



# Annual Audit Letter

Redcar and Cleveland Borough Council

Year ending 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 Redcar and Cleveland Borough Council (the Council) 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 30 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 financial position as at 31 March 2019 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 2018/19.</li></ul>
Other information published alongside the audited financial statements	<p>Our auditor's report issued on 30 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>We issued an 'except for' qualification on the value for money conclusion in our auditors report in respect of the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources. This is linked to weaknesses in proper arrangements for securing sustainable resource deployment in planning finances effectively to support the sustainable delivery of strategic priorities.</p>
Reporting to the group auditor	<p>In line with group audit instructions issued by the NAO, on 30 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 whether they give a true and fair view of the Council's financial position as at 31 March 2019 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 Council'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 30 July 2019, stated that, in our view, the financial statements give a true and fair view of the Council's financial position as at 31 March 2019 and of its 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 Council which is our trivial threshold.

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

		£000's
Financial statement materiality	Our financial statement materiality is based on 2% of Gross Revenue Expenditure	7,776
Trivial threshold	Our trivial threshold is based on 3% of financial statement materiality.	233
	We have applied a lower level of materiality to the following areas of the accounts:	
Specific materiality	- Senior officer remunerations	150
	- Exit packages	100
	- Members allowances	38

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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 financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Governance Committee within our 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</b> 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 there is a risk of material misstatement due to fraud 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>We found no evidence of management override of controls</p>
<p><b>Revenue recognition</b> Our audit methodology incorporates this risk as a significant risk at all audits, although based on the circumstances of each audit, it is rebuttable. We have concluded that there are insufficient grounds for rebuttal in 2018/19. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.  For the Council, we see the revenue recognition significant risk as being principally in relation to cut-off, and specifically the risk of income being recognised in 2018/19, which relates to 2019/20.</p>	<p>We addressed this risk by undertaking the following:</p> <ul style="list-style-type: none"> <li>testing income before and after the year-end to ensure it has been recognised in the right year;</li> <li>testing journals;</li> <li>obtaining direct confirmation of year-end bank balances and testing the reconciliations to the ledger; and</li> <li>testing material year end receivables</li> </ul>	<p>Our work has provided us with the assurance we sought and has not highlighted any material issues to bring to your attention.</p>

## 2. AUDIT OF THE FINANCIAL STATEMENTS

Identified significant risk	Our response	Our findings and conclusions
<p><b>Defined benefit liability valuation</b></p> <p>The financial statements contain material pension entries in respect of 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 addressed this risk by discussing with key contacts any significant changes to the pension estimates prior to the preparation of the financial statements. In addition to our standard programme of work, we also:</p> <ul style="list-style-type: none"> <li>evaluated the management controls in place to assess the reasonableness of the figures provided by the actuaries; and</li> <li>considered the reasonableness of the actuaries' outputs, referring to an expert's report on all actuaries nationally which is commissioned annually by the National Audit Office.</li> </ul>	<p>The material amendments relating to the impact of national legal cases on the pension liabilities have been amended by the Council. Our audit work has not identified any further material issues to report.</p>
<p><b>Property, plant and equipment valuation</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 Property, Plant and Equipment (PPE).</p> <p>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.</p>	<p>We addressed this risk through the following procedures:</p> <ul style="list-style-type: none"> <li>assessing the Council's arrangements for ensuring that PPE valuations are reasonable;</li> <li>assessing the data provided by our consulting Valuer, Gerald Eve, as part of our challenge of the reasonableness of the valuations provided by the Council's Valuer;</li> <li>considering the competence, skills and experience of the Valuer and the instructions issued to the Valuer; and</li> <li>where necessary, performing further audit procedures on individual assets to ensure the basis of valuations is appropriate.</li> </ul>	<p>Our work has provided us with the assurance we sought and has not highlighted any material issues to bring to your attention.</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. Our work has not identified any significant deficiencies in our 2018/19 audit to report, and there were none in 2017/18 to follow up.

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### 3. VALUE FOR MONEY CONCLUSION

Value for Money conclusion

'Except for' Qualification

#### 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 30 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, 'except for' arrangements for securing sustainable resource deployment in planning finances effectively to support the sustainable delivery of strategic priorities.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<p>The Council operates a Cabinet with a Leader model, and this is governed by the Council Constitution including all of the normal features of an effective governance framework in local government. The Council Plan, 'Our Flourishing Future', sets out the Council's priorities and how it is focussing on the most important issues of growing the economy and creating more jobs, developing great places to live and improving quality of life.</p> <p>Key priorities for the Council include strong and confident communities, prosperity for all, a brighter future for children, longer and healthier lives, attractive and vibrant places, good connections, clean and safe environment, enriching lives through culture and sport and improving the way the Council works. Delivery is monitored in quarterly performance reports.</p> <p>There is evidence of financial reporting being used to deliver strategic objectives and in allocating resources to priority areas. In addition, regular financial reporting takes place, with formal reporting quarterly to Cabinet.</p> <p>The Council has a risk management strategy and framework in place. The Council's system of internal control is subject to Internal Audit and for 2018/19, the Council's Head of Internal Audit has given an opinion of good assurance. The Governance Committee is in place to oversee the governance framework including the work of internal audit and approval of the Council's financial statements.</p>	Yes



### 3. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment	<p>The Council has delivered significant savings in recent years, aiming to do this whilst minimising the impact on service delivery. In the Financial Outturn report for 2018/19, the Council reported that it had “delivered in excess of £90.5m in cuts and lost 1,400 jobs” since 2010. This has been a prolonged period of public sector austerity.</p> <p>The final outturn for 2018/19 was an underspend of £2k against the budget. To achieve this position, £5.0m of revenue reserves were used, which was broadly in line with plans. In addition, the Council has a good track record of delivering savings, and during 2018/19, the Council delivered £10.5m of its £11.3m ‘Shaping Our Future’ target savings and income growth.</p> <p>The main area of budget pressure in 2018/19, in common with many local authorities, was in children’s services where there was an overspend of £4.9m as a result of increased numbers of children in care and other demand led pressures. Despite these financial pressures, the Council was able to make compensating savings which resulted in the overall underspend of £2k.</p> <p>The Council’s 2019/20 budget was balanced after planned use of a further £8.9m of its revenue reserves. A budget gap of £34.2m for 2020/21 to 2022/23 was included in the Medium Term Financial Strategy (MTFS) reported to the Council on 27 February 2019, with £11.6m of this relating to 2020/21. After accounting for the use of reserves in 2019/20, the remaining revenue reserves available to the Council are only £16.1m, which includes the £5.1m General Fund Balance which the Council has identified as the minimum needed to be kept aside for unforeseen circumstances.</p>	Partial



## 5. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Arrangements in place?
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Sustainable resource deployment (continued)	The table below shows the downward trend in earmarked revenue reserves that are available to support budget planning and smooth expenditure between years, and projects the impact on reserves in the medium term given the initial budget gap and other assumptions used in the 2019/20 budget process.	Partial
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The balance of other earmarked reserves projected for 31 March 2020 (£10.971m) is less than the initial budget gap for 2020/21 (£11.6m).

On the Council's current spending trajectory and without identifying and delivering savings, the Council is in danger of exhausting its revenue reserves in one to two years, and would be unable to finance its projected expenditure in 2020/21.

Financial year end	Total usable reserves *	General Fund Balance (minimum needed for unforeseen events)	Other earmarked revenue reserves (can be made available to support the budget) **
31 March 2016	£46.741m	£5.925m	£32.908m
31 March 2017	£39.174m	£5.225m	£23.451m
31 March 2018	£41.805m	£4.905m	£25.058m
31 March 2019	£34.817m	£5.100m	£19.898m
Projected for 31 March 2020	£25.890m	£5.098m	£10.971m (based on plan to use £8.927m reserves to support the 2019/20 budget)
Projected for 31 March 2021	£15.875m (note that £1.584m of expenditure can not be funded)	£6.056m	Initial budget gap of £11.597m Revenue reserves = £0; unable to finance £1.584m of expenditure after contributing additional £0.958m required for the GF balance
Projected for 31 March 2022	£15.875m (note that £10.808m of expenditure can not be funded)	£6.056m (planned at £6.159m, but insufficient resources to increase to this level given budget gap)	Initial budget gap of £10.808m Revenue reserves = £0; unable to finance £10.808m of expenditure in year
Projected for 31 March 2023	£15.875m (note that £11.836m of expenditure can not be funded)	£6.056m (planned at £6.262m, but insufficient resources to increase to this level given budget gap)	Initial budget gap of £11.836m Revenue reserves = £0; unable to finance £11.836m of expenditure in year

\* The total usable reserves in this column include school balances and capital reserves that are not available to support the revenue budget (as at 31 March 2019, these are £9.819m of the total usable reserves, and we have assumed that this is reflected in the projections for 2019/20 to 2022/23).

\*\* Although earmarked revenue reserves can be made available to support the revenue budget, they are also set aside for specific purposes and some of these could not be re-purposed to plug the gap without changing other commitments.

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## 5. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment (continued)	<p>Consequently, when setting the 2019/20 budget and MTFS in February 2019, the Council balanced the budget for 2019/20, but did not present a balanced or sustainable financial position over the medium term.</p> <p>We recognise that it is not uncommon for local authorities to identify a budget gap over the medium term, and then work on the measures to address this after the budget has been set. The difference in this budget round is that on the Council's current spending trajectory, and without firm and decisive action, the Council is in danger of exhausting its revenue reserves.</p> <p>As a result of this, we are qualifying our VFM conclusion in relation to the Council's arrangements to ensure sustainable resource deployment in the medium term.</p> <p>We appreciate that at the point of setting the 2019/20 budget and MTFS in February 2019, there were, and still are, key uncertainties in the Council's funding relating to the Government Comprehensive Spending Review, the Fair Funding Review in Local Government, and the impact on the Council of the 100% business rates retention scheme.</p> <p>We also note that the budget gap presented in February 2019 was intended to be a worst case scenario and the Council does have a range of options to bridge the gap, including identifying further reductions in expenditure and increasing income.</p> <p>The Corporate Director for Resources and Chief Finance Officer recognises that the Council can not afford to draw on reserves at the same levels in its 2020/21 budget as is planned for 2019/20. The 2019/20 budget report stated "Use of reserves in this way can only be a very temporary arrangement and there is an imperative to identify a permanent solution in future years. Ongoing use of reserves in this way clearly cannot be sustained."</p> <p>Since preparing the MTFS, officers have continued to explore the options to bridge the budget gap. This has included reviewing the assumptions and financial pressures identified in the initial budget and working on phase 4 of its 'Shaping Our Future' programme, with a view to identifying further savings and increasing income generation.</p> <p>At the point of preparing our report, the Corporate Director for Resources and Chief Finance Officer explained to us that the budget gap has been narrowed significantly, and that some measures identified may be delivered in time to reduce the draw on reserves in 2019/20.</p>	Partial

## 5. VALUE FOR MONEY CONCLUSION

Sub-criteria	Commentary	Arrangements in place?
Sustainable resource deployment (continued)	<p>We are mindful that savings options which will be a significant part of the Council's plans to ensure its future financial sustainability are still being developed, that after years of austerity there are no easy options left and that the options identified will require consideration and approval by the Cabinet and the Council, and will then need to be implemented and monitored as to whether planned savings and increased income are achievable.</p> <p>The Cabinet and the Council is at a key decision point in terms of ensuring a sustainable financial position in the medium term. Decisive action to bridge the budget gap over the medium term is a key priority for the Council.</p>	Partial
Working with partners and other third parties	<p>All 'Shaping Our Future' service reviews include consideration of alternative ways of providing services including partnership working.</p> <p>The Council is working jointly with the local Clinical Commissioning Group (CCG) on social care and with the other local authorities as part of the Tees Valley Combined Authority.</p> <p>The Council's website includes a section on how to do business with the Council to explain procurement and provide useful information to suppliers and members of the public.</p>	Yes

## 6. VALUE FOR MONEY CONCLUSION

### Significant audit risks

The NAO's guidance requires us to carry out work to identify whether or not a risk to our value for money conclusion exists. Risk, in the context of our 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 Strategy Memorandum, we reported that we had identified one significant value for money audit risk. The work we carried out in relation to this significant risks is outlined below.

Risk	Work undertaken	Conclusion
<p><b>Responding to financial pressures</b></p> <p>Our audit work in previous years has concluded that the Council has arrangements in place for Medium Term Financial Planning. The Council continues to face financial pressure in the coming years and the Council has recently updated its medium term financial strategy (MTFS).</p> <p>We need to ensure our knowledge of the Council's MTFS 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 have reviewed the Council's updated MTFS and reviewed and updated our knowledge of the arrangements the Council has in place to monitor progress against its savings plans and assumptions that underpin the MTFS.</p>	<p>As has already been described in the comments on sustainable resource deployment, we noted that when setting the 2019/20 budget and Medium Term Financial Strategy (MTFS) in February 2019, the Council balanced the budget for 2019/20, but did not present a balanced or sustainable financial position over the medium term (2020/21 to 2022/23).</p> <p>We recognise that it is not uncommon for local authorities to identify a budget gap over the medium term, and then work on the measures to address this after the budget has been set. The difference in this budget round is that on the Council's current spending trajectory, and without firm and decisive action, the Council is in danger of exhausting its revenue reserves in one to two years.</p> <p>As a result of this, we are qualifying our VFM conclusion in relation to the Council's arrangements to ensure sustainable resource deployment in the medium term.</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 a referral to the Secretary of State where we believe that a decision has led to, or would lead to, unlawful expenditure, or an action has been, or would be unlawful and likely to cause a loss or deficiency; and
- Make written recommendations to the Council which must be responded to publicly.

We have not exercised any of these statutory reporting powers.

### 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 30 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 our 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 Council 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	£95,733	£95,733

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

### Fees for other work

We have been engaged to carry out non-audit work in relation to the Council's housing benefit subsidy claim. We expect to be engaged to undertake the assurance work in relation to teachers' pensions, although this has not been confirmed at the time of preparing this report.

Area of work	2018/19 proposed fee	2018/19 final fee ***
Housing Benefit Subsidy Claim	£9,900	£9,900
Teachers' Pensions	To be agreed	To be agreed

\*\*\* This work has not yet been completed so we are unable to confirm the final fee at this stage.

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## 6. FORWARD LOOK

### Financial outlook

As reported in our Value for Money Conclusion in this report, the Council has identified significant budget gaps in its medium term financial plan and is currently working on measures to address this. This is a challenging financial position and the Corporate Director for Resources and Chief Finance Officer has explained to us that the budget gap has been narrowed significantly, and that some measures identified may be delivered in time to reduce the planned draw on reserves in 2019/20.

Decisive action to bridge the budget gap over the medium term is a key priority for the Council or it is in danger of exhausting its revenue reserves in one to two years.

### Operational challenges

As summarised in the Council's annual governance statement, the main challenges facing the Council include:

- balancing the medium term financial plan including managing children's social care pressures; and
- education standards in secondary schools

The Council will also have to manage the recent change to senior management structures and governance arrangements, including operating without a Chief Executive.

### How we will work with the Authority

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 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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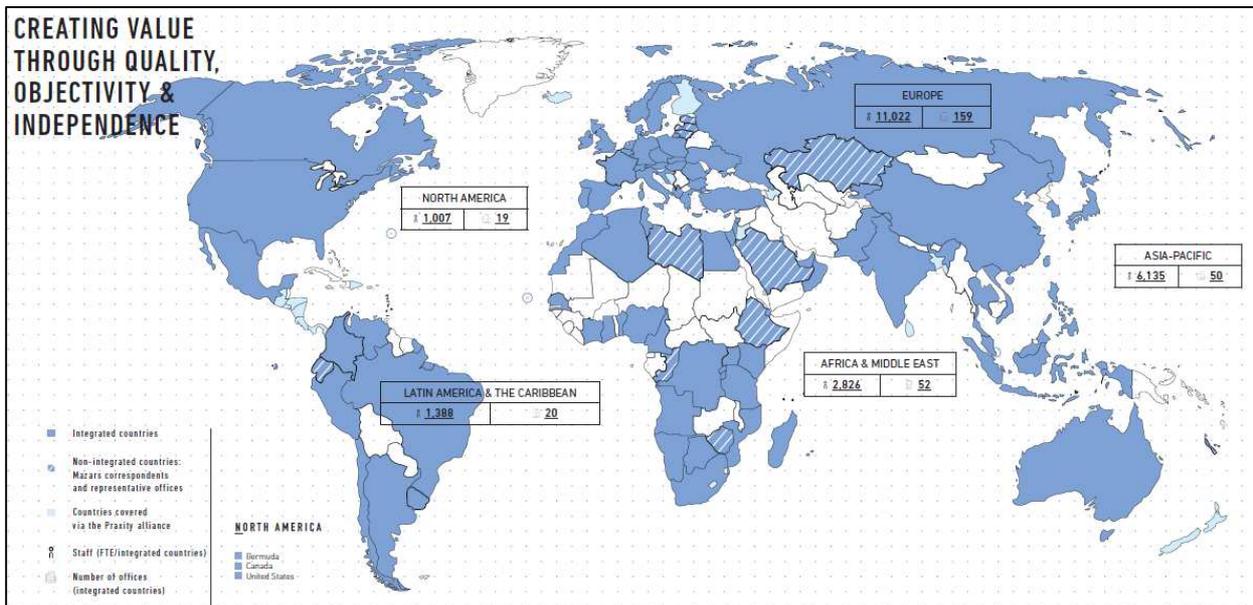
6. Forward look

# MAZARS AT A GLANCE

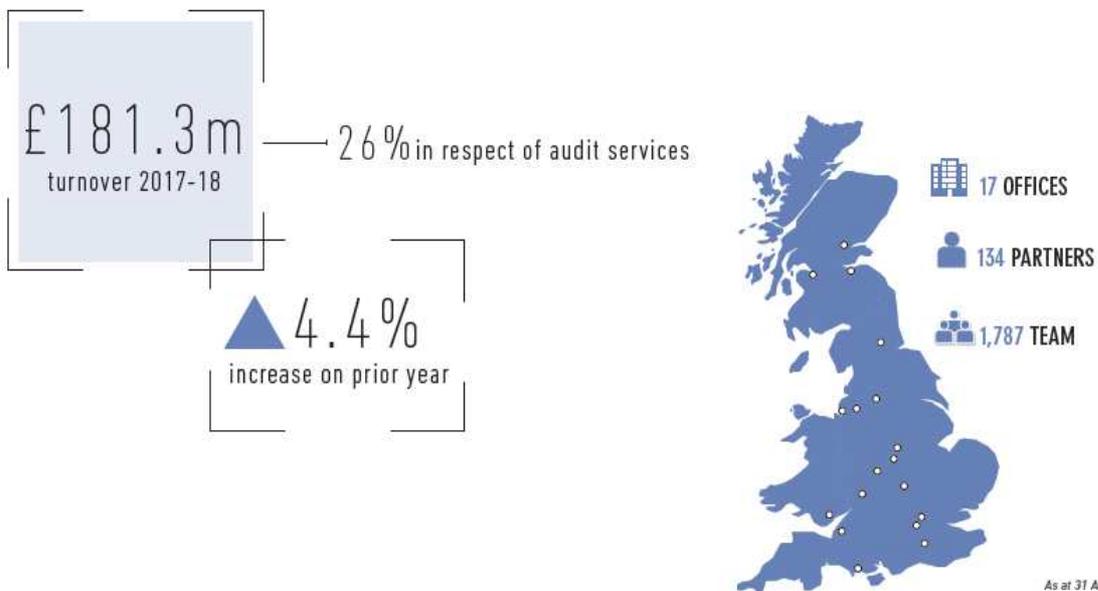
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- Fee income €1.6 billion
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- Over 300 locations
- Over 20,000 professionals
- International and integrated partnership with global methodologies, strategy and global brand

## Mazars Internationally



## Mazars in the UK



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