

Audit of Financial Statements Progress Report

City and County Of Swansea

Audit year: 2013-14

Issued: 17 September 2014

Document reference: C14212

Purpose of this document

This document is a draft supplied in confidence solely for the purpose of verifying the accuracy and completeness of the information contained in it and to obtain views on the conclusions reached.

Handling prior to publication

This document and the copyright comprised therein is and remains the property of the Auditor General for Wales and/or the Appointed Auditor. It contains information, which has been obtained under statutory functions solely to discharge statutory functions and has been prepared as the basis for an official document that may be issued or published in due course. It may also contain information the unauthorised disclosure of which may be an offence under section 54 of the Public Audit (Wales) Act 2004. Except as expressly permitted by law, neither the document nor any of its content may be reproduced, stored in a retrieval system and/or transmitted in any form or by any means, or disclosed to any person other than the original recipient without the prior written permission of the relevant Engagement Director. It must be safeguarded at all times to prevent publication or other improper use of its content. Unauthorised use or disclosure may result in legal proceedings.

Status of report

This document was produced by PricewaterhouseCoopers LLP on behalf of Anthony Barrett, the Appointed Auditor. The team who delivered the work comprised Kevin Williams, Engagement Leader and Rebecca Nelson, Engagement Manager.

Contents

There are some areas of audit work that remain outstanding that are detailed within this report. This audit work will be completed prior to financial statements being approved and an audit report being issued by Anthony Barrett, as Appointed Auditor.

Summary report

Introduction	4
Status of the audit	4
Significant issues arising from the audit	5
Risk of Fraud	12
Independence and objectivity	12
Fee update	12

Introduction

1. Anthony Barrett, as Appointed Auditor, is responsible for providing an opinion on whether the financial statements give a true and fair view of the financial position of the City and County of Swansea (“the Authority”) at 31 March 2014 and its income and expenditure for the year then ended.
2. This report has been prepared and presented by PricewaterhouseCoopers LLP (“PwC”), who undertake the audit work on behalf of the Auditor General for Wales.
3. 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.
4. The quantitative level at which we judge such misstatements to be material to the Authority is £8.54m for income and expenditure items and working capital balances. 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.
5. 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.
6. This report sets out for consideration the matters arising from the audit of the financial statements of the Authority, for 2013-14, that require reporting under ISA 260.

Status of the audit

7. We received the draft financial statements for the year ended 31 March 2014 on 8th July 2014; this was in line with our agreed timescales. At the date of our presentation of this report there was audit work outstanding in the following areas:
 - Testing the revaluation of investment property
 - Testing the revaluation of property, plant and equipment
 - Testing the application of capital grants
 - Obtaining bank confirmation for school bank balances
 - Detailed review and testing of employment provisions
 - Review of landfill provisions
 - Review of post year end supplier invoices
 - Testing of deferred income
 - Review of the cash flow statement
 - Review of group accounts
 - Testing of reserves
 - Review of senior officer emoluments
 - Review of the amounts reported for resource allocation decisions note
 - Testing of grants credited to services
 - Testing of termination benefits
 - Detailed testing of the Whole of Government Account return

8. 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 Finance and Delivery.
9. We are unable at this time to provide the Proposed Audit Report of the Appointed Auditor or the Proposed Letter of Representation. This is due to the outstanding items listed above. We aim to provide these documents and an updated report to Cabinet on 23 September 2014.

Significant issues arising from the audit

Uncorrected misstatements

10. We set out below the misstatements we have identified in the financial statements as at 01 September 2014, which have been discussed with management but remain uncorrected. Management has decided not to correct these misstatements as they are not considered to be material to the users of the financial statements either individually or in aggregate.
11. We have reported all proposed audit adjustments which management has not elected to change with a value greater than £100k.

Nature of Correction	Comprehensive Income and Expenditure		Balance Sheet		Movement in Reserves	
	Debit (£'000)	Credit (£'000)	Debit (£'000)	Credit (£'000)	Debit (£'000)	Credit (£'000)
<p>Our work on impairment identified that £73,960 was inappropriately debited to the Revaluation Reserve rather than the Comprehensive Income and Expenditure Statement. Investigation by management identified further instances where it was inappropriate to debit such a movement to the revaluation reserve, giving a total adjustment of £441,437.07</p> <p>Impairment Revaluation Reserve Capital Adjustment Account Movement in Reserves</p>	441				441	441
<p>Our work on impairment identified that £221,266 of capital expenditure on Swiss Cottage, and its subsequent impairment, had been recorded within the "Other Land and Buildings" movement schedule rather than the Heritage Assets note. Our work as to the appropriateness of the associated impairment is ongoing.</p> <p>Heritage Assets (Impairment) Property Plant and Equipment (Impairment) Heritage Assets (Additions) Property, Plant and Equipment (Additions)</p>			221	221		
<p>Our work on the valuation of Council Houses identified a variance between the valuation calculated by the Internal Valuer and the value included in the fixed asset register.</p> <p>Council Dwellings Revaluation Reserve</p>			805			805
<p>Our review of the discounted cash flow model used to value council dwellings identified that borrowing costs had been included. It is noted that this approach is unusual. An adjustment has been proposed to remove these costs.</p> <p>Revaluation Reserve Council Dwellings</p>				1,102	1,102	

Nature of Correction	Comprehensive Income and Expenditure		Balance Sheet		Movement in Reserves	
	Debit (£'000)	Credit (£'000)	Debit (£'000)	Credit (£'000)	Debit (£'000)	Credit (£'000)
Our work on the landfill provision identified that all of the provision relating to the capping and remediation work to be carried out at the Tir John site has been recognised as a long term provision.						
Management estimate that £3,408k of the provision is to be spent during 2014-15, therefore it is appropriate to classify this element of the provision as short term						
Long Term Provisions			3,408			
Short Term Provisions				3,408		

Corrected misstatements

12. There are no misstatements that have been corrected by management, which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process.
13. It is noted that management have made a number of narrative adjustments to the accounts.

Matters on which management have consulted with us upon

14. The Council Tax Reduction Scheme was introduced in April 2013, replacing Council Tax Benefit. Following this change, the Authority discussed with us the various potential accounting treatments that could be applied.
15. Previously a credit to Taxation and Non-Specific Grant Income was recorded in order to recognise the income from the Council Tax Reduction Scheme. A debit to services was also recorded to recognise notional Council Tax Benefit expenditure. Gross Council Tax income was also recorded within Taxation and Non-Specific Grant Income.
16. Following discussions with us, management have proposed the following adjusting entry in order to remove the grossing up effect caused by recording Council Tax income gross along with notional Council Tax Benefit expenditure:
 - Debit Taxation and Non-Specific Grant Income - £19,159k
 - Credit Central Services to the Public - £19,159k

This correction has no impact upon the Total Comprehensive Income and Expenditure for the year.

Significant and elevated audit risks

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

Significant Risk	Audit Outcome
<p>Management override of controls The risk of management override of controls is present in all entities.</p>	<p>We have understood and evaluated internal control processes and procedures as part of our planning work.</p> <p>Testing of a sample of journals is currently ongoing. Our sample is based on risk and seeks to ascertain if journals were processed appropriately and related to genuine business transactions.</p> <p>We have considered significant management estimates in order to identify any evidence of management bias. Our work with regard to employee provisions and property valuations is currently ongoing.</p> <p>We designed and performed procedures in order to confirm our understanding of the business rationale for significant transactions.</p> <p>Our audit procedures also include an unpredictable element that varies year on year. Based on the work completed to date, we have not identified any matters to report to you.</p>
<p>Revenue and expenditure recognition There is a risk that the Authority could adopt accounting policies or treat income and expenditure transactions in such a way as to lead to material misstatement in the Comprehensive Income & Expenditure Statement.</p>	<p>We undertook the following procedures in response to this risk:</p> <ul style="list-style-type: none"> • tested the appropriateness of a sample of journals processed to income and non-pay expenditure ledger codes during the year; • reviewed the relevant accounting policies to ensure that they are in compliance with accounting standards; and • performed substantive procedures on a sample basis to ensure that income and non-pay expenditure has been appropriately accounted for in accordance with the stated accounting policy and in the correct period. <p>We have not identified any matters to report to you.</p>

Elevated Risk

Valuation of property, plant and equipment (PPE) and investment property

The Authority is required to ensure that PPE and Investment Property assets held on the Balance Sheet are valued sufficiently regularly to ensure that the carrying amount is not materially different from the fair value of these assets at the year end.

Audit Outcome

We have considered the Authority's proposed approach to the valuation of PPE and Investment Properties.

We note that the Authority values its land and buildings on a five year rolling programme. The Authority is yet to finalise its assessment, which involves a consideration of the likelihood that there has been material changes in value during the year for assets that have not been revalued in the sample of assets that have been formally valued.

Equal pay and job evaluation

The Single Status Agreement committed authorities to undertake equal pay reviews and to introduce non-discriminatory pay structures, addressing the fact that local government employees were often employed on differing terms and conditions.

The Authority has settled a number of equal pay claims to date and has undertaken a significant amount of work to develop a model to support the calculation of its provision for Equal Pay and Job Evaluation. The valuation of this provision is subject to a number of judgements.

We have reviewed the status of the equal pay and job evaluation exercise with officers and considered whether the associated the accounting treatment as appropriate. We are currently completing our assessment of the continued appropriateness of the methodology used to derive the overall estimate and the reasonableness of the assumptions therein. This will be facilitated through sample testing of individual cases.

We will also consider the extent to which the provision has been utilised after the year end, compare the payments made to the amounts provided for in the accounts.

We have not identified any matters to report to you to date.

Group accounts

During 2013-14 the trading operations of Swansea City Waste Disposal Company Limited (SCWDC) were transferred to the Council. The Council fully owned SCWDC as at 31 March 2013. Therefore, the presentation and disclosure of this transaction in the accounts of the Authority will need to be assessed and the requirement to produce group accounts considered.

Work is currently ongoing in order to review the substance and accounting treatment of the transaction. We are also considering the adequacy of disclosures in the accounts and group accounts of the Authority.

Significant estimates

18. During the course of our audit we undertook specific procedures in respect of areas subject to estimation risk as follows.

Fixed asset valuation methodology and assumptions

19. The Authority formally valued a proportion of its land and buildings as at 31 March 2014. We have selected a sample of the revalued assets to evaluate the methodology and assumptions used by the Authority's internal valuer.

20. We have performed testing of a sample of 20 assets to agree the base data (floor area etc) used in the valuation to supporting documentation. Testing of such assets is being finalised.
21. We confirmed the upload of the revaluation data from the information provided by the valuer to ensure that it has been accurately reflected in the Council's asset register.
22. The Authority values its land and buildings on a five year rolling programme. The Code of Practice on Local Authority Accounting states that revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using the fair value at the end of the reporting period.
23. The Authority has yet to finalise an assessment as to the sufficiency of the regularity of their revaluation programme.

Council Dwellings

24. The Authority uses a discounted cash flow model to value its Council Dwellings. We have reviewed the assumptions made by the Authority in this model and have noted that the Authority has included the effect of borrowings.
25. This treatment is considered to be unusual. Including borrowings has the effect of increasing the value of Council Dwellings by £1,102k. The impact of this has been included within the list of uncorrected misstatements listed above.
26. It is also noted that a transposition error occurred between the discounted cash flow model and the fixed asset register. This has the effect of decreasing the value of Council Dwellings by £805k.

Investment property

27. The Code of Practice on Local Authority Accounting requires that the Authority's investment properties are held at their fair value at each balance sheet date. The Authority's approach to doing this was to re-value all investment property assets as at 31 March 2014.
28. We have reviewed the methodology and assumptions used by the Authority's internal valuer, in conjunction with our own in-house valuer, and have not noted any material issues or matters to report to you.

Employment provisions

Equal pay

29. The Authority is in the latter stages of agreeing, and paying out, equal pay and backpay settlements with employees. The accounts include a provision in respect of this liability.
30. In 1997, local government employers and the trade unions signed the "Single Status Agreement". Enshrined in equal pay legislation, the Single Status Agreement committed authorities to undertake equal pay reviews and to introduce non-discriminatory pay structures, addressing the fact that local government employees were employed on differing terms and conditions. This review identified some elements of pay discrimination and resulted in the recognition of back pay liabilities to compensate for this, at most local authorities.
31. Following the receipt of claims from employees, and having assessed its position, the Authority has offered relevant employees a settlement in respect of the equal pay

back-pay liability. The Authority has also paid out, and therefore fully settled, a significant amount of the claims. However, there may be some claims which are not fully settled and may progress to an employment tribunal.

32. The Authority has undertaken an extensive modelling exercise to provide an estimate of the potential liability arising in respect of these claims for both financial and management accounting purposes.
33. Our audit is currently considering whether the provision included in the Authority's financial statements is a reasonable estimate of the expected total liability in respect of equal pay claims.

Job Evaluation

34. The Authority has also undertaken a review of its pay and grading structure. New pay structures have been implemented and any additional payments due have been backdated to 1 April 2010.
35. The Authority has included a provision to recognise potential costs of implementing the new structure from 1 April 2010. This provision includes those claimants who had previously settled equal pay claims but have subsequently lodged a new claim with the Employment Tribunal. We consider that this treatment is appropriate on the basis that the agreements to settle previous claims expired on 31 March 2010.
36. The Authority has used an external consultant to model the impact of the new pay regime. We are currently in the process of completing out testing of this model to assess the reasonableness of the provision.

Landfill provisions

37. At a Cabinet meeting in January 2013 a decision was taken to transfer the operations of Swansea City Waste Disposal Company into the Authority and close it using a solvent liquidation. The transfer of assets and liabilities occurred in July 2013.
38. As part of its responsibilities, the Authority will be required to undertake future capping and aftercare on the Tir John landfill site. As such a provision of £7.25m has been recognised in the 2013-14 accounts.
39. The Authority has taken the decision to enter into a procurement process for the future management of the site. This, combined with the Authority's own internal assessment of the likely future costs connected with the site, has informed the value of the provision for capping and aftercare.
40. Our work in this area is yet to be finalised. However, we have noted that the Authority has classified the entire provision as long term. The Authority estimates that £3.4m of the provision will be utilised in 2014-15 and as such we have proposed that this element of the provision is classified as short term.

Other significant issues arising from the audit

41. 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 significant issues arising in these areas this year:
 - **In our view the qualitative aspects of your accounting practices and financial reporting continues to improve.** Generally, we found the information provided to be relevant, reliable, comparable, material and easy to understand.
 - **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.

- **Other than matters previously reported, there are no additional 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 significant or material weaknesses in your internal controls to report to you.** We will report to you, all weaknesses in internal control that we have identified, and proposals for improvement, following completion of our audit.
- **There are no other matters specifically required by auditing standards to be communicated to those charged with governance.**

Risk of Fraud

42. 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.

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
 - to investigate any alleged or suspected instances of fraud brought to your attention.
43. 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 in relation to fraud will be included in the letter of representation.

Independence and objectivity

44. As part of the finalisation process, we are required to provide you with representations concerning our independence.
45. 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 or PricewaterhouseCoopers LLP and the City and County of Swansea that we consider to bear on our objectivity and independence.

Fee update

46. The requirements of the Public Audit (Wales) Act 2013 introduced a slightly revised fee-setting requirement on the new Wales Audit Office for all audit work once its provisions came into effect from 1 April 2014. Accordingly, the Wales Audit Office have reviewed its cost allocation and apportionment processes to ensure that, going forward, our fee setting fully complies with these new statutory requirements. Our fees charged are:

	2013/14 fee
City and County of Swansea Financial Audit	£262,000
City and County of Swansea Performance Programme	£107,550

- 47.** Our fee for certification of grants and claims is yet to be finalised for 2013/14 and will be reported to those charged with governance in due course.

Wales Audit Office
24 Cathedral Road
Cardiff CF11 9LJ

Tel: 029 2032 0500

Fax: 029 2032 0600

Textphone: 029 2032 0660

E-mail: info@wao.gov.uk

Website: www.wao.gov.uk

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: info@wao.gov.uk

Gwefan: www.wao.gov.uk