

# Audit Progress Report

Manchester City Council

July 2020





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# 1. AUDIT PROGRESS

## **Purpose of this report**

This report provides the Audit Committee with an update on progress in delivering our responsibilities as your external auditors.

## **Ensuring resilience and maintaining the level and quality of client service**

Since the Committee last met the impact of the Covid-19 pandemic has changed our environment in a way not seen before. Mazars has implemented clear and decisive measures to ensure the welfare of our people and clients while ensuring that we continue to deliver for those who rely on us.

On the 17 March 2020, following Government announcements the following evening, Mazars made the decision to close its offices and require all staff to work from home. The challenges this has brought are significant and still being worked through.

Beyond protecting the welfare of our clients and people, Mazars' first priority is to continue to deliver on our business commitments. As part of our existing contingency planning, we have implemented systems and procedures to ensure continuity and to minimise any disruption. In a shifting environment, we will continue to adapt our approach to best navigate the uncertain situation while keeping our people and our clients front of mind.

Our teams have full access to remote working technology with secure access to their applications, tools and data, wherever they are, and agile working processes are well-established across the firm. All partners and staff are working remotely, and our teams are making full use of virtual meetings and agile working technology to stay connected with each other and our clients, deliver on our commitments, and provide continuity and support at the time it's most needed.

Mazars' external website contains further details of its response to the emerging situation, along with daily economic briefings.

## **Responding to the changes – working with the Council**

We are committed to supporting the Council as best we can throughout the current period, recognising first and foremost the need to be flexible as the current environment changes, but also the significant pressures on the Council's finance team. We have continued to maintain open communication throughout the audit period.

We are able to carry out the audit remotely and have put in place arrangements to allow this, such as routine regular update meetings, use of our Huddle file sharing site for secure transfer of data and keeping query logs. The key difference is we will not, until further notice, have a physical on-site presence. We will however maintain communication via regular webex and video calls.

## **Update on our proposed audit programme and external audit fees**

As set out in our Audit Strategy Memorandum, presented to the Audit Committee in February 2020, we communicate promptly with you when there are changes to our audit work which may impact on the proposed level of external audit fees. There are two elements that we wish to communicate with you relating to our audit of 2019/20.

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## Public Interest Entity

The statutory audit legislation relating to Public Interest Entities (PIE) came into effect for all financial years starting on or after 17 June 2016. The PIE definition includes organisations with transferable securities listed on regulated markets and governed by law. Manchester City Council has a small amount of listed debt, and as a result the Council falls under the definition of a PIE. Consequently there are additional requirements at both the planning and the reporting stages of the audit which culminate in the requirement to produce a more detailed 'long form' audit report.

## Audit Regulator recommendations

We continually strive to maintain high standards of audit quality. One mechanism for doing this is to consider the outcome of independent quality reviews of our audit work and that of other audit suppliers, in particular those carried out by the Audit Quality Review team of the Financial Reporting Council. As a result of the increased expectations on external auditors following recent reviews, we are planning increases in the level of work we carry out on:

- The value of the Council's defined benefit pension scheme assets and liabilities; and
- The value of the Council's property, plant and equipment and investment property assets, including those relating to its consolidated interests in Manchester Airport Group and Manchester Convention Centre.

We have discussed the driving factors with Council officers through our liaison discussions, and we will revisit our audit fee for 2019/20 to reflect the increased level of risk-based work that was not considered by PSAA when the scale fee was set.

The Committee should note that any agreed additional fee is subject to detailed scrutiny by the PSAA as part of the approval process.

## **Audit progress**

With regards to our external audit of the Council, since the last Committee meeting we have:

- Maintained a regular dialogue with the City Treasurer, the Chief Accountant and the finance team. We have carried out fortnightly video calls with the finance team since March 2020 to ensure that we remain up to speed with the Council's response to the challenges and its plans regarding financial reporting.
- Revised our audit resource plans to ensure that we deliver the external audit of the financial statements in line with the Council's revised plans, as set out below. The Council intends to provide draft accounts before the end of July although this is dependent on obtaining the information from the Council's external valuer to produce the Council's group financial statements. Our revised resource plans will ensure that we complete our audit of the financial statements before the revised statutory deadline of the end of November.
- The closedown process has been understandably slower than would ordinarily be the case, with the challenges of the Council's finance team all working remotely, and having additional workload in addition to closing down the accounts. Our experience from our other audits that have been carried out since March indicate that the audit process is similarly challenging and we will keep the Council apprised of our progress once the audit has commenced.
- Liaised with the Council on specific financial reporting challenges in the current time, particularly reflecting information and views from our national networks with MHCLG, NAO, CIPFA, and other audit suppliers. For example:

# 1. AUDIT PROGRESS

- The significant impact of the pandemic on the financial markets means that there are likely to be significant impacts on the valuation of financial pension fund assets. We suggested that the Council in these circumstances should consider obtaining a second actuarial report from the GM Pension Fund actuary, in order that the report includes the actual return on assets for both the Council and its group subsidiary components. The Council received its updated actuarial report in June 2020.
- There is increased uncertainty around the valuation of the Council's Property, Plant & Equipment, particularly where that valuation is based on market conditions. The Royal Institute of Chartered Surveyors (RICS) have provided guidance to their members. Consequently we expect that valuers will be actively considering the need for their valuation reports to include a reference to a material uncertainty in their valuations, reflecting the uncertainty in the market conditions that existed at 31 March 2020. Although the Council's valuer has reported that they do not consider there to be a material impact on the valuations for 2019/20, the Council is actively discussing the specific circumstances relating to its valuations with its external valuer.
- There is increased potential for the Council's other financial assets, for example its investments in companies, or its outstanding debtors, to require impairment, reflecting an increased likelihood of expected losses in the current economic climate.

There are no additional matters to report to the Audit Committee relating to our 2019/20 external audit.

## 2. NATIONAL PUBLICATIONS

	Publication/update	Key points	Page
<b>Mazars</b>			
1	<b>Mazars' response to the Brydon Review</b>	Mazars' response to the latest review into the auditing profession which was published in December 2019.	8
2	<b>Annual Transparency Report</b>	Sets out the steps we take to enhance the quality of our audit work and ensure that quality is consistent across the firm.	8
<b>Public Sector Audit Appointments</b>			
3	<b>Publication of 2020/21 scale of audit fees</b>	PSAA has written to all Councils setting out the next year's external audit fees	9
<b>National Audit Office</b>			
4	<b>New Code of Audit Practice 2020/21</b>	Publication of the Code of Practice that prescribes the focus of the external audit and auditor reporting for five years from 2020/21	10
5	<b>Local authority investment in commercial property</b>	Report on the developments of LA investments in commercial property	10
6	<b>Managing PFI assets and services as contracts end</b>	Information on managing PFI contracts as they come to an end	11
<b>Chartered Institute of Public Finance and Accountancy (CIPFA)</b>			
7	<b>Local Government Financial Resilience index</b>	Online data tool which measures local authorities against a range of indicators to assess their level of resilience.	12
8	<b>Financial Management Code</b>	Guidance for good and sustainable financial management in local authorities.	12
9	<b>Prudential Property Investment</b>	Guidance on prudent investments in commercial properties.	13
10	<b>IFRS9 Financial Instruments: A guide for Local Authority practitioners</b>	Updated guidance to assist Councils to comply with the requirements of IFRS9	13
11	<b>IFRS 16 Leases: An Early Guide for Local Authority Practitioners</b>	Guidance to assist the preparations for the 2020/21 application of IFRS16	14

## 2. NATIONAL PUBLICATIONS

	Publication/update	Key points	Page
<b>Ministry of Housing, Communities &amp; Local Government (MHCLG)</b>			
12	<b>Coronavirus support package for Councils</b>	Press release announcing the latest government support	15
<b>Other</b>			
13	<b>Statement on Covid-19, Financial Reporting Council and other Regulators</b>	Statement on the impact of the Covid-19 pandemic on accounting, reporting and auditing	16

## 2. NATIONAL PUBLICATIONS – MAZARS

### 1. Mazars' response to the Brydon Review, Mazars, December 2019

The Brydon Review is one of four key reviews into the scope and quality of audit, namely:

- Competition and Market's Authority (CMA): resilience and competition in the audit market;
- Kingman's Review (review of the Financial Reporting Council and regulatory oversight);
- The Brydon Review (tone and aspirations for the future of the industry); and
- The Redmond Review (quality of local authority financial reporting and external audit).

The Brydon Review contains various recommendations and essentially recommends a major overhaul of audit which would see the creation of a separate 'corporate auditing profession', greater focus on fraud detection during audits, and the replacement of the 'true and fair' concept, with a greater focus on going concern.

Mazars' response to the latest Brydon Review report issued in December 2019 is detailed per the link below.

<https://www.mazars.co.uk/Home/News-Events/Latest-news/Mazars-response-to-the-Brydon-report>

#### Link to the Brydon Review

Published in December 2019, focusing on the quality and effectiveness of audit.

<https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review>

#### Link to the Kingman's Review

Published in December 2018, this review recommended the replacement of the Financial Reporting Council with a new independent statutory regulator, accountable to Parliament. The new regulator will be called the Audit, Reporting and Governance Authority (ARGA).

<https://www.gov.uk/government/news/independent-review-of-the-financial-reporting-council-frc-launches-report>

#### Link to the Redmond Review

At the time of writing this report, the outcome from the Redmond Review has not been published.

<https://www.gov.uk/government/consultations/review-of-local-authority-financial-reporting-and-external-audit-call-for-views>

### 2. Annual Transparency Report, Mazars, December 2019

Mazars produces an annual transparency report, setting out the steps we take to enhance the quality of our audit work and ensure that quality is consistent across the firm. The report includes:

- Public Interest Committee Report;
- UK Governance Council Report;
- Inspiring Stakeholder Confidence in Audit Quality (including quality monitoring and audit quality indicators);
- Our risks; and
- Structure, Leadership and Governance.

<https://www.mazars.co.uk/Home/About-us/Corporate-publications/Transparency-reports/Mazars-UK-Transparency-Report-2018-2019>

## 2. NATIONAL PUBLICATIONS – PSAA

### 3. PSAA 2020/21 scale of audit fees, March 2020

PSAA has published the fee scale for the audit of the 2020/21 accounts of opted-in principal local government and police bodies, and wrote to those bodies to notify them of the fee.

The 2020/21 fee scale document sets out the scale of fees for the audit work to be undertaken by appointed auditors in respect of the 2020/21 financial statements at relevant principal authorities that have opted into PSAA's national auditor appointment arrangements.

PSAA describes in their letter that local audit and audit more widely is subject to a great deal of turbulence with significant pressures on fees. In their letter they conclude that

“we do not expect the final audit fee to remain at that level for most if not all bodies because of a variety of change factors, the impact of which cannot be accurately or reliably estimated at this stage. The impact of these changes is likely to vary between bodies depending on local circumstances, and information to determine that impact with any certainty is not yet available. Our view is that it would also be inappropriate to apply a standard increase to all authorities given the differing impact of these changes between bodies. As the impact of these changes is understood, fee variations will need to be identified and agreed reflecting the impact on each audit.”

The published scale fee for the Council's 2020/21 audit is unchanged from 2019/20 at £159,519.

<https://www.psa.co.uk/audit-fees/2020-21-audit-fee-scale/>

## 2. NATIONAL PUBLICATIONS – NATIONAL AUDIT OFFICE

### 4. New Code of Audit Practice 2020/21, February 2020

The NAO have published their final draft of the Code following the consultation process. The Code has now been laid before Parliament and, subject to Parliamentary approval, will come into force on 1 April 2020. The new Code will apply from audits of local bodies' 2020/21 financial statements onwards.

Accompanying the Code is a document that sets out the issues the NAO considered as a result of the feedback to Stage 2 of the consultation on the exposure draft of the Code, and highlights the key changes made to the text of the final draft of the Code.

[https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code\\_of\\_audit\\_practice\\_2020.pdf](https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice_2020.pdf)

[https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code\\_of\\_audit\\_practice-consultation\\_response.pdf](https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice-consultation_response.pdf)

### 5. Local authority investment in commercial property, February 2020

In response to substantial falls in funding since 2010/11, local authorities have made reductions in revenue spending on services. Increasingly, authorities have also sought to offset funding reductions by generating new income through a range of strategies. A key component within these responses has been a rapid expansion in the acquisition of commercial property, often funded by borrowing.

The NAO estimates that authorities spent £6.6 billion on purchasing commercial property from 2016/17 to 2018/19 – 14.4 times more than in the preceding three years. This includes an estimated £3.1 billion on acquiring offices; £2.3 billion on retail property, including £759 million on shopping centres or units within them and £957 million on industrial property. The majority of the £6.6 billion was spent by only 49 local authorities, with those authorities accounting for 80% of the spend. Many authorities have borrowed to finance these purchases. The NAO estimates that between 38% and 91% of spending on these purchases across the sector was financed by borrowing in this period.

The report concludes that although there is evidence of authorities mitigating these risks, such as by recruiting specialist staff, undertaking due diligence on their purchases, drawing on external expertise and establishing contingency funds, there was room for improvement in the governance and risk mitigation arrangements of some authorities.

The Ministry of Housing, Communities and Local Government (MHCLG) is responsible for the framework of statutory codes and guidance that set the parameters for local authority borrowing and capital spending. MHCLG has made changes to aspects of the framework in response to the recent increased investment in commercial property. Recent activity has raised questions about the extent to which MHCLG can rely on the present framework to support authorities to make decisions which demonstrate good value for money.

The NAO recommends that MHCLG improves the relevance and quality of data and analysis it has on authorities' acquisition of commercial property to understand more fully any risks and to provide greater assurance that authorities are complying with the framework. It also recommends that the Ministry should review whether the current framework is still achieving its intended aims.

<https://www.nao.org.uk/report/local-authority-investment-in-commercial-property/>

## 2. NATIONAL PUBLICATIONS – NATIONAL AUDIT OFFICE

### 6. Managing PFI assets and services as contracts end, June 2020

The NAO have published a report providing information on managing PFI contracts as they come to an end and considering whether government is making appropriate preparations to manage the expiry of PFI contracts. There are currently over 700 operational PFI contracts in place in the UK with a capital value of £57 billion. This study focusses on the 571 English PFI contracts, excluding those for which devolved governments are responsible.

The purpose of the report is to draw out the challenges and best practice that can most benefit those managing PFI contracts coming to an end. NAO identify illustrative examples from specific PFI contracts, and provide helpful prompts to draw the reader's attention to some of the potential risk's authorities may face, enabling preventative steps to be considered.

In the report, NAO examines:

- the background to PFI, the contracts which are due to expire, and the roles and responsibilities of key stakeholders;
- the skills and capabilities of authorities for the expiry process and aspects of day-to-day management of the contracts relevant for the preparation process; and
- the preparation for and delivery of contract expiry.

<https://www.nao.org.uk/report/managing-pfi-assets-and-services-as-contracts-end/>

## 2. NATIONAL PUBLICATIONS – CIPFA

### 7. Local Government Financial Resilience index, CIPFA, December 2019

The resilience index is an online data tool which measures local authorities against a range of indicators to assess their level of resilience against financial shocks and to support financial decision making. Upper tier authorities are judged against nine indicators including social care.

The indicators measured include:

- levels of reserves;
- change in reserves;
- reserves sustainability;
- interest payable/net revenue expenditure;
- gross external debt;
- social care ratio;
- fees and charges to service expenditure ratio;
- council tax requirement/net expenditure ratio; and
- growth above baseline.

The tool allows for year on year comparisons of each authority's performance, as well as comparisons with similar and neighbouring authorities. Trend analysis is also available for some of the indicators outlined above.

<https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-launches-local-government-financial-resilience-index>

### 8. Financial Management Code, CIPFA, October 2019

Strong financial management is an essential part of ensuring public sector finances are sustainable. The Financial Management Code (FM Code) provides guidance for good and sustainable financial management in local authorities and aims to provide assurance that they are managing resources effectively.

It requires authorities to demonstrate that the processes they have in place satisfy the principles of good financial management. The FM Code identifies risks to financial sustainability and introduces a framework of assurance. This framework is built on existing successful practices and sets explicit standards of financial management. Complying with the standards set out in the FM Code is the collective responsibility of elected members, the chief finance officer and their professional colleagues in the leadership team. Complying with the FM Code with help strengthen the framework that surrounds financial decision making.

The FM Code built on elements of other CIPFA codes during its development and its structure and applicability will be familiar to users of publications such as The Prudential Code for Capital Finance, Treasury Management in the Public Sector Code of Practice and Code of Practice on Local Authority Accounting in the United Kingdom.

The Code applies to all local authorities, including police, fire and other authorities.

By following the essential aspects of the FM Code, local authorities are providing evidence to show they are meeting important legislative requirements in their jurisdictions.

The first full year of compliance will be 2021/22. This reflects the recognition that organisations will need time to reflect on the contents of the Code and can use 2020/21 to demonstrate how they are working towards compliance.

<https://www.cipfa.org/policy-and-guidance/publications/ff/financial-management-code>

## 2. NATIONAL PUBLICATIONS – CIPFA

### 9. Prudential Property Investment, CIPFA, November 2019

Increasingly there has been a move towards investments in commercial properties, funded by borrowing, with the key driver of this activity appearing to be the generation of revenue. This publication provides guidance on making the assessments needed to ensure that such acquisitions are prudent and on the risks local authorities must manage when acquiring property.

Statutory investment guidance from the Ministry of Housing, Communities and Local Government (MHCLG) last year set out clearly that local authorities need to consider the long-term sustainability risk implicit in becoming too dependent on commercial income, or in taking out too much debt relative to net service expenditure.

The increased scale of investment in property was recognised by revisions to CIPFA's Prudential Code for Capital Finance and the Treasury Management Code in 2017, but the growing amounts being borrowed for such a purpose are putting a strain on the creditability of the Prudential Framework and reinforce the need to ensure that such acquisitions are affordable, prudent and sustainable.

In addition to the core issue of borrowing in advance of need, which the Prudential Code has very clear provisions on, this publication provides guidance on the risk perspective to the practical assessment of prudence and affordability. Those risks could be very difficult to manage. Even when these issues are managed and there is reliance on investment income, a potential failure or a downturn of the property market may have a direct impact upon local services.

This publication considers such issues and the actions local authorities would need to take to mitigate against such risks.

<https://www.cipfa.org/policy-and-guidance/publications/p/prudential-property-investment>

### 10. IFRS 9 Financial Instruments: A Guide for Local Authority Practitioners, CIPFA, December 2019

The Code of Practice on Local Authority Accounting in the UK adopted IFRS 9 Financial Instruments in its 2018/19 edition, with an application date of 1 April 2018.

In order to allow practitioners to prepare in good time, CIPFA issued guidance in 2017 in advance of the 2018/19 Code being published, based on a companion publication to the 2017/18 Code: Forthcoming Provisions for IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers in the Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

This publication updates the 2017 guidance to reflect:

- provisions in the 2018/19 Code that were not included in the Forthcoming Provisions publication
- changes to the 2019/20 Code resulting from amendments to IFRS 9
- experience of implementing IFRS 9 in the 2018/19 annual accounts.

This guidance provides comprehensive coverage of the requirements of the Code, including recognition, measurement, treatment of gains and losses, derecognition and presentation and disclosure in the financial statements. It also covers statutory reversals and the continuing impact of transitional provisions.

<https://www.cipfa.org/policy-and-guidance/publications/i/ifrs-9-financial-instruments-a-guide-for-local-authority-practitioners>

## 2. NATIONAL PUBLICATIONS – CIPFA

### 11. IFRS 16 Leases: An Early Guide for Local Authority Practitioners, CIPFA, December 2019

Although changes will not have an effect until the 2021/22 financial statements, CIPFA/LASAAC consulted in the summer of 2018 on amendments to the Code of Practice on Local Authority Accounting for IFRS 16 Leases. The Standard is expected to have a potentially significant practical and financial effect for local authorities, and it was considered that early notice of the technical requirements was advisable.

It will be of wide interest because of the prevalence of leasing in local government and the risk that the changes could have a budgetary impact if not managed effectively.

This guidance provides comprehensive coverage of the proposed requirements for lessees, including the accounting definition of a lease, recognition of assets and liabilities, measurement, derecognition and presentation, and disclosure in the financial statements. Although there have not been significant changes to the requirements for lessors, the guidance includes extensive commentary of this area.

The guidance covers in particular:

- identifying arrangements that meet the accounting definition of a lease
- determining the term of a lease where there are options to extend or terminate
- for lessees:
  - recognising right-of-use assets and lease liabilities, and their initial and subsequent measurement
  - reassessment of lease liabilities and treatment of lease modifications
- for lessors, distinguishing between finance and operating leases and accounting accordingly
- dealing with sale and leaseback transactions
- presenting lease transactions and balances in the financial statements
- disclosure of information about leases in the notes to the accounts
- harmonising with statutory accounting requirements
- the mechanics of making the transition in the 2021/22 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).

<https://www.cipfa.org/policy-and-guidance/publications//ifrs-16-leases-an-early-guide-for-local-authority-practitioners>

## 2. NATIONAL PUBLICATIONS – MHCLG

### 12. Coronavirus support package for Councils, July 2020

On 2<sup>nd</sup> July 2020 MHCLG announced the latest support package for Councils to respond to the challenges of the Covid-19 pandemic. The press release announced a further, unringfenced £500 million to respond to spending pressures they are facing. In addition the announcement highlighted a new scheme to reimburse lost income, whereby where Councils' losses are more than 5% of their planned income from sales, fees and charges, the government will provide cover them for 75% of the lost income. Furthermore the Local Government Secretary also announced a proposal for a phased repayment of council tax and business rates deficits over 3 years, rather than requiring complete repayment of deficits next year.

<https://www.gov.uk/government/news/comprehensive-new-funding-package-for-councils-to-help-address-coronavirus-presses-and-cover-lost-income-during-the-pandemic>

## 2. NATIONAL PUBLICATIONS – OTHER

### 13. Statement on Covid-19, Financial Reporting Council and other Regulators, March 2020

A joint statement was issued by the Financial Reporting Council, the Financial Conduct Authority and Prudential Regulation Authority in response to the current situation.

The statement sets out that:

*“Successful and sustainable businesses underpin our economy and society by providing employment and creating prosperity. Equity and debt capital markets play a vital role providing finance to these businesses and will aid the recovery. Governments and regulators around the world remain focused on keeping capital markets open and orderly.*

*Capital markets rely on timely, accurate information. Investors and other stakeholders rely on financial reporting – backed by high-quality auditing. However, companies and their auditors currently face unprecedented challenges in preparing and auditing financial information”*

The statement highlights:

- The likelihood of an increase in the number of modified audit opinions (where there are difficulties in obtaining evidence or other issues);
- Increased going concern assumption considerations and uncertainties; and
- Guidance for companies and auditors.

<https://www.fca.org.uk/news/statements/joint-statement-fca-frc-pra>

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