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Archwilydd Cyffredinol Cymru
Auditor General for Wales

2014-15 Local Government Accounts

WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

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

The team who delivered the work comprised John Herniman and Jeremy Saunders.

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The Auditor General is independent of the National Assembly and government. He examines and certifies the accounts of the Welsh Government and its sponsored and related public bodies, including NHS bodies. He also has the 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.

The Auditor General, together with appointed auditors, also audits local government bodies in Wales, conducts local government value for money studies and inspects for compliance with the requirements of the Local Government (Wales) Measure 2009.

The Auditor General undertakes his work using staff and other resources provided by the Wales Audit Office, which is a statutory board established for that purpose and to monitor and advise the Auditor General.

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Summary report

1 This is my fifth annual report on local government bodies' accounts. It summarises the results of my work for 2014-15 at the following types of local government bodies (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	5[1]
Harbour authorities	1[2]

2 Local government 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.

3 Producing accurate and timely accounts is a significant task but necessarily required to demonstrate accountability for the stewardship and governance of the public money under the organisation's control. Failing to publish accurate and audited accounts by the prescribed deadlines can reflect badly on the organisation, undermining its financial management and corporate governance arrangements, as well as overall confidence in the organisation.

1 There were 17 joint committees last year but 12 of these have either disbanded or are now below the threshold for preparing full accounts and only require a limited assurance audit. The results of these limited assurance audits are not included in this report.

2 For the first time in 2014-15, harbour authorities (the transactions of which have previously been included in the accounts of relevant unitary authorities) were required to produce separate accounts. One of these required a full audit whereas the others were below the threshold for preparing full accounts and only required a limited assurance audit. The results of these limited assurance audits are not included in this report.

4 Following the introduction of the Public Audit (Wales) Act 2013, I am now the auditor for all local government bodies in Wales, replacing the previous arrangements where I appointed auditors. As such, I am required to audit and issue an opinion on their accounts. The Public Audit (Wales) Act 2004 requires me to examine and certify the accounts, and satisfy myself that the accounts:

- give a true and fair view of the audited bodies' financial position;
- comply with all relevant legislative requirements; and
- have been prepared in accordance with proper accounting practices.

5 The production of a set of accounts, by the 30 June deadline, requires effective project management and coordination across a number of departments and external advisors and is not solely the preserve of finance departments. In 2014-15, all accounts were certified by Responsible Finance Officers (RFOs) by the 30 June deadline.

6 I was able to issue unqualified audit opinions before the 30 September deadline for all audited bodies. Three bodies' audit opinions included an 'emphasis of matter' paragraph where I draw the reader's attention to specific issues reported upon in the accounts.

7 The quality of accounts and supporting working papers for most bodies was similar to 2013-14, although in a number of cases, standards had deteriorated with auditors reporting concerns about the standard of working papers and supporting information.

8 The audits of most of the accounts highlighted that a number of amendments were required but, of greater concern, is that the number of bodies where the accounts had to be amended for material items increased once again this year. This is a worrying trend that has emerged over the last few years and brings into question the quality of accounts production and review arrangements. The areas where most adjustments were required again related to accounting for property, plant and equipment with particular issues around valuation methodologies. Those bodies that continue to experience significant amendments to their accounts following audit need to review their accounts production processes to ensure that sufficient quality assurance and review steps are built into the process.

9 Earlier deadlines for the closure and audit of accounts are likely to become a requirement in future years. The shortcomings in some bodies' arrangements to prepare materially accurate accounts and timely supporting working papers, if not addressed, will impact on their ability to meet earlier statutory deadlines.

10 Proposals for earlier closing of local government body accounts over the next few years will be challenging and require significant changes for both bodies and auditors alike. Having said that, there are potential benefits that can arise from earlier closure of accounts, including: delivering more timely Whole of Government Accounts (WGA); earlier assurance over the previous year's position before embarking on major financial decisions for the future; and increased time for finance staff to spend on other financial management and planning matters to help address financial pressures.

11 Although deadlines for unaudited WGA returns required extensions, an increased number of audited returns were submitted on time, albeit one return was qualified this year.

12 Managing the austerity agenda will also require significant changes in the way that audited bodies' finances are managed and governed, as approaches to financial management that were once good enough, are now unlikely to be fit for purpose to continue to deliver robust financial outcomes in the future.

13 Later this year, I will publish an update on the financial resilience of councils in Wales. The report will look at the robustness of councils' financial planning and management arrangements, focusing on how they set and then deliver their budget and savings targets. The report will contain the key indicators of financial performance setting out trends in Wales and will use risk ratings to determine the effectiveness of councils' financial planning, financial control and financial governance arrangements. This analysis will identify where improvements are required and help to support councils to address the difficult financial challenges they face.

Detailed report

Local government bodies generally prepared good-quality financial statements and working papers although standards have deteriorated in some cases, with an increased number of bodies' statements requiring material amendments: despite this, I issued unqualified opinions on all bodies by 30 September

14 The Accounts and Audit (Wales) Regulations 2014 (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 Regulations also require that by 30 September, the audited body formally approves, certifies and publishes its accounts. 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.

15 Preparation of draft accounts is a complex process requiring sound project management. All bodies prepared and certified draft accounts by 30 June in line with the Regulations.

16 On or around 30 June, in agreement with audited bodies, 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 published by 30 September.

Working papers to support accounts were generally of a good standard; however, the quality of working papers at several bodies has deteriorated

17 In order to support the entries in the accounts and to expedite a smooth audit process, audited bodies should provide timely, 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.

18 Audited bodies and auditors have continued to work hard to ensure that they share an understanding of what is expected, what works locally and continue to streamline arrangements based on learning from previous years. Where the process works well, there is ongoing and open dialogue; they discuss 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. Such improvements can include providing greater clarity over working paper requirements, access to timely information and information systems, timing of key tasks etc.

19 Working papers to support accounts were generally of a good standard. However, in a number of audited bodies, auditors reported that some or all aspects of the quality, timeliness and accuracy of supporting working papers for the accounts have deteriorated. These 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 increases the risk that the accounts are not completed by the statutory deadline.

20 Where arrangements for producing accurate and timely working papers are poor, then these bodies will not be well placed to deliver on the proposed faster closing requirements in the future which I comment on further later in this report.

The number of accounts that required material amendments increased again this year and a number of other issues arose

21 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. Information is material if its omission or misstatement could influence the reader of the accounts to come to a wrong conclusion about the body or its financial position. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Therefore, a relatively small amount could be considered material if it might mislead or influence a user of the accounts, eg an error in the stated pay of a senior officer.

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

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

23 The amount above which a misstatement may be considered material ranged from £6,000 in smaller audited bodies, such as a joint committee, to £24 million in large pension funds. 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. 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.

24 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 (usually a council or its audit committee). Auditors seek an explanation of why the adjustments have not been made before the accounts are approved.

25 In 2014-15, 30 of the 50 bodies (60 per cent) covered by the report, made material adjustments to their accounts following audit. This represented an increase compared to the previous year where it was 32 of 61 (52 per cent).

26 Whilst there are often likely to be minor errors in the accounts presented for audit, material items should be much less common. In signing the accounts prior to audit, the RFO is certifying that they are materially correct. Such a large and increasing number of material errors undermines that certification process and brings into question the effectiveness of the accounts production, quality assurance and review processes.

27 Good accounts production processes with robust internal quality assurance and review arrangements should be capable of identifying material errors prior to the RFO certifying them as materially correct. Bodies where material amendments are made should review their accounts production and quality assurance arrangements to ensure they are capable of picking up such errors before the accounts are certified and passed for audit.

28 The main areas where misstatements, material and non-material, were identified from audit work in 2014-15 and other qualitative issues are summarised below.

Property, plant and equipment

29 Property, plant and equipment remains an area where a significant number of audited bodies struggle to apply accounting treatment correctly. Material errors in this area of the accounts have increased significantly since last year. Some of the general problems encountered in previous years arose again, including:

- Failure to account for revalued properties correctly or revaluing them using an incorrect basis. A particular issue arose this year where some authorities had incorrectly included financing costs in their valuation of schools using the depreciated replacement cost methodology. These and other valuation problems are often attributed to poor communication between finance and valuers. It is essential that as part of the closedown project plan that all those involved are clear about expectations, timing of information flows and technical requirements.

- Asset registers could not be fully reconciled with accounting records, with some common problems, such as some assets being counted twice and others excluded from the accounts.

- General issues around correctly accounting for depreciation, recognising and accounting for impairments, treatment and disclosure of non-enhancing expenditure and the classification of assets.

30 The 2014-15 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) details the issues that local authorities should consider when accounting for non-current assets used by local authority maintained schools. LAAP Bulletin 101 Accounting for non-current assets used by local authority maintained schools, published in December 2014, sets out further guidance on these issues. Despite this updated guidance, auditors found some authorities had excluded assets from their balance sheets which should have been included or included others which should have been excluded.

31 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. This remains an issue where greater consistency of approach would be beneficial. I believe that any methodology involving discounted cash flow of future rentals streams may not be compliant with the 2015-16 Code and auditors will be discussing this issue with relevant audit bodies at an early stage for next year.

Provisions

32 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.

33 In common with previous years, it is disappointing to note that a number of audited bodies continued to inappropriately set up provisions and others had failed to set up provisions when required.

34 One particular theme which arose (and is likely to be more common going forward) is provisions for organisational/departmental restructuring and exit costs. Audited bodies need to pay close attention when carrying out restructuring exercises to the requirements of International Accounting Standard 37 as the timing of consultation and communication of decisions is relevant to whether a provision is required.

Income and expenditure internal recharges

35 An emerging issue last year at a number of bodies was the non-elimination of internal recharges from gross expenditure and gross income. Several audited bodies had significantly overstated both gross income and gross expenditure because such items had not been properly netted off as is required to show true external income and expenditure. Although the net expenditure was fairly stated, material amendments were required to both gross income and gross expenditure and many of the supporting notes to the accounts.

36 It was reassuring this year that the number of bodies where this was an issue reduced. However, those bodies which still have issues need to ensure they improve the arrangements in place to eliminate internal recharges from reported gross income and gross expenditure.

Accounting for jointly controlled operations

37 Changes were made to the Code around the requirements for accounting for jointly controlled operations. This caused accounting difficulties for a number of audited bodies which needed to correctly account for jointly controlled operations such as joint committees, collaboration arrangements and subsidiaries. The main difficulties encountered were in relation to agreeing the basis of cost apportionment and the provision of timely accounting information for inclusion in the draft accounts.

Chief officer median salary ratio

38 For the first time this year, the Accounts and Audit Regulations required audited bodies to disclose ratios of chief officer salaries to the median salary. A significant number of bodies needed to make amendments to their calculations to correctly calculate the ratio.

Minimum revenue provision

39 Under regulation 21 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 as amended (the Regulations), local authorities (including police, fire and national park bodies) must charge to a revenue account a Minimum Revenue Provision (MRP) in respect of capital expenditure incurred in a prior year. Until 2008, MRP was calculated in accordance with a formula set out in the Regulations. In 2008, this requirement was replaced by Regulation 22 (Calculation of minimum revenue provision) which states ‘A local authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent’.

40 In March 2008, the Welsh Government published statutory guidance entitled **Guidance on Minimum Revenue Provision**. Local authorities in Wales are required to have regard to this guidance. The guidance notes that the prudent amount of provision should normally be determined in accordance with the principle that:

‘The broad aim of prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by the Welsh Assembly Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.’

41 It goes on to note that Welsh Ministers consider that the methods of making prudent provision include four options set out in the guidance but notes that approaches differing from those exemplified are not ruled out.

42 I have recently written to audited bodies setting out my views on issues which I believe should, and should not, be considered when setting this provision and audit teams will consider the approach taken by authorities in setting MRP as part of their audit work.

Unqualified opinions were issued on all accounts but three opinions needed an ‘emphasis of matter’ paragraph

43 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 an improvement on previous years, all audited bodies’ accounts were approved and unqualified audit opinions issued on them all by the 30 September deadline.

44 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.

45 Three bodies needed emphasis of matter paragraphs:

- Carmarthenshire County Council: to draw attention to the unlawful expenditure on senior officer remuneration in the prior-year comparative figures;
- Newport City Council: to draw attention to the non-consolidation of the accounts of Newport Transport; and
- Pembrokeshire County Council: to draw attention to the unlawful expenditure on senior officer remuneration in the prior-year comparative figures and the accounting treatment for the Cleddau Bridge.

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

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

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

47 Where issues remain 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 once his final report has been considered by the audited body and the accounts reapproved.

48 For seven audited bodies (including two 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 mainly because issues relating to electors' questions and objections remained outstanding. 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.

49 Once I have issued my final report concluding on any matters outstanding, in accordance with the regulations the audited body must consider this report and formally re-approve the accounts before I issue my certificate closing the audit. The work on two audits has subsequently been completed and these audits concluded.

Although deadlines for unaudited Whole of Government Accounts returns required extensions, an increased number of audited returns were submitted on time albeit one return was qualified this year

50 The WGA consolidates the audited accounts of around 4,000 organisations across the public sector in order to produce a comprehensive, accounts-based picture of the financial position of the UK public sector. WGA is based on International Financial Reporting Standards (IFRS), the system of accounts used internationally by the private sector.

51 Public sector bodies are required to provide WGA information under the HM Treasury's Whole of Government Accounts (Designation of Bodies) Order 2015. This identifies the Welsh bodies to be included in the 2014-15 WGA. The designated consolidation officer at each body is 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.

52 The Comptroller & Auditor General is responsible for the overall audit opinion on the WGA. The audit opinion is underpinned by work carried out by the auditors of component bodies that are included in WGA. The Auditor General is required to audit the Welsh block of the WGA. For 2014-15, a UK threshold of £350 million was in place, with all designated bodies above this threshold requiring an audit of their WGA return.

53 The Welsh Government determined that for 2014-15 all local authorities, fire authorities, and police and crime commissioners required audit irrespective of the value of their 2014-15 statutory financial statements. With regard to our 2015-16 WGA audits, we will be liaising with the Welsh Government on the audit threshold that it decides to apply in Wales.

54 The 2014-15 deadlines that HM Treasury set for Welsh local authority bodies were:

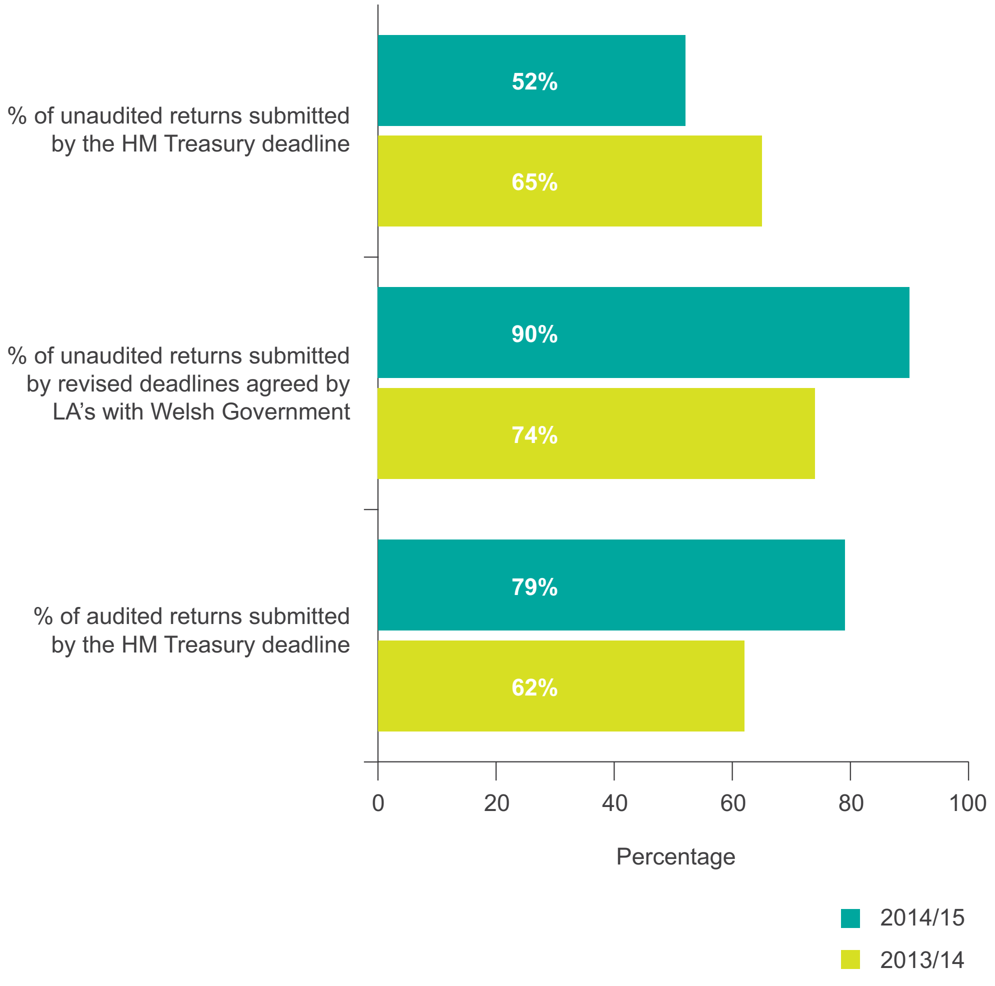
- 10 July 2015 for unaudited returns to be submitted to the Welsh Government and local audit teams; and
- 2 October 2015 for audited returns to be submitted to the Welsh Government.

55 For the unaudited returns, the Welsh Government extended the deadline to 14 July 2015 for all local authorities and thereafter, for five local authorities, extended the deadline further by a few days. Only three bodies failed to meet these extended deadlines but the Welsh Government received all unaudited returns by 22 July 2015.

56 As shown in Exhibit 2, whilst the number of authorities meeting the HM Treasury deadline for submission of unaudited returns actually fell this year by 13 per cent, the percentage improved for those submitted by the revised submission deadlines agreed by local authorities with the Welsh Government.

57 The percentage of audited returns submitted by the HM Treasury's deadline also notably improved this year, increasing by 17 per cent. One return, Monmouthshire County Council, was qualified this year because it was not consistent with the council's audited financial statements.

Exhibit 2 - WGA returns



Source: Wales Audit Office review of WGA returns

58 Whilst the overall timeliness of submission of audited and unaudited returns has improved (when taking into account deadline extensions granted by the Welsh Government), the challenge ahead is for local authorities to deliver good-quality returns by the tighter deadlines that HM Treasury has made clear it will be setting. Auditors will be engaging with their local authority to support the achievement of the WGA goals to be set for 2015-16 and beyond.

Proposals for earlier closing of local government body financial statements over the next few years will present challenges for audited bodies and auditors alike but will also bring some potential benefits

59 The Welsh Government is consulting with local government bodies on introducing an earlier closing timetable to be phased in over the next few years. The proposals ultimately result in local government bodies producing their accounts by the end of May and having them audited by the end of July each year. Essentially, this reduces the total time available by two months. The consultation proposal is summarised in Exhibit 3.

Exhibit 3

Authorities	Current to 2017-18	2018-19	2019-20	2020-21
Police, fire and national parks	Prepare a/c 30 June	Prepare a/c 31 May	Prepare a/c 31 May	Prepare a/c 31 May
	Publish 30 Sept	Publish 31 July	Publish 31 July	Publish 31 July
Unitary authorities	Prepare a/c 30 June	Prepare a/c 30 June	Prepare a/c 30 June	Prepare a/c 31 May
	Publish 30 Sept	Publish 31 August	Publish 31 August	Publish 31 July

Source: Welsh Government consultation on faster closing

60 Planning for the successful introduction of this revised timetable will need close coordination between audited bodies and their local auditors and will present challenges for all of us.

61 I have recently hosted a number of shared learning seminars, the aim of which has been to share learning from bodies who have managed to change processes and close accounts and have them audited in a tighter timeframe. These seminars were not focused on detailed processes but rather the organisational and cultural changes needed to start the journey. However, I plan to hold further seminars and workshops over the coming years exploring the more detailed aspects of faster closing. Information on these events can be found on our website and will be added to over time (www.audit.wales/events/faster-closure).

62 Whilst faster closing will present challenges, there are potential benefits that will accrue to audited bodies and the public sector as a whole. In addition to the production of more timely Whole of Government Accounts, individual organisations should see benefits in areas such as:

- more timely financial reporting internally and to wider stakeholders;
- earlier assurance over the previous year's position before embarking on major financial decisions for the future;
- finance staff can spend more time tackling the wider financial management and planning required to address increasing financial pressures; and
- reviews of financial systems with the aim of faster closing often lead to improvements in financial controls.

63 Auditors and audited bodies will need to start giving consideration to the requirements of the faster closing timetable and how it can be met. A prerequisite to the ability to address this new challenge is continuing to improve the quality of accounts and working papers to address the points made earlier in this report.

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