Annual Audit Letter

Manchester City Council

Year ended 31 March 2019

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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 for the year ended 31 March 2019. 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	Our auditor's report issued on 31 July 2019 included our opinion that the financial statements: • give a true and fair view of the Council's financial position as at 31 March 2019 and of its expenditure and income for the year then ended; and • have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 An unadjusted difference impacting the pension liability significant risk is reported on page 7. In addition, the Group accounts were amended to reflect material adjustments to Airport land and buildings valuations, which impacted on the value of the Council's investment in the joint venture.
Other information published alongside the audited financial statements	Our auditor's report issued on 31July 2019 included our opinion that: • the other information in the Statement of Accounts is consistent with the audited financial statements.
Value for Money conclusion	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 2019.
Reporting to the group auditor	In line with group audit instructions issued by the NAO, in June 2019 we will report to the group auditor in line with the requirements applicable to the Council's WGA return. The deadline for this submission is 13 September 2019.
Statutory reporting	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

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 2019 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, issued to the Council on 31 July 2019, stated that, in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2019 and of its financial performance for the year then ended.

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.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

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 2019:

		Council	Group
Financial statement materiality	Our financial statement materiality is based on 1.68% of Gross Revenue Expenditure at Surplus/deficit on Provision of Services level	£30.261m	£35.735m
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£0.907m	£1.072m
Specific materiality	We have applied a lower level of materiality to the following area of the accounts: Senior Officer Remuneration	£5,000	n/a

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 the 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.

Management override of controls

Description of the significant risk

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. Due to 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.

How we addressed the significant risk

We addressed this risk through performing audit work over:

- Accounting estimates impacting on amounts included in the financial statements;
- Consideration of identified significant transactions outside the normal course of business
- Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Audit conclusion

There are no significant matters arising from our work on the management override of controls.

Valuation of Property, Plant & Equipment

Description of the significant risk

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 & 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 fairly stated 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.

How we addressed the significant risk

We have:

- Critically assessed the Council's valuer's scope of work, qualifications, objectivity and independence to carry out the Council's programme of revaluations;
- Considered whether the overall revaluation methodology used by the Council valuer is in line with industry practice, social housing statutory guidance, the CIPFA Code of Practice and the Council's accounting policies;
- Critically assessed the appropriateness of the underlaying data and the key assumptions used in the valuer's calculations;
- Critically assessed the appropriateness of the social housing factor applied to the valuation of the Council Dwellings;
- Assessed the movement in market indices between the revaluation dates and the year end to determine whether there have been material movements over that time;
- Critically assessed the treatment of the upward and downward revaluations in the Council's financial statements with regards to the requirements of the CIPFA Code of Practice;
- Critically assessed the approach that the Council adopts to ensure that assets not subject to revaluation in 2018/19 are materially fairly stated; and
- Tested a sample of items of capital expenditure in 2018/19 to confirm that the additions are appropriately valued in the financial statements.

Audit conclusion

We have not identified any significant matters from our testing and have concluded that the Council's Property, Plant & Equipment is materially fairly stated.

2. AUDIT OF THE FINANCIAL STATEMENTS (CONTINUED)

Valuation of Defined Benefit Pension Liability

Description of the key audit matter

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 2016.

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.

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.

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 2018/19.

How we addressed the key audit matter

We have:

- Critically assessed the competency, objectivity and independence of the Greater Manchester Pension Fund's Actuary, Hymans Robertson;
- Liaised with the auditors of the Greater Manchester Pension Fund to gain assurance that the controls in place at the Pension Fund are operating effectively. This included the processes and controls in place to ensure data provided to the Actuary by the Pension Fund for the purposes of the IAS19 valuation is complete and accurate;
- Reviewed the appropriateness of the Pension Asset and Liability valuation methodologies applied by the Pension Fund Actuary, and the key assumptions included within the valuation. This included comparing them to expected ranges, utilising information provided by PWC, consulting actuary engaged by the National Audit Office;
- Agreed the data in the IAS 19 valuation report provided by the Fund Actuary for accounting purposes to the pension accounting entries and disclosures in the Council's financial statements.

Observations and conclusions

We have not identified any significant matters from our testing, and we have concluded that the Council's reported net defined benefit pension liability is materially fairly stated. We have reported a non-material estimation difference regarding the impact of Guaranteed Minimum Pension and McCloud legal cases. Management identified the impact following a revised actuarial valuation in July 2019.

Area of management judgement

Group Financial Statements consolidation process

Description of the management judgement

The Council has made judgements around which of its group entities it consolidates into its Group Financial Statements, and how it consolidates the transactions and balances into the Group.

How our audit addressed this area of management judgement

We have reviewed the Council's judgements relating to the entities that are consolidated into the Group financial statements, and we have reviewed and tested the method of consolidation of those group entities into the Group financial statements.

Management prepared the initial consolidation of Manchester Airport Holdings Ltd (MAHL) based upon their draft financial results. MAHL subsequently provided audited financial statements which were used by management to re-prepare the consolidation.

Management commissions an independent valuation of Manchester Airport and the Manchester Convention Centre to convert to IFRS Fair Value for consolidation.

Audit conclusion

Our review of the Council's independent valuations of Manchester Airport land resulted in management recognising these assets were double counted in the Group financial statements because the Council's interest was added to the component bodies interests. The same also applied to the consolidation of Destination Manchester Ltd (DML) property. This resulted in an amendment to reduce the investment in MAHL by £92.8m and DML by £15.2m.

A further Group consolidation amendment was required regarding the calculation of the annual uplift of land and buildings used in the consolidation of the MAHL accounts. This resulted in an increase in the investment in MAHL of £37.2m in 2018/19 and an associated prior year adjustment of £42.9m.

None of the above adjustments impacted the accounts of DML, MAHL or the Council's single entity accounts.

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. We identified the following deficiencies in internal control as part of our audit.

Description of deficiency	Members and senior officers are not requested to declare their interests on an annual basis. An annual declaration is considered to be good practice.
Potential effects	Interests which may conflict with the Council's activities and associated safeguards could be missed.
Recommendation	Undertake an annual exercise to request all Members and Senior Officers to update the Register of Interests.
Management response	We agree in principal with the recommendation and will liaise with Democratic Services to amend the Council Constitution and implement a process to update the Register of Interests.

Description of deficiency	There are 112 Active Directory privileged users registered at the Council. Privileged access gives administrator rights and access to critical systems and data and should therefore be tightly controlled. We consider that 112 privileged users appears high.
Potential effects	A high number of privileged users increases the risk of privileged access being abused impacting on the security and integrity of systems and data.
Recommendation	The number of active privileged user accounts (identified with the privileged user prefix) should be reviewed and if no longer required should be disabled or deleted.
Management response	The recommendation is duly noted and accepted. Work is underway to ensure the number of privileged users aligns to the specific roles and responsibilities that require privileged access. Where it is identified that privilege access is no longer required or appropriate then this access will be removed. We will liaise with the Council's audit team to review progress.

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion	Unqualified

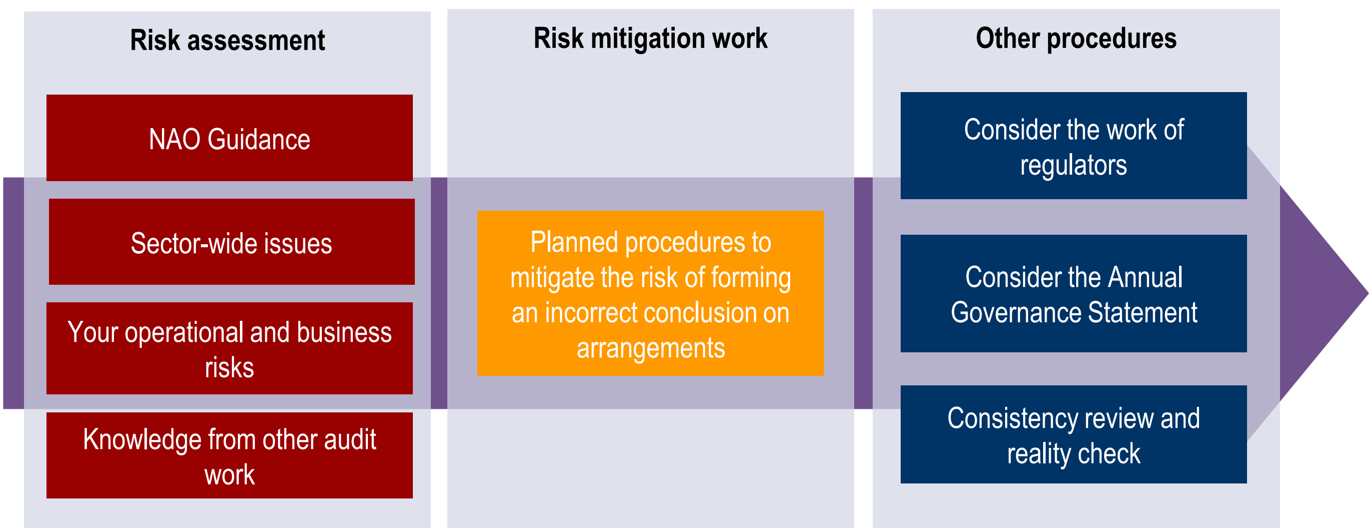
Our approach to Value for Money

We are required to form a conclusion as to 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.

A summary of the work we have undertaken is provided below:



Significant Value for Money risks

The NAO’s guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money 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 Value for Money risk relating to the financial sustainability of the Council in the medium term.

The work we carried out in relation to the significant risk is outlined overleaf.

Our overall Value for Money conclusion

Our audit report issued on 31 July 2019 reported an unqualified Value for Money conclusion for the 2018/19 financial year.

3. VALUE FOR MONEY CONCLUSION (CONTINUED)

Significant Value for Money risks

The work we carried out in relation to significant risk is outlined below.

Risk	Work undertaken	Conclusion
Health and Social Care Integration From 1 April 2017 the Manchester Health and Care Commissioning (MHCC) Board has been in place, with representatives from health and social care commissioning, governing the commissioning spend in Manchester. A key part of the single commissioning function is that integrated decision making will take place for the health and social care commissioning budgets in Manchester. The partnership between the Clinical Commissioning Group (CCG) and the Council is supported through a new section 75 partnership arrangement (S75) from 1 April 2018. As part of the partnership arrangements, the CCG and the Council have agreed to establish and maintain an Integrated Care Budget which will be used by the MHCC Board to commission the Services as set out in the Locality Plan.	We have reviewed documentation to gain an understanding of the governance and decision making arrangements which underpin successful joint commissioning across Manchester. This has included understanding the financial impact for the Council. We have also noted and reflected the valuable insight from the Council's Internal Audit function. The Council has worked closely with health partners across the city to improve and coordinate health and care services for residents. Service delivery and governance arrangements for MHCC and the Manchester Local Care Organisation (MLCO) are reported to Members and Senior Management through Senior Management Team, Executive, Health & Wellbeing Board and Health Scrutiny Committee. MHCC operates as a partnership between the Council and CCG under a Section 75 agreement underpinned by a financial framework. MHCC leads the commissioning of health, adult social care and public health services although statutory responsibility for social care and public health remains with the Council. Reporting is through MHCC Finance Executive and upwards to MHCC Executive. The governance function was strengthened in the autumn of 2018 building upon lessons learnt from the early stages of joint working. The financial framework requires an Integrated Care Budget (ICB) of which the Better Care Fund (BCF) is a subset. Total BCF funding for 2018/19 was £110.3m of which the Council contributed £38.2m (35%) and CCG £72.1m (65%). Of the total, £72.3m was spent on new delivery models of integrated care. MLCO is the vehicle for the delivery of commissioned health and care. Although not a statutory partnership between health providers there is a ten year partnering agreement effective 1 April 2018. Statutory responsibility for adult social care remains with the Council. MLCO Executive receives monthly performance updates.	We conclude that for 2018/19 the Council has proper governance arrangements to deliver joint Health and Social Care Commissioning. This should help integrate the three pillars of the overall Locality Plan being the LCO, Joint commissioning by MHCC and the singe hospital service.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	**No matters to report**
Completion of group audit reporting requirements	**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 plan to submit this information to the NAO by the deadline of 13 September.

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 panel in December 2018.

Having completed our work for the 2018/19 financial year, we can confirm that our final fees are as follows:

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£159,519	£159,519

Fees for other work

We have been invited and agreed to undertake a Homes England Certification audit for the Council. The audit fee for the work is £2,750.

6. FORWARD LOOK

Audit Developments

Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. We have responded to the National Audit Office's consultation on the content of the Code (https://www.nao.org.uk/code-audit-practice/about-code/)

A new Code will be laid in Parliament in time for it to come in to force no later than 1 April 2020.

Financial Resilience

Government Spending Review

The Council will need to incorporate the outcome of the Spending Review in its Medium Term Financial Plan. The Government has announced that a one year spending review will be completed in September for 2020/21, with the next multi-year Government Spending Review being delayed until 2020. The Spending Review will set out the department allocations for 2020/21 and potentially beyond. Regardless of the timing and period covered by the Spending Review, the Council recognises the key issue is the management of general reserves to a level that ensures it remains financially resilient and able to deliver sustainable services. It must, therefore, ensure it clarifies and quantifies how it will bridge the funding gap through planned expenditure reductions and/ or income generation schemes.

Local Authority Financial Resilience Index

CIPFA is moving forward with its financial resilience index, which it believes will be a barometer on which local authorities will be judged. We would expect the Council to have at least considered the index once it is formally released.

Commercialisation

The National Audit Office will be publishing a report on Commercialisation during 2019. Depending on the Council's appetite for Commercialisation, we would expect the Council to consider the outcome of the report and ensure any lessons learnt are incorporated into business practice.

Further, the UK Debt Management Office's Annual Report, published on 23 July 2019, reported that, as at 31 March 2019, the Public Works Loan Board's loan book was £78.3 billion with 1,308 new loans totalling £9.1 billion advanced during the year. As a result, we expect local authorities to clearly demonstrate:

- the value for money in the use of Public Works Loan Board funds to acquire commercial property
- the arrangements for loan repayment through the updated Statutory Guidance on Minimum Revenue Provision in 2019/20, 2020/21 and beyond.

6. FORWARD LOOK (CONTINUED)

Financial Reporting

UK Local Government Annual Accounts

The CIPFA/LASAAC Local Authority Code Board specifies the financial reporting requirements for UK local government. A consultation is underway to inform the direction and strategy for local government annual accounts. We will be submitting our response and suggest practitioners also voice their opinion.

Lease accounting

The implementation of IFRS 16 *Leases* in the Code is delayed until 1 April 2020. The Council will need a project plan to ensure the data analysis and evaluation of accounting entries is completed in good time to ensure any changes in both business practice and financial reporting are captured.

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