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Archwilydd Cyffredinol Cymru  
Auditor General for Wales

# Local Government Financial Statements 2015-16



WALES AUDIT OFFICE  
SWYDDFA ARCHWILIO CYMRU





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

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He also has the power to report to the National Assembly on the economy, efficiency and effectiveness with which those organisations have used, and may improve the use of, their resources in discharging their functions.

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

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**Mae'r ddogfen hon hefyd ar gael yn Gymraeg.**

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# Summary report

## Wales' local government bodies have improved the quality of their pre-audit financial statements for 2015-16, but still face challenges in the medium term to improve and produce their accounts earlier

- 1 This is my sixth annual report on local government bodies' accounts (their financial statements). It summarises the results of my audit work on the 2015/16 financial statements of the larger local government bodies in Wales. 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. These 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.

### Exhibit 1 – Larger local government bodies in Wales

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

<b>Larger local government bodies in Wales</b>	<b>Number</b>
Unitary authorities (County and County boroughs)	22
Police and Crime Commissioners and Chief Constables	8
Fire and Rescue Authorities	3
National park authorities	3
Joint committees	4
Harbour authorities	1

- 2 These 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 £1.8 billion in council tax;
  - receive £4.3 billion in direct revenue funding from Welsh government; and
  - spend over £9.4 billion on delivery of services.
- 3 In common with the rest of the public sector, local government bodies are held accountable under the law for their stewardship and governance of the public money they manage. The principal means by which this responsibility is reported to stakeholders is through their annual financial statements (accounts) and governance statements.
- 4 The Public Audit (Wales) Act 2004 requires local government bodies to submit their annual financial statements to me for audit. My responsibilities are to satisfy myself that:
  - the financial statements are prepared in accordance with regulations;
  - they comply with the requirements of all other statutory provisions applicable to the financial statements; and
  - proper practices have been observed in the compilation of the financial statements.
- 5 The sector faces a number of challenges that can impact on the quality of its 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.
- 6 The Welsh Government is consulting with local government bodies on changes to the statutory timetable set out in the Accounts and Audit (Wales) Regulations 2014. The proposed changes will eventually result in local government bodies producing their financial statements by the end of May and having them audited by the end of July each year. This reduces the total time to publication by two months.

## Exhibit 2 – Accounts and Audit (Wales) Regulations deadlines

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

Authorities	Current to 2017-18	2018-19	2019-20	2020-21
Police, fire and national parks	Prepare a/c 30 June  Publish 30 Sept	Prepare a/c 31 May  Publish 31 July	Prepare a/c 31 May  Publish 31 July	Prepare a/c 31 May  Publish 31 July
Unitary authorities	Prepare a/c 30 June  Publish 30 Sept	Prepare a/c 15 June  Publish 15 September	Prepare a/c 15 June  Publish 15 September	Prepare a/c 31 May  Publish 31 July

- 7 Planning for the successful introduction of this revised timetable will need close co-ordination between audited bodies and their auditors and will present challenges for all of us.
- 8 In 2015 and in 2016 I hosted a number of shared learning seminars, the aim of which 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. Information on these events can be found on [our website](#) and will be added to over time.
- 9 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 leading to improvements in financial controls.

- 10 Auditors and audited bodies will need to start giving consideration to the requirements of the earlier closing timetable and how it can be met. A prerequisite to the ability to address this new challenge, is continuing to improve the quality of financial statements and working papers.
- 11 Local government in Wales faces significant financial challenges in the medium term. Budgets across the sector are under increasing pressure from a decline in central government funding, increasing demand for services and increasing costs. These pressures impact on and are addressed by individual bodies in different ways, mainly through a combination of reducing costs, increasing revenue and utilising reserves, or a combination of all three. Effective financial planning and budgetary control is therefore essential if bodies are going to live within their financial means.
- 12 Local government bodies need to consider how they will deal with the financial challenges they face. While the amount set aside in reserves has continued to increase, bodies need to ensure their medium-term financial plans are robust, and that they critically appraise their holding of reserves and factor their use into their plans in a sustainable way.
- 13 There is variation in how well placed councils are to address future financial pressures and I have issued a separate report on the [Financial Resilience of Local Government Bodies](#) which sets out these challenges and the response to them in more detail.
- 14 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 accounts 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.
- 15 Austerity challenges also impact upon the financial statements production process. Finance team capacity may be reduced to release savings, thereby adding to the pressures faced by teams preparing financial statements.



- 16 For 2015-16, 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 accounts earlier. The key findings from my audits of local government bodies were:
- unqualified audit opinions were issued for most local government bodies on both their annual financial statements and their Whole of Government Accounts returns in accordance with the required timetables;
  - while there remains scope for improvement, local government bodies generally prepared good-quality financial statements and working papers and fewer financial statements required material amendments than last year;
  - auditors continue to identify similar errors in the pre-audit financial statements as have been reported in previous years;
  - faced with significant financial pressures, local government bodies have reduced expenditure on services but some have also increased reserves; and
  - local Government bodies will need to address a number of challenges and accounting changes in coming years when preparing their financial statements.
- 17 In order to meet the challenges presented by the earlier closing deadlines, authorities will need to address these common areas and reduce further the number of amendments required to the financial statements.

# Detailed report

## I issued unqualified audit opinions for most local government bodies on both the annual financial statements and the Whole of Government Accounts returns in accordance with the required timetables

Unqualified audit opinions on the financial statements were issued on time for 39 of 41 local government bodies, and four of these were issued well in advance of the statutory deadline

- 18 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 prior to 30 September to enable bodies to publish audited financial statements by the statutory deadline.
- 19 Auditors may issue an unqualified audit opinion, meaning that the financial statements present a 'true and fair' view of the bodies' income and expenditure and its financial position, or may issue a modified opinion. Further explanation of what a 'modified opinion' means is given in [Appendix 1](#).
- 20 For 2015-16, all except two audits were completed and audit certificates issued by 30 September. One local authority met the proposed earlier deadline of 31 July and a further two bodies were certified in early August, over a month ahead of the current statutory deadline. The audit of the two fire and rescue authorities was delayed due to a number of accounting issues. All the opinions issued in relation to 2015-16 were unqualified.

### Exhibit 3 – Timing of audit opinions issued for local government bodies 2015-16

The Auditor General issued audit opinions at 39 out of 41 local government bodies by 30 September.

	Unitary Authorities	Police bodies	Fire & Rescue Authorities	National Park Authorities	Other
Number of bodies	22	8	3	3	5
Opinions issued:					
By 31 July	1	0	0	0	0
By 31 August	2 <sup>1</sup>	0	0	0	0
By 30 September	19	8	1	3	5
By 31 December			1		
Not yet issued			1		

<sup>1</sup> Accounts completed and approved in July. Audit certified early August.

## Unqualified opinions were issued on all Whole of Government Accounts returns and there has been an improvement in timeliness of submission by local government bodies

- 21 The Whole of Government Accounts (WGA) consolidates the audited accounts of around 4,000 organisations across the public sector in order to produce a comprehensive, accounts-based picture of the financial position of the UK public sector. All public bodies with income and expenditure above £10 million must submit a WGA return to the Welsh Government.
- 22 For 2015-16, WGA returns only required an audit if any of the following exceeded £350 million:
- assets (excluding property, plant and equipment);
  - liabilities (excluding pension liabilities); or
  - gross income or expenditure.
- 23 In 2015-16 sixteen local government bodies required an audit of their WGA returns. All except one of those bodies required to have the WGA returns certified, met the deadline set by Welsh Government. This is an improvement on 2014-15 when only 79% of bodies met the deadline. For 2015-16 I issued unqualified assurance statements for all WGA returns that were required to be audited.

## I did not need to exercise my statutory reporting powers at local government bodies in 2016

- 24 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.
- 25 The Act also requires audited bodies to formally consider and respond to these reports and recommendations. However, 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.
- 26 In previous years I, or my appointed auditor, issued a number of public interest reports and/or made statutory recommendations. However, no reports or statutory recommendations were made in 2016.

## I have not yet certified one audit as complete because of unresolved accounting and audit issues

- 27 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.
- 28 I can issue an opinion on the financial statements where issues remain outstanding, providing 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 may reissue the opinion and certify the audit as complete.
- 29 Audit opinions were not issued by 30 September at the following bodies:
- South Wales Fire Authority
  - Mid and West Wales Fire Authority
- 30 At both these bodies, accounting and related audit issues prevented the issue of an opinion by 30 September. I issued my audit opinion on the South Wales Fire Authority's financial statements on 21 December 2016 and certified that the audit had been completed.
- 31 As at the date of publication of this report, I have not issued an audit opinion on the financial statements of Mid and West Wales Fire Authority and the audit remains open. This does not necessarily mean that any formal audit action will ultimately be necessary. However, 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.

## While there remains scope for improvement, local government bodies generally prepared good-quality financial statements and working papers, and fewer financial statements required material amendments than last year

### Fewer local government financial statements had material amendments in 2015-16 when compared with 2014-15

- 32 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 2](#).
- 33 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.
- 34 Any non-material, but nevertheless significant misstatements, are also brought to the RFO's attention. Auditors request the RFO to correct such errors.
- 35 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). Auditors seek an explanation of why the adjustments have not been made before the financial statements are approved.
- 36 In 2014-15, 60% of local government bodies made material amendments to their financial statements following the audit. For 2015-16, where the audit has been completed, 52% of audited financial statements required material amendments. While this improvement is welcomed, the number of bodies whose pre-audit financial statements contain material errors, remains too high.
- 37 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 large number of material errors undermines that certification process and brings into question the effectiveness of the financial statements production, quality assurance and review processes.

- 38 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.
- 39 Improving the financial statements production and quality assurance processes will be a key requirement for authorities to meet the earlier closing deadlines.
- 40 Further detail on the types of errors identified is set out later in this report.

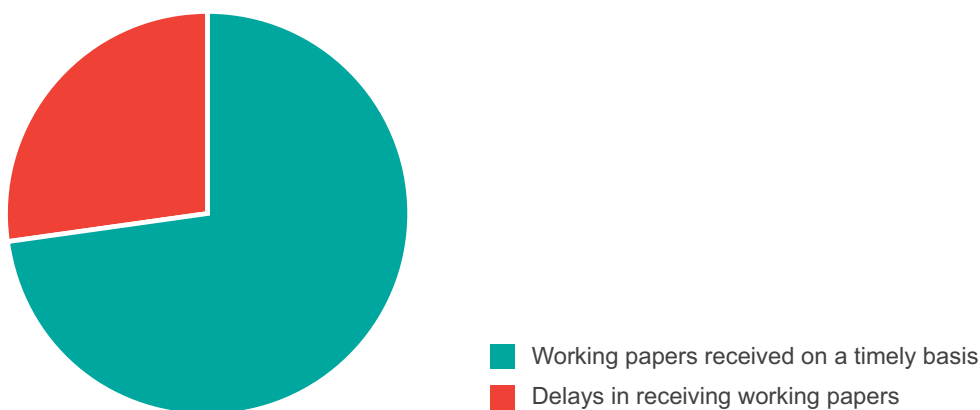
**Although there remains scope for improvement, in general, audited bodies maintained or improved the quality of their working papers**

- 41 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 increases 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.
- 42 Audited bodies and auditors need to ensure that they share an understanding of what is expected, what works locally and continue to streamline arrangements based on learning from previous years. Where the process works well, there is ongoing and open dialogue; issues are discussed in advance of, and throughout, the financial statements process. Experience shows that one of the most valuable tools for improving arrangements continues to be a joint post-project learning session where auditors and management share their views in an open way about the 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.
- 43 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. At my recent Good Practice Exchange (GPX) seminars, delegates identified 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.

- 44 It is important that working papers are easy to follow and provide a complete audit trail. In many cases, auditors will examine working papers sometime 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.
- 45 Auditors assessed the standard of working papers provided and half were considered to be of a good standard. While many aspects of the working papers provided were satisfactory, auditors identified scope for improvement at the remaining bodies.
- 46 Auditors reported the following issues:
- due to a lack of documentary evidence to support judgements made, valuers had to recreate file notes to explain the reasons for the decisions they made;
  - working papers provided did not reconcile to or did not fully support the note included in the financial statements; and
  - some working papers were unclear and lacked sufficient detail to enable Council staff to respond to audit enquiries without significant additional effort.
- 47 The timeliness of working papers is a key factor in the 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. As shown in [Exhibit 4](#), auditors reported that working papers provided to support financial statements were generally provided in a timely manner.

**Exhibit 4 – Auditors’ assessment of timeliness of local government working papers**

73% of audited bodies provided working papers to local audit teams in a timely manner.



Source: Wales Audit Office analysis

### More work is required by local government bodies in Wales to reduce the size and complexity of their financial statements

- 48 Local government financial statements are long and complex documents. In recent years, auditors have been encouraging audited bodies to streamline their financial statements, where possible, and remove non-material notes and disclosures that only add to the complexity of the financial statements. CIPFA have also committed to the simplification and streamlining of local government financial statements as part of their 'Telling the story' review.
- 49 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.
- 50 Auditors reported that while 45% of audited bodies have taken steps to streamline their financial statements, 55% have made limited progress and need to undertake further work in this area.

### Auditors continue to identify similar errors in the pre-audit financial statements as have been reported in previous years

- 51 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.
- 52 This will be particularly important as the timetable for closing and publishing the financial statements is brought forward. Earlier closing will increase the risk of errors being made, and audited bodies need to ensure they have robust financial statements production and review processes in place in readiness to face this particular challenge.
- 53 The main areas where misstatements, material and non-material, were identified from audit work in 2015-16, and other qualitative issues, are summarised below.

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

- 54 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.



- 55 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. In 2015-16, approximately 50% of local government bodies made adjustments to their financial statements in this area as a result of errors identified during the course of the audit.
- 56 Auditors reported the following issues:
- A school was valued on the basis of pupil capacity rather than actual pupil numbers as required by the CIPFA Property Asset Valuation Handbook.
  - A car park was replaced on the site of the existing facility and the cost of the new facility added to the asset register. However, the value of the replaced car park remained recorded in the financial statements.
  - Assets were incorrectly classified as investment properties resulting in a valuation being carried out on an incorrect basis.
  - Assets meeting the conditions as 'assets held for sale' were incorrectly classified as surplus assets resulting in a valuation being carried out on an incorrect basis.
  - The accounting treatment applied for subsequent expenditure on assets was not in accordance with the Code.
- 57 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.
- 58 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 is 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.

## Half of audited bodies did not initially properly disclose senior officer remuneration as required by the Accounts and Audit (Wales) Regulations

- 59 The Accounts and Audit (Wales) Regulations 2014 specify that local government bodies must include in their annual financial statements, certain information related to their senior officers' remuneration. The disclosures include detailed disclosures for certain officers, and disclosure of the numbers of officers whose remuneration falls within specified bands beginning at £60,000.
- 60 These disclosures are relatively straightforward to prepare. However, auditors identified that approximately 50% of bodies did not properly prepare them.
- 61 Auditors reported the following issues:
- although disclosure is required by statutory regulations, severance and redundancy payments were excluded when calculating remuneration for the disclosure of numbers of employees with remuneration set out in bands of £5,000;
  - in calculating gross remuneration for senior officers, taxable benefits in kind were excluded from gross remuneration; and
  - errors were made in calculating the median salary for all employees to compare this with the highest paid employee.

## Audited bodies continue to incorrectly report internal transactions in their pre-audit financial statements

- 62 Any individual authority's financial statements are intended to summarise how it has managed its resources. The financial statements are an externally facing document. Internal transactions, ie, those which recharge costs from one cost centre to another, should be excluded from the authority's gross income and expenditure.
- 63 In my reports on the 2013-14 and 2014-15 financial statements, I noted that a number of local government bodies had significantly overstated both gross income and gross expenditure because internal recharges had not been netted off (ie, removed). While this was again an issue in 2015-16, the number of bodies who continue to report these internal transactions incorrectly continues to reduce.
- 64 Auditors reported the following issues:
- charges made by one department to another for the supply of goods and services were incorrectly reported as: income for the department supplying goods and services, and expenditure for the department receiving the goods and services; and

- financial statements incorrectly overstated year-end debtor and creditor balances by including balances between the authority and its schools.

### Audited bodies make simple errors of classification of debtor and creditor balances

65 The Code requires debtor and creditor balances to be analysed between long-term and short-term balances. Where material, authorities provide an analysis of the amount of debtors and creditors between:

- Central government bodies
- Other local authorities
- NHS bodies
- Public bodies and trading funds
- Bodies external to general government

66 In a number of bodies, items were misclassified between these headings.

67 Auditors reported the following issues:

- amounts due to other local authorities are reported as balances due to central government and bodies external to general government; and
- incorrectly recorded amounts due to the local government pension fund meant the reported debtors and creditor balances did not agree with the amounts recorded by the pension fund accounts.

### Audited bodies often do not properly report cash flow transactions

68 The cash flow statement is one of the primary accounting statements but is often not given the same level of attention to detail as the other statements. Many of the transactions included in the cash flow statement are derived from, or reconciled to, the other primary statements. Auditors identified issues related to the cash flow statement at almost 25% of audited bodies.

69 Auditors reported the following issues:

- cash balances were recorded as bank overdrafts;
- entries in the cash flow statement did not agree to underlying records; and
- items included in the cash flow statement were not presented in accordance with the requirements of the Code.

## Faced with significant financial pressures, local government bodies have reduced expenditure on services, but some have also increased reserves

70 In October 2016, the Welsh Government announced that local authorities will see a small increase in its funding for 2017-18 compared with 2016-17. However, the sector still faces significant challenges in the years ahead. Local authorities continue to deliver services within the context of an ongoing austerity agenda and must deal with numerous pressures on budgets.

### Local authority and police spending on frontline services continued to decrease in 2015-16 and is now 7% lower in real terms than in 2011-12

71 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 specific grants fund about 40% of the total cost of council services. The remaining 60% is general revenue funding comprising Revenue Support Grant, non-domestic rates and council tax.

72 **Exhibit 5** shows that in 2015-16, 60% of total expenditure by local authorities was spent on children and education services (42%) and adult social care (18%).

73 Local authorities' gross expenditure on services and net expenditure on services after income from fees, charges and specific grants, decreased by 2% in 2015-16 when compared with 2014-15. **Exhibit 6** shows the longer term trend which has seen gross expenditure on services decrease by 7% in real terms since 2011-12, and net expenditure on services fell by 5% in the same period.

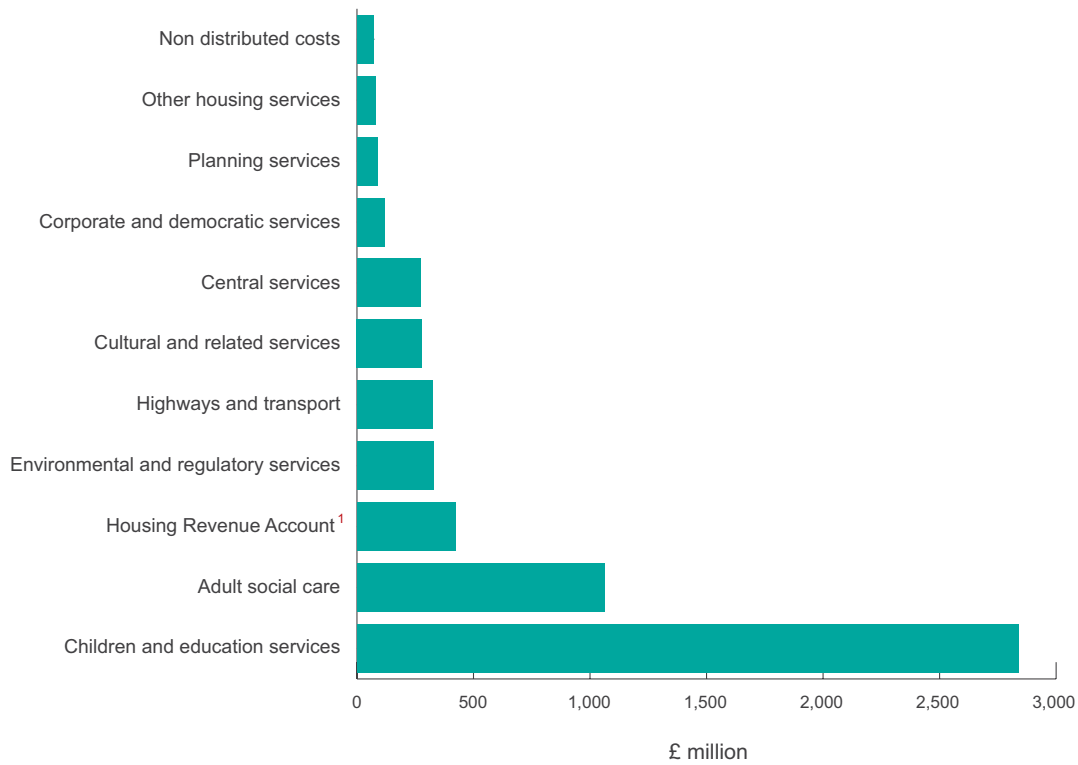
74 However, this reduction in expenditure has not been applied equally to all services. Between 2011-12 and 2015-16, gross expenditure on adult social care has increased in real terms by 3%. Expenditure on other service areas has declined in real terms with expenditure on cultural and related services and environmental, regulatory and planning services reduced by 20%.

75 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. The underlying budget pressures are likely to persist for the immediate future, making it increasingly important for authorities to manage their recurring expenditure.

76 Having risen between 2012-13 and 2014-15, primarily due to increased expenditure as a result of the NATO summit held in Newport in September 2014, **Exhibit 7** identifies that spending on police services also declined in 2015-16.

### Exhibit 5 – Local authority gross expenditure on services in 2015-16

Adult social services and children and education services represent the largest single items of local government spending in Wales.



<sup>1</sup> Housing Revenue Account expenditure excludes £918 million one-off expenditure paid to HM Treasury to exit from the HRA subsidy system in Wales.

Source: Wales Audit Office analysis of local authority accounts 2015-16

**Exhibit 6 – Local authorities' gross expenditure and expenditure net of fees, charges and specific grants, on services since 2011-12**

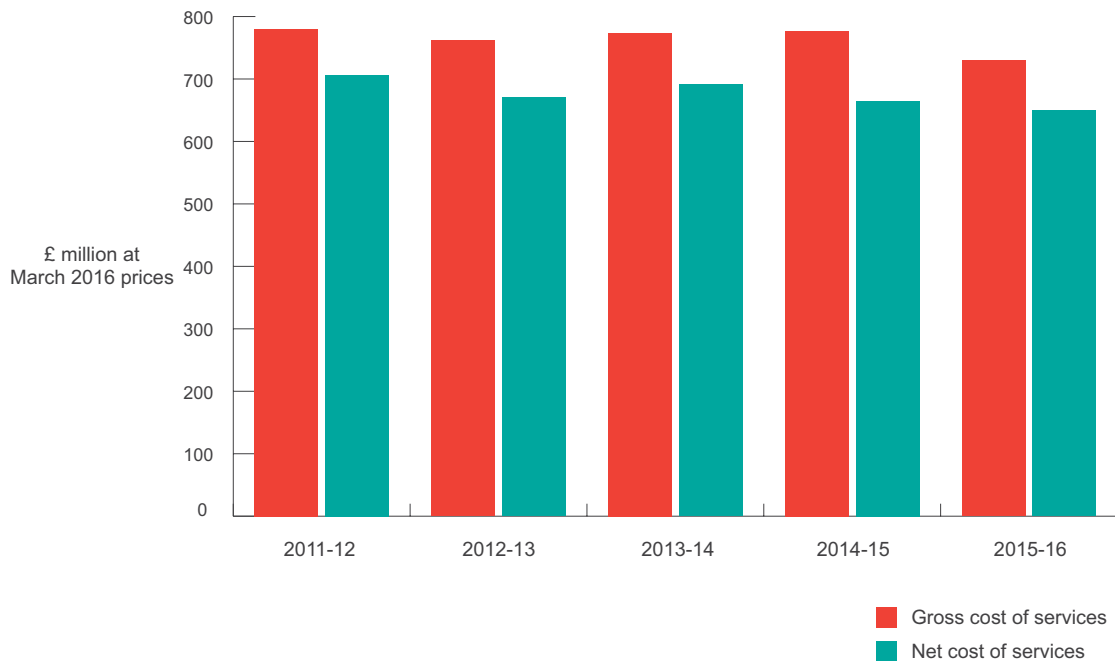
Local authorities' gross revenue expenditure declined by 7% and net revenue expenditure by 5% in real terms since 2011-12.



Source: Wales Audit Office analysis of local authority accounts 2011-12 to 2015-16 adjusted to March 2016 prices calculated using the HM Treasury GDP deflator series published in December 2016

**Exhibit 7 – Police gross expenditure, and expenditure net of fees, charges and specific grants, on services since 2011-12**

Police bodies' gross revenue expenditure has declined by 6% and net revenue expenditure by 8% in real terms.



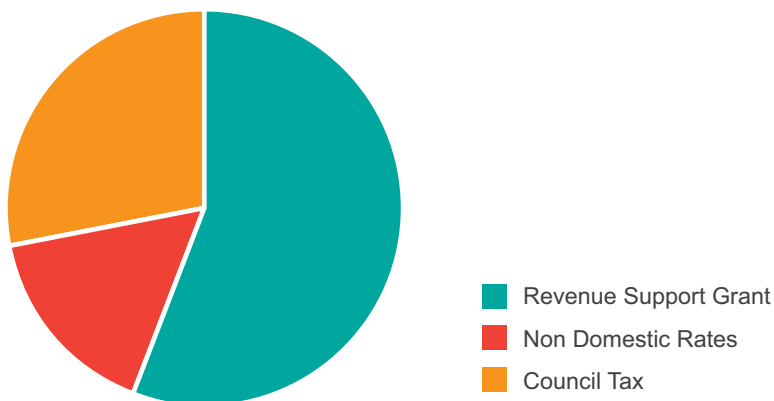
Source: Wales Audit Office analysis of police bodies' accounts, 2011-12 to 2015-16, adjusted to March 2016 prices calculated using the HM Treasury GDP deflator series published in December 2016

In real terms, local authorities' and police bodies' revenue income has fallen since 2011-12, and while central government funding remains the most significant source of income, an increasing proportion of income is raised from council tax

- 77 Councils fund their net cost of delivery of services by revenue support grant, receipt of non-domestic rates and council tax. Exhibit 8 shows that in 2015-16, Welsh Government Revenue Support Grant (RSG) and non-domestic rates provide about 72% of this general revenue funding, with council tax accounting for the remaining 28%.
- 78 Since 2011-12, councils have experienced a real terms decline in general revenue funding. As shown in Exhibit 9, between 2011-12 and 2015-16, councils' income from revenue support grant, non-domestic rates and council tax has reduced in real terms by 4%. While it remains the largest source of local government funding, Welsh Government revenue support grant fell by the equivalent of around £441 million (12%) in real terms between 2011-12 and 2015-16. During this period, the proportion of general revenue funding raised as council tax has increased from 25% to 28% in 2015-16.

**Exhibit 8 – Council's general revenue funding in 2015-16**

Councils' general revenue funding in 2015-16 was £5.6 billion, and 56% of this came from revenue support grant, and a further 16% from non-domestic rates.

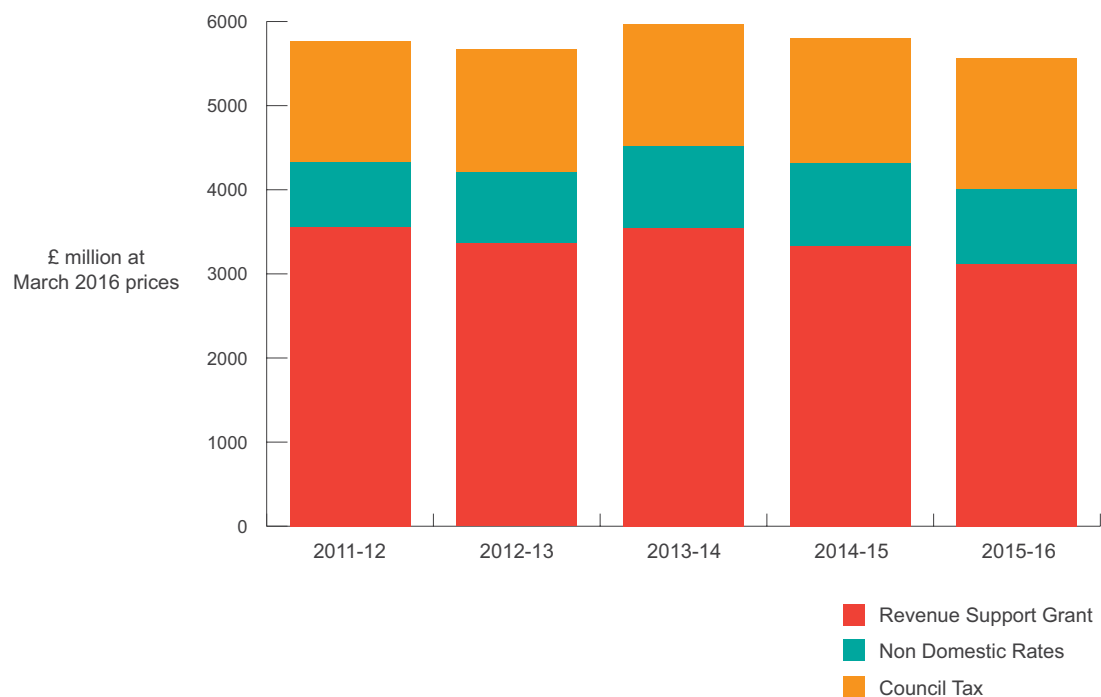


Source: Wales Audit Office analysis of local authority accounts 2015-16



### Exhibit 9 – Real terms council general revenue funding since 2011-12

General revenue funding has reduced by 7% in real terms since 2011-12.

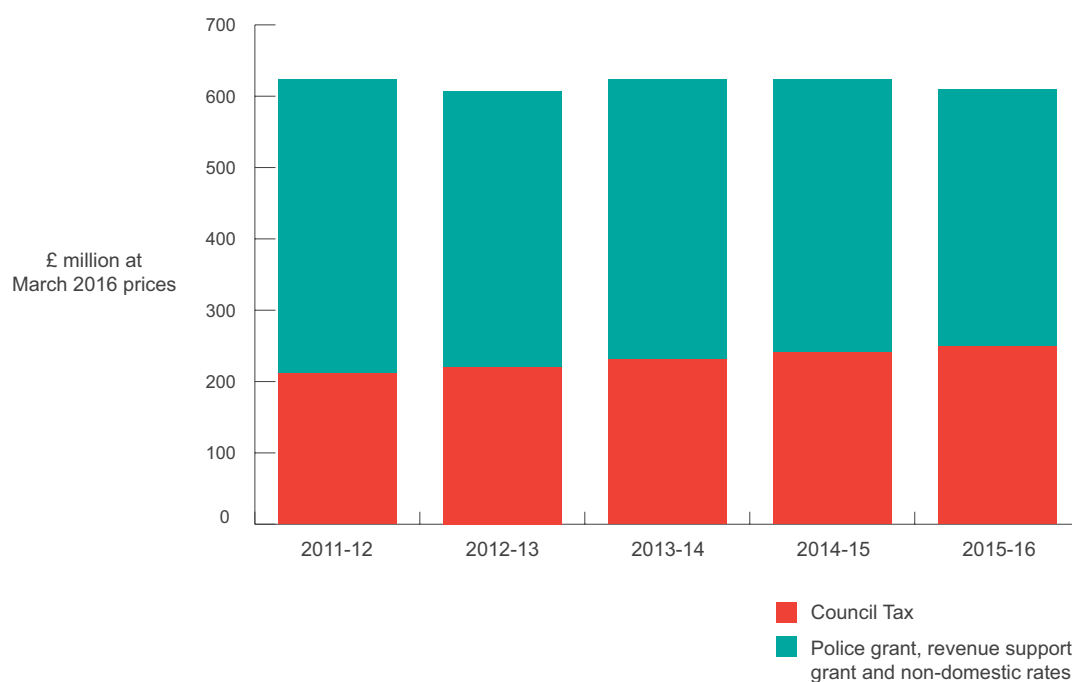


Source: Wales Audit Office analysis of local authority accounts 2011-12 to 2015-16 adjusted to March 2016 prices calculated using the HM Treasury GDP deflator series published in December 2016

- 79 The reduction in central funding places an increasing emphasis on how local authorities raise funds directly. In my report on **Charging for services and generating income by local authorities** in November 2016, I concluded that authorities are not pursuing all options to generate income because of weaknesses in their policies and in how they use data and information to support decision making.
- 80 Police services similarly fund their net cost of services (after fees, charges and specific grants), from Home Office police grant, revenue support grant, non-domestic rates and council tax. **Exhibit 10** shows that in 2015-16, police grant, revenue support grant and non-domestic rates provide about 59% of this general revenue funding. Council tax accounts for 41% of general revenue funding.

### Exhibit 10 – Police service general revenue funding in Wales at March 2016 prices

Since 2011-12, income from police grant, revenue support grant, non-domestic rates and council tax has declined in real terms by 8% since 2011-12.



Source: Wales Audit Office analysis of police bodies' accounts 2011-12 to 2015-16 adjusted to March 2016 prices, calculated using the HM Treasury GDP deflator series published in December 2016

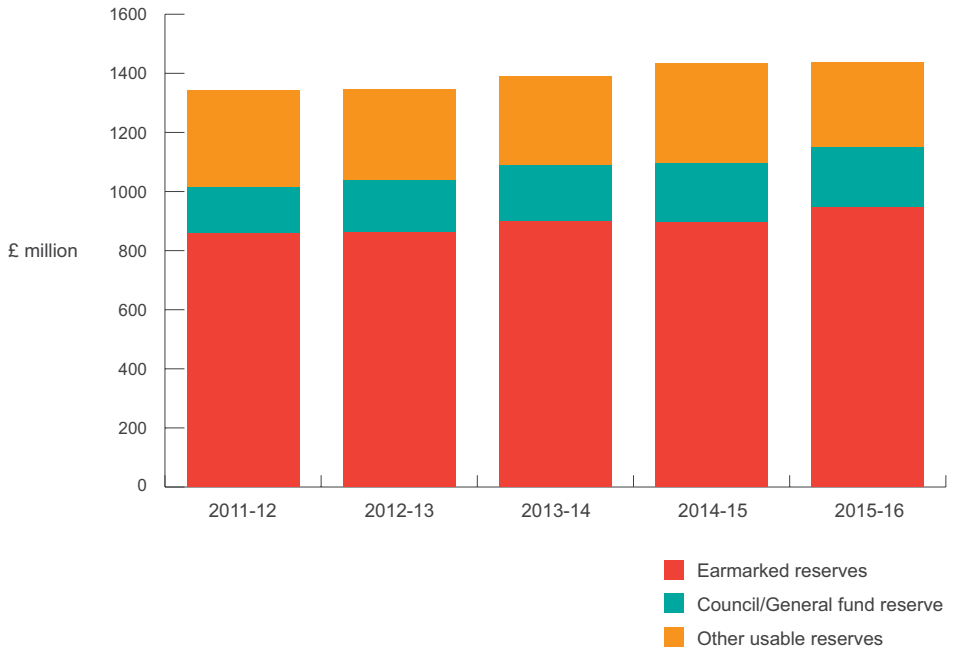
- 81 In cash terms, police bodies' general revenue funding has reduced from £623 million in 2011-12 to £610 million in 2015-16. At March 2016 prices, this equates to a decline of £51 million or 8%. Exhibit 10 summarises income sources for the police bodies in Wales at March 2016 prices. An increasing proportion of police bodies' general revenue funding is raised from council tax. In 2011-12, council tax payers provided 34% of police general revenue funding. By 2015-16, this had increased to 41% while the proportion received from central government declined from 66% to 59%.
- 82 Since 2011-12, various specific police grants have been absorbed into the revenue settlement from the Home Office and Welsh Government. This means that the reduction in general revenue funding is actually greater than shown above.

**Local authority usable reserves represent about 28% of annual expenditure on services (net of fees and charges) and have increased in real terms by 8% over the past five years, while police bodies have used some of their reserves in 2015-16**

- 83 Bodies maintain usable reserves that can be used to support services and unusable reserves which represent accounting adjustments for items such as changes in valuation of land and buildings.
- 84 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.
- 85 As shown in [Exhibit 11](#), the value of local authority usable reserves continues to increase. By March 2016, total usable reserves have risen by 7% since 2011-12 (2% in real terms) with an additional £4 million set aside in usable reserves in 2015-16. Earmarked and other usable reserves currently represent 86% of local authority usable reserves. In 2015-16, local authorities set aside an additional £2 million in earmarked and other usable reserves. Earmarked and other usable reserves are £46 million (4%) higher than 2011-12.
- 86 Despite the increased challenges facing local authorities in Wales, local authorities have not yet made significant use of their reserves. While income and expenditure have been falling, the value of authorities' usable reserves has been increasing.
- 87 In 2011-12, usable reserves represented 26% of the net cost of council services after receipt of fees and charges. In 2015-16, usable reserves had increased to 28% of the net cost of services.
- 88 For police bodies, some reserves have been used to support services. As shown in [Exhibit 12](#), following a small increase in overall reserves in 2014-15, Welsh police bodies have applied some of their earmarked reserves in 2015-16 to support specific projects. Police usable reserves total 20% of gross revenue expenditure in 2015-16 compared with 21% in 2011-12.

**Exhibit 11 – Local authority usable reserves**

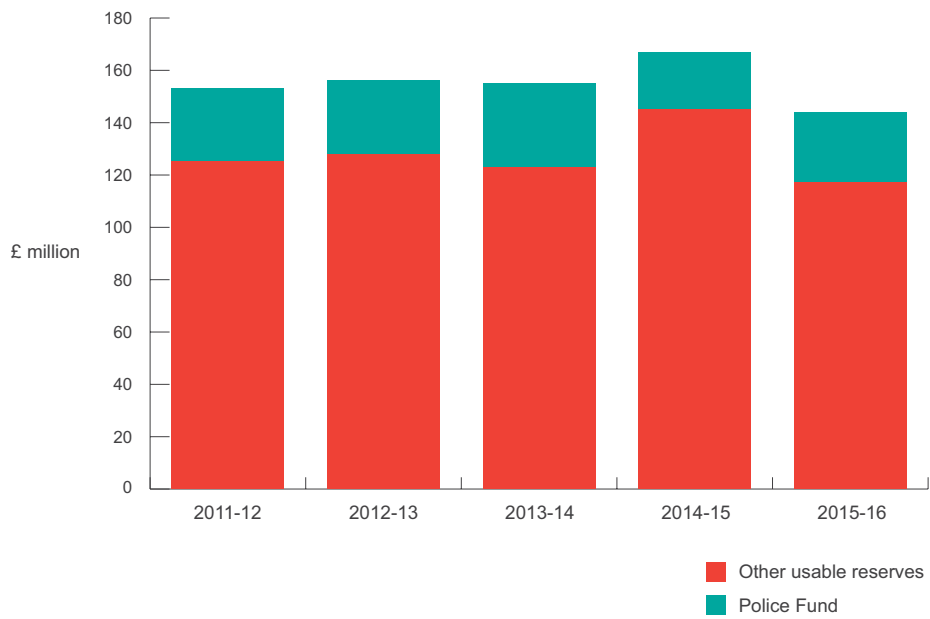
Local authorities’ usable reserves have increased 7% in cash terms since 2011-12.



Source: Wales Audit Office analysis of local authority accounts 2011-12 to 2015-16

**Exhibit 12 – Police bodies’ reserves in Wales**

Police bodies in Wales have applied some of their earmarked reserves in 2015-16, reducing the total value of reserves from £167 million in 2014-15 to £144 million in 2015-16.



Source: Wales Audit Office analysis of police bodies’ accounts 2011-12 to 2015-16

## Local Government bodies will need to address a number of challenges and accounting changes in coming years when preparing their financial statements

For 2016-17, authorities will need to implement a number of significant changes to their accounting practices

- 89 Local government bodies prepare their financial statements following the Code of Practice on Local Authority Accounting issued by CIPFA/LASAAC. The 2016-17 Code has been amended to reflect the new format and reporting requirements for the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement (MiRS). The key change to the CIES is the removal of the requirement for the service expenditure analysis to reflect the requirements of the Service Reporting Code of Practice. Authorities will now allocate income and expenditure to services based on how they manage or operate services locally.
- 90 As a result of the 'Telling the story' review of local authority financial statements, the 2016-17 Code includes a requirement to prepare a new Expenditure and Funding Analysis. This analysis aims to demonstrate how the authority has used the funds available (grants, rents, council tax and business rates) to provide services in comparison with the resources consumed by the authority.
- 91 These changes must be made retrospectively. That is, in the 2016-17 financial statements, authorities will need to restate the accounts for the 2015-16 financial year. Therefore, authorities will need to ensure they have sufficient information available to complete the 2016-17 financial statements.

Although CIPFA have deferred the new accounting arrangements for the Highways Network Asset, authorities will need to maintain the momentum in preparing for this significant change

- 92 In November 2016, the CIPFA/LASAAC Local Authority Accounting Code Board (Code Board) decided to defer the planned move to measuring the local authority highways network asset (HNA) at depreciated replacement cost. The Code Board will consider whether the central GRC rates and central assurance processes will be delivered in a timely manner to enable successful implementation in 2017-18 at its meeting in March 2017. It is anticipated that the Code Board will introduce the revised valuation requirements for the HNA in the 2017-18 Code.
- 93 It will, however, be important for authorities to maintain their momentum in preparing for this significant change. Information regarding unclassified roads is currently limited in many authorities, and is therefore an area where further effort is required. It would be unacceptable for local authorities in Wales to be unprepared for a 2017-18 implementation of the amended Code requirements.

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

- 94 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.
- 95 **Exhibit 13** identifies three key accounting changes and the date by which they are expected to be included in the CIPFA/LASAAC Code of practice.
- 96 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.

## The impact of the Well-being of Future Generations Act and the integrated reporting initiative on the audit of financial statements is currently being considered

- 97 Local government bodies are being increasingly challenged with maintaining or improving outcomes within the same or reduced resources. Communicating how, and how well prepared they are, to achieve this will be critical to public accountability.
- 98 In the public sector, two initiatives seek to improve reporting by public bodies:
- HM Treasury's Simplifying and Streamlining Accounts Project aims to simplify and streamline the presentation of statutory annual report and accounts 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.
- 99 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 accounts 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.

### 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.

Accounting standard	Effective date	Impact
IFRS 9 Financial instruments	2018-19	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.
IFRS 15 Revenue from contracts with customers	2018-19	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.
IFRS 16 Leases	2019-20	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. This is 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 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.

Source: Wales Audit Office analysis

Adopting an integrated reporting model will assist bodies to demonstrate they have complied with their responsibilities to meet the sustainable development principle set out in the Well-being of Future Generations (Wales) Act 2015 (the Act).

- 100 The Act requires me to report every five years to the National Assembly on how public bodies apply the sustainability principles. During 2016, I consulted on my options for reshaping public audit in Wales.
- 101 In 2017, I will work collaboratively with a small number of public bodies, including the local government sector, to develop an audit approach which is rigorous, meaningful and proportionate. As part of this work, I will consider how the Act impacts on local authority financial statements.



# Appendices



# Appendix 1 - Qualified and unqualified audit opinions

## Types of audit opinion

Type of opinion	Description
Unqualified opinion	The financial statements give a true and fair view, in all material respects, in accordance with the identified financial reporting framework.
Qualified 'except for' opinion – limitation of scope	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.
Qualified 'except for' opinion - disagreement	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.
Adverse opinion	There was a disagreement that was so material, or pervasive, the financial statements as a whole were misleading or incomplete.
Disclaimer of opinion	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.

## 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 Auditor General reports by exception if:

- 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, eg, 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.

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