

Archwilydd Cyffredinol Cymru  
Auditor General for Wales



WALES AUDIT OFFICE  
SWYDDFA ARCHWILIO CYMRU

# Audit of Financial Statements Report

## **Caerphilly County Borough Council**

**Audit year:** 2015-16

**Issued:** 14 September 2016

**Document reference:** CCBCA2016

# Status of report

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This document has been prepared as part of work performed in accordance with statutory functions.

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 and the Wales Audit Office are relevant third parties. Any enquiries regarding disclosure or re-use of this document should be sent to the Wales Audit Office at [info.officer@audit.wales](mailto:info.officer@audit.wales).

The team who delivered the work comprised Barrie Morris, Engagement Lead, Laura Hallez, Audit Manager and Grace Hawkins, Audit Executive.

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The Auditor General intends to issue an unqualified audit report on your financial statements. There are some issues to report to you prior to their approval.

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# Summary report

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## 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 2016 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 financial statements being misled.
3. The quantitative levels at which we judge such misstatements to be material for Caerphilly County Borough Council are £3,957,000 generally. 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, for example, the audit fees disclosure and senior officer remuneration disclosures.
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 2015-16, that require reporting under ISA 260.

## Status of the audit

6. We received the draft financial statements for the year ended 31 March 2016 on 30 June 2016, in line with our planned timetable.  
Our audit work is substantially complete with the only work outstanding relating to our finalisation procedures, that can only be completed after the Council has received or report and approved the accounts and provided us with the signed letter of representation. We will then review and consider any post balance sheet events up to the date of the approval of the financial statements.
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 Interim Head of Corporate Finance and Acting Director of Corporate Services.

## Proposed audit report

8. It is the Auditor General's intention to issue an unqualified audit report on the financial statements once you have provided us with a Letter of Representation based on that set out in [Appendix 1](#).
9. The proposed audit report is set out in [Appendix 2](#).

## Response to financial audit risks

10. Our Audit Plan which was presented to the Audit Committee in June 2016 set out the risks relating to the Council's financial statements. As part of our interim audit, we completed work in a number of areas to consider the risks and provided an update to the Council's finance team on our work on these risks.
11. As part of our final accounts audit, we have reviewed the remaining areas and have set out below our final conclusions on the work completed. Our review of the current issues facing the Council has not identified any additional audit risks that we need to bring to your attention.

Financial audit risk	Response
<p>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>We have:</p> <ul style="list-style-type: none"> <li>• tested the appropriateness of a sample of journal entries, based on our risk assessment, and other adjustments made in preparing the financial statements;</li> <li>• reviewed accounting estimates for bias; and</li> <li>• evaluated the rationale for any significant transactions outside the normal course of business.</li> </ul> <p>We have no matters to report as a result of our audit work.</p>
<p>Operating Expenses – Creditors related to core activities understated or not recorded in the correct period.</p>	<p>We have:</p> <ul style="list-style-type: none"> <li>• documented our understanding of the controls operating in the creditors system;</li> <li>• performed a walkthrough to confirm that the controls identified are in operation;</li> <li>• tested for completeness of operating expenses including agreeing to source documentation and reviewing invoices received after the year end, for a sample of payments;</li> <li>• obtained an understanding of the accruals process; and</li> <li>• tested for unrecorded liabilities, including review of payments made after the year end, on a sample basis.</li> </ul> <p>We have no matters to report as a result of our audit work.</p>

Financial audit risk	Response
<p>Employee Remuneration and benefit obligations and expenses understated</p>	<p>We have:</p> <ul style="list-style-type: none"> <li>• documented our understanding of the controls operating in the payroll system;</li> <li>• performed a walkthrough to confirm that the controls identified are in operation;</li> <li>• undertaken analysis of trends and relationships to identify any anomalous areas for further investigation;</li> <li>• reviewed and tested the reconciliation of payroll system to the general ledger;</li> <li>• performed substantive testing, on a sample basis, of staff and officer payroll payments, ensuring that payments are made in accordance with the individual's contract of employment; and</li> <li>• reviewed a sample of payments made to former employees to ensure all costs are accurately reflected in the notes to the financial statements.</li> </ul> <p>As a result of our audit work, we recommended two amendments to the disclosures, detailed in Appendix 3, which have been processed by management.</p>
<p>Valuation of property, plant and equipment</p>	<p>We have:</p> <ul style="list-style-type: none"> <li>• reviewed management's processes and assumptions for the calculation of the estimate;</li> <li>• reviewed the competence, expertise and objectivity of any management experts used;</li> <li>• reviewed the instructions issued to valuation experts and the scope of their work;</li> <li>• held discussions with the valuer about the basis on which valuations are carried out and challenged the key assumptions where appropriate;</li> <li>• reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding; and</li> <li>• tested revaluations made during the year, on a sample basis, to ensure they are input correctly into the Council's asset register and correctly reflected in the financial statements.</li> </ul> <p>Following our audit work, and in discussion with management of amendments that they had identified, a number of amendments have been made to the final version of the accounts, as detailed in Appendices 3 and 4.</p>

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## Significant issues arising from the audit

### Uncorrected misstatements

12. There are no misstatements identified in the financial statements, which remain uncorrected.

### Corrected misstatements

13. 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

14. In the course of the audit, we consider a number of matters both qualitative and quantitative relating to the financial statements and report any significant issues arising to you.
15. **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.
16. **We did not encounter any significant difficulties during the audit.** We received information in a timely and helpful manner and were not restricted in our work.
17. **There were no significant matters discussed and corresponded upon with management which we need to report to you.**
18. **There are no other matters significant to the oversight of the financial reporting process that we need to report to you.**
19. **We did not identify any material weaknesses in your internal controls.**
20. **There are no other matters specifically required by auditing standards to be communicated to those charged with governance.**

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## Other matters arising from the audit

### Fair value disclosure of PWLB borrowings

20. The Council currently has PWLB loans that are held and measured at amortised cost in its balance sheet. Following the adoption of IFRS 13, local authorities are also required to disclose, in a note to the financial statements, the fair value of financial liabilities which are held at amortised cost in the balance sheet.
21. The Council has disclosed its fair value of PWLB loans using the premature repayment rate as its discount factor. It is our view that the use of premature repayment rates is not an appropriate discount factor and that new borrowing rates should be used.
22. CIPFA confirms in its LAAP Bulletin 104, issued on 17 March 2016, that 'a redemption rate is unlikely to provide an appropriate measure of fair value, as such a measurement would be specific to the local authority i.e. entity-specific. The PWLB redemption rate is not a price for transferring a liability between market participants under current market conditions.' It also states 'However, the redemption rate may provide useful information to the users of local authority financial statements'.
23. As the calculations of fair value under the new borrowing rates is materially different to that currently disclosed in the Council's financial statements, the Council has updated its disclosures in note 15 to reflect these revised amounts. This adjustment is a disclosure matter and does not affect the reported outturn position of the Council.

### Post balance sheet events – Impact of EU referendum outcome

24. With the vote to leave the EU confirmed on 24 June 2016, global stock markets have, as expected, responded with some significant fluctuations. Whilst these significant fluctuations are expected to ease in the coming weeks, the Council will need to consider the impact of these events on its financial statements at the time of their approval. As an authority and an admitted body to a pension fund, with balances held in investments and other liabilities held at fair value, it may be impacted by these events. In this case the values reported may be significantly lower, or possibly higher, than the position reported at 31 March 2016. Whilst this is a non-adjusting post balance sheet event, the Council should include appropriate disclosure in its financial statements about the volatility in markets following the referendum outcome, and its assessment of the impact, if any, on its future

## Recommendations arising from our 2015-16 financial audit work

25. The recommendations arising from our financial audit work are set out in [Appendix 4](#). Management has responded to them and we will follow up progress on them during next year's audit. Where any actions are outstanding, we will continue to monitor progress and report it to you in next year's report.



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## Independence and objectivity

26. As part of the finalisation process, we are required to provide you with representations concerning our independence.
27. 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 Wales Audit Office, Grant Thornton UK LLP and Caerphilly County Borough Council that we consider to bear on our objectivity and independence.

# Appendix 1

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## Final Letter of Representation

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

14 September 2016

## Representations regarding the 2015-16 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 2016 for the purpose of expressing an opinion on their truth and fairness. 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 Code of Practice; 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.

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- 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.

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. There were no uncorrected misstatements.

### Representations by the Audit Committee

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 the Council on 28 September 2016.

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:

Signed by:

# Appendix 2

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

### Auditor General for Wales' report 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 2016 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 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 2015-16 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 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 Narrative Report 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.

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### 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 2016 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 2015-16.

### Opinion on other matters

In my opinion, the information contained in the Narrative Report 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

I certify that I have completed the audit of the accounts of Caerphilly County Borough Council in accordance with the requirements of the Public Audit (Wales) Act 2004 and the Auditor General for Wales' Code of Audit Practice.

**For and on behalf of the Auditor General for Wales**  
**24 Cathedral Road**  
**Cardiff**  
**CF11 9LJ**

## Appendix 3

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### Summary of corrections made to the draft financial statements which should be drawn to the attention of the Audit Committee

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. These adjustments have no impact on cash or general fund balances.

Value of correction (£'000)	Nature of correction	Reason for correction
67,098	<b>Financial Instruments</b> Correction of the fair value disclosure of loans and PFI liability in Note 10 - Financial Instruments note.	To ensure that the fair value of loans is calculated using the 'new borrowing rate as at 31 March' as opposed to 'premature borrowing rate' as the discount factor.
75,996	<b>Comprehensive Income and Expenditure Statement and various disclosure notes</b> The HRA Subsidy buy-out has been disclosed as an exceptional item throughout the financial statements and removed from Note 22 – Property, Plant and Equipment, as it should not be capitalised.	HRA Subsidy buy-out should not be capitalised as it does not result in the creation of an asset. It is disclosed as exceptional item for greater transparency.
545	<b>Cash and Cash Equivalents</b> Reclassification of cash in hand to cash at bank in Note 28 – Cash and cash equivalents.	To ensure that cash held at financial institutions has been correctly classified within the financial statements.
6,662	<b>Property, Plant and Equipment</b> Differences were noted in the classification of assets between the asset register and the ledger. Assets were reclassified in the financial statements to accurately reflect the class of asset. This only has effect on note 22 Property, Plant and Equipment.	To ensure the general ledger and financial statements were consistent with the asset classes held in the Logotech Asset Register.
6	<b>Officer Emoluments</b> Senior Officer pay narrative for full annualised salary updated to reflect the correct amount of days in the period.	To ensure the correct number of days were used to calculate the full annualised salary.

137,796	<p><b>Property, Plant and Equipment</b></p> <p>Council Dwellings were revalued after the draft financial statements, in agreement with ourselves, as a result of the need for the Council to change the valuation basis for these assets to the adjusted vacant possession (Beacon principle) basis. This adjustment was made using the valuation provided by an external valuer.</p>	To ensure Council Dwellings are included in the financial statements at the correct amount by following the right valuation basis.
701	<p><b>Comprehensive Income and Expenditure Statement, Provisions and Movement on Reserves</b></p> <p>The amounts for senior officer pay and the associated legal costs was transferred from provisions to an earmarked reserve.</p>	To ensure the obligation is treated in line with IAS requirements.
13,978	<p><b>Comprehensive Income and Expenditure Statement</b></p> <p>Transfer the cost of Council Tax Reduction Scheme Expenditure from 'Taxation and Non-Specific Grant Income' to 'Housing Services'.</p>	To ensure that expenditure was being accounted for against the service to which it relates as opposed to being netted off grant income.
n/a	<p><b>Financial Instruments</b></p> <p>Correction to Note 10 - Financial Instruments to ensure the fair value categorisations of debt and PFI liabilities complied with the new requirements of IFRS 13.</p>	To ensure that the notes to the financial statements comply with the disclosure requirements of IFRS 13.
n/a	<p><b>Post Balance Sheet Events</b></p> <p>A non-adjusting post balance sheet disclosure was added to reflect the Council's consideration of the EU referendum outcome and any impact on its financial statements.</p>	To ensure the notes to the financial statements reflect any significant post balance sheet events up to the date of approval of the financial statements.
n/a	A number of other minor disclosure issues were identified.	To enhance the overall quality and presentation of the financial statements.

## Appendix 4

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### Recommendations arising from our 2015-16 financial audit work

We set out all the recommendations arising from our audit with management's response to them. We will follow up these next year and include any outstanding issues in next year's audit report:

<b>Matter arising 1 – Depreciation Calculation</b>	
<b>Findings</b>	Calculation of Depreciation
<b>Priority</b>	High
<b>Recommendation</b>	As a result of our audit findings, we recommend that management review how the Logotech Asset System calculates depreciation for revalued assets. Our work identified that revalued assets are being depreciated one year too quickly due to the incorrect 'Useful Economic Life' being used post revaluation.
<b>Benefits of implementing the recommendation</b>	The maximum error was not material in year. However, assets are being depreciated one year too quickly and as a result the depreciation figure charged each year is higher than expected. This has no impact on the general fund balance.
<b>Accepted in full by management</b>	Yes
<b>Management response</b>	Management have agreed to review how the Logotech system calculates depreciation after revaluations.
<b>Implementation date</b>	31 March 2017



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**Matter arising 2 – Aged Debtors and Creditors**

<b>Findings</b>	Accumulated Debtors and Creditors Balances
<b>Priority</b>	High
<b>Recommendation</b>	<p>Our audit work identified that the Council is carrying forward historical aged debtor and creditor balances rather than writing them off. This produces a significant number of balances that have no realisable value.</p> <p>Aged debtor and creditor balances should be written off and removed from the brought forward balances.</p>
<b>Benefits of implementing the recommendation</b>	The level of balances to be reviewed by management will be reduced to a level that reflects those with a realisable value.
<b>Accepted in full by management</b>	Yes
<b>Management response</b>	Debtor and creditor balances will be reviewed within the 2016/17 financial year.
<b>Implementation date</b>	31 March 2017.

Wales Audit Office  
24 Cathedral Road  
Cardiff CF11 9LJ

Tel: 029 2032 0500

Fax: 029 2032 0600

Textphone: 029 2032 0660

E-mail: [info@audit.wales](mailto:info@audit.wales)

Website: [www.audit.wales](http://www.audit.wales)

Swyddfa Archwilio Cymru  
24 Heol y Gadeirlan  
Caerdydd CF11 9LJ

Ffôn: 029 2032 0500

Ffacs: 029 2032 0600

Ffôn Testun: 029 2032 0660

E-bost: [post@archwilio.cymru](mailto:post@archwilio.cymru)

Gwefan: [www.archwilio.cymru](http://www.archwilio.cymru)