

Middlesbrough Council incorporating Teesside Pension Fund

Annual Audit Letter to the Members of the Council for the year ended 31 March 2015



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The big picture

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 2015. The letter is to be published on the Council’s website.

Below are the conclusions we have formed on the significant areas of the audit process.

The Council’s financial statements	We have issued an unqualified opinion on the Council’s financial statements for the year ended 31 March 2015.
The Council’s local government pension scheme annual report	We have issued an unqualified opinion on the Teesside Pension Fund annual report for the year ended 31 March 2015.
Value for money conclusion	We have issued a qualified conclusion on the Council’s arrangements for securing value for money for the year ended 31 March 2015. Further details relating to the qualification are discussed on page 6.
Whole of Government Accounts return	We have met the National Audit Office reporting deadline of 2 October 2015, reporting that the consolidated return is consistent with our audited statutory accounts and we have no errors in excess of the reporting threshold to report.
Grants certification	We undertake work on grant claims and other returns on behalf of the Audit Commission and provide certificates to grant funders regarding compliance with aspects of the terms on which funds have been granted. Grant procedures are currently ongoing in accordance with the agreed timetable. We will issue a separate annual report in respect of grants upon completion of this work, but at this stage there are no matters we wish to bring to your attention.
Statutory powers and duties	During September 2014 we received a formal objection to the 2013/14 accounts in respect of taxi license fee income. This objection was also made to the 2014/15 accounts. We issued a Statement of Reasons to the Council and the Objector on 15 September 2015, setting out our decision not to petition the Courts to have the income declared unlawful. The Objector then had 28 days to appeal against our decision. We are not aware of any such appeal being made, and in accordance with guidance issued by the National Audit Office, we issued our completion certificates on the 2013/14 and 2014/15 audits on the 19 October 2015.

1. Purpose and responsibilities

Purpose of this letter

The purpose of this Annual Audit Letter (“Letter”) is to summarise the key issues arising from the work that we have carried out during the year.

We have addressed this Letter to the members of the Council as it is the responsibility of the members to ensure that proper arrangements are in place for the conduct of its business and that the Council has relevant safeguards and properly accounts for public money.

The Letter will be published on the Public Sector Audit Appointments Limited website at www.psa.co.uk and should also be published on the Council’s website.

Responsibilities of the appointed auditor and the Council

Responsibilities of the appointed auditor

We have been appointed as the Council’s independent external auditors by the Audit Commission, the body responsible for appointing auditors to local public bodies in England, including local authorities.

As your appointed auditor, we are responsible for planning and carrying out an audit that meets the requirements of the Audit Commission’s Code of Audit Practice (the Code). Under the Code, we review and report on:

- the Council’s financial statements;
- the Council’s local government pension scheme annual report; and
- whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources (value for money conclusion) in respect of its local authority functions.

We also provide an assurance report to the National Audit Office on the financial information prepared by the Council for consolidation into the Whole of Government Accounts.

Responsibilities of the Council

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

As part of our procedures we have considered how the Council has fulfilled these responsibilities.

2. Financial reporting

Key issues arising from the audit of the Council's financial statements

We have issued a separate report to the Corporate Affairs and Audit Committee for the year ended 31 March 2015, which details the findings from our audit of the financial statements and the Council's value for money arrangements.

In that report we explained how we focused our work on areas which involve more complex accounting judgements and estimation. A summary of the significant risks identified as part of our audit is included below:

Significant audit risk	Conclusion
Grant income recognition	Grant income was identified as a significant audit risk due to the requirement for management to consider each type of grant individually to consider appropriate treatment, and the associated judgement in relation to this. Revenue grant income of £292.4m was recorded in the year (2013/14: £280.5m), with capital grant and contributions income of £14.9m (2013/14: £13.8m) being recognised. Our testing identified a number of adjustments, reducing revenue grant income recognised by £0.3m, and capital grant income by £3.5m. These adjustments did not impact on the availability of resources to the Council, but instead on the timing of the recognition of these resources.
Management override of controls	Auditing standards require us to consider the risk of management override of controls as a significant audit risk. Our testing identified one deficiency in internal controls in this area, in that year end adjustment journals were not reviewed by a second officer prior to posting. However, we did not identify any inappropriate journals being raised. We also did not identify any improper use of accounting estimates or judgements.
Valuation of Property, Plant and Equipment and Investment Properties	Property valuation was identified as a significant risk because of the size of the property balance in relation to the overall financial statements, and because any valuation is subject to estimates and assumptions. Our testing has concluded that, subject to two adjustments totalling £1.9m, the assumptions used in the valuation of the property portfolio are within an acceptable threshold. This represents an improvement on the prior year, where significant adjustments were required to the PPE and Investment Properties balances.
Disclosure of Related Party Transactions	The adequacy of disclosure of related party transactions was considered a significant audit risk following adjustments being required to the disclosure in previous years. Minor adjustments were made to clarify the disclosure and ensure consistency with underlying records.

Our report to the Corporate Affairs and Audit Committee also included a number of recommendations for improvement to the Council's systems and processes to improve its financial reporting in future years.

Key issues arising from the audit of the Pension Fund annual report

We reported our findings on the audit of the Pension Fund in a separate report to the Teesside Pension Fund and Investment Panel on 16 September 2015. No significant issues were identified in relation to the audit. A summary of the significant risks identified as part of our audit is included below:

Significant audit risk	Conclusion
Management override of controls	We have not identified any material weaknesses in controls or any evidence of management override. We have not identified any improper use of accounting estimates or judgements. One unusual transaction was identified, in relation to the bulk transfer of Probationary Trust members to Greater Manchester Pension Fund. This bulk transfer is part of the process to consolidate all Probationary Trust members in to one local government pension fund and no concerns were identified in relation to how this transaction has been accounted for.

2. Financial reporting (continued)

Key issues arising from the audit of the Pension Fund annual report (continued)

Significant audit risk	Conclusion (continued)
Contributions	Contributions income is a significant audit risk due to complexity of tiered employee contribution rates, changes to what qualifies as pensionable service and a new schedule of rates coming in to force in the year. Our testing concluded that contribution income recognised is appropriate.
Benefits	Benefits paid is a significant audit risk due to the complexity of benefits in retirement, as they accrue under both the historic scheme rules and the new career average section of the scheme, changes to revaluation and accrual rates and the complexity of calculation for ill health and death benefits. Our testing concluded that benefits paid are not materially misstated.
Investments	Investment valuations of certain investments have been identified as a risk because the valuation of unquoted funds is performed by the fund managers and prices for these investments are not publically available and direct property as the valuation is subject to estimates and assumptions. Our testing has concluded that investments held by the pension fund are not materially misstated.

Key issues arising from the work performed on the Whole of Government Accounts return

Whole of Government Accounts (WGA) are commercial-style accounts covering all the public sector and include some 1,700 separate bodies. Auditors appointed by the Audit Commission have a statutory duty under the Code of Audit Practice to review and report on the Council's WGA return. Our report is used by the National Audit Office ("NAO") for the purposes of their audit of the Whole of Government Accounts.

We reported to the National Audit Office on the WGA ahead of the October deadline. We reported that we consider the consolidation return to be consistent with the audited statutory accounts and that there are no uncorrected errors above £1m to report.

3. Value for Money

Background

Under the Code of Audit Practice 2010 we are required to include in our audit report a conclusion on whether Middlesbrough Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources - this conclusion is known as “the VFM conclusion”.

Specified criteria for auditors’ VFM conclusion

Focus of the criteria for 2015

The organisation has proper arrangements in place for securing financial resilience.

The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Audit work completed in respect of the Value for Money conclusion

We draw sources of assurance relating to our VFM responsibilities from:

- the Council’s system of internal control as reported on in its Annual Governance Statement;
- the results of the work of the Commission, other inspectorates and review agencies to the extent that the results come to our attention and have an impact on our responsibilities;
- any work mandated by the Commission – of which there was none in 2015; and
- any other locally determined risk-based VFM work that auditors consider necessary to discharge their responsibilities.

Significant risks

As part of our planning procedures we identified two significant risks to the Value for Money conclusion. These related to:

- financial planning, change programme and efficiency plans; and
- property disposals.

During the course of our testing, we identified an additional significant risk, relating to project management, being an area regarded by Internal Audit as a “Cause for Concern”.

Our ISA260 report, discussed by the Corporate Affairs and Audit Committee on 24 September 2015 contains details of the procedures performed and conclusions reached.

On the basis of the work performed, we issued a qualified opinion on the Council’s arrangements for securing Value for Money. We were satisfied with the Council’s arrangements, except for in three areas, being:

- project management arrangements;
- capital programme monitoring reports; and
- governance arrangements for the disposal of properties.

A copy of the text of the qualification is included on the next page.

3. Value for money conclusion (continued)

We issued a qualified VFM conclusion.

Our testing raised concerns over a number of inter-related issues in respect of project management, the disposal of property and the monitoring and reporting of the capital programme. On the basis of these findings we issued an “except for” qualification. Our VFM conclusion is set out below.

Basis of qualification

In considering the arrangements for securing economy, efficiency and effectiveness in the Authority's use of resources, we have considered:

- project management arrangements: an Internal Audit review concluded that the existing governance arrangements do not support the Council's vision and objectives; there is currently no effective overall programme management of the Council's portfolio of capital projects; and the Council has not established a project management framework together with associated procedures to be used by all officers engaged in project management assignments. The absence of the framework has had an adverse impact on the delivery of some key projects;
- capital programme monitoring reports: the reports to the Executive present the changes in planned spend, with extensive levels of spend being reprofiled into subsequent years, but no information is provided on the capital programme itself in terms of performance against budget or progress in the delivery of key strategic projects or the overall programme; and
- governance arrangements for the disposal of properties: although we have no evidence of value for money not being achieved in the sales price obtained for the disposal of properties, the lack of clear documentation in some cases, particularly in relation to decision-making, make it difficult to assess. The weaknesses in project management arrangements have also impacted this area.

The Council had previously identified the need for improvement in these areas and initiated action to address these issues. However the issues identified provide evidence that in 2014/15 the corporate governance arrangements did not operate in these instances to challenge how the Council secures economy, efficiency and effectiveness in its use of resources.

Qualified conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2014, with the exception of the matter reported in the basis for qualified conclusion paragraph above, we are satisfied that, in all significant respects, Middlesbrough Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2015.

5. Other matters

Background

Under the Audit Commission Act 1998, an elector for the Council has the right to appear before the auditor and make a formal objection to any item of account included within those financial statements. In September 2014, such an objection was made in respect of a number of issues relating to taxi license fees, requesting that we petition the Courts to have taxi license fee income deemed an unlawful item of account. This objection was made to the 2013/14 accounts, and repeated to the 2014/15 accounts.

Procedures performed

We conducted a review of all aspects of the objection to assess its substance. This review included the consideration of relevant legislation, supporting documentation, and legal advice received by the Council.

On the basis of the work performed, we issued a Statement of Reasons to the Council and the Objector, setting out our conclusions on 15 September 2015. Following the issue of our Statement of Reasons, the Objector had 28 days in which to appeal our decision. We are not aware of any such appeal being made, and in accordance with guidance issued by the National Audit Office, we issued out completion certificates on the 2013/14 and 2014/15 audits on the 19 October 2015.

Conclusions reached

We have concluded that the fees were not set in accordance with proper processes, but are exercising our discretion not to apply to the court to have the revenue arising declared unlawful; as we do not believe that to be in the interests of the taxpayer.

The 2013/14 taxi licence fees, which remained current in 2014/15, were set by an officer delegated decision in 2012 but the Council has been unable to provide evidence that sufficient financial information was taken into account when making that decision; and drivers licence fees were subsidised by operator and vehicle licence fees, contrary to s70 of the Local Government (Miscellaneous Provisions) Act 1976. It is also possible that the Council needed to pass a second resolution to adopt the 1976 Act in relation to Nunthorpe, following changes to the area for which the Council is responsible, although the position is very unclear and the Council believes this was not required.

Our reasons for not taking further action are fully set out in our Statement of Reasons, but key amongst them are:

- it is reasonable that fees are charged to cover reasonable costs;
- the Council has already taken steps to address the position; and
- the benefits, if there were any, would be disproportionate to the costs to public funds which would result.

We have made recommendations that:

- the Council reviews the guidance that officer delegated decisions to set charges do not require formal recording, to ensure such decisions are sufficiently transparent; and
- when officers are making delegated decisions in areas where the process is prescribed in legislation, legal advice is provided to ensure compliance with those requirements.

4. Purpose of our report and responsibility statement

What we report

Our report is designed to help the Council discharge its governance duties and includes:

- Results of our work on key audit judgements and our observations on the quality of your Financial Statements.
- Our value for money conclusion, based on work undertaken in response to our risk assessment and guidance issued by the Audit Commission in October 2014.
- Results of any other work undertaken in relation to our responsibilities and duties in line with the Audit Commission Act 1998 and Code of Audit Practice 2010.
- Any conclusion, opinion or comments expressed herein are provided within the context of our opinion on the financial statements and our conclusion on value for money as a whole, which was expressed in our auditors' report.

What we don't report

- As you will be aware, our audit is not designed to identify all matters that may be relevant to the Council.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by Officers or by other specialist advisers.
- Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

- The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body and in this report is prepared on the basis of, and our audit work is carried out, in accordance with that statement.
- This report should be read alongside the supplementary "Briefing on audit matters" circulated to you previously.

We welcome the opportunity to discuss our report with you and receive your feedback.



Deloitte LLP
Chartered Accountants

Leeds
30 October 2015

This report has been prepared for the Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

Appendix 1: Independence and fees

Independence confirmation	We confirm that we comply with APB Revised Ethical Standards for Auditors and that, in our professional judgement, we are independent and our objectivity is not compromised.
Non-audit services	In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	There are no other relationships with the Council and its known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.

	Current year £'000	Prior year £'000
Fees payable in respect of our work under the Code of Audit Practice in respect of Middlesbrough Council's annual accounts, assurance report on the Whole of Government accounts and the value of money conclusion (note 1)	154	159
Fees payable in respect of our audit of the Teesside Pension Fund (note 2)	29	37
Fees payable for the certification of grant claims (note 3)	10	17
Total fees payable in respect of our role as Appointed Auditor	193	213
Non audit fees (note 4)	10	57

Note 1:

The reduction in fee for the audit from the prior year represented an extension agreed with the Council and the Audit Commission to address the Value for Money risk around the role of the s151 officer. This is not required in 2014/15.

Note 2:

The audit fee for the Teesside Pension Fund for 2013/14 represents an increase in respect of delays experienced during the audit, as agreed with management.

Note 3:

The scale fee for 2014/15 is based on actual certification fees for 2011/12 adjusted to reflect the absence of NNDR3 certification and the exclusion of Council Tax Benefit from the Housing Benefit subsidy certification work. The reduction between the prior and current year is due to the end of the Tees Valley Bus Network Improvement (TVBNI) project, which no longer requires certification. The Commission accept that grants work varies year on year and the work in 2011/12 may not be representative of the work required in 2014/15 and hence an adjustment may be required once the 2014/15 work is complete. This is expected by the end of November 2015.

Note 4:

Non audit fees in the prior year includes fees in relation to work reviewing the Council's estates strategy conducted by colleagues from Deloitte Real Estate, work undertaking a review of Digital City, and in respect of additional work performed to support our Governance Review. Non-audit fees in 2014/15 consist of further work by Deloitte Real Estate, as well as review of the Council's Teachers' Pensions End of Year Certificate.

We have agreed additional fees with Council in respect of the 2013/14 objection and the 2014/15 Value for Money conclusion of £21k and £16k respectively. These will be agreed with PSAA in due course and confirmed to the Council.

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