



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

Archwilydd Cyffredinol Cymru
Auditor General for Wales

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

Audit year: 2018-19

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Mae'r ddogfen hon hefyd ar gael yn Gymraeg. This document is also available in Welsh.

This document was produced by Barrie Morris and Grace Hawkins of Grant Thornton UK LLP.

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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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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 2019 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 levels at which we judge such misstatements to be material for Caerphilly County Borough Council are £6.5 million 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.
- 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 2018-19, that require reporting under ISA 260.

Status of the audit

- 6 We received the draft financial statements for the year ended 31 March 2019 on 7 June 2019, in line with the agreed deadline. As at 23 July 2019, our audit work is partially complete, and we are completing our final testing in several areas. Other than as outlined in this report, we have not identified any issues in those areas tested and we aim to complete this work to enable the Council to approve the final version of the accounts at the special council meeting on 30 July 2019. The areas that are still outstanding as at 23 July 2019 are:
 - Payroll testing (not including senior officer remuneration)
 - Welfare Expenditure testing
 - Review of Pension Fund Auditor assurances and the resolution of discussions on the accounting implications of the McCloud Judgement and the subsequent completion of our review of the actuary's work and assumptions;
 - Transactional testing of income, grants, disposals, additions, and creditors.
 - Testing of journal entries
 - Review of revaluations of property, plant and equipment
 - Review of the disclosure of financial instruments
 - Receipt and review of the final financial statements

- Completion of our Whole of Government Accounts audit work (September 2019 deadline. This is not covered by the audit opinion).

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. We will provide a further update on any matters arising and the current status of the outstanding issues at the Council meeting on 30 July 2019. The audit team has already discussed these issues with officers.

Proposed audit report

8 Based on the audit work completed to date 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 April 2019, 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.

Exhibit 1: response to financial audit risks

Financial audit risk – Significant Risk	Response
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>We have:</p> <ul style="list-style-type: none"> • tested the appropriateness of a sample of journal entries, based on our risk assessment, and other adjustments made in preparing the financial statements; • reviewed accounting estimates for bias; and • evaluated the rationale for any significant transactions outside the normal course of business. <p>One recommendation has been raised in appendix 4 as a result of our work to date. Our work in this area is still ongoing.</p>

Financial audit risk – Significant Risk	Response
Valuation of property, plant and equipment (Gross)	<p>We have:</p> <ul style="list-style-type: none"> • reviewed management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • considered the competence, expertise and objectivity of any management experts used; • discussed with the valuer the basis on which the valuation is carried out and challenged the key assumptions where appropriate; • reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding; and • tested revaluations made during the year to ensure they are input correctly into the asset register and correctly reflected in the financial statements. <p>Our work to date has identified one amendment in relation to the valuation of Council Dwellings that was highlighted by management. This has been reported in appendix 3.</p> <p>Our work is still ongoing in this area.</p>

Financial audit risk – Significant Risk	Response
<p>Valuation of Pension Fund Net Liability</p>	<p>We have:</p> <ul style="list-style-type: none"> • identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We also assessed whether these controls have been implemented and operated as expected and whether they are sufficient to mitigate the risk of material misstatement. • evaluated the competence, expertise and objectivity of the actuaries who carried out your pension fund valuations. We gained an understanding of the basis on which the valuations were carried out. • undertook procedures to confirm the reasonableness of the actuarial assumptions made. • checked the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial reports from your actuaries. <p>Our audit work to date has not identified any issues in respect of the valuation of the net defined benefit pension liability. However, discussions are ongoing with officers and the wider sector about the potential impact of legal proceedings in respect of the McCloud Judgement on the valuation of the net defined benefit pension liability. We are also awaiting a letter of assurance from the Pension Fund auditor in respect of the process and data supplied by the pension fund to the actuary.</p>
<p><u>Other Audit Matters</u></p>	
<p>New accounting standards IFRS 9 financial instruments applies from 1 April 2018 and brings in a new principles-based approach for the classification and measurement of financial assets. It also introduces a new impairment methodology for financial assets based on expected losses rather than incurred losses. This will result in earlier recognition of expected credit losses and will impact on how the bad debt provision is calculated.</p> <p>IFRS 15 revenue from contracts with customers introduces a principles-based five-step model for</p>	<p>We have:</p> <ul style="list-style-type: none"> • reviewed the Council's assessment of the impact of the introduction of the new standards. • reviewed the disclosures in the accounts to determine if they are sufficient and reasonable against the Code of Practice on Local Authority Accounting in the United Kingdom <p>Our work in this area is still ongoing.</p>

Financial audit risk – Significant Risk	Response
recognising revenue arising from contracts with customers. It is based on a core principle requiring revenue recognition to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration a body expects to be entitled to, in exchange for those goods or services. It will also require more extensive disclosures than are currently required.	

Significant issues arising from the audit

Uncorrected misstatements

- 12 There are no misstatements identified in the financial statements from our testing so far, which remain uncorrected.

Corrected misstatements

- 13 There are misstatements that will be 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 accounts and report any significant issues arising to you. There were some issues arising in these areas this year:

- **We have no concerns about the qualitative aspects of your accounting practices and financial reporting.**
- **We did not encounter significant difficulties during the audit.**
- **There was one significant matter discussed and corresponded upon with management, which we need to report to you.**

Impact of the McCloud/Sergeant ruling re age discrimination on pension liabilities - The Court of Appeal has ruled that there was age discrimination in the judges and firefighters pension schemes where there were transitional protections given to scheme members (the McCloud and Sergeant cases respectively). The legal ruling around age also has implications for other pension schemes where transitional arrangements on changing benefits were implemented, and this includes the Local Government Pension Scheme (LGPS). The Government had applied to the Supreme Court for permission to appeal but this was rejected in June 2019 which confirmed

that there was a present obligation to pay additional benefits to scheme members affected, and that it is probable that there will be an outflow of cash as a result of this. We have been discussing the implications of this with management and more widely with the sector as a whole to ensure consistency. We have requested that management discuss the implications of the current situation with their actuary and obtain additional information from them in order to ascertain whether the net defined pension liability could be materially understated. This information was received by the Council on 12 July 2019 and a subsequent adjustment will be made to the accounts as per appendix 3.

- 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.**
- There are not any other matters specifically required by auditing standards to be communicated to those charged with governance.

Recommendations arising from our 2018-19 financial audit work

- 15 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.

Independence and objectivity

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

Appendix 1

Final Letter of Representation

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

31 July 2019

Representations regarding the 2018-19 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 2019 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; and
- 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.

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 30 July 2019.

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

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

The independent auditor's report of the Auditor General for Wales to the members of Caerphilly County Borough Council

Report on the audit of the financial statements

Opinion

I have audited the financial statements of Caerphilly County Borough Council for the year ended 31 March 2019 under the Public Audit (Wales) Act 2004.

Caerphilly County Borough Council's financial 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 and the related notes, including a summary of significant accounting policies.

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 2018-19 based on International Financial Reporting Standards (IFRSs).

In my opinion the financial statements:

- give a true and fair view of the financial position of Caerphilly County Borough Council as at 31 March 2019 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with legislative requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2018-19.

Basis for opinion

I conducted my audit in accordance with applicable law and International Standards on Auditing in the UK (ISAs (UK)). My responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of my report. I am independent of the council in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and I have fulfilled my other ethical responsibilities in accordance with these requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Conclusions relating to going concern

I have nothing to report in respect of the following matters in relation to which the ISAs (UK) require me to report to you where:

- the use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or

- the responsible financial officer has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the council's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The responsible financial officer is responsible for the other information in the annual report and accounts. The other information comprises the information included in the annual report other than the financial statements and my auditor's report thereon. My opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated later in my report, I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information to identify material inconsistencies with the audited financial statements 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.

Report on other requirements

Opinion on other matters

In my opinion, based on the work undertaken in the course of my audit:

- the information contained in the Narrative Report for the financial year for which the financial statements are prepared is consistent with the financial statements and the Narrative Report has been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2018-19;
- The information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and the Annual Governance Statement has been prepared in accordance with guidance.

Matters on which I report by exception

In the light of the knowledge and understanding of the council and its environment obtained in the course of the audit, I have not identified material misstatements in the Narrative Report or the Annual Governance Statement.

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

- proper accounting records have not been kept;
- the financial 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.

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.

Responsibilities

Responsibilities of the responsible financial officer for the financial statements

As explained more fully in the Statement of Responsibilities for the Statement of Accounts set out on page 11, the responsible financial officer is responsible for the preparation of the statement of accounts, which give a true and fair view, and for such internal control as the responsible financial officer determines is necessary to enable the preparation of statements of accounts that are free from material misstatement, whether due to fraud or error.

In preparing the statement of accounts, the responsible financial officer is responsible for assessing the council's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

Auditor's responsibilities for the audit of the financial statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of my auditor's report.

Anthony J Barrett

For and on behalf of the Auditor General for Wales

[Date]

24 Cathedral Road

Cardiff

CF11 9LJ

Electronic publication of financial statements

The maintenance and integrity of the Caerphilly County Borough Council website is the responsibility of the Council. The work carried out by the auditor does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Statement of Accounts since they were initially presented on the web site.

Appendix 3

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

During our audit we identified the following misstatements that will be 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.

Exhibit 2: summary of corrections made to the draft financial statements

Value of correction	Nature of correction	Reason for correction
-2,373,360	HRA housing stock revaluation adjustment	An error on the original valuation report from the VOA was identified by management due to the Council Dwelling stock numbers used. The report has now been updated and the accounts will be amended, resulting in a decrease to the revaluation gain. This adjustment will not impact on cash balances.
-4,962,000	Impact of McCloud/Sergeant judgement on Council's total pension liabilities.	Impact of the McCloud/Sergeant ruling regarding age discrimination on pension liabilities. The legal ruling around age has implications for pension schemes where transitional arrangements on changing benefits were implemented, and this includes the Local Government Pension Scheme (LGPS). We have been discussing the implications of this with management and more widely with the sector as a whole to ensure consistency. Management obtained updated figures from the Pension Fund Actuary which has resulted in an increase in the liability and a subsequent adjustment to the statement of accounts.

Appendix 4

Recommendations arising from our 2018-19 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:

Exhibit 3: matter arising 1

Matter arising 1 - Internal Audit - tracking of recommendations	
Findings	Internal Audit - tracking of recommendations
Priority	Medium
Recommendation	<p>The Audit Committee does not have oversight of the recommendations made by Internal Audit. A tracking document should therefore be produced which shows the progress of these recommendations.</p> <p>This was raised in the prior year and ongoing discussion with management has confirmed that a new audit software is to be implemented in 2019/20 that will enable such information to be reported to those charge with governance.</p>
Benefits of implementing the recommendation	The Audit Committee have oversight over the recommendations made and progress in clearing these.
Accepted in full by management	Yes
Management response	The setting up of the new software system parameters and the population of datasets is well underway. It is anticipated that full test usage will begin in September 2019 with ongoing development work running in parallel.
Implementation date	Full test usage from September 2019.

Exhibit 4: matter arising 2

Matter arising 2 – Journals authorisation	
Findings	Journals authorisation
Priority	High
Recommendation	<p>Not all journals are authorised within the authority. This was raised in prior years and management have reviewed the process and lowered the authorisation threshold to £100k as reported to the Audit Committee. However, many journals still remain that are not reviewed and authorised before being posted to the general ledger.</p>

Matter arising 2 – Journals authorisation	
Benefits of implementing the recommendation	There is currently a risk that an inappropriate or erroneous journal could be processed and impact on the financial statements
Accepted in full by management	No
Management response	At its meeting on the 16 th October 2018 the Audit Committee endorsed a recommendation by Officers to implement an authorisation threshold of £100,000 to its journal transfer software. There are no plans to review this limit at the present time.
Implementation Date	N/A

Exhibit 5: matter arising 3

Matter arising 3 – Journals users	
Findings	Monitoring of Journals Users
Priority	High
Recommendation	During the course of audit, we were provided with the most recent schedule of council employees that were able to access the ledger and post journals. Our testing identified an employee who had two access logins active simultaneously due to a transfer to another team during the year. These accounts have different access rights within the system. We would recommend that the access to the general ledger system and the posting of journals is monitored and a central schedule is maintained and kept up to date to record who has access to process journals. Access rights for an employee should be disabled when a transfer between departments occurs
Benefits of implementing the recommendation	This will reduce the risk of unauthorised personnel posting journal entries to the general ledger that will impact the financial reporting.
Accepted in full by management	Yes
Management response	We will undertake a further review of current procedures to ensure that user profiles are updated centrally when staff changes occur.
Implementation Date	Immediately.

Exhibit 6: matter arising 4

Matter arising 4 – Provision for doubtful debts	
Findings	The opening balance contained a significant amount of historical data that had been brought forward from previous years.
Priority	Medium
Recommendation	As a result of the audit work performed, we recommend that a detailed review of historical debtor balances is reviewed each financial year. This recommendation was also raised in the prior year.
Benefits of implementing the recommendation	Reviewing the balances regularly ensures that the doubtful debt provision is a true reflection of the position at the year-end.
Accepted in full by management	Yes
Management response	A number of historic balances were cleared during 2018/19. A further review of balances will be undertaken during the current financial year.
Implementation date	31 st March 2020

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