

Report of:	Director of Finance (S151 Officer)
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Submitted to:	Corporate Affairs and Audit Committee
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Date:	23 September 2022
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Title:	Highways Infrastructure Assets - Update
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Report for:	Information
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Status:	Public
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Strategic priority:	All
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Key decision:	Not applicable
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Why:	Not applicable
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Urgent:	Not applicable
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Why:	
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Executive summary

This report follows on from the 'approval of the audited Statement of Accounts' for the 2020/21 financial year considered by the Committee on 22 July 2022. At that point, Members approved the accounts following the Audit Results Report from Ernst & Young (EY). However, this was subject to further updates on the finalisation of the Annual Governance Statement for that year and on Highways Infrastructure Assets.

Both of these issues were delegated to the Director of Finance to resolve and sufficient clarity is needed on these two issues before the audit opinion on the accounts can be issued by EY and the audit process for 2020/21 be brought to a close.

The Annual Governance Statement for 2020/21 has now been agreed and signed (see previous report on the agenda) and we now have a proposed way forward on Highways Infrastructure Assets that will be the basis of the report and is for Member's information.

Purpose

1. The purpose of the report is to update Members on the Highways Infrastructure Assets position for 2020/21 following the Chartered Institute of Public Finance & Accountancy's review on this subject earlier this year.
2. A way forward on this issue, which is acceptable to both the Council and to the external auditors, will allow EY to issue their opinion on the financial statements and to close the audit process for that financial year. This would be useful given the length of the current audit and the need to move on with the audit of the 2021/22 accounts for the Council which have now been prepared.

Background and relevant information

3. The draft Statement of Accounts for 2020/21 was presented to this Committee on 5th August 2021 which gave Members an understanding of the Council's financial position, performance and cash flows at 31st March 2021, and how it had performed against its revenue and capital budget plans. Significant issues included within the financial statements were also discussed for information at that stage.
4. Further updates have been given to the Committee on progress during the audit, principally on the 31 March, 9 June and 22nd July 2022 when EY's audit results report and an updated Statement of Accounts were presented. These reports explained the various delays experienced so far on the audit of the accounts and why statutory date had not been met.
5. At the meeting on 22 July, the Committee approved the audited statement of accounts subject to; the annual governance statement being finalised and agreed by the Mayor, the Chief Executive & the Director of Finance, and the Highways Infrastructure Assets issue, which had been raised during the audit being resolved.
6. A signed annual governance statement for 2020/21 is included within the agenda papers for this meeting. In order for EY to issue their audit opinion for the financial year, a resolution on the position on highways assets is required.

Highways Infrastructure Assets

7. The report to the Committee on 9th June 2022 sets out the current issue on this subject and the reasons why this was delaying external auditors issuing opinions on the financial statements. In summary, this relates to an uncertainty on whether these assets have been fully depreciated over their useful life before they have been replaced. If this is not the case then the totals in the balance sheet for these assets could be materially misstated. Further details on this subject are included in Appendix 1 for Members information, as this is a technical area of the accounts.
8. The total of these assets stated in the Council's Balance Sheet as at 31st March 2021 is as follows:

- Gross Book Value:	£221.151M
- Accumulated Deprecation:	(£88.224M)
- Net Book Value	<u>£132.927M</u>

9. The above balances contain the main types of highways asset, including roads, bridges, street furniture, adopted land etc. They do not include becks, flood prevention assets or the Transporter Bridge, which are also accounted for as infrastructure. The accounting policy for these at present is to capitalise at historic cost when recognised and then to depreciate their value over the useful economic life of the asset, which would normally be between 25 – 40 years. The amounts are recorded in the Council's fixed asset register along with other types of tangible assets such as property, plant & equipment.
10. CIPFA undertook some work via an urgent task and finish group in April and May of this year to assess what was needed as a temporary solution to allow any open 2020/21 audits to be finalised. Some guidance was initially published based on the conclusions of the group and a consultation was held seeking stakeholder views from the wider sector, which closed on 14 June 2022. The main issue to note being that these assets have long life spans and that local authorities only hold partial and insufficient records in relation to their individual histories, particularly where de-recognition is concerned.
11. The current advice from CIPFA is inconclusive. From their perspective, the issue is complicated and needs further work and consultation with stakeholders before a final solution is recommended. This work is ongoing with late 2022/early 2023 suggested as timescales for a possible resolution.

Limitation of Scope – Audit Opinion

12. The lack of definitive guidance by CIPFA is problematic for any local authority with audits still open for the 2020/21 financial year. Local audit firms are unable to sign-off audit opinions on the financial statements at present given this issue.
13. There are discussions at both national and local levels about how to resolve this particular impasse. One simple option is for the local authority to keep its accounts open until a way forward is proposed by CIPFA. However, this might take a significant time to resolve, as councils would need to undertake the appropriate work to review and restate account balances even once any guidance is finalised. This work would then have to be audited and assessed for reasonableness. There may also be reputational issues for keeping the accounts open for even longer and practical issues around how much audit work could be done on the 2021/22 accounts in the interim. The second option available may be to adopt a limitation of scope position.
14. In an audit, a limitation of scope is a situation where auditors cannot obtain sufficient appropriate evidence to make a conclusion on certain account balances, transactions or events. This is the position with highways assets where local authorities hold some data but the accounting records do not generally record and adjust for de-recognitions (or disposals) in sufficient detail. The normal approach to this would be for the auditors to modify their opinion on the financial statements as a result.
15. The limitation of scope approach is attractive for some Councils. It would allow the audit process for 2020/21 to be completed with a view from EY that the financial statements give a true and fair view in all regards and for all key balances, except for Highways Infrastructure Assets. This would allow the Council to publish their audited Statement of Accounts for 2020/21 and EY to move on with their audit of the 2021/22 accounts.
16. Although Middlesbrough's highways service does maintain an information management system (Symology) and some of the information that is required for the accounting

process is recorded within this system. We are not confident that this is sufficient to restate the balances needed back to 2011 when international financial reporting standards were first introduced. Although further work could be done to extract the information and to use local knowledge to fill in the gaps, this is seen as a large piece of work that could take several months. The current accountancy fixed asset register does not also provide the level of detail required in relation to new additions and de-recognitions to be able to account for these assets in a reasonable way.

17. We are however more confident that Symology can be used to capture the correct level of data going forwards and that this work can be linked with the Council's fixed asset register to produce the correct capital accounting entries going forwards.
18. As a result, the view of the Director of Finance (as responsible financial officer) is that the limitation of scope option to close the external audit for 2020/21 brings more benefits than disadvantages and that the Council should pursue this option with EY. It is also sensible given the circumstances as it allows the maximum certainty on the Council's financial position and to stakeholders.
19. At present, we are only aware of one other local authority who has finalised their audit on this basis. This is Cambridgeshire County Council. However, given the current position on a formal view from CIPFA taking some time, we are aware that a number of Councils are now proposing a limitation of scope way forward to close their audits for the financial year.
20. The Council finance team will continue to work with the Highways service to see what information is needed/available to resolve this issue, both retrospectively and going forwards. We will also monitor the position on future CIPFA guidance, changes to the accounting code of practice and will bring updates to the Committee on an interim basis.
21. Although this is a S151 Officer decision rather than for the Committee to make, we are interested in Member's views on the subject before confirming to EY. In advance of the meeting if Members feel they need more information or would welcome a discussion on the subject, this can be arranged.
22. If the Committee agree with the Director of Finance's view on this EY will need to modify their audit results report for the 2020/21 financial year. The auditor will give an update on this at the meeting if this is the proposed way forward.

What decision(s) are being recommended?

That the Corporate Affairs and Audit Committee:

- Note the contents of the report and the position on the audit process for 2020/21;
- Form a view as to whether they support the Director of Finance's advice to accept a limitation of scope option in relation to Highways Infrastructure assets for the year in question.

Rationale for the recommended decision(s)

23. The limitation of scope option will allow the completion of the external audit process for the financial year and confirm the material balances in the accounts at 31st March 2021. It will also allow the audit of accounts for 2021/22 to be progressed.

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

24. The only other option available to the Council is to leave the accounts open until a solution is recommended by CIPFA and agreed with EY.

Impact(s) of the recommended decision(s)

Legal

25. 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

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

27. 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

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

Financial

29. 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

Action	Responsible Officer	Deadline
To agree the limitation of Scope option for Highways Infrastructure Assets in order to close the external audit for 2020/21.	Director of Finance	TBC as depends on internal process within EY to ratify this option for Middlesbrough.

Appendices

1	Appendix 1 – CIPFA note on Infrastructure Assets
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Background papers

Body	Report title	Date
Corporate Affairs & Audit Committee	Draft Statement of Accounts 2020/21	5 th August 2021
Corporate Affairs & Audit Committee	Statement of Accounts (Financial Element)	31 st March 2022
Corporate Affairs & Audit Committee	Infrastructure Assets & Statement of Accounts 2020/21	9 th June 2022
Corporate Affairs & Audit Committee	Audited Statement of Accounts 2020/21	22 nd July 2022

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