MIDDLESBROUGH COUNCIL

Report of:	Director of Finance
Submitted to:	Corporate Affairs and Audit Committee
Date:	9 June 2022
Title:	Statement of Accounts 2020/21 & Infrastructure Assets
Report for:	Information
Status:	Public
Strategic priority:	All
Key decision:	Not applicable
Why:	Report is for information only
Urgent:	No

Executive summary

This report advises Corporate Affairs and Audit Committee of the current infrastructure assets (Highways) accounting issue, which has delayed the audit opinion on the Council's financial statements & statement of accounts for 2020/21.

It outlines more details on why this is an important issue for both the Chartered Institute of Public Finance & Accountancy (CIPFA) and external auditors nationally, and a proposed temporary solution for any ongoing local authority audits for 2020/21, which CIPFA is currently consulting on.

Based on information available at present, a timeline is set out for when Members may expect to approve the Audited Statement of Accounts. This should be before the draft accounts are presented to Committee for the 2021/22 financial year on 21st July.

Purpose

1. This report advises Corporate Affairs and Audit Committee of the current position on the external audit of the statement of accounts for 2020/21. It also gives some more details on the infrastructure accounting issue that is delaying audits being approved nationally for Members information.

Background and relevant information

2. On 31st March 2022, the Committee received a report outlining the progress on the audit of the statement of accounts for 2020/21. This explained that the approval process for the audited accounts consists of a joint audit opinion – one on the financial statements and one on the council's arrangements for achieving value for money. Both of these need to be complete before the external auditors can sign-off the accounts. Members will recall that the statutory date for publishing the audited accounts for the financial year was 30 September 2021 but that only 9% of local authorities in England had achieved this date for a variety of reasons.

3. The report highlighted three main areas where work was still outstanding to achieve this at the end of March. These were as follows:

    - Some final amendments were required on the financial statements and notes to the accounts as a result of the audit. These needed review and ratification by Ernst & Young (EY) once made by the Council's finance team;

    - The review of the arrangements for achieving value for money had identified a major issue in relation to the Council's approach to Governance. Additional work has been required by EY to assess the risks associated with this;

    - A technical accounting issue had been identified as part of a local government audit for 2020/21 relating to highways infrastructure assets. This could potentially result in material errors being included in local authority accounts. CIPFA agreed to consider this issue further in the context of on-going audits for 2020/21 and in the interim external auditors stopped issuing audit opinions on these sets of accounts until this had been resolved.

4. At the end of May, the first two items are progressing well and are close to completion.

5. The rest of this report considers the technical accounting issue on highways infrastructure assets; what is involved, why is it important, what is being done to resolve this issue and when are the audited accounts for 2020/21 likely to be approved by the Committee.

    <u>Infrastructure Assets</u>

6. Accounting for infrastructure in local government has not historically been an area of significant audit risk, due to the inalienable nature of the assets and the use of a historical cost basis of accounting. However, concerns raised by a local government auditor that some authorities are not applying component accounting requirements appropriately have recently come to light, via audit network discussions convened by the National Audit Office. The underlying issues appear to be more prevalent than anticipated and this is now an area of focus for all local audit firms

7. Infrastructure assets are one of the few categories of property, plant and equipment measured at historical cost rather than at an asset measurement described as ‘current value’. The valuation process for these assets at current value was deemed to be too costly when reviewed around 5 years ago by CIPFA, and therefore infrastructure assets continue to held in local authority balance sheets at depreciated historical cost.

8. Normal custom and practice for (highways) infrastructure assets is that derecognition (or removal of these assets from the accounts) does not affect asset balances included in the accounts because the assets are expected to have been fully used up before the replacement expenditure takes place. This though does require that assets are properly depreciated in line with the requirements of the Accounting Code.

9. This issue arises in part because of limitations on historical information relating to when the highways assets were first recorded on local authority balance sheets in the early 1990s, and where there have been transfers of assets because of local authority reorganisations. It is also extremely difficult to clearly identify the parts of the assets, which are being replaced.

10. CIPFA has offered to assist resolution by providing additional guidance and by pursuing whether any augmentations to the Accounting Code would assist with the situation. The CIPFA LASAAC Local Authority Accounting Code Board (CIPFA LASAAC) has agreed to consider such proposals.

11. In terms of Middlesbrough’s accounts for 2020/21, the net book value of infrastructure assets in the Balance Sheet was £134.6m and this balance mainly consists of highways assets. Given the Council’s materiality level for this audit was £5m and with the issue set out above, the probability of a material error being included is relatively high.

Task & Finish Group & temporary solution

12. Due to the audit concerns raised, CIPFA convened an urgent task and finish group to consider the issue and the impact on 2020/21 audits. This group met three times between late March and late April 2022 to discuss a way forward. There was an acknowledgement from this group that a temporary solution was needed to address audits that were still open and a longer-term solution that would need subsequent discussion for future years. The group’s work would focus on the former and CIPFA LASSAC would consider the latter in due course.

13. Following the advice of the Task and Finish Group, CIPFA LASAAC has proposed a temporary solution, with changes to the Code for the reporting, including proposals to:
    - confirm the accounting consequences of derecognition, i.e. that the effect on the carrying amount is nil (on the presumption that replaced parts are fully depreciated)
    - temporarily adapt the code to remove the reporting requirements for gross historical cost and accumulated depreciation
    - provide extra guidance on how depreciation may be applied for infrastructure assets

14. The temporary solution is under consultation at present with local authorities and other stakeholders. The consultation period is for four weeks in total and closes on the 14th June. Following that CIPFA will evaluate responses, clarify its stance on the position

formally and then look for approval from the Financial Reporting Advisory Board. Once this is agreed, the relevant changes to the current Accounting Code of Practice can be made and the issue can move forward.

15. It is expected that local authorities will be required to confirm their position on the accounting consequences of derecognition, i.e. have all highways assets been fully depreciated before replacement and to make appropriate adjustments to the current property, plant and equipment note in the accounts to remove the gross carrying values and accumulated depreciation. These changes will have no impact on the figures in the financial statements previously presented via the last report on 31st March 2022 but are important to comply with the CIPFA recommendations. Auditors will then need to consider whether they need to do any further testing around this assumption on derecognition and associated depreciation balances within the Council's asset register.

16. As the FRAB approval is not due until 28th June and then CIPFA need to confirm their advice to local authorities and external auditors, the earliest the audited accounts may be available for approval is mid-July. Given that the Council's draft accounts for 2021/22 are expected to be presented to the Committee on 21st July, it is felt beneficial that the audited accounts should be considered via a special committee meeting before this. The benefit of this is that comparative figures in the new year draft accounts will have an audited and agreed starting point, plus this would also spread the workload burden on the accounts over two separate meetings. Members' comments on the order and timing of these meetings can be discussed further at the meeting.

What decision(s) are being recommended?

That the Corporate Affairs and Audit Committee note the contents of the above report and the timescales for submitting the 2020/21 audited statement of accounts for approval.

Rationale for the recommended decision(s)

17. Not Applicable.

Other potential decision(s) and why these have not been recommended

18. Not applicable

Impact(s) of the recommended decision(s)

Legal

19. 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.

Strategic priorities and risks

20. As the Statement of Accounts covers all financial transactions of the Council, it encompasses all strategic priorities and risks.

21. 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.

Human Rights, Equality and Data Protection

22. There are no relevant considerations in these areas in respect of this report.

Financial

23. 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.

Actions to be taken to implement the recommended decision(s)

Action	Responsible Officer	Deadline
Not applicable		

Appendices

Not Applicable

Background papers

Body	Report title	Date
Corporate Affairs & Audit Committee	Draft Statement of Accounts – 2020/21	5th August 2021
Corporate Affairs & Audit Committee	2020/21 EY Planning Report	5th August 2021
Corporate Affairs & Audit Committee	Statement of Accounts (Financial Element)	31st March 2022

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