

# Annual Audit Letter

## South Tees Development Corporation (and Group)

Year ended 31 March 2020





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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 2020. 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	<p>Our auditor's report issued on 4 December 2020 included our opinion that the financial statements:</p> <ul style="list-style-type: none"><li>• give a true and fair view of the Corporation's and Group's financial position as at 31 March 2020 and of its 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 2019/20</li></ul>
Other information published alongside the audited financial statements	<p>Our auditor's report included our opinion that the other information in the Statement of Accounts is consistent with the audited financial statements.</p>
Value for money conclusion	<p>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 2020.</p>
Reporting to the NAO as group auditor	<p>The Corporation/Group do not prepare a WGA return as they are consolidated into Tees Valley Combined Authority Group. As such, we have not reviewed a return for the Corporation/Group for 2019/20.</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 Corporation.</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 Corporation/Group and whether they give a true and fair view of the Corporation's and Group's financial position as at 31 March 2020 and of its 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/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, 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 2020 and of its financial performance for the year then ended. We included an emphasis of matter paragraph in our report to highlight to readers the valuation uncertainty arising due to the COVID-19 pandemic, that was disclosed by the Corporation/Group in the financial statements. Our opinion was not modified in respect of this matter.

### 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 2020:

Financial statement materiality	Our financial statement materiality is based on 2% of Gross Operating Expenditure for the Corporation, and 2% of Total assets for the Group.	Corporation: £105k Group: £556.7k
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	Corporation: £3.15k Group: £16.7k
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 our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report, and subsequent follow up letters. 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 (Corporation 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. Because of 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 work provided the assurance we sought in each of these areas and did not highlight any material issues.</p>
<p><b>Property, Plant and Equipment Valuation (Group)</b></p> <p>The 2019/20 Group financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Group PPE.</p> <p>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.</p>	<p>As the valuation of PPE was undertaken for Group reporting purposes we did not rely on the component auditor of the Corporation's subsidiary, and instead undertook our own audit work to consider the reasonableness of the chosen classification category of the PPE under the Cipfa Code, and gain assurance that the valuation was materially fairly stated.</p> <p>We assessed the competence, skills and experience of the Corporation's appointed valuer, and used indices provided by our own expert to assess the movement from 2018/19 to 2019/20 to gain assurance it was not materially misstated.</p> <p>We also considered the impact of COVID-19 on the valuation to gain additional assurance on it's reasonableness.</p>	<p>The valuer followed guidance issued by the Royal Institute of Chartered Surveyors and their valuation report disclosed a "material valuation uncertainty" in relation to the valuation of the land valued.</p> <p>We requested management add a reference to this in the financial statements, and we included reference to this disclosure as an 'emphasis of matter' in our audit report. The purpose of this paragraph is to draw attention to this disclosure, it is not a qualification and did not modify our opinion on the financial statements. Our work provided the assurance we sought and did not identify any material issues.</p>
<p><b>Defined benefit liability valuation (Corporation and Group)</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.</p> <p>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.</p>	<p>Our work provided the assurance we sought and did not highlight any material issues.</p>



## 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 did not identify deficiencies in internal control as part of our audit in 2019/20.

We followed up the four internal control matters identified in our prior year 2018/19 audit, and no similar matters came to our attention during our 2019/20 audit.



### 3. VALUE FOR MONEY CONCLUSION

Value for money conclusion

Unqualified

#### Our audit approach

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; and
- working with partners and other third parties.

Our auditor’s report, 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 2020.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<ul style="list-style-type: none"> <li>• Constitution in place, available on the Corporation’s website, and refreshed to reflect the changing nature of the Corporation.</li> <li>• Corporation has a ‘Master Plan’ which details the plan in place for the redevelopment and regeneration of the South Tees site.</li> <li>• 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.</li> <li>• Management team in place (with links to TVCA and STSC).</li> <li>• No data quality issues in respect of performance information we are aware of.</li> <li>• Audit and Risk Committee meets on a regular basis, which oversees internal and external audit, and has spent considerable time this year reviewing the strengthening of the Corporation’s arrangements for risk management.</li> <li>• Internal audit function in place.</li> <li>• Budgets in place.</li> <li>• Periodic reporting to Board and Audit Committee of financial performance in the year.</li> </ul>	Yes
Sustainable resource deployment	<ul style="list-style-type: none"> <li>• Master Plan and Financial Plan in place (within known funding timescales).</li> <li>• Master Plan identifies future large scale capital schemes/priorities.</li> <li>• Risk management of capital asset purchased in the year evident from reporting to Board and the Audit and Risk Committee.</li> <li>• HR/payroll functions in place through other bodies.</li> <li>• Finance function supported by TVCA.</li> </ul>	Yes
Working with partners and other third parties	<ul style="list-style-type: none"> <li>• Master Plan details the key strategic plans and priorities and how it will work with partners to develop the South Tees Site.</li> <li>• The Corporation has written procedures for procuring products and services, which are within its Constitution.</li> </ul>	Yes



### 3. VALUE FOR MONEY CONCLUSION

The Corporation continues to grow and develop and we have seen arrangements change since 2018/19 as it has done so. We also note that it has continued to change arrangements since March 2020 to respond to its changing structures. 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 audit 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 Strategy Memorandum, we reported that we had not identified any significant Value for Money risk(s). We kept this under review throughout our audit and were satisfied that there are no significant risks apparent.



## 4. OTHER REPORTING RESPONSIBILITIES

Exercise of statutory reporting powers	No matters to report
Completion of NAO group audit reporting requirements	Not applicable
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/Group are consolidated into Tees Valley Combined Authority Group, and as such, the Corporation/Group does not complete a WGA return. As such, we have not reviewed a return for the Corporation/Group for 2019/20 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 and Group'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 March 2020.

Having completed our work for the 2019/20 financial year, we can confirm that our final fees are as follows:

Area of work	2019/20 proposed fee	2019/20 final fee
Delivery of audit work under the NAO Code of Audit Practice; plus	£13,860*	£13,860*
<ul style="list-style-type: none"><li>Audit fees relating to work on group audit, which are not included in the scale fee</li></ul>	£6,038*	£6,038* **
<ul style="list-style-type: none"><li>Audit fees relating to the increased regulatory burden and additional work/skill mix to respond to it, for property plant and equipment valuations and pensions</li></ul>		£1,813**
<ul style="list-style-type: none"><li>Audit fees relating to additional time and level of skill mix required in 2019/20 to deal with level of matters arising in draft statements, additional liaison time due to delays in component audit, and additional time to respond to matters in relation to the COVID-19 pandemic, i.e. the impact on valuations and pensions.</li></ul>		£3,955**
<b>Total audit fees</b>	<b>£19,898</b>	<b>£25,666</b>
Other non-Code work	NIL	NIL

\* As reported in our Audit Strategy Memorandum.

\*\* Subject to agreement by PSAA Ltd.

### Fees for other work

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



## 6. FORWARD LOOK

### Financial outlook

The Corporation has set out its financial plan in its updated medium term financial plan. It will need to ensure delivery of the plan is closely monitored and updated as its progress on delivering its core aims continues.

The Corporation recognises the key issue of clear planning and management of its finances to ensure it remains financially resilient if it is to deliver its Master Plan. Changes to its group structure, including the introduction of partners in its delivery bring more complexity, meaning this task is more vital than ever.

### Operational challenges

The Corporation's aims are clearly set out in its Master Plan. The recent acquisition of further areas of land as part of its Compulsory Purchase Order, and recent transfer of South Tees Site Company Limited to the Corporation's control, mean that its operational aims are now being kick started. The Corporation and Board face a very complex challenge ahead in delivering the development, which is very significant in both scale and size. The Corporation needs to ensure its risk management and other operational arrangements keep pace with its changing nature and complexity.

### 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 2019/20 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.



## 6. FORWARD LOOK

### Changes to the Code of Audit Practice

The Code of Audit Practice (the Audit Code), issued by the Comptroller and Auditor General, prescribes the way we carry out our responsibilities as your auditors. On 1<sup>st</sup> April 2020 a new Code came in to force and will apply to our work from 2020/21 onwards.

The new Audit Code continues to apply the requirements of International Standards on Auditing (ISAs) to our audit of the financial statements. While there are changes to the ISAs that are effective from 2020/21 the Audit Code has not introduced any changes to the scope of our audit of the financial statements. We will continue to give our opinion on the financial statements in our independent auditor's report.

There are however significant changes to the work on value for money arrangements, and the way we report the outcomes of our work to you.

#### The auditor's work on value for money arrangements

From 2020/21 we are still required to satisfy ourselves that you have made proper arrangements for securing the economy, efficiency and effectiveness in your use of resources, however unlike under the 2015 Audit Code, we will no longer report in the form of a conclusion on arrangements. Instead, where our work identifies significant weaknesses in arrangements, we are required to report those weaknesses to you, along with the actions that need to be taken to address those weaknesses.

Our work on value for money arrangements will focus on three criteria, specified in the revised Audit Code:

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

Under the new Audit Code we will be expected to report and make recommendations as soon as we identify a significant weakness in arrangements, as opposed to reporting our conclusion on arrangements at the end of the audit cycle as has previously been the case.

#### Reporting the results of the auditor's work

We currently issue you with an Annual Audit Letter which provides a summary of our work across all aspects of our audit. From 2020/21 the Annual Audit Letter will be replaced by the Auditor's Annual Report. This will continue to provide a summary of our work over the year of audit but will also include a detailed commentary on your arrangements in place to achieve economy, efficiency and effectiveness. This commentary replaces the conclusion on arrangements that was previously provided and will include details of any significant weakness identified and reported to you, follow up of any previous recommendations made, and the our view as to whether recommendations have been implemented satisfactorily.

The guidance supporting the new Audit Code is being developed by the National Audit Office and we will provide you with any further updates to our approach arising from this guidance when it is released.



## 6. FORWARD LOOK

### Redmond Review

In September 2020, Sir Tony Redmond published the findings of his independent review into the oversight of local audit and the transparency of local authority financial reporting. The report makes several recommendations that, if implemented, could affect both the financial statements that local authorities are required to prepare and the work that we as auditors are required to do.

The report and recommendations are wide-ranging, and includes:

- the creation of the Office of Local Audit and Regulation (OLAR), be created to manage, oversee and regulate local audit;
- reviewing reporting deadlines;
- reviewing governance arrangements in local authorities, including the membership of the Audit Committee; and
- increasing transparency and reducing the complexity of local authority financial statements.

The recommendations and findings will now be considered by the Ministry of Housing, Communities and Local Government and we look forward to working with all stakeholders to implement changes to ensure the development and sustainability of local audit.

The full report is available here: <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>



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