Finance Business Continuity Management Group and took part in a market wide business continuity exercise conducted in November 2011.</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. Additionally the DMO has dedicated relationship managers who meet regularly with key suppliers and monitor performance against agreed SLAs.</p>
Transaction processing	
<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 the CRND to operational risk arising from process breakdown and human error.</p>	<p>A key component of the CRND's control framework is the segregation of duties to ensure independent checking and reconciliation, and to avoid concentration of key activities or related controls in individuals or small groups of staff. In particular, segregation of duties takes place between front and back office activities.</p> <p>All teams, including CRND, have documented procedures for their main activities and there are clearly defined authorisation levels for committing the DMO externally. In 2011-12 system enhancements were made to improve management information on trade activity and regular accounting reports.</p> <p>The RMU conducts regular control and compliance testing, 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 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>

People risk	
<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.</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>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 Accounting Officer and board.</p> <p>The DMO was reaccredited as an Investor in People in 2011.</p>
IT and security	
<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.</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 also provides assurance to the board that information risks are being managed effectively.</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. This is a condition for continuing connection to the Government Secure Internet (GSI).</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 the CRND's aims and objectives has been in place throughout 2011-12. 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.

Plans to address weaknesses and ensure continuous improvement of the system are in place.

No significant internal control issues, including data security incidents, have been identified in 2011-12, and no ministerial directions were given.

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

Jo Whelan 12 July 2012
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 2012 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 2012, 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

16 July 2012

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

Income Statement for the year ended 31 March 2012

	Notes	2012 £000	2011 £000
Interest income	2	12,064	11,687
Other gains	3	0	6,302
Surplus for the year		<u>12,064</u>	<u>17,989</u>

Statement of Comprehensive Income for the year ended 31 March 2012

	2012 £000	2011 £000
Surplus for the year	12,064	17,989
Other comprehensive income:		
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	18,809	3,256
Realised gains on UK Government gilt-edged securities classified as available-for-sale transferred to the income statement	0	(6,302)
Total comprehensive income for the year	<u>30,873</u>	<u>14,943</u>

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

Statement of Financial Position as at 31 March 2012

	Notes	2012 £000	2011 £000
Assets			
Demand deposits with the Debt Management Account and the National Loans Fund (NLF)		992,791	1,103,881
UK Government gilt-edged securities classified as available-for-sale	4	285,916	260,684
Total		<u>1,278,707</u>	<u>1,364,565</u>
Client Funds			
NLDF funds		1,278,707	1,364,565
Total		<u>1,278,707</u>	<u>1,364,565</u>

Jo Whelan 12 July 2012
 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 2012

	2012 £000	2011 £000
Operating activities		
Interest received on demand deposits	5,609	5,329
Decrease/(increase) in demand deposits	<u>111,067</u>	<u>(66,932)</u>
Net cash flow from/(used in) operating activities	116,676	(61,603)
Investing activities		
Interest received on UK Government gilt-edged securities classified as available-for-sale	5,426	4,281
Sales of UK Government gilt-edged securities classified as available-for-sale	0	260,909
Purchases of UK Government gilt-edged securities classified as available-for-sale	<u>(5,371)</u>	<u>(265,190)</u>
Net cash from investing activities	55	0
Financing activities		
Funds received from NLDF	1,663,266	1,547,920
Funds paid to NLDF	<u>(1,779,997)</u>	<u>(1,486,317)</u>
Net cash (used in)/from financing activities	(116,731)	61,603
Increase/(decrease) in cash	<u>0</u>	<u>0</u>

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

Statement of Changes in Client Funds

	NLDF Funds excluding revaluation reserve £000	Revaluation reserve £000	Total NLDF Funds £000
At 1 April 2010	1,287,086	933	1,288,019
Surplus for the year	17,989	0	17,989
Realised gains transferred to income statement on disposal of UK Government gilt-edged securities classified as available-for-sale	0	(6,302)	(6,302)
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	0	3,256	3,256
Funds received from NLDF	1,547,920	0	1,547,920
Funds paid to NLDF	(1,486,317)	0	(1,486,317)
At 31 March 2011	1,366,678	(2,113)	1,364,565
Surplus for the year	12,064	0	12,064
Fair value gains on UK Government gilt-edged securities classified as available-for-sale	0	18,809	18,809
Funds received from NLDF	1,663,266	0	1,663,266
Funds paid to NLDF	(1,779,997)	0	(1,779,997)
At 31 March 2012	1,262,011	16,696	1,278,707

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

Notes to the accounts for the year ended 31 March 2012

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
- IAS 7 Statements of cash flows (revised 2007)
- 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, which will impact on the NLDFA in subsequent reporting periods. These are:

IFRS 9 Financial Instruments, which will replace IAS 39.

IFRS 9 is expected to improve and simplify the reporting of financial instruments. Application of IFRS 9 is required for any reporting period beginning on or after 1 January 2015. Earlier application is permitted. The NLDFA expects to apply IFRS 9 in its 2015-16 Accounts. The application of IFRS 9 is not expected to impact on the disclosure of financial instruments reported by the NLDFA.

1.2 Assets

Deposits

Deposits with the Debt Management Account (DMA) & 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.

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

In addition to marketable gilts NLDFA hold non-marketable gilts, which do not exist outside CRND. These were created to ensure there is no market distortion caused by large CRND trades. These gilts mirror exactly the equivalent marketable gilts and are treated as available for sale assets.

Available-for-sale assets are non-derivative financial assets that are designated as available-for-sale. They are initially recognised on trade date, when NLDFA enters into contractual arrangements with counterparties (primarily the National Loans Fund) to purchase securities. The assets are derecognised when the rights to receive cash flows have expired or NLDFA transferred substantially all the risks and rewards of ownership. The fair value of a financial instrument on recognition is normally the transaction price. Following initial recognition, the fair values of financial assets that are quoted in active markets are based on bid prices. Gains and losses arising from changes in fair value are recognised in the revaluation reserve until sale when the cumulative gain or loss is transferred to the statement of comprehensive income.

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.

1.3 Administrative expenditure

Administrative costs are accounted for in the DMO Report and Accounts 2011-12 and a recovery is made from DCMS.

2 Interest income

	2012	2011
	£000	£000
UK Government gilt-edged securities classified as available-for-sale	6,477	6,431
Demand deposits with the Debt Management Account and the National Loans Fund	5,587	5,256
	12,064	11,687

3 Other gains

	2012	2011
	£000	£000
Profit on disposal of UK Government gilt-edged securities classified as available-for-sale	0	6,302
	0	6,302

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

	2012	2012	2011	2011
	Nominal	Fair value	Nominal	Fair value
	£000	£000	£000	£000
Maturity analysis				
Due within 1-5 years				
Non marketable	266,036	279,217	266,036	259,521
Marketable	3,841	4,031	1,192	1,163
Due in five years				
Marketable	2,192	2,668	0	0
	272,069	285,916	267,228	260,684

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 NLDFIA.

The investments of NLDFIA comprise deposits and gilts. The deposits are with either the DMA or the NLF and are considered to have no exposure to credit risk because both accounts are backed by HM Government. Similarly gilts are considered to be free of credit risk because they have the backing 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 NLDFIA is considered to comprise interest rate risk.

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

The market value of gilts is sensitive to movements in interest rates. However, gilts tend to be held over the longer term to provide a guaranteed interest return, rather than to generate trading profits. Holding gilts to maturity can generate guaranteed interest returns over the life of the holding, but any disposals of holdings may incur profits or losses.

CRND monitors interest rate movements to help inform the NLDF of potential issues and events. The Fund is not subject to active management and thus no formal market risk parameters are in place.

5.3 Liquidity Risk

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

Assets held by NLDFIA are highly liquid to enable all client obligations to be met as they fall due.

6 Related Parties

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

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

During the year, NLDFIA had a significant number of material transactions with NLDF due to NLDF receiving funds from the National Lottery for investment. During the year, NLDF withdrew £116.7m (net of advances) with NLDFIA (2010-11: net deposit of £61.6m).

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

DG Ref: 009945

Published by TSO (The Stationery Office) and available from:

Online

www.tsoshop.co.uk

Mail, Telephone, Fax & email

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/general enquiries: 0870 600 5522

Order through the Parliamentary Hotline Lo-call 0845 7 023474

Fax orders: 0870 600 5533

Email: customer.services@tso.co.uk

Textphone 0870 240 3701

The Parliamentary Bookshop

12 Bridge Street, Parliamentary Square,
London SW1A 2JX

Telephone orders/general enquiries 020 7219 3890

Fax orders 020 7219 3866

Email: bookshop@parliament.uk

Internet: <http://www.bookshop.parliament.uk>

TSO@Blackwell and other accredited agents

ISBN 978-0-10-297064-7



9 780102 970647