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**Middlesbrough Council**  
**Management Letter 2013/14**

**29 January 2015**



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# Executive summary

## Background

We conducted our 2013/14 audit in compliance with International Standards on Auditing (ISA UK & Ireland) and guidance provided by the Audit Commission. We issued an unmodified opinion on the financial statements on 30 September 2014, as well as an unmodified Value for Money conclusion by the same date. We issued a “consistent with” opinion on the Council’s Whole of Government Accounts (WGA) submission on 3 October 2014.

## This letter

This letter is written to summarise observations and insights identified during the course of our audit of your financial statements. It is written to assist management in identifying areas for improvement, opportunities to strengthen the control environment and to generate efficiencies in controls and processes to help the organisation.

This letter is designed to help the Corporate Affairs and Audit Committee and the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 to communicate with you regarding your oversight of the financial reporting process and your governance requirements. This letter summarises our observations which were developed in the context of our audit of the financial statements, which is not designed to identify all matters that may be relevant to the Council. Whilst our reports may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Authority’s system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice.

The letter follows our ISA260 report which was discussed at the Corporate Affairs and Audit Committee on 26 September 2014.

This letter has been prepared for the Corporate Affairs and Audit Committee, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

## Independence confirmation

As part of our obligations under International Standards on Auditing (UK & Ireland) and the Code of Audit Practice, we are required to confirm to you that we comply with the APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.

## Recommendations arising

We make a number of specific recommendations later in this document for management to consider implementing which we hope will be beneficial to Middlesbrough Council. Our recommendations are summarised into a number of key areas:

- Recommendations to assist with the financial reporting process;
- Recommendations around PPE and Intangible Assets;
- Recommendations around Debtors;
- Recommendations around Revenue and Government Grants; and,
- Recommendations regarding Transparency Disclosures.

# 1 Recommendations to assist with the Financial Reporting Process

## Background

We audited the accounts for the year to 31 March 2014 during the period July to September 2014. We have a number of recommendations to make in order to assist the Council to improve its financial reporting process for the March 2015 year-end onwards.

### Minimising off-ledger adjustments

Description	Impact
During the Audit we noted that the production of the financial statements requires a significant number of manual, off-ledger adjustments. The change in ledger system from SAP to AGRESSO represents an opportunity to replace these manual adjustments, which are made principally via excel spreadsheets, with journal adjustments. Minimising manual adjustments would enable a clearer review process to take place, and illustrate greater control over the transactions. This also means if more adjustments are done within the ledger, the financial statements could be closed down and produced in a shorter timescale.	This would increase control over the financial statements closing process, and enable faster closedown at year end.

### Recommendation

The council should reduce the number of off-ledger adjustments necessary in the preparation of the financial statements.

### Management comment

Agreed. Currently a number of the technical year end transactions are not processed through SAP. They are however accounted for correctly in the Council's accounts. Wherever possible all entries will now be processed directly through the SAP system in 2014/15. The transfer to AGRESSO will provide further opportunities for us to review the coding structure in order to minimise the number of off-system adjustments.

## Processing of low-value Journals

### Description

During the audit it was noted that a large number of low value journals are processed;

Our analytic tools noted 597 journals of less than £1 in total and a further 6,750 journals of less than £10 (but more than £1) were posted during the year.

### Impact

This may be an inefficient way of processing journals given the potential time cost of processing small adjustments.

### Recommendation

The Council should implement a process for which Journals of less than a certain amount should not be posted immediately, but instead be recorded, reviewed and posted with one entry each month to minimise time spent preparing and posting trivial adjustment journals. This would also assist line managers and management to understand the level of low value adjustments required each month and to identify ways of reducing them.

### Management comment

The vast majority of the low value journals referred to are system generated and don't involve any manual intervention. A manual journal posting protocol is already in place which states that no individual entries should be posted for less than £100 unless absolutely necessary. This will be rigorously enforced.

## Review of lease listing used to compile Note 38 'Minimum lease payments receivable'

### Description

During the Audit, it was discovered that the list of leases used to compile a required disclosure of future lease income receivable by the council included leases for properties that had been sold during the year.

### Impact

The value of minimum lease payments receivable per Note 38 was overstated.

### Recommendation

Management should cross-reference lease receivable working papers with the asset register to ensure that the listing of leases used to compile the value of lease payments receivable in future years does not include leases for properties that have been sold during the year.

### Management comment

Agreed. Requirement for reconciliation between the leasing lists and the leasing details included on the asset register will be incorporated into the closure of accounts timetable.

## Improvement of communications between Pension fund team and the change fund team /accounting team

Description	Impact
<p>During the audit It was noted that an expense accrual for individuals who had left in 2013/14 but did not have their Redundancy pension contribution processed until 2014/15 was made on the Middlesbrough council side however an accrued income for the amount was not processed on the Teesside Pension Fund side.</p> <p>This was as a result of inadequate communication between teams and has resulted in the accrual being made on MBC accounts and not being made on the Teesside pension accounts.</p>	<p>The Impact was understatement of accrued income within the Teesside pension fund accounts</p>
<b>Recommendation</b>  Reconciliation should be undertaken by both teams to ensure that balances are matched at year end. Increased communication should be encouraged between both teams to improve the quality of the draft accounts.	
<b>Management comment</b> Agreed. Closure of accounts timetable will include this reconciliation check.	

# 2 Recommendations regarding PPE and Intangible Assets

## Background

The Council holds material balances of Property Plant and Equipment (PPE) and these are significant to the Council's operations. We have identified a number of potential improvements which could be made to the Council's controls with respect to PPE and Intangible Assets.

### Increase the detail of information contained within the Fixed Asset Register

Description	Impact
All PPE assets included within the Council's Balance Sheet are either valued by the Depreciated Replacement Cost (DRC) for specialised properties or the Existing Use Value (EUV) for non – specialised properties. During the audit it was necessary to perform a desktop revaluation following movements in the index rates supporting DRC valuations. Updating the Asset Register to include more specific details would clearly identify where an asset may be affected by the movement in a valuation index, and permit a desktop revaluation to be undertaken more easily.	There are easier ways for the Council to identify triggers that would assist in undertaking desktop exercises for DRC valuations.

### Recommendation

The Council should add more information to the asset register to enable better identification of impairment/valuation triggers and to enable a more effective desktop exercise where necessary.

### Management comment

Finance and Valuations Sections will agree a process to ensure that any material variations in asset values at year end are incorporated into a desktop revaluation exercise prior to the completion of the draft Statement of Accounts.

## Valuation of assets with significant capital spend

### Description

When considering the need for revaluation of assets, the Council should consider which assets have been subject to significant capital improvements, particularly to specialised assets, and include these in the revaluation schedule. Management should revalue the asset at the conclusion of the works to ascertain whether the works have added value, or extended the life of the asset.

### Impact

Improved accuracy in valuations on assets.

### Recommendation

Management should document the consideration of assets to be revalued, including revaluation triggers such as significant capital expenditure.

### Management comment

Consideration is already given to the impact of capital improvements on asset valuations. There was however no impact in 2013/14 as no material capital improvements were carried out.

## Cleansing of the Intangible Asset Register

### Description

The Intangible assets balance contains a large amount of fully amortised assets held at nil Net Book Value (NBV). It is unclear whether these assets are still in use by the Authority.

### Impact

Writing off nil NBV assets no longer in use by the Council maintains an accurate intangible asset register.

### Recommendation

Management should ensure that there is regular cleansing of the asset register for Intangible asset balances no longer in use.

### Management comment

A review of intangible asset balances to confirm those still in use will be carried out as part of this year's annual asset cleansing exercise.



# 3 Recommendations regarding Debtors

## Background

Debtors represent a material balance for the Council, and are significant to the cash flow of the organisation. During the audit, we identified two areas of improvement with respect to debtors to aid the production of clear and accurate financial information, both for management information and the financial statements.

### Receipts not matched to associated debtor balance

Description	Impact
Payments received are not matched directly against the associated debtor. This has resulted in the ledger accounts being populated with items that have already been received but not cleared down on a line by line basis, although the net balance may be correct. This means there are various balances from multiple years ago remaining in the ledger despite being netted down to an appropriate carrying value.	Debtors balances on an individual basis are not easily identifiable at any given period.

### Recommendation

Management should utilise the transfer to the AGRESSO ledger to ensure that only open balances are transferred to improve the clarity of the information on the ledger.

### Management comment

It is already possible to obtain debtors balances on an individual basis from the system but the implementation of AGRESSO will give us the opportunity to further improve the clarity of debtors reports.

## Bad Debt Provision for Benefit Claimants

Description	Impact
Following changes to the Council Tax Benefit system from 1 April 2013, the Council required all working age claimants to contribute towards their Council Tax. The Council was then required to consider providing for the non-recovery of these balances. The level of the provision should be monitored through the forthcoming year. This information could then be used to calculate the required bad debt provision.	The Council would calculate a more accurate bad debt provision.

### Recommendation

The Council should calculate its 31 March 2015 bad debt provision for Council Tax from claimants in receipt of a Council Tax Reduction based on observed data on their likelihood of payment.

### Management comment

The Council was already intending to use data from 2013/14 as a basis for estimating the bad debt provision required as at 31<sup>st</sup> March 2015.

# 4 Recommendations around Revenue and Government Grants

## Background

The Council receives a significant proportion of its revenue from government grants, many of which have conditions attached to them. The Code of Practice of Local Authority Accounting requires such grants with conditions attached be deferred until those conditions are met. This was a significant area of audit focus in the 2013/14 audit and we propose a key recommendation to assist the Council in improving its processes in this area.

## Grant Recognition

### Description

### Impact

The level of oversight of the decision to recognise grant income could be improved to ensure there was adequate and effective review of the terms and conditions of the grant to support the recognition decision.

Accurate grant income recognition.

When a grant is not recognised in income, the Code requires it to be deferred and carried as Income in Advance until the conditions are either met or the funding is repaid to the grant awarding body.

## Recommendation

All carried forward grants should be evaluated critically against the grant conditions provided by the awarding body before being recognised as revenue or deferred to future years. This analysis and review should be clearly documented on a grant by grant basis.

## Management comment

Additional review to be carried out by the Deputy Chief Finance Officer and the Accounting Services Manager to ensure that all grant carry forwards have been accounted for properly.

In addition to this, in house training will be provided for Accountancy staff to improve understanding of the required treatment of carried forward grants.

It should be borne in mind that although some grant income was misclassified, there was no change to the level of resources available to the Council.

# 5 Recommendations regarding Related Party Disclosures

## Background

The Code requires the Council to make a number of disclosures in respect of Related Parties. Related Party relationships occur when individuals who have the potential to exercise control or influence at the Council (such as Members or Senior Officers) hold positions or interests with other bodies. Where the Council engages in transactions with these entities, these are required to be disclosed in the financial statements.

### Officers' register of interests

Description	Impact
The data used to prepare the related parties disclosure in respect of the interests of senior officers are prepared annually by disclosure made by the relevant officer specifically for the financial reporting process. An improvement would be maintaining this information in a register of interests, which is annually updated.	Related parties could be missed from disclosure in the Related Parties note.

### Recommendation

A register of senior officers' interests should be maintained. This should be updated as and when interests arise or become no longer applicable. The register should then be cross checked to the annual returns when completing the related parties note in the accounts to ensure all related parties are disclosed.

### Management comment

A register of Senior Officers' interests has been set up and will be cross checked to the annual returns.

## Interests of individuals who have left their post within the year

Description	Impact
<p>The current process for receiving and reviewing returns from Members and Officers is only effective where the individual is in post at the end of the year. Related party Transactions are still required to be disclosed even if the individual no longer holds the position at the year end.</p> <p>The Council should ensure its processes can capture the interests of individuals who have left the Council before the year end.</p>	<p>Related parties could be missed from disclosure in the Related Parties note.</p> <p>This may have a more significant impact at the March 2015 year end, given the Local elections to take place in May 2015.</p>

### Recommendation

Senior Officers and Members who leave the Council before the financial year end should be requested to complete a declaration of interest form as part of their leaving check list and pack.

### Management comment

Agreed. Human Resources will arrange for a form to be included with the leavers check list.

## Related Parties – Completeness of disclosure forms

Description	Impact
<p>A number of Councillors did not complete and return disclosure forms to assist with the 2013/14 annual accounts production process. This presents a risk that the data in the Register of Councillor's interests is incomplete.</p>	<p>To Minimise risk of incomplete disclosures</p>

### Recommendation

The Council should ensure it has adequate processes to request members to complete related party disclosure forms and ensure returns are received from all members.

### Management comment

The Council has contacted the six Members who have yet to submit a related party disclosure form for 2013/14. Regular reminders will be sent during the closure of accounts period to Members who have not submitted returns by the specified deadline.

## Related Parties - Procurement team's knowledge

Description	Impact
<p>The Council will inevitably enter into transactions with related parties owing to the nature of its operations. For example, Councillors represent Middlesbrough on Cleveland Fire Authority. Currently, the process for identifying related party transactions is reactive, and occurs after the year end. Were the Purchasing or procurement team to be aware of these (e.g. with flags on the supplier screen), this would enable the Council to demonstrate transactions occurred at arm's length and make more substantial disclosures in this regard.</p>	<p>Strengthens controls around payments and enables a proactive approach to identifying related party transactions.</p>
<b>Recommendation</b>  To add markers for all related parties to suppliers in the payments system to require additional approval for expenditure incurred with the counterparty.	
<b>Management comment</b>  The Council's Commissioning & Procurement Section will ensure that any Officers or Members involved in a tendering process will be required to complete a register of pecuniary interests prior to the commencement of the process.	

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