Grant Thornton

Audit & Standards Committee Update – Warwickshire County Council

Year ended 31 March 2015

29 January 2015

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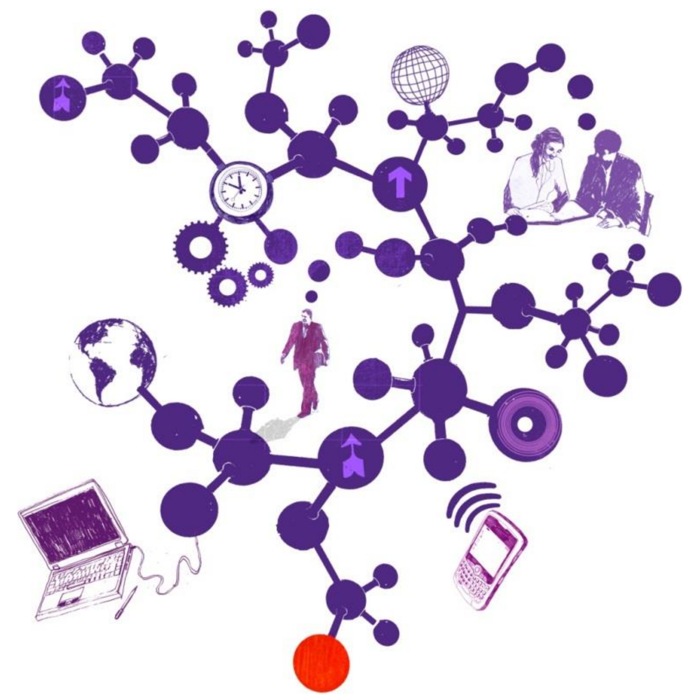

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Introduction

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.

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Progress at 29 January 2015

Work	Planned date	Complete?	Comments
2014-15 Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Authority setting out our proposed approach in order to give an opinion on the Authority's 's 2014-15 financial statements.	February 2015	Y	Audit plan on agenda for February meeting of Audit & Standards Committee
Interim accounts audit Our interim fieldwork visit includes: • updating our review of the Council 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.	January – March 2015	N	-
2014-15 final accounts audit Including: • audit of the 2014-15 financial statements • proposed opinion on the Authority's accounts • proposed Value for Money conclusion.	June - September 2015	N	-

Progress at 29 January 2015

Work	Planned date	Complete?	Comments
Value for Money (VfM) conclusion The scope of our work to inform the 2014/15 VfM conclusion comprises assessment against two specified criteria • 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	February – September 2015	N	-
Objection to 2013/14 accounts We are currently considering our response to the formal objection to the Council's 2013/14 accounts which we received on 7 September 2014.		N	

Rising to the challenge

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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.

2020 Vision

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Our national report '2020 Vision' is available at: http://www.grant-thornton.co.uk/en/Publications/2014/2020-Vision-Exploring-finance-and-policy-futures-for-English-local-government-as-a-starting-point-for-discussion/

In a time of unprecedented challenge for English local government, how can the sector develop towards 2020 if it is to have a sustainable future? Our latest report provides a thorough analysis of the current political and economic context, explores a range of potential policies and outcomes, and suggests several scenarios to facilitate an open debate on the future for the sector.

Produced in collaboration with the University of Birmingham's Institute for Local Government Studies (INLOGOV), our report suggests that fundamental changes to local government are both operationally necessary and constitutionally inevitable, for the sector to remain relevant by 2020. The report offers a thorough analysis of the current political and economic context and explores a range of potential future policies and outcomes that English local government will need to adopt and strive towards as they seek to adapt and overcome these challenges.

Placed in the context of enhanced devolution, following the Scottish independence referendum, 2020 Vision maintains a wary eye fixed on the 2015/16 Spending Round and looks ahead to the life time of the next government. It highlights that the economic and financial situation remains increasingly untenable, with an expanding North/South divide arising from the pattern of funding reductions and economic growth.

It highlights that English local authorities continue to face unprecedented challenges, relating to the pressures of austerity and central government funding reductions, and demographic and technological change. Our report highlights the vital role of a successful local government sector and encourages it to think hard about how it will cope in the future.

Informed by the views of a broad range of local authority leaders, chief executives and other sector stakeholders, the report offers a set of six forward-looking scenarios* in which councils could be operating within by 2020. Though not mutually exclusive, we suggest that key stakeholders need to take urgent action to avoid a potential slow and painful demise for some councils by 2020.

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

Pulling together the Better Care Fund

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Our national report 'Pulling together the Better Care Fund' is available at: http://www.grant-thornton.co.uk/en/Publications/2014/Pulling-together-the-Better-Care-Fund/.

The reports asks 'Do local authorities and clinical commissioning groups (CCGs) have effective arrangements to develop joint Better Care Plans for agreement by the health and wellbeing boards (HWBs) and how ready are they for the pooled fund in April 2015?'

Our report draws on our review of the introduction of draft Better Care Fund (BCF) plans for both the February and April submissions. It is based on a sample of our findings from 40 HWB localities. It considers the partnership arrangements across a HWB planning area and is supported by discussions with the sector, across the country. The result is a snap shot of progress as at 30 June 2014, prior to the issue of revised planning guidance by NHS England and the Local Government Association on 25 July 2014.

It provides you with:

- an understanding of how your approach to introducing BCF compares to others across the country
- assistance in identifying the key issues to delivering Better Care Fund plans effectively
- insight into current best practice
- practical areas for consideration for improving arrangements in the future.

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

Accounting for schools

Accounting and audit issues

Accounting for schools

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. This includes school income and expenditure as well as 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. This view has been set out in more detail in LAAP 101 (Accounting for Non-Current Assets Used by Local Authority Maintained Schools). 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.

Continued overleaf …..

Accounting for schools (continued)

Accounting and audit issues

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.

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 of the investee (relevant activities being the ones that determine the return for the investors – the return could be in the form of a service rather than money)
- 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.

In the commercial sector, this is generally thought to have resulted in more entities being treated as subsidiaries. However, the change is in both directions: some subsidiaries have been redefined as associates. 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.

Group accounting standards (continued)

Accounting and audit issues

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. IFRS 11 bases its definition of joint ventures on the substance of the arrangement rather than legal status. 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. To do this the entity needs to consider the structure and legal form of the arrangement, the terms agreed by the parities and any other relevant facts and circumstances. Appendix B to IFRS 11 provides further explanation and examples of joint operations and joint ventures.
- 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.

Disclosure of interests in other entities

IFRS 12 makes consistent the requirements for disclosures in relation to subsidiaries, joint arrangements, associates and unconsolidated entities. It includes the need for transparency about the risks to which the reporting entity is exposed as a consequence of its investment in such arrangements.

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.

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.

Local government financial reporting remains strong

Local government guidance

The Audit Commission published its report, Auditing the Accounts 2013/14: Local government bodies, on 11th December.

Financial reporting was consistently strong for most types of principal local authority in 2013/14 when compared to the previous financial year. This year the Commission has congratulated 16 bodies where auditors were able to issue an unqualified opinion and a VFM conclusion on the 2013/14 accounts by 31 July 2014, and the body published audited accounts promptly. Although, as only 21 principal bodies have managed to publish their audited accounts by 31 July since 2008/09, a move to bring the accounts publication date forward is likely to cause significant challenges for the majority of public bodies.

The Commission reports that auditors were able to issue the audit opinion by 30 September 2014 at 99 per cent of councils, 90 per cent of fire and rescue authorities, 97 per cent of police bodies, all other local government bodies and 99 per cent of both parish councils and internal drainage boards. This is consistent with last year for most groups, but an improvement for councils and small bodies compared to 2012/13.

Eight principal authorities were listed where the auditor was unable to issue an opinion by the 30th September deadline.

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