

Report

Governance and Audit Committee

Part 1

Date: 30th March 2023

Subject **Lessons Learned – 2021-22 Accounts Closedown and Financial Statements Preparation**

Purpose This report presents the findings of an initial lessons learned review carried out by finance officers following the 2021/22 accounts closedown. It gives an assessment on the findings of the lessons learned review and the plans in place to implement for 2022/23 and the key risks to the closedown process for 2022/23.

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Ward All

Summary Following the closedown of the 2021/22 accounts, a lessons learned review was undertaken to put into place further improvements for the closedown of the accounts process. This lessons learned review is taken as a matter of course, and with the issues that arose from the audit of the 2021/22 accounts, this review is of high importance to ensure improvements are delivered for 2022/23.

Proposal **To note the lessons learned process that has been carried out to date and the planned improvement following lessons learned review.**

Action by Chief Accountant / Assistant Head of Finance

Timetable Immediate

This report was prepared after consultation with:

- Finance Teams
- Audit Wales

Signed

Background

Audit Wales have issued an unqualified true and fair view assessment of the Statement of Accounts for 2021/22. However, there will always be refinement issues from the annual audit process captured in Audit Wales' ISA260 Report and this year was no exception.

This report considered improvements alongside the ISA260 Report which was submitted to Governance & Audit Committee on 26th January 2023. The ISA260 reports captured the issues raised, their cause and an initial reflection about how such issues can be mitigated in future, where possible.

Whilst the volume is similar to that of previous years, there are 2 notable trends

- the extent of work required to fixed asset presentation;
 - This included reviewing and removing net nil book asset entries
 - As a result of late changes to national requirements by Audit Wales and CIPFA, Newport were also required to adjust PPE for construction inflation and infrastructure asset reporting changes
- a number of audit points pertain to the incorporation of data from other organisations (e.g., City Deal, Newport Transport, related parties).

Process for improvement

The process for challenge and improvement for the 2022/23 accounts closedown and financial statements has taken place and key officers involved in the accounts closedown were asked to provide their thoughts on what went well, key areas of risk and how they could be managed and improved upon. The next stage of this process is now to review these findings and look at the improvements that can be implemented prior to the preparation of the 2022/23 year end accounts.

In general, it was felt that the Statement of Accounts process went well, but there are always areas that can be improved upon and the audit process will always provide improvement suggestions. Indeed, it should be noted that the majority of treatments reflecting £738million gross assets, £684million liabilities and net £54million reserves, and annual revenue expenditure transactions of £293million and income transactions of £284million are accounted for satisfactorily and go unreported. However, this report will focus on the areas that could be improved and detail the work that can be done to facilitate this.

Pre-draft accounts preparation

Whilst Covid restrictions relaxed in 2022/23, the production of the 2021/22 Statement of Accounts was still set against the continued backdrop of the pandemic, which impacted on the completion of the accounts in a number of ways. This included the usual resource challenges within the small team primarily responsible for producing the accounts, as well as introducing extraordinary volatility in the form of "late" grant awards and administration.

The team has also been a key part of the move towards a new ledger system, so key individuals needed to balance their time effectively through the audit process to satisfy both priorities. This also involved other colleagues stepping forward and doing tasks for the first time. Unhelpfully, this coincided with a need to accommodate significant movements in fixed asset reporting, increasing the level of work required when resources are already tight.

One issue highlighted in the ISA260 Report was the need to include a compensatory entry of £893,000 to the Movement in Reserves Statement (MIRS) to allow that to balance. This was discussed with auditors at drafting stage as the Council had exhausted its review and it was hoped by making that adjustment and allowing the audit process to kick off, that a fresh pair of eyes and insight might better identify the cause. This was not the case and Audit Wales included a recommendation for the Council to review and address this prior to the 2022/23 closedown process commencing. It is important to note that this compensatory entry was only required in order to correctly classify £893k within the various department headings in the

statement of accounts. All technical adjustments have been done correctly and as such, the balancing entry did not compromise the quality of the accounts. However, work has started to resolve this and a large proportion of this £893k has been reviewed and now classified correctly.

In common with previous years, a task timetable was agreed with senior accountants. Most tasks were completed within timescale, but as with previous years the accruals process overran, and the earmarked reserve position continued moving until the 3rd week in May.

Reserves

The 2021/22 revenue outturn position was significantly more favourable than anticipated, resulting in a large underspend, partly driven by the late allocation of grant funding by Welsh Government to local authorities across Wales. The intention had been to transfer the full underspend to a single reserve, for allocation following the May election. However, it proved necessary to make transfers to other reserves, which introduced significant delays, with the final earmarked reserves position only crystallising in late May. Whilst the technical team was able to proceed on limited aspects of the balance sheet preparation in the meantime, reserves presentation remains fundamental to many notes and so the process was delayed.

In order to try and mitigate this risk for 2022/23 a number of changes are being introduced within this area so the impact on statement of accounts is minimised. The administration and approval will be done before the year end for those transfer requests which are either budgeted for or previously agreed, which will ensure that the work required to be done for the accounts is completed as much as possible before year end and minimise the level of transfers requiring member approval.

Accruals

The accruals process (the creation of debtor and creditor balances) also overran from the date agreed within the timetable. Part of this remains due to the volume of necessary housekeeping undertaken during year end on outstanding purchase orders. This remains a particular challenge in Education due to Easter holidays impacting schools' admin staff availability, and most schools still do not use the Council's corporate ordering system.

Meeting the earlier statutory deadlines remains extremely difficult and those councils that manage to do so, are only able to, having moved much of that housekeeping and administration to during the year rather than at the year end, so they can more quickly progress the Accounts preparation and production at year end.

Also, many have moved to an automated system generated process where for instance expenditure accruals are based on purchase orders outstanding that have been goods receipted. In Newport, there is still a degree of manual intervention, as colleagues report that services are responsible for housekeeping their orders and that exercise isn't being done frequently or robustly to be able to rely upon the automated production of accruals with considerable review by service accounting teams. This is something that will need to be addressed once the new system is introduced for it to work as effectively as it should.

Information from Third Parties

A number of ISA260 Report recommendations pertain to the incorporation of data from third parties (e.g., Newport Transport and City Deal), and the manual nature of process will always introduce an increased risk of error or misinterpretation. There are simple care and attention and transposition errors regarding related party disclosures, which are easy audit criticisms and do not involve any technical judgements. Due to the resource challenges that come from having a small team, the capacity of the team is being increased by one extra post and it is expected that this additional resource will reduce some of the pressure around year end and enable more time to be spent on reviewing working papers and notes to the accounts.

Some of the Newport Transport issues appear to follow a historic convention, which suggests a greater emphasis of checking whether our interpretation of provided information is clear/understandable to any reader, when our usual focus is primarily on getting our sole entity accounts right. There will also be a

focus on looking at City Deal aspects as part of the MIRS imbalance review, which may result in subsequent revised treatment.

Importance of Coding and Categorising

An increasing focus of Audit Wales feedback has been on gross rather than net account presentation, which has led them to conclude “overstatements” to individual notes. Whilst our traditional net position remains accurate in the Statement of Accounts and so main Statements are correctly reported, staff will be reminded of the importance about how transactions are subsequently categorised so that this issue is resolved for 2022/23.

Annual Governance Statement

A significantly revised version of the Annual Governance Statement was received on 6th December 2022 with a final signed version of the statement received 23rd January 2023. The timetabling of this activity does need to be reviewed. It needs to be brought far further forward in the process in getting both draft and final discussed by Governance & Audit Committee earlier and ultimate sign off by Chief Executive and Leader prior to the draft Accounts submitted to the Governance & Audit committee which would usually be June/July. This would align with the Welsh Government recommendation that the Annual Governance Statement is published at the time the draft annual accounts are signed and dated by the responsible financial officer.

Audit Wales are required to use the version supplied to get comfort about the control environment in operation, which it cannot do if a significant adjusted version is provided in December, which would be one to two months after the traditional end of the audit process and was only able to be accommodated this year due to the audit process not concluding as early as it normally would. For 2022/23, the intention is for the Annual Governance Statement to be completed much earlier in the process, which should avert the issues experienced last year.

Fixed Assets

There were three main issues relating to fixed assets in this year’s accounts, two of which could not have been reasonably foreseen prior to preparing the draft accounts.

- Construction inflation uplift – this was an all-Wales issue, which was raised by Audit Wales from their quality assurance exercise of the previous year. It was shared with Newport after the draft Accounts were prepared. As our current system only expects to see one valuation change per asset per annum, it was not straightforward applying this construction inflation uplift after the 2021/22 valuations and reconciling asset movements subsequently, given their impact to impairment, revaluation reserve, depreciation reconciliation etc.

There will be the same issue for the 2022/23 so the annual construction inflation will need to be resolved early on in the year end process, so that it can be added to any Norse generated valuation changes and impairment aspects, ensuring that it is only the net resulting position that becomes adjusted for in the Fixed Asset Register.

- Infrastructure assets – highly unusually, CIPFA issued retrospective guidance on the treatment of this class of assets which could not have been anticipated at the time draft accounts were prepared. The main focus of the revised guidance and statutory override allows assumption to conclude gross book value and accumulated depreciation of replaced components are self-balancing when they are written out, on the premise that the whole economic life for those old assets would have expired.

Whilst this is a national issue, it has meant that, whilst reviewing our treatments, we have not decommitted any amounts when we have added Highways capital maintenance additions annually – so we would struggle to be able to conclude our infrastructure value is not overstated (ignoring

the fact that the various CIPFA requirements over the years mean it will never equate to an accurate value of the infrastructure network). This review will be important when migrating information over to the new system, to ensure that the data transferred has been cleansed. The process for what is required to transfer the data over to the new system has been agreed and documented.

- As part of their audit, Audit Wales identified £23.0 million of property, plant and equipment assets with a net book value of zero in the draft accounts. £12.8 million of those assets were confirmed as no longer in use by the Council, and so therefore needed to be removed from the 2021-22 accounts, which was done for the final accounts. Whilst we were planning on undertaking this exercise as part of the work migrating data to the new system, the auditor's overstatement challenge is reasonable and stems from not having a robust approach to be able to ascertain whether we have retained relatively short life vehicle, plant and equipment once their economic life has been exhausted, or if they have been disposed of. Much of this is due to the historic identification of these assets within the fixed asset register, and the lack of information or service contact. This is not an easy retrospective fix and current staff are working with the vagaries of their predecessors. There is a recommendation within the ISA260 Report which states that this review should continue into 2022/23.

To address this recommendation, and improve the process and avoid the need for the extraordinary efforts this year to get net nil book asset queries below audit materiality levels, each record will now require a service contact and a proforma form will be devised that prompts a response from the service area when an asset life expires to understand whether they have disposed of asset, (and in which case both gross book value and accumulated depreciation can be deleted from Fixed asset register), or if they are still using it, what secondary value and life they attach to it so that asset record can be amended/updated.

Valuations Process

In addition to the traditional recurrent rolling 5-year valuations, assets can also be revalued annually if they have also derived enhancing capital expenditure. Anecdotal examples suggest there may be some opportunities to reduce the volume of those ad hoc annual valuations that are deemed necessary. For instance, Norse regarded water main replacement as enhancing expenditure to require a new valuation at a school which it only formally revalued a year earlier. So whilst it is agreed a school needs access to water, if that is a repair to maintain the service rather than significantly increasing the capacity, there is argument that it is secondary to the purpose of the asset and not enhancing to prompt a valuation recalculation of the school, and advocate reaffirming to Norse a convention that "enhancing" capital expenditure ought to equate closely to our capital definition tests i.e. that to be enhancing, it must significantly enhance the value of an asset, its life or its usefulness.

Education colleagues ought to have a plan as to what the capacity needs are across the City into the future, and their capital building programmes act to address, influence and satisfy that necessity. So, it may be more appropriate/strategic to switch to a more holistic future centric school roll target in such revaluations. But if so those conversations with Norse would need to be concluded prior to the year end to affect their 2022-23 valuations.

Leasing & IFRS 16 adoption

As we move towards adopting IFRS 16 (Leases), our accounting and records for leases is being reviewed. It will change on adoption, but in the interim, there remains some ambiguity caused by services practices and their using the term "lease" to cover a multitude of situations when, for instance, they may instead

mean contract hire. Unfortunately, due to the time constraints during the closing process, the team is not able to scrutinise each agreement to ascertain the spirit or legal form and commonly if the service suggests it being a lease it has been accepted as such.

The general premise of lease accounting is fairly straight forward to recognise the value of the arrangement in full upfront and unwind it over the period of lease through the payment of annual revenue amounts. Historically, this has been complicated when those recurrent revenue payments have instead been afforded by capital expenditure, as mistakenly the value of that expenditure has been equated to the value of the asset in some situations. A document has been compiled which can be referred to when considering leasing activities as to how they should be shown and their categorisation considerations. The accounting entries required upon implementation of IFRS 16 have also been worked through when adopting “on use” assets. Welsh Government have been notified that we will not be adopting IFRS 16 until 2024/25 so there is time to review and refine our approach.

Related Party relationships

For the 2021/22 accounts, 16 members did not submit updated annual declarations. This is the second year that Audit Wales have flagged this weakness within the ISA 260. This is also despite additional measures being introduced to try and increase the level of declarations received. The importance of the submitting the returns will be highlighted to members again as well as seeking the engagement of Party Leaders to help ensure updated declarations are received. The process will continue to be reviewed in 2022/23 and so if there is no improvement to the number of returns received more tougher measures will be considered.

Financial Summary (Capital and Revenue)

There are no direct financial implications arising from this report

Risks

There are a number of key risks to the closedown process that need to be mitigated against. The following table highlights these.

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Delayed accounts due to reliance on third parties	M	L	Estimations/judgements may be required where the information isn't available from third parties i.e., accruals Ensure third parties are aware of timetable deadlines	Finance
New policies/treatments	L	L	Knowledge of changes to the 'Code' and impact on the Authority's financial statements. Attendance at relevant year end courses. Discussions with auditors at early stage of process.	Finance

Impact of new system migration on key staff	H	M	Constant Communication between the Council and the Audit team needs to happen to ensure that areas of work are prioritised depending on when Accountancy staff need to be released to work on the new system. As part of the council down process, additional staff are being trained to ensure there is some additional capacity within the team	Chief Accountant
Failure to approve and publish the accounts before the 31 May deadline increases the risk of qualification and increases reputational external perception risks.	M	L	The Council works with its Auditors to ensure the Accounts are prepared and suitably reflect the financial position of the authority	Chief Accountant /Assistant Head of Finance

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

Effective financial management is essential if an organisation is to achieve its stated objectives.

Options Available and considered

Note and provide any comment for the planned improvement following lessons learned review.

Preferred Option and Why

As above

Comments of Chief Financial Officer

The outcome of the 2021/22 audit process was largely positive, in that an unqualified opinion was issued and the number of issues identified within Audit Wales' ISA 260 report was relatively low. However, there are always opportunities to improve the process and reduce the issues identified in future years. This report highlights areas that will be reviewed in advance of the 2022/23 closedown process and, ideally, rectified so that they are not issues in future years. In addition, an internal process of review will continue so that other opportunities to identify efficiencies or improve the quality of the accounts can be capitalised upon.

Comments of Monitoring Officer

There are no legal implications arising. The Council is fulfilling its statutory and regulatory requirements in ensuring that it can meet statutory deadlines regarding its Statement of Accounts.

Comments of Head of People, Policy and Transformation

There are no staffing implications arising from the report which is a key part of our regulatory framework and reflects sound financial management

Scrutiny Committees

N/A

Fairness and Equality Impact Assessment:

- **Wellbeing of Future Generation (Wales) Act**
- **Equality Act 2010**
- **Socio-economic Duty**
- **Welsh Language (Wales) Measure 2011**

For this report, a full Fairness and Equality Impact Assessment has not been undertaken. This is because this report is not seeking any strategic decisions or policy changes, with their purpose being to provide members with an overview of the steps being taken in preparing for the forthcoming closure of accounts process. The Wellbeing of Future Generations (Wales) Act 2015 forms an integral part of the financial management of the Council

To support the delivery of the Wellbeing of Future Generations Act, public sector bodies including local authorities should be considering the seven corporate areas of change including finance. This report submitted to the Audit Committee is a demonstration of how the Council's finance team are self-reflecting on their performance and improving their delivery. This is also a good demonstration of having a collaborative approach with the Council's service areas and External Audit (Audit Wales) to implement their improvements and to have sufficient assurance that the processes are effective and efficient to meet the necessary legislative requirements

Crime and Disorder Act 1998

N/A

Consultation

N/A

Background Papers

Statement of Accounts 2021/22 - available to public.

ISA 260 Audit of Financial Statements 2021/22 – available to public

Dated: