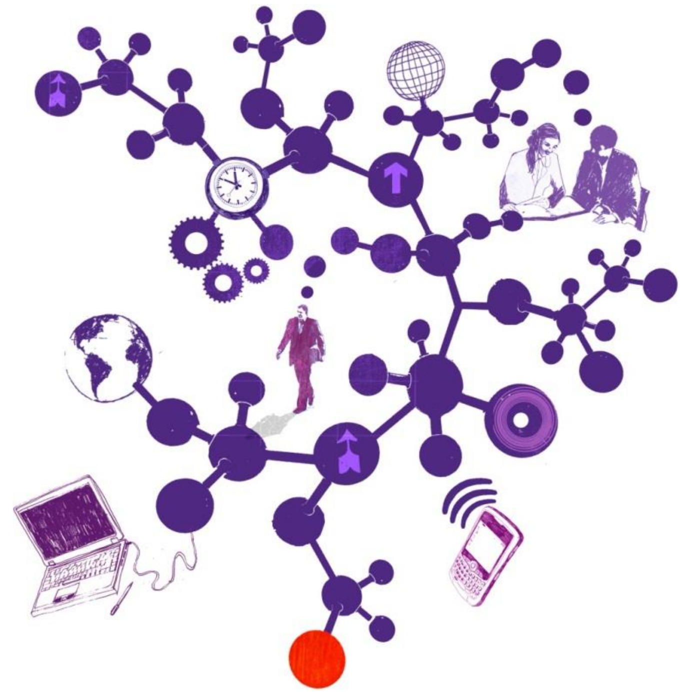
Grant Thornton

Audit Committee Update for Shropshire Council

Year ended 31 March 2015

February 2015



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Introduction

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

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

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

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

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

Progress to date

Work	Planned date	Complete?	Comments
2013/14 Objection We received a formal objection to an element of expenditure within the 2013/14 financial statements relating to taxi licence fees. This did not impact on our ability to provide our opinion on the financial statements.	November 2014 – March 2015	In progress	We are reviewing the response from the Council and have undertaken some meetings to understand the background and detail behind this work. We hope to prepare our formal response to the objector in March 2015. Once we have concluded on this matter we will be in a position to issue our certificate indicating that the 2013/14 audit is formally closed.
2014/15 Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Council setting out our proposed approach in order to give an opinion on Council's 2014/15 financial statements.	February 2015	Yes	We continue to assess the risks facing your Council and meet with Senior Officers to ensure that these risks are fully understood and our proposed audit work is appropriate to support our final opinion and VfM conclusion. If there are any revisions to the plan we will agree this with the Head of Finance, Governance and Assurance and report back to Audit Committee.
Interim accounts audit Our interim fieldwork visit includes: • updating our review of the Council's control environment • updating our understanding of financial systems • review of Internal Audit reports on core financial systems • early work on emerging accounting issues • early substantive testing • proposed Value for Money conclusion.	November 2014 – April 2015	In progress	We have commenced regular meetings with the finance team to streamline and improve the audit approach for 2014/15 and discuss technical issues early. We have agreed topics and agreed to refresh each month to ensure we are picking up all emerging issues. We continue to work closely with Internal Audit in relation to risk, work on the financial statements and fraud. Our approach for 2014/15 will be to undertake as much early testing as possible to reduce pressure on the finance and audit team over the summer months.

Progress to date (continued)

Work	Planned date	Complete?	Comments
2014/15 final accounts audit Including: • audit of the 2014/15 financial statements • proposed opinion on the Council's accounts • proposed Value for Money conclusion.	June – September 2015	Not started	The onsite work is due to commence from 20th July 2015
Value for Money (VfM) conclusion For 2014/15, auditors of Local Government bodies are required to give their statutory conclusion on arrangements to secure value for money based on the following two criteria specified by the Audit Commission: • The organisation has proper arrangements in place for securing financial resilience. • The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.	December 2014 – June 2015	In progress	The scope of our work to inform the 2014/15 VfM conclusion is detailed within the Audit Plan. We have already started attending meetings with key Senior Officers to inform our overall understanding of the Council and capture evidence of how the Council is securing value for money in all areas of service delivery. There will also be a strong focus on financial resilience and how the Council is preparing itself for future years.
Grant work (Audit Commission regime) We plan to certify the following claim: • Housing Benefits Claim 2013/14 (BEN01)	June – November 2015	Not started	Our Certification Plan will be prepared and submitted to the June 2015 Audit Committee
Other areas of work The Council has not engaged us to complete any additional work at this time.	N/A	N/A	N/A

Reporting the certification of grant claims (non Audit Commission regime)

We were engaged by the Council to certify four grant claims which fall outside the Audit Commission regime. This work was completed and reported in 2013/14 although need not relate to the claim within that period. Certification of these claims represents a final but important part of the process to confirm the Council's entitlement to funding. The four claims are detailed below.

There are no issues arising from this certification work which we wish to highlight for your attention. We are satisfied that the Council has appropriate arrangements to compile complete, accurate and timely claims/returns for audit certification in these areas.

Claim	Value	Amended	Qualified?	Fee	Comments
Homes & Communities Agency 2012/13 Decent Homes Funding	£1.2 million	No	No	£2,750	
Homes & Communities Agency 2013/14 Decent Homes Funding	£0.794 million	No	No	£2,750	
Homes & Communities Agency 2014/15 Affordable Homes compliance work	N/A	N/A	No	£3,500	This work related to a spot check requested by the HCA where they chose a sample of schemes. The work did not focus on value of funding, but on arrangements in place and legality and governance issues.
Teachers' Pension Agency 2013/14 Certification	£14,442 million	No	No	£4,200	The fee set by the Audit Commission in 2012/13 was £5,877.

Emerging issues and developments

Grant Thornton – Rising to the challenge

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

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

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

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

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

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

Accounting for schools

Accounting and audit issues

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

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

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

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

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

We are working with the Audit Commission, CIPFA and the other audit firms suppliers to try to seek a practical way forward as soon as possible. We will continue to share the latest developments with officers. In the mean time we would recommend that you continue your preparations for recognising school land and building including:

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

Challenge questions

Is your Head of Finance, Governance and Assurance able to provide our auditors with evidence which supports the judgements around how these schools should be consolidated (whether legally based or operationally based)?

Group accounting standards

Accounting and audit issues

The CIPFA Code has adopted a new suite of standards for accounting for subsidiaries, associates and joint arrangements. These changes affect how local authorities account for services delivered through other entities and joint working with partners. The key changes for 2014/15 are to:

- the definition of control over 'other entities'. The revised definition is set out in IFRS 10 and determines which entities are treated as subsidiaries
- the accounting for joint arrangements. This now follows IFRS 11 and includes changes to the definition of joint ventures and how joint ventures are consolidated in group accounts
- disclosures in relation to subsidiaries, joint arrangements, associates and unconsolidated entities as set out in IFRS 12.

Changes to the definition of control over 'other entities'

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

- the investor has the rights to direct the relevant activities (the ones that determine the return for the investors) of the investee
- the investor has exposure, or rights, to variable returns from its involvement with the investee
- the investor has the ability to use its power over the investee to affect the amount of the investor's returns.

Local authorities with investments in 'other entities' will need to consider whether:

- they control any entities using the new definition. Local authorities will need to pay particular attention to special purpose vehicles and any other entities where there was a close judgement call under the old IAS 27
- there is a need for a prior period adjustment.

Changes to accounting for joint arrangements

Joint arrangements are contractual arrangements between two or more parties where there is joint control. IFRS 11 makes three key changes from IAS 31:

- there are now only two types of joint arrangements: joint operations and joint ventures
- In a joint operation the investing parties have rights and obligations in relation to the arrangement's assets and liabilities, whereas in a joint venture the parties have rights to the arrangement's net assets. It is for the entity to assess whether a joint arrangement is a joint operation or joint venture by considering its rights and obligations arising from the arrangement.
- local authorities are still required to consolidate joint ventures in their group accounts but must now do so using the equity (single line) method. The option for proportionate (line-by-line) consolidation has been removed.

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

Challenge questions

- Does your Head of Finance, Governance and Assurance have a plan of how to prepare to implement this change in accounting standards?

Earlier closure and audit of accounts

Accounting and audit issues

DCLG is consulting on proposals to bring forward the audit deadline for 2017/18 to the end of July 2018. Although July 2018 is almost 4 years away, both local authorities and their auditors will have to make real changes in how they work to ensure they are 'match-fit' to achieve this deadline. This will require leadership from members and senior management. Local government accountants and their auditors should start working on this now.

Top tips for local authorities:

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

Challenge questions

- Has your Head of Finance, Governance and Assurance put in place a plan to address the earlier close date?

Financial sustainability of local government

Local government guidance

In November the National Audit Office published their report on the Financial Sustainability of Local Government.

The report concludes that Local authorities have coped well with reductions in government funding, but some groups of authorities are showing clear signs of financial stress. The Department for Communities and Local Government has a limited understanding of authorities' financial sustainability and the impacts of funding cuts on services, according to the National Audit Office.

The Government reduced its funding to local authorities by an estimated 28% in real terms between 2010-11 and 2014-15. Further planned cuts will bring the total reduction to 37% by 2015-16, excluding the Better Care Fund and public health grant. Although there have been no financial failures in local authorities in this period, a survey of local auditors shows that authorities are showing signs of financial pressure. Over a quarter of single tier and county councils had to make unplanned reductions in service spend to deliver their 2013-14 budgets. Auditors are increasingly concerned about local authorities' capacity to make further savings, with 52% of single tier and county councils not being well-placed to deliver their medium-term financial plans.

There are significant differences in the scale of funding reductions faced by different authorities. Authorities that depend most on government grant are the ones most affected by funding reductions and reforms. This was an outcome of policy decisions to tackle the fiscal deficit by reducing public spending, and for local authority funding to offer incentives for growth.

Local authorities have tried to protect spending on social care services. Other service areas such as housing services and culture and leisure services have seen larger reductions. While local authorities have tried to make savings through efficiencies rather than by reducing services, there is some evidence of reduction in service levels.

According to the NAO, however, the Department does not monitor in a coordinated way the impact of funding reductions on services, and relies on other departments and inspectorates to alert it to individual service failures. In consequence, the Department risks becoming aware of serious problems with the financial sustainability of local authorities only after they have occurred.

The Department's processes for assessing the capacity of authorities to absorb further funding reductions are also not sufficiently robust.

Kerslake report on Birmingham City Council

Local government guidance

Sir Bob Kerslake published his report, The way forward: an independent review of the governance and organisational capabilities of Birmingham City Council, on 9th December.

Commissioned by the Secretary of State this comes off the back of well publicised failures in Children's Services and the Trojan Horse issue in Birmingham Schools. It includes some tough messages for Birmingham City, but there are issues that resonate with all large local authorities.

The report's recommendations include the following.

- The Council needs an external Improvement Board to show that it is making the changes it needs to effectively serve its population.
- Internal governance needs fundamental change, including the relationship between members and officers, how it plans for the future, a stronger corporate core and a programme of culture change.
- The Council needs more political clarity, moving away from annual thirds elections and reducing the number of members. This includes redesigning the model for representative governance.
- Medium term financial planning needs greater clarity, and the Council cannot assume that it will get any additional Government support.
- In moving from a 20,000 people organisation in 2010 to a 7,000 people one by 2018 the Council needs fit for purpose workforce planning.
- Devolution within the Council and across the City needs simplifying and a greater outcome focus.
- Partnership working needs redefining, with the Council moving away from a 'Big Brother' approach.
- The Council needs to work with the other West Midland MBCs to make the combined authority a reality that delivers jobs and prosperity to the region.

Challenge questions

- Has Shropshire Council considered whether there are lessons or issues from the report that it also needs to action?