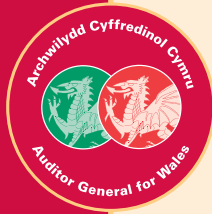




THE GENERAL REPORT OF THE AUDITOR GENERAL FOR WALES 2004

Report prepared for the Auditor General for Wales by the National Audit Office Wales



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John Bourn
Auditor General for Wales

National Assembly for Wales
Cardiff Bay
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11 June 2004

The Auditor General for Wales is totally independent of the National Assembly. He certifies the accounts of the Assembly and its associated sponsored public bodies; and he has statutory authority to report to the Assembly on the economy, efficiency and effectiveness with which the Assembly and its sponsored public bodies have used their resources in discharging their functions.

This report was prepared for the Auditor General for Wales by the National Audit Office Wales.

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Report by Auditor General for Wales, presented to the National Assembly for Wales on 11 June 2004

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Foreword by the Auditor General for Wales

I am delighted to present this General Report to the National Assembly for Wales.

My financial audit work at the National Assembly for Wales and its related public bodies enables me to provide independent assurance that the annual financial statements are properly prepared and that income and expenditure has been applied for the purposes intended by the relevant United Kingdom statutes.

The report summarises the results of financial audit work undertaken in respect of the 2002-03 accounts. It also provides an update on other important areas of work undertaken in the period to 31 March 2004, including the investigation of issues arising from the correspondence I have received from Assembly Members and the general public, and the audit of European-funded projects.

Overall, I consider that standards of financial management and probity remain high in Wales. In this report, however, I describe a number of areas where improvements need to be put in place, for example in the monitoring, controlling and documentation of expenditure by grant awarding bodies. Effective financial stewardship and public accountability also requires that all bodies prepare their annual statements of account promptly after their financial year end. In the report I set out the challenge that faces a number of Welsh public sector bodies to improve the timeliness of their annual accounts preparation exercises. I am also pleased to acknowledge in this report the valuable advisory role being played by the National Assembly for Wales to the Welsh public sector in the area of procurement of goods and services.

At the time of publication of this report, the Public Audit (Wales) Bill remains under consideration in Parliament. If enacted, the Bill will create a new Wales Audit Office, headed by the Auditor General for Wales. The existing situation, whereby public sector expenditure in Wales is audited by two distinct bodies—the Audit Commission in Wales and the National Audit Office Wales—will then cease on 1 April 2005 and the staffs of both organisations will transfer to the new, unified audit organisation. I wholeheartedly welcome the Government's proposals in the Bill currently before Parliament, which I believe will strengthen further the audit of public expenditure within Wales.

I aim to continue to provide an efficient and effective audit service to my client bodies and other stakeholders, work with them to secure improvements in the delivery of public services and provide independent assurance on public spending to the National Assembly and the people of Wales.

John Bourn
10 June 2004

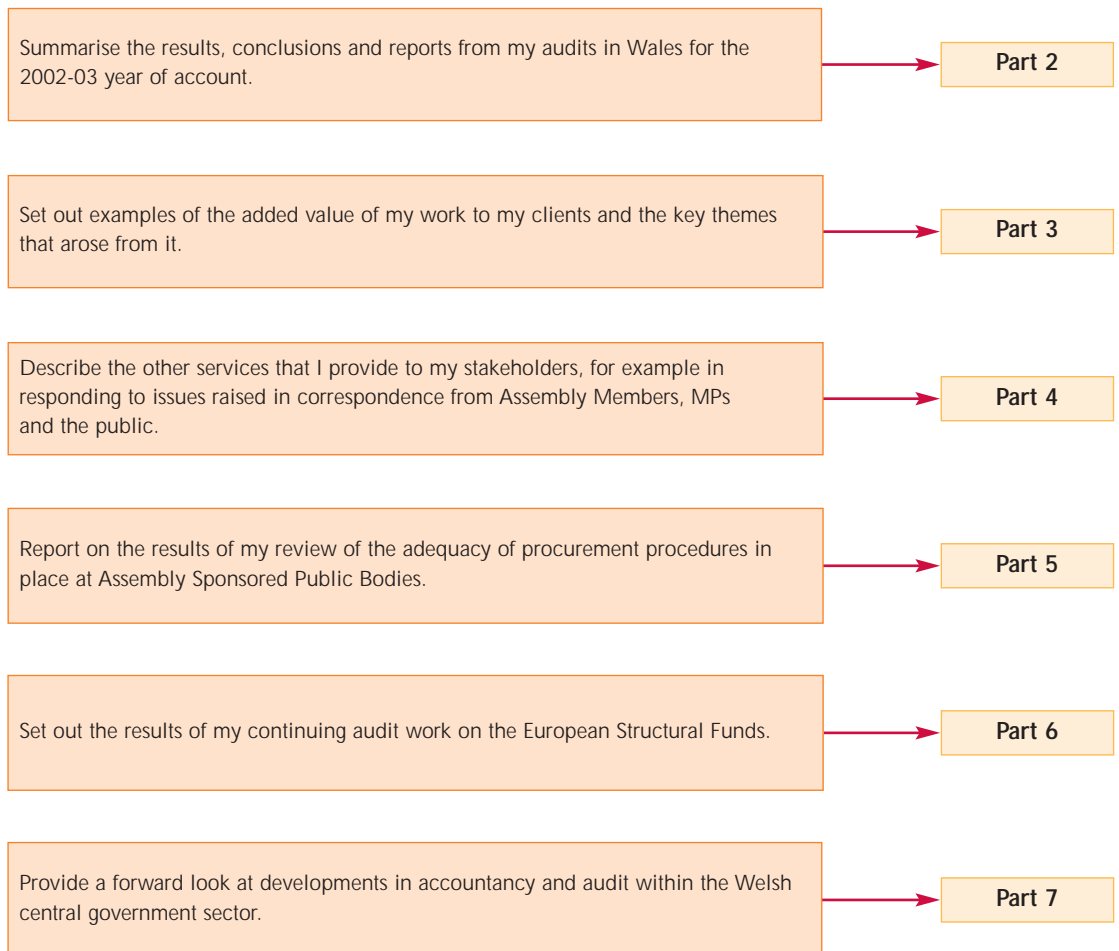
1 Introduction

1.1 This report to the National Assembly for Wales summarises the results of my examination and certification of the 2002-03 accounts, the last of which I certified on the 26 March 2004. The report also summarises the results of my other financial audit work through to 31 March 2004.

1.2 This report does not deal with the value for money (VFM) audit work of the National Audit Office Wales, which supports the production of my published VFM reports. During 2002-03, I published eight VFM reports, which are listed at Appendix A to this report and which are available on the internet at www.agw.gov.uk. These reports are considered separately by the Assembly's Audit Committee and records of the Committee's meetings are available on the Assembly's website at www.wales.gov.uk.

Coverage of this report

In this report I:



Financial Audit in 2002-03

2

Introduction

2.1 This part of the report summarises the results and conclusions from my financial audit work for the 2002-03 year of account. Specifically, it:

- sets out the results of my examinations on each of the accounts that I audited in 2002-03; and
- provides summaries of the substantive reports that I issued on the accounts of the National Council for Education and Training for Wales, the Higher Education Funding Council for Wales, the summarised account of the Welsh health authorities and on the financial health of NHS Wales.

2.2 In general, standards of financial control in client bodies throughout Wales remained good. During the course of its work, and as in previous years, the National Audit Office Wales was also able to make a wide range of recommendations to the Accounting Officers and senior management of client bodies for improvements to systems of control, compliance with the regulatory framework and accounting processes.

- undertake procedures designed to obtain sufficient, reliable and appropriate audit evidence to determine with reasonable confidence whether the financial statements are free of material misstatement; and
- assess the overall presentation of the financial statements in order to ascertain whether they have been prepared in accordance with Accounting Standards and the relevant Accounts Directions.

2.5 In addition, and unique to public bodies, is the requirement for income and expenditure only to be applied to the purposes intended by Parliament and/or the National Assembly for Wales and to comply with all relevant governing authorities and statutes - '**regularity**'.

2.6 I therefore design my audit examinations to satisfy myself that, in all material respects, money provided to and by the National Assembly for Wales has been used only for the purposes intended. In carrying out this work, I also have regard for the **propriety** with which public funds have been handled and the manner in which public business has been conducted.

Auditor General for Wales

2.3 As Auditor General for Wales, I am required by statute to examine and certify the annual accounts of the National Assembly for Wales, its sponsored public bodies and certain other public bodies, and to report my audit opinions to the Assembly.

2.4 I conduct my financial audits in accordance with Auditing Standards issued by the Auditing Practices Board. In common with private sector practice, these auditing standards require me to:

National Audit Office Wales

2.7 The National Audit Office Wales, under my direction, conducts the detailed financial audit work necessary to support my duties and statutory responsibilities. For the 2002-03 year of account, they audited 32 accounts which reported the spending programmes financed by the Welsh block budget of some £10.5 billion.

2.8 The Assembly and its sponsored public bodies prepared the accounts that were audited in compliance with directions issued by both the Assembly and Treasury, as appropriate. The various organisations differ greatly in nature, size and complexity and operate an array of financial procedures and accounting systems. **Figure 1** illustrates the variety and numbers of accounts audited for 2002-03 (a full listing is set out in Appendix B to this Report).

2.11 Each Accounting Officer is supported in executing these responsibilities by the body's Corporate Governance or Audit Committee and by the senior management team, together with advice from the internal auditors and the National Audit Office Wales.

2.12 Each Accounting Officer can be summoned by the Assembly's Audit Committee to give oral or written evidence on reports that I may produce on the accounts of the bodies for which they are responsible. The Committee, which is chaired by an Assembly Member belonging to an opposition party, considers this evidence and then produces its own reports containing recommendations to which the Welsh Assembly Government is required to respond within 30 working days.

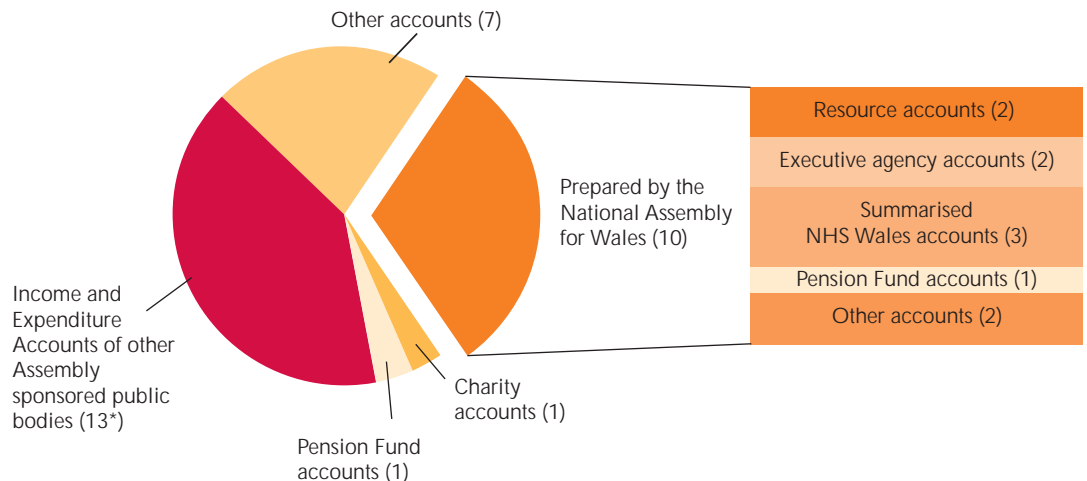
2.13 Taken together, these audit and reporting arrangements provide a significant level of public accountability and assurance to the people of Wales that public money is being spent wisely and in accordance with the intentions of the Assembly. In the remaining parts of this report, I set out the key findings and results of my financial audit work in respect of the 2002-03 financial year.

Role of the Accounting Officer

2.9 Each body that I audit has a designated 'Accounting Officer' - usually the Permanent Secretary or Chief Executive. This role includes responsibility for financial management and control within the organisation as set out in the Statement of Accounting Officer's Responsibilities, which is published alongside each annual account.

2.10 **Figure 2** illustrates a number of the responsibilities of the Accounting Officer.

1 Accounts audited by the Auditor General for Wales, 2002-03



NOTE

* Four of these bodies also have charitable status

Source: National Audit Office Wales

2

Responsibilities of the Accounting Officer



Source: National Audit Office Wales and Government Accounting 2000

Reporting the results of audit examinations

2.14 **Figure 3** illustrates the ways in which I report the results of my financial audit work:

3

Reporting the results of financial audit work

- **Audit Certificates on the financial statements**, giving a clear expression of my audit opinion;
- **Published reports on the account**, bringing to the Assembly's attention matters that have a direct or indirect effect on public expenditure. (I always report on an account when I qualify my audit opinion, and I may also report matters without qualifying my opinion if I believe them to be of significant interest to Assembly Members); and
- **Unpublished reports to the audited client body's management**, drawing attention to areas where improvements to systems and procedures may be made and providing constructive recommendations and advice (addressed in Part 3 of this report).

Audit Certificates on the financial statements

- 2.15 The preparation of accounts on an income and expenditure basis involves the use of judgement in determining accounting estimates and policies, and the uncertainties inherent in financial estimates. In assessing such judgements, the auditor considers the relative importance of each issue arising from the audit in the context of the whole account. A matter is regarded as material if its misstatement or omission would reasonably influence the users of the financial statements in drawing conclusions from the information contained within them. I report my opinion as to whether the financial statements give a **true and fair view** and have been **properly prepared** in accordance with the relevant statute and Treasury directions.
- 2.16 I also report my opinion as to whether the transactions contained within the financial statements are regular; that is, that in all material respects they have been undertaken in accordance with primary and secondary legislation, other regulations issued by Ministers, and with Parliamentary and Treasury authority.

My audit opinions in 2002-03

- 2.17 As Auditor General for Wales, I gave an unqualified audit opinion on all but one of the 32 Welsh accounts that I certified in respect of the 2002-03 financial year. I qualified my opinion on the summarised account of the health authorities in Wales. My report on this account explained the reason for my qualified opinion and a summary of this report, together with summaries of those reports published where I did not qualify my audit opinion, are set out below.

Reports on accounts

- 2.18 For the 2002-03 financial year, I made substantive published reports in respect of the following:
- the National Council for Education and Training for Wales;
 - the Higher Education Funding Council for Wales
 - the Summarised Account of the Health Authorities in Wales; and
 - Financial Health of the NHS in Wales.

National Council for Education and Training for Wales

- 2.19 My report to the National Assembly for Wales on the accounts of ELWa - The National Council for Education and Training for Wales (the National Council) - was the third that I had made on that body since its establishment on 1 April 2001.
- 2.20 I qualified my regularity audit opinion on the National Council's first set of accounts for the period to 31 March 2002, and published a report with these accounts in January 2003 to explain that this was because of irregular expenditure totalling some £2 million incurred by the National Council during that period on procurement contracts. I also issued a report in September 2003 on the National Council's management of its Partnership and Innovation Development projects. That report set out a range of serious weaknesses in the National Council's handling of a range of projects within its Innovation and Development Programme, including the Pop Centre MP3 Café project.

2.21 In my third report, on the National Council's 2002-03 accounts, I set out the results of my audit on those accounts and provided an update on the actions taken by the Council's management in response to my previous two reports. I noted that a range of measures had been implemented by the National Council to tighten controls over procurement procedures. Testing by National Audit Office Wales found that controls were being applied rigorously and supported the assurances of the National Council's own internal auditors on the adequacy, reliability and effectiveness of the body's systems of procurement. I also noted that the National Council had undertaken a rigorous and complete management review of all live projects following the weaknesses highlighted in projects including the Pop Centre MP3 Café. The necessary retrospective approvals had been granted in most cases and action had been taken to guard against recurrences.

2.22 However, there were a number of difficulties with the implementation of the National Council's new accounting system and my report summarised the significant weaknesses that had been identified by my staff and by the National Council's internal audit team as part of its planned annual programme of work. In particular, duplicate payments totalling some £27,000 were made to suppliers by the National Council during 2002-03. As a result of the weaknesses identified within the financial systems the Head of Internal Audit issued a qualified annual audit opinion on the system of internal control for the 2002-03 financial year. My report described corrective actions that had been implemented as a result and also noted that appropriate steps were being taken to recover the money paid out in error.

Higher Education Funding Council for Wales

2.23 The Higher Education Funding Council for Wales (the Council) shares its core financial systems and other key business processes with the National Council for Education and Training for Wales. In my report I commented on certain of the issues raised by the Chief Executive of the Council in his Statement on Internal Control in respect of the Council's 2002-03 annual accounts.

2.24 The Chief Executive's Statement on Internal Control set out in detail a range of weaknesses within the Council's financial systems during 2002-03 and the reasons these occurred, together with actions that had been taken to rectify those matters. The weaknesses included difficulties that both the Council and the National Council had experienced in the implementation of their new accounting system. As with the National Council, the weaknesses had resulted in the making of some small duplicate payments.

Summarised Account of Health Authorities in Wales

2.25 In carrying out my audit of the summarised accounts of the health authorities and trusts in Wales I have regard to work undertaken by the auditors of those bodies, which are appointed by the Audit Commission (the "appointed auditors"). In 2002-03, for the third successive year, I qualified the regularity element of my audit opinion on the summarised account of the health authorities in Wales in respect of a potential shortfall in prescription income. This qualification mirrored the qualifications given by the appointed auditors to the 2002-03 accounts of four out of five health authorities in Wales. Work being undertaken by the Assembly to address fraud is described in Para 2.32.

2.26 In my report I also noted that the appointed auditors of the Dental Practices Board had qualified their regularity opinion on the Board's 2002-03 financial statements covering England and Wales on the basis that the absence of controls could result in potentially inappropriate payments, for example through administrative error, misunderstanding of regulations, inappropriate or poor quality work and deliberate theft.

Financial health of the NHS in Wales

2.27 My annual report for 2004 on the finances of NHS Wales was published on 1 April 2004. In that report, I commented on issues of financial performance in 2002-03 and also considered other key challenges impacting on delivery of service, including restructuring of the NHS in Wales and progress in tackling fraud.

Financial Performance of NHS Wales

2.28 There was a continuing significant deterioration in the financial health of NHS Wales during 2002-03. The overall result for the year was a deficit of £37 million, compared with a deficit of £16 million in the previous year. Health communities have been asked by the Welsh Assembly Government to produce Strategic Change and Efficiency Programmes to eradicate deficits by March 2006.

Structural Change Costs

2.29 On 31 March 2003, the five health authorities were abolished and replaced by 22 Local Health Boards. The total accumulated net deficit of the health authorities in Wales at the date of their abolition was £60.2 million. The Minister for Health and Social Services stated in July 2002 that the transitional costs would be in the range of £12.5 million to £15.5 million. A revised transitional costs budget estimate of £10.9 million to £14.1 million was reported to the Health and Social Services Committee in March 2003. My report noted that, excluding transition funding for the Business Services Centre, the latest available forecast of £12.57 million lay within the approved budget range.

Challenges facing NHS Wales

2.30 **Cost of Agency Nursing Staff:** The cost of using agency nursing staff in Wales continues to rise significantly each year, as shown in **Figure 4**.

4 Costs of employing agency nurses in NHS Wales	
	£ million
2002-2003	18
2001-2002	15
2000-2001	10
1999-2000	8

Source: National Audit Office Wales analysis

The costs in 2002-03 represented approximately 1 per cent of the total NHS pay bill. The Welsh Assembly Government has launched a number of initiatives to reduce this expenditure and will also set targets for trusts to reduce the usage of Agency nurses. In addition, each trust has developed Recruitment and Retention strategies which have been implemented in 2003-04.

2.31 **Welsh Risk Pool:** During 2002-2003, the Welsh Risk Pool strengthened its financial management arrangements. These revised arrangements have helped ensure that the Pool's expenditure of £43 million on the settlement of 246 clinical negligence and personal injury claims have been met from within its budget and without the need for additional premiums to be levied on NHS bodies.

Progress in tackling NHS Fraud

2.32 During the last year the Welsh Assembly Government continued to work with the NHS Counter Fraud Service to develop an effective structure to counter fraud in Wales. In my report I noted the results of this work, including the results of a second measurement exercise on the estimated amount of income lost as a result of Optical Patient and Contractor fraud in Wales. The exercise concluded that the level of optical fraud in Wales had fallen from £1.2 million per year to £0.9 million per year.

2.33 Between October 2002 and December 2003 the Post Payment Verification Unit checked approximately 350,000 scripts and recovered total income of £31,000; another £34,000 was being recovered in penalties and surcharges. The Unit was set up in 2002-03 by the Welsh Assembly Government to investigate claims for exemptions from prescription charges.

2.34 The NHS Counter Fraud Service (Wales) was established by the Counter Fraud and Security Management Service in August 2001. My report noted that since then it had received 37 referrals of alleged fraud, recovered £233,402 and was currently investigating cases involving funds of approximately £550,000.

Adding Value 3

Introduction

- 3.1 In this part of my report, I describe the various audit services provided to my clients arising from the annual financial audit work undertaken on my behalf by the National Audit Office Wales and highlight the key issues arising from this work on the 2002-03 accounts.

Reporting to client management

- 3.2 When performing an audit of a body's annual financial statements, the National Audit Office Wales assesses the adequacy of a body's accounting systems and records to the extent necessary to form an opinion on the accounts. In undertaking this work, the National Audit Office Wales is able to offer constructive **advice to management** where it identifies weaknesses in the design, operation or application of these systems or potential improvements that could be made to the effectiveness or efficiency of the client's operations.

Management Letters

- 3.3 Advice provided during the course of an audit is often given orally. However, the more significant issues are raised formally at the end of the audit in the form of a **management letter** addressed to the client's senior management. Each of the observations raised by the National Audit Office Wales is agreed for factual accuracy by client management, who provide a formal substantive response to each point raised, together with a target date for implementation of each of the recommendations made. This enables me to monitor progress. The National Audit Office Wales recognises the need for controls to operate cost-effectively, and aims to produce practical recommendations that genuinely aid clients in their attempts to conduct their businesses efficiently and effectively without creating unnecessary bureaucracy.

Reporting to the National Assembly for Wales' Accounting Officer

- 3.4 I also, at the request of the Assembly Accounting Officer, undertake **additional assurance reviews** at Assembly Sponsored Public Bodies. The intention of these reviews is to provide both the management of audited bodies and Welsh Assembly Government officials with assurance over and above that obtained from the standard external audit of the accounts themselves. In many cases, this work can also add value by recommending improvements to systems, controls and operating procedures.

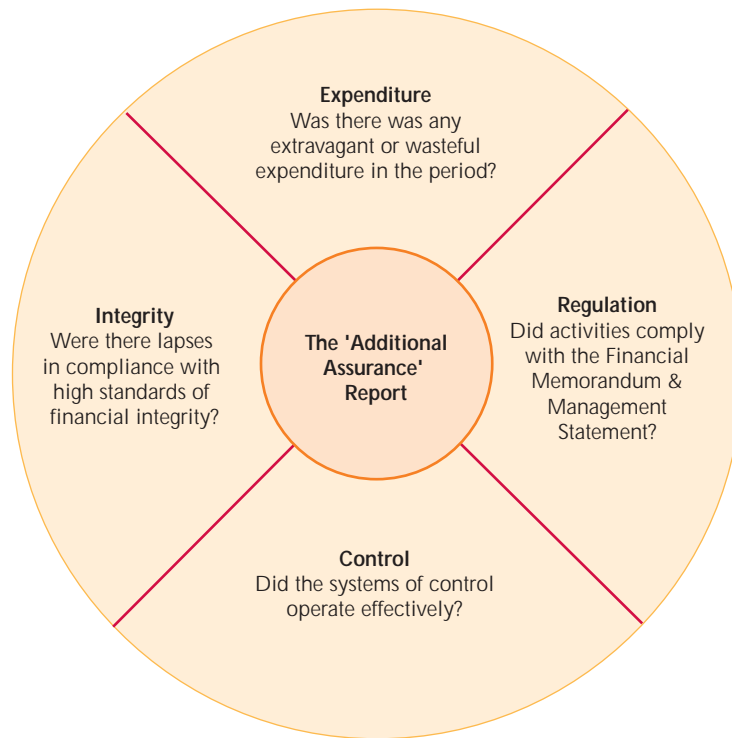
Additional Assurance reviews

- 3.5 Whilst the precise scope of each review is tailored to the operating framework of the audited body, there are certain core elements to each review. **Figure 5** shows some of the checks designed to provide the required assurances to Welsh Assembly Government Officials and the audited body's management.

Findings Arising from 2002-03 Audit Work

Recommendations made from audit work

- 3.6 The overall results of my work in financial audit indicate that, in general, the standards of financial control in audited client bodies throughout Wales remained good during 2002-03. However, the National Audit Office Wales was able to make a number of recommendations in its Management Letters to client management for improvements to the bodies' control environments and accounting processes. I also highlighted instances of non-compliance with Financial Memoranda and Management Statements in several of my 'Additional Assurance' reports to client management and the Welsh Assembly Government.



Source: National Audit Office Wales

- 3.7 The National Audit Office Wales made 160 recommendations in the Management Letters and Additional Assurance reports issued as a result of the work carried out on audited bodies' accounts and operations for the year 2002-03. **Figure 6** provides an analysis, by category, of the recommendations made.
- 3.8 Analysis of Figure 6 shows that, whilst the number of necessary recommendations in most categories has reduced, those addressing 'Regularity and Propriety' have increased from just 4 recommendations made in 2001-02 to a total of 20 made in 2002-03. The majority of these latter recommendations are grant or procurement-related, and I report in more detail on these topics in paragraphs 3.9 - 3.13 and Part 5 of this report.
- 3.9 In the following paragraphs, I report on a theme which emerged from the points raised in my Management Letters from the audit of the 2002-03 accounts: **grants awarded by Assembly sponsored public bodies**.
- 3.10 In my 2001 General Report, I noted the need for all grant-making bodies to have effective systems in place for the appraisal of grant applications; and that the timely monitoring of grants both during and on completion of the project being funded is fundamental to the safeguarding of public funds and the achievement of good value for money. I reported that recommendations relating to the approval and monitoring of grants had been raised with several audit clients and I provided examples of these.
- 3.11 Expenditure on grants represents a major area of activity for many Assembly sponsored public bodies and amounted to some £800 million in 2002-03. (Grants have been defined for this purpose as expenditure that involved: an appraisal of the application; the possibility of conditions attached to the award or offer; some form of monitoring during the project period; and a possibility of claw-back if grant conditions were not met.)

6 Recommendations made to client management 2000-01 to 2002-03



NOTES

- 1 Recommendations to ensure that proper financial procedures are followed and that accounting for transactions is in accordance with accounting standards and directions made by HM Treasury
- 2 Recommendations to ensure that transactions are applied to the purposes intended by the National Assembly for Wales and the financial transactions conform to the authorities which govern them
- 3 Recommendations to ensure that assets held by the body are controlled and safeguarded
- 4 Recommendations to improve the identification and management of risk

NB: analysis excludes recommendations made from the auditor of the Forestry Commission and Forest Enterprise, as the recommendations are not specific to the Welsh operations of these two organisations.

Source: National Audit Office Wales analysis

3.12 This year I raised a total of thirty separate observations relating to grants expenditure in connection with the accounts of ten individual bodies. The observations made related to a number of internal control weaknesses including the understating of grant expenditure commitments, a failure to comply with grant guidelines, and a failure to document funding decisions. Specific examples included:

- Grants paid in excess of maximum.
- Retention fees not deducted from advance payments.
- Payments continuing after a breach of grant conditions, for example without receipt of audit certificate to support expenditure.
- Grant payments made when there was no evidence that the applicant had complied with the grant requirements to provide three years' audited accounts to support the grant application.
- Final instalment of grant paid without receipt of a required monitoring and evaluation form.

3.13 Inevitably with the very large volume of grant payments under many different grant schemes, there will always be some points that will arise out of my audit. However, there remains much that can be done by grant awarding bodies to strengthen controls in this area. I emphasise the need for the Welsh Assembly Government and its sponsored bodies to assess on a continuing basis the systems in place for the monitoring, controlling and documenting of grant expenditure and to take corrective action as necessary.

Lack of action by management in respect of previous years' recommendations

3.14 In my 2003 report, I made an undertaking to review the position on the lack of action by management in respect of recommendations that I had made in previous years. My findings this year are that there remain instances where action agreed by client management in response to points raised in management letters, or observations raised in additional assurance reports, is still outstanding.

3.15 In summary the results of my review were that, at 31 March 2004:

- Thirteen audit bodies had actions outstanding on management letter recommendations that had been raised on their 2001-02 accounts.
- Two of these bodies also had actions still outstanding from management letter recommendations raised from my audit of their 2000-01 accounts.

3.16 My findings shown above indicate that more needs to be done by the senior management of many of the bodies that I audit to ensure that agreed actions in response to audit recommendations are actually taken and taken in a timely manner. I would expect, therefore, both the Welsh Assembly Government and its sponsored bodies to prioritise the outstanding action points during this coming year. This can be assisted through monitoring undertaken by the bodies' Audit Committees of progress being achieved in this area. I will also be instructing the staff of the National Audit Office Wales to continue to review the position as part of the financial audit examinations to be carried out on the 2003-04 accounts.

Submission of Accounts for Audit

3.17 As part of its planning process, the National Audit Office Wales agrees with each of its clients a schedule of key dates for accounts preparation and audit that, jointly, both aim to adhere to. This discipline not only ensures that the accounts are prepared, audited and certified within statutory deadlines but also assists both parties to the audit process in their resource planning.

3.18 Of the thirty two 2002-03 accounts that were audited by my staff, six accounts were not submitted for audit by the agreed date. Of these, one account failed subsequently to achieve the statutory deadline for signature by the Accounting Officer. My staff will again be agreeing key dates for the audits of the 2003-04 accounts as part of the established planning procedures and I look to those bodies which failed to achieve agreed dates in 2002-03 to put in place improved internal control procedures to avoid any recurrence of late submission.

Corporate governance

3.19 In my previous reports, I have reported how my staff have worked with audited bodies to ensure that the requirements of the Treasury Guidelines in respect of Corporate Governance are met. This has included for example, attendance at management workshops and other liaison work.

3.20 'Best practice' guidelines advocate the identification, analysis and formal recording of the potential risks that an organisation may face. To be truly embedded within the organisation, the risk management process should be formalised and form a part of an organisation's routine management processes. The recording of identified risks should lead to the establishment of a risk register which should then be reviewed and updated on a regular basis.

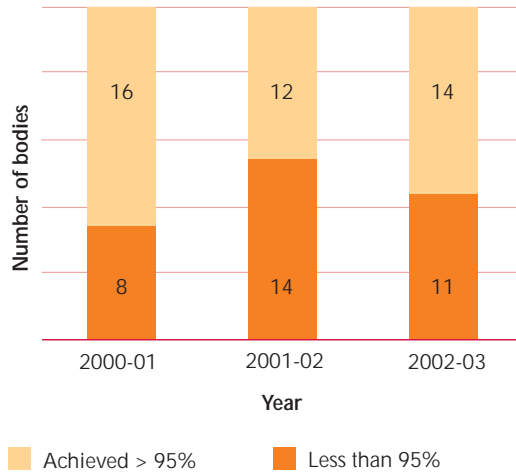
3.21 As part of its routine financial audit procedures the National Audit Office Wales reviews the risk management processes of audited bodies to ensure that the contents of their Statements of Internal Control do not conflict with the auditors' knowledge of each organisation's business. It also ensures that the results of audit testing do not give any indication that the Statement may not accurately reflect the effectiveness of the body's control framework. As part of this work, audit staff examine whether organisations have taken steps to document their identified risks via a risk register.

3.22 Of the bodies that I audited in 2002-03, risk registers have now been set up in all but one (relatively new) body. It is good practice for the responsibility for managing individual risks to be spread throughout an organisation. This not only minimises the risk of over-reliance on one or a small number of client staff but also helps to ensure that the management of risk is truly embedded and is taken seriously in all departments of the body. I was encouraged to find that even in the smallest of bodies that I audit responsibility for managing risks has been dispersed throughout the organisation.

3.23 Once a risk register is established it is vital that it is regularly reviewed by senior management for continued relevance, identification of new risks and as a check on the appropriateness of the ranking of identified risks in terms of possibility of occurrence and potential impact on the organisation. Although there is no specified time frame for review, I consider that there is scope for some bodies who review their risks just twice a year, to undertake a more frequent review. The majority of bodies I audit undertake quarterly or more frequent reviews of their risk registers and this should be encouraged as exemplifying good practice. Typically, each body's own Audit Committee also conducts a periodic review of the internal control procedures for the identification, assessment and management of risk and this too is to be commended.

7 Payment performance for the financial years 2000-01 - 2002-03

Analysis of number of bodies achieving 95% or more payments within 30 days



Source: National Audit Office Wales analysis

Payment performance

3.24 The regulatory framework for a number of the accounts that I audit requires disclosure within the Foreword to the annual accounts of the percentage of all payments that are made within the specified 30-day period. This requirement stems from the Late Payment of Commercial Debts (Interest) Act 1998 which reinforces the terms of the UK Government's Better Payment Practice Code. The Act also enables suppliers to claim statutory interest from the public sector if valid invoices are paid late.

3.25 In my report on the 2001-02 accounts, I reported a decline in the number of clients that had attained a 95% achievement level for payment of invoices within 30 days. Analysis of the 2002-03 accounts shows that there has been a very slight improvement on last year but not to the level achieved in 2000-01. **Figure 7** shows the year-on-year trend of payment performance over the past three years.

- 3.26 A detailed review of the 2001-02 and 2002-03 audited accounts shows that:
- 10 audit clients improved upon their prior year performance;
 - 2 bodies did not show any improvement; and
 - 12 bodies failed to reach the same level of payment performance as they had achieved in 2001-02, although 4 of these did still exceed the 95% performance level.

3.27 The results of the analysis of payment performance show that many bodies have failed to achieve a sustained and significant improvement in this area. I look to the management of the relevant organisations to attend to this as a matter requiring further action, not least because of the impact that such payment delays may have on the cash-flows of small businesses.

Working with other auditors

Internal Audit

3.28 The internal audit function constitutes an important part of the system of control within each organisation. The results of its work inform the Accounting Officer about the effectiveness of the body's internal control framework. The Annual Assurance given by the Internal Audit function to the Accounting Officer also influences the body's Statement of Internal Control required for all Public and Private sector bodies. In carrying out its audits and in helping to inform its risk assessment, the National Audit Office Wales has considered the work of internal audit and sought wherever possible to take assurance from its work. This reliance, facilitated by regular liaison and collaboration, provides audit cost savings to my clients by reducing the overall audit burden.



3.29 An example of where co-operation between internal and external auditors has worked particularly well in the period is in the investigation, at the request of the Assembly's Audit Committee, of the administration and monitoring of the Innovation and Development Programme operated by the National Council for Education and Training for Wales. In an effort to avoid duplication of effort, and to minimise the burden of audit scrutiny on officials of the organisation, my staff worked closely with the body's own Internal Audit function who had already undertaken its own comprehensive review of some projects funded within this particular Programme.

3.30 The National Audit Office Wales' team advised the Internal Audit team on the scope and conduct of the further work it planned to do to cover additional projects within the Innovation and Development Programme. This enabled the National Audit Office Wales team to place reliance on the work undertaken by the Internal Audit team. The National Audit Office Wales' team then carried out further audit scrutiny in areas to which Internal Audit did not have access rights.

Other auditors

3.31 I am required by Section 98(4) of the National Health Service (NHS) Act 1977 to examine, certify and report on the NHS summarised accounts. These accounts are prepared by the National Assembly for Wales from the underlying primary accounts submitted by the five health authorities (from 2003-04 twenty two local health boards), the Dental Practices Board and the 15 NHS trusts. The primary auditors of these accounts are appointed by the Audit Commission. In order to fulfil my responsibilities under the Act, and consistent with the principles of Statement of Auditing Standard 510 (The Relationship between Principal Auditors and Other Auditors), my staff have reviewed the work of the primary auditors, scrutinised their reports and discussed their findings with them.

3.32 I look forward to reporting further collaborative work with Internal Audit and other Auditors as part of my 2005 report.

Other services provided 4

Introduction

4.1 In parts two and three of my Report, I highlight the key issues arising from my examination of the annual accounts of the National Assembly for Wales, its sponsored public bodies and certain other public bodies. As Auditor General for Wales I provide other services to client management and other stakeholders and, in this part of my Report, I set out examples of such advice during 2002-03.

Other advice to client management

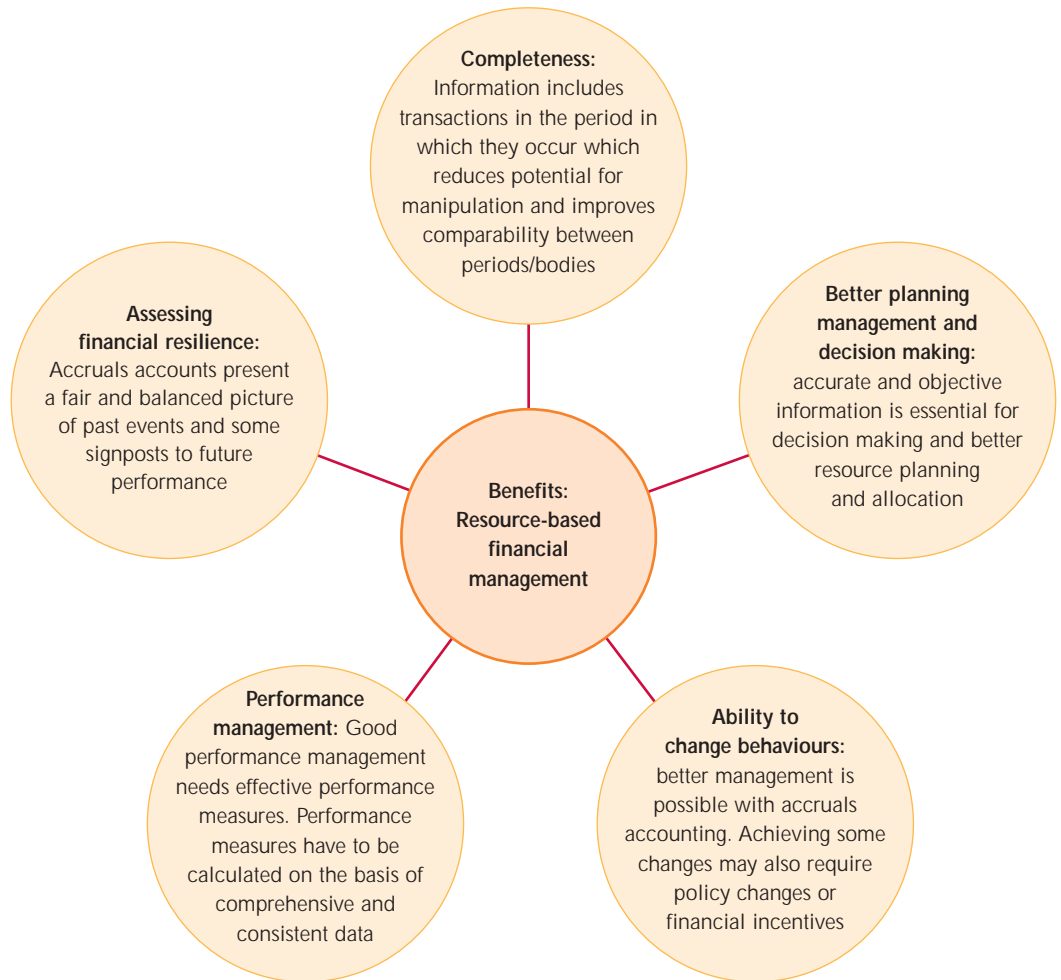
4.2 The advice of the National Audit Office Wales is sought by client management at all stages of the audit cycle. During the 2002-03 financial year, a number of client organisations sought advice on accounting, regulatory and control-environment issues. In addition, I am often asked to undertake work over and above my statutory duties. The following paragraphs provide examples of the advice provided to client management and how I have responded positively to their requests for assistance.

Resource-based financial management

4.3 In last year's General Report, I noted developments with resource-based financial management. The Welsh Assembly Government agreed, in principle, to the introduction of resource-based financial management from 2002-03. The 2001 budget planning round, which set the budget of the Welsh Assembly Government from 2002-03 to 2004-05, was the first in Wales to be undertaken on a resource-basis. I noted that, given the significance of the change, it was important for senior officials to take full account of the new resource-based budgeting principles and to introduce and implement effective resource-based budgeting procedures.

4.4 Resource-based financial management is designed to bring the reporting and budgeting process together on an *accruals* rather than a *cash* basis. This means that the non-cash effect of transactions and other events are now reflected, as far as is possible, in the financial statements for the accounting period in which they occur, and not in the period in which cash is received or paid. Financial statements prepared on an accruals basis therefore provide a more accurate record of resources expended. Further benefits are also derived, by senior managers, when management information is prepared on a resource basis. These benefits are shown at **Figure 8**.

4.5 The results of my 2002-03 audit work showed that public sector bodies in Wales have not fully embraced resource-based financial management. Staff of the National Audit Office Wales have provided advice to client management on resource-based financial management practices and have made recommendations for improvement. In addition, during 2004, as part of its additional assurance reviews at each Assembly sponsored body, the National Audit Office Wales are undertaking a review of the extent to which accruals-based financial information is being used to inform decision making by managers. This work should encourage senior officials of these bodies to review their current processes and consider whether the information currently produced meets the needs of their organisation.



Source: 'The Whole Truth or why Accruals Accounting Means Better Management', the Public Audit Forum

Developments in accounting

4.6 An important aspect of my work is the accounting advice I provide to audited bodies. The public sector is increasingly required to exercise judgement in deciding upon the accounting treatment of income, expenditure, assets and liabilities. This also now includes the accounting treatment of retirement benefits in line with recent changes in disclosure requirements in this area set out in Financial Reporting Standard 17 issued by the Accounting Standards Board. I am responsible for advising on such treatments and for concluding on the appropriateness of the accounting judgements made by the bodies concerned.

System developments

- 4.7 Computer-based systems form an integral part of the financial control and reporting systems used by all clients. Changes in reporting requirements and/or information needs, often result in the need to replace existing finance systems.
- 4.8 Whenever one of my clients implements a new finance system, staff of the National Audit Office Wales conduct a review of the implementation process, ensuring in particular the integrity of the data transferred between the old and new systems. If significant issues of concern are found, then I may elect to place a report on the accounts

of the body (paragraph 2.22 refers to such a report that I issued on the National Council). If issues of lesser importance are found, then the National Audit Office will report these to the client's senior management. In either case, appropriate corrective action can then be taken promptly by the client.

4.9 During 2002-03, staff of the National Audit Office Wales carried out a review of the implementation of a new finance system by one such client. Our review of the new system examined key stages of the project. Effective project management is critical for the delivery of change, the controllable use of resources, the ability to manage business continuity and the achievement of the objectives set. In line with good practice, the client used a process-based approach for the management and implementation of the project. The project was overseen by a Project Board, chaired by an appropriate senior official.

4.10 While we were satisfied that the system had the potential to offer significant benefits in terms of financial management and reporting information, we reported a number of issues. These are relevant, not only to this particular client but also more widely to any new project being initiated by clients and include:

- **Implementation** Phased implementation sometimes leads to dissatisfaction where expected benefits are not achieved early. This can be addressed by raising awareness of the progress being made and of future plans for development;
- **Training:** It is important that a comprehensive training programme is implemented for all relevant stakeholders. This should ensure that the benefits of change are maximised;
- **Assessment of risks:** Project management should include an assessment of the risks to the project. It is important that an action plan is developed to address these risks and that responsibility for actions is assigned to individuals with agreed timescales; and
- **Further changes:** Where further, significant changes are proposed, it is important that regular reviews are undertaken to ensure that the overall control environment keeps pace with these developments. These reviews could be undertaken by internal audit.

Other advice to stakeholders

Correspondence work handled in 2002-03

4.11 My work in respect of correspondence and other enquiries from Assembly members, members of the public, businesses, and officials continues to increase. This increase has been particularly evident in respect of correspondence received from the public, which I believe reflects a heightened awareness of my role as the independent watchdog of public expenditure in Wales.

4.12 During 2002-03, I received 95 letters from Assembly Members, Members of Parliament and the general public, many of which required a full examination by the National Audit Office Wales and a substantive response. This is an increase of 76 per cent on the number I received in the previous twelve months. Issues raised with me during 2002-03 included concerns regarding:

- the regularity and propriety of expenditure by the Assembly or its sponsored public bodies;
- alleged failures to secure good value for money in the disposal of public assets; and
- instances of the poor management or application of public funds resulting in delays or deficiencies in the provision of public services.

4.13 I consider dealing with such correspondence to be an important aspect of my work and it is important for the people of Wales to know that all concerns raised with me are taken seriously, investigated fully and objectively, and responded to promptly.

- 4.14 In 2002-03 concerns raised by correspondents about the disposal by NHS Wales of the Mid Wales Hospital at Talgarth prompted me to instigate a review of the issues raised. I published a report of my findings and provided further information on aspects of the disposal for the National Assembly's Audit Committee in a subsequent memorandum. The Committee took evidence from the Director of NHS Wales, other Welsh Assembly Government officials and the Accountable Officers of the NHS bodies involved in the sale process before issuing its own report in January 2004 recommending changes to the arrangements in place for the future disposal of NHS Wales' property.
- 4.15 I am also a 'prescribed person' under the Public Interest Disclosure Act 1998. This Act provides protection for employees wishing to make disclosures regarding alleged malpractice in the workplace that threatens the public interest. A small proportion of the correspondence addressed to me has been raised by individuals (whistleblowers) wishing to make disclosures under the Act.

Other advice

- 4.16 In November 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) held its third annual conference in Wales. I was delighted to be invited to open the second day of proceedings, the theme for which was 'Progress, partnership and improvement'. In my speech to delegates I provided a detailed insight into the changes to the audit regime in Wales. Staff from the National Audit Office Wales also managed a workshop for conference delegates to explore this theme in greater detail.

Conclusion

- 4.17 I welcome the opportunity to provide professional advice and guidance to the Welsh central government sector and other stakeholders and to respond to correspondence. I will continue to work with client management and other stakeholders with the aim of making a continued contribution to the improvement of the standards of financial management throughout the Welsh central government sector.

Procurement 5

Introduction

5.1 In this chapter I report on:

- the results of my review of the adequacy of procurement procedures at Assembly Sponsored Public Bodies; and
- the work of the Welsh Procurement Initiative Team, set up and funded by the National Assembly for Wales, and how its work plays a key role in improving procurement standards within the Assembly and its Sponsored Bodies.

Review of Procurement Procedures

5.2 In my 2003 General Report, I undertook to review the adequacy of the procurement procedures in place at the Assembly sponsored bodies as part of my work for the coming year.

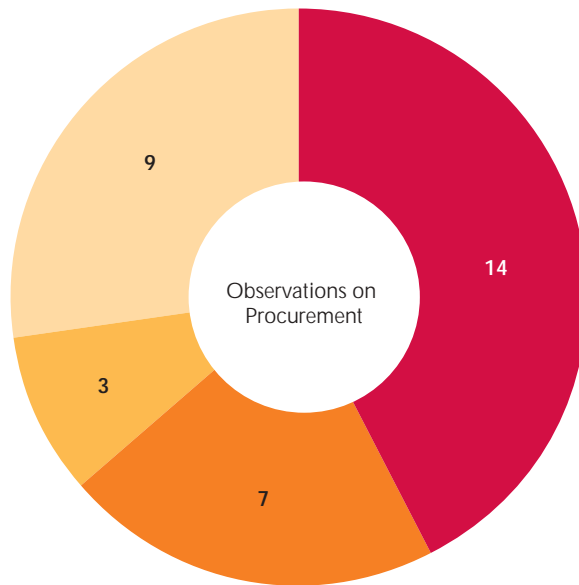
5.3 The audit work undertaken for me by the National Audit Office Wales focused on two related areas:

- Assessing the effectiveness and adequacy of the general control environment for procurement; and
- Testing a small sample of contract tendering exercises to ensure compliance with established guidelines and procedures.

5.4 The work carried out by the National Audit Office Wales included:

- Establishing the inherent nature and extent of risk within the procurement area linked to the body's business, nature of activities and types of goods and service it purchases.
- Assessing the existence and adequacy of written policies and guidance covering the procurement process.
- For the sample testing: ensuring compliance with the established tendering procedures; examining documentation to support the tender evaluation process to ensure that it was sufficient, reliable and adhered to; ensuring that the contract was adequately monitored, and confirming that progress payments were being checked against contractual terms and conditions.

5.5 As a result of my review, I raised a total of 33 observations and recommendations for improvement relating to procurement at audited bodies. The findings are summarised in **Figure 9**, overleaf.



- Inadequacies in guidelines or procedures
- incomplete documentation to support management decisions
- approvals from Welsh Assembly Government not sought, received, or retained
- non-compliance with contract and tendering procedures

Source: National Audit Office Wales analysis

5.6 Overall, I found the standards of controls operated by Assembly sponsored public bodies in Wales over purchasing during the 2002-03 year of account to be of good quality. The results of my financial audit work do indicate, however, that there remains further scope for the operation of procurement controls to be improved within the bodies I audit. In implementing improvements to procedures in this area, those bodies can also obtain advice and guidance on best practice from organisations such as the Welsh Procurement Initiative Team and the Office of Government Commerce. I describe below the extent to which use of such organisations is currently being made by the Assembly and its sponsored public bodies in Wales.

Welsh Procurement Initiative Team

5.7 The Welsh Procurement Initiative Team (the Team) was created by the Welsh Assembly Government in April 2001 to take forward the recommendations of the 'Better Value Wales' review of public sector procurement carried out in February 2001. It aims to work in partnership with the Welsh public sector as a catalyst to improve the value for money organisations obtain from their procurement activities. The National Assembly for Wales has agreed funding for the Team to March 2005 and its success is measured by the amount of savings it can identify in the public sector. For the financial year 2002-03, it identified savings of £7.2 million against a first 12-month target of £6 million.

5.8 The National Audit Office Wales keeps in close contact with the work of the Team. Areas of common interest for review are determined, taking the interests of both parties into consideration, and duplication of effort is hence avoided. By regular liaison with the Team throughout the year, my staff are kept informed of work that it has in hand with audit clients. This knowledge assists the audit teams in their assessment of client risks undertaken as part of the audit planning process. Wherever possible, the audit staff also draw on the Team's findings to reduce the audit burden for the Assembly and its Sponsored Bodies.

5.9 Three areas of work currently in hand by the Team that can be highlighted are as follows:

- **Gateway Reviews** which involve capital expenditure projects of high value, complex or novel in nature being subjected to a Quality-Assurance process. One Assembly sponsored body is scheduled to have such a review during 2003-04.
- **Procurement Strategy Templates** to assist organisations to have in place, an effective procurement strategy. One Assembly sponsored body is piloting this document which itself was devised with input from the National Audit Wales and other informed parties.
- **Procurement Fitness Checks** designed to help organisations recognise their strengths in this area as well as identify areas for improvement. These are in the process of being carried out at three Assembly sponsored bodies. A further phase of these checks will be undertaken during 2004 at other Assembly sponsored public bodies.

Participation by Assembly sponsored public bodies in the Team's initiatives

5.10 The activities of the Team are wide ranging; offering training courses, setting up web-sites advertising contract opportunities, encouraging the use of a Welsh procurement card and setting up a database of information recording expenditure by supplier and product type. From my audit work in 2002-03 I found that:

- at least eight audit clients had participated in the Team's initiatives;
- six of these bodies had attended training courses or seminars; and
- six bodies were also making use of the Team's Best Practice Guidelines.

5.11 I also found that a number of audited bodies had achieved savings from participating in the Team's **collaborative procurement arrangements** whereby organisations act in consortium to maximise the potential to achieve value for money in their purchasing. The Team is negotiating to extend such arrangements currently in place for telecommunications procurement to other commonly purchased goods and services such as car hire, electricity, IT equipment, use of direct mail and the hiring of agency staff.

Office of Government Commerce

5.12 The Office of Government Commerce is responsible for a wide-ranging programme, which focuses on improving the efficiency and effectiveness of central government procurement. A number of audit clients have informed my staff that they currently use the services of the Office of Government Commerce, in particular its arrangements for helping secure efficiency and value for money in the purchase of IT equipment.

Conclusion

5.13 The need for robust, established procurement procedures that are complied with on a consistent basis is vital if the Welsh public sector is to achieve maximum value for money on its spending on procurement. I look to the public bodies I audit to remain vigilant in ensuring that their procurement processes are of sufficient quality to ensure that they comply with laid down procedures.

5.14 On a wider value for money perspective I welcome the work being carried out in Wales by the Welsh Procurement Initiative Team. It, and other advisory bodies such as the Office of Government Commerce, offer Welsh public bodies opportunities to secure procurement expertise, to embrace best practice and to maximise value for money in their purchasing from public funds. My staff will also continue to work closely with the Welsh Procurement Initiative Team in the coming year to monitor future initiatives and exchange knowledge in areas of common interest.

European Structural Funds 6

Introduction

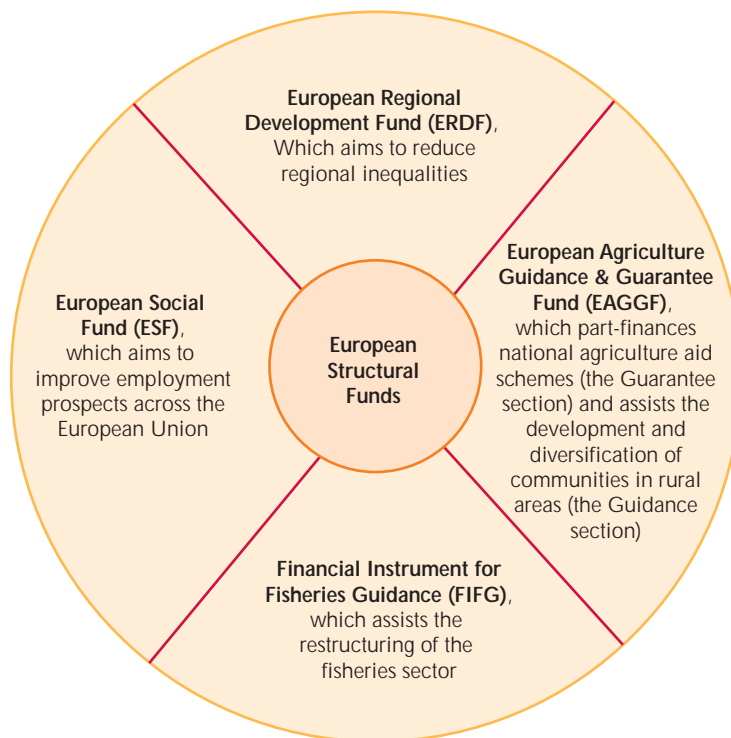
6.1 In my last General Report I explained the European Commission's reporting requirements associated with the closure of the 1994-1999 European Structural Fund programmes. In this part of the report I summarise the findings of the independent examination of this closure process by the Head of Internal Audit of the National Assembly for Wales, and the observations of the National Audit Office Wales arising from its audits of European grant expenditure claims.

The European Structural Funds in Wales

- 6.2 The aim of the European Structural Funds is to reduce social and economic inequalities by providing grant aid funding for projects which have been approved under targeted programmes agreed between the European Commission (the Commission) and Member States.
- 6.3 Funding is distributed under four Structural Funds, shown at **Figure 10**. Organisations¹ with projects that meet the criteria agreed by the Commission for individual programmes may apply for grant aid towards the total costs of their project. The level of grant awarded varies, but is usually around 50 per cent of the total estimated cost.

10

European Structural Funds



Source: EC Guidance

¹ Organisations include public and private companies, public bodies and the voluntary sector.

The remainder, known as match funding, must be raised by the organisation sponsoring the project.

- 6.4 Funding from the Structural Funds is provided for defined periods, known as the 'programming periods'. The current programming period began on 1 January 2000 and will run to 31 December 2006. The previous programme (referred to as the 'old' programming period) covered the period 1 January 1994 to 31 December 1999.
- 6.5 In the current programming period, funding is being made available under objectives described at **Figure 11**. The regions in Wales in which these objectives are operating are shown in **Figure 12**.
- 6.6 In addition to the Objective Programmes, the European Structural Funds provide grant aid for smaller Community Initiatives. For the current programming period, there are four Community Initiatives operating in Wales. These are INTERREG IIIa, EQUAL, URBAN II and LEADER+. The collective term for funding awarded under the Objectives and Community Initiatives is 'European programmes' (or Programmes).

Management of the Programmes

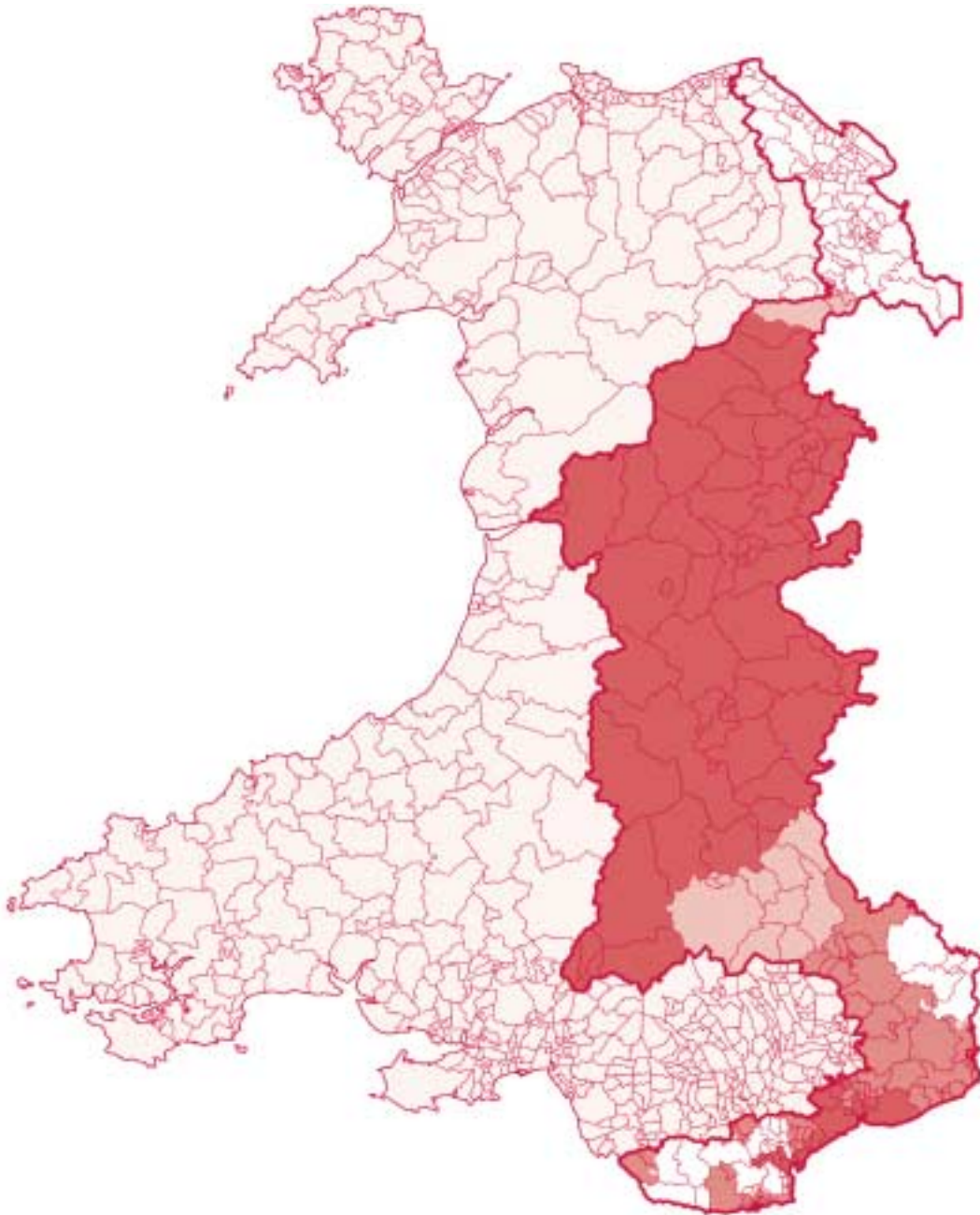
- 6.7 The European Union requires that at least one body within each region in receipt of grants be accountable for key management tasks related to the Programmes:
 - The **Managing Authority** is responsible for the efficiency and correctness of management and implementation; and
 - The **Paying Authority** is responsible for drawing up and submitting certified payment applications and receiving payments from the Commission.
- 6.8 The same organisation may undertake both roles but, to avoid conflicts of interest, there must be an adequate separation of functions within the body concerned. Within Wales, these roles were initially delegated to an executive agency of the Welsh Assembly Government, the Welsh European Funding Office (WEFO). However, on 23 July 2003, WEFO ceased to have status as a separate agency and it continued to exercise its functions and responsibilities as part of the Economic Development and Transport Department of the Welsh Assembly Government.

11 Objective Programmes

Objective	Funds Available	Aim of the Objectives for the 2000-06 Programming Period
1	ERDF ESF EAGGF FIFG	To assist the development and structural adjustment of regions lagging behind those in the rest of the EU, generally those with a per capita GDP less than 75% of the EU average
2	ERDF	To assist the economic and social conversion of areas facing structural difficulties
3	ESF	To assist the adaptation and modernisation of national policies and systems of education, training and employment. Focus is on disadvantaged social groups rather than regions

Source: EC Guidance

12 Mainstream European Structural Fund Programme Areas 2000-2006



- Objective 1 Area
- Objective 3 boundary
- Objective 2 Areas
- Transitional Objective 2 Areas
- Transitional Objective 5b Areas
- Electoral Division boundary

Source: *The National Assembly for Wales*

6.9 In line with European Commission guidance, the Welsh Assembly Government has made partnership a key concept in the operation of the Structural Funds in Wales. Partners include those with a clear interest in the delivery and outcome of the programmes and include businesses, trade unions, voluntary bodies, environmental and equality groups, and public sector bodies. The Welsh Assembly Government is, however, responsible for final decisions on approving funding and for managing the payments, monitoring and reporting of the Programmes.

6.11 Monies from Structural Funds had also been received in Wales for eight programmes supported as part of UK-wide initiatives. These had been administered by other government departments, including the Department for Trade and Industry and the Department for Environment, Food and Rural Affairs.

6.12 **Figure 13** provides statistics of eligible expenditure and the Commission's contribution for the 18 programmes supported in Wales during the old programming period.

Closure of the Old Programmes (1994-1999)

Closure process and timetable

6.10 During the old programming period, Wales received funding directly from the Commission in respect of 10 separate programmes. These were administered by WEFO (and its predecessor body, the Welsh European Programme Executive Limited).

6.13 As part of the process for closing these programmes, WEFO and the Agriculture and Rural Affairs Department of the Welsh Assembly Government were required to make payment of any outstanding balances of grant on approved projects and to prepare closure documentation on the old programmes by a deadline set by the Commission of 31 March 2003. Under Regulation (EC) 1260/99 the Commission was empowered automatically to 'decommit' (that is withdraw) any outstanding balance of grant if closure action had not been completed by this deadline.

13 Statistics for programme closures by programme

1994-99 Programme	Eligible Project Expenditure	EC Funding Contribution to Project	Number of Projects
	£	£	
Projects administered by the Agriculture and Rural Affairs Department of the Welsh Assembly Government These were under the Processing and Marketing Grant scheme and Aquaculture projects (funded by FIFG), the Processing and Marketing Grant scheme (funded by EAGGF), the Farm and Conservation Grant Scheme (funded by EAGGF) and the Hill Livestock Compensatory Allowances (funded by EAGGF).	219,675,838	42,335,017	17,311
Projects administered by the Welsh European Funding Office - WEFO (and formerly, the Welsh European Programme Executive Limited - WEPE) Projects include ISW 1997-99, Interreg II, Rechar II, Resider II, SME and Urban (funded by ERDF), Rural Wales and Rural Wales II (funded by EAGGF and ERDF).	595,018,784	226,159,475	1,737
Projects supported as part of UK-wide initiatives These include projects undertaken in conjunction with the Department for Trade and Industry (Konver II, Retex II and Pesca II) and the Department for Environment, Food and Rural Affairs (Pesca II).	6,528,818	2,732,042	55
Totals	821,223,440	271,226,534	19,103

Source: National Assembly for Wales analysis

6.14 An earlier internal deadline of 31 December 2002 had been set by the Welsh Assembly Government for it to submit closure documentation in respect of the eight programmes administered by other government departments so that they in turn had sufficient time to complete their submissions by the Commission's deadline of 31 March 2003.

6.15 The required closure documentation included a General Statement of Expenditure and a request to the Commission to release the final balance of grant due on each programme. It also included a requirement to prepare closure statements on individual programmes.

Closure statements

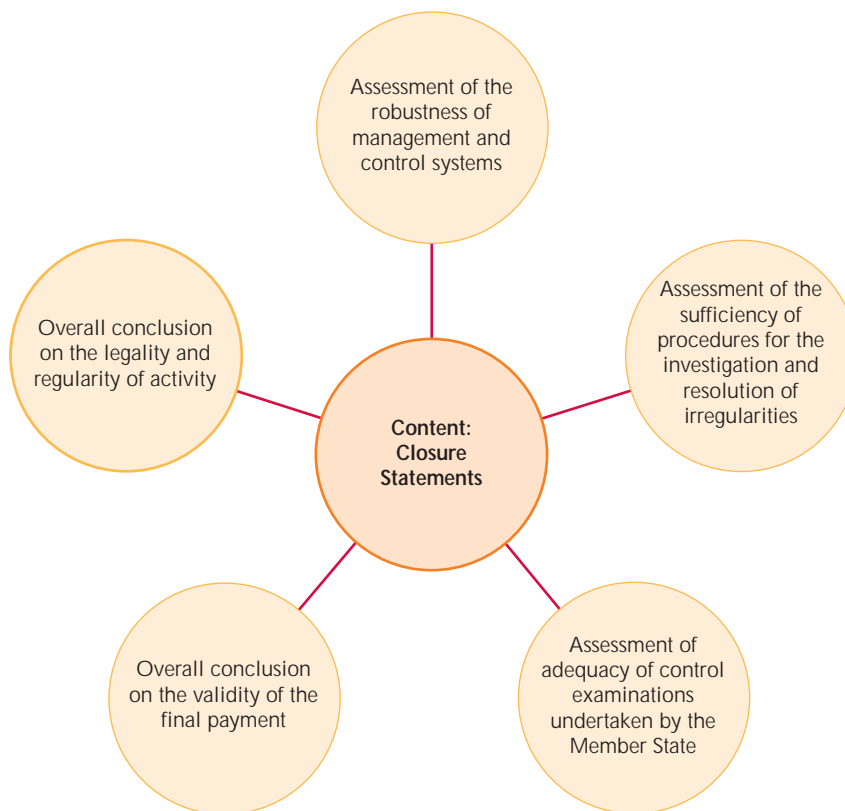
6.16 The closure statements, which Commission regulations stated should be prepared by an independent audit body, were required to

provide an overall conclusion on the **accuracy of the financial data** submitted to the Commission and to give an overall conclusion on the **management of the programmes** by the administering body. The Commission agreed that, in Wales, programme closure statements should be prepared by the Head of Internal Audit of the National Assembly for Wales. A similar arrangement was in place in other UK Government Departments.

6.17 The Welsh Assembly Government's Head of Internal Audit produced statements in respect of all 18 programmes operating in Wales. The closure statements prepared in respect of UK-wide programmes were submitted to the relevant government departments. All other closure statements were submitted direct to the Commission.

6.18 The content of closure statements is shown at **Figure 14**.

14 Content of closure statements



Source: National Audit Office Wales analysis

Results

- 6.19 All closure documentation that had to be lodged directly with the Commission was deposited on the 31 March 2003, and therefore by the Commission's deadline. The Head of Internal Audit submitted statements to the relevant government departments in March 2003, later than the target date of 31 December 2002.
- 6.20 The Welsh Assembly Government's Head of Internal Audit gave qualified audit opinions on 17 of the 18 closure reports. The Head of Internal Audit was not able to give an opinion on one of the closure statements

prepared by the Welsh Assembly Government's Agriculture and Rural Affairs Department. Expenditure on this programme amounted to almost £4 million. A number of explanations were given in support of this decision, including the failure of the Department to produce a final claim in time for audit clearance. For all programmes, the Head of Internal Audit provided a substantive report on his observations and examples of his key findings are shown at **Figure 15**.

- 6.21 In the following paragraphs, I report on a number of themes raised by the Head of Internal Audit in his substantive reports.

15

Examples of key findings reported by the Welsh Assembly Government's Head of Internal Audit



- Administration of Control visits
- Concerns raised in control visit reports
- Compliance with European Regulations
- Preparation of Statements

Lack of documentation

6.22 The Head of Internal Audit reported that there was a general lack of documentation in support of expenditure incurred on the programmes. For example, the primary accounting ledgers used to record transactions for periods prior to 1 April 1996 were not available to the auditors as they had been destroyed, in line with the Welsh Assembly Government's record retention policy.

Timeliness and quality of control visits

6.23 Commission Regulation (EC) No 2064/97, issued in autumn 1997, requires that Member States conduct a sample of control visits to grant recipients to confirm that Commission funding has been spent correctly. It states that control visits should be spread over a programming period, adequately cover the range of activity and account for at least 5 per cent of the total eligible expenditure.

6.24 Whilst the Head of Internal Audit concluded that the requirement that the sample of control visits cover all programmes had been met, he reported a number of concerns in respect of WEFO's administration of this process:

- **Delays in undertaking visits:** no visits were carried out under the Welsh Office and only commenced following the creation of WEFO. The first visits had been undertaken in the autumn of 2000, some three years after the Regulation had been issued;
- **Risk:** in his summary audit report for the closure of the Programmes, the Head of Internal Audit noted that "the sampling methodology was simplistic and failed to undertake a systematic analysis of risk". He confirmed that this was despite the observation of the Commission's auditors - when they completed their review of Wales's compliance with Regulation 2064/97 some two years previously - that "project selection should take more account of risk in the light of the experiences of earlier work";
- **Timeliness:** the Head of Internal Audit also reported findings on the timeliness of the post control visit reports and on their content. For 25 of the 56 control visits undertaken for eight programmes for which WEFO was responsible, it took an average of over 300 days to produce the associated report; and
- **Lack of follow-up:** In the narrative reports accompanying the closure statements of four of the programmes, the Head of Internal Audit noted that the control team had not conducted follow-up work where significant concerns had been identified during monitoring visits.

Commission's response to the closure documentation

6.25 The Head of Internal Audit has reported to Welsh Assembly Government officials the Commission's intention to conduct its own review to examine the quality of the closure audits. That audit commenced in April 2004 and the results are expected by September. He has also reported that it is likely that the Commission will request that further work is undertaken in respect of the qualified audit opinions before the programmes are closed and payments of final instalments are made. In his summary audit report for the closure of the Programmes, the Head of Internal Audit concludes it will probably result in the need for further verification work and "could also result in financial loss" for the National Assembly for Wales. The value of the potential financial loss has not yet been quantified. I shall review closely the developments in this area and I shall report, if necessary, in my next General Report.

Audit of claims issued in respect of the new European Programmes

Requirement for audit examinations

6.26 Organisations in receipt of European funding are required to submit audit certificates² to the Welsh Assembly Government (formerly, WEFO) in support of their annual claims for grant. At the end of each project, a final audit certificate must also be submitted to the Welsh Assembly Government before the last instalment of grant is paid.

² Grants awarded from the European Social Fund (ESF) for less than £20,000 are exempted from this requirement.

6.27 Grant recipients are required to appoint an independent accountant as auditor of their annual and final claims. Welsh Assembly Government guidelines define the qualifications required of such a person. I have been contracted to audit the claims of seven bodies for which I am also the external auditor. In auditing annual and final project claims for European grants, staff of the National Audit Office Wales have regard to audit instructions issued by the Welsh Assembly Government, as well as to auditing standards issued by the Auditing Practices Board.

Results of audit examinations

6.28 In the nine months to 31 December 2003, the National Audit Office Wales issued a total of 31 audit certificates. This represents an increase from the 23 certificates issued during the year to 31 March 2003.

6.29 All but one of these certificates were qualified, with an average of five separate audit observations made on each. At **Figure 16**, I provide examples of the reasons for audit qualification.

Documentation provided in support of the claim

6.30 Commission regulations set out the documentation requirements for recipients of European Funding. These include the requirement for recipients to keep evidence for all financial elements of the project, and WEFO has issued guidance to applicants to explain this requirement. In my last General Report, I stated that over half of the observations made in the reports accompanying audited claims for the year to 31 March 2003 related to insufficient documentation being held in support of claims. For the audit certificates issued in the nine months to 31 December 2003, the auditors noted an improvement in this area such that the proportion of observations relating to insufficient documentation had reduced to around one-fifth of the total made.

Compliance with European Regulations

6.31 European Structural Funds and match funding can support all costs relating to project activity as long as the costs are eligible. One of the general principles is that all costs must be actual costs, with no estimates, notional charges or budgeted costs. Almost 20 per cent of the reported findings related to grant recipients apportioning costs, such as staff costs, rent and overheads, to projects on a notional, rather than an actual, basis.

Limitation of my audit opinion

6.32 Under the Structural Funds Regulations, grant support can only be provided to obtain added value, that is, funding must lead to additional, measurable and positive outcomes that would have not been made without support from the Structural Funds. With the agreement of the National Assembly for Wales, the audit examinations undertaken by the National Audit Office Wales do not include an assessment of whether the projects have met the criteria for added value.

6.33 The reports accompanying six audit certificates reported that the audit examination did not include a verification of outputs. This is in accordance with the grant instructions issued which state that the audit of outputs is not required in relation to grants awarded under ERDF and EAGGF.

Impact

6.34 The Welsh Assembly Government has informed the National Audit Office Wales that, as a result of the audit work undertaken, funding amounting to £230,413 has been withheld from grant recipients.

Conclusions

6.35 The year to 31 December 2003 has presented challenges for those involved with the operation and audit of European projects and it is important that lessons are learned:

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Examples of the reasons for qualification of audit certificates for European funded projects



■ Documentation provided in support of the claim ■ Compliance with European Regulations

Source: National Audit Office Wales

■ The Welsh Assembly Government should address the weaknesses identified by its Head of Internal Audit in his closure statements for the old programmes and arising from my audit examination of grant claims under the new programmes. For example, issues relating to the quality of documentation in support of expenditure within the old programmes remains a problem also within the new programmes; and

■ The Welsh Assembly Government should also put procedures in place to ensure that any recommendations made by the Commission and its auditors are actioned on a timely basis.

6.36 Staff of the National Audit Office Wales will continue to work closely with project sponsors and the Welsh Assembly Government, to provide support and guidance to the bodies for which I am the appointed auditor.

7 Looking Forward

Introduction

- 7.1 In this part of my report, I look beyond the 2002-03 financial year and consider potential changes to the scope of my work in 2003-04 and beyond.

New clients: 2003-04 and beyond

Public Services Ombudsman

- 7.2 The 'Public Services Ombudsman' is a non-statutory title for the holder of the separate offices of the Commissioner for Local Administration in Wales, Health Service Commissioner for Wales and Welsh Administration Ombudsman. The aim of unifying all three posts is to provide a clear and direct route for members of the public who wish to complain about a public service provider but are unsure about to which Ombudsman to make a complaint. Establishing a unified service in Wales will require primary legislation and this is currently being pursued by the Secretary of State for Wales.

Health Commission Wales

- 7.3 Health Commission Wales (Specialist Services) - an executive agency of the Welsh Assembly Government - was established on 1 April 2003. It provides the specialist health commissioning function for tertiary and other highly specialised acute services throughout Wales. Under the Government of Wales Act 1998, I am the external auditor of the agency, which is to produce its first accounts for year ending 31 March 2004.

NHS Wales

- 7.4 In my last General Report, I noted the changes to the scope of my work as a result of the restructuring of the National Health Service (NHS) in Wales. On 31 March 2003, the five health authorities were abolished and replaced by 22 Local Health Boards. The accounts for the year ending 31 March 2004 will, therefore, be the first to be produced by the Boards. These will be audited by appointees of the Audit Commission and I will be responsible for auditing the summarised account to be prepared by the Welsh Assembly Government.
- 7.5 The Health (Wales) Act 2003 created two Assembly sponsored public bodies for which I am the external auditor: the Wales Centre for Health; and Health Professions Wales. Health Professions Wales undertakes quality assurance of pre-registration nurse, midwife and health visitor training and quality assurance work. The Act enabled the Assembly to establish Health Professions Wales as an Assembly sponsored public body on 1 April 2004. However, since 1 April 2002, its functions had been delivered by a unit of the Welsh Assembly Government and so I audited its first financial statements during 2003.
- 7.6 The Wales Centre for Health is an independent training, advisory and research body, bringing together information and evidence and providing advice on which policy-makers can base decisions, co-ordinate professional surveillance of health trends and undertake risk assessments of threats to health and well-being. On 1 June 2002, the Welsh Assembly Government established the Centre as a discrete business division of the Velindre NHS Trust. However, the Welsh Assembly Government intends to establish the Centre as an Assembly sponsored public body with effect from 1 April 2005.

Whole of Government of Wales Accounts

7.7 In my last General Report, I noted that the Treasury had introduced its 'Whole of Government Accounts' project and provided a summary of the Assembly's achievement to date against Treasury targets. The ultimate aim of the project is to produce a set of commercial style consolidated accounts for the whole of the public sector in the United Kingdom.

7.8 The Treasury is introducing Whole of Government Accounts in two phases:

- (i) Preparation of a 'Central Government Account' (CGA), including the financial results of government departments, central funds, the devolved administrations, and non-departmental public bodies (in Wales, Assembly sponsored public bodies).
- (ii) Preparation of a 'Whole of Government Account' (WGA), including additionally the financial results of trading funds, public corporations, local authorities and NHS Trusts.

Figure 17 sets out the current timetable for the project.

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Timetable for preparation of central Government and Whole of Government Accounts

	Financial Year	Status
Central Government Accounts	2002-03	Dry Run
	2003-04	Published
Whole of Government Account	2004-05	Dry Run
	2005-06	Dry Run
	2006-07	Published

Source: HM Treasury

7.9 In Wales, the National Assembly for Wales is also preparing a Whole of Government of Wales Account within a development timescale running parallel to that for Central Government Accounts and Whole of Government Accounts. The Welsh Assembly Government expects to prepare a published Whole of Government of Wales Account for 2003-04; the number of public bodies included within the Account will then increase in line with the Treasury's timetable for Whole of Government Accounts.

7.10 The Finance Department of the Welsh Assembly Government is co-ordinating the CGA and WGA accounts preparation process in Wales. This includes preparation of a sub-consolidation of the Assembly's own financial results together with those of the other involved bodies in Wales, such as Assembly sponsored public bodies, for onward transmission to the Treasury.

7.11 For the 2002-03 dry run Central Governments Account preparation exercise the Welsh Assembly Government's Finance Department was required to submit its sub-consolidation return to the Treasury by a deadline of 19 December 2003 and for this information to have been audited by the National Audit Office Wales by the end of January 2004. The Welsh Assembly Government actually submitted its information on 18 March 2004. The delay in submission for audit of the dry run accounts was caused by slippage in the preparation of the Assembly's own consolidated resource account due mainly to difficulties in validating WEFO creditor information. The result of the delay was that the Assembly was the last UK body to submit its 2002-03 dry run Central Government Accounts return to the Treasury. In the parallel exercise in 2001-02 the Assembly had been the sixth earliest body to complete the task.

7.12 It is likely that the timetable for preparation of the first published Central Government Account in 2003-04 will be more compressed than for the previous dry run accounts. In parallel with this, the Treasury has introduced a "faster closing" initiative which, from 2005-06, will require government departments to lay their resource accounts before Parliament by the time of its summer recess. Whilst in Wales the timetable for preparation of the Assembly's own accounts is laid down by the Government of Wales Act, this does not preclude an earlier preparation of these accounts.

7.13 The planned introduction of Whole of Government Accounts (including Whole of Government of Wales Accounts) together with the faster closing initiative will place increasing pressure on the Assembly and other public bodies in Wales to prepare their accounts to more rigorous timetables than in the past. I welcome the work being carried out by the Welsh Assembly Government to provide guidance and help across the Welsh public sector in this process whilst recognising that significant improvements are still required in the accounts preparation process in general.

A Single Audit Body for Wales

7.14 In my last General Report, I noted legislative developments to establish a single audit body for Wales from 2005. The body, to be headed by the Auditor General Wales, would incorporate the work currently undertaken in Wales by the Audit Commission and, on my behalf, the National Audit Office Wales.

7.15 At the date of publication of this report, the Public Audit (Wales) Bill had passed through the House of Lords and was now under consideration by the House of Commons. I will provide further details on developments in my Annual Report for 2003-04.

Adding value

7.16 The National Audit Office Wales continues to provide advice to client organisations, informally and formally, on a range of finance related matters. The National Audit Office Wales remains committed to ensuring that the Assembly and its sponsored bodies maintain a high level of regularity and propriety in their day to day activities and in serving the people of Wales.

Appendix A

List of Value for Money reports published in 2002-03

- Continuing the regeneration of Cardiff Bay
- European Union Structural Funds: maximising the benefits for Wales
- The renewal and disposal of property held by the National Health Service in Wales
- The disposal of the Mid Wales Hospital
- Osiris: the PFI contract for information technology in the National Assembly for Wales
- The National Assembly's new building: update report
- Management of the Further Education estate in Wales
- The procurement of primary care medicines

B Appendix

Accounts covered by this report

This Report covers all of the 2002-03 accounts prepared by the National Assembly for Wales and the other public bodies that I audit. A complete listing is given below:

Accounts prepared by the National Assembly for Wales

- Assembly Core Resource account
- Assembly Consolidated Resource account
- Cadw: Welsh Historic Monuments
- Welsh non-Domestic Rating
- Summarised Health Authorities' account (closing account)
- Summarised NHS Trusts' account
- Summarised Funds Held on Trust account
- Welsh European Funding Office
- Assembly Members' Pension Fund Account
- Health Professions Wales

Accounts prepared by other bodies categorised by subject area

Agriculture and Rural Development

- Countryside Council for Wales
- Forestry Commission Wales
- Forest Enterprise Wales

Economic Development

- Wales Tourist Board
- Welsh Development Agency

Health and Social Services

- Care Council for Wales
- Health Service Commissioner for Wales

Local Government and Environment

- Local Government Boundary Commission for Wales

Education and Lifelong Learning, Sport, Culture and Heritage

- Arts Council of Wales
- National Council for Education and Training for Wales
- Higher Education Funding Council for Wales
- National Library of Wales
- National Library for Wales - Staff Superannuation Scheme Account
- National Museum and Galleries of Wales
- Qualifications, Curriculum and Assessment Authority for Wales
- Sports Council for Wales
- Sports Council for Wales Trust Account
- Welsh Language Board
- Estyn
- General Teaching Council for Wales

Other

- Welsh Administration Ombudsman
- Children's Commissioner for Wales

Welsh accounts audited by the Comptroller and Auditor General and laid before the National Assembly for Wales

The Comptroller and Auditor General was responsible for the audit of the following Welsh accounts for 2002-03:

The Secretary of State for Wales (Wales Office) resource account

This account is prepared by the National Assembly for Wales on behalf of the Wales Office, but as this is a Whitehall department it is subject to audit by the Comptroller and Auditor General (NB: from 2003-04 the accounts of the Wales Office will be incorporated into those of the Department for Constitutional Affairs, a new government department formed in July 2003);

Sports Council and Arts Council Lottery Distribution Accounts

The Sports Council for Wales and the Arts Council of Wales are Lottery distributors. Each prepares a separate annual statement of account for the discharge of their Lottery functions. These activities are not devolved responsibilities and are instead performed under delegated authority from the Department of Culture, Media and Sport;

The European Agriculture Guidance and Guarantee Fund

This European fund pays subsidies to Welsh farmers, which are routed through the National Assembly for Wales and the Countryside Council for Wales. This is not a devolved function, and an annual account is prepared by each body in the form prescribed by the European Commission.