

Archwilydd Cyffredinol Cymru
Auditor General for Wales



WALES **AUDIT** OFFICE
SWYDDFA **ARCHWILIO** CYMRU

Audit of Financial Statements Report

Rhondda Cynon Taf County Borough Council

Audit year: 2013-14

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Status of report

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The team who delivered the work were John Herniman, Jeremy Saunders, Helen Holt, Simon Howells, Gareth Lewis, David Williams, Alexis Smith, John Jones, Dylan Rees, Andrew Davies, Johanna Butt and Richard Thomas

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

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Summary report

Introduction

1. The Appointed Auditor is responsible for providing an opinion on whether the financial statements give a true and fair view of the financial position of Rhondda Cynon Taf County Borough Council (the Council) at 31 March 2014 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 mislead a reader of the accounts.
3. The quantitative level at which we judge such misstatements to be material for the Council are £7,872,000 for income and expenditure items and working capital balances, and £10,033,000 for other balances. Whether an item is judged material can also be affected by certain qualitative issues such as legal and regulatory requirements and political sensitivity. 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.
4. This report sets out the matters arising from the audit of the Council's financial statements for 2013-14, that require reporting under ISA 260.

Status of the audit

5. We received the draft financial statements for the year ended 31 March 2014 on 30 June 2014 which met the submission deadline and have now substantially completed the audit work on them.
6. 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 Head of Financial Reporting.

Proposed audit report

7. It is the Appointed Auditor'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](#). The proposed audit report is set out in [Appendix 2](#).

Issues arising from the audit

Uncorrected misstatements

8. There are no uncorrected misstatements in the financial statements.

Corrected misstatements

9. There are misstatements that management has corrected which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process. The main items are set out below along with explanations:

Description of correction	Reason for correction
Our testing identified that gross income and gross expenditure in net cost of services included amounts relating to internally provided services and as such were overstated. Management performed an exercise that identified these charges. As such gross income and gross expenditure within net cost of services were both reduced by £29,247,000 to eliminate these transactions. These adjustments had no impact on net cost of services	The Code requires that all internal recharges within and between directorates are removed such that the costs presented in the Statement of Accounts reflect the true cost to the Council.
The Trading operations entries in Financing and Investment Income and Expenditure should only reflect the external trading operations of the council. Internal trading should be reflected in net cost of services. Income was overstated by £6,652,000 and expenditure overstated by £7,367,000, with the balance reflected in net cost of services.	The Code requires that trading operations recorded in Financing and Investment Income and Expenditure should only reflect external trading.
From 1 April 2013 Council Tax Benefit was abolished and replaced by local Council Tax reduction schemes. The Government introduced a grant to compensate Councils for this change. The Council initially accounted for this grant in net cost of services when it should have been included in Taxation and non-specific grant income. As such, net cost of services income was reduced by £22,061,000 and Taxation and non-specific grant income increased by £22,061,000.	The Code requires that non ring-fenced government grants should be recorded in Taxation and non-specific grant income.
Accounts of Joint Committees are consolidated into the Council's accounts in accordance with the proportion of the Council's stake in the joint committee. Transactions between the Council and the joint committee and the Council should be eliminated as part of this consolidation. The transactions between the Council and the South East Wales Transport Agency totalling £9,165,000 had not been eliminated. As such, income and expenditure for Highways and Transport services in net cost of services were both overstated by £9,165,000.	The Code requires that on consolidation of joint committee transactions all inter-body transactions should be eliminated.

10. Further less significant adjustments are included in [Appendix 3](#),

Significant audit risks

11. In our Financial Audit Strategy, we set out information regarding the significant and other audit risks that were identified during the audit planning process. The table below sets out the initial risks identified and the outcome of our audit procedures in respect of those risks:

Significant risks

Risks	Action taken
Control environment risks	
<p>Management override of controls</p> <p>In any organisation, management may be in a position to override the financial controls that you have in place. A breach of controls of this nature may result in a material misstatement.</p>	<ul style="list-style-type: none"> • We understood and evaluated internal control processes and procedures as part of our planning work. • We reviewed and tested the appropriateness of a sample of manual journals processed during the year. • We looked carefully at management estimations and considered if they were subject to bias. • We understood the business rationale for significant transactions which appeared out of the normal course of business. • Our audit procedures also included an unpredictable element that varies year on year. <p>We have not identified any misstatements as a result of our testing.</p>
<p>Revenue recognition</p> <p>There is an inherent risk of material misstatement due to fraud in revenue recognition in entities with material revenue sources and, as such, this is treated as a significant risk. However, my initial assessment of the Council's income sources indicates that apart from grants there are no individual sources of revenue which are above my materiality threshold.</p>	<ul style="list-style-type: none"> • We reviewed the controls over grant income during the year. • We substantively tested the significant grants recorded in the Council's accounts. <p>We have not identified any misstatements as a result of our testing.</p>

Other risks

Risks	Action taken
Control environment risks	
<p>The Council needs to make significant efficiency savings, in order to bridge the funding gap for the 2013-14 financial year. The Council may not make the efficiency savings it needs and there could be an impact on the accounts or the accounting treatment for specific items.</p>	<p>We monitored the Council's financial position throughout the year and are satisfied that the accounts reflect the budget out-turn. We confirmed that the Council considered amounts in earmarked reserves when setting budgets and that its material earmarked reserves are held for specific purposes which are appropriately explained.</p>
<p>The Council holds material amounts within earmarked reserves. The Council will need to ensure that all relevant information is taken into account when establishing these reserves and setting budgets.</p>	<p>We confirmed that the Council considered amounts in earmarked reserves when setting budgets and that its material earmarked reserves are held for specific purposes which are appropriately explained.</p>
Preparation of accounts risks	
<p>The Code requires the fair value of specialised property, which is rarely sold, to be estimated using the Depreciated Replacement Cost (DRC) method of valuation. Fair values of specialised property may be misstated.</p>	<p>We reviewed a sample of DRC based valuations to assess whether:</p> <ul style="list-style-type: none"> • the Gross Replacement Cost of the Modern Equivalent Asset reflects the actual usage rather than the capacity of the existing asset; • an appropriate adjustment has been made for physical obsolescence; and • consideration has been given to the functionality and specification of the existing asset compared to its modern equivalent. <p>We also reviewed the process adopted by the Council, to satisfy itself that the valuations provided by the valuer are in accordance with the Code requirements.</p>
<p>During the 2012-13 year, the Revenue Expenditure Funded from Capital Under Statute (REFCUS) was not reflected in the property plant and equipment note in accordance with the requirements of the code. It was included as an addition and impaired rather than revenue expenditure. This may reoccur in 2013-14.</p>	<p>We reviewed and tested the accounts to confirm that the REFCUS expenditure had been reflected in accordance with the Code requirements for 2013-14. We have not identified any misstatements as a result of our testing.</p>

Risks	Action taken
<p>In the 2012-13 draft financial statements, the intra-group transactions were not correctly eliminated in the group accounts that were prepared. This may re-occur in 2013-14.</p>	<p>We reviewed the group accounts to confirm that intra-group transactions have been correctly eliminated.</p>
<p>The Council has approved a scheme for reducing employment costs. Given the budget pressures being experienced at the Council, there is a risk that the full liabilities in respect of any employees who take up the scheme are not fully recorded in the financial statements.</p>	<p>We reviewed and tested transactions to confirm that the amounts included in the financial statements in respect of the employees who have taken up voluntary severance are the total liabilities for the Council.</p>
<p>The Council has approved a number of school closures. These need to be accounted for appropriately.</p>	<p>We reviewed the accounting treatment and tested transactions for school closures to ensure they were in accordance with the Code. We have not identified any misstatements as a result of our testing.</p>

Other issues arising from the audit

12. 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 no issues arising in these areas this year:
- **We have two concerns about the qualitative aspects of your accounting practices and financial reporting.**
 - The Council has a process for accounting for internal recharges for central services such as HR, legal and accountancy. This ensures that the expenditure on these services only appears once in the accounts. The Council also has processes for internal invoicing where one service provides a service to another or one element of a service provides services to other elements within the same service, for example, the central education department providing services to schools. These processes are fine for budgetary control purposes at a service level but mean that, at a Council level, income and expenditure is recorded twice in net cost of services in the statement of accounts. There was no process in place to identify and eliminate this double counting. We worked with Council to identify and eliminate this double counting from net cost of services. As indicated above, this resulted in a reduction in gross income and gross expenditure of around £30 million. For future years' accounts the Council has agreed to put in place arrangements to eliminate these transactions from the draft accounts presented for audit.

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- In line with some other councils in Wales, the Council made payments totalling £5.24 million in 2013-14 in order to resolve equal pay claims made by employees. On the basis of legal advice available to it, the Council has not provided for related pension contributions. Legal advice obtained by the Appointed Auditor suggests that pension contributions should be made on the payments to resolve equal pay claims. The potential pension contributions not recognised in the accounts at 31 March 2014 amount to £1.0 million. This is in addition to unrecognised pension contributions we have reported to you in previous years. In light of the diverging legal views and the uncertainty regarding the need to recognise a provision in respect of pension contributions on equal pay settlements, the Appointed Auditor has concluded that he is not required to undertake any further action regarding this matter as part of the 2013-14 audit of accounts. The Council needs to be alert to any future court decisions on this issue that could clarify the legal position and impact on the need for a provision. In the event of any such decisions, the Appointed Auditor will also need to reconsider his position.
 - **We did not encounter any significant difficulties during the audit.**
We received information in a timely and helpful manner.
 - **There were no matters discussed and corresponded upon with management which we need to report to you.**
 - **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 relating to fraud, compliance with laws and regulations, subsequent events etc, required by auditing standards to be communicated to you.**

Independence and objectivity

13. As part of the finalisation process, we are required to provide you with representations concerning our independence.
14. 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 and Rhondda Cynon Taf County Borough Council that we consider to bear on our objectivity and independence.

Appendix 1

Final Letter of Representation

Anthony Barrett
Wales Audit Office
24 Cathedral Road
Cardiff
CF11 9LJ
[Date]

Representations regarding the 2013-14 financial statements

This letter is provided in connection with your audit of the financial statements of Rhondda Cynon Taf County Borough Council and Group for the year ended 31 March 2014 for the purpose of expressing an opinion on their truth and their proper preparation and the regularity of income and expenditure.

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 2013-14; in particular the financial statements give a true and fair view in accordance therewith.

I acknowledge our responsibility for 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;

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- 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 Rhondda Cynon Taf 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 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 Rhondda Cynon Taf County Borough Council on 24 September 2014.

Section 151 Officer

Leader of the Council

Appendix 2

Proposed audit report of the Appointed Auditor to the Members of Rhondda Cynon Taf County Borough Council

I have audited the accounting statements and related notes of:

- Rhondda Cynon Taf County Borough Council;
- Rhondda Cynon Taf County Borough Council Group; and
- Rhondda Cynon Taf Pension Fund;

for the year ended 31 March 2014 under the Public Audit (Wales) Act 2004.

Rhondda Cynon Taf County Borough Council's accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet and the Cash Flow Statement.

Rhondda Cynon Taf County Borough Council's Group accounting statements comprise the Group Movement in Reserves Statement, the Group Comprehensive Income and Expenditure Statement, the Group Balance Sheet and the Group Cash Flow Statement.

Rhondda Cynon Taf County Borough Council Pension Fund's accounting statements comprise the Fund Account and the Net Assets 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 2013-14 based on International Financial Reporting Standards (IFRSs).

Respective responsibilities of the responsible financial officer and the independent auditor

As explained more fully in the Statement of Responsibilities for the Statement of Accounts set out on pages 13 and 14, the responsible financial officer is responsible for the preparation of the statement of accounts, including the Rhondda Cynon Taf County Borough Council's Group accounting statements and Rhondda Cynon Taf Pension Fund's accounting statements, 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 Auditing Practices Board'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 Rhondda Cynon Taf County Borough Council; Rhondda Cynon Taf County Borough Council's Group and Rhondda Cynon Taf Pension Fund'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 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 Rhondda Cynon Taf County Borough Council

In my opinion the accounting statements and related notes:

- give a true and fair view of the financial position of Rhondda Cynon Taf County Borough Council as at 31 March 2014 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 2013-14.

Opinion on the accounting statements of Rhondda Cynon Taf County Borough Council Group

In my opinion the accounting statements and related notes:

- give a true and fair view of the financial position of Rhondda Cynon Taf County Borough Council Group as at 31 March 2014 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 2013-14.

Opinion on the accounting statements of Rhondda Cynon Taf Pension Fund

In my opinion, the pension fund accounts and related notes:

- give a true and fair view of the financial transactions of the Rhondda Cynon Taf Pension Fund during the year ended 31 March 2014 and of the amount and disposition of the fund's assets and liabilities as at that date, other than liabilities to pay pensions and benefits after the end of the scheme year ; and
- have been properly prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013-14.

Opinion on other matters

In my opinion, the information contained in the Foreword for the financial year for which the accounting statements and related notes are prepared 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 Governance Statement on which I report to you if, in my opinion, it does not reflect compliance with 'Delivering Good Governance in Local Government: Framework' published by CIPFA/SOLACE in June 2007, or if the statement is misleading or 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 Rhondda Cynon Taf County Borough Council in accordance with the requirements of the Public Audit (Wales) Act 2004 and the Code of Audit Practice issued by the Auditor General for Wales.

Anthony Barrett
Appointed Auditor
Wales Audit Office
24 Cathedral Road
CARDIFF

Date **September 2014**

Appendix 3

Summary of other corrections made to the draft financial statements which should be drawn to the attention of the Council

During our audit we identified the further 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
£502,000	Testing of year-end creditors identified some capital creditors where goods had not been fully received by the year-end. As such, creditors and capital expenditure additions were reduced by £502,000.	Overstatement of creditors and capital expenditure.
£6,165,000	Testing identified that Revenue Expenditure Funded Under Statute (REFCUS) and the grants associated with such had been netted off in net cost of services. As such, gross income and gross expenditure were increased by £6,165,000.	REFCUS and associated grants should not be netted off but shown gross.
n/a	Note 24 Amounts reported for resource allocation decisions need reworking to reflect adjustments for changes in net costs of services relating to internal recharges and consolidation adjustments.	To reflect the changes made in the Comprehensive Income and Expenditure Statement.
£25,245,000	Prior year figures in net cost of services gross income and gross expenditure were both reduced by £25,245,000 to eliminate internal recharges. There was no impact on net cost of services.	Eliminate internal recharges double counted in gross income and gross expenditure in prior year comparatives.
£6,098,000	Prior year comparators for central government bodies creditors were overstated by £6,098,000 and other entity creditors understated by £6,098,000 in Note 14 Short term creditors.	Correction of prior year comparators.

Value of correction	Nature of correction	Reason for correction
£6,067,000 and £6,568,000	In the prior year comparators for Trading operations entries in Financing and Investment Income and Expenditure, income was overstated by £6,067,000 and expenditure overstated by £6,568,000 with the balance reflected in net cost of services.	Correction of prior year comparators.
n/a	There were several other minor adjustments and enhanced disclosures made to the draft accounts.	Adjustments made to capture relevant disclosures and correct minor errors noted in the first draft.

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