



# Annual Audit Letter

Stockton-on-Tees Borough Council  
Year ended 31 March 2019





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Our reports are prepared in the context of the 'Statement of responsibilities of auditors and audited bodies' issued by Public Sector Audit Appointments Ltd. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the Council and we take no responsibility to any member or officer in their individual capacity or to any third party.

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# 1. EXECUTIVE SUMMARY

## Purpose of the Annual Audit Letter

Our Annual Audit Letter summarises the work we have undertaken as the auditor for Stockton-on-Tees Borough Council (the Council) and the Stockton-on-Tees Borough Council Group (the Group) for the year ended 31 March 2019. Although this letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (the NAO). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of responsibility	Summary
Audit of the financial statements	<p>Our auditor's report issued on 29 July 2019 included our opinion that the financial statements:</p> <ul style="list-style-type: none"><li>• give a true and fair view of the Council's and Group's financial position as at 31 March 2019 and of the Council's and Group's expenditure and income for the year then ended; and</li><li>• have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.</li></ul>
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 29 July 2019 included our opinion that:</p> <ul style="list-style-type: none"><li>• The other information in the Statement of Accounts is consistent with the audited financial statements.</li></ul>
Value for Money conclusion	<p>Our auditor's report concluded that we are satisfied that in all significant respects, the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.</p>
Reporting to the group auditor	<p>In line with group audit instructions issued by the NAO, on 29 July 2019 we reported to the group auditor in line with the requirements applicable to the Council's WGA return.</p>
Statutory reporting	<p>Our auditor's report confirmed that we did not use our powers under s24 of the 2014 Act to issue a report in the public interest or to make written recommendations to the Council.</p>

## 2. AUDIT OF THE FINANCIAL STATEMENTS

Opinion on the financial statements

Unqualified

### The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Council and Group, and whether they give a true and fair view of the Council's and Group's financial position as at 31 March 2019 and of the Council's and Group's financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Council's and Group's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

Our auditor's report, issued to the Council on 29 July 2019, stated that, in our view, the financial statements give a true and fair view of the Council's and Group's financial position as at 31 March 2019 and of the Council's and Group's financial performance for the year then ended.

### Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit and Governance Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2019:

Financial statement materiality	Our financial statement materiality is based on 2% of Gross Operating Expenditure at the surplus or deficit on provision of services level.	Council: £9.417m Group: £9.426k
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	Council: £282k Group: £282k
Specific materiality	We have applied a lower level of materiality to the following areas of the accounts: - Members allowances - Senior manager remuneration - Exit packages	£173k £165k £501k

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## 2. AUDIT OF THE FINANCIAL STATEMENTS

### Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's and Group's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit and Governance Committee within the audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Identified significant risk	Our response	Our findings and conclusions
<p><b>Management override of controls (Council and Group)</b></p> <p>In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.</p>	<p>We addressed this risk through performing audit work over:</p> <ul style="list-style-type: none"> <li>Accounting estimates impacting on amounts included in the financial statements;</li> <li>Consideration of identified significant transactions outside the normal course of business; and</li> <li>Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.</li> </ul>	<p>Our audit work provided the assurance we sought and did not identify any material issues.</p>
<p><b>Property, Plant and Equipment Valuation (Council)</b></p> <p>The financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Council's holding of PPE. Although the Council employs an internal valuation expert to provide information on valuations, there remains a high degree of estimation uncertainty associated with the revaluation of PPE due to the significant judgements and number of variables involved in providing revaluations. We have therefore identified the revaluation of PPE to be an area of risk.</p>	<p>We considered the Council's arrangements for ensuring that PPE values are reasonable and engaged our own expert to provide data to enable us to assess the reasonableness of the valuations provided by the Council's valuer. We also assessed the competence, skills and experience of the valuer.</p> <p>We also performed further audit procedures on individual assets to ensure that the basis and level of revaluation is appropriate.</p>	<p>Our audit work provided the assurance we sought and did not identify any material issues.</p>

## 2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p><b>Defined benefit liability valuation (Council)</b></p> <p>The financial statements contain material pension entries in respect of the retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.</p>	<p>We discussed with key contacts any significant changes to the pension estimates. In addition to our standard programme of work in this area, we evaluated the management controls you have in place to assess the reasonableness of the figures provided by the Actuary and considered the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned annually by the NAO.</p> <p>We also considered some national issues arising that impact on pension entries, including what has become known as the 'McCloud legal case'.</p>	<p>Our audit work provided the assurance we sought. The material change relating to the impact of the McCloud legal case on pension liabilities is a national issue and the Council has adjusted the accounts.</p>

### Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls.

Our work did not identify any significant deficiencies to report.



### 3. VALUE FOR MONEY CONCLUSION

**Value for Money conclusion**

**Unqualified**

#### Our approach to Value for Money

We are required to consider whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, 'in all significant respects, the 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.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

Our auditor's report, issued to the Council on 29 July 2019, stated that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31<sup>st</sup> March 2019

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<ul style="list-style-type: none"> <li>• Constitution in place which is available on the Council's website.</li> <li>• Council plan in place for the period 2018 to 2021, and on the Council's website.</li> <li>• Leader's retrospective annual review undertaken.</li> <li>• Management team revised in 2016 to adapt to the Council's future plans, and to revised again in 2019 on departure of previous Chief Executive.</li> <li>• No data quality issues in respect of performance information we are aware of.</li> <li>• Regular reporting to 'Those charged with governance' of performance and financial information, including variances.</li> <li>• Medium Term Financial Plan (MTFP) updated at least annually as part of budget setting. Medium term planning undertaken and plans in place; i.e. Council Plan 2018/2021 and MTFP, and which are updated at least annually. Mid-year report to Cabinet also sets out position on MTFP and impact for future years.</li> <li>• Regular and timely reporting to members.</li> <li>• Risk register and risk management arrangements in place. Risks reported to Audit Committee and regular reporting by Internal Audit.</li> <li>• Annual governance statement prepared, reviewed and approved by Members.</li> </ul>	Yes



### 3. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment	<ul style="list-style-type: none"> <li>Financial and performance reports record achievement in meeting financial targets.</li> <li>Need to transform services to reduce costs recognised.</li> <li>MTFP updated at least annually as part of budget setting and progress monitoring undertaken including achieving savings targets.</li> <li>Asset register in place and Capital Strategy in place.</li> <li>Smarter Working Programme incorporates use of assets/estate.</li> <li>HR policies and procedures in place.</li> <li>Sickness information and reports are provided to Corporate Management Team, Human Resources Service Group and Assistant Directors.</li> </ul>	Yes
Working with partners and other third parties	<ul style="list-style-type: none"> <li>Examples of partnership working in place to reduce costs and improve service delivery.</li> <li>Better Care Fund in place with Health and Wellbeing Board having oversight and receiving quarterly updates.</li> <li>Council plan in place for the period 2018 to 2021, and on the Council's website.</li> <li>Council has written procedures for procuring products and services, which are within its Constitution (part 3).</li> </ul>	Yes



### 3. VALUE FOR MONEY CONCLUSION

#### Significant Value for Money risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to the Value for Money conclusion exists. Risk, in the context of our Value for Money work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Council being inadequate. In our Audit Completion Report, we reported that we had identified one significant Value for Money risk. The work we carried out in relation to significant risk is outlined below.

Risk	Work undertaken	Conclusion
<p>Sustainable resource deployment</p> <p>Our audit work in previous years has concluded that the Council has robust arrangements in place for Medium Term Financial Planning. The Council continues to face financial pressure in the coming years and the Council is currently updating its medium term financial plan (MTFP).</p> <p>We need to ensure our knowledge of the Council's MTFP arrangements and its monitoring of the planned delivery of savings, remains up to date in order to ensure we give the correct VFM conclusion.</p>	<p>Building on our work in previous years, we:</p> <ul style="list-style-type: none"> <li>reviewed the Council's updated 2019/2020 MTFP to ensure it reflects the latest funding position from central government; and</li> <li>reviewed and updated our knowledge of the arrangements the Council has in place to monitor progress against its savings plans that underpin the MTFP.</li> </ul> <p>We found that the latest MTFP, issued in February 2019, reports the significant changes that could lead from national reviews of future funding arrangements that are not yet finalised, and as such the funding position in the medium term remains uncertain.</p> <p>The overall position for the Council based on known factors and current plans is a budget gap of circa £3.7m from 2020/21. Officers are looking at plans to address this gap for members consideration. The Council recognises that delivering savings is becoming ever more challenging.</p> <p>The Council has adequate reserves in the medium term, including £73m in useable revenue reserves at the end of March 2019. In the context of this level of reserves, this budget gap is manageable. Although there is no room for complacency, our experience is that the Council has a history of delivering its savings plans, and reserves are used only when necessary and when planned as part of the agreed MTFP.</p>	<p>We updated our knowledge of the arrangements the Council has in place, and our work has mitigated the risk we identified at the planning stage. The MTFP reflects the latest Government announcements, and arrangements to monitor savings plan delivery are adequate.</p> <p>We note that action is needed to address the budget gap over the medium term, and this needs to be an important priority for the Council.</p>



## 4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of group audit reporting requirements	Below testing threshold
Other information published alongside the audited financial statements	Consistent

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

### Matters on which we report by exception

The 2014 Act provides us with specific powers where matters come to our attention that, in our judgement, require reporting action to be taken. We have the power to:

- Issue a report in the public interest;
- make statutory recommendations that must be considered and responded to publicly;
- apply to the court for a declaration that an item of account is contrary to law; and
- issue an advisory notice under schedule 8 of the 2014 Act.

We have not exercised any of these statutory reporting powers.

The 2014 Act also gives rights to local electors and other parties, such as the right to ask questions of the auditor and the right to make an objection to an item of account. We did not receive any such objections or questions.

### Reporting to the NAO in respect of Whole of Government Accounts consolidation data

The NAO, as group auditor, requires us to complete the WGA Assurance Statement in respect of its consolidation data. We submitted this information to the NAO on 29 July 2019.

### Other information published alongside the financial statements

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the other information in the Statement of Accounts is consistent with the audited financial statements.

## 5. OUR FEES

### Fees for work as the Council's auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to the Audit and Governance Committee in February 2019.

We have completed our work for the 2018/19 financial year, but at the time of producing this report, we have not yet finalised our audit fees for the year. If the final fee varies from that in the table below, we will write to the Chief Financial Officer setting out the proposed variation and any reasons for the variation, and seeking agreement to it. Any variations to the final fee will also require the approval of Public Sector Audit Appointments Limited, which manages the contracts for our work.

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£100,824 plus VAT*	£100,824 plus VAT**

\* As reported in our Audit Strategy Memorandum in February 2019.

\*\* Please note that at the time of producing this report, the audit fee for 2018/19 has not yet been finalised.

### Fees for other assurance work

We have been engaged to carry out non-audit work in relation to the Council's housing benefit subsidy claim for 2018/19 and we have also undertaken the assurance work in relation to teachers' pensions for 2017/18 in the period since we issued our 2017/18 Annual Audit Letter.

Area of work	2018/19 proposed fee	2018/19 final fee
Housing Benefit Subsidy Claim (2018/19 claim)	£9,900 plus VAT	£9,900 plus VAT ***
Teachers' Pensions Claim (2017/18 claim)	£3,850 plus VAT	£3,850 plus VAT

\*\*\* our work is ongoing and is not due for completion until November 2019 in line with the national timetable for this work.

We expect to be engaged to undertake the assurance work in relation to teachers' pensions for 2018/19, although this has not been confirmed at the time of preparing this report.

### Fees for non audit/assurance work

Non-audit work has been undertaken in the period since we issued our 2017/18 Annual Audit Letter totalling £3,480 plus VAT, which includes ad hoc VAT and tax advice. This is undertaken by the firm's specialist tax teams and is separate from the audit team.

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## 6. FORWARD LOOK

### Financial outlook

It is clear that the Council faces some of the most difficult decisions it has ever faced in balancing the budget going forwards. Although the Council does have reserves available to minimise the immediate impact, in accordance with the Council's own strategy, these are a temporary or transitional cushion while the savings needed are identified and delivered. The key message from those councils that have already faced a financial crisis, such as Northamptonshire and others, is the importance of taking early action to secure financial sustainability before the position becomes unmanageable.

The position beyond 2019/20 is very uncertain as much depends on the outcome of the comprehensive spending review, fair funding review and the measures that will be taken in relation to the future operation of the business rates system.

However, it seems unlikely that the overall financial position for the Council will improve sufficiently to allow it to defer any of the difficult decisions needed. Decisive action to bridge the budget gap over the medium term is a key priority for the Council.

### How we will work with the Council

We will focus our work on the risks that your challenges present to your financial statements and your ability to maintain proper arrangements for securing value for money.

In the coming year we will continue to support the Council by:

- continued liaison with the Council's Internal Auditors to minimise duplication of work;
- attending Audit and Governance Committee meetings and presenting an Audit Progress Report including updates on regional and national developments; and
- hosting events for staff, such as our Local Government Accounts workshop.

We will meet with key Council officers to identify any learning from the 2018/19 audit and will continue to share our insights from across local government and relevant knowledge from the wider public and private sector.

In terms of the technical challenges that officers face around the production of the statement of accounts, we will continue to work with them to share our knowledge of new accounting developments and we will be on hand to discuss any issues as and when they arise.

The Council has taken a positive and constructive approach to our audit and we wish to thank Members and officers for their support and co-operation during our audit.

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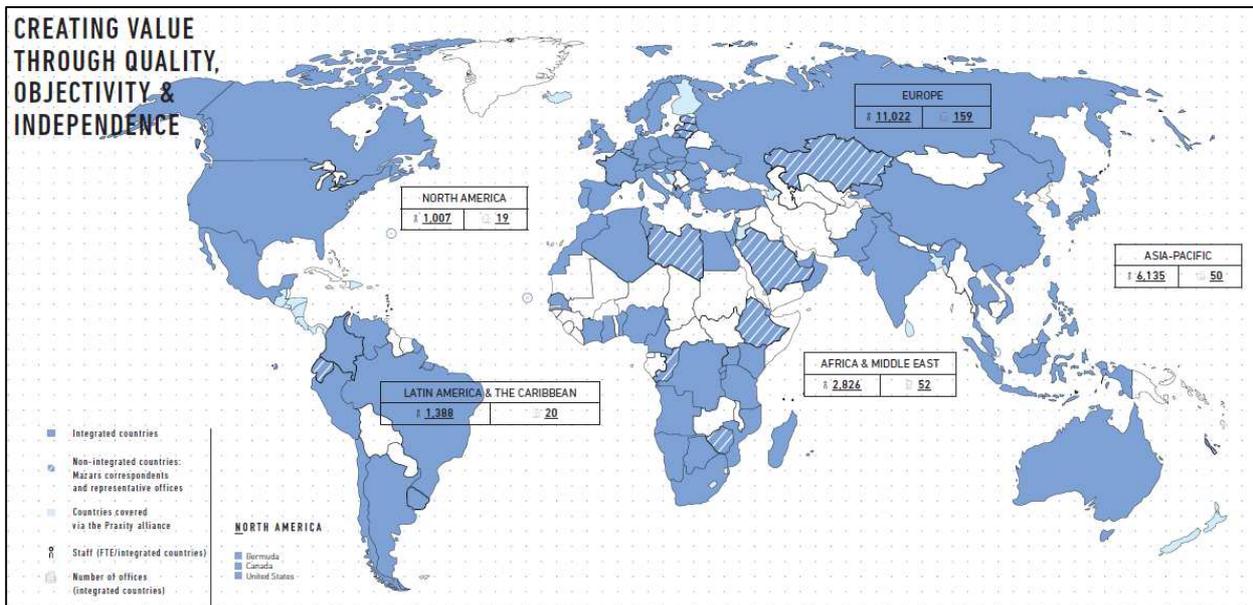
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# MAZARS AT A GLANCE

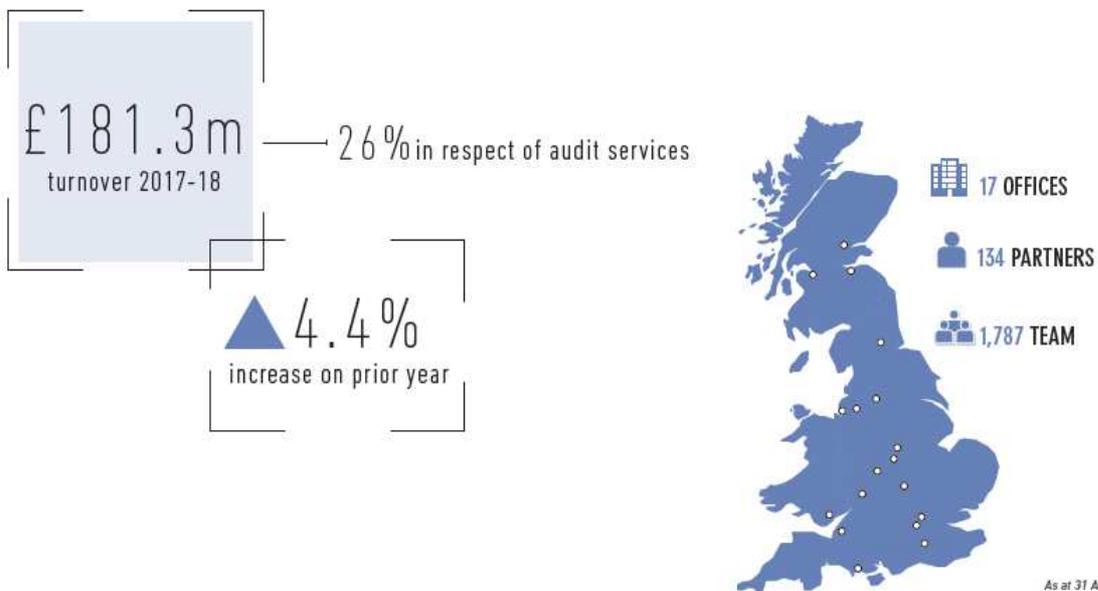
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