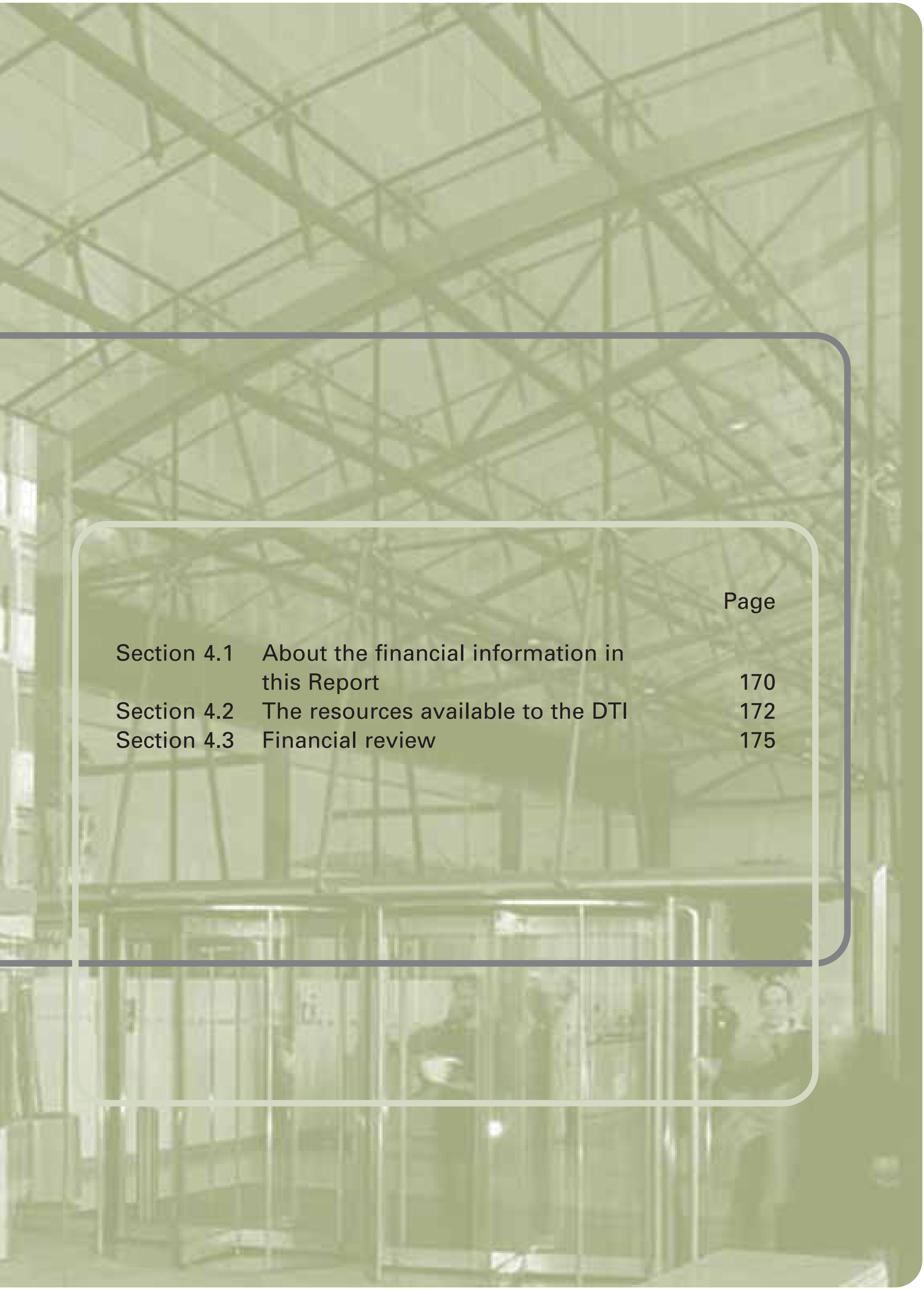
CHAPTER 4

Introduction to the Department's finances



Section 4.1

About the financial information in this Report

4.1 The financial information in this Report is shown from two different perspectives:

- the budgetary spend of the 'Departmental family' (i.e. the Department and all of its delivery partners as described in section 3.3), and
- the Consolidated Resource Accounts for the core Department and those of its delivery partners that are consolidated in the Resource Accounts.

4.2 The Departmental family delivers on its objectives through its budgets. The Department is ultimately responsible for these resources and the bodies who spend them. These budgets together with supplementary information about them are provided in Chapter 6 of this Report. This sets out the total spend required to deliver the Department's objectives, regardless of which body or bodies within the wider Departmental family manage the spend. What constitutes the Departmental family is set out on pages 125 to 129.

4.3 The Consolidated Resource Accounts in Chapter 5 include only the following bodies:

- the Department;
- the Department's elements of the administration expenditure of UK Trade & Investment, a joint operation of the Department and the Foreign and Commonwealth Office (FCO);
- the Insolvency Service[1], the National Weights and Measures Laboratory and the Small Business Service, which are executive agencies of the Department; and
- The Advisory, Conciliation and Arbitration Service, which is a Crown Executive Non Departmental Public Body (NDPB).

The remaining bodies, which constitute the Departmental family are listed on pages 125 to 129 and are not included in the Consolidated Resource Accounts, apart from the inclusion of cash payments to them, via grant in aid. The income and expenditure of all bodies within the Departmental family is shown in Chapter 6.

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[1] The Insolvency Service also receives monies, under the Insolvency Service Act 1986, which are excluded from these accounts because they are subject to a different financial control framework. Under Section 403 of the Act, sums are received from the realisation of assets from bankruptcies and company liquidations. The monies are held by the Secretary of State and interest earned on balances is surrendered to HM Treasury in accordance with Section 405 of the Act. Further details are available in the published accounts of the Insolvency Service which can be obtained from http://www.insolvency.gov.uk.

4.4 The 2006-07 Consolidated Resource Accounts can be found on pages 190 to 262. In common with other central Government bodies, the Department's Consolidated Resource Accounts are audited by the National Audit Office on behalf of the Comptroller & Auditor General. Most of the Department's bodies that sit outside of the accounting boundary produce their own annual report and resource accounts; see Section 3.3 for more information.

4.5 Section 4.2 of this Report provides the background to the way in which accounting and budgeting in Government is managed and controlled, and shows how this regime impacts the Department. This is followed by the Department's financial review of the year, which highlights and explains some of the key information in the Consolidated Resource Accounts on the one hand and the section on budgetary spend on the other.

4.6 The 2006-07 audited Consolidated Resource Accounts (i.e. the primary statements and supporting notes) are contained in Chapter 5 of the Report. Information about budgetary expenditure is contained in Chapter 6.

Section 4.2
The resources available to the Department

4.7 The Department operates within the wider Government financial environment. The resources available to the Department and how it reports on and is held accountable for these resources has to be seen within this environment. This section sets out the broad principles of budgeting and accounting in Government, explains some of the key terms which are used and explains how the Department manages its resources in this context.

The Spending Review process

4.8 The Spending Review (SR) is the process by which the Government sets spending plans, usually for the coming three years. This determines the overall control total, Total Managed Expenditure (TME). TME is made up of two components, the Departmental Expenditure Limit (DEL) and Annually Managed Expenditure (AME). The DEL is set annually within the context of the Department's 3 year SR settlement and AME is set in consultation with HM Treasury through twice yearly reviews. The most recent review, SR 2004, was concluded in 2004 and covered the three-year period 2005-06, 2006-07 and 2007-08. This set the Department's budgets for these periods.

4.9 In July 2005 the Government announced that a Comprehensive Spending Review 2007 (CSR07) would take place. As part of the CSR07 review, the Department has been working closely with HM Treasury. It reached agreement on its administration budgets, in line with the 2006 Pre-Budget Report announcement that administration budgets across departments will be reduced by at least 5% in real terms over the CSR07 period. Early settlement of the 2008-11 science budget was announced in the Chancellor's 2007 Budget which will ensure that total science expenditure will rise on average by 2.7% annually, in real terms over the CSR period. The Department's non-science budget was settled on 27 June 2007.

From budgets to Estimates to accounts

4.10 The following paragraphs explain the process that the Department, in common with other Government departments, goes through to obtain the resources that are ultimately reported on in their Resource Accounts, as well as explaining the differences between budgets, Estimates and the accounts.

The Department's budget

4.11 The Departmental family measures and manages its expenditure through budgets. The Department has two types of budgets which are described below:

- DEL, which the Department can largely control overall, though some elements may be demand-led. It is set annually within the context of the

Department's 3 year financial settlement, as set out in the Spending Review.

- AME, which is demand-led and volatile and therefore difficult to predict. AME budgets are set in consultation with HM Treasury through twice yearly reviews. The majority of the Department's AME expenditure relates to nuclear provisions, coal health liabilities, Royal Mail restructuring costs, the Post Office revolving loan and the Redundancy Payments Service.

4.12 Within DEL and AME there are resource budgets and capital budgets, which are further broken down into administration and programme budgets.

4.13 The Department's DEL budget for 2006-07 was £7,011.4 million (2005-06 £6,950.7 million) and the AME budget amounted to £517 million (2005-06 £25,186.8 million).[2] Explanations for movements in budgets from year to year are given in Chapter 6.

4.14 Some of the Department's DEL and AME budgets are ring-fenced by HM Treasury. 80% of the 2006-07 DEL was ring-fenced leaving only 20% (£1,388.5 million) available for discretionary allocation by the Department.

4.15 There are also further classifications of expenditure within resource budgets termed 'near cash' and 'non cash'. Near cash items are transactions that result in real cash flows in the near future (accruals based) e.g. pay costs, purchases and grants. Importantly it also includes cash expenditure against provisions (e.g. spend to reduce coal health liabilities).

4.16 Non cash items are components of departments' budgets that are included to reflect the full economic cost of activities and the usage of long-term assets. Non cash items include depreciation, cost of capital, profit or loss on disposal of balance sheet assets and changes in provisions.

4.17 The Department is responsible for all of the resources available to the Departmental family. In order to meet this responsibility the Department has put in place a strong budgetary control process.

4.18 The Department allocates budgets in March of each year and monitors them on a monthly basis. Forecasts of expenditure are reviewed monthly and updated where appropriate. More in-depth reviews of forecasts are carried out quarterly with particular emphasis on end December reviews (as these are used by HM Treasury as a basis for total spend across Government for the year) and end February reviews (to identify changes to be made through the Spring Supplementary Estimate). Updated information is then reported at corporate level through the Department's financials which are presented to the Management Board monthly by the Finance Director.

4.19 Budgets are usually amended via the Winter and Spring Supplementary Estimates. Monthly budget monitoring helps to inform this process although formal commissioning also takes place to gather full information on required changes. Changes in Estimates impact the budgets directly with the exception of the NDPBs, as the Estimates only reflect the grant in aid (cash) paid to these bodies. The actual expenditure and income of these NDPBs is treated as non-voted

[2] Includes £24,300 million increase in provisions for the nuclear liabilities of the NDA.

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(i.e. not voted by Parliament, as only the cash payments made to these bodies are voted) and appears by way of a note in the Estimates.[3] A formal process ensures that any required changes are captured. The Supplementary Estimates include gaining access to funding from utilisation of end year flexibility which arises due to savings achieved in previous years.

The Estimates process

4.20 Having set its budgets the Department has to request resources from Parliament annually in order to formally fund the delivery of its objectives. Main Estimates are the means by which departments seek parliamentary authority for their spending each year.

4.21 The Estimates are made up of DEL, AME and 'non-budget' requests i.e. transactions which do not count as budgets due to their classification. The DEL and AME relate to requests for expenditure and income recorded in the Statement of Parliamentary Supply on page 202 of the Consolidated Resource Accounts. The non-budget requests largely relate to grant in aid (cash paid) which the Department uses to fund its NDPBs.

4.22 In the context of the Estimates and Consolidated Resource Accounts, the funding voted to Departments for their NDPBs is only for the grant in aid payments made to them.

4.23 The Government seeks approval from Parliament for its Main Estimates for the year in April or May. Supplementary Estimates can then be submitted in the summer, winter and spring. The Estimates follow a standard format, with one or more Requests for Resources (RfR), which set a limit on the resources required for each main Departmental activity, a request for capital funding and a Net Cash Requirement (NCR), which represents the actual cash flowing out of the Exchequer in order to fund the Department's activities.

4.24 Each RfR is accompanied by a formal description (ambit) of the services to be financed under it. Money voted by Parliament should be used to finance services that fall within the ambit of the RfR.

The accounts

4.25 The Department's total expenditure is covered by two RfRs and these are reported on in its Consolidated Resource Accounts:

- RfR1 – increasing UK competitiveness; and
- RfR2 – increasing scientific excellence in the UK and maximising its contribution to society.

4.26 It also has a separate Estimate and RfR for the effective management of the UKAEA pension schemes. Copies of the UKAEA Pension Accounts are available at www.ukaeapensions.org.uk.

4.27 At the end of the year the Department is required to report actual expenditure against Estimates in its Consolidated Resource Accounts.

[3] Details of the Estimates can be found on the HM Treasury website at http://www.hm-treasury.gsi.gov.uk

Section 4.3

Financial Review

4.28 This section reviews the Department's financials for 2006-07. It covers both the performance of the consolidated Department in the context of the Resource Accounts, and how the Department has performed compared to the final Estimate.

Reconciling Estimates, accounts and budgets

4.29 As explained earlier, adjustments are required to reconcile the different types of resources included in the Department's Estimates, accounts and budgets. The table below includes the following reconciliations:

- Estimates to accounts – how the Net Resource Outturn (voted by Parliament), shown in the Statement of Parliamentary Supply on page 202 is reconciled to the Net Operating Cost which is shown in the Operating Cost Statement in the Accounts on page 203; and
- Accounts to budgets – how the Net Operating Cost is reconciled to the Resource Budget Outturn shown in Chapter 6 on page 274.

Estimates to accounts

4.30 The Department's Estimate is reconciled to the Net Operating Cost through two adjustments. The first adjustment requires the inclusion of expenditure not formally approved by Parliament in the Supply Estimates.[4] For the Department, this is a combination of National Insurance Fund expenditure, the cost of capital credit on the net liabilities of Royal Mail Holdings plc and the cost of capital charge on the net assets of BNFL plc. Further details are provided in Note 3 to the Accounts. The second adjustment requires the inclusion of Consolidated Fund Extra Receipts (CFERs) which are classified as operating income and therefore included in Net Operating Cost. These CFERs arise from the operating activities of the Department, but are not used by the Department and are not classified as income for Estimates purposes i.e. not included in Net Resource Outturn. The receipts are paid directly to HM Treasury.

Accounts to budgets

4.31 The Net Operating Cost of the Department in the reporting period is reconciled to the Department's budget through the removal of cash payments to the Department's NDPBs (mainly grant in aid), adjusting for capital grants; and the inclusion of the NDPBs' income and expenditure on an accruals basis (resource consumption). A further adjustment is made to eliminate those CFERs that are classed as being outside of the budgeting boundary.

[4] House of Commons paper 293 (06/07)

Figure 4.1

	2006-07	2005-06
	£'000	**£'000**
Net Resource Outturn (Estimates)[1]	**6,111,241**	**5,847,974**
Adjustments in respect of:		
Non-Supply expenditure in the Operating Cost Statement (OCS)[2]	3,563	252,733
Consolidated Fund Extra Receipts (CFERs) in the OCS[2]	(1,848,720)	(456,727)
Net Operating Cost (Accounts)[3]	**4,266,084**	**5,643,980**
Adjustments in respect of:		
Capital grants [4]	399,291	300,797
Voted expenditure outside the budget[5]	(6,506,721)	(6,239,874)
Adjustments to additionally include:		
Other CFERs	1,821,212	61,440
Resource Consumption of Non-Departmental Public Bodies[6]	5,740,123	5,419,477
Other adjustments[7]	(12,212)	1,067
Resource Budget Outturn (Budget)[8]	**5,707,777**	**5,186,887**
Of which:		
Departmental Expenditure Limits (DEL)[9]	5,505,330	5,086,102
Annually Managed Expenditure (AME)	202,447	100,785

Notes

1 Disclosed in the Statement of Parliamentary Supply on page 202 of the Accounts.

2 See Note 3 to the Accounts on page 216.

3 Disclosed in the Operating Cost Statement on page 203 of the Accounts.

4 Where capital receipts are greater than expenditure the adjustment will be positive.

5 Mainly grant in aid payments to NDPBs.

6 Income and expenditure of NDPBs.

7 For 2006-07 other adjustments mainly relate to adjustments to the Resource Account made after the submission of budget outturns to meet the deadline for the Public Expenditure Outturn White Paper.

8 Total DTI Resource AME outturns as shown in Chapter 6 Table 2, is £441 million. This includes £239 million in respect of the UKAEA Superannuation Fund, the accounts of which are published separately.

9 See table 2 in Section 6.3.

The Primary Statements in the Consolidated Resource Accounts

4.32 The primary statements in the Consolidated Resource Accounts comprise: the Statement of Parliamentary Supply; the Operating Cost Statement; the Statement of Recognised Gains and Losses; the Balance Sheet; the Consolidated Cash Flow Statement; and the Consolidated Statement of Operating Costs by Departmental Aim and Objectives.

Statement of Parliamentary Supply

4.33 This is the accountability statement for parliamentary reporting purposes. It records the net resource outturn compared to Estimate and only includes expenditure and income (Appropriations in Aid) allowable against the Estimate. Explanation of why the outturn in 2006-07 was different from the Estimate is given in paragraph 4.36. This statement also includes a comparison of non-operating cost Appropriations in Aid with the amount voted by Parliament in the Estimate, and discloses amounts payable to the Consolidated Fund as Extra Receipts (CFERs).

4.34 Non-operating Cost Appropriations in Aid reduced by £6.6 billion, from £15.2 billion in 2005-06 to £8.6 billion due to a reduction in loan repayments on the Post Office revolving loan.

4.35 CFERs increased by more than £5 billion due to a special dividend received from BNFL plc, the repayment of the BNFL debenture; and liquidation of the Nuclear Liabilities Investment Portfolio (NLIP). Further details can be found in Notes 16, 19 and 21 to the Accounts.

4.36 Net resource outturn for 2006-07 (as shown in the Statement of Parliamentary Supply) was £6,111 million. This is broadly similar to the outturn for 2005-06 of £5,848 million, which was restated to account for Machinery of Government (MoG) changes. This compares to a final Estimate of £6,824 million, giving an underspend of £713 million. The significant reasons (where the variance is greater than 10%) for the difference of £713 million between Estimate and outturn are as follows:

- Net expenditure on Extending Competitive Markets was £10 million (13%) less than the Estimate largely as a result of a lower than expected requirement for grant in aid for the consumer competition NDPBs, as a result of tighter cost controls together with higher than expected income levels. Additionally expenditure on other consumer support and competition policy programmes was lower than anticipated.
- Sustainability and the Environment net expenditure was £32 million (30%) lower than the Estimate. The variance was mainly due to changes in the timing of the payments of capital grants for sustainable energy projects, including those in respect of carbon abatement technologies. Additionally, the Supply Estimate made available capital grant funding for smart metering schemes, which proved not to be required because of the nature of the expenditure actually incurred.
- Enterprise Growth and Business Investment net expenditure was around £49 million (33%) less than the Estimated spend. The principal reason was a lower than anticipated number of applications for new loans under the Small Firms Loan Guarantee Scheme (SFLGS).
- The significantly lower than expected net expenditure on Regional Economies of around £157 million (82%) was mainly due to a reduced requirement for grant in aid for the Regional Development Agencies together with a slippage in Regional Selective Assistance capital grants.
- There was a £10 million (24%) under spend on Trade and Investment during the year. This reflects the fact that UKTI's restructuring was effected more quickly than anticipated, with the result that greater savings were realised in the current year.
- Net expenditure on Maximising Potential in the Workplace was £38 million (35%) less than estimated. This was largely due to lower than anticipated expenditure on contributions to the Inland Revenue in respect of paternity and adoption payments, as a direct result of a lower than expected take up of paternity payments and delays in the introduction of some adoption payments.

- There was lower than expected net expenditure on Corporate Activity and the Insolvency Framework, which amounted to £15 million (25%). The variance was due to an under spend by the Insolvency Service, partly as a result of additional fee income.
- There was a £322 million (17%) under spend on the Department's Assets and Liabilities during the reporting period. This was largely due to the reduced grant in aid requirement of the Nuclear Decommissioning Authority (NDA), as a result of utilisation of existing cash reserves, and a rigorous cost control exercise resulting in deferring some spend to 2007-08 and re-prioritising and re-phasing other activities. This also led to a shortfall in income against Estimate, which mitigated the variance to some extent. The non cash costs associated with Coal Health provisions were also lower than anticipated.
- The lower than expected outturn for Nuclear Security and Export Control which amounted to nearly £7 million (11%) arose due to slippage in expenditure on nuclear support to the former Soviet Union, and reduced grant in aid requirements of the Civil Nuclear Police Authority.
- There was a lower than expected requirement for expenditure for Activities in Support of all Objectives. The under spend of approximately £65 million (21%) arose mainly as a result of savings on accommodation costs and the costs of IT services, and greater than anticipated savings on restructuring costs. The expenditure for the year also includes a cost of capital credit in respect of working capital balances, for which no provision was made in the Estimate.
- The variance relating to Office of Science and Innovation initiatives of £2 million (23%) was mainly due to slippage in new science reviews and international partnership projects, and in the late adoption of framework programmes during the reporting period.

Operating Cost Statement

4.37 The Operating Cost Statement is similar to an income and expenditure Account in not-for-profit bodies and includes all operating income and expenditure relating to the consolidated bodies on an accruals accounting basis, including that which sits outside of the Estimate. Apart from the additional income arising from the receipt of a special dividend from BNFL plc (£1,800 million), the consolidated net operating cost for the reporting period of £4,266 million is broadly similar to the consolidated restated net operating cost for 2005-06 (£5,644 million).

4.38 The differences between net operating cost and net resource outturn are disclosed in Note 3 to the accounts. The main differences relate to expenditure for the redundancy payments payable from the National Insurance Fund, the cost of capital credit on the net liabilities of Royal Mail Holdings plc; the cost of capital charge on the net assets of BNFL plc which are not included in the Estimates; and income payable to the Consolidated Fund for a special dividend from BNFL plc.

4.39 Operating income includes dividends declared by Companies House and the Patent Office. These dividends represent the return on investment of Public

Dividend Capital (PDC), as shown in Note 16 of the accounts. The Companies House dividend is expected to be £2 million, representing a return of 3.5% on the Companies House average capital employed. The Patent Office dividend is expected to be £2.8 million representing a return of 4% of the Patent Office's average capital employed.

4.40 Grant in aid and other grants represented nearly 91% of gross expenditure for programmes in 2006-07.

Statement of Recognised Gains and Losses

4.41 This statement reflects the unrealised element of revaluations to fixed assets and investments. These gains have not been reflected in the Operating Cost Statement. The large gain on investments is mainly due to gains on the coal pension investment reserves.

Balance Sheet

4.42 The Balance Sheet discloses the assets and liabilities of the Department at the balance sheet date. The main changes in the Department's assets and liabilities during the year are described below. The Department had Total Net Liabilities of (£203 million) in 2005-06. This has changed to a position of Total Net Assets of £2,407 million, a net increase in asset value of £2,610 million. The main reasons for this change relate to the increase in the valuation of Coal Pension Investments (£1,286 million), following the Government Actuary Department (GAD) triennial valuations and subsequent releases from the Guaranteed Fund; an increase in the Department's investments in Royal Mail Holdings plc (£430 million), and a net reduction in provisions (£769 million). More detail is set out below and in the notes to the Accounts.

4.43 There have been a number of disposals of assets in-year. The most significant disposals were the liquidation of the Nuclear Liability Investment Portfolio and the repayment of the BNFL Debenture. These movements were matched by a corresponding reduction in liabilities to the Consolidated Fund. These movements in aggregate therefore have a net nil effect. Further information can be found in paragraphs 45-47, below and in Notes 16 and 19 of the Accounts.

4.44 Tangible fixed assets increased by £26 million reflecting a small reduction in the assets of the Department's agencies and a £31 million increase in assets in the core Department. Increases in the core Department's assets resulted from an increase in assets under construction including additional work on the National Physical laboratory, improvements to buildings on the Departmental estate and spend on major IT projects.

Nuclear Liabilities Investment Portfolio (NLIP)

4.45 Following the transfer of the responsibility for the discharge of the nuclear liabilities to the NDA, the Nuclear Liabilities Investment Portfolio and the Springfield Investments (known together as the NLIP) passed to the Government. The investment was remitted to the Secretary of State for Trade and Industry and returned to the Consolidated Fund once sold. The market valuation of the NLIP, as at 31 March 2006, was £3,706 million. The portfolio was fully liquidated as at 31

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March 2007. The amount realised from the sale during 2006-07 was £3,767 million and all proceeds were surrendered to the Consolidated Fund.

BNFL Debenture and Special Dividend

4.46 On 1 April 2005, BNFL issued a debenture for £575 million to the Secretary of State for Trade and Industry, under Schedule 6 of the Energy Act. Although the final redemption date was not until 31 March 2012, BNFL repaid £19 million of its debenture plus interest in May 2006, a further £8 million was repaid in September 2006 and, following the sale of its Westinghouse subsidiary in October 2006, the remaining balance of £523 million was repaid. The BNFL debenture provided a mechanism for returning the proceeds of disposals from the BNFL Group to the Government and incentivised its management to maximize cash generation and reduce the outstanding amount of the debenture, so reducing the Group's interest payments.

4.47 Westinghouse, the power station construction arm of BNFL, was sold to Toshiba in February 2007. The Deparment received £1.8 billion, by way of special dividend, from BNFL on 19 February 2007. This dividend payment is treated as operating income in the Department's Accounts and the cash was paid to the Consolidated Fund.

Royal Mail Holdings Plc

4.48 Royal Mail Holdings plc is a company that is wholly owned by Government. Its core operating subsidiary is Royal Mail Group Limited (mails business). Post Office Limited (POL) is the subsidiary of the Group that provides the post office network arm of the business. The Government has provided financial support to the Royal Mail Group of companies via three different routes – equity injection, debt financing and subsidy payment.

Equity injection

4.49 Further investments into Royal Mail were made by the Department during the year when the Department purchased 5 shares at a total cost of £430.27 million increasing the equity from £0.05 million to £430.32 million. The primary purpose of this was to inject funds into POL as part of the 2002-03 POL funding agreement, approved by the EU Commission.

Debt financing

4.50 On 6 February 2001 Royal Mail utilised a £500 million National Loans Fund (NLF) loan facility that was made available to it, to assist with the company's acquisitions which included German Parcel. The facility comprises 20 separate tranches of £25 million each, the first tranches of which do not begin to mature until 20 March 2021. Therefore the outstanding balance for this NLF loan on 31 March 2007 remains at the full £500 million. Royal Mail makes bi-annual interest payments on the loan amounting to £29.17 million per annum.

4.51 At the end of 2002, the Government agreed a financing package with the Royal Mail mails business. This package initially comprised £1,044 million of debt finance from Government (subsequently reducing to £844 million) on commercial terms to provide Royal Mail with access to funds to assist it in delivering its 3 year restructuring programme for the mails business.

4.52 On 26 March 2007 the Secretary Of State confirmed via written statement to Parliament finalisation of a new financing framework for Royal Mail. Part of this framework includes new debt facilities of £900 million to be provided by the NLF on commercial terms (comprising a revolving facility of up to £300 million and a separate facility of up to £600 million). This new package replaces and increases the current package agreed in 2002 (for borrowing facilities of £844 million) and these debt facilities are further supplemented by a £300 million shareholder loan, also to be provided on commercial terms. The agreed package will allow the company to embark on an investment programme so that it can further transform its effectiveness and secure the efficiency improvements required under the latest regulatory settlement. The new debt facilities became effective from 23 March 2007, but had not been utilised before 31 March 2007.

4.53 The Department has also made available to POL, through an agreement reached on 17 October 2003, a revolving loan facility based on commercial terms of up to £1.15 billion. This is to help the company fund its working capital requirements in light of the migration of state benefits to a system of direct payment and the loss of pre-funding to POL from the Department of Work and Pensions, alongside a Government commitment that benefit recipients will still be able to collect their benefit, in cash and in full, from Post Office branches. POL began utilising this facility on 1 December 2003. The facility matures on 31 March 2010 by when any outstanding amounts will need to have been repaid.
The outstanding balance as at 31 March 2007 was £400 million.

Subsidy payment

4.54 In October 2002 the Department secured Parliamentary approval for funding of up to £210 million for POL's Urban Network Reinvention Scheme, to implement its programme to restructure the network of urban sub-post offices. Funding is provided under Section 8 of the Industrial Development Act 1982 and the scheme, which is administered by POL, is UK-wide and applicable only to urban offices located in communities of more than 10,000 inhabitants. To date a total of £182.9 million has been provided by Government (£4.1 million in 2006-07) funding almost 4,000 grants and enabling 2,486 closures. The Department will monitor the take up of residual investment grant funding. There is no set end date for the scheme, though it is now expected that any remaining funds will not be made available beyond 2007-08.

4.55 From 2003-04 the Government made available a subsidy known as the Social Network Payment, aimed at supporting the provision of rural post offices by helping to cover POL's costs of keeping open non-commercial branches. This funding arrangement has received State Aid approval up until the end of 2007-08 and in recent years the required payments have been at an annual level of £150 million. On 17 May 2007, the Government published its response to a recent consultation on any new arrangements to be applied beyond 2007-08.

European Commission state aid investigation

4.56 The European Commission will be examining some aspects of the support package provided by the Government to Royal Mail, to determine whether they constitute state subsidies or whether they meet 'market investor' conditions. Broadly speaking, provision of funding on terms which would be acceptable to a

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private investor operating in a market economy is not considered to be state aid. The Department is clear that it has taken appropriate steps to ensure that all areas under examination represent funding on commercial terms.

Coal Pension Investment Reserve

4.57 The Investment Reserves are Government assets held within the closed coal pension schemes. There are two schemes, the British Coal Staff Superannuation Scheme and the Mineworkers Pension Scheme (BCSSS and MPS). As part of coal privatisation the Government guaranteed members' pension entitlements. The coal pension schemes themselves are currently fully funded. The investment reserves exist as a guarantee for the Government in case this situation were to change.

4.58 If the funds do fall into deficit then the Government pays money into the funds from the investment reserves to make this up. If, at a future point in time the funds then return to surplus then these monies lent to the funds must be repaid to the investment reserves (together with any capital gain made on the funds in this time).

4.59 When the previous triennial actuarial valuations of the schemes were carried out in 2002 and 2003 for BCSSS and MPS the schemes were in deficit. The Government consequently lent the schemes £575 million to cover these deficits. Both the funds have received their updated triennial valuation in 2006-07 and following the recovery in the global equity values the schemes are in surplus and the Government can be paid back its loan (together with the capital gain on it in that time). The repayment received in 2006-07 was £970 million.

4.60 When the guarantee was negotiated in 1994, the Government agreed to leave the Investment Reserves in these pension schemes until at least 2019 on the basis that they would be gradually drawn down to nil over the period, with withdrawals likely to be weighted towards the second half of the 25 year period. Any withdrawals are at the discretion of GAD, which acts as the scheme actuary.

4.61 Further detail on the investments and the pension scheme accounts can be found in Note 16 to the accounts.

4.62 In return for acting as guarantor on the schemes the Government is entitled to 50% of any surplus made on the funds from which the guaranteed pensions are paid. This money is held in a separate fund and is released over a 10 year period. In 2006-07 the fund increased by £679.2 million through a combination of transfers from the Guaranteed Fund and the revaluation of exisiting funds. £569 million was released to the Guarantor. Further details on these funds can be found in Note 19 to the accounts.

Coal Provisions

4.63 The liabilities of British Coal transferred to the Department on 1 January 1998 (under the terms of the Coal Industry Act 1994). There are two schemes to compensate coal miners and their families in relation to respiratory disease (chronic obstructive pulmonary disease) and Vibration White Finger (VWF). The liabilities in relation to these provisions as at 31 March 2007 were £682 million and £273 million respectively. The schemes are now closed to new claimants. Around 762,000 claimants have been registered in both schemes.

4.64 Coal provisions reduced by £688 million, mainly due to a reduction in the chronic obstructive pulmonary disease (COPD) provision of £527 million due to payments of claims totalling £522 million and a small decrease in the provision based on the model used to predict future cash flows. This scheme closed in 2004. With the exception of concessionary fuel which increased by £53 million all other coal provisions have decreased.

4.65 Handling agreements for the two schemes were negotiated with a group of solicitors (for each disease) who were the chosen representatives for the large numbers of firms involved. The agreements are necessarily complex as they define exactly how claims will be dealt with by claimants' solicitors, the Department's claims handlers, the medical assessors etc. They specify the compensation a claimant would have expected to get if he had pursued his claim under common law through the courts. They give claimants a fair entitlement tailored to reflect their disability. They are not flat rate schemes and reflect other factors set out in the Court judgements.

4.66 Additionally there is a further health provision, which incorporates other injury-related compensation claims such as deafness, accidents and miscellaneous diseases. This also covers payments under British Coal's Pneumonoconiosis Compensation Scheme and associated administration costs of managing the health claims. The value of the provision as at 31 March 2007 was £181 million.

4.67 Apart from the health provisions, the Department has a responsibility to provide either solid fuel or a cash alternative to over 102,000 beneficiaries. Approximately three quarters of these have opted for the cash alternative which is index-linked to fuel and light prices. The value of the provision as at 31 March 2007 is estimated to be £405 million; payments in the year amounted to £47 million.

Other provisions

4.68 Other provisions (SFLG, UKAEA restructuring, Early Retirement and British Shipbuilders), have reduced by £49 million, mainly due to the change in the SFLG, where volumes of loans fell significantly during 2006-07.

Revaluation reserve

4.69 The revaluation reserve, which records gains/losses on revaluation of assets in the period, shows a £1.3 billion increase; largely due to gains arising in the year on coal pensions. This was primarily due to the results of the 2005-06 triennial actuarial valuations of the two schemes, BCSSS and the MPS, which were completed in September 2006 and February 2007 and which revealed substantial surpluses.

Cash Flow Statement

4.70 The Department also has to estimate how much cash it is going to need in the year – the Net Cash Requirement. The Net Cash required to fund the Department's activities during 2006-07, as shown in Note 27 to the Cash Flow Statement, amounted to £7,375 million compared to an Estimate of £8,890 million, an underspend of £1,515 million.

4.71 Explanations for significant variances (+/-10%) between actual (outturn) and Estimate Net Cash Requirement are as follows:

- Capital investments were £4,004 million (31%) less than anticipated because the Estimate provided for the maximum permissible gross borrowing (at £12,990 million) by the Royal Mail under its working capital facility. Outturns at £8,590 million were much lower than this limit. This was also the reason why Non-operating Appropriations in Aid (A in A) investments were £3,320 million (28%) lower than anticipated.
- Non-cash items. The variance reflects a larger movement in British Energy provisions than was anticipated in Estimates. Additionally, the Insolvency Service wrote off a balance of £12 million in respect of irrecoverable case administration fee income; and there was a larger cost of capital credit due to the charge on the net assets/liabilities of the public corporations. These were offset to some extent by lower than anticipated rises in the SFLG and Coal Health provisions.
- Changes in working capital and changes in creditors falling due within one year resulted in a greater movement than anticipated of £56 million. This was mainly due to an increase in debtors and prepayments, after taking out the movement in creditors relating to the liquidation of the NLIP and the repayment of the BNFL debenture, the proceeds of which were paid to the Consolidated Fund.
- Use of provisions. The variance is primarily due to lower than anticipated spend on coal health provisions, where claims were paid at a lower rate than originally anticipated owing to the volume and complexity of claims received.

Statement of Operating Cost by Departmental Aim and Objectives

4.72 The Statement of Operating Costs by Departmental Aim and Objectives shows how resources, as set out in the Operating Cost Statement, have been deployed to each of the Department's objectives.

Other information

Restatement of prior year comparatives

4.73 In accordance with the HM Treasury Financial Reporting Manual (FReM), where functions are transferred between Government Departments they are accounted for using merger accounting. Prior-year comparative figures are restated to reflect this. The 2005-06 transactions and balances in these accounts have been restated to reflect the transfer of the Employment Tribunal Service (ETS) to the Ministry of Justice, to become part of the new Tribunals Service; the transfer of the Engineering Inspectorate Directorate to the Health and Safety Executive, part of the Department for Work and Pensions; the transfer of the Equal Opportunities Commission and Women and Equality Unit, to the Department for Communities and Local Government; and the transfer of the Social Enterprise Unit to the Cabinet Office.

Risks and uncertainties that might affect the Department's long-term position

4.74 The Management Board reviews each month the Department's principal risks that might impact on the organisation's position either in the immediate or long-term future. During the year these risks have included:

- potential major company failures;
- security of energy supply;
- better regulation;
- UK energy policy;
- science and innovation funding;
- Royal Mail;
- Nuclear Decommissioning Authority;
- Companies Act implementation;
- budget funding;
- the implications of Machinery of Government (MoG) changes.

The policy for managing risks is outlined in the Department's Statement on Internal Control on pages 194 to 198.

Liquidity and currency risks

4.75 The Department has no borrowings and relies primarily on voted funds from Parliament for its cash requirements. It is therefore not exposed to liquidity risk. It has no material deposits so it is not exposed to interest rate risk and all material assets and liabilities are denominated in sterling so it is not exposed to material currency risk. Further disclosures are provided in Note 33 to these accounts.

Pension liabilities

4.76 The Department's staff can become members of the Principal Civil Service Pension Scheme (PCSPS). The Department's employer's contributions into the scheme are reflected in the Resource Accounts within staff costs.

4.77 The PCSPS is an unfunded multi-employer defined benefit scheme and the Department is consequently unable to identify its share of the underlying assets and liabilities. There is therefore no reflection of the scheme on the Department's Balance Sheet. Further details can be found in Note 9 to the accounts.

Payment of suppliers

4.78 The Department's policy is to comply with the Better Payment Practice Code, which includes the Late Payments of Commercial Debts (Interest) Act 1988. The Department's standard terms and conditions for the supply of goods or services specify payment within 30 days, or other agreed credit terms, of receipt of goods or services or a valid invoice, whichever is the later. In 2006-07, the core Department paid 98.3% of undisputed invoices within the 30 days (93.9% in 2005-06) and is currently working with relevant staff and suppliers to improve this rate. The consolidated Department paid 98.1% of undisputed invoices within 30 days (95.7% in 2005-06).

4.79 During 2006-07 the Department paid a total of £1,139 (2005-06 £4,054) to suppliers for the late payment of invoices.

Post balance sheet events

Sale of British Energy interests

4.80 On 1 June 2007 the Nuclear Liabilities Fund (NLF), a Central Government body, in which the Department has an interest, but which is not consolidated in the Accounts (as it is outside the accounting boundary), converted and sold 450 million shares in British Energy Group plc (BE) at £5.20 per share realising £2.3 billion, reducing the NLF's interest in BE from 64% to 36%. The Department estimates that the contingent asset disclosed on page 254 to the accounts has increased to £2.6 billion as a result of this transaction. The increase in the contingent asset is principally driven by the value of BE shares which increased between the year end and the date of sale.

4.81 The Department's Interest in British Energy arises from its relationship with the NLF. The NLF is considered to be a 100% subsidiary of the Department and BE is a 64% quasi-subsidiary of NLF and hence the Department. In accordance with the FReM, these bodies are not consolidated into the Departmental Resource Accounts, but information on the assets and liabilities, and results, of the two bodies is provided in Note 16. BE makes contributions into the NLF to meet future decommissioning and uncontracted liabilities costs. One of these contributions is referred to as the cash sweep payment. During 2006-07, its inflows included 65% of the free cash from BE (cash sweep) plus returns on its investments. Its liabilities are the estimated, discounted costs of decommissioning.

Technology Strategy Board

4.82 The March 2006 Budget stated that the advisory Technology Strategy Board (TSB) would be given a wider remit to stimulate business innovation in those areas that offered the greatest scope for boosting growth and productivity, and that it should be set up at arm's length to the Government. In November 2006, the Secretary of State announced that the new TSB would be an executive NDPB, based in Swindon.

4.83 Following debates in both Houses of Parliament, an Order in Council establishing the TSB under the Science and Technology Act was approved by the Privy Council in February 2007, and the Royal Charter incorporating the body was printed and sealed on 27 March 2007. The new body was formed on 2 July 2007.

The Science and Technology Facilities Council

4.84 The Science and Technology Facilities Council (STFC), a new research council resulting from the merger of the Particle Physics and Astronomy Research Councils (PPARC) and the Council for the Central Laboratory of the Research Council (CCLRC), was formed by Royal Charter, with NDPB status, on 1 April 2007.

Post Office Network Support

4.85 On 14 December 2006 the Department launched a 12 week national consultation on proposals for the future of the Post Office network. The consultation closed on 8 March 2007 having attracted some 2,500 responses. The Department published its response on 17 May 2007 announcing investment of up to £1.7 billion, subject to EC State Aid clearance; the compensated closure of a maximum of 2,500 branches, partly offset by 500 new Outreach sites; and the introduction of minimum access criteria. The Government's package is aimed at maintaining a national network and placing it on a sustainable footing for the longer term.

Small Business Service

4.86 The Secretary of State announced in Parliament in October 2006 that the Small Business Service (SBS) would become a smaller, sharply focused policy unit with close links with business and with other parts of Government. The SBS would no longer deliver services. Wherever possible, support programmes would be run by its delivery partners close to customers, regionally or locally. SBS would no longer need the status of being an executive agency. In April 2007 it started operating as a policy unit within the Department's Enterprise and Business Group.

Machinery of Government changes

4.87 Following an announcement by the Prime Minister on 28 June 2007 about the way Government is organised, the Department ceased to operate as the DTI. The Department for Business, Enterprise and Regulatory Reform (BERR) was created. The successor Department will assume much of the work of the DTI. At the same time the Department for Innovation, Universities and Skills was established, which will take forward the science and innovation aspects of the DTI's work. These changes also resulted in changes to Ministerial responsibilities.

Auditors

4.88 These financial statements have been audited, under the Government Resources and Accounts Act 2000, by the Comptroller and Auditor General (C&AG), who is appointed under statute and reports to Parliament. The audit opinion is on pages 199 to 201. The notional cost to the Department of the external audit of the core account by the National Audit Office for the C&AG was £266,000 (2005-06 – £242,000). The total cost of work on the Consolidated Account was £348,000 (2005-06 – £343,000).

4.89 The NAO also completed other work relating to the core Department's activities. The main areas of work where subsequent reports were published by the Public Accounts Committee during 2006-07 or subsequently were as follows:

- The Closure of MG Rover report noted that the collapse of MG Rover cost the taxpayer some £270 million. The Department responded effectively where it had contingency plans, for example arranging the immediate support for former employees following the collapse, but needed to strengthen its approach on some other aspects. The various bodies did well to respond quickly and effectively in the immediate aftermath of the company collapse (PAC Report HC 1003 issued 25 July 2006).

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- The Small Business Service (SBS) report noted that the Service is being reformed as a smaller policy unit within the Department. It found that the Government's support network of around 3,000 national, regional and local programmes was too large and complex and noted the Government's intention to cut the number to fewer than 100. It found that the SBS, and the Government as a whole, had not been able to evaluate fully enough its impact against Government aims and objectives for the sector (PAC Report HC 262 issued 6 February 2007).
- The termination of the PFI Contract for the National Physical Laboratory report found that the Department handled the termination of the contract well but noted that the project had incurred extra costs of some £10 million, plus a delay of five years or more. The Department too readily assumed that the winning bidder would be able to meet the exceptionally demanding specification for this state-of-the-art scientific facility. The report recommended that public sector clients should always satisfy themselves that contractors have the technical and financial capacity to handle the degree of project risk which they undertake to bear (PAC Report HC 359 issued 27 February 2007).

4.90 During 2006-07, and subsequently the NAO also published reports on:

- Big science: public investment in large scientific facilities, published in January 2007. The C&AG found current planning and delivery arrangements should yield a significant contribution to development of the nation's scientific infrastructure. However some project teams have underestimated the likely running costs of facilities, and the economic potential of facilities was less fully analysed than scientific opportunities.
- The Shareholder Executive and Public Sector Business, published in February 2007. The C&AG concluded that the Shareholder Executive had improved Government's performance as owner of public businesses and was already providing some real financial gains for the public sector. However, increasing the Executive's powers, such as expanding its remit to cover all public sector businesses and giving it greater independence, could enhance its future effectiveness.

4.91 In addition, the NAO is currently engaged on work in the following main areas:

- the Department's administration of the Coal Health Compensation Schemes; and
- the site management contracts of the Nuclear Decommissioning Authority, a non-departmental public body sponsored by the Department.

Disclosure of audit information

4.92 As Accounting Officer, as far as I am aware there is no relevant audit information of which the Department's auditors are unaware. I have taken all of the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the Department's auditors are aware of that information.

Brian Bender

Sir Brian Bender KCB
Principal Accounting Officer and Permanent Secretary

12 July 2007

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