ISA260 – Report on the External Audit to the Corporate Affairs and Audit Committee for year ended 31 March 2015

20 October 2015

Contents

I am pleased to present our ISA260 report on the findings of our 2014/15 audit of the Council's financial statements. We include a number of insights and recommendations to assist the Council in making arrangements to secure Value for Money and improve its financial reporting in the future.

Chris Powell, Audit Partner

The big picture

The big picture

We have set out below an overview of the audit procedures performed and our significant conclusions on various matters considered as part of our audit.

- This report represents an update to the ISA260 report presented to the Corporate Affairs and Audit Committee on 24 September 2015. Following the issue of that report, we have completed our audit procedures. We worked with management to make a number of adjustments to the accounts, and, following completion of our procedures, we issued an unmodified opinion on the accounts by the 30 September deadline.
- We issued a qualified opinion on the Council's arrangements for securing Value for Money in its use of resources. More details of the qualification are included from page 16 of this report, including the text of the qualification on page 19.
- We completed our work on the Council's submission as part of the Whole of Government Accounts (WGA) process, providing a consistency opinion to the National Audit Office (NAO) by the deadline of 2 October 2015.
- We set materiality at a level of £4.4m (2014: £4.0m) and report all uncorrected errors over a threshold of £0.22m (2014: £0.20m) within Appendix 3.
- We identified one deficiency with respect to a significant internal control, which we discussed with management. This relates to a lack of separation of duties in making journal adjustments to the accounting records. Whilst we identified this deficiency, we did not identify any errors related to the sample of journals tested. We discussed this with management, and made a recommendation for senior staff to perform sample checks in this area, and further recommendations in other areas of the financial reporting process in Appendix 4.
- We received an objection to the 2013/14 accounts under the Audit Commission Act, 1998, which we considered and concluded we did not believe it to be in the taxpayers' interest to take further action. Further details are included on page 31.
- As a result of the objection to the accounts, we were unable to issue the completion certificate on the 2013/14 or 2014/15 accounts at the same time as signing our opinion on the accounts. As we are not aware of any appeal to our decision in relation to the objection, and in line with guidance from the National Audit Office, the completion certificates on both audits were issued on 19 October 2015.

Value for Money (VfM) conclusion

We performed a risk assessment regarding the Value for Money arrangements in place at the Council in line with the guidance issued by the Audit Commission and identified two significant risks:

- financial planning, change programme and efficiency plans; and
- property disposals.

During the course of our work, an additional risk was identified in relation to project management as Internal Audit issued a "Cause for Concern" opinion in this area. Linked to this, we have also raised concern over the adequacy of capital programme reporting and monitoring.

We have completed our work and issued an "except for" qualification to our VFM conclusion, meaning that we are satisfied with arrangements in place during 2014/15 except for those in three inter-related areas:

- project management arrangements;
- capital programme monitoring reports; and
- governance arrangements for the disposal of properties.

Good progress has been achieved in a number of other areas we have considered including the development and implementation of the Change Programme, Middlesbrough Manager and the level of reserves held by the Council.

The big picture – significant risks and VfM

Key areas of audit focus for 2014/15

Significant audit risks

- **Recognition of grant income**

  Our testing identified a number of errors in the application of the principles of grant recognition. We discussed our findings with management, who made adjustments to the accounts, reducing the amount of revenue grant income recognised by £325k (to £292.404m), and the amount of capital grants and contributions recognised by £3.487m (to £14.902m). Whilst these reduce the amount of income recognised, this reflects the timing of recognition, and the resources remain available to the Council. We have made a recommendation to improve the processes and controls around the recognition of grant income.

- **Valuation of Property, Plant and Equipment and Investment Properties**

  This was raised as a significant risk owing to a history of error in the valuation of property in prior years. The overall methodology used by the Council to value its assets is appropriate, and non-material adjustments have been made to the draft accounts in respect of one clarified valuation report. We also identified one unadjusted misstatements in respect of valuation matters, which we do not consider to be material, either individually or collectively. This is shown in Appendix 3. We recognise that this is an improvement over the material adjustments required in the prior year.

- **Adequacy of Related Party Disclosures**

  This was raised as a significant risk owing to disclosure errors in previous years. We reviewed the returns made by Members and Senior Officers and consulted external data sources to confirm the completeness of their disclosures. We reviewed the information presented in the draft financial statements for completeness and accuracy, and management made minor amendments to the amounts and relationships disclosed in the final accounts.

- **Management override of key controls, as presumed by auditing standards**

  We tested a risk based sample of journals posted to adjust the financial records. We also considered a range of specific judgements and estimates made by the Council in preparing the financial statements. There were no significant issues to report from our testing.

Significant adjustments made during the audit of the financial statements

We have not identified any material adjustments to the financial statements. The most significant adjustments noted are:

- Adjustment in the presentation of £2.452m of NDR (non domestic rates) bad debt written off in the collection fund, increasing NDR income and the debt written off as unrecoverable;
- A valuation change of £1.044m reflecting the assumed timing of receipts for an individual asset;
- Adjustments between debtors and creditors totalling £3.310m reflecting the allocation of cash received before the year end against debtors rather than as income in advance; and,
- Adjustments to the amount of grant income recognised, of £325k to revenue grant income and £3.487m to capital grant and contributions income. It is noted that these adjustments reflect the amount of income which is appropriate to recognise, but not the level of resources available to the Authority.

General Fund net expenditure (£m)

£136.804m audited 31/3/14

£126.746m draft 31/3/15

£124.794m revised 31/3/15

General Fund reserve (£m)

£9.633m audited 31/3/14

£13.489m draft 31/3/15

£15.439m revised 31/3/15

Long Term Asset Value (£m)

£479.435m audited 31/3/14

£525.540m draft 31/3/15

£527.440m revised 31/3/15

Our Audit Quality Promise

Our audit quality promise

Our new quality standard

The quality of our audit delivery is of great importance to us. In order to ensure we deliver an excellent service to you, we have developed our audit quality promise. Key aspects of this delivery are:

- how we communicate with you throughout the year;
- what insight we bring around the quality of your control environment, systems and audit risk areas; and
- how we ensure that our team is delivering the best quality audit at every level.

This section sets out our commitments to management, officers and members in these areas and we seek feedback on how we have performed against them.

From discussions with you and our experience with other Councils, we know that you value an integrated audit approach which encompasses the main financial statements audit, value for money conclusion and certification of relevant grants and returns. Our Audit Quality promise takes this into account.

We have maintained a consistent audit team in as many instances as possible. Chris Powell has taken over as Engagement Partner from David Wilkinson. Chris is an experienced Engagement Partner who has many years experience working with Local Government. Celia Craig has taken over as Audit Director from Nicky Cooke. Celia also has many years experience working with Local Government, both as Audit Director and Engagement Lead, and worked with the Council for several years up to 2011. We have maintained key individuals in the Manager and Field Manager positions in Alistair Ross and Harriet Ebere respectively, who both have multiple years of experience working directly with the Council.

We have supplemented them as necessary with skilled, experienced and knowledgeable individuals to ensure timely and effective delivery of our audit.

Our commitment to you

Year round communication

We maintained regular contact with Martin Padfield and other members of the Finance Team to ensure we remained up to date with the developing issues at the Council through the year, and we provided, in advance, any papers we presented to a meeting of the Corporate Affairs and Audit Committee.

Senior Members of the team have attended all meetings of the Corporate Affairs and Audit Committee during the year and following the year end.

We made ourselves available through the year for ongoing discussions as necessary. During February we facilitated a development session for various members of the Finance team, to assist with the year end closedown process, which was well received.

During the main audit period

During the audit period we worked closely with Martin Padfield and other key members of the Finance team. Where required, we also worked with other members of staff who have assisted with our audit work.

We worked with Tony Parkinson, Paul Slocombe and Ian Wright as our key points of contact for the Value for Money conclusion, along with other key members of staff.

During the final audit visit we held regular meetings with Martin and his team to discuss progress on the audit. We held a close meeting with management following completion of the outstanding items, prior to presenting this report to the Corporate Affairs and Audit Committee.

Open feedback process

In February at our development session with Finance staff we shared our findings from the previous audit, for ways the Council could improve their interactions with ourselves, and the ways we could improve for 2014/15.

We will be happy to meet with Paul Slocombe and Martin Padfield to discuss how we have delivered against the commitments on both sides, as set out in this document, and any other aspects of our delivery.

Responding to queries and requests

We have responded to queries promptly during the year and have provided solutions for resolution.

We made ourselves available to discuss issues as they arise and maintained regular contact regarding the closedown and accounts production processes to align our audit timetable.

Scope of work and approach

This section sets out our scope for the audit of the Council's financial statements, as well as in relation to our other responsibilities as your external auditors.

Scope of work and approach

We have five key areas of responsibility under the Audit Commission's Code of Audit Practice

Financial statements

We have conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISA (UK and Ireland)") as adopted by the UK Auditing Practices Board ("APB") and the Audit Commission's Code of Audit Practice. The Council has prepared its accounts under the Code of Local Authority Accounting. There are no significant changes in respect of the scope of our work in relation to this area of responsibility.

Assurance report on the Whole of Government Accounts return

Whole of Government Accounts (WGA) are commercial-style accounts covering the whole of the public sector and include some 1,700 separate bodies. We performed similar procedures on the Council's consolidation pack as in prior years, confirming the pack is consistent with the accounts and that intra-government balances have been accurately identified.

Value for Money conclusion

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Our conclusion is given in respect of two criteria:

- Whether the organisation has proper arrangements in place for securing financial resilience; and,
- Whether the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

In discharging this responsibility, we take into account our work on the Annual Governance Statement and the work of regulators.

Annual Governance Statement

We are required to consider the completeness of the disclosures in the Annual Governance Statement (AGS) in meeting the relevant requirements and identify any inconsistencies between the disclosures and the information that we are aware of from our work on the financial statements and Value for Money conclusion.

Further comments on your AGS are included on page 30 of this report.

Grants

Under Section 28 of the Audit Commission Act 1998, the Commission was responsible for making arrangements for certifying claims and returns in respect of grants or subsidies made or paid by any Minister of the Crown or a Public Authority to a Local Authority.

The appointed auditor carries out work on individual claims and returns as an agent of the Commission under certification arrangements made by the Commission which comprise certification instructions which the auditor must follow.

We produced an annual report summarising our work in respect of grants which is discussed at the Corporate Affairs and Audit Committee meeting on 25 June 2015.

Only one grant is required to be certified under the Audit Commission/Public Sector Audit Appointments (PSAA) arrangements. This is the Council's claim from the Department of Work and Pensions for Housing Benefit Subsidy. This grant is required to be certified by the end of November 2015. We will present a separate report to the Corporate Affairs and Audit Committee following the completion of our procedures on this grant.

Significant audit risks

This section sets out our comments regarding the significant audit risks identified. We explain the nature of the risk itself, how these risks were addressed by our audit work and any related presentational and/or disclosure matters within the financial statements.

Risk assessment is at the heart of our integrated audit approach as it is only with proper identification of the most significant audit risks, that we are able to provide the highest quality assurance in the most efficient and effective manner.

We performed an assessment of risk which included considering the size, composition and qualitative factors relating to account balances, classes of transactions and disclosures. This enabled us to determine the scope of further audit procedures to address the risk of material misstatement. Having considered the qualitative significance, value and predictability of the inventory and intangible assets, we concluded the risk of material misstatement was remote and have therefore performed limited procedures on these balances.

For the Council's 2014/15 financial statements, we set materiality at **£4.4 million** based on gross expenditure for the year. We report to the Corporate Affairs and Audit Committee on all unadjusted misstatements greater than **£220k** and other adjustments that are qualitatively material.

1. Revenue recognition

We identified a significant risk in relation to the early recognition of grant income where conditions exist within the grant terms.

We identified the early recognition of grant income as a significant risk on the grounds that:

- The Code of Practice on Local Authority Accounting states that grant income cannot be recognised until all conditions associated with it have been met;
- Many financially significant grants contain detailed conditions restricting their recognition which management needs to assess;
- Management makes key judgements as to whether the grant conditions have been met, and these judgements could be prone to bias; and,
- Recognising income in an incorrect period would be a method by which management may seek to improve the financial performance of the Council in order to present a more favourable year end position.

This is a risk which is widely expected at many Local Authorities, given the size, impact and judgemental nature of recognition decisions.

Procedures performed and findings

Our testing of grant income identified a number of adjustments, which management agreed to make. These related to inappropriate recognition of grant income, where the terms and conditions of the grant had yet to be met.

We discussed these identified errors with management, who agreed to amend the financial statements, reducing the amount of revenue grant income recognised by £325k, and capital grant and contributions income be £3.487m. Of this reduction to capital grant income, £1.352m was instead reclassified as a loan, based on the underlying contract.

These adjustments did not affect the availability of resources to the Council, only the timing of their recognition or their classification within the financial statements.

Observations

- We considered the design of the controls in place to ensure the appropriate recognition of grant income. The design of the control (being a separate review of judgements made to recognise or defer income) is appropriate. However, given that there are areas where amendments have been required, it is evident that this control has not functioned on all grants during the year.
- Our testing of revenue grants noted an improvement in the controls during the year, with fewer adjustments being required compared with the previous years' audit. Further work is required however on capital grants, to ensure the Council's controls correctly identify the conditions within capital grants and contribution contracts, and whether the terms have been met.

2. Valuation of PPE and Investment Property

We identified a significant risk in relation to the valuation of PPE and Investment Property assets owing to the prevailing conditions in the property market at this time.

We identified a significant risk having considered the nature of the Property, Plant and Equipment (PPE) and Investment Property balances. This was because:

- The Council held significant amounts of Land and Buildings (£255m net book value as at 31/3/15) and Investment Property (£72m carrying value at 31/3/15);
- We have required significant adjustments to the carrying value of both PPE and Investment Properties in previous audits. Valuations involve an element of professional judgement, both in terms of ascertaining the appropriate valuation, but also in terms of identifying the assets which may have been subject to changes in valuation over the previous 12 months; and,
- Effective valuations require the use of expert knowledge to maintain materially accurate valuations, and the assessment of market values are inherently judgemental.

Procedures performed and findings

We considered the Council's controls in relation to identifying the need for revaluations. These included the procurement of specific valuer's reports on individual assets, as well as an overarching report considering the changes in value of the wider, un-revalued estate. We also reviewed a sample of valuations performed in year by the Council's valuer.

We have used our specialist valuers, Deloitte Real Estate, and challenged the assumptions and methodologies used by the Council's external valuer for a sample of valuations. We have also confirmed these valuations to relevant supporting documentation on which the valuer has relied.

We have identified one, isolated error, in respect of an input adopted in a desktop revaluation of a specialist asset. The value of this adjustment is £856k. This is a significant improvement over the prior year, where we identified an adjustment of £14m to the valuation of specialised properties.

Observations

- As part of an arrangement with the Homes and Communities Agency (HCA), immediately prior to the year end the Council took control of a number of assets in the Middlehaven Dock area of the town. Two small assets were transferred to the Council, which require revaluation at the year end, instead of the nominal amount they were purchased for. We are satisfied that these assets would yield only a trivial increase to the value of assets, however, the Council should ensure it has effective lines of communication so that these assets can be identified, added to the asset register and revalued appropriately.
- We are aware of an expected change to the Code of Practice on Local Authority Accounting that will require the Council to change the basis of valuing Infrastructure Assets from Depreciated Historic Cost to Depreciated Replacement Cost (DRC). This is expected to be required from the 31 March 2017, with comparative data for the previous year. The Council should therefore ensure it is able to collect the appropriate data to meet this requirement.

3. Adequacy of disclosures of related party transactions

The Council is required to disclose transactions with various related parties.

We identified the adequacy of disclosures of related party transactions as a significant risk.

As a result of our audit in previous years, the Council made a number of amendments to the related party disclosures note in the financial statements. These amendments were necessary to ensure the accounts achieved fair presentation and complied with the Code of Practice on Local Authority Accounting.

We have raised recommendations in previous years to improve the level of information held by the Council regarding both Members and Senior Officers related parties, and the processes in place to ensure it is up to date. In 2013/14 we also raised a recommendation around documenting the review of key judgements made in preparing the financial statements disclosure.

Procedures performed and findings

We reviewed the disclosures contained within the draft accounts and tracked information through from the disclosures made by Councillors and Senior Officers. We also performed checks to independent sources of information including Companies House, to ensure the completeness of the disclosures made.

We cross-checked a sample of annual returns made by members to the Register of Members Interests and the accounts to ensure all relationships have been identified.

Overall our testing in this area was satisfactory, but we proposed minor amendments to the narrative and quantitative disclosures within the note to comply with the Code, which management accepted.

Observations

- In the previous year, we recommended that it would be good practice for procurement staff to have access to related party information to enable additional controls to be put in place to identify transactions in advance of them occurring, rather than merely as part of preparation for audit. We repeat this recommendation here.
- We also recommended the Council introduce a Register of Interests for Senior Officers. Whilst there are relatively few interests for Senior Officers, a register, again shared with the procurement team, would represent an improvement on the design of the system.
- We noted that a number of annual declarations were not returned by elected members at the point the Council was preparing its financial statements. Review of these declarations represents the Council’s control to mitigate the risk of material misstatement, which cannot function effectively if not all members return declarations that can be considered as part of the accounts production process. We recommend that the Council continues to work with members to ensure the relevant information is available by May each year for a financial reporting purpose. This could be aligned to an annual update of the Register of members Interests, aligned to the Council’s election cycle.

4. Management override of controls

In accordance with International Standards on Auditing (ISA 240), we presume that there is a risk of fraud as a result of management override of controls.

We have adopted ISA240s presumed risk of management override of controls as a significant risk.

This risk recognises that management is in a unique position to manipulate the financial position of the authority and could do this via various means, including the processing of incorrect journals or the making of incorrect or biased estimates.

Journals are the principal means of making adjustments to the accounting records. These may exist formally within the accounting system or as an off-ledger adjustment made as part of the financial statements closing processes.

Journal testing

We have examined the Council's controls around the processing of journals.

We used our leading-edge Spotlight technology to interrogate the ledger for journals which have been processed, both during the financial year and as part of the closedown of the accounts.

We considered a number of risk factors relating to individual journals and profiled the population according to these risk characteristics. We then performed detailed testing on journals which have some characteristics which may be indicative of fraudulent financial reporting. With regard to the journals selected for testing, we did not identify any journals where the adjustments posted were inappropriate.

Observations

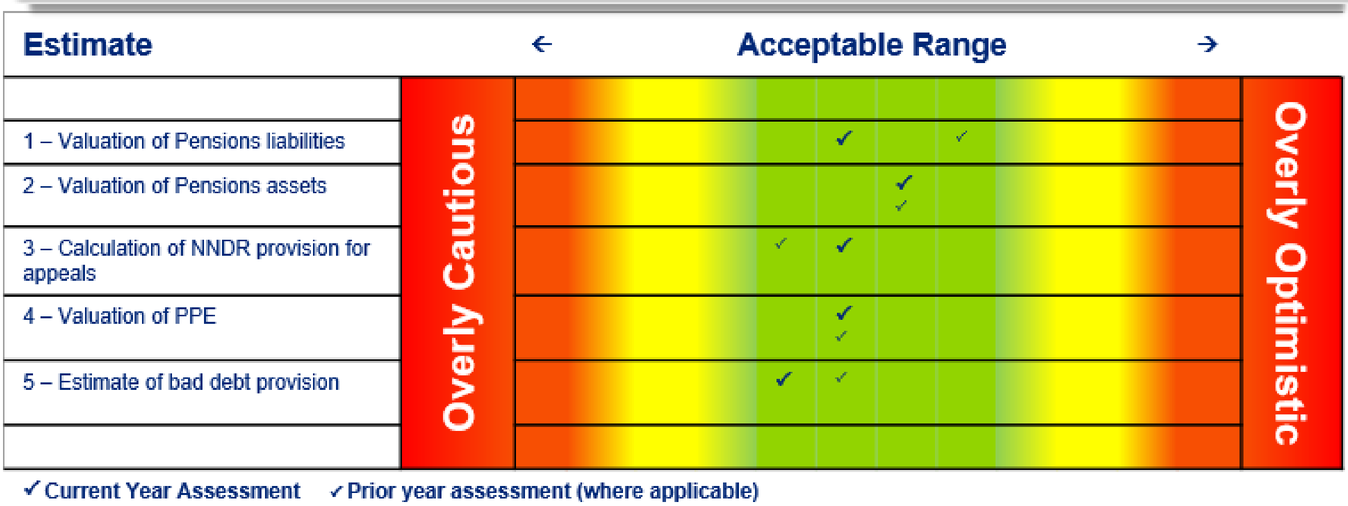
- During our testing we identified two issues with the controls around the processing of journals. Our walkthrough test of the implementation of a separation of duties control failed, as the year end journal selected at random had not been reviewed by a second officer. We recommend that the Council implement their separation of duties control, supplemented by spot checks by more senior staff to ensure the control is operating effectively. Secondly, we identified one officer who had access the post journals when they did not require it. As part of good ledger management we recommend the Council annually review the access rights of all individuals with access to the financial system.
- On the next page we present our analysis of significant judgements the Council has made in the application of its accounting policies. Taken together, we consider these to be reasonable.
- In the previous year we noted there were a significant number of manual adjustments required between the final ledger balances and the draft financial statements. We recommended that, as part of the introduction of the new financial ledger system, changes are made to reduce the need for such off-ledger adjustments and streamline the financial reporting process. In 2014/15 there were a similar number of manual off-ledger adjustments required, and we repeat our recommendation.

4. Management override of controls (continued)

The risk of management override of controls requires us to consider the appropriateness of estimates made by management.

Management are required to make significant estimates as part of the production of the accounts. There are various methods we can use to validate the estimates used.

The below table documents a number of the significant estimates and identifies where we consider them on a range between overly cautious and overly optimistic. The green area in the centre of the chart indicates the acceptable range for an individual estimate.



Specific estimates

1 – We sought advice from our consulting actuaries, DTRB, as to the appropriateness of the assumptions used in calculating the pensions liability. We concluded that the assumptions adopted are slightly cautious, principally in respect of the discount applied to RPI inflation to approximate CPI inflation, but within the acceptable range.

2 – We consulted the Teesside Pension Fund audit team to obtain assurance over the value of assets in the Fund, and Middlesbrough Council's share. We considered that the estimates used by the actuary as to the year end asset value are slightly higher than the outturn figures.

3 – A provision is required for the expected value of business rates payable by the Collection Fund in respect of successful appeals against the assessed rateable value. We have considered the Council's estimate to be reasonable, based on the guidance available.

4 – As discussed in the valuation of PPE risk, we have identified two errors in the calculation of carrying amounts of PPE. Excluding these items, which we do not consider to be material, we consider the estimates made to be reasonable.

5 – A bad debt provision represents an estimate of the level of receivables which will not be recovered from debtors. We are satisfied with the majority of estimates, although we consider the provision applied to Council Tax debtors from benefit recipients to be overly cautious. We have noted this as a judgemental misstatement, of value £266k. This has been calculated by comparing the level of provision with receipts made from this category during the year.

Value for money conclusion

Value for money conclusion

Our work focussed on the extent to which the Council has proper arrangements in place to secure value for money.

Scope

Under the Code of Audit Practice 2010 we are required to include in our audit report a conclusion on whether the Council has put in place proper arrangements to secure financial resilience and economy, efficiency and effectiveness in its use of resources - this conclusion is known as the "VFM conclusion".

Specified criteria for auditors' VFM conclusion	Focus of the criteria for 2015
The organisation has proper arrangements in place for securing financial resilience.	The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.	The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Approach to our work

We draw sources of assurance relating to our VFM responsibilities from:

- the audited body's system of internal control as reported on in its Annual Governance Statement;
- the results of the work of the Commission, other inspectorates and review agencies to the extent that the results come to our attention and have an impact on our responsibilities;
- any work mandated by the Commission – of which there was none in 2015; and
- any other locally determined risk-based VFM work that auditors consider necessary to discharge their responsibilities.

Value for money conclusion (continued)

Preliminary assessment

Our preliminary assessment identified two significant risks in relation to our VFM conclusion:

- financial planning, change programme and efficiency plans; and
- property disposals.

These risks are discussed in more detail on the following pages. This preliminary view was based on the undertaking of a risk assessment, which involved consideration of common risk factors for local authorities identified by the Audit Commission, concluding on whether they represent actual risks for the purpose of our VFM conclusion on Middlesbrough Council.

We undertook this preliminary work through review of relevant documentation, including Executive and committee papers, and discussion with officers as necessary.

During the course of our work, an additional risk was identified in relation to project management as Internal Audit issued a “Cause for Concern” opinion in this area. Linked to this, we have also raised concern over the adequacy of capital programme reporting and monitoring.

Overall conclusion

We completed our work and issued an “except for” qualification to our VFM conclusion, meaning that we are satisfied with arrangements in place during 2014/15 except for those in three inter-related areas:

- project management arrangements;
- capital programme monitoring reports; and
- governance arrangements for the disposal of properties.

The wording of our VFM conclusion is set out below and the details of our findings are set out in the remainder of this section of the report.

In summary, although we have identified some suggestions for improvement, we have noted good progress in the development and implementation of the Change Programme, and in the Middlesbrough Manager initiative which is crucial to the Programme. The Change Programme and MTFP are broadly aligned in terms of spending profile and plans are in place to deliver savings required in 2015/16. The level of reserves has also continued to improve and we are satisfied that the Council has sufficient financial reserves to cope with the risk of non-achievement of savings in the short term, whilst work is ongoing to develop the plans for the subsequent years.

Management are also working to address the concerns that are the subject of the VFM conclusion qualification as detailed in this report.

Value for money conclusion (continued)

We issued a qualified VFM conclusion.

Our testing raised concerns over a number of inter-related issues in respect of project management, the disposal of property and the monitoring and reporting of the capital programme. On the basis of these findings we issued an "except for" qualification. The VFM conclusion is set out below.

Basis of qualification

In considering the arrangements for securing economy, efficiency and effectiveness in the Authority's use of resources, we have considered:

- project management arrangements: an Internal Audit review concluded that the existing governance arrangements do not support the Council's vision and objectives; there is currently no effective overall programme management of the Council's portfolio of capital projects; and the Council has not established a project management framework together with associated procedures to be used by all officers engaged in project management assignments. The absence of the framework has had an adverse impact on the delivery of some key projects;
- capital programme monitoring reports: the reports to the Executive present the changes in planned spend, with extensive levels of spend being reprofiled into subsequent years, but no information is provided on the capital programme itself in terms of performance against budget or progress in the delivery of key strategic projects or the overall programme; and
- governance arrangements for the disposal of properties: although we have no evidence of value for money not being achieved in the sales price obtained for the disposal of properties, the lack of clear documentation in some cases, particularly in relation to decision-making, make it difficult to assess. The weaknesses in project management arrangements have also impacted this area.

The Council had previously identified the need for improvement in these areas and initiated action to address these issues. However the issues identified provide evidence that in 2014/15 the corporate governance arrangements did not operate in these instances to challenge how the Council secures economy, efficiency and effectiveness in its use of resources.

Qualified conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2014, with the exception of the matter reported in the basis for qualified conclusion paragraph above, we are satisfied that, in all significant respects, Middlesbrough Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2015.

VFM Risk – Financial resilience

The Council faces a significant challenge to reform to ensure it continues to operate effectively with reduced resources.

The Council faces a challenging set of circumstances resulting from reductions in revenue made available from Central Government and additional budget pressures including growing demand for services, leaving the Council in a difficult financial position. Despite significant savings being made in previous years, further reductions in budgets are required in future years to ensure the Council can continue to provide its core services.

The Council's budget for 2015/16, as set in February 2015, recognised a £13.4m reduction in central government support, and proposed reductions of £14.1m across the Council's nine strategic themes, with further budget reductions of £16.4m planned in both 2016/17 and 2017/18. The 2015/16 budget included provision to utilise £2.2m of reserves in 2015/16, with further plans to use £2.4m of reserves across the Medium Term Financial Plan (MTFP).

In the previous year we considered the level of the Council's reserves for adequacy, and noted no issues with the closing level of reserves. The General Fund reserves are currently above the Chief Finance Officer's recommended minimum level, but plans exist to partially utilise these.

Procedures performed

We reviewed the MTFP although we did not receive the detailed working papers supporting the MTFP that we requested to complete our review.

We selected a sample of budget reduction measures to assess the reasonableness of the quantification of the savings to be achieved, the risk assessment and the processes for identifying and addressing any costs of implementation. We did not, however, receive supporting information to complete our review of all savings in our sample.

To gain assurance over the Council's financial resilience, we considered the financial planning process, performance against budget and level of reserves.

We maintained a watching brief over the delivery of the savings and progress in the development of the savings plans to address the remaining balance.

We also maintained a watching brief over progress in the Change Programme and in developing future financial plans.

In carrying out this work, we have followed up our prior year audit findings to assess progress in implementing improvements and recommendations.

Findings and observations

MTFP, Change Programme and savings

At present the MTFP provides a high level summary of the resources, expenditure and funding gap of the Council. As we reported in our 2013/14, there would be significant benefit in more of the detailed information that underpins the plan being reflected within the document itself to provide transparency and facilitate greater understanding of the financial position for the wider corporate team.

VFM Risk – Financial resilience (continued)

Findings and observations (continued)

We were unable to complete our work on all savings selected for testing as supporting information was not provided by management in relation to the demand mitigation savings. No issues were identified in our testing of the remainder of our sample.

The level of reserves has continued to improve, with increases in the General Fund of £5.8m and earmarked reserves (excluding schools) of £10.9m being reported in 2014/15. We are satisfied that in the short term the Council has sufficient financial resources to cope with the risk of non-achievement of savings plans. However, in the medium and long term, real transformational change will be required to provide services at a lower cost base.

Good progress has been made with the development and implementation of the key elements of the Change Programme. The Council has now moved from an annual to a continuous, longer term, integrated and rigorous development process supported by an ongoing programme of transformation projects.

At a high level the Change Programme and MTFP are broadly aligned in terms of spending profile, with budget savings, after use of reserves, of £48m over the three years to 2018. Plans are in place to deliver the 2015/16 savings of £14m and whilst a high level plan is in place for the subsequent two years, significant work is required to develop detailed proposals and actions to deliver this.

Key risk areas within the savings plans are unit cost reductions, demand mitigation and automation and ICT, which together account for 59% of total planned savings over the next three years. Proportionately the larger element of these are in the later years but given the level of work required to finalise and implement plans, these are red-rated within the Council's monitoring process. Issues that need to be addressed in taking these forward include:

- The collation and use of baseline activity data underpinning the demand elements needs to be strengthened so that it can be more accurately measured and understood.
- The potential impact of current issues in relation to the HR/Payroll system (see Project management arrangements section below) on the delivery of savings from automation and ICT, key to the Council's self-serve agenda which underpins a number of other initiatives, should be assessed and monitored.

The Middlesbrough Manager

The Middlesbrough Manager initiative appears to have made good progress with tangible evidence over the implementation of key aspects of the programme. We identified previously that the cultural and operational changes present a risk in relation to the current capability and experience of many staff who are from non-technical / non-financial backgrounds and are not familiar with, nor practiced in critically reviewing, analysing and reporting finance information. Whilst a training and development programme is being rolled out, the emphasis to date seems to be focused on softer people skills. The success of the Middlesbrough Manager programme will only be determined once managers fully take on the self-service aspect of the role.

VFM Risk – Financial resilience (continued)

Findings and observations (continued)

Performance management

Although still in its early stages, good progress appears to have been made in relation to the introduction of the performance management framework and the implementation of the new appraisal process.

We understand that there are current issues around benchmarking, consistency of scoring and distribution of scoring in relation to the appraisal process and that the process is being slowed by concerns about openness & sharing of scoring and overall confidentiality. Work is ongoing to understand and address issues arising.

Whilst the introduction of the balanced scorecard process is a significant step forward, continuing work is required to ensure that the scorecard is relevant and focussed on the key actions that are required to deliver the change programme, and continued development of the metrics and KPIs is needed in this area.

Financial reporting

During the year the Council has changed the format and content of its budget reporting so that it now aligns with the internal organisation of staffing and reporting against the nine outcome areas providing greater clarity and accountability.

The Councils budget monitoring reports continued to show significant variances particularly in the final quarter which we understand are due to a very prudent approach to recognising the impact of savings schemes and contingencies.

We also note that the Council can improve the clarity and timeliness of its financial reporting (including both revenue and capital), to ensure members are clear as to the organisation's key issues and financial performance at a given date, and that reports are prepared in a timely manner, to allow members to direct corrective action, where necessary.

The Council is currently in the process of agreeing "service promises" that define the standards, roles, responsibilities and timeliness of reporting which are designed to address many of the identified shortcomings.

Risk management

The Council is in the process of implementing a new risk management policy with the assistance of external advisors. By refreshing the current arrangements this is expected to provide increased oversight, however, the Council should ensure its adopted procedures allow for additional challenge and review of risk registers, including by Officers and Members, to ensure these adequately reflect the risks, mitigating actions and exposure the Council faces.

VFM Risk – Financial resilience (continued)

Findings and observations (continued)

Recommendations

Our detailed recommendations for improvement will be reported to management separately but the key themes for improvement are:

- The Council should seek to expand its MTFP to be supported by a more detailed breakdown in its income and expenditure position across the life of the plan. The supporting detailed information should clearly correlate both with the Change Programme and the Mayor's strategic vision for the town in the coming years and include a range of key balance sheet ratios and non-financial activity / demand led metrics. The Council should have more transparently available financial information to enable medium term decisions to be made with greater certainty.
- The Council needs to look at making further transformational changes to its operations in future years to ensure its Change Programme can deliver new ways of working to meet the savings targets required.
- The Council needs to ensure that Middlesbrough Managers have sufficient knowledge and technical expertise to both use automated systems efficiently and to validate and interpret the data produced in order to operate an effective budget monitoring process.
- Ongoing work to develop the balanced scorecards should include consideration of clear identification of the key issues, the use of comparative data and trends, and the alignment and sourcing of financial and non-financial data to both determine an appropriate suite of KPIs and ensure timeliness of reporting.
- Improvements can be made to the content, consistency and the timeliness of in year financial reporting against both revenue and capital budgets. These should allow the reader to clearly identify movements between periods on significant budget lines, and to be reported in a sufficiently timely manner so as to allow corrective action to be taken where members deem it necessary.
- The level of internal challenge of the risk register as well as scrutiny by members could be improved to ensure the risks recorded are an appropriate reflection of the risks faced by the organisation.

VFM Risk – Property disposals

Governance arrangements for the disposal of properties need to be strengthened.

The Council owned some of the buildings and grounds of Acklam Hall, a grade I listed building, with the remainder being owned by Middlesbrough College. Following a lengthy process, the Council and College sold the Acklam Hall site in 2014/15 to a developer in a joint transaction, achieving a sale price of £0.9m (Council share: £0.66m), a significant reduction from the initial expected price of £2m, as a result of abnormal costs and restrictions on the development.

In response to a series of allegations in the press over whether value for money was achieved in the sale, the Council has carried out an internal investigation to:

- identify the key issues and lessons that can be learned from the Acklam Hall project; and
- ascertain if there is adequate assurance in respect of Acklam Hall:

➢ in terms of appropriate decision making; and

➢ whether the sale represented value for money.

Concerns were identified in relation to the process in place for the disposal of Acklam Hall, broadly categorised between project management and governance issues, including the quality of documentation to support decision-making and the clarity of those decisions. These issues may have had implications for other transactions so the investigation was extended to consider other property disposals. Further work was also being undertaken by Internal Audit to consider potential issues identified on a sample of other property disposals.

A number of changes in procedures had already been implemented prior to this investigation, including a change in the delegated authority for making decisions on the sale of property, a revised approach to the documentation and tracking of decisions, and the allocation of responsibility for ensuring an appropriate capital monitoring framework is in place.

Procedures performed

In the early stages of the internal investigation, we reviewed the proposed scope for the work, to be carried out under the supervision of the Council's Monitoring Officer, and concluded that it was appropriate to address the audit risk.

We reviewed the results of the internal investigation and Internal Audit work. We also reviewed the supporting documentation for one property within the sample considered as part of the internal investigation, to obtain assurance that the investigation was undertaken robustly, and that the conclusions reached were appropriately supported.

We considered the adequacy of actions arising from the investigation, in light of changes previously implemented.

VFM Risk – Property disposal (continued)

Findings and observations

Internal Audit reported that they found no evidence that the values quoted in the press were ever realistically achievable, because there was no documentary evidence to support valuations at such a level, and the planning and conservation restrictions imposed due to its listed status restricted the disposal options available to the Council.

The report on the internal investigation of the disposal of Acklam Hall did, however, conclude:

- the need for improvements in project management arrangements and the lack of a complete and clear source of information and audit trail made it hard to assess whether the transaction was carried out in an effective and efficient way (as reported by Internal Audit); however
- the objectives set by the Executive in April 2007 were achieved in that it secured the use and protection of Acklam Hall, a grade 1 listed building; and
- the sale complied with the Council's governance arrangements although openness and transparency could have been improved, particularly in relation to the decision-making process.

In light of the concerns over the clarity of decision-making, Internal Audit carried out a review of other property disposals initiated during the period prior to the new arrangements. At the time of issuing our audit report, this work was nearing completion and the draft report was being discussed with management. We acknowledge, therefore, that aspects of the detailed findings may change as the internal audit is completed, but we reviewed the draft report, the work programme and associated findings and supporting working papers provided by Internal Audit, and are satisfied that the work undertaken by Internal Audit is robust, and we had sufficient evidence to support our conclusions.

Issues similar to those identified in relation to the disposal of Acklam Hall have impacted other transactions. There have been several instances of weak project management arrangements and a lack of audit trail making assessment of the processes difficult. Recommendations for improvement included in the Internal Audit report should be addressed as a matter of priority.

VFM Risk – Project management arrangements

The Council does not have a project management framework in place.

In July 2015, Internal Audit issued a report on Project Management concluding that there is "Cause for Concern". In addition, as detailed above, the initial investigation into the disposal of Acklam Hall identified a number of governance and project management issues.

The overall conclusions of Internal Audit in relation to project management arrangements were:

- the existing governance arrangements do not support the Council's vision and objectives;
- there is currently no effective overall programme management of the Council's portfolio of capital projects; and
- the Council has not established a project management framework together with associated procedures to be used by all officers engaged in project management assignments.

A range of further issues were identified during the testing of a sample of 25 projects.

Procedures performed

We reviewed the report and findings of Internal Audit, and the proposed response and action plan by management. At the time of our review, the action plan proposed by Internal Audit had been fully accepted by management although the proposed response was still being developed. Our observations on the draft proposed response are set out below and these should be taken into consideration as the action plan is being finalised.

Improvements in this area should be progressed as a matter of priority.

Findings and observations

Internal Audit's work was robust, appropriately focused on risk and the conclusions were clearly supported by the testing and findings. We have not repeated the recommendations raised by Internal Audit which have been accepted by management.

The need for an appropriate IT solution is recognised but this is expected to take c18months to implement. Interim arrangements, based on a spreadsheet for monitoring, will be established. The need for guidance and training is also recognised, as is the need for service areas to be responsible for the delivery of projects. It is less clear, however, how the need for overall programme management (rather than simple monitoring) will be addressed.

VFM Risk – Project management arrangements (continued)

Findings and observations (continued)

It is also not yet clear how a degree of flexibility will be incorporated into the arrangements, to ensure that the processes and controls are proportionate to the nature of individual projects. Full project management principles need to be in place for key strategic and higher cost projects, but this is not appropriate for the large number of smaller value projects that are undertaken. If this balance is not achieved, there will be a significant risk of the issues identified by Internal Audit not being successfully addressed.

Significant problems have been encountered with the proposed implementation of the HR/Payroll modules of Agresso, largely due to a failure to assess the capabilities of the system and potential benefits at the initial decision-making stage and poor project management arrangements during both the planning and implementation phases. The system was due to go live in line with staff transferring from Mouchel into the Council in October 2015. At the time of our review, the project was under review whilst the benefits of the system were being investigated and a decision as to whether to continue with the implementation as planned was expected to be made over the next few weeks. Additional costs will be incurred as a result of interim arrangements being required whilst the position is addressed.

We acknowledge that the Council has a significant number of large and complex projects ongoing, and that resources are reducing as austerity cuts impact. These pressures will continue, as will the level of activity in both capital and revenue projects, increasing the importance and urgency in addressing the weaknesses in the arrangements in place.

VFM Risk – Capital programme monitoring reports

Capital monitoring reports do not provide adequate information on the delivery of the capital programme.

The Internal Audit report on Project Management identified a significant underspend of £30m (48%) in the delivery of the capital programme in 2013/14. In light of the overall findings in relation to project management arrangements, this presents a risk in terms of achieving value for money in the delivery of the capital programme so we extended our planned work to consider the adequacy of the reporting.

Procedures performed

We reviewed the 2014/15 capital programme monitoring reports presented to the Executive to assess the extent to which it has been delivered and the adequacy of the reports to Members to support monitoring and decision-making in the event of problems arising.

Findings and observations

Reports were issued to the Executive in November (as at 31 August), April (as at 31 January) and July (outturn). Reports are not, therefore, sufficiently timely to facilitate any remedial actions to be taken.

The reports provide details of changes in the planned spend since the previous report and very little information is provided on the delivery of the programme itself, progress on strategic projects, any delays or risks to delivery.

The planned spend for 2014/15 (per the 2013/14 outturn report) was £82.7m. The actual spend reported in the 2014/15 outturn report was, however, only £62.1m spend. Within this, £31m was re-profiled to future years, £6m has been brought forward from 2015/16 into 2014/15 and £4.4m of new projects were added into the programme.

No details are provided on the performance against budget in terms of over/underspends. In April 2015, some commentary was included in the report on the "top 10" projects but this was at a high level and did not provide a good overview of progress on the projects, or the forecast outturn, either on cost or achievement of planned outcomes.

The development of meaningful monitoring reports on the capital programme will continue to be very difficult in the absence of a project management framework. The proposed measures to be included in the balanced scorecards include:

- performance against capital budget;
- performance against key milestones; and
- mitigation actions for significant risks.

For this to be successfully achieved, it is essential that reporting arrangements are considered as a key aspect of the project management framework as it is developed, and in the interim period whilst the framework is being established, key strategic projects within the programme should be identified and reported regularly. The programme monitoring should also include forecast delivery of key planned outcomes and benefits realisation assessments.

Other matters

Other matters

We are required to consider the Council's Annual Governance Statement against specified content criteria.

The Council is required to produce an Annual Governance Statement (AGS) for publication with the annual accounts. The AGS is required to summarise significant governance issues, and provide an open analysis of significant governance matters within the Council.

We are also required to consider whether the AGS presents an accurate view of the organisation, on the basis of our accumulated knowledge.

Procedures performed

We reviewed the draft AGS for compliance with stated guidance, and for consistency with our understanding of the Council. We discussed a number of amendments with the Council to better reflect our understanding of the Council and its operations.

We also raised a number of recommendations arising from our review of the AGS and supporting documentation.

Findings and observations

The draft AGS did not adequately disclose the senior management arrangements with regard to compliance with the CIPFA/SOLACE Statement on the Role of the Chief Finance Officer (CFO). On discussion with senior officers, the statement has been revised, to reflect the fact the CFO did not sit on the senior decision making body (CMT) during the year, although alternative arrangements were in place to deliver a similar impact. We do however note that these arrangements have been revised since the year end, with the most senior decision making body (LMT) now including the CFO, as well as other Assistant Directors.

From our review of supporting documentation, we noted that one document, the Council's Code of Corporate Governance, was in need of an update to reflect the changing requirements placed upon Councils. The Code of Corporate Governance was published in 2008 and makes reference to the Audit Commission's Comprehensive Performance Assessment, which has been discontinued for over four years. We recommend the Council should ensure its policies are up to date, by conducting a review of corporate policies at least every three years.

The AGS was also amended by the Council to include a more comprehensive action plan in response to issues arising in relation to the issues raised during our value for money work.

Other matters (continued)

Details of other matters arising as part of our audit under the Audit Commission Act.

The Audit Commission Act 1998, provides for various rights for electors of the Council area and their representatives. These include a right to inspect various documents which support the accounts, the ability to ask questions of the auditor, and the ability to formally object to an item of account.

An objection can only be valid if it is made by, or on behalf of an elector for the Council area. It is also required to refer only to the accounts being subject to audit. We are not required to consider any objections which do not meet these criteria.

2013/14 objection

We received and accepted as valid a formal objection to an item of account, namely the income arising from taxi licence fees, in the 2013/14 accounts.

Our investigations were ongoing when we signed the opinion on the 2013/14 accounts, having concluded that there was no material impact on the financial performance reported.

We have now completed our investigations and issued our Statement of Reasons summarising our conclusions on 15 September 2015.

We have concluded that the fees were not set in accordance with proper processes but are exercising our discretion to not apply to the court to have the revenue arising declared unlawful as we do not believe that to be in the interests of the taxpayer.

The objector had a right to appeal within 28 days of the issue of our statement of reasons and, in the absence of any notification of an appeal at the end of this period, we issued our completion certificate for the 2013/14 audit on 19 October 2015.

2014/15 objection

We received the same objection to the 2014/15 accounts but as our conclusions have now been issued, we did not carry out any additional work in relation to 2014/15.

Findings and recommendations

The 2013/14 taxi licence fees were set under by officer delegated decision in 2012 but the Council has been unable to provide evidence that sufficient financial information was taken into account when making that decision, and drivers licence fees were subsidised by operator and vehicle licence fees, contrary to s70 of the Local Government (Miscellaneous Provisions) Act 1976.

Our reasons for not taking further action are fully set out in our Statement of Reasons, but key amongst them are:

- it is reasonable that fees are charged to cover reasonable costs; and
- the Council has already taken steps to address the position.

We recommend that:

- the Council reviews the guidance that officer delegated decisions to set charges do not require formal recording, to ensure such decisions are sufficiently transparent; and
- when officers are making delegated decisions in areas where the process is prescribed in legislation, legal advice is provided to ensure compliance with those requirements.

Responsibility statement

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

What we report

- Our report 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. Our report includes:
    - Results of our work on key audit judgements and our observations on the quality of your Financial Statements;
    - Our views on the effectiveness of your system of internal control relevant to risks that may affect financial reporting; and,
    - Other insights we have identified from our audit.

What we don't report

- As you will be aware, our audit was not designed to identify all matters that may be relevant to the Council.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- While our reports may include suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of the Authority's system of internal control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice
- Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements.

The scope of our work

- Our observations are developed in the context of our audit of the financial statements.
- We described the scope of our work in our audit plan and the supplementary "Briefing on audit matters" which was circulated as an appendix to the Audit Plan.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP

Chartered Accountants

Leeds

20 October 2015

This report 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.

Appendices

Appendix 1: Independence and fees

We confirm we are independent of Middlesbrough Council.

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

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.
Fees	Our audit fees are set by the Audit Commission in line with national scale fees. During the year the Audit Commission announced a rebate to be payable to the Council, which has resulted in lower audit fees for the Council. Details of the non-audit services fees proposed for the period have been presented separately on the following page.
Non-audit services	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 any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

Appendix 1: Independence and fees (continued)

We have set out below our audit fees for 2014/15

The table below details our proposed audit fees and non-audit fees for the year ending 31 March 2015 for those services for which we have been engaged or proposed for as at the date of this report.

	Current year £'000	Prior year £'000
Fees payable in respect of our work under the Code of Audit Practice in respect of Middlesbrough Council's annual accounts, assurance report on the Whole of Government accounts and the value of money conclusion (note 1)	154	159
Fees payable for the certification of grant claims (note 2)	10	17
Total fees payable in respect of our role as Appointed Auditor	**164**	**176**
Non audit fees (note 3)	10	57

Note 1:

The reduction in fee for the audit from the prior year represented an extension agreed with the Council and the Audit Commission to address the Value for Money risk around the role of the s151 officer. This is not required in 2014/15.

Note 2:

The scale fee for 2014/15 is based on actual certification fees for 2011/12 adjusted to reflect the absence of NNDR3 certification and the exclusion of Council Tax Benefit from the Housing Benefit subsidy certification work. The reduction between the prior and current year is due to the end of the Tees Valley Bus Network Improvement (TVBNI) project, which no longer requires certification. The Commission accept that grants work varies year on year and the work in 2011/12 may not be representative of the work required in 2014/15 and hence an adjustment may be required once the 2014/15 work is complete.

Note 3:

Further information is provided on the next slide. Non audit fees in the prior year includes fees in relation to work reviewing the Council's estates strategy conducted by colleagues from Deloitte Real Estate, work undertaking a review of Digital City, and in respect of additional work performed to support our Governance Review. Non-audit services in the current year are described on the next page.

Appendix 1: Independence and fees (continued)

As part of our obligations under International Standards on Auditing (UK and Ireland) and the APB's Ethical Standards we are required to report to you on all relationships (including the provision of non-audit services) between us and the audited entity:

Relationship / Service provided	Fees £'000	Threats to auditor independence	Safeguards in place
Additional grants work – teachers pensions	2.5	A self-interest threat may exist that Deloitte may be influenced by the scale of non-audit service fee income.	The level of fee income is not considered significant to influence our judgement. This work is considered complimentary to our role as external auditors as Deloitte have the knowledge of Council systems to complete the work.
Real Estate Advisory	7.5	A threat exists that Deloitte will review work performed by the Firm to support the objectives of management which may be relevant for accounting entries. A separate threat exists that Deloitte will be taking management decisions.	The work in this area was performed by Deloitte Real Estate, a separate section of the Firm and reviewed by separate partners. Individuals involved in performing this work were not used as auditor's experts in valuations work to address the significant risk raised above. The nature of the work performed by Deloitte Real Estate does not impact on the valuation of the Council's estate. The work performed by Deloitte Real Estate has been performed in an advisory role, and no executive decision making powers have been devolved to Deloitte staff. Middlesbrough Council staff continue to make all decisions in this area.
Total	10		

It is our conclusion that our independence is not impaired by the level of non-audit fees receivable. We are also satisfied that appropriate safeguards are in place to ensure our independence is maintained.

Appendix 2: Fraud: responsibilities and representations

As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Characteristics

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Responsibilities

Your responsibilities

- The primary responsibility for the prevention and detection of fraud rests with Officers and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our responsibilities

- We are required to obtain representations from your Management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out above we have identified the risk of fraud in revenue recognition and management override of controls as a key audit risk for the Council.

Our responsibilities and those of the Council are explained in the Audit Commission's publication, 'The responsibilities of Auditors and of Audited Bodies – Local Government' issued March 2010.

Appendix 3: Uncorrected Misstatements

We set out below a schedule of uncorrected misstatements identified.

Main statements	(Credit)/ charge to deficit on provision of services £'000	Credit/ (charge) to other comprehensive income £'000	Increase/ (decrease) in Assets £'000	(Increase)/ decrease in liabilities £'000
Factual misstatements				
Recognition of additional capital accruals not made [1]	-	-	369	(369)
Impact on valuation of Schools capital accruals [2]	266	-	(266)	-
Impact on capital grant income relating to overoptimistic capital expenditure accruals [3]	136		(136)	
Difference between the carrying value of borrowings and valuation at amortised cost [4]	791			(791)
Sub-total	**1,193**	**-**	**(33)**	**(1,160)**
Judgemental misstatements				
Level of Provision for bad debt for Council Tax debtors in receipt of benefits at the year end [5]	(266)	-	266	-
Sub-total	**(266)**	**-**	**266**	**-**
Total	**927**	**-**	**233**	**(1,160)**

Explanations of uncorrected misstatements

[1] Our testing identified two payments for capital additions made after the year end for work done in March 2015, which had not been accrued. In addition to these, two capital accruals were under-estimated, and one capital accrual over-estimated. The net effect of these balances would increase the Property, Plant and Equipment and creditor accruals balances by £369k.

[2] As two of the adjustments relate to capital additions to schools, we have considered how these additions should be valued. The Depreciated Replacement Cost (DRC) methodology requires us to consider the service potential of the school, which is not increased by these additions. These should therefore be written off to expense at the year end.

[3] Further, where an adjustment referred to in [1] relates to an over-accrual of capital grant expense, this has a resultant impact on the level of grant income which can be recognised, as for this grant, the income is conditional on the expenditure incurred.

[4] A technical accounting adjustment is required to bring the carrying value of borrowings in line with the accounting standards, There would be no impact on the general fund for this item.

[5] The Council has made an assumption as to the likelihood of recovery of Council Tax debt from those in receipt of a reduction in their Council Tax due owing to low income. We have compared this estimate with the percentage recovered from this category in the prior year, and identified a judgemental misstatement between the proportion recovered in 2014/15 and management's estimate of the debt recoverable.

Appendix 3: audit adjustments

We set out a summary of adjusted items identified from our audit.

Summary of adjusted misstatements

Financial statements adjustments

- Reduction to the value of revenue grant income recognised by £325k, and capital grant income by £3.487m, with a resultant increase in borrowing of £1.352m as a result of reviewing the terms and conditions of grant contracts;
- Reclassification of an item of £2.45m in the Collection fund as a credit to income and a debit to bad debts written off, reflecting this was a prior year income item now deemed irrecoverable;
- Correction to increase both debtors and creditors by £383k in respect of a balancing figure between the Northgate and SAP systems for NNDR refunds processed close to the year end;
- A reclassification, identified by management, of £1.95m of expenditure against the ring-fenced public health grant where the expenditure was permitted to be charged against the grant;
- An adjustment of £1.04m to Investment property to reflect an assumed phasing of receipts in the valuation, which is a more appropriate valuation methodology, and an adjustment of £856k in respect of an error in the calculation of one PPE revaluation; and
- An adjustment of £3.31m between creditors and debtors, in respect of cash received before the year end but not allocated against a debtor. We have raised a separate recommendation (recommendation 9) in respect of this item.

Disclosure adjustments

A number of adjustments were made to the draft accounts following consultation with management. In addition to the consequential effects of amendments to the main statements, discussed on the previous page, these included:

- Amendments to the Accounting Policies note to improve the clarity of presentation and disclose the transaction involving MIMA's transfer to the University of Teesside as a critical judgement;
- Correction of the audit fees note to align with fee levels set by Public Sector Audit Appointments Limited;
- Correction to note 42 to include teachers from a small number of schools previously excluded from the analysis in error;
- Addition of a table in note 15 to specify the Council's capital commitments under contracts, in addition to the budgeted allocations;
- Clarification of Local Government Pensions Scheme costs, split between funded and unfunded movements in note 28;
- Consequential amendments as a result of making the amendments noted above; and
- Other individually insignificant adjustments to improve the presentation of the accounts.

Appendix 3: audit adjustments

We set out below a schedule of uncorrected disclosure misstatements identified

Disclosure	Deficiency
Heritage Assets (note 9)	The Code requires financial data around Heritage Assets to be disclosed at the current and previous four Balance Sheet dates. The Council's disclosure contains only the current and previous financial years' data.
Lease receivables (note 38)	In testing the future minimum lease income receivable under operating leases, we identified one item in our sample which was not supported by a signed lease. This created an extrapolated error whereby the note is overstated by £301,403. Additionally, when comparing the lease agreement value in the note to the amounts being invoiced, we identified one property where the amount being invoiced was lower than that specified in the agreement. Whilst this specific property was under-invoiced by only £500 in 2014/15, this situation had existed since the last rent review 4 years ago.

Appendix 4: Audit recommendations

We present recommendations arising from our audit below

We have discussed the below recommendations with management, who will respond separately in the form of an action plan to the Committee.

Ref	Recommendations	Priority H/M/L
1	The Council should ensure journals posted to the financial ledger have been independently reviewed as part of posting. Whilst we have noted this weakness in the operation of the control, we note that we did not identify any inappropriate adjustments as a consequence of this. This independent review should be supplemented by spot checks by a more senior officer to ensure the control is operating effectively.	H
2	The Council should review its level of provisioning for bad debts, including those from individuals in receipt of Council Tax support, to determine the appropriate level of provisioning to apply.	M
3	The Council should, on an annual basis, review the access rights of individuals to the financial system, to ensure they still require access, and the level of access is appropriate to their job role.	M
4	The Council should ensure that all members complete declarations of interest forms to support the production of the accounts. This should be done on an annual basis, and timed so that the responses can be used in the production of the accounts. This could be aligned to the Council's electoral cycle, and also include updates to the Register of Members' Interests to be received by May each year.	M
5	Our testing of grant income has identified a number of errors in the application of the recognition criteria. Whilst the number of errors has reduced from the previous year, we would recommend the level of management review was increased to ensure the appropriate recognition criteria are adopted.	M
6	In the previous year we recommended that Procurement should be provided with details of Councillor and Senior Officer interests, to enable them to prevent orders from related parties without additional authorisation. We repeat this best practice recommendation here.	M
7	As part of our review of controls we identified that the payroll team do not operate a separation of duties control in the processing of amendments to standing payroll data, such as that relating to new starters, once the payroll clerk is deemed sufficiently experienced. All amendments to standing data should either be made via a self-service function by the individual themselves, or cross-checked by a second payroll clerk to ensure the amendment is legitimate and accurate.	M

Appendix 4: Audit recommendations (continued)

We present recommendations arising from our audit below

Ref	Recommendations	Priority H/M/L
8	The implementation of a new finance system, Agresso, presents a number of challenges to the Council, including financial reporting. The Council may benefit from a "dry-run" of the closure of accounts, potentially at the end of December, to ensure that all information required as part of the production of the financial statements can be readily and easily obtained, to facilitate faster preparation of the annual accounts as at 31 March 2016. This may also allow the Council to reduce the level of manual intervention through off-ledger adjustments required between the Trial Balance and draft financial statements.	M
9	Our testing identified a significant level of cash receipts which had not been allocated against a debtor account at the year end. This could mean that debtors are chased for payment who have already paid, and lead to incorrect financial reporting. As part of the transition to Agresso, the Council should review their procedures to ensure as many receipts as possible can be matched automatically, and minimise the level of manual intervention required to identify receipts.	M
10	As part of Fixed Asset testing we identified properties which had transferred to the Council shortly before the year end. As part of closedown procedures, such assets should be identified through discussion between relevant services, to ensure they can be captured and considered for re-valuation as necessary.	M
11	It is anticipated that the Code of Practice on Local Authority Accounting will adopt a change in the valuation approach for infrastructure assets from the 31 March 2017 Balance Sheet. The Council will be required to provide valuations as at 31 March 2017 and comparators as at 31 March 2016 of a Depreciated Replacement Cost (DRC) basis. The Council should ensure it has the necessary information regarding its infrastructure assets to procure the required valuations.	L
12	When preparing invoices for leased properties, the Council should review the rent agreements to ensure that both a signed lease exists, and the full amount the Council is entitled to has been invoiced.	M
13	The Council should review its intangible assets register to remove the gross cost and accumulated amortisation of fully amortised assets it no longer controls.	L

Appendix 5: Draft letter of representations

We set the representations we required the Council to make prior to signing the audit opinion

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of both Middlesbrough Council and the Teesside Pension Fund (hereafter collectively referred to as “The Council”) for the year ended 31 March 2015 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of The Council as of 31 March 2015 and of the results of its operations, other recognised gains and losses and its cash flows for the year then ended in accordance with the applicable accounting framework.

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, as set out in the terms of the audit engagement letter.

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. A list of the uncorrected misstatements and disclosure deficiencies is detailed in appendix 1 of this document.

6. The measurement processes, including related assumptions and models used to determine accounting estimates in the context of the applicable financial reporting framework are appropriate and have been applied consistently.

7. The assumptions appropriately reflect our intent and ability to carry out specific courses of action on behalf of the entity where relevant to the accounting estimates and disclosures.

Appendix 5: Draft letter of representations (continued)

8. The disclosures related to accounting estimates under the entity's applicable financial reporting framework are complete and appropriate.

9. The Council has satisfactory title to all assets and there are no liens or encumbrances on the Council's assets and assets pledged as collateral.

10. We have disclosed to you all deficiencies in internal control of which we are aware.

11. 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.

12. We have considered the Council's portfolio of financial liabilities and confirm that these financial liabilities are neither held for trading purposes nor designated as financial liabilities at fair value through profit and loss. As such, we confirm that they should be measured at amortised cost. We confirm that the difference between the carrying value and amortised cost of these financial liabilities is immaterial.

13. We have reconsidered the remaining useful lives of the fixed assets and confirm that the present rates of depreciation are appropriate to amortise the cost or revalued amount less residual value over the remaining useful lives.

14. We are not aware of events or changes in circumstances occurring during the period which indicate that the carrying amount of fixed assets may not be recoverable.

15. We confirm that:

a) all retirement benefits and schemes, including UK, foreign, funded or unfunded, approved or unapproved, contractual or implicit have been identified and properly accounted for;
b) all settlements and curtailments have been identified and properly accounted for;
c) all events which relate to the determination of pension liabilities have been brought to the actuary's attention;
d) the actuarial assumptions underlying the valuation of the scheme liabilities (including the discount rate used) accord with the directors' best estimates of the future events that will affect the cost of retirement benefits and are consistent with our knowledge of the business;
e) the actuary's calculations have been based on complete and up to date member data as far as appropriate regarding the adopted methodology; and
f) the amounts included in the financial statements derived from the work of the actuary are appropriate.

Appendix 5: Draft letter of representations (continued)

16. We recognise that we are responsible for ensuring that the statement of accounts as published on the website properly presents the financial information and your auditor's report and for the controls over, and security of, the website. We also recognise that we are responsible for establishing and controlling the process for electronically distributing annual reports and other information.

17. We confirm that for those assets not valued at 31 March 2015, the carrying amount does not differ materially from the fair value.

Information provided

18. 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.

19. All transactions have been recorded and are reflected in the financial statements and the underlying accounting records.

20. We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

21. 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.

22. We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects The Council and involves:
    - management;
    - employees who have significant roles in internal control; or
    - others where the fraud could have a material effect on the financial statements.

23. 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.

24. 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.

Appendix 5: Draft letter of representations (continued)

25. We have disclosed to you the identity of the Councils related parties and all the related party relationships and transactions of which we are aware.

26. 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. On the basis of legal advice we have set them out in the attachment with our estimates of their potential effect. No other claims in connection with litigation have been or are expected to be received.

27. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities reflected in the financial statements.

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

Paul Slocombe
Chief Finance Officer
Signed on behalf of the Council

Attached to this letter will be appendices covering the unadjusted misstatements, copying those disclosed within appendix 3.

Appendix 6: Our approach to audit quality

Recognition of and further impetus for our quality agenda

In May 2015 the Financial Reporting Council ("FRC") issued its Annual Report on Audit Quality Inspections which provides an overview of its activities of its Audit Quality Review ("AQR") team for the year ended 31 March 2015. It also issued individual reports on each of the four largest firms, including Deloitte. We adopt an open and communicative approach with the regulator and their contribution to audit quality is respected and supported at all levels of our firm. We consider that the AQR's report provides a balanced view of the focus and results of its inspections and its recognition of the emphasis we place on our overall systems of quality control is welcome. We value the regulator's inspection and comments, and the review performed by the AQR forms an important part of our overall inspection process. We perform causal factor analysis on each significant finding arising from both our own internal quality review and those of our regulators to fully identify the underlying cause. This then drives our careful consideration of each of the FRC's comments and recommendations, as well as findings arising from our own review to provide further impetus to our quality agenda.

Audit quality is our number one priority. We pride ourselves on our commitment to quality and our quality control procedures. We have an unyielding pursuit of quality in order to deliver consistent, objective and insightful assurance.

The AQR's conclusion on Deloitte

"The firm places considerable emphasis on its overall systems of quality control and, in most areas, has appropriate policies and procedures in place for its size and the nature of its client base. Nevertheless, we have identified certain areas where improvements are required to those policies and procedures. These are set out in this report. Our findings relating to reviews of individual audits largely relate to the application of the firm's procedures by audit personnel, whose work and judgments ultimately determine the quality of individual audits. The firm took a number of steps in response to our prior year findings to achieve improvements in audit quality. This included enhanced guidance, technical communications and audit training on the recurring themes. Certain aspects of the guidance could, however, have been issued on a more timely basis."

2014/15 Audit Quality Inspection Report on Deloitte LLP

Public Sector Audit Appointments Ltd monitors the performance of all the audit firms delivering work on its behalf covering:

- the quality of audits: an annual quality review programme assessing the firm's quality control procedures and reviewing a sample of the firm's quality monitoring reviews; and
- regulatory compliance: monitoring the firm's compliance with the Commission's regulatory requirements and performance against key performance indicators.

Quarterly compliance reports and an annual Regulatory Compliance and Quality Report are published on PSAA's website.

Fifteen of the audits reviewed by the AQR were performed to a good standard with limited improvements required and five audits required improvements. No audits were assessed as requiring significant improvements. The overall analysis of the AQR file reviews by grade for the last five years evidences that, among the largest firms, Deloitte remains at the forefront of audit quality with 68% of audits reviewed by the AQR assessed as good with limited improvements required and, at 5%, the lowest level of audits being assessed as significant improvement required, with none in this category in 2014/15.
We have already taken action to respond to the key themes of the report and will continue to undertake further activities to embed the changes