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Date: 2nd September 2015

Dear Sir/Madam,

A meeting of **Audit Committee** will be held in the **Sirhowy Room, Penallta House, Tredomen, Ystrad Mynach** on **Wednesday, 9th September, 2015** at **10.00 am** to consider the following agenda item, which was marked 'to follow' when the agenda was sent to print and is now available.

Yours faithfully,

A handwritten signature in blue ink that reads 'Chris Burns'.

Chris Burns
INTERIM CHIEF EXECUTIVE

A G E N D A

- 4 The Audit of Financial Statements Report - To Follow.

Circulation:

All Members And Appropriate Officers

A greener place Man gwyrddach

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Audit of Financial Statements Report **Caerphilly County Borough Council**

Audit year: 2014-15

Issued: September 2015

Document reference: [\[XXXA201X\]](#)

Status of report

This document has been prepared for the internal use of as part of work performed in accordance with statutory functions, the Code of Audit Practice and the Statement of Responsibilities issued by the Auditor General for Wales.

No responsibility is taken by the Auditor General or the Wales Audit Office in relation to any member, director, officer or other employee in their individual capacity, or to any third party.

In the event of receiving a request for information to which this document may be relevant, attention is drawn to the Code of Practice issued under section 45 of the Freedom of Information Act 2000. The section 45 Code sets out the practice in the handling of requests that is expected of public authorities, including consultation with relevant third parties. In relation to this document, the Auditor General for Wales is a relevant third party. Any enquiries regarding disclosure or re-use of this document should be sent to the Wales Audit Office at infoofficer@wao.gov.uk.

This document was produced by PricewaterhouseCoopers LLP and the Wales Audit Office on behalf of the Auditor General. The team who delivered the work comprised Lynn Pamment, Ian Davies, Osian Lloyd and Ben Jones from PricewaterhouseCoopers LLP.

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Summary report

Introduction

1. The Auditor General is responsible for providing an opinion on whether the financial statements give a true and fair view of the financial position of Caerphilly County Borough Council at 31 March 2015 and its income and expenditure for the year then ended.
2. We do not try to obtain absolute assurance that the financial statements are correctly stated, but adopt the concept of materiality. In planning and conducting the audit, we seek to identify material misstatements in your financial statements, namely, those that might result in a reader of the accounts being misled.
3. The quantitative level at which we judge such misstatements to be material for Caerphilly County Borough Council is £6m. Whether an item is judged to be material can also be affected by certain qualitative issues such as legal and regulatory requirements and political sensitivity.
4. International Standard on Auditing (ISA) 260 requires us to report certain matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action.
5. This report sets out for consideration the matters arising from the audit of the financial statements of Caerphilly County Borough Council for 2014-15 that require reporting under ISA 260.

Status of the audit

6. We received the draft financial statements for the year ended 31 March 2015 on 30 June 2015 in accordance with the agreed deadline, and at the date of writing this report our work in respect of the following is still to be completed:
 - Senior officer pay disclosures
 - Completion of work on valuation of property, plant and equipment including council dwellings properties
 - Completion of testing of income and expenditure and balance sheet items
 - Whole of government accounts
 - Completion procedures
 - Management representation letter
7. We are reporting to you the more significant issues arising from the audit, which we believe you must consider prior to approval of the financial statements. The audit team has already discussed these issues with the Acting Director of Corporate Services and S151 Officer and members of her team.

Proposed audit report

8. It is the Auditor General's intention to issue an unqualified audit report on the financial statements following completion of our work and once you have provided us with a Letter of Representation based on that set out in [Appendix 1](#).

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9. The proposed audit report is set out in [Appendix 2](#).

Significant issues arising from the audit

Valuations of fixed assets

10. In previous years we have reported significant adjustments having been made to correct the balance of property, plant and equipment within the statement of accounts. Whilst these have had no impact on the general fund the corrections have been significant, ranging from £60m to £120m. The Authority has introduced additional procedures to reduce the levels of errors in accounting for fixed assets. Whilst we are in the process of finalising our work in this area we have not identified errors of this scale this year. A number of smaller errors were identified and these are described below.

Current year valuations

11. The valuation of fixed assets is the most significant judgement in the accounts, due to the large asset base of the Authority.
12. The Authority undertakes a full valuation on approximately 40 of its highest value assets each year, providing coverage of approximately 60% of the net book value of its assets. Other assets (excluding council dwellings) are formally valued over a rolling five year period. The values of assets not valued in the year as part of the rolling programme are checked to ensure that their carrying values are not materially different from fair values by using construction indices to recalculate values. Material movements are adjusted for. Council dwellings are revalued every year.
13. The Council primarily relies on its internal valuations team to undertake the valuations of its assets.
14. As a result of its consideration of the valuation of fixed assets, the Authority has increased the value of its assets by approximately £140m.
15. We are finalising our testing of the underlying assumptions and data used by the Authority as the basis of its valuations and we involve our own valuations expert in this process.
16. We have also considered the accounting adjustments made by the Authority to record the valuation movements in its statement of accounts. We have identified some small errors which are set out below.

Senior officers' pay

17. The Authority had included a provision of £395k in respect of further payments to be made to suspended senior officers up to 31 January 2016. The amounts have been provided as the Authority will not receive services from the individuals whilst they remain suspended. In June 2015, Council agreed to allocate funds to cover the costs

of the suspended senior officers up to 31 August 2016 based on more up to date information, taking into account the pending court appearances of the suspended officers. As a result the Authority has increased the provision in the draft accounts by £278k to cover the additional costs up to 31 August 2016.

Other significant risks identified at the planning stage of the audit

18. In our Financial Audit Strategy, we set out information regarding the significant audit risks that were identified during the audit planning process. The table below sets out the outcome of our audit work in response to these risks.

Financial audit risk	Audit outcome
<p>Management override of controls The risk of management override of controls is present in all entities. Due to the unpredictable way in which such override could occur, it is viewed as a significant risk [ISA 240.31-33].</p>	<p>Our work in this areas is ongoing. Our work includes</p> <ul style="list-style-type: none"> • Understanding and evaluating internal control processes and procedures as part of our planning work. • Reviewing and testing the appropriateness of a sample of manual journals processed during the year. • Considering the categorisation of expenditure between the HRA and general fund by reviewing journals and reserve movements. • Looking carefully at management estimations and considering if they were subject to bias. • Our audit procedures also include an unpredictable element that varies year on year. <p>To date we have not identified any areas of concern.</p>
<p>Risk of fraud in revenue and expenditure recognition There is a risk of material misstatement due to fraud in revenue recognition and as such it is treated as a significant risk (ISA 240.26-27). We also extend this risk to cover expenditure recognition, as there is a risk that the Council could adopt accounting policies or treat income and expenditure transactions in such a way as to lead to material misstatement in the Comprehensive Income and Expenditure Statement. We have specifically identified two risks. The first is in respect of non-recurring revenue grants funding, in that revenue may not be recognised in line with the</p>	<p>We have understood and evaluated the controls in place to mitigate this risk and:</p> <ul style="list-style-type: none"> • tested key reconciliations; • tested that the Council was entitled to include income recognised in respect of grants funding in its accounts; and • tested that transactions that occurred around year-end were appropriately classified within the financial year to which they related. This included testing for unrecorded liabilities and the appropriateness of accruals. <p>We have considered the accounting policies adopted by the Authority and subjected income and expenditure to an</p>

Financial audit risk	Audit outcome
<p>terms and conditions of its funding where these grants are for specific programmes or one-off purposes.</p> <p>The second is in respect of expenditure relating to non-payroll costs which may be recognised incompletely or in the wrong accounting period.</p>	<p>appropriate level of testing. We have also considered the work we undertook in relation to the risk of management override of controls (see above). We are in the process of finalising our work but have not identified any significant matters to date.</p>
<p>Complex supplier arrangements</p> <p>The Financial Reporting Council (FRC) recently published a press release regarding complex supplier arrangements, which increases the focus on the review and accounting for such arrangements. There is a significant risk that such transactions may not be accounted for or disclosed appropriately.</p>	<p>We are in the process of reviewing the Authority's significant contracts and have not identified any issues to date.</p>

Uncorrected misstatements

19. We set out below the misstatements we identified in the financial statements, which have been discussed with management but remain uncorrected, and request that these are corrected. These are summarised in Appendix 1. If you decide not to correct these misstatements, we ask that you provide us with the reasons for non-correction.
20. The financial statements do not include a provision for the aftercare costs of the Trehir landfill site. The Authority's estimate of the cost of the aftercare is £1,641k and there are currently earmarked reserves of £600k. Whilst these items are in the process of being audited, they would lead to a net charge against the general fund of £1,041k if adjusted. In some instances it may be possible that such aftercare costs are able to be capitalised as part of the initial capital costs of landfill sites. However in the case of the Authority, it did not own the asset when it was initially constructed and so such treatment would not be appropriate here.
21. The Authority's share of the assets and liabilities and the financial results in its joint operations (including for example joint committees) has not been recognised within the Authority's own Balance Sheet and Income and Expenditure Statement. The Authority's share of the joint committees' aggregate assets and liabilities is a net asset of £973k and the impact of including the share of assets and liabilities would be to increase usable reserves by £618k. However as many of these arrangements are ongoing the Authority does not have access to these reserves in the short term.
22. Minor works assets, with a value of £479k, which do not meet the Authority's criteria for capitalisation are included in property, plant and equipment in the balance sheet. These should be included as expenditure items in the income and expenditure account. This adjustment, if made, would not impact on the Authority's usable reserves.
23. We identified a further misstatement in the treatment by the Authority of certain valuation movements in the year which would result in a net adjustment to the income

and expenditure account (reducing the surplus) of £271k. The latter adjustment would not impact on usable reserves.

24. An error in the calculation of the value of land owned by the Authority has meant that property values in the balance sheet are understated by £176k. Again, any adjustment for this error would not impact on the Authority's usable reserves.

Corrected misstatements

25. There are misstatements that have been corrected by management, but which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process. They are set out with explanations in [Appendix 3](#).

Other significant issues arising from the audit

26. In the course of the audit, we consider a number of matters both qualitative and quantitative relating to the accounts and report any significant issues arising to you.
- **We have no concerns about the qualitative aspects of your accounting practices and financial reporting.** We found the information provided to be relevant, reliable, comparable, material and easy to understand. We concluded that accounting policies and estimates are appropriate and financial statement disclosures unbiased, fair and clear.
 - **We have not encountered any significant difficulties during the audit to date.** We received information in a timely and helpful manner and were not restricted in our work.
 - **There were some significant matters discussed and corresponded upon with management which we need to report to you.** These are set out above.
 - **There are no other matters significant to the oversight of the financial reporting process that we need to report to you.**
 - **We did not identify any material weaknesses in your internal controls**

Risk of fraud

27. International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
28. Your responsibility as part of your governance role is:
- to evaluate management's identification of fraud risk, implementation of antifraud measures and creation of appropriate "tone at the top"; and
 - to investigate any alleged or suspected instances of fraud brought to your attention

-
- 29.** In presenting this report to you we ask for your confirmation that there have been no changes to your view of fraud risk and that no additional matters have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud is included in the letter of representation.

Independence and objectivity

- 30.** As part of the finalisation process, we are required to provide you with representations concerning our independence.
- 31.** We have complied with ethical standards and in our professional judgment, we are independent and our objectivity is not compromised. There are no relationships between the Auditor General, Wales Audit Office and Caerphilly County Borough Council that we consider to bear on our objectivity and independence.

Appendix 1

Draft Letter of Representation

[Audited body's letterhead]

Auditor General for Wales
Wales Audit Office
24 Cathedral Road
Cardiff
CF11 9LJ

30 September 2015

Representations regarding the 2014/15 financial statements

This letter is provided in connection with your audit of the financial statements of Caerphilly County Borough Council for the year ended 31 March 2015 for the purpose of expressing an opinion on their truth and fairness and their proper preparation.

We confirm that to the best of our knowledge and belief, having made enquiries as we consider sufficient, we can make the following representations to you.

Management representations

Responsibilities

We have fulfilled our responsibilities for:

- The preparation of the financial statements in accordance with legislative requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2014-15; in particular the financial statements give a true and fair view in accordance therewith.
- The design, implementation, maintenance and review of internal control to prevent and detect fraud and error.

Information provided

We have provided you with:

- Full access to:
 - all information of which we are aware that is relevant to the preparation of the financial statements such as books of account and supporting documentation, minutes of meetings and other matters;

-
- additional information that you have requested from us for the purpose of the audit; and
 - unrestricted access to staff from whom you determined it necessary to obtain audit evidence.
 - The results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
 - Our knowledge of fraud or suspected fraud that we are aware of and that affects Caerphilly County Borough Council and involves:
 - management;
 - employees who have significant roles in internal control; or
 - others where the fraud could have a material effect on the financial statements.
 - Our knowledge of any allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, regulators or others.
 - Our knowledge of all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.
 - The identity of all related parties and all the related party relationships and transactions of which we are aware.

Financial statement representations

All transactions, assets and liabilities have been recorded in the accounting records and are reflected in the financial statements.

Significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable.

Related party relationships and transactions have been appropriately accounted for and disclosed. I confirm that the attached appendix to this letter is a complete list of the Authority's related parties. All transfers of resources, services or obligations between the Authority and these parties have been disclosed to you, regardless of whether a price is charged. We are unaware of any other related parties, or transactions between disclosed related parties.

I confirm that we have made you aware of all employee benefit schemes in which employees of the Authority participate.

All contractual arrangements (including side-letters to agreements) entered into by the Authority have been properly reflected in the accounting records or, where material (or potentially material) to the statement of accounts, have been disclosed to you.

All events occurring subsequent to the reporting date which require adjustment or disclosure have been adjusted for or disclosed.

All known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

The financial statements are free of material misstatements, including omissions. The effects of uncorrected misstatements identified during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of these items is set out below:

		MIRS statement £k		I&E £k		Balance sheet £k	
1.	Dr I&E Cr Landfill provision Dr Usable reserves – earmarked reserves Dr Usable reserves – general fund Cr Movement in reserves Trehir landfill site		1,641	1,641		600 1,041	1,641
2.	Dr Net assets Cr Income Dr Movements in reserves Cr Usable reserves Cr Unusable reserves	973			973	973	618 355
3.	Dr I&E Cr PPE Cr Movement in reserves Dr Capital adjustment account Minor works capitalised below de minimus		479	479		479	479
4.	Dr PPE – accumulated depreciation Cr PPE – cost Dr PPE - cost Dr I&E Dr Accumulated depreciation Cr Movement in reserves Dr Capital adjustment account Cr Unusable reserves - Reval reserve Adjustment to revaluation postings				271	267 267 271	267 267 538

		MIRS statement £k		I&E £k		Balance sheet £k	
5.	Dr PPE Cr Unusable reserves - reval reserve Correction to underlying data used for the valuation					176	176

Representations by those charged with governance

We acknowledge that the representations made by management, above, have been discussed with us.

We acknowledge our responsibility for the preparation of true and fair financial statements in accordance with the applicable financial reporting framework. The financial statements were approved by Caerphilly County Borough Council on 29 September 2015.

We confirm that we have taken all the steps that we ought to have taken in order to make ourselves aware of any relevant audit information and to establish that it has been communicated to you. We confirm that, as far as we are aware, there is no relevant audit information of which you are unaware.

Signed by:

[Officer who signs on behalf of management]

Date:

Signed by:

[Member who signs on behalf of those charged with governance]

Date:

Appendix: List of related parties (to be inserted)

Appendix 2

Proposed audit report of the Auditor General to the Members of Caerphilly County Borough Council

I have audited the accounting statements and related notes of Caerphilly County Borough Council for the year ended 31 March 2015 under the Public Audit (Wales) Act 2004.

Caerphilly County Borough Council's accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Movement on the Housing Revenue Account Statement and the Housing Revenue Account Income and Expenditure Statement.

The financial reporting framework that has been applied in their preparation is applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2014-15 based on International Financial Reporting Standards (IFRSs).

Respective responsibilities of the responsible financial officer and the Auditor General for Wales

As explained more fully in the Statement of Responsibilities for the Statement of Accounts set out on page 10, the responsible financial officer is responsible for the preparation of the statement of accounts, which gives a true and fair view.

My responsibility is to audit the accounting statements and related notes in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Financial Reporting Council's Ethical Standards for Auditors.

Scope of the audit of the accounting statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements and related notes sufficient to give reasonable assurance that the accounting statements and related notes are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Caerphilly County Borough Council's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the responsible financial officer and the overall presentation of the accounting statements and related notes.

In addition, I read all the financial and non-financial information in the Explanatory Foreword to identify material inconsistencies with the audited accounting statements and related notes and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies, I consider the implications for my report.

Opinion on the accounting statements of Caerphilly County Borough Council

In my opinion the accounting statements and related notes:

-
- give a true and fair view of the financial position of Caerphilly County Borough Council as at 31 March 2015 and of its income and expenditure for the year then ended; and
 - have been properly prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014-15.

Opinion on other matters

In my opinion, the information contained in the Explanatory Foreword is consistent with the accounting statements and related notes.

Matters on which I report by exception

I have nothing to report in respect of the following matters, which I report to you, if, in my opinion:

- adequate accounting records have not been kept;
- the accounting statements are not in agreement with the accounting records and returns; or
- I have not received all the information and explanations I require for my audit;
- the Annual Governance Statement contains material misstatements of fact or is inconsistent with other information I am aware of from my audit.

Certificate of completion of audit

The certificate that the audit of the accounts has been completed in accordance with the requirements of Public Audit (Wales) Act 2004 and the Code of Audit and Inspection Practice issued by the Auditor General for Wales cannot be issued because court proceedings in respect of the decision of the senior remuneration panel in September 2012 have not yet been completed. The Appointed Auditor will consider the outcome of these proceedings when completed to determine whether any further audit action should be taken in respect of this matter.

For and on behalf of
Huw Vaughan Thomas
Auditor General for Wales
24 Cathedral Road
Cardiff CF11 9LJ
30 September 2015

Appendix 3

Summary of corrections made to the draft financial statements which should be drawn to the attention of those charged with governance

During our audit we identified the following misstatements that have been corrected by management, but which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process.

Value of correction	Nature of correction	Reason for correction
£278k	Increased provision for suspended senior officers' payments	Revision to judgement concerning period of ongoing suspension
£482k	Decrease in accumulated absences provision	Incorrect calculation of provision
£333k	Disclosure adjustment	Incorrect disclosure of creditor balance

The increased provision for suspended senior officers' payments reduces the Authority's general fund balance by £278k.

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