Middlesbrough Council
Audit Planning Report

Year ended 31 March 2021

July 2021

Building a better working world

July 2021

Corporate Affairs and Audit Committee
Middlesbrough Council
Civic Centre
Middlesbrough
TS1 9GA

Dear Corporate Affairs and Audit Committee Members

Audit Planning Report

We are pleased to attach our Audit Planning Report which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Corporate Affairs and Audit Committee with a basis to review our proposed audit approach and scope for the 2020/21 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's new 2020 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks. Our planning procedures have yet to be fully completed; should any material changes arise we will communicate these to the committee, as appropriate.

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

We welcome the opportunity to discuss this plan with you on 23 July 2021 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

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

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

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

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

01 Overview of our 2020/21 audit strategy

Overview of our 2020/21 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Corporate Affairs and Audit Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from prior year	Details
Risk of fraud in revenue and expenditure recognition	Fraud risk	No change in risk or focus	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.
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	As identified in 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 would otherwise appear to be operating effectively.
Valuation of land and buildings	Significant risk	No change in risk or focus	Land and buildings are the most significant assets on the Council's Balance Sheet. The valuation of land and buildings is dependent upon a number of judgements and assumptions, small changes in which can have a significant impact upon the financial statements.
Valuation of defined benefit pension liability	Inherent risk	No change in risk or focus	The defined benefit pension liability is the most significant liability on the Council's Balance Sheet. The assessment of the present value of future obligations requires detailed actuarial calculations. Small changes in the assumptions used for the calculations can have a significant impact upon the financial statements.
Going Concern and associated disclosures	Inherent risk	No change in risk or focus	The Covid-19 pandemic has had a significant impact on local authority finances, with new expenditure streams being incurred, loss or reduction to existing income streams and new grant income streams arising. The Council has also seen significant cashflows passing through it where it acts as an agent. Management will need to undertake their going concern assessment against the backdrop of ongoing uncertainty over the financial impact of the pandemic. They will also need to ensure that going concern disclosures within the financial statements appropriately present management's assessment.

Overview of our 2020/21 audit strategy

Audit risks and areas of focus			
Risk / area of focus	**Risk identified**	**Change from prior year**	**Details**
Provision of Children's Services	Significant value for money risk	No change in risk or focus	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. 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 previous year-end. Accordingly, we qualified our value for money opinion for 2019/20 with regards to the provision of children's social care services. The reports of the appointed Commissioner for Children's Services in Middlesbrough and the subsequent Ofsted monitoring visit support that the Authority has since put in place appropriate governance structures to respond to the Ofsted findings. We also note management's understanding of the performance of the service, in particular that it is highlighted as an area of improvement. Nevertheless, 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 2020/21. Given the significance of children's services to the Council's activities and the nature of the conclusions reached by Ofsted, we consider it appropriate to recognise a significant value for money risk in respect of the Council's delivery of children's services.

In the prior year we also recognised the Council's financial sustainability as a significant value for money risk. The National Audit Office have issued a new Code of Audit Practice, effective for our 2020/21 audit, which significantly changes the framework for our value for money work. We have assessed, considering the requirements of the new Code of Audit Practice, our knowledge of the Council and the results of the 2019/20 value for money work, that financial sustainability does not warrant recognition as a significant value for money risk for our 2020/21 audit. Further details of the new framework are provided in Section 3.

Overview of our 2020/21 audit strategy

Materiality

Planning materiality
£7.9m

Materiality has been set at £7.9 million, which represents 1.8% of the prior year's gross expenditure on provision of services.

Performance materiality
£5.9m

Performance materiality has been set at £5.9 million, which represents 75% of materiality.

Audit differences
£0.4m

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement and collection fund) greater than £0.4 million. Other misstatements identified will be communicated to the extent that they merit the attention of the Corporate Affairs and Audit Committee.

Overview of our 2020/21 audit strategy

Audit scope

This Audit Planning Report covers the work that we plan to perform to provide you with our audit opinion on whether the consolidated and single entity financial statements of Middlesbrough Council give a true and fair view of the financial position as at 31 March 2021 and of the income and expenditure for the year then ended.

We are also required to report by exception if we conclude that you have not put in place proper arrangements to secure value for money in your use of resources for the relevant period.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements;
- Developments in financial reporting and auditing standards;
- The quality of systems and processes;
- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

Taking the above into account, and as articulated in this Audit Planning Report, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditor's assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 15 in recent years as well as the expansion of factors impacting the value for money conclusion. Therefore to the extent any of these or any other risks are relevant in the context of the Council's audit, we will discuss these with management as to the impact on the scale fee.

02 Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Risk of fraud in revenue and expenditure recognition*

Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. These accounts had the following balances in the 2019/20 financial statements:

- Income Account: £394 million
- Expenditure Account: £438 million

What is the risk?

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.

We have considered the income and expenditure streams of the Council and our assessment is that the risk is most prominent with regards to:

- Inappropriate recognition of Covid-related grant funding, including incorrect identification of whether the Council is acting as the principle or an agent and whether any associated terms and conditions were met prior to recognition;
- Inappropriate recognition of capital grants and contributions against revenue expenditure;
- Inappropriate capitalisation of revenue expenditure; and
- The omission of expenditure from the financial statements.

What will we do?

- Review the accounting treatment of new Covid-related grants for 2020/21 to confirm that they have been correctly accounted for as either a principle or agent arrangement;
- Test a sample of new Covid-related grants to ensure that any terms and conditions were met prior to recognition as income;
- Test a sample of capital grants and contributions to confirm that they have been recognised in accordance with agreed terms and conditions;
- Test a sample of Revenue Expenditure Funded from Capital Under Statute (REFCUS) to confirm that it meets the criteria set down in governing regulations;
- Test a sample of capital additions to confirm they meet the criteria for capitalisation set out in accounting standards;
- Test samples of invoice postings and cash disbursements made after 1 April 2021 to confirm whether the expenditure to which they relate has been recorded in the correct reporting period; and
- Review minutes of Council and other key meetings to identify any potential accruals or provisions which may have been omitted from the financial statements.

Our response to significant risks (continued)

Misstatements due to fraud or error*	What is the risk?	What will we do?
	The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	‣ Identifying fraud risks during the planning stages of our audit; ‣ Inquire of management about risks of fraud and the controls put in place to address those risks; ‣ Understand the oversight given by those charged with governance of management's processes over fraud; ‣ Consider the effectiveness of management's controls designed to address the risk of fraud; ‣ Determine an appropriate strategy to address those identified risks of fraud; and ‣ Perform mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments made in the preparation of the financial statements.

Our response to significant risks (continued)

Valuation of land and buildings

Financial statement impact

Misstatements that occur in relation to the risk of valuation of land and buildings could affect the property, plant and equipment and investment property accounts. These accounts had the following balances in the 2019/20 financial statements:

- Property, Plant and Equipment: £400 million
- Investment Property: £16 million

What is the risk?

Land and buildings are the most significant assets on the Council's Balance Sheet. The valuation of land and buildings is dependent upon a number of judgements and assumptions, small changes in which can have a significant impact upon the financial statements.

Our assessment is that the risk of misstatement is greatest in those assets whose value is dependent to a large extent on the existence and terms of commercial tenancies.

The Council has relatively few such assets, however it did acquire several such assets during 2019/20, including Centre Square and the Tees Advanced Manufacturing Park (TAMP), and has acquired several further such assets during 2020/21.

We therefore attach our significant risk to the Council's investment property, including assets under construction which will be reclassified to investment property upon completion. We recognise an inherent risk over the valuation of other land and buildings.

What will we do?

- Consider 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;
- Sample test key asset information used by the valuers in performing their valuation (e.g. rental terms to support valuations based on rental income);
- Consider the annual cycle of valuations to ensure that assets have been valued within a five year rolling programme as required by the Code. We will also consider if there are any specific changes to assets that have occurred and whether these have been communicated to the valuer;
- Review assets not subject to valuation in 2020/21 to confirm that the remaining asset base is not materially misstated;
- Consider changes to useful economic lives as a result of the most recent valuation; and
- Test accounting entries have been correctly processed in the financial statements.

Other areas of audit focus

What is the risk/area of focus?	What will we do?
Valuation of defined benefit pension liability The Local Authority Accounting Code of Practice and IAS 19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by the Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2020 this totalled £284 million. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. The information disclosed is based on the IAS 19 report issued to the Council by the Council's actuary. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	▸ Liaise with the audit team of the Teesside Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Middlesbrough Council. Note that the audit of the Pension Fund is also performed by EY; ▸ Assess the work of the Pension Fund actuary (Aon Hewitt), including the assumptions they have used, by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by our own EY actuarial specialists; and ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS 19.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Going concern and associated disclosures The Covid-19 pandemic has had a significant impact on local authority finances, with new expenditure streams being incurred, loss or reduction to existing income streams and new grant income streams arising. The Council has also seen significant cashflows passing through it where it acts as an agent. Management will need to undertake their going concern assessment against the backdrop of ongoing uncertainty over the financial impact of the pandemic. They will also need to ensure that going concern disclosures within the financial statements appropriately present management's assessment. *Going Concern Compliance with ISA 570* This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after. The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the Council is the audit of the 2020/21 financial statements. The revised standard increases the work we are required to perform when assessing whether the Council is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards; and we have therefore judged it appropriate to bring this to the attention of the Corporate Affairs and Audit Committee.	We will meet the requirements of the revised auditing standard on going concern (ISA 570) and consider the adequacy of the Council's going concern assessment and its disclosure in the accounts by: ▸ Challenging management's identification of events or conditions impacting going concern; ▸ Testing management's resulting assessment of going concern by evaluating supporting evidence (including consideration of the risk of management bias); ▸ Reviewing the Council's assessment that it is appropriate for the financial statements to be prepared on a going concern basis; ▸ Reviewing the Council's cashflow forecast covering a period of atleast 12 months from the reporting date, to ensure that it has sufficient liquidity to continue to operate as a going concern; ▸ Undertaking a 'stand back' review to consider all of the evidence obtained, whether corroborative or contradictory, when we draw our conclusions on going concern; and ▸ Challenging the disclosure made in the accounts in respect of going concern and any material uncertainty. We have discussed the detailed implications of the new standard with finance staff during the 2019/20 audit. Furthermore, we have agreed with management to liaise with them on the Council's going concern assessment in advance of the 2020/21 year-end audit in order to provide management with feedback on the adequacy and sufficiency of the proposed disclosures in relation to going concern.

03 Value for money risks

Value for money

Council responsibilities for value for money

The Council is required to maintain an effective system of internal control that supports the achievement of its policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

As part of the material published with its financial statements, the Council is required to bring together commentary on its governance framework and how this has operated during the period in a governance statement. In preparing its governance statement, the Council tailors the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on its arrangements for securing value for money from their use of resources.

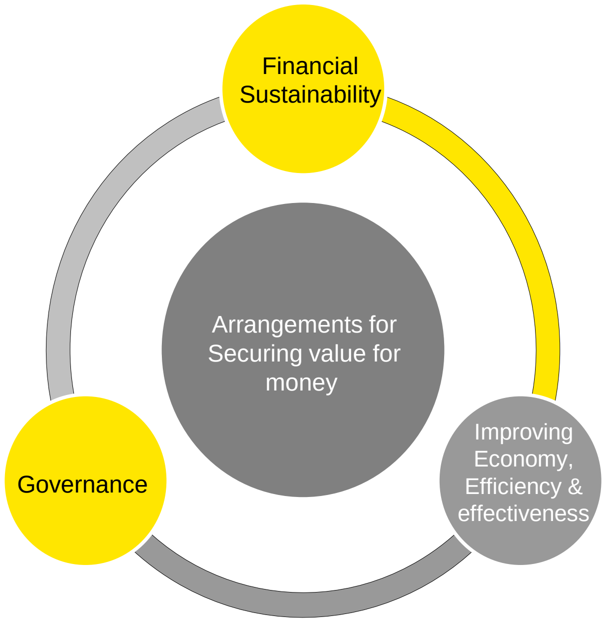
Auditor responsibilities under the new Code

Under the revised 2020 Code of Audit Practice we are still required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. However, there is no longer overall evaluation criterion which we need to conclude on.

Instead the 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Council a commentary against specified reporting criteria (see below) on the arrangements the Council has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

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



Value for money risks

Planning and identifying VFM risks

The NAO's guidance notes require us to carry out a risk assessment which gathers sufficient evidence to enable us to document our evaluation of the Council's arrangements, in order to enable us to draft a commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations. This is a change to the 2015 Code of Audit Practice guidance notes where the NAO required auditors, as part of planning, to consider the risk of reaching an incorrect conclusion in relation to the overall criterion.

In considering the Council's arrangements, we are required to consider:

- The Council's governance statement
- Evidence that the Council's arrangements were in place during the reporting period;
- Evidence obtained from our work on the accounts;
- The work of inspectorates (such as Ofsted) and other bodies; and
- Any other evidence source that we regard as necessary to facilitate the performance of our statutory duties.

We then consider whether there is evidence to suggest that there are significant weaknesses in arrangements. The NAO's guidance is clear that the assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement. However, the NAO states that a weakness may be said to be significant if it:

- Exposes – or could reasonably be expected to expose – the Council to significant financial loss or risk;
- Leads to – or could reasonably be expected to lead to – significant impact on the quality or effectiveness of service or on the Council's reputation;
- Leads to – or could reasonably be expected to lead to – unlawful actions; or
- Identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

We should also be informed by a consideration of:

- The magnitude of the issue in relation to the size of the Council;
- Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves (where applicable), or impact on budgets or cashflow forecasts;
- The impact of the weakness on the Council's reported performance;
- Whether the issue has been identified by the Council's own internal arrangements and what corrective action has been taken or planned;
- Whether any legal judgements have been made, including judicial review;
- Whether there has been any intervention by a regulator or Secretary of State;
- Whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- The impact on delivery of services to local taxpayers; and
- The length of time the Council has had to respond to the issue.

Value for money risks

Responding to identified risks

Where our planning work has identified a risk of significant weakness, the NAO's guidance requires us to consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including where appropriate, challenge of management's assumptions. We are required to report our planned procedures to the Corporate Affairs and Audit Committee.

Reporting on VFM

In addition to the commentary on arrangements, where we are not satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources the 2020 Code has the same requirement as the 2015 Code in that we should refer to this by exception in the audit report on the financial statements.

However, a new requirement under the 2020 Code is for us to also include commentary on arrangements in a new Auditor's Annual Report. The 2020 Code states that the commentary should be clear, readily understandable and highlight any issues we wish to draw to the attention of the Council or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with our view as to whether they have been implemented satisfactorily.

Status of our 2020/21 VFM planning

We have completed our preliminary assessment of the Council against the revised criteria of the 2020 Code and have identified one risk of significant weakness in the Council's arrangements to secure value for money through economic, efficient and effective use of its resources during 2020/21. We provide further details of this risk on the next slide.

We will continue to update our understanding of the Council's arrangements and evaluate them against the criteria of the 2020 Code during the course of our audit, and will report to the Corporate Affairs and Audit Committee if we identify any further risks of significant weakness in the Council's arrangements.

Our response to risks of significant weaknesses in arrangements

Provision of children's services

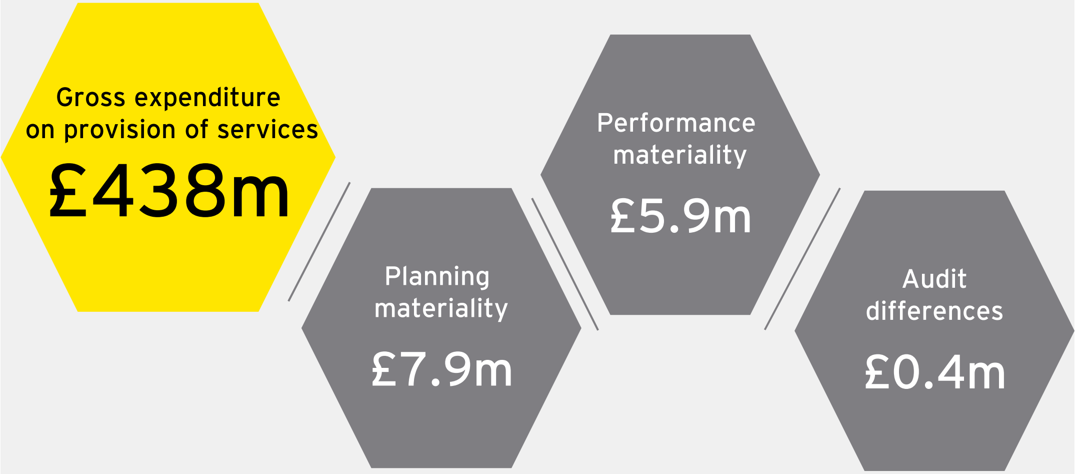
What is the risk?	What will we do?
On 24 January 2020, the Office for Standards in Education, Children's Services and Skills (Ofsted) released the results of its inspection of the Council's children's social care services performed between 25 November 2019 and 6 December 2019. The report concluded that 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. 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 previous year-end. Accordingly, we qualified our value for money opinion for 2019/20 with regards to the provision of children's social care services. The reports of the appointed Commissioner for Children's Services in Middlesbrough and the subsequent Ofsted monitoring visit support that the Authority has since put in place appropriate governance structures to respond to the Ofsted findings. We note management's understanding of the performance of the service in particular is highlighted as an area of improvement. Nevertheless, 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 2020/21. Given the significance of children's services to the Council's activities and the nature of the conclusions reached by Ofsted, we consider it appropriate to recognise a significant value for money risk in respect of the Council's delivery of children's services.	‣ Make enquiries of management to understand the progress being made against the Council's Improvement Plan; ‣ Review the findings of subsequent monitoring inspections of the Council's children's services as third party evidence of the progress being made by the Council; and ‣ Evaluate whether the above indicates that a material weakness in arrangements was present during 2020/21, and consider the implications for our auditor reporting.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2020/21 has been set at £7.9 million. This represents 1.8% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



We request that the Corporate Affairs and Audit Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £5.9 million which represents 75% of planning materiality. We have used a 75% threshold as we have identified limited audit adjustments in previous years.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, housing revenue account and collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Corporate Affairs and Audit Committee, or are important from a qualitative perspective.

Specific materiality – We have set a materiality of nil for remuneration disclosures, which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to these.

05 Scope of our audit

Our Audit Process and Strategy

Objective and scope

Under the Code of Audit Practice, our principal objectives are to review and report on the Council's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. **Financial statement audit**

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

2. Arrangements for securing economy, efficiency and effectiveness (value for money)

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2020/21 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Corporate Affairs and Audit Committee.

Internal audit

We will meet with Internal Audit, and review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.

06 Audit team

Audit team

The engagement team is led by Stephen Reid, who will have responsibility for ensuring that our audit delivers high quality and value to the Council.

Mark Rutter will be the manager responsible for the day-to-day direction of audit work and is the key point for contact for the finance team.

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of land and buildings	Align (management's valuation specialists) EY Real Estate valuation specialists (as deemed necessary)
Pensions disclosure	Aon Hewitt (management's actuarial specialists) EY Actuaries

In accordance with auditing standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- Assess the reasonableness of the assumptions and methods used;
- Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

07 Audit timeline

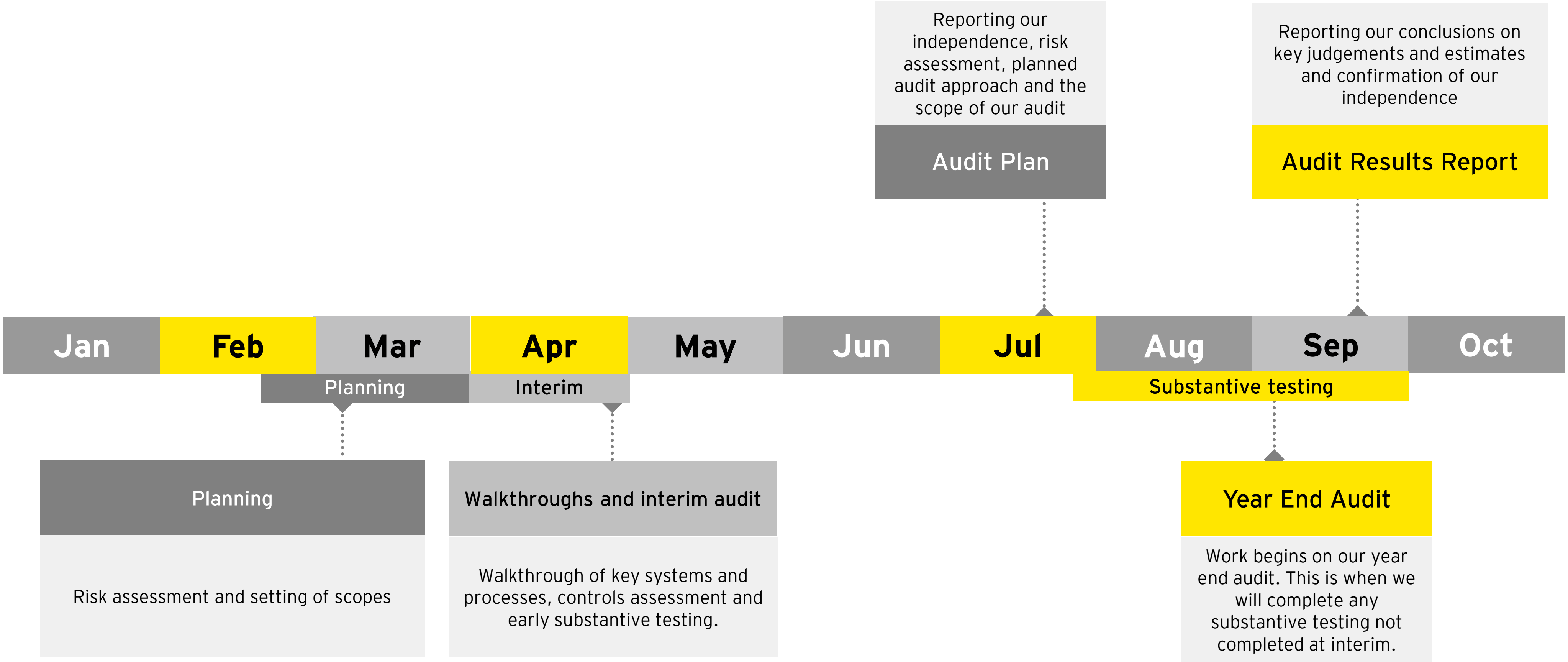
Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2020/21.

From time to time matters may arise that require immediate communication with the Corporate Affairs and Audit Committee and we will discuss them with the Corporate Affairs and Audit Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.



08 Independence

Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in December 2019, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
► The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between you, your affiliates and directors and us; ► The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ► The overall assessment of threats and safeguards; ► Information about the general policies and processes within EY to maintain objectivity and independence; and ► Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard.	► In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ► Details of non-audit services provided and the fees charged in relation thereto; ► Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ► Written confirmation that all covered persons are independent; ► Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ► Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ► An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted.

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

New UK independence standard

The Financial Reporting Council (FRC) published the Revised Ethical Standard 2019 in December and it applies to accounting periods starting on or after 15 March 2020. A key change in the new Ethical Standard is a general prohibition on the provision of non-audit services by the auditor (and its network) which applies to UK Public Interest Entities (PIEs). A narrow list of permitted services continues to be allowed.

Summary of key changes

- Extraterritorial application of the FRC Ethical Standard to UK PIE and its worldwide affiliates;
- A general prohibition on the provision of non-audit services by the auditor (or its network) to a UK PIE, its UK parent and worldwide subsidiaries;
- A narrow list of permitted services where closely related to the audit and/or required by law or regulation;
- Absolute prohibition on the following relationships applicable to UK PIE and its affiliates including material significant investees/investors:
  - Tax advocacy services
  - Remuneration advisory services
  - Internal audit services
  - Secondment/loan staff arrangements
- An absolute prohibition on contingent fees;
- Requirement to meet the higher standard for business relationships i.e. business relationships between the audit firm and the audit client will only be permitted if it is inconsequential;
- Permitted services required by law or regulation will not be subject to the 70% fee cap;
- Grandfathering will apply for otherwise prohibited non-audit services that are open at 15 March 2020 such that the engagement may continue until completed in accordance with the original engagement terms;
- A requirement for the auditor to notify the Audit Committee where the audit fee might compromise perceived independence and the appropriate safeguards; and
- A requirement to report to the audit committee details of any breaches of the Ethical Standard and any actions taken by the firm to address any threats to independence. A requirement for non-network component firm whose work is used in the group audit engagement to comply with the same independence standard as the group auditor. Our current understanding is that the requirement to follow UK independence rules is limited to the component firm issuing the audit report and not to its network. This is subject to clarification with the FRC.

Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under the FRC Revised Ethical Standard 2019.

We do not currently provide any non-audit services which would be prohibited under the new standard.

Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non-audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Stephen Reid, your audit engagement partner, and the audit engagement team have not been compromised.

Self interest threats

A self interest threat arises when EY has financial or other interests in your Council. Examples include where we have an investment in related companies; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees, non-audit fees or business relationships and therefore no additional safeguards are required.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

There are no other self interest threats at the date of this report.

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of your council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

Relationships, services and related threats and safeguards

EY Transparency Report 2020
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 period ended 3 July 2020: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2020/ey-uk-2020-transparency-report.pdf

09 Appendices

Appendix A

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

Description	Planned Fee 2020/21 £	Scale Fee 2020/21 £	Final Requested Fee 2019/20 £	*Notes*
Base Audit Fee – Code Work (Council)	88,578	88,578	88,578	*1*
Base Audit Fee – Code Work (Pension Fund)	21,972	21,972	21,972	*1*
Changes in work required to address professional and regulatory requirements and scope associated with risk (Council)	64,381	-	64,381	*2*
Changes in work required to address professional and regulatory requirements and scope associated with risk (Pension Fund)	33,602	-	33,602	*2*
Revised Proposed Scale Fee	**208,533**	**110,550**	**208,533**	
IAS 19 Procedures – Code Work (Pension Fund)	8,500	N/A	6,000	*3, 4*
IAS 19 Procedures – Non-Code Work (Pension Fund)	-	N/A	2,000	*4*
Revised Proposed Scale Fee (inc. IAS 19 Procedures)	**217,033**	**N/A**	**216,533**	
Additional specific one-off considerations requiring additional work (Council)	-	N/A	24,750	*5, 6*
Additional specific one-off considerations requiring additional work (Pension Fund)	-	N/A	12,455	*5, 6*
Total Audit Fee	**217,033**	**N/A**	**253,738**	
Non-Audit Fee – Housing Benefit Certification Work	13,450	N/A	12,800	
Non-Audit Fee – Teachers' Pension Certification Work	5,250	N/A	5,000	
Total Fees	**235,733**	**N/A**	**271,538**	

All fees exclude VAT

Fees (continued)

Notes

1) The base audit fees reflect the amounts determined by Public Sector Audit Appointments Limited (PSAA) in March 2020.
2) We wrote to management and the Corporate Affairs and Audit Committee Chair on 10 February 2020 setting out our considerations on the sustainability of UK local public audit. 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. These amounts are not specific to the findings in a particular audit cycle and would therefore apply to both 2019/20 and 2020/21.
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. Management may opt to recharge this fee to the relevant member bodies.
4) In 2019/20, the provision of IAS 19 assurances to the auditor of the Care Quality Commission was not covered by the NAO Code of Audit Practice (2015) and we performed this work under a separate engagement agreement between ourselves and the Pension Fund. From 2020/21, this work is now covered by the new NAO Code of Audit Practice (2020) and the fee reflected within the fee for IAS 19 work performed under the Code of Audit Practice.
5) In 2019/20, we performed additional procedures over what we planned at the start of our audit, to respond to the impacts of the Covid-19 pandemic on the financial statements. This included additional consultations on the form of our audit opinion and additional procedures to review and challenge management's assessment of the impact of Covid-19 on asset valuations. The amounts on the previous page represent the additional fees we 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) We note that there continue to be factors which increase the extent of our audit procedures over and above the levels envisaged by PSAA when determining scale fees. For 2020/21, this will include the increasing role of Middlesbrough Development Company, the ongoing impact of the Covid-19 pandemic (including where we have recognised a significant risk over the recognition of associated grant funding), the increasing complexity of the Council's property portfolio, the implementation of the NAO's new Code of Audit Practice and the implications of the new Code for our value for money work and the adoption of a new auditing standard *ISA 540: Auditing Accounting Estimates and Related Disclosures* which requires us to perform addition work around accounting estimates. We will discuss the impact of these factors on our audit fees with management once the full extent of additional effort has been determined.

The fees presented are based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- Our accounts opinion being unqualified;
- No material weaknesses in arrangements for us to report on;
- Appropriate quality of documentation is provided by the Council; and
- The Council has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

Required communications with the Corporate Affairs and Audit Committee

Our Reporting to you

We have detailed below the communications that we must provide to the Corporate Affairs and Audit Committee.

Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the Corporate Affairs and Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The Statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The Statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Planning Report (this report)
Significant findings from the audit	▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures; ▸ Significant difficulties, if any, encountered during the audit; ▸ Significant matters, if any, arising from the audit that were discussed with management; ▸ Written representations that we are seeking; ▸ Expected modifications to the audit report; and ▸ Other matters if any, significant to the oversight of the financial reporting process	Audit Results Report (September 2021)

Required communications with the Corporate Affairs and Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ▸ Whether the events or conditions constitute a material uncertainty; ▸ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements; and ▸ The adequacy of related disclosures in the financial statements	Audit Results Report (September 2020)
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation; ▸ The effect of uncorrected misstatements related to prior periods; ▸ A request that any uncorrected misstatement be corrected; ▸ Corrected misstatements that are significant; and ▸ Material misstatements corrected by management	Audit Results Report (September 2020)
Fraud	▸ Enquiries of the Corporate Affairs and Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity; ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist; and ▸ A discussion of any other matters related to fraud	Audit Results Report (September 2020)
Related parties	▸ Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ▸ Non-disclosure by management; ▸ Inappropriate authorisation and approval of transactions; ▸ Disagreement over disclosures; ▸ Non-compliance with laws and regulations; and ▸ Difficulty in identifying the party that ultimately controls the entity	Audit Results Report (September 2020)

Required communications with the Corporate Affairs and Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence. Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: ▶ The principal threats; ▶ Safeguards adopted and their effectiveness; ▶ An overall assessment of threats and safeguards; and ▶ Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report (this report); and Audit Results Report (September 2020)
External confirmations	▶ Management's refusal for us to request confirmations; and ▶ Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report (September 2020)
Consideration of laws and regulations	▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off; and ▶ Enquiry of the Corporate Affairs and Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Corporate Affairs and Audit Committee may be aware of.	Audit Results Report (September 2020)
Internal controls	▶ Significant deficiencies in internal controls identified during the audit	Audit Results Report (September 2020); and Management Letter (September 2020)

Appendix B

Required communications with the Corporate Affairs and Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Representations	Written representations we are requesting from management and/or those charged with governance	Audit Results Report (September 2020)
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise.	Audit Results Report (September 2020)
Auditors report	Any circumstances identified that affect the form and content of our auditor's report.	Audit Results Report (September 2020)
Fee Reporting	▸ Breakdown of fee information when the audit plan is agreed; ▸ Breakdown of fee information at the completion of the audit; and ▸ Any non-audit work	Audit Planning Report (this report); and Audit Results Report (September 2020)
Certification work	Summary of certification work undertaken.	Certification Report (February 2021)

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	▶ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion; ▶ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control; ▶ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management; ▶ Concluding on the appropriateness of management's use of the going concern basis of accounting; ▶ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation; ▶ Reading other information contained in the financial statements, the Corporate Affairs and Audit Committee reporting appropriately addresses matters communicated by us to the Corporate Affairs and Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▶ Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines the level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

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