

Middlesbrough Council

Annual Audit Letter for the year ended 31 March 2017

October 2017

Ernst & Young LLP



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Public Sector Audit Appointments Ltd (“PSAA”) have issued a “Statement of responsibilities of auditors and audited bodies”. 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 (updated 23 February 2017)” 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 Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure - If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or associate partner contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

A hand with white nail polish is writing on a document with a blue pen. In the background, there is a calculator, a laptop, and a white mug. A yellow rectangular box is overlaid on the left side of the image.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Middlesbrough Council following completion of our audit procedures for the year ended 31 March 2017.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's and Pension Fund's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2017 and of its expenditure and income for the year then ended.
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the annual accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources, except for in relation to informed decision making. Further details can be found on page 15.

Area of Work	Conclusion
Reports by exception: ▶ Consistency of Annual Governance Statement	The Annual Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

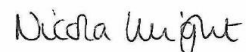
Area of Work	Conclusion
Reporting to the National Audit Office ("NAO") on our review of the Council's Whole of Government Accounts return ("WGA")	We had no matters to report.

As a result of the above, we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit	Our Audit Results Report setting out our findings on the Council's financial statements was presented to the Corporate Affairs and Audit Committee on 28 September 2017. Our Audit Results Report setting out our findings on the Teesside Pension Fund financial statements was presented to the Teesside Pension Fund and Investment Panel on 27 September 2017.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 28 September 2017.

In December 2017, we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council and Pension Fund's staff for their assistance during the course of our work.



Nicola Wright
Associate Partner
For and on behalf of Ernst & Young LLP

Purpose



Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report to the 28 September 2017 Corporate Affairs and Audit Committee, representing those charged with governance. The detailed findings arising from our audit of the Teesside Pension Fund were reported to the 27 September 2017 Teesside Pension Fund and Investments Panel. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.



Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued on 9 March 2017 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2016/17 financial statements, including the Pension Fund; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the Annual Governance Statement is misleading or not consistent with our understanding of the Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office ("NAO") on your Whole of Government Accounts return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement ("AGS"). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

A blurred office desk with a laptop, glasses of water, and financial documents. The scene is brightly lit, likely from a window with blinds in the background. A yellow rectangular box is overlaid on the left side of the image, containing the text 'Financial Statement Audit'.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council and Pension Fund's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 28 September 2017.

Our detailed findings for the Council were reported to the 28 September 2017 Corporate Affairs and Audit Committee, whilst our detailed findings for Teesside Pension Fund were reported to the 27 September 2017 Teesside Pension Fund and Investments Panel.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
<p>Management override of controls – Council and Pension Fund</p> <p>A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p>	<p>We performed the following procedures to mitigate the risk:</p> <ul style="list-style-type: none"> • We tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; • We reviewed accounting estimates for evidence of management bias; and • We evaluated the business rationale for any significant unusual transactions. <p>We have not identified any material weaknesses in controls or evidence of material management override.</p> <p>We have not identified any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Council's or Pension Fund's normal course of business.</p>

Significant Risk	Conclusion
<p>Revenue and expenditure recognition – Council only</p> <p>Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.</p> <p>We respond to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the year end.</p>	<p>We performed the following procedures to mitigate the risk:</p> <ul style="list-style-type: none"> • We reviewed and tested revenue and expenditure recognition policies as part of our review of accounting policies; • We reviewed and substantively tested accounting estimates for evidence of management bias, including: <ul style="list-style-type: none"> • Year-end accruals; • Depreciation and impairment; • Valuations; and • Provisions; • We tested material expenditure streams, including testing revenue and capital expenditure to ensure it has been correctly classified; and • We tested revenue and expenditure cut-off before and after 31 March 2017. <p>Our testing has not revealed any material misstatements with respect to revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any issues or unusual transactions which indicated that there had been any misreporting of the Council's financial position.</p>
<p>Valuation of land and buildings – Council only</p> <p>Land and buildings is one of the most significant balances in the Council's Balance Sheet. The valuation of land and buildings is subject to a number of assumptions and judgements. A small movement in these assumptions could have a material impact on the financial statements.</p> <p>In addition there is judgement applied in determining the classification of the asset between property, plant and equipment and investment property, which has an impact on the valuation basis used.</p>	<p>We completed the following work in this area:</p> <ul style="list-style-type: none"> • We reviewed the output of the Council's valuer; • We challenged the assumptions used by the Council's valuer, by reference to external evidence and the CIPFA Code of Practice on Local Authority Accounting; and • We tested the journals for the valuation adjustments to check that they had been accurately processed in the financial statements. <p>Our testing did not identify any material misstatements within the valuation of land and buildings.</p>

Valuation of complex pooled investment vehicles – Pension Fund only

The Fund's investments include complex pooled investment vehicles, which include pooled property funds and infrastructure funds.

Judgements are taken by the Investment Managers to value investments whose prices are not publically available.

Current market volatility means such judgments can quickly become outdated, especially when there is a significant time period between the latest available audited information and the fund year end. Such variations could have a material impact on the financial statements.

We identified the valuation of the Pension Fund's investment in complex pooled investment vehicles as a significant risk, as even a small movement in these assumptions could have a material impact on the financial statements.

We completed the following work in this area:

- We documented and walked through the process and assessed the effectiveness of the design and implementation of the controls over the valuation process;
- We obtained third party confirmations of the complex pooled investment vehicles at the Pension Fund's year end from the investment manager;
- We reviewed the investment manager controls' reports for qualifications or exceptions that may affect the audit risk;
- We reviewed the bases of valuation of the complex pooled investment vehicles; and
- Where possible we compared the movement in value of the investments in year to relevant benchmarks and trends to help provide further assurance that the valuation was reasonable.

Our testing did not identify any material misstatements within the valuation of complex pooled investment vehicles.

Valuation of directly held properties – Pension Fund only

The Fund has a significant portfolio of directly held property investments amounting to circa £205 million.

The valuation of land and buildings is subject to a number of assumptions and judgements.

We have identified the valuation of these investments as a significant risk as a small movement in these assumptions could have a material impact on the financial statements.

We completed the following work in this area:

- We documented and walked through the process and assessed the effectiveness of the design and implementation of the controls over the valuation process;
- We obtained an independent copy of the valuation report from Cushman and Wakefield (the valuer) and reconciled the valuation to the financial statements;
- We assessed the qualifications and experience of the valuer to gain assurance we can rely upon as an expert; and
- We compared the movement in valuation over the financial year to available property market trend indices available to gain assurance that the valuation is reasonable in line with expectations.

Our testing did not identify any material misstatements within the valuation of directly held properties.

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Council materiality

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £10.4 million (2016: £7.8 million), which is 2% of gross expenditure reported in the accounts.</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Corporate Affairs and Audit Committee that we would report to the Committee all audit differences in excess of £440,000 (2016: £390,000).</p>

Pension Fund materiality

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £38.5 million (2016: £31.3 million), which is 1% of net assets reported in the accounts.</p> <p>We consider net assets to be one of the principal considerations for stakeholders in assessing the financial performance of the Pension Fund.</p>
Reporting threshold	<p>We agreed with the Teesside Pension Fund and Investments Panel that we would report to the Panel all audit differences in excess of £1.5 million (2016: £1.5 million).</p>

A close-up, shallow depth-of-field photograph of a stack of coins. The coins are stacked vertically, with the edges of several coins visible. The lighting is warm, highlighting the metallic texture and the ridges on the edges. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Value for Money".

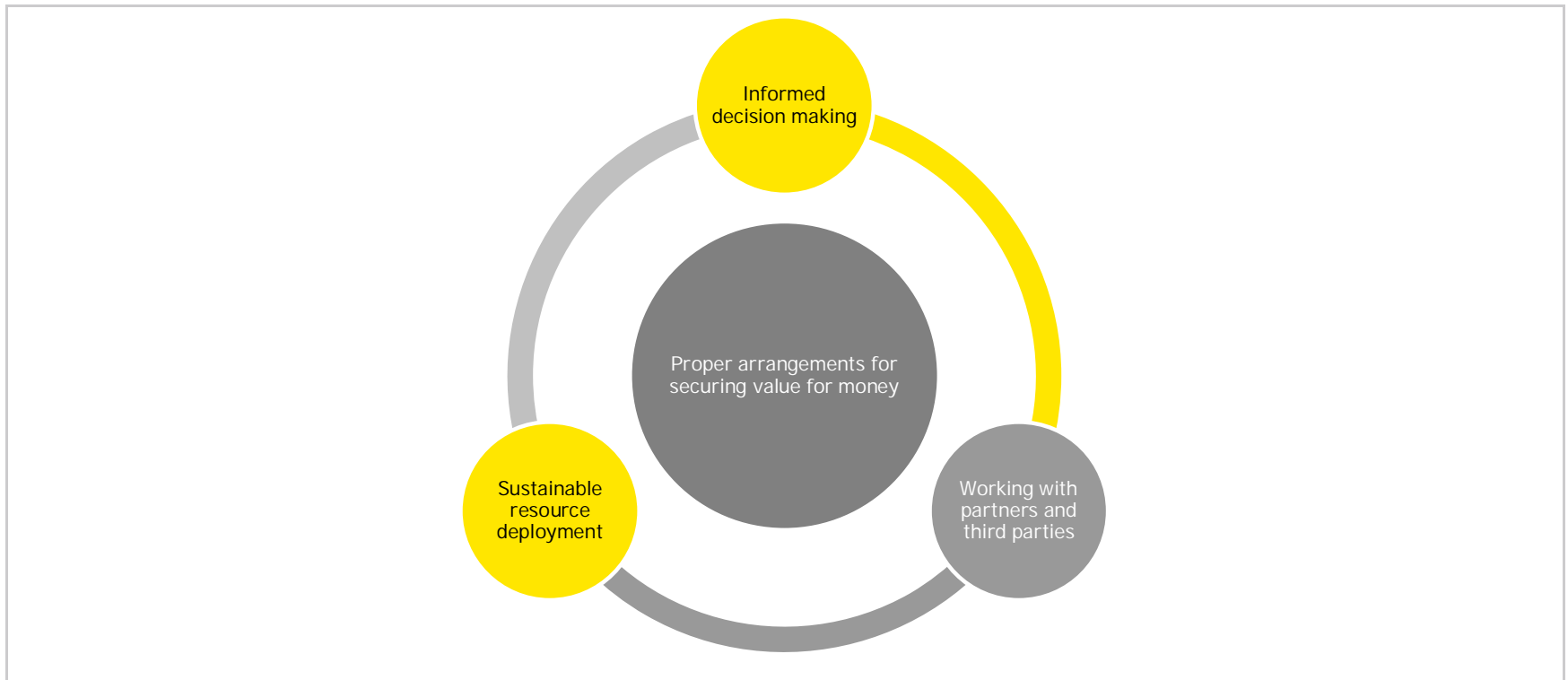
Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We identified one significant risk regarding the governance arrangements in place for project management, capital programme monitoring reports and property disposals. This significant risk arose due to our prior year value for money modified opinion, which related to these three areas. The table below presents our findings in response to this risk.

Overall, sufficient progress has been made by the Council in relation to project management and the capital programme monitoring reports when compared to 2015/16. However, the changes made to the governance arrangements for property disposals had not fully embedded by 31 March 2017 and, as a result, we have issued an "except for" modified opinion in relation to the governance arrangements for property disposals.

Significant Risk	Conclusion
<p>Project management, capital programme monitoring reports and property disposal governance arrangements In 2015/16, we issued the Council with an 'except for' VFM conclusion due to the identification of weaknesses in project management, capital programme monitoring reports and property disposal governance arrangements.</p> <p>During 2016/17, the Council have introduced a number of new frameworks, including a new project management and a new property disposal framework, to resolve the weaknesses identified.</p>	<p>Project management governance arrangements We completed the following work in this area:</p> <ul style="list-style-type: none"> • We met with, and reviewed the reports produced by, the Council's advisor (Deloitte) regarding the progress made by the Council in this area; • We have reviewed the Project Management Follow Up report issued by the Council's internal auditor, TVAAS; • We have reviewed the Project and Programme Management ("PPM") framework introduced by the Council to address the governance concerns raised previously; and • We have selected a sample of full framework projects and projects on a page and tested these projects to ensure that they are compliant with the PPM framework. <p>We are satisfied that project management governance arrangements have improved and are operating effectively.</p> <p>Capital programme monitoring reports We completed the following work in this area:</p> <ul style="list-style-type: none"> • We met with, and reviewed the reports produced by, the Council's advisor (Deloitte) regarding the progress made by the Council in this area; and • We have obtained copies of the quarterly budget and balanced scorecard reports issued to Executive throughout the year. We have then reviewed these reports to consider whether the information provided covers sufficient detail to allow informed decisions to be taken. <p>We note that a revised monitoring approach for capital programmes has been adopted. This approach has seen additional information reported to Members and senior management such as reporting on milestones, delivery of benefits and the impact of slippages, allowing for more effective scrutiny of capital projects.</p>

Significant Risk	Conclusion
<p>Project management, capital programme monitoring reports and property disposal governance arrangements</p> <p>In 2015/16, we issued the Council with an 'except for' VFM conclusion due to the identification of weaknesses in project management, capital programme monitoring reports and property disposal governance arrangements.</p> <p>During 2016/17, the Council have introduced a number of new frameworks, including a new project management and a new property disposal framework, to resolve the weaknesses identified.</p>	<p>Property disposal governance arrangements</p> <p>We completed the following work in this area:</p> <ul style="list-style-type: none"> • After receiving direct correspondence highlighting potential issues with the process undertaken by the Council regarding the disposal of specified assets, we engaged internal specialists to support the audit team in considering the disposal process for one of those assets; • We met with, and reviewed the reports produced by, the Council's advisor (Deloitte) regarding the progress made by the Council in this area; • We reviewed the Asset Disposal Policy that was presented to the Executive Sub Committee for Property on 7 December 2016. We have then requested further information to support compliance with specific areas of the policy; and • We have selected a sample of assets that the Council has identified as potential disposals and tested these assets to ensure that the process undertaken so far by the Council was in line with the Asset Disposal Policy. <p>The testing performed by our internal specialists identified clear governance weaknesses in the disposal process of the specific asset reviewed. However, these weaknesses relate to processes commenced in previous years, and had already been reported to members by TVAAS and formed part of the previous two prior year value for money opinion modifications.</p> <p>During 2016/17, the Council has worked to strengthen the asset disposal governance arrangements, culminating in the introduction of a new Asset Disposal Policy. Our testing of this policy has identified that improvements have been made. However, we do not believe that these improvements were sufficiently embedded at 31 March 2017, as a number of actions were not completed until after this date.</p>



Other Reporting
Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and identified a small number of areas where further disclosure was required to reflect the position at the Council. The areas identified for inclusion were the governance actions undertaken by the Council following the Grenfell Tower fire and the governance impact of the recent employment tribunal. The Council amended the Annual Governance Statement to include these areas.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2016/17 financial statements from member of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Corporate Affairs and Audit Committee on 28 September 2017. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in the financial statements of the Council however we have identified an area for improvement, which is set out below:

Pay policy and early retirement – During 2016/17 the Council contributed £164,000 towards the early retirement of the former Chief Executive. Under the terms of the Council's Pay Policy, there is no requirement for this amount to be approved by full Council as the policy only requires redundancy payments over £100,000 to be approved. However, we believe that best practice would be to take any future early retirements over this value to full Council or another appropriate committee for consideration and approval.

A close-up photograph of a person's face as they look through a pair of black binoculars. The person's eyes are focused on the lenses, and their hands are visible holding the device. The background is a soft, out-of-focus white. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Focused on your future".

Focused on your
future

Focused on your future

Area	Issue	Impact
Early Close	The main area for change in the Audit and Accounts Regulations 2015 is the requirement for Councils to approve and publish their accounts by 31 May and 31 July respectively (currently 30 June and 30 September).	<p>It is imperative that there is early dialogue between the Council and your audit team to agree a planned approach to support you in achieving the challenges of early close. This dialogue will result in new ways of working, which could include:</p> <ul style="list-style-type: none"> • Increased focus on data quality to minimise reworking and adjustments at year-end; • A clear understanding of what information will help your audit team complete their year-end audit visit, for example a detailed client assistant schedule; • Consideration of what areas of the final accounts process can be delivered early and can be audited before the year-end, for example property valuations, material provisions and accruals, group boundary assessments and accounting policies; • Review of the Council's accounting policies to assist the early close process, for example a de-minimis accruals policy; and • Consideration of 'soft closes' at key points during the year, for example month 6 and 9, to enable interim audits prior to year-end therefore spreading the work through the year and reducing the workload at year-end.

Appendix A

Audit Fees



Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our Annual Results Report.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work	TBC*	115,037	115,037	115,037
Total Audit Fee – Certification of Housing Benefit Subsidy Claim	TBC	10,335	10,335	10,571
Non-audit work – Certification of other claims**	TBC	3,200	N/A	3,200

*A further fee will be charged for the additional work required in year relating to value for money and dealing with third party queries. We will report this fee to the Corporate Affairs and Audit Committee once agreed with management and the PSAA.

**We confirm that we have undertaken the certification of one claim that falls outside of the PSAA's requirements.

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ED None

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