

Middlesbrough Council

Report to the Corporate Affairs Committee on the 2012
Audit

Progress Report

26 September 2012

Deloitte LLP
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Newcastle upon Tyne
United Kingdom

Corporate Affairs Committee
Middlesbrough Council
Middlesbrough
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Dear Sirs

We have pleasure in setting out in this document our report to the Corporate Affairs Committee of Middlesbrough Council (henceforth "the Council") for the year ended 31 March 2012. This report covers the principal matters that have arisen to date from our audit for the year ended 31 March 2012.

In summary:

- our audit testing is not yet complete;
- the results of our work to date in relation to the significant risks, which are summarised in the Executive Summary, are set out in our report;
- we currently expect to meet the agreed audit and financial reporting timetable.



Deloitte LLP
Chartered Accountants
Newcastle-upon-Tyne

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Executive Summary

We have pleasure in setting out in this document our report to the Corporate Affairs Committee of Middlesbrough Council ("the Council") for the year ended 31 March 2012. This report summarises the principal matters that have arisen from our audit for the year ended 31 March 2012. We would like to thank those officers involved in the audit.

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

Completion of the audit

Our work is currently ongoing in a number of areas, however we expect to complete the audit in line with the statutory timetable.

At the time of writing this report, certain procedures are still outstanding and need to be finalised before we can finalise our audit:

- final review of the accounts and Annual Governance Statement to be completed;
- receipt of Letter of Representation;
- 1 school bank letter and legal letters;
- completion of revenue grants testing;
- testing of underlying information that support the valuations of fixed assets;
- receipt of 5 supplier confirmations;
- sundry pieces of audit evidence to support testing;
- completion of internal review procedures;
- update of subsequent events to signing of the audit report;
- completion of our value for money procedures; and
- Whole of Government Accounts testing.

We will report to you orally in respect of any modifications to the findings or opinions contained in this report that arise on completion of these matters.

Overall view

<p>Accounts to be signed by 28 September 2012. WGA to be signed by 5 October 2012</p>	<p>On satisfactory completion of the outstanding matters, we anticipate issuing an unmodified audit opinion on the truth and fairness of the financial statements, in addition to giving an audit opinion on the whole of government accounts forms.</p> <p>The matters that we have taken into account in forming our overall view are described in the following sections.</p>	<p>N/A</p>
<p>We do not anticipate reporting any VfM issues.</p>	<p>As part of our audit we have undertaken "high level" interviews and reviewed supporting evidence enabling us to form a conclusion on the Trust's arrangements for securing economy, efficiency and effectiveness in the use of resources ("Value for Money", "VfM").</p> <p>Our work in this area is on-going, but at this stage of our work we do not anticipate reporting any matters within our audit report in respect of the Council's overall VfM arrangements.</p>	<p>Section 2</p>

Executive summary (continued)

● Risk appropriately addressed and limited audit work outstanding

● Risk satisfactorily addressed but with issues or unadjusted errors identified or where testing is ongoing

● Material unresolved matter or where significant audit work is outstanding

Status	Description	Detail
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Significant audit risks		Status
<p>Testing on audit risks is on-going. The only significant audit adjustments at the point of writing this report relate to the valuation of fixed assets.</p> <p>We will provide a verbal update to the Corporate Affairs Committee on any further findings that arise as we complete our testing.</p>	<ul style="list-style-type: none"> Revenue recognition: recognising grant income We have identified a risk in relation to the possible non-compliance with conditions attached to grants received by the Council resulting in revenue being recognised in the incorrect period. Our testing to date has found no evidence that revenue recognition was not in line with relevant accounting standards. The testing is ongoing and we will provide a verbal update to the Corporate Affairs Committee. 	● Page9
	<ul style="list-style-type: none"> Recoverability of investments Due to the current economic climate, there is increased risk that organisations the Council has invested its money with come into increased financial difficulty. There have been no issues noted from our testing. 	● Page 9
	<ul style="list-style-type: none"> Valuation of fixed assets We have raised a risk in relation to the valuation of fixed assets, due to the level of judgement and uncertainty involved. As a result of the audit the Council has made 3 adjustments to the value of fixed assets as at 31 March 2012. The net impact of these adjustments is to reduce the value of assets on the balance sheet by approx. £11.5m and reclassify car parks from operational assets to investment properties. We have work ongoing to test the underlying information on which the valuations are based and we need to review the financial statements following the entries made by the Council to adjust for the errors noted. 	● Page10
	<ul style="list-style-type: none"> Accounting for Heritage Assets The requirement to account for and value heritage assets is new for 2012 and involves a significant amount of judgement and estimation. The results of our testing have not highlighted any issues indicating that assets have not been valued appropriately. 	● Page12
	<ul style="list-style-type: none"> Disclosure of related parties A risk has been raised in relation to the appropriate disclosure of related parties due to errors noted in the prior year. 	● Page13

Executive summary (continued)

Status	Description	Detail
Significant audit risks		Status
<p>Testing on audit risks is on-going.</p> <p>The only significant audit adjustments at the point of writing this report relate to the valuation of fixed assets.</p> <p>We will provide a verbal update to the Corporate Affairs Committee on any further findings that arise as we complete our testing.</p>	<p>We have noted two disclosure errors from our work on related parties to date, which have been corrected by management.</p> <ul style="list-style-type: none"> <p>• Presentation of summary financial statements</p> <p>The Council is proposing to produce summary financial statements for 2012 and therefore we have raised a risk in relation to possible inconsistencies with the summary and full financial statements.</p> <p>Overall our testing has concluded the new presentation of the financial statements is in line with the Code.</p> <p>We noted a small number of disclosure deficiencies such as changes in narrative and the accounting policies. The majority of these have been adjusted by management within the accounts. The main corrected and uncorrected disclosure deficiencies are included in appendix 1.</p> <p>• Risk of Accounts Payable control deficiencies</p> <p>The fraud perpetrated on the Council in the year gives rise to a risk of internal control deficiencies within the Accounts Payable process which could lead to further risk of fraud or error.</p> <p>We have reviewed the new internal controls implemented following the fraud and have identified further improvements that the Council could make to strengthen these. These will be reported in a separate management letter.</p> <p>Other work in this area is ongoing and we will provide a verbal update to the Corporate Affairs Committee.</p> <p>• Management override of internal control</p> <p>Auditing standards requires a presumed risk of management override of controls which will be addressed via the testing of journals and assessing management judgements and estimates for bias.</p> <p>No inappropriate instances of management override of controls were noted as a result of our testing to date.</p> <p>• Financial standing</p> <p>We have primarily addressed the risks to the Council's financial standing through our work on Value for Money which is detailed in section 2. Other aspects of financial standing were considered throughout our audit testing such as via our testing of management override of controls. Work is ongoing in this area.</p> 	<p>● Page 13</p> <p>● Page 14</p> <p>● Page14</p> <p>● Page15</p>

Executive summary (continued)

Status	Description	Detail
Value for Money		
<p>Our work in this area is on going, but there are no issues that we have noted from our work to date.</p>	<p>As part of our audit we are required to form a conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources ("Value for Money", "VfM"). We are required to report in the Audit Report should any significant weaknesses be identified through the course of our audit work.</p> <p>The key audit risks which we have identified as part of our overall audit strategy were:</p> <ul style="list-style-type: none"> • financial sustainability; • asset management and the development of the 'hub'; and • management of information across the Council. 	<p>Section 2</p>
Our observations on your financial statements		
	<p>The following financial reporting presentational and disclosure matters are significant to the 2012 accounts:</p> <ul style="list-style-type: none"> • Implementation of FRS 30 Heritage Assets; • Related party disclosures; • Change in the format of the accounts; and • Disclosure of critical accounting judgements and key sources of estimation uncertainty. <p>Section 1 will consider these matters as these areas are covered within the Significant Risks that have been raised within the audit.</p>	<p>Section 1</p>
Our observations on the explanatory forward		
<p>Our review of the explanatory forward is consistent with the annual accounts.</p>	<p>We are required to read the explanatory forward of your annual accounts to consider consistency with the financial statements and any apparent misstatements. Our review highlighted no areas whereby there were inconsistencies with the annual accounts.</p>	<p>N/A</p>
Risk management and internal control systems		
<p>We have raised some insights over the Council's internal control systems. We will report these to the Corporate Affairs Committee separately.</p>	<p>As set out in the Annual Governance Statement management's assessment of the risk management and internal control systems is satisfactory. Our audit findings did not identify any significant deficiencies in the financial reporting systems.</p> <p>Our control observations arising from our audit procedures will be reported to the Audit and Governance Committee at a later date.</p> <p>None of these impacted upon our audit approach.</p>	

Executive summary (continued)

Identified misstatements and disclosure misstatements		
<p>Identified uncorrected misstatements would decrease net assets by £581k and increase the net deficit by £84k.</p>	<p>Materiality levels are calculated on the basis of total expenditure for the period. Materiality levels were set at £4,173k (2010/11: £4,059k). We report to the Corporate Affairs Committees on all individual unadjusted misstatements which are greater than £208k, (2010/11: £203k) or are qualitatively material, and in aggregate on all other unadjusted misstatements.</p> <p>Uncorrected misstatements identified to date would decrease net assets by £581k, and increase the net deficit by £84k. Management has concluded that the total impact of the uncorrected misstatement is not material in the context of the financial statements taken as a whole. The definitive summary of uncorrected misstatements will be attached to the representation letter obtained from management.</p> <p>Details of corrected audit adjustments are included in Appendix 1. The impact of these adjustments was to decrease net assets by £11.5m and increase the net deficit by £4.5m. There was a £nil impact on the general fund.</p> <p>The impact of management's IAS19 pension adjustment is £65.2m. The total impact of these adjustments is a £53.7m increase in net assets.</p>	<p>Appendix 1</p>
Management representations will be circulated separately.		
<p>Management representations will be circulated separately.</p>	<p>A copy of the representation letter to be signed on behalf of the Council has been included in Appendix 2.</p>	<p>Appendix 2</p>
Independence		
<p>No independence issues.</p>	<p>Our reporting requirements in respect of independence matters, including fees, are covered in Section 5.</p>	<p>Section 5</p>
Other issues		
<p>Change in IAS 19 pension assumptions.</p>	<p>Management undertook a review of the assumptions used by the actuary to calculate the IAS19 pension liability within the statutory accounts. Following this review it was decided that given the current pay freezes within local authorities, the salary assumption included within the original calculation was too high and this was reduced by 0.5%. It was also decided that as the discount rate was at the lowest end of the benchmarking data available to the Council, the discount rate would be increased to 4.8% which is the median in the benchmark report.</p> <p>The impact on the accounts was to reduce the pension liability and increase the the pension reserve by £65m.</p>	<p>Section 5</p>

Executive summary (continued)

Liaison with internal audit		
<p>We have reviewed the internal audit reports as part of our on-going risk assessment. No additional risks were raised that impacted on our audit approach.</p>	<p>The audit team, following an assessment of the independence and competence of the internal audit department, reviewed the reports issued by internal audit during the year and adjusted our audit approach as deemed appropriate.</p>	<p>N/A</p>

1. Significant audit risks

The results of our audit work on significant audit risks are set out below:

Revenue recognition: recognising grant income	Deloitte response	
<p>Our testing to date has found no evidence that revenue recognition was not in line with relevant accounting standards.</p> <p>The testing is ongoing and we will provide a verbal update to the Corporate Affairs Committee.</p>	<p>A significant component of Middlesbrough Council's income derives from government grants. Each grant will have a specific set of conditions, raising the risk that revenue is recognised before each condition has been met. In order to recognise grant income, management must assess the Council's position against the criteria and be able to prove that revenue has been classified in the correct period.</p> <p>We have identified a risk in relation to the possible non-compliance with conditions attached to grants received by the Council resulting in revenue being recognised in the incorrect period.</p>	<p>We have reviewed management's process for identifying and assessing the conditions attached to each grant. We have performed substantive testing over a sample of grants recognised as income, in order to assess the reasonableness of management's determination that any attached conditions for the receipt of the grant money have been satisfied. We have also focused our testing on grant income deferred to future periods to ensure that the deferral is appropriate.</p> <p>To date, the results of our testing have not highlighted any issues indicating that grants have not been accounted for in line with the Code. The testing is currently ongoing and we provide a verbal update to the results of our testing at the Corporate Affairs Committee.</p>

Recoverability of investments	Deloitte response	
<p>There have been no issues highlighted from our testing.</p>	<p>Middlesbrough Council has historically held numerous investments with private funds, banks, co-operatives and other local authorities in order to earn interest income.</p> <p>Due to the current economic climate, there is the possibility that organisation which the Council have invested in come into financial difficulty. This raises a risk over the recoverability of the Council's investments.</p>	<p>We have reviewed all short and long term investments held by the Council. External investments letters were requested as part of the audit and were reviewed by Deloitte.</p> <p>No issues were noted from our testing.</p>

1. Significant audit risks (Continued)

Valuation of fixed assets	Deloitte response
<p>As a result of the audit the Council has made 3 adjustments to the value of fixed assets as at 31 March 2012. The net impact of these adjustments is to reduce the value of assets on the balance sheet by approx. £11.5m and reclassify car parks from operational assets to investment properties.</p>	<p>1) The valuations undertaken in the financial year resulted in a large impairment of approx. £70 million. The majority of this impairment related to a small number of assets which fell into two categories: the municipal buildings and town hall and multi-storey car parks.</p> <p>The rationale for the impairment was due to the change in valuation basis for these two types of assets from depreciated replacement cost (DRC), which meant the assets were valued based on gross replacement cost, to existing use value (EUUV) for the office space within the municipal buildings and the town hall and market value for the multi-storey car parks.</p> <p>We have performed a detailed review of a sample of valuation reports produced in the year including the multi-storey car parks and the municipal buildings. In consultation with our in-house valuers, Drivers Jonas Deloitte, we have assessed the validity and reasonableness of key assumptions used by management in order to assess the value of fixed assets.</p>
<p>We have work ongoing to test the underlying information on which the valuations are based and we need to review the financial statements following the entries made by the Council to adjust for the errors noted.</p>	<p>Our findings to date are as follows:</p> <ul style="list-style-type: none">• The initial valuation reports provided to the Council by the valuers, lacked detail and adequate explanations to support the valuations and to allow management to provide adequate challenge to the underlying assumptions. We will be raising a recommendation in relation to this in the management letter which will be issued at the next Corporate Affairs Committee.• Following additional evidence received we were able to conclude that the assumptions and basis on which the valuations have been undertaken were reasonable.• The work to verify the underlying information on which the valuations are based, such as car park income, rental value per square foot is currently on-going and we will report back our findings on this work orally.• The large impairments in the year suggested that there was a potential impairment trigger in relation to car parks and other operational office buildings and we requested that the Council undertake an impairment review of these assets.

1. Significant audit risks (Continued)

Valuation of fixed asset continued...

Deloitte response

- The review showed that the other operational office buildings were already valued using EUV however due to changes in the expected rental values for each of these assets, it was calculated that the value had fallen by £1.6m. This has been adjusted within the financial statements.
- The review also showed that the majority of the car parks were already valued at market value, although due to the fall in income over the past 12-24 months the value of car parks had fallen by a further £1.5m. Management have decided to adjust the financial statements for this impairment.
- Following discussions with the Council, we challenged the classification of car parks as operational assets, as the rationale to support the classification in previous years, such as the link to regeneration, subsidised parking and use by employees was no longer deemed appropriate. It was agreed that the classification of car parks would be changed from operational assets to investment properties within the accounts.
- Finally, it was noted that finance costs had been included within the calculations for DRC valuations. Whilst this is in line with RICS guidance, CIPFA guidance states that finance costs shouldn't be included. The difference in the CIPFA guidance is not explicit and this had not been picked up by the Council or the valuers. The adjustment to remove the finance costs included within the DRC valuations would reduce the value of PPE by approx. £8.2m. This is being processed as an in year change in estimate by the Council and we concur with this treatment.

2) We have reviewed the current valuation of the Inner Middlesbrough Development Project to assess whether the carrying value is materially accurate. It was noted as part of this testing that the accounting entry to reflect the movement on the Phase 2b element of the project had been incorrectly calculated, which had led to the asset being over stated by £910k. This is included as an unadjusted audit misstatement in Appendix 1.

3) Our testing of the sample of valuation reports above included reviewing the key judgements made in order to identify their useful life and depreciation rate. It also involved reviewing the Council's componentisation policy to ensure it is in line with the Code and other Local Government bodies. No issues were noted from this element of our testing.

1. Significant audit risks (Continued)

Accounting for heritage assets		Deloitte response
<p>The results of our testing have not highlighted any issues indicating that assets have not been valued appropriately.</p>	<p>The Code of Practice on Local Authority Accounting has introduced in 2011/12 the need to account for Heritage Assets. As there is no applicable IFRS for Heritage Assets, the Code instructs LAs to adopt FRS 30.</p> <p>A heritage asset is defined as a "tangible asset with historical, artistic, scientific, technological, geophysical, or environmental qualities that is held and maintained principally for its contribution to knowledge and culture". For example, this may include art work or historic buildings. Heritage assets will be held, where possible, at valuation. Where not practicable to get a valuation, heritage assets will be held at historical cost.</p> <p>A risk has been raised in relation to the requirement for the Council to adopt a new accounting policy and due to the inherent judgement involved in applying FRS 30, either to value an asset or to determine that a valuation is impracticable.</p>	<p>We have obtained and reviewed management's valuations of the heritage assets.</p> <p>We have selected a sample of items and where possible we have agreed the valuation to external valuations.</p> <p>For items at the Dorman Museum and the Captain Cook Birthplace Museum assurance has been obtained through reference to an internal valuation done by the museums' curator.</p> <p>Where an external valuation has not been obtained, the items have been tested with reference to the most recently commissioned assets.</p> <p>The results of our testing have not highlighted any issues indicating that assets have not been valued appropriately.</p> <p>The accounts do not reflect the full disclosure requirements of the Heritage Assets standard. For example a summary of transactions has been disclosed for 2 years instead of 5 years.</p> <p>Management chose to minimise this disclosure as part of the project to streamline the accounts and make them more transparent and therefore do not consider this additional disclosure to be material to the reader.</p>

1. Significant audit risks (Continued)

Related parties		Deloitte response
<p>We have noted two disclosure errors from our work on related parties, which have been corrected by management.</p>	<p>In our prior year audit we noted errors in the disclosure of related parties. Certain balances, namely debtors, were not split correctly between the various classifications of counter parties.</p> <p>We have therefore raised a risk in relation to the correct disclosure of related parties in the 2012 accounts.</p>	<p>We have reviewed management's process for identifying related party transactions at the Council. Central government, local government and NHS balances have been tested as part of the audit procedures regarding debtors, creditors and income and expenditure. For officers, a sample of balances and transactions has been agreed to the underlying financial system. For members, the register of interests has been obtained and tested on a sample basis to ensure completeness.</p> <p>From our testing it was noted that certain sundry creditors had not been analysed to split out central government, local government and NHS balances. This analysis has now been performed by the Council and the corresponding adjustment has been processed within the statutory accounts.</p> <p>From our review of the register of interests, we have noted one related party relationship which has not been disclosed in the accounts. This has been corrected by management in the statutory accounts.</p>

Presentation of summary financial statements		Deloitte response
<p>Overall our testing has concluded the new presentation of the financial statements is in line with Code.</p> <p>We noted a small number of disclosure deficiencies. The majority of these have been corrected within the accounts.</p>	<p>The Council is proposing to produce summary financial statements for 2012 and therefore we have raised a risk in relation to possible inconsistencies with the summary and full financial statements.</p>	<p>Although the Council has not yet prepared summary financial statements for 2012, it has reviewed the presentation of the full financial statements with the objective to make the accounts more reader friendly. This has led to a change in presentation since the original draft accounts were issued.</p> <p>We have performed a review of the updated draft financial statements to consider if these are fully compliant with accounting standards and the Code.</p> <p>A small number of disclosure deficiencies have been identified and have been raised with management. The financial statements have been updated for the majority of the changes suggested by Deloitte. The main corrected and uncorrected disclosure deficiencies are shown in Appendix 1.</p>

1. Significant audit risks (Continued)

Risk of Accounts Payable control deficiencies	Deloitte response
<p>We have reviewed the new internal controls implemented following the fraud and have identified further improvements that the Council could make to strengthen these. These will be reported in a separate management letter.</p> <p>Other work in this area is ongoing and we will provide a verbal update to the Corporate Affairs Committee.</p>	<p>We have reviewed the internal audit fraud report investigating the fraud and their report on additional accounts payables controls carried out after the fraud. We have gained an understanding of the accounts payables controls implemented following the fraud. From this work we have identified further improvements that the Council could make to strengthen the internal controls in this area. For example, it was noted that the new control, to directly contact a supplier who requests to change their bank details, was not used when the accounts payable team received the request from one of the internal service teams. The recommendations will be included in our management letter which will be issued at the next Audit and Governance Committee.</p> <p>We have obtained a population of suppliers whose bank account details were changed in the year and sent confirmation requests to a sample of suppliers from this population to ask them to confirm the balance held with the Council at the year end. We are awaiting responses from these organisations, but once these are obtained we will reconcile them to the creditor ledger to test for any missing payments that may have been made to fraudulent bank accounts.</p>

Management override of controls	Deloitte response
<p>No inappropriate instances of management override of controls were noted as a result of our testing to date.</p> <p>Management occupy a unique position within the Council in that:</p> <ul style="list-style-type: none"> • their financial success, standing among their peers, and future career prospects can be heavily influenced by the financial results achieved by the Council; and • they are able, through the exercise of management judgement, bias and posting of management journals, to override the normal operational controls within the Council and fraudulently manipulate the financial results. <p>This incentive and opportunity to manipulate the financial statements presents a risk of material misstatement to the financial statements.</p>	<p>We have performed the following:</p> <ul style="list-style-type: none"> • gained an understanding of the controls over journal entries and tested the appropriateness of a sample of such entries and adjustments; • reviewed 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; • performed a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and • Obtained an understanding of the business rationale of significant transactions that we are aware of that are outside the normal course of business. <p>No indications of inappropriate management override of controls have been noted from our testing to date.</p>

2. Value for money (VFM) conclusion

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

- proper arrangements 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 are 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 have planned our local programme of work based on our risk assessment, which is informed by a series of risk factors determined by the Audit Commission.

The key audit risk which we identified as part of our overall audit strategy is the delivery of financial targets and the management of the reduction in financial resources.

Delivery of financial targets and the management of reduction in resources

Financial planning and efficiency plans

In response to the significant financial pressures that the Council is facing over the next few years the Council has put in place efficiency plans to achieve the cost cutting target for 2012/13 and is developing plans for the next two years.

However, the severity of the pressures facing the Council means that it will be unable to continue to provide current or historic levels of services (scope or quantum) and in order to respond to this, the Council needs to go beyond cost cutting into a process of service and finance transformation.

To date the Council has or is in the process of implementing major cost reduction programmes, which the Members have been involved with. It is also implementing some changes that are needed to achieve financial transformation, such as workforce planning in some areas. However, as we highlighted in the prior year in order to achieve transformation effectively, the Council must be clear about its strategic direction and what the vision for the Council is at the end of the Medium Term Financial Plan period. There should be clear communication to the officers and budget holders so that they are fully aware of the objectives they are working towards to enable transformation.

Deloitte response

We have reviewed the financial planning process, including the extent to which tools such as modelling and sensitivity analysis is used to support the process. Progress in updating the medium term financial plan (MTFP) as well as the reasonableness of assumptions built into the budget and MTFP have been considered as part of our work.

We have selected a sample of budget reduction measures to assess the reasonableness of the quantification of savings to be achieved, and the processes for identifying and addressing any costs of implementation.

We have followed up on our findings from the prior year's audit to understand how far the Council has moved towards articulating its strategic direction and its vision for what the Council will look like at the end of the Medium Term Financial Plan period.

Our work in this area is continuing but no issues have arisen from our work to date that would impact on our Vfm conclusion. We will provide a verbal update on our progress to the Corporate Affairs Committee and we will report back our more detailed findings and recommendations within a separate management letter.

2. Value for money (VFM) conclusion (Continued)

Asset management strategy

Asset management strategy and review of the 'hub' initiative

At the time of our audit last year, the Council was in the process of reviewing the capital programme for the next 5 years, a process, which whilst considered on an annual basis, is undertaken in detail every 3 years. This process involved reviewing the potential funding streams available from the various sources and prioritising schemes in accordance with the Council's strategy. It was also due to encompass a review of the accommodation strategy, which in turn would shape the plan to address the significant backlog maintenance.

The Council continues to recognise that as financial challenges increase and specific funding streams are no longer available that their financial and capital planning processes must be extremely robust to ensure risks are managed effectively and resources continue to be targeted in priority areas. On this basis specific estates initiatives have been developed as part of the Council's cost reduction plans and one of the key projects is development of 'hubs'.

We will update our understanding of the Council's approach to asset management and consider how the resources are being aligned with strategic priorities. In particular, we will review the 'hubs' initiative, understanding the expected outcome and benefits of this initiative and how these expected benefits will be tracked and monitored.

Deloitte response

We have focused our work in relation to this risk across two main areas: the non-strategic asset review and the hub initiative.

Through discussion with management, we have gained an understanding of the non-strategic asset review, which is underway within the Council. In particular we have considered how this feeds into the overall transformation programme and cost cutting plans, and how the Council has considered value for money in relation to the decisions that have been taken. No concerns in relation to the value for money opinion have arisen from this work.

We have carried out discussions with management and individuals responsible for implementation of the 'hub' initiative to gain further understanding about the expected outcome and benefits of this initiative and how these expected benefits will be tracked and monitored.

We are currently awaiting further information and audit evidence to conclude on our work in this area.

2. Value for money (VFM) conclusion (Continued)

Information management

Management of information across the Council

As part of our risk assessment and from our cumulative audit knowledge and experience we have identified a potential risk in relation to the management of information across the Council.

There are a number of different independent sources of information across the Council, both IT based and manual and this can lead to information being siloed and difficult to access, which can impact on the quality and level of data that is available to management on which to base their decisions.

Deloitte response

As discussed within the Audit Plan we focused our work in this area on a case study on the information flows on safeguarding within the Children, Family and Learning Directorate due to the continued financial pressures in this area.

Further, as part of financial sustainability work above, we have considered the level and quality of information available to the senior management team in relation to the strategic change agenda which would inform their wider consideration of the Medium Term Financial Plan.

Our work in this area is substantially complete and overall there are no issues that have arisen that would impact on our value for money conclusion.

We have, however, noted a number of observations and recommendations both in relation to the sources of information available to the Council and also how the information is used. We will provide a separate report of our findings to management and the significant recommendations that arise from this will be reported to the next Audit and Governance Committee in our management letter.

3. Annual Governance Statement (AGS)

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 a Council's activities, including in particular those designed to ensure that:

- the Council's policies are implemented in practice;
- high quality services are delivered efficiently and effectively;
- the Council'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 Council'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 Council's governance arrangements and internal controls derived from our audit work.

4. 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.

Other issues

Management undertook a review of the assumptions used by the actuary to calculate the IAS19 pension liability within the statutory accounts. Following this review it was decided that given the current pay freezes within local authorities, the salary assumption included within the original calculation was too high and this was reduced by 0.5%. It was also decided that as the discount rate was at the lowest end of the benchmarking data available to the Council, the discount rate would be increased to 4.8% which is the median in the benchmark report.

The impact on the accounts was to reduce the pension liability and and increase the the pension reserve by £65.2m.

Independence

We confirm 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.

If the Corporate Affairs Committee wishes to discuss matters relating to our independence, we would be happy to arrange this.

Non-audit services

In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the Trust's policy for the supply of non audit services or of any apparent breach of that policy.

We apply the following safeguards to eliminate identified threats to independence or reduce them to an acceptable level are as follows:

Service provided	Identified threats to independence	Safeguards applied
Provision of advisory services in the year in relation to ongoing VAT advice to recover VAT on a number of income streams. (Fee: £19,200)	The key potential threat identified is: <ul style="list-style-type: none"> - Self-interest threat - Advocacy threat. 	We do not regard there to be a self-interest threat as the level of fees are not material to either the individual tax, audit and consulting departments or to Deloitte as a whole and are not inconsistent with our role as auditors. Mitigation of advocacy threat, Deloitte ensure that management own the decisions made and do not represent MBC in any discussions with HMRC.
Project to review the feasibility of regional collaboration for adults and children's services across 2 of the Tees Valley Councils. (Fee: £18,000)	The key potential threat identified is: <ul style="list-style-type: none"> - Self-interest threat - Advocacy threat. 	We manage the risk of making management decisions by undertaking work on the information provided by management and by ensuring that management take responsibility for all management decisions. Further although we do not regard there to be a significant self-review threat due to the type of work being undertaken, the team undertaking this piece of work are separate from the audit team.

4. Other matters for communication (continued)

Audit fees

The external audit fees in relation to audit services provided on behalf of the Audit Commission in the period from 1 April 2011 to 31 March 2012 are as follows:

Fees payable for the audit of the annual accounts (excluding Audit Commission rebate £20,308 and VAT)	£253,854
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The audit fee has been calculated in accordance with Audit Commission fee scale.

The fees for certification of claims and returns are estimated at £35,000 and will be confirmed in our Annual Audit Letter.

5. 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 audit bodies by summarising, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do. Responsibility for the adequacy and appropriateness of these methodologies and data rests with the Audit Commission.

Our report has been prepared on the basis of, and our work carried out in accordance with, the Code and the Statement of Responsibilities.

While our report includes suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of Middlesbrough Council'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.

We view this report as part of our service to you for use, as Members, 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 parties 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 the controls over and security of the website. You are also responsible for establishing and controlling the process for electronically distributing accounts and other information.



Deloitte LLP

Chartered Accountants
Newcastle-upon-Tyne
26 September 2012

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: Audit adjustments and uncorrected misstatements

Recorded audit adjustments – corrected misstatements

We report all individual identified recorded audit adjustments in excess of £208k and other identified misstatements in aggregate adjusted by management in the table below:

	(Credit)/ charge to deficit on provision of services £'000	(Increase)/ decrease in liabilities £'000	Increase/ (decrease) in assets £'000	(Increase)/ decrease in reserves £'000
Factual misstatement				
Reclassification of car park from PPE to Investment property (nil impact, adjustment of £7,119k)			(7,119) 7,119	
Impairment of car park (non current asset)*	731		(1,569)	838
Impairment of admin buildings (non current asset)*	1,104		(1,674)	570
Adjustment to remove finance costs from PPE*	2,621		(8,255)	5,634
Impact on the general fund reserve of the above adjustments:				
Transfer from general fund				(4,456)
Transfer to capital adjustment account				4,456
Change in assumptions within the IAS19 pension calculation**			65,213	(65,213)
Total misstatements				
	4,456	-	53,715	(58,171)
Net impact on General Fund		nil		

* For each of these adjustments to PPE the accounting entries were to Debit the I&E, Credit Fixed Assets and Debit the Revaluation Reserve.

**Adjustment due to management reassessment of the assumptions used in the IAS19 calculation by the actuary.

Corrected disclosure deficiencies:

There have been disclosure deficiencies which have been corrected by management. The majority of these were presentational in nature the main adjustments included:

- Reclassification of sundry creditors presentation;
- Addition of a related party within the disclosure;
- Fair value of loans;
- Additional disclosure in relation to impairments; and
- Inclusion of additional contingent liability in respect of Municipal Mutual Insurance.

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.

	(Credit)/ charge to deficit on provision of services £'000	(Increase)/ decrease in liabilities £'000	Increase/ (decrease) in assets £'000	(Increase)/ decrease in reserves £'000
Factual misstatement				
<u>Reclassification of My place and Executive initiative provision from provision to Earmarked reserve (Transfer of £329k from general fund to Earmarked reserve)</u>	(329)	329		
<u>Unrecorded liability (relating to a capital invoice not accrued as at the year end)</u>			471	
Dr Fixed Assets		(471)		
Cr Accruals				471
<u>Reclassification of PWLB loan from creditors to loans</u>				
Dr Creditors		3,255		
Cr Loans		(3,255)		
<u>Impairment of Gresham</u>				
Cr Investment Properties			(910)	
Dr Income & Expenditure	413			497
Dr Revaluation Reserve				
Cr General Fund				(413)
Dr Capital Adjustment Account				413
Total factual misstatements	84	(142)	(439)	497
Likely misstatement				
Extrapolation of the above error- unrecorded liability				
Dr Fixed Assets		(337)	337	
Cr Accruals				
Total misstatements	84	(479)	(102)	497

Uncorrected disclosure deficiencies:

There was a new requirement in the year to disclose the accounting policy and a disclosure note in relation to accounting for the Carbon Reduction Commitment Scheme (CRC). The Council have correctly accounted for the scheme, but have not included the additional disclosure.

There is also a requirement to disclose the accounting policy and a note to discuss how the Council accounts for Landfill Allowance (LAT). The Council have correctly accounted for the scheme, but have not included the disclosure.

Due to the quantum of both the CRC and LAT transactions in the year, management do not view this as a material mis-statement.

The accounts do not reflect the full disclosure requirements of the Heritage Assets standard. For example a summary of transactions has been disclosed for 2 years instead of 5 years. Management chose to minimise this disclosure as part of the project to streamline the accounts and make them more transparent and therefore do not consider this additional disclosure to be material to the reader

Appendix 2: Draft Management Representation letter

Middlesbrough Council – Audit of the annual accounts for the year ended 31 March 2012

Deloitte LLP
One Trinity Gardens
Broad Chare
Newcastle
NE1 2HF

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of Middlesbrough Council and the Teeside Pension Fund (hereafter collectively referred to as the Middlesbrough Council) for the year ended 31 March 2012 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of Middlesbrough Council as of 31 March 2012.

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

Financial statements

1. We understand and have fulfilled our responsibilities for the preparation of the financial statements in accordance with the applicable financial reporting framework which give a true and fair view.
2. Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
3. Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of IAS24 "Related party disclosures".
4. 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.
5. [The effects of uncorrected misstatements and disclosure deficiencies are immaterial, both individually and in aggregate, to the financial statements as a whole. Cumulatively uncorrected adjustments below this level identified to date would decrease net assets by £581k, and increase the net deficit by £84k. There are no uncorrected disclosure deficiencies. To be updated on completion of the audit]
6. We confirm that the financial statements have been prepared on the going concern basis. We are not aware of any material uncertainties related to events or conditions that may cast significant doubt upon the Council's ability to continue as a going concern. We confirm the completeness of the information provided regarding events and conditions relating to going concern at the date of approval of the financial statements, including our plans for future actions.
7. We confirm that in our view the provision in relation to council tax debt is adequate.
8. We confirm that in our view the disclosure and accounting treatment of heritage assets is complete and in accordance with accounting requirements.

Appendix 2: Draft Management Representation letter (continued)

Information provided

9. We have provided you with:
 - access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - additional information that you have requested from us for the purpose of the audit; and
 - unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
10. All transactions have been recorded and are reflected in the financial statements and the underlying accounting records.
11. We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
12. 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.
13. We are not aware of any fraud or suspected fraud that affects the entity and involves:
 - (i). management;
 - (ii). Members of the Council;
 - (iii). employees who have significant roles in internal control; or
 - (iv). others where the fraud could have a material effect on the financial statements.
14. We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.
15. We are not aware of any instances of non-compliance, or suspected non-compliance, with laws, regulations, and contractual agreements whose effects should be considered when preparing financial statements
16. We have disclosed to you the identity of the Council's related parties and all the related party relationships and transactions of which we are aware.
17. All known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to you and accounted for and disclosed in accordance with the applicable financial reporting framework. No other claims in connection with litigation have been or are expected to be received.
18. All known material liabilities have been properly included in the annual accounts and all material contingent liabilities have been disclosed.
19. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.

Appendix 2: Draft Management Representation letter (continued)

20. Pension Scheme:
- all retirement benefits and schemes have been identified and properly accounted for;
 - all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
 - the actual assumptions underlying the value of scheme liabilities accord with the members' best estimates of the future events that will affect the cost of retirement benefits and are consistent with the members' knowledge of the business;
 - the actuary's calculations have been based on complete and up-to-date member data (as far as is appropriate regarding the adopted methodology); and
 - the amounts included in the financial statements derived from the work of the actuary are appropriate.
21. Where required, the value at which assets and liabilities are recorded in the balance sheet is, in the opinion of the Members, the fair value. 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 the Council. Any significant changes in those values since the balance sheet date have been disclosed to you.
22. The Council has satisfactory title to all assets and there are no liens or encumbrances on the Council's assets.
23. We are not aware of any potential clawback by grant payers of grants that have been released to income.
24. There have been no events since the balance sheet date which require adjustment of or a disclosure in the financial statements or notes thereto that have not been fully disclosed. Should further material events occur, which may necessitate revision of the figures included in the annual accounts or inclusion of a note thereto, we will advise you accordingly.
25. Our Annual Report will be consistent with and include the financial statements as audited.

We confirm that the above representations are made on the basis of adequate enquiries of management and staff (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

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