



WALES AUDIT OFFICE
SWYDDFA ARCHWILIO CYMRU

Archwilydd Cyffredinol Cymru
Auditor General for Wales

Audit of Financial Statements Report – Newport City Council and Newport City Council Group

Audit year: 2018-19

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infoofficer@audit.wales.

We welcome correspondence and telephone calls in Welsh and English. Corresponding in Welsh will not lead to delay. Rydym yn croesawu gohebiaeth a galwadau ffôn yn Gymraeg a Saesneg. Ni fydd gohebu yn Gymraeg yn arwain at oedi.

The team who delivered the work comprised Anthony Veale, Gareth Lucey and Ramim Khan.

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Summary report

Introduction

- 1 The Auditor General is responsible for providing an opinion on whether the financial statements give a true and fair view of the financial position of Newport City Council (the Council) and Newport City Council Group (the Group) 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 both the Council and the Group is £5.0 million. 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, we adopt lower materiality levels for the audit of officers' remuneration and related party 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 the Council and the Group, 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, prior to the required deadline of 15 June 2019, and have now substantially completed the audit work.
- 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 Head of Finance and Assistant Head of Finance.

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](#).

Significant issues arising from the audit

Uncorrected misstatements

- 10 We set out below the misstatements we identified in the financial statements, which have been discussed with management but remain uncorrected, and request that these are corrected. If you decide not to correct these misstatements, we ask that you provide us with the reasons for non-correction within your letter of representation.

Understatement of pension liability by £2.562 million arising from the McCloud judgement

A legal challenge was recently brought by a group of firefighters and judges against the UK Government. The group claimed that changes to their relevant pension schemes in 2015 (specifically the introduction of new career average schemes, with transitional arrangements for those close to retirement age) were discriminatory.

In December 2018, the Court of Appeal upheld the challenge, confirming that these changes to pension schemes discriminated on the grounds of age. This decision was further upheld by the Supreme Court in June 2019, which denied the UK Government permission to appeal. This matter is widely referred to as the 'McCloud judgement'.

The UK Government accepts that this judgement has implications for other public sector pension schemes including the Greater Gwent Pension Fund, of which the Council is a member. It is anticipated that the costs of providing a remedy to affected employees will be significant.

We have concluded that the McCloud judgement gives rise to an increase in the past service cost and pension liability as a reasonable estimate of its impacts can be made. The Council's actuary has assessed the financial impact of this legal judgement as £2,562,000.

The Council has not increased the past service cost and pension liability by £2,562,000 but has disclosed the impact of the McCloud judgement as a contingent liability in Note 43 of the financial statements.

Accounting treatment of loan modifications under IFRS 9

The introduction of International Financial Reporting Standard 9 (IFRS 9) by the CIPFA Code in 2018-19 confirms the accounting treatment for loan modifications (that is, any instance where an existing loan is replaced by a new loan). In short, where the terms and conditions of the two loans are not 'substantially' different, the new loan should be accounted for as if the terms and conditions of the old loan were still in place.

The Council replaced a Public Works Loan Board loan in 2000 with a new loan with a lower interest rate, but without 'substantially' different terms and conditions. Applying the previous higher interest rate reduces the carrying value of the loan by £1.385 million under IFRS 9, which the Council has recognised as an increase to opening earmarked reserves in 2017-18 (refer to Note 10 of the draft accounts).

The CIPFA Code requires that any differences in loan values should only be recognised as an adjustment to opening reserves in 2018-19, within the Movement in Reserves Statement. In addition, our audit work identified that the carrying value of this loan should only decrease by £900,000 under IFRS 9, as part of the loan was repaid in 2009.

The Council's treatment in this instance is therefore not in line with the CIPFA Code (albeit not material) and so this is reported here as an unadjusted misstatement.

Corrected misstatements

- 11 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

- 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 no concerns about the qualitative aspects of your accounting practices and financial reporting.**

We found the information provided to be relevant, reliable, comparable, and easy to understand. We concluded that accounting policies and estimates are appropriate and financial statement disclosures unbiased, fair and clear.

- **We did not encounter any significant difficulties during the audit.**

We generally received information in a timely and helpful manner and were not restricted in our work. However, Council staff did not receive declarations of interest from the majority of Council Members as part of our work over related party disclosures (in 2017-18, we received 42 declarations out of 50). In response, we have performed other audit work to provide assurance over the completeness of these disclosures in the 2018-19 financial statements.

In this report we have outlined the future requirements for the submission and audit of the financial statements, for your attention.

- **There were no significant 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 required by auditing standards to be communicated to those charged with governance.**

Recommendations arising from our 2018-19 financial audit work

13 The recommendations arising from our financial audit work will be reported separately in a Financial Accounts Memorandum, which we expect to present to the Audit Committee in November 2019. We will follow up progress on recommendations during next year's audit. Where any recommendations are outstanding, we will report them to you in next year's report.

Independence and objectivity

- 14 As part of the finalisation process, we are required to provide you with representations concerning our independence.
- 15 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 the Council or the Group that we consider to bear on our objectivity and independence.

Future accounts and audit deadlines

16 As outlined in our 2017-18 Audit of Financial Statements Report, the Council and the Auditor General must now meet earlier statutory financial reporting deadlines. The deadlines are being moved forward in stages towards 2020-21. **Exhibit 1** sets out how these deadlines are changing.

Exhibit 1: changes to financial reporting deadlines in future years

Annual financial statements	Draft financial statements signed by the responsible finance officer (Section 151 Officer)	Financial statements approved by the Council and published (with the signed audit certificate or an explanation for its absence)
2017-18	30 June 2018	30 September 2018
2018-19	15 June 2019	15 September 2019
2019-20	15 June 2020	15 September 2020
2020-21 onwards	31 May 2021	31 July 2021

- 17 For 2018-19 the Audit Committee received draft financial statements on 6 June and audited financial statements on 5 September, within the required deadlines. From 2020-21 onwards, Committee dates will need to be brought forward to incorporate the earlier statutory deadlines above.
- 18 The draft 2018-19 financial statements were presented for audit in early June, a couple of weeks earlier than in 2017-18. After submitting the statements for audit, Council officers engaged with us well throughout the audit, helping us to substantially complete our audit work within a seven-week window.
- 19 Further work by the Council and us is required to meet the tighter deadlines from 2020-21 onwards. As we have worked through the 2018-19 accounts and audit process, we and the Council have identified further areas of work (such as valuations of property, plant and equipment) which could be completed and audited before receipt of the draft accounts.
- 20 We will continue to work closely with Council officers over the autumn to identify and implement improvements to the preparation and audit of the 2019-20 financial statements, with the aim of meeting the revised deadlines by 2020-21.

Appendix 1

Final letter of representation

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

5 September 2019

Representations regarding the 2018-19 financial statements

This letter is provided in connection with your audit of the financial statements (including that part of the Remuneration Report that is subject to audit) of Newport City Council and Newport City Council Group for the year ended 31 March 2019 for the purpose of expressing an opinion on their truth and fairness and their proper preparation.

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

Management representations

Responsibilities

We have fulfilled our responsibilities for:

- The preparation of the financial statements in accordance with legislative requirements and the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom 2018-19; in particular the financial statements give a true and fair view in accordance therewith.
- The design, implementation, maintenance and review of internal control to prevent and detect fraud and error.

Information provided

We have provided you with:

- Full access to:
 - all information of which we are aware that is relevant to the preparation of the financial statements such as books of account and supporting documentation, minutes of meetings and other matters;
 - additional information that you have requested from us for the purpose of the audit; and

- unrestricted access to staff from whom you determined it necessary to obtain audit evidence.
- The results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- Our knowledge of fraud or suspected fraud that we are aware of and that affects Newport City Council and Newport City Council Group 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.

There are no material differences between the accounting policies of Newport City Council and Newport City Council Group.

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

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

Understatement of pension liability by £2.562 million arising from the McCloud judgement

The McCloud judgement is a complex matter which is yet to be fully resolved. An Employment Tribunal will further consider these specific cases in the summer of 2020, where it will determine an appropriate remedy to those affected individuals (it is expected that this remedy will then be applied across all affected pension schemes).

Given the current uncertainty surrounding the exact remedy to be applied, that the current estimate of the impact by the Council's actuary (£2.562 million) is not material to the Council's accounts, and the adjustment would be reversed out through the pension reserve (with no impact on the general fund) we determine that it is reasonable to record this as a contingent liability rather than increase the pension liability at this stage.

Any updated position will be reflected in the updated valuations received from the actuaries in 2019/20 and will be accounted for at that point.

Accounting treatment of loan modifications under IFRS 9

While the accounting treatment for the gain arising from this loan modification is not strictly in line with CIPFA Code requirements, we believe that this treatment discloses the impact of IFRS 9 in a meaningful way. The CIPFA Code treatment would lead to an increase in the Council's General Fund being displayed in the Movement in Reserves Statement, this however is purely an accounting treatment adjustment and does not create a cash backed reserve. Therefore, we believe showing an increase in the general fund reserve during the financial year would be inappropriate and while it doesn't follow the Code exactly, the overall impact to the reserves is the same.

As the amount is not material to the Council's accounts (and will only reduce to zero over the remaining life of the loan in question) we do not propose to amend this item.

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 Audit Committee on 5 September 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:

Meirion Rushworth

Head of Finance/Section 151 Officer

Date: 5 September 2019

Signed by:

John Baker

Audit Committee

Date: 5 September 2019

Appendix 2

Proposed audit report of the Auditor General to Newport City Council

The independent auditor's report of the Auditor General for Wales to the members of Newport City Council

Report on the audit of the financial statements

Opinion

I have audited the financial statements of:

- Newport City Council; and
- Newport City Council Group

for the year ended 31 March 2019 under the Public Audit (Wales) Act 2004.

Newport City Council's financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, and the related notes, including a summary of significant accounting policies.

Newport City Council Group's financial statements comprise the Group Movement in Reserves Statement, the Group Comprehensive Income and Expenditure Statement, the Group Balance Sheet, the Group Cash Flow 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 Newport City Council and Newport City Council Group 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 and its group 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 or group's ability to continue to adopt the going concern basis of accounting for a period of at least 12 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 statement of accounts. The other information comprises the Narrative Report and the Annual Governance Statement included in the financial statements. 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 the group 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 Newport City Council and Newport City Council Group 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, the responsible financial officer is responsible for the preparation of the statement of accounts, including Newport City Council Group's financial statements, 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 and group'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
10 September 2019

24 Cathedral Road
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Appendix 3

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

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.

There are no corrections which affect the Council's General Fund balance.

Exhibit 2: corrections to the financial statements that do not affect the General Fund

Value of correction	Nature of correction	Reason for correction
£6.2 million decrease in income and expenditure within the Comprehensive Income and Expenditure Statement (CIES).	To remove income and expenditure which does not relate to Council activity in 2018-19.	The Council processes payroll for Newport Live. In prior years, staff costs for leisure were correctly recorded in the Council's accounts, but Newport Live is now independent of the Council. Newport Live staff costs and other related costs for 2018-19 had been incorrectly charged to expenditure, with recharges recorded as income. This correction reduces both income and expenditure in the CIES. Therefore, it does not affect the General Fund.

Exhibit 3: corrections relating to presentational/disclosure matters only

Area of correction	Nature of correction	Reason for correction
Note 14 (Property, Plant and Equipment): Classification of impairments.	To ensure that impairments are presented in line with the CIPFA Code.	Our audit identified three buildings under construction that were completed during 2018-19. On completion, these buildings were revalued in line with the CIPFA Code, leading to a total reduction in value of £30.5 million. However, these reductions in value were incorrectly recorded as 'downward revaluations' instead of 'impairments' in Note 14. They also were not recorded in Note 37 (impairment losses).
Note 14 (Property, Plant and Equipment): Understatement of asset revaluations.	To correct the valuation of two assets.	John Frost School and Ysgol Gyfun Gwent Is Coed were valued on completion during 2018-19. However, these valuations were understated as the value of school playing fields associated with the sites had not been considered by the valuers. The relevant land assets were therefore undervalued by £2.6 million in Note 14.

Area of correction	Nature of correction	Reason for correction
Note 14 (Property, Plant and Equipment): Derecognition of assets.	To derecognise assets no longer controlled by the Council.	Our audit identified £1.8 million of items in the Council's fixed asset register relating to Duffryn High School (now replaced by Ysgol Gyfun Gwent Is Coed and John Frost School). As Duffryn High School no longer exists (and the two new schools have been valued on completion), these assets have now been removed from the fixed asset register and Note 14.
Note 14 (Property, Plant and Equipment): Recognition of disposals.	To derecognise assets no longer controlled by the Council.	Our audit identified three separate parcels of land worth £381,000, which were included in the draft accounts but had been sold by the Council on 29 March 2019. These assets have now been removed from the fixed asset register and Note 14, and any gain/loss on disposal of the assets has also been recorded.
Note 19 (Short Term Debtors): Reclassification of debtor balances.	To accurately classify debtors within the Note.	Our audit identified £1.1 million of debtors classified under 'central government bodies' in Note 19, which actually related to 'NHS bodies'. These debtors have now been reclassified correctly in the final accounts.
Note 30 (Officer Remuneration): Amendment of Council disclosures on senior employees and remuneration ratios.	To accurately present these disclosures in line with the Accounts & Audit Regulations (Wales) 2014.	Our audit identified a number of presentational amendments required throughout the disclosures in this note relating to senior officer remuneration, banding tables, and the remuneration ratio. Amendments have now been processed, and consequently we are now satisfied that this disclosure complies with the Regulations and the CIPFA Code.
Note 35 (Leases): Correction of disclosures.	To correct disclosures of operating leases (Council as lessor).	Our audit identified that the future lease payments receivable under operating leases was understated by £1.6 million. This disclosure has now been corrected in Note 35.
Note 42 (Financial Instruments): Amendment of loan maturities.	To correctly disclose the loan maturity table in the 'liquidity risk' section.	Our audit identified that £30.0 million of loans (correctly classified in the Balance Sheet) had been incorrectly classified as due in less than one year in Note 42, when they fall due in over five years. The table has now been amended to correctly reflect the Council's loan maturities.
Group Accounts: Valuation of property, plant and equipment.	To present Property, Plant and Equipment in line with the Group's accounting policies.	In previous years we have reported that Newport Transport Ltd.'s bus depot was valued at historical cost less depreciation, while the Group's accounting policies required revaluation every five years. A correction has now been made to the final Group accounts, increasing the value of the bus depot by £468,000 in line with a valuation obtained in 2015.

Area of correction	Nature of correction	Reason for correction
Various: Other presentational changes to supporting notes.	To ensure that all disclosures are accurately presented.	A number of other narrative, presentational and minor amendments were made to supporting notes throughout the final financial statements.

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