WALES AUDIT OFFICE
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Local Authority Accounts 2011-12

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.

The Auditor General is totally independent of Government, the National Assembly and the other bodies that he audits and inspects. Furthermore, in order to protect the constitutional position of local government, he does not report to the National Assembly specifically on local government work, except where required to do so by statute.

The Auditor General and his staff together comprise the Wales Audit Office. For further information about the Wales Audit Office please write to the Auditor General at the address above, telephone 029 2032 0500, email: wales@wao.gov.uk, or see web site http://www.wao.gov.uk

Contents

Summary report

1 Local government bodies (authorities) 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. The production of accurate and timely accounts is a significant task that contributes to effective corporate governance. 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.

2 The Auditor General appoints auditors to all authorities 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 accounts:

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

3 This, my second annual report on local authority accounts, summarises the results of auditors' work for 2011-12 at the following types of authorities in Wales:

Exhibit 1

Type of body	Number
Unitary authorities (including eight pension funds)	22
Police authorities	4
Fire and rescue authorities	3
National park authorities	3

4 Other, smaller, local government bodies whose accounts are also audited, eg joint committees and community and town councils, are not included in the scope of this report.

5 The Accounts and Audit (Wales) Regulations 2005, as amended (the Regulations), require authorities 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 authority must publish a statement which provides details of actions (including timescales) being taken to prepare, approve and certify the accounts.

6 2011-12 was a year of consolidation following the challenges in 2010-11 of introducing International Financial Reporting Standards (IFRS) for the first time. The main challenges this year, on top of some further technical changes, was to embed the ongoing requirements of IFRS, change the basis of accounting for heritage assets and restore the upward trend in the quality of accounts and working papers which overall had shown a dip in the previous year.

7 On the whole the quality of accounts and supporting working papers improved compared to 2010-11, although a small number of authorities still struggled to provide timely and accurate working papers to support their accounts, particularly in the area of property, plant and equipment entries and transactions.

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 2011-12, all accounts were certified by RFOs by 30 June. Following the audit of those accounts, unqualified opinions were issued before 30 September deadline in all but two cases. In one of those cases, an unqualified opinion was issued in October and the other is still under consideration. The audits of most of the accounts highlighted that a number of amendments were required, some of which were material. 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.

9 There are still some areas where a lack of definitive accounting guidance leads to inconsistencies. Three of the main areas where this occurs are in relation to: the valuation of council houses; the treatment of voluntary schools; and the restoration of landfill sites. Further guidance and progress is required to address these in future years.

10 The returns required from authorities 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, having dealt with the issues of IFRS last year, there would be an improvement in the timeliness of returns. Whilst the majority of final audited returns were completed on time, or within a few days of the deadline, it does highlight that authorities need to place greater emphasis on completing the WGA returns in a timely and accurate manner.

11 Annual governance statements, a requirement from 2010-11, continue to be refined and improved but there remains scope to further improve their usefulness. As such, I am currently carrying out an improvement study to evaluate the effectiveness of authorities' reviews of governance.

12 An effective internal audit service is an important element of an authority's internal control framework providing independent assurance to management and members on its governance and financial control arrangements. Authorities' internal audit services were generally assessed as complying with the required CIPFA standards.

Authorities generally prepared timely accounts and supporting working papers, and in most cases we issued unqualified audit opinions by 30 September

13 The Regulations require authorities' 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 authority 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 authority 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 On or around 30 June, in agreement with authorities, 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 authorities and for audit opinions to be issued by 30 September.

15 The majority of authorities require full council (or equivalent) to approve their accounts at the end of the audit process, with only a small number delegating this responsibility to their Audit Committee under Regulation 9 of the Regulations. The Local Government (Wales) Measure 2011 (the Measure) which was introduced earlier this year requires authorities to establish audit committees and sets 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:

- consider and comment on the authority's certified draft financial statements; and
- see to what extent the statements take cognisance of audit reports during the year, and changes in accounting policy and internal control mechanisms.

16 As this was the first year that the Measure applied and the statutory guidance was not issued until June 2012, many authorities were still establishing audit committees and appointing lay members in September 2012. For next year, authorities will need to further consider how they build in sufficient time for review by their audit committees prior to the accounts being approved.

All authorities prepared and certified draft accounts by 30 June but work was not complete at that point in all cases

17 All authorities prepared and certified draft accounts by 30 June. Preparation of draft accounts is a complex process requiring sound project management and certification by 30 June represents an achievement.

18 However, in a small number of cases, work was still being undertaken by the authorities post 30 June deadline in relation to property, plant and equipment (non-current assets) entries and balances to ensure they were accurate and complete. During the audit, material adjustments were made to the figures and these were reflected in the final audited sets of accounts. Notwithstanding the complexities of local government accounts, the draft accounts are being certified by the RFO as 'true and fair' and should therefore be complete before being certified. Where the preparation of the accounts is not completed by 30 June, certification should be delayed.

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

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

20 In recent years there has been an overall trend of continuous improvement in the timeliness and quality of working papers provided to support the accounts, although this was reversed last year following the additional complications caused by the introduction of IFRS. It is pleasing to report that, in the main, the trend of continuous improvement has resumed.

21 Authorities and auditors have continued to work hard to ensure that there is a shared understanding of what is expected and, in an increasing number of bodies, other arrangements to support the process have continued to develop including, for example:

- auditors having read-only access to ledger systems;
- working papers provided in electronic format;
- working papers deposited on a shared network drive, accessible by the body and the auditor;
- auditors and bodies sharing information about new or contentious areas in advance of the production of the accounts; and
- regular reporting of progress and issues as they arise throughout the accounts production and audit process.

22 In a small number of authorities, there have been difficulties in providing accurate and timely supporting working papers for entries relating to equal pay provisions and disclosures and property, plant and equipment.

23 Authorities and auditors need to continue to work together to improve the quality and timeliness of working papers supporting the accounts. Experience shows that one of the most valuable tools for improving arrangements is 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.

24 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 website[1]. It includes guidance and case studies on culture change, planning, working practices during the year, and closing and reporting.

There were a number of adjustments required to the draft accounts, mainly in relation to property, plant and equipment

25 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.

26 The auditor's determination of materiality is a matter of professional judgment 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.

27 For authorities referred to in this report, the approximate aggregated total gross revenue expenditure (as shown in the accounts) was £10 billion and long-term assets totalled £15.5 billion. The net assets of the eight pension funds amounted to £9.6 billion.

28 The amount above which a misstatement may be considered material ranged from £35,000 in smaller authorities to £10 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.

29 Through their work, auditors may identify material misstatements in an authority'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 non-standard (ie qualified) opinion.

30 In 2011-12, 17 (53 per cent) of bodies covered by the report, made material adjustments to their accounts following audit. This was one more than in 2010-11. In total, material adjustments were made to accounts of £323 million (£613 million in 2010-11) for balance sheets and £51 million (£502 million in 2010-11) for Statements of Comprehensive Income and Expenditure (SCIE).

31 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. In 2011-12, unadjusted (but not material) misstatements remained in audited accounts of £25.9 million (£33.3 million in 2010-11) for balance sheets and £9.2 million (£22.9 million in 2010-11) for SCIE.

32 The main areas where misstatements, material and non-material, were identified from audit work in 2011-12 are summarised below.

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

Property, plant and equipment

33 Property, plant and equipment remains an area where a significant number of authorities struggle to apply accounting treatment correctly. In addition, for 2011-12, authorities were required for the first time to apply FRS 30 Heritage Assets. This in particular caused problems for some authorities in terms of correctly identifying and accounting for such assets. 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 (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.

Provisions

34 Authorities 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.

35 In common with last year, a number of authorities 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.

Income and expenditure

36 Although generally the amounts involved are non-material, auditors reported to a number of authorities 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.

Equal pay claims and pension contributions

37 Last year I reported that due to differing legal opinions on whether pension payments were payable on equal pay claim settlements, some authorities included provisions for pension entitlements and others did not. This year, legal advice obtained by the Appointed Auditor suggests that pension contributions should be made on the payments to resolve equal pay claims. However, the contrary view taken by some authorities on the basis of their legal advice is that compromise agreements entered into when settling claims removed the necessity to include pension contributions.

38 Therefore, some authorities have included pension costs in their provisions and others have not done so based on their own legal advice. Due to the differing legal views and uncertainties surrounding this issue, both approaches have been accepted for accounting purposes this year.

39 However, authorities need to be alert to any future court decisions on this issue that could clarify the legal position and impact on the need for pension contributions to be recognised on claims.

40 In addition to the issue of whether pension contributions are required, a number of equal pay provisions included in draft accounts were amended to ensure they were appropriate and reasonable.

Pension funds

41 Auditors reported a variety of issues in relation to pension fund accounts this year, predominately involving:

- audit assurance reports not being available from fund managers;
- valuation of investments and their correct classification and disclosure; and
- treatment of the bulk transfer of staff in relation to the Wales Probation Trust.

All but two authorities received unqualified audit opinions by 30 September

42 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 authorities' accounts were approved and unqualified audit opinions issued on them by the 30 September deadline. However, there were two authorities – Newport City Council and City and County of Swansea – where the accounts were not certified by the deadline.

43 For Newport City Council, on the day the accounts were due to be approved by the Council and signed by the auditor (27 September 2012), additional information became available nationally relating to liabilities for the former Municipal Mutual Insurance Company. This initially indicated that a material change might be required to the Council's accounts. Following further work by the Council and the auditor, it subsequently transpired that a change was required but that it was not material. As such, an unqualified opinion was issued on 22 October 2012, the earliest date the Council could arrange for re-approval.

44 In the case of City and County of Swansea, the approved accounts contained accounting treatment and disclosure in respect of certain banking and cash management arrangements between the Council and Pension Fund, which are the subject of discussions between the Council and the auditor.

Some authorities are still not meeting the requirements to publish their accounts by 30 September

45 Authorities are required, by the Regulations, to publish their statement of accounts (whether audited or not) by 30 September each year. Whilst publication does not require any preparation beyond the statements themselves, nor the distribution of copies of the statements to persons who have not expressed an interest in receiving them, it does require positive action.

46 The approach to meeting the requirement to 'publish' varies. However, it is not sufficient for the accounts to only be available via committee papers or by providing copies to enquirers on demand; it is expected that accounts become publicly available. The most efficient way is usually for the audited accounts to be published via a body's website. However, Welsh Government guidance suggests that authorities should not rely on only one method of publication. Most bodies now provide copies of their audited accounts on their website and some also in public offices. However, some still only make them available via committee papers. Additionally, some delays in placing the accounts on websites have been attributed to translation of the accounts to ensure both English and Welsh versions are available at the same time. However, some produce bilingual versions in readiness for sign-off and publication at the end of September. Authorities need to ensure that appropriate arrangements are put in place to properly publish their accounts by the deadline.

Issues under consideration in relation to questions raised by local government electors meant that the auditor has not yet certified a small number of audits as complete

47 Before issuing opinions and concluding the audit, there are a number of issues auditors need to consider:

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

48 Where there remain issues outstanding, the auditor can issue an opinion on the financial statements where he considers that 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.

49 For five authorities, the certificate concluding the audit has not been given as there remain issues outstanding relating to electors' questions and objections. 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 and resolved, however, the audits cannot be certified as complete.

There remains scope to clarify accounting treatment in a number of areas

Accounting for schools continues to require clarification

50 In my report on *Local Authority Accounts 2010-11*, 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 authorities. In the absence of definitive guidance, authorities have again in 2011-12 adopted inconsistent accounting treatments regarding these schools, with some authorities recognising them on the balance sheet and others not doing so.

51 CIPFA/LASAAC included accounting for schools in its consultation regarding amendments to the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) that will apply to the financial year 2013-14. CIPFA/LASAAC is considering the responses received to the consultation.

52 Once the 2013-14 Code has been finalised, authorities will need to consider whether their accounting treatment is consistent with Code requirements and make any necessary adjustments in the 2013-14 accounts.

Council house valuation methodologies produce inconsistent valuations

53 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.

54 In my report last year, I noted that there are two methodologies for calculating EUV-SH: adjusted vacant possession and discounted cash flow. Both methodologies are used and appear to produce significantly different valuations.

55 During the 2011-12 audit cycle, the Wales Audit Office has sought to understand how such variations arise. We identified that, in some instances, the outlying valuations arose as a result of authorities using inappropriate assumptions and the relevant authorities adjusted their calculations as appropriate. There does, however, continue to be differences arising from the methodology used. It is, therefore, desirable that a single methodology for calculating EUV-SH be used in Wales. We will continue to discuss this issue with representatives of the Welsh Government and local authorities to ensure consistency of valuation.

Obligations relating to the restoration of landfill sites have not been recognised on a consistent basis

56 Entities that operate (or have operated) a landfill site have a duty arising from conditions in planning consents and Environment Agency permits, to carry out restoration works which include:

- installing a suitable cap and drainage to the site; and
- undertaking appropriate aftercare, including the monitoring and control of gas and leachate production at the sites for several decades after closure.

57 A number of authorities in Wales still operate landfill sites; others are responsible for sites that are now no longer operational but which still require aftercare and monitoring. Authorities may also have liabilities as a result of providing financial support/guarantees to Local Authority Waste Disposal Companies (LAWDCs).

58 In 2011-12, auditors identified that authorities in Wales may not be recognising obligations relating to the restoration of landfill sites on a consistent basis. Some authorities have recognised an obligation for the capping and draining of the sites. However, it is not clear whether this has been capitalised or treated as revenue expenditure. Other authorities have simply established a reserve, rather than making provision for the obligation. Few authorities have recognised a provision for obligations relating to aftercare obligations.

59 We have worked with CIPFA to improve the guidance regarding the restoration of landfill sites. Auditors will be consulting with directors of finance to help ensure that the obligations are appropriately accounted for in 2012-13.

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

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

61 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 judgments support the return. These arrangements cover all but one of the authorities in this report (one authority is below the £10 million WGA threshold).

62 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. In Wales, I provide assurance statements to the C&AG on the three Welsh sub-consolidations including the local government sub-consolidation, which incorporates all Welsh local government bodies.

63 For 2011-12, the timescales were:

- WGA returns to be provided to the Welsh Government and local audit teams by 13 July; and
- audited and finalised WGA returns to be provided to the Welsh Government by 28 September.

64 Only two authorities met the deadline for the submission of draft returns while a further five agreed extensions with Welsh Government. Of the five that agreed extensions, three of these did not achieve their revised timescales with one exceeding it by 10 working days.

65 This situation was very disappointing as there was an expectation that authorities would do better considering that the one-off IFRS restatement of the 2010-11 and 2009-10 accounts was behind them and the 2011-12 accounts were prepared on an IFRS basis from the outset.

66 Despite this, the majority of final audited returns were submitted on time; there was a short delay of just two working days beyond the deadline for five authorities and one further has yet to be certified. All were unqualified. This does highlight that greater emphasis needs to be placed on completing the WGA returns in a timely and accurate manner.

Annual governance statements were generally well prepared although scope remains to improve their effectiveness

67 My *Local Authority Accounts 2010-11* report highlighted that there was generally scope for further improvement in the production and content of annual governance statements. There was also scope to improve the benefits derived from their production, and the annual review of effectiveness of arrangements that authorities are required to undertake, by linking the work more closely to the duties placed on most authorities by the 2009 Measure. In 2011-12, authorities have continued to refine and improve their annual governance statements including 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.

68 Having consulted improvement authorities on my programme of work, I am currently undertaking an improvement study to evaluate the effectiveness of authorities' reviews of governance. This is with a view to identifying how they can be improved to give assurance that they are a reliable mechanism of self-evaluation.

69 The study will focus on identifying learning points for authorities to consider during their reviews of governance that will result in the 2012-13 annual governance statements. The work will evaluate the review activity that resulted in the 2011-12 statements, in the light of CIPFA guidance.

70 The study does not require an audit of an authority's governance systems and structures. Rather, it is an examination of what an authority itself has done to review its governance arrangements.

71 A national summary report will be published in the form of a 'practice note'. This will summarise the key learning points at a national level and identify the steps that authorities will need to take to ensure governance reviews are as effective as they could be.

Auditors assessed most authorities' internal audit services as compliant with CIPFA standards

72 Internal audit is a key part of an authority's internal control environment, providing independent assurance on its governance arrangements and financial systems and controls. An effective internal audit service helps ensure the organisation achieves the high standards of probity that are required when dealing with public money, supports the audit committee in carrying out its functions and also contributes to the annual governance statement.

73 ISA 610 requires external auditors to assess Internal Audit each year where it is relevant to their risk assessment. Where appropriate, external auditors can then rely on the work of Internal Audit to support their own work. This helps to avoid duplication and also provides an independent assessment of Internal Audit arrangements in place. The assessment is made against the standards set out in the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. With effect from 1 April 2013, these standards will be replaced by the Public Service Internal Audit Standards which are being produced by CIPFA and the Institute of Internal Auditors.

74 Where such an assessment has been carried out, auditors found internal audit services on the whole complied fully with the CIPFA standards. At a small number of authorities, recommendations were made for further improvements and where this was the case the areas needing further development were:

- planning and risk assessment;
- maintaining full independence (some chief internal auditors had operational roles);
- quality control and review of audit work; and
- staffing levels and continuing professional development.

75 Nevertheless, auditors were able to rely on Internal Audit's work where this was relevant to addressing risks of material misstatement in the accounts.