



WALES **AUDIT** OFFICE
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2012-13 Local Government Accounts



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I have prepared and published this report in accordance with the Public Audit (Wales) Act 2004.

The Wales Audit Office study team that assisted me in preparing this report comprised John Herniman and Jeremy Saunders.

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The Auditor General appoints auditors to local government bodies in Wales, conducts and promotes value for money studies in the local government sector and inspects for compliance with best value requirements under the Wales Programme for Improvement.

He also examines and certifies the accounts of the Welsh Government and its sponsored and related public bodies, including NHS bodies in Wales. He has the statutory power to report to the National Assembly on the economy, efficiency and effectiveness with which those organisations have used, and may improve the use of, their resources in discharging their functions.

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Summary report

- 1** Local government bodies (audited bodies) provide a wide range of services, and in doing so, spend a significant amount of public money. Like all public bodies, they are required to produce, and have audited, a set of annual financial statements (accounts) to demonstrate and report on their stewardship of the public funds entrusted to them.
- 2** The production of accurate and timely accounts is a significant task that is necessary to demonstrate accountability for the stewardship and governance of the public money under the organisation's control. Any failure to publish accurate and audited accounts by the prescribed deadlines can reflect badly on the organisation, undermining its financial management and corporate governance arrangements.
- 3** The Auditor General appoints auditors to all local government bodies in Wales to audit and issue an opinion on their accounts. The Public Audit (Wales) Act 2004 requires appointed auditors to examine and certify the accounts, and satisfy themselves that the accounts:
 - a** give a true and fair view of the audited bodies' financial position;
 - b** comply with all relevant legislative requirements; and
 - c** have been prepared in accordance with proper accounting practices.

- 4** This, my third annual report on local government bodies' accounts, summarises the results of auditors' work for 2012-13 at the following types of audited bodies in Wales:

Exhibit 1

Audited bodies	Number
Unitary authorities	22
Local government pension funds	8
Police and crime commissioners and chief constables*	8
Fire and rescue authorities	3
National park authorities	3
Joint committees	11

* In 2012, the Police Reform and Social Responsibility Act 2011 abolished police authorities and created a police and crime commissioner and a chief constable as separate legal entities in each local police area. These new bodies produced their first accounts for the year ended 31 March 2013.

- 5** I have also included for the first time this year a brief summary of audit work at local councils. I am responsible for the audit of 737 local town and community councils and the majority of these were completed on time but a significant number were qualified.

- 6** The Accounts and Audit (Wales) Regulations 2005, as amended (the Regulations), require audited bodies to prepare accounts and for the Responsible Financial Officer (RFO) to certify them by 30 June with final audited accounts to be re-certified, approved and published by 30 September. Where there is any failure to meet either of these deadlines, the audited body must publish a statement which provides details of actions (including timescales) being taken to prepare, approve and certify the accounts.
- 7** Overall, the quality of accounts and supporting working papers improved compared to 2011-12, although in a number of cases there was a deterioration and there are still some particular account areas where improvements are required.
- 8** The production of a set of accounts, by the 30 June deadline, requires effective project management and co-ordination across a number of departments and services. For 2012-13, all accounts were certified by RFOs by the 30 June deadline. Similarly to previous years, unqualified opinions were able to be issued before the 30 September deadline for all but one authority. In this case the appointed auditor is still considering his opinion due to issues with senior officer pay disclosures.
- 9** This year however, there were six bodies where audit opinions included emphasis of matter paragraphs where the auditor draws the reader's attention to specific issues reported upon during the year or other aspects of the accounts.
- 10** The audits of most of the accounts highlighted that a number of amendments were required, but of greater concern is that this year saw an increase in the number of bodies where the accounts had to be amended for material items. The areas where most adjustments were required related to accounting for property, plant and equipment (non-current assets) which is mainly attributed to the complex requirements in this area. As this is a common and recurring theme, audited bodies need to pay close attention to this when preparing their accounts and ensure findings from previous years' accounts preparation and audit and any new accounting requirements are addressed.
- 11** Following the enactment of the Police Reform and Social Responsibility Act 2011 in 2012-13, this is the first year that separate accounts were required for police and crime commissioners, chief constables and group accounts covering both. This change required a significant amount of work for police bodies over and above the accounts preparation processes of previous years. It is pleasing to report that all police bodies in Wales coped well with the changes this year. We have worked jointly with the Welsh police bodies to identify and resolve the significant accounting issues that this change has presented which has helped ensure there was consistency in terms of major accounting issues. Looking ahead, further changes to governance arrangements will be required by police bodies and there will be a need to ensure that the accounting statements reflect these changes in a consistent manner.

- 12** The initial returns required from audited bodies to support the national Whole of Government Accounts (WGA) were, in the majority of cases, not completed on time. This situation is disappointing as there was an expectation that there would be an improvement in the timeliness of returns. Some of this delay can be attributed to the Treasury's introduction of a new data collection tool which was not without its own teething problems. Whilst the majority of final audited returns were completed on time, or within a few days of the deadline, audited bodies need to place greater emphasis on completing the WGA returns in a timely and accurate manner.
- 13** Annual governance statements, a requirement from 2010-11, continue to be refined and improved but there remains scope to further improve their usefulness. I have undertaken an improvement study in 2012-13 to evaluate the effectiveness of audited bodies' reviews of governance on which I will report later this year.
- 14** The financial outlook for 2013-14 and beyond will represent a significant challenge to public sector bodies. Local government and police bodies will need to develop robust medium-term financial plans, supported by plans to reform service delivery that enable them to meet this challenge. As part of this, bodies will need to critically appraise their holding of reserves and where able to do so, factor their use into their medium-term financial plans in a sustainable way. Later in January 2014 I will publish a further report on how local government in Wales is meeting the financial challenges it faces.

Detailed report

Audited bodies generally prepared timely accounts and supporting working papers and, with one exception, unqualified audit opinions were issued by 30 September although six of these opinions needed emphasis of matter paragraphs

- 1.1** The Regulations require audited bodies' RFOs to prepare and certify accounts by 30 June that present a true and fair view of the financial position of the body at 31 March and the body's income and expenditure for that year. The same Regulations require that, by 30 September, the audited body formally approves the accounts and that they are certified by the RFO and the person presiding at the meeting where they are approved. If either of the June or September deadlines are missed, the Regulations require the audited body to publish (ie make available to the public) a statement explaining why it has failed to prepare and certify the accounts, and provide details of actions (including timescales) being taken to prepare and certify the accounts.
- 1.2** Preparation of draft accounts is a complex process requiring sound project management so completion by 30 June represents an achievement. All bodies prepared and certified draft accounts by 30 June in line with the Regulations.
- 1.3** On or around 30 June, in agreement with audited bodies, appointed auditors receive accounts and supporting working papers allowing them to carry out their audit work. Auditors complete and conclude their work in time for the accounts to be re-certified by RFOs, approved by audited bodies and for audit opinions to be issued by 30 September.
- 1.4** The Local Government (Wales) Measure 2011 (the Measure) required audited bodies to establish audit committees and set out a number of requirements for their membership and activities. In relation to the accounts, the statutory guidance under the Measure requires audit committees to:
- a** consider and comment on the audited body's certified draft financial statements; and
 - b** see to what extent the statements take cognisance of audit reports during the year, and changes in accounting policy and internal control mechanisms.
- 1.5** Around half of audited bodies have supplemented these requirements by changing their accounts approval arrangements so the responsibility is delegated from council to the audit committee under Regulation 9 of the Accounts and Audit Regulations (Wales) 2005 (as amended). The remainder still use the audit committee for the statutory requirements above but reserve approval of the accounts for full council.

1.6 In police bodies, the situation is slightly different in that the responsibility for approving and signing the accounts rests entirely with the two corporations sole – the police and crime commissioner and the chief constable. However, in line with what I would consider good practice, all police bodies had their accounts reviewed by their respective audit committees prior to them being signed.

Police bodies coped well with the significant changes in financial reporting brought about by new legislation

1.7 During the 2012-13 financial year, the Police Reform and Social Responsibility Act 2011 came into effect. This legislation abolished police authorities and created an elected police and crime commissioner with effect from 22 November 2012. The Act also established the position of chief constable as a separate legal entity for the first time. Both the police and crime commissioner and the chief constable are established as corporations sole and are therefore required to each produce a set of financial statements. In addition, the police and crime commissioner is also responsible for producing a consolidated or 'group' set of financial statements that incorporate both sets of financial statements plus the police pension fund.

1.8 This was a major challenge for police bodies in 2012-13 as they introduced new financial management, reporting and governance arrangements to support the new structural model of working brought about by the legislative change. In Wales, all police bodies and auditors worked together to ensure there was a high degree of consistency in the way the accounts were compiled and presented. Police bodies coped well with the changes, producing accounts by the 30 June deadline and receiving unqualified audit opinions by the end of September.

1.9 Looking ahead, during the current year police bodies are required to design and submit to the Secretary of State for approval a transfer scheme which will become effective from 1 April 2014. These schemes will set out what staff and responsibilities will transfer from the police and crime commissioner to the chief constable and will require further changes to operational governance and accounting arrangements. There is a risk that these changes will make police body accounts more complex and less comparable and we will be continuing to work with police bodies, the Chartered Institute of Public Finance and Accountancy and the Home Office to identify ways to reduce this risk.

Working papers to support accounts were generally of a good and improving standard, however there is still a need for improvement in some audited bodies

1.10 In order to support the entries in the accounts and to expedite a smooth audit process, audited bodies should provide, in a timely manner, comprehensive and complete working papers to support their accounts. It is important that auditors and audited bodies agree working paper and other audit requirements in advance to facilitate the timely completion of audit work.

1.11 Audited bodies and auditors have continued to work hard to ensure that there is a shared understanding of what is expected, what works locally and a continued streamlining of arrangements based on learning from previous years. Where the process works well, there is ongoing and regular dialogue of issues arising in advance of and throughout the accounts process. Experience shows that one of the most valuable tools for improving arrangements continues to be a joint post-project learning session where auditors and management share their views in an

open way about the accounts production and audit process following its completion. Such sessions have enabled auditors and management to share experiences and views on what went well and not so well and have helped identify improvements for the following year.

1.12 However, in a small number of audited bodies, auditors have reported that there was a deterioration in some or all aspects of the quality, timeliness and accuracy of supporting working papers for the accounts. Where this is the case, the bodies need to address the weaknesses reported by their auditors and work with them to overcome issues for future years. Poor or substandard working papers lead to increased pressure on audited bodies' finance teams and auditors and increase the risk that the accounts are not completed by the statutory deadline.

1.13 We have also developed a good practice guide which can help bodies plan for, and deliver, faster closing of their accounts. The guide is written for public bodies and their external auditors, and can be found on our Good Practice Exchange website¹. It includes guidance and case studies on culture change, planning, working practices during the year, and closing and reporting.

The number of accounts that required material amendments increased this year, the majority of which related to property, plant and equipment

1.14 When auditing the accounts, auditors do not provide absolute assurance that the financial statements are correctly stated, but adopt the concept of materiality. In planning and conducting the audit, auditors seek to identify material misstatements whether caused by fraud or error in the accounts. Material misstatements are those that might result in a reader of the accounts being misled.

1.15 The auditor's determination of materiality is a matter of professional judgment and is influenced by several factors including:

- a** the type of audited body;
- b** the nature of the services the body provides;
- c** legislative requirements; and
- d** the financial information needs of legislators and other users of the accounts.

1.16 The amount above which a misstatement may be considered material ranged from £6,000 in smaller audited bodies to £20 million in large ones. Whether an item is judged to be material can also be affected by certain qualitative issues such as legal and regulatory requirements and political sensitivity. Balances and transactions with lower values may therefore be considered to be material to the accounts for example remuneration payments etc.

¹ www.wao.gov.uk/goodpractice/goodpracticeexchange.asp

1.17 Through their work, auditors may identify material misstatements in an audited body's accounts. In this case, the auditor will request the RFO to amend the accounts to correct the errors. If the material misstatements are not corrected, or it is not possible to change them due to insufficient information, the auditor may consider issuing a modified (ie qualified) opinion.

1.18 In addition, other non-material but nevertheless significant misstatements are also brought to the RFO's attention. Auditors request the RFO to amend the accounts to correct such errors. Where such errors and other significant misstatements are brought to the RFO's attention but are not adjusted, auditors bring these to the attention of those charged with governance. They seek an explanation of why the adjustments have not been made before the accounts are approved.

1.19 In 2012-13, 18 bodies covered by the report, made material adjustments to their accounts following audit. On a like-for-like basis this represented an increase compared to 2011-12. Whilst there are often likely to be minor errors in the accounts presented for audit, material items should be much less common. Good accounts production arrangements with robust internal quality assurance and review arrangements should be capable of identifying material errors prior to the RFO certifying at the end of June that the accounts are materially correct. Bodies where there are material amendments made should review their accounts production and review arrangements to ensure they are capable of picking up such errors before the accounts are certified and passed for audit.

1.20 The main areas where misstatements, material and non-material, were identified from audit work in 2012-13 are summarised below.

Property, plant and equipment

1.21 Property, plant and equipment remains an area where a significant number of audited bodies struggle to apply accounting treatment correctly. Some of the general problems encountered in previous years arose again, including:

- a** failure to account for revalued properties correctly or revaluing them using an incorrect basis (often attributed to poor communication between finance and estates departments);
- b** asset registers could not be fully reconciled with accounting records, with some common problems (some assets being counted twice and others excluded from the accounts); and
- c** general issues around correctly accounting for depreciation, recognising and accounting for impairments, treatment and disclosure of non-enhancing expenditure and the classification of assets.

1.22 In my reports on *Local Authority Accounts 2010-11 and 2011-12*, I noted that there was a lack of clarity regarding the recognition of foundation, voluntary aided and voluntary controlled school assets on the balance sheets of audited bodies. In the absence of definitive guidance, audited bodies have again in 2012-13 adopted inconsistent accounting treatments regarding these schools, with some audited bodies recognising them on the balance sheet and others not doing so. Once the guidance is finalised, probably for 2014-15, audited bodies will need to review their treatment of these assets.

1.23 The Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires council dwellings to be valued using Existing Use Value – Social Housing (EUV-SH). This is the estimated amount at which the property should change hands between a willing buyer and a willing seller in an arm's length transaction on the date of valuation. In my previous reports on local government accounts, I have highlighted that this is an area where accounting errors often occur and variations and errors in valuation approaches appear to produce significantly different valuations. We will continue to discuss this issue with representatives of the Welsh Government and local audited bodies to ensure consistency of valuation approach.

Provisions and equal pay

- 1.24** Audited bodies are required to consider whether events which occurred prior to the year-end may result in a future liability. If it is more likely than not that a liability will crystallise and it can be reliably estimated, then a financial provision will be required relating to that event.
- 1.25** In common with last year, a number of audited bodies had inappropriately set up provisions and others had failed to set up provisions when required. There were again a number of misstatements relating to insurance accounting, with some provisions incorrectly accounted for as reserves and vice versa.
- 1.26** The area where most issues arose with provisions is in relation to accounting for equal pay claims. Over recent years local government bodies have made progress to settle, or agree a basis for settling, these claims and those positions were not always accurately represented in the accounts with amounts being shown as contingent liabilities

rather than provisions and vice versa. The issue reported in previous years about whether such payments are pensionable is still an area where there are various interpretations which have also impacted on the amount, and accounting treatment, of the provisions. Next year, audited bodies will undoubtedly progress further with this issue and will need to ensure that the most up-to-date position is taken into account when producing their accounts.

Income and expenditure

1.27 Although generally the amounts involved are non-material, auditors reported to a number of audited bodies issues around income and expenditure transactions. In the main, these related to year-end cut-off of debtors, creditors and accruals or the netting of income and expenditure items. There were also a few issues around the non-consolidation (or incorrect consolidation) of joint committee transactions and balances.

Pension fund disclosures

1.28 Several audited bodies' pension disclosures were amended because of reconciliation issues between membership data held by the pension fund and passed to the actuary and the membership data held by the audited body.

Pension funds

- 1.29** Auditors reported a variety of issues in relation to pension fund accounts this year, predominantly involving:
- a** weaknesses in reconciling membership data between admitted and scheduled body payroll information and pension system data (referred to above);

- b correct classification and disclosure of various types of investments; and
- c year-end cut-off for investment valuations.

Unqualified opinions were issued in all but one case by the 30 September deadline, however, six needed emphasis of matter paragraphs

1.30 The Public Audit (Wales) Act 2004 requires auditors to issue an opinion on the accounts on completion of the audit. Auditors aim to issue opinions by 30 September, to enable bodies to publish audited accounts by the statutory deadline. This year, as in previous years, the vast majority of audited bodies' accounts were approved and unqualified audit opinions issued on them by the 30 September deadline.

1.31 However, there is one audited body, Pembrokeshire County Council, where an audit opinion is yet to be issued as there is a difference of opinion between the appointed auditor and the Council about payments to senior officers that the appointed auditor considers contrary to law. The appointed auditor is considering whether further audit action is required in relation to this issue.

1.32 Where the auditor is able to conclude that a body's accounts are materially correct but would nevertheless like to draw the reader's attention to an item disclosed within them, it is possible to add an emphasis of matter paragraph into the audit report to explain the issue to the reader. Whilst this represents a non-standard audit opinion, the opinion itself is still unqualified.

1.33 In 2012-13, there were six bodies where non-standard opinions were given:

- a Caerphilly County Borough Council received an audit report drawing attention to unlawful expenditure in relation to senior officers' pay. In March 2013, the appointed auditor issued a report in the public interest on the circumstances surrounding senior officer pay at Caerphilly County Borough Council and a further report in the public interest in December 2013 concerning payments made to buy out chief officer essential car user and annual leave allowances.
- b Carmarthenshire County Council received an audit report drawing attention to the appointed auditor's view on the lawfulness of a 'pay supplement' for senior officers and an indemnity granted to a senior officer for a libel counterclaim. The appointed auditor is considering whether further audit action is required in relation to these issues.
- c The City and County of Swansea received an audit report with an emphasis of matter paragraph drawing attention to the accounting treatment and disclosure in respect of certain banking and cash management arrangements between the council and pension fund, which was the subject of a similar paragraph in the 2011-12 report. This issue was a reflection of a transaction that took place in 2011-12, which was subsequently corrected in 2012-13.

- d The audit reports on three joint committee accounts and returns included a paragraph drawing attention to the fact that accounts had not been prepared, as required, for prior years – Joint Planning Policy Committee (Anglesey and Gwynedd), Special Educational Needs Joint Committee (Anglesey and Gwynedd) and Taith Regional Transport Consortia (the six North Wales councils).

We have not yet certified some audits as complete because of unresolved issues relating to questions from electors and potential public interest issues

1.34 On completion of all work in relation to any particular year, the appointed auditor must certify that that audit is complete. Before issuing the opinion and concluding the audit, there are a number of issues auditors need to consider:

- a whether to issue a report in the public interest or take any other formal audit action; and
- b whether all questions and/or objections from electors have been dealt with satisfactorily.

1.35 Where there remain issues outstanding, the auditor can still issue an opinion on the financial statements where the issues will not have a material impact on the accounts. Once outstanding issues have been resolved, the auditor may reissue the opinion and certify the audit as complete.

1.36 For 14 audited bodies (including four pension funds because the audit is associated with the administering authority), the certificate concluding the audit had not been given at the time the opinion was issued. This was

because there remained issues outstanding relating to electors' questions and objections or consideration was being given to issuing reports in the public interest. The prevalence of elector questions varies between councils with some receiving a significant number. Where the certificate remains open because of these, this does not necessarily mean that any formal audit action will ultimately be necessary, as there may not be any significance to the issues raised. Until the issues are fully considered, however, the audits cannot be certified as complete.

The majority of audited bodies did not prepare their initial Whole of Government Accounts returns on time although most final returns were completed by the required date

1.37 The WGA are a set of commercial-style consolidated financial statements for the UK public sector. Prepared by the HM Treasury, in accordance with International Financial Reporting Standards, around 1,400 bodies' accounts are consolidated into the UK WGA.

1.38 HM Treasury determines the bodies to be included in the WGA each year. It also designates a consolidation officer at each body. They are responsible for providing the information required for the WGA return in a timely manner, and ensuring that adequate systems and appropriate accounting judgements support the return. These arrangements cover all audited bodies in this report with expenditure above the £10 million WGA threshold.

1.39 The statutory auditor of the WGA is the Comptroller and Auditor General (C&AG) of the National Audit Office. His work is underpinned by the work carried out by the auditors of component bodies that are included in the WGA. For 2012-13, HM Treasury introduced a new data collection tool to compile the WGA returns. The roll out of the new system was intended to be in place by March 2013 but due to significant delays, the data collection tool was not available for Welsh local government bodies to use until 24 July 2013. Whilst overall, the Treasury did not extend the deadlines for the completion and audit of 2012-13 WGA returns, local government bodies did have four weeks to prepare the initial returns which were due to be submitted to the Welsh Government by 21 August 2013.

1.40 The timescales for the 2012-13 WGA process were:

- a** initial WGA returns to be provided to the Welsh Government and local audit teams by 21 August; and
- b** audited and finalised WGA returns to be provided to the Welsh Government by 4 October.

1.41 Only 19 authorities met the deadline for the submission of initial returns; a further 11 agreed extensions with the Welsh Government – the majority of these were to the end of August, with four needing extensions to the first week of September. Even so, three of the four authorities who had agreed extensions to September did not meet the revised date.

1.42 Despite these delays, the majority of final audited returns were submitted on time; there was a short delay for six authorities and one further has yet to be certified. All but one were unqualified. For Isle of Anglesey County Council the return was qualified because of disagreement of material balances and transactions with the Welsh Government.

1.43 All this continues to highlight that greater emphasis needs to be placed on completing the WGA returns in a timely and accurate manner especially as HM Treasury is committed to continually bringing forward the publication date for WGA.

Annual governance statements generally complied with the requirements although scope still remains to improve their effectiveness

1.44 Our *Local Authority Accounts 2010-11 and 2011-12* reports highlighted that there was generally scope for further improvement in the production and content of annual governance statements and scope to improve the benefits derived from their production.

1.45 I have undertaken an improvement study during 2012-13 to evaluate the effectiveness of audited bodies' reviews of governance. A national summary report will be published in the form of a 'practice note' later this year. This will summarise the key learning points at a national level and identify the steps that audited bodies will need to take to ensure governance reviews are as effective as they could be.

1.46 In 2012-13, audited bodies have continued to refine and improve their annual governance statements including in some cases stating how governance issues that have arisen have been dealt with. However, it remains the case that further improvements are still required to both what is reported in the statements themselves, and how they are compiled. In terms of the content, there is more scope to move away from descriptive explanations of governance process to a more challenging evaluation of the effectiveness of the governance framework including details of any significant issues that have arisen and how they are being addressed. To achieve this, the process for compiling the annual governance statement needs to be more inclusive and draw on the various sources of evidence that exist in an open and challenging manner.

There are still a significant number of local town and community councils receiving qualified audit opinions

1.47 In September 2013, I published *Improving Financial Management and Governance: Issues from the Audit of Community Council Accounts 2011-12*. This report highlighted that local councils need to maintain a clear focus on improving their financial management and governance arrangements. The report concluded that the number and range of issues identified by auditors suggest that there are systemic weaknesses that local councils need to address. The appointed auditor has issued a number of public interest reports in recent years on local councils and is currently considering issuing further reports on councils where there have been financial reporting and/or governance failings.

1.48 Initial data identifies an improvement in the timeliness of the completion of audits of the 2012-13 accounts. As at 30 September 2013, auditors had concluded 91 per cent of all local council audits (30 September 2012, 87 per cent). However, the number of audit qualifications remains high with 19 per cent of councils receiving a qualified audit opinion and still a number with no accounts for a few years.

1.49 I will publish an update to my September 2013 report later this year.

The outlook for 2013-14 and beyond will be a period of further austerity which will challenge audited bodies' financial management

1.50 Local government bodies, like the rest of the public sector, are facing a period of financial uncertainty and contraction. Between 2010-11 and 2013-14, local government has faced real terms cuts in the revenue funding it receives from the Welsh Government of around four per cent. The position for 2014-15 is more significant with the provisional local government revenue settlement indicating an average reduction of 3.5 per cent across all councils. Indicative budget proposals for 2015-16 show a further revenue reduction of over three per cent in real terms. The provisional 3.5 per cent reduction for 2014-15 is the average with individual reductions ranging from 1.2 per cent to 4.6 per cent. Alongside the financial reductions, local government services in Wales continue to face considerable demands and cost pressures. This combination presents a significant challenge to audited bodies and will require effective financial management and

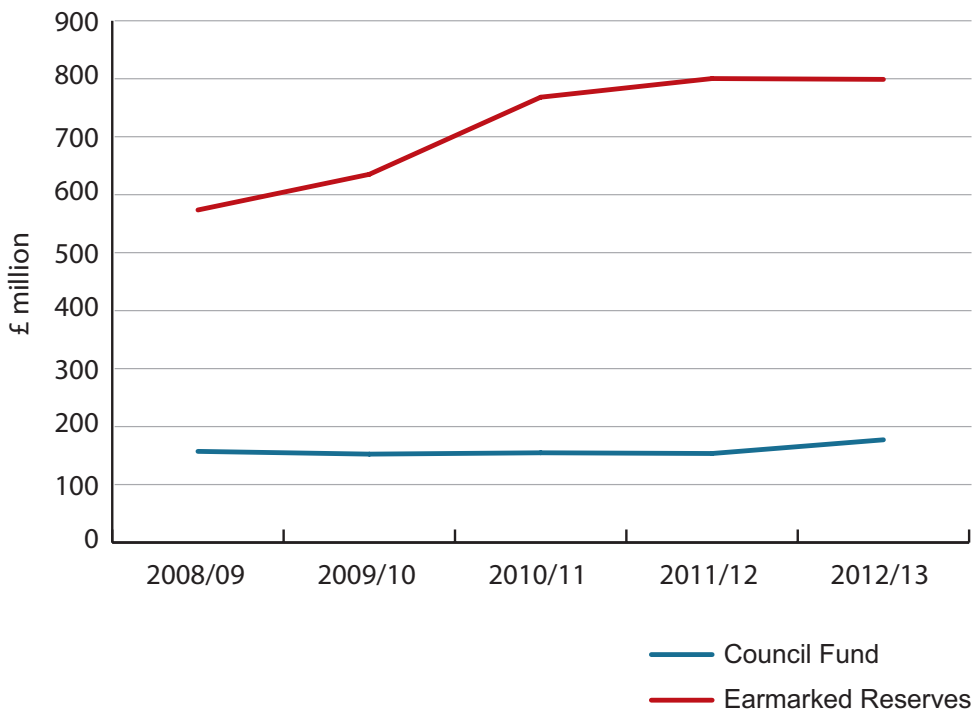
medium-term financial planning that is linked to, and supported by, robust plans for transforming services.

1.51 Local authority balance sheets contain amounts set aside in reserves. The ability to hold reserves represents an important element of their financial management and longer-term financial planning arrangements. Audited bodies are required to hold various types of reserves, some of which are useable to support spending and others which are unusable, merely being held for technical accounting purposes. Those that are useable

and cash backed are either held in relation to specific commitments or cost pressures (earmarked reserves) or as security against unforeseen expenditure or events (council fund or general reserves).

1.52 As can be seen from **Figure 1**, over recent years the overall level of reserves held by Welsh unitary authorities increased. In 2012-13, general reserves increased by £23.6 million whereas earmarked reserves decreased slightly by £1.4 million.

Figure 1 - Council fund and earmarked reserves Welsh unitary authorities



Source: Published accounts

- 1.53** Audited bodies are able to determine the extent of the reserves they hold based on their assessment of need, risks and future commitments. Earmarked reserves make up the largest element of total reserves and include balances and amounts set aside for, amongst other items, equal pay or single status costs, insurance, PFI payments, funding for capital schemes or repairs and renewals. The amount of general and earmarked reserves as a percentage of gross revenue expenditure varies between audited bodies from 7 per cent to 22 per cent with the average being around 13 per cent.
- 1.54** The tough financial outlook means that audited bodies will need to critically appraise their holding of reserves and where necessary factor their use into the budget-setting process and medium-term financial plans. Whilst the amounts in absolute terms may appear significant, they do only represent a relatively small proportion of the annual expenditure and can only be used once. Audited bodies therefore need to ensure that they are used in a sustainable way that supports ongoing service change and transformation rather than simply supporting annual revenue expenditure on an ongoing basis.
- 1.55** Last year, I published a research paper on local authority reserves² which contained a number of areas of good practice for members and officers to consider as part of their management of their reserves position. Later in January 2014, I will be publishing a further report on how local government in Wales is meeting the financial challenges it faces.

² www.wao.gov.uk/assets/Wales_Audit_Office__Report_Local_Authority_Reserves_and_Unsupported_Borrowing_July_2012_-_Final.pdf