

# Middlesbrough Council

Audit Results Report – ISA (UK and Ireland) 260  
for the year ended 31 March 2016

September 2016

Ernst & Young LLP



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## Contents

<b>1. Executive summary.....</b>	<b>1</b>
<b>2. Responsibilities and purpose of our work.....</b>	<b>3</b>
<b>3. Financial statements audit.....</b>	<b>4</b>
<b>4. Value for money .....</b>	<b>8</b>
<b>Appendix A – Corrected audit differences.....</b>	<b>11</b>
<b>Appendix B – Outstanding matters.....</b>	<b>12</b>
<b>Appendix C – Independence .....</b>	<b>13</b>
<b>Appendix D – Auditor fees .....</b>	<b>14</b>
<b>Appendix E – Draft audit report .....</b>	<b>15</b>
<b>Appendix F – Management representation letter .....</b>	<b>18</b>
<b>Appendix G – Required communications with the Corporate Affairs and Audit Committee</b>	<b>21</b>

In April 2015, Public Sector Audit Appointments Ltd (PSAA) issued the ‘Statement of responsibilities of auditors and audited bodies 2015-16’. It is available from the Chief Executive of each audited body and via the PSAA website ([www.psa.co.uk](http://www.psa.co.uk)).

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 from 1 April 2015’ 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 Audit Results Report is prepared in the context of the Statement of responsibilities. This report is intended solely for the use of the Members of the audited body. 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 Steve Varley, 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.

## 1. Executive summary

The National Audit Office's Code of Audit Practice ("the Code") requires us to report to those charged with governance, the Corporate Affairs and Audit Committee, on the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified. This report summarises the findings from the 2015/16 audit which is substantially complete. It includes messages arising from our audit of your financial statements and the results of the work we have undertaken to assess your arrangements to secure economy, efficiency and effectiveness in your use of resources.

Below are the results and conclusions on the significant areas of the audit process.

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### **Status of the audit**

We have substantially completed our audit of the financial statements of Middlesbrough Council for the year ended 31 March 2016. Subject to satisfactory completion of the outstanding items included in Appendix B, we will issue an audit opinion in the form which appears in Appendix E.

We have performed the procedures outlined in our Audit Planning Report and anticipate issuing an unqualified opinion on the Council's financial statements.

We expect to conclude that you have put in place proper arrangements to secure value for money in your use of resources, except for in relation to informed decision making. Further details relating to our work in this area are set out in Section 4, Value for Money, on page 9.

We have performed the procedures required by the National Audit Office (NAO) regarding the Whole of Government Accounts submission.

We expect to issue the audit certificate at the same time as the audit opinion.

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### **Audit differences**

Our audit identified some audit differences which our team highlighted to management for amendment. These have been corrected during the course of our work. We set out information regarding these amendments in Appendix A. There are no uncorrected audit differences to report.

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### **Scope and materiality**

In our External Audit Update Report, presented at the June 2016 Corporate Affairs and Audit Committee meeting, we communicated that our audit procedures would be performed using a materiality of £7.9m. We have reassessed this based on the actual results for the financial year and have performed our work using a materiality of £7.8m.

The threshold for reporting audit differences which impact the financial statements has reduced from £393,500 to £390,000.

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### **Significant audit risks**

We identified the following significant audit risks during the planning phase of our audit, and reported these to you in our Audit Planning Report and External Audit Update Report:

- Risk of management override of controls;
- Risk of fraud in revenue and expenditure recognition;
- Implementation of a new finance system; and
- Valuation of land and buildings.

The 'addressing audit risks' section of this report sets out how we have gained audit assurance over these risks.

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**Other reporting issues**

We have no other matters we wish to report.

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**Control observations**

We have adopted a fully substantive approach and have therefore not tested the operation of controls. However, we did identify four improvement recommendations in relation to management's financial processes and controls. These are set out in the 'control themes and observations' section of this report on page 7.

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



Nicola Wright

Executive Director  
For and on behalf of Ernst & Young LLP

## 2. Responsibilities and purpose of our work

### **The Council's responsibilities**

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

### **Purpose of our work**

Our audit was designed to:

- ▶ Express an opinion on the 2015/16 financial statements and the consistency of other information published with them;
- ▶ Report on an exception basis on the Annual Governance Statement;
- ▶ Consider and report any matters that prevent us being satisfied that the Council had put in place proper arrangements for securing economy, efficiency and effectiveness in the use of resources (the value for money conclusion); and
- ▶ Discharge our statutory duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

In addition, this report contains our findings related to the areas of audit emphasis and any views on significant deficiencies in internal control or the Council's accounting policies and key judgments.

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

### 3. Financial statements audit

#### Addressing audit risks

We identified the following audit risks during the planning phase of our audit, and reported these to you in our Audit Planning Report and External Audit Update Report. Here, we set out how we have gained audit assurance over those risks.

A significant audit risk in the context of the audit of the financial statements is an inherent risk with both a higher likelihood of occurrence and a higher magnitude of effect should it occur and which requires special audit consideration. For significant risks, we obtain an understanding of the Council's controls relevant to each risk and assess the design and implementation of the relevant controls.

Significant Risks (including fraud risks)	Audit procedures performed	Assurance gained and issues arising
<p><b>Risk of management override</b></p> <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<ul style="list-style-type: none"> <li>• Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements;</li> <li>• Reviewed accounting estimates for evidence of management bias; and</li> <li>• Evaluated the business rationale for any significant unusual transactions.</li> </ul>	<p>We have no matters to report arising from our work.</p>
<p><b>Risk of fraud in revenue and expenditure recognition</b></p> <p>Under ISA (UK and Ireland) 240, there is a presumed risk that revenue may be misstated due to improper recognition of revenue.</p> <p>In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p>	<ul style="list-style-type: none"> <li>• Reviewed and tested revenue and expenditure recognition policies;</li> <li>• Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias, including significant provisions and accruals, and criteria for recognition of grant income;</li> <li>• Developed a testing strategy to test material revenue and expenditure streams; and</li> <li>• Reviewed and tested revenue and expenditure cut-off at the period end date.</li> </ul>	<p>In the draft accounts, the Council had not made a provision for redundancies relating to the Leadership Team Review or business rates appeals. This was amended in the final accounts.</p> <p>We have no other matters to report arising from our work.</p>
<p><b>Implementation of a new finance system</b></p> <p>The Council have implemented a new financial system (Agresso) during 2015/16. As with any new system, there is a risk that it does not operate as expected and that data migrated to the new system is incomplete or inaccurately recorded. If either of these risks were to materialise, this could potentially lead to a material misstatement.</p>	<ul style="list-style-type: none"> <li>• Agreed the prior year closing trial balance, per SAP, to the opening trial balance, per Agresso;</li> <li>• Substantively tested the parallel running between SAP and Agresso to ensure that all transactions processed in SAP were transferred to Agresso; and</li> <li>• Reviewed the work performed by Tees Valley Audit &amp; Assurance Service.</li> </ul>	<p>No issues were identified from our sample testing of the migration of data.</p> <p>However we did identify that Council officers had limited involvement in the implementation of the new finance system, as this was led by Agresso. As a result, the Council had limited knowledge of the controls used to ensure the successful migration of data between systems.</p>

<p><b>Valuation of land and buildings</b></p> <p>Land and buildings is the most significant balance in the Council's Statement of Financial Position. The valuation of land and buildings is subject to a number of assumptions and judgements and even a small movement in these assumptions, could have a material impact on the accounts.</p>	<ul style="list-style-type: none"> <li>· Reviewed the output of the Council's valuer;</li> <li>· Challenged the assumptions used by the Council's valuer by reference to external evidence; and</li> <li>· Tested the journals for the valuation adjustments to check that they have been accurately processed in the accounts.</li> </ul>	<p>We have no matters to report arising from our work.</p>
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We also identified the following other audit risks during the planning phase of our audit, and reported these to you in our Audit Planning Report. Here, we set out how we have gained audit assurance over these other risks.

Other Risks	Audit procedures performed	Assurance gained and issues arising
<p><b>Accounting for pensions obligations</b></p> <p>Funding of the Council's participation in the local government pension scheme will continue to have an impact on both Council cash flows and balance sheet liabilities.</p> <p>The pension liability is the most significant liability on the Council's balance sheet and is calculated through use of a number of actuarial assumptions. A small movement in these assumptions could have a material impact on the balance sheet.</p>	<ul style="list-style-type: none"> <li>· Reviewed the output of the report from the Council's actuary;</li> <li>· Reviewed the assumptions used by the actuary to determine whether they are in our expected range; and</li> <li>· Tested the journal entries for the pensions transactions to check that they have been accurately processed in the accounts.</li> </ul>	<p>We have no matters to report arising from our work.</p>
<p><b>Grant recognition</b></p> <p>In the prior year, Deloitte reported that their testing of grants identified a number of errors in the application of the principles of grant recognition. This resulted in adjustments to the financial statements, reducing the amount of revenue grant income recognised by £325k, and the amount of capital grants and contributions recognised by £3.487m.</p>	<ul style="list-style-type: none"> <li>· Discussed with management the Council's significant grant funding streams and how these are accounted for; and</li> <li>· Tested a sample of grants through to terms and conditions to ensure that they are recognised correctly.</li> </ul>	<p>We have no matters to report arising from our work.</p>
<p><b>Financial statement close process</b></p> <p>In the previous year, Deloitte reported that there were a significant number of manual adjustments required between the final ledger balances and the draft financial statements. They recommended that, as part of the introduction of the new financial ledger system, changes are made to reduce the need for such off-ledger adjustments and streamline the financial reporting process.</p>	<ul style="list-style-type: none"> <li>· Reviewed the implementation of Agresso and considered the closedown process; and</li> <li>· Considered our experience of the closedown process in 2015/16.</li> </ul>	<p>We have no matters to report arising from our work.</p>

## Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we are required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process, including the following:

- ▶ Qualitative aspects of your accounting practices, estimates and disclosures;
- ▶ Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions;
- ▶ Any significant difficulties encountered during the audit; and
- ▶ Other audit matters of governance interest.

### **Disposal of asset in the course of construction**

During 2015/16, the Council treated as "disposed" an asset held in the course of construction of £3.2m. This relates to BoHo 5, where the Council is constructing the asset on behalf of the Homes and Communities Agency (HCA). The Council capitalised the costs of the construction work on its balance sheet in the prior year as it believed the asset would be owned by the Council on completion. However during 2015/16 on review of the agreement with the HCA, it was identified that the asset in fact would remain with the HCA. We understand that the construction costs are fully funded by the HCA. We recommend that lease agreements and contracts are reviewed prior to the commencement of building work so that the correct accounting treatment can be implemented at the start of a capital project.

### **Council Tax and Business Rates Income**

We noted that the Business Rates income disclosed in the taxation and non-specific grant income note was overstated by £1m and Council Tax income was understated by £1m, due to a classification error in the note. This has now been amended by management.

## **Provisions**

### ***Leadership Team***

The provisions note in the draft accounts did not include a balance for the senior officers made redundant as part of the Leadership Team review. As the decision relating to these redundancies was made and communicated before 31 March 2016, a provision for the costs should be made at year end. Management has made an adjustment of £0.1m in the final accounts to recognise this balance. These redundancies have also been added to the exit packages and officers' remuneration notes.

We also note that no provision or disclosure has been made at year end in respect of employment claims made against the Council. We have reviewed the legal advice received and agree that there is sufficient uncertainty for any provision to be required under accounting rules.

### ***Business Rates Appeals Provision***

We noted that the Council had used the full value of the business rates appeals provision in year. A new appeals provision of £0.5m was therefore recognised for future claims.

### **Other amendment to disclosures**

In addition to the above, we made a number of other amendments to disclosures in the accounts including:

- ▶ Amendment to the audit fee note to clarify fees relating to specific audit providers; and
- ▶ Amending segmental reporting for incorrect payroll values.

## Control themes and observations

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

We have adopted a fully substantive approach and have therefore not tested the operation of controls. We did identify four recommendations relating to:

- ▶ Improvements required in the process to approve earmarked reserves: we noted that at other councils, earmarked reserves are reviewed and approved at the end of each financial year. The introduction of this would help improve management's ability to challenge the reserves that are held by the Council.
- ▶ Payroll reconciliations between the payroll system and the general ledger not being carried out on a regular basis. The risk relating to non-performance of reconciliations is that errors are not picked up and corrected in a reasonable time period.
- ▶ The need to review new leases or contracts on a timely basis to determine accounting treatment prior to the commencement of capital spending as noted above.
- ▶ Council officers should have more involvement in the implementation of new systems in order to ensure that appropriate controls, which are relevant to the Council, are introduced. This refers to our review of the Agresso implementation.

We have reviewed the Annual Governance Statement and can confirm that it not misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Council.

## Request for written representations

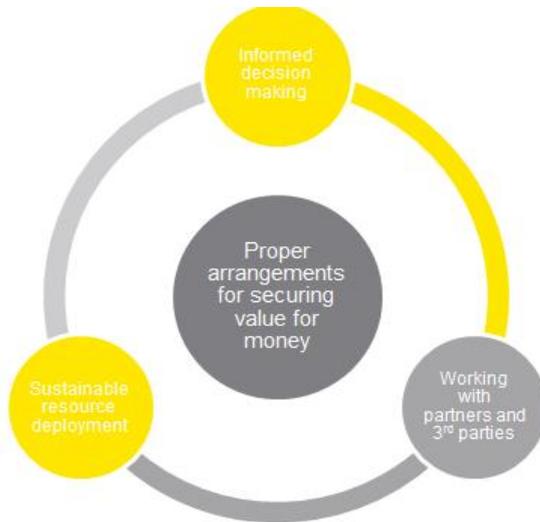
We have requested a management representation letter to gain management's confirmation in relation to a number of matters, as outlined in Appendix F.

## Whole of Government Accounts

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

We have no matters to report arising from this work.

## 4. 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. 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.

We identified three significant risks to the Value for Money opinion as follows:

Significant Risks	Audit procedures performed	Assurance gained and issues arising
<p><b>Project management and property disposals</b></p> <p>Deloitte’s prior year 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 they issued an “except for” qualification.</p> <p>The Council commissioned an investigation by TVAAS on Project Governance and Asset Disposal. TVAAS confirmed senior management concerns and provided a “Cause for Concern” opinion on the basis that “Major improvements need to be made to the Council’s project governance and asset disposal processes in order to ensure that the control environment is effective going forward”.</p> <p>On the basis of the conclusion provided by Deloitte, the follow up investigation performed by TVAAS and our discussions with senior management, we believe that the risk of achieving value for money in project management and property disposals remains.</p>	<ul style="list-style-type: none"> <li>· Reviewed the report produced by TVAAS during their Project Governance and Asset Disposal Investigation and discussed the findings with the Head of Internal Audit;</li> <li>· Reviewed the capital programme monitoring reports presented to members in year;</li> <li>· Reviewed the report by Deloitte on the Council Improvement Plan;</li> <li>· Discussed a sample of significant projects with management and considered any areas of weakness identified in the project management process; and</li> <li>· Considered our testing on fixed asset disposals in year.</li> </ul>	<p>We recognise the substantial efforts made by the Council to improve processes and have evidenced some improvements already taking place in 2016/17.</p> <p>Following the qualification received in September 2015, management undertook a planning process to identify the actions required to secure improvement, including commencement of a Leadership Team Review. Although we can see that progress has been made against the Council Improvement Plan, the majority of this progress has therefore occurred after 31 March 2016.</p> <p>During 2015/16, a decision was made to abort the implementation of the Agresso payroll module due to delivery and cost concerns. This demonstrates that project management still requires further strengthening.</p> <p>We remain concerned that there is a challenging series of actions for the Council to deliver over the next financial year, and a number of the solutions identified relate to implementing new IT systems, for example a new system to improve project management.</p> <p>There is a danger that staff become overwhelmed by the volume of new initiatives and actions.</p> <p>On the basis of the above findings, we have issued a qualified conclusion on value for money.</p>

<p><b>Financial resilience</b></p> <p>The Council faces a challenging set of financial circumstances, resulting from reductions in revenue made available from Central Government and additional budget pressures, including growing demand for services.</p> <p>Despite significant savings being made in previous years, further reductions in budgets are required in future years to ensure the Council can continue to provide its core services.</p> <p>The Council's budget for 2015/16 proposed reductions of £14.1m across the Council's nine strategic themes, with further budget reductions required in response to the £23m reduction in Revenue Support Grant over the next four years.</p> <p>In the previous year, Deloitte considered the level of the Council's reserves for adequacy, and noted no issues with the closing level of reserves.</p> <p>Due to changes in the scope of our value for money conclusion, we are required to undertake a wider review of the governance of the Medium Term Financial Plan ("MTFP"), including how the Council take informed decisions around planning savings.</p>	<ul style="list-style-type: none"> <li>· Reviewed the MTFP and considered the assumptions made in preparing the plan;</li> <li>· Met with officers to discuss the risks associated with the assumptions made; and</li> <li>· Considered the arrangements in place to monitor performance against the MTFP.</li> </ul>	<p>We note a balanced budget is forecast in the medium term.</p> <p>There is minimal reliance on contributions from reserves forecast in achieving the budget; however total useable reserves at 31 March 2016 stood at £51m and therefore there is flexibility to redirect some of this resource should it be required. Plans to utilise these balances are included in the MTFP.</p>
<p><b>Leadership Team Review</b></p> <p>The Mayor and Chief Executive presented a joint report to the Council on 6 January 2016 to seek approval for the proposed revision to the senior management structure.</p> <p>Whilst the Chief Executive believes that the basic senior management model is strong and performing well, "there are a number of changes and external influences that require the leadership team to be reviewed and its fitness for purpose re-examined".</p> <p>A number of changes to the Leadership Team have been proposed to address the risks identified. We will review the decision-making process and consider any implications for our value for money conclusion.</p>	<ul style="list-style-type: none"> <li>· Reviewed the proposed revision to the Leadership Team structure;</li> <li>· Reviewed legal advice received by the Council in respect of the restructuring process; and</li> <li>· Reviewed redundancy payments against contractual terms.</li> </ul>	<p>We note earlier in our report that amendments were made to the draft accounts to reflect the costs of redundancy.</p> <p>We have no other matters to report arising from our work.</p>

We have also considered the output of other internal audit reports, VfM profiles issued by PSAA, inspection reports and other sources of information and did not identify any additional VfM risks to our audit opinion.

## Overall conclusion

We identified significant weaknesses in the Council's arrangements relating to "informed decision making". We have therefore issued a qualified "except for" conclusion, as set out in Appendix E. The draft wording of our qualified conclusion is as follows:

### *Basis for Qualified Conclusion*

#### ► *Informed decision making*

*In 2014/15, Middlesbrough Council was the subject of a qualified conclusion, issued in September 2015. In 2015/16, the Authority established a Council Improvement Plan to address each area identified in the qualification, focussing on project management arrangements, capital programme monitoring reports and governance arrangements for the disposal of properties.*

*Although progress was made against this action plan in 2015/16, a number of significant actions remained incomplete as at 31 March 2016. Work commissioned during the year by the Authority from its internal auditor on project management and property disposal arrangements confirmed limited progress in strengthening these processes.*

### *Qualified conclusion*

*On the basis of our work, having regard to the guidance issued by the C&AG in November 2015, 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 2016.*

We therefore have concluded that you have put in place proper arrangements to secure value for money in your use of resources, except for the matters as outlined above.

## Appendix A – Corrected audit differences

Disclosure	Description of difference
Provisions – Leadership Team	Provision for redundancy costs created of £0.1m.
Provisions – Business Rates Appeals Provision	Provision for Business Rates Appeals created of £0.5m. This is recognised in the Business Rates Income value in the Taxation and Non Specific Grant Income note.
Council Tax and Business Rates income	Council Tax Income has increased by £1m and Business Rates Income decreased by £1m in the taxation and non-specific grant income note, following the amendment of a classification error.
Segmental reporting	Employee expenses value in note 41 – Amounts Reported for Resource Allocation Decisions has been reduced by £17.3m.
External audit costs	Amended to clarify fees paid to predecessor auditor

## Appendix B – Outstanding matters

The following items relating to the completion of our audit procedures are outstanding at the date of the release of this report.

Item	Actions to resolve	Responsibility
Management representation letter	Receipt of signed letter of representation	Management and Corporate Affairs and Audit Committee
Annual accounts	Approval of accounts by Corporate Affairs and Audit Committee	EY, management and Corporate Affairs and Audit Committee
Subsequent events review	Completion of the subsequent events procedures to the date of signing the audit report	EY and management

## Appendix C – Independence

We confirm there are no changes in our assessment of independence since our confirmation in our Audit Planning Report dated March 2016.

We complied with the Auditing Practices Board's Ethical Standards for Auditors and the requirements of the Public Sector Audit Appointments Ltd Terms of Appointment. 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 of regulatory and professional requirements.

We confirm that we are not aware of any relationships that may affect the independence and objectivity of the firm that we are required by auditing and ethical standards to report to you.

We consider that our independence in this context is a matter that should be reviewed by both you and ourselves. It is therefore important that you consider the facts of which you are aware and come to a view. If you wish to discuss any matters concerning our independence, we will be pleased to do so at the forthcoming meeting of the Corporate Affairs and Audit Committee in September 2016.

We confirm that we have met the reporting requirements to the Corporate Affairs and Audit Committee, as 'those charged with governance' under International Standards on Auditing (UK and Ireland) 260 – Communication with those charged with governance. Our communication plan to meet these requirements was set out in our Audit Planning Report of March 2016.

## Appendix D – Auditor fees

The table below sets out the scale fee and our final proposed audit fees.

Description	Proposed final Fee 2015/16 £	Scale Fee 2015/16 £
Total Audit Fee - Code work	115,037	115,037
Certification of claims and returns	10,571	10,571

Our actual fee is in line with the scale fee set by the PSAA, subject to satisfactory clearance of the outstanding work.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

## Appendix E – Draft audit report

### Independent auditor's report to the members of Middlesbrough Council

#### Opinion on the Authority's financial statements

We have audited the financial statements of Middlesbrough Council for the year ended 31 March 2016 under the Local Audit and Accountability Act 2014. The financial statements comprise the:

- Movement in Reserves Statement;
- Comprehensive Income and Expenditure Statement;
- Balance Sheet;
- Cash Flow Statement; and
- Collection Fund and the related notes.

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

This report is made solely to the members of Middlesbrough Council, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

#### Respective responsibilities of the Chief Financial Officer and auditor

As explained more fully in the Statement of the Chief Financial Officer's Responsibilities set out on page 12, the Chief Financial Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

#### Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Financial Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Statement of Accounts 2015/16 to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

### **Opinion on financial statements**

In our opinion the financial statements:

- give a true and fair view of the financial position of Middlesbrough Council as at 31 March 2016 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

### **Opinion on other matters**

In our opinion, the information given in the Annual Statement of Accounts 2015/16 for the financial year for which the financial statements are prepared is consistent with the financial statements.

### **Matters on which we report by exception**

We report to you if:

- in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Council;
- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects.

## **Conclusion on Middlesbrough Council's arrangements for securing economy, efficiency and effectiveness in the use of resources**

### **Authority's responsibilities**

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

### **Auditor's responsibilities**

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office (NAO) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

### **Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources**

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General (C&AG) in November 2015, as to whether Middlesbrough Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether Middlesbrough Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2016.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, Middlesbrough Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

### **Basis for qualified conclusion**

- Informed decision making

In 2014/15, Middlesbrough Council was the subject of a qualified conclusion. In 2015/16, the Authority established a Council Improvement Plan to address each area identified in the qualification, focussing on project management arrangements, capital programme monitoring reports and governance arrangements for the disposal of properties.

Although progress was made against this action plan in 2015/16, a number of significant actions remained incomplete as at 31 March 2016. Work carried out during the year by the Authority's internal auditor on project management and property disposal arrangements highlighted limited progress in strengthening these processes.

### **Qualified conclusion**

On the basis of our work, having regard to the guidance issued by the C&AG in November 2015, 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 2016.

### **Certificate**

We certify that we have completed the audit of the accounts of Middlesbrough Council in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice issued by the National Audit Office.

Nicola Wright (senior statutory auditor)

for and on behalf of Ernst & Young LLP, Appointed Auditor

Newcastle upon Tyne

29 September 2016

## Appendix F – Management representation letter

To be prepared on Middlesbrough Council's letterhead

[Date]

Ernst & Young LLP  
Citygate  
St James' Boulevard  
Newcastle upon Tyne  
NE1 8HW

This letter of representations is provided in connection with your audit of the financial statements of Middlesbrough Council ("the Council") for the year ended 31 March 2016. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the financial statements give a true and fair view of the Council financial position of Middlesbrough Council as of 31 March 2016 and of its income and expenditure for the year then ended in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

We understand that the purpose of your audit of our financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK and Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

### **A. Financial Statements and Financial Records**

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.
2. We acknowledge, as members of management of the Council, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of the financial position, financial performance (or results of operations) and cash flows of the Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16. We have approved the financial statements.
3. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.
4. As members of management of the Council, we believe that the Council has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16, that are free from material misstatement, whether due to fraud or error.
5. There are no unadjusted audit differences identified during the current audit and pertaining to the latest period presented.

### **B. Fraud**

1. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
2. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
3. We have disclosed to you all significant facts relating to any frauds, suspected frauds or allegations of fraud known to us that may have affected the Council (regardless of the source or form and including, without limitation, allegations by “whistle-blowers”), whether involving management or employees who have significant roles in internal control. Similarly, we have disclosed to you our knowledge of frauds or suspected frauds affecting the entity involving others where the fraud could have a material effect on the financial statements. We have also disclosed to you all information in relation to any allegations of fraud or suspected fraud communicated by employees, former employees, analysts, regulators or others, that could affect the financial statements.

### **C. Compliance with Laws and Regulations**

1. We have disclosed to you all identified or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.

### **D. Information Provided and Completeness of Information and Transactions**

1. We have provided you with:
  - ▶ Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - ▶ Additional information that you have requested from us for the purpose of the audit; and
  - ▶ Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
2. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
3. We have made available to you all minutes of the meetings of the Council and committees (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the period to the most recent meeting on the following date: 29 September 2016.
4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Council’s related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the period end. These transactions have been appropriately accounted for and disclosed in the financial statements.
5. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.
6. We have disclosed to you, and the Council has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

### **E. Liabilities and Contingencies**

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.

2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent.

**F. Subsequent Events**

1. There have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

**Use of the Work of a Specialist**

We agree with the findings of the specialists that we engaged to evaluate the valuation of land and buildings and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.

Yours faithfully,

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Chief Financial Officer

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Chairman of the Corporate Affairs and Audit Committee

## Appendix G – Required communications with the Corporate Affairs and Audit Committee

There are certain communications that we must provide to those charged with governance of UK clients. These are detailed here:

Required communication	Reference
<p><b>Planning and audit approach</b></p> <p>Communication of the planned scope and timing of the audit, including any limitations.</p>	Audit Planning Report
<p><b>Significant findings from the audit</b></p> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> </ul>	Audit Results Report
<p><b>Going concern</b></p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	No conditions or events were identified, either individually or in aggregate, that indicated there could be doubt about the Council's ability to continue as a going concern for the 12 months from the date of our report.
<p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ In writing, corrected misstatements that are significant</li> </ul>	Audit Results Report
<p><b>Fraud</b></p> <ul style="list-style-type: none"> <li>▶ Enquiries of the Corporate Affairs and Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	We have made enquiries of management. We have not become aware of any fraud or illegal acts during our audit.
<p><b>Related parties</b></p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	We have no matters we wish to report.

Required communication	Reference
<p><b>External confirmations</b></p> <ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	We have received all requested confirmations.
<p><b>Consideration of laws and regulations</b></p> <ul style="list-style-type: none"> <li>▶ 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</li> <li>▶ 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</li> </ul>	We have not identified any material instances of non-compliance with laws and regulations.
<p><b>Independence</b></p> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats</li> <li>▶ Safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	Audit Planning Report and Audit Results Report
<p><b>Significant deficiencies in internal controls identified during the audit</b></p>	Audit Results Report
<p><b>Fee Information</b></p> <ul style="list-style-type: none"> <li>▶ Breakdown of fee information at the agreement of the initial audit plan</li> <li>▶ Breakdown of fee information at the completion of the audit</li> </ul>	Audit Planning Report Audit Results Report
<p><b>Certification work</b></p> <ul style="list-style-type: none"> <li>▶ Summary of certification work undertaken</li> </ul>	Certification Report – to be issued

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