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AUDIT COMMITTEE

7 JANUARY 2020

CONSIDERATION OF CONSOLIDATING THE ACCOUNTS OF COUNCIL OWNED SUBSIDIARIES

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Summary

This report considers the requirements of International Financial Reporting Standards (IFRS) 10,11, and 12, being Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities respectively, and explores whether the Council is required to produce group accounts within the financial statements for 2019/20.

1. Budget and Policy Framework

1.1 The approval of the Council's financial statements is a matter for the Audit Committee.

2. Background

2.1 The Audit Committee, at its meeting of 26 September 2019, requested that a report be presented to the next meeting "on the possibility of consolidating the accounts of Council owned subsidiaries so that it had an overview of their accounts in the interests of greater transparency."

3. Local Authority Financial Reporting Requirements

3.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Accounting Code of Practice (the Code) sets out a requirement to prepare group accounts where the authority has interests in subsidiaries, associates and/or joint ventures, subject to consideration of materiality.

3.2 A subsidiary is defined as an entity where the authority is exposed to (or has rights to) variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

3.3 Medway Council has the following entities that fall into this category:

- Medway Commercial Group Ltd (MCG)
- Medway Development Company Limited (MDC)

3.4 An associate is defined as an entity for which the authority is an investor that has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee (stopping short of control or joint control). It is presumed that holding more than 20% of the voting power of an investee (either directly or indirectly) brings significant influence, but this presumption can be rebutted. It is possible for significant influence to be exerted where an investor has less than 20% of the voting power or where another party has majority ownership.

3.5 Medway Council does not have any interests in entities that would fall within this category.

3.6 A joint venture is classed as an arrangement under which two or more parties have contractually agreed to share control, such that decisions about activities that significantly affect returns require the unanimous consent of the parties sharing control, and joint ventures have rights to the net assets of the arrangement.

3.7 Medway Council has the following entities that fall into this category:

- Medway Norse Limited
- Medway Norse Transport

3.8 Medway Norse Limited and Medway Norse Transport are jointly controlled by Medway Council and Norse Commercial Services Ltd. The Code requires a local authority to prepare group accounts if it has a control over one or more other legal entities and its interest in them is material. Medway Council has a controlling interest in Medway Norse due to the decision making structure agreed at its inception.

3.9 In addition to the above, consideration has been given to the recent decision to award the Council's waste collection contract to Medway Norse with effect from October 2019. The latest estimates show that whilst the projected turnover for 2019/200 is circa £20.9m, approximately £19m of this is due to services provided to Medway Council i.e. intra group transactions, and therefore would be excluded from any published group accounts. Medway Norse has no non-current assets and therefore, due to materiality, there would be no requirement to produce group accounts based upon these estimates.

3.10 With regards to its subsidiaries, the Code requires that Group Accounts are considered subject to materiality and the exclusion of intra group transactions i.e. those between the parent and the subsidiary. For 2018/19, materiality was set at £10.1m by our external auditors, Grant Thornton. Whilst this figure has yet to be set for 2019/20, it is unlikely that it will vary significantly from the previous year's figure.

3.11 As such the Turnover or Long Term Assets net of intra group transactions would need to be in excess of that figure to trigger the requirement to produce Group Accounts.

3.12 Medway Commercial Group has estimated turnover in the region of £16m for 2019/20, but of this, £13.5m is likely to consist of intra group transactions, leaving a net figure of £2.5m to be considered which is not material to the Council's accounts. Non-Current Assets are anticipated to be in the region of £0.5m as at 31 March 2020, which again would not be material.

3.13 For MDC, the estimated turnover as at 31 October 2019 was £0.164m with estimated non-current assets circa just £0.002m.

3.14 Therefore neither of the above accounting values would result in the need to generate group accounts on a materiality basis.

3.15 Another reason for looking at the possibility of producing group accounts is to aid the Audit Committee to have an overview of their accounts in the interests of greater transparency.

3.16 With regards to the Council's subsidiaries, both MCG and MDC and Medway Norse, the Council's Joint Venture produce regular monitoring reports to Cabinet, which includes the latest financial projected position for the reporting period. In addition to this, the audited accounts are available from the Companies House website within nine months of the end of the financial period to which they relate in line with private sector accounting regulations.

3.17 Due to the fact that financial projections are made regularly and audited financial statements are available publicly together with the consideration that none of the entities have external transactions that would trigger a material difference to the Council's financial statements, the Council's Chief Finance Officer has concluded that the Council are not required to produce group accounts for 2019/20.

3.18 Discussions were held with the Council's external auditors, Grant Thornton LLP during the 2018/19 audit of the financial statements and an agreement was reached that on the basis of materiality, group accounts were not required, whilst Grant Thornton agreed with this approach for 2018/19 they will not be able to make a formal decision until they have considered the year-end figures during the audit. Whilst they are not able to formalise this opinion until they have concluded their audit work in the summer of 2020, they have confirmed that on the basis of the projected estimates alone, they would agree in principle with the conclusion of the Chief Finance Officer that group accounts will not be required this year.

3.19 This position will however be reviewed on an annual basis, and if circumstances have changed the Council will produce group accounts when required. It is the Chief Finance Officer's opinion that in order to prepare for the possibility of future consolidation, all subsidiaries should ensure they move towards aligning their accounting policies and financial reporting timetables with the Council's, where this is currently not the case.

4. Risk management

Risk	Description	Action to avoid or mitigate risk	Risk rating
Lack of Transparency	The omission of Group Accounts relating to subsidiaries will result in a lack of transparency for the Audit Committee when reviewing the Councils financial statements.	Regular monitoring reports are provided to Cabinet and audited financial statements are lodged with Companies House.	E3

Failure to comply with accounting regulations	The decision to not undertake Group Accounts could mean that the Council does not comply with accounting regulations.	The financial statements of the entities will be reviewed on an annual basis, and if changes from the previous year mean that Group Accounts are required i.e. due to materiality, then these will be duly added to the Council's financial statements.	E3

5. Financial implications

5.1 There are no direct financial implications arising from this report.

6. Legal implications

6.1 The Council has a statutory duty to prepare financial statements in accordance with the Accounts and Audit Regulations 2015, published Financial Reporting and Accounting Standards and the CIPFA Accounting Code of Practice. The Council's external auditors are required to report on the outcome of their audit work, which includes confirming the Council's compliance with the Regulations, Standards and Code.

7. Recommendation

7.1 Audit Committee notes the regulatory requirements for consolidation of Council owned subsidiaries into financial statements, and notes the decision of the Chief Finance Officer that these do not need to be produced for 2019/20.

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Appendices

None

Background papers

None