WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

AGW Report on the 2006-07 Consolidated Resource Accounts of the National Assembly for Wales

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Note for readers:

The Auditor General for Wales has issued this report to accompany his unqualified audit opinion on the 2006-07 Consolidated Resource Accounts of the National Assembly for Wales.

The report text included within this document is extracted from pages 96 to 116 of the full 2006-07 Accounts document, which was laid before the National Assembly for Wales on 26 October 2007. That complete document can be obtained via the following web-link:

http://www.assemblywales.org/bus-home/bus-guide-docs-pub/bus-business-documents/bus-business-documents-doc-laid.htm?act=dis&id=63001&ds=10/2007

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Report of the Auditor General for Wales on the 2006-07 Consolidated Resource Accounts

In this report, and without qualifying my audit opinion, I set out a range of matters relating to the merger into the Welsh Assembly Government on 1 April 2006 of four Assembly Sponsored Public Bodies, and comment on other important financial management developments within the Welsh Assembly Government.

My report is set out in four parts, addressing:

1. **the project management of the merger process;**
2. **continuity of business during and after the merger itself;**
3. **the impact of the merger on the production and publication of the 2006-07 accounts; and**
4. **the Welsh Assembly Government's plans to transform its financial management and reporting arrangements.**

1. Assembly Government officials put in place robust project management arrangements in response to the First Minister's announcements, with the full involvement of the Assembly sponsored bodies earmarked for merger

The Assembly Government ensured that prior to the merger the National Assembly for Wales had considered and passed all of the legislation necessary to enact the changes announced by the First Minister

1.1. Following the First Minister's announcements in July and November 2004 that four Assembly Sponsored Public Bodies[1] (ASPBs) were to be merged into the Welsh Assembly Government, robust project management arrangements were established to oversee the merger process.

1.2. This was a particularly complex and large-scale reorganisation, involving the transfer of some 1,600 staff from the former ASPBs to the Assembly Government's own employment, together with the wide range of statutory responsibilities, powers and functions previously undertaken by those bodies. A range of project tasks such as the harmonisation of terms and conditions for all staff and the design and implementation of consistent internal control frameworks had to be implemented across the enlarged Assembly Government organisation. In addition, the assimilation of the widely differing business cultures that existed amongst the merging bodies also posed a significant set of challenges for staff and management alike.

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[1] From 1 April 2007, such bodies were renamed Assembly Government Sponsored Bodies (AGSBs)

1.3. In order for the mergers to take place on 1 April 2006, extensive amendments to existing primary legislation were required, together with the approval of four Statutory Instruments in November 2005. Other enabling mechanisms included:

- National Assembly for Wales approval of the relevant Motions delegating transfer powers to the First Minister;
- delegations from the First Minister to Welsh Ministers;
- delegations from the Welsh Ministers to Assembly Government officials; and
- amendment of the Permanent Secretary's own delegation arrangements (made under section 62(3) of the Government of Wales Act 1998) to reflect the intended post-merger management structures for the new Department for Education, Lifelong Learning and Skills[2] (DELLS), and the new Department for Enterprise, Innovation and Networks[3] (DEIN).

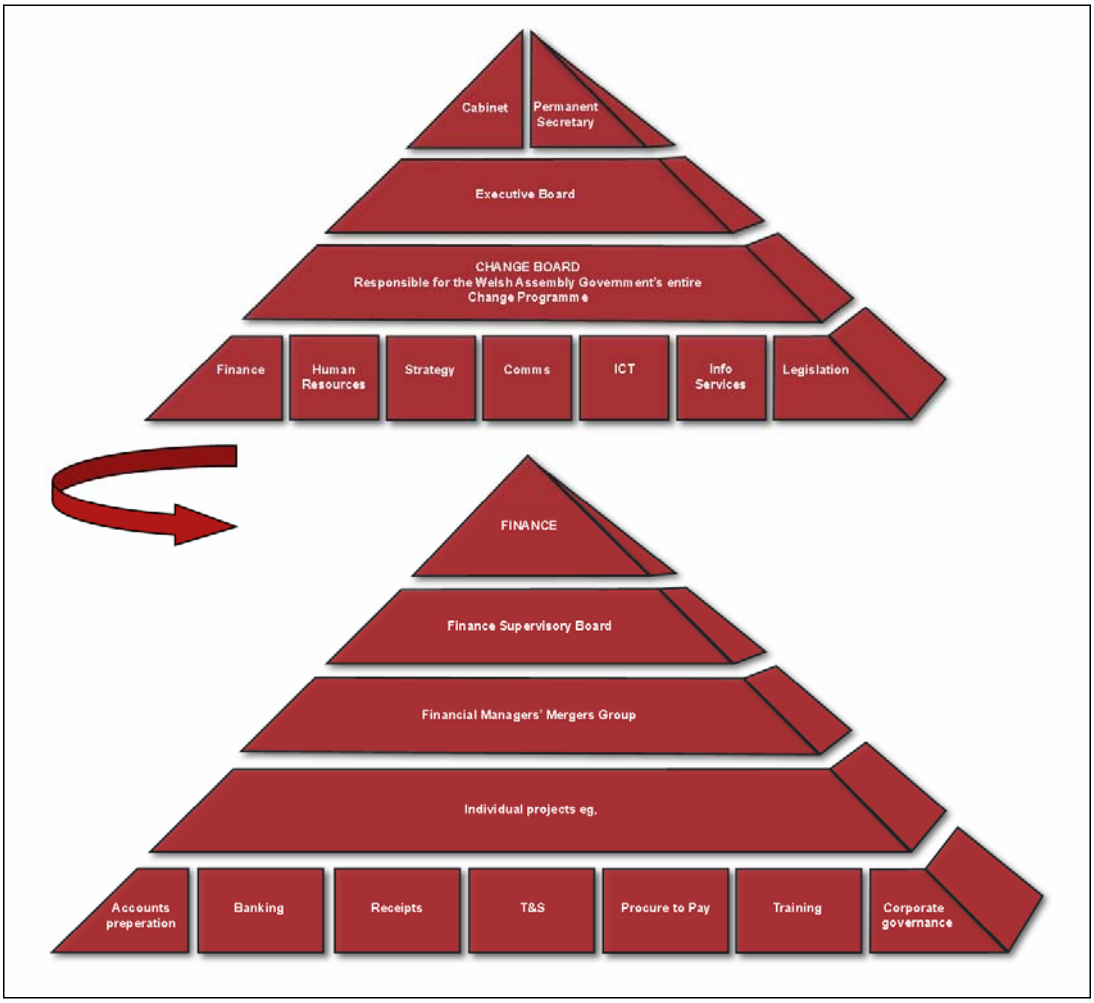
Assembly Government officials put in place a sound project management structure, which played a crucial role in both overseeing and delivering the merger

1.4. The timing of the ASPB mergers meant that Assembly Government officials were able to designate the management of the merger process itself as a core project within their wider internal 'Change Programme', which they had already created in response to *Making the Connections*[4]. The existence of that Change Programme meant that Assembly Government officials considered themselves well placed to take on the challenge of the mergers.

1.5. The **Change Programme Board** (the Board), a sub-committee of the Assembly Government's Executive Board chaired by the Permanent Secretary, was designated as the programme board for the merger process. The Board met monthly from March 2005 and determined that the merger programme would be managed in accordance with the principles outlined by the Office of Government Commerce in '*Managing Successful Programmes: OGC's Best Practice Guide'*, with individual projects adopting the PRINCE 2 methodology. The Board set out in its Programme Definition Document the management structure for the project, the accountability arrangements, the responsibilities of individual project teams and how the various inter-dependencies would be managed. Assembly Government officials told me that the complexity of the project management arrangements reflected the nature and scale of the merger process, and drew on lessons learned from previous change programmes elsewhere in the public sector. The Assembly Government's project management structure for the ASPB merger process is set out in Exhibit 1.

[2] Since renamed as the Department for Children, Education, Lifelong Learning and Skills (DCELLS)
[3] Since renamed as the Department for the Economy and Transport (DE&T)
[4] *Making the Connections – Delivering better public services in Wales* - National Assembly for Wales, Oct 2004

Exhibit 1 shows the Project Management Structure that supported the ASPB merger process



In addition to the sound structure, the leadership and involvement of the sponsored bodies' senior managers and other officers played an equally important role in the delivery of the merger

1.6. Shortly after the First Minister's announcement in July 2004, the Chief Executives of the merging ASPBs, the Assembly Government's Corporate Directors and the trade unions came together to establish the **Merger Working Group.** The Group initially conducted a scoping study to investigate costs and benefits, identify risks, consider the operational structures, and to determine the various strands of project work needed in preparation for the merger. As the overall project progressed, the role of the Group evolved to complement the formal project management structures that Assembly Government officials had put in place.

1.7. To oversee the financial management aspects of the merger project, a **Finance Supervisory Board** was created, comprising the Finance Directors of the merging organisations, chaired by the Assembly Government's Principal Finance Officer. The Board met monthly to supervise progress on several individual finance projects, each of which was the responsibility of a discrete project team. These projects included banking, receipts, procure to pay and financial accounts.

1.8. Staff from all of the merging bodies joined each project team, in order that their differing working practices and operational needs could be identified and addressed. Each project manager (all were existing Assembly Government officials) met together fortnightly and reported to the **Financial Managers' Mergers Group**, which dovetailed with the monthly Finance Supervisory Board meetings. This scheduling enabled effective two-way communication between the project managers and the Supervisory Board.

1.9. Similar working arrangements were also in place across the merger project, and created a robust communication network throughout the project management structure. Such a network ensured that the Change Board was able to advise the Executive Board in a complete and timely manner on progress throughout the various stages of the merger project.

In the months leading to the merger, the sponsored bodies put in place robust governance processes that ensured a well-managed handover of responsibilities to the Assembly Government

1.10. The former ASPBs put in place sound governance arrangements that ensured a smooth transition to the enlarged Assembly Government Departments. In doing so, their Audit Committees played an important compliance and due diligence role as part of the handover.

1.11. Good practice was exhibited in particular by the Audit Committee of the former Welsh Development Agency, which prepared a formal 'handover' statement for consideration by the Corporate Governance Committee of the DEIN. That statement described the role, composition, Terms of Reference and function of the Audit Committee. It also contained specific details on various key matters that had been considered during the 2005-06 financial year. The statement concluded by confirming the Committee's satisfaction with the adequacy and effectiveness of the governance, internal control and risk management systems that had operated within the Welsh Development Agency during the 2005-06 financial year.

1.12. Each of the Audit Committees of the merging ASPBs prepared a summary of key governance issues as at the merger date. These summaries were considered in detail by the relevant Assembly Government departmental Corporate Governance Committee at its first meeting following the merger, ensuring strong continuity of governance oversight and scrutiny.

Both pre and post-merger, the Assembly Government strengthened its departmental governance arrangements, helped in part by adopting where appropriate the good practice of the former sponsored bodies

1.13. The Corporate Governance Work-stream [see Exhibit 1] advised on the construction of appropriate governance structures for the enlarged Assembly Government. These were designed to provide sufficient assurance to the Permanent Secretary (as Principal Accounting Officer), whilst not hampering the effective and efficient conduct of work within the enlarged departments of DELLS and DEIN, each of which was headed by a newly-appointed sub-Accounting Officer.

1.14. The work-stream concluded at an early stage that modification, rather than radical change to existing Assembly Government governance structures would be required. This was because prior to the announcement of the mergers, the Assembly Government's corporate governance arrangements were already evolving to meet the needs of the new departmental sub-Accounting Officers which had been created in April 2005. These arrangements included the establishment of departmental Corporate Governance Committees, which were well placed to take on the roles previously performed by the Audit Committee of each merging ASPB. They also included the issue of a comprehensive Assembly Government Corporate Governance handbook and the post-merger delivery of detailed governance training to appropriate Assembly Government officials.

1.15. Each of the merging ASPBs had previously operated in accordance with the Treasury's best-practice guidance on the operation of Audit Committees in the public sector. Each had appointed an independent non-executive member to the position of Chair of the Audit Committee, and adopted a robust approach to constructive challenge of the senior management team.

1.16. The Assembly Government has largely replicated these arrangements in its post-merger governance structures and processes. Each department's Corporate Governance Committee, which broadly equates to the Audit Committee within an ASPB, is chaired by an independent person. The respective chairs of the Corporate Governance Committees for DELLS and DEIN have been drawn from the membership of the relevant Ministerial Advisory Panels.

1.17. Both the Permanent Secretary's own corporate governance committee and the committees for two of the five Assembly Government departments that had not been directly affected by the merger also operate with an independent external chair. The other three Assembly Government departments have each appointed a senior official from another department to undertake this important role.

2. Assembly Government officials rightly prioritised the need for the continuity of all essential financial services and reporting

Although the merger process placed significant additional demands on the Assembly Government and its sponsored bodies, they planned and delivered the merger while also successfully maintaining their day-to-day operations

2.1. I am pleased to report that, during the period immediately before and after the date of the merger, I have observed no evidence that either the Assembly Government itself or the merging ASPBs experienced any widespread reduction in the level of service provided to their external customers and other stakeholders in respect of financial matters.

Assembly Government officials put in place satisfactory arrangements for the post-merger preparation of the 2005-06 accounts of the former ASPBs

2.2. At the merger date, responsibility for the preparation and submission for audit of the closing 2005-06 accounts of the merged ASPBs passed from the Accounting Officers of those bodies to the sub-Accounting Officers of the relevant Assembly Government departments. Whilst the accounts preparation and audit processes were more inherently complicated than in previous years, the Assembly Government was able to produce the various sets of draft financial statements for audit on a timely basis and to satisfactory standards.

2.3. In each case, the sub-Accounting Officer responsible for the final accounts of the merged ASPB was able to sign those accounts broadly in line with the planned dates agreed with my audit staff. In signing the Statement on Internal Control within each set of accounts, the sub-Accounting Officer was able to derive appropriate assurances over the satisfactory operation of systems of control within the ASPB for the 2005-06 financial year from the reports provided to him by his Corporate Governance Committee. The conclusions in those reports were themselves informed by the issues raised within the formal written statements of the Audit Committees of the former ASPBs.

2.4. Staff of the Wales Audit Office completed their audits of the 2005-06 accounts of the merged ASPBs with satisfactory results, and I was therefore able to issue unqualified audit opinions on each of those accounts well within the statutory deadlines for their publication.

The Assembly Government terminated on a timely basis most of the financial arrangements that it did not need to retain post-merger, although officials did not fully explore opportunities to negotiate cost reductions for all ongoing contracts

2.5. Wherever possible (for example, in the provision of anti-virus software), the Assembly Government terminated all Information Communications Technology (ICT) contracts held by the merged ASPBs prior to the merger, replacing them with services procured under its own 'Merlin' ICT outsourcing arrangement.

2.6. My staff also found in some cases that officials had negotiated lower maintenance charges for the various ICT services that needed to be accessed by staff of the former ASPBs beyond the merger date. These reductions in costs were generally secured by paying for fewer user licences for those systems, as they were expected to be operated only for information archiving purposes.

2.7. Where other transferred ICT service contracts could not be replaced by the Merlin arrangements, my staff found that there had been few changes to the contract terms. Indeed, Assembly Government officials did not explore opportunities to negotiate such cost reductions, as departmental budget allocations equal to the cost of the existing contracts had already been made. Instead, they intend to address the continuing appropriateness of these contracts (which have a total value of some £1.5 million) as each comes up for renewal, in order to establish whether any efficiency savings can be made.

While Assembly Government officials had put sound arrangements in place to manage the merger process, it did give rise to some significant, although isolated, impacts on financial management

2.8. In certain specific aspects of the post-merger financial management arrangements operated by Assembly Government officials, I have identified some areas where adverse impacts arose.

The post-merger integration of the various ASPBs' payrolls into the Assembly Government's own payroll system proved more problematic than expected

2.9. Responsibility for salary and other payments to the former staff of both ACCAC and ELWa was transferred to the Assembly Government's payroll system on 1 April 2006. For the WDA and WTB staff, the services of the former WDA's external payroll provider were deliberately retained for a further six months following the merger, in order that a phased migration might reduce the level of potential risks of error.

2.10. The Assembly Government's Internal Audit Service (IAS) carried out a review of the ACCAC and ELWa payroll integration processes to review the controls over the migration of payroll data from the two bodies and to ensure that no duplicate payments were made. Based on this work, IAS was able to provide only limited assurance to the Permanent Secretary that the payroll integration process had been managed effectively. This was because Assembly Government officials had not retained the results of their payroll migration testing, and also the lack of a complete centrally-held audit trail which meant that overall reconciliations could not be performed by the internal audit team.

2.11. Phase two of the payroll integration involved approximately 1,400 employees of the former WDA and WTB. Assembly Government officials implemented the IAS recommendations from the ACCAC and ELWa payroll migration review, and undertook this element of the integration in a more robust manner. Identified good practice included:

- the use of an electronic data migration process, rather then the manual data transfer that was adopted for the ACCAC and ELWa payroll information;
- the participation of a representative of the external payroll service provider on the project team that planned and managed the phase two integration; and
- the use of a parallel payroll data system to test the integrated payroll arrangements using dummy data before the system went live.

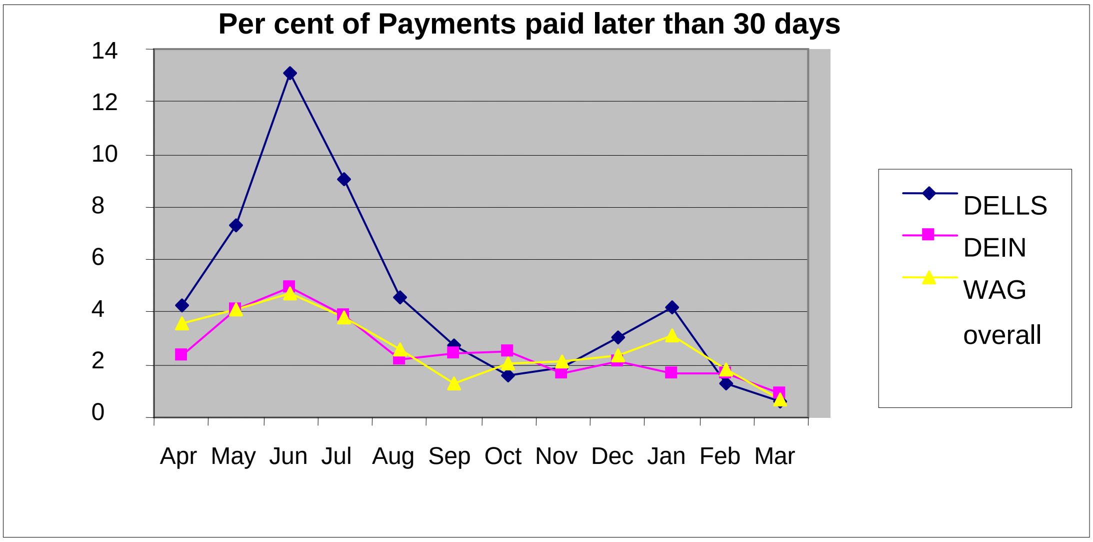
2.12. For phase two, IAS provided an enhanced level of assurance that the migration of the former WDA and WTB payrolls had been implemented successfully. However, while IAS found no instances of erroneous payments to Assembly Government staff, it remained unable to confirm for either phase of the payroll project that duplicate or erroneous payments could not have arisen. My staff have reviewed the results of the IAS work and discussed their findings with them, and I am accordingly satisfied that any potential under or over-payments that might have occurred would not have given rise to material levels of error in the 2006-07 accounts.

For 2006-07, overall prompt payment performance was maintained above the public-sector benchmark of 95 per cent, although the absorption of ELWa into DELLS created a short-term decline in that department's payment performance in the period following the ASPB mergers

2.13. The Late Payment of Commercial Debts (Interest) Act 1998 requires public bodies to pay suppliers' undisputed invoices within 30 days of receipt of goods or service or valid invoice, whichever is the later. The overall performance for the National Assembly for Wales in 2006-07 was 97.4 per cent, as disclosed on page 7 of the accounts accompanying this report.

2.14. My staff undertook work to establish whether there had been any significant changes in payment performance as a result of the mergers. They found that, for the six months following the merger, DELLS experienced a significant decline in its prompt payment performance. This was largely due to the absorption of ELWa into DELLS, as that ASPB had only achieved a prompt payment performance of 70 per cent in its final year of existence. My staff also found that, for the same period, DEIN was one of the three poorest performing departments of the Assembly Government against the prompt payment target although, as Exhibit 2 indicates, its performance remained above the 95 per cent target throughout the year.

Exhibit 2 shows the monthly percentage of invoices paid outside the 30 day target during 2006-07 for the two departments created to effect the merger, and that overall Assembly Government performance remained above the 95 per cent prompt payment target throughout the year

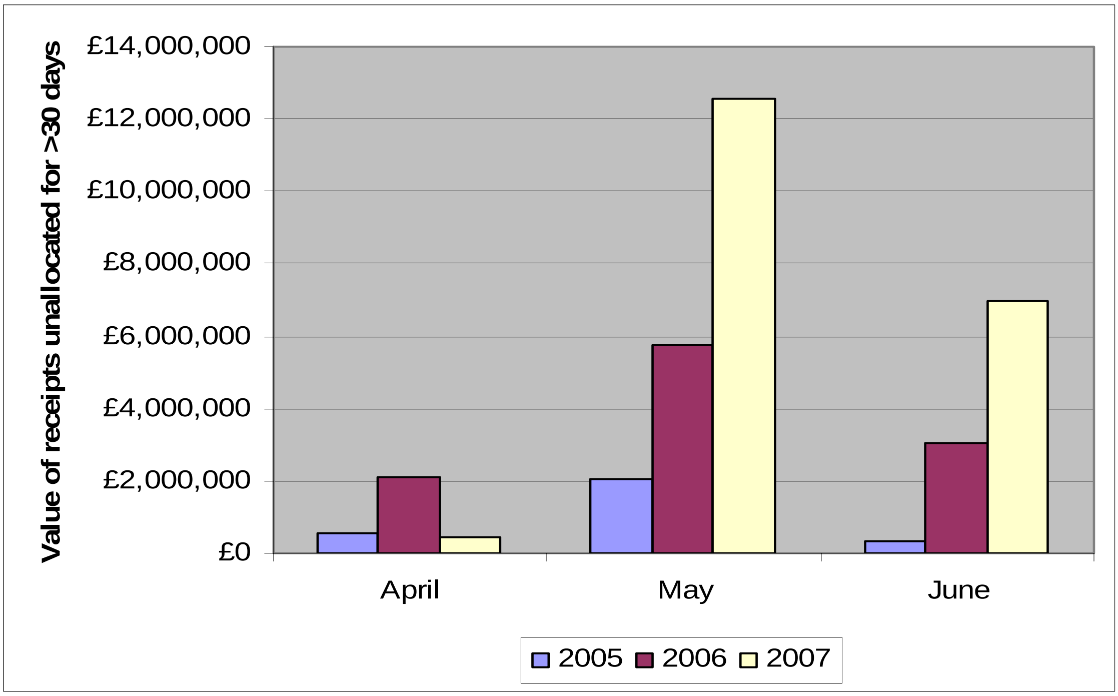


2.15. On the date of the merger, the Assembly Government introduced its new purchase order and grant-administration systems (known as 'e-purchases' and 'e-grants') on a phased basis in order to streamline its payment arrangements. In doing so Assembly Government officials embraced some of the electronic-based working practices of some of the merged ASPBs. Assembly Government officials told my staff that in the first few months following the merger there had been delays in setting up certain internal delegation arrangements within the new systems to allow invoices to be authorised for payment. I note that the Assembly Government's overall prompt payment performance remained above the 95 per cent target throughout the year and exceeded 99 per cent for the month of March 2007.

Since the merger, the significant increase in receipt transaction volumes has led to a decline in the timeliness of their allocation by Assembly Government officials to the relevant department

2.16. When the Assembly Government receives cash payments, it is important to allocate them swiftly to the relevant department. If this is not done, management information in each department will be inaccurate and it would even be possible for debt recovery action to be taken against people who had already paid. Following the merger, there were significant delays in allocating payments to departments, mainly because there were many more such payments but also because some of the payments involved more administration than in the previous Assembly Government systems. Exhibit 3 compares the relative performance of the Assembly Government's receipts allocation processes for the first quarters of 2005-06, 2006-07 (the immediate post-merger period) and 2007-08 (the current financial year).

Exhibit 3 shows the value of receipts that took longer than 30 days to be allocated in the first quarter of the financial year for 2005-06, 2006-07 and 2007-08



The Assembly Government's financial reporting arrangements capture many, although not all, of the merger-related costs

2.17. Following the First Minister's announcements of the ASPB mergers in 2004, the Assembly Government stated publicly that it had identified a provisional budget of some £11.9 million for costs relating to the merger, and that recurring annual savings of some £10 million would be generated from 2009, once the merger process was completed. The provisional cost estimate (which comprised £4.7 million for 2005-06 and £7.2 million for 2006-07) excluded all redundancy costs, as these could not be assessed at that stage.

2.18. The Assembly Government was required to include in its resource accounts the costs of the ASPB mergers and the other inward transfers of functions (including the Wales Youth Agency), to comply with UK accounting standards. Note 35 to the account discloses the merger costs that were either incurred by the ASPBs in the pre-merger period or which were funded from the Assembly Government's Investment Fund Mergers budget. This latter category represents the element of the total merger costs incurred by the Assembly Government that could not be funded from savings elsewhere within departmental running cost budget allocations for the 2005-06 and 2006-07 financial years. No separate recording of costs funded from those budget allocations was made by Assembly Government officials and, in the absence of a detailed time recording system to capture the staff time spent on merger-related activities, it is therefore not possible to identify the total expenditure incurred on the ASPB merger process.

2.19. Exhibit 4 summarises by organisation the recorded costs of the merger to date, together with expected future costs as at 31 March 2007, and reconciles this to the total costs reported in Notes 16 and 35 to the 2006-07 accounts. Exhibit 5 then provides an analysis of those total recorded costs by type of expenditure, as this information is not disclosed within the accounts themselves. (The figures in both exhibits are shown in £000's, for consistency with the rounding convention used in the accounts.)

Exhibit 4 shows that merger-related costs totalling £10.8 million have been incurred against the original £11.9 million forecast for the ASPB mergers. Total reported costs, including redundancies and the transfer of the Wales Youth Agency into the Assembly Government, amount to £14.5 million

Merged Body	Note 35		Estimate of Future costs – Note 16 £'000	Total £'000
	2005-06 (restated) £'000	2006-07 £'000		
ACCAC	154			154
ELWa	597			597
WDA	938			938
WTB	110			110
NAW consolidated account	3,983	3,244	456	7,683
Culture	-	282	-	282
Health Professions Wales	-	273	-	273
Tir Gofal	-	806	-	806
sub-Total (actual expenditure against budget)	**5,782**	**4,605**	**456**	**10,843**
add: WDA Redundancy costs	3,297			3,297
add: Transfer of the Wales Youth Agency	-	400	-	400
TOTAL (per 2006-07 accounts)	**9,079**	**5,005**	**456**	**14,540**

Exhibit 5 provides an analysis by cost category of the merger-related costs reported in Notes 16 and 35 to the 2006-07 accounts

Type of Expenditure	Note 35		Estimate of Future costs Note 16 £'000	Total £'000
	2005-06 (restated) £'000	2006-07 £'000		
Redundancy	3,297	-	-	3,297
Other staff costs	1,082	1,743	-	2,825
IT costs	3,182	756	-	3,938
Accommodation	624	1,105	456	2,185
Consultancy	402	982	-	1,384
Training	384	115	-	499
Other	108	304	-	412
Total	**9,079**	**5,005**	**456**	**14,540**

The Assembly Government is yet to realise the totality of its planned merger-related savings, but achieved savings to date are ahead of the original forecasts

2.20. The identification and delivery of savings arising from the merger is being led by each of the relevant departments and is overseen by an Efficiencies Project Board comprising Assembly Government Directors. Assembly Government officials anticipate that the Organisational Development projects currently underway in the four departments which absorbed the vast majority of the ex-ASPB staff will, when completed, deliver the majority of the planned savings. Of the estimated annual savings of £10 million, some £1.5 million was scheduled to be realised by 31 March 2007. Assembly Government officials have calculated that the actual savings achieved by that date totalled some £3.5 million in real terms. I intend to continue to monitor the progress being reported against the £10 million target and to examine the final out-turn at the conclusion of the process in 2010.

Assembly Government officials reasonably decided to minimise the operational and financial risks of the merger by maintaining their existing financial systems in the short term

2.21. Given the relatively short pre-merger window, Assembly Government officials decided not to take the immediate opportunity afforded by the merger process to introduce a new finance system to meet their existing and future business needs.

2.22. Instead, Assembly Government officials reasonably opted to continue to use their own existing financial systems in the post-merger period, thereby intending to reduce the risk of any loss of service to both internal users and external stakeholders. This allowed them to gain a fuller understanding of the financial and management-information needs of their enlarged business operations in the post-merger period, and then to determine whether a new finance system would be required in the medium-term.

By making only minimal changes to core systems at the merger date, Assembly Government officials did not take the opportunity to overhaul their financial coding structure

2.23. Prior to the merger, Assembly Government officials decided not to overhaul the financial coding structure of their main accounting system, in order for it to accommodate more effectively the coding structures operated by the merging ASPBs. Assembly Government officials informed my staff that while they had recognised that a change of this nature would be beneficial and indeed desirable, from a risk management perspective they determined that the Finance Division did not have sufficient capacity to undertake the changes successfully and to time; particularly as many Finance staff were already committed to merger-related matters.

2.24. The lack of a revised and compatible accounting structure created the need for a manual alignment, post-merger, of the various coding structures. Rather than using an automated transfer process to migrate the balances and transactions of the former ASPBs into the Assembly Government's financial records, a largely manual transfer process was used, which proved to be less efficient and more prone to error.

2.25. Assembly Government officials also opted to undertake the initial data migration on a summarised basis, rather than at the level of individual transactions (as is more usual in such cases in both the public and private sector). For example, the total debtor balances of each ASPB as at 31 March 2006 were transferred into the Assembly Government's ledgers, but they did not transfer the individual debtor balances until several months later. This meant that some former ASPB staff had to access multiple systems during that period to obtain meaningful management information on pre-merger transactions.

Staff from the former ASPBs experienced a reduction in the usefulness of the management information available to them

2.26. The merger project did consider the management information needs of the enlarged Assembly Government and, in particular, the provision of appropriate training for incoming staff on the Assembly Government's own systems and business processes. The introduction of the new e-purchases and e-grants systems was an example of this. However, the project did not give detailed consideration to the nature and quality of management information that would be required within the Assembly Government following the merger, and whether the simple continuation of its existing arrangements would meet the business needs of staff of the merged ASPBs.

2.27. During the course of their audit work on the 2006-07 accounts, my staff established that many former ASPB staff had experienced a deterioration in the overall utility of the management information available to them, compared with their previous systems and reporting arrangements. As a consequence, some staff of the former ASPBs had developed a range of local data capture and reporting arrangements to supplement the Assembly Government's core business information systems. For example, the DEIN continued the use of a separate and self-contained reporting package (that had previously been operated by the WDA) to provide certain key business information that was deemed critical to managing its operations and budgets.

2.28. One significant issue for former staff of the WDA and WTB was that they were long-accustomed to using finance systems that operated on a commitment-recording basis. Whilst the Assembly Government's main accounting system is capable of recording transactions on this basis, it is not currently configured to be used in that way; although its new e-purchases and e-grants systems were acquired to enhance the functionality of the main accounting system. One effect of this was that the financial information produced by the main accounting system was perceived by some former WDA and WTB staff to be of less relevance and usefulness to them.

2.29. The use of local arrangements to address shortcomings in the core financial system, such as the purchase of additional systems or use of local spreadsheets, is in my view invariably inefficient from an organisation-wide perspective. Such arrangements increase the inherent risk of errors and inconsistencies; give rise to the need for further control checks and staff effort in ensuring consistency between systems that rarely talk to each other; and fail to address the underlying weaknesses that are perceived to exist in the reporting capabilities of the core system.

2.30. In Part 4 of this report, I comment on the actions that Assembly Government officials are taking to transform their financial management arrangements.

3. Production of the 2006-07 consolidated resource account was finalised earlier than for 2005-06, although slippages in the merger accounting process meant that the ambitious project timetable was not fully achieved

Assembly Government officials overran their planned timetable significantly in collating the various assets and liabilities inherited from the former sponsored bodies into a restated Opening Balance Sheet as at 1 April 2006

3.1. The changes brought about by the First Minister's announcement of the ASPB mergers were required to be accounted for in the 2006-07 accounts that accompany this report. This complex process involved the review and harmonisation of accounting policies, and also the restatement of balance sheet figures and adjustments to the previously-reported results of the National Assembly for Wales for the 2005-06 financial year. All this was required in order to produce an Opening Balance Sheet as at 1 April 2006 that reflected the accounting consequences of the merger on that date of the four Assembly Sponsored Public Bodies and the transfer of certain other functions into the Welsh Assembly Government.

3.2. The Assembly Government's Resource Accounts Team rightly identified the construction of the Opening Balance Sheet as a project in its own right, to be completed in advance of the production of the 2006-07 annual accounts. This required the identification and reconciliation of all of the former ASPBs' individual assets and liabilities, together with gaining a sound understanding of their previous accounting practices and records. (Many of the business transaction types generated by the activities of the former ASPBs were new to Assembly Government finance staff, and they had to establish how to account correctly for each of these.) The original intention was for this work to be performed in autumn 2006, and for the Opening Balance Sheet then to be audited and agreed by December 2006.

3.3. The planned milestone dates for this activity and other key accounts preparation tasks, together with the actual dates of completion for each, are shown in Exhibit 6.

Exhibit 6: Planned and achieved milestone dates for the merger accounting and 2006-07 accounts production processes

Activity	Planned date for completion	Actual date completed	Comments
Transfer of the accounting records of the merged ASPBs to the Assembly Government's financial systems	October 2006	October 2006	
Closure of the various ASPB bank accounts	12 October 2006	November 2006 and January 2007	ELWa, WDA, ACCAC = Nov 2006; WTB = Jan 2007
Construction of the Opening Balance Sheet as at 1 April 2006 and the provision of supporting information for audit	October 2006 (for both Phases I and II)	Phase I = January 2007 Phase II = 23 August 2007	Phase I = Merged ASPBs. Phase II = other merged activities and functions.
Month 9 'soft close' process	February 2007	n/a	Process incomplete and only partially successful.
Completion of 31 March 2007 bank reconciliation	1 June 2007	14 August 2007	The 28 February 2007 bank reconciliation was completed on 16 July 2007.
Production of 2006-07 draft 'core' account for audit	18 June 2007	19 June 2007	The 19 June draft was not wholly complete. A complete draft was submitted for audit on 3 August 2007.
Production of 2006-07 draft consolidated account for audit	3 August 2007	17 August 2007	The 17 August draft also had some omissions. A complete draft was submitted for audit on 10 September 2007.
Signature of the audited 2006-07 consolidated accounts by the Principal Accounting Officer	31 August 2007	24 September 2007	The accounts were signed five days earlier than in the previous year.
Submission to HM Treasury of the 2006-07 Whole of Government Accounts data return for the National Assembly for Wales	28 September 2007	27 September 2007	The Treasury deadline of 30 September 2007 was achieved.

3.4. Assembly Government officials planned to complete the transfer of balances and transactions in sufficient time for my staff to audit the 1 April 2006 opening balance sheet by October 2006. However, they were unable to meet this original timetable. Whilst the balances of the merging ASPBs were migrated, as planned, onto to the Assembly Government's own accounting system in October 2006, and were reviewed by the Wales Audit Office shortly afterwards, the more detailed transaction-level work was still being collated by Assembly Government officials and its size and complexity meant that it was not fully available until the very end of 2006.

3.5. The revised timetable agreed by the Assembly Government's Resource Accounting Project Board stated that the remainder of the opening balance sheet material would be presented for audit in early January 2007, with an agreed deadline for audit completion of 16 February 2007. However, after analysing in greater detail the range of changes that would need to be reflected in the amended opening balance sheet, the Assembly Government's Resource Accounts Team decided instead to conduct this work in two discrete phases:

- Phase I – accounting for the merger of the four ASPBs.
- Phase II – the implementation of accounting and disclosure changes resulting from the remaining transfers of functions to the Assembly Government. These included the Welsh arm of the Learning and Skills Development Agency, the Countryside Council for Wales's Tir Gofal Scheme, and the functions previously carried out by Health Professions Wales.

3.6. Despite separating the work into these two phases, Assembly Government officials were unable to complete it within the revised timescales. To help alleviate the knock-on effect of these slippages on the audit timetable, they further divided the submission for audit of the Phase I work into two sub-elements; dealing firstly with WDA and ELWa, and then ACCAC and the WTB.

The delay in producing the 1 April 2006 opening balance sheet, together with the poor quality of the data received, led Assembly Government officials to truncate an important component of their planned process for preparing the 2006-07 consolidated resource account

3.7. Assembly Government officials and the Wales Audit Office considered jointly how problems identified during the 2005-06 accounts preparation and audit process could be addressed in 2006-07, to ensure that the Assembly Government could meet the increasingly demanding timetable required by the Treasury for faster closing of the accounts of public bodies.

3.8. One of the agreed actions was the completion by Assembly Government officials of a 'soft close' at Month 9 (that is, as at 31 December 2006) of certain balance sheet items with the aim of reducing the volume of work to be undertaken in preparing the accounts at the financial year-end.

3.9. Such 'soft close' exercises are commonplace amongst organisations which produce timely year-end financial accounts, and their use is becomingly increasingly widespread amongst Whitehall departments, the vast majority of whom publish their annual accounts before the Parliamentary summer recess. Final signing of the 2006-07 accounts by the Principal Accounting Officer was therefore scheduled for 31 August 2007, a full month ahead of the date achieved in the previous year.

3.10. This was the first time that a 'soft close' process on this scale has been attempted by the Welsh Assembly Government. It is not a straightforward process and it was likely from the outset that there would be some difficulties. However, the degree of slippage in the timetable for the Opening Balance Sheet reported above, and the generally poor quality of returns received from individual Assembly Government departments in respect of their Month 9 balances led eventually to a truncation of the 'soft close' project for the 2006-07 accounts. Despite these setbacks the 'soft close' process did help inform the preparation of the annual consolidated resource account.

A significant backlog in the timely completion of monthly bank reconciliations was allowed to develop during the 2006-07 financial year

3.11. A further impact of the increased level and complexity of financial work arising from the merger was on the timely completion of the Assembly Government's monthly bank reconciliations. Such reconciliations are a key financial control for any organisation, as they involve agreeing the balance reported by the bank at the month end with the body's own financial ledgers and cashbook. It is standard practice for bank reconciliations to be completed and reviewed very shortly after each month end as a minimum.

3.12. I note with considerable concern that the monthly reconciliations of the Assembly Government's own bank accounts were allowed to fall behind during the 2006-07 financial year.

3.13. Unsurprisingly, when Assembly Government officials finally started to tackle the backlog of reconciliations that had built up, they found this to be a larger and more complex task than they had anticipated as some items proved hard to trace. The 28 February 2007 reconciliation was not completed until 16 July 2007, and the crucial year-end reconciliation as at 31 March 2007 was only finalised on 14 August 2007. The backlog of outstanding monthly reconciliations for the 2007-08 financial year was finally cleared in September 2007, and since then Assembly Government officials have been checking transactions against bank statements on a daily basis.

3.14. One further consequence of the delays in finalising the year-end bank reconciliation was that Assembly Government officials were only able to establish in August 2007 that the Assembly Government had not drawn down the full balance of Exchequer funds that it required for the 2006-07 financial year. Instead, it had inadvertently used other, non-Exchequer, sources of income to cover elements of its Exchequer-funded operations. Because of the requirement to establish the 1 April 2007 opening balance for the new Welsh Consolidated Fund (which is not permitted to maintain overdrawn balances), Assembly Government officials have recently had to obtain special Treasury consent for a further notional draw-down of £685,000 of Exchequer funds, in order to establish an opening £nil balance on the Welsh Consolidated Fund.

These problems meant that Assembly Government officials missed their ambitious target for publishing the 2006-07 consolidated resource account, although the account was still finalised earlier than for 2005-06 and by the Treasury's deadline

3.15. It is clear that the significant delays in the compilation of the 1 April 2006 opening balance sheet, coupled with the only partial completion of the Month 9 'soft close' project, have had a significant impact on the overall process for the preparation and audit of the 2006-07 Consolidated Resource Accounts. I also consider that the failure of Assembly Government officials to finalise bank reconciliations in a timely manner over many months represents a significant and unacceptable breach in a key internal financial control. In my view, this should have been identified and addressed more promptly by senior management when the problem first arose, with additional staff resources deployed if necessary to make good the backlog. I note that the Permanent Secretary initiated urgent corrective action as soon as he became personally aware of this problem on 23 July 2007.

3.16. It is disappointing that the intention of Assembly Government officials to bring forward the timetable for production and audit of the 2006-07 accounts by one month has only been partially achieved. My staff have worked closely with Assembly Government officials over recent months to try to make up the lost ground in the accounts production and audit process and it is pleasing that, as a result of intense and sustained efforts by both parties, the cumulative impact of the delays and difficulties recorded in this report was reduced to a slippage of just three weeks in the overall project timetable. I also note that I have been able to give an unqualified audit opinion on the 2006-07 accounts, and that the statutory and Treasury deadlines for submission of audited information have been met.

3.17. It will be important that Assembly Government officials conduct a thorough 'lessons learned' exercise this autumn, in readiness for the 2007-08 accounts process, and my staff stand ready to assist in that review.

4. The Assembly Government has initiated an ambitious transformation of its financial management arrangements. Whilst it is too early to assess the success of this complex programme, continued top-level ownership of the change process will be essential if the planned benefits are to be realised

Assembly Government officials have rightly recognised the need to change fundamentally their financial management arrangements in order to respond to a wide range of business-critical challenges, including the consequences of the ASPB mergers

4.1. In light of their experiences of the ASPB mergers, Assembly Government officials have recognised the need for fundamental change to their financial management arrangements, if they are to successfully meet the wide-ranging challenges and pressures that they face in the near future. The Assembly Government faces a wide range of business-critical challenges, and I comment below on some of the most important:

- The establishment of the new **Finance Committee** of the National Assembly for Wales is expected to lead to a significant increase in detailed scrutiny of the Assembly Government's financial management arrangements. The provision of briefing and other information for that Committee will require that management information be produced on a more timely, consistent and reliable basis.
- The Government of Wales Act 2006 also introduces a tightening of the Assembly Government's internal **budgeting timetables**, requiring in turn a flexible and effective finance system to support that increasingly complex process.
- The **creation of the Welsh Consolidated Fund** from 1 April 2007 necessitates considerable improvements in the Assembly Government's cash management and forecasting arrangements. This is particularly important since, unlike under the previous banking arrangements that were operated for the Assembly Government by the Paymaster General's Office, it is not possible to incur an overdraft on the Consolidated Fund.
- Whilst the initial stages of the ASPB mergers have been completed, there remains much further work to **integrate the financial management functions**. Assembly Government officials have identified a range of problems caused by weaknesses in their existing systems and processes, and I have commented on some of these in this report.

- As with all public sector bodies, there is a requirement from HM Treasury that statutory annual accounts should be produced to an earlier timetable. Whilst the Assembly Government has made some progress in this area over recent years, there is empirical evidence that most Whitehall departments are considerably more advanced in their '**faster closing**' procedures. For most of these bodies (as in much of the private sector), the year-end accounts process has become a natural extension of robust and timely in-year reporting of financial results. By contrast, the Assembly Government's current accounts preparation process requires a substantial and manually-intensive single annual exercise to obtain, review and present information for audit. This is a major barrier to achieving improvements in performance and it is therefore important that these weaknesses are addressed.
- Within the Welsh public sector context, the successful delivery by the Assembly Government of some of the key goals identified in the **Beecham Review** is reliant in large part on an improved financial management environment.

4.2. It is probable that a significant failure in any of these key areas would have serious operational consequences for the Assembly Government, and also create the potential risk of reputational damage.

The Assembly Government has embarked on a complex and ambitious Change Programme intended to transform its financial management arrangements, modernise its business processes and support wide-ranging improvements in service delivery

4.3. In July 2007, the Strategy Sub-Committee of the Permanent Secretary's Management Board approved the Outline Business Case for a 'Corporate Finance Change Programme'. This complex and ambitious £9 million transformation programme originated from an internal review commissioned by the Director of Finance shortly after she took up post in 2006. That review examined whether the Assembly Government's existing finance function was best placed to meet its future challenges.

4.4. The underlying aim of the Change Programme is to '*create a reliable and future-proof technological platform to meet the ongoing organisational requirements over the next 10 years*'[5]. I fully support the Change Programme's objectives, which are intended to:

- provide consistent, timely and reliable financial information for departmental and corporate senior management teams, staff and external stakeholders, both on a monthly basis and at the year-end;
- standardise financial business processes and activities across the entire Assembly Government in order to deliver the most effective and efficient service;
- automate processes and minimise duplication;

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[5] *Corporate Finance Change Programme* paper CPP (07) presented to Corporate Performance Planning Committee meeting, 3 April 2007

- deliver an integrated finance system on a resource accounting basis (thereby meeting HM Treasury's accounting and reporting requirements); and
- deliver these changes in the most effective, value for money way.

4.5. I intend to provide appropriate support to the Assembly Government, as its independent external auditor, in helping to ensure the success of this important project. A senior member of the Wales Audit Office will attend meetings of the Project Board as an observer, and we will draw on our experience of similar previous projects at other public sector bodies in identifying and disseminating shared learning and good practice with the members of the project team.

It is too early to assess whether the Change Programme will deliver all of the planned benefits, but robust risk management and continuing top-level ownership of the change process will be vital ingredients in its success

4.6. I am encouraged by what I have seen so far in terms of strong senior management and stakeholder support within the Assembly Government for the aims of the Change Programme, and by the results of the independent Gateway Review that has recently been undertaken.

4.7. To help ensure successful implementation of the Change Programme, I consider it vital that the Assembly Government should:

- continue to exercise robust risk management in respect of the Change Programme and its constituent sub-projects;
- retain senior management and stakeholder support;
- instil across its various departments a stronger appreciation of the importance of robust financial management, ensuring that this is fully embedded into decision-making processes; and
- foster an organisation-wide desire for success and for acceptance of the cultural changes that a programme of this size and complexity will inevitably require.

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