

Auditor General for Wales

Annual report on the 2010/11 audit

Prepared for the Auditor General
for Scotland

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 AUDIT SCOTLAND



Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds

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Key messages

2010/11

The responsibilities of the Auditor General for Scotland, as auditor of the accounts of the Auditor General for Wales for the 2010/11 year of account, were established by a motion passed by the National Assembly for Wales on 18 March 2011, under the Government of Wales Act 2006. We have audited the financial statements. The audit has also followed up the reviews undertaken by the Public Accounts Committee and others on previous years' accounts and related matters. This report sets out the key findings of the audit.

Financial statements

The Auditor General for Scotland has given an unqualified opinion on the financial statements of the Auditor General for Wales. This audit opinion also concluded that, in all material respects, the expenditure and income in the financial statements were incurred or applied to the purposes intended by the National Assembly for Wales and the financial transactions conform with the authorities that govern them.

The Auditor General for Scotland has also prepared a substantive report on the accounts, which concluded that the recommended actions of the Public Accounts Committee have been implemented. These included: HM Treasury issuing a new accounts direction; the restatement of 2009/10 accounts figures, in particular to account properly for pension liabilities; and the adoption of a resource accounting format.

Financial position

Following prior period adjustments the reserves position at 31 March 2010 was restated as a deficit of £1.246m, compared to the position previously reported in the 2009/10 accounts of available reserves of £0.117m. The net reserves position at 31 March 2011 is available reserves of £0.162m. The turn around from the restated deficit position reflects the significant reduction in net expenditure in 2010/11 compared to the previous year. As highlighted in the annual report and accounts, this was achieved through a combination of cost reduction, efficiency measures and deferred expenditure. An amount of £0.629m is repayable to the Welsh Consolidated Fund at 31 March 2011.

Governance and accountability

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall, the high level corporate governance and control arrangements for the Auditor General for Wales operated satisfactorily during the year, as reflected in the Statement on Internal Control. We carried out a review of the internal audit function and concluded we could place reliance on their work.

Outlook

The position going forward remains challenging with 2011/12 cost savings requiring a further reduction in staff numbers; the new governance committees to be embedded; and planned improvements to other internal controls to be implemented, including the further development of budgeting and cost allocation arrangements to improve the basis for estimates, financial reporting and accountability in future years.

Introduction

1. A motion, on behalf of the Public Accounts Committee (PAC), was passed by the National Assembly for Wales (NAW) on 18 March 2011, under the Government of Wales Act 2006 (the 2006 Act), and appointed the Auditor General for Scotland as the auditor of the accounts of the Auditor General for Wales (AGW), in relation to the year of account 2010/11, on the terms contained in a memorandum dated 9 March 2011.
2. The 2006 Act refers to the AGW, but much of the corporate documentation associated with the AGW, his staff and office is published under the banner of the Wales Audit Office (WAO). In this report we have adopted an approach of using the AGW when referring to explicit statutory matters, such as the accounts and audit certificate. We have used WAO when referring to more corporate activity or concepts associated with the AGW's staff and organisation.
3. This report is the summary of our findings arising from the 2010/11 audit of the AGW. The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit that has been conducted, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising.
4. Appendix A is an action plan setting out the most significant issues and risks we have identified from the audit. Officers have considered these and the Appendix records the agreed "planned management action". We do not expect all risks to be eliminated or even minimised. We expect that the AGW and WAO understand their risks and have arrangements in place to manage these risks. The AGW and WAO should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.
5. This report is addressed to the PAC, the AGW and the Auditor General for Scotland and should also form a key part of discussions with the WAO's Audit and Risk Management Committee (ARMC), either prior to or as soon as possible after the formal completion of the audit of the financial statements. Reports should be made available to stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
6. This report will be published on our website after consideration by the PAC, the AGW and the ARMC.
7. The AGW is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve the AGW or management from their responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

8. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
9. As auditors we are required to audit financial statements and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
 - the regularity of the expenditure and income.
10. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, statement on internal control and the remuneration report. This section summarises the results of our audit on the financial statements.

Audit opinion

11. The Auditor General for Scotland has provided an unqualified opinion on the financial statements of the AGW for 2010/11. His audit certificate includes his opinion that the financial statements give a true and fair view in accordance with the 2006 Act and directions made thereunder by HM Treasury.

Regularity

12. He has also provided an opinion, that in all material respects, the expenditure and income in the financial statements were incurred or applied to the purposes intended by the NAW and the financial transactions conform with the authorities that govern them.

Remuneration report and statement on internal control

13. In his opinion, the audited part of the remuneration report has been properly prepared and the remaining elements of the remuneration report and management commentary are consistent with the financial statements.
14. He also confirmed that he has no issues to report on the statement of internal control and its compliance with the relevant HM Treasury guidance.

Report of the Auditor General for Scotland

15. The Auditor General for Scotland has prepared a report on the accounts in which he considers how the recommendations of the PAC in relation to the 2009/10 accounts have been addressed and concluded that the recommended actions have been implemented. Specifically:

- An updated accounts direction has been issued by HM Treasury (paragraph 17)
- the 2010/11 accounts have complied with the revised accounts direction and the Financial Reporting Manual (FRoM) taking account of all the previous accounting and reporting issues raised by the National Audit Office and others, in particular through the adoption of a Summary of Resource Outturn (paragraph 16)
- the 2009/10 comparative figures have been restated (paragraph 21)

Summary of Resource Outturn

16. One of the key elements of the recommendations was the adoption of a new primary statement, the Summary of Resource Outturn, which records the outturn against the use of resources authorised by a budget motion of the NAW. This is a substantial change in approach. The new statement demonstrates that the AGW's expenditure for 2010/11 was within the resource and cash limits established by the relevant budget motion of the NAW. It also shows that £0.629m is repayable to the WCF. This represents amounts drawn down from the WCF or collected from non-local government audits as detailed in a budget motion of the NAW but not utilised during the year that are due to be returned to the NAW. This is considered further in paragraphs 36 to 40 in the section of the report which comments on the WAO's financial position.

Accounting issues

New accounts direction

17. A new accounts direction (paragraph 15) was requested from HM Treasury in December 2010 to reflect the passing of the 2006 Act, the establishment of the WCF, and the statutory requirement for expenditure by the WAO to be authorised by a budget motion of the Assembly. A draft was received in January 2011 and following consultation with the Welsh Government, the NAW and Audit Scotland a final direction was issued in June 2011.

Accounts preparation and review

18. The financial statements were submitted for audit on 5 June, in accordance with a pre-agreed timetable. The statements originally submitted were incomplete and further significant submissions were received on 9 June, 22 June and 1 July, with a complete annual report and accounts presented at the latter date. Matters arising from our financial statements work were reported to officers on 21 June and 1 July. With our audit work nearing completion we were able to submit a draft ISA 260, to the ARMC on 13 July. A further submission of the draft annual report and accounts was received on 3 August, with the AGW signing on 31 August 2011.
19. The governance arrangements over the preparation of the 2010/11 AGW's accounts were strengthened to ensure that potentially contentious matters, or omissions, were properly brought to attention. However, the implementation of these revised arrangements remained challenging. We note, for example, the significant time pressure on both peer reviewers and

external audit to provide input on the draft annual report and accounts prior to the consideration of these documents by the ARMC. We recommend a review of the experience in 2010/11 to ensure that there is sufficient time for the arrangements to work effectively in future years.

Refer Action Plan No. 1

Presentational and monetary adjustments to the unaudited accounts

20. As a result of our review a number of presentational changes were required to the financial statements, particularly in relation to the Summary of Resource Outturn. There were also some monetary changes identified during the audit process including to amounts payable to WCF (£0.629m) and to the accrual for holiday entitlement not yet taken (£0.116m). The audited financial statements have been adjusted to reflect these issues.

Prior period adjustments

21. No provisions for future pension costs in respect of early departures had been recognised in previous financial statements. Accounting policies were amended in 2010/11 to make full provision for the costs of early retirements and severances at the point at which these were agreed. This was applied by means of a prior period adjustment which resulted in additional liabilities of £1.336m being recognised in the opening balance sheet.
22. Also in line with recommendations arising from the reviews by the National Audit Office and others, the accounting policies adopted were amended in 2010/11 to treat funding from the WCF as financing and not as income. The consequence of this is that this financing is shown as a credit to the Statement of Changes in Taxpayers' Equity and not as income in the Statement of Comprehensive Net Expenditure. The latter statement shows a deficit of £3.037m as a result, reflecting net expenditure required to be financed from the WCF.
23. All central government bodies have been affected by the removal of the cost of capital in the 2010/11 FReM. As a consequence £0.004m notional cost of capital expenditure was no longer chargeable to 2009/10 operating costs.
24. A receivable of £0.027m from the WCF was wrongly included in the accounts at 31 March 2010. This was corrected as a part of the restatement of 2009/10 figures.
25. The changes summarised above are identified in Note 21: Prior year adjustments to the accounts as correction of errors or changes in accounting policy. We confirm that appropriate amendments have been made to the prior year statements.

Cost allocation and segmental reporting

26. The accounts of the AGW cover local authority activity, which is not part of the budget motion, and central government and NHS activity which is the basis for the budget motion. The accounting policy on cost allocation is, therefore, fundamental in determining the budget and presenting the outturn position. A new Note 2: Analysis of net expenditure by segment is included to the 2010/11 accounts. This not only provides an analysis of net expenditure by

operating segment but is also used to provide the income and expenditure amounts in the Summary of Resource Outturn.

27. In line with previous practice the £5.047m revenue funding from the WCF is included as a separate segment in Note 2, representing the funding of the costs of operating the WAO that are not allocated directly to other operating segments. While welcoming the improved disclosure in this area we recommend that the AGW continues to review the basis of segmental reporting for budgeting, management information and financial reporting for 2011/12 and future years to ensure the most effective approach is adopted and that the monitoring of compliance with this aspect of their statutory reporting framework is embedded in WAO procedures.

Refer Action Plan No. 2

Income recognition and work-in-progress

28. A key area of judgement for both the preparation of the accounts and the audit is income recognition and work-in-progress. The accounting policies adopted in relation to the recognition of fee income and associated balances (trade receivables, work in progress and deferred income) are appropriate and consistent with those adopted in previous years. The amount of fee income recognised is directly related to the extent to which individual exercises have been assessed as completed, independently of the amounts billed or collected. The full amount billed is shown as a trade receivable, and any amount billed but not yet recognised as income is shown as deferred income. Work in progress relates to income earned but not yet billed. Fee income and associated balances have been accounted for appropriately during 2010/11.

VAT

29. Discussions between the WAO and HM Revenue and Customs (HMRC) continue as for a number of years there has been significant uncertainty about the VAT status of the AGW's activity. This issue was inherited at the formation of the WAO and management has continued to apply VAT treatments adopted by predecessor bodies. The AGW has decided that it is not appropriate to provide for any potential liability at 31 March 2011 as it is less than 50% probable that any obligation exists and that it is not possible to assess the extent of any such obligation. The VAT situation is disclosed as an unquantifiable contingent liability in the notes to the accounts of the AGW.

Refer Action Plan No. 3

Bad debt provision

30. Management has reviewed the manner in which provision is made for bad and doubtful debts, reducing significantly the proportion of trade receivables that has been provided for. The current level of provision is described in the accounting policies at Note 1(x). In assessing the level of bad debt provision that is appropriate management has considered the prevailing financial climate facing audit clients and other relevant contextual information. The accounting

judgement made about the level of provision is reasonable; and management will continue to keep this under review in light of actual experience of non-payment.

Outlook

31. The main change in the financial reporting framework (FReM) next year (2011/12) relating to government grants and donated assets are not relevant to the AGW's accounts.

Audit appointment for 2011/12

32. The motion appointing the Auditor General for Scotland as the auditor of the accounts of the AGW was for the 2010/11 financial year only. We would like to acknowledge the good working relationship that existed during this appointment and to thank officials and members of the ARMC for their assistance. We will communicate with the incoming external auditors as part of a managed changeover process.

Financial position

33. The AGW is responsible for conducting his affairs and for putting in place proper arrangements to ensure that the WAO's financial position is soundly based.
34. Auditors consider whether audited bodies have established adequate arrangements and examine:
- financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
35. This section summarises the financial position, compliance with statutory financial requirements and outlook for the organisation.

Financial results 2010/11

36. Under Section 125 of the 2006 Act, Ministers must move a budget motion in the NAW to authorise the use of resources, retention of income and drawings of cash from the WCF for certain relevant persons, including the AGW. The AGW's budget is determined, under Paragraph 12 of Schedule 8 of the 2006 Act, after the Audit Committee (PAC) has examined his annual estimate of income and expenses, and laid it before the NAW. A comparison between the 2010/11 Annual Budget Motion laid before the NAW in December 2009 and the 2010/11 outturn is shown in Exhibit 1.

Exhibit 1: Comparison between 2010/11 Annual Budget Motion and outturn (£ m)

Limits	Budget	Actual Outturn	Variance
Resources other than accruing resources for use by the AGW on the administration of the WAO, and the discharge of the statutory functions of the AGW and local government appointed auditors	5.047	4.478	0.569

Limits	Budget	Actual Outturn	Variance
Accruing resources from fees and charges for audit and related services (excluding income under Part 1 and Section 33 of the Local Government Act 1999, and Part 2 of the Public Audit (Wales) Act 2004); other recoveries of costs associated with the functions of the AGW; miscellaneous income from publications, conferences, provision of administrative and professional and technical services etc.; recoveries of costs of seconded staff; repayments of staff loans; recoveries of car leasing payments; and interest received on working balances fees for use by the AGW on related services and the administration of the WAO	10.772	7.913	2.859
Net cash requirement from the WCF to meet the net amounts falling due for payment in the year by the AGW	5.074	4.445	0.629

Source: Annual Budget Motion and AGW Annual Report and Accounts 2010/11

Compliance with statutory requirements

37. In accordance with the accountability rules for the NAW, the prior period adjustment (paragraph 21) is brought to account in the Summary of Resource Outturn for 2010/11, it having not been brought to account in previous years. Applying the cost allocation accounting policy (paragraph 25), £0.544m of the total prior period adjustment is brought to account in the Summary of Resource Outturn, being the share attributable to central government and NHS work. Taken together with an appropriate share of capital expenditure, the total resource outturn remains within the limit established by the budget motion. The net cash requirement also remains within the corresponding limit.
38. To ensure improvements in the basis for estimates, financial reporting and accountability in future years the Auditor General for Scotland noted in his report on the 2010/11 accounts (paragraph 15) that further development of budgeting and cost allocation arrangements is underway as part of the preparation for the submission of the AGW's budget for 2012/13.

Refer Action Plan no. 2

39. The comparative figures for the Summary of Resource Outturn for 2009/10 are not included in the 2010/11 accounts. This reflects that, in previous years, capital expenditure was not included in either the budget or the outturn against budget reported in the accounts (for 2009/10 capital expenditure was £0.457m in total, of which approximately £0.184m was

attributable to WCF funded activity). This is an unusual circumstance and the way forward should be clarified as part of the discussions on 2012/13 budgeting referred to in Action plan point 2.

Financial position at 31 March 2011

40. Once the prior period adjustments were made (paragraphs 20 to 24) the reserves position at 31 March 2010 is a deficit of £1.246m, in comparison with the previously reported position of a surplus of £0.117m. The net reserves position at 31 March 2011 is available reserves of £0.162m. The turn around from the restated deficit position reflects the significant reduction in net expenditure in 2010/11 compared to the previous year. As highlighted in the annual report and accounts, this was achieved through a combination of cost reduction, efficiency measures and deferred expenditure.

Outlook

2011/12 budget

41. The limits included in the 2011/12 Annual Budget Motion laid before the NAW in March 2011 are all reductions on the previous year's budget motion and reflected the AGW's plans to continue reducing net expenditure. The budget for net cash requirement is £4.753m (2011: £5.074m). The budget for revenue resource is £4.853m (2011: £5.047m) and the budget for income to be retained is £8.024m (2011: £10.722m).

Governance and accountability

42. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accounting officer.
43. Through its chief executive or accounting officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
44. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
 - corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption
45. In this part of the report we comment on key areas of governance.

Governance Committees

46. In response to issues that predated his appointment, and consistent with the reviews by PAC and others, the AGW has established a Resources Committee and a Remuneration Committee to enhance the existing independent scrutiny of WAO by the ARMC. The recruitment of members to the new committees was completed in March and chairs were appointed in July. The committees' draft terms of reference and business cycle are being finalised ready for the committees' first formal meetings in the autumn of 2011. While welcoming these steps to strengthen this aspect of the governance arrangements, we have not formally reviewed these as part of the 2010/11 audit as revised arrangements have only recently been established.

Refer Action Plan no. 4

Internal control

47. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal

control environment and the effective production of financial statements. In its annual report for 2010/11 WAO Internal Audit provided its overall conclusion that the WAO's systems are capable of delivering effective internal control and risk management, but that specific and significant deficiencies in internal control were identified. The specific and significant deficiencies in internal control identified related to 2009/10 and earlier years (paragraph 50).

Statement on internal control

48. The Statement on Internal Control (SIC) provided by the AGW records that he has responsibility for maintaining a sound system of internal control that supports the achievement of the WAO's policies, aims and objectives, whilst safeguarding the public funds and assets for which he is personally responsible. This is in accordance with the responsibilities assigned to him in the Memorandum for the Accounting Officer of the WAO issued on 2 November 2010 by the PAC.
49. The SIC noted the deficiencies in internal control relating to 2009/10 and earlier years which resulted in the PAC holding a number of hearings in 2010/11 that culminated in their report of March 2011 "Accounting, governance and propriety issues at the Wales Audit Office". The Auditor General for Scotland records the findings from his review of the implementation of the recommendations included in this report in his report on the accounts (paragraph 15).
50. The SIC also noted that in 2010/11 internal audit undertook a review of the conduct of the former AGW, Mr Colman and that the Head of Internal Audit concluded that the specific and significant deficiencies in internal control relating to 2009/10 and earlier years were attributable to specific root causes which are being addressed through the introduction of improved governance and control arrangements. We note that management are aware of and acting to improve financial and performance management monitoring, records management, IT monitoring, and HR and staff management issues and updating WAO's Financial Policies.

Refer Action Plan no. 4

51. The SIC also summarises the process by which the AGW obtains assurances on the contents of the SIC. Currently this review is informed by the work of the internal and external auditors and the senior managers who have responsibility for the development and maintenance of the internal control framework. However, the assurances provided by senior managers are not as formal as we have seen elsewhere. We recommend a cascade of assurances to include formal assurance by managers providing a certificate of assurance covering their areas of responsibility to relevant Executive Committee member, who then provide an appropriate assurance to the AGW.

Refer Action Plan no. 5

Internal Audit

52. A key element of our work on internal controls is the extent of reliance that we can place on the work of internal audit in terms of ISA 610 (Considering the work of internal audit). We carried out a review of the internal audit function in May 2011 and concluded that the work of the WAO's internal audit service is carried out in accordance with Government Internal Audit

Standards. In particular, for our financial statements audit, we placed reliance on the testing of financial functions and the review of the new accounting system, as planned. As a result of the review we also made some recommendations for improvement, which were accepted by WAO.

Outlook

53. The AGW is introducing an Oversight Framework ("Proposed new governance arrangements for the WAO – Briefing paper for the PAC" dated 7 October 2010 paragraphs 19 and 20) to improve transparency and clarify aspects of his responsibilities within the Financial Reporting Framework.

Appendix A: action plan

Key Issues/ Risk Areas and Planned Management Action

Action Point	Refer Para No	Issue/ Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	18 and 19	The preparation and governance arrangements over the completion of the AGW's annual report and accounts should be further reviewed to ensure that sufficient time is available for the key stages of the process.	We will review the entire accounts process, including the particular challenges we faced and the effectiveness of each of the key stages of the preparation and governance processes adopted for 2010/11. We will then identify which stages of the process will be retained, and whether any additional or different stages are necessary. Following agreement of the key stages, a timetable will be developed to allow sufficient time for each of those stages to be completed.	Assistant Auditor General (Planning and Resources)	March 2012
2	27 and 38	Budgeting process and segmental reporting should be further developed in 2011/12 and 2012/13 to ensure transparency between budgets and subsequent management and financial reporting, including for capital expenditure.	We have already started the process of developing our budgeting process and segmental reporting, starting with the Estimate paper for 2012/13 that will be presented to the PAC on 11 October 2011. In the light of this work we will also consider the implications for our 2011/12 accounts.	Assistant Auditor General (Planning and Resources)	March 2012

Action Point	Refer Para No	Issue/ Risk Identified	Planned Management Action	Responsible Officer	Target Date
3	29	When the AGW's VAT status is agreed a significant liability may arise, which could impact on the AGW's financial position.	We are continuing to liaise with the HMRC and our professional advisors on this matter in order to resolve it as a matter of priority. In the event that any liability is determined and quantified we will consider whether this can be funded from existing resources or whether additional resources need to be obtained. This matter has been, and will continue to be, referred to in both our accounts and Estimate until it is resolved.	Assistant Auditor General (Planning and Resources)	Timing is dependent on reaching agreement with HMRC
4	46 and 50	Governance arrangements are being strengthened but are not yet fully embedded and progress should be kept under review.	We are working to embed the new arrangements. The effectiveness of the new arrangements will be reviewed on an ongoing basis.	Auditor General for Wales' Private Secretary	Under review on an ongoing basis
5	51	WAO officers should provide formal certificates of assurance on internal controls systems covering their areas of responsibility as part of a cascade of assurances to the AGW.	We will review existing practices and, where necessary, we will develop an appropriate process for the provision of assurances, balancing the need for clear and documented assurance that adds value with the time constraints recognised in action point 1.	Assistant Auditor General (Planning and Resources)	July 2012