

Middlesbrough Council

Our ISA260 to the Corporate
Affairs Committee on the
2012/2013 Audit

4 October 2013

Corporate Affairs Committee
Middlesbrough Council
Middlesbrough
TS1 9FT

4 October 2013

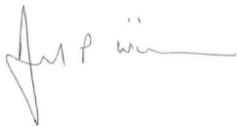
Dear Sirs

We have pleasure in setting out in this document our report to the Corporate Affairs Committee of Middlesbrough Council for the year ended 31 March 2013. This report covers the principal matters that have arisen from our audit for the year ended 31 March 2013. This report updates our progress report, dated 13 September 2013 that was presented to and discussed at the Corporate Affairs Committee meeting on 25 September 2013.

In summary:

- Our audit testing is now complete;
- The results of our work in relation to the significant risks, which are summarised in the Executive Summary, are set out in our report;
- We issued an unqualified opinion on the Council's Statement of Accounts and an unqualified Value for Money Conclusion by the 30 September deadline; and
- We issued an "except for" conclusion in the Whole of Government Accounts (WGA) Assurance Statement.

We would like to take this opportunity to thank senior officers for their assistance and co-operation during the course of our audit work.



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Executive summary

Status	Description
Completion of the audit	
We completed our audit and gave our opinion by the 30 September deadline	Whilst we encountered some difficulties in our audit testing, notably in relation to the valuation of Fixed Assets, we completed our audit and gave our opinion on the Statement of Accounts and Value for Money conclusion by the 30 September deadline.
Overall view	
Following the conclusion of our audit, we issued an unmodified opinion on the Statement of Accounts and Value for Money Conclusion	<p>We issued an unmodified audit opinion on the truth and fairness of the financial statements.</p> <p>We also issued an unmodified opinion on the Council's arrangements for delivering Value for Money in its use of resources.</p> <p>The matters that we have taken into account in forming our overall view are described in the following sections.</p>
Whole of Government Accounts (WGA) Opinion	
We are required to issue an opinion on the Council's submission for WGA. We issued an "Except for" conclusion in this matter	<p>We issued an "except for" conclusion to reflect the fact one item in the Council's WGA consolidation pack did not agree to the audited accounts.</p> <p>This was due to an error in the consolidation pack provided to the Council, which forced an incorrect counterparty to be entered for one transaction.</p>

Executive summary (continued)

Status	Description	Detail
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1. Revenue recognition: recognising grant income Status

Our testing identified one instance of incorrectly recognised grant income, which management agreed to correct

- The Council has recognised £242,729k of grant income and contributions (note 28). A number of these grants and contributions come with attached conditions. Where these are not met, accounting standards prohibit the recognition of income.
- Our testing identified one grant of £2,162k, which had been inappropriately recognised. Management amended the financial statements to correct this error.
- Our testing also identified an additional 2012/13 revenue grant of £802k without conditions, which the Council agreed to recognise.



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2. Recoverability of investments Status


Our testing has not identified any Council investments that are unlikely to be recovered


- The Council invests surplus cash under a member approved Treasury Management Policy so that the Council can meet its liabilities as they fall due.
- The Council's cash investments in the Balance Sheet consist of £1,014k of Long Term Investments, £17,510k of Short Term Investments and £10,000k of on-call accounts recognised as Cash and Cash Equivalents.
- Our testing did not identify a material doubt over the recovery of any of the Council's investments.



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 Risk appropriately addressed

 Risk satisfactorily addressed following amendment to the statements

 Material unresolved matter

Executive summary (continued)

Status	Description	Detail
3. Valuation of Fixed Assets		
<p>Our testing identified a material error in the prior year valuation of a number of assets, which resulted in a Prior Period Adjustment (PPA) being required.</p> <p>We requested a number of additional valuations to support our conclusion on this matter</p>	<ul style="list-style-type: none"> The Council's draft financial statements showed an asset base of £297,396k of Land and Buildings and £63,468k of Investment Property. The Code of Practice on Local Authority Accounting sets out the valuation methodologies and requirements the Council must follow in revaluing its asset base. Our testing identified a material prior period error in the valuation of a number of assets. This caused us to propose a Prior period adjustment ("PPA") to correct these errors. We requested the Council perform a number of additional revaluations to ensure their value in the Balance Sheet is materially correct. On review of these valuation reports, we considered that four of these assets should also be included within the PPA, as they had not been re-valued with sufficient frequency to maintain a materially correct valuation in prior years. We also requested a revaluation of a piece of investment land, on the basis that sufficient progress had not been made to justify recognising the change in valuation proposed by management. 	<p>● Page 9</p>
4. Disclosure of related parties		
<p>Our testing identified a number of additional disclosures which are required to ensure compliance with the Code of Practice</p>	<ul style="list-style-type: none"> Related Parties exist where individuals with control of the operations of the Council also have influence in external organisations. Where the Council has transactions with these organisations, these require disclosure to enable the user of the accounts to assess the nature and impact of these transactions. From our review of Councillor and Senior Officer disclosures, as well as access to additional external information, we have sought a number of additional disclosures to ensure compliance with the Code. 	<p>● Page 10</p>

Executive summary (continued)

Status	Description	Detail
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5. Management override of controls Status

<p>Our testing did not identify any inappropriate use of journals or management bias in forming accounting estimates</p>	<ul style="list-style-type: none"> • Auditing standards require that in every audit the auditor assumes that there is a risk of material misstatement connected with management’s ability to fraudulently manipulate the reported position by overriding controls. • We have reviewed accounting estimates for bias and indications of fraud, notably in the estimation of the Council’s pension liability. Our testing in this respect has found that the Council’s estimates are reasonable and not indicative of bias. • We have reviewed a variety of significant transactions to understand their economic rationale. In all instances we are satisfied as to the business rationale of the material transactions the Council has entered into. • Our risk-based testing of significant adjustment journals did not identify any instances where management had sought to manipulate the financial position of the Council. 	<p>●</p>	<p>Page 11</p>
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Value for Money Conclusion Status

<p>We issued an unmodified Value for Money Conclusion</p>	<ul style="list-style-type: none"> • Under the Code of Audit Practice published by the Audit Commission, we are required to assess whether the Council has put in place appropriate arrangements to secure economy, efficiency and effectiveness in its use of resources. • Our testing identified one recommendation for the Council in relation to the Looked After Children budget, but overall we were satisfied as to the Council’s arrangements and issued an unmodified Value for Money Conclusion. 	<p>●</p>	<p>Page 13</p>
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Executive summary (continued)

Status	Description	Detail
Recommendations for improvements		
We have a number of comments to make on the Council's processes involved in producing the financial statements	<p>We have the following insights to raise on the processes and procedures adopted by the Council which we have encountered in the course of our audit:</p> <ul style="list-style-type: none">• Heritage Assets – involvement of curators in the year-end closedown process• Heritage Assets – improving documentation of heritage assets on asset registers• Communication – improving communication across the Council in producing the accounts• Fixed Asset valuations – better utilising knowledge obtained by the valuer• Related parties – adopting a register for senior officer interests• NHS contracts – reviewing contracts where counterparties have changed to ensure their enforceability• Treasury Management Policy compliance – increased frequency of reporting to members• Presentation – improving the structure and flow of the annual accounts• Looked After Children budget – adopting a demand based budget model	Page 16
Identified misstatements and disclosure misstatements		
We identified two misstatements which management elected not to correct	<p>Audit materiality was set at £3,880k (2012 £4,173k).</p> <p>A schedule of unadjusted misstatements is attached at Appendix 1. We do not consider that these misstatements have a material effect on a user of the accounts.</p> <p>As required by International Standards on Auditing, we requested that any items management has elected not to correct are corrected. A summary of uncorrected misstatements was attached to the representation letter obtained from the Council.</p>	

Executive summary (continued)

Status	Description	Detail
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Significant corrected misstatements

Management elected to correct the financial statements for a number of misstatements. The Committee's attention is drawn here to those considered significant

Details of significant recorded audit adjustments are included in Appendix 1. The following adjustments are brought to your attention:

Appendix 1

- Prior Period Adjustment relating to the valuation of property assets, due to estimation or calculation errors in valuations and a number of additional valuations being required to comply with the Code of Practice. These adjustments reduced the Council's 31 March 2011 Balance Sheet value by £30,533k, with subsequent adjustments of £29,527k and £14,113k made to the 31 March 2012 and 31 March 2013 Balance Sheets respectively.
- An amendment was made to the fair value of a piece of investment land, reducing the Council's Investment Property balance by £5,509k compared to the draft Statement of Accounts. This was because sufficient progress had not been made with the proposed housing development to permit full recognition of the estimated development value. A corresponding adjustment was made through the Movement in Reserves Statement in line with proper practice resulting in no impact on the General Fund.
- Incorrect classification of a revenue grant as capital (£2,162k) relating to the weekly waste collection grant. Corresponding adjustments have been made through the Movement in Reserves Statement in line with proper practice resulting in no impact on the General Fund.
- Amendment made to recognise an additional £802k of grant income (the Local Authority Central Spend Equivalent Grant) which had not been identified as receivable in the preparation of the financial statements.
- Amendments have been made to note 19 on Senior Officers' Remuneration and Exit Packages, to ensure appropriate disclosures are made in line with the Code of Practice and the Accounts and Audit Regulations.
- Amendments have been made to increase Debtors and reduce the Loss on Disposal of Investment Property (note 3) by £1,060k to reflect the deferred consideration receivable by the Council on disposal of an Investment Property.
- An amendment has been made to include a provision for liabilities relating to Municipal Mutual Insurance Ltd, no longer being likely to achieve a solvent run-off. This results in a provision of £1,020k, which is funded by a transfer from the earmarked insurance reserves.

1. Significant audit risks

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

Status	Description	Detail
1. Revenue recognition: recognising grant income		
<p>Status - ●</p> <p>Our testing identified one grant which had been incorrectly recognised as a capital grant, and one grant receivable which had not been recognised by the Council</p>	<ul style="list-style-type: none"> International Standards on Auditing require us to specifically consider the risk of incorrect revenue recognition in our audit. Our planning procedures identified that for the Council, this risk relates to the incorrect recognition of grant income based on the terms and conditions related to that grant or contribution. The Council has recognised £242,729k of revenue grant income and contributions (note 28). A number of these grants and contributions come with attached conditions. Where these are not met, accounting standards prohibit the recognition of income. Typically these grant conditions include only claiming expenditure associated with the project and as agreed by the grant providing body (often central government departments), or that procurement has followed a mandated process. 	<p>Deloitte response</p> <p>We have reviewed the design and implementation of management's controls to ensure grant income is not inappropriately recognised.</p> <p>Our testing involved reviewing the grant terms and conditions for a number of grants recognised by the Council, and reviewing a number of similar organisations and external data to confirm the completeness of the grants recognised.</p> <p>Our identified one instance where a grant whose terms and conditions note it specifically as a revenue grant that had been recognised by the Council as a capital grant. This related to the Weekly Collection Support Grant and totalled £2,162k in 2012/13. Management agreed to amend the treatment of this grant, which then includes the amount being applied to finance the related capital expenditure. This results in no net effect to the General Fund following this audit adjustment.</p> <p>We also identified one unrecognised grant of £802k (Local Authority Central Spend Equivalent Grant) which management agreed to recognise in 2012/13.</p>

● Risk appropriately addressed

● Risk satisfactorily addressed following amendment to the statements

● Material unresolved matter

1. Significant audit risks (continued)

Status	Description	Detail
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2. Recoverability of investments

Status - ●	Description	Deloitte response
<p>Our testing has not identified any Council investments that are unlikely to be recovered</p>	<ul style="list-style-type: none"> The Council invests surplus cash under a member approved Treasury Management Policy so that the Council can meet its liabilities as they fall due. Owing to the current economic climate, a risk exists that invested balances may not be recoverable due to the weakening position of some of the financial and other institutions the Council permits investment with. For example, following the year end, the Co-operative Bank was downgraded by various ratings agencies. The Council has not placed investments with the bank following its downgrade. The Council's cash investments in the Balance Sheet consist of £1,014k as Long Term Investments, £17,510k as Short Term Investments and £10,000k of on-call accounts recognised as Cash and Cash Equivalents. Our testing has not identified a material doubt over the recovery of any of the Council's investments. 	<p>We have reviewed the design and implementation of management's controls to ensure investments are only made with approved counterparties. Members annually approve the Council's Treasury Management Policy which contains the list of counterparties with which the Council is approved to invest.</p> <p>We have performed detailed testing of the compliance of investments with the Treasury Management Policy and found that all investments had been made in line with policy.</p> <p>We have obtained independent confirmation of the value of cash investments held by the Council and considered the implications for recovery of changing market conditions. All investments included in the Balance Sheet have been returned when their maturity would have expected them to be returned.</p> <p>We have raised a recommendation in section 4 in relation to improving member scrutiny of the Council's Treasury Management activities, but this does not affect the recoverability of investments.</p>

1. Significant audit risks (continued)

Status	Description	Detail
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3. Valuation of Fixed Assets	Deloitte response
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Status - ●

Our testing identified a material error in the prior year valuation of a number of assets, which resulted in a PPA being required. We also asked management to revalue a piece of investment land, resulting in a reduction in its carrying value

- The Council's draft financial statements showed an asset base of £297,396k of Land and Buildings and £63,468k of Investment Property. The Code sets out the valuation methodologies and requirements the Council must follow in revaluing its asset base.
- Volatility in the property market both locally and nationally can result in significant changes to the carrying value of property. The Code requires that valuations of land and buildings and investment property assets take place at least every five years, and with sufficient regularity so as to maintain a materially correct carrying value.
- A PPA is required to correct a material error in previous years based on information that has come to light in the current period.

Our testing identified a material prior period error in the valuation of a number of assets. This has caused us to propose a PPA to correct these errors.

We requested that the Council perform a number of additional revaluations to ensure that the value of assets in the Balance Sheet was materially correct.

This resulted in a £30,533k adjustment to the 31 March 2011 Balance Sheet, and consequential adjustments as at 31 March 2012 and 2013. The assets affected were Middlesbrough Bus Station, three leisure centres and one office building.

We challenged the valuation of a piece of investment land valued for housing development. Following consultation with Deloitte Real Estate, and discussions with the Council's valuer, planning department and senior officers, we concluded that progress on the development was insufficient to warrant such an increase in value. Management agreed to reduce the valuation from the draft financial statements by £5,509k.

We have raised a recommendation in section 4 in relation to improving interaction with the valuer to seek to prevent similar issues occurring in the future.

1. Significant audit risks (continued)

Status	Description	Detail
4. Disclosure of related parties	Deloitte response	
Status - ● Our testing identified a number of additional disclosures which are required to ensure compliance with the Code of Practice	<ul style="list-style-type: none"> • Related Parties exist where individuals with control of the operations of the Council also have influence in external organisations. Where the Council has transactions with these organisations, these require disclosure to enable the users of the accounts to assess the nature and impact of these transactions. • This was identified as an area of significant risk due to errors in the disclosure in the previous year. 	<p>We have reviewed the design and implementation of controls management have put in place to collect details of related parties, consider them and generate the disclosure in the annual accounts.</p> <p>From our review of Councillor and Senior Officer disclosures, as well as access to additional external information, we have sought a number of additional disclosures to ensure compliance with the Code.</p> <p>We have raised a recommendation in section 4 to assist the Council in preparing the note in future years by maintaining a register of interests for senior officers.</p>

1. Significant audit risks (continued)

Status	Description
5. Management override of controls	
Status - ● Our testing did not identify any inappropriate use of journals or management bias in forming accounting estimates	<p>Auditing standards require that in every audit, the auditor assumes that there is a risk of material misstatement connected with management's ability to fraudulently manipulate the reported position by overriding controls.</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>

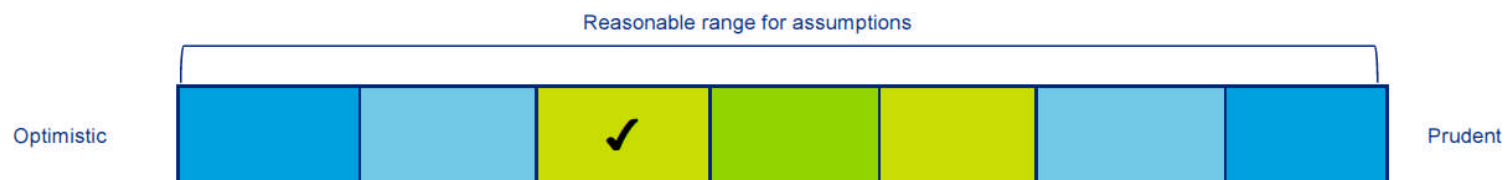
1. Significant audit risks (continued)

5. Management override of controls (continued)

Deloitte response

We have reviewed accounting estimates for bias and indications of fraud, notably in the estimation of the Council's pension liability. Our testing in this respect has found that the Council's estimates are reasonable and not indicative of bias.

With regard to the estimates and assumptions used to calculate the pensions liability, we have sought advice from our internal pensions experts, Deloitte Total Reward and Benefit (DTRB). DTRB have reviewed the assumptions which the Council have adopted on advice of the Council's actuary, Aon Hewitt. The chart below shows our assessment of the suite of assumptions used by the Council and actuary. The green areas in the centre of the chart show the range of assumptions we consider to be reasonable, the blue areas indicative of bias.



We have concluded that the assumptions used fall within the reasonable range and are therefore not indicative of management bias in the preparation of the pensions estimates. The Council's estimates are considered slightly optimistic, as standard rather than specific assumptions have been adopted, and the expected performance of the Council's assets estimated in quarter 4 was slightly optimistic compared to the performance indicated by the fund as a whole.

We have reviewed a variety of significant transactions to understand their economic rationale. In all instances we are satisfied as to the business rationale of the material transactions the Council has entered into.

We also reviewed a series of journals prepared by management during the course of the year and in the production of the financial statements. Journals are manual entries made in the accounting record to make adjustments as deemed necessary. We adopted a risk based approach to identify journals of specific audit interest. Our testing of these journals determined that they had been appropriately prepared and were genuine accounting entries required by accounting standards.

2. Value for Money Conclusion

The approach to local Value for Money (VfM) audit work at councils is specified by the Audit Commission. Consistent with last year, auditors are 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, which assesses the arrangements in place and not the decisions made, based on our risk assessment, which is informed by a series of risk factors determined by the Audit Commission.

The results of our audit work on the Value for Money risks are set out below:

Status	Description	Detail
1. Delivery of financial targets and the management of reduction in resources	Deloitte response	
Status - ● Our work in this area identified one reported saving we consider inappropriate, resulting in a recommendation raised in section 4	<ul style="list-style-type: none"> • In response to the significant financial pressures that the Council is facing over the next few years the Council put in place efficiency plans to achieve the cost cutting target for 2012/13. • During the second half of 2012/13 the Council started to make significant progress in moving from a focus on cost cutting to service and finance transformation. For example, the Council is developing cost saving initiatives that span the medium term financial period, rather than just focusing on annual targets and considering which services the Council may not deliver in future. • In September 2012, the Council launched its new strategic vision and is currently going through a process of communicating this vision and the underlying transformation plan to the Members and to staff across the Council. • As the Council finalises its transformation plan and moves further into implementation, there will be an increased need to ensure that there is good project management in place to support and facilitate the changes, and also robust governance to ensure the Council monitors the impact of the changes. 	<p>We have reviewed a sample of the Council's cost saving schemes as reported with the 2012/13 revenue outturn to the Overview and Scrutiny Board in July 2013. In general, we found that appropriate recurrent savings had been made. However, we raise a recommendation in respect of the Looked After Children budget in section 4.</p> <p>We have reviewed the Council's Strategic Vision and the Medium Term Financial Plan and have determined their principles are appropriately embedded within the Council's Change Programme which will support it to deliver services within a reduced spending envelope.</p> <p>We have reviewed the Terms of Reference of the Change Programme Board and concluded its status as a discussion forum but non-decision making body is appropriate for the Council.</p>

2. Value for Money Conclusion (continued)

Status	Description	Detail
2. Information management	Deloitte response	
<p>Status - ●</p> <p>We noted areas where the Council does not operate as an integrated single unit, but are generally satisfied with the Council's arrangements for information management</p>	<ul style="list-style-type: none"> In a period of significant financial challenge and change, the quality of management data is an important tool to help Officers and Members make decisions based on evidence. In the prior year as part of our risk assessment and from our cumulative audit knowledge and experience we identified a potential risk in relation to the management of information across the Council. 	<p>We have reviewed the Council's Directorate structure which was revised in 2012/13 and concluded the structure is appropriate for the Council. However as part of our audit work, we identified that there are a number of areas where the Council does not act as an integrated single unit. This is evidenced by a weakness in communication between departments as part of the preparation of the financial statements.</p> <p>We have reviewed the Council's future plans for monitoring performance and providing information for management decisions, and concluded that in general, targets are appropriately identified to support the decision making process.</p> <p>We have also undertaken a high-level review of the Adult Social Care demand led budget model. We have concluded that it provides good information to management on which to base decisions, by separating the impact of non-controllable changes in demand from other controllable costs. In section 4, we recommend the Council adopt such a model for the Looked After Children budget which is also considered to be demand-led.</p> <p>We have completed our review of the governance arrangements in place during the year to support our VfM conclusion. We will report separately to the Audit and Governance Committee on our view of the post-year end changes to the senior management structure</p>

3. Other issues

Scoping of material account balances, classes of transactions and disclosures

Our audit is designed to address the risk of material misstatement. As such, we principally direct our resources to the areas of greatest risk

We perform an assessment of risk which includes considering the size, composition and qualitative factors relating to account balances, classes of transactions and disclosures. This enables us to determine the scope of further audit procedures to address the risk of material misstatement.

In respect of Intangible Assets of £704k, Long Term Debtors of £682k, Inventories of £2,111k and Long Term Creditors of £380k we determined that these account balances, classes of transactions and disclosures did not require further audit procedures because our risk assessment, taking qualitative factors into account, resulted in us assessing the risk of material misstatement as remote.

Going concern

Going Concern refers to the ability of the Council to continue providing services in future years

Within local government there is an implicit assumption that Councils will continue as going concerns for the foreseeable future. The Council has approved a balanced budget for 2013/14 and prepared a Medium Term Financial Plan for future years. Savings programmes have been initiated to ensure the Council can meet its budget gap in future years.

Deloitte response

We have reviewed the 2013/14 budget and savings programmes for adequacy, and considered the Council's ability to meet its liabilities and provide services in the future.

We have concluded that the Council is able to prepare accounts on the Going Concern basis.

Whole of Government Accounts (WGA) Opinion

We are required to issue an opinion on the Council's submission for WGA. We issued an "Except for" conclusion in this matter

The Council is required to participate in a consolidation exercise in order to produce a set of accounts covering the whole of the UK public sector. As the Council's auditor, we are required to conclude on whether the consolidation pack is consistent with the audited accounts, and whether the appropriate intra-group eliminations have been identified.

Our conclusion in this regard is that the consolidation pack is consistent with the audited accounts, except for one specific item. In order to submit the Council's consolidation pack, the spreadsheet provided to the Council forced the entry of an incorrect counterparty for a current asset. We are required to report this in our assurance statement to make the WGA auditor (the National Audit Office) aware of the incorrect counterparty disclosed.

4. Recommendations for improvement

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 Council's accounting policies and estimates are discussed below.

Heritage Assets – involvement of curators in year-end processes		Management response
Description	The curators within the Council's Museums and Art Galleries are well placed to identify donated assets and material changes in the value of Heritage Assets held. Liaising with curators will enable the Council to identify previously unrecognised donated assets or changes in asset values owing to market conditions.	
Recommendation	The Council should involve curators in Museums and Art Galleries in the accounts production process.	Agreed. The Council will set up a process to ensure that Curators are contacted on a regular basis going forward and that details of any donated assets or material changes in value in existing Heritage Assets are identified and forwarded to Strategic Resources.

Heritage Assets – improving the documentation of heritage asset registers		Management response
Description	The current heritage asset registers used in the production of the accounts do not specify individual assets, but rather the category of asset, and then the approximate value of the assets based on a banding.	
Recommendation	The Council should document its Heritage Assets individually on asset registers which can be used to compile the accounts.	The Council will review the process for recording details of Heritage Assets on the Asset Register. Heritage Assets will be recorded individually on the Asset Register after due consideration is given to materiality and the cost effectiveness of obtaining the necessary information.

4. Recommendations for improvement (continued)

Communication – improving information flows across the Council in producing the accounts		Management response
Description	In a number of areas, information being used by Finance to prepare the accounts was different to that held by the relevant managing departments. With regard to Leases, the Land Terrier held different information to that being used to prepare the leases notes. For Infrastructure assets, the Highways team did not inform Central Finance of changes to infrastructure assets to allow the Fixed Asset Register to be updated accordingly.	
Recommendation	The Council should seek to use a broad base of knowledge from departments outside of Finance to confirm data and contribute to the production of the financial statements.	All services will be reminded of the importance of informing Strategic Resources of any sales/purchases of assets or events that may materially affect the valuation of an existing asset.

Fixed Asset Valuations – better utilising knowledge obtained by the valuer		Management response
Description	The Council uses an external valuer to provide valuations of Fixed Assets for inclusion in the financial statements. Currently this is limited to valuing the assets based on a five year rolling programme. The Council's internal valuer is also well placed to provide challenge to the external valuer and make inferences about the Council's wider property portfolio on the basis of valuation reports received.	
Recommendation	The Council should identify a system whereby they can use the knowledge provided by the valuer to understand broader changes in the local property market and the potential impact on the valuations of other assets.	Quarterly meetings will be set up between Strategic Resources and the Valuation Service to review the valuation process. The Valuation Service will consider valuing high value assets more frequently than as part of the rolling five year programme to improve the accuracy of the asset valuations contained in the annual statement of accounts.

4. Recommendations for improvement (continued)

Related Parties – Senior Officers disclosures		Management response
Description	The Council currently compile the Related Party Transactions disclosure for Senior Officers based on returns made by relevant officers specifically for the purpose of preparing the note. This includes various relationships being added based on Finance staff's knowledge where the disclosure is inconsistent with officers' understanding.	
Recommendation	The Council should implement a Register of Interests for Senior Officers and cross-reference this to returns made in support of the Related Party Transactions disclosure.	The Council will ensure that a Register of Interests for Senior Officers is set up and maintained.
NHS contracts – reviewing contracts where counterparties have changed		Management response
Description	The NHS has recently undergone significant structural change, including the reforms relating to Transforming Community Services (TCS) and the replacement of Primary Care Trusts (PCTs) with Clinical Commissioning Groups (CCGs). The Council recognised revenue contributions of £14,604k from NHS bodies in 2012/13 (note 28). At the year end, the Council reported NHS debtors of £1,442k. At the date of our audit, £126k receivable from Middlesbrough PCT was being disputed by its successor body, South Tees CCG. Where services have transferred, there is a risk that debts become unenforceable as successor bodies are not aware of the nature of their liabilities.	
Recommendation	The Council should assure itself that NHS contracts can be tied to the current provider of the service to ensure debts can be enforced. Whilst existing older contracts with these bodies may have been novated, it would be beneficial to review these and consider the implementation of new contracts that reflect the current arrangements and relationships.	The council will review the NHS contracts as recommended.

4. Recommendations for improvement (continued)

Treasury Management Policy compliance – increased frequency of reporting to members		Management response
Description	Before the beginning of the financial year, the Council receives a report on Prudential Indicators, Investment and Treasury Management & Minimum Revenue Provision Policy. This contains a Treasury Management Policy which sets out various matters, including the intended frequency of reporting to members, in line with the CIPFA Code of Practice on Treasury Management. The 2012/13 report committed the Council to receiving a mid-year report and year end review of the performance of the Treasury Management function. Neither of these were presented to Members.	
Recommendation	The Council should be more involved in reviewing the Treasury Management function by receiving the reports set out in the Council's Treasury Management Policy.	The Council will provide an annual report containing details of the year end position and the projected year end position for the following year.

Presentation – improving the structure and flow of the accounts		Management response
Description	The requirements of the Code are numerous and varied, making clear, concise presentation of the accounts difficult to achieve. During the year the Council sought to amend its presentation of the accounts to improve clarity for the reader. However, this has resulted in connected notes being spread across the financial statements, which does not assist the reader in understanding the accounts.	
Recommendation	The Council should review the presentation of its financial statements to make them more readable, coherent and user-friendly.	The council will review the presentation of its financial statements as part of the closure of accounts process for 2013/14 and make any amendments to the layout it deems appropriate to make the financial statements more user friendly.

4. Recommendations for improvement (continued)

Looked After Children – Adopting a demand based budget model	Management response
<p>Description</p> <p>In support of our Value for Money Conclusion, we considered a number of savings which the Council had identified in its outturn statement as having been made. In reviewing a saving reported against the Looked After Children budget, we concluded it was inappropriate to report the saving given the net overspend of the service</p> <p>We contrasted this with the demand based budget model applied in respect of Adult Social Care, where non-controllable changes in demand for the service do not result in reported savings, but controllable factors, such as renegotiated prices, are reported as savings.</p> <p>We also noted that the initial budget set for the year for Looked After Children would not have been sufficient, had all the children in care at 1 April 2012 remained in care for the full year. We do however note that management allocated additional funds at the start of 2012/13 and has set aside funds in its 2014/15 Medium Term Financial Plan (MTFP) to resolve this issue.</p>	
<p>Recommendation</p> <p>The Council investigate adopting the principles of the Adult Social Care demand based budget model for Looked After Children budget, to demonstrate a better understanding the scope for savings.</p>	<p>The Council will ensure it maintains current principles for assessing demand led pressures for Social Services (Adults & Children). This approach will be maintained across these services.</p>

5. Independence

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

Confirmation			
We do not believe our independence is compromised	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.		
Non-audit services			
We are currently involved in undertaking a Governance review for the Council, which we do not believe compromises our independence	In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the Council'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
	Governance review into the changed governance structures being implemented at the Council	No threats to independence are identified as the work is considered complimentary to our role as auditors	We have applied our standard safeguards involving independent review and challenge of work performed.
A project to review the feasibility of joint working in relation to regional collaboration for Adult and Childrens' services	Threats of self-review and self-interest exist	Work has been conducted by independent teams with no contact with the audit engagement team. Fees are not considered significant to impair our judgement.	
Fees			
Audit fees for 2012/13 were in line with those set by the Audit Commission.	The fees payable to Deloitte for the period from 1 April 2012 to 31 March 2013 were £152k (2011/12: £254k) in relation to external audit services. The reduction in fee represents savings negotiated by the Audit Commission. Our work on the certification of claims is still on-going but the fees are anticipated to be in line with the fee set by the Audit Commission of £23k and will be reported in our annual report on this work. Our non-audit work identified above resulted in fees being payable totalling £27k (2011/12: £37k)		

6. 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 Council by 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 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.

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 auditor's 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 electronically distributing accounts and other information.

Deloitte LLP

Chartered Accountants

Newcastle Upon Tyne
4 October 2013

Appendix 1: Audit adjustments

Uncorrected misstatements

Our audit identified two misstatements which management has declined to correct on the grounds that they are projected misstatements which are not considered material to users of the financial statements.

As stated in our audit plan, we only report to you uncorrected misstatements that are either qualitatively material or exceed the clearly trivial threshold of £194k.

Uncorrected Financial Statements Misstatements		Credit/ (charge) to current year Comprehensive Income & Expenditure £'000	Increase/ (decrease) in Useable Reserves £'000	Increase/ (decrease) in prior year General Fund £'000	Increase/ (decrease) in Unusable Reserves £'000
Projected misstatements					
Incorrect recognition of a revenue invoice in 2012/13	[1]	(253)	(253)	-	-
Total		(253)	(253)	-	-

[1] An invoice totalling £50,000 for Middlesbrough PCT recognised in 2012/13 relating to funding for a literacy programme which was considered to relate to 2013/14 instead. This was extrapolated over the balance of NHS debtors as a suitable parent population, resulting in a projected overstatement of income and debtors.

Uncorrected Disclosure Misstatements		Source of disclosure requirement
Future Minimum Lease Payments (note 31)	[2]	Code of Practice on Local Authority Accounting

[2] The disclosure on leases (note 31) is based on information which had not been updated with changes to the terms of a number of leases. Three leases were identified where this applied, with a total annual error of £10,489. This was extrapolated across the disclosed balance for the life of each lease to give a projected error of £1,705k.

Appendix 1: Audit adjustments (continued)

Recorded audit adjustments

We report all individual identified recorded audit adjustments in excess of the trivial threshold and other identified misstatements in aggregate adjusted by management. The threshold determined as clearly trivial is £194k.

	Property, Plant and Equipment (PPE) £'000	Capital Adjustment Account (CAA) Unusable Reserve £'000	Revaluation Reserve (RR) Unusable reserve £'000
Factual misstatements – Prior year			
Previously reported Balance Sheet 31 March 2011	569,386	440,307	81,863
Revaluation of the Bus Station	(16,921)	-	(16,921)
Revaluation of Other Assets	(13,612)	(9,335)	(4,227)
Restated Balance Sheet 31 March 2011	538,853	430,972	60,665
Previously Reported Balance Sheet 31 March 2012	470,655	357,912	72,126
Knock on effect of above changes	(30,533)	(9,335)	(21,197)
Reduced depreciation charge 2011/12	1,006	1,006	-
Restated Balance Sheet 31 March 2012	441,129	349,583	50,929

The table above shows the impact of the Prior Period Adjustments on the Balance Sheets previously reported as at 31 March 2011 and 31 March 2012. The impact of the revaluations was taken to the Revaluation Reserve and Capital Adjustment Account, which are also adjusted in the Balance Sheets. The reduced asset value results in a lower depreciation charge to the Comprehensive Income and Expenditure Statement being made in 2011/12. These entries are then reversed in line with proper practice, resulting in no net impact on the Council's usable reserves.

Appendix 1: Audit adjustments (continued)

		Credit/ (charge) to current year Comprehensive Income & Expenditure £'000	Increase/ (decrease) in Useable Reserves £'000	Increase/ (decrease) in Fixed Assets £'000	Increase/ (decrease) in Unusable Reserves £'000
Factual misstatements – Current year					
Treatment of Weekly Waste Collection Support Grant as a revenue not capital grant	[1]	-	-	-	-
Recognition of the deferred consideration receivable on the disposal of an investment property	[2]	1,060	1,060	-	-
Unrecognised Grant receivable	[3]	802	802	-	-
Unrecognised Heritage Asset donations received	[4]	618	-	-	618
Recognition of MMI provision	[5]	(1,020)	(1,020)	-	-
Reduction in value of a piece of investment land	[6]	(5,509)	-	-	(5,509)
Valuation changes	[7]	408	-	(10,206)	(9,798)
Total		(3,641)	842	(10,206)	(14,689)

[1] This grant was specifically a revenue grant that the Council had recognised as a capital grant. The value of the grant was £2,162k. No figures are shown in the table above as the correcting adjustments off-set the initial error to yield a nil effect on closing reserves in line with proper practice.

[2] The Council sold a piece of development land from within Investment Property where the payment terms included a phased payment, with £1,060k receivable in 2013/14. This has not been recognised within the Profit/Loss on disposal, or in debtors.

[3] A government grant receivable by the Council (the Local Authority Central Spend Equivalent Grant) for 2012/13 had not been recognised as it was not paid or identified in the year. This has been credited to Taxation and Non-Specific Grant Income, and debited to debtors.

Appendix 1: Audit adjustments (continued)

[4] £618k of donated Heritage Assets had not been recognised within the financial statements. This should have been recognised as an addition to net assets and as Taxation and Non-Specific Grant Income. The Income is then reversed to unusable reserves through the Movement in Reserves Statement in line with proper practice.

[5] Following the company Administrator advising a solvent run-off of the Municipal Mutual Insurance Company was now unlikely, the Council can make a reasonable estimate of the amount it is to be re-charged to meet the company's financial liabilities. Accounting standards therefore require a provision to be recognised within expenditure. The Council held reserves with which to meet this expense, and transfers have been made in order to negate the impact on the General Fund.

[6] We challenged the valuation of a piece of housing investment land on the grounds that insufficient progress had been made towards any housing development to support the valuation recorded in the Council's draft accounts. On consultation with the Council's valuers, management agreed to reduce the valuation by £5,509k.

[7] Changes resulting from the PPA and additional in year valuations reduced the depreciation charged in 2012/13 and decreased the value of Property, Plant and Equipment on the Council's Balance Sheet.

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable audit committees to evaluate the impact of those matters on the financial statements. The table below highlights those areas of disclosure that we consider significant.

Disclosure		Source of disclosure requirement	Quantitative or qualitative consideration
Senior Officers' Remuneration and Exit Packages	[1]	Accounts and Audit Regulations	Qualitatively significant, as the disclosures relating to Senior Officers are of significant interest to the user of the accounts.
Related Party Transactions	[2]	Code of Practice on Local Authority Accounting	Qualitatively significant, as the disclosure provides the user of the accounts with information on transactions with individuals and bodies considered to be related parties.

[1] In the draft financial statements, the disclosure of Senior Officers' Remuneration and Exit Packages did not contain all the information required by the Code. On discussion with Officers, an amendment has been made to ensure the disclosure is complete, accurate and complies with the Code.

[2] Disclosure amendments were made to the Related Party Transactions note to ensure adequate disclosure of related party transactions.

Appendix 2: Additional resources available to you

Additional information on current and future technical developments

IASPlus	<p>The IAS Plus website, maintained by Deloitte, provides the most comprehensive information on the Internet about international financial reporting. It is aimed at accounting professionals, businesses, financial analysts, standard-setters and regulators, and accounting educators and students. The site, which is totally free of charge, has a broad array of resources about the International Accounting Standards Board, International Financial Reporting Standards, and international accounting and auditing in general. It includes:</p> <ul style="list-style-type: none">• Summaries of all IASB standards and interpretations;• Background on all IASB and IFRIC agenda projects plus summaries of all IASB and IFRIC meetings;• Comparisons of IFRSs and various local GAAPs;• Updates on national accounting standards development in around 80 countries and regions throughout the world; and• Free e-learning modules for each IAS and IFRS – made available at no charge in the public interest. <p>The site is available to browse at any time; alternatively you can subscribe to e-mail alerts and newsletters by going to http://www.iasplus.com/subscribe.htm.</p>
Our range of publications	<p>Our iGAAP and ukGAAP books are available to our clients electronically and in hard copy. These include our major manuals providing comprehensive, practical guidance to companies reporting under the relevant GAAP; model annual report and financial statements; and our major text on financial instruments providing in depth support to preparers and auditors in this challenging area.</p> <p>Our range also includes quarterly iGAAP newsletters providing a round up of recent developments. iGAAP and ukGAAP alerts are issued whenever a new exposure draft or standard is issued.</p>
Stay tuned online: Internet-based corporate reporting updates	<p>The Deloitte UK Technical Team run a series of internet-based financial reporting updates, aimed at helping finance teams keep up to speed with IFRS, UK GAAP and other reporting issues.</p> <p>Each update lasts no more than one hour, and sessions are held three times a year, at the end of March, July and November. Recordings of past sessions are available via www.deloitte.co.uk/audit.</p>
Audit podcasts	<p>Our leading experts provide you with a short discussion of new IFRS standards and practical insights. These can be accessed via our website, www.deloitte.co.uk/audit. Alternatively, you can subscribe to our podcasts via iTunes – just search for Deloitte IFRS.</p>

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