MIDDLESBROUGH COUNCIL

Report of:	Director of Finance (Section 151 Officer)

Submitted to:	Corporate Affairs and Audit Committee – 31 March 2022

Subject:	Statement of Accounts 2020/21

Summary

Proposed decision(s)
That the Corporate Affairs and Audit Committee note the update on the audit of the 2020/21 Statement of Accounts, the main reasons for the length of the audit so far and the revised financial statements presented.

Report for:	**Key decision:**	**Confidential:**	**Is the report urgent?**[1]
Information	No	No	No

Contribution to delivery of the 2020-23 Strategic Plan		
People	**Place**	**Business**
Improved financial governance will underpin the delivery of all strategic priorities.	Improved financial governance will underpin the delivery of all strategic priorities.	The preparation and publication of the Council's Statement of Accounts is key to the good governance of the Council and high quality financial reporting.

Ward(s) affected
None.

What is the purpose of this report?

1. To give Members of the Corporate Affairs and Audit Committee an update on the status of the external audit of the 2020/21 Statement of Accounts. As the financial statements element of the audit is reaching completion a revised set of accounts are now available. The report will identify any key revisions to the accounts as part of the audit process.

Why does this report require a Member decision?

2. Corporate Affairs and Audit Committee are responsible for the approval of the Statement of Accounts as part of both its governance and audit remit under the Council's constitution. Although this report is not asking for approval of the audited accounts at this stage, it is important that Members are kept informed of progress, any issues raised by the external auditor and any relevant changes in the financial statements and position of the Council.

Report Background

3. Like all large organisations, Middlesbrough Council is required by law (the Accounts & Audit regulations) to publish and report on its financial position, performance and cash flows during each financial year. It does this by producing and publishing a Statement of Accounts each year.

4. On 22nd July 2021, a draft statement of accounts for 2020/21 was considered by the Committee, which presented the finances of the Council at 31st March 2021. These accounts had been authorised by the Director of Finance as Section 151 Officer for issue and were published on the Council's website after the meeting.

5. The Statement of Accounts is a complex and technical document with the draft version for 2020/21 consisting of 175 pages in order to cover the multi service nature of the Council's operations, plus the extensive requirement of the Local Authority Accounting Code of Practice developed by the Chartered Institute of Public Finance and Accountancy (CIPFA).

6. An essential part of the governance process for the Statement of Accounts, given that it is a representation of how public money has been spent, is for these accounts to be scrutinised by an appropriately qualified and experienced external auditor. For Middlesbrough, Ernst & Young (EY) have been appointed to audit the Council's accounts from 2017/18 to 2022/23.

7. The following timetable for the audit and approval of the accounts, with Covid-19 still having a significant impact on preparation and approval times for accounts within the local authority sector, was set out at the July meeting.

Action	Timeframe
Publish the draft Accounts for 2020/21 signed by the Chief Finance Officer.	22 July 2021
Public Inspection Period	From 26 July to 3 September 2021
External Audit Period	20 July to Mid-September 2021
Publish Audited Accounts approved by Corporate Affairs and Audit Committee.	30 September 2021

8. Given some of the issues and complexities involved in the external audit of the accounts for 2019/20, which eventually led to these being signed off and published several months after the statutory deadline of the end of November 2020. The

dates relating to the audit period for 2020/21 were contingent on a number of factors around Covid-19, accounting issues and staff resources. It was highlighted that there was a fair probability that the audited accounts may be approved later than the dates outlined above.

Progress on the audit and reasons for delay in completion

9. The audit of the statement of accounts for 2020/21 is now substantially complete. It will though only be finalised once EY issue their opinion on the accounts. This consists of two parts: One opinion relates to the financial statements (& notes to the accounts) and whether these give a true and fair view on the Council's financial position. An additional opinion is also made on the arrangements within the Council to achieve value for money on the resources being used and whether these are appropriate and effectively support the achievement of its key strategic outcomes. The audit is only complete once the Council receives both opinions.

10. The work on the financial statements part of the audit is now complete (barring a few final queries) and as such, a set of revised accounts and notes are available for Members information in **Appendix 1**. Details as to the changes made due to the audit are outlined in paragraphs 21 to 38. It is important for Members to have visibility of these so they can understand the impact and explore further the reasons for these if required. Some final checks are needed by EY to validate the revised statement of accounts; however, we do not expect any further amendments being needed beyond these. We also hope to receive an unqualified opinion on this part of the audit if these changes are made to the financial statements.

11. Members will be aware of a number of matters that have happened within the Council in the last two years which are non-Covid-19 related but which the external auditors need to form a view on in relation to our governance controls and any potential impact on the value for money assessment. These include the Children Services improvement plan, Mayoral allegations following the resignation of a number of Executive members, the Transporter Bridge, Middlesbrough Development Company etc.

12. Additional governance work on these areas has been undertaken by EY following an initial assessment by Veritau – the Council's internal auditors. As a result of this, the annual governance statement is in the process of being revised and is not included in the updated statement of accounts at Appendix 1. Although the work is well advanced, it is not yet complete and therefore the value for money assessment & opinion is still outstanding.

13. In view of this, EY are unable to issue the joint opinion on the audit meaning the Committee cannot approve the audited accounts at today's meeting. Current indications are that this should be possible at the meeting on 28 April 2022.

Delays in completing the Audit process

14. The statutory deadline for completing the 2020/21 audit of the statement of accounts was 30th September 2021. It is now six months beyond this. The main reasons for the length of the current external audit and the reasons why it is not yet complete are set out in the paragraphs below. It should be noted by Members that only 9% of local authorities within England had their audit of accounts complete at the statutory date and albeit this had increased somewhat to 40% at 31st January

2022, many audits are still not complete for the 2020/21 financial year. These figures illustrate the size of the issue facing local government and external audit firms in England on the timely completion of local audits and this has been highlighted as a problem in current discussions between central government and CIPFA. The principal reasons though for the length of the audit are as follows:

15. Covid-19: The pandemic and both central government and local authority responses to this situation has created a complex financial framework of additional grants, returns and accounting treatment issues both for the preparation of the Council's own management accounts ('the revenue and capital outturn positions) but also for reporting under the local authority code of accounting practice. The range of grants involved and the work necessary to ensure that the transactions have been accounted for correctly and in line with the appropriate grant conditions has led to significant additional time being required by both auditors and finance teams.

16. Going Concern: Due to a number of high profile corporate failures in the private sector in recent years plus the potential impact on Covid-19 on the financial sustainability of local authorities, there is now significant additional work required by auditors to form a view on this area. Members will be aware that the financial statements of the Council are prepared on a going concern basis i.e. that the local authority will continue operating in the medium to long term and auditors need to vouch that this is the case as part of the audit process. Again, similar to Covid-19 this means extra work for both auditors and finance teams who need to provide additional evidence beyond what has been required in previous years.

17. One specific area of focus and additional work on the going concern concept relates to liquidity and the need to prepare longer-term cash flow forecasts for two years after the current balance sheet date of 31st March 2021 to show that the Council's operations have adequate cash resources available to pay staff and suppliers over this period. Covid-19 has significantly increased the levels of cash resources since the pandemic started in March 2020 (these have been in excess of double the normal operating amounts at many times). This was still the case even as late as early March 2022. This has made the forward look between April 2022 and March 2023 more complicated given the expectations that normal activities and funding may resume during this period.

18. IAS19: The assets and liabilities within the Council's accounts relating to retirement benefits (or pensions) are around £1bn in each area. The process for completing the IAS19 entries for the Council includes an actuary needing to undertake this specialist work, but this is reliant on investment returns data from the Teesside Pension Fund accounts. The audit of the pension fund accounts identified a number of possible misstatements on external investments, which might affect the IAS19 position, plus some queries from the auditors of other local authorities within the Tees Valley. Reaching a conclusion on whether there may be a material adjustment to make to the figures used in the draft accounts has taken longer than expected.

19. Staff resources available: Members will be aware from previous discussions that the Council has had no Chief Accountant in post for the last two years. This post provides senior leadership and technical expertise to the Statement of Accounts and audit process. Although the Head of Finance & Investments has been covering this role in the interim, capacity to resolve and respond to audit queries has taken longer than in previous years. In addition, there has also been other

staff vacancies internally within finance, which have contributed to length of time taken to move the audit forward. These staffing issues are now resolved but resources has been a particularly acute problem for the 2020/21 audit.

20. There have also been a number of similar issues re staff retention and continuity for EY within their local audit team. Both of these factors have meant that the process has taken much longer than expected to bring matters to a conclusion.

Revised Financial Statements

21. Given the scale and complexity of the accounts produced by a local authority, the financial values involved and that a number of areas of accounting policy require a degree of professional judgement, it is inevitable that changes are required between the draft accounts produced and the final version after audit. At present, there are five main changes since the draft accounts and these have been reflected in the financial statements in Appendix 1. More details on these are set out below.

Adjusted misstatements

22. *IAS 19 - Value of assets held:* Each year our pension's actuary calculates an updated assessment of the value of the assets and liabilities of the Teesside Pension Fund attributable to each employer within the pension scheme. The assets are a proportionate share of the fund's total investments and the liabilities are based on a range of assumptions around scheme member's retirement plans, mortality rates, expected inflation levels etc.

23. The audit identified that scheme assets include in the draft accounts at £817.4m based on the advice of the actuary were understated by £5.9m. This difference relates to some minor discrepancies in the information provided to the actuary by the Pension Fund, plus some investment values used in the draft accounts that were based on estimated positions that proved to be different once final returns were received from fund managers. The £5.9m is an improvement on the position reported in the draft accounts and reduces the net pension's liability in the Balance Sheet by this amount to £308.1m.

24. *Covid-19 - Agency adjustment:* As part of the government's response to the pandemic a range of new grants were given to local authorities to distribute to businesses that had to close or who were disrupted, individuals who had to isolate and to maintain the Council's operations in affected services. The total of these grants provided for 2020/21 was in excess of £40m.

25. The grants were awarded to local authorities by central government as these are best placed to distribute the funds available to the local community. Although the grants were administered on an applications based process, the Council had to follow government based schemes and criteria when allocating these grants. No discretion was available at a local level. The Council was therefore acting as a government agent when pass porting these funds. In these type of situations, the accounting policy is not to recognise the income or expenditure in the financial statements for these amounts. There is no control for the local authority over the use of these funds and the financial impact is limited to the cash movements only on the local authority.

26. As the pandemic continued during 2020/21, the government moved from a full national lockdown to a tiered approach based on infection rates in particular areas. The grants available also changed from a mandatory scheme initially to ones where local authorities had discretion over the design of the support schemes and who to award to and how much would be available for individual applications. In these cases, the Council is acting as the decision maker/principal and should recognise the income and expenditure in their accounts.

27. Although the agent/principal split was correctly accounted for on the Covid-19 grants allocated for service delivery, it was not on some of the business grants schemes. As a result, the total gross income and expenditure in the Comprehensive Income and Expenditure Statement was understated by these discretionary amounts. The total involved is £5.4m or just over 1% of total expenditure for the year. The accounts are now up to date for this error. This adjustment does not affect either the net expenditure incurred for 2020/21, the revenue outturn position or the value of usable reserves available to the Council.

28. *Other operating income & expenditure – Disposal of Assets:* When a local authority disposes of an asset, it generates capital receipts. These amounts are usable under regulations to repay existing debt or finance new investment. In addition, the value of the asset in the accounts needs de-recognising in the Balance Sheet with any profit or loss on these transactions reflected in the comprehensive income and expenditure statement.

29. These accounting entries were produced by the Council's asset register system and as part of the audit, it has been shown that the transactions have been reflected gross in both income and expenditure totals in the financial statements rather than on a net basis for the profit/loss produced, which is not in line with the accounting code of practice. This means that total income and expenditure has been over-stated by the value of capital receipts for 2020/21, which is £6.2m. The CIES has been updated for the removal of these amounts.

30. *Creditor analysis disclosure – Housing Benefit payments:* Creditors are amounts owed to external parties for goods and services received. They can also include any income received in advance of need that may need to be repaid in the future. Due to scale of the Council's operations amounts owed at any point can be significant. At 31st March 2021 the total short-term creditors was £58.3m in total. Given this is a material sum the amount needs to be analysed further into its main component parts in the disclosures (note 35).

31. A creditor amount of £3.3m was identified in this year's audit relating to payments to individuals on housing benefits were the cash was transferred in the first week in April but the payments related to March. This is just a timing difference. The entry was accounted for in the correct financial year by the inclusion of the creditor. However, this was analysed in the note as being an amount owed to other local authorities rather than other entities and individuals. This was due to an error in the coding used for the entry in the accounts and has now been corrected. This error was also made in previous years but was not identified.

32. *Property Plant & Equipment (PPE) disclosure – Transporter Bridge:* Each asset owned by the Council is recorded at a specific value in the Council's accounts based upon their future economic benefit or service potential. The Transporter Bridge is an infrastructure asset, as opposed to land or buildings, which is the main type of PPE held. This means it is valued at historic cost (the amount spent on the asset for capital purposes less any depreciation incurred) rather than being revalued on a regular basis.

33. At 31st March 2021, the value of the bridge in the Council's accounts was £3.9m. However due to an internal audit report which addressed a number of governance and maintenance issues for the asset and a surveyors report into the condition of the Bridge, a programme of works was established to ensure that bridge is structurally sound for the foreseeable future. This programme will be significantly more expensive than the current value of the bridge over the medium term. As a result, the value in the accounts has been reduced to nil to reflect this.

34. Any asset value movements need disclosing in the notes to the accounts to give further information on the reasons for the reductions. For the bridge, this was initially categorised as a downward revaluation with additional depreciation being incurred. The auditors view though is that the surveyors report shows a significant physical degradation or damage to the asset and this is more akin to an impairment event than just general wear and tear. Impairment needs to be separately identifiable to depreciation in the disclosure note. The appropriate changes to notes 23 and 24 have been made for this. There are though no changes to the balance sheet totals involved.

Unadjusted misstatements

35. There are a small number of other misstatements that EY have identified as part of their audit work. Due to either their size, nature and/or the potential restatement work involved, we have decided not to adjust the accounts for these. More details will be included in the approval report to the 28 April meeting and these will also be included in the audit results report by EY. However, as no changes have been made to the financial statements for these, the details are not included within this report. Further information can be provided on these items to Members at this stage if required after the meeting.

Disclosure Note changes

36. Amendments have also been made to a number of disclosure notes to ensure they full comply with the requirements of the accounting code of practice or regulations. The main changes have been as follows:

- Officers Remuneration and Exit packages (Note 14);
- Financial Instruments (Notes 29 to 31);
- Leasing (Notes 41 & 42);
- Property Plant & Equipment/Heritage Assets (Notes 23 to 25)
- Capital Commitments (Note 22)
- Earmarked Reserves (Notes 7 & 37).

37. There have also been some changes to the narrative report at the introduction to the Statement of Accounts to ensure that any relevant figures are consistent with any audit changes made.

Impact on the Financial Statements

38. Only the first three adjusted misstatements impact on the totals in the balance sheet & comprehensive income and expenditure statement.

- The IAS 19 adjustment results in the net worth of the balance sheet improving by £5.9m to a negative net worth of £44.9m.
- The Covid business grants adjustment increases the gross expenditure and income totals by £5.4m. This is offset by the £6.2m reduction in income and expenditure on the disposal of assets. The net impact on the income and expenditure statement being a reduction of £0.8m since the draft accounts. There is no overall change in net expenditure.

Neither of these three adjustments impact on the revenue and capital outturn positions reported to Executive in June 2021 or on the level of usable reserves available to the Council.

What decision(s) are being asked for?

39. For Members to note the position on the audit of the Statement of Accounts for 2020/21 for the Council and the reasons why this has taken longer than normal this year. Although the audit is not fully complete yet, we are able to provide an update on the issues from the financial statements part of the audit and a revised set of accounts and disclosure notes. These will be useful to consider prior to any approval meeting.

Why is this being recommended?

40. The Committee is responsible for the approval of the Statement of Accounts once the audit process is complete under the Council's Constitution.

Other potential decisions and why these have not been recommended

41. n/a.

Impact(s) of recommended decision(s)

42. n/a

Legal

43. The external audit of the Statement of Accounts is a legal requirement under the Accounts & Audit Regulations 2015. Under the amended coronavirus regulations for 2021, the audit process should be complete by 30th September 2021. However, under the Act there are provisions for continuation of the audit where it is not complete. There is currently a notice on the Council's website that indicates that the audit is not yet complete and under which statutory provision this can occur. The aim being to finalise the audit and publish the audited accounts as soon as possible afterwards.

Financial

44. Although the Statement of Accounts is the main method of external financial reporting to the public and other stakeholders by the Council, there are no specific financial implications of the content of this report or the external audit not yet being complete.

Policy Framework

45. The Statement of Accounts published in line with the Policy Framework.

Equality and Diversity

46. There are no implications in this area as a result of this report.

Risk

47. The main risks associated with the late completion of the external audit and publication of the accounts are:

    - Reputational (i.e. how this is seen by other external bodies and the public in terms of the Council not being able to publish these on time); and
    - The impact that this has on the capacity of the internal finance team to plan and deliver the next set of accounts as at 31st March 2022.

Actions to be taken to implement the decision(s)

48. n/a.

Appendices

49. Appendix 1 – Statement of Accounts for 2020/21. Latest version

Background papers

50. Corporate Affairs & Audit Committee: Draft Statement of Accounts 2020/21 – 22 July 2021.

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