



WALES **AUDIT** OFFICE

SWYDDFA **ARCHWILIO** CYMRU

Estimate of income and expenditure of the Wales Audit Office for the year ending 31 March 2008

Submitted to the Audit Committee of the
National Assembly for Wales under Section
93(4) of the Government of Wales Act 1998

October 2006

Summary

1. Under Section 125 of the Government of Wales Act 2006 Ministers are required to move a Budget Motion in the Assembly for the purposes of authorising the use of resources, retention of income and cash drawings from the Welsh Consolidated Fund for certain relevant persons, including the Auditor General. The budget of the Auditor General to be included in that Budget Motion is determined, pursuant to Section 93 of the Government of Wales Act 1998, by the requirement that the Audit Committee examine his annual estimate of the income and expenses and then lay it before the Assembly.
2. The Audit Committee of the National Assembly for Wales is therefore invited to endorse this estimate of the income and expenses of the Auditor General for the year ending 31 March 2008.
3. The proposed estimate balances known cost pressures with increased efficiency at least equal to the 1 per cent improvement expected of public bodies under *Making the Connections*. The Auditor General is seeking an overall increase of just £0.5 million in this 2007/2008 estimate. This figure takes account of the cost pressures that will arise from delivering additional audit work in 2007/2008, including specifically:
 - a the audit of additional expenditure of around £900 million as a result of the 2004 comprehensive spending review;
 - b stronger corporate governance following the high profile corporate collapses such as Enron which give rise to a need for additional training and audit work to give the necessary assurances in relation to public bodies in Wales; and
 - c new work in relation to the audit of the new National Assembly for Wales Commission.
4. As well as reflecting the costs arising from additional work as outlined above, the Auditor General is also fully absorbing the cost pressures associated with harmonisation of terms and conditions, proposed head office relocation from two sites to a single site, and the procurement of new core systems covering payroll, HR and resourcing. In the current financial year, the Auditor General expects to absorb some £2.3 million of unforeseeable costs arising from the statutory transfer of former Audit Commission staff into the Principal Civil Service Pension Scheme (further details are given in paragraph 36 below). It is a considerable achievement to be able to absorb such a large cost, which was both unexpected and wholly outside the Auditor General's control. To do so, significant in-year cost efficiencies are being delivered as well as concentrated effort on fee-earning work. In addition the reserves carried forward from previous years will be fully exhausted.

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5. The 2006 Act has introduced a major change in the way Welsh public expenditure, including that of the Auditor General, is authorised. Hitherto the control has been over cash but in future resources as well as cash will be subject to control. In respect of the services and purposes of the Auditor General in the year ending 31 March 2008, the Budget Motion will therefore authorise:
- a the amount of resources to be used by the Auditor General;
 - b the amount of resources accruing to the Auditor General which may be retained by him (rather than paid into the Welsh Consolidated Fund); and
 - c the amount which may be paid out of the Welsh Consolidated Fund to the Auditor General.

6. These requirements are summarised in the table below.

Table 1: Summary of the 2007/2008 budget requirements	
	£m
Resources other than accruing resources for use by the Auditor General on the administration of the Wales Audit Office and the discharge of the statutory functions of the Auditor General and local government appointed auditors[1].	4.3
Accruing resources from fees and charges for audit and related services (excluding income under Part 1 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 Auditor General; miscellaneous income from publications, conferences, provision of administrative 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 Auditor General on related services and the administration of the Wales Audit Office[2]. (see note (i) Table 3)	9.1
Net cash requirement from the Welsh Consolidated Fund to meet the net amounts falling due for payment in the year by the Auditor General[3].	4.2

7. Because of the changed system for authorisation comparison of these figures with the expenditure in the current year is not straightforward. See Table 3.

^[1] This is the net revenue and capital expenditure in resource terms that the Assembly will be requested to authorise by budget motion under Section 125(1)(a) of the 2006 Act.

^[2] This is the income accruing to the Auditor General (other than that arising from local government activities) that the Assembly will be asked to authorise by Budget Motion under Section 125(1)(b) for use on related services rather than being paid into the Welsh Consolidated Fund.

^[3] This is the cash needed from the Welsh Consolidated Fund to meet the Auditor General's estimated net payments (payments less receipts) falling due in the year for authorisation by the Assembly by budget motion under Section 125(1)(c) of the 2006 Act.

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8. In addition to the amounts shown in Table 1, the Auditor General accrues resources from local government activities under Part 1 of the Local Government Act 1999 and Part 2 of the Public Audit (Wales) Act 2004 which he is permitted to retain for use in connection with the exercise of functions under those statutory provisions. During 2007/2008 these are estimated to amount to £11.3 million. Under Paragraph 9 of Schedule 8 to the 2006 Act, the Auditor General is authorised to retain such income rather than paying it into the Welsh Consolidated Fund. It will not therefore form part of the amount to be authorised by budget motion under Section 125(1)(b) of the 2006 Act and is included for information.

Estimate of income and expenditure of the Wales Audit Office

9. The remainder of this document deals with the details of the estimate of the income and expenditure for 2007/2008 of the Wales Audit Office. Some of the uncertainties identified last year have been resolved but a number remain.
10. As this is the first year in which the budget of the Auditor General is being set in accordance with the Government of Wales Act 2006, the estimate takes a different form from previously. It is therefore convenient for this document to set out a comprehensive picture of the prospective workload and financial issues facing the Wales Audit Office. The following sections describe:
- a the role of the Auditor General;
 - b how the work of the Wales Audit Office is funded;
 - c additional audit work arising in 2007/2008;
 - d progress on the financial issues identified in last year's estimate submission to the Audit Committee; and
 - e analysis of estimated income and expenditure for 2007/2008.

The role of the Auditor General

11. The Auditor General, supported by the Wales Audit Office:
- a Audits the accounts of the Assembly, the Assembly Government, its sponsored and related public bodies and all NHS Wales bodies. He also appoints auditors to local government bodies (including fire, police, probation services and national parks).
 - b Has the power to undertake examinations of economy, efficiency and effectiveness in all parts of the Welsh public sector.
 - c Is required to undertake inspection activities for best value authorities under the Wales Programme for Improvement.
12. In determining how to exercise his functions under 11(b), the Auditor General is required to take into account the views of the Audit Committee as to the examinations which he should carry out.
13. On 1 April 2005, the Public Audit (Wales) Act 2004 introduced major changes to the audit and inspection regime for the Welsh public sector. It

transferred to the Auditor General the functions exercised previously by the Audit Commission in Wales in respect of health and local government. It established the Wales Audit Office, as the Auditor General and his staff, by transferring the staffs of the Audit Commission in Wales and the National Audit Office Wales to the Auditor General's employment. The Act also enhanced the audit and inspection regime in Wales, by among other things:

- a improving access rights for auditors to follow public money to end recipients; and
 - b conferring various duties to collaborate and share information with other auditors, inspectors and regulators.
14. The Auditor General has the power to follow public money vertically through the funding chain to ensure that it is spent properly and wisely, as well as to undertake studies of a cross-cutting nature and report holistically on the delivery of public services.
15. The Government of Wales Act 2006 establishes the role and functions of the Auditor General on a slightly revised basis with effect from May 2007. It introduces a new function of the Auditor General, namely that of granting approvals to draw from the Welsh Consolidated Fund.

How the work of the Wales Audit Office is funded

16. The Wales Audit Office undertakes a wide variety of audit and inspection work on Welsh public sector organisations. The main elements, together with the sources of funding, are set out in Table 2.

Table 2: Main activities of the Wales Audit Office and sources of funding

Activity	Scale	How funded
Value for money/performance audit work on the Assembly, its sponsored and related public bodies, NHS Wales and the further and higher education sectors. Support to the Audit Committee and other Assembly Committees. Correspondence from Assembly Members and from members of the public.	Total expenditure subject to value for money/performance audit over £14 billion. Briefing the Audit Committee in advance of its 9-10 annual meetings; supplying draft reports; advising on Welsh Assembly Government responses.	Grant from the Welsh Consolidated Fund.
Audit of accounts prepared by the Assembly, its sponsored and related public bodies, local health boards and NHS trusts.	9 accounts prepared by the Assembly. Over 60 accounts, including 22 local health boards and 15 NHS trusts.	Fees charged to audited bodies.

Activity	Scale	How funded
Financial, value for money/performance audit and inspection (Wales Programme for Improvement) work on local government bodies.	22 unitary authorities; 4 police authorities; 3 fire and rescue authorities; 4 probation boards; 3 national park authorities; and 734 community councils.	Fees charged to audited and inspected bodies. The Welsh Assembly Government part funds Wales Programme for Improvement work.
Grant certification work and other work undertaken by agreement.	Work undertaken at 22 unitary authorities, the Welsh Assembly Government and several Assembly-sponsored public bodies.	Fully funded by fees.

Note. Work of a cross-cutting nature, such as a study covering the Welsh Assembly Government and local government, could fall under more than one of the above activities and therefore be funded by both Assembly grant and fees in appropriate proportions.

17. The majority of the work undertaken by the Wales Audit Office or by firms under appointment or contract is funded by fees charged to audited and inspected bodies. These fees are set so as to recover the full cost of the work involved.

Additional audit work arising in 2007/2008

Restructuring

18. The Government of Wales Act 2006 will, following the May 2007 elections, create an executive government for Wales that is accountable to but legally separate from the Assembly. This separation of the Assembly's executive and legislative/scrutiny arms will be a significant restructuring posing a range of risks that will need to be properly managed, and which will be subject to Wales Audit Office review.

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19. The new Act will, from 1 April 2007, also create a Welsh Consolidated Fund which the Auditor General will audit and authorise issues from. To ensure that there is adequate segregation of duties and no conflicts of interest when the fund is to be audited, mechanisms for issuing approvals to draw down being put in place. Any costs arising from this new function will be borne within the cost structure of the Wales Audit Office and will therefore require no additional resources.
 20. As the Audit Committee has previously noted, the absorption into the Welsh Assembly Government of the functions that were exercised by Assembly Sponsored Public Bodies does not significantly reduce the level of audit scrutiny that needs to be given to those functions. This is because the reorganisation of functions should not result in any consequential reduction in the ability of the National Assembly for Wales to hold the executive to account. Nevertheless there will be some efficiency savings in audit costs. The Auditor General has identified recurring annual efficiency savings in audit fees totalling some £73,000 arising from this process.
 21. A new body, the National Assembly for Wales Commission, will be established to provide support and services to the National Assembly for Wales. This body will be subject to the same level of scrutiny as other sponsored bodies.

2004 Spending Review

22. Under the terms of the July 2004 Comprehensive Spending Review, Wales will receive approximately £14 billion in 2007/2008, some £900 million more than 2006/2007. The resulting additional expenditure – and any increased income to Welsh public bodies – will, of course, need to be audited and will unavoidably give rise to some additional costs compared with those incurred in previous years.

Stronger corporate governance

23. A number of high profile corporate collapses, such as Enron, led to a renewed awareness of the importance of governance arrangements within organisations. The Auditor General is committed to applying the highest standards of audit and to helping audited and inspected bodies achieve the highest standards of financial reporting and corporate governance.
24. For example, auditors are becoming more involved in ensuring that organisations' audit committees and non-executive members are as effective as possible. This gives rise to additional work, such as training, as well as increased audit activity in order to provide the necessary assurances in relation to corporate governance.

Implications

25. These three aspects of additional work and other changes, such as the expansion of whole of government accounts to include the wider public

sector (including local government and NHS trusts) and the need to comply with new international accounting and auditing standards are expected to give rise to additional audit costs in 2007/2008 which are in line with inflation and will be recharged across the various income heads (Table 3).

Progress on financial issues identified in last year's estimate submission to the Audit Committee

26. Last year's estimate outlined the critical issues impacting on the costs expected to be incurred by the new organisation. This section presents an updated picture of the position in respect of those cost pressures and highlights areas of new or ongoing uncertainty.

Harmonisation of staff terms and conditions

27. On 1 April 2005, Audit Commission and National Audit Office staff based in Wales transferred to the Auditor General's employment with continuity of employment and on terms and conditions that, taken as a whole, were no less favourable than those in place immediately before the transfer. This was a statutory requirement. The estimate for 2005/2006 made no specific provision for any additional costs of organisational and structural changes required as the new organisation beds in. Following a review by a professional firm of HR consultants the Auditor General was able to adopt recommendations regarding the terms and conditions for the 272 full time equivalent staff which are currently employed. He is pleased to note that the costs relating to those recommendations have been absorbed within the day to day operation of the organisation without any further recourse for resources or cash from the Assembly.
28. The Auditor General intends that any further costs arising from harmonisation will be absorbed within the day to day operations of the organisation.

Accommodation and facilities

29. Wales Audit Office staff are located throughout Wales. There are Wales Audit Office staff in the majority of local authorities, and there are Wales Audit Office offices in Carmarthen, Ewloe, Swansea and Cardiff. The Transfer Orders provided for the leases on the two separate buildings in Cardiff occupied by the National Audit Office and the Audit Commission in Wales to be transferred to the Auditor General together with associated contractual commitments (eg, facilities management arrangements). The existing leases on both buildings will either expire, or break out clauses can be exercised, between 2007-2009. It is prudent to avoid running such leases to the last moment and the Auditor General therefore aims to acquire a new building during 2007/2008, on a leasehold basis, to consolidate the existing Cardiff offices. Such a move would lead both to operational efficiency savings, as staff will be co-located, and also cash savings resulting from the need to service one rather than two buildings.

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30. The choice of a location and the economic and financial implications of the various options are being examined through a rigorous options appraisal and the Auditor General will require a robust business case before he can decide which option to choose. The estimate therefore provides in advance of the decision for some initial costs that may arise in 2007/2008 due to the requirement to fit out the new building whilst operating existing buildings.

Corporate services

31. As stated in last years budget submission, the precursor organisations relied substantially on their respective headquarters for corporate services. The Auditor General had to implement arrangements to secure the necessary services for the new organisation. The systems underpinning payroll, financial management and HR were provided by the Audit Commission on an interim basis for two years ending on 31 March 2007. The estimate provides for the costs in 2007/2008 of acquiring new systems for these core services. The business case for these new systems shows that very significant savings will be realised in subsequent years.

External suppliers

32. The Audit Commission previously appointed private sector firms of accountants to act as appointed auditors for the audit of a number of local government and NHS bodies in Wales. The total contract values were around £4m of fee income per annum equating to around 14 appointments to major audited and inspected bodies and to over 550 community councils. Most of the firms' appointments last until 2007 and may be extended by agreement. Under the legislation, these appointments transferred to the Auditor General on 1 April 2005, and he is bound by their terms and conditions for their duration.
33. A new contract is currently in the process of being tendered. The Auditor General expects to be in a position to award new contracts in the early part of 2007 with appointments running from the 2007/2008 financial year. The new contracts will engage firms to act either as contractor to the Auditor General or (in local government only) as appointed auditors. The total quantum of work that the Auditor General intends to award under these contracts is expected to be similar to that previously contracted, though there may be some flexibility depending on the tenders received. The Auditor General has put quality and service at the top of the selection criteria but will also, naturally, be looking to secure advantageous prices from the firms.

Transitional costs

34. The one-off capital and revenue costs of establishing the Wales Audit Office (eg, IT and telecommunications networking, hardware, software and project management) incurred in 2004/2005 and 2005/2006 were detailed in the set-up cost budget and approved by the Audit Committee

on 6 May 2004. Special financial arrangements were in place to ring-fence these set-up costs and the final outturn was reported in the 2005/2006 accounts. All expenditure was contained within the approved budget of £979,000.

Staff pension costs

- 35.** Auditor General staff are not civil servants but, in common with the staff of a number of other public sector bodies not staffed by civil servants, are eligible for membership of the Principal Civil Service Pension Scheme (PCSPS). The Scheme's managers have now increased the contributions payable by all employers of PCSPS members from 1 April 2005. This will give rise to an increased funding requirement of approximately £25,000 in 2007/2008.
- 36.** During the drafting of the Public Audit Wales Bill, before the creation of the Wales Audit Office, it was decided as a matter of policy that the staff who were to transfer from the Audit Commission in Wales on 1 April 2005 should be eligible to transfer their accrued pension entitlements. That policy was reflected in the statutory obligation binding the Auditor General to offer his new staff terms no less favourable than those to which they had previously been entitled.
- 37.** At the time it was assumed, presumably because the benefits offered by the two schemes were broadly equivalent, that a transfer of staff between the two pension schemes would not involve any cost. In the event that assumption has proved to be unfounded: the Audit Commission pension scheme can pay out no more than a transfer value calculated on a basis that is standard for that scheme; the PCSPS requires a payment calculated in a manner standard for that scheme; but there is a difference between the two amounts. Thus a cost has arisen that will need to be paid later this year when the transfer is expected to be completed. It is expected that the cost will be approximately £2.3 million.
- 38.** At the time of the Auditor General's estimate submission last year, it was known that a cost may arise from the pension transfer (see paragraph 33 of *Estimate of the income and expenditure for the year ending 31 March 2007*) but the cost could not then be quantified and the budget for 2006/2007 could make no allowance for it. Nevertheless, after very careful consideration, the Auditor General has decided that he can seek to absorb the whole of this £2.3 million cost in the current year without seeking addition funds from the Assembly. To do so, it is necessary to expend all financial reserves inherited from the precursor bodies, to realise efficiency gains, and to make a specifically focused effort to speed up the delivery of fee-earning work creating a one-off increase in fee income.
- 39.** It is clearly an unsatisfactory position to run with no reserves in respect of local government work which accounts for nearly half of the Auditor General's income, and reserves will have to be re-established in line with accepted practices and the new financial arrangements that will come into existence under the Government of Wales Act 2006.

Value Added Tax

40. As in last year's estimate submission, HM Revenue & Customs has yet to rule on the Audit Commission's practice of adding VAT to its audit and inspection fees chargeable to local government and NHS bodies, and off-setting this against VAT payable on supplies and services.
41. As an interim measure, HM Revenue & Customs has agreed that the existing arrangements can continue pending review. The Auditor General understands that this review should be finalised in 2007/2008. As last year, he has therefore assumed that the existing arrangements will continue unchanged for the purpose of compiling the 2007/2008 estimates and have not included any provision for additional irrecoverable VAT. Should any changes be necessary, the Wales Audit Office will need to discuss with the Welsh Assembly Government and the Audit Committee whether the increased costs should be financed through additional fees, a further grant from the Welsh Consolidated Fund or a combination of both.

Analysis of estimated income and expenditure for 2007/2008

42. Table 3 provides a forecast of the Wales Audit Office's income and expenditure for 2007/2008 compared with estimated figures for 2006/2007, including a breakdown of the main areas of expenditure. With the exception of the anticipated rationalisation of offices and the investment in software, both of which will deliver cost savings in the next few years, the Auditor General has been able to restrict the request for resources to deliver the savings as identified in *Making the Connections*.

Table 3: Forecast of Wales Audit Office income and expenditure 2007/2008

	Original estimate of income and expenditure for 2006/2007		Updated estimate of income and expenditure for 2006/2007		2007/2008	
	£m	£m	£m	£m	£m	£m
Income						
Audit and inspection of local government bodies		8.0		9.8		9.4
Wales Programme for Improvement grant		1.5		1.8		1.5
Certification of grant claims		1.6		2.0		2.2
Audit of the Assembly, its sponsored and related public bodies		0.9		1.4		1.2
Audit of NHS Wales bodies		4.6		5.9		5.6
Other		0.3		0.5		0.5
Total income		16.9		21.4		20.4
Expenditure						
Staff costs and related costs		13.2		14.7		14.9
Bulk pension transfer		0		2.3		0
Fees payable to appointed auditors, contractors and consultants		4.2		5.4		5.0
Accommodation and related costs	0.9		1.2		1.3	
Supplies and services	1.0		1.2		1.2	
Corporate services	1.2		2.2		2.1	
Capital charges	0.2	3.3	0.2	4.8	0.2	4.8
Total revenue expenditure		20.7		27.2		24.7
Release of reserves		0		1.8		0
Capital expenditure		0		0		0
Net request for resources		3.8		4.0		4.3
Net cash requirement		3.8		3.8		4.2

Note

i. Reconciling income to Table 1

Accruing resources under Part 1 of the Local Government Act 1999 and Part 2 of the Public Audit (Wales) Act 2004 consists of:-


	2007/2008 £m
<i>Certification of grant claims</i>	2.2
<i>Audit of the Assembly, its sponsored and related public bodies</i>	1.2
<i>Audit of NHS Wales bodies</i>	5.6
<i>Other</i>	0.1
Total	9.1

Table 4: Reconciliation of resource requirement to cash drawing requirement from the Welsh Consolidated Fund

	2007/2008 £m
Net request for resources	4.3
Movement in provisions for liabilities and charges	0
Movement in year end debtors, creditors and deferred income	0
(Increase)/decrease in provisions	
Use of provisions	0.1
Capital charges (interest and depreciation)	(0.2)
Net cash requirement	4.2

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5 October 2006

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