Audit Committee Update for Manchester City Council

Year ended 31 March 2015

January 2015

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Introduction

This paper provides the Audit Committee with a report on progress in delivering our responsibilities as your external auditors. The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you; and
- a number of challenge questions in respect of these emerging issues which the Committee may wish to consider.

Members of the Audit Committee can find further useful material on our website www.grant-thornton.co.uk, where we have a section dedicated to our work in the public sector (http://www.grant-thornton.co.uk/en/Services/Public-Sector/). Here you can download copies of our publications including:

- "Rising to the challenge: the evolution of local government", summary findings from our fourth year of financial health checks of English local authorities
- "2020 Vision", exploring finance and policy future for English local government
- "Where growth happens", on the nature of growth and dynamism across England

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Audit Manager.

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Progress at January 2015

Work	Planned date	Complete?	Comments
2013-14 Certification of claims and returns We certify certain claims and returns prepared and submitted by the Council on an annual basis.	December 2014	Complete	We completed our certification work on the Council's 2013-14 claims and returns in December 2014. Our annual report on the certification of claims and returns under Audit Commission arrangements is included on the Committee's agenda.
2014-15 Accounts Audit Plan We will issue a detailed accounts audit plan to the Council, setting out our proposed approach in order to give an opinion on the Council's 2014-15 financial statements, on completion of our interim audit.	March 2015	On track	Our audit plan will highlight risks identified from our audit planning and interim audit work and will set out the work we propose to address those risks. Our audit plan will include, for example, reference to audit work to be performed in relation to the fair valuation of Council assets including the Council's interest in Manchester Airport Holdings Limited and in relation to the issue of accounting for schools. We will present our plan to the next meeting of the Audit Committee.
Interim accounts audit Our interim fieldwork visit will include the following: • updating our understanding of the Council's control environment • updating our understanding of the Council's financial systems • review of Internal Audit reports on core financial systems • early work on emerging accounting issues • early substantive testing • early Value for Money conclusion work.	January – March 2015	On track	We are currently planning our interim audit and we will report any significant findings and conclusions within the Audit Plan to be presented to the next meeting of the Audit Committee. As part of our early planning work will we provide officers with a schedule of working paper requirements and we will continue to hold regular liaison meetings with the key officers involved in the preparation of the Council's accounts. Representatives of the Council's finance team have been invited to a Grant Thornton PFI workshop being held in Manchester on 20 February to explore opportunities to make savings in existing PFI contracts and to consider aspects of PFI accounting that have given difficulty in the past. We will also invite officers to our 2015 Local Government Accountants' Workshop.

Progress at January 2015

Work	Planned date	Complete?	Comments
2014-15 final accounts audit Including: • audit of the 2014-15 financial statements • proposed opinion on the Council's accounts • proposed Value for Money conclusion.	July – September 2015	On track	Our Annual 'Audit Findings Report' to the Audit Committee will summarise the findings from our final accounts audit and will be presented in September.
Value for Money (VfM) conclusion We will give our statutory VfM conclusion on the Council's arrangements to secure economy, efficiency and effectiveness based on two criteria specified by the Audit Commission: • securing financial resilience – focusing on whether the Council is managing its financial risks to secure a stable financial position for the foreseeable future; and • challenging how the Council secures economy, efficiency and effectiveness – focusing on whether resources are being prioritised within tighter budgets.	January – August 2015	On track	We are currently undertaking our initial risk assessment procedures to inform our 2014-15 VfM audit work. Our VfM work will be completed in August 2015 and our VfM conclusion will be presented alongside our opinion on the Council's accounts. We continue to take into account correspondence received from a member of the public in relation to the Council's LED street lighting proposals as part of our responsibilities in relation to Value for Money.

Progress at January 2015

Work	Planned date	Complete?	Comments
2014-15 Annual Audit Letter On completion of the audit we will prepare an Annual Audit Letter to summarise our work, including: • the accounts audit; and • our VfM work.	October 2015	On track	Our Annual Audit Letter will summarise the findings from our 2014-15 audit.
2014-15 Certification of claims and returns We will complete a programme of work to certify those of the Council's 2014-15 grant claims and returns requiring auditor certification.	June – December 2015	On track	We will liaise with the Council's grant claims and returns co-ordinator in relation to the claims and returns that will require certification and the timetable for their preparation and audit.
Other activity undertaken We have now completed work in connection with the HCA Decent Homes grant awarded to the Council.	December 2014	Completed	We were able to report, on 11 December 2014, that in our opinion the Council's Statement of Grant Usage had been prepared, in all material respects, in accordance with the definition of eligible expenditure. The Council's Statement recorded £10 million of capital expenditure incurred in bringing homes to the Decent Homes standard.
We have now completed work in connection with the Council's 2013-14 Teachers' Pensions End of Year Return (EOYCa).	December 2014	Completed	We were able to report, on 23 December 2014, that, except for the omission of data relating to four schools, the Council's EOYCa had been prepared, in all material respects, in accordance with the regulations underpinning the Teachers' Pensions Scheme. The omission from the return related to schools that do not use the Council's payroll and amounted to approximately £200,000 of contributions. We have discussed this matter with Internal Audit, and understand that work is planned to strengthen controls to reduce the risk of similar omissions from returns to Teachers' Pensions in the future.

Emerging issues and developments

This section of the Audit Committee update paper provides a summary of some of the emerging national issues and developments that Grant Thornton is aware of. It includes emerging finance, accounting and audit issues as well as a summary of recent Grant Thornton reports. We will continue to work closely with officers to understand the Council's approach in key areas and we will reflect any significant issues in future reports to the Audit Committee.

Rising to the challenge

Grant Thornton

Our national report, Rising to the Challenge, the Evolution of Local Government, was published in December and is available at: http://www.grant-thornton.co.uk/en/Publications/2014/Rising-to-the-challenge---The-evolution-of-local-government/

This is the fourth in our series of annual reports on the financial health of local government. Like previous reports, it covers key indicators of financial performance, strategic financial planning, financial governance and financial control. It also includes case studies of best practice and a comparison to the NHS. This year it has been extended to use benchmarking information on savings plans and budget performance.

The overall message is a positive one. What stands out is how well local authorities have navigated the first period of austerity in the face of ever increasing funding, demographic and other challenges. Many authorities are forecasting financial resilience confidently in their medium term financial strategy. This reflects an evolution in financial management that would have been difficult to envisage in 2010. However, there remains much to be achieved if the sector is to become sustainable in the long term, and authorities should consider if their:

- medium- to long-term strategy redefines the role of the authority creatively
- operational environment will adapt, working in partnership with other authorities and local organisations
- strategy looks beyond the traditional two- to three-year resource planning horizon
- organisational culture is aligned to where the authority needs to be in the medium to long term
- senior leadership teams – both officers and members – have the necessary skills and capacity to ensure delivery against the medium-term challenges
- corporate governance arrangements ensure effective oversight and scrutiny of the organisation as it adapts to the challenges it faces.

The importance of these actions will be magnified if local government devolves further, particularly in relation to fiscal devolution. The new-found confidence of local government in responding to the medium-term challenges will be tested significantly by the second phase of austerity.

Hard copies of our report are available from your Engagement Lead or Engagement Manager.

Accounting for schools

Accounting and audit issues

Accounting for schools

The debate about the recognition of school land and buildings on local authority balance sheets (which most commentators had thought settled) has been reignited. Grant Thornton is taking a leading role in trying to resolve this unexpected development.

In March, CIPFA/LASAAC Code concluded that under IFRS 10, maintained schools (but not free schools or academies) meet the definition of entities that need to be consolidated in group accounts. However, rather than requiring local authorities to prepare group accounts, the CIPFA/LASAAC Code requires local authorities to account for maintained schools within their single entity accounts. This includes school income and expenditure as well as assets and liabilities. The general expectation in the sector was that:

- the vast majority of voluntary aided, voluntary controlled and foundation schools would be recognised on local authority balance sheets
- a small number of school buildings that are provided at no charge by a religious body and where there was a realistic possibility that they could be taken back by their owners would be treated as assets of the religious body and so not recognised on the local authority balance sheet.

However, at the CIPFA conference in November, CIPFA clarified that it considers that most voluntary aided and voluntary controlled school buildings would **not** be recognised on the balance sheet. This view has been set out in more detail in LAAP 101. This is because the religious bodies have a legal right to take back these assets. Nor does CIPFA consider the position for foundation school building to be clear cut, and local judgement will need to be applied. We are discussing issues with CIPFA in particular:

- how the treatment proposed by CIPFA complies with the Code
- the significant practical implications for the sector
- the potential for inconsistent accounting treatments depending on local judgement.

We are working with the Audit Commission, CIPFA and the other audit firms suppliers to try to seek a practical way forward as soon as possible.

Continued overleaf …..

Accounting for schools (continued)

Accounting and audit issues

We will continue to share the latest developments with officers. In the mean time the following matters warrant consideration:

- identifying those schools where school buildings are owned by third parties (such as church dioceses) and determining under what circumstances the buildings could be taken back by the third party
- valuations for school land and buildings for each of the three balance sheet dates (1 April 2013, 31 March 2014, 31 March 2015) may be required
- obtaining sufficient information to enable the Council to restate its revaluation reserve and capital adjustment account.

Group accounting standards

Accounting and audit issues

The CIPFA Code has adopted a new suite of standards for accounting for subsidiaries, associates and joint arrangements. These changes affect how local authorities account for services delivered through other entities and joint working with partners.

The key changes for 2014/15 are to:

- the definition of control over 'other entities'. The revised definition is set out in International Financial Reporting Standard (IFRS) 10 ("Consolidated financial statements") and determines which entities are treated as subsidiaries
- the accounting for joint arrangements. This now follows IFRS 11("Joint arrangements") and includes changes to the definition of joint ventures and how joint ventures are consolidated in group accounts
- disclosures in relation to subsidiaries, joint arrangements, associates and unconsolidated entities as set out in IFRS 12 ("Disclosure of interests in other entities").

Changes to the definition of control over 'other entities'

Control was previously defined in terms of power to govern the financial and operating policies of an entity. IFRS 10 sets out three elements for an investor to be considered as controlling an investee (all of which must be met):

- the investor has the rights to direct the relevant activities of the investee (relevant activities being the ones that determine the return for the investors – the return could be in the form of a service rather than money)
- the investor has exposure, or rights, to variable returns from its involvement with the investee
- the investor has the ability to use its power over the investee to affect the amount of the investor’s returns.

In the commercial sector, this is generally thought to have resulted in more entities being treated as subsidiaries. However, the change is in both directions: some subsidiaries have been redefined as associates. Councils with investments in 'other entities' will need to consider whether:

- they control any entities using the new definition. Councils will need to pay particular attention to special purpose vehicles and any other entities where there was a close judgement call under the old IAS 27 ("Consolidated financial statements and accounting for investments in subsidiaries")
- there is a need for a prior period adjustment.

Group accounting standards (continued)

Accounting and audit issues

Changes to accounting for joint arrangements
Joint arrangements are contractual arrangements between two or more parties where there is joint control. IFRS 11 makes three key changes from IAS 31 ("Joint ventures"):

- there are now only two types of joint arrangements: joint operations and joint ventures
- in a joint operation the investing parties have rights and obligations in relation to the arrangement's assets and liabilities, whereas in a joint venture the parties have rights to the arrangement's net assets. IFRS 11 bases its definition of joint ventures on the substance of the arrangement rather than legal status. It is for the entity to assess whether a joint arrangement is a joint operation or joint venture by considering its rights and obligations arising from the arrangement. To do this the entity needs to consider the structure and legal form of the arrangement, the terms agreed by the parities and any other relevant facts and circumstances. Appendix B to IFRS 11 provides further explanation and examples of joint operations and joint ventures.
- local authorities are still required to consolidate joint ventures in their group accounts but must now do so using the equity (single line) method. The option for proportionate (line-by-line) consolidation has been removed.

The key challenge for most councils will be determining whether their joint arrangements are joint ventures or joint operations. The difference should be clear from the contract but in some cases judgement may be required. Councils that have previously used the proportionate consolidation method will need to account for the move to equity accounting as a prior period adjustment.

Disclosure of interests in other entities
IFRS 12 makes consistent the requirements for disclosures in relation to subsidiaries, joint arrangements, associates and unconsolidated entities. It includes the need for transparency about the risks to which the reporting entity is exposed as a consequence of its investment in such arrangements.

Challenge questions

- Has the potential impact of these standards on the Council's financial statements been assessed?

Earlier closure and audit of accounts

Accounting and audit issues

DCLG is consulting on proposals to bring forward the audit deadline for 2017/18 to the end of July 2018. Although July 2018 is over 3 years away, both councils and their auditors will have to make real changes in how they work to ensure they are 'match-fit' to achieve this deadline. This will require leadership from members and senior management. Local government accountants and their auditors should start working on this now.

Top tips for councils:

- make preparation of the draft accounts and your audit a priority, investing appropriate resources to make it happen
- make the year end as close to 'normal' as possible by carrying out key steps each and every month
- discuss potential issues openly with auditors as they arise throughout the year
- agree key milestones, deadlines and response times with your auditor
- agree exactly what working papers are required.

Challenge questions

- Is the Council putting a plan in place to address the earlier close date?

Local government financial reporting remains strong

Local government guidance

The Audit Commission published its report, Auditing the Accounts 2013/14: Local government bodies, on 11th December.

Financial reporting was consistently strong for most types of principal local authority in 2013/14 when compared to the previous financial year. This year the Commission has congratulated 16 bodies where auditors were able to issue an unqualified opinion and a VFM conclusion on the 2013/14 accounts by 31 July 2014, and the body published audited accounts promptly. Although, as only 21 principal bodies have managed to publish their audited accounts by 31 July since 2008/09, a move to bring the accounts publication date forward is likely to cause significant challenges for the majority of public bodies.

The Commission reports that auditors were able to issue the audit opinion by 30 September 2014 at 99 per cent of councils, 90 per cent of fire and rescue authorities, 97 per cent of police bodies, all other local government bodies and 99 per cent of both parish councils and internal drainage boards. This is consistent with last year for most groups, but an improvement for councils and small bodies compared to 2012/13.

Eight principal authorities were listed where the auditor was unable to issue an opinion by the 30th September deadline.