

# Annual Audit Letter

## Stockport Metropolitan Borough Council

Year ending 31 March 2020





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# 1. EXECUTIVE SUMMARY

## Purpose of the Annual Audit Letter

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

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

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 27 November 2020 included our opinion that the financial statements:</p> <ul style="list-style-type: none"><li>• give a true and fair view of the Council's financial position as at 31 March 2020 and of its expenditure and income for the year then ended; and</li><li>• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20</li></ul>
Other information published alongside the audited financial statements	<p>Our auditor's report included our opinion that:</p> <ul style="list-style-type: none"><li>• the other information in the Statement of Accounts is consistent with the audited financial statements.</li></ul>
Value for money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020</p>
Reporting to the group auditor	<p>In line with group audit instructions, issued by the NAO on 4<sup>th</sup> November, we reported to the group auditor in line with the requirements applicable to the Council's WGA return.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.</p> <p>The report also confirmed that we did not exercise any other special powers of the auditor under sections 28, 29 or 31 of the 2014 Act.</p>



## 2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

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

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

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

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

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

### Our approach to materiality

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

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

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

Financial statement materiality	Our financial statement materiality is based on 2% of gross expenditure at the Surplus/Deficit on Provision of Services level.	£16,309k
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	£489k
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Officer Remuneration bandings	£5k



## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks

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

Identified significant risk	Our response	Our findings and conclusions
<b>Management override of controls</b> In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Because of the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits	We addressed this risk through performing audit work over: <ul style="list-style-type: none"><li>• Accounting estimates impacting on amounts included in the financial statements;</li><li>• Consideration of identified significant transactions outside the normal course of business; and</li><li>• Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.</li></ul>	We did not identify any significant matters arising from our testing of the risk of management override of controls.



## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks continued

Identified significant risk	Our response	Our findings and conclusions
<b>Valuation of land and buildings and investment properties</b> <p>The Council's accounts contain material balances and disclosures relating to its holding of property, plant and equipment (PPE) including investment properties, with the majority of property assets required to be carried at valuation. Due to the high degree of estimation uncertainty associated with these valuations especially within land and buildings, we have determined there is a significant risk in this area.</p>	<p>We assessed the valuer's qualifications, objectivity and independence to carry out such valuations, and reviewed the valuation methodology used, including testing the underlying data and assumptions. We compared the valuation output with market intelligence provided by Gerald Eve, consulting valuers engaged by the National Audit Office, to obtain assurance that the valuations are in line with market expectations. We engaged an external valuation specialist to review the more complex investment property valuations.</p> <p>We reviewed the Council's approach to ensuring that assets not subject to valuation in 2019/20 are materially misstated and we considered the approach in light of the valuation information reported by the valuers. In addition, we considered the movement in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values have moved materially over that time.</p> <p>We also considered the potential impact of the Covid-19 pandemic on the Council's asset valuations and the adequacy of the disclosures in the financial statements, specifically those relating to the material uncertainty disclosed by your valuer to their valuations.</p>	<p>We concluded that the valuation of the Council's Property, Plant &amp; Equipment was materially fairly stated.</p> <p>Our sample testing of valuations identified a small number of immaterial errors. We extrapolated the errors across the population tested and noted an unadjusted, non-material understatement of £3,254k.</p> <p>However, the Council disclosed in Note 4 that the valuation of the property assets were subject to 'material valuation uncertainty' as a result of COVID-19, and we included an 'emphasis of matter' in our auditor's report. A 'material valuation uncertainty' declaration does not mean that the valuation cannot be relied upon, but that, less certainty can be attached to the valuation.</p>





## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks continued

Identified significant risk	Our response	Our findings and conclusions
<p><b>Valuation of Defined Benefit Pension Liability</b></p> <p>The net pension liability represents a material element of the Council's balance sheet. The Council is an admitted body of Greater Manchester Pension Fund, which had its last triennial valuation completed as at 31 March 2019.</p> <p>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.</p> <p>There is a risk that the assumptions and methodology used in valuing the Council's pension obligation are not reasonable or appropriate to the Council's circumstances. This could have a material impact to the net pension liability in 2019/20.</p>	<p>As part of our work we reviewed the controls that the Council has in place over the information sent to the Scheme Actuary, including the Council's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of the scheme Actuary, Hymans Robertson.</p> <p>We reviewed the appropriateness of the methodology applied in the valuation of the liability by Hymans Robertson, and the key assumptions included within the valuation, comparing them to expected ranges, utilising the information provided by PwC, consulting actuary engaged by the National Audit Office. We considered the Council's response to the key risks that emerged through the audit relating to legal cases that impact on the Local Government Pension Scheme.</p> <p>In addition our work focused on two issues that emerged through 2020. In July 2019, MHCLG consulted on the proposed remedy for the 'McCloud' case, an estimate of which was included in the Council's liability in 2018/19 and 2019/20. The proposed remedy indicates that the actuarial estimate of the liability for 2018/19 and 2019/20 was likely to be overstating the pension fund liability but not materially.</p> <p>A second emerging issue this year is the 'Goodwin' case which also relates to groups of pension fund members suffering discrimination. Although the impact of 'Goodwin' is still being clarified the Council's actuary have provided evidence to support their assessment of the impact on the Council's liability. They conclude that the impact is not likely to be material. In both issues, we engaged with the Council's actuary and reviewed the evidence provided by the pension fund and the Council's actuary in order to conclude on the material accuracy of the liability.</p>	<p>Our work on the valuation of the LGPS Pension Liability has not identified any significant issues and we have obtained assurance that the valuations are not materially misstated. Our other work on the Pension disclosures identified some non-material disclosure adjustments. The Council amended the financial statements for all the adjustments.</p> <p>However, the Council disclosed in Note 4 that the valuation of the property assets held by Greater Manchester Pension Fund were subject to 'material valuation uncertainty' as a result of COVID-19, and we included an 'emphasis of matter' in our auditor's report.</p>



## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Internal control recommendations

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

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

We identified three internal control deficiencies. These were not significant in nature and related to general IT controls. Management has agreed to strengthen arrangements to address the control recommendations during 2020/21. We are content with management's response.





### 3. VALUE FOR MONEY CONCLUSION

Value for money conclusion	Unqualified
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#### Our audit approach

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

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

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

#### Significant audit risks

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

#### Overall Conclusion

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



### 3. VALUE FOR MONEY CONCLUSION

Risk	Work undertaken	Conclusion
<b>Financial Sustainability</b> <p>The Council's medium term financial strategy for the period 2020/21 to 2022/23 sets out the financial challenges it faces. Across the three year period there is a cumulative savings requirement of £17.0m. The Q3 reporting for 2019/20 indicates that the Council is projecting a surplus of £0.966m (forecast expenditure of £239.554m at 31 March 2020). Cash limited budgets are tightly controlled with the largest variance being an overspend within Adult Care and Health of £0.497m reflecting pressures felt nationally. This pressure is offset by the non-cash limited budget gain with the Manchester Airport Group Interim Dividend, declared in December 2019, being £0.929m above budget. This was not unexpected but the Council is prudent not to recognise the dividend until confirmed.</p> <p>Despite the favourable position at Q3, the continuing challenges the Council faces are not new and are not unique to Stockport Metropolitan Borough Council. The challenges therefore present a significant audit risk in respect of considering the arrangements that the Council has in place to deliver financial sustainability over the medium term.</p>	<b>Work undertaken</b> <p>We reviewed the arrangements the Council had in place throughout 2019/20 for ensuring financial resilience. Specifically we reviewed whether the medium term financial plan took into consideration factors such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors. We also reviewed the arrangements in place to monitor progress delivering the budget and related savings plans. In addition to considering the Council's arrangements in place in 2019/20 in the context of the emerging impact of the COVID-19 pandemic.</p> <p><b>Findings</b></p> <p>The Council set robust and balanced budgets for 2019/20 and 2020/21. Detailed progress reports are provided to Cabinet on a quarterly basis allowing for effective monitoring of progress against budget.</p> <p>The Council's final reported outturn was a surplus position of £0.8m. This is following net transfers to the Council's earmarked reserves position of £5.8m which are available to support the Council in managing future financial pressures and supporting one-off positive investments in the local area.</p> <p>However, the outbreak of the COVID-19 presents a new and significant challenge to the Council's longer-term financial sustainability for the coming years. Additional cost pressures and reduced income have led to the need for the Council to reassess its 2020-21 budget and medium term financial strategy. Work is now well underway to monitor and assess the impact of the pandemic on the Council's operations and its financial position. The Council continues to respond to central government's request for monthly returns and as at the end of quarter one the forecast outturn for 2020/21 is a £10.4m deficit net of financial support received from government.</p> <p>The Council has significant levels of earmarked reserves as at 31 March 2020, but these are not sufficient to sustain the Council's financial position over the medium term given the estimated impact of COVID-19. The Council has acknowledged that it needs to quickly make difficult strategic decisions, particularly relating to its capital programme and through detailed reviews of the Council's Reserves Policy and Medium Term Financial Plan. Ensuring the Council remains in a robust financial position is essential.</p>	<p>We concluded that for 2019/20 the Council has made proper arrangements to deliver financial sustainability in the medium term.</p>



## 4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of group audit reporting requirements	Consistent
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 submitted this information to the NAO on 5 March 2021.

### 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 audit committee in August 2020.

Having completed our work for the 2019/20 financial year, we can confirm that our final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice	£97,119	£97,119
<b>Fee variations*:</b>		
<b>Recurrent scope changes</b> due to increased regulatory expectations:		
• Additional testing on Property, Plant & Equipment		£9,650
• Share of the cost of the external valuer for work on the Manchester Airport land valuation		£750
• Additional testing on Defined Benefit Pensions Schemes		£6,250
<b>In year scope changes</b> due to Covid-19 and pension legal cases including, but not limited to:		
• impact of 'Material Valuation Uncertainty' on the Council's land and buildings and its share of Pension Fund property assets;		£1,500
• additional considerations of estimation uncertainty in going concern;		£2,000
• changes impacting pension liabilities through the McCloud and Goodwin legal cases.		£1,000
<b>Other matters:</b>		
• External valuer work on the valuation of investment properties		£3,000
<b>Total audit fee</b>		<b>£121,169</b>

\*Fee variations are subject to approval by PSAA.

### Fees for other work

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



## 6. FORWARD LOOK

### Financial outlook

The COVID-19 pandemic and the consequences of local and regional lockdowns and restrictions will have a significant impact on the UK economy for years to come. The pandemic has created significant uncertainties and pressures in the Council's medium term financial planning arrangements. Clarity over the impact will only be known when the virus has been brought under control and the impact on the economy becomes clearer. The Council is monitoring and updating plans but is anticipating future pressures in the income it receives. In particular, Collection Fund income is likely to be affected by any negative impact to the local and national economy. Public spending is also likely to be tightly controlled as the Government begins to manage the levels of borrowing incurred.

There is also uncertainty stemming from the UK's new trading arrangements with the European Union. While this may not directly impact on the Council's supply chains, the impact on the overall economy may create indirect pressures.

It is critical that the Council continues to monitor and refresh its medium term plan so that potential funding shortfalls can be identified as early as possible and mitigations identified to minimise the impact on services.

### How we will work with the Council

In terms of the technical challenges around the production of the statement of accounts, we will continue to offer accounting workshops to finance officers, and the audit team will continue to share our knowledge of new accounting developments. We will also be on hand to discuss any issues as and when they arise.

Given the impact of COVID-19 on the 2019/20 reporting timetable, there is some uncertainty in respect of the 2020/21 completion dates. We have held initial discussions on the timing of the audit with the Council's finance team and planned dates based on provisional timescales. We will continue to work with the finance team to ensure timely completion of our audit work.

We will also share relevant insights that we have as a national and international accounting and advisory firm with experience of working with other public sector and commercial service providers.



## 6. FORWARD LOOK

### Changes to the Code of Audit Practice

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

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

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

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

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

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

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

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

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

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

The guidance supporting the new Audit Code is being developed by the National Audit Office and we will provide you with any further updates to our approach arising from this guidance when it is released.





## 6. FORWARD LOOK

### Redmond Review

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

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

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

The recommendations and findings will now be considered by the Ministry of Housing, Communities and Local Government and we look forward to working with all stakeholders to implement changes to ensure the development and sustainability of local audit.

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



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