Middlesbrough Council

Value for Money Interim Report

Years ended 31 March 2022 and 31 March 2023

10 July 2024

10 July 2024

Audit Committee
Middlesbrough Council
Civic Centre
Middlesbrough
TS1 9GA

Dear Audit Committee Members

Value for Money Interim Report up to and including 31 March 2023

We are pleased to attach our interim commentary on the Value for Money (VFM) arrangements for Middlesbrough Council. This commentary explains the work we have undertaken and highlights any significant weaknesses identified along with recommendations for improvement. The commentary covers our interim findings for the audit years 2021/22 and 2022/23.

The Department for Levelling Up, Housing and Communities (DLUHC) has worked collaboratively with the Financial Reporting Council (FRC), as incoming shadow system leader, and other system partners to develop measures to address the delay in local audit. The National Audit Office (NAO) issued a consultation on 8 February 2024 seeking views on changes to the Code of Audit Practice (the Code) to support auditors to meet backstop dates and promote more timely reporting of their work on value for money arrangements. The consultation proposes to reduce the scope of the VFM reporting up to and including the 2022/23 financial year. At this stage, we are continuing to report VFM in line with our existing responsibilities as set out in the 2020 Code.

This report is intended solely for the information and use of the Audit Committee and management. It is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss the contents of this report with you at the Audit Committee meeting on 25 July 2024.

Yours faithfully

Stephen Reid

Partner

For and on behalf of Ernst & Young LLP

Encl

Contents

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/auditquality/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 July 2021)” 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 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 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 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.

01 Executive Summary

Executive Summary

Purpose

Auditors are required to be satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We do not issue a ‘conclusion’ or ‘opinion’, but where significant weaknesses are identified we will report by exception in the auditor’s opinion on the financial statements. In addition, auditors provide an annual commentary on arrangements published as part of the Auditor’s Annual Report. In doing so, we comply with the requirements of the 2020 Code of Audit Practice (the Code) and Auditor Guidance Note 3 (AGN 03).

The purpose of this interim commentary is to explain the work we have undertaken during the period 1 April 2021 to 31 March 2023 and highlight any significant weaknesses identified along with recommendations for improvement. It includes the significant weaknesses in arrangements we previously reported to full Council in our ‘Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014’ report issued on 21 August 2023.

This commentary covers our interim findings for audit years 2021/22 and 2022/23. The NAO has confirmed that where VFM reporting is outstanding for more than one year, the auditor can issue one report covering all years.

The Department for Levelling Up, Housing and Communities (DLUHC) has worked collaboratively with the Financial Reporting Council (FRC), as incoming shadow system leader, and other system partners, to develop measures to address the delay in local audit. As part of the NAO consultation issued on 8 February 2024, there is a proposal to reduce the scope of the VFM reporting up to and including the 2022/23 financial year. However, the consultation states that where auditors have begun or already undertaken work that no longer falls under the reduced scope (if agreed once the consultation closes), they may still report on it in accordance with Schedule 4. We are continuing to report VFM in line with our existing responsibilities as set out in the 2020 Code to ensure a smooth transition to the 2023/24 audit year when auditors are currently required to meet the full Code reporting responsibilities.

The report sets out the following areas which have been assessed up to the point of issuing this interim report:

- Any identified risks of significant weakness, having regard to the three specified reporting criteria;
- An explanation of the audit procedures performed to respond to the significant risks identified;
- Findings to date from our responsive procedures; and
- A summary of arrangements over the period covered by this report.

We will summarise our final view of the value for money arrangements as part of the Auditor’s Annual Report once the audit reports have been issued for 2021/22 and 2022/23.

Executive Summary (continued)

Risks of significant weakness

In undertaking our procedures to understand the body's arrangements against the specified reporting criteria, we identify whether there are risks of significant weakness which require us to complete additional risk-based procedures. AGN 03 sets out considerations for auditors in completing and documenting their work and includes consideration of:

- Our cumulative audit knowledge and experience as your auditor;
- Reports from internal audit which may provide an indication of arrangements that are not operating effectively;
- Our review of Council committee reports;
- Meetings with the Chief Executive, Director of Finance and Monitoring Officer (inc. current and previous postholders, where applicable);
- Information from external sources; and
- Evaluation of associated documentation through our regular engagement with Council management and the finance team.

We identified a total of 6 significant risks as part of our risk assessment procedures, cutting across each of the three specified reporting criteria. We set out our identified significant risks and the procedures performed to respond to these risks in the table below:

Description of risk identified	Work performed to address the risk of significant weakness
Governance: Member and Senior Officer Relationships ***Applicable to 2021/22 and 2022/23*** As part of our 2020/21 audit, we reported significant weaknesses in the Council's arrangements to secure value for money during the year to 31 March 2021 arising from 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. 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 implemented commenced during the year ended 31 March 2023. We therefore consider there to be a risk that these matters continued to have an adverse impact on the effectiveness of the Council's governance processes.	• We held regular discussions with stakeholders covering the relationships within the Council throughout 2021/22 and 2022/23 as part of the finalisation of our 2020/21 audit work, which was ongoing at the time, and commencement of our 2021/22 audit work. • We considered our own observations from direct interactions with officers and members, and from attendance at meetings of the Corporate Affairs and Audit Committee (Audit Committee from October 2023). • We made enquiries of management, and reviewed reports presented to full Council and the Improvement Board, to understand the Council's progress against the Governance Improvement Plan. • We considered information brought to our attention through correspondence received from various stakeholders. We note that the volume of correspondence we receive in relation to the Council is significantly higher than we would expect for this type of entity. • We evaluated whether the above indicates that material weaknesses in arrangements were present during 2021/22 or 2022/23, and considered the implications for our auditor reporting.

Executive Summary (continued)

Risks of significant weakness

Description of risk identified	Work performed to address the risk of significant weakness
Governance: Asset Acquisitions ***Applicable to 2022/23 only*** In February 2023, the Council purchased the Crown Pub from a private owner for £750,000. Following changes in senior management shortly afterwards, concerns emerged over the governance processes supporting the purchase and management requested that internal audit undertake a review of the acquisition. That review, which covered the events leading up to the purchase, concluded and reported in February 2024. Given there was sufficient concern from management over the acquisition to request a review by internal audit, we consider there to be a risk that appropriate arrangements were not followed in the acquisition of this property.	• We reviewed the internal audit report into the acquisition of the Crown Pub for indicators of weaknesses in the Council's arrangements. • We discussed the findings of the internal audit report with management, and observed the discussion of the internal audit report at the Council's Audit Committee. • We evaluated whether the above indicates that a material weakness in arrangements was present during 2022/23, and considered the implications for our auditor reporting.
Financial Sustainability: Financial Sustainability ***Applicable to 2021/22 and 2022/23*** The Council experienced a significant deterioration in its financial position between April 2021 and March 2023, in part due to significant overspends within its Children's Services directorate in both 2021/22 and 2022/23. A Financial Recovery Plan was implemented in October 2022, and the Council sought additional non-financial support from CIPFA as part of the budget setting process for the Council's 2023/24 budget. We therefore consider there to be a risk that the Council did not have proper arrangements in place to manage its financial position.	• We held regular discussions with the Council's Section 151 officers, of which there were 3 between 1 April 2021 and 31 March 2023 (the latter being a temporary acting up of one of the Council's Deputy Section 151 officers prior to the interim appointment of the current Section 151 officer in April 2023), Head of Financial Planning and Support and Head of Finance & Investments to understand the Council's financial position and actions being taken to manage financial pressures. • We reviewed the Council's quarterly Revenue and Capital Budget reporting to the Executive. • We reviewed the Council's Financial Recovery Plan. • We reviewed the report "A review of the Council's financial position, affordability, and financial outlook" produced by CIPFA in February 2023, and the Interim Director of Finance's Section 25 report on the Council's 2023/24 budget. • We evaluated whether the above indicates that material weaknesses in arrangements were present during 2021/22 or 2022/23, and considered the implications for our auditor reporting.

Executive Summary (continued)

Risks of significant weakness

Description of risk identified	Work performed to address the risk of significant weakness
Improving Economy, Efficiency and Effectiveness: Contracting and Procurement ***Applicable to 2021/22 and 2022/23*** The Council undertakes significant procurement activity, contracting with a wide range of suppliers in support of the delivery of Council activities. Concerns were raised to us by senior management that one of the Council's larger contracts for external social work support, which ran throughout 2021/22 and was extended during 2022/23, may not have been procured in accordance with the Council's policies and procedures. We therefore consider there to be a risk that the Council did not have proper arrangements in place with regards to contracting and procurement activities.	• We discussed the contract for external social work support with management to understand the nature of the concerns raised in relation to this contract. • We reviewed the results of a fact-finding exercise into the external social work support contract performed by the Council's Director of Regeneration, as a member of senior management removed from the day-to-day activities of the contract. • We utilised our EY Forensics specialists to perform a review of documentation and interviews with officers to confirm the facts in relation to the external social work support contract. • We also utilised our EY Forensics specialists to perform a review of a sample of contracts awarded by the Council during 2021/22, to assess whether contracts were awarded in accordance with the Council's Financial and Contract Procedure Rules. • We evaluated whether the above indicates that material weaknesses in arrangements were present during 2021/22 or 2022/23, and considered the implications for our auditor reporting.
Improving Economy, Efficiency and Effectiveness: Oversight of Middlesbrough Development Company ***Applicable to 2021/22 and 2022/23*** In February 2019, the Council established Middlesbrough Development Company as a subsidiary (called MHomes Limited at the time). The activities of the subsidiary were limited up to 31 March 2021, however the Council has delivered several significant capital projects through the subsidiary since 1 April 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. We therefore consider there to be a risk that the Council did not have proper arrangements in place with regards to oversight of its subsidiary.	• We reviewed the internal audit report into the governance arrangements in respect of Middlesbrough Development Company for indicators of weaknesses in the Council's arrangements. • We reviewed the Executive committee paper in support of the decision to demise Middlesbrough Development Company. • We discussed the findings of the internal audit report and content of the Executive report with management. • We evaluated whether the above indicates that material weaknesses in arrangements were present during 2021/22 or 2022/23, and considered the implications for our auditor reporting.

Executive Summary (continued)

Risks of significant weakness

Description of risk identified

Improving Economy, Efficiency and Effectiveness: Provision of Children's Services

Applicable to 2021/22 only

On 24 January 2020, the Office for Standards in Education, Children's Services and Skills (Ofsted) released the results of its inspection of the Council's children's social care services performed between 25 November 2019 and 6 December 2019. The report concluded that the quality of the Council's children's services had deteriorated since the previous inspection in 2015 and were now inadequate.

Following publication of the Ofsted report, management developed an Improvement Plan to address the findings raised by Ofsted and an Independent Children's Commissioner was appointed to oversee progress against the Improvement Plan.

Implementation of the Improvement Plan remained ongoing as of 1 April 2021, therefore we consider that there remains 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 2021/22.

Note: *In our Audit Planning Report for the year ended 31 March 2022, issued in November 2022, we included the overspends within the Council's Children's Services as part of this risk and our planned audit response. We have since recognised a separate significant VFM risk in relation to financial sustainability (see previous pages), including the overspends within the Council's Children's Services directorate, and therefore narrow the scope of the previously reported risk to focus specifically on the underlying provision of children's services.*

Work performed to address the risk of significant weakness

- We reviewed the reports of ongoing focused and monitoring visits performed by Ofsted for indicators of weaknesses in the Council's arrangements.
- We reviewed the 12-month report of the Independent Children's Commissioner, issued in July 2021, and the subsequent notification of withdrawal of the Independent Children's Commissioner issued to the Council in November 2021.
- We made enquiries of management to understand the Council's progress against the Children's Services Improvement Plan.
- We evaluated whether the above indicates that a material weakness in arrangements was present during 2021/22, and considered the implications for our auditor reporting.

Executive Summary

Reporting

Our interim commentary for 2021/22 and 2022/23 is set out over pages 12 to 33. The interim commentary on these pages summarises our understanding of the arrangements at the Council based on our evaluation of the evidence obtained in relation to the three reporting criteria (see table below) throughout 2021/22 and 2022/23. We include within the VFM commentary below the associated recommendation(s) we agreed with the Council.

In accordance with the NAO's 2020 Code, we are required to report a commentary against the three specified reporting criteria. The table below sets out the three reporting criteria, whether we identified a risk of significant weakness as part of our planning procedures, and whether, at the time of this interim report, we have concluded that there is a significant weakness in the body's arrangements.

Reporting Criteria	Risks of significant weaknesses in arrangements identified?	Actual significant weaknesses in arrangements identified?
Governance: How the Council ensures that it makes informed decisions and properly manages its risks	• Member and Senior Officer Relations (2021/22 and 2022/23); • Asset Acquisitions (2022/23 only)	• Member and Senior Officer Relations (2021/22 and 2022/23); • Asset Acquisitions (2022/23 only)
Financial sustainability: How the Council plans and manages its resources to ensure it can continue to deliver its services	• Financial Sustainability (2021/22 and 2022/23)	• Financial Sustainability (2022/23 only)
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	• Contracting and Procurement (2021/22 and 2022/23); • Oversight of Middlesbrough Development Company (2021/22 and 2022/23); • Provision of Children's Services (2021/22 only)	• Contracting and Procurement (2021/22 and 2022/23); • Oversight of Middlesbrough Development Company (2021/22 and 2022/23)

The volume and breadth of significant weaknesses in the Council's arrangements during both 2021/22 and 2022/23, and the fact they cover all 3 of the reporting criteria against which the Council's arrangements are assessed, is of significant concern. Whilst management has taken steps since the end of the periods being reported on to address these weaknesses (see pages 31 to 33), it is likely to take sustained effort over a period of time for the Council to fully address all of the weaknesses in its arrangements identified and demonstrate that it has robust arrangements to secure value for money in its use of resources.

Executive Summary

Independence

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY) and the Council, and its members and senior management and its affiliates, including all services provided by us and our network to the Council, its members and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 April 2021 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

EY Transparency Report 2023

Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year end 30 June 2023:

[EY UK 2023 Transparency Report | EY UK]

02 Value for Money Commentary

Value for Money Commentary

Governance: How the Council ensures that it makes informed decisions and properly manages its risks

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 a number of Scrutiny Panels, with each able to refer decisions back to the Executive for further consideration.

The Corporate Affairs and Audit Committee (restructured into the Audit Committee post 31 March 2023) receives reports on the Council's internal control environment from internal and external audit and monitors the implementation of recommendations to address identified weaknesses.

In our value for money commentary for the year ended 31 March 2021, we reported that we had observed evidence which led us to conclude that the culture and governance arrangements at the Council had not been operating as expected and that this was undermining the effectiveness of the Council’s governance framework. In addition, we reported our observation that there was a pervasive lack of trust within the Council between officers and elected members, and between elected members, which was having a significant impact on the governance of the Council and was a contributing factor to the respective roles and responsibilities of officers and members not being adhered to. The recommendations agreed with management to address these challenges were not agreed until July 2022, therefore they were not in place during the year ended 31 March 2022, and management acknowledged at the time that relationships at the Council had continued to deteriorate beyond 31 March 2021.

Also in July 2022, the Council’s Chief Executive and Section 151 Officer provided an update to the Corporate Affairs and Audit Committee which articulated that, at that time, they did not feel able to sign the Council’s Annual Governance Statement for the year ended 31 March 2021 on the grounds that the statement did not fully reflect the size and scale of the cultural change required at the Council.

Alongside our value for money commentary and management’s update on the Annual Governance Statement, the July 2022 meeting of the Corporate Affairs and Audit Committee was presented with a joint paper from the Council’s Chief Executive, Section 151 Officer and Monitoring Officer entitled ‘Commencing a Corporate Governance Improvement Journey’ which sought endorsement from the committee to appoint the Chartered Institute of Public Finance and Accountancy (CIPFA) to undertake an initial diagnostic piece of work to better understand the cultural and governance issues which exist within the Council and propose further steps to address these. The committee provided the requested endorsement and the CIPFA review commenced in late July 2022.

Following interviews with over 40 individuals from across the Council, including members of the Executive, political group leaders and senior officers, and a review of other documentation, CIPFA issued the results of their review in September 2022. The review further highlighted the significance of the cultural and governance issues at the Council, concluding:

> *“It is clear from what we have seen that the issues facing the Council are significant. They are having a negative impact on the culture of the Council and, as identified by the External Auditor, affecting the Council’s ability to deliver good governance. In the context of what will be a very difficult 2023/24 budget settlement, and a cost-of-living crisis that is affecting the lives of the citizens of Middlesbrough, the issues identified in this report have the potential to increase the risk that the Council will not be able to deliver its priorities.*

Value for Money Commentary

The Council has an opportunity to make considerable improvements, but not without acceptance that the issues contained in this report are real, serious and need resolution."

Alongside their observations, CIPFA recommended the development of an action plan to address the issues raised and the use of cross-party working groups to involve members in this process. The CIPFA report and recommendations, alongside management's proposal for an Improvement Board to oversee the action plan was presented to, and approved by, a meeting of the full council in October 2022.

An updated version of the Annual Governance Statement for 2020/21 was also produced which included additional narrative highlighting further deterioration in relationships at the Council since 31 March 2021, concerns that there was insufficient acceptance of the significance of the cultural issues at the Council and their impact on the Council's governance processes and, consequently, that there are significant risks to the Council being able to deliver the necessary improvement. Similar concerns regarding the acceptance of the scale of issues at the Council and the Council's ability to deliver improvement were also raised to us by multiple elected members of the Council.

The Improvement Board was led by an independent chair from the Local Government Association, and membership included the Council's Mayor, the Executive Member for Finance and Governance, the Chief Executive, the Monitoring Officer, political group leaders and a representative from CIPFA. The Improvement Board was supported by four task and finish sub-groups focusing on roles and responsibilities within the Council, training and development, the Council's Constitution and the culture and communications within the Council. The first meeting of the Improvement Board took place on 2 November 2022, at which the Board approved its terms of reference and an action plan based around 30-, 60- and 90- day milestones. Establishment of the task-and-finish working groups and agreement of the 30-, 60- and 90- day milestones was considered 'phase one' of the Council's Corporate Governance Improvement Plan.

In January 2023, the Council was issued with a Best Value notice by the Department for Levelling Up, Housing and Communities (DLUHC) in relation to the weaknesses in the Council's arrangements reported in our value for money commentary.

In February 2023, the Council reported to the Governance Improvement Board that all of the 30- and 60- day actions had been delivered, along with 6 of the 27 90-day actions. It was also reported that 'phase two' of the Corporate Governance Improvement Plan had been substantially completed and that outstanding actions would be incorporated into 'phase three'. The Board agreed to seek finalisation of the actions for phase three of the Corporate Governance Improvement Plan ready for approval by the Board at the end of March 2023.

Also in February 2023, 17 of the Council's members wrote to the Council's Chief Executive to express a loss of confidence in their leadership of the Council, citing the assessment of the Council's Children's Services in December 2019 as inadequate, the cultural and governance issues raised in our value for money commentary and a deterioration in the Council's financial position.

The letter sought the immediate resignation of the Chief Executive, and its signatories included the leaders of several of the Council's political groups, several committee chairs and more than half of the Council's Executive. On 10 March 2023, the Corporate Affairs and Audit Committee approved the terms of the Chief Executive's departure from the Council and he formally left the Council on 24 March 2023. We note that external legal advice was sought by the Council as to whether the terms of the Chief Executive's departure represented value for money and were proportionate and appropriate prior to being submitted to the Corporate Affairs and Audit Committee for approval. External legal advice was also sought on the correct committee, under the Council's Constitution, to approve such terms.

Value for Money Commentary

Also during March 2023, the Council agreed the early termination of the interim appointment of the Section 151 Officer which had been due to conclude in June 2023. The Interim Section 151 Officer left the Council on 31 March 2023.

Both the Chief Executive and Section 151 Officer posts were subsequently filled by interim appointments in March and April 2023, respectively. Between the departure of the previous Interim Section 151 Officer and the appointment of the new Interim Section 151 Officer, the Council designated the Head of Financial Planning and Support as the Council's Section 151 Officer.

As part of the follow-up of the Best Value notice by DLUHC, senior officers met with representatives of the Department on a fortnightly basis to discuss the Council's progress. As these meetings developed, the Department's interest has expanded beyond the cultural and governance issues which were the focus of the Best Value notice to also include the Council's Children's Services Improvement Plan, the Council's financial position and the high levels of turnover in senior management positions.

Given the Council's response to the recommendations made in our value for money commentary for the period ended 31 March 2021 did not commence until July 2022, and both officers and members have reported a continued deterioration of relationships during 2021/22, it is clear that the significant weakness in arrangements reported in 2020/21 in relation to member and senior officer relationships remained a significant weakness throughout 2021/22.

During 2022/23, the Council did take positive actions to respond to our recommendations, including the commissioning of external work by CIPFA to assist in identifying the root causes of relationship issues at the Council and an action plan to address them, implementation of an Improvement Board with an external chair and strong representation from elected members and senior officers, and reporting of these actions through full council. These steps are in-line with those we expected to see from the Council in responding to our previous recommendations.

It is however clear that there was also significant concern amongst a number of stakeholders over the ability of the Council to deliver on these actions, characterised by expressions of a lack of confidence in the acceptance by individuals of the significance of the governance issues identified at the Council and the commitment of all necessary stakeholders towards meaningful change. The events of February and March 2023 demonstrate that strained relationships at the Council remained a significant influence upon the effectiveness of governance as of March 2023, therefore we conclude that this significant weakness was not satisfactorily addressed during 2022/23 and consider a significant weakness to have existed during this period as well.

We therefore conclude that member and senior officer relationships was a significant weakness in the Council's arrangements during both 2021/22 and 2022/23.

We previously reported our conclusion that the Council had not made satisfactory progress in addressing this significant weakness in arrangements reported in our value for commentary for 2020/21 as part of our report 'Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014' report issued on 21 August 2023, which included the following statutory recommendations we issued to the Council in respect of this significant weakness:

1. **We recommend that the Council ensures the recent progress with development of the next phase of the Corporate Governance Improvement Plan is progressed without further delay, and that appropriate prioritisation is given to actions which address the cultural and governance issues of the Council within the expanded scope of the revised Corporate Governance Improvement Plan.**
2. **We recommend that the Council develop contingency and succession governance protocols to ensure that delivery of the Corporate Governance Improvement Plan is not further disrupted by any future changes in one or more of the Council's senior leadership positions.**

Value for Money Commentary

One of the four areas of focus for the task-and-finish groups supporting the Council’s Improvement Board was focused on the Council’s Constitution. During the course of our assessment of the Council’s arrangement and our response to the risks of significant weaknesses we identified, we noted several areas of poor practice within the Council’s Constitution in effect during the periods 2021/22 and 2022/23 and its implementation within the Council including:

- There are multiple references within the Constitution to job titles or grades which are not otherwise used by the Council. We noted differing interpretations within the Council as to how these terms map onto the job titles and grades which are in use within the Council, resulting in a lack of clarity as to how the responsibilities and approval requirements defined within the Constitution in reference to such job titles and grades should be applied;
- Article 17 of the Constitution specifies that the Financial and Contract Procedure Rules (Standing Orders) are part of the Constitution and that “all financial transactions and contract proceedings must be carried out in accordance with the Middlesbrough Borough Council Financial and Contract Procedure Rules”. The Financial and Contract Procedure Rules should therefore be a key document for the Council, however it is our assessment that there is a limited understanding of the requirements of the Financial and Contract Procedure Rules within the Council. As a result, non-adherence to the requirements of the Financial and Contract Procedure Rules is pervasive within the Council and practices which do not meet the requirements of the Financial and Contract Procedure Rules are well established and widely adopted. This is a contributory factor to several of the significant weaknesses in arrangements highlighted in this commentary; and
- Prior to submitting the terms of the Chief Executive’s departure to the Corporate Affairs and Audit Committee for approval, the Council sought legal advice as to the correct committee under the Council’s Constitution to make this decision. This advice relied upon Article 16 of the Constitution which states that the Corporate Affairs and Audit Committee has delegated powers to “deal with any matter, which is not an Executive function and that has not delegated to any other committee of the Council”. In effect, this Article establishes the Corporate Affairs and Audit Committee as the committee of default or last resort for all non-Executive decisions. In our view, it is not appropriate for the audit committee-equivalent body to take such decisions as it creates a risk of conflicts of interest for the committee between decision making processes and the independent challenge to decisions which such bodies should provide.

These observations were also reported as part of our report ‘Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014’ report issued on 21 August 2023, which included the following statutory recommendation we issued to the Council in respect of the Council’s Constitution:

3. **We recommend that the Council prioritises the conclusion of its review and updating of the Constitution, drawing upon examples of best practice and ensuring that the refreshed Constitution is clear in its language and requirements. Training on the refreshed Constitution should be provided to all officers and members to ensure that changes are appropriately understood and implemented.**

In December 2021, the Council contacted the owners of the Crown Pub, a prominent vacant building within the town centre, requesting engagement from the property’s owners in respect of the property. The letter sent by the Council to the property's owners noted the poor condition of the property and its detrimental impact upon the town centre, and highlighted the possibility that the Council could pursue a compulsory purchase of the property if arrangements to bring the property back into use could not be established.

In July 2022, a representative of the property’s owner contacted the Council to discuss planning principles in advance of a submission for planning permission for the site. Around the same time, the Council submitted an application to the Levelling-Up Fund for £20 million of funding to support the regeneration of the town centre. Included within the £20 million of sought funding was £7.5 million for redevelopment of the Crown pub site.

Value for Money Commentary

Between August 2022 and November 2022, there was regular contact between the Council and representatives of the property's owner culminating in a meeting on 29 November 2022 between the Council's Chief Executive and the property owner's representative where potential purchase of the property by the Council was discussed. No other officers attended this meeting and it was not minuted. Following this meeting, the property owner's representative e-mailed the Chief Executive to confirm an openness to selling the Crown Pub to the Council and cited a price of £750,000.

On 24 January 2023, the Council's Executive approved the purchase of the Crown Pub for £750,000. The supporting paper provided to the Executive in support of this decision, which is required by The Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012 to be published at least 5 clear days before the date of the Executive meeting, included reference to the property being included in the Council's bid to the Levelling-Up Fund and estimated that up to £7 million might be needed for restoration and structural works to bring the property up to the required standard for future use (though no commitment to restoration work was made as part of the Executive decision taken). Between issuance of the supporting paper and the date of the Executive meeting, the Council learnt that its bid to the Levelling-Up Fund had been unsuccessful however this was not communicated to the Executive prior to the decision to acquire the Crown Pub being made.

Following the changes in senior management shortly after the acquisition, the Council's new Interim Chief Executive requested a review of the purchase of the Crown Pub by internal audit. In addition to the failure to notify the Executive that the bid to the Levelling-Up Fund for funding to purchase and redevelop the Crown Pub had been unsuccessful, the internal audit report highlighted a number of other weaknesses in the governance processes supporting the Council's acquisition of the property, including:

- It is unclear why the Crown Pub site was identified by the Council as a particular site of interest from December 2021, having not previously been included on lists of priority 'eyesore' sites produced in June 2020 or September 2021. The Council is therefore unable to demonstrate the relative merits of pursuing this site for redevelopment over other sites within the town;
- The Council did not produce a meaningful business case in support of the purchase which would have set out the pros and cons to inform any decision to purchase the property, with internal audit describing the business case which had been produced as "*superficial and did not present a detailed analysis of the case for purchasing the property*". The absence of a robust business case also meant that the Council did not have a clear plan for the future use of the property, and therefore lacked a detailed assessment of the investment into the property which would be required post-acquisition. The potential structural and redevelopment costs cited in the Executive report were also likely to be inaccurate as the Council did not complete a detailed survey of the property prior to purchase;
- Poor communication between the Chief Executive and other officers resulted in the property owner's initial proposal of a purchase price of £750,000 being understood by officers as having been agreed by the Chief Executive. As a result, the Council did not seek to negotiate on the purchase price despite the Council's own valuation valuing the property at just £460,000. Officers also reported to internal audit feeling that they were being asked to complete the purchase at pace without time to complete proper due diligence on the purchase; and
- Elements of the report submitted to the Council's Executive in support of the decision to purchase the property were assessed by internal audit as "*either missing or misleading*". In addition to the factors already noted above, this included the report giving an impression that the purchase process was at a less advanced stage than it really was, that a decision by DLUHC on the Council's application to the Levelling-Up Fund was further away than it actually was (the report referred to a decision being due "in the spring") and references being made to the potential future transfer of the property to Middlesbrough Development Corporation without appropriate highlighting of the uncertainty of this (at the time of the report, Middlesbrough Development Corporation had not yet been established and any assets to be transferred to it remained subject to further decision making outside of the Council's control).

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In our view, there are clear indicators that the cultural and governance weaknesses at the Council were evident in the way the purchase of the Crown Pub was completed. There are however also further clear indicators of weaknesses in the Council's processes in support of asset acquisitions which we consider to demonstrate a separate significant weakness in the Council's arrangements during 2022/23. We therefore conclude that asset acquisitions was a significant weakness in the Council's arrangements during 2022/23 and make the following recommendations:

4. **We recommend that management develop an action plan to address each of the recommendations raised by internal audit in their report into the acquisition of the Crown Pub.**
5. **We recommend that management review the processes for identifying and communicating where the facts or conditions set out in committee papers change between the date on which papers are published and the date on which the committee meeting is held, to ensure that where there are changes in circumstances relevant to decisions being made this is shared with decision makers prior to decisions being taken.**

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.

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.

Value for Money Commentary

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.

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.

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. Recommendations in relation to elected member training on declarations of potential conflicts of interest and the Council’s assurances over the completeness of such declarations were made as part of our commentary on the Council’s arrangements for the year ended 31 March 2021 and incorporated into the Council’s Corporate Governance Improvement Plan from July 2022.

Value for Money Commentary

Financial Sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services

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.

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.

Budget holders work with finance business partners to maximise the outcomes achieved for the allocated budget. The Council recognises that certain costs, such as social care, are demand-led and mitigations for overspends are addressed to a greater extent at directorate or council level rather than by individual budget holders for these areas.

For the year ended 31 March 2022, the Council reported an overspend of £2.5 million against its budgeted outturn and a further net impact of £0.4 million from the direct impacts of the Covid-19 pandemic which the Council reported separately to its main budget. Within the overall overspend of £2.5 million, the Council reported an overspend of £7.9 million by its Children's Services directorate, equivalent to 19% of the Children's Services budget, which was offset by underspends in other parts of the Council. In October 2021, the Council adopted a Flexible Use of Capital Receipts Strategy under which it released £5 million of capital receipts, against qualifying revenue expenditure intended to transform its services, to its General Fund for the year ended 31 March 2022 to offset the overspends against its budget. The Council also increased the budget of its Children's Services directorate by £6 million, 15% of its prior year budget, for the year to 31 March 2023.

The Council was ultimately able to manage its financial position through 2021/22 without a reduction to its core reserves, and through setting a budget for 2022/23 which included a significant increase to its Children's Services budget was taking steps to address the areas of financial pressure during 2021/22. We are therefore content that the Council had proper arrangements during 2021/22 to manage its financial position, however there were increasing warning signs of the challenges the Council would face during 2022/23.

By September 2022 the Council was forecasting a full-year overspend against budget of £7.7 million for Children's Services and £9.4 million for the Council as a whole. The Council attributed the anticipated overspend to a combination of pressures relating to additional inflation, an increased pay award, and increased demand, placement and agency costs within Children's Services.

In October 2022, the Council implemented a Financial Recovery Plan which sought to make additional savings of £6.9 million and generate additional revenue of £0.5 million to mitigate the majority of the anticipated overspend against budget. The Council was able to deliver £4.8 million of the £7.4 million aggregate impact of savings and additional revenues under the Financial Recovery Plan, which contributed to the final overspend for the year to 31 March 2023 being reduced to £3.5 million. Further flexible use of capital receipts was used to release £0.8 million to the General Fund to partially offset the impact of this overspend on reserves.

The final overspend within Children's Services for the year to 31 March 2023 was £10.7 million excluding the impact of flexible use of capital receipts, equivalent to 21% of its revised budget including reallocations from other directorates during the year totalling £5.5 million as well as the increase from the prior year.

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The Council has recognised that the budget baselines for its Children's Services directorate are not deliverable and sought to 'reset' its budget through a £17 million increase to its Children's Services budget for the year to 31 March 2024, including £5.2 million included in the Children's Services budget for the year to 31 March 2023 on an initial temporary basis being made permanent, applied on top of general increases for inflation and pay growth. In order to afford this increase, the Council's budget for the year to 31 March 2024 also includes £9.4 million of required savings and a requirement for an additional £1.2 million from opportunities for additional income generation. This was a significant change and challenge for the Council, which has not had to include savings targets within its budgets for a number of years.

To provide assurance to its members over the scale of required savings, the Council requested an independent review by CIPFA of its financial position, budget affordability, and financial outlook. This review concluded that "*CIPFA expect that the Council will produce a balanced budget for 2023/24*", however it also concluded that "*It is not possible for CIPFA to have confidence in the delivery against the savings targets identified for Childrens Services*". The review also raised concerns over the low levels of reserves held by the Council, noting "*The Council needs to be very clear that there is no or very limited scope for central funding of overspends*" and "*Failure to deliver the planned savings will place the Council at the risk of having to issue a Section 114 Notice with expenditure likely to exceed financial resources available to the Council*". It is our understanding that circulation of a draft version of the CIPFA report within the Council was a significant factor in the decision by 17 of the Council's members to write to the Council's Chief Executive to request their resignation, as noted earlier in this commentary.

The Council ended the 2022/23 financial year with a General Fund balance of £12 million and unrestricted usable reserves of £2.8 million. With planned savings and additional income generation of £10.6 million built into the 2023/24 budget, the Council has minimal financial headroom available to absorb future financial pressures or the non-achievement of planned savings and, as at 31 March 2023, there was a very real risk that the Council would need to issue a Section 114 Report within the following financial year (though this did not ultimately occur). A Section 114 Report arises when the Council's Section 151 Officer believes that the expenditure of the Council will exceed the resources available to it for the current financial year, or that the Council is unable to set a balanced budget for the following financial year, and would require the Council to cease all new expenditure other than that supporting functions which are required by statute to be delivered.

The Council is in a strained financial position and faces significant financial challenges, including high levels of demand for its social care services and the impact of inflation. Whilst the Council has taken steps to address these challenges, including a 'reset' of its Children's Services budget and implementation of both financial recovery and savings plans, these actions have not been able to stabilise the deterioration in the Council's financial position. Without more significant intervention during 2023/24, the Council was, at 31 March 2023, highly likely to deplete its limited remaining reserves over the following 12-18 months and, in effect, run out of resources.

We are therefore unable to conclude that the Council has had proper arrangements in place to manage its financial position during 2022/23 and conclude that the absence of such arrangements represents a significant weakness in the Council's arrangements to secure value for money. We have previously reported our conclusion that the Council did not have proper arrangements in place to manage its financial position as part of our report 'Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014' report issued on 21 August 2023, which included the following statutory recommendations we issued to the Council in respect of this significant weakness:

6. **We recommend that the Council builds upon the steps already taken to control its expenditure to identify specific deliverable savings over the short term (next 12 months) and protect its limited remaining reserves. Where appropriate, this may need to include the Council changing how it meets its statutory responsibilities and the extent to which it delivers services which are not required to discharge its statutory responsibilities.**

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7. **We recommend that the Council reviews its service delivery models to ensure that they are efficient, represent value for money and achieve the outcomes required for the resources invested. Where opportunities to improve service delivery models are identified, the Council should develop detailed plans for implementation of service delivery transformation and how the up-front transformation costs will be funded.**
8. **We recommend that the Council review its financial forecasting processes to understand why significant financial pressures, over and above those anticipated and reflected in the Council's annual budget, have emerged within the first half of both the 2022/23 and 2023/24 financial years and ensure future forecasting reflects the lessons learned.**

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 the Local Government Finance Settlement, service demand led pressures & savings, grant funding changes, inflation and other spending and income policy adjustments.

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.

Financial resilience is tested against various scenarios within the financial strategy, medium term financial plan modelling, capital strategy and treasury management strategy. Responses to financial pressures are developed in conjunction with service directors and key assumptions are tested before they are incorporated into the MTFP through regular presentations to, and discussions with, the Leadership Management Team and Executive.

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

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. Where possible, the Council looks to use its revenue reserves as appropriate to smooth the impact of any savings targets over the 3-year MTFP period rather than seeking large savings over short periods of time. Budget gaps of £0.858 million in the 2022/23 budget and £12.059 million in the 2023/24 budget were 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 delivery of savings programmes is subsequently included within the budget monitoring reporting process.

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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. No required savings were identified within the 2022/23 budget, however identified savings within the 2023/24 budget exceeded required savings by £1.5 million.

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.

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.

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. The Council's assessment of the minimum reserves which should be held in the General Fund has increased as a result of known financial pressures and uncertainties. A minimum reserve balance of £11 million applied during 2021/22, an increase from £9.4 million in 2020/21, and was increased to £12 million in the Council's budgets for 2022/23 and 2023/24.

The Council's MTFPs produced during 2021/22 and 2022/23 included a balanced budget for the following year and indicative budgets for the two subsequent years. The 2022/23 MTFP forecast a balanced budget in 2023/24 and a budget deficit of £2.3 million for 2024/25. In the Council's 2023/24 MTFP the deficit for 2024/25 had increased to £2.7 million and a similar £2.7 million deficit was forecast for 2025/26. Plans to address these deficits form part of the Council's MTFPs for future periods.

Value for Money Commentary

Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers services

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 the 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 below.

In February 2020, the Council's Executive approved the commissioning of external social work audit support for children's services as part of the Council's Children's Services Improvement Plan. The Council awarded this contract as a direct award to the preferred supplier under the permitted exemption within the Financial and Contract Procedure Rules for "*social care services under the National Health Services and Community Care Act, 1990 or the Children Act, 1989*". The contracted services were assessed by the Council's procurement team as falling within this definition, however this was not confirmed by the Council's legal team.

In July 2020, the Council directly awarded a second contract to the same supplier to provide an external team of social workers to assist the Council with the ongoing Children's Services Improvement Plan. The documented rationale for direct award of the second contract was a combination of the social care-basis used for the first contract and a further permitted exemption under the Financial and Contract Procedure Rules "for work, supplies and services which are patented or of a proprietary or special character and for which it is not possible or desirable to obtain competitive prices". The Council's Executive gave retrospective approval for the contract on 14 July 2020, and in November 2020 approved a further 24 month extension of the contract.

Also in November 2020, the Council awarded a third contract to the supplier for a second external team of social workers for an intended duration of 6 months. The Council asserts that this contract was approved through the 'Gold Command' process in place during the Covid-19 pandemic, however we have been unable to find reference to it in relevant minutes from that period. We have also been unable to establish the basis on which the contract was deemed exempt and directly awarded to the supplier. This contract was also subsequently extended, however no formal approval for this extension was documented.

In August 2022, the Council awarded a fourth contract to the supplier for a third external team of social workers. No formal approvals or exemptions were sought prior to entering into this contract. Concerns about the awarding of this contract were raised by the Council's procurement team, with a subsequent investigation by the Council confirming that the Council's policies and procedures had not been followed in the awarding of the contract.

Subsequent to the contract awards and extensions documented above, the Council continued to extend the second, third and fourth contracts until April 2023 (second contract) and May 2023 (third and fourth contracts). The Council estimates that total expenditure under these four contracts to May 2023 was £4.3 million. This significantly exceeds the thresholds under which direct award of contracts is permitted under both the Council's Financial and Contract Procedure Rules and The Public Contracts Regulations 2015. Whilst this amount relates to the four contracts in aggregate, three of these contracts individually exceed the £663,540* threshold at which the Council is required undertake a competitive tendering exercise under The Public Contracts Regulations 2015. It is therefore our view that in addition to failing to comply with its own Financial and Contract Procedure Rules, the Council has failed to comply with applicable procurement law in the awarding of these contracts.

** Threshold represents the level effective from January 2022. Lower thresholds applied prior to this date.*

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Where a contract is awarded under the reduced requirements of The Public Contracts Regulations 2015 (commonly referred to as being under the 'Light Touch Regime'), The Public Contracts Regulations 2015 place restrictions on the subsequent modifications which may be made to the contract whilst remaining within the scope of the reduced requirements. Such modifications may include extension of the original contract or a change in the scope of the contract. The Council has been unable to demonstrate that it has controls in place to monitor and assess whether modifications to its contracts made after the initial award fall within these criteria, therefore we consider there to be an increased risk that the Council may have other contract arrangements which are not in accordance with The Public Contracts Regulations 2015.

The majority of activity in procuring these contracts occurred within the Council's Children's Services directorate and was unknown to the Council's procurement team. Accordingly, the Council had not recorded any of these contracts on its contracts register. Since the Council's procurement team became aware of these contracts, a control has been implemented to reconcile larger items of expenditure recorded by the Council to known contracts in order to identify any additional unrecorded contract arrangements which may exist. Prior to late 2022 however, the Council had no such control in place and hence is unable to demonstrate that these contracts are an isolated occurrence.

A review of those contracts which the Council had recorded on its contract register as awarded between 1 April 2021 and 31 March 2022 found that of a sample of 12 contracts entered into by multiple directorates, 7 were awarded using some form of exemption. In each case, the application of the exemption had been approved by the Service Head and Head of Commissioning and Procurement however there was no further documented approval. Under the Council's Financial and Contract Procedure Rules, all exemptions require approval by the Section 151 Officer. Other than in a limited number of specified circumstances, the Financial and Contract Procedure Rules also require that exemptions are approved by the Council's Monitoring Officer. There is no requirement under the Financial and Contract Procedure Rules for exemptions to be approved by the Head of Commissioning and Procurement.

It is evident to us that the Council has a well established informal and undocumented practice when it comes to application of procurement exemptions which is neither compliant with the requirements of the Financial and Contract Procedure Rules or as robust. Whilst the procurement of the four social care contracts, or at least aspects of them, appear to have also occurred outside of this informal practice, the widespread non-adherence to the Council's formal policies and procedures is likely to have been a contributory factor as to why this occurred.

In our view, non-adherence to the Council's Financial and Contract Procedure Rules was pervasive within the Council during both 2021/22 and 2022/23 and significantly increases the risk that exemptions were applied inappropriately and that the Council is not able to demonstrate that it was securing value for money in its procurements. We consider that this is a significant weakness in the Council's arrangements to secure value for money. We have previously reported our conclusion that the Council did not have proper arrangements in place with regards to contracting and procurement as part of our report 'Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014' report issued on 21 August 2023, which included the following statutory recommendations we issued to the Council in respect of this significant weakness:

9. **We recommend that the Council conclude its review of its Financial and Contract Procedure Rules to ensure that they reflect the needs of the Council and the expectations of members and implement the revised rules without delay. This should include being explicit on how contract modifications should be assessed and managed, as the Financial and Contract Procedure Rules do not currently address contract extensions;**
10. **We recommend that, once the Financial and Contract Procedure Rules are finalised, training is provided to all officers involved in contracting, procurement or financial decision making to ensure that the requirements of the Financial and Contract Procedure Rules are understood and adhered to; and**

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11. **We recommend that the Council complete their review of all ongoing contracts which were initially awarded under an exemption but have been subject to subsequent amendment (including extension) to identify whether they are compliant with The Public Contracts Regulations 2015. If further non-compliance is identified, the Council should evaluate whether any remedial action is necessary.**

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.

In September 2022, the Council concluded its first review into the partnership arrangements recorded on its Partnership Register since its Partnership Governance Policy was introduced in 2019/20, and intends for this to become an annual exercise.

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.

In February 2019, the Council established MHomes Limited as a subsidiary company with the intention of using it as a housing delivery vehicle. Following a change in political administration in the May 2019 election, the subsidiary was rebranded as Middlesbrough Development Company and the Council changed the proposed focus of the subsidiary away from housing delivery and towards urban regeneration projects. This corresponded with a change by the Council itself towards a more expansive capital programme focusing on redevelopment of Middlesbrough town centre. During 2021/22 and 2022/23, Middlesbrough Development Company oversaw two large capital projects on behalf of the Council, the development of Boho Village and the redevelopment of the former Tollesby Shops site, along with a number of smaller scale projects to restore empty homes and ‘eyesore’ sites. The activities of Middlesbrough Development Company are funded through a combination of loan and grant funding provided by the Council.

In May 2021, 5 of the 7 members of the Council’s Executive resigned citing a number of concerns over the conduct of the Council’s Mayor and the Council requested the Council’s internal auditor investigate the concerns raised. We reported on the results of these investigations within our value for money commentary on 2020/21, however follow-up work by internal audit in relation to the governance of Middlesbrough Development Company was deferred in anticipation of additional good practice guidance being published by CIPFA.

In May 2022, CIPFA published ‘Local Authority Owned Companies: A Good Practice Guide’ and the Council requested that internal audit undertake an assessment of the governance of Middlesbrough Development Company against this good practice guidance. The Council’s internal auditor undertook this review as an advisory piece of work, and did not therefore seek to offer an overall rating on arrangements, however a draft version of their report shared with senior officers in January 2023 raised some significant concerns over the Council’s oversight and governance of the subsidiary. The Council’s internal auditor issued the final version of their report at the end of July 2023, in addition within their Annual Head of Internal Audit Report for 2022/23 they noted their review found ‘a number of weaknesses’, including in relation to:

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- A lack of clarity in respect of roles and responsibilities (including officers and members);
- The composition and training of members of the Board;
- Performance management; and
- Documentation of Board meetings.

As a result of the concerns raised in the draft report the Council's Executive agreed in January 2023 to recommend to the directors of Middlesbrough Development Company that the subsidiary body be wound up. Within the covering report submitted to the Executive to inform this decision, the Council stated:

> *"As the activities of the company have turned from theoretical to actual, and the practicalities of taking and implementing board decisions have become more complex, a number of weaknesses have been identified in the board arrangements and the relationship with the Council that would need addressing. Veritau, the Council's internal auditors were asked to provide a view on the overall governance situation, and the improvements that would be required to meet the highest standards of good governance. Early conclusions from this work include:*
>
> *a. the roles and responsibilities within the company are insufficiently defined for a local authority trading company, with potential conflicts of interest arising through lack of clarity and lack of separation. The role of the shareholder is particularly unclear; and,*
>
> *b. some of the operational aspects of the company do not reflect local authority regulations, or frameworks – such as procurement, risk, performance management and project management.*
>
> *The relationship with the company would also require further work from the Council's perspective, as there needs to be a suitable governance structure put in place within the Council structures to review performance, or provide the necessary oversight and accountability for it to function effectively. Specifically issues around Information Governance, Data Protection and other legal requirements are not governed by an appropriate agreement with the Council – which could cause unnecessary risks in the future. Additional work is also required to provide improved transparency around Value for Money and alignment of investments with Council priorities.*
>
> *It is clear from the review that revising the arrangements to follow the higher standards of governance set out by Local Partnerships, and CIPFA in their recently published Local Authority Owned Companies – A Good Practice Guide, and to minimise any future risk to the Council would require a significant investment of time and money to achieve. The board of the company would need to be reshaped, the staffing structure bolstered, and the arrangements the Council employs to monitor and support it would need to change.*
>
> *The key gaps identified in issues such as procurement and risk management would require additional staffing to be brought in to manage processes to the standard required by local authorities (and advocated by CIPFA), as would bolstering arrangements around performance management and project management. The current staffing/operation of the company is geared towards commercial expertise and would not therefore have the capacity or experience to adopt the policies and frameworks to align with the Council's approach. Recent examples of issues around Information Governance have highlighted this further, where the company needs to register with the Information Commissioner's Office independently from the Council."*

Whilst the Council has taken the decision to recommend winding-up the subsidiary, this has not yet occurred and the subsidiary remains responsible for the regeneration projects previously assigned to it. Up to the point at which the decision was taken to recommend winding-up the subsidiary, the Council had provided £11.9 million in funding to the subsidiary and the estimated lifetime budget of its projects was £13.3 million.

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Management assert that the financial statements of Middlesbrough Development Company are subject to external scrutiny via the subsidiary's external auditor, however we have been unable to corroborate that external audits of the subsidiary's financial statements have taken place. Within the Council's draft Statements of Account for both 2021/22 and 2022/23, the following disclosure is made:

> *"Under Section 477 of the Companies Act 2006 (in respect of the current annual turnover of the company which is a deficit and the number of employees at 1) MDC is exempt from the requirement of the Act for the audit of its accounts for the financial year. However due to the need to consolidate the accounts into the Council's group arrangements, the company directors have decided to appoint an external auditor and undertake an audit process."*

The disclosure within the Council's draft 2021/22 Statement of Accounts included cross-reference to the Middlesbrough Development Company website, which is no longer available, and the draft 2022/23 Statement of Accounts included cross-reference to the Council's own website for copies of the Middlesbrough Development Company financial statements. The financial statements of Middlesbrough Development Company published on the Council's website contain an unsigned audit report for the year ended 31 March 2022 and are explicitly presented as unaudited for the year ended 31 March 2023. The accounts filed by Middlesbrough Development Company with Companies House for the year ended 31 March 2022 were unaudited financial statements, and the financial statements for the year ended 31 March 2023 are shown on the Companies House website as overdue as of June 2024. In our view, the disclosure within the Council's Statement of Accounts is therefore misleading to readers of the Council's financial statements.

In our view, the concerns raised by the Council's internal auditor and the subsequent assessment by the Council that "a significant investment of time and money" would be required to meet the standards of governance set out within the CIPFA good practice guidance are indicative that the Council did not have proper arrangements in place to oversee the activities of its subsidiary and ensure that Middlesbrough Development Company delivered value for money with the resources provided to it by the Council during either 2021/22 or 2022/23. Given the material levels of funding provided by the Council to Middlesbrough Development Company, we consider that this is a significant weakness in the Council's arrangements to secure value for money. We have previously reported our conclusion that the Council did not have proper arrangements in place with regards to its oversight of Middlesbrough Development Company as part of our report 'Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014' report issued on 21 August 2023, which included the following statutory recommendations we issued to the Council in respect of this significant weakness:

12. **We recommend that the Council review its oversight arrangements for Middlesbrough Development Company for the period up to the demise of the entity, so that it can satisfy itself that Middlesbrough Development Company is delivering value for money with the resources provided to it during this period; and**
13. **We recommend that the Council develop an action plan for the demise of Middlesbrough Development Company which sets out how the Council will realise the value which has been created through the resources provided to Middlesbrough Development Company by the Council.**

Value for Money Commentary

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, including progress against the milestones set out in the Council's Strategic Plan.

In January 2020, the Council's provision of childrens 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'. In response to the Ofsted findings, the Council implemented a Children's Services Improvement Plan which remained in effect at the commencement of 2021/22. Delivery against this plan was overseen by a Multi-Agency Strategic Board, supported by a Multi-Agency Operational Board, which was described by the Independent Children's Commissioner in July 2021 as "highly effective".

In July 2021, the Independent Children's Commissioner issued a 12 month review on the Council's implementation of the Children's Services Improvement Plan which was very positive on the progress being made by the Council, concluding that:

> *"Considerable progress has been made and there is evidence of real impact. Most impressively in the face of significant demand and need, the LA has tackled legacy issues which had inflated the volume of cases in higher tiers of provision. Significant reductions in the care population have been achieved through a focus on permanency and supporting families locally and important reductions in children on child protection plans and within social care generally have taken place. The LA knows itself well and has clearly moved beyond having "the necessary building blocks" in place to an organisation impacting on outcomes and progressing impressively on their improvement journey.*
>
> *On this basis, I would recommend to the Minister that no further direct engagement of an appointed Commissioner is required and continued monitoring and support to improvement is afforded by the Advisor and core DfE team.*

The appointment of the Independent Children's Commissioner was formally concluded in November 2021.

Throughout 2021/22 and 2022/23, the Council received regular focused and monitoring visits from Ofsted. The findings reported by these visits consistently recognised that the Council was making progress in addressing the findings of the 2020 Ofsted report, most significantly in the Council's understanding of the challenges it faces, whilst acknowledging that the Council was starting from a "*very low base*" and a range of improvements were still required. A full reinspection of the Council's provision of childrens social care services in March 2023 resulted in an upgrading of the Council's rating from 'inadequate' to 'requires improvement to be good' across each of the categories assessed.

Whilst we note that the Council's Children's Services were not yet consistently delivering the expected levels of performance, especially during 2021/22, this reflects the status of the service at the start of the 2021/22 financial year. The Council's actions during the year to 31 March 2022, as assessed by the Commissioner for Children's Services in Middlesbrough, demonstrate that the Council had appropriate arrangements in place during 2021/22 to deliver against the Improvement Plan. The subsequent Ofsted inspection results of March 2023 demonstrate that the Council continued to improve the delivery of its Children's Services through 2022/23.

We do not therefore report a significant weakness in the Council's arrangements during the year ended 31 March 2022 in respect of the provision of Children's Services, and did not recognise this as a risk for the year ended 31 March 2023.

Value for Money Commentary

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.

Performance against non-financial metrics, including milestones of the Council's Strategic Plan, are also presented to the Executive and Overview and Scrutiny Board on a quarterly basis.

Value for Money Commentary

Arrangements since 31 March 2023

Our commentary on the Council's arrangements to secure value for money in its use of resources is specific to the periods being audited, the financial years ended 31 March 2022 and 31 March 2023. Our appointment as the external auditor of the Council concludes with the audit for the year ended 31 March 2023.

The following additional information relates to the actions the Council has taken to address the significant weaknesses in arrangements reported in our commentary since the end of the reporting periods. This information is provided for context and based on more limited audit procedures than for the period 1 April 2021 to 31 March 2023, and we do not express a view within this report on the Council's arrangements since 31 March 2023 as we are not the Council's external auditor for periods commencing on or after 1 April 2023.

Culture and Governance

The May 2023 election saw a change in both the Mayoral leadership of the Council and the overall political control of the Council, following on from the significant changes in the senior officer leadership of the Council in February and March 2023 noted earlier in our commentary. In light of these changes, the Council concluded that a review and reset of the Corporate Governance Improvement Plan would be appropriate prior to detailed development of 'phase 3' of the Corporate Governance Improvement Plan. The Council also reported that the Governance Improvement Board, which had overseen progress up to February 2023 (no meetings were held after this date) would be replaced with an Improvement Advisory Panel. The Improvement Advisory Panel includes external advisors and experts, including an independent chair.

A revised plan for 'phase 3' of the Council's Corporate Governance Improvement Plan was approved by full Council on 18 September 2023, alongside a proposed action plan to respond to the statutory recommendations issued as part of our 'Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014' report issued on 21 August 2023 (referred to by the Council as its 'Section 24 Action Plan'). A proposed updated Constitution, including updated Financial and Contract Procedure Rules, was also submitted to full Council at this time.

In January 2024, the Chief Officer Appointments Committee approved extension of the appointments of both the Council's Interim Chief Executive and Interim Director of Finance to 31 March 2025 in order to provide stability to the Council's leadership as it continues with the implementation of the Corporate Governance Improvement Plan and Section 24 Action Plan.

Also in January 2024, the Best Value Notice issued to the Council by DLUHC, which had been for an initial period of 12 months, was extended for an additional 6 months to July 2024. In the notification of the extension the Department acknowledged that the Council has "*implemented a range of improvement measures to begin to effectively address the identified concerns*", but highlighted that the Department "*has ongoing concerns regarding your authority*" and the extension was "*in response to the need for continuing reassurance on the Council's capacity to transform at sufficient pace*".

As of March 2024, the most recent update on the progress of the Corporate Governance Improvement Plan and Section 24 Action Plan presented to full Council, the Council was reporting that 57% of actions under the Corporate Governance Improvement Plan and 61% of the actions under the Section 24 Action Plan had been delivered. A small number of actions, equating to 6% of actions under the Corporate Governance Improvement Plan and 8% of actions under the Section 24 Action Plan, were reported as off-track however all other open actions were reported as being on-track for delivery by their target completion dates.

We also note that both senior officers and members have reported, both directly to us and in public meetings such as the Council's Audit Committee, a noticeable positive change in culture at the Council since 31 March 2023 and more collaborative working between members and officers.

Value for Money Commentary

Financial Sustainability

The Council has recognised that it commenced the 2023/24 financial year in a challenging financial position and implemented enhanced scrutiny of its financial outturn and forecasts, with additional monthly reporting to its Leadership Management Team (LMT) and additional finance meetings with each directorate head added to the existing quarterly reporting. Officers have also sought to engage more proactively with elected members on the Council's financial challenges, including introducing quarterly member-led budget challenge sessions.

Through this enhanced scrutiny of its financial position, the Council identified as early as P2 (May 2023) that it was not on track to deliver against its budget for the year ended 31 March 2024. As of Q1 (June 2023), the Council was forecasting an overspend against its budget of £11.6 million. This represented over 9% of the Council's annual budget. The Council only attributed £2.6 million of the anticipated overspend to non-achievement of the savings and additional income generation included within its 2023/24 budget, with the majority relating to cost pressures not allowed for within the budget. The most significant of these included a national pay award above the Council's expectations, demand and inflationary pressures within both adult's and children's social care and rising home-to-school transportation costs. These pressures contain a mixture of factors within the Council's control, such as those related to how it delivers it services, and those beyond its control, such as the national pay award.

The Council implemented a range of measures to address the overspend for 2023/24 projected at Q1, including the use of vacancy control panels to constrain new recruitment to essential posts only, additional restrictions on spending issued by the Interim Director of Finance in July 2023 and an in-year uplift to fees and charges effective from December 2023. These measures helped to reduce the forecast overspend to £8.6 million by the end Q2 (September 2023), £5.5 million by the end of Q3 (December 2023) and £3.6 million by the end of the 2023/24 financial year (March 2024).

The continued overspend against the Council's budget has been assessed by the Council's Interim Director of Finance as critical, with the Council unable in their view to set a balanced budget for 2024/25, whilst maintaining adequate reserves, without exceptional financial support. In January 2024, the Council's Executive approved submission of an application to DLUHC for £15 million of exceptional financial support. In March 2024, full Council approved the Council's budget for 2024/25 inclusive of £13.4 million of exceptional financial support offered by DLUHC in the form of additional Council borrowing. Had the Council's request for exceptional financial support not been accepted by DLUHC, the Council would have been forced to issue a Section 114 notice (see page 21).

The financial position of the Council remains precarious. The Council is reliant upon both the sale of assets and the achievement of significant planned savings for its short-term viability, but requires more significant transformation of the way it delivers its services to become viable over the medium-to-long term. This fact is recognised by management, with the exceptional financial support applied for by the Council including up-front funding for transformation as well as addressing immediate day-to-day budgetary challenges. A detailed proposal setting out the proposed direction, aspirations, investment, and funding requirements of the Council's Recover, Reset, Deliver Transformation Programme was approved by full Council in April 2024.

The Council has also commissioned CIPFA to undertake a review of its financial management practices using the CIPFA Financial Management Model to assist it with identifying areas where its financial management practices could be improved. The results of this review have recently been reported to the Council's management and will be presented to the Council's Executive on 24 July 2024.

Value for Money Commentary

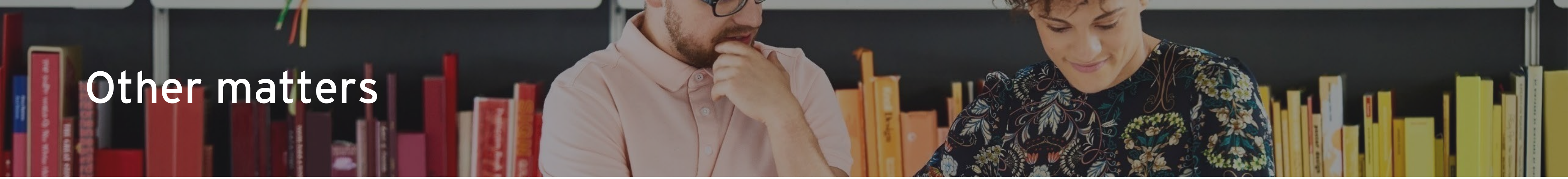
Middlesbrough Development Corporation

On 13 March 2024, the Secretary of State for Levelling Up, Housing and Communities approved the transfer of a number of the Council's assets to the newly formed Middlesbrough Development Corporation, which will oversee redevelopment of key sites within the town centre. Middlesbrough Development Corporation is a subsidiary of the Tees Valley Combined Authority, and is completely separate from the Council's own subsidiary Middlesbrough Development Company.

Transfer of the Council's assets to Middlesbrough Development Corporation was not a decision within the control of the Council, though we note that the Council's members voted against endorsing the principles behind the formation of Middlesbrough Development Corporation and the transfer of Council assets in February 2023.

The Crown Pub is included within the assets to be transferred to Middlesbrough Development Corporation, therefore future structural and restoration costs for this property will not now fall on the Council.

03 Other Matters



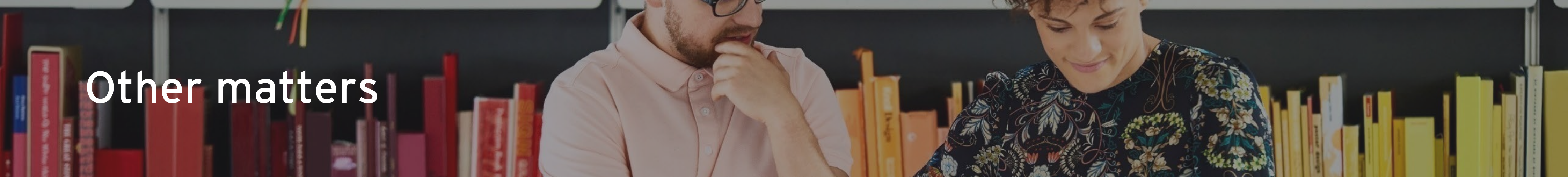
Other matters

Financial reporting

In support of our identification of risks of significant weaknesses in the Council's arrangements to secure value for money in its use of resources, we have performed the following procedures to ensure that the Council's draft Statement of Accounts for the years ended 31 March 2022 and 31 March 2023 are consistent with underlying accounting records and have been properly prepared and presented in accordance with legislative and reporting framework requirements. These procedures were not designed to ensure that the underlying accounting records were correct or that the draft Statements of Account were free from material error:

- We reconciled the draft Statement of Accounts for the years ended 31 March 2022 and 31 March 2023 to the trial balances for each period obtained from the Council's accounting system;
- We performed casting and internal consistency checks on the draft Statement of Accounts for the years ended 31 March 2022 and 31 March 2023 to ensure that financial statements were arithmetically correct and internally consistent;
- We completed the CIPFA disclosure checklists for the periods ended 31 March 2022 and 31 March 2023 to ensure that all material required disclosures had been included within the draft Statements of Account;
- We performed an overall analytical review to understand movements in the financial statements between 2020/21 and 2021/22, and between 2021/22 and 2022/23, to identify any unusual or unexpected movements which may indicate either misstatement of the financial statements or significant changes in the Council's underlying activities;
- We reviewed the Council's bank reconciliations as at 31 March 2022 and 31 March 2023 to ensure that accounting records had been appropriately reconciled to the bank statements; and
- We inspected details of the accounts inspection periods notified by the Council and considered whether they met the requirements of The Accounts and Audit Regulations 2015.

We did not identify any additional risks of significant weaknesses in the Council's arrangements through these procedures, however we noted a number of observations we would like to bring to the Audit Committee's attention. These are set out on pages 36 and 37.



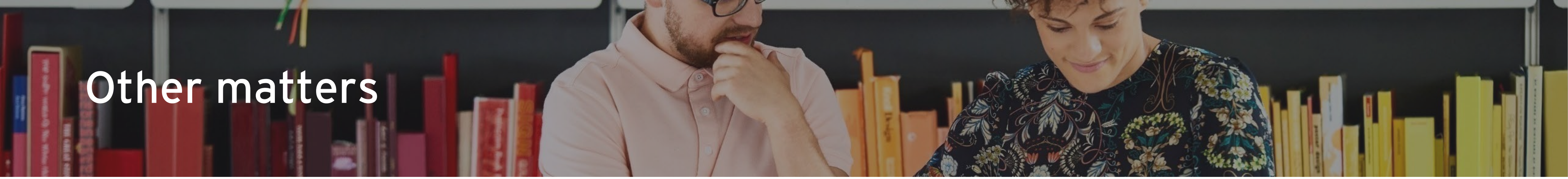
Other matters

Presentation of the Statement of Accounts

- In the Draft Statement of Accounts for 2021/22, the actuarial gain on pensions for the year is stated as £107.235 million on the Comprehensive Income and Expenditure Statement and individual actuarial gains and losses on gross pension assets and liabilities agreeing to this amount are disclosed within the detailed reconciliation of movements in gross assets and liabilities of Note 39. The summary table at the start of Note 39 however incorrectly states the actuarial gain for the year as £nil. The total net assets of the Council are also presented as net liabilities within the Narrative Report;
- In the Draft Statement of Accounts for both 2021/22 and 2022/23, the return on pensions assets and the interest on pension liabilities are disclosed as gross income and expenditure, respectively, within Note 10. On the Comprehensive Income and Expenditure Statement the net of these two amounts is however presented as expenditure, leading to material inconsistency between the gross income and expenditure on the primary statements and in the supporting notes. These amounts were presented as gross income and expenditure within the Comprehensive Income and Expenditure Statement of the Council's final Statement of Account for 2020/21;
- In the Draft Statement of Accounts for 2022/23, there are multiple errors in the presentation of the Statements of Cash Flows and supporting notes. These include a difference of £20.985 million between the cashflows from operating activities per the single-entity Statement of Cash Flows and per the supporting note, the Group Statement of Cash Flows cross-referring to the supporting notes to the single-entity Statement of Cash Flows for further details of operating, financing and investing cashflows despite the Group and single-entity cashflows being different (no supporting notes to the Group Statement of Cash Flows are disclosed) and poor alignment of line item descriptions in the single-entity Statement of Cash Flows with potential to confuse readers as to which amounts relate to which line item descriptions; and
- We noted a number of minor casting and internal consistency errors in both sets of draft statements which we would expect to be addressed by a robust quality review process.

As set out within the Statement of Responsibilities included within both the 2021/22 and 2022/23 Draft Statement of Accounts, the Interim Director of Finance is responsible for the preparation of the Council's statement of accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting. As noted above, the Draft Statement of Accounts for both 2021/22 and 2022/23 contain material misstatements or disclosure errors therefore we would encourage management to address these observations prior to finalising the Statement of Accounts for 2021/22 and 2022/23, and to review the quality assurance processes which support the Interim Director of Finance's sign-off of the Statement of Accounts.

Management have asserted that they have continued to work on the financial statements for both the year ended 31 March 2022 and the year ended 31 March 2023 since publication of the draft financial statements, including through development of an integrity checker to address inconsistencies between disclosures, the impact of which will be reflected in the final financial statements for each period when published by the Council.



Other matters

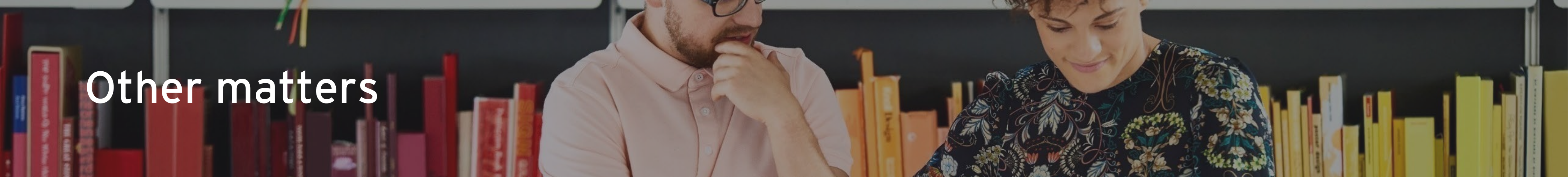
Inspection of the Accounts

The Accounts and Audit Regulations 2015 require local authorities such as Middlesbrough Council to commence the inspection period for its Draft Statement of Accounts no later than 1 June each year. For 2021/22, this date was amended by The Accounts and Audit (Amendment) Regulations 2021 to 1 August 2022. The Council commenced its inspection period for the 2021/22 Statement of Accounts on 30 August 2022 due to a combination of capacity challenges within the Council's Finance Team, including vacancy of the Chief Accountant post, and the external audit of the Council's 2020/21 Statement of Accounts being ongoing due to the impact on other audit work of the cultural and governance issues reported on in our 2020/21 value for money commentary and a sector-wide technical accounting issue in respect of infrastructure assets, and therefore did not comply with the statutory requirement. There is no requirement for the external audit of the previous year's Statement of Accounts to be concluded prior to publication of Draft Statement of Accounts, which are unaudited, for the following year.

The Accounts and Audit Regulations 2015 also require that either within or alongside the Draft Statement of Accounts, a Draft Annual Governance Statement is available during the inspection period. As noted on pages 13 and 14, the finalisation of the Council's Annual Governance Statement for 2020/21 was delayed due to senior officers taking the view that they were unable to sign the Council's Annual Governance Statement for the year ended 31 March 2021 on the grounds that the statement did not fully reflect the size and scale of the cultural change required at the Council. This had a knock-on impact on preparation of the Draft Annual Governance Statement for 2021/22, and the inspection period therefore took place without this being made available contrary to the statutory requirements. The Council published its Draft Annual Governance Statement for 2021/22 in December 2022 as part of the papers for the Corporate Affairs and Audit Committee, but has not made it available on the same part of the Council's website as the Annual Governance Statements for other periods.

The Council commenced its inspection period for the 2022/23 Statement of Accounts on 8 January 2024, significantly behind the statutory deadline, due primarily to an ongoing review of the Council's Collection Fund provisions for impairment across both the 2021/22 and 2022/23 statements (see next page). As for 2021/22, the inspection period took place without publication of the Annual Governance Statement as required by the Accounts and Audit Regulations 2015. After we reported this to management, the Council performed a second inspection period commencing 22 February 2024 following publication of a Draft Annual Governance Statement for 2022/23.

Responsibility for ensuring the Council complies with statutory requirements relating to the inspection of the accounts rests with management.



Other matters

Collection Fund provisions for impairment

The Council's financial statements include the Collection Fund Accounts, which set out details of the Council Tax and Non-Domestic Rates balances for which the Council is the billing authority. Included within the Collection Fund Accounts are provisions for impairment of outstanding balances owed to the Council, as billing authority, in relation to Council Tax and Non-Domestic Rates. Within the Council's Draft Statement of Accounts for 2021/22, these balances totalled £25.005 million for Council Tax and £8.987 million for Non-Domestic Rates. These amounts relate to the total amounts collected by the Council, including those amounts collected on behalf of central government, the Cleveland Police and Crime Commissioner and the Cleveland Fire Authority, however the Council also recognises its share of these provisions within its own financial statements.

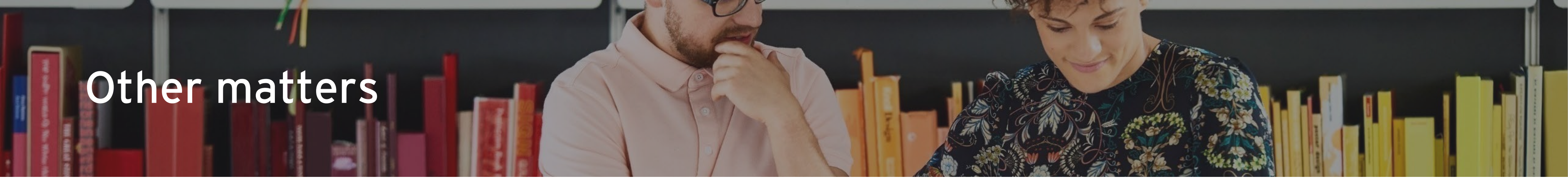
In our Audit Results Reports for the 2020/21 audit issued in July 2022 and April 2023, we included a control observation that assumptions underpinning the Council's provisions for impairment of irrecoverable debt had not changed for a number of years and, where adjustments had been made, there was a limited evidence base for the size of those adjustments giving rise to a risk that they are no longer appropriate and the Council was not accurately calculating its exposure to irrecoverable balances. We recommended that management review the assumptions used to ensure they remained appropriate. Management's response to our recommendation had the greatest impact on the provisions relating to Collection Fund balances, as the largest impairment provisions recognised by the Council.

In August 2023, management informed us that they had completed a review of the Collection Fund impairment calculations in response to our recommendation and had identified a potential adjustment to the draft 2021/22 financial statements which would have a material downward impact upon the valuation of provisions for impairment. Management also advised us that the impact from this release of provisions would be carried into the Council's 2024/25 budget setting exercise, in-line with normal practice for Collection Fund balances and as the Council's budget for 2023/24 had already been set, with the intention of being held within usable reserves. Given the financial challenges highlighted earlier in this report, this was an important factor in the Council's ability to set a balance budget for 2024/25 whilst beginning to rebuild the Council's low level of reserves. It was agreed that given the significance to the Council's overall financial position audit review of these revised impairment calculations would be prioritised.

Following audit challenge of the methodology adopted in the determination of the revised provisions, management developed a different methodology for determining the Collection Fund impairment provisions which increased the size of the release from provisions. We have worked with management to review the overall methodology adopted, the key judgements and assumptions and the data used (though we have not sought to test the accuracy of input data as the focus has been on methodology).

The Draft Statement of Accounts for 2022/23 published by the Council on 28 December 2023 included opening balances as at 1 April 2022 and closing balances as at 31 March 2023 for the Collection Fund impairment provisions calculated in accordance with management's revised methodology. The total Collection Fund bad debt provisions as at 31 March 2022 reflected in the Draft Statement of Accounts for 2022/23 was £16.484 million for Council Tax and £5.725 million for Non-Domestic Rates. These amounts represent reductions of £8.521 million (34%) for Council Tax and £3.262 million (36%) for Non-Domestic Rates compared to the amounts included within the Council's Draft Statement of Accounts for 2021/22.

Management has continued to refine their modelling of the provisions for impairment as at both 31 March 2022 and 31 March 2023 since publication of the Draft Statement of Accounts for 2022/23 to ensure they most appropriately reflect the levels of anticipated irrecoverability within Collection Fund balances. Our assessment is that the revised overall methodology developed by management should be capable of determining appropriate impairment provisions for the Collection Fund, however discussions with management are ongoing in relation to a small number of assumptions and judgements in the application of that methodology and require conclusion before we are able to conclude on whether the revised level of impairment provisions are within an acceptable range.



Other matters

Objection

The Local Audit and Accountability Act 2014 allows for an elector to raise an objection to the Council's Statement of Accounts to the external auditor, during the accounts inspection period. where the objection concerns a matter in respect of which the external auditor could issue a Public Interest Report or seek a declaration that an item of account is unlawful.

We received one objection in relation to the Council's Statement of Accounts for 2022/23, concerning the Council's joint application to the Levelling-Up Fund with Redcar and Cleveland Borough Council for funding to improve accessibility in South Middlesbrough and whether the application for funding had been approved within the Council in accordance with the Council's Financial Procedure Rules. The objection was raised to us as a request to seek a declaration that the associated items of account were unlawful.

It was announced on 18 January 2023 that the Council's application for funding had been successful, however management have confirmed to us that no monies were received by the Council and no expenditure to be funded by the application incurred prior to 31 March 2023. Consequently, there are no items of account appearing within the accounts for the year ended 31 March 2023 upon which an application to the courts for a declaration that such items are contrary to law could be made. On this basis, we decided not to accept the objection.

We have not sought to establish the facts in relation to the application to the Levelling-Up Fund in question and whether the application was approved in accordance with the Council's Financial Procedure Rules in this specific instance, but highlight our conclusion within our value for commentary that non-adherence to the Council's Financial and Contract Procedure Rules was pervasive within the Council during both 2021/22 and 2022/23.

We did not receive any objections in relation to the Council's Statement of Accounts for 2021/22.

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