

External Audit Update Report

Middlesbrough Council

June 2016



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In April 2015, Public Sector Audit Appointments Ltd ("PSAA") issued the 'Statement of responsibilities of auditors and audited bodies 2015-16'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psa.co.uk).

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment from 1 April 2015' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice ("the Code") and statute, and covers matters of practice and procedure which are of a recurring nature.

This report is prepared in the context of the Statement of responsibilities. It is addressed to the Corporate Affairs and Audit Committee, and is prepared for the sole use of the audited body. We, as appointed auditor, take no responsibility to any third party.

Introduction

The purpose of this report is to provide members of the Corporate Affairs and Audit Committee with an update on the progress of our external audit for the year ended 31 March 2016. In particular, it covers:

- ▶ A summary of the work we have undertaken to date;
- ▶ Changes to our risk assessment in our Audit Planning Report presented to the Corporate Affairs and Audit Committee on 24 March 2016; and
- ▶ An indication of our initial materiality estimates.

We welcome any comments or feedback on the content of this report or our work undertaken to date.

Audit progress

Our audit team was onsite for the interim audit visit in March 2016 during which time we completed the following audit procedures:

- ▶ We performed walkthroughs of the material financial systems of the Council to update our understanding of the financial processes followed;
- ▶ We met with Internal Audit to assist us in developing our understanding of the control environment of the Council;
- ▶ We met with Officers to update our understanding of significant audit and accounting matters which have occurred during 2015/16, including the move to a new finance system and considering actions taken to strengthen governance following the areas for improvement identified by the previous external auditor;
- ▶ We have obtained data downloads from the general ledger and payroll systems to test our data analytics tools in advance of their use at the year-end; and
- ▶ We performed a review of the 2014/15 statutory accounts against the requirements of the Code.

There were no significant findings arising from our interim audit work for reporting to the Corporate Affairs and Audit Committee.

Changes to our risk assessment

We have reviewed the risk assessment in our Audit Plan presented to the Corporate Affairs and Audit Committee on 24 March 2016 and propose the following change.

Change in risk classification – valuation of land and buildings

In our Audit Plan, we identified 'valuation of land and buildings' as an 'other financial statement risk'. We have now completed our interim work at our portfolio of local government bodies and have reassessed this risk across all our clients as being significant in nature. The reason for this reassessment is that the fixed asset balance is one of the most significant assets on the Council's balance sheet and valuation of these assets can be complex. A small movement in the assumptions behind the valuation could have a material impact on the Balance Sheet.

For a risk to be designated as 'significant' for the purposes of our audit, there needs to be a higher likelihood of occurrence and, if the risk was to occur, it could result in a material misstatement in the financial statements. We have reconsidered our original assessment and noted:

- ▶ There are a variety of valuation methods used by the Council's valuers, as the land and buildings owned by the Council are diverse in nature, which require expert knowledge and are inherently judgemental in nature; and
- ▶ Our review of prior year working papers at other local government bodies has highlighted some errors in valuations that have led to material adjustments in the financial statements.

On this basis we propose that we change the risk for valuation of land and buildings to a significant risk.

We seek approval from the Corporate Affairs and Audit Committee to make this change to our Audit Plan.

Materiality update

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality also provides a basis for identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

In our Audit Plan presented to the Corporate Affairs and Audit Committee on 24 March 2016, we committed to provide you with an update on our proposed materiality levels. At this stage, we consider the most appropriate basis for assessing materiality for the Council to be 2% of expenditure for the year. Based on 2014/15 expenditure in the audited accounts, we anticipate planning materiality to be in the region of £7,868,900. We will report all unadjusted misstatements over £393,500 identified during the course of our audit to the Corporate Affairs and Audit Committee.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all the circumstances that might ultimately influence our judgement. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

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