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Archwilydd Cyffredinol Cymru
Auditor General for Wales

2013-14 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 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 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.

3 I appoint 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:

- 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.

4 My fourth annual report on local government bodies' accounts, summarises the results of auditors' work for 2013-14 at the following types of audited bodies in Wales:

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	17

5 The quality of accounts and supporting working papers for most bodies was similar to 2012-13, although in a number of cases standards had deteriorated and there are still some particular account areas where improvements are required.

6 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 again this year. The areas where most adjustments were required related to accounting for property, plant and equipment (non-current assets) and, an emerging area this year, double counting of internal recharges in gross income and gross expenditure.

7 Authorities need to pay closer attention to complex accounting areas and ensuring a thorough quality assurance review is carried out before accounts are certified by Responsible Financial Officers (RFOs).

8 In future, the shortcomings in some bodies' arrangements to prepare accurate draft accounts and timely supporting working papers could impact on their ability to close their accounts earlier.

9 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 2013-14, all accounts bar one 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 two authorities. One was a week late because of council approval delays and the other is still outstanding because of a matter raised by an elector.

10 One body's audit opinion included an 'emphasis of matter' paragraph where the auditor draws the reader's attention to specific issues reported upon in the accounts. Another is still outstanding but is expected to also include an 'emphasis of matter' paragraph.

11 There has been no notable improvement in the timeliness of preparing draft Whole of Government Accounts (WGA) returns, which remains poor and only two-thirds of audited returns were completed by the deadline. Improvements in timeliness will be required as HM Treasury seeks to bring the deadlines forward in future years.

12 The financial outlook for 2014-15 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 continue 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 this year 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 just two exceptions, unqualified audit opinions were issued by 30 September but more accounts than previously needed material adjustments

13 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 and certifies the 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.

14 Preparation of draft accounts is a complex process requiring sound project management so completion by 30 June represents an achievement. With one exception, all bodies prepared and certified draft accounts by 30 June in line with the Regulations. The exception certified the accounts on 7 July.

15 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 published by 30 September.

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

16 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.

17 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.

18 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 has 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 leads to increased pressure on audited bodies' finance teams and auditors and increases the risk that the accounts are not completed by the statutory deadline.

19 Where arrangements for producing accurate and timely working papers are poor then these bodies may not be well placed to deliver on any faster closing requirements in the future.

20 We have developed a good practice guide to help public bodies plan for, and deliver, faster closing of their accounts[1]. 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 again this year

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 statements. 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 £20 million in large ones such as a pension fund. 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.

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

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 2013-14, 32 of the 61 bodies (52 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 18 of 55 (33 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 number of material errors undermines that certification process and brings into question the quality of the accounts production process.

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 2013-14 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. 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 (often attributed to poor communication between finance and estates departments);
- 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; and
- 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 In my previous reports on *Local Government Accounts*, I noted that there was a lack of clarity regarding the recognition of foundation, voluntary aided and voluntary controlled school buildings as non-current assets on the balance sheets of audited bodies. In the continuing absence of definitive guidance, audited bodies have again in 2013-14 adopted inconsistent accounting treatments regarding these schools, with some audited bodies recognising them on the balance sheet and others not doing so. CIPFA/LASAAC has concluded on the appropriate accounting approach for these assets and the 2014-15 Code of Practice on Local Authority Accounting in the United Kingdom (the Code) details the issues that local authorities should consider. *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 and concludes that these assets should not be recognised on local authorities' balance sheets. Audited bodies need to review their treatment of these assets in 2014-15.

31 The Code of Practice on Local Authority Accounting in the United Kingdom 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 and we continue to discuss this with representatives of the Welsh Government and audited bodies.

Provisions and equal pay

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, a number of audited bodies had inappropriately set up provisions and others had failed to set up provisions when required.

34 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. Accounts did not always accurately represent those positions with amounts being shown as contingent liabilities rather than provisions and vice versa. I have previously reported that there are various interpretations about whether such payments are pensionable and this lack of clarity has also impacted on the amount, and accounting treatment, of the provisions. The Appointed Auditor's view is that these payments are pensionable. 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 internal recharges

35 An emerging issue this 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 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 The main areas where the errors were encountered were in relation to non-elimination of internal trading transactions between various services and incorrectly showing grant payments to schools as expenditure.

37 Bodies need to ensure they have arrangements in place to eliminate internal recharges and trading activities from reported gross income and gross expenditure.

Pension fund issues

38 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.

39 International Accounting Standard 19 (Employee Benefits) (IAS 19) requires bodies to disclose in their accounts the assets, liabilities and transactions, together with certain information regarding underlying assumptions, in respect of retirement benefits.

40 The actuary prepares both a triennial funding valuation and an annual valuation of the pension fund liabilities, on an IAS 19 basis, which provides both revenue and balance sheet disclosures for inclusion in the financial statements. These are prepared using a range of data, provided by pension fund administering authorities.

41 It is critical, therefore, that the administering authority's membership records are up to date and accurately record data for active, deferred and pensioner records. Employer bodies (admitted bodies) and administering authorities need to work together to ensure that membership records are accurate and up to date. This not only has implications for the IAS 19 disclosures in the financial statements for admitted and administering bodies, but also for the individual pension fund members.

42 Auditors also reported other issues in relation to pension fund accounts this year, predominately involving:

- correct treatment for deficit funding and bulk transfers; and
- little or no internal audit coverage of the pension fund.

43 Section 151 officers need to be satisfied that there is sufficient coverage of pension fund activity by their internal audit function to provide assurance over the significant sums involved. Administering bodies should also ensure that their annual governance statement reflects and comments upon the governance arrangements, issues and risks in relation to the pension fund.

Unqualified opinions were issued in all but one case which is still outstanding and one opinion included an 'emphasis of matter' paragraph

44 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.

45 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.

46 For 2013-14, there was one body where a non-standard opinion was given. In January 2014, the Appointed Auditor issued two reports in the public interest on Carmarthenshire County Council. These reports identified unlawful expenditure in relation to a pay supplement for senior officers and an indemnity granted to the Chief Executive for a libel counterclaim. This position was disclosed in the 2013-14 accounts of the council and drawn to the attention of a reader of the accounts in an 'emphasis of matter' paragraph in the auditor's report on the accounts.

47 There is one audited body, Pembrokeshire County Council, where an audit opinion is yet to be issued as there is a potential material outstanding issue in relation to a question from an elector which needs to be resolved. When issued, this audit opinion is also expected to include an 'emphasis of matter' paragraph drawing attention to unlawful expenditure arising from a 'pay supplement' for senior officers. A report in the public interest was published in January 2014 referring to this issue. Subsequent to this, the council proposed a severance payment to the Chief Executive including items of expenditure which would have been unlawful. The Appointed Auditor served an advisory notice on the council in October 2014 to prevent such unlawful expenditure. As a result, a settlement was made which removed the payments which would have been unlawful (reducing the settlement by £52,760).

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

48 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:

- 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.

49 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.

50 For six 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.

There has been no notable improvement in the timeliness of preparing draft Whole of Government Accounts returns although two-thirds of the audited returns were completed by the required date

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

52 HM Treasury determines the bodies to be included in the WGA each year. It also designates a consolidation officer at each body. The officer 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. These arrangements apply to unitary authorities, police and crime commissioners, fire and rescue authorities and two national parks (although the latter do not require audit).

53 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.

54 The timescales that HM Treasury set for the 2013-14 WGA process required draft returns to be submitted by 30 June 2014. The Welsh Government negotiated an extension to this deadline, to 11 July 2014, in order to ease the time pressures on local authority bodies. The 2013-14 timescales for Welsh local authority bodies were:

- initial WGA returns to be provided to the Welsh Government and local audit teams by 11 July; and
- audited and finalised WGA returns to be provided to the Welsh Government by 30 September.

55 Two authorities did well in achieving the HM Treasury deadline of 30 June for completion of the draft WGA return; a further 18 bodies achieved the 11 July deadline. Of the remaining 11 bodies:

- six agreed further extended deadlines with the Welsh Government, although half of these bodies did not achieve the later dates; and
- five did not negotiate any further extension, and of these, the last two returns were not received until well in to August 2014.

56 Despite the high number of extensions required and the widespread delays in producing the initial returns, the majority (62 per cent) of final audited returns were submitted on time. With the exception of two, all other audited returns were received within a week of the deadline. None of the returns were qualified.

57 Generally, the timeliness of preparation of draft WGA returns has not improved from last year. Local authority bodies will find the WGA timescales increasingly challenging as HM Treasury is committed to continually bring forward the publication date for the WGA.

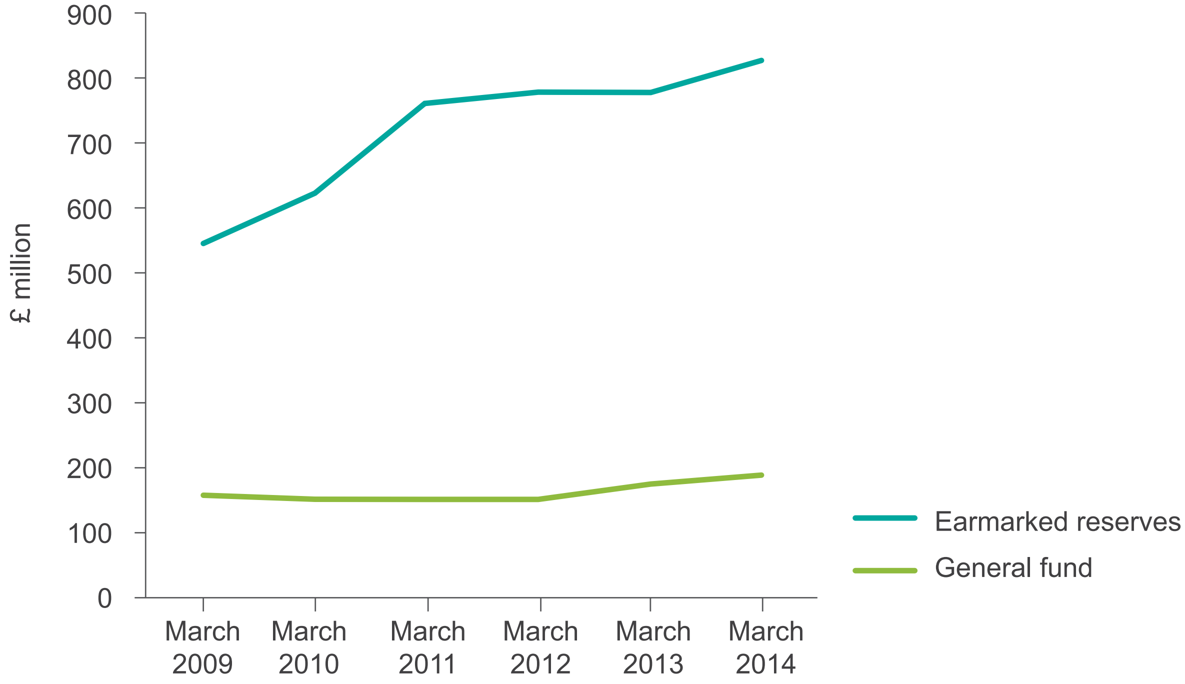
The financial outlook for 2014-15 and beyond will be a period of continuing austerity which will further challenge audited bodies' financial management

58 Local government bodies, like the rest of the public sector, are facing a period of financial uncertainty and contraction. Between 2010-11 and 2014-15, local government has faced real terms reductions in the revenue funding it receives from the Welsh Government of around four per cent. The position for 2015-16 continues to be challenging with the revenue settlement being a 3.4 per cent reduction (£145 million) from 2014-15. This reduction is the average across all authorities with individual reductions ranging from 2.4 per cent to 4.5 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 and councils will require effective financial management and medium-term financial planning that is linked to, and supported by, robust plans for transforming services.

59 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).

60 As can be seen from Figure 1, over recent years the overall level of reserves held by Welsh unitary authorities increased. In 2013-14, general reserves increased by £15.2 million and earmarked reserves increased by £49.0 million. This increase is somewhat surprising as finance directors indicated two years ago that they expected reserves to fall significantly in 2013-14. However, this may be due to a combination of issues including the timing of budget reductions, delivery of financial savings or deliberate plans to build up reserves to manage future risks. The position will be explored further in my report on how local government is meeting the financial challenges that I will publish before the end of the current financial year.

Figure 1 – General fund and earmarked reserves: Welsh unitary authorities at the end of each financial year



Source: Wales Audit Office review of published accounts

61 Audited bodies must 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 significantly between audited bodies.

62 The tough financial outlook means that audited bodies will need to critically appraise their holding of reserves, and where able to do so, 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. Using reserves to fund current revenue expenditure is not sustainable as eventually the reserves will be depleted and the financial pressure will remain. 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.

63 Local authority reserves are coming under increasing public and political scrutiny and it is important that authorities have sound and transparent arrangements to establish, manage and report on the reserves they hold in addition to including them in their annual accounts. In 2014, CIPFA issued *LAAP Bulletin 99: Local Authority Reserves and Balances* which reiterates the many factors that need to be considered as part of the budget-setting process in terms of reviewing reserves and determining an appropriate level based on operational and financial risks. It also recommends, in addition to financial reporting requirements, that for each earmarked reserve there should be a clear protocol setting out:

a the reason for/purpose of the reserve;

b how and when the reserve can be used;

c procedures for the reserve management and control; and

d a process and timescale for review of the reserve to ensure continuing relevance and adequacy.

64 I support the recommendations in LAAP Bulletin 99 and local auditors will be considering the extent to which authorities have addressed these recommendations as part of their audit.

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