

# Annual Audit Letter

## Manchester City Council

Year ending 31 March 2020





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# 1. EXECUTIVE SUMMARY

## Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Manchester City Council (the Council) for the year ended 31 March 2020. Although this letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 30 November 2020 included our opinion that the financial statements:</p> <ul style="list-style-type: none"><li>• give a true and fair view of the Council's financial position as at 31 March 2020 and of its expenditure and income for the year then ended; and</li><li>• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20</li></ul>
Other information published alongside the audited financial statements	<p>Our auditor's report included our opinion that:</p> <ul style="list-style-type: none"><li>• the other information in the Statement of Accounts is consistent with the audited financial statements.</li></ul>
Value for money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020.</p>
Reporting to the group auditor	<p>In line with group audit instructions, issued by the NAO on 4<sup>th</sup> November, we are completing work required to report to the group auditor in line with the requirements applicable to the Council's WGA return.</p> <p>This work is not yet completed because of challenges the Council have experienced in completing the WGA return, in part caused by the new HM Treasury system.</p> <p>We hope to complete this work before the end of May 2021.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.</p> <p>The report also confirmed that we did not exercise any other special powers of the auditor under sections 28, 29 or 31 of the 2014 Act.</p>



## 2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

### The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Council and whether they give a true and fair view of the Council's financial position as at 31 March 2020 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report, stated that in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2020 and of its financial performance for the year then ended. Our report included an emphasis of matters paragraph. This drew attention to the financial statement disclosures explaining that COVID-19 had contributed to 'material valuation uncertainty' in the valuation of the property assets in the Council's group entities, in its own property assets and in the Council's share of Greater Manchester Pension Fund's property assets included in the net Pension Liability.

### Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2020:

		Council	Group
Financial statement materiality	Based on 2% of the gross expenditure at the Surplus/Deficit on Provision of Services level	£31,489,000	£36,829,000
Trivial threshold	Based on 3% of financial statement materiality	£945,000	£1,105,000
Specific materiality	Officer Remuneration bandings	£5,000	n/a



## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
<p><b>Management override of controls</b></p> <p>In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Because of the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits</p>	<p>We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> <li>Accounting estimates impacting on amounts included in the financial statements;</li> <li>Consideration of identified significant transactions outside the normal course of business; and</li> <li>Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.</li> </ul>	<p>There were no significant matters arising from our work on the management override of controls</p>





## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks (continued)

Identified significant risk	Our response	Our findings and conclusions
<p><b>Property, plant and equipment valuation</b></p> <p>The CIPFA Code requires that where assets are subject to revaluation, their year-end carrying value should reflect the fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued in a five-year cycle. The valuation of Property, Plant &amp; Equipment involves the use of a management expert (the valuer) and incorporates assumptions and estimates which impact materially on the reported value. There are risks relating to the valuation process. As a result of the rolling programme of revaluations, there is a risk that individual assets which have not been revalued for up to four years are not valued at their materially correct fair value. In addition, as the valuations are undertaken through the year there is a risk that the fair value as the assets is materially different at the year end. Council Dwelling valuations are based on Existing Use Value, discounted by a factor to reflect that the assets are used for Social Housing (EUV-SH). The Social Housing adjustment factor is prescribed in MHCLG guidance, but this guidance indicates that where a valuer has evidence that this factor is different in the Council's area they can use their more accurate local factor. There is a risk that the Council's application of the valuer's assumptions is not in line with the statutory requirements and that the valuation is not supported by detailed evidence.</p>	<p>We:</p> <ul style="list-style-type: none"> <li>• Obtained an understanding of the skills, experience and qualifications of the valuer, and considering the appropriateness of the instructions to the valuer from the Council;</li> <li>• Obtained an understanding of the basis of valuation applied by the valuer in the year;</li> <li>• Obtained an understanding of the Council's approach to ensure that assets not subject to revaluation in 2019/20 are materially fairly stated;</li> <li>• Obtained an understanding of the Council's approach to ensure that assets revalued through 2019/20 are materially fairly stated at the year end;</li> <li>• Sample tested the completeness and accuracy of underlying data provided by the Council and used by the valuer as part of their valuations;</li> <li>• Used relevant market and cost data to assess the reasonableness of the valuation as at 31 March 2020;</li> <li>• Compared the valuations of a sample of revalued assets to our external valuation expert's estimate of the valuation;</li> <li>• Obtained an understanding of the valuer's consideration of RICS guidance on material uncertainty relating to valuations, and considering whether there was evidence of material uncertainty; and</li> <li>• Tested the accuracy of how valuation movements were presented and disclosed in the financial statements.</li> <li>• Tested a sample of items of capital expenditure in 2019/20 to confirm that the additions are appropriately valued in the financial statements.</li> </ul>	<p>We concluded that the valuation of the Council's Property, Plant &amp; Equipment was materially fairly stated.</p> <p>However, the Council disclosed in Notes 9.1 and 9.2 that the valuation of the Council's land &amp; buildings and investment were subject to 'material valuation uncertainty' as a result of COVID-19, and we included an 'emphasis of matter' in our auditor's report</p>



## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks (continued)

Identified significant risk	Our response	Our findings and conclusions
<p><b>Valuation of Defined Benefit Pension Liability</b></p> <p>The net pension liability represents a material element of the Council's balance sheet. The Council is an admitted body of Greater Manchester Pension Fund, which had its last triennial valuation completed as at 31 March 2019. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.</p> <p>There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates and mortality rates. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>There is a risk that the assumptions and methodology used in valuing the Council's pension obligation are not reasonable or appropriate to the Council's circumstances. This could have a material impact to the net pension liability in 2019/20.</p>	<p>We:</p> <ul style="list-style-type: none"> <li>• Obtained an understanding of the skills, experience and qualifications of the actuary, and considering the appropriateness of the instructions to the actuary from the Council;</li> <li>• Obtained confirmation from the auditor of the Greater Manchester Pension Fund that there were no deficiencies in controls in place at the Pension Fund. This included the controls in place to ensure data provided to the Actuary by the Pension Fund for the purposes of the IAS19 valuation of the gross asset and liability is complete and accurate;</li> <li>• Reviewed a summary of the work performed by the Pension Fund auditor on the Pension Fund investment assets, and evaluating whether the outcome of their work would affect our consideration of the council's share of Pension Fund assets. The Pension Fund auditor work included comparing the asset values used for the actuarial valuation to those subjected to audit by the Pension Fund auditor;</li> <li>• Reviewed the actuarial allocation of Pension Fund assets to the Council by the actuary, including comparing the Council's share of the assets to other corroborative information;</li> <li>• Reviewed the appropriateness of the Pension Asset and Liability valuation methodologies applied by the Pension Fund Actuary, and the key assumptions included within the valuations for the Council. This included comparing them to expected ranges, utilising information provided by PWC, consulting actuary engaged by the National Audit Office; and</li> <li>• Agreed the data in the IAS 19 valuation reports for the Council provided by the actuary for accounting purposes to the pension accounting entries and disclosures in the Council's financial statements.</li> </ul>	<p>Our work on the valuation of the LGPS Pension Liability has not identified any significant issues and we have obtained assurance that the valuations are not materially misstated.</p> <p>However, the Council disclosed in Note 9.7 that the valuation of the property assets held by Greater Manchester Pension Fund were subject to 'material valuation uncertainty' as a result of COVID-19, and we included an 'emphasis of matter' in our auditor's report.</p>



## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls.

The matters we report are limited to those deficiencies and other control recommendations that we have identified during our normal audit procedures and that we consider to be of sufficient importance to merit being reported.

We identified one internal control deficiency. This related to improving the audit trail from the Council's valuers to enable an efficient audit of the valuations. Management has strengthened the control arrangements during 2020/21.





### 3. VALUE FOR MONEY CONCLUSION

Value for money conclusion	Unqualified
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#### Our approach to the value for money conclusion

We are required to consider whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, ‘in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.’ To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

#### Significant audit risks

The NAO’s guidance requires us to carry out work to identify whether or not a risk to our conclusion exists. Risk, in the context of our work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate. In our Audit Strategy Memorandum, we reported that we had identified one significant audit risk. The work we carried out in relation to the significant risk is outlined overleaf.

#### Overall Conclusion

Our auditor’s report, stated that that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2020.



### 3. VALUE FOR MONEY CONCLUSION

#### Significant audit risks (continued)

Risk	Work undertaken	Conclusion
<p><b>Financial Sustainability</b></p> <p>2019/20 is the final year of the Councils three year strategy (2017-20), a period which has seen considerable budget cuts. The 2019/20 budget is balanced following an increase in Council Tax of 3.49% but requires the achievement of £15m savings.</p> <p>The continuing challenges the Council faces are not new and are not unique to Manchester City Council. The challenges do, however, present a significant audit risk in respect of considering the arrangements that the Council has in place to deliver financially sustainability.</p>	<p><b>Work undertaken</b></p> <p>We reviewed the arrangements the Council had in place throughout 2019/20 for ensuring financial resilience.</p> <p>Specifically we reviewed whether the medium term financial plan took into consideration factors such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors. We also reviewed the arrangements in place to monitor progress delivering the budget and related savings plans. In addition to considered the Council’s arrangements in place in 2019/20 in the context of the emerging impact of the COVID-19 pandemic.</p> <p>The Council set balanced budgets for 2019/20 and 2020/21. The budget for 2019/20 was set with assumptions of utilising significant levels of earmarked reserves and required significant levels of savings from the previous year. At the same time the budget increased the resources available relating to the increase in some demand-led services. The outturn reported results for the year show a very small overspend against the budget (£0.5m) and delivery of £15m savings as planned. This enabled the Council to not have to rely on utilising additional reserves in 2019/20 to support the spending, and this has meant the General Fund balance is £21m and Usable Earmarked Reserves for revenue purposes (excluding schools) are £349m as at 31 March 2020.</p> <p>The Council’s monitoring of its 2019/20 budget has been through detailed ‘officer-led’ monthly monitoring, with regular reporting to Council members in the Executive. The reporting provides a timely and detailed report of the current position and the projected position at the year end. The review of the monitoring in year identifies that the Council undertakes a robust review and regular reporting. The in year monitoring has been largely accurate and has predicted the level of overspending through the year, enabling timely mitigating decisions to be taken.</p>	<p>We concluded that for 2019/20 the Council has made proper arrangements to deliver financial sustainability in the medium term.</p>

(continued)



### 3. VALUE FOR MONEY CONCLUSION

#### Significant audit risks (continued)

Risk	Work undertaken	Conclusion
<b>Financial Sustainability (continued)</b>	<p><b>Findings (continued)</b></p> <p>The financial position for 2020/21 is significantly more challenging. The Council agreed its budget for 2020/21 before the COVID-19 pandemic. And even before the impact of COVID-19 on the Council's financial position, the 2020/21 budget presented a significant challenge to the Council's long term financial sustainability balancing the increased costs from demand-led services with increasingly stretched resources.</p> <p>The Council is continuing to refine its assessment of the impact of COVID-19 on 2020/21 and future years and has recently commenced a consultation on reshaping the Council to ensure it remains financially sustainable in the medium term. What is certain is that there are significant additional cost pressures, particularly in delivering Adult &amp; Children's Social Care, and very significant levels of lost income relating to the loss of the dividend from Manchester Airport, reduced fees and charges and the impact on the Collection Fund.</p> <p>The Council does have significant levels of earmarked reserves as at 31 March 2020, but these are not sufficient to sustain the Council's financial position over the medium term given the current projected impact and will not insulate the Council from making difficult decisions to deliver the medium term financial sustainability.</p>	



## 4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of group audit reporting requirements	Work is still to be completed
Other information published alongside the audited financial statements	Consistent

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

### Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

### Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the WGA Assurance Statement in respect of its consolidation data, and to carry out certain tests on the data. We received the Council's WGA submission on 1 April 2021. The Council reported significant problems with the new HM Treasury system which caused delays in submitting the information. Although our work has progressed since receiving the submission, the Council has yet to finalise the submission to enable us to report to the NAO. The Council is working with HM Treasury to resolve these issues.

### Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.



## 5. OUR FEES

### Fees for work as the Council's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the Audit Committee in February 2020.

Our work on the Council's WGA return is still to be completed, but based on the completion of the work on the financial statements and VFM conclusion our proposed final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice	159,519	159,519
<b>Fee variations *:</b>		
<b>Recurrent scope changes</b> due to increased regulatory expectations:		
• Additional testing on Property, Plant & Equipment		20,000
• Cost of engaging an external valuer		13,750
• Additional testing on Defined Benefit Pensions Schemes		6,000
<b>In year scope changes</b> due to Covid-19 and pension legal cases including:		
• Impact of 'Material Valuation Uncertainty' on the Council's property assets;		2,000
• Additional considerations of estimation uncertainty in going concern;		2,500
• Changes impacting pension liabilities through the McCloud and Goodwin legal cases.		1,000
<b>Additional requirements for Manchester CC:</b>		
• Enhanced audit reporting		4,500
<b>Total audit fee</b>	<b>159,519</b>	<b>209,269</b>

\* Fee variations subject to confirmation from PSAA

### Fees for other work

We confirm that we have not undertaken any non-audit services for the Council in the year.



## 6. FORWARD LOOK

### Changes to the Code of Audit Practice

The Code of Audit Practice (the Audit Code), issued by the Comptroller and Auditor General, prescribes the way we carry out our responsibilities as your auditors. On 1<sup>st</sup> April 2020 a new Code came in to force and will apply to our work from 2020/21 onwards.

The new Audit Code continues to apply the requirements of International Standards on Auditing (ISAs) to our audit of the financial statements. While there are changes to the ISAs that are effective from 2020/21 the Audit Code has not introduced any changes to the scope of our audit of the financial statements. We will continue to give our opinion on the financial statements in our independent auditor's report.

There are however significant changes to the work on value for money arrangements, and the way we report the outcomes of our work to you.

### The auditor's work on value for money arrangements

From 2020/21 we are still required to satisfy ourselves that you have made proper arrangements for securing the economy, efficiency and effectiveness in your use of resources, however unlike under the 2015 Audit Code, we will no longer report in the form of a conclusion on arrangements. Instead, where our work identifies significant weaknesses in arrangements, we are required to report those weaknesses to you, along with the actions that need to be taken to address those weaknesses.

Our work on value for money arrangements will focus on three criteria, specified in the revised Audit Code:

- Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;
- Governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

Under the new Audit Code we will be expected to report and make recommendations as soon as we identify a significant weakness in arrangements, as opposed to reporting our conclusion on arrangements at the end of the audit cycle as has previously been the case.

### Reporting the results of the auditor's work

We currently issue you with an Annual Audit Letter which provides a summary of our work across all aspects of our audit. From 2020/21 the Annual Audit Letter will be replaced by the Auditor's Annual Report. This will continue to provide a summary of our work over the year of audit but will also include a detailed commentary on your arrangements in place to achieve economy, efficiency and effectiveness. This commentary replaces the conclusion on arrangements that was previously provided and will include details of any significant weakness identified and reported to you, follow up of any previous recommendations made, and the our view as to whether recommendations have been implemented satisfactorily.

The new Audit Code will result in additional officer time and auditor time and therefore audit fees.





## 6. FORWARD LOOK: AUDIT CHANGES 2020/21

### Redmond Review

In September 2020, Sir Tony Redmond published the findings of his independent review into the oversight of local audit and the transparency of local authority financial reporting. The report makes several recommendations that, if implemented, could affect both the financial statements that local authorities are required to prepare and the work that we as auditors are required to do.

The report and recommendations are wide-ranging, and includes:

- the creation of the Office of Local Audit and Regulation (OLAR), to manage, oversee and regulate local audit;
- reviewing reporting deadlines;
- reviewing governance arrangements in local authorities, including the membership of the Standards and Audit Committee; and
- increasing transparency and reducing the complexity of local authority financial statements.

The full report is available here: <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>

The recommendations and findings have been considered by the Ministry of Housing, Communities and Local Government and their response was published in December 2020. The response accepted some recommendations but did not accept others.

We look forward to working with all stakeholders to implement changes to ensure the development and sustainability of local audit.



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