# Middlesbrough Council

Annual Audit Letter for the year ended 31 March 2020

April 2021

EY

Building a better working world

# Contents



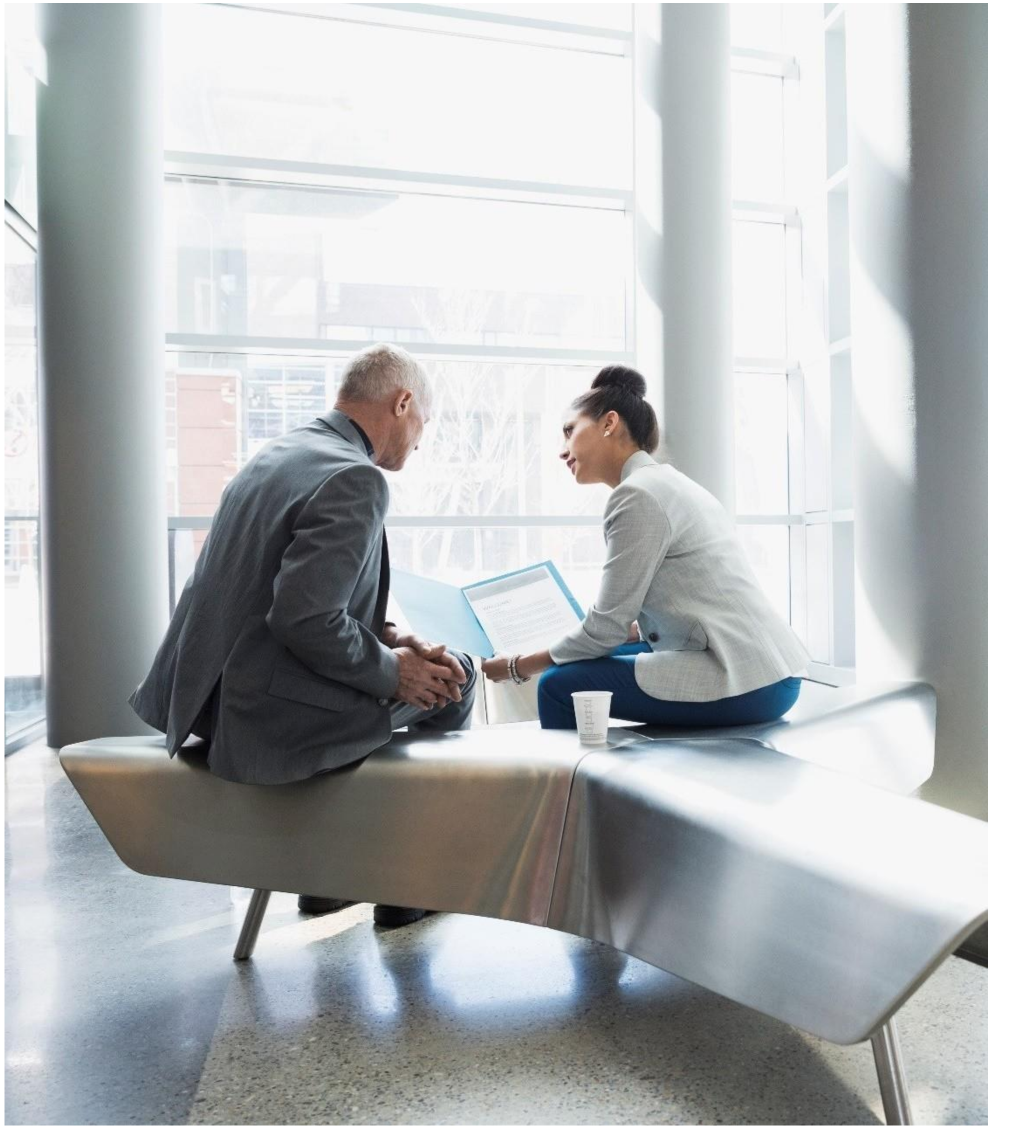
Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk).

This 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 (updated April 2018)' issued by 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 statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of Responsibilities and the Terms of Appointment. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

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



Section 1

# Executive Summary

# Executive Summary

We are required to issue an annual audit letter to Middlesbrough Council (the Council) following completion of our audit procedures for the year ended 31 March 2020. Covid-19 had an impact on a number of aspects of our 2019/20 audit. We set out these key impacts below.

| Area of impact | Commentary |
| --- | --- |
| **Impact on the delivery of the audit** | |
| ► Changes to reporting timescales | As a result of Covid-19, new regulations, the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 No. 404, were published and came into force on 30 April 2020. This announced a change to publication date for final, audited financial statements from 31 July 2020 to 30 November 2020 for all relevant authorities. Due to a number of factors relating to the pandemic, we completed our audit on 3 March 2021. |
| **Impact on our risk assessment** | |
| ► Valuation of Property Plant and Equipment | The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty were included in the year-end valuation reports produced by the Council's external valuer. We consider that the material uncertainties disclosed by the valuer gave rise to an additional risk relating to disclosures on the valuation of property, plant and equipment. |
| ► Disclosures on Going Concern | Financial plans for 2020/21 and medium term financial plans required revision for Covid-19. We considered the unpredictability of the current environment gave rise to a risk that the Council would not appropriately disclose the key factors relating to going concern, underpinned by managements assessment with particular reference to Covid-19 and the Council's actual year end financial position and performance. |
| **Impact on the scope of our audit** | |
| ► Information Produced by the Entity (IPE) | We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the Council due to the inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We undertook the following to address this risk:<br>► Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and<br>► Agreed IPE to scanned documents or other system screenshots. |
| ► Consultation requirements | Additional EY consultation requirements concerning the impact on auditor reports. The changes to audit risks and audit approach changed the level of work we needed to perform. |

# Executive Summary (continued)

The tables below set out the results and conclusions on the significant areas of the audit process.

| Area of Work | Conclusion |
|---|---|
| **Opinion on the Council's and Pension Fund's:** | |
| ► Financial statements | Unqualified – the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2020 and of their expenditure and income for the year then ended. |
| ► Consistency of other information published with the financial statements | Other information published with the financial statements was consistent with the Annual Accounts. |
| ► Concluding on the Council's arrangements for securing economy, efficiency and effectiveness | We concluded that you have put in place proper arrangements to secure value for money in your use of resources, except with regards to the provision of children's services. |

| Area of Work | Conclusion |
|---|---|
| **Reports by exception:** | |
| ► Consistency of Governance Statement | The Governance Statement was consistent with our understanding of the Council. |
| ► Public interest report | We had no matters to report in the public interest. |
| ► Written recommendations to the Council, which should be copied to the Secretary of State | We had no matters to report. |
| ► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014 | We had no matters to report. |

| Area of Work | Conclusion |
|---|---|
| **Whole of Government Accounts (WGA):** | |
| ► Reporting to the National Audit Office (NAO) on our review of the Council's WGA return | The Council is below the specified audit threshold of £500 million. Therefore, we did not perform any audit procedures on the consolidation pack. |

# Executive Summary (continued)

As a result of the above we have:

| Area of Work | Conclusion |
|---|---|
| Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit. | Our Provisional Audit Results Report was issued on 24 November 2020 and our Final Audit Results Report was issued on 23 February 2021. |
| Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice. | Our certificate was issued on 3 March 2021. |

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

Section 2

# Purpose and responsibilities

# Purpose

| The Purpose of this Letter |
| --- |
| The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.<br>We have already reported the detailed findings from our audit work in our 2019/20 Provisional Audit Results Reports presented to the 26 November 2020 meeting of the Corporate Affairs and Audit Committee, representing those charged with governance, and issued updated final reports on 23 February 2021.<br>We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council. |

# Responsibilities

### Responsibilities of the Appointed Auditor

Our 2019/20 audit work has been undertaken in accordance with the Audit Planning Report that we issued on 26 February 2020, including the subsequent addendum considering the impacts of Covid-19 on our audit issued on 22 July 2020, and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2019/20 financial statements, including the pension fund; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

We undertake any other work specified by the Code of Audit Practice or Public Sector Audit Appointments Limited (PSAA).

### Responsibilities of the Council

The Council is responsible for preparing and publishing its Statement of Accounts, accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Section 3

# Financial statement audit

# Financial statement audit

**Key Issues**

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

We audited the Council and Pension Fund's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 3 March 2021.

Our detailed findings were reported to the 26 November 2020 Corporate Affairs and Audit Committee, with an update on the matters outstanding at this point issued to members of the Committee on 23 February 2021.

The key issues identified as part of our audit were as follows:

| Significant Risk | Conclusion |
|---|---|
| **Misstatements due to fraud or error – Council and Pension Fund**<br><br>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.<br><br>As identified in International Standard on Auditing (UK) 240 (ISA 240), management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement. | **What we did:**<br><br>We tested a sample of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements to ensure they were appropriate. Sample items were identified for testing based upon characteristics which could be indicative of management override.<br><br>We reviewed accounting estimates for evidence of management bias.<br><br>We evaluated the business rationale for any significant and/or unusual transactions.<br><br>**Our conclusions:**<br><br>We did not identify any material weaknesses in controls or evidence of material management override.<br><br>We did not identify any instances of inappropriate judgements being applied.<br><br>We did not identify any transactions during our audit which appeared unusual or outside of the Council's or the Pension Fund's normal course of business. |

# Financial statement audit (continued)

| Significant Risk | Conclusion |
| --- | --- |
| **Risk of fraud in revenue and expenditure recognition - Council only**<br>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. | **What we did:**<br>We considered the income and expenditure streams of the Council and our assessment was that the risk is most prominent with regards to inappropriate recognition of capital grants and contributions against revenue expenditure, inappropriate capitalisation of revenue expenditure and the omission of expenditure from the financial statements.<br>We tested a sample of capital grants and contributions to confirm that they had been recognised in accordance with agreed terms and conditions.<br>We tested a sample of Revenue Expenditure Funded from Capital Under Statute (REFCUS) to confirm that it met the criteria set down in governing regulations.<br>We tested a sample of capital additions to confirm they met the criteria for capitalisation set out in accounting standards.<br>We tested samples of invoice postings and cash disbursements made after 1 April 2020 to confirm whether the expenditure to which they relate had been recorded in the correct reporting period.<br>We reviewed minutes of Council, Cabinet and other key meetings to identify any potential accruals or provisions which may have been omitted from the financial statements.<br>**Our conclusions**<br>Our testing did not identify any misstatements arising from fraud in revenue and expenditure recognition, or other matters relating to this risk to bring to your attention. |

# Financial statement audit (continued)

| Significant Risk | Conclusion |
| --- | --- |
| **Valuation of land and buildings – Council only**<br><br>The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Authority's financial statements and is subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded on the balance sheet.<br><br>Material impairment was recognised in the draft statements in respect of Centre Square and the Teesside Advanced Manufacturing Park (TAMP). | **What we did:**<br><br>We considered the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.<br><br>We sample tested key asset information used by the valuer in performing their valuation (for example, floor plans to support valuations based on price per square metre).<br><br>We considered the annual cycle of valuations to ensure that assets have been valued within a five year rolling programme, as required by the Council's reporting framework. We also considered if there were any specific changes to assets that have occurred and whether these were communicated to the valuer, and reviewed assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated.<br><br>We utilised EY Real Estates, our internal specialists on asset valuations, to review the valuations of both Centre Square and TAMP. We focused on these assets as they were constructed or acquired during 2019/20, are intended to generate rather than satisfy demand and did not have tenancy agreements in place at 31 March 2020.<br><br>**Our conclusions**<br><br>We concluded that the valuations of Centre Square and TAMP were within the expected ranges. We do however note that the Authority's valuer adopted cautious assumptions about future occupancy levels and this resulted in valuations which were towards the bottom end of our expected range.<br><br>Whilst the valuations of these assets at 31 March 2020 were considered reasonable, we noted an £8.5 million overstatement of the in-year revaluation loss on the two Centre Square assets as a result of overstatement of the asset's cost on acquisition during the year. These assets were acquired under finance leases and there was a corresponding overstatement of finance lease liabilities.<br><br>We reviewed the financial statement disclosure related to the fact valuations were prepared on the basis of a 'material valuation uncertainty' as a significant accounting judgement and concluded that the uncertainty in property valuations was adequately disclosed.<br><br>This basis of valuation did not impact the assurance we were able to obtain over the valuation of property assets, and we are satisfied that land and buildings are not materially misstated. |

# Financial statement audit (continued)

| Significant Risk | Conclusion |
| --- | --- |
| **Valuation of unquoted pooled investment vehicles – Pension Fund only**<br><br>The Fund's investments include unquoted pooled investment vehicles. Judgement is required from investment managers to value these investments as prices are not publicly available. The material nature of these investments means that any error in these judgements could result in a material valuation error.<br><br>We identified the valuation of the Fund's investments in unquoted pooled investment vehicles as a significant risk, as even a small movement in the assumptions underpinning investment manager valuations could have a material impact upon the financial statements. | **What we did:**<br><br>We obtained third party confirmations of the valuation of unquoted pooled investments at the reporting date from the Fund's investment managers, including updated valuations where the original valuations were not fully revised as at 31 March 2020, and cross-checked these confirmations to the confirmation of assets held obtained from the Fund's custodian. We also reviewed the relevant investment manager and custodian controls' reports for qualifications or exceptions that may affect this audit risk.<br><br>We also compared the movement in the valuation of investments in unquoted investment vehicles with the returns recognised as investment income per the investment manager confirmations, and investigated any unusual variances.<br><br>**Our conclusions**<br><br>We identified a number of differences between the amounts included within the financial statements and the confirmations provided by investment managers and the Fund's custodian, the aggregate impact of which was to overstate the assets of the Fund by £40 million. Our audit procedures covered 100% of the investments population.<br><br>Management adjusted the financial statements in respect of identified differences with a net impact of £33.1 million, leaving uncorrected differences with a net impact of £6.9 million in the final financial statements. We are content these differences are immaterial to the Fund.<br><br>We made a recommendation to management in respect of the Fund's processes for assuring the completeness and accuracy of information received from the Fund's custodian and the accounting treatment of timing differences as a result of these observations.<br><br>Our review of the updated valuations obtained from investment managers did not identify any significant changes in valuations which required reflecting in the financial statements. |

# Financial statement audit (continued)

| Significant Risk | Conclusion |
| --- | --- |
| **Valuation of directly held property – Pension Fund only**<br><br>The Fund has a significant portfolio of directly held property investments. The valuation of these properties is subject to a number of assumptions and judgements, small changes in which could have a significant impact upon the financial statements.<br><br>In-line with guidance issued by the Royal Institution of Chartered Surveyors (RICS), the Fund's property valuer provided their valuation of the Fund's directly held property at 31 March 2020 on the assumption that there is a 'material valuation uncertainty' due to the impact of Covid-19 on the real estate market. | **What we did:**<br><br>We obtained the valuation report provided by the Fund's external valuer and agreed the valuations included within the financial statements to this report. We also assessed the qualification and experience of the valuer to ensure it is appropriate to rely upon their work when preparing the financial statements.<br><br>We reviewed the valuation of individual properties held by the Fund and identified 10 properties which we considered had characteristics which indicated an increased risk of misstatement, including due to the potential impacts on property valuations of the Covid-19 pandemic. We asked our EY Real Estate specialists to review the valuation of these properties.<br><br>We reviewed the financial statement disclosures to ensure that the preparation of valuations on the basis of a 'material valuation uncertainty' had been appropriately disclosed.<br><br>**Our conclusions**<br><br>We noted that 5 of the 10 property valuations reviewed by our EY Real Estate specialists were at the upper end of the expected range, with the other 5 in the middle of the expected range. We are content that the valuations used are appropriate, but note that overall the Fund's property valuations are therefore towards the upper end of the expected range.<br><br>We reviewed the financial statement disclosure of the fact valuations were prepared on the basis of a 'material valuation uncertainty' as a significant accounting judgement and concluded that the uncertainty in property valuations was adequately disclosed.<br><br>This basis of valuation did not impact the assurance we were able to obtain over the valuation of property assets, and we are satisfied that property assets are not materially misstated. |

# Financial statement audit (continued)

| Other key findings | Conclusion |
|---|---|
| **Valuation of defined benefit pension liabilities – Council only**<br><br>Accounting for the participation in the Local Government Pension Scheme (LGPS) involves significant estimation and judgement, therefore management engages an actuary to undertake the calculations on their behalf. The information disclosed in the financial statements is based on the IAS 19 report issued to the Council by the actuary.<br><br>ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates. | We assessed the work of the Pension Fund actuary, including the assumptions they have used, by relying on the work of PWC as consulting actuaries commissioned by the National Audit Office for all Local Government sector auditors and the review of this work by our own EY actuarial team. We were able to conclude that the work of the actuary was appropriate.<br><br>The Council's net pension liabilities were impacted by decreases in the valuation of pension assets in the fourth quarter of the year as a result of the Covid-19 pandemic. Our audit of the Council received assurance over these movements from our audit of the pension fund, however the Council's net pension liability was impacted by the overstatement of the Pension Fund's assets noted on page 14. Management estimated the impact on the Council's pension liability to be £4.7 million, an assessment we are reviewed and consider reasonable, and the financial statements were adjusted by this amount.<br><br>On 16 July 2020, the Ministry for Housing, Communities and Local Government (MHCLG) published the proposed remedies for removing age discrimination from the LGPS. The proposed remedy is very similar to the basis of valuation used in the financial statements for active members, but includes additional liabilities in respect of deferred and pensioner members. We have used our EY actuarial team to confirm these additional liabilities would not be material to the Council. |

# Financial statement audit (continued)

| Other key findings | Conclusion |
|---|---|
| **Going concern and associated disclosures – Council only**<br><br>The Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires that the financial statements of Local Authorities are prepared on a going concern basis, unless there is an intention by government that the services provided by the authority will no longer be provided.<br><br>Due to the unpredictability of the current environment, there was a need for additional disclosures to be made by the Council in the financial statements, that detail the full financial and operational impact of Covid-19 in 2020/21 and beyond. | On 2 September 2020, the Council approved the transfer of the £4.9 million balance on the Authority's Investment Fund Contingency Reserve into the General Fund to cover the estimated £4.4 million impact of the Covid-19 pandemic on the Authority's 2020/21 budget. Our review of management's estimation of the impact of the pandemic on the Authority's 2020/21 budget has not identified any issues with this estimate.<br><br>The Authority has sufficient reserves to absorb management's estimate of the impact on the 2020/21 budget, but will need to agree a budget for 2021/22 which balances after allowance for the impact of Covid-19 as further reserves are not available for transfer.<br><br>Our review of management's cashflow forecasts to 31 March 2022 also did not identify any matters to report. The Authority has sufficient liquidity, including from planned borrowing, to support management's forecast cashflows over the period to 31 March 2022.<br><br>The financial statement disclosures in respect of going concern have been expanded as a result of audit challenge on the extent of disclosures, and we are content the disclosures within the final statements are adequate and appropriate, |

# Financial statement audit (continued)

**Our application of materiality**

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

| Item | Thresholds applied |
|---|---|
| Planning materiality | We determined planning materiality for the Council's financial statements to be £8 million (2019: £9 million), which is 1.8% of the gross expenditure on the provision of services reported in the financial statements.<br><br>We consider the gross expenditure on the provision of services to be one of the principal considerations for stakeholders in assessing the financial performance of the Council<br><br>We determined planning materiality for the Pension Fund financial statements to be £37.4 million (2019: £40.8 million), which is 1% of the net assets of the Fund. |
| Reporting threshold | We agreed with the Audit Committee that we would report to the committee all audit differences in excess of £0.4 million (2019: £0.4 million) for the Council and all audit differences in excess of £1.9 million (2019: £2 million) for the Pension Fund. |

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

Section 4

# Value for money

# Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

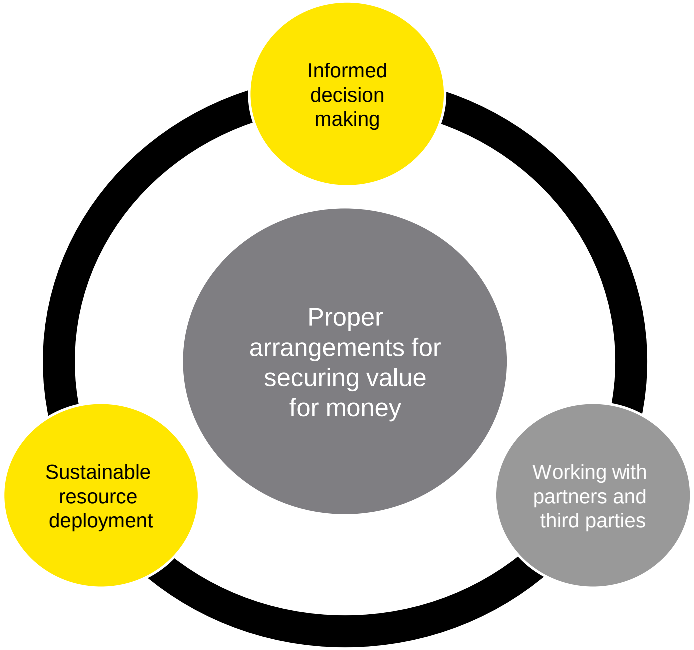
On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19. This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider the local authority's response to Covid-19 only as far as it relates to the 2019/20 financial year; only where clear evidence comes to the auditor's attention of a significant failure in arrangements as a result of Covid-19 during the financial year would it be appropriate to recognise a significant risk in relation to the 2019-20 VFM arrangements conclusion.

We identified two significant risks in relation to these arrangements. The table below presents the findings of our work in response to the risk identified.

We have performed the procedures outlined in our audit plan.

In light of the observations and conclusions set out in the Ofsted report of January 2020, we are unable to conclude that the Council had 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 2019/20. We have therefore qualified our value for money opinion in respect of the provision of children's social care services, further details of which are provided on the next pages.

Other than in respect of children's social care services, we did not identify any significant weaknesses in the Council's arrangements.



# Value for Money (continued)

| Significant Risk | Conclusion |
| --- | --- |
| **Financial sustainability**<br><br>The Council operates in a challenging financial environment. Reduced central government funding, increased reliance on locally raised taxes and increased demand for services are all putting pressure on the Council's budget and the financial sustainability of its services. In particular the Council has faced pressures within Children's Services during 2019-20, with an overspend anticipated against budget for most of the year.<br><br>Management have developed a Medium Term Financial Plan which includes the need for significant savings. Detailed plans have been developed by management to deliver on these savings, however the delivery of these plans is not certain.<br><br>The Council may also face additional cost pressures, not reflected in the most recent Medium Term Financial Plan, in responding to the findings of the Ofsted inspection. | We have reviewed the financial outturn of the Authority against budget and note that the Authority's revenue activities were overbudget by £6.6 million for 2019/20. As a result, the Authority's general fund balance at 31 March 2020 was down to the minimum level prescribed by the Section 151 Officer. The overspend in 2019/20 was driven by children's services, which as a directorate overspent by £7.2 million with all other parts of the Authority delivering a net underspend of £0.6 million.<br><br>We made enquiries of management and reviewed the assumptions used in the 2020/21 budget, which was set prior to the Covid-19 pandemic, to confirm they were reasonable. We note that the budget includes an additional £3.5 million of funding for children's services to mitigate demand pressures in that service, in addition to more general inflationary pressures. Despite these challenges, we note that the Authority had identified schemes for the full £6.4 million of required savings to achieve a balanced budget in 2020/21 without utilising reserves.<br><br>We also made enquiries of management and reviewed assumptions used to quantify the impact of the Covid-19 pandemic on the 2020/21 budget. Management estimate that they will need to utilise £4.4 million of reserves in 2020/21 due to additional cost pressures and lost income as a result of the pandemic, after allowing for additional funding. The Authority has insufficient reserves within the general fund to accommodate this impact, therefore management has proposed to release the £4.9 million set aside in the Investment Fund Contingency Reserve to maintain the general fund above the minimum prescribed level of £9.4 million.<br><br>Management therefore have arrangements in place to manage the impact of the Covid-19 pandemic on the Authority for 2020/21, however future budgets will need to address the longer term impacts of the pandemic without ongoing reliance on reserves. |

# Value for Money (continued)

| Significant Risk | Conclusion |
|---|---|
| **Provision of children's services**<br><br>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 are now inadequate.<br><br>Under Auditor Guidance Note 3: Auditor's Work on Value for Money (VFM) Arrangements, published by the National Audit Office, we are required to consider the findings of external inspectorates, such as Ofsted, as part of our value for money considerations.<br><br>Given the significance of children's services to the Council's activities and the nature of the conclusions reached by Ofsted, we considered it appropriate to recognise a significant value for money risk in respect of the Council's delivery of children's services. | Following publication of the Ofsted report, management developed an Improvement Plan to address the findings raised by Ofsted. Given its wide reaching scope, it took time for management to implement the Improvement Plan and, due to the relatively late stage of the year at which the Ofsted report was released, this was still in progress at the year-end.<br><br>On 4 June 2020, the Secretary of State appointed Commissioner for Children's Services in Middlesbrough published a follow-up report which concluded that the Council should be "commended" for its response to the Ofsted report and that "there is sufficient confidence in the changes being made to indicate that this is not a Local Authority where we should move quickly to consider alternative delivery mechanisms".<br><br>On 23 September 2020, Ofsted performed their first monitoring visit to the Authority since their report. The final report from Ofsted on the monitoring visit has not been released as of the completion of our audit, however we have reviewed the draft version provided to management. We note it identifies several areas of children's social care services where the Authority has made improvements since the original report, however it also highlights the significant work still to be done by the Authority to bring the quality of other parts of the service up to the required standard.<br><br>Whilst the original Ofsted inspection took place between 25 November 2019 and 6 December 2019, the nature of the issues raised are such that the report's findings are indicative of the effectiveness of the Council's children's social care services for the period between 1 April 2019 and the dates of inspection.<br><br>The reports of the appointed Commissioner for Children's Services in Middlesbrough and the Ofsted monitoring visit support that the Authority has since put in place appropriate governance structures to respond to the Ofsted findings, and we note management's understanding of the performance of the service in particular is highlighted as an area of improvement.<br><br>The majority of these structures were however implemented very late in, or after, the period under audit. We are therefore unable to conclude that the Council had 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 2019/20. Accordingly, we have qualified our value for money opinion for 2019/20 with regards to the provision of children's social care services.<br><br>We expect that we will continue to monitor management's implementation of the Improvement Plan, including any further assessments by external parties, as part of our 2020/21 audit. |

Section 5

# Other reporting issues

# Other Reporting Issues

**Whole of Government Accounts**

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. The Council was below the specified audit thresholds for 2019/20, therefore no audit procedures were performed in respect of the consolidation pack.

**Annual Governance Statement**

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading. We completed this work and did not identify any areas of concern.

**Report in the Public Interest**

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public. We did not identify any issues which required us to issue a report in the public interest.

**Written Recommendations**

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response. We did not identify any issues which required us to issue a written recommendation.

**Objections Received**

We did not receive any objections to the 2019/20 financial statements from members of the public.

**Other Powers and Duties**

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

**Independence**

We communicated our assessment of independence in our Provisional Audit Results Report to the Corporate Affairs and Audit Committee on 26 November 2020 and reconfirmed this in our Final Audit Results Report issued to Committee members on 23 February 2021. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

# Other Reporting Issues (continued)

**Control Themes and Observations**

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

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

| Description | Impact |
| --- | --- |
| **Management review of information provided by the Pension Fund's custodian**<br>Management rely on information provided by the Fund's custodian when preparing the financial statements. Our audit procedures identified a number of issues with this information, the absolute value of which was material to the financial statements. The aggregate net impact of all misstatements identified during the audit, including those relating to the information provided by the Fund's custodian, was also material to the financial statements. | We consider there to be a risk of material misstatement arising from errors in the information provided by the Fund's custodian remaining uncorrected and being utilised in the production of the financial statements.<br>We therefore recommend that management review the processes in place for assuring the information provided by the Fund's custodian is accurate and complete. Where timing differences are known to exist, management should ensure that they have processes in place to determine the impact on the financial statements and, where appropriate, the information provided by the custodian should be adjusted prior to inclusion within the financial statements. |

Section 6

# Focused on your future

# Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

| Standard | Issue | Impact |
| --- | --- | --- |
| **IFRS 16 Leases** | Originally intended to be applicable for local authority accounts from the 2020/21 financial year, the adoption of the new standard has been deferred to avoid placing additional pressure on local authority finance teams during the Covid-19 pandemic. It is current proposed that IFRS 16 will be applicable for local authority accounts from the 2022/23 financial year.<br><br>The main impact of the new standard is to remove (for lessees) the traditional distinction between finance leases and operating leases. Finance leases have effectively been accounted for as acquisitions (with the asset recognised on the balance sheet, together with a liability to pay for the asset acquired). In contrast, operating leases have been treated as "pay as you go" arrangements, with rentals recognised as expenditure in the year they are paid. IFRS 16 requires all substantial leases to be accounted for using the acquisition approach, recognising the rights acquired to use an asset.<br><br>For local authorities who lease a large number of assets the new standard will have a significant impact, with the majority of current leases likely to be included on the balance sheet.<br><br>There are transitional arrangements within the standard and although the 2022/23 Accounting Code of Practice for Local Authorities will not be issued for some time yet, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue. | Until the revised 2022/23 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.<br><br>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented. |

Section 7

# Audit fees

# Audit Fees

Our fee for 2019/20 is set out in the table below and is in-line with the amounts communicated in our Audit Planning Report and Audit Results Reports:

| Description | Final Planned Fee 2019/20 £ | Planned Fee 2019/20 £ | Final Fee 2018/19 £ |
|---|---|---|---|
| Base Audit Fee – Code Work (Council) [note 1] | 88,578 | 88,578 | 88,578 |
| Base Audit Fee – Code Work (Pension Fund) [note 1] | 21,972 | 21,972 | 21,972 |
| Changes in work required to address professional and regulatory requirements and scope associated with risk (Council) [note 2] | 64,381 | - | - |
| Changes in work required to address professional and regulatory requirements and scope associated with risk (Pension Fund) [note 2] | 33,602 | - | - |
| **Revised Proposed Scale Fee** | **208,533** | **110,550** | **110,550** |
| IAS 19 Procedures – Code Work (Pension Fund) [note 3] | 6,000 | - | - |
| IAS 19 Procedures – Non-Code Work (Pension Fund) [note 4] | 2,000 | 2,000 | 2,000 |
| **Revised Proposed Scale Fee (inc. IAS 19 Procedures)** | **216,533** | **112,550** | **112,550** |
| Additional specific one-off considerations requiring additional work (Council) [notes 5, 6] | 24,750 | - | 2,500 |
| Additional specific one-off considerations requiring additional work (Pension Fund) [note 5] | 12,455 | - | - |
| **Total Audit Fee** | **253,738** | **112,550** | **115,050** |
| Non-Audit Fee – Housing Benefit Certification Work | 12,800 | 12,800 | 10,500 |
| Non-Audit Fee – Teachers' Pension Certification Work | 5,000 | 5,000 | 4,500 |
| **Total Fees** | **271,538** | **130,350** | **130,050** |

See notes on next page.

When undertaking non-audit work, we have adopted the necessary safeguards in our completion of this work and complied with Auditor Guidance Note 1 issued by the NAO in December 2017.

# Audit Fees

Notes:

1) The base audit fees reflect the amounts determined by Public Sector Audit Appointments Limited (PSAA) in March 2019.
2) We wrote to management and the Audit Committee Chair on 10 February 2020 setting out our considerations on the sustainability of UK local public audit. Our Audit Planning Report presented to the Audit Committee on 5 March 2020 highlighted that we would be having further discussions with management to agree a scale fee variation for 2019/20 and set out some of the factors informing this discussion. We have not been able to agree a scale fee variation with management and have therefore asked PSAA to make a determination as to the scale fee variation to be applied. PSAA have not yet made this determination. The table on the previous page reflects the amount we have submitted to PSAA as our assessment of the additional fee required to reflect changes in the level of work required to address professional and regulatory requirements and scope associated with risk.
3) As part of our audit of the Pension Fund we undertake additional procedures to enable us to report to the auditors of scheduled bodies that are subject to the NAO Code of Audit Practice. These procedures are additional to the procedures we must complete to support our opinion on the financial statements of the Pension Fund. We have not previously charged for this work, however the increasing costs of delivering our audit of the Pension Fund mean we are no longer able to absorb these costs. This fee has been agreed with management and management may opt to recharge this fee to the relevant member bodies.
4) The fee for the provision of IAS 19 assurances to the auditor of the Care Quality Commission (CQC), which is not subject to the NAO Code of Audit Practice, is covered by a separate engagement agreement between ourselves and the Fund. Management may opt to recharge such fees to the Care Quality Commission.
5) We have had to perform additional procedures, over what we planned at the start of our audit, to respond to the impacts of the Covid-19 pandemic on the financial statements. This has included additional consultations on the form of our audit opinion and additional procedures to review and challenge management's assessment of the impact of Covid-19 on asset valuations. The amounts on the previous page represent the additional fees we have determined as commensurate with the additional work undertaken. We have not been able to agree these impacts on our fee with management and have therefore asked PSAA to make a determination as to the additional fee to be applied. PSAA have not yet made this determination.
6) The additional one-off considerations in the prior year related to first-time adoption of new accounting standards and consideration of the impact on the Local Government Pension Scheme liability of recent court judgements on age discrimination (McCloud) and the Guaranteed Minimum Pension (GMP).

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