

Deloitte & Touche LLP

Report to the Corporate
Affairs Committee on the
28th September 2011 Audit
Final Report

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Key findings

We have pleasure in setting out in this document details of our audit of Middlesbrough Council (the Authority) for the year ending 31 March 2011. We have issued a separate document which contains details of our audit of Teesside Pension Fund for the year ended 31 March 2011.

On 13 August 2010, the Secretary of State for Communities and Local Government announced the proposed abolition of the Audit Commission. The proposed abolition will be from March 2012 and the Audit Commission has confirmed that there is no immediate change to your audit arrangements which should be unaffected for the year ended 31 March 2012. Both we and the Audit Commission will keep you informed of further developments.

This summary is not intended to be exhaustive but highlights the most significant matters to which we would like to bring your attention. It should, therefore, be read in conjunction with the report and the appendices thereto.

Description	Detail
<p>Audit status</p>	<p>We are satisfied that the status of the audit is as expected at this stage of the timetable agreed in our audit plan.</p> <p>Details of other matters outstanding at the date of preparation of this report are:</p> <ul style="list-style-type: none"> • completion of equal pay and capital grants testing; • certain testing sections to be fully completed; • receipt of 2 bank, 4 investment, 4 loan and 2 legal letters; • bank statements from Oakfields College (see Section 6); • receipt of the management representation letter; • completion of internal review procedure; • update of subsequent events to signing of the audit report; • completion of our value for money procedures; and • Whole of Government Accounts testing. <p>We will report to you verbally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters. On satisfactory completion of the outstanding matters, we anticipate issuing an unmodified audit opinion on the truth and fairness of the financial statements and an unqualified value for money conclusion.</p>
<p>Key findings on audit risks and other matters</p>	<p>The key findings regarding the risks we identified are listed below:</p> <ul style="list-style-type: none"> • International Financial Reporting Standards (IFRS) conversion of opening balances: we have completed our review of the conversion work performed on the 2009 and 2010 balances. Overall, the process was well managed by the Authority. We did note some audit adjustments, primarily in relation to deferred grants (totalling £4.6m in each year), which the Council has processed within the accounts. Other corrected misstatements are detailed in Section 1. There were a small number of minor adjustments arising from our testing, which the Council decided not to process on the grounds of materiality. All uncorrected adjustments are in Appendix 1; • Format and presentation of IFRS accounts: the first draft of accounts presented for audit were in compliance with the Code with only a small number of minor IFRS disclosure deficiencies noted. There were a larger number of presentational errors noted, but most of these were subsequently corrected by management. Uncorrected deficiencies are noted in section 3;

Key findings (continued)

Description	Detail
<p>Key findings on audit risks and other matters (continued)</p>	<p>Section 1</p> <ul style="list-style-type: none"> • Complexities of fixed asset accounting: we have noted an adjustment in this area relating to the treatment of impairments and disposals totalling £18.8m, and an additional adjustment relating to the recognition of adopted roads, totalling £0.9m. The Authority also identified an asset which had been retained on the balance sheet but was no longer owned. This resulted in an adjustment of £16.5m in both 2008/09 and 2009/10; • Valuation of fixed assets: following the review of a sample of the Authority's Depreciated Replacement Cost valuations, by our in-house valuers, the Authority re-visited the indices used within the calculation and an adjustment was processed to reduce the revaluation in the year by £11.6 million; • Valuation of investment properties: from our testing in this area we noted that the Inner Middlesbrough development project was not accounted for in line with International Accounting Standard (IAS) 40 – Investment Property. This led to an adjustment, which has been processed within the accounts, to impair the value of the assets by £12.2 million. This is discussed in more detail in section 1; • Classification of provisions and earmarked reserves: we have performed a review of the provisions and earmarked reserves against the Code guidance and have no issues to bring to your attention from our testing to date; • Valuation of equal pay claims: the equal pay claim calculations were reviewed for reasonableness and the treatment assessed against the Code. We have no issues to bring to your attention from our testing to date, although this is yet to be fully completed; • Presumed risk of revenue recognition fraud: for the Council we consider that the specific revenue recognition risk relates to the appropriate cut-off of grant income. The results of our testing led to an adjustment to decrease income in the Statement of Comprehensive Income and Expenditure by £1.36 million. There was no overall impact on the general fund arising from this adjustment; • Recoverability of investments: we have reviewed the short term investments held by the Authority and no recoverability issues were identified. A manager from our Treasury Team has undertaken a review of the Treasury function within the Authority and the recommendations arising from this are discussed in section 2; • Accounting for the voluntary redundancy scheme: there are no issues to bring to your attention from our testing of the redundancy scheme accounting entries; and • Presumed risk of management override of controls: no issues of management override were noted from the testing performed.

Key findings (continued)

Description	Detail	
<p>Identified misstatements</p>	<p>Audit materiality was calculated as £4,059,000. The threshold for reporting misstatements was £202,957.</p> <p>The unadjusted audit misstatements would have the impact of decreasing the surplus on provision of services in the Statement of Comprehensive Income and Expenditure by £0.6 million and decreasing net assets by £2 million. There would be no impact on the movement on the general fund.</p>	<p>Appendix 1</p>
<p>Accounting policies and financial reporting</p>	<p>As part of our audit, we consider the quality and acceptability of the Authority's accounting policies and financial reporting.</p> <p>The Statements of Accounts have to be prepared under an International Financial Reporting Standards ("IFRS") - based Code of Practice on Local Authority Accounting for the first time in 2010/11.</p> <p>The draft financial statements presented for audit substantially met the disclosure requirements of the IFRS Code 2010/11.</p>	<p>Section 3</p>
<p>Accounting and internal control systems</p>	<p>As part of our audit we consider the quality and robustness of the Authority's internal control environment. We have not identified any significant internal control weaknesses during the course of our work. However, we have identified some recommendations and these are outlined in Section 2.</p> <p>We have also documented an update on the Information Technology controls points identified in the prior year.</p>	<p>Section 2</p>
<p>Financial Standing</p>	<p>We have considered the financial standing of the Authority for 2010/11. We have considered this based on current/ongoing expenditure demands, expected grant income and the current cash position of the Authority. Public sector funding cuts have caused a reduction in grant income received in the 4 year period from 2011/12 to 2014/15. The Authority has drawn up detailed plans on how to deal with reduction in funding in 2011/12 and is currently in the process of developing its detailed budgets for 2012/13. The Authority also has in place high level strategies for the later years.</p>	

1. Key audit risks

The results of our audit work on key audit risks are set out below. The background sections of each risk are reproduced from our planning report.

Format and presentation of IFRS accounts

Background	There is a risk that the format and presentation of the 2010/11 accounts are not fully compliant with the requirements of IFRS, particularly as this is the first year of reporting under IFRS. There are some key changes which will need to be made in order for the accounts to be IFRS-compliant and hence given the volume of change and complexity of the changes, there is a risk that all required presentational changes are not made.
Deloitte response	We have reviewed the accounts against the Code's IFRS disclosure checklist and noted only a small number of disclosure deficiencies, which have been corrected by management. There were a greater number of presentational deficiencies within the accounts, the most significant of which are documented in Section 3.

IFRS conversion of opening balances

Background	The financial statements of all Councils are required to comply with the accounting requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 ("the Code") based on International Financial Reporting Standards ("IFRS"). There are various changes, required as a consequence of the transition to IFRS, which will affect balances in the accounts such as leases, fixed assets, deferred grants and employee benefits. The comparative figures for the year ended 31 March 2009 and 2010 are required to be retrospectively reworked on this new basis and the financial statements will include a prior period restatement in respect of this change in the accounting framework. There is a risk that some of the changes in the accounting framework may be overlooked or misinterpreted hence resulting in misstated opening balances.
Deloitte response	<p>We reviewed the Authority's IFRS working papers and compared the adjustments made to the transitional guidance provided in the Code. Overall, the process was well managed by the Authority, although we did note some adjustments following our testing. The more significant of which are discussed below:</p> <p>The IFRS adjustments primarily related to capital grants, some of which had been recognised as income when conditions had not clearly been met. This resulted in a total adjustment of £4.55m in 2008/09 to increase deferred income, and £4.58m in 2009/10, both of which were corrected by management.</p> <p>An additional adjustment was noted in 2009/10 whereby the repayment of a capital grant had been incorrectly capitalised. This resulted in an adjustment for £2.5m to reduce the value of fixed assets. This adjustment was posted by management.</p> <p>The Authority had also incorrectly treated revenue funding set aside from the budget as a capital grant. This resulted in adjustments of £3.1m and £3.3m in 2008/09 and 2009/10 respectively, both of which were corrected by management.</p> <p>It was noted that the Authority had not separately accounted for multi-use properties; for example where a property is partially held for investment purposes and partially held to provide services, this was accounted for on a majority use basis. In strict accordance with the Code, such properties should be split and accounted for separately. As such, an unadjusted misstatement is noted in each of the three years in relation to this, and further details can be found in Appendix 1.</p>

1. Key audit risks (continued)

Complexities of capital accounting

Background

In the prior years there have been a number of errors and adjustments required within Fixed Assets due to the complexity of the SORP Capital Accounting rules. These complexities still exist under the IFRS Code and therefore there is a risk that the complexities are not fully understood and adhered to, particularly with the changes incurred due to the IFRS transition.

Deloitte response

Our fixed asset testing was performed strictly in accordance with the new Code in order to highlight any areas of non-compliance.

We reviewed the outcome of the restatement exercise to understand any areas where the Council's initial treatment was not in line with IFRS, so we could consider this as part of the year-end audit.

The following issues were noted as a result of our work:

The Authority identified during the IFRS conversion process that Teesside Magistrates Court was still retained on the balance sheet despite ownership being transferred to central government in 2008. An adjustment has been proposed and posted to remove this asset from the balance sheet in 2008/09 and 2009/10. This adjustment totals £16.5m. We performed both physical verification and agreement to legal deeds for a sample of other property as part of our year end procedures and no other issues were noted from the sample selected.

During the IFRS conversion process, the Authority also noted that adopted roads, which are those roads which have been built on private housing estates and transfer ownership to the Authority once the development is complete, had never been included in the accounts. The Authority posted adjustments to recognise these adopted roads in the restated figures 2009/10. However, as the adopted roads for a single year totalled £1.2m we requested that the Authority quantify the total value of adopted roads since the formation of Middlesbrough Council in 1996. This has resulted in a total addition of £22m. We are currently auditing the adjustment calculated by management and will update you orally if the values are amended.

As part of our disposal testing it was noted that a number of assets had been impaired to nil and subsequently derecognised in the same month. Where there is no economic benefits to be derived from the asset, this should be accounted for as a derecognition in line with the Code. The costs associated with impairments and derecognitions are recognised in different lines within the Comprehensive Income and Expenditure Statement and therefore this has a direct impact on the primary statement. This has resulted in a reclassification adjustment totalling £18.8m, which has been included as a corrected misstatement on Appendix 1.

It was also noted that the accounting software used by the Authority does not charge depreciation in the month of disposal, and therefore credits back one month's depreciation charge when an impairment and disposal occur in the same month. This results in assets of nil value appearing to have a net book value at the point of disposal. This only affects assets which have been impaired and disposed of in the same month. The impact in 2010/11 was immaterial, and if the correct treatment is applied to derecognitions going forwards then this software issue will cease to have a financial impact, and hence we have not raised this as a control recommendation in the current year.

1. Key audit risks (continued)

Complexities of capital accounting (continued)

Deloitte response (continued)

As part of our work we observed recommendations within Capital accounting, however as we are aware that Internal Audit have recently undertaken a study in this area and from discussions with both Internal Audit and management we understand that the themes across our work and the draft report are similar. We have therefore not included our recommendations within this report to prevent duplication and we will provide you with details of our observations in the next Committee meeting if we have any additional observations to note.

Valuation of fixed assets

Background

In the current climate the property market is still volatile and there is the potential for valuations of property and other assets to have fallen.

There is also a new requirement under IFRS for all new or revalued fixed assets with component parts, which may have different useful lives, to be reviewed and the components to be depreciated at different rates according to their useful lives. This requirement applies prospectively from 1 April 2010.

Deloitte response

Our internal valuers, Drivers Jonas Deloitte, have reviewed a sample of properties revalued during 2010/11 and consulted directly with the Authority's valuers. Our valuer identified a risk that the current year revaluations for properties valued using depreciated replacement cost had been overstated in the accounts due to the type of index used in the calculation. The Authority used the General Build Cost Index, but our valuers are of the opinion that the All-in TPI index is a more accurate assessment of general build costs as it reflects the developer's profit and the fact that overall tender costs have decreased due to cost cutting, which have reduced contractors' margins.

The Authority undertook a review to assess the cumulative impact of using the All-in TPI indices by comparing the indices across last three years. Following this assessment it was noted that the new indices would only have a small immaterial impact on the 1 April 2009 balance sheet, but had a significant impact on the value of fixed assets in 31 March 2010 and 31 March 2011 balance sheets. This led to the Authority processing an adjustment to decrease the value of fixed assets by £11.6 and £7.6 million within both the 31 March 2010 and 2011 accounts respectively. Our valuers also raised recommendations in relation to the methodology used and level of documentation available to support the valuations. This is discussed further in section 2.

No properties in the current valuation programme were componentised. At our request the finance team have performed an exercise to determine what the impact would have been if a de minimis level had been set in relation to the asset value. We are satisfied that the impact of componentising in the current year would be immaterial, however the Authority should ensure that they document the rationale supporting the basis of its componentisation policy for the rolling programme of valuation in future years. This should conclude why the Authority believes that its policy ensures that the asset values are fairly stated and in compliance with the Code.

1. Key audit risks (continued)

Valuation of investment properties

Background With the current fall in property prices the Council's investment properties may have decreased in value. The risk surrounds this valuation and whether the properties are fairly valued at year end, as well as whether any impairment is adequate.

Deloitte response We have reviewed the valuation of investment properties and note that the development project, Inner Middlesbrough, was not appropriately valued in the accounts. This project is made up of a number of phases and areas. The Authority is buying the properties in each phase with the intention of demolishing the properties and selling on the land following clearance. Individual assets have been fully impaired only following the demolition of the property. In accordance with IAS40 the phases should be considered separately and the fair value assessed against the future selling price less the costs to complete the phase. Management have been in consultation with the valuers to assess the fair value of each phase at our request. The assessment results in an additional impairment of £12.2m which has been noted at Appendix 1.

Classification of provisions and earmarked reserves

Background There are similarities between the characteristics of provisions and of ear-marked reserves, however the different accounting treatments have a significant effect on the presentation on the statement of financial position. In prior years it was identified that there were some items which had the characteristics of a provision which were included in the specific revenue reserves area of the balance sheet, and audit adjustments were posted as a result. Although no issues were identified with the classification in 2009/10, the risk is that other provisions, including new ones, may be inappropriately presented, which could affect a user's understanding of the accounts. Additionally items included in ear-marked reserves may be incorrectly classed, and may need to be presented as provisions in line with the Code requirements.

Deloitte response We have performed a detailed review of the earmarked reserves and provisions and assessed each one against the criteria outlined in the Code and IAS37- Provisions, Contingent Liabilities and Contingent Assets. The review indicated that all items have been appropriately classified.

Valuation of equal pay claims

Background The Council has been subject to a number of equal pay claims which are still being settled, although minimal new cases have arisen in 2010/11. The valuation of the HR initiatives and equal pay provision has been noted as a specific risk area, since there is some judgement involved, and there are a number of different balances relating to equal pay in the accounts, which must be in strict accordance with the Code.

Deloitte response We have obtained workings behind the equal pay calculations and an update on the status of equal pay claims at the Authority. From our testing, there are no issues noted to date, however our work is still being finalised and we will update you orally if any issues arise.

1. Key audit risks (continued)

Presumed risk of revenue recognition of fraud

Background	<p>International Standards on Auditing (UK and Ireland) 240 – “The auditor’s responsibility to consider fraud in an audit of financial statements” requires the auditors to perform certain audit procedures related specifically to fraud risk, and requires a presumption that revenue recognition is a key audit risk.</p> <p>For the Council we consider that the specific revenue recognition risk relates to the appropriate cut-off of grant income.</p>
Deloitte response	<p>We performed substantive testing over the grants recognised as income, in order to ascertain how management had determined that any attached conditions for the receipt of the grant money had been satisfied. We also focused our testing on grant income deferred to future periods to ensure that the deferment is appropriate.</p> <p>The results of our testing highlighted that some of the grants had not been accounted for in line with the Code, which had resulted in income being recognised incorrectly within the 2010/11 Statement of Comprehensive Income and Expenditure. In response to our findings the Authority reviewed the basis of the grant income recognised within ear-marked reserves, which led to an adjustment being processed to derecognise income of £1.36m from the Statement of Comprehensive Income and Expenditure and increase income in advance by the same value. There is no impact on the movement on the general fund. See appendix 1.</p>

Recoverability of investments

Background	<p>A significant proportion of the Council's interest income come from short and long term investments. Due to the current economic circumstances there is the possibility of establishments (in particular non-UK banks) coming into financial difficulty and therefore the recoverability of these investments could be at risk. A provision may be necessary to account for any loss of an investment.</p>
Deloitte response	<p>We have reviewed the short term investments held by the Authority and have not identified any recoverability issues to date. We are still awaiting the receipt of several external investment letters.</p> <p>A manager from our Treasury Team has undertaken a review of the Treasury function within the Authority. The main focus of the review was to identify potential opportunity for efficiency improvements or to highlight weaknesses in the internal control framework and processes used in treasury management. The findings from this review are discussed in Section 2 and appendix 3.</p>

Accounting for the voluntary redundancy scheme

Background	<p>As part of the required savings to be made resulting from the Comprehensive Spending Review, the Council is currently undertaking a voluntary redundancy programme. The identified risk is that year-end liabilities are not accounted for in line with IAS37 Provisions, Contingent Liabilities and Contingent Assets.</p>
Deloitte response	<p>We have performed detailed testing on the redundancy provision within the accounts and can conclude that the provision has been recognised in line with IAS37.</p>

1. Key audit risks (continued)

Presumed risk of management override of controls

Background

International Standards on Auditing (UK and Ireland) requires the auditors to perform certain audit procedures to respond to the risk of management's override of controls.

This includes the following:

- understand and evaluate the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, and test the appropriateness of a sample of such entries and adjustments;
- review accounting estimates for biases that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of management;
- a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and
- obtain an understanding of the business rationale of significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the organisation and its environment.

Deloitte response

We have substantially completed our testing in the above areas, and have no issues to bring to your attention. However, we will continue to assess accounting estimates and management judgements up to the point of signing, and therefore will provide you with a verbal update if any additional issues arise.

2. Control recommendations

This section of the report summarises the key control recommendations that we have raised during the audit, together with management's responses.

We have not identified any significant control weaknesses from our audit in the current year however we have noted some areas for potential improvement to the control environment, and these are outlined below.

We have noted several control observations in relation to fixed assets. However, we understand that Internal Audit are in the process of finalising their Asset Management report and as we do not wish to duplicate recommendations, we will provide you with details of our observations in the next Committee meeting if we have any additional observations to note.

In previous years we have also identified areas of improvement to the IT environment of the Authority. For financial audit planning purposes we have held discussions with IT management to gain an understanding of the IT environment and IT governance arrangements. Whilst not performing any validation work, from these discussions it appears that a significant number of findings from our prior year report have been resolved.

The following finding remains outstanding, which has been orally discussed with IT management:

- Minor weaknesses in the password requirements (such as minimum length, complexity and history) for AXIS and the "FIRST_DEFAULT" profile in iWorld.

These weaknesses in the IT governance framework increase the risk of changes to systems or data which could affect the confidentiality, integrity or availability of the systems and their financial information.

Efficiencies in the year end process

Background

During the audit we have noted a number of specific recommendations which would improve the efficiency of the year end closedown process. These are outlined below:

Recommendation

- 1) The cash flow was prepared using the direct method in which major classes of gross cash receipts and payments are disclosed. This proved to be a complex method of preparation and resulted in the cashflow being re-drafted during the audit. Under the previous SORP the indirect method was a more complex method of preparation, but this has been simplified under the Code. We recommend that management prepare the cashflow under the indirect method in the forthcoming year to improve efficiencies in the closedown process.
- 2) Under the Code authorities are required to disclose year end debtors and creditors in specific categories, such as local government, NHS and other public entities. We understand that management undertook a manual exercise to review the composition of the major account codes and determine the overall debtors and creditors in each of the required categories. Management should seek to ensure that they make maximum use of their integrated accounting system in such cases. We understand that management are looking into ways in which the accounting software can be configured to automatically categorise the debtors and creditors into the required categories.
- 3) Whilst it is appreciated that the accountancy staff had to deal with the significant changes in the format and content of the 2010/2011 Statement due to the introduction of IFRS, there were a number of presentational errors in the original draft. The roles and responsibilities of individual officers in the closure process should be reviewed.

2. Control recommendations (continued)

Efficiencies in the year end process (continued)

- Management response**
- 1) The Council accepts the recommendation to change to the indirect method for preparing the Cashflow Statement. The CIPFA cash flow module will be evaluated. Staff will be given training in the new method.
 - 2) The Council will update the General Ledger coding structure in SAP to automatically split debtors and creditors into the specific categories (Central Government/Local government /NHS/Other public bodies/miscellaneous) which must now be shown in the accounts.
 - 3) The Director of Resources is carrying out a full review of the accountancy service.

Budgeting process

Background

Following our testing of the budget process and the Statement of Comprehensive Income and Expenditure, we have laid out below some suggestions in relation to the budgeting process, which the Authority may wish to consider as part of the efficiency review it is undertaking.

Recommendation

1) It was noted that there are instances when the actual transactions are posted to different account codes to the budget and we also saw examples where the prior year budget had been rolled forward without due consideration of whether this was still an appropriate base.

Whilst this mainly occurs within a cost centre or a defined set of cost centres, this can:

- a. increase the number of potential variances that have to be investigated which can increase inefficiency; and
- b. make the comparison of budget against actual at a subjective level less accurate.

A review of how budgets and actual transactions are posted on to the budgets is recommended, to understand the root causes of the differences in the postings. This may result in further standardising the account codes that each Directorate can use as part of their financial reporting or changing the split of budgets when entered onto the system;

2) From working with the service accountants across the different Directorates, it was evident that a number of different budget templates and systems were used by the accountants to monitor and analyse their budgets. Introducing standardised template working papers and training the team to further understand the functionality available in SAP can both increase efficiency, improve the consistency and comparability of information and can also increase ease of understanding across directorates.

We understand that the cost versus the benefit of any changes would need to be considered before implementing any changes to the budgeting system.

Management response

- 1) The review of budgets is an ongoing process across the Council. The Council will carry out a comparison of budgets and actual transactions. The Council will also carry out an analysis of the use of material codes for services to ensure costs are posted to the correct GL codes.
- 2) The Council had identified an issue across services with the varied use of the different monitoring reports available in SAP during the internal review of reducing financial bureaucracy. One "standard" budget monitoring report has now been selected and improved and is being rolled out to all managers in the services with support of accountancy staff. This report will also form the basis of the revised Financial Management Training Course.

2. Control recommendations (continued)

Valuation reports

Background	<p>Our in-house valuers performed a review of a number of properties revalued by Mouchel under the rolling programme. A number of observations were made with regards to the level of supporting evidence for the assertions made in the valuations and these are noted below.</p>
Recommendation	<p>The fair value and market value valuations, although generally well set out, do not provide any directly comparable market evidence and nor do they contain any commentary with regards to the assumptions made or to the market rents and yields adopted.</p> <p>We would recommend that a more thorough explanation of the methodology adopted, including justification for the use of indices, is included within all valuations.</p> <p>Further whilst it is reasonable to use indices for interim valuations within a quinquennial valuation programme, provided the source of the indexation is clearly stated, when the asset is to be fully revalued, we would expect to see a reasoned valuation undertaken by way of up to date build costs for specific types of property rather than a general "all property" index figure applied to the previous valuation.</p> <p>Going forward the Authority should review the methodology and basis used for undertaking the quinquennial valuations. As discussed in Section 1, this should also consider the impact of componentisation on the value of the asset and corresponding depreciation.</p>
Management response	<p>1) The documentation supporting all future valuations will include a full explanation of the methodology adopted, the reason for the use of the methodology and details of any indices used.</p>

2. Control recommendations (continued)

Treasury Function

Background

In order to inform the audit risk around the recoverability of investments, our internal treasury specialists performed a high-level review of the Authority's key treasury management practices. A summary of the resulting control observations are outlined below:

Recommendation

- 1) **The cash management, investment and dealing processes are very manual and rely heavily on spreadsheets. This can increase the risk of errors and is time consuming.** Increasingly many forward looking corporates are moving towards process automation to cut costs and improve efficiency. Many corporate entities with similar treasury work flow have benefitted by implementing a low cost Treasury Management System (TMS) to automate and optimise processes. A TMS can help an organisation by delivering enabling technology to help drive integration, automation, visibility and collaboration while also offering improvements to the internal control framework including full audit trail, data security and business continuity. We understand that the Authority has evaluated this a number of years ago and did not consider this financially viable at that time. As technology continues to evolve, it may be beneficial to further evaluate the costs and benefits a TMS could deliver to treasury management activities (both for the Authority and Teesside Pension Fund).
- 2) **The Authority relies upon market intelligence for setting and monitoring counterparty credit limits.** The Treasury Management Practices (TMPs) do not clearly articulate the approach to counterparty credit assessment. From our discussions, we understand that the process operated involves ongoing monitoring of credit ratings in conjunction with an assessment of the wider financial and operating factors affecting a counterparty's creditworthiness. We note that this is consistent with the approach organisations are increasingly adopting for robust credit limit decision making and during the review we observed that the Authority was taking an active approach in reducing limits in accordance with perceived risk factors. Whilst we acknowledge the imperfections in relying upon external credit ratings alone, using these to set maximum risk tolerances may serve as a useful starting point to ensure limits are set in accordance with risk appetite. The other benefit of this approach is that it could eliminate the need to specify each individual counterparty limit, in the TMPs which could quickly become outdated.
- 3) **The Authority would continue to benefit from exploring different sources to satisfy future borrowing requirements as Public Works Loans Body (PWLB) rates increase.** The central government has decided to increase PWLB interest rates on all new loans to an average of 1.00% above the Government's cost of borrowing. Accordingly, the Authority should challenge their future cash requirements to assess whether they can avoid drawing down additional facilities when their current facilities expire to minimise their borrowing and the associated interest costs. The Authority may benefit from considering other forms of bank or capital market borrowings to satisfy future funding requirements and minimise the cost of simultaneously holding cash and debt.

We have provided a more detailed analysis in appendix 3.

2. Control recommendations (continued)

Management response	<ol style="list-style-type: none">1) The Loans & Investment Manager will reconsider the use of a Treasury Management System (TMS) and will report to the Director of Resources by 31 December 2011,2) The Loans & Investment Manager will report the review of Treasury Management Practices (TMPs) to the Director of Resources regarding the current use of credit ratings and any proposed changes.3) The Loans & Investment Manager will continue to evaluate the opportunities for greater use of capital market (i.e. non-PWLB) borrowing and will report to the Director of Resources accordingly.
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3. Accounting policies and financial reporting

In the course of our audit of the financial statements, we consider the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements.

Our comments on the quality and acceptability of the Authority's accounting policies and financial reporting are discussed below.

Accounting policies

The 2010/11 accounts have been prepared under the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 based on International Financial Reporting Standards.

Accounting policies adopted by the Authority, including revised accounting policies in relation to grants, leases and cash and cash equivalents. New accounting policies have been included in respect of non-current assets held for resale, investment properties and short term short term compensated employee benefits. There are no matters to bring to your attention from our review of these accounting policies.

Financial reporting

There are six uncorrected misstatements above our threshold in the current year of which only one would impact the reported deficit in the Comprehensive Income and Expenditure Account. (See Appendix 1)

As noted in previous sections the draft accounts presented to audit were in line with disclosure requirements of the Code, and only a small number of minor deficiencies were noted which have subsequently been adjusted.

There were a number of presentational errors noted, which were corrected by the Authority. The more significant ones include:

- The categorisation of current debtors across the new categories of central government bodies, other local authorities, NHS Bodies and public corporations and trading funds;
- The classification of balances within the cashflow disclosure;
- The decrease in both gross expenditure and income on the face of the Statement of Comprehensive Income and Expenditure to leave only the Authority's share of income and expenditure in relation to contractual relationships where the Authority act as an agent rather than the principal;
- The correction of the fair value disclosure within the Financial Instrument note; and
- Small corrections in relation to IFRS adjustments within the Fixed Asset and Reserves notes.

The below disclosure deficiencies have been identified that have not been amended by Officers:

- The split between owned and donated assets has not been disclosed; and
- The Housing Pension Contribution Deficit provision has not been discounted.

4. Corporate Governance review and our responsibilities

Annual governance statement

In June 2007, CIPFA in conjunction with the Society of Local Authority Chief Executives ("SOLACE") published 'Delivering Good Governance in Local Government: A Framework'. This framework replaced the previous CIPFA/SOLACE framework 'Corporate Governance in Local Government – A Keystone for Community Governance: A Framework' which was published in 2001.

The framework introduced, from 2007/08, an integrated Annual Governance Statement ("AGS").

The AGS covers all significant corporate systems, processes and controls, spanning the whole range of an Authority's activities, including in particular those designed to ensure that:

- the Authority's policies are implemented in practice;
- high quality services are delivered efficiently and effectively;
- the Authority's values and ethical standards are met;
- laws and regulations are complied with;
- required processes are adhered to;
- financial statements and other published performance information are accurate and reliable; and
- human, financial, environmental and other resources are managed efficiently and effectively.

Our review is directed at:

- considering the completeness of the disclosures in the governance statement and whether it complies with proper practice as specified by CIPFA; and
- identifying any inconsistencies between the disclosure and the information that we are aware of from our work on the financial statements and other work relating to the Code of Audit Practice.

We have reviewed the Authority's AGS in line with the requirements above. We have concluded that the AGS includes all appropriate disclosures and is consistent with our understanding of the Authority's governance arrangements and internal controls derived from our audit work.

5. Value for Money (VFM) conclusion

From 2010/11 the Audit Commission has introduced new requirements for local value for money ("VFM") audit work at councils. This year, auditors are required to give their statutory VFM conclusion based on the following two criteria:

- proper arrangements in place for securing financial resilience: work to focus on whether the Council has robust systems and processes to manage risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future; and
- proper arrangements for challenging how economy, efficiency and effectiveness is secured: work to focus on whether the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We determined our local programme of work based on our risk assessment, which was informed by a series of risk factors determined by the Audit Commission. There were no changes to our risk assessment as reported to the Audit Committee in June.

The key audit risks which we identified as part of our overall audit strategy were:

1. the delivery of financial targets and the management of reduction in resources;
2. effective member challenge;
3. effective internal audit;
4. the implementation of changes to the performance management arrangements;
5. asset management and the management of backlog maintenance; and
6. changes in the finance function and structures.

It should be noted that the work carried out has been light touch, in line with Audit Commission guidance, focusing on updating our understanding of arrangements and controls in place. Where arrangements have previously been assessed as adequate and we are not aware of any changes, we did not carry out detailed testing of the implementation of those controls in the current year.

The work in this area is still on-going and we plan to provide a verbal update at the Audit Committee and provide a written report documenting our findings at the next Audit Committee.

There are no issues that have to come to light from our work to date that need to be reported to those charged with governance and based on our current findings we expect to issue an unqualified value for money conclusion.

6. Other matters for communication

As part of our obligations under International Standards on Auditing (UK & Ireland) we are required to report to you on the matters listed below.

Independence	<p>We consider that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff is not compromised.</p> <p>If the Audit Committee wishes to discuss matters relating to our independence, we would be happy to arrange this.</p>						
Non-audit services	<p>We are not aware of any inconsistencies between APB Revised Ethical Standards for Auditors and the Authority's policy for the supply of non audit services or of any apparent breach of that policy</p> <p>There have been no non-audit fees charged during 2010/11.</p>						
Audit fee	<p>The professional fees earned by Deloitte in relation to audit services provided on behalf of the Audit Commission in the period from 1 April 2010 to 31 March 2011 are as follows:</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 70%;"></th> <th style="width: 15%; text-align: center;">2011</th> <th style="width: 15%; text-align: center;">2010</th> </tr> </thead> <tbody> <tr> <td>Fees payable to the auditors for the annual audit (excluding VAT)</td> <td style="text-align: right;">£282,060</td> <td style="text-align: right;">£274,200</td> </tr> </tbody> </table> <p>The fees payable to the auditors have been calculated in accordance with the Audit Commission guidance on fees for 2010/11.</p> <p>Fees for the certification of claims and returns have not yet been finalised as our work is ongoing. These will be determined in line with the Audit Commission guidance and reported in our annual letter on certification work to be issued early in 2012.</p>		2011	2010	Fees payable to the auditors for the annual audit (excluding VAT)	£282,060	£274,200
	2011	2010					
Fees payable to the auditors for the annual audit (excluding VAT)	£282,060	£274,200					
International Standards on Auditing (UK and Ireland)	<p>We consider that there are no additional matters in respect of those items highlighted in our publication "Briefing on audit matters" to bring to your attention that have not been raised elsewhere in this report or our audit plan.</p>						
Liaison with internal audit	<p>The audit team, following an assessment of the independence and competence of the Internal Audit department, reviewed the findings of Internal Audit to inform the risk assessment and consider the impact on our audit approach as deemed appropriate. No adjustments were made to the audit approach as a result of our review of the work of Internal Audit.</p>						
Written representations	<p>A copy of the representation letter to be signed on behalf of the members is included at Appendix 1.</p>						
Other issues to report	<p>As part of our audit procedures, we encountered significant delays in obtaining evidence from Oakfields College. This was due to the College not being willing to provide information to the Authority, due to a mis-understanding in relation to its Statutory requirements to do so. This situation has not yet been fully resolved. However, access has been granted to Deloitte in relation to the items requested for the audit although some information is still outstanding at the point of issuing this report.</p> <p>We will provide a verbal update at the Committee in respect of the outstanding information.</p>						

6. Other matters for communication (continued)

We also bring to your attention other regulatory matters which are relevant to the Authority:

Bribery Act 2010

Background

The public sector falls within the scope of the Bribery Act 2010, which came into force on 1st July 2011. Specifically, public sector organisations, including the Authority can commit offences in these sections of the Act:

- Section 1 – bribing another person;
- Section 2 – offences relating to being bribed; and
- Section 6 – bribing a foreign public official.

If a public sector organisation commits any of those offences then senior officers can be personally liable if it was committed with their consent or connivance. On conviction under the Act an individual may be sentenced to up to 10 years in prison. An organisation may be subject to an unlimited fine.

The new offence of a commercial organisation failing to prevent bribery (set out in Section 7) only applies to incorporated companies and partnerships that carry on a business in the UK. However, bodies created by statute as corporate bodies could fall within the scope of the offence.

Most of the commentary on the Act has focused on the new Section 7 offence, and in particular on the defence available to an organisation if it can show that it had in place 'adequate procedures' designed to prevent bribery. The Government published guidance for consultation on what will constitute adequate procedures for the purposes of the Act.

Unfortunately, this guidance does not consider the definition of a commercial organisation set out in the Act. In light of this lack of clarity, public sector organisations that believe they could fall within the definition should consider how the draft guidance could be adapted to reflect their own organisational structures and practices.

Impact

Most public authorities already have bribery procedures in place and while this will help in the prevention and detection of bribery in the public sector and where it works alongside the private sector, it will not make public body staff immune to involvement in situations where bribery may occur. Clearly, the public sector will be expected to play its part in reporting any suspicious activity in the private sector.

The Bribery Act should be considered by the Authority as part of the Corporate Risk Assessment, and the Code of Conduct should be revised to incorporate it. Additionally, to ensure that the Authority is prepared for the Act, it should:

- update procurement documentation and precedent contracts to refer to the new provisions;
- consider making changes to procurement practices. For example it would be embarrassing for the Authority if a contractor was found to have committed an offence relating to services provided to or on behalf of a public authority. An explicit right to terminate a contract in these circumstances would show that the Authority had tried to prevent such actions and was able to deal with the breaches effectively.

6. Other matters for communication (continued)

FRC guidance on Audit Committees

Background

The Financial Reporting Authority (FRC) Guidance on Audit Committees (formerly known as the Smith Guidance) was first published in 2003 and most recently updated in December 2010. It is intended to assist organisations when implementing the sections of the UK Corporate Governance Code dealing with committees such as the Audit and Governance Committee and to assist members of such panels in carrying out their role. Organisations are encouraged to use the 2010 edition of the guidance with effect from 30 April 2011.

Impact

In accordance with the updated guidance the Committee should set up and apply a formal policy specifying:

- non audit services which the external auditor is pre-approved in providing;
- non audit services requiring specific approval from the Panel; and
- non audit services which the external auditor is excluded from providing.

Pre-approved services are only appropriate for routine work where the fee is not significant for an audit-related service.

Although not mandatory to implement the above procedures, we recommend that it is good practice to do so in accordance with the revised FRC guidance.

7. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audited bodies by summarising where, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body begin and end, and what is expected of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our audit plan has been prepared on the basis of, and our audit work carried out in accordance with the Code and the Statement of Responsibilities, copies of which have been provided to the Authority by the Audit Commission.

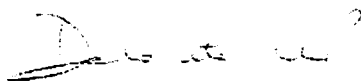
The audit may include the performance of national studies developed by the Audit Commission, where the auditors are required to follow the methodologies and use the comparative data provided by the Commission. Responsibilities for the adequacy and appropriateness of these methodologies and the data rests with the Audit Commission.

While our reports may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Authority's system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

Any conclusion, opinion or comments expressed herein are provided within the context of our opinion on the financial statements and our conclusion on value for money as a whole, which was expressed in our auditors' report.

We view this report as part of our service to you for use as Members of Middlesbrough Council for Corporate Governance purposes and it is to you alone that we owe a responsibility for its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any other purpose. It should not be made available to any other parties without our prior written consent

If you intend to publish or distribute financial information electronically, or in other documents, you are responsible for ensuring that any such publication properly presents the financial information and any report by us thereon and for controls over, and security of the website. You are also responsible for establishing and controlling the process for electronic distributing accounts and other information.



Deloitte LLP

Chartered Accountants

Newcastle-upon-Tyne, UK
21 September 2011

For your convenience, this document has been made available to you in electronic format. Multiple copies and versions of this document may therefore exist in different media - in the case of any discrepancy the final signed hard copy should be regarded as definitive. Earlier versions are drafts for discussion and review purposes only.

Appendix 1: Misstatements and audit adjustments

1. Uncorrected misstatements

The following uncorrected misstatements were identified during the course of our audit. We will obtain written representations from the Corporate Affairs Committee confirming that after considering all these uncorrected items, both individually and in aggregate, in the context of the Statement of Accounts taken as a whole, no adjustments are required.

We have presented three tables of uncorrected misstatements. Table 1.1 shows the uncorrected misstatements in the current financial year. Tables 1.2 and 1.3 show any uncorrected misstatements arising from our audit of the re-statement of the opening balances following the implementation of IFRS for the year ended 31 March 2010 and as at 1 April 2009 respectively.

1.1 Uncorrected misstatements 2010/11

Description	Assets DR / (CR) £'000	Liabilities DR / (CR) £'000	Equity DR / (CR) £'000	Income Statement DR / (CR) £'000
Known errors				
<i>S Properties all classified where majority are falls</i>				
Reclassification of multiuse properties				
Dr PPE	550	-	-	-
Cr Investment Property	(550)	-	-	-
Unrecorded liability <i>missed accrual relating to Tarmac work</i>				
Cr accruals	-	(284)	-	-
Dr cost of services	-	-	-	284
Unrecorded liability - capital <i>missed accrual relating to inventory re</i>				
Dr PPE	154	-	-	-
Cr accruals	-	(154)	-	-
Overstatement of actuarial value of assets <i>From Pension Fund credit re timing of information sent</i>				
Dr pensions reserve	-	-	1,324	-
Cr pension liability	-	(1,324)	-	-
Reclassification of credit balances within debtors <i>Cr Tax Credit Balances incorrectly netted off Debtors figure.</i>				
Dr debtors	848	-	-	-
Cr creditors	-	(848)	-	-
Reclassification of debtors accounts to income in advance <i>Debtor ledgers with credit Balances</i>				
Dr debtors	674	-	-	-
Cr income in advance	-	(674)	-	-
Extrapolated errors				
Unrecorded liability				
Cr accruals	-	(360)	-	-
Dr cost of services	-	-	-	360
Total errors	1,676	(3,644)	1,324	644

Appendix 1: Misstatements and audit adjustments (continued)

1.2 Uncorrected misstatements 2009/10

Description	Assets DR / (CR) £'000	Liabilities DR / (CR) £'000	Equity DR / (CR) £'000	Income Statement DR / (CR) £'000
Known errors				
Reclassification of multiuse properties				
Dr PPE	797	-	-	-
Cr Investment Property	(797)	-	-	-
Reversal of depreciation charged in relation to Teesside Magistrates Court				
Dr Capital Adjustment Account	-	-	485	-
Cr income and expenditure	-	-	-	(485)
Reclassification of debtors accounts to income in advance				
Dr debtors	1,308	-	-	-
Cr income in advance	-	(1,308)	-	-
	<u>1,308</u>	<u>(1,308)</u>	<u>485</u>	<u>(485)</u>

Handwritten notes:
 - Properties all classified where majority use falls
 - Teesside Magistrates Adjusted as Net Figure. Did not adjust depreciation

1.3 Uncorrected misstatements 2008/09

Description	Assets DR / (CR) £'000	Liabilities DR / (CR) £'000	Equity DR / (CR) £'000	Income Statement DR / (CR) £'000
Known errors				
Reclassification of multiuse properties				
Dr PPE	1,424	-	-	-
Cr Investment Property	(1,424)	-	-	-
Remaining asset value on balance sheet in relation to Teesside Magistrates Court				
Dr Capital Adjustment Account	-	-	485	-
Cr PPE	(485)	-	-	-
Reclassification of debtors accounts to income in advance				
Dr debtors	308	-	-	-
Cr income in advance	-	(308)	-	-
	<u>(177)</u>	<u>(308)</u>	<u>485</u>	<u>-</u>

Handwritten notes:
 - Properties all classified where majority use falls
 - No Adj to depn charged in previous years

Appendix 1: Misstatements and audit adjustments (continued)

2. Corrected misstatements 2010/11

The table below shows the corrected misstatements relating to the current financial year which have processed in the accounts by the Authority following our audit:

Description	Assets DR / (CR) £'000	Liabilities DR / (CR) £'000	Equity DR / (CR) £'000	Income Statement DR / (CR) £'000
Understatement of income and expenditure in the Collection Fund				
<i>Incorrect figure taken from Yr End System Collection report.</i>				
Dr expenditure	-	-	-	386
Cr income	-	-	-	(386)
Reclassification of impairment assets to derecognised assets				
<i>Demolished schools Treated as impaired. Should have been derecognition (disposal)</i>				
Dr other operating expenditure	-	-	-	18,842
Cr cost of services	-	-	-	(18,842)
Recognition of adopted roads				
<i>Incorrect rate applied by Env services to adopted roads 930</i>				
Dr PPE	-	-	-	-
Cr Capital Adjustment Account	-	-	(930)	-
Recognition of impairment on Inner Middlesbrough development project				
<i>Gresham, St Hiljas, Incorrect valuation Basis used.</i>				
Dr other operating expenditure	-	-	-	516
Dr financing and investment income	-	-	-	11,718
Cr PPE	(12,234)	-	-	-
Dr Capital Adjustment Account	-	-	12,234	-
Cr General Fund Reserve	-	-	(12,234)	-
Reversal of the grossing up of income and expenditure in relation to agency services				
<i>S Arrangements - Showed gross Inc + Exp. Should have shown MBC share only.</i>				
Dr income	-	-	-	31,820
Cr expenditure	-	-	-	(31,820)
Recognition of revenue grants as deferred income where conditions have not been met				
<i>Revenue grants not meeting conditions</i>				
Dr income	-	-	-	1,360
Cr income in advance	-	(1,360)	-	-
Dr revenue grants earmarked reserves	-	-	1,360	-
Cr general fund reserve	-	-	(1,360)	-
Reversal of revaluations				
<i>Incorrect Indices applied in valuation of D R C Assets</i>				
Dr cost of services	-	-	-	1,429
Dr revaluation reserve	-	-	10,223	-
Cr Fixed Assets	(11,652)	-	-	-
	<u>(22,956)</u>	<u>(1,360)</u>	<u>9,293</u>	<u>15,023</u>

Appendix 2: Letter of management representations

Deloitte LLP
One Trinity Gardens
Broad Chare
Newcastle-upon-Tyne
NE1 2HF

Our Ref: DPW/NC

Date: X September 2011

Middlesbrough Council – Audit of the annual accounts for the year ended 31 March 2011

This representation letter is provided in connection with your audit of the financial statements of Middlesbrough Council for the year ended 31 March 2011.

This representation letter is given for the purpose of expressing an opinion as to whether the financial statements present a true and fair view of the financial position of Middlesbrough Council as of 31 March 2011 and of the results of its operations, other recognised gains and losses and its cash flows for the year then ended in accordance with applicable accounting framework and relevant statutory authorities.

We acknowledge our responsibilities for preparing financial statements for Middlesbrough Council which present a true and fair view and for making accurate representations to you.

We confirm, to the best of our knowledge and belief, the following representations.

1. All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Middlesbrough Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of Council and relevant committee meetings; have been made available to you.
2. We acknowledge our responsibilities for the design, implementation and operation of internal control to prevent and detect fraud and error.
3. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
4. We are not aware of any significant facts relating to any frauds or suspected frauds affecting Middlesbrough Council involving:
 - management and other employees who have significant roles in the system of internal accounting control
 - irregularities involving other employees or members that could have a material effect on the financial statements or
 - communications from regulatory agencies concerning non-compliance with or deficiencies on, financial reporting practices which could have a material effect on the financial statements.
5. We have disclosed to you our knowledge of any allegations of fraud, or suspected fraud, affecting Middlesbrough Council financial statements communicated by employees, former employees or others.
6. We are not aware of any actual or possible instances of non-compliance with laws, regulations and code of practice the effects of which would likely have a significant effect on the finances or operations of the Middlesbrough Council. Middlesbrough Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

Appendix 2: Letter of management representations (continued)

7. We have considered the unadjusted misstatements and disclosure deficiencies detailed in the appendix 1 to this report to the Corporate Affairs committee. We believe that no adjustment is required to be made in respect of any of this item as they are individually and in aggregate immaterial having regard to the financial statements taken as a whole.
8. Where required, the value at which assets and liabilities are recorded in the balance sheet is, in our opinion, the fair value or other value as required by the applicable accounting framework and relevant statutory authorities. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of Middlesbrough Council. Any significant changes in those values since the balance sheet date have been disclosed to you.
9. We confirm the completeness of the information provided regarding the identification of related parties, and the adequacy of related party disclosures in the financial statements. We have made enquiries of members and other individuals who are in a position to influence, or who are accountable for the stewardship of the reporting entity and confirm that we have disclosed in the financial statements all transactions relevant to Middlesbrough Council and we are not aware of any other such matters required to be disclosed in the financial statements, whether under IAS24 "Related party disclosures" or other requirements.
10. There are no other contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:
 - no claims in connection with litigation have been or are expected to be received, other than those already disclosed in the financial statements
 - there are no material commitments or contractual issues, other than those already disclosed in the financial statements
 - no financial guarantees have been given to third parties.
11. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.
12. All events subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment of or disclosure have been adjusted or disclosed.
13. There are no formal or informal compensating balancing arrangements with any of our cash and investment accounts.
14. We have properly recorded the bank balances of all school bank accounts in the financial statements.
15. We have evaluated the adequacy of the self-insurance reserve maintained and consider it to be appropriate.
16. We confirm that no amounts are expected to be paid in respect of any legal claims, which are being dealt with by our solicitors, other than those already provided in the annual accounts and no other legal claims have been received or are expected to be received that would have a material impact on the annual accounts.
17. We confirm that where grant income has been received that the income has been recognised in the appropriate period based on whether the grant conditions have been met.
18. We confirm that no significant fixed assets have been sold or scrapped during the financial year other than those identified in the financial statements.
19. We have considered the remaining useful lives of the fixed assets and confirm that the present rates of depreciation are appropriate to amortise the cost less residual value over the remaining useful lives.
20. We confirm that in relation to accounting and disclosures of the pension costs and liabilities in Middlesbrough Council's financial statements:
 - there are no schemes of which you have not been made aware or properly accounted for;
 - all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
 - the actuarial assumptions underlying the valuation of the scheme liabilities accord with the management's best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the Council; and

Appendix 2: Letter of management representations (continued)

- the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology the amounts included in the financial statements derived from the work of the actuary are appropriate.
21. We recognise that we are responsible for ensuring that the statement of accounts as published on the website properly presents the financial information and your Auditors' report and for the controls over, and security of, the website. We also recognise that we are responsible for establishing and controlling the process for electronically distributing annual reports and other information.

We confirm that the above representations are made on the basis of adequate enquiries of management and staff of Middlesbrough Council (and where appropriate, inspection of evidence) sufficient to satisfy ourselves that we can properly make each of the above representations to you.

Yours faithfully

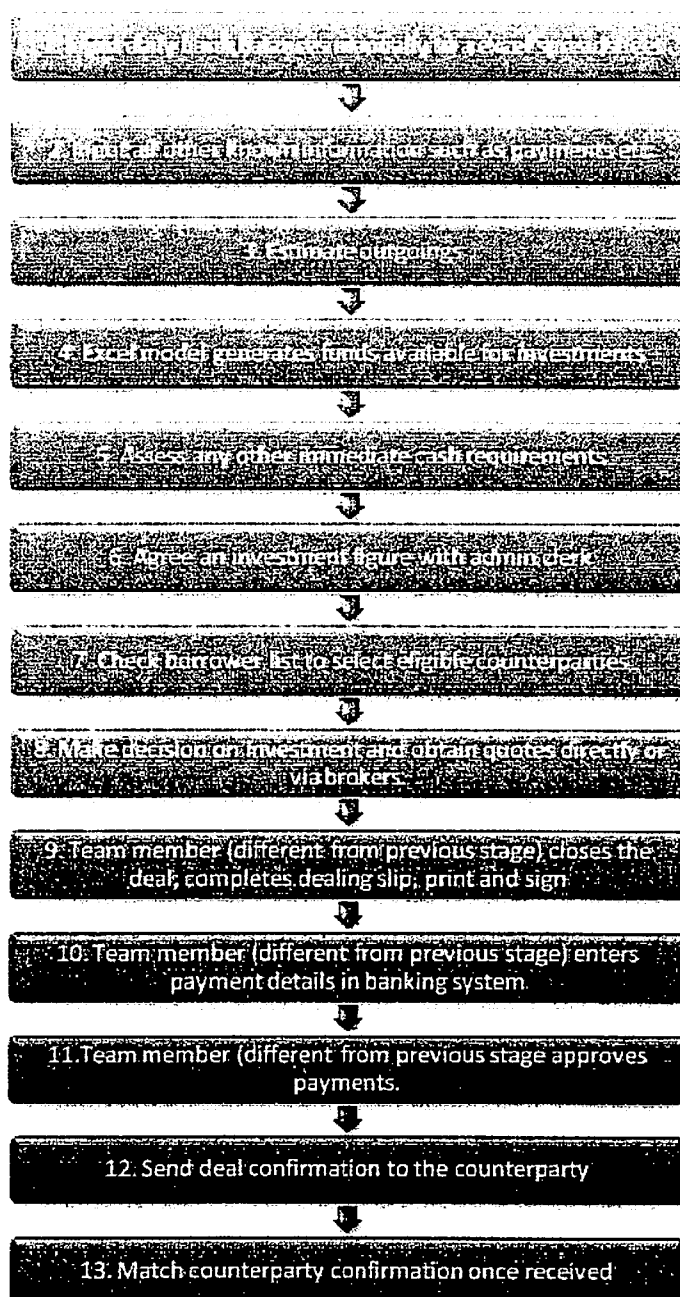
Signed on behalf of Middlesbrough Council

Appendix 3: Treasury review

10. Cash management, investment and dealing processes are very manual and rely extensively on spreadsheets

What is the risk?

The Council relies extensively upon a combination of spreadsheets and manual intervention at different stages for data collection, integration, reporting & analysis and accounting. The following flow chart attempts to summarise the current cash management, investment and dealing process at Middlesbrough Council.



Manual processes and spreadsheets are not only prone to errors but also less efficient compared to automated processes.

Appendix 3: Treasury review

Recommendation

Increasingly many forward looking corporates are moving towards process automation to cut costs and improve efficiency. Many corporate entities with similar treasury work flow have benefitted by implementing a low cost Treasury Management System (TMS) to automate and optimise processes. A TMS can help an organisation by delivering enabling technology to help drive integration, automation, visibility and collaboration while also offering improvements to the internal control framework including full audit trail, data security and business continuity. We understand that the Authority has evaluated this a number of years ago and did not consider this financially viable at that time. As technology continues to evolve, it may be beneficial to further evaluate the costs and benefits a TMS could deliver to treasury management activities (both for the Authority and Teesside Pension Fund).

2) The Council relies upon market intelligence for setting and monitoring counterparty credit limits

Since the credit crunch rating agencies have actively worked towards changing their rating models which now actively takes into account a greater emphasis on qualitative information as well as the quantitative performance. The recent warning and downgrade of sovereign debts, specially the USA, may suggest they are monitoring the markets more closely than ever before and will not refrain from issuing warnings of this kind. These warnings are not based on pure speculation, but on a careful evaluation of the best available financial and political information concerning present circumstances and future prospects. Middlesbrough Council do not consider rating agencies published ratings when assessing counterparties, determining the appropriate limits or monitoring continued creditworthiness.

What is the risk?

The Treasury Management Practices (TMPs) do not clearly articulate the approach to counterparty credit assessment. From our discussions, we understand that the process operated involves ongoing monitoring of credit ratings in conjunction with an assessment of the wider financial and operating factors affecting a counterparty's creditworthiness. We note that this is consistent with the approach organisations are increasingly adopting for robust credit limit decision making and during the review we observed that the Authority was taking an active approach in reducing limits in accordance with perceived risk factors. Whilst we acknowledge the imperfections in relying upon external credit ratings alone, using these to set maximum risk tolerances may serve as a useful starting point to ensure limits are set in accordance with risk appetite. The other benefit of this approach is that it could eliminate the need to specify each individual counterparty limit, in the TMPs which could quickly become outdated.

Recommendation

Treasury Management Practices may benefit from clarification of the approach to counterparty credit assessment and limit setting. Whilst the overall approach to credit risk assessment used by Middlesbrough Council takes into account published credit ratings and other available information, consideration should be given to the use of credit ratings to set a maximum risk tolerance.

The Council would continue to benefit from exploring different sources to satisfy future borrowing requirements as PWLB rates increase

The Public Works Loans Board (PWLB) has historically been a significant source of funding for local authorities. In 2009/10 the PWLB lent £5.1bn to UK local authorities and at 31 March 2010 had £51.2bn of debt outstanding.

The Comprehensive Spending Review (CSR) in October 2010 focussed on measures to reduce the government's deficit. Local authority debt is included within the government's overall debt. So the review included measures that impact on local authorities' debt. These included the increase in PWLB rates and reduction in central government support for capital. These measures were designed to "better reflect the availability of capital funding".

Prior to the increase made to interest rates, PWLB lending was a cost effective means of borrowing compared with the only other available sources of funding such as Lender Option Borrower Options (LOBOs) arrangements. The increased PWLB rate, especially given increased restrictions on banks' balance sheets and maturity structures, has not increased the availability of market loans. This has however, encouraged some authorities to consider entering the market for raising bonds and other alternative funding sources.

Appendix 3: Treasury review (continued)

In a recent development, efforts by councils to gain access to financial instruments that could lower the cost of entering the bond market were blocked by ministers. In interdepartmental correspondence, local government minister Bob Neill has indicated he would not be prepared to allow councils to use their new 'general power of competence' to gain access to derivatives markets.

What is the risk?

The finance restructuring and capital financing requirement of the Council is as follows:

Loan profile as at 31st March 2011:

Type of loan:

	£'000
Public Works Loan Board	(42,000)
Money Market Bonds	(33,253)
	(75,253)

Maturity profile of loans:

Maturing in 1-2 Years	(6,500)
Maturing in 2-5 Years	(10,000)
Maturing in 5-10 Years	0
Maturing in over 10 Years	(58,753)
	(75,253)

Capital financing requirement forecast

31/03/11 £000 Estimate	31/03/12 £000 Estimate	31/03/13 £000 Estimate	31/03/14 £000 Estimate
115,599	123,011	130,509	133,286

Net borrowing forecast

31/03/11 £000 Estimate	31/03/12 £000 Estimate	31/03/13 £000 Estimate	31/03/14 £000 Estimate
45,275	61,363	67,904	70,681

The Council needs to plan well in advance and explore all the sources available for fulfilling the funding requirements to be able to select the most efficient and best value for money option. There is a risk if the strategic cashflow and funding requirement is not managed properly the Council may end up paying higher interest cost for their funding requirements.

Recommendations

The Council should challenge their future funding requirements to assess whether they can avoid drawing down additional facilities when their current facilities expire to minimise their borrowing and the associated interest costs. As the cost of funding is set to increase, the Council may look into alternative sources of funding to satisfy future requirements. This may include funding that facilitates more efficient cash management and flexibility (for example a revolving credit facility). It is advisable that for meeting any funding requirement beyond the level of cash available and anticipated cash inflows, the Council may wish to explore options, understand costs and benefits and develop relationships for the future.

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