Annual Audit Letter

South Tees Development Corporation (and Group)

Year ended 31 March 2019

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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 South Tees Development Corporation (the Corporation) and the South Tees Development Corporation Group (the Group) for the year ended 31 March 2019. Although this letter is addressed to the Corporation, 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	Our auditor's report issued on 25 July 2019 included our opinion that the financial statements: • give a true and fair view of the Corporation's and Group's financial position as at 31 March 2019 and of the Corporation's and Group's 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 2018/19.
Other information published alongside the audited financial statements	Our auditor's report issued on 25 July 2019 included our opinion that: • The other information in the Statement of Accounts is consistent with the audited financial statements.
Value for Money conclusion	Our auditor's report concluded that we are satisfied that in all significant respects, the Corporation has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.
Reporting to the NAO as group auditor	The Corporation is classed as a minor body, and as such does not complete a WGA return. As such, we have not reviewed a return for the Corporation for 2018/19.
Statutory reporting	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 Corporation.

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 Corporation and Group and whether they give a true and fair view of the Corporation's and Group's financial position as at 31 March 2019 and of the Corporation'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 Corporation'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 Corporation on 25 July 2019, stated that, in our view, the financial statements give a true and fair view of the Corporation's and Group's financial position as at 31 March 2019 and of the Corporation'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 Risk 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.	Corporation: £54.6k Group: £74.8k
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	Corporation: £1.6k Group: £2.2k
Specific materiality	We did not identify any areas where we considered that a specific materiality level should apply.	~

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 Corporation's and Group's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit and Risk 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
Management override of controls (Corporation and Group) 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.	We addressed this risk through performing audit work over: • Accounting estimates impacting on amounts included in the financial statements; • Consideration of identified significant transactions outside the normal course of business; and • Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.	Our work provided the assurance we sought in each of these areas and did not highlighted any material issues.
Property, plant and equipment valuation (Group) The 2018/19 Group financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Group PPE. The Corporation engaged a 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 therefore identified the revaluation of PPE to be an area of risk.	We considered the reasonableness of the chosen classification category of the PPE under the Cipfa Code. We assessed the competence, skills and experience of the Corporation's valuer, and due to the nature of the asset being valued we also engaged our own expert to enable us to assess the reasonableness of the valuation provided by the Corporation's valuer.	We concluded that the classification category chosen by management, being operational PPE was not unreasonable. After issuing our initial enquiries to the Corporation's valuer, we were advised that the valuation report was to be updated. This resulted in a revised valuation of £12m (from £15m that had been included in the draft financial statements published on 31 May 2019). Our expert valuer reviewed the basis of the Corporation's valuer's updated valuation, including supporting information, and based on their findings we concluded that, taking into account the valuation is an accounting estimate, it was not unreasonable.
Defined benefit liability valuation (Corporation and Group) 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.	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. We also considered national pensions issues arising.	Our work provided the assurance we sought and did not highlight any material issues. Our work identified no indication of material estimation error in respect of pensions.

2. AUDIT OF THE FINANCIAL STATEMENTS

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. We identified the following deficiencies in internal control as part of our audit.

Description of deficiency	The Corporation's control framework failed to identify in a timely manner a transaction that was enacted by a member of staff that was deemed to be acting outside of their powers.
Potential effects	Potential inappropriate and unauthorised expenditure.
Recommendation	The Corporation needs to implement controls to ensure such a recurrence cannot occur.
Management response	The necessary controls are in place. All transactions are reviewed, including ensuring all expenditure is budgeted for, is assigned to a budgeted purchase order, and has been undertaken within the necessary authorisations. A detailed & analysed budget to actual variance report is presented to the new monthly financial review meeting and exceptional variances are reported to the Board. HR forms including new starters and exceptional payments are signed by Head of Finance and there is further scrutiny of recruitment by the Search & Remuneration Committee The above controls will also be the subject of review by internal audit.

Description of deficiency	On identifying the issue of the termination payment, the Corporation did not take advice from its own Monitoring Officer on a timely basis to gain assurance it was acting within its powers.
Potential effects	Potential inappropriate and illegal expenditure.
Recommendation	The Corporation needs to ensure it takes advice from its Monitoring Officer on a timely manner where there is uncertainty around whether it is acting within its powers.
Management response	Formal Monitoring Officer advice will be requested in the future.

2. AUDIT OF THE FINANCIAL STATEMENTS

Description of deficiency	The Corporation did not have an SLA in place that covered the charging arrangements between itself and South Tees Site Company for the Chief Executive and PA.
Potential effects	Lack of clarity about respective responsibilities of each organisation, and the staff member.
Recommendation	Where staff are shared between organisations, SLAs should be in place to clearly set out the relevant responsibilities and cost sharing arrangements.
Management response	This was an oversight as the arrangements were long standing. There are SLAs in place in future and management will ensure that these included all relevant arrangements.

Description of deficiency	Loan agreements for the intra group loans between Tees Valley Combined Authority, the Corporation, and South Tees Developments Limited were not put in place and signed until July 2019.
Potential effects	Lack of clarity about responsibilities and obligations between the different group organisations, including payment terms if signed agreements are not in place.
Recommendation	If funds are made available to other bodies in the group, this should be underpinned by formal agreements, which should be signed at the time the funds are released.
Management response	Whilst we recognise that funding agreements should be in place, this is an inter group loan where the terms were agreed between the parties at the time albeit not documented. We will endeavour to ensure that such loans are documented contemporaneously in future.

3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion	Unqualified

Our approach to Value for Money

We are required to consider whether the Corporation 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 Corporation 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 Corporation on 25 July 2019, stated that, in all significant respects, the Corporation put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31st March 2019

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	• Constitution in place, available on the Corporation's website, which includes financial regulations, Delegation to officers and Code of Conduct. • Corporation has put in place a Master Plan which details the plan in place for the redevelopment and regeneration of the South Tees site. • Board with elected Mayor of Tees Valley Combined Authority (TVCA), leaders of the 2 local authorities and other members from the wider business community, South Tees Site Company Ltd (STSC) and LEP/TVCA board members. • Management team in place (with links to STSC) and DoF (also DoF of TVCA). • No data quality issues in respect of performance information we are aware of. • Audit and Risk Committee meets on a regular basis, which oversees internal and external audit, and has spent considerable time this year reviewing the Corporation's arrangements for risk management. • Internal audit function in place. • 2018/19 and 2019/20 budgets in place. • Periodic reporting to Board in the year. • Risk management arrangements developed in the year, which is ongoing.	Yes

3. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment	• Master Plan and Financial Plan in place (within known funding timescales). Longer term financial plans to be developed when funding timescales are clarified. • Master Plan identifies future large scale capital schemes/priorities. • Risk management of capital asset purchased in the year evident from reporting to Board and the Audit and Risk Committee. • HR/payroll functions provided by Stockton BC (Xentrall). • Finance function supported by TVCA.	Yes
Working with partners and other third parties	• Master Plan details the key strategic plans and priorities and how it will work with partners to develop the South Tees Site. • The Corporation has written procedures for procuring products and services, which are within its Constitution.	Yes

The Corporation continues to grow and develop and we have seen arrangements change since 2017/18 as it has done so. Management and the Board will need to continue to ensure that arrangements and policies and procedures for securing economy, efficiency and effectiveness in its use of resources remain under review and are adjusted appropriately as the organisation continues to grow and becomes ever more complex.

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 Corporation being inadequate. In our Audit Completion Report, we reported that we had not identified any significant Value for Money risks for 2018/19.

Other matters coming to our attention

We considered two specific matters coming to our attention during the course of our audit, and as part of our 'reality check' up to the signing of our Value for Money conclusion. They were in relation to:

- a termination payment made by the Corporation in the year, for which we have made internal control recommendations in section 2; and
- as a result of a bad debt arising at Group level after the year end, specific evidence of the arrangements in place to ensure 'informed decision making' by the Board in respect of relevant financial risk related to the debt at the time of the purchase of the land by the Corporation's subsidiary.

In both cases we were satisfied that they did not have an adverse impact in forming our overall Value for Money conclusion.

4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	**No matters to report**
Completion of group audit reporting requirements	**Below the 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 Corporation'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 Corporation is classed as a minor body, and as such does not complete a WGA return. As such, we have not reviewed a return for the Corporation for 2018/19 or made any report to the NAO.

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 Corporation. 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 Corporation's auditor

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

Having completed our work for the 2018/19 financial year, we can confirm that our final fees are as follows:

Area of work	2018/19 proposed fee	2018/19 final fee
Delivery of audit work under the NAO Code of Audit Practice	£17,080 plus VAT*	£21,264 plus VAT**
Non Audit related Services	NIL	NIL

* As reported in our Audit Strategy Memorandum.

** Subject to agreement by PSAA, and in line with fees reported in our update letter issued to Audit and Risk Committee in July 2019.

Fees for other work

We confirm that we have not undertaken any non-audit services for the Corporation in the year.

6. FORWARD LOOK

Audit Developments

Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. We have responded to the National Audit Office's consultation on the content of the Code (https://www.nao.org.uk/code-audit-practice/about-code/)

A new Code will be laid in Parliament in time for it to come in to force no later than 1 April 2020.

Financial Resilience

The Corporation will need to incorporate the outcome of the Spending Review, due in the latter half of 2019, to its Medium Term Financial Plan. The Spending Review will set out the department allocations for 2020/21 and potentially beyond. Regardless of the timing and period covered by the Spending Review, the Corporation recognises the key issue is the planning and management of its finances to ensure it remains financially resilient and able to deliver its Master Plan.

Financial Reporting

UK Local Government Annual Accounts

The CIPFA/LASAAC Local Authority Code Board specifies the financial reporting requirements for UK local government (which includes the Corporation). A consultation is underway to inform the direction and strategy for local government annual accounts. We will be submitting our response and suggest practitioners also voice their opinion.

Lease accounting

The implementation of IFRS 16 Leases in the Code is delayed until 1 April 2020. The Corporation (and the Group) will need a project plan to ensure the data analysis and evaluation of accounting entries is completed in good time to ensure any changes in both business practice and financial reporting are captured.

Next year's audit and how we will work with the Corporation

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 Corporation by:

- continued liaison with the Corporation's Internal Auditors to minimise duplication of work;
- attending Audit and Risk 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 the Corporation 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.

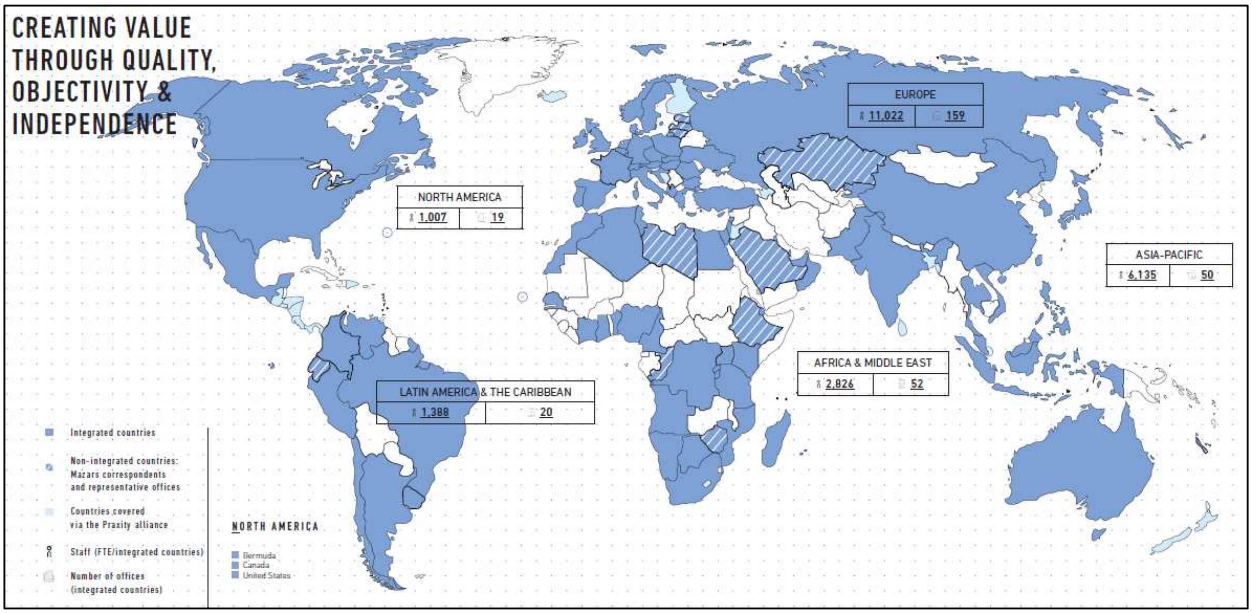
The Corporation has taken a positive and constructive approach to our audit and we wish to thank the Board, Audit and Risk Committee members and officers for their support and co-operation during our audit.

MAZARS AT A GLANCE

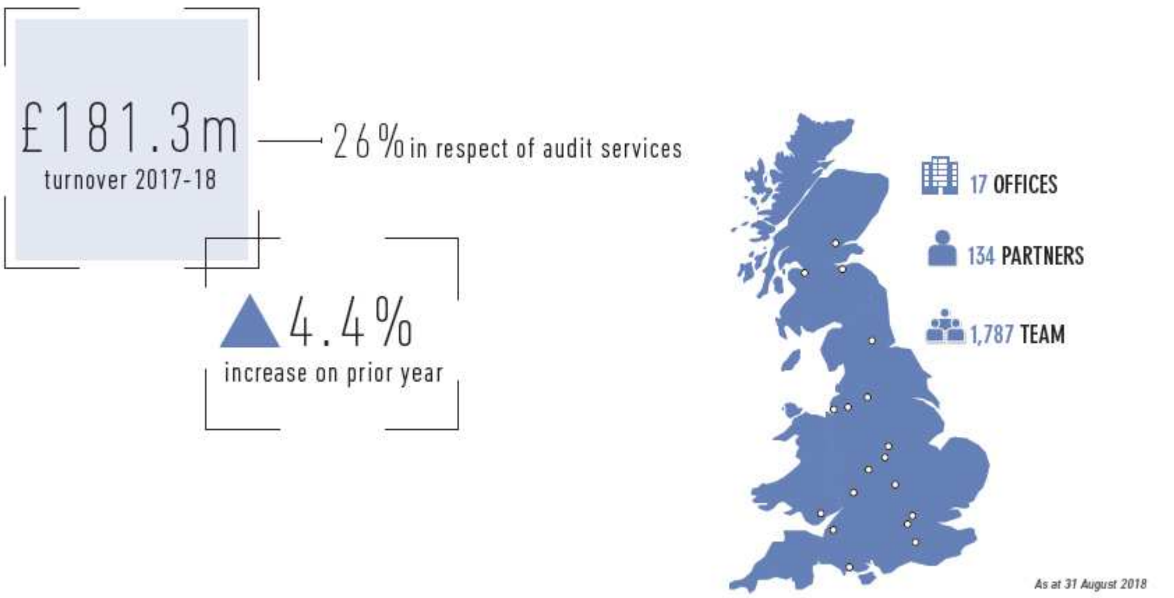
Mazars LLP

- Fee income €1.6 billion
- Over 86 countries and territories
- Over 300 locations
- Over 20,000 professionals
- International and integrated partnership with global methodologies, strategy and global brand

Mazars Internationally



Mazars in the UK



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