



# The Annual Audit Letter for Manchester City Council

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**Year ended 31 March 2016**

26 October 2016

**Andy Mack**

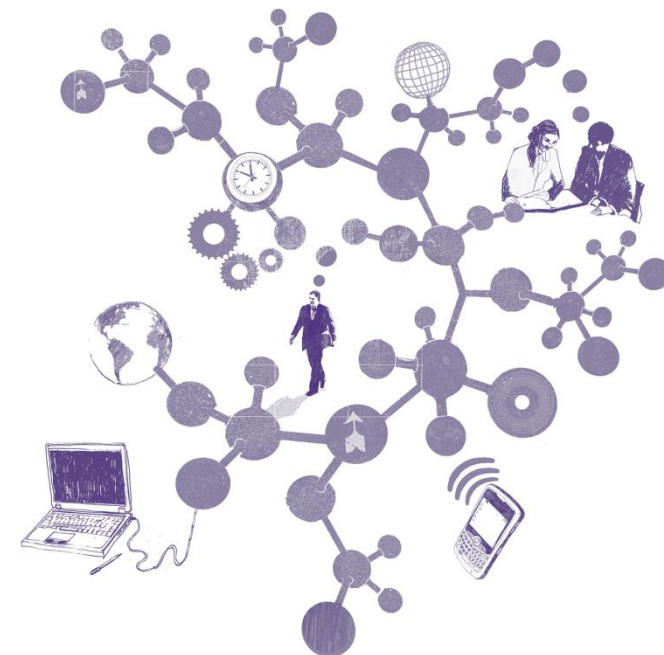
Director  
T 0207 728 3299  
M 07880 456 187  
E [andy.l.mack@uk.gt.com](mailto:andy.l.mack@uk.gt.com)

**John Farrar**

Associate Director  
T 0161 234 6384  
M 07880 456 200  
E [john.farrar@uk.gt.com](mailto:john.farrar@uk.gt.com)

**Simon Livesey**

Assistant Manager  
T 0161 234 6370  
M 07887 958 437  
E [simon.d.livesey@uk.gt.com](mailto:simon.d.livesey@uk.gt.com)



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# Executive summary

## **Purpose of this letter**

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Manchester City Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit Committee as those charged with governance in our Audit Findings Report on 15 September 2016.

## **Our responsibilities**

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

## **Our work**

### **Financial statements opinion**

We gave an unqualified opinion on the Council's financial statements on 30 September 2016.

### **Value for Money Conclusion**

The publication of an inspection report by Ofsted dated September 2014 concluded that the overall arrangements for ensuring the effectiveness of Children's Services at the Council and the Local Safeguarding Children Board in the Manchester City Council area were judged to be 'inadequate'.

We recognise that the Council has secured progress in improving Children's Services in a number of areas and that the Council's improvement plan is designed to ensure that the service continues to develop and raise its standards, however our Value for Money Conclusion was based on the position in 2015/16 and the overall quality of social work intervention remained variable during 2015/16, with too much work judged below standard.

We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016 except for the effects of the matter described above. We therefore qualified our value for money conclusion, on an 'except for' basis, in our audit report on 30 September 2016.

### **Use of additional powers and duties**

We are required under the Act to give electors the opportunity to raise questions about the Council's accounts and we consider and decide upon objections received in relation to the accounts.

On 11 August 2016 we received an objection to the Council's 2015/16 financial statements from a Manchester elector. The objection is concerned with the Council's portfolio of 'Lender Option Borrower Option' (LOBO) loans, and requests that we issue a Public Interest Report and consider an application to the courts for a declaration that the LOBO borrowing is unlawful.

As at 31 March 2016, the principal outstanding on the Council's LOBO borrowing was £411m.

We took account of the objection in concluding our work to provide an opinion on the Council's 2015/16 financial statements, and a Value for Money Conclusion.

We will communicate with the objector and with the Council as we undertake further work to enable us to reach decisions in determining the objection.

### **Whole of government accounts**

We completed work on the Council's consolidation return following guidance issued by the NAO and issued an unqualified report on 21 October 2016.

### **Certificate**

We are currently unable to certify that we have completed the audit of the accounts of Manchester City Council as we have not yet completed our work in respect of the objection referred to above.

### **Certification of grants**

We also carry out work to certify the Council's Housing Benefit (HB) subsidy claim on behalf of the Department for Work and Pensions. We certified the Council's 2014/15 HB claim, which was for a total value of £279 million, on 30 November 2015. We were able to certify the Council's claim without amendment or qualification.

Our work on the Council's 2015/16 HB claim is not yet complete, but will be finalised by 30 November 2016. We will report the results of this work to the Audit Committee in our Annual Certification Letter.

### **Other work completed**

During the year we have provided Accountant's Reports relating to the Council's 2014/15 Teachers' Pensions End of Year return and the 2014/15 Pooling of Housing Capital Receipts return.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's officers.

**Grant Thornton UK LLP**  
**October 2016**

# Audit of the accounts

## Our audit approach

### Materiality

In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's and Group accounts to be £31,800,000 and £36,700,000 respectively, 1.75% of the Council's and Group's gross revenue expenditure. We used this benchmark, as in our view, users of the accounts are most interested in how income raised from taxation and grants has been applied during the year.

We also set a lower level of materiality for certain areas such as disclosure of officers' remuneration, salary bandings and exit packages and auditor's remuneration. Due to the public interest in these disclosures we expect all such disclosures to be correct and where relevant within the appropriate banding.

We set lower thresholds of £1,590,000 and £1,840,000, for the Council and Group respectively, above which we reported errors to the Audit Committee in our Audit Findings Report.

### The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

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

We also read the narrative report and annual governance statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

The tables that follow summarise the risks which had the greatest impact on our overall strategy and where we focused more of our work.

<b>Risks identified in our audit plan</b>	<b>How we responded to the risk</b>
<p><b>The revenue cycle includes fraudulent transactions</b></p> <p>Under International Standard on Auditing (ISA) (UK &amp; Ireland) 240 there is a presumed risk, for all organisations subject to audit, that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition</li> <li>• opportunities to manipulate revenue recognition are very limited and</li> <li>• the culture and ethical frameworks of local authorities, including at Manchester City Council, mean that all forms of fraud are seen as unacceptable.</li> </ul> <p>Our detailed audit work did not identify any issues in respect of revenue recognition.</p>
<p><b>Management over-ride of controls</b></p> <p>Under ISA (UK &amp; Ireland) 240 it is presumed that the risk of management over-ride of controls is present in all entities.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• reviewed entity level controls</li> <li>• tested samples of journal entries</li> <li>• reviewed significant accounting estimates, judgements and decisions made by management; and</li> <li>• reviewed unusual significant transactions.</li> </ul> <p>Our audit work did not identified any evidence of management over-ride of controls.</p>

# Audit of the accounts

Risks identified in our audit plan	How we responded to the risk
<p><b>Valuation of property plant and equipment (PPE)</b></p> <p>The Council revalues its assets on a rolling basis over a five year period. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from current value. This represents a significant estimate by management in the financial statements.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• reviewed management's processes and assumptions for the calculation of significant estimates in relation to the valuation of PPE</li> <li>• considered the competence, expertise and objectivity of any management experts used</li> <li>• reviewed the instructions issued to valuation experts and the scope of their work</li> <li>• communicated with valuers about the basis on which valuations are carried out and considered the appropriateness of the key assumptions</li> <li>• reviewed the information used by valuers to ensure it is robust and consistent with our understanding</li> <li>• tested revaluations made during the year to ensure they are input correctly into the Council's fixed asset register</li> <li>• evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value.</li> </ul> <p>We did not identify any issues to report.</p>

# Audit of the accounts

Risks identified in our audit plan	How we responded to the risk
<p><b>Valuation of pension fund net liability</b> The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• identified the controls put in place by management to ensure that the pension fund liability is not materially misstated. We also assessed whether these controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement</li> <li>• reviewed the competence, expertise and objectivity of the actuary who carried out your pension fund valuation and gained an understanding of the basis on which the valuation is carried out</li> <li>• used the work of an auditor's expert to gain assurance that methods and assumptions used in the valuation are reasonable and appropriate</li> <li>• reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary.</li> </ul> <p>We did not identify any issues to report.</p>
<p><b>Better Care Fund</b> The Council is party to significant pooling of resources with the Manchester Clinical Commissioning Groups, under NHS Act 2006 Section 75 agreements. The Better Care Fund (BCF) has increased the amount pooled from 1 April 2015 and there is a risk that transactions are not accounted for in accordance with the requirements of the Code and accounting standards.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• obtained an understanding of the nature of the BCF arrangements in place</li> <li>• reviewed the Council's proposed accounting treatment</li> <li>• completed tests of detail on accounting entries and disclosures within the financial statements.</li> </ul> <p>We did not identify any issues to report.</p>



Risks identified in our audit plan	How we responded to the risk
<p><b>Operating expenses</b></p> <p>Operating expenses or creditors understated or not recorded in correct period.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• updated our accounting system and key controls documentation and undertaken system walkthroughs</li> <li>• completed substantive testing of expenditure ensuring valid spend and appropriate categorisation within net cost of services headings in the comprehensive income and expenditure statement</li> <li>• sample tested payables and accrued expenditure, including reviewing post year end invoices and payments</li> <li>• reviewed control account reconciliations.</li> </ul> <p>We did not identify any issues to report.</p>
<p><b>Employee remuneration</b></p> <p>Remuneration expenses not correct (remuneration accruals understated).</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• updated our accounting system and key controls documentation and undertaken system walkthroughs</li> <li>• reviewed the payroll accrual processes</li> <li>• reviewed key payroll reconciliations</li> <li>• sample tested employee expenses to staff records, pay rates and classification in the nominal ledger,</li> </ul> <p>We did not identify any issues to report.</p>
<p><b>Welfare expenditure</b></p> <p>Welfare benefits improperly computed.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• updated our accounting system and key controls documentation and undertaken system walkthroughs</li> <li>• completed "HB Count" testing modules 2 (system parameter updating), 4 (analytical review), 5 (software diagnostic and overall reconciliation)</li> <li>• in line with our audit approach, partially completed "HB Count" module 3 (detailed testing of HB cases) – the remainder of our testing will be completed as part of our work on the Council's 2015/16 Housing Benefit grant claim.</li> </ul> <p>Our audit work did not identified any significant issues in relation to the risk identified.</p>

Risks identified in our audit plan	How we responded to the risk
<p><b>Group audit</b></p> <p>As Group auditors we are required to obtain sufficient appropriate audit evidence regarding the financial information of group entities and the consolidation process. We identified Manchester Airport Holdings Limited as financially significant to the Council Group.</p>	<p><b>During the course of our audit we:</b></p> <ul style="list-style-type: none"> <li>• reviewed the outcome of the full scope UK statutory audit of Manchester Airport Holdings Limited's 2015/16 financial statements performed by non-Grant Thornton firm KPMG UK LLP;</li> <li>• reviewed the consolidation process by which the Council's Group accounts were prepared.</li> </ul> <p>We did not identify any issues to report.</p>

# Audit of the accounts

## **Audit opinion**

We gave an unqualified opinion on the Council's accounts on 30 September 2016, in advance of the national deadline.

The Council made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

## **Issues arising from the audit of the accounts**

We reported the key issues from our audit of the accounts of the Council to the Council's Audit Committee on 15 September 2016.

## **Annual Governance Statement and Narrative Report**

We are also required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council.

## **Whole of Government Accounts (WGA)**

We carried out work on the Council's consolidation schedule in line with instructions provided by the NAO. We issued a group assurance certificate which did not identify any issues for the NAO, as WGA group auditor, to consider.

## **Other statutory duties**

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have not exercised any of our additional powers and duties under the Act, but as noted on page 4 of this report we have received and we are still considering an objection to the Council's 2015/16 financial statements. We will report on progress in determining the objection to the Council's Audit Committee, and following determination of the objection we will provide a summary of our work and conclusions in our 2016/17 Annual Audit Letter.

## **The way forward**

The deadlines for preparation and audit of the Council's financial statements will be brought forwards for the 2017/18 financial year. We are working with the Council's finance officers and bringing forwards our respective timetables for 2016/17, in advance of the earlier statutory deadlines.

# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

*In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

## Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out in table overleaf.

As part of our Audit Findings Report agreed with the Council in September 2016, we agreed a recommendation to further refine the performance improvement tracker reported to the Children's Services Improvement Board.

## Overall VfM conclusion

We were satisfied that, in all significant respects, except for certain matters relating to arrangements for planning, organising and developing the workforce effectively to deliver strategic priorities, the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

Our overall conclusion reflects the work we conducted in relation to the Council's response to Ofsted's 2014 inspection of Children's Services. We provide further information on this work, our findings and conclusions on page 13.

Risk identified	Work carried out	Findings and conclusions
<p><b>Ofsted inspection of children's services</b>                      The Council's progress in responding to Ofsted's 'inadequate' findings, following their review of Children's Services and the Local Safeguarding Children Board, is insufficient to enable us to remove our 'except for' qualification of the Value for Money Conclusion.</p>	<p>We have monitored the Council's progress in delivering improvements in its children's services during the course of our 2014/15 and 2015/16 audits.</p> <p>In particular, we have:</p> <ul style="list-style-type: none"> <li>• taken account of relevant reports presented to the Council's Young People and Children Scrutiny Committee, Ofsted sub-group, Audit Committee and full Council</li> <li>• discussed the Council's improvement plans and progress with the Director of Children's Services and Deputy Chief Executive</li> <li>• taken account of relevant Internal Audit reports</li> <li>• attended meetings of, and reviewed papers presented to, the Children's Services Improvement Board.</li> </ul>	<p>We noted that the Council had secured progress on a number of fronts during 2015/16, including:</p> <ul style="list-style-type: none"> <li>• securing a permanent senior management team</li> <li>• developing new models of practice</li> <li>• reducing average caseloads and reducing staff turnover</li> <li>• improving compliance with processes, for example completion of Personal Education Plans and Independent Return Interviews (following a child returning from being missing from home or care).</li> </ul> <p>However, the overall quality of social work intervention remained variable during 2015/16, with too much work judged below standard. We concluded that there were weaknesses in the Council's arrangements for planning, organising and developing the workforce effectively to deliver strategic priorities, and qualified our Value for Money Conclusion on an 'except for' basis.</p> <p>Following the issue of our 2015/16 Value for Money Conclusion, Ofsted issued a letter (<a href="https://reports.ofsted.gov.uk/local-authorities/manchester">https://reports.ofsted.gov.uk/local-authorities/manchester</a>) summarising the findings of a monitoring visit on 14 and 15 September 2016. Ofsted noted that the Council has made improvements where there had been very poor practice, and some progress towards meeting the recommendations from the 2014 inspection. Ofsted noted that senior leaders and managers demonstrated a good understanding of the improvement required, that the pace of change had increased significantly in the preceding six months and that appropriate plans are now in place to support change, although many key actions were too recent to have yet made a difference to the work done with children.</p>
<p><b>Financial resilience</b>                      The Council's response to continuing financial austerity is insufficient, placing the Council's medium term financial plans in jeopardy.</p>	<p>We have considered the Council's budget setting and monitoring arrangements and taken into account the findings from our audit of the Council's 2015/16 financial statements.</p>	<p>Despite continuing financial austerity, the Council has continued to set and deliver balanced budgets. The Council continued to manage its finances prudently, for example by internally borrowing to reduce the finance costs associated with capital investment. The Council underspent its 2015/16 budget by £2m (0.3%). The Council has a well established framework for budget setting, allowing for consultation with the public, and scrutiny and approval by elected Members. This budget process was well underway for 2017/18 at the time we issued our 2015/16 Value for Money Conclusion.</p>

# Working with the Council

## **Our work with you in 2015/16**

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Together we have delivered some great outcomes.

An efficient audit – our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that adds value and also provides constructive challenge.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness. We attended the Children's Services Improvement Board on a regular basis during the year to maintain our understanding of the progress being made to secure service improvement.

Sharing our insight – we provided regular Audit Committee updates covering best practice. Areas we covered included "Knowing the ropes", our cross-sector review of audit committee effectiveness; our "Business Location Index" and "Health and Wellbeing Index". We also kept you updated on relevant financial reporting developments.

We will continue to provide you with our insights as you bring forward the production of your year-end accounts.

## **Our work with you in 2016/17**

We will continue to liaise with the Council's senior officers on emerging issues and accounting developments, and provide timely feedback.

We will focus on:

- an efficient audit – continuing to deliver an efficient audit, to an earlier deadline
- understanding and supporting the work of the Council – we will focus attention on Children's Services developments as part of value for money conclusion work
- supporting development – including providing informal briefings to members of the Council's Audit Committee.

# Working with the Council

## **Working with you in 2016/17 - Highways Network Asset**

The Code of Practice on Local Authority Accounting (the Code) requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset (the HNA Code), which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets should always have been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost (DHC) to DRC under which these assets will be separated from other infrastructure assets, which will continue to be measured at DHC.

This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure.

Under the current basis of accounting values will only have been recorded against individual assets or components acquired after the inception of capital accounting for infrastructure assets by local authorities. Authorities may therefore have to develop new accounting records to support the change in classification and valuation of the HNA.

The nature of these changes means that finance officers will need to work closely with colleagues in the highways department and potentially also to engage other specialists to support this work.

Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have been working with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We have issued two Client Briefings which we have shared with officers. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

This significant accounting development is likely to be a significant risk for our 2016/17 audit, so we have already had some preliminary discussions with the Council to assess the progress it is making in this respect.

We will continue to liaise closely with the senior finance team during 2016/17 on this important accounting development, with timely feedback on any emerging issues.

The audit risks associated with this new development and the work we plan to carry out to address them will be reflected in our 2016/17 audit plan.

## Appendix A: Reports issued and fees

We confirm below our fees for the audit and provision of audit-related services.

### Fees

	Proposed fee £	Final fee £	2014/15 fee £
Council audit	207,167	TBC*	276,222
Grant certification – Housing Benefit claim	11,625	TBC**	15,050
<b>Total audit fees (excluding VAT)</b>	<b>218,792</b>	<b>TBC</b>	<b>291,272</b>

\* Our 2015/16 final audit fee for the core audit is £207,167. An additional fee will be payable in relation to our work on the objection to the Council's 2015/16 financial statements.

\*\* Our work in relation to the Council's 2015/16 Housing Benefit claim is currently still in progress.

### Fees for other services

Service	Fees £
<b>Audit related services:</b>	2,750 (excluding VAT)
• 2014/15 Pooling Housing Capital Receipts Return (finalised January 2016)	
• 2014/15 Teachers' Pensions End of Year return (finalised November 2015)	4,600 (excluding VAT)

### Reports issued

Report	Date issued
Audit Plan	2 June 2016
Audit Findings Report	9 September 2016
Annual Audit Letter	26 October 2016





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