CORPORATE AFFAIRS AND AUDIT COMMITTEE

A meeting of the Corporate Affairs and Audit Committee was held on Monday 5 December 2022.

PRESENT: Councillors B Hubbard (Chair), J Platt (Vice-Chair), T Higgins, C Hobson, T Mawston, D Rooney and C Wright

ALSO IN ATTENDANCE: Tebbs (Ernst Young), M Rutter (External Auditor) (Ernst Young) and M Thomas (Internal Auditor) (Veritau)

OFFICERS: C Benjamin, S Lightwing, C Benjamin, A Johnstone, H Seechurn and J Weston

APOLOGIES FOR ABSENCE: were submitted on behalf of Councillor Wright

22/35 **WELCOME AND EVACUATION PROCEDURE**

The Chair welcomed all present to the meeting and read out the Building Evacuation Procedure.

22/36 **DECLARATIONS OF INTEREST**

Name of Member	Type of Interest	Item/Nature of Interest
Councillor Higgins	Non Pecuniary	Member of Teesside Pension Fund
Councillor C Hobson	Non Pecuniary	Member of Teesside Pension Fund
Councillor Hubbard	Non Pecuniary	Member of Teesside Pension Fund
Councillor Rooney	Non Pecuniary	Member of Teesside Pension Fund

22/37 **MINUTES - CORPORATE AFFAIRS AND AUDIT COMMITTEE - 23 AND 29 SEPTEMBER 2022**

The minutes of the Corporate Affairs meetings held on 23 and 29 September 2022 were submitted and approved as a correct record, subject to the following amendment:

29 September 2022 – M Rutter (Ernst Young) – name to be moved from heading "Officers" to "Also in Attendance".

22/38 **TEESSIDE PENSION FUND AUDIT RESULTS REPORT 2020/21**

Due to issues in relation to insurance and some adjustments that were needed, as well as national advice and guidance that was awaited, this item was deferred for consideration at a future meeting.

AGREED that the Teesside Pension Fund Audit Results Report 2020/2021 was **DEFERRED.**

22/39 **EXTERNAL AUDIT - VALUE FOR MONEY GOVERNANCE UPDATE**

The External Auditor presented the Value for Money Governance Update.

The Council had taken positive actions to respond to the Auditor's previous recommendations, including the commissioning of external work by CIPFA to assist in identifying the root causes of relationship issues at the Council and an action plan to address them, implementation of an Improvement Board with an external chair and strong representation from elected members and senior officers, and reporting of those actions through full Council.

These steps were in line with expectations and the future actions identified to date appeared to be appropriate steps towards addressing both the depth and breadth of cultural and governance issues at the Council.

It was clear however, that there was significant concern amongst a number of stakeholders over the ability of the Council to deliver on these actions, characterised by expressions of a lack of confidence in the acceptance by individuals of the significance of the governance issues identified at the Council and the commitment of all necessary stakeholders towards meaningful change. It would take all of the Council's elected members and senior officers working together to address the issues faced by the Council, however it remained unclear whether this could be achieved.

In addition, the Improvement Plan prepared by the Council focused on actions to be completed over the next 90 days. Whilst these were positive first steps, the Council would not be able to enact the necessary cultural changes within the Council which were required within this timescale, and concerted effort over a much longer period of time would be required.

It was clear that significant barriers to implementation of the Improvement Plan existed, however the actions taken to date had been appropriate and given sufficient prominence amongst Elected Members and senior officers. On this basis, the External Auditor did not consider that it was either necessary, or would be beneficial, to escalate their recommendation through the exercise of additional auditor reporting powers (including statutory recommendations) at this time. The Council was currently taking appropriate steps and should be given time to demonstrate whether those steps could have the necessary impact on the Council's culture and governance.

The External Auditor would continue to monitor the progress of the Council against the Improvement Plan as part of the value for money assessment, where EY recognised the Council's governance as a risk of significant weakness, and would report on the Council's progress through the value for money commentary. Should this assessment provide evidence that the Council was not making satisfactory progress against the Improvement Plan, or the actions taken were not having the necessary effect on the Council's culture, the External Auditor would reconsider whether a statutory recommendation or exercise of other auditor reporting powers might be appropriate. The Auditor confirmed that all documentation from the Improvement Groups was shared with them and formed part of their evidence base.

AGREED that the report was received and noted.

22/40 **ANNUAL GOVERNANCE STATEMENT 2021/22**

A copy of the update Annual Governance Statement (AGS) 2021/2022 was presented. The AGS set out the Council's position at the end of the 2021/22 financial year in relation to compliance with the Local Code of Corporate Governance (LCCG) which set out the standards to be achieved across the corporate governance framework.

The following areas were highlighted:

• Progress made during 2021/2022 - This section would normally set out progress made against the previous year's Annual Governance Statement which had been considered 12 months before this statement. Delays in the signing off of the 2020/21 AGS meant that document had only recently been approved and it therefore contained little movement between the table set out in the 2020/21 AGS and this document, at this stage. Actions due to be delivered in October in relation to delivery of officer training in relation to understanding governance and delivery of advice and challenge had been completed.

• Internal Audit during 2021/2022 – details of 20 audits undertaken during the year were set out at Appendix 1 to the submitted report.

• Corporate Affairs and Audit Committee during 2021/2022 – corporate governance related items considered by the Committee.

• Overview and Scrutiny during 2021/2022 – items considered by the Board.

• Other Governance related events during 2021/2022 which included:
  - Covid-19
  - Governance allegations
  - Resignation of Executive Members
  - Organisational culture and Member/Officer relationships
  - Boho X and CCTV internal audits

Post-OFSTED improvement journey
Inflation and cost of living
Middlesbrough Development Company activity during 2021/2022.

Concern was voiced by several Members in relation to Member/Officer relationships and whether those individuals responsible could be identified. The Monitoring Officer explained that at future meetings of the Standards Committee, Members would receive notice of all Code of Conduct complaints that had been submitted and whether they had, or would be, dealt with formally or informally.

In relation to measuring progress it was confirmed that the Improvement Action Plan included milestones which provided a quantitative measure. A baseline survey of staff and Members had been completed and this would be repeated as a qualitative measure. This would provide a good basis for evidence that would be provided to the Improvement Board.

Internal Audit were currently undertaking an assessment of the Middlesbrough Development Company and considering the future role of the Company and any possible recommendations or changes to strengthen governance arrangements. It was clarified that if the MDC was to continue, governance changes would be needed to ensure best practice. The Auditor confirmed that the field work on this audit had been completed and some initial findings had been shared with Officers.

The final query from Members was with regard to communication with Officers via telephone and email. It was confirmed that this issue was being addressed by one of the Improvement Board sub groups.

AGREED that the Annual Governance Statement 2021/2022 was received and noted.

22/41 **COUNCIL AUDIT PLANNING REPORT 2021/22**

The External Auditor presented the Audit Planning Report for the year ended March 2022.

The Audit Planning Report set out how External Audit intended to carry out their responsibilities and provide the Corporate Affairs and Audit Committee with a basis to review the proposed audit approach and scope for the 2021/22 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. The Planning Report also aimed to ensure that the audit was aligned with the Committee's service expectations.

The plan summarised External Audit's initial assessment of the key risks driving the development of an effective audit for the Council, and outlined the planned audit strategy in response to those risks. External Audit's planning procedures were substantially complete subject to final review, however the 2020/21 audit was not yet complete and should any material changes arise these would be communicated to the Committee as appropriate.

Group materiality had been set at £6.9 million, which represented 1.5% of the gross expenditure on provision of services per the draft Statement of Accounts. The threshold used for materiality assessment had been decreased from the 1.8% of gross expenditure used in the prior year due to the increased interest in the Council's Statement of Accounts as a result of the significant weaknesses in governance.

Group performance materiality had been set at £3.4 million, which represented 50% of materiality. The percentage of materiality used for performance materiality from 75% to 50% had been decreased as the volume and size of misstatements identified in recent audits led Audit to conclude there was a higher risk of undetected misstatement.

All uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement and collection fund) greater than £0.3 million would be reported. The reporting threshold for the prior year's audit was £0.4m. Other misstatements identified would be communicated to the extent that they merited the attention of the Corporate Affairs and Audit Committee.

The Auditor highlighted the following audit risks and areas of focus along with any changes from the prior year:

- Risk of fraud in revenue and expenditure recognition.
- Misstatements due to fraud or error
- Variation of land and buildings.
- Accounting for infrastructure assets.
- Valuation of defined benefit pension liability.
- Member and senior officer relationships.
- Provision of Children's Services.

In relation to Accounting for infrastructure assets it was clarified that the Council's records were not sufficiently detailed to allow identification of individual assets or components. It was confirmed that the Council had now had a system in place to capture this information but there was insufficient detail for previous years and a reconciliation exercise needed to be undertaken.

It was noted in that report that a high volume of correspondence with regards to the Council was received by the Auditor and much of this correspondence was directly or indirectly linked to the significant weaknesses in arrangements previously reported. The Auditor confirmed that correspondence was received from a wide range of sources including Elected Members, members of the public and other groups that worked with the Council. EY considered such correspondence as information brought to the Auditor's attention for the purposes of the value for money assessment and, where appropriate, designed additional procedures to respond to any risks raised by consideration of that information.

In relation to the proposed Mayoral Development Corporation (MDC) and the Council's assets, the Auditor clarified that if assets were transferred to different ownership they would not be included in the Council's accounts.

A discussion took place in relation to the MDC and the Monitoring Officer explained that the Council was currently in discussions with the Tees Valley Combined Authority (TVCA) about the Constitution of MDC and transfer of assets and planning powers. In terms of any changes to assets, this would affect the budget and policy framework and would need to be brought to the Council for consideration.

AGREED that the information provided was received and noted.

22/42 **TEESSIDE PENSION FUND PLANNING REPORT 2021/22**

The External Auditor presented the Outline Audit Planning Report which set out how External Audit intended to carry out its responsibilities as auditor.

The purpose of the report was to provide the Corporate Affairs and Audit Committee with a basis to review the proposed audit approach and scope for the 2021/22 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. The report was also intended to ensure that the audit was aligned with the Committee's service expectations.

The plan summarised External Audit's initial assessment of the key risks driving the development of an effective audit for the Pension Fund, and outlined the planned audit strategy in response to those risks. External Audit's planning procedures were substantially complete subject to final review, however the 2020/21 audit was not yet complete and should any material changes arise they would be communicated to the committee, as appropriate.

Materiality had been set at £50.7m, which represented 1% of the Fund's net assets at 31 March 2022 as per the draft financial statements. Materiality was also set at 1% of the Fund's net assets for the prior year's audit.

Performance materiality had been set at £25.3m, which represented 50% of materiality. The percentage of materiality used for performance materiality had been decreased from 75% to

50% as the size of misstatements identified in recent audits led the Auditor to conclude there was a higher risk of undetected misstatement.

All uncorrected misstatements relating to the primary statements (Fund Account and Net Asset Statement) greater than £2.5 million would be reported. The reporting threshold for the prior year's audit was £2.3m. Other misstatements identified would be communicated to the extent that they merited the attention of the Corporate Affairs and Audit Committee.

The Auditor highlighted the following audit risks and areas of focus along with any changes from the prior year:

- Misstatements due to fraud or error
- Valuation of pooled investment vehicles.
- Valuation of private market investments.
- Valuation of directly held property.
- Recognition of investment income.

AGREED that the report was received and noted.

22/43 **INTERNAL AUDIT AND COUNTER FRAUD PROGRESS REPORT 2022/23**

The internal audit progress report was attached as Annex 1 to the submitted report and reported on progress against the internal audit work programme. A summary of current work in progress, internal audit priorities for the year, completed work, and follow-up of previously agreed audit actions was also included. Two draft reports had been issued: Payroll and Burial Grounds and those reports would be finalised for the next meeting. A final report on Main Accounting had also been issued with substantial assurance. A number of actions had been implemented by management and revised target implementation dates had been agreed for 17 actions which would be followed up.

The counter fraud progress report was attached as Annex 2 to the submitted report and detailed progress against the counter fraud work programme. A range of work such as activity to promote awareness of fraud, work with external agencies, and information on the level of fraud reported to date was included in the report.

AGREED that the Committee noted the progress of internal audit and counter fraud work in 2022/2023.

22/44 **CAPITAL STRATEGY 2022/23 - MID YEAR UPDATE**

The Director of Finance presented a report on Capital Strategy. The Capital Strategy 2022/2023 Mid Year Update Report provided a high-level overview of how capital expenditure, capital financing and treasury management activities contributed to the provision of local public services at the Council. In addition, an overview of how the associated risks involved were managed and the implications for future financial sustainability were provided.

The Capital Strategy report for the Council covered the following areas:

- How the Investment Strategy was funded.
- The relevant Prudential Indicators to monitor the performance, affordability and sustainability of the capital expenditure being proposed in line with the requirements of the prudential code.
- Treasury Management arrangements in place for investing surplus funds and borrowing to fund capital expenditure.
- The types of investments the Council made as part of managing its cash balances – the Annual Investment Strategy.
- Minimum Revenue Provision policy – including outlining how much the Council set aside to re-pay debt built up to fund prior year's capital expenditure in the Borough.

The Director drew the Committee's attention to the following:

The table at paragraph 8 of the submitted report showed the Council's capital expenditure, how this was financed and the amount of borrowing. There had been a significant amount of slippage in this year's programme and therefore approximately £20 million less borrowing compared to the budget. The cost as a percentage of revenue budget was 8.9% which was below the guideline of 10% and allowed some headroom if any emergency works were required.

The forecast overall total long term external debt at the end of 2022/23 was expected to be around £250 million. This should be compared with the estimated Capital Financing Requirement (the underlying value which the Council needed to borrow to fund capital activities) of £283 million. The Council therefore had an expected under-borrowed position of circa £33 million or 12%, which had provided some annual savings in interest payments, as other revenue and capital cash had been used in lieu of borrowing.

On local authority borrowing, there had been much interest from both regulators and the media in recent months around individual councils taking significant amounts of long-term debt from the Public Works Loan Board (PWLB) for the sole purposes of commercial activity – generally property investment. Under the Prudential Code, local authorities had lots of freedom to conduct and self-regulate their own borrowing and investment activities. The Director confirmed that Middlesbrough did not use PWLB funding for property investment.

Increasingly local authorities were moving to an annuity basis of Minimum Revenue Provision (MRP) provision which catered for lower debt repayments in earlier years, with the consequence of greater amounts in later years, recognising that interest paid was higher in the earlier years. It was proposed that the Council moved to an annuity basis of MRP provision on unsupported debt from 2008. This was the significant part of the Council's capital financing requirement.

The impact of the MRP change would be to improve the management of the revenue budget for capital financing and to smooth the total cost of capital financing over many years. Under regulation the Council was unable to backdate the policy for prior financial years and would continue to hold MRP already provided on the balance sheet. Only future charges would be influenced by the new policy. The Director confirmed that the decision could be reversed if required.

In response to a question about the Council's level of debt in comparison to other Local Authorities, it was clarified that Middlesbrough was in the bottom quartile of the CIPFA financial sustainability index that was referenced annually.

AGREED as follows that:

1. The report was received and noted.
2. The proposed change on Minimum Revenue Provision was endorsed by the Committee.

22/45 **ANY OTHER URGENT ITEMS WHICH IN THE OPINION OF THE CHAIR, MAY BE CONSIDERED**

None.