Local Government Financial Reporting 2016-17

Archwilydd Cyffredinol Cymru
Auditor General for Wales
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, Deryck Evans, Dave Jones and Hefin Davies

Huw Vaughan Thomas
Auditor General for Wales
Wales Audit Office
24 Cathedral Road
Cardiff
CF11 9LJ

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Mae’r ddogfen hon hefyd ar gael yn Gymraeg.
Local government bodies in Wales have made further progress in improving the quality and timeliness of their annual financial statements but more remains to be done to meet the challenge of earlier reporting deadlines

1 Larger local government bodies are rising to the challenge of earlier closing deadlines but much remains to be done

Within the next four years, larger local government bodies will need to prepare their annual financial statements and have them audited two months earlier than under the current timetable

This year, six local government bodies published their financial statements by 31 July and the audit of a further two bodies was completed by 31 August

Local government bodies and my auditors are working together to meet the challenge of the earlier closing deadlines although further work is still needed in some area

2 Most local government bodies received unqualified audit opinions within the statutory timescale

I issued unqualified audit opinions on 39 out of 41 financial statements by 30 September and unqualified opinions on all Whole of Government Accounts returns

I have not yet issued audit opinions for two audits because of unresolved accounting and audit issues

In 2017, I exercised my statutory reporting powers to support the preparation of financial statements that present a true and fair view of the authority’s finances and are supported by a clear audit trail
3 Overall, local government bodies have improved the timeliness and quality of the financial statements and supporting working papers although there remains scope for improvement

The number of local government financial statements requiring material amendments continued to decline in 2016-17

The accessibility of local government financial statements is improving but they remain lengthy and complex documents

There has been a significant improvement in the timeliness with which local government bodies prepare financial statements and supporting working papers

Although there remains scope for improvement, most local-government bodies have maintained or improved the quality of their working papers

4 Local government bodies have dealt effectively with changes to accounting practices but further improvement is needed to address recurring problems and new requirements

Local government bodies have generally dealt effectively with the introduction of the Expenditure and Funding Analysis and other changes but further clarity is needed on the status of the Expenditure and Funding Analysis

Accounting for non-current assets remains the most common area where auditors identify errors in financial statements

Auditors continue to identify errors in financial statements that could have been identified by more effective internal review processes

Local government bodies will need to consider three key changes to accounting standards in the medium term
5 As expenditure rises, local authorities are raising an increasing proportion of funding from council tax and are beginning to use reserves to finance this expenditure 40

Local authorities’ revenue income increased in real terms during 2016-17 and the proportion raised from council tax continues to rise 41

Local government expenditure on services increased by around 3% in 2016-17 in real terms 43

Local-authority usable reserves represent about 27% of net annual expenditure on services although authorities are now beginning to apply the reserves to finance expenditure 46

6 A greater proportion of police bodies’ expenditure is being funded from local taxation with bodies continuing to apply their earmarked reserves 50

Funding for police services in Wales increased in 2016-17 although an increasing proportion of this comes from local taxes 51

Expenditure on policing has declined by 2% in real terms in 2016-17 53

Police usable reserves represent approximately 23% of annual expenditure on police services (net of fees, charges and service specific grants) and are increasingly being applied to fund expenditure 54

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Local government bodies in Wales have made further progress in improving the quality and timeliness of their annual financial statements but more remains to be done to meet the challenge of earlier reporting deadlines.

1. In common with the rest of the public sector, local government bodies are held accountable under the law for the stewardship and governance of the public money they manage. The principal means by which this responsibility is reported is through their annual financial and governance statements.

2. The Public Audit (Wales) Act 2004 requires local government bodies to submit their annual financial statements to me for audit. My responsibilities are to, by examination of the financial statements and otherwise, satisfy myself of the following:
   - that the financial statements are prepared in accordance with regulations;
   - that they comply with the requirements of all other statutory provisions applicable to the financial statements; and
   - that proper practices have been observed in the compilation of the financial statements.

3. This is my seventh annual report on local government bodies’ financial statements (their financial statements). It summarises the results of my audit work on the 2016-17 financial statements of the larger local government bodies in Wales and tracks the progress of how these local government bodies are improving their financial statements.

4. Throughout this report, I give examples of auditors’ findings to illustrate my conclusions. These examples are taken from the Audit of Financial Statements Reports issued to the individual audited bodies. Those reports are issued in accordance with International Standards on Auditing (ISA) – 260 and formally communicate the findings and conclusions from my audit of their financial statements.
There are 41 larger local government bodies, with annual income and expenditure exceeding £2.5 million, in Wales. Those bodies provide a wide range of services to the Welsh public including education, social services, refuse collection and disposal, leisure and libraries, tourism and conservation, and police and fire services. In doing so they collectively:

- levy £1.64 billion in council tax and receive £928 million in non-domestic rates;
- receive £3.2 billion in direct revenue funding from the Welsh Government; and
- spend a total of over £9.2 billion on delivery of services or £5.5 billion after deducting fees and charges for services and service-specific grants.

Exhibit 1: larger local government bodies in Wales

There are 41 larger local government bodies, with annual income and expenditure exceeding £2.5 million, in Wales.

<table>
<thead>
<tr>
<th>Number</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Unitary authorities (County and County boroughs)</td>
</tr>
<tr>
<td></td>
<td>Police and Crime Commissioners and Chief Constables</td>
</tr>
<tr>
<td></td>
<td>Fire and Rescue Authorities</td>
</tr>
<tr>
<td></td>
<td>National park authorities</td>
</tr>
<tr>
<td></td>
<td>Joint committees</td>
</tr>
<tr>
<td></td>
<td>Harbour authorities</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis

Local government bodies are being increasingly challenged with maintaining or improving outcomes with the same or reduced resources. Communicating how, and how well prepared they are, to achieve this will be critical to public accountability.
In the public sector, two initiatives seek to improve reporting by public bodies:

- HM Treasury’s Simplifying and Streamlining Financial statements Project aims to simplify and streamline the presentation of statutory annual report and financial statements produced by central-government entities so as to better meet the needs of users. This sees the restructuring of the traditional ‘front-half’ annual report and ‘back-half’ financial statements into three more integrated reporting requirements based on performance, accountability and financial statements.

- through its Telling the Story publications, CIPFA has also taken steps to both streamline the financial statements and improve their accessibility to users. The changes made to date reconnect the financial statements of local authorities with the way those authorities are organised and funded. CIPFA’s aim is to assist authorities to adopt an integrated reporting model that communicates the full range of factors that affect their operations and delivery of services.

This increasing focus on more user-friendly accounting information combining financial and non-financial performance means that local government bodies in Wales will need to reconsider how they present their financial statements and the accompanying narrative report. This is likely to be an iterative process but will support a better understanding of the impact of decisions, taking into account the broad range of relevant factors and not just short-term financial considerations. I will review the narrative reports for local government bodies in 2018 in order to identify and share good practice.

The sector faces a number of challenges that can impact on the quality of their accounting and reporting arrangements including:

- earlier reporting deadlines for the preparation and publication of their annual financial statements;

- the continuing austerity agenda presents challenges to the ways in which public finances are managed; and

- changing models of service delivery will impact on bodies’ accounting and reporting processes.

I anticipate the Welsh Government will shortly make changes to the statutory timetable for the financial statements and audit that is set out in the Accounts and Audit (Wales) Regulations 2014. These changes will reduce the time allowed for local government bodies to produce their annual financial statements and to publish audited financial statements by two months.
It is pleasing to see that the sector is rising to the challenge of meeting the shortened deadlines. Many bodies are already taking steps to meet the proposed timetable and, indeed, some authorities have successfully achieved publication of the audited financial statements by 31 July.

Whilst earlier closure of financial statements 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.

As bodies make progress in meeting the earlier closing timetable, they will experience pressures and an increased risk of errors. A prerequisite to addressing the challenge of earlier closing is to ensure there are effective arrangements in place to improve the quality of the financial statements themselves and supporting working papers. Many bodies are making improvements to their financial statements production procedures and are seeing the benefits of more accessible financial statements and a reduction in the numbers of errors reported.

Local government bodies need to consider how they will deal with the financial challenges they face. All bodies face future funding gaps that require further savings or a greater use of their reserves. While in cash terms, the amount set aside in reserves has continued to increase, bodies need to ensure that their medium-term financial plans are robust and that they critically appraise their holding of reserves and factor the use of reserves in a sustainable way.
The challenges of austerity can also impact upon the financial statements production process. In order to meet savings targets, finance team capacity may be reduced, thereby adding to the pressures faced by teams preparing the financial statements. The Wales Audit Office’s pan-Wales graduate-trainee programme is used to support secondments across the Welsh public sector, with the dual aim of helping to remodel our own workforce through the greater use of trainees and to contribute to the future pool of finance talent available to the wider Welsh public sector. This initiative will assist audited bodies by providing additional resources to meet short-term needs.

There is variation in how well placed councils are to address future financial pressures. In 2016, I issued a report on the Financial Resilience of Local Government Bodies which sets out the challenges faced by local government bodies and the response to them in more detail. In 2017, I examined savings planning at individual local authorities and issued a report on Savings Planning in Councils in Wales. Overall, the report concluded that medium-term financial planning in councils is generally effective, but shortcomings in savings planning present a risk that some councils will not achieve the savings they need to make.

In many cases, bodies will need to change the way in which they provide services. This may involve collaborative working with other bodies both within and outside of local government. In my previous reports on local government financial statements I have identified some of the difficulties local government bodies have experienced when accounting for such arrangements. 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 pre-audit financial statements. These difficulties will become more common as service delivery models change and accounting deadlines are brought forward. I have issued a national summary report on good governance when determining significant service changes to provide insight, share existing practice and prompt further conversations and discussions between councils and other organisations.
For 2016-17, I concluded that local government bodies have improved the quality of their pre-audit financial statements, but still face challenges in the medium term to improve and produce their financial statements earlier. The key findings from my audits of local government bodies are set out below:

**Larger local government bodies are rising to the challenge of earlier closing but much remains to be done**

Within the next four years, larger local government bodies will need to prepare their annual financial statements and have them audited two months earlier than under the current timetable. This year, six local government bodies published their financial statements by 31 July and the audit of a further two bodies was completed by 31 August. Local government bodies and my auditors are working together to meet the challenge of the earlier closing deadlines although further work is still needed in some areas.

**Most local government bodies received unqualified audit opinions within the statutory timescale**

I issued unqualified audit opinions on 39 out of 41 financial statements by 30 September and unqualified opinions on all Whole of Government Accounts returns. I have not yet issued audit opinions for two audits because of unresolved accounting and audit issues. In 2017, I exercised my statutory reporting powers to support the preparation of financial statements that present a true and fair view of the authority’s finances and are supported by a clear audit trail.

**Overall, local government bodies have improved the timeliness and quality of the financial statements and supporting working papers although there remains scope for improvement**

The number of local government financial statements requiring material amendments continued to decline in 2016-17. The accessibility of local government financial statements is improving but they remain lengthy and complex documents. There has been a significant improvement in the timeliness with which local government bodies prepare financial statements and supporting working papers. Although there remains scope for improvement, most local government bodies have maintained or improved the quality of their working papers.
Local government bodies have dealt effectively with changes to accounting practices but further improvement is needed to address recurring problems and new requirements

Local government bodies have generally dealt effectively with the introduction of the Expenditure and Funding Analysis and other changes but further clarity is needed on the status of the Expenditure and Funding Analysis. Accounting for non-current assets remains the most common area where auditors identify errors in financial statements. Auditors continue to identify errors in financial statements that could have been identified by more effective internal review processes. Local government bodies will need to consider three key changes to accounting standards in the medium term.

As expenditure rises, local authorities are raising an increasing proportion of funding from council tax and are beginning to use reserves to finance this expenditure

Local authorities’ revenue income increased in real terms during 2016-17 and the proportion raised from council tax continues to rise. Local government expenditure on services increased by around 3% in 2016-17 in real terms. Local-authority usable reserves represent about 27% of net annual expenditure on services although authorities are now beginning to apply the reserves to finance expenditure.

A greater proportion of police bodies’ expenditure is being funded from local taxation with bodies continuing to apply their earmarked reserves

Funding for police services in Wales increased in 2016-17 although an increasing proportion of this comes from local taxes. Expenditure on policing has declined by 2% in real terms in 2016-17. Police usable reserves represent approximately 23% of annual expenditure on police services (net of fees, charges and service specific grants) and are increasingly being applied to fund expenditure.
Larger local government bodies are rising to the challenge of earlier closing deadlines but much remains to be done.
Within the next four years, larger local government bodies will need to prepare their annual financial statements and have them audited two months earlier than under the current timetable

1.1 The Public Audit (Wales) Act 2004 requires me to issue an opinion on the financial statements on completion of the audit. I aim to issue opinions to enable bodies to publish audited financial statements by the statutory deadline of 30 September.

1.2 In 2016, the Welsh Government consulted with local government bodies on changes to the statutory timetable set out in the Accounts and Audit (Wales) Regulations 2014. I anticipate that amending Regulations will be in place by 31 March 2018.

1.3 The Welsh Government’s proposals will require local government bodies to produce their financial statements by the end of May and to publish audited financial statements by the end of July each year. This reduces the total time leading up to publication by two months compared with the current Regulations.

1.4 These changes will be introduced on a phased basis to allow local government bodies to plan and prepare for what will be a significant change to their reporting deadlines. Exhibit 2 summarises the changes and how these will affect different types of local government bodies.

Exhibit 2: Accounts and Audit (Wales) Regulations deadlines

The statutory deadlines will be brought forward on a phased basis between now and 2020-21.

<table>
<thead>
<tr>
<th>Authorities</th>
<th>2016-17 and 2017-18</th>
<th>2018-19</th>
<th>2019-20</th>
<th>2020-21</th>
</tr>
</thead>
<tbody>
<tr>
<td>Police, fire</td>
<td>Prepare by 30 June</td>
<td>Prepare by 31 May</td>
<td>Prepare by 31 May</td>
<td>Prepare by 31 May</td>
</tr>
<tr>
<td>and national</td>
<td>Publish by 30</td>
<td>Publish by 31</td>
<td>Publish by 31</td>
<td>Publish by 31</td>
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<tr>
<td>parks</td>
<td>September</td>
<td>May</td>
<td>May</td>
<td>May</td>
</tr>
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<td></td>
<td></td>
<td>Publish by 31</td>
<td>Publish by 31</td>
<td>Publish by 31</td>
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<td></td>
<td></td>
<td>July</td>
<td>July</td>
<td>July</td>
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<tr>
<td>Unitary authorities</td>
<td>Prepare by 30 June</td>
<td>Prepare by 15</td>
<td>Prepare by 15</td>
<td>Prepare by 15</td>
</tr>
<tr>
<td></td>
<td>Publish by 30</td>
<td>June</td>
<td>June</td>
<td>June</td>
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<td>September</td>
<td>September</td>
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</tbody>
</table>

Source: Wales Audit Office analysis of proposed changes to Accounts and Audit (Wales) Regulations 2014
This year, six local government bodies published their financial statements by 31 July and the audit of a further two bodies was completed by 31 August

1.5 In 2015-16, all except two audits were completed and audit certificates issued by 30 September. One local authority met the proposed deadline of 31 July and a further two bodies were certified in early August, over a month ahead of the current statutory deadline.

1.6 There was a significant improvement this year. Six bodies approved and published their financial statements before the proposed deadline of 31 July. A further two bodies approved their financial statements in August, over a month ahead of the current statutory deadline.

1.7 Exhibit 3 shows the progress made by local government bodies in 2016-17. My audit work was completed at 11 bodies during July 2017. I issued audit opinions at six of these bodies in July. In some cases, while audit work was completed early, bodies took a pragmatic approach and arranged meetings to approve the financial statements in August or September to allow for unforeseen delays. In 2016, I issued only one audit opinion by the end of July and two in August.

Exhibit 3: Completion of audit work

Audit work is being completed ahead of the current statutory timetable at more local government bodies

Source: Wales Audit Office analysis
1.8 There is, however, considerable progress still to be made over the next few years to ensure all bodies are able to meet the revised deadlines.

Local government bodies and my auditors are working together to meet the challenge of the earlier closing deadlines although further work is still needed in some areas.

1.9 Planning for the successful introduction of this revised timetable will need close co-ordination between local government bodies and their auditors, and will present challenges for all of us.

1.10 Over the last three years, I have hosted a number of shared-learning seminars specifically looking at this issue. The aim of the seminars has been to share learning from bodies who have managed to produce their financial statements and have them audited to a tighter timeframe. These seminars focused initially on the organisational and cultural changes needed to start the journey and, more recently, on the detailed processes that audited bodies will need to go through to achieve the earlier deadlines. I plan to hold further seminars and workshops over the coming years to explore more detailed aspects of earlier closing and the lessons that audited bodies and auditors are learning. The past events webpage on the Wales Audit Office website has more information, and will be added to over time.

1.11 Local government bodies and my audit teams are actively planning for the challenges of meeting the earlier deadlines. Auditors have reported that many authorities are taking steps to bring forward the financial statements closure timetables. I would urge all local government bodies to consider the example changes set out below and build these into their closedown plans where appropriate.
Exhibit 4: steps being taken to meet earlier closing deadlines

Local government bodies and audit teams are taking a number of steps to meet the proposed earlier closing deadlines.

<table>
<thead>
<tr>
<th>Steps being taken to achieve earlier closing of local government financial statements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset valuation programme was brought forward to enable adjustments to the fixed asset register and the financial ledger to be completed prior to the 31 March year-end. This allowed audit testing to be completed at the interim audit rather than after the financial statements were received by the audit team.</td>
</tr>
<tr>
<td>Financial statements preparation timetable and authority meeting cycles were aligned to ensure that once the financial statements had been prepared and the audit completed, relevant committee and authority meetings were available to meet the earlier deadlines.</td>
</tr>
<tr>
<td>Improved delegation arrangements within the finance team to distribute the burden of preparing the financial statements and reduced the risk of potential bottlenecks in the process.</td>
</tr>
<tr>
<td>Early workshops were held between finance departments, other service departments and audit teams to ensure the financial statements preparation and audit processes were aligned. This included identifying and planning audit work around the availability of key finance staff during the audit.</td>
</tr>
<tr>
<td>Regular meetings are held between the finance and audit teams to ensure progress is effectively monitored, and where issues or delays emerge, the risk of delays to completion of the financial statements and/or the audit can be mitigated.</td>
</tr>
<tr>
<td>Audited bodies and audit teams have agreed on detailed requirements for deliverable working papers including timetables to ensure key tasks are prioritised and working papers are delivered on schedule.</td>
</tr>
<tr>
<td>Finance and audit teams undertook early reviews of proposed financial statements disclosures to ensure a common understanding of the audit evidence that would be required to support the disclosure notes.</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis
1.12 While progress towards the earlier deadlines has been made by many local government bodies, auditors reported some key challenges that are commonly faced. These include:

- quality assurance arrangements need to be improved to ensure working papers provided for the audit are complete and accurate and fully support entries in the financial statements.

- at some bodies, especially the smaller bodies, capacity in the finance team can be an issue due to the limited numbers of staff available to undertake financial statements preparation and deal with audit queries. This is compounded when staff take unexpected leave during the audit.

1.13 Auditors also reported that, in some cases, the completion of the audit was delayed due to avoidable issues on the part of the audited body. These issues include:

- significant numbers of errors requiring amendments to the financial statements, including errors processing initial amendments; and

- delays in receiving adequate working papers.

I provide further comment on these issues in the remainder of this report.
Part 2

Most local government bodies received unqualified audit opinions within the statutory timescale
I issued unqualified audit opinions on 39 out of 41 financial statements by 30 September and unqualified opinions on all Whole of Government Accounts returns

2.1 Audit opinions may be unqualified, meaning that the financial statements present a ‘true and fair’ view of the bodies’ income and expenditure and its financial position, or they may be modified. Further explanation of what a ‘modified opinion’ means is given in Appendix 1.

2.2 I issued unqualified audit opinions on the financial statements of 39 out of 41 local government bodies by 30 September.

2.3 I also issue audit opinions on local government bodies' Whole of Government Accounts (WGA) returns. The WGA consolidates the audited financial statements of around 4,000 organisations across the public sector in order to produce a comprehensive, financial statements-based picture of the financial position of the UK public sector. All public bodies with income and expenditure above £10 million must submit a WGA return to the Welsh Government, although an audit opinion is only required for the largest bodies.

2.4 I issued unqualified audit opinions on each of the 18 WGA returns of local government bodies that required an audit certificate.

I have not yet issued audit opinions for two audits because of unresolved accounting and audit issues

2.5 On completion of all work in relation to any particular year, I must certify that the audit is complete. Before issuing the opinion and concluding the audit, there are a number of issues I 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.

2.6 I can issue an opinion on the financial statements where issues remain outstanding, providing I am content those issues will not have a material impact on the financial statements. Once outstanding issues have been resolved, the final audit report considered by the body and the financial statements reapproved, I reissue the opinion and certify the audit as complete.

2.7 I have not completed the audit of the bodies listed in Exhibit 5 below due to ongoing accounting and/or audit issues.
Exhibit 5: local government bodies where the 2016-17 audit opinion has not been issued

Ongoing accounting and audit issues prevent me from issuing an audit opinion at two local government bodies

<table>
<thead>
<tr>
<th>Audit opinion issued</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Blaenau Gwent County Borough Council</td>
<td>No</td>
</tr>
<tr>
<td>Mid and West Wales Fire Authority</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis

2.8 Until all issues arising during the audit in relation to the financial statements have been considered and addressed, an audit opinion cannot be given and the audit cannot be certified as complete.
In 2017, I exercised my statutory reporting powers to support the preparation of financial statements that present a true and fair view of the authority’s finances and are supported by a clear audit trail

2.9 The Public Audit (Wales) Act 2004 gives me powers to report publicly and draw to the attention of the public and audited bodies, matters that come to my attention during the course of the audit. This may be done by:

• issuing a report in the public interest under section 22 of the Act; and/or
• making a written recommendation under section 25 of the Act – such recommendations are referred to as statutory recommendations.

2.10 While the Act requires bodies to formally consider and respond to these reports and recommendations, in my view, all audited bodies should consider the reported issues and reflect on any lessons that can be learned or best practice that can be applied.

2.11 I have yet to complete the audit of the 2015-16 financial statements for the Mid and West Wales Fire Authority. The Authority has presented a number of different versions of financial statements, each of which have contained material errors and have been of generally poor quality, which the Authority is intent on correcting. Due to these circumstances, my audit team has been unable to conclude the audit. The Authority is due to present a revised set of the financial statements in January 2018.

2.12 Given the history of the previous versions of the 2015-16 financial statements, I believe it is imperative that the Authority takes clear and agreed actions to ensure that the financial statements to be presented in January 2018 are prepared to a satisfactory standard, are true and fair and are fit for audit. Therefore in October 2017, I made three statutory recommendations to the effect that the revised financial statements must be subject to rigorous and timely review and sign-off by management prior to their submission for audit. On 11 December, the Fire Authority considered and accepted the statutory recommendations, which are now being implemented.
Overall, local government bodies have improved the timeliness and quality of the financial statements and supporting working papers although there remains scope for improvement.
The number of local government financial statements requiring material amendments continued to decline in 2016-17

3.1 When auditing the financial statements, auditors do not provide absolute assurance that the financial statements are correctly stated, but adopt the concept of ‘materiality’. Further information on how auditors consider whether or not an error is material is provided in Appendix 1.

3.2 Through their work, auditors may identify material misstatements in an audited body’s financial statements. In this case, the auditor will request the Responsible Financial Officer (RFO) to amend the financial statements to correct the errors. If the material misstatements are not corrected, or it is not possible to identify the value of the error due to insufficient information, the auditor may consider issuing a modified (ie qualified) opinion.

3.3 Any non-material, but nevertheless significant misstatements, are also brought to the RFO’s attention. Where errors and significant misstatements brought to the RFO’s attention are not adjusted, auditors bring these matters to the attention of those charged with governance (usually the full council or its audit committee). Earlier closure of financial statements will require the application of more estimation to prepare the financial statements and this is likely to lead to a higher incidence of errors being identified. In many cases, these will be due to timing. Auditors will identify the errors but will recognise the difficulties in correcting all errors within the shortened timescales.

3.4 Whilst there are likely to be minor errors in the financial statements presented for audit, material items should be rare. In signing the financial statements prior to audit, the RFO is certifying that they are materially correct. The presence of material errors undermines that certification process and brings into question the effectiveness of the financial statements production, quality assurance and review processes.

3.5 For 2016-17, where the audit has been completed, 41% of audited financial statements required material amendments compared with 52% for 2015-16 and 60% for 2014-15. While this improvement is welcomed, the number of bodies whose pre-audit financial statements contain material errors, remains too high.

3.6 Good financial statements 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 financial statements production and quality assurance arrangements to ensure they are capable of picking up such errors before the financial statements are certified and passed for audit.
3.7 Improving the financial statements production and quality assurance processes will be a key requirement for authorities to meet the earlier closing deadlines.

3.8 Further detail on the types of errors identified is set out later in this report.

The accessibility of local government financial statements is improving but they remain lengthy and complex documents

3.9 Local government financial statements are complex and technical documents. However, they are the primary means by which local government bodies demonstrate their accountability for the effective stewardship of the public funds they manage.

3.10 In recent years, auditors have been encouraging audited bodies to streamline their financial statements and make them simpler, more accessible and readable. CIPFA has also committed to the simplification and streamlining of local government financial statements as part of their ‘Telling the story’ review.

3.11 More concise financial statements have two key benefits. They are more accessible and understandable to users, and they remove unnecessary burdens from those who prepare them. This reduced burden on preparers will also support audited bodies to meet the earlier reporting and publication deadlines.

3.12 My analysis of auditors’ comments in Exhibit 6 has identified that there are considerable variations between financial statements prepared by local government bodies.
Local government financial statements 2016-17

Exhibit 6: length of local government body financial statements

Local government financial statements are lengthy documents but there are considerable differences between individual authorities

<table>
<thead>
<tr>
<th></th>
<th>Unitary authorities 2016-17 (2015-16)</th>
<th>Police, fire and national parks 2016-17 (2015-16)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of pages in accounting statements and notes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>94 (97)</td>
<td>53 (53)</td>
</tr>
<tr>
<td>Highest</td>
<td>148 (147)</td>
<td>69 (74)</td>
</tr>
<tr>
<td>Lowest</td>
<td>54 (54)</td>
<td>17 (22)</td>
</tr>
</tbody>
</table>

| Number of pages in Accounting Policies Note |                                       |                                               |
| Average                                     | 16 (17)                                | 12 (12)                                       |
| Highest                                     | 24 (23)                                | 36 (37)                                       |
| Lowest                                      | 11 (13)                                | 3 (3)                                         |

| Number of notes to the accounting statements |                                       |                                               |
| Average                                     | 44 (46)                                | 39 (39)                                       |
| Highest                                     | 64 (63)                                | 47 (45)                                       |
| Lowest                                      | 27 (27)                                | 14 (14)                                       |

Source: Wales Audit Office analysis

3.13 Auditors report that some local government bodies have taken positive steps to reduce the length and complexity of their financial statements. They have done so by reviewing the notes to the financial statements and removing those that they consider to be non-material. The analysis above demonstrates the range of the numbers of notes included in the financial statements. At one authority, reducing the number of notes from 63 to 56 reduced the overall length of the financial statements by 11 pages.
3.14 In collaboration with my local audit teams, all local-government bodies should consider what steps they can take to improve the accessibility of the financial statements to potential readers of the financial statements.

There has been a significant improvement in the timeliness with which local government bodies prepare financial statements and supporting working papers

3.15 In order to support the entries in the financial statements and to expedite a smooth audit process, audited bodies should provide timely, comprehensive, complete and clear working papers to support their financial statements. Late, poor or substandard working papers lead to increased pressure on audited bodies’ finance teams and auditors, and increase the risk that the audited financial statements are not published by the statutory deadline. 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.

3.16 The timeliness of working papers is a key factor in the efficient delivery of the audit and will play a significant role in future years when early closing is fully implemented. Auditors therefore assessed the timeliness with which a complete set of working papers that support the financial statements were provided to the local audit team.

3.17 As shown in Exhibit 7, auditors reported that financial statements and supporting working papers generally provided in a timely manner, with 97% of local government bodies providing the financial statements and working papers within the timescale agreed with the audit team. This is a significant improvement on 2015-16 and reflects the work done by local government bodies and auditors as they work towards meeting the earlier closing deadlines. All bodies prepared financial statements by the end of June.
Exhibit 7: timeliness of local-government financial statements

There has been a significant improvement in the number of local government bodies that provide auditors with draft financial statements and supporting working papers in accordance with the timescale agreed with the audit team.

Source: Wales Audit Office analysis
Although there remains scope for improvement, most local government bodies have maintained or improved the quality of their working papers

3.18 It is important that working papers are easy to follow and provide a complete audit trail. In many cases, auditors will examine working papers some time after they have been prepared. Ensuring that they are comprehensive, complete and accurate reduces the need for auditors to make additional enquiries and reduces the amount of time and effort that goes into dealing with those audit enquiries.

3.19 Auditors reported that most local government bodies have maintained or improved the standard of their working papers although they noted deterioration in standards at a small number of bodies.

Exhibit 8: improvements in working papers

With a small number of exceptions, local government bodies are maintaining or improving the standard of their working papers

<table>
<thead>
<tr>
<th></th>
<th>2016-17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Working papers improved</td>
<td>17</td>
</tr>
<tr>
<td>Standard of working papers maintained</td>
<td>20</td>
</tr>
<tr>
<td>Deterioration in standard of working papers</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis

3.20 However, despite an overall trend of improvement, there remains scope for further development. Auditors reported the following issues with working papers.
Exhibit 9: Improvements required to working papers

Auditors identified several recurring issues requiring improvement to working papers provided to support the financial statements.

<table>
<thead>
<tr>
<th>Improvements to working papers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Papers supporting the analysis of property, plant and equipment included errors in valuation workings and other calculations.</td>
</tr>
<tr>
<td>Handwritten working papers are presented but are difficult to follow.</td>
</tr>
<tr>
<td>Some working papers provided are superfluous.</td>
</tr>
<tr>
<td>Excel-based working papers:</td>
</tr>
<tr>
<td>• are developed incrementally over time but these need to be reviewed to ensure that they do not contain redundant calculations and that they follow a logical structure;</td>
</tr>
<tr>
<td>• inconsistent approaches to roundings and calculations; and</td>
</tr>
<tr>
<td>• poor signposting making it difficult to navigate complex spreadsheets.</td>
</tr>
<tr>
<td>Working papers not updated to reflect changes made to financial statements</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis
3.21 Audited bodies and auditors need to ensure that they share an understanding of what is expected, what works locally, and that they continue to streamline arrangements based on learning from previous years. This includes a better understanding of what is meant by ‘audit evidence’. Where the process works well, there is ongoing and open dialogue, issues are discussed in advance of, and throughout, the financial statements process. Experience shows that the most valuable tools for improving arrangements include:

- agreeing before the start of the audit, a bespoke deliverables document that sets out what working papers will be provided for the audit, their contents and format and a timetable for their completion and delivery.

- holding a joint post-project learning session where auditors and management share their views in an open way about the financial statements production and audit process following its completion. These 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, easier access to information systems and improved scheduling of key tasks etc.

3.22 Where arrangements for producing accurate and timely working papers are poor, bodies will not be well placed to deliver on the proposed early closing requirements. Delegates at my Good Practice Exchange (GPX) seminars consistently identify that early agreement of working paper requirements between finance staff and auditors is one of the most important factors in achieving earlier closure of financial statements.
Local government bodies have dealt effectively with changes to accounting practices but further improvement is needed to address recurring problems and new requirements.
Local government bodies have generally dealt effectively with the introduction of the Expenditure and Funding Analysis and other changes but further clarity is needed on the status of the Expenditure and Funding Analysis

4.1 The 2016-17 Code introduced the Expenditure and Funding Analysis (EFA) to local government financial statements in order to better present how local-government bodies’ annual expenditure is funded from annual resources (government grants, rents, council tax and business rates). It compares this expenditure with those economic resources consumed or earned by bodies as calculated in accordance with generally accepted accounting practices. The EFA also shows how this expenditure is allocated for decision-making purposes between the bodies’ directorates, services or departments. Income and expenditure accounted for under generally accepted accounting practices is presented more fully in the Comprehensive Income and Expenditure Statement (CIES).

4.2 The introduction of the EFA presented local government bodies with a significant challenge. In general, bodies in Wales dealt with the changes effectively although there were some teething problems with the new requirements including some issues related to its format and disclosure requirements.

Exhibit 10: issues arising with the EFAs

Auditors identified various issues related to the new EFA

<table>
<thead>
<tr>
<th>Audit issues related to the Expenditure and Funding Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Classification of costs</td>
</tr>
<tr>
<td>Auditors identified classification errors in the EFA:</td>
</tr>
<tr>
<td>• corporate democratic core costs were incorrectly classified in the 2015-16 comparative information.</td>
</tr>
<tr>
<td>Reconciliation with Comprehensive Income and expenditure</td>
</tr>
<tr>
<td>Auditors identified difficulties in reconciling the CIES and EFA:</td>
</tr>
<tr>
<td>• amounts recorded in the EFA as being derived from the CIES did not agree with the corresponding amounts recorded in the CIES.</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis
4.3 The Code requires that the EFA needs to be positioned in the financial statements where it is most accessible and relevant to its users. The Code makes it clear that the EFA is a note to the financial statements. However, illustrative financial statements included in the Guidance Notes for Practitioners places it before the main statements, effectively giving it the prominence of a primary statement. Just over a half of Welsh local government bodies disclosed the EFA as if it were an accounting statement and the remainder included the EFA within the notes to the financial statements. I do not think this inconsistency is helpful to readers of local government financial statements and would urge CIPFA to issue further guidance.

Accounting for non-current assets remains the most common area where auditors identify errors in financial statements

4.4 Accounting for non-current assets (property, plant and equipment – capital accounting) is a complex area of accounting. In the local government context, there are additional complexities due to statutory provisions which modify normal accounting practices.

4.5 In my previous reports, I have identified capital accounting as an area where a significant number of audited bodies struggle to apply the correct accounting treatment. This year, approximately 50% of local government bodies made adjustments to their financial statements as a result of errors related to non-current assets.
Exhibit 11: examples of capital accounting errors

Auditors identified various errors related to capital accounting.

<table>
<thead>
<tr>
<th>Capital accounting errors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>School valuations</strong></td>
</tr>
<tr>
<td>Auditors identified errors in the valuation of schools:</td>
</tr>
<tr>
<td>• the valuation of a school did not reflect an impairment arising from the demolition of the previous school building; and</td>
</tr>
<tr>
<td>• the methodology used to value schools used a local factor to adjust the value of schools despite the valuation being based on actual costs, thereby mitigating the need to apply a local factor.</td>
</tr>
<tr>
<td><strong>Asset classifications</strong></td>
</tr>
<tr>
<td>Auditors identified errors in the classification of assets:</td>
</tr>
<tr>
<td>• assets held for sale were incorrectly classified as other categories of assets;</td>
</tr>
<tr>
<td>• expenditure on assets under construction was incorrectly classified as an addition to operational assets; and</td>
</tr>
<tr>
<td>• an intangible asset was incorrectly classified as ‘vehicles, plant and equipment’.</td>
</tr>
</tbody>
</table>

Source: Wales Audit Office analysis

4.6 As authorities introduce earlier closing and publication of their annual financial statements, they will need to ensure that they resolve their capital accounting issues at an early stage. Adjusting for errors in non-current assets impacts across all of the primary accounting statements and several notes to the financial statements. Correcting these errors is a time-consuming process and increases the risk that bodies will fail to achieve the statutory timetable for publication of their financial statements.

4.7 At my recent Good Practice Exchange (GPX) seminars, delegates identified that one of the best ways to resolve capital accounting issues is the early engagement between the body and the audit team. Early preparation and planning, involving authority finance and estates staff, auditors and valuers are critically important. Key dates need to be agreed to allow early agreement on assumptions, classification issues, valuation methodologies and when and how estimates will be used. Plans should ensure that information will be available on a timely basis. This is seen as one area where significant amounts of audit work can be completed early.
Auditors continue to identify errors in financial statements that could have been identified by more effective internal review processes

4.8 Last year, I reported on a range of other errors identified during the course of the audit. For 2016-17, auditors have again reported similar errors in the financial statements.

Exhibit 12: examples of other accounting errors

Auditors identified errors related to various aspects of the financial statements.

<table>
<thead>
<tr>
<th>Other accounting and disclosure errors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Remuneration notes required by the Financial Statements and Audit (Wales) Regulations</strong></td>
</tr>
<tr>
<td>Auditors identified errors in the banding of remuneration as per the Regulations:</td>
</tr>
<tr>
<td>• exit packages were not correctly included in the remuneration bands specified by the Regulations; and</td>
</tr>
<tr>
<td>• calculations supporting the median salary used data from the wrong financial year.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Classification errors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors identified various classification errors that resulted in transactions being incorrectly described in the financial statements:</td>
</tr>
<tr>
<td>• a £629,000 unidentified reconciling item arising from transfer of financial statements between banks was incorrectly classified as a cash balance;</td>
</tr>
<tr>
<td>• £452,000 was recorded as a short-term debtor although the council had received the monies before the year-end; and</td>
</tr>
<tr>
<td>• disclosures related to commitments under operating leases were misstated due to misclassification of individual leases.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Accounting for grants</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors noted that bodies did not always apply the correct accounting treatment for grants received:</td>
</tr>
<tr>
<td>• grants totalling over £1 million were recorded as grants received in advance rather than as income as required by proper accounting practice.</td>
</tr>
</tbody>
</table>
4.9 Identifying, reporting and clearing audit adjustments, including restating the financial statements themselves, can add a significant amount of elapsed time to the audit process. In many cases, these errors could have been identified by the bodies’ own internal quality review processes. In order to meet the earlier closing deadlines, bodies will need to ensure that they have effective internal review processes in place to minimise the number of errors identified during the audit.

Local government bodies will need to consider three key changes to accounting standards in the medium term

4.10 In the run up to the implementation of earlier closing deadlines, audited bodies will need to consider three significant changes to accounting standards. These changes will impact upon areas where auditors frequently find errors in local government financial statements. Bodies will therefore need to consider, at an early stage, how these changes will impact on the accounting and financial reporting processes.

4.11 Exhibit 13 identifies three key accounting changes and the date by which they will be included in the CIPFA/LASAAC Code of practice.

Exhibit 13: forthcoming changes to accounting standards

Forthcoming changes to accounting standards dealing with financial instruments, revenue from contracts with customers and leases, introduce key changes to the accounting principles to be applied by local government bodies.

<table>
<thead>
<tr>
<th>Accounting standard</th>
<th>Effective date</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS 9 Financial instruments</td>
<td>2018-19</td>
<td>IFRS 9 financial instruments will replace IAS 39 and includes a new principles-based approach for the classification and measurement of financial assets. It also introduces a new impairment methodology for financial assets based on expected losses rather than incurred losses. This will result in earlier recognition of credit losses. The accounting requirements for financial liabilities are almost all carried forward unchanged from IAS 39.</td>
</tr>
<tr>
<td>Accounting standard</td>
<td>Effective date</td>
<td>Impact</td>
</tr>
<tr>
<td>---------------------</td>
<td>----------------</td>
<td>--------</td>
</tr>
<tr>
<td>IFRS 15 Revenue from contracts with customers</td>
<td>2018-19</td>
<td>IFRS 15 Revenue from contracts with customers introduces a principles-based five-step model for recognising revenue arising from contracts with customers. It is based on a core principle requiring revenue recognition to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration the body expects to be entitled to, in exchange for those goods or services. It will also require more extensive disclosures than are currently required.</td>
</tr>
<tr>
<td>IFRS 16 Leases</td>
<td>2019-20</td>
<td>IFRS 16 will replace the current leases standard IAS 17. The key change is that it largely removes the distinction between operating and finance leases for lessees by introducing a single lessee accounting model that requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. It will lead to all leases being recognised on a balance sheet as an asset based on a 'right-of-use' principle with a corresponding liability for future rentals. This is a significant change in lessee accounting.</td>
</tr>
</tbody>
</table>

**Source: Wales Audit Office analysis**

4.12 While these changes are some time away, local government bodies will need to plan for them now and build them into their early closure plans.

4.13 In addition, the administering authorities for the eight Local Government Pension Scheme (LGPS) funds in Wales are establishing a pension investment pool in line with government requirements. The Wales LGPS Investment Pool Joint Governance Committee must be operational by April 2018 with investment money starting to transition into the pool after this point. Pension-fund administering bodies will need to ensure that arrangements are in place to provide and receive the information and assurances to support the production and audit of the accounts in time to meet their closure deadlines.
Part 5

As expenditure rises, local authorities are raising an increasing proportion of funding from council tax and are beginning to use reserves to finance this expenditure
Local authorities’ revenue income increased in real terms during 2016-17 and the proportion raised from council tax continues to rise

5.1 Local authorities provide a wide range of services to the public. These are funded in part by fees and charges for those services and specific grants towards the cost of those services. Fees and charges and service specific grants fund about 37% of the total cost of council services. The remaining 63% is general revenue funding and comprises Revenue Support Grant from the Welsh Government and local taxation in the form of non-domestic rates and council tax.

Exhibit 14: local-authority income 2016-17

Almost 40% of local-authority income is raised from fees, charges and service specific grants. The remaining income is received from Revenue Support Grant and local taxation.

Source: Wales Audit Office analysis of local authorities’ 2016-17 financial statements
5.2 In my last report on the 2015-16 financial statements, I noted that local authorities’ general revenue funding had declined in real terms by 4% since 2011-12. In 2016-17, general revenue funding increased by 0.85%. The balance of this funding continues to change. Local taxation in the form of council tax provides £1.6 billion in funding for local authorities and now provides 29% of general revenue funding compared with 28% in 2015-16 and 26% in 2011-12. Conversely, the proportion received from the Welsh Government Revenue Support Grant has declined to 55% of general revenue funding compared with 56% in 2015-16 and 59% in 2011-12.

Exhibit 15: local taxation forms an increasing proportion of local-authority general revenue funding

Council tax now provides 29% of general revenue funding while the proportion provided by central government has declined from 56% to 55%
5.3 In my report on Charging for Services and Generating Income by Local Authorities published in November 2016, I reported on how local authorities use their powers to introduce and increase charges on services, how performance on generating income has changed in recent years, and how the process of consulting with users, and assessing the impact of charging decisions on users, is managed. I concluded that there is scope for authorities to develop their policies and enhance how they use data to support decision making.

**Local government expenditure on services increased by around 3% in 2016-17 in real terms**

5.4 Local authorities’ gross expenditure on services and net expenditure on services after deducting income from fees, charges and service-specific grants increased by 3.4% and 2.9% respectively in 2016-17 when compared with 2015-16.
Exhibit 16: local authorities’ gross expenditure and expenditure net of fees, charges and specific grants

Local authorities’ gross and net revenue expenditure on services has increased in real terms by 3% compared with 2015-16.

![Bar chart showing gross and net expenditure on services from 2012-13 to 2016-17.]


5.5 Although expenditure increased in real terms in 2016-17, gross expenditure in real terms remains 2.5% less than in 2012-13. Net expenditure in real terms is broadly similar to 2012-13.
5.6 This increase in expenditure in 2015-16 exceeds the increase in income of 0.85% referred to above. In my report on Financial Resilience of local authorities in Wales published in August 2016, I considered how well placed local authorities are to manage budgets and service expenditure. Although the Welsh Government announced in October 2016 that local authorities will see a small increase in its funding for 2017-18, the sector still faces significant challenges in the years ahead. Local authorities must continue to deliver services within the context of an ongoing austerity agenda and must deal with numerous pressures on budgets. The underlying budget pressures are likely to persist for the immediate future, making it increasingly important for authorities to manage their recurring expenditure.

5.7 Local authorities are increasingly looking for ways in which to make budget savings. One area commonly considered is the statutory charges local authorities make for the repayment of debt. Each year, local authorities must charge to their revenue accounts, a sum that they consider to be a prudent amount. The Welsh Government guidance on this statutory provision states:

‘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.’

5.8 I have undertaken an initial review of charges reported in the 2016-17 accounts and noted variations in the statutory provisions made. In 2018, I will review the policies adopted by local authorities to understand why these variations occur.
Local-authority usable reserves represent about 27% of net annual expenditure on services although authorities are now beginning to apply the reserves to finance expenditure.

5.9 Local authorities maintain usable reserves that can be used to support services and unusable reserves which represent accounting adjustments for items such as changes in the valuation of land and buildings.

5.10 Bodies must consider how much money to hold in reserves for both unexpected events and planned spending commitments in line with their medium-term financial plans. Careful consideration of reserves is particularly important as it is not sustainable to rely on reserves to support ongoing costs – once they have been depleted, other sources of funds or cost efficiencies must be identified. It is also a statutory requirement for bodies to consider their reserves when setting their budgets for the year.

5.11 As shown in Exhibit 17, although there has been a small increase in the cash value of local-authority usable reserves, in real terms the value has declined since 2014-15.
There has been a real-terms reduction in local-authority usable reserves since 2014-15.

5.12 In real terms, general fund reserves have remained stable from 2015-16 to 2016-17. Local authorities are now reducing their earmarked and other usable reserves to finance expenditure.
Exhibit 18: usable reserves

The value of local authorities earmarked and other usable reserves has reduced in real terms.


5.13 Earmarked and other usable reserves currently represent 85% of local-authority usable reserves. Although earmarked reserves are 5% higher in real terms than in 2012-13, authorities are now reducing these reserves to help finance expenditure. Additionally, other usable reserves have fallen by 13% in real terms in the same period as they too are applied to finance expenditure.

5.14 Local-authority general fund reserves represent 15% of total usable reserves at 31 March 2017 having increased by £6 million (3%) in 2016-17. General-fund reserves are now 11% higher in real terms than in 2012-13.

5.15 In 2012-13, usable reserves represented 26% of the net cost of council services after receipt of fees and charges. General-fund reserves represented 3% of the net cost of council services. As at 31 March 2017, usable reserves had increased to 27% of the net cost of services. Local authorities now hold general-fund reserves at 4% of the net cost of services.
Exhibit 19: local-authority reserves as a percentage of net cost of council services

The proportion on net cost of services held as reserves has increased in 2016-17.

Source: Wales Audit Office analysis of local-authority financial statements 2012-13 to 2016-17
A greater proportion of police bodies’ expenditure is being funded from local taxation with bodies continuing to apply their earmarked reserves.
Funding for police services in Wales increased in 2016-17 although an increasing proportion of this comes from local taxes

6.1 Police services fund their net cost of services (after fees, charges and specific grants), from central-government grants, including Home Office police grant and Welsh Government Revenue Support Grant, and from local taxation in the form of non-domestic rates and council tax.

6.2 Exhibit 20 shows that in 2016-17, central-government funding provided about 50% of total police funding with council-tax payers providing 42%, and non-domestic rates 8% of the total.

Exhibit 20: sources of police funding in Wales

Central government provides 50% of the funding required for police services with the remainder coming from local taxation.

Source: Wales Audit Office analysis of police body financial statements 2016-17
6.3 In real terms, funding for police bodies in Wales increased by 1% in 2016-17 compared to 2015-16. However, in real terms, funding remains lower than in 2013-14.

6.4 The balance of funding of police services is changing. Police bodies in Wales are raising an increasing proportion of their income from charges to council tax. Council tax (in the form of police precepts on unitary authorities) now provides over £250 million or 42% of police revenue funding compared with 35% in 2012-13. The proportion of income received from non-domestic rates has fallen from 15% to 8% in the same period.

Exhibit 21: sources of police funding in Wales

Council tax provides an increasing source of funding for police services in Wales.

Exhibit 21: sources of police funding in Wales

Source: Wales Audit Office analysis of police and crime commissioner financial statements 2012-13 to 2016-17

6.5 The national police funding formula is currently under review. There is uncertainty about the impact this review will have on the future funding of police services in Wales.
Expenditure on policing has declined by 2% in real terms in 2016-17

6.6 Gross revenue expenditure by police bodies has declined in real terms in 2016-17. In cash terms it is now £40 million or 6% lower than in 2013-14, equivalent to a real-terms reduction of over £70 million. Taking into account income received from fees, other charges and specific grants, in real terms, the net cost of police services has reduced by 4% since 2015-16 and by 10% since 2013-14.

Exhibit 22: cost of police services

Gross and net expenditure, after fees and charges, continues to decline in both cash and real terms.

Police usable reserves represent approximately 23% of annual expenditure on police services (net of fees, charges and service specific grants) and are increasingly being applied to fund expenditure.

6.7 Police bodies maintain usable reserves to support services and unusable reserves, which represent accounting adjustments for items such as changes in the valuation of land and buildings. Bodies’ ability to apply usable reserves may be restricted, eg capital receipts reserves. Police bodies also earmark specific sums of money towards specific projects and identify these separately to the general police fund.

6.8 Usable reserves held by police bodies have fallen in line with reductions in gross revenue expenditure and account for about 23% of gross revenue expenditure. Police bodies continue to use some reserves to support expenditure on specific projects and services.
Exhibit 23: police reserves as a percentage of net service expenditure

Police bodies hold reserves equivalent to 23% of net expenditure on police services.


6.9 As shown in Exhibit 24, the total value of usable reserves held by police bodies in Wales have decreased by £1.5 million in real terms. Although the general fund reserves increased by £3.2 million, police bodies applied £4.8 million of reserves to meet the cost of expenditure incurred in 2016-17.
Exhibit 24: police reserves in real terms
Police bodies across Wales continue to use their earmarked reserves to finance expenditure.

Appendix 1

Audit opinions

This table briefly describes each of the five types of audit opinion: unqualified; qualified ‘except for’ opinion – limitation of scope; qualified ‘except for’ opinion – disagreement; adverse opinion; and disclaimer of opinion.

<table>
<thead>
<tr>
<th>Type of opinion</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unqualified opinion</td>
<td>The financial statements give a true and fair view, in all material respects, in accordance with the identified financial reporting framework.</td>
</tr>
<tr>
<td>Qualified ‘except for’ opinion – limitation of scope</td>
<td>The financial statements give a true and fair view, except for the effect of a matter where the auditor was unable to obtain sufficient evidence. For example, the auditor considers the accounting records for a material transaction or balance in the financial statements to be inadequate.</td>
</tr>
<tr>
<td>Qualified ‘except for’ opinion – disagreement</td>
<td>The financial statements give a true and fair view, except for the effect of a matter where there was a material disagreement between the auditor and audited body about how the matter was treated in the financial statements.</td>
</tr>
<tr>
<td>Adverse opinion</td>
<td>There was a disagreement that was so material, or pervasive, the financial statements as a whole were misleading or incomplete.</td>
</tr>
<tr>
<td>Disclaimer of opinion</td>
<td>The auditor was not able to express an opinion, because they could not obtain evidence to such an extent that the financial statements as a whole could be misleading or incomplete.</td>
</tr>
</tbody>
</table>
Emphasis of matter, other matters, and reports by exception

The audit report may also contain an ‘emphasis of matter’ paragraph after the audit opinion. This draws the attention of users of the financial statements to a matter, or matters, presented or disclosed in the financial statements, which are of such importance that they are fundamental to users’ understanding of the financial statements. This does not affect the Auditor General’s opinion on the financial statements.

The Auditor General may add an ‘other matter’ paragraph if he considers it necessary to communicate a matter, other than those that are presented or disclosed in the financial statements, that is relevant to users’ understanding of the audit, the auditor’s responsibilities or the audit report.

- the annual governance statement does not reflect compliance with guidance;
- the information given in the explanatory foreword was not consistent with the financial statements; or
- the Auditor General exercised any additional powers or duties under the Public Audit (Wales) Act 2004.
Appendix 2

What does ‘material’ mean?

In planning and conducting the audit, auditors seek to identify material misstatements whether caused by fraud or error in the financial statements. Information is material if its omission or misstatement could influence the reader of the financial statements 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 financial statements, e.g. an error in the stated pay of a senior officer.

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 financial statements.

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.