

CORPORATE AFFAIRS AND AUDIT COMMITTEE

A meeting of the Corporate Affairs and Audit Committee was held on Thursday 26 November 2020.

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

OFFICERS: C Benjamin, S Bonner, B Carr, A Johnstone, S Lightwing, S Reynolds, P Stephens, J Weston and I Wright

APOLOGIES FOR ABSENCE: None received.

20/30 **DECLARATIONS OF INTEREST**

NAME OF MEMBER	TYPE OF INTEREST	ITEM/NATURE OF INTEREST
Councillor B Hubbard	Non pecuniary	Agenda Item 5 - Member of the Teesside Pension Fund
Councillor D Rooney	Non pecuniary	Agenda Item 5 - Member of the Teesside Pension Fund
Councillor D Rooney	Non pecuniary	Agenda Item 5 – Former Director of Middlesbrough Development Company

20/31 **MINUTES - CORPORATE AFFAIRS AND AUDIT COMMITTEE - 15 OCTOBER 2020**

The minutes of the Corporate Affairs meeting held on 15 October 2020 were submitted and approved as a correct record.

20/32 **AUDIT RESULTS REPORTS**

The provisional audit results report for Middlesbrough Council for 2019/2020 was presented.

The impact of the Covid-19 pandemic had caused significant additional work given the increase in the risk profile across all Local Authority audits. Key areas of the impact on risk assessment were in relation to property, plant and equipment, work around key judgements in respect of pensions and judgemental balances, and disclosures around going concern and whether their ought to be any material uncertainties around the financial position disclosed within Local Authority Financial Statements.

Subject to concluding outstanding matters listed in the submitted report, the External Auditor, Ernst Young, (EY) expected to issue an unqualified audit opinion on the financial statements. As previously advised, the value for money opinion would be modified in respect of the provision of Children's Services following the OFSTED inspection findings published in January 2020.

Section 4 of the submitted report identified the audit differences and they were also set out in the covering paper to the Financial Statements prepared by management. EY had confirmed their independence as required, together with other matters that had to be reported under auditing standards, in the appendices to the submitted report. EY were in discussion with management with a view to agreeing fees for 2019/2020 and any additional elements of impact in relation to 2019/2020 for the reasons outlined.

The auditor commented that there continued to be good working relationships between auditors and Council Officers and all had worked well to navigate through the challenges of the Financial Statement preparation process and the audit process, with a focus on quality as well as the wellbeing of the finance and audit teams. The auditor thanked the finance team for the support provided to EY in allowing them to make good progress in the discharge of their responsibilities.

Key aspects in terms of the findings were highlighted as follows:

- Risk of fraud in revenue and expenditure recognition.

Testing had not identified any misstatements arising from fraud in revenue and expenditure, or other matters relating to this risk to bring to the Committee's attention.

- Valuation of land and buildings.

It was previously reported in the Audit Plan Addendum that the Council's valuation this year was provided on the basis of material valuation uncertainty and the accounts disclosed that fact. The audit focussed on the Council's three main commercial assets: the two Centre Square buildings and the Tees Advanced Manufacturing Park (TAMP), since they were most likely to be impacted by the Covid-19 pandemic. EY's property experts agreed with the Council's valuation and noted that the valuations in the accounts were towards the bottom end of what was expected, but within a reasonable range. The Centre Square assets were recognised in-year as a finance lease, and came onto the balance sheet during the year with matching entries to the liabilities and were re-valued at the year-end. In the original draft accounts there was an impairment on those assets and Officers were now working through an updated lease calculation. This would not change the end value of the assets in the accounts and the net impact would be a reduction to the expenditure for the year due to a lower impairment charge and a lower liability on the Balance Sheet. The final numbers would be confirmed at a later date.

- Valuation of defined benefit pension liabilities.

The audit of the Teesside Pension Fund identified misstatement within the asset values provided to the Authority's Actuary to inform the preparation of the Authority's IAS 19 report. Council Officers had assessed the impact on the Authority's allocated share of the Pension Fund's assets and quantified an overstatement of the Authority's pension assets of £4.7 million. This amount had been adjusted for in the Authority's Financial Statements.

The Ministry for Housing, Communities and Local Government (MHCLG) had published proposed remedies for removing age discrimination from the Local Government Pension Scheme (LGPS) as a result of the McCloud case. The valuation of scheme liabilities as at 31 March 2020 did not include the impact of remedies affecting deferred and pensioner members. EY did not expect these liabilities to be material, but were engaging with their pensions specialists to confirm this. This was noted as an outstanding matter in Appendix D to the submitted report.

- Going concern and associated disclosures.

The Auditor confirmed that the Council had sufficient liquidity, including from planned borrowing, to support management's forecast cash flows over the period to 31 March 2021. EY had requested further cash flow forecasts for the period beyond 31 March 2021 to allow auditors to assess the required period of at least 12 months from the date of the auditor's report.

EY noted that the Council approved the transfer of the £4.9 million balance on the Authority's Investment Fund Contingency Reserve into the General Fund to cover the estimated £4.4 million impact of the Covid-19 pandemic on the Authority's 2020/2021 budget. The 2021/2022 budget would need to allow for the full impact of Covid-19, as the reserve transfer was a one-off that could not be repeated every year.

The cash flows for the period after 31 March 2021 and the going concern disclosures were noted as outstanding items in Appendix D to the submitted report.

- Value for Money Risk.

EY's intention to qualify the Value for Money opinion in response to the OFSTED Inspection findings on Children's Services had been previously reported to the Committee. The reports of the appointed Commissioner for Children's Services in Middlesbrough and the Ofsted monitoring visit supported that the Council had since put in place appropriate governance structures to respond to the Ofsted findings. The majority of these structures however, were

implemented very late in, or after, the period under audit. Accordingly, the auditor confirmed the intention to modify the value for money opinion for 2019/20 with regards to the provision of children's social care services.

Responding to a Member's question in relation to the overspend in Children's Service over a several years, the Director of Finance confirmed that under the Council's budgetary framework, individual Directors had delegated responsibility for their own budgets. It was pointed out that there were demand-led provisions within children's social care and statutory responsibilities that had to be met by the Council. The Director of Finance outlined measures that would be taken going forward to ensure that overspends did not continue. The £6.7 million forecast for the overspend in the current year was the headline overspend against the budget that was set for Children's Services at the start of the year. Included in the budget for 2020/21 was a £3 million demand provision in Central Services that could be offset against the £6.7 million leaving a net £3.7 million forecast overspend. A number of initiatives were being implemented through the work around the improvement journey and the improvement practice that would allow more timely and higher quality interventions for children and would cost less. A key part of future budget setting would be to ensure appropriate provision in light of financial sustainability. The Director of Finance commented that Children's Services had improved their effectiveness and there was a better understanding of demands which would enable better budget forecasting than in previous years.

The Executive Member for Finance and Governance informed the Committee that a Members' Briefing would be arranged in the near future to provide an update Children's Services.

It was noted that the Value for Money judgement for 2020/2021 by the auditor would be made over the full period and would depend on how much progress had been made by 31 March 2021 as well as the opinions of OFSTED, the Department For Education (DfE) and their Commissioners.

In relation to the Teesside Pension Fund (TPF) audit, the auditor acknowledged the support and assistance of Council Officers during a difficult year. EY had substantially completed the audit of Teesside Pension Fund for the year ended 31 March 2020. Subject to concluding the outstanding matters listed in the submitted report, the auditor confirmed that EY expected to issue an unqualified audit opinion on the financial statements. The audit opinion would include additional narrative to highlight financial statement disclosures that the valuations of directly held property had been prepared on the basis of a 'material valuation uncertainty'. These matters did not constitute a qualification of the audit opinion.

The auditor highlighted the following key points of the report:

- Misstatements due to fraud or error.

No material weaknesses had been identified in controls or evidence of management override.

- Valuation of unquoted pooled investment vehicles and Valuation of directly held property.

A lot of investments in the Pension Fund were Level 3 investments that were not valued in reference to public information and this made them more difficult to value. The Covid-19 pandemic had had a significant impact on markets and investments in the Pension Fund and resulted in a reduction in the value of the Fund relative to the prior year. Following discussions with Officers and Investment Managers, the Auditor was confident that the impact of Covid-19 had been reflected on the Financial Statements.

A number of misstatements within the information used to prepare the accounts had been identified and these were listed at page 15 of the submitted report. The auditor commented on two items relating to inaccurate information received from the Custodian, and a balance of £13.9 million for which there was insufficient supporting evidence to justify its recognition as an asset of the Fund. The auditor had provided recommendations in relation to resolving these issues in next year's accounts.

The other aspect of Level 3 investments was property. All of the assets in the Pension Fund tended to be more commercial and income generating in purpose. EY's experts had looked at a range of assets across different categories, focussing in particular on retail and assets that were at higher risk of misstatement due to the Covid-19 pandemic. It was highlighted that the

valuations were at the upper end of the range.

AGREED as follows:

1. the Middlesbrough Council Audit Results Report for the Year Ended 31 March 2020 was received and noted.
2. the Teesside Pension Fund Audit Results Report for the Year Ended 31 March 2019 was received and noted.

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AUDITED STATEMENT OF ACCOUNTS 2019/2020

The purpose of the report was to present the audited accounts for Middlesbrough Council for 2019/2020. Members' approval would be subject to satisfactory completion of a number of outstanding items in EY's results report and any changes that might occur consequent to that.

The draft Statement of Accounts (SOA) 2019/2020 had previously been considered by the Committee at a meeting held on 30 July 2020 and a training session had also been provided for Members on 5 November 2020 to ensure that Members were equipped to take a judgement on the Accounts.

The Committee's attention was drawn to five main accounting issues, four of which had been amended in the update accounts and one that had not, due to its relatively small size and the amount of work that would be needed to restate. The amendments were as follows:

- Pensions Liabilities

The overstatement of assets on the Pension Fund meant there was a direct correlation of that to the size of the net Pensions Liability in the Accounts and also in the other Tees Valley Local Authorities' Accounts. All the Councils were making changes for the overstatement of assets on the Pensions Fund.

- Finance Lease Liability

The amount that should have been recognised in the Accounts had been recalculated at £12.374m, a difference of £8.460m from the draft Statements in July 2020. The value of the lease liability in the Accounts would be revisited annually to ensure it is assessed each financial year in line with the standard approach. The Accounts had been updated with the revised amount and the net liabilities recorded on the Council's Balance Sheet had improved due to this audit adjustment.

- School Bank Accounts
- Interest Accruals

Minor errors had been identified which were resolved through adjustments in the Balance Sheet between creditors and cash and borrowing.

- Lease Surrender Costs

It was proposed that the Accounts were not adjusted for this transaction given that it was only 7% of the Council's materiality threshold.

A number of disclosures issues were also highlighted. More explicit information was included in relation to Going Concern, due to the risk presented by Covid-19 to local income streams. An additional and comprehensive disclosure had been included in Note 1 on accounting policies to satisfy this requirement. Enhanced disclosures in relation to the Centre Square liabilities had also been included.

Although the Pension Fund Accounts were subject to a separate audit from the Council's accounts, they were included within Middlesbrough's Statement of Accounts due to its role as the administering authority. A number of disclosures had also been given greater focus due to Covid-19, including the impact of material valuation uncertainty on the Fund, the Going Concern basis for the preparation of the financial statements, 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 2020/2021.

Members raised the following queries:

- Officers' Remuneration

The Chief Finance Officer agreed to undertake an analysis of savings on Officers' remuneration in relation to savings from staff restructures and circulate the information to the Committee.

- Borrowing

Assumptions around borrowing and the Council's Investment Strategy were factored into the Medium Term Financial Plan (MTFP) and it was confirmed that there was sufficient funding to cover existing borrowing and any future borrowing planned.

Over the last two to three years of the Council's Investment Strategy, capital expenditure had been significantly higher than previous years, due to the delivery of large projects such as Tees Advanced Manufacturing Park (Tees AMP) and the two Centre Square office blocks. The Council's approach was to borrow at the lowest interest rates and the best value for money process. The Council was prudent in terms of investment, looking at affordability and sustainability of investment plans going forward.

It was suggested that an audit of the Council's current borrowing should be carried out.

- Middlesbrough Development Company (MDC)

MDC was a wholly owned subsidiary of the Council and as more projects were approved the Company's financial assets and liabilities would have an impact on the Council's financial position. For the 2020/2021 financial year it was anticipated that Group Accounts would be prepared and MDC's Accounts would be incorporated into the Council's as an addendum to the Statement of Accounts.

- Reserves

With the agreement of Council, £4m had been moved into reserves from the capital programme, towards the costs associated with addressing issues arising from the Covid-19 pandemic, to ensure the Council's reserve fund was above the recommended level of balances of £9.4m.

The Chief Finance Officer wished to place on record his thanks to Council Officers and Auditors for their hard work and dedication in producing the Statement of Accounts in difficult circumstances due to the Covid-19 pandemic.

AGREED as follows that:

1. Middlesbrough Council Audited Statement of Accounts 2019/2020 was received and noted.
2. An analysis of savings on Officers' remuneration as a result of staff restructures would be undertaken and the result circulated to the Committee.
3. The Chair and Chief Finance Officer would discuss a potential audit of the Council's current borrowing and present any proposals to the Committee for approval.

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LETTERS OF REPRESENTATION

The Director of Finance presented the Letters of Representation 2019/2020 for Middlesbrough Council and Teesside Pension Fund.

The Letters were technical documents required by External Audit from the Council setting out a formal record of the representations made by the management of the Council to confirm certain matters or to support other audit evidence as part of the preparation of the financial statements.

AGREED that Letters of Representation 2019/2020 for Middlesbrough Council and Teesside Pension Fund were received and noted.

20/35 **APPROVAL OF AUDITED ACCOUNTS**

The Chair asked Members to give consideration to approval of the Audited Statement of Accounts 2019/2020.

AGREED that Middlesbrough Council's Audited Statement of Accounts 2019/2020 was approved.

20/36 **ANY OTHER URGENT ITEMS WHICH IN THE OPINION OF THE CHAIR, MAY BE CONSIDERED**

Boho X

As requested by the Corporate Affairs and Audit Committee, the Ad Hoc Scrutiny Panel had undertaken a review of Elected Members' role in decision-making in relation to Boho X, at a meeting held on 23 November 2020.

The Chair of Corporate Affairs and Audit Committee had attended the Ad Hoc Scrutiny Panel meeting and was concerned with regard to the process outlined in relation to the awarding of £20 million funding, that was allocated to the Boho X project from the Tees Valley Combined Authority (TVCA).

The Chair suggested that it would be appropriate to clarify with the Overview and Scrutiny Board of the TVCA as to the governance process for the allocation of funding.

AGREED that the Chair would write to the Chair of the TVCA Overview and Scrutiny Board and request clarification regarding the allocation of funding.