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| Report of: | Director of Finance – Ian Wright |
| Submitted to: | Corporate Affairs & Audit Committee – 26 th November 2020 |
| Subject: | Audited Statement of Accounts – 2019/20 |

Summary

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| Proposed decision(s) |
| The proposed decision is for Members to approve the Council’s Statement of Accounts for 2019/20 following external audit. |

| Report for: | Key decision: | Confidential: | Is the report urgent?¹ |
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| Decision | Not Applicable – statutory requirement | No public decision. | Not applicable. Does not follow normal decision-making process for Executive. |

| Contribution to delivery of the 2020-23 Strategic Plan | | |
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| People | Place | Business |
| Part of the financial management and reporting process that underpin all key strategic aims. | Part of the financial management and reporting process that underpin all key strategic aims. | Part of the financial management and reporting process that underpin all key strategic aims. |

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| Ward(s) affected |
| All – corporate report. |

What is the purpose of this report?

1. The purpose of the report is for Members to review and approve the Council’s Statement of Accounts for 2019/20 following external audit.

Why does this report require a Member decision?

2. It is a statutory requirement under the Accounts & Audit Regulations 2015 for the Council to approve the audited Statement of Accounts each year. Under the Constitution, that body is the Corporate Affairs & Audit Committee.

Report Background

3. The draft Statement of Accounts for 2019/20 was presented to this Committee on 30th July 2020 which gave Members an understanding of the Council's financial position at 31st March 2020 and how it had performed against its revenue and capital budget plans. Significant issues included within the financial statements were also discussed for information.
4. The preparation and external audit of the Statement of Accounts and their timeliness for presentation to Committee has been significantly affected by the Covid-19 pandemic and the impact that this has had on local authorities, their workload and with the majority of staff having to work from home. Because of this, the Audit and Accounts Regulations 2015 were amended by the Coronavirus regulations 2020 to allow additional time to be factored in for this work. The revised statutory deadlines for 2019/20 being 31st August 2020 for the draft accounts and 30th November 2020 for the audited accounts.
5. The statutory regulations also require a 30 working day period where the accounts are held on deposit by the Council and can be inspected by members of the public. This was held from 27th July 2020 to 7th September 2020. No requests to inspect either the accounts or supporting information were received during this period.
6. The draft accounts have now been substantially audited by the Council's external auditors Ernst and Young (EY). They expect to give an unqualified opinion on the financial statements i.e. the accounts give a true and fair view of the financial position of the Council as at 31st March 2020 and have been prepared in accordance with the CIPFA Code of Practice for Local Authority Accounting.
7. As is usual during the audit process, EY have identified a number of issues that require changes to be made to the draft accounts and these have been reflected in the revised final Statement of Accounts attached. Details of the adjustments that have been made to the accounts are included in EY's audit results report and are explained below.
8. There are five main accounting issues which should be drawn to the Committee's attention. Four of these have been amended in the updated accounts and one has not due to its relatively small size and the amount of work that would be needed to restate.

Pensions Liabilities

9. As Members will be aware the net pensions liability in the accounts in respect of retirement benefits (IAS 19) is a significant figure. In the draft balance sheet presented on 30th July the liability was £278.9m. The effect of this large balance and movement in year (almost £80m increase) means that the total liabilities of the Council exceed assets owned for the first time.
10. The assets that are part of the net pensions liability under IAS 19 are derived from a % of the total assets held by the Teesside Pension Fund. As part of EY's audit of the pension fund, they have identified a misstatement in relation to the total value of assets held of £26m (0.7% of the Fund). This reduction in assets has a direct impact on the IAS 19 assets held in the Council's accounts. Our relevant share is around £4.7 and this increases the net liability above to £283.6m.

11. There is also still some on-going discussion with EY around whether the legal ruling for the McCloud age discrimination case has been correctly factored into the triennial valuation of the pension fund and into 2019/20 liabilities. Most of this information has been provided via the Council's pensions actuary and therefore should not require any further adjustments to be made to the net liability position.

Finance Lease Liability

12. The lease liability in the draft accounts for the centre square buildings was originally recognised based on the construction cost of the asset at £20.834m and that total cash flows over the next 35 years would be split between principal and interest in terms of an amortised cost model based on actual expected payments.

13. However, IAS17, the international accounting standard on leasing states that the valuation of the obligation of the lease needs to be based on minimum rather than actual lease rental payments and that these should be discounted over the lease term. As a result, the liability has been overstated substantially.

14. The amount that should have been recognised in the accounts has now been recalculated at £12.374m, a difference of £8.460m from the draft financial statements in July. Although this may seem strange to recognise a liability at a much lower value than the cost of the asset, this difference essentially reflects the time value of money over the lease period.

15. The value of the lease liability in the accounts will be revisited on an annual basis to ensure it is assessed each financial year in line with the standard approach. The accounts have been updated for this revised amount and the net liabilities recorded within the Council's balance sheet have improved because of this audit adjustment.

Schools Bank Accounts

16. As part of the closure of holding accounts that support the accounting process for schools with their own bank accounts, a creditor (amount owed) was included in the Balance Sheet for £0.622m. This was on the basis of amounts owed to academy schools as part of their transfer from local authority status.

17. On further examination, this amount is not owed to academies but includes a number of funding and expenditure items that have not been cleared over a number of years. As it is not a creditor, the easiest way to resolve this is to reverse the year end accrual back to the holding account which forms part of the Council's cash balances and to investigate these transactions during 2020/21

Lease Surrender Costs

18. As part of the legal process to declare Newham Farm as surplus to requirements and to generate a capital receipt for the land attached, a lease surrender cost of £0.607m was paid by the Council to the Farm's tenant during 2019/20. As this cost can be offset against the capital receipt it was carried forward as a payment in advance to match the receipt in a future year.

19. The above accounting treatment though does not recognise the lease surrender cost as an expense in the comprehensive income and expenditure statement. In

theory until the capital receipt is generated, this is just a normal revenue cost to be recognised in the usual way, which needs to be realised at the point of contractual exchange i.e. in 2019/20. As the cost is part of a future profit/loss on disposal the transaction does not count against the general fund balance in year and can be reversed out via the Movement in Reserves statement as a negative carry forward against usable capital receipts reserve.

20. The accounting treatment behind this is complex and would affect all of the primary financial statements, as well as many of the notes to the accounts. It would also impact on the capital financing outturn position for the Council as less capital receipts should have been used and more borrowing undertaken if the expense was carried forward against the usable capital receipts reserve. Given these issues, Officers are proposing that the accounts are not adjusted for this transaction given that it is only 7% of the Council's materiality threshold.

Interest Accruals

21. The traditional accounting treatment for interest owed on long-term borrowing at the financial year-end was to account for these as creditors (amounts owed) to lenders, with the amount of principal outstanding on the loan recorded separately in the Balance Sheet.

22. From 2007 and with the introduction of international financial reporting standards the accounting treatment changed to that of amortised cost for long terms loans. This means that the carrying value of the loan should be equivalent to the amount initially recognised at the contract date, less any principal repayments made plus any interest owed at the balance sheet date. The Council has continued to follow the traditional method of accounting treatment from 2007 to 2020 without this being identified in previous audits.

23. The issue has been raised as part of this year's audit and as a result and to ensure compliance in future years, it is proposed that the accounts are changed. This is a cosmetic adjustment between creditors and long-term loans and only affects a small number of disclosure notes. The amount involved for 2019/20 is £1.089m.

Disclosure Changes

24. There are two main disclosure changes that are required in the audited accounts. These relate to a specific disclosure on the going concern basis of the preparation of the financial statements and a full disclosure around the leasing arrangements for 1 & 2 Centre Square. There are references to these in other parts of the accounts but given their relative importance. However, these are important issues for the Council and it has been agreed to give these higher prominence so users of the accounts can understand their significance better.

25. **Going Concern** – Given the current Covid-19 pandemic, there has been much discussion in the media around the impact on individual local authority financial positions and subsequent budget setting processes. This is on the back of more than a decade of austerity and savings proposals as central government funding has reduced and there has been a greater emphasis on local taxation and use of earmarked reserves.

26. Because of these pressures and a number of high profile cases of financial difficulty in local government, there is a greater scrutiny on whether individual authorities are going concerns in the medium term. IAS1 relating to the 'Presentation of Financial Statements' indicates that for each set of accounts, Management should make an assessment of an entities ability to continue as a going concern into the foreseeable future. As Covid-19 could threaten this assumption, specific disclosure is required in the accounting policies, as to why management has come to this conclusion for the Council.
27. In previous years, this has been implicit due to the framework that local authorities work within and has not needed additional information. For 2019/20, this needs to be more explicit due to the risk presented by Covid to local income streams. An additional and comprehensive disclosure has therefore been included in Note 1 on accounting policies to satisfy this requirement.
28. **Centre Square leases** - During 2019/20 the Council entered into leasing arrangements for buildings 1 & 2 at Centre Square. The creation of high quality accommodation in the Town Centre is a key strand of the Mayor's strategic plan. Contracts were signed by the Council to lease these buildings during the financial year with financial commitments in place for a 35-year period.
29. As the risks and rewards of the leases fall mainly to the Council, the buildings have been accounted for in the same way as if the property was owned.
30. Although the accounting has been undertaken in line with the Code of Practice requirements, the value of the asset is material in the Balance Sheet and not enough details of this transaction have been disclosed in the draft accounts. More information on these transactions are now included in the leasing note.
31. Also minor changes have been made to the following disclosure notes following audit testing. These relate to the following:
- Related Party Transactions
 - Dedicated Schools Grant
 - Property Plant & Equipment
 - Financial Instruments
 - Debtors & Creditors
 - Officers Remuneration
32. Further details can be provided to Members on these disclosure note changes if these are required.

Pension Fund Accounts

33. Although the Pension Fund accounts are subject to a separate audit from the Council's accounts, they are included within Middlesbrough's Statement of Accounts due to its role as the administering authority.
34. The main issue in the Pension Fund accounts because of the external audit results to the overstatement of assets in the draft accounts by £32.9m or 0.88%. This was due to an error in the information provided by one of the Fund's external managers plus a double count as part of the preparation process for the accounts.

35. A number of disclosures have also been given greater focus given Covid-19 and its impact on the pension fund accounts. These include the impact of material valuation uncertainty on the Fund, the going concern basis for the preparation of the financial statements (see the Council issue highlighted above) and a post balance sheet event note to indicate that the losses on the fund experienced in February and March 2020 were mainly recovered in the first quarter of 2020/21. Again, these were implicit within the draft accounts but are now more explicit and extensive in the revised set of accounts.
36. The revised Statement of Accounts post audit for 2019/20 is attached to this report as **Appendix 1** with an updated set of summary accounts (which is not subject to audit) as **Appendix 2**. After approval by the Committee and sign off by the Director of Finance, these documents will replace the current draft set of accounts on the Council's website as its formal external financial reporting record for the year once the audit opinion on the accounts has been received.

What decision(s) are being asked for?

37. The proposed decision is for Members to approve the Council's Statement of Accounts for 2019/20 following external audit.

Why is this being recommended?

38. It is a statutory requirement of the Accounts and Audit Regulations 2015 – (Coronavirus amendments 2020) that the audited 2018/19 Statement of Accounts are approved by Members of the Committee and published on the Council's website on or before 30 November 2020. In order to comply with the regulations the Chief Finance Officer and Chair of the Committee should sign the Statement of Responsibilities confirming the approval of the accounts and the authorisation to issue these as a public document.

Other potential decisions and why these have not been recommended

39. This is a statutory decision to approve the Statement of Accounts so no other options are available for the Committee to consider.

Impact(s) of recommended decision(s)

40. Approval of the audited accounts demonstrates that the Council is fully compliant with the requirements of the Accounts & Audit Regulations 2015 and the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20. The Code of Practice is seen as best practice for local authority financial reporting and compliance ensures that the accounts present a true and fair view of the financial position and transactions of the Council as at 31 March 2020 and during the year

Legal

41. Compliance with relevant statutory deadlines for external financial reporting.

Financial

42. The Audited Statement of Accounts is consistent with the Council's Medium Term Financial Plan and its assumptions regarding its reserves and balances

Policy Framework

43. The report forms part of the framework that ensures the Council's corporate governance arrangements are fit for purpose, ensuring the Council is best placed to support delivery of the Mayor's vision.

Equality and Diversity

44. There are no direct implications arising from this report on equality and diversity.

Risk

45. Failure to approve and publish the accounts by 30th November 2020 in line with the statutory requirements would lead to reputational damage to the Council and possible Government intervention.

Actions to be taken to implement the decision(s)

46. Following approval, the Audited Statement of Accounts will be published on the Council's website in line with statutory requirements.

Appendices

Appendix 1 – 2019/20 Audited Statement of Accounts.

Appendix 2 – 2019/20 Summary Statement of Accounts

Background papers

| Body | Report title | Date |
|-------------------------------------|---------------------------------------|----------------------------|
| Corporate Affairs & Audit Committee | Draft Statement of Accounts – 2019/20 | 30 th July 2020 |

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