



# Middlesbrough Council

Auditor's Annual Report  
Year ended 31 March 2021

June 2023



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Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (<https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/>). The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Corporate Affairs and Audit Committee and management of Middlesbrough Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Corporate Affairs and Audit Committee and management of Middlesbrough Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Corporate Affairs and Audit Committee and management of Middlesbrough Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Hywel Ball, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Section 1

# Executive Summary



## Executive Summary: Key conclusions from our 2020/21 audit

Area of work	Conclusion
<b>Opinion on the Council and Pension Fund's:</b>	
Financial statements	<p>Unqualified – the financial statements give a true and fair view of the financial position of the Council and of the Pension Fund as at 31 March 2021 and of their expenditure and income for the year then ended. The financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2020/21 as amended by the Update to the Code and Specifications for Future Codes for Infrastructure Assets (November 2022).</p> <p>We issued our auditor's reports on 27 April 2023.</p>
Going concern	We have concluded that the Director of Finance's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.
Consistency of the Narrative Report and other information published with the financial statements	Financial information in the Narrative Report and published with the financial statements was consistent with the audited accounts.
Consistency of the Pension Fund Annual Report and other information published with the financial statements	Financial information in the Pension Fund Annual Report and published with the financial statements was consistent with the audited accounts.
<b>Reports by exception:</b>	
Value for money (VFM)	<p>We identified a significant weakness in relation to member and senior officer relationships and therefore reported by exception on the Council's VFM arrangements in the audit report on the financial statements.</p> <p>We have included our VFM commentary in Section 4.</p>
Consistency of the Annual Governance Statement	We were satisfied that the Annual Governance Statement was consistent with our understanding of the Council.
Public interest report and other auditor powers	We had no reason to use our auditor powers, however we highlight within our VFM commentary that we may do so in future if we are not satisfied with the Council's response to our VFM recommendations.

# Executive Summary: Key conclusions from our 2020/21 audit

As a result of the work we carried out we have also:

Outcomes	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	<p>We issued a Draft Audit Results Report for our audit of the Council in July 2022 and a Final Audit Results Report in April 2023 to the Corporate Affairs and Audit Committee.</p> <p>We issued our Audit Results Report for our audit of the Pension Fund in September 2022 to the Corporate Affairs and Audit Committee.</p>
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2020 Code of Audit Practice.	<p>We have not yet issued our certificate for 2020/21 as we are not yet able to confirm we have performed all of the procedures required by the National Audit Office on the Whole of Government Accounts submission. The guidance for 2020/21 was not issued until July 2022 and, whilst the procedures required to date have been performed, there remains scope for further procedures to be requested by the National Audit Office. We will issue our certificate once confirmation has been received that no further procedures will be required.</p>

## Fees

We carried out our audits of the Council's and Pension Fund's financial statements in line with PSAA Ltd's "Statement of Responsibilities of auditors and audited bodies" and "Terms of Appointment and further guidance (updated April 2018)". As outlined in the Audit Results Reports we were required to carry out significant additional audit procedures to address audit risks in relation to misstatements due to fraud or error (Council and Pension Fund), fraud in revenue and expenditure recognition (Council), the valuation of land and buildings (Council), the accounting for infrastructure assets (Council), the valuation of unquoted pooled investment vehicles (Pension Fund), the valuation of directly held property (Pension Fund), the provision of children's services (VFM, Council) and member and senior officer relationships (VFM, Council). As a result, we have requested an associated additional fee. We include details of the final audit fees in Appendix 1.

We would like to take this opportunity to thank the Council staff for their assistance during the course of our work.

Stephen Reid, Partner  
For and on behalf of Ernst & Young LLP

Section 2

## Purpose and responsibilities



# Purpose and responsibilities

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This report summarises our audit work on the 2020/21 financial statements.

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## **Purpose**

The purpose of the auditor's annual report is to bring together all of the auditor's work over the year. A core element of the report is the commentary on VFM arrangements, which aims to draw to the attention of the Council or the wider public relevant issues and recommendations arising from the audit and follow-up of recommendations issued previously, along with the auditor's view as to whether they have been implemented satisfactorily.

## **Responsibilities of the appointed auditor**

We have undertaken our 2020/21 audit work in accordance with the Audit Planning Reports that we issued in July 2021. We have complied with the National Audit Office (NAO)'s 2020 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the NAO.

As auditor we are responsible for:

Expressing an opinion on:

- the 2020/21 financial statements;
- conclusions relating to going concern; and
- the consistency of other information published with the financial statements, including the Narrative Report and Pension Fund Annual Report.

Reporting by exception:

- if the governance statement does not comply with relevant guidance or is not consistent with our understanding of the Council;
- if we identify a significant weakness in the Council's arrangements in place to secure economy, efficiency and effectiveness in its use of resources; and
- any significant matters that are in the public interest.

## **Responsibilities of the Council**

The Council is responsible for preparing and publishing its financial statements, the Narrative Report and Annual Governance Statement and the Pension Fund Annual Report. It is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Section 3

# Financial Statement Audit





# Financial Statement Audit

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We have issued an unqualified audit opinion on the Council's 2020/21 financial statements.

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## Key issues

The Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

On 27 April 2023, we issued an unqualified opinion on the financial statements. We reported our detailed findings to the 22 July 2022 and 28 April 2023 meetings of the Corporate Affairs and Audit Committee. We outline below the key issues identified as part of our audit, reported against the significant risks and other areas of audit focus we included in our Audit Planning Reports.

Significant risk	Conclusion
<p><b>Misstatements due to fraud or error (Council and Pension Fund)</b></p> <p>As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>Within our commentary on the Council's arrangements to secure value for money through economic, efficient and effective use of its resources, set out in section 4, we note several instances where the Council entered into transactions without following its normal procurement processes. In one case, the Council subsequently assessed these transactions as being unlawful. We are however satisfied that the value of these transactions is not material to the financial statements.</p> <p>We have not identified any other significant or unusual transactions which we consider give rise to a misstatement of the financial statements or should be brought to the attention of the Corporate Affairs and Audit Committee.</p> <p>We are therefore satisfied that the financial statements are not materially misstated as a result of fraud or error.</p>

# Financial Statement Audit

Significant Risk	Conclusion
<p><b>Risk of fraud in revenue and expenditure recognition</b> <b>(Council only)</b></p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>We identified this risk as most likely to manifest within the recognition of Covid-related grant funding, the recognition of capital grants, the capitalisation of expenditure or the omission of expenditure from the financial statements.</p>	<p>Our testing of Covid-related grants which were new for 2020/21 identified grants which management had incorrectly assessed as being on an agency basis, meaning the Council had incorrectly assessed it had no control over their use, and hence had been excluded from the financial statements. Once this was identified, management undertook a review of all Covid-related grants and identified amounts totalling £5,363,000 which had been incorrectly omitted. Corresponding expenditure funded by these grants had also been omitted, therefore there was no net impact on the deficit on provision of services but gross income and expenditure were both understated by £5,363,000.</p> <p>Management corrected the financial statements for this matter, however within the correction we identified one grant for £549,000 where the income had already been recorded but the expenditure had not. This income should not therefore have been included in management's adjustment, resulting in an uncorrected overstatement of income of £549,000.</p> <p>We have no other matters to report in relation to this risk.</p> <p>We are therefore satisfied, following management's adjustment, that the financial statements are not materially misstated as a result of fraud in revenue and expenditure recognition.</p>
<p><b>Valuation of land and buildings</b> <b>(Council only)</b></p> <p>Land and buildings are the most significant assets on the Council's balance sheet. The valuation of land and buildings is dependent upon a number of judgements and assumptions, small changes in which can have a significant impact upon the financial statements.</p> <p>Our assessment is that the risk of misstatement is greatest in those assets whose value is dependent to a large extent on the existence and terms of commercial tenancies.</p> <p>We consider the valuation of other land and buildings to be an area of audit focus.</p>	<p>Our testing identified a transposition error in the recording of the floor area of Centre Square 2 used by the Council's external valuer to inform their valuation of the asset. As a result, the valuation of this asset was overstated by £693,000.</p> <p>Our review of disclosures relating to land and buildings also identified a few presentational errors, including misclassification of a £3,880,000 impairment of the Transporter Bridge as depreciation and an erroneous negative £1,190,000 disposal. These matters had no impact on the valuation of land and buildings recorded on the balance sheet.</p> <p>We have no other matters to report in relation to this risk.</p> <p>We are therefore satisfied that the financial statements are not materially misstated as a result of the valuation of land and buildings.</p>

# Financial Statement Audit

Significant Risk	Conclusion
<p><b>Accounting for infrastructure assets (Council only)</b></p> <p>The Council has not maintained sufficiently detailed accounting records to enable it to identify individual infrastructure assets within the accounting records. As a result, it is unable to demonstrate that individual assets have been accounted for in accordance with the requirements of the reporting framework. In particular, the Council is unable to demonstrate that remaining asset balances have been derecognised when an asset has been replaced (for example a road re-laid).</p> <p>There is a high probability that the valuation of infrastructure assets is materially misstated, however the Council lacks the necessary accounting records to quantify the extent of misstatement and make correcting entries.</p>	<p>As this issue impacts a large number of local authorities, not just the Council, temporary amendments have been made to the Council's reporting framework to enable authorities and auditors to finalise statements of account whilst a longer term solution is sought.</p> <p>The financial statement disclosures appropriately reflect the changes which have been made to the reporting framework. Our review of the useful lives applied to infrastructure assets noted that there is considerable variability in the useful lives applied and the useful lives adopted were not always in-line with the guidance ranges published by CIPFA or reflective of the different components of an asset which may exist.</p> <p>We are content that net valuations at 31 March 2021 are materially correct, in part because of the statutory presumption that balances at 1 April 2020 were correct, however the risk of misstatement in net valuations due to inappropriate useful lives being applied will increase year-on-year.</p> <p>Longer term, the amendments to the reporting framework are temporary and will apply only until 2024/25. Whilst the detailed requirements which will apply beyond this point are still to be determined, it is highly likely that they will require the Council to develop better information on the Council's infrastructure assets than it currently holds</p>
<p><b>Valuation of unquoted pooled investment vehicles (Pension Fund only)</b></p> <p>The Fund's investments include unquoted pooled investment vehicles. Judgement is required from Investment Managers to value these investments as prices are not publicly available. The material nature of these investments means that any error in these judgements could result in a material valuation error.</p> <p>We identified the valuation of the Fund's investments in unquoted pooled investment vehicles as a significant risk, as even a small movement in the assumptions underpinning investment manager valuations could have a material impact upon the financial statements.</p>	<p>Included within the initial draft accounts presented to us for audit was the quarter three valuations rolled forward to produce a year end valuation. Upon receipt of the year end confirmations it was apparent that the valuations were higher than the amounts included in the accounts. This resulted in a net understatement of investments by £26.4m. Management chose not to adjust for this valuation movement due to it being immaterial.</p> <p>We have no other matters to report in relation to this risk.</p>

# Financial Statement Audit

Significant Risk	Conclusion
<b>Valuation of directly-held property (Pension Fund only)</b> The Fund has a significant portfolio of directly held property investments. The valuation of these properties is subject to a number of assumptions and judgements, small changes in which could have a significant impact upon the financial statements.	A sample of valuations were reviewed by our EY Real Estate specialists and all found to be within an acceptable range. We have no other matters to report in relation to this risk.

# Financial Statement Audit

In addition to the significant risks above, we also concluded on the following areas of audit focus.

Other area of audit focus	Conclusion
<p><b>Valuation of defined benefit pension liability (Council only)</b></p> <p>The defined benefit pension liability is the most significant liability on the Council's balance sheet. The assessment of the present value of future obligations requires detailed actuarial calculations. Small changes in the assumptions used for the calculations can have a significant impact upon the financial statements.</p> <p>We focus on the appropriateness of assumptions used by the Council's actuary in valuing pension liabilities and the accuracy of pension asset valuations.</p>	<p>The Pension Fund auditor identified misstatements within the valuation of the Pension Fund's assets provided to the Council's actuary to inform the valuation of the Council's net pension liabilities.</p> <p>We quantified the impact on the Council's financial statements as an understatement of the Council's pension assets of £5,947,000, and hence an overstatement by the same amount of the Council's net pension liabilities. The financial statements were amended to correct this impact.</p> <p>In addition, we noted that the Council had incorrectly presented the return on pension assets as income within the CIES when the correct treatment is to recognise the net cost of interest on pension liabilities and the return on plan assets as a net amount within expenditure. As a result, income and expenditure were both overstated by £6,224,000 however the net impact was correct. The financial statements were also amended to correct this matter.</p> <p>We have no other matters to report in relation to this risk.</p> <p>We are therefore satisfied that the financial statements are not materially misstated as a result of the valuation of defined benefit pension liabilities.</p>
<p><b>Going concern and associated disclosures (Council only)</b></p> <p>The Covid-19 pandemic has had a significant impact on local authority finances, with new expenditure streams being incurred, loss or reduction to existing income streams and new grant income streams arising. The Council has also seen significant cashflows passing through it where it acts as an agent.</p> <p>Management had to undertake their going concern assessment against the backdrop of ongoing uncertainty over the financial impact of the pandemic. They also needed to ensure that going concern disclosures within the financial statements appropriately presented management's assessment.</p>	<p>The Council has seen a significant increase in its level of usable reserves between 31 March 2020 and 31 March 2021, primarily due to the impact of the business rates reliefs given to businesses during the pandemic and the government decision to allow local authorities to spread the impact of these over a number of years. These amounts will naturally unwind over the next few years, and the Council's reserves have reduced since 31 March 2021.</p> <p>Management's final going concern assessment is based upon the Council's 2023/24 budget, which includes £9.4 million of required savings as a result of a significant increase in budget for Children's Services to address overspends in 2021/22 and 2022/23.</p> <p>An independent review of planned savings by CIPFA concluded that the Council is unlikely to deliver all of the planned savings. The Council has sufficient reserves to mitigate the likely impact of this over the going concern period, however the Council faces a challenging financial outlook over the medium term and further cost-saving measures are likely to be necessary.</p> <p>We are satisfied that the financial statement disclosures adequately reflect these challenges, however we made a number of recommendations to management to enhance the disclosures.</p>

# Financial Statement Audit

## Audit differences (Council)

Uncorrected misstatements would increase the deficit on provision of services by £2.9 million. The most significant of which included:

- ▶ Our testing of the Council's trade receivables identified an invoice for £1,492,000 relating to Section 106 income which had been raised in error, and the Council had issued credit notes to clear this balance after the year end. As a result, the Council's income and trade receivables were overstated by £1,492,000;
- ▶ Our testing of the valuation of Centre Square 2 identified a transposition error in the floor area recorded by the Council's external valuer and used to inform their valuation of the asset. As a result, the valuation of this asset and the gain on revaluation recorded in the CIES were overstated by £693,000; and
- ▶ Management made an adjustment to the pre-audit financial statements to correct for the incorrect classification of Covid-related grants as agency rather than principle. Within this correction, management double-counted one grant resulting in an overstatement of income, and earmarked reserves, of £549,000.

Management corrected identified misstatements with net nil impact on the deficit on provision of services. The most significant of which included:

- ▶ Our testing of pension disclosures identified that the Council had incorrectly presented the return on pension assets as income within the CIES when the correct treatment is to recognise the net cost of interest on pension liabilities and the return on plan assets as a net amount within expenditure. As a result, income and expenditure were both overstated by £6,224,000 however the net impact was correct;
- ▶ Our testing of Covid-related grants which were new for 2020/21 identified grants which management had incorrectly assessed as being on an agency basis, meaning the Council had incorrectly assessed it had no control over their use, and hence had been excluded from the financial statements. Once this was identified, management undertook a review of all Covid-related grants and identified amounts totalling £5,363,000 which had been incorrectly omitted. Corresponding expenditure funded by these grants had also been omitted, therefore there was no net impact on the deficit on provision of services but gross income and expenditure were both understated by £5,363,000;
- ▶ The audit of the Teesside Pension Fund identified misstatements within the valuation of the pension fund's assets provided to the Council's actuary to inform their valuation of the Council's net pension liabilities. Based on this, we determined that the Council's net pension liability, and the actuarial loss for the period, was overstated by £5,947,000;
- ▶ Our testing of property, plant and equipment disclosures identified that the Council had incorrectly recorded an in-year impairment of the Transporter Bridge as accelerated depreciation rather than an impairment. As a result, depreciation for the year was overstated and impairments understated by £3,880,000;
- ▶ Our testing of creditor balances identified that amounts due to individuals in relation to Housing Benefit had been incorrectly classified as owed to local authorities, resulting in an overstatement of amounts owed to other local authorities and understatement of amounts owed to other entities and individuals of £3,252,000; and

# Financial Statement Audit

## Audit differences (Council) (continued)

- ▶ As part of our discussions around the 2021/22 audit, management highlighted their intention to recognise a provision in the 2021/22 Statement of Accounts for insurance liabilities. We challenged management as to whether these liabilities also existed at 31 March 2021 and should be recognised within the 2020/21 Statement of Accounts, resulting in the recognition of additional provisions and expenditure of £3,250,000. A contingent liability has also been disclosed for insurance liabilities for which no claim had been received by the Council at 31 March 2021 but past experience suggests claims may be submitted in future for events occurring before 31 March 2021.

During the course of the audit we also identified a number of disclosure errors and made a number of recommendations to management to improve the presentation of financial statement disclosures. The most significant of which included:

- ▶ Our testing of the disclosure of future amounts receivable by the Council under operating leases found that the amounts disclosed were overstated by £10,804,000 due to inaccurate lease information being recorded in the Council's leases register. This disclosure was also overstated by £10,282,000 in the prior year;
- ▶ Within the disclosure of senior officer remuneration, an amount of £66,454 paid to the former Executive Director of Growth and Places was incorrectly reported as strain on the pension fund rather than compensation for loss of office. In addition, the total cost of this departure of £292,555 was incorrectly reported within the exit packages note as a voluntary departure when it was in fact a compulsory redundancy. Had this been a voluntary redundancy, approval by full council would have been required under the Council's Pay Policy Statement however this is not required for compulsory redundancies;
- ▶ The accounting treatment of the Dedicated Schools Grant was changed with effect from 1 April 2020, requiring the Council to treat the accumulated balance at this date of £2,783,000 as an unusable reserve rather than a usable reserve as had previously been the case. The draft financial statements omitted disclosure of this as an adjustment to opening balances, meaning that opening balances were inconsistent with the balances reported in the prior period; and
- ▶ Within the disclosures relating to property, plant and equipment, the valuation of assets transferred to Sport & Leisure Management under a service concession arrangement had not been updated from the prior year. The valuation in the updated disclosure was higher than the prior year's disclosure by £2,591,000.

# Financial Statement Audit

## **Audit differences (Pension Fund)**

Uncorrected misstatements, identified as the aggregate difference between recorded amounts and those confirmed by investment managers, would increase the net assets of the Fund by £26.40m.

Management corrected identified misstatements with a net impact of increasing the net assets of the Fund by £0.04m. The most significant of which included:

- ▶ Our agreement of investment cash balances to confirmations provided by the counter-party identified an overstatement of investment cash of £8,750,000; and
- ▶ Our reconciliation of cash deposits recorded by the Fund's custodian to those recorded by the Fund identified an understatement of cash of £8,100,000 arising from erroneous posting of a journal to April 2021 rather than March 2021.

During the course of the audit we also identified a number of disclosure errors and made a number of recommendations to management to improve the presentation of financial statement disclosures. The most significant of which included:

- ▶ The valuation of the Fund's directly-held property portfolio was disclosed as being prepared on the basis of a material valuation uncertainty due to the impact of the pandemic on property valuations, however this was the case for the prior year only and should not have been stated in respect of current year's valuations; and
- ▶ The contribution rates disclosed in the schedule of contribution rates were incorrect for a small number of employers.



# Financial Statement Audit

## Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
<b>Planning materiality</b>	<p>We determined planning materiality for the Council to be £8.2 million as 1.8% of gross revenue expenditure reported in the accounts. We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p> <p>We determined planning materiality for the Pension Fund to be £45.6m as 1% of net assets reported in the accounts. We consider net assets to be one of the principal considerations for stakeholders in assessing the financial performance of the Pension Fund.</p>
<b>Reporting threshold</b>	<p>We agreed with the Corporate Affairs and Audit Committee that we would report to the Committee all audit differences in excess of £0.4 million for the Council and £2.3 million for the Pension Fund.</p>

We also identified remuneration disclosures as an area where misstatement at a lower level than our overall materiality level might influence the reader. For this area, we applied a materiality level equal to the level of rounding used in disclosures.

Section 4

## Value for Money



## Value for Money (VFM)

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We identified two risks of significant weaknesses in the Council's VFM arrangements for 2020/21.

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### **Scope and risks**

We have complied with the NAO's 2020 Code (2020 Code) and the NAO's Auditor Guidance Note in respect of VFM. We presented our VFM risk assessment to the 5 August 2021 Corporate Affairs and Audit Committee meeting which was based on a combination of our cumulative audit knowledge and experience, our review of minutes from the Council's committees, enquiries of the Section 151 Officer and evaluation of associated documentation through our regular engagement with Council management and the finance team. We reported that we had identified one risk of significant weaknesses in the Council's VFM arrangements for the year ended 31 March 2021.

### *Provision of Children's Services*

We qualified our VFM opinion for the year ended 31 March 2020 in respect of the Council's provision of children's social care services following an assessment by Ofsted in December 2019 that services were inadequate. Following the Ofsted inspection, the Council put in place an Improvement Plan and subsequent reports by the appointed Commissioner for Children's Services in Middlesbrough and Ofsted supported that the Council has put in place appropriate governance structures to respond to the Ofsted findings.

Nevertheless, there remained a risk that the Council did not have proper arrangements in place to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people within its children's social care services during the year ended 31 March 2021.

We responded to this risk by making enquiries of management to understand the progress being made against the Improvement Plan and reviewing the findings of subsequent external assessments of the Council's Children's Services as third party evidence of the progress being made by the Council. Based on the insight gained from these procedures, we formed an assessment of whether a significant weakness in the Council's arrangements existed during the year to 31 March 2021. We concluded that no significant weakness existed. Further details of our assessment are provided within the 'How the body evaluates the services it provides to assess performance and identify areas for improvement' section below.

## Value for Money (VFM)

### Scope and risks (continued)

During the course of our audit, additional matters came to our attention which indicated a further risk of significant weaknesses in the Council's VFM arrangements for the year ended 31 March 2021. We therefore recognised a further significant risk of significant weaknesses in the Council's VFM arrangements for the year ended 31 March 2021.

#### Member and Senior Officer Relationships

During the course of our audit a number of matters were brought to our attention by management, internal audit, elected members and external parties which indicated potential weaknesses in the Council's governance arrangements and its ability to ensure Council policies and procedures were adhered to. We noted that a common theme to the matters brought to our attention were observations and concerns about strained relationships between the Council's senior officers and elected members, and between elected members, and the impact of those on the effectiveness of the Council's governance processes. Based on identification of these matters and in accordance with the proper arrangements criteria set out in the 2020 Code, we recognised a risk that the Council did not "have proper arrangements in place to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people".

We responded to this risk by following up on each of the individual matters brought to our attention through enquiries of management and the Council's internal auditor, review of reports and other documentation, including reports commissioned by management to investigate the more serious concerns raised and consideration of the consistency of the information obtained in the course of these enquiries with other information obtained during the course of our audit. Based on the insight gained from these procedures, we formed our assessment of whether a significant weakness in the Council's arrangements existed during the year to 31 March 2021. We concluded that significant weaknesses did exist, and provide further details of these in the sections below.

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We reported on significant weaknesses in arrangements in the audit report.

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### Reporting

We completed our VFM arrangements work in July 2022 and identified a significant weakness in the Council's VFM arrangements in relation to member and senior officer relationships and the impact of these on the Council's governance processes. We reported this matter by exception in the audit report on the financial statements and provided further details in the Audit Results Report. We include within the VFM commentary below the associated recommendation(s) we have agreed with the Council.

# Value for Money (VFM)

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Our VFM commentary highlights relevant issues for the Council and the wider public

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## VFM Commentary

In accordance with the NAO's 2020 Code, we are required to report a commentary against three specified reporting criteria:

- *Financial sustainability*  
How the Council plans and manages its resources to ensure it can continue to deliver its services;
- *Governance*  
How the Council ensures that it makes informed decisions and properly manages its risks; and
- *Improving economy, efficiency and effectiveness*  
How the Council uses information about its costs and performance to improve the way it manages and delivers its services.

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## Introduction and Context

The 2020 Code confirms that the focus of our work should be on the arrangements that the audited body is expected to have in place, based on the relevant governance framework for the type of public sector body being audited, together with any other relevant guidance or requirements. Audited bodies are required to maintain a system of internal control that secures value for money from the funds available to them whilst supporting the achievement of their policies, aims and objectives. They are required to comment on the operation of their governance framework during the reporting period, including arrangements for securing value for money from their use of resources, in a governance statement.

We have previously reported the VFM work we have undertaken during the year including our risk assessment. The commentary below aims to provide a clear narrative that explains our judgements in relation to our findings and any associated local context.

For 2020/21, the significant impact that the Covid-19 pandemic had on the Council has shaped decisions made, how services have been delivered and financial plans have necessarily had to be reconsidered and revised.

We have reflected these national and local contexts in our VFM commentary.

# Value for Money (VFM)

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The Council has not had the arrangements we would expect to see to enable it to make informed decisions and properly manage its risks.

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## Governance

*How the body ensures it makes properly informed decisions, supported by appropriate evidence and allowing for challenge and transparency. This includes arrangements for effective challenge from those charged with governance/audit committee.*

The Council has a number of Executive and other committees, operating at both Council-wide and service level, which are responsible for approving key decisions. Committee discussions are informed by a standard reporting template which sets out the background to the decision, available alternatives to the proposed decision, the advantages and disadvantages of available options and any financial or legal implications for the Council of the proposed action.

The Council also has an Overview and Scrutiny Board whose role is to scrutinise the performance of Council functions and the decisions taken by Executive committees. The Overview and Scrutiny Board is supported by 7 Scrutiny Panels and a joint committee with Redcar and Cleveland Council, with each able to refer decisions back to the Executive for further consideration.

The Corporate Affairs and Audit Committee receives reports on the Council's internal control environment from internal and external audit and monitors the implementation of recommendations to address identified weaknesses.

The Council's largest project during the year was the development of a specialist digital office space known as Boho X. The Council's Executive originally approved a 60,000 square foot design for this project in March 2019, before approving a revised 20-floor 100,000 square foot design in March 2020. Between March 2020 and August 2020, the design of Boho X changed again from the 100,000 square foot design to a revised 6-floor 60,000 square foot design. We have not sought to assess the merits of each Boho X design nor the strength of the evidence base informing them.

Under the Council's Constitution, elected members have no role in the delivery of projects, however changes in design were recorded by the external contractor as being approved by the Council's Mayor and followed meetings between the contractor and the Mayor which were held without Council officers being present. The changes in design were not submitted through the formal project change control process, as required by the Council's Programme and Project Management Framework (PPMF), and no meetings of the Internal Project Board were held during the period when changes occurred. The impact of the Covid-19 pandemic was cited by the Council as the reason for the change in design during public consultation and approval by the Executive of the revised design, however there is no documentation of the reasons for the change to support this assertion and the decision-making process remains unclear.

## Value for Money (VFM)

Whilst the Council's Mayor understood that he had been authorised to discuss changes to the design with the external contractor by a senior officer, in our view the communication on which this was based did not explicitly provide such authority and such approval would in any event have been contrary to the Council's Constitution and the PPMF. It is therefore our assessment that there have been significant weaknesses in the Council's management of the Boho X project which undermine the Council's ability to demonstrate that the project represents value for money for taxpayers.

In addition to the changes in design for the Boho X project, we have identified several other transactions entered into by the Council during the year where Council policies and procedures were not followed and where a lack of adherence to the respective roles of officers and members was a key factor. These included the purchase of Covid-19 antibody tests which were not approved for use by the Medicines and Healthcare Products Regulatory Authority and therefore could not be used as the Council had intended, and the provision of political and administrative support to the Mayor by an outside party. In both cases, concerns about the proposed transactions were raised by senior officers prior to the transactions being entered into however both subsequently proceeded without following the Council's proper procurement processes. Whilst the monetary value of these transactions was not significant in the context of the financial statements, they demonstrate that the weaknesses identified in the Boho X project were not a one-off and that there are wider weaknesses in the Council's arrangements in particular where reliant on appropriate working between officers and elected members.

We have also noted multiple further examples of difficult relationships between officers and members, and between members, across a number of areas in the course of performing our audit work. As part of our reporting on the Council's audit for the year ended 31 March 2018, we reported that:

*"We have observed that the relationship between some Councillors and senior officers is strained. This appears to be due to a mutual level of mistrust. Officers consider that the level of challenge provided by some Councillors is excessive. Officers have also noted that they are required to spend disproportionate amounts of time on issues that, in their opinion, have been previously addressed. We note that concerns about the style of communication between members and officers have also been expressed that have resulted in Standards Committee action.*

*In contrast, some members consider that the information provided by officers, in relation to their challenge, is in some cases not adequate or is deliberately withheld, and as a result they are unable to make informed decisions. This has also led to members sharing concerns directly with internal and external audit regarding ongoing matters as a way to address their concerns, rather than being confident to address matters with the responsible statutory officers and ultimately the head of paid service."*

## Value for Money (VFM)

Since 2018 there have been a number of changes to both the senior officers of the Council and to elected members. Despite these changes, our observations during the year ended 31 March 2021 are that a lack of trust is still pervasive within the organisation and is undermining the effectiveness of the Council's governance arrangements. In our view these are serious matters indicative of deep rooted cultural and relationship issues which require urgent action. This lack of trust extends beyond the relationships between officers and members to the relationships between members, in particular between the Council's Executive and other members. This in turn hinders efforts to improve the relationships between officers and all members, as officers feel they are regarded by members as 'taking sides' in areas of disagreement between members.

**1. We therefore recommend that the Council develop a comprehensive Improvement Plan to address the cultural and relationship issues which exist within the Council as a matter of urgency. In our view it is the responsibility of all elected members and officers to work together to address these serious matters. This will require the involvement of external specialists as, in our view, the relationships within the Council have deteriorated to a point which the Council will not be able to remedy on its own.**

We consider that the Council needs to take this step as an immediate action and we will be following up on the Council's response to our recommendation over the next 6 months. Where we remain unsatisfied with the Council's progress, we will consider exercising our further powers by making formal statutory recommendations. This would require a formal public response from the Council and be notified to the Secretary of State.

*How the body monitors and ensures appropriate standards, such as meeting legislative/regulatory requirements and standards in terms of officer or member behaviour (such as gifts and hospitality or declarations/conflicts of interests)*

The Council's Overview and Scrutiny Board monitors the performance of the Council's services and has the power to invite expert witnesses, such as professionals or service users, to advise the Board. The Council's Constitution includes Codes of Conduct for both elected members and employed officers which set out the expected behaviour of individuals, including the management of conflicts of interest. Failure to adhere to the Codes of Conduct may result in disciplinary proceedings under the Council's HR policies.

Elected members are required to complete annual declarations of any potential conflict of interest, which are maintained on a register by the Council. A gifts and hospitality register is also maintained and available for public inspection.



## Value for Money (VFM)

Like many organisations, the Council is reliant on self-reporting by elected members and officers of any conflicts of interest, however we have identified a small number of instances where declarations made by elected members were either incomplete or inconsistent with previous declarations. We have also observed that there is a lack of trust between elected members that relevant interests are declared at decision making meetings, which contributes to a lack of confidence from some elected members in decisions being taken.

**2. We therefore recommend that refresher training be provided to all of the Council's elected members on the requirements of the Council's Code of Conduct for Members, including the disclosure of pecuniary interests and the Seven Principles of Public Life (also known as the 'Nolan Principles'), as set in the Council's Constitution.**

**3. Whilst we recognise that the responsibility to declare actual or potential conflicts of interest sits with members under both statute and the Council's Code of Conduct, given our observations we also recommend that management implement additional assurance checks over elected member declarations of interest, for example by cross-referencing to Companies House records or declarations made by elected members to other public bodies, to provide additional comfort over their completeness.**

As a local authority with a mayoral model, the Council is entitled to utilise its resources to appoint a mayoral political assistant. A mayoral political assistant is a local government employee who undertakes research and provides administrative support to the Mayor. The mayoral political assistant post is a politically restricted post, and there are strict rules set out within The Local Authorities (Elected Mayor and Mayor's Assistant) (England) Regulations 2002 which govern appointments to this post. These include that the role must be performed by an employee of the Council. The Council's mayoral assistant post has remained vacant since September 2019.

Between October 2019 and November 2020, the Council engaged an external advisor through a local publicity company, at a cost of £32,000, to work directly with the Council's Mayor. The Council has been unable to explain the exact nature of services provided by this external advisor, however it has accepted that they likely included activities which fall within the scope of the role of the mayoral political assistant. This arrangement was terminated in November 2020 after it was assessed by the Council to be unlawful under The Local Authorities (Elected Mayor and Mayor's Assistant) (England) Regulations 2002. The payments made to the publicity company under this arrangement were therefore also unlawful, however we note they were not material to our opinion on the Council's financial statements.

## Value for Money (VFM)

The arrangement was entered into by the Council without following either the Council's recruitment policies, which would have applied to a permanent employee of the Council, or the Council's procurement policies, which would have applied to an external supplier. Payments to the publicity company were directly approved by the Council's Chief Executive despite the Council not being able to explain the nature of services received. Notwithstanding the lawfulness of the arrangement, by making payments to a supplier without understanding the nature of services being received in exchange for those payments the Council is unable to demonstrate that the payments represented value for money for taxpayers.

**4. We therefore recommend that management undertake a review to establish whether there are any other arrangements at the Council which may have been entered into without following proper Council processes and, if so, review those arrangements to ensure that they are appropriate and represent value for money for the Council.**

*How the body monitors and assesses risk and how the body gains assurance over the effective operation of internal controls, including arrangements to prevent and detect fraud*

The Council maintains a Strategic Risk Register which is used to record and monitor the most significant risks, both financial and non-financial, identified by the Council. Beneath the Strategic Risk Register, each directorate maintains its own risk register and can escalate risks up to the Strategic Risk Register when sufficiently significant.

The strategic and directorate risk registers are reviewed monthly by the Leadership Management Team and directorate management teams, respectively. The Strategic Risk Register is also reviewed quarterly by the Executive and the Overview and Scrutiny Board.

Internal audit undertake an annual programme of work to provide assurance over the operation of the Council's internal controls. Risks identified and recorded on the Council's risk registers are used to inform the annual internal audit plan. Internal audit also provide a programme of counter-fraud activity to the Council.

A number of the matters which have been brought to our attention during the course of our audit were also reported to senior officers and the Council commissioned several reviews by internal audit to respond to the matters raised. These included reports on the management of the Boho X project, the purchase of the Covid-19 tests and the completeness of member declarations of interest. In our view, the scope of this work was not always sufficient to provide assurance to management on the full extent of issues or the wider risks posed to the Council as the work was narrowly defined and it was not always evident that there was follow-up on findings which indicated areas where additional risks may exist beyond the initial scope of work.

## Value for Money (VFM)

Budget limitations were cited as a reason for this, however the reports produced did not highlight these areas for consideration of follow-up work by officers or the Corporate Affairs and Audit Committee. Significant reliance was also placed by internal audit on verbal evidence from individuals relating to events which occurred sometime previous, and there appeared to be a lack of documented challenge by internal audit to assertions received from those subject to enquiry.

**5. We recommend that management consider whether further assurance is required to establish whether the risks identified by the Council to date are complete and the actions taken to respond to those risks sufficient.**

**6. We also recommend that management work with internal audit to ensure that where future pieces of work identify evidence of wider risks which are not immediately followed-up on, these are reported so that the Council's officers and the Corporate Affairs and Audit Committee can decide whether further investigation is appropriate.**

### *How the body approaches and carries out its annual budget setting process*

The Council maintains a Strategic Plan which sets out the key priorities for the Council, including those of the Mayor, over a multi-year period. The Strategic Plan forms the basis for the Council's budget setting exercise, along with forecasts from individual directorates for existing plans and services. These are collated with assumptions for cost pressures and future funding levels to produce a draft budget.

The draft budget is reviewed and stress tested for different scenarios by the Council's Leadership Management Team and Executive, before being issued to key stakeholders for consultation.

Management review the responses received from stakeholder consultations and make any necessary amendments to the draft budget, before submitting the finalised budget to meeting of the full Council for approval.

### *How the body ensures effective processes and systems are in place to ensure budgetary control; to communicate relevant, accurate and timely management information (including non-financial information where appropriate); supports its statutory financial reporting requirements; and ensures corrective action is taken where needed*

The Council delegates budgets to individual cost centre managers, who are responsible for ensuring delivery within the delegated budget. Financial training is provided to all budget holders, who meet regularly with finance business partners to monitor financial performance.

## Value for Money (VFM)

Financial performance against budget and updated forecasts for the remainder of the year are presented to the Council's Leadership Management Team and Executive on a quarterly basis, along with proposals for corrective actions where required.

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The Council has had the arrangements we would expect to see to enable it to use information about its costs and performance to improve the way it manages and delivers services.

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### **Improving economy, efficiency and effectiveness**

#### *How financial and performance information has been used to assess performance to identify areas for improvement*

Financial performance is monitored via management accounts and presented to the Executive and the Overview and Scrutiny Board on a quarterly basis. Reporting includes comparison of both performance to date and full-year forecasts against budgets, with explanations provided for significant variances. Comparison is also made to the position in previous reporting to monitor whether improvement actions have had the desired impact.

Beneath the Council's high-level reporting, budgets and performance are monitored at service line and budget holder levels, with individual budget holders responsible for ensuring delivery against delegated budgets and the accurate forecasting of future performance.

#### *How the body evaluates the services it provides to assess performance and identify areas for improvement*

Business intelligence dashboards are used by both Council leadership and service line management to monitor key performance indicators across the Council's services and track the implementation of previously agreed actions.

In January 2020, the Council's provision of children's social care services was rated inadequate by the Office for Standards in Education, Children's Services and Skills (Ofsted), who noted that 'leaders have not sufficiently focused on the significant areas of weakness to ensure that the needs of children and care leavers are properly met'. Our value for money opinion in 2019/20, issued in accordance with the 2015 Code of Audit Practice extant at the time, was qualified in respect of this matter.

In response to the Ofsted findings, the Council implemented a Children's Services Improvement Plan. Delivery against this plan is overseen by a Multi-Agency Strategic Board, supported by a Multi-Agency Operational Board.

## Value for Money (VFM)

The appointed Commissioner for Children's Services in Middlesbrough issued a 12-month review of the Council's progress against the Improvement Plan in July 2021, covering the period to May 2021. This review noted that "considerable progress has been made and there is evidence of real impact" and recommended that the Council be allowed to retain control of its Children's Services. The report did however note that the Council's Improvement Plan remains a multi-year exercise and, whilst good progress is being made, the Council has more to do before its Children's Services can be considered as adequate in all regards.

Whilst we note that the Council's Children's Services are not yet consistently delivering the expected levels of performance, this reflects the status of the service at the start of the 2020/21 financial year. The Council's actions during the year to 31 March 2021, as assessed by the Commissioner for Children's Services in Middlesbrough, demonstrate that the Council had appropriate arrangements in place during 2020/21 to deliver against the Improvement Plan. We do not therefore report a significant weakness in the Council's arrangements during the year ended 31 March 2021 in respect of the provision of Children's Services, however we will continue to monitor the Council's progress against the Improvement Plan.

The provision of children's social care is a key financial pressure for the Council. Whilst the Council has invested additional resources in the delivery of the Children's Services Improvement Plan, it is management's expectation over the medium term that the improvements in service delivery will ultimately decrease costs by more effectively meeting the needs of service users during the earlier, lower cost, stages of care.

*How the body ensures it delivers its role within significant partnerships, engages with stakeholders it has identified, monitors performance against expectations, and ensures action is taken where necessary to improve*

The Council has a Partnership Governance Policy which governs how the Council develops and manages its partnerships. All new partnership arrangements are considered to be projects and subject to the approval processes of the Council's Programme and Project Management Policy.

Each partnership arrangement has a dedicated lead manager who is responsible for managing the partnership's performance and governance. A register is maintained of all Council partnerships and the performance of significant partnerships is included in quarterly performance reporting to the Executive and Overview and Scrutiny Board.

A number of the Council's elected members also hold positions in local and regional partner organisations to promote effective cross-working between partnership members.

## Value for Money (VFM)

Through the Multi-Agency Strategic Board and Multi-Agency Operational Board, the Council has worked particularly closely during 2020-21 with the Department for Education (DfE) and the DfE appointed Commissioner for Children's Services in Middlesbrough on the delivery of the Council's Children's Services Improvement Plan.

*Where the body commissions or procures services, how the body ensures that this is done in accordance with relevant legislation, professional standards and internal policies, and how the body assesses whether it is realising the expected benefits*

The Council uses the North East Procurement Organisation (NEPO), a regional procurement hub for North East local government authorities, for all of its tendered procurements. NEPO also maintain a public contracts register which lists all of the Council's current contracts. The Council also has a central procurement unit, which provides support to individuals within the Council overseeing procurement activity through NEPO.

The Council has a Strategic Procurement Strategy and Contract Management Framework which are used to provide a framework for the commissioning of services and evaluation of the services received under awarded contracts.

The monitoring of the performance received from suppliers is integrated into the Council's overall processes for monitoring the delivery of its services to service users, as detailed above.

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The Council has generally had the arrangements we would expect to see to enable it to plan and manage its resources to ensure that it can continue to deliver its services, however the identified weaknesses in governance create additional risks to these arrangements.

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### **Financial sustainability**

*How the body ensures that it identifies all the significant financial pressures that are relevant to its short and medium-term plans and builds these into them*

The Council undertakes an annual exercise to set its annual budget for the following financial year and to update its Medium Term Financial Plan (MTFP), which covers the following three years. Key inputs to this exercise include forecasts for pay and non-pay inflation, changes in the level of demand for the Council's services and changes in funding received from central government. The MTFP for 2021-24 also included consideration of additional costs and funding relating to the Covid-19 pandemic.

The Council's finance team work with the heads of individual directorates to identify cost pressures, including due to changes in demand for services, and model the impacts of different scenarios on the Council's finances. Significant changes are discussed by the Leadership Management Team and Council Executive prior to being implemented in the MTFP.

Performance against the current year's budget is monitored on a quarterly basis during the year and used to identify cost pressures which require reflecting in subsequent MTFPs.

## Value for Money (VFM)

### *How the body plans to bridge its funding gaps and identifies achievable savings*

As part of the annual budget setting exercise, the Council identifies the level of savings required to match the anticipated net cost of services to the levels of available funding. For the 2021-22 budget, a budget gap of £1.626 million was identified.

Individual directorates are required to identify potential savings within their service area, which may arise from reductions to expenditure or increases to income. Savings may also be identified through the Council's finance team, as they are not always directly related to service delivery. Where proposed savings may have a significant impact on service delivery, the Council holds a public consultation prior to incorporating the saving into financial plans.

The level of savings identified and incorporated into the Council's budget exceeds the required level of savings to provide additional buffer against the non-achievement of planned savings. For the 2021/22 budget, identified savings exceeded required savings by £0.695 million.

### *How the body plans finances to support the sustainable delivery of services in accordance with strategic and statutory priorities*

The impact of changes to the Council's financial plans are modelled through a minimum of 3 years as part of the MTFP and any resulting budget gap over that period quantified and incorporated into the following budgeting cycle.

The Council aims to meet the costs of its day-to-day activities from available funding, but borrows for capital investment purposes. The impact of planned borrowing (i.e. interest charges) is incorporated into the Council's revenue budget and MTFP.

During 2020/21, management undertook a self-assessment against the CIPFA Financial Management Code, which promotes the financial sustainability of local authority capital expenditure and associated borrowing. Several actions were identified to strengthen the Council's processes, however no major weaknesses were noted.

## Value for Money (VFM)

Under the Council's constitution there is a clear delineation between the responsibility for setting the Council's strategic objectives, which sits with members and the Executive, and the responsibility for delivery of the operational activities which underpin the strategic objectives, which sits with officers. We have however identified multiple instances, as detailed above, where the involvement of members strayed into operational matters. We also note that where this occurred, it was often known to officers and insufficient challenge was provided to members on the boundaries of members' and officers' respective responsibilities. A lack of adherence to the delineation between strategic and operational responsibilities increases the risk that operational decisions are taken which are not optimal for the Council or the Council is unable to demonstrate represent value for money. Examples of this noted above include the Boho X project and the purchase of Covid tests.

**7. We therefore recommend that the Council provides additional training to members and officers on the boundaries of respective responsibilities under the Council's Constitution. The Council should also seek to ensure that a culture of challenge, where these boundaries are not being adhered to, is understood by and expected from all parties as part of the wider Improvement Plan to address the cultural and relationship issues which exist within the Council.**

*How the body ensures that its financial plan is consistent with other plans such as workforce, capital, investment, and other operational planning which may include working with other local public bodies as part of a wider system*

The Council develops its Capital Strategy and Investment Strategy alongside the MTFP and incorporates the revenue impact of planned capital expenditure and borrowing into the MTFP.

The Council operates a finance business partner model to facilitate regular communication between finance staff and the Council's directorates to ensure that other plans being prepared by the Council are consistent with the Council's financial planning.

The Council also requires that all decisions which are deemed significant enough to warrant approval by the senior management team or elected members are approved by the Council's Director of Finance to ensure that the financial implications of significant decisions are considered and reflected in the Council's financial planning.



## Value for Money (VFM)

*How the body identifies and manages risks to financial resilience, e.g. unplanned changes in demand, including challenge of the assumptions underlying its plans*

The Council maintains a number of earmarked reserves, which represent amounts set aside from the Council's General Fund to be used for specified purposes in the future. Management use earmarked reserves to allow for known or potential future cost pressures. During 2020-21, management released a previously held Investment Fund Reserve to offset the impact of the Covid-19 pandemic on the Council's finances.

In addition, the Council sets a minimum level for its General Fund in order to ensure that the Council does not fully deplete its reserves through normal activities. During 2020/21, the Council increased this minimum level from £9.4 million to £11 million, effective from 2021/22, to reflect higher uncertainty in the Council's financial projections, including the ongoing impact of the Covid-19 pandemic. At 31 March 2021, the Council's General Fund balance was above the £9.4 million minimum level in effect for 2020/21 at £10.5 million and is forecast to increase to the revised minimum level of £11 million during 2021/22.

The Council's MTFP produced during 2020/21 included a balanced budget for 2021/22 and indicative budgets for 2022/23 and 2023/24. The MTFP forecast a budget deficit of £0.6 million in 2022/23, which the Council intends to finance from reserves, and a budget deficit of £3.1 million for 2023/24 which the Council will need to address in future MTFPs.

## Value for Money (VFM)

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The Council has agreed 7 recommendations which we will follow up as part of our 2021/22 VFM arrangements work.

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### **Recommendations**

As a result of the VFM procedures we have carried out we have agreed seven recommendations with the Council:

#### *Recommendation 1*

We therefore recommend that the Council develop a comprehensive Improvement Plan to address the cultural and relationship issues which exist within the Council as a matter of urgency. In our view it is the responsibility of all elected members and officers to work together to address these serious matters. This will require the involvement of external specialists as, in our view, the relationships within the Council have deteriorated to a point which the Council will not be able to remedy on its own.

#### *Management response*

The Council has proposed, within the draft Annual Governance Statement, that a Corporate Governance Improvement journey is commenced. It is intended that this will be informed by the views of external specialists, CIPFA, who have been commissioned to undertake an independent diagnostic piece of work, engaging with all stakeholders over the summer. This will inform the proposed content of a Corporate Governance Improvement Plan which will be submitted to Full Council for consideration.

In order for this to be successfully delivered, it will require full buy in from all stakeholders in this process. There is a significant risk that this action cannot be achieved if this is not gained. This is reflected within the Annual Governance Statement and has been highlighted to EY.

#### *Recommendation 2*

We therefore recommend that refresher training be provided to all of the Council's elected members on the requirements of the Council's Code of Conduct for Members, including the disclosure of pecuniary interests and the Seven Principles of Public Life (also known as the 'Nolan Principles'), as set in the Council's Constitution.

#### *Management response*

Refresher training on the code of conduct was provided to members during 2021/22 (27/9/21). 21 members attended that training. Training also included ethics within public life. Following the event the training presentation was emailed to all Councillors.

## Value for Money (VFM)

### *Recommendation 3*

Whilst we recognise that the responsibility to declare actual or potential conflicts of interest sits with members under both statute and the Council's Code of Conduct, given our observations we also recommend that management implement additional assurance checks over elected member declarations of interest, for example by cross-referencing to Companies House records or declarations made by elected members to other public bodies, to provide additional comfort over their completeness.

### *Management response*

Member refresher training was delivered during 2022 on the code of conduct and included information on hospitality requirements and registers of interests. A separate micro session was also delivered on members interests on 22 Sept 21. As standard materials from all training events is sent out to all councillors.

While it is an Elected Member's sole responsibility to ensure that they appropriately declare interests, the Council will undertake periodic spot checks on a risk based basis at least three times a year of one or more Members' declarations during 2022/23 to assess whether there are ongoing compliance issues.

### *Recommendation 4*

We therefore recommend that management undertake a review to establish whether there are any other arrangements at the Council which may have been entered into without following proper Council processes and, if so, review those arrangements to ensure that they are appropriate and represent value for money for the Council.

### *Management response*

The council will consider the findings of the pre-formal fact finding to date and use this to propose a scope of reviews that will test similar arrangements to those that were within the scope of the pre-formal fact-finding. This will be embedded within the Internal Audit programme for 2022/23.

## Value for Money (VfM)

### *Recommendation 5*

We recommend that management consider whether further assurance is required to establish whether the risks identified by the Council to date are complete and the actions taken to respond to those risks sufficient.

### *Management response*

The Council has recently refreshed its approach to Risk Management and tasked all senior officers to review existing risks. This is an ongoing exercise.

Senior Managers will consider whether risk has been fully identified as part of steps in response to recommendations and to establish whether there are additional areas of Council business that that require further governance review.

Risk register content is available to LMT on the dashboard, performance against existing risk is presented on a monthly basis and risk register content is reviewed regularly within the quarterly performance report. The Q1 process will include an assessment of risk changes as a result of the VfM judgement and the update of the Annual Governance Statement.

### *Recommendation 6*

We also recommend that management work with internal audit to ensure that where future pieces of work identify evidence of wider risks which are not immediately followed-up on, these are reported so that the Council's officers and the Corporate Affairs and Audit Committee can decide whether further investigation is appropriate.

### *Management response*

Management will work with Veritau to build the highlighting of identified wider risks into the audit reporting process. The reporting of these risks will then be built into regular Internal Audit updates to Corporate Affairs and Audit Committee.

## Value for Money (VFM)

### *Recommendation 7*

We therefore recommend that the Council provides additional training to members and officers on the boundaries of respective responsibilities under the Council's Constitution. The Council should also seek to ensure that a culture of challenge, where these boundaries are not being adhered to, is understood by and expected from all parties as part of the wider Improvement Plan to address the cultural and relationship issues which exist within the Council.

### *Management response*

There is a planned action within the Annual Governance Statement to complete mandatory refresher training on the officer and member protocol within Middlesbrough Council's constitution for all members and senior officers during 2022/23.

This is supplemented by training already delivered during 2021/22 on roles and responsibilities in a range of corporate governance areas:

- Refresher senior leadership development work programme delivered by the Local Government Association to ensure officer and member roles continue to be understood and adhered to.

And other training planned for delivering during 2022/23:

- Refreshed training approach to ensure senior officers training encompasses the full suite of corporate governance training;
- Refresh training on the Equality Act and the impact assessment process, ensuring it is mandatory for key officers;
- Refreshed and strengthened training to officers delivering projects to ensure project and wider Council decision making governance is understood and adhered to;
- Delivery of training to all Members on roles and responsibilities in relation to Programme and Project Management;
- Delivery of training for Senior Officers on the officer code of conduct and the provision of effective advice and challenge;
- Complete mandatory refresher training on the officer and member protocol within Middlesbrough Council's constitution for all members and senior officers.

The Council has also commissioned CIPFA to undertake an independent diagnostic piece of work, engaging with all stakeholders over the summer. This will inform the proposed content of a Corporate Governance Improvement Plan which will be submitted to Full Council for consideration. As a result of this work, it is likely that further training needs will be required to drive required culture changes that are needed.

## Value for Money (VFM)

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The Council faces further challenge and change beyond 2021 which will form part of our future VFM arrangements work.

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### **Forward look**

#### *Senior officer and member relations*

The Council faces significant challenges in addressing the deep rooted cultural and relationships issues which existed during the year ended 31 March 2021. The recommendations agreed with management to address these challenges were not agreed until July 2022, sixteen months after the end of the period under audit, therefore they were not in place during the year ended 31 March 2022 and management have acknowledged that relationships at the Council continued to deteriorate beyond March 2021.

The Council was issued with a Best Value notice by the Department for Levelling-Up, Housing and Communities (DLUHC) in January 2023 due to concerns over governance and culture at the Council.

In our view it is the responsibility of all elected members and officers to work together to address these serious matters.

#### *Children's Services*

The Council will also need to ensure that addressing these matters does not distract from the Children's Services Improvement Plan. Whilst the Council has made good progress during the year ended 31 March 2021 against this plan, this was only the first year of a multi-year plan and the Council has more to do before its Children's Services can be considered as adequate in all regards.

In addition, the Council reported a significant overspend in Children's Services for the year ended 31 March 2022 of £8.3 million (prior to application of flexible capital receipts) and is forecasting an even larger overspend of £10.1 million for the year ended 31 March 2023. The Council's budget for the year ending 31 March 2024 includes additional amounts of £7.2 million for increased demand for Children's Services and £9.8 million for other additional investment, together representing an increase of over one third in the Children's Services budget, and the Council has implemented a Children's Services Financial Recovery Plan.

The scale of this additional investment has necessitated savings of £9.4 million to also be incorporated into the Council's budget for the year ending 31 March 2024, following several years with no significant savings being required. An independent review of planned savings by CIPFA concluded that the Council is unlikely to deliver all of the planned savings, as well as highlighting the low level of reserves held by the Council, and further cost-saving measures are likely to be necessary to ensure the financial sustainability of the Council.

## Value for Money (VFM)

### *Middlesbrough Development Company*

In February 2019, the Council established Middlesbrough Development Company as a subsidiary (called MHome Limited at the time). The activities of the subsidiary were limited up to 31 March 2021, however the Council has delivered or is still delivering several significant capital projects through the subsidiary since 31 March 2021.

Subsidiary companies act with a greater degree of separation from both the management and elected members of the Council, and appropriate governance arrangements are required to oversee the activities of the subsidiary and ensure that it delivers value for money with the resources provided to it by the Council.

In January 2023, the Council decided to demise the subsidiary as no longer meeting the strategic needs of the Council. This decision was taken following a draft report from internal audit highlighting that significant investment would be required to bring the Council's arrangements for overseeing the subsidiary up to the expected standard.

The Council will now need to manage the demise of the subsidiary, including transfer back to the Council of any remaining assets and settlement of the amounts loaned to the subsidiary by the Council.

### *Adherence to Council policies and procedures*

Our value for money commentary highlights several examples where the Council's internal policies and procedures were not adhered to, including in relation to procurement. Since we undertook our value for money work, further matters have been brought to our attention which indicate this has continued to be a concern after 31 March 2021. This includes the extension of a significant contract which management subsequently had concerns over and, following an internal investigation, have concluded was not undertaken in accordance with the Council's policies and procedures.

Our audit work to support our commentary on the Council's arrangements for the year ending 31 March 2022 is ongoing and includes the use of EY forensic specialists to assist with evaluating the extent to which non-adherence with policies and procedures may be pervasive within the Council.

### *Stability of senior management*

Between 31 March 2021 and the date of this report, the Council has had 4 Section 151 Officers (including a short-term internal appointment between external appointments). It has also changed its Chief Executive, Director of Children's Services and Director of Children's Care, and the current holders of all 4 posts are interim appointments whose current terms of employment expire within 12 months.

At a time when the Council has several significant improvement plans in progress, including in relation to Children's Services and the Council's overall culture and governance, a lack of stability in senior post holders increases the risks that the Council is not able to deliver against its improvement plans.

## Value for Money (VFM)

### *Exposure to commercial risks*

During the year ended 31 March 2021, the Council acquired the Cleveland Centre shopping centre and the former House of Fraser department store in Middlesbrough town centre. Since the 31 March 2021, the Council has also acquired the Captain Cook Square retail centre and has announced ambitious plans to redevelop these sites as part of its efforts to regenerate the town centre.

Combined with the purchase of the two Centre Square office buildings in the year ended 31 March 2020 and the ongoing construction of the Tees Advanced Manufacturing Park, the Council has significantly increased its exposure to commercial income streams compared to a few years ago. Such activities carry both upside and downside risks which the Council will need to manage as part of its financial planning.

### *Inflationary pressures*

All local government authorities face rising costs as a result of levels of inflation not seen in the UK economy for two decades, including significant increases in energy prices which can have a disproportionate impact on providers of public services which typically have large physical estates. Increases in interest rates will also make it more expensive for local authorities to borrow to fund capital programmes.

The impact of inflationary pressures on individuals is also likely to increase demand for council services and may reduce the income from discretionary council services. Local authorities may also seek to provide additional support to individuals.

All of which may have adverse impacts on the Council's financial position and make it more difficult for the Council to ensure it is financially stable over the medium term.



A photograph of a business meeting in progress. Several people are gathered around a wooden conference table, looking at documents. A woman with blonde hair is in the foreground, resting her chin on her hand. A man in a blue suit and red tie is standing in the background. The scene is brightly lit, suggesting a modern office environment. A large yellow rectangular overlay covers the left side of the image, containing text.

Section 5

## Other Reporting Issues

## Other Reporting Issues

### **Governance Statement**

We are required to consider the completeness of disclosures in the Council's governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it complies with relevant guidance.

We completed this work and did not identify any areas of concern.

### **Whole of Government Accounts**

We have performed all of the procedures required to date by the National Audit Office on the Whole of Government Accounts consolidation pack submission. We cannot however formally conclude the audit and issue our audit certificate until the NAO as group auditor has confirmed that no further assurances will be required from us as component auditors of Middlesbrough Council. We are satisfied that this work does not have a material effect on the financial statements or our work on value for money arrangements.

We have no matters to report from the procedures performed to date.

### **Report in the Public Interest**

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

### **Other powers and duties**

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

We do however note that within our VFM commentary we have highlighted that if we are not satisfied with the Council's progress against our recommendations, we will consider exercising our further powers by making statutory recommendations. We reported in December 2022 to the Council's Corporate Affairs and Audit Committee that the Council has taken positive actions to respond to our recommendations (issued in draft in July 2022), however it is clear that there is significant concern amongst a number of stakeholders over the ability of the Council to deliver on these actions.

We will continue to monitor the progress of the Council against the Improvement Plan as part of our value for money assessment for future periods. Should this assessment provide evidence that the Council is not making satisfactory progress against the Improvement Plan or the actions taken are not having the necessary effect on the Council's culture, we will reconsider whether a statutory recommendation or exercise of other auditor reporting powers may be appropriate.

## Other Reporting Issues

### Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

The matters reported are shown below and are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported.

Description	Recommendation
<p><b>Maintenance of infrastructure asset accounting records</b></p> <p>The Council has not maintained appropriate accounting records to allow it to account for infrastructure assets in accordance with the requirements of the reporting framework. Specifically, the Council is not able to separately identify individual assets within its accounting records and, therefore, cannot evidence that individual assets have been accounted for appropriately.</p> <p>The reporting framework has been modified for 2020/21 so that the Council does not need to separately disclose the gross cost and accumulated depreciation and impairment of infrastructure assets, only the net valuation, and can assume that the net valuation as at 1 April 2020 was correct. These modifications are however temporary, applying only until the 2024/25 financial year.</p> <p>The detailed requirements which will apply after 2024/25 are still to be determined, however it is highly likely that they will require the Council to develop better information on the Council's infrastructure assets than it currently holds.</p>	<p>The Council should review how it records its expenditure on infrastructure assets, in particular to allow it to separately identify individual assets within its accounting records.</p> <p>In addition, the Council should review what information it holds for existing assets in other forms, for example within the highways team, and how this can be used to disaggregate existing accounting records.</p>

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### Application of procurement processes

Our audit procedures identified a number of instances where goods or services were procured outside of the Council's normal policies and procedures, including the provision of mayoral support activities and the purchase of unusable Covid-19 tests.

The Council's policies allow for formal exemptions to full procurement processes to be applied, as may have been appropriate during the pandemic response, however the fact an exemption was applied and the reason for doing so should be clearly documented.

The Council has been unable to evidence documentation of an exemption in the cases noted.

We recommend the Council review its procurement processes to ensure that policies and procedures are either applied in full, or clear documentation is made of the reasons why exemptions have been applied.

## Other Reporting Issues

Description	Recommendation
<p><b>Inspection of the accounts</b></p> <p>Under the Local Audit and Accountability Act 2014, the Council is required to provide a period of 30 working days after publication of the draft financial statements during which local electors may inspect the draft statements and raise any questions on them to the Council. Due to a technical issue, the Council did not identify the one query received during the inspection period and did not therefore respond to the query in a timely manner. The Council did respond to the query once the failure to respond to the original request was reported through other channels.</p>	<p>We recommend that management review the process by which electors may raise queries during the accounts inspection period to ensure that any requests received during the inspection period for the 2021/22 Statement of Accounts are identified and responded to in a timely manner.</p>
<p><b>Accuracy of leases register</b></p> <p>Our testing of lease-related disclosures found a number of issues with inaccurate information being recorded in the Council's leases register. In addition to causing a misstatement of disclosures, inaccurate information on the Council's lease arrangements may have a negative impact on the accuracy of financial forecasting and expose the council to operational risks, such as being unaware a lease has expired.</p> <p>In 2024/25, the Council will adopt IFRS 16, a new accounting standard for leases which will increase the balances recognised on the balance sheet. Accurate information on the terms of the Council's leases will be key to successful adoption of this new standard.</p>	<p>We recommend management review the process by which lease information is updated and reviewed within the Council's leases register to ensure that information recorded in the register is complete and accurate.</p>
<p><b>Response to freedom of information and subject access requests</b></p> <p>In most cases, the Council is required by the Freedom of Information Act 2000 to respond to requests for information within 20 days and by the Data Protection Act 2018 to respond to Subject Access Requests (SARs) within one month. For the 2020 calendar year, the Council has reported compliance with these targets for 73% of information requests and 58% of SARs. Response times to such requests are specified in legislation therefore the Council's failure to respond consistently within these timescales is non-compliant with these pieces of legislation.</p> <p>Management have recognised the need to address a backlog of cases and have implemented a recovery plan to facilitate this.</p>	<p>We recommend the Council continues to review progress against the recovery plan and take further steps if the Council's compliance rate with statutory timescales does not sufficiently improve.</p>

## Other Reporting Issues

Description	Recommendation
<p><b>Useful lives of infrastructure assets</b></p> <p>In considering how the Council has applied the reporting framework amendments for infrastructure assets, we undertook a more detailed review of the useful lives applied to individual infrastructure assets.</p> <p>Our review noted that there is considerable variability in the useful lives applied and the useful lives adopted were not always in-line with the guidance ranges published by CIPFA or reflective of the different components of an asset which may exist.</p> <p>We are content that net valuations at 31 March 2021 are materially correct, in part because of the statutory presumption that balances at 1 April 2020 were correct, however the risk of misstatement in net valuations due to inappropriate useful lives being applied will increase year-on-year.</p>	<p>We recommend that management review the useful lives applied to infrastructure assets, including whether different useful lives should be applied to different components of each asset, against both the CIPFA guidance and the Council's own past experience of the frequency with which assets are replaced.</p>
<p><b>Allowances for bad and doubtful debt</b></p> <p>Our testing of the Council's allowances for bad and doubtful debt noted that key assumptions within the calculations, in particular around the recoverability of aged debt, have not changed for a number of years. Whilst management did include manual adjustments to account for the impact of the pandemic in specific circumstances, there was a limited evidence base for the size of these adjustments.</p> <p>There have been significant changes to the economic environment at both the macro and local level since many of the assumptions used were set, therefore there is a risk that these are no longer appropriate and the Council is not accurately calculating its exposure to irrecoverable balances..</p>	<p>We recommend that management review the assumptions used to inform the calculation of allowances for bad and doubtful debt to ensure they remain appropriate. Management should also ensure their calculations comply with the requirements of accounting standards, including the 'expected loss' model of IFRS 9 for non-statutory balances.</p>

Appendix A

## Audit Fees



## Audit Fees

We set out below a summary of our fees for the year ended 31 March 2021.

Description	Final Fee	Planned Fee	Final Fee
	2020/21	2020/21	2019/20
	£	£	£
Base scale fee – Council (note 1)	88,578	88,578	88,578
Base scale fee - Pension Fund (note 1)	21,972	21,972	21,972
Increase for changes in risk and regulatory environment – Council (notes 2,3,8)	81,850	-	53,960
Increase for changes in risk and regulatory environment – Pension Fund (notes 2,3,8)	39,359	-	14,033
<b>Revised base fee</b>	<b>231,759</b>	<b>110,550</b>	<b>178,543</b>
IAS 19 procedures (Code work) (notes 4,5)	8,500	N/A	6,000
IAS 19 procedures (non-Code work) (notes 4,5)	-	N/A	2,000
<b>Revised base fee (inc. IAS 19 procedures)</b>	<b>240,259</b>	<b>110,550</b>	<b>186,543</b>
Additional audit fee for response to specific audit findings – Council (notes 6,7,8)	184,572	-	20,745
Additional audit fee for response to specific audit findings – Pension Fund (notes 6,7,8)	5,000	-	5,202
<b>Total audit fee</b>	<b>429,831</b>	<b>110,550</b>	<b>212,490</b>
Non-audit services – Housing Benefit certification work	13,450	N/A	12,800
Non-audit services – Teachers Pension certification work	5,250	N/A	5,000
<b>Total fees</b>	<b>448,531</b>	<b>110,550</b>	<b>230,290</b>

### Notes

1. The base audit fees reflect the amounts determined by Public Sector Audit Appointments Limited (PSAA) in March 2020.
2. We wrote to management and the Corporate Affairs and Audit Committee Chair on 10 February 2020 setting out our considerations on the sustainability of UK local public audit. In our Audit Planning Report we reported that we had submitted proposals of £64,381 for the Council and £33,602 for the Pension Fund to PSAA as our assessment of the additional fee required to reflect changes in the level of work required to address professional and regulatory requirements and scope associated with risk for our 2019/20 audits. The amounts shown for 2019/20 in the table reflect the final amounts determined by PSAA (see note 8).

## Audit Fees

3. The amounts reported for 2020/21 are the amounts we have communicated to management and will submit to PSAA as our assessment of the additional fee required to reflect changes in the level of work required to address professional and regulatory requirements and scope associated with risk for our 2020/21 audits. In addition to the factors applicable to the 2019/20 audits, which remain relevant for the 2020/21 audits, the level of audit work required for 2020/21 was impacted by the adoption of the new auditing standard ISA 540: Auditing Accounting Estimates and Related Disclosures and the new framework applicable to our value for money assessment. Amounts for these factors have been based on anticipated fee impacts communicated by PSAA to auditors and audited bodies.
4. As part of our audit of the Pension Fund we undertake additional procedures to enable us to report to the auditors of scheduled bodies that are subject to the NAO Code of Audit Practice. These procedures are additional to the procedures we must complete to support our opinion on the financial statements of the Pension Fund. Management may opt to recharge this fee to the relevant member bodies.
5. In 2019/20, the provision of IAS 19 assurances to the auditor of the Care Quality Commission was not covered by the NAO Code of Audit Practice (2015) and we performed this work under a separate engagement agreement between ourselves and the Pension Fund. From 2020/21, this work is now covered by the new NAO Code of Audit Practice (2020) and the fee reflected within the fee for IAS 19 work performed under the Code of Audit Practice.
6. In 2019/20, we performed additional procedures over what we planned at the start of our audit, to respond to the impacts of the Covid-19 pandemic on the financial statements. This included additional consultations on the form of our audit opinion and additional procedures to review and challenge management's assessment of the impact of Covid-19 on asset valuations. In our Audit Planning Report we reported amounts of £24,750 for the Council and £12,455 for the Pension Fund as the additional fees we determined as commensurate with the additional work undertaken, which we had submitted to PSAA. The amounts shown for 2019/20 in the table reflect the final amounts determined by PSAA (see note 8).
7. Where we identified significant risks and other areas of audit focus as part of our 2020/21 audits, as reported to the Corporate Affairs and Audit Committee, we undertook additional procedures to obtain the appropriate levels of evidence to support our opinion. For 2020/21, this has included an exceptional level of audit effort to address the additional risk of significant weakness relating to member and senior officer relationships reported in section 5 which, due to its nature, has had to be performed by the most senior members of the audit team. Audit resources have also been required to respond to a very high level of correspondence we have received during the course of the 2020/21 audit, changes to the reporting framework for infrastructure assets and multiple extensions to management's going concern assessment. The amounts of £184,572 for the Council and £5,000 for the Pension Fund represents our assessment of the additional fees we have determined as commensurate with the additional work undertaken.
8. PSAA provided final additional fee determinations of £74,705 for the Council and £19,235 for the Pension Fund in respect of 2019/20 audits. These amounts were not broken down further by PSAA, therefore for the purposes of the table on the previous page we have apportioned these amounts between the increase for changes in risk and regulatory environment and additional audit fee for response to specific audit findings in proportion to the amounts originally requested.



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