

External Audit
Report by Chief Financial Officer

Summary: This report appends:

- (i) the Annual Audit Letter for 2017/18.
- (ii) the Local Government Audit Committee Briefing by Ernst & Young

Recommendation:

- (i) That the Annual Audit Letter for 2017/18 be noted.
- (ii) That the briefing, including the key questions for Audit Committees as set out on page 10 in Appendix 2, be noted.

1 Introduction

- 1.1 The Annual Audit letter for 2017/18 summarises the key issues arising from the audit. These key findings are set out on page 9 of Appendix 1. The Audit results were considered at 24 July FSAC committee.

2 Financial Implications

- 2.1 The final audit fee remained the same as detailed in the audit plan and was charged to the accounts for the year.

3 External Audit Briefing

- 3.1 This briefing is presented “for information”.

- 3.2 The items of relevance to the Authority are:

- EY Item Club Economic Briefing (page 2);
- Brexit (page 3);
- CIPFA consultation on proposed local authority financial resilience index (page 4);
- CIPFA consultation on implementation of IFRS 16 and 9 (pages 5 and 6); and
- The first year of faster close (page 6).

Background papers:	None
Author:	Emma Krelle
Date of report:	20 November 2018
Broads Plan Objectives:	None
Appendices:	APPENDIX 1 – Ernst & Young Annual Audit Letter 2017/18 APPENDIX 2 – Local Government Audit Committee Briefing (Quarter 3 2018)

Broads Authority

Annual Audit Letter for the year
ended 31 March 2018

August 2018

The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing downwards towards the top right corner of the logo area.

Building a better
working world

Contents



Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment (updated 23 February 2017)' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.



01 Executive Summary



Executive Summary

We are required to issue an annual audit letter to the Broads Authority (the Authority) following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Authority's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Authority as at 31 March 2018 and of its expenditure and income for the year then ended.
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Authority's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources .

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Authority.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Authority, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Authority's Whole of Government Accounts return (WGA).	The Broads Authority is below the threshold of £20 million and considered a minor body. Therefore, we did not perform any audit procedures on this area.



Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Authority communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 10 July 2018.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 27 July 2018.

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

Kevin Suter

Associate Partner

For and on behalf of Ernst & Young LLP



02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Authority.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Report to the 24 July 2018 Financial Scrutiny and Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Authority.

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plan that we issued on 12 February 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2017/18 financial statements; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Authority has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Authority;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Authority, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Authority is considered a minor body and therefore we do not perform any procedures on this area.

Responsibilities of the Authority

The Authority is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Authority reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Authority is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



03

Financial Statement Audit

Financial Statement Audit

Key Issues

The Authority's Statement of Accounts is an important tool for the Authority to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Authority's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 27 July 2018.

Our detailed findings were reported to the 24 July 2018 Financial Scrutiny and Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
<p>Management override</p> <p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation.</p> <p>We considered the accounting estimates most susceptible to bias and considered judgements made were reasonable.</p> <p>We evaluated the business rationale for any significant unusual transactions.</p> <p>We tested the capitalisation of revenue expenditure and did not identify any items inappropriately capitalised.</p> <p>We have not identified any material weaknesses in controls or evidence of material management override.</p> <p>We have not identified any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Authority's normal course of business.</p>

Financial Statement Audit (cont'd)

Other Key Findings	Conclusion
<p>Valuation of Land and Buildings</p> <p>The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Authority's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>	<p>We did not identify any material misstatements from the work undertaken.</p> <p>The work performed by managements valuation expert was based on reasonable assumptions that we were able to corroborate through our sample testing.</p> <p>Our consideration of the annual cycle of valuations did not identify any issues with the implemented plan or with the movement on assets not revalued in year.</p> <p>The audit work undertaken on the entries to the financial statements identified one minor disclosure misstatement. All other accounting entries had been appropriately made.</p>
<p>Pension Liability Valuation</p> <p>The Local Authority Accounting Code of Practice and IAS 19 require the Authority to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Norfolk County Council.</p> <p>The Authority's pension fund deficit is a material estimated balance and the Code requires that the liability be disclosed on the Broads Authority balance sheet.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>We reviewed the assessment of the pension fund actuary by PWC and EY pensions and have undertaken the work specified.</p> <p>A movement on the total fund asset between the estimated year end balance and the actual was identified by the pension fund auditor. The impact of this was an understatement of the Authority's pension assets by £226k. This amount is material and has been adjusted in the accounts.</p> <p>We have not identified any issues with the accounting entries and disclosures made within the financial statements.</p>

The Authority's Statement of Accounts is an important tool for the Authority to show how it has used public money and how it can demonstrate its financial management and financial health.

Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £158k (2017: £158k), which is 2% of gross expenditure on provision of services reported in the accounts of £7.9mn adjusted for interest costs.</p> <p>We consider gross expenditure on provision of services to be one of the principal considerations for stakeholders in assessing the financial performance of the Authority.</p>
Reporting threshold	<p>We agreed with the Financial Scrutiny and Audit Committee that we would report to the Committee all audit differences in excess of £7.8k (2017: £8k)</p>

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits: reduced materiality level of £5,000 applied in line with bandings disclosed.
- ▶ Related party transactions and members allowances: reduced materiality level applied equal to the reporting threshold.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

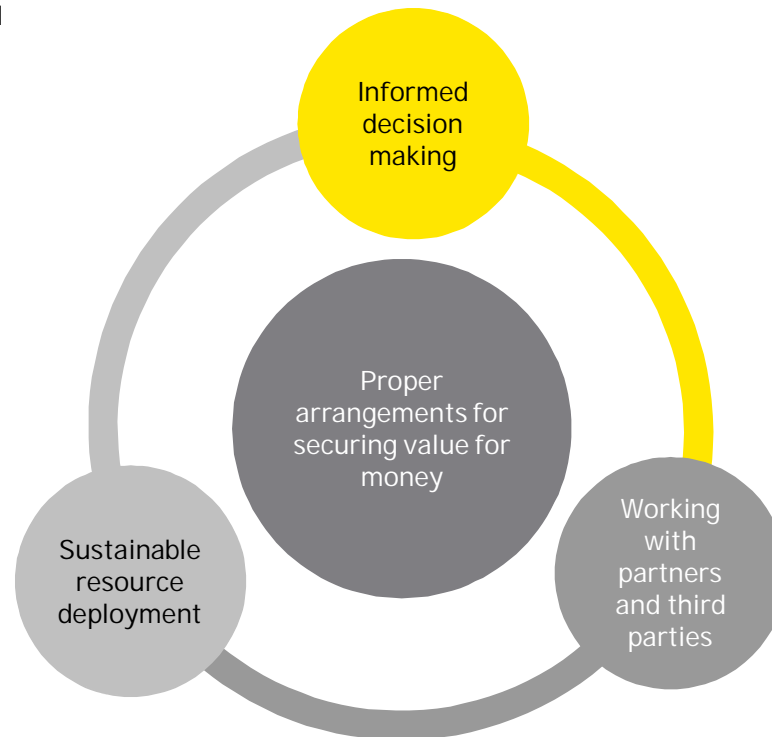


04 Value for Money

We are required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- ▶ Take informed decisions;
- ▶ Deploy resources in a sustainable manner; and
- ▶ Work with partners and other third parties.



We did not identify any significant risks in relation to these criteria.

We did not identify any significant weaknesses in the Authority's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore issued an unqualified value for money conclusion on 27 July 2018.



05 Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

The Authority is below the specified audit threshold of £20 million and considered a minor entity. Therefore, we did not perform any audit procedures.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Authority's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Authority or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Other Reporting Issues (cont'd)

Independence

We communicated our assessment of independence in our Audit Results Report to the Financial Scrutiny and Audit Committee on 24 July 2018. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls.

Our audit did not identify any controls issues to bring to the attention of the Financial Scrutiny and Audit Committee.



06 Data Analytics



Use of Data Analytics in the Audit

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2017/18, our use of these analysers in the authority's audit included testing journal entries to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis

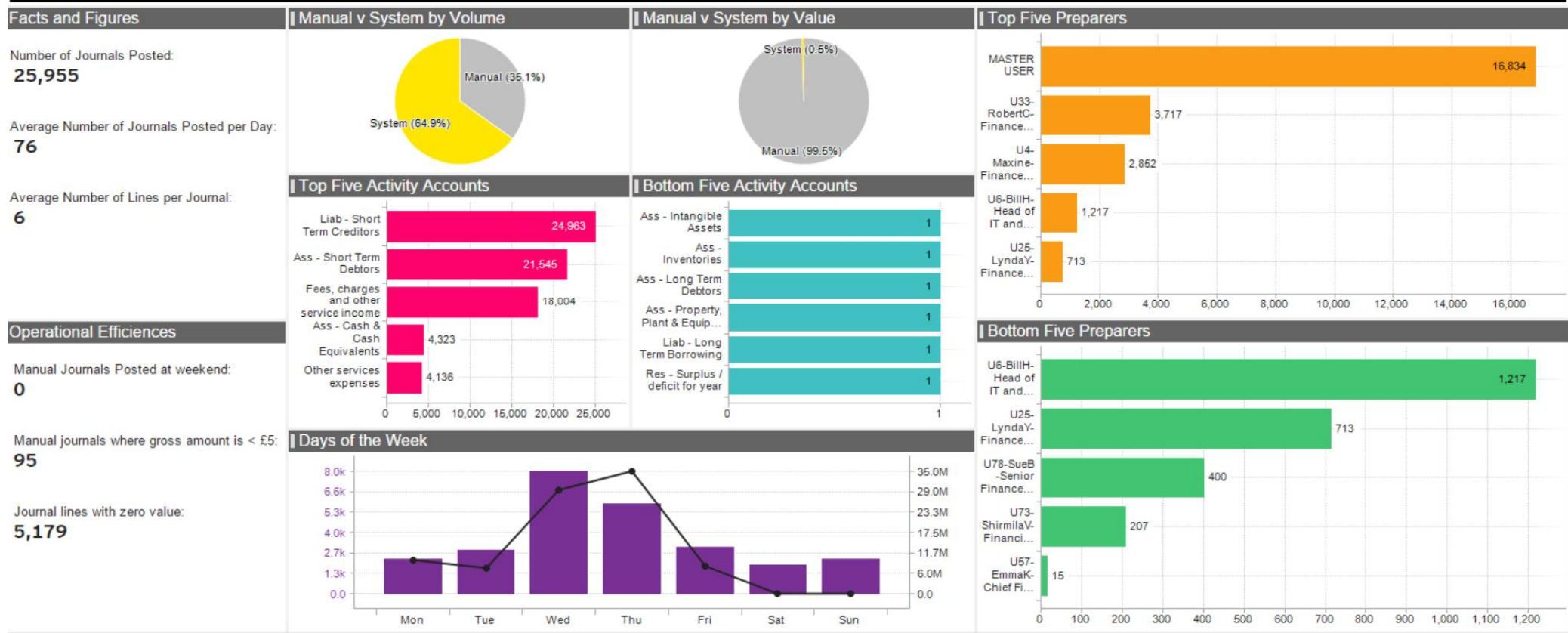
We obtain downloads of all financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our Audit Plan.

Journal Entry Data Insights

The graphic outlined below summarises the Authority's journal population for 2017/18. We review journals by certain risk based criteria to focus on higher risk transactions, such as journals posted manually by management, those posted around the year-end, those with unusual debit and credit relationships, and those posted by individuals we would not expect to be entering transactions.

The purpose of this approach is to provide a more effective, risk focused approach to auditing journal entries, minimising the burden of compliance on management by minimising randomly selected samples.

EY Helix - GLASS: Journal Entry Data Insights - 18 Broads Authority - YE - 31/03/2018



Data Analytics (cont'd)

Journal Entry Testing

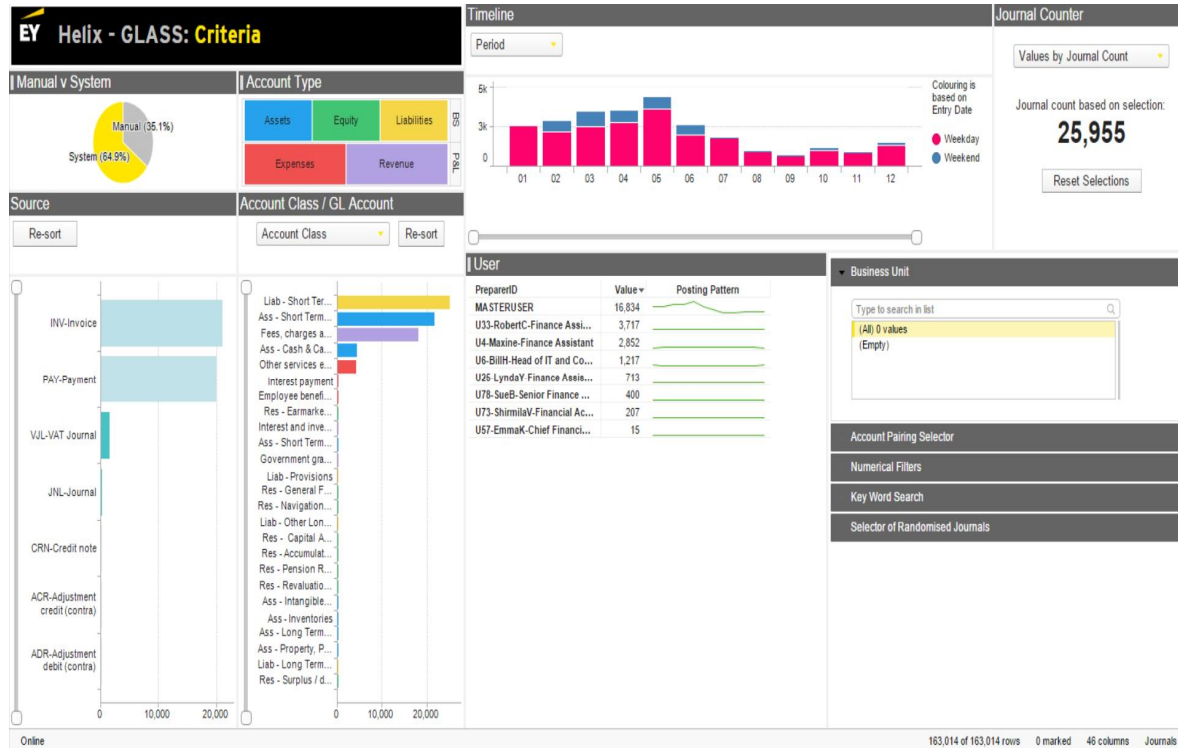
What is the risk?

In line with ISA 240 we are required to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

What judgements are we focused on?

Using our analysers we are able to take a risk based approach to identify journals with a higher risk of management override, as outlined in our audit planning report.

Journal entry data criteria – Broads Authority – 31 March 2018



What did we do?

We obtained general ledger journal data for the period and have used our analysers to identify characteristics typically associated with inappropriate journal entries or adjustments, and journals entries that are subject to a higher risk of management override.

We then performed tests on the journals identified to determine if they were appropriate and reasonable.

What are our conclusions?

We isolated a sub set of journals for further investigation and obtained supporting evidence to verify the posting of these transactions and concluded that they were appropriately stated.



07 Focused on your future



Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Authority is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	<p>Applicable for local authority accounts from the 2018/19 financial year and will change:</p> <ul style="list-style-type: none">• How financial assets are classified and measured;• How the impairment of financial assets are calculated; and• The disclosure requirements for financial assets. <p>There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.</p>	<p>Although the Code has now been issued, providing guidance on the application of the standard, along with other provisional information issued by CIPFA on the approach to adopting IFRS 9, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty. However, what is clear is that the Authority will have to:</p> <ul style="list-style-type: none">• Reclassify existing financial instrument assets• Re-measure and recalculate potential impairments of those assets; and• Prepare additional disclosure notes for material items.
IFRS 15 Revenue from Contracts with Customers	<p>Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except:</p> <ul style="list-style-type: none">• Leases;• Financial instruments;• Insurance contracts; and• For local authorities; Authority Tax and NDR income. <p>The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.</p>	<p>As with IFRS 9, some provisional information on the approach to adopting IFRS 15 has been issued by CIPFA in advance of the Guidance Notes. Now that the Code has been issued, initial views have been confirmed; that due to the revenue streams of Local Authorities the impact of this standard is likely to be limited.</p>



Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Authority will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Authority must therefore ensure that all lease arrangements are fully documented.</p>

A close-up photograph of a person's hand sorting through several hanging file folders. The folders are filled with papers, and the hand is reaching into one of them. The background is a textured wall.

08 Audit Fees

Audit Fees

Our fee for 2017/18 is in line with the scale fee set by the PSAA and reported in our 10 July 2018 Annual Results Report.

Description	Final Fee 2017/18 £	Planned Fee 2017/18 £	Scale Fee 2017/18 £	Final Fee 2017/18 £
Total Audit Fee – Code work	13,943	13,943	13,943	13,943

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

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2018 EYGM Limited.
All Rights Reserved.

ED None

EY-000070901-01 (UK) 07/18. CSG London.



In line with EY's commitment to minimise its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com

An aerial photograph of the London skyline, featuring the Gherkin in the foreground on the left and The Shard on the right. The sky is filled with dramatic, dark clouds. A large yellow banner is positioned in the upper right corner, containing the title text.

Local government audit committee briefing




EY

Building a better
working world



Contents at a glance





This sector briefing is one of the ways that we support you and your organisation in an environment that is constantly changing and evolving.

It covers issues which may have an impact on your organisation, the Local Government sector, and the audits that we undertake.

The briefings are produced by our public sector audit specialists within EY's national Government and Public Sector (GPS) team, using our public sector knowledge, and EY's wider expertise across UK and international business.

The briefings bring together not only technical issues relevant to the Local Government sector but wider matters of potential interest to you and your organisation.

Links to where you can find out more on any of the articles featured can be found at the end of the briefing.

We hope that you find the briefing informative and should this raise any issues that you would like to discuss further, please contact your local audit team.



Government and economic news

EY ITEM Club – Local Government Economic Briefing Q3

The outlook for the UK economy appears to be worsening in 2018, as challenges continue for consumption, investment and trade. Local authorities are increasingly under pressure to deliver local economic growth and improved services within this uncertain environment.

A cloudier outlook for the UK economy may impact local authority MTFPs

The UK has witnessed a recovery in services output and consumer activity, partially in response to the sunny weather and the World Cup; however, weaker overseas growth (exacerbated by escalating fears of global trade disputes) has contributed to a slowing momentum in some sectors.

The ultimate impact is a continued slowdown in real GDP growth during 2018, with the EY ITEM Club revising its forecast for GDP growth to 1.4% in July 2018, down from the 1.6% expected in April 2018. The increasingly uncertain global outlook has led the EY ITEM Club to also renew its interest rate position, predicting that there will be only one rate rise in 2018 rather than the two

forecasted previously. Local authority short-term borrowing increased by 31% in 2017/18, meaning that such a delay in interest rate hikes will likely be positive news to many local authorities. On August 2018, the Bank of England has since raised the interest rate by a quarter of a percentage point, from 0.5% to 0.75% – the highest level since March 2009, which will be re-considered by the EY ITEM Club in our next forecast.

Whilst it is still early days as far as predicting 2018/19's fiscal performance, a downgraded forecast for GDP growth this year and next, compared to the expectation three months ago, implies a bigger fiscal deficit.

On the whole, a weaker outlook for the UK economy should signal caution for local authorities. Increased pressure on real incomes and affordability has dampened activity in the housing market, with house price inflation slowing to 2%. However the ratio of prices to average earnings is still stretched by historical standards. Despite a record high employment rate, annual pay growth has not responded in turn, falling to 2.5% in April. These dynamics suggest that pressure on social housing will continue in the medium-term.

Slower growth should be considered in the light of local authorities' proposed or existing commercial activity. Dampened economic activity may also impact local businesses, leading to an

increase in high street vacancies. Furthermore, local authorities should also factor a more negative economic outlook into its supply chain risk assessments, with the potential of it increasing the chances of firms collapsing.

How do local authorities respond to the struggling retail sector?

As the retail sector undergoes significant structural change, local authorities need to consider how they can respond to this and adapt both their regeneration and investment plans accordingly.

The increasing drive towards online shopping along with rising operating costs for retailers has led to decreasing footfall in shopping centres and high streets as well as record levels of shop closures. Noteworthy retailers, including House of Fraser, Poundworld, Maplin and Toys R Us as well as a number of chain restaurants, have proposed restructures or shop closures, or have fallen into administration. There are concerns that the number of shops is too high as sustained vacancy rates continue.

Over the past two years, local authorities in England have made debt funded investment of around £1.7bn in commercial property assets. This has included a number of investments in shopping centres and other retail focused assets. These investments are likely to see a period of underperformance, with estimations suggesting a potential 10% fall in shopping centre capital value, driven by higher vacancy rates. Yields are likely to be lower than anticipated, along with there being a requirement for an increase in active management of these units, further eating into returns.

Local authorities need to consider the changing retail sector in light of their regeneration plans. There is a consensus that too much high street and town centre space is dedicated to retail. The think tank Centre for Cities has stated that shops take up twice as much space as offices in struggling town centres, whilst successful town centres tend to have three times as much office space than retail. Local authorities need to ensure that regeneration plans have appropriately considered the medium and longer term outlook for the retail sector.

The structural changes evident in the retail sector shouldn't deter local authorities from maintaining an active role in driving town centre regeneration nor in retail investment. Rather, local authorities should be integral to undertaking active investment ensuring the aim is focused on socio-economic regeneration as opposed to merely revenue generation. It is vital that local authorities are at the helm of repurposing town centres, ensuring that the public realm centres on public spaces, homes and community assets, rather than retail. This will help to ensure the sustainability of our town centres, whilst at the same time helping local authorities to achieve their regeneration and financial goals.

Brexit

A CIPFA survey has found that three quarters of public service leaders feel that central government is not engaged or has not communicated sufficiently over Brexit. CIPFA's Brexit Advisory Commission has commented that in order for local authorities to plan effectively and identify opportunities, communication channels need to be open between the government and public service leaders. Anticipating an increase in cost, public service leaders are purchasing more from suppliers now to prevent potential higher costs in the future.

Public service leaders are also anticipated a staffing pressures. Nationally it is estimated that 7% of the social care sector's workforce are non-UK EU nationals. However, in some regions of the UK non-UK EU nationals make up a significantly larger proportion.

Another major concern is regarding replacement of EU funding which is currently worth £8.4bn. In a recent white paper the Government has proposed a UK Shared Prosperity Fund (UKSPF) to replace the existing EU regional funding. Details of how local authorities can bid to secure this funding has yet to be determined.



Accounting, auditing and governance

EY's response to CIPFA consultation on its proposed local authority financial resilience index

On 24 August CIPFA closed its consultation on its plans to launch an authoritative measure of local authority financial resilience through the creation of a new index. CIPFA's proposals include using a range of indicators for the index and a dashboard enabling comparison with similar authorities. CIPFA has reported that it has had an unprecedented number of responses- not a surprise given the current profile of local authority financial resilience and the noise in the sector over CIPFA's proposals. We summarise EY's response below.

Whilst we support CIPFA's ambition to support senior officers and members with an early warning system for financial resilience issues we are unconvinced that the proposed indicators provide sufficient depth and sophistication to reflect the complexities of local authorities. In particular it is unclear how the indicators take account of the different type of reserves (earmarked, un-earmarked, usable and unusable), general fund and housing balances, income generated from other sources and borrowing plans (including recognising the different types of borrowing). Reference should also be made to the scale of borrowing to

invest in commercial property, as well as exposure to material outsourcing contracts and associated supplier risk, noting that current focus on the risk that these issues are generating in the sector. There is no reference to how the culture of an organisation impacts its financial plans and its appetite for risk. In addition, many authorities work significantly in partnership with others. In our experience, whilst the proposed indicators may provide a crude indication of financial resilience, senior officers and members would value an output that takes into account these other major influencers of financial resilience.

We have suggested that the proposed index could be treated as the first step to developing a more sophisticated index, using some of the same principles but taking into account the complexities outlined above. While CIPFA have stated that the index is not designed to predict financial issues, we would welcome the development of forward looking indicators using information from an authority's medium term financial plan as well as taking into account historic performance in achieving planned savings, unplanned use of un-earmarked reserves as well as an assessment of forward looking demographic and economic forecasts for a locality. In addition, a developing index can incorporate important changes in the way local authorities operate, for example greater integration between health and social care and the impact of CQC reviews on local health systems.

We supported the proposal for a single dashboard showing the individual authority and the relevant comparator group performance. However, we questioned the use of the terms 'best' and 'worst' performers if the index is to avoid 'naming and shaming' authorities.

We look forward to seeing CIPFA's response to the consultation and will share our views of their next steps.

EY's response to CIPFA consultation on implementation of the new adoption of IFRS 16

On 7 September CIPFA closed its consultation on proposals for developing the new edition of the Local Authority Accounting Code for 2019/20 in relation to implementing the new leasing accounting standard, IFRS 16.

IFRS 16 aims to increase the transparency of financial reporting on leases. It removes the previous lease classifications of operating and finance leases for lessees and it requires that a right-of-use asset (i.e., a lessee's right to use an asset over the life of a lease) be recognised for all leases (there are exemptions for short-term and low value leases) with a corresponding lease liability representing the lessee's obligation to make lease payments for the asset. This will be a significant change for local authorities and present practical challenges for processes, systems and data collection.

IFRS 16 will mean that current value depreciation and depreciation is charged to the Surplus or Deficit on the Provision of Services. It will also impact on the statutory reporting and capital finance requirements for leased assets which currently refer to finance leases. The recognition of right-to-use assets will bring leases into the scope of the Prudential Framework. The cost (on initial recognition) of the right-to-use asset will meet the definition of capital expenditure in contrast to the current revenue treatment of operating leases.

We generally support the CIPFA proposals with the following matters to highlight:

- ▶ **Clarification of what 'low value' is.** There are exemptions under IFRS 16 for 'low value' leases but there is no clear definition. The proposals do not make reference to assets that may be of low value, but are only used or used to maximum

effect by being part of a network e.g., photocopiers can be used off-line but are more usually used on-line; laptops could have a similar position. The Code needs to clarify what low value is and what being part of a network is as this would be a potential area of disagreement and inconsistency. A number of clients have suggested using their de minimis level for capitalisation as the 'low value'. The Code should emphasise that these are two different concepts.

- ▶ **Measurement of the lease liability.** The lease liability is calculated from the present value of the lease payments payable over the lease term. This is discounted at the interest rate implicit in the lease or the authority's incremental borrowing rate. In our experience many authorities do not have information on the rate implicit in their operating leases. For consistency and cost effectiveness mandating the use of the incremental borrowing rate for all leases would be a positive step.
- ▶ **Subsequent measurement.** To measure the right-of-use asset we support the approach of current value measurement with materiality based practical expedients. This would be consistent with the current approach for PPE assets. It would be unsupportable to have different valuation models for the same asset types based on whether they were controlled directly or controlled via lease.
- ▶ **Housing authorities and the Capital Financing Requirement (CFR).** The HRA CFR was effectively capped following HRA self-financing under Regulation. As many HRA authorities are at their HRA CFR limit the addition of right-of-use assets would lead to breaches of the HRA CFR cap. Given the categorisation of such assets as capital in nature this change will restrict the ability of HRA authorities to enter such leases which in some cases may severely impact on their 30 year HRA financial plan. Amending Regulations could be laid that allow the HRA CFR cap to be increased by the value of any right-of-use assets identified. This would maintain the integrity of the current system regarding capital expenditure but also maintain the current flexibility in respect of operating leases. We have suggested that CIPFA should seek discussions with the Ministry of Housing, Communities and Local Government to address this issue.

Consultation on proposed statutory overrides for IFRS 9

Local authorities will be required to implement the new IFRS 9 Financial Instruments standard for the 2018/19 financial year. The sector has made representations to government on the anticipated negative impacts of the new standard which could result in income statement volatility, earlier recognition of impairment losses on receivables and loans and significant new disclosure requirements. Ministry of Housing Communities and Local Government (MHCLG) has set a response date of 28 September 2018 for the following matters:

Time limited statutory override on fair value movements for pooled investment funds

One of the consequences of IFRS 9 is that fair value changes in pooled investments fund will be accounted for at fair value through profit and loss which will impact non-ringfenced revenue reserves, annual balanced budget calculations and ultimately mean there is less money available to fund services.

MHCLG is proposing a three year grace period to adapt to the accounting changes, requiring local authorities to reverse out fair value movements on pooled investments to unusable reserves until 1 April 2021. MHCLG believes this should give local authorities sufficient time to divest themselves of these types of funds or alternatively build up sufficient revenue reserves to mitigate the impact. To aid in transparency, fair value movements relating to IFRS 9 should be separately disclosed in the Unusable Reserves note.

Earlier recognition of impairments on loans and trade receivables

MHCLG does not intend to mitigate the impact of early impairment recognition of loans and receivables, owing any substantial impairment a direct result to the authorities risk appetite. Local authorities will need to keep a close eye on the budgetary position to accommodate this accounting change.

Disclosure Requirements

MHCLG does not intend to reduce any disclosure requirements, despite the administrative burden that may arise in first time implementation, as the new and enhanced disclosure requirements will benefit the users of the accounts.

The first year of local government faster close

After almost two years preparation, numerous discussions between auditors and finance teams, several reminders to audit committees and a significant amount of hard work, the end of July, the new deadline for local authorities to publish audited accounts, came and went. Across the 150 EY local authority audit portfolio, the new deadline was met at 132 authorities (88%). Nationally, we hear, and it's an unaudited figure, the outcome was 15% missed the earlier deadline, compared with 5% that missed the previous year's end of September deadline.

Auditors are already meeting with finance teams to de-brief and learn lessons for FY19. We outline below our immediate views on the key factors for both authorities and auditors that contributed to meeting the faster close deadlines.

- 1. Project management:** Authorities with a clear, well thought through, detailed and actively managed action plan, involving their auditors, were more likely to be successful in delivering closedown, accounts preparation and the audit to time. Project plans that made preparation of supporting working papers an integral part of the process resulted in better quality financial statements. When things were going off track, decisive action was taken to make a change and get progress moving in the right direction. Often project management resided with one or two key individuals in finance and audit teams who had the ability to influence others and make decisions on priorities and resource allocation.
- 2. Communication:** Early and honest communication on progress, key judgements and potential problems enabled officers and auditors to find solutions and agree on matters promptly and efficiently rather than having limited time to deal with late and unexpected issues.
- 3. Capacity and contingency:** The shorter period between accounts preparation and publication of audited accounts increased pressure on teams and squeezed the time to deal with late issues. Successful delivery was more likely where officers and auditors built capacity and contingency into their respective scheduling plans.

4. Dealing with accounting estimates: Authorities and auditors need to be clearer on their approach to preparing and auditing accounting estimates. Notably in respect of the two biggest estimates an authority makes relating to pensions and the valuation of property, plant and equipment. Both rely on the work of a specialist and are determined by an authority as part of closedown. Both are also estimates that auditors will always challenge and draw on the latest available information.

5. Streamlining the accounts: We were surprised that we didn't see much evidence of authorities using the opportunity to review their accounts and taking out non-material disclosures. This may be an area that authorities and auditors would find it helpful to discuss as part of planning for 2018/19.

We encourage audit committees to consider the five key factors in relation to their plans for preparing their 2018/19 statement of accounts and supporting the associated audit.

CIPFA Governance Guidance for LEPs

Over the years, the amount of public expenditure that Local Enterprise Schemes (LEPs) are responsible for has increased and the role of the section 151 officer has become of greater importance in the LEP assurance model. CIPFA, in collaboration with the Cities and Local Growth Unit, has developed five key principles for LEP section 151 officers which would result in more proportional financial governance for LEPs. The five key principles are as follows:

1. Enshrining a corporate position for the section 151 officer in LEP assurance.

- ▶ This will result in a shared responsibility arrangement between the chair, the chief executive, and the section 151 officer. Section 151 officers will also be required to provide an Annual Assurance Statement.

2. Creating a formal/structured mandate for the section 151 officer.

- ▶ This will allow the section 151 officer to attend board meetings and provide recommendations on financial administration.

3. Embedding good governance into decision making.

- ▶ This will result in section 151 officers taking an active role in the financial and risk-based decision making.

4. Ensuring effective review of governance.

- ▶ Internal audit will need to include a risk-based audit plan which will provide assurance to the board and the section 151 officer. Where there are serious concerns, such as non-compliance with legal requirements or fraud, the section 151 officer will be required to report these to the Cities and Local Growth Unit.

5. Appropriate skills and resourcing.

- ▶ This will ensure LEPs have the appropriate skills and resources, including audit, to enable the Section 151 officer to carry out their function.



Other

Social Care Spending

Age UK has published a report on a study conducted by health policy and communication specialists, Incisive Health, which shows that the social care system in the England 'lags behind' other countries. The report states that countries such as Germany and Japan have made sustainable social care policy changes in 1995 and 2000, respectively; whilst the social care system in England has remained largely unchanged despite several government consultations and green or white papers.

In response to this report, the Local Government Association (LGA) has attributed the delay in progression of adult social care system to underfunding, a rise in demand and increased cost for care and support. The LGA has estimated that there is a £3.5bn funding gap facing adult social care by 2025 to maintain the existing standards of care.

Research conducted by the Association of Directors of Adult Social Services has estimated that English councils in 2018/19 have cut social care spending by £700m which is equivalent to 5% of the total £14.5bn budget and that since 2010 social care spending has decreased by £7bn. The survey also found that half of councils in England overspent on adult social care budgets in 2017/18, half of which have drawn on council reserves to meet overspends. This is a concerning statistic given that the National Audit Office (NAO) has warned that 10% of councils will exhaust their reserves at the current rate of use.

To help bridge the funding gap, the LGA is currently consulting on its own proposals which includes an increase to national insurance by 1% on the basic rate and an additional social care premium for over-40s.

Social housing

There are 1.2 million people on waiting lists for social housing and for these people affordable housing is becoming more and more unaffordable as their incomes are squeezed. To address this issue the Government has released a consultation green paper which has proposed the building of new affordable housing by 'exploring flexibilities' on how local authorities spend the money from homes sold under the Right to Buy (RTB) scheme. Current funding allows for local authorities to keep one third of each RTB receipt to build a replacement RTB home; but does not allow authorities to borrow money to make up the shortfall for financing the replacement RTB home. The green papers also contains proposals to allow tenants to purchase as little as 1% of their property each year through shared ownership.

The LGA response to the Government's green paper was that the consultation showed positive signs, however the government could do much more for example allowing local authorities to keep all of the RTB receipts to allow councils to more easily finance replacement RTB homes and scraping the housing borrowing cap. The current proposals do not directly allocate funding to local authorities to build more social housing.

Organisational Transformation Guidance for Audit Committees

Transformation plans of any organisation can be highly complicated and risky, even more so for large organisations. Transformation plans can be broad in scope, evolve over time and it can be difficult to measure the impact of transformational change. The exercising of good governance by Audit Committees is essential for the success of major transformation projects. To aid Audit Committees, the NAO has issued guidance which sets out the initial questions that could be asked of officers in the 'set up' phase, 'delivery' phase and 'live running and benefit realisation' phase.

Further details of this guidance can be found through the link in the [Find out more](#) section below.

EY cybersecurity strategies

There's a new way of thinking about cybersecurity. New security approaches are moving from thinking about cybersecurity as a defensive approach, to thinking about it as a source of transformation. Here are some ways to position your cybersecurity strategies for a distinct advantage.

Make it a team sport that everyone is a part of

The number one cause of large security breaches remains phishing, according to the EY 2017/18 Global Information Security Survey of over 1,200 companies. On mobile devices, phishing attacks have increased by an average of 85% year on year for the last seven years, so you are still more likely to be made vulnerable by a member of staff opening a rogue email than anything else.

This is often the result of a lack of cybersecurity awareness – whether about generic malware, scams related to fake LinkedIn profiles, or hacks on public Wi-Fi.

Therefore, developing a culture where staff at all levels understand how to protect data and systems, including mobile devices, through up-to-date training, drills and regular communication, will help build and maintain a cybersecurity advantage.

Cyber policies are vital as a living, breathing reference to help manage a fraught and fast-moving situation, yet these aren't effective if staff outside of the cyber function don't know about them.

Embedding a cyber conscious culture that heightens awareness and behaviours amongst all employees can help you pull ahead of the competition, instead of scoring an own goal.

Keep to a small window for damage control

The UK's national cyber security centre recently described a need to act collaboratively and collectively against cyber threats, urging organisations to raise the bar.

Cyber threats don't respect borders, jurisdictions or organisational boundaries, and there is a small window in which to minimise the damage.

Under GDPR, the new mandatory 72-hour breach reporting could be too long a timeline in the court of public opinion, and focusing on the first 2 to 5 hours instead could provide a much needed advantage.

Outlining key stages of your breach response in the first few hours across functions from IT, security, PR to legal, and identifying at which points to get an external view, could make the difference between a forgiving public or not.

As we start to see more threats and regulations emerge across the world, how organisations come together, under extreme time pressures, will provide much needed collaborative gains.

Use different approaches for evolving risks

Cyber risks aren't constant. The nature of the risks are always changing – which means resources to fight them can't be allocated on a set basis.

Increasingly, cybersecurity requires bringing together a wide range of capabilities to deliver value.

Whether that be through enhancing cyber resources with new skillsets, leveraging emerging technology from hardware authentication, virtualised intrusion detection, or using AI and machine learning.

With cybersecurity increasingly becoming a competitive battleground, that's all the more reason to start thinking about how your organisation can build an effective cybersecurity advantage.

Key questions for the Audit Committee

Brexit

Has your authority considered the implications of Brexit? What plans does your authority have in plan to mitigate potential risks associated with Brexit?

CIPFA Financial Resilience Index

Does the proposed CIPFA financial resilience index provide your authority with the support needed to achieve a balanced budget?

Consultation on the adoption of IFRS 16

How prepared is your Fire Authority for the changes in processes, systems and data collection as a result of CIPFA implementation of IFRS 16?

Consultation on proposed statutory overrides for IFRS 9

Has your authority assessed the impact of the new accounting standard IFRS 9 Financial Instruments and the potential statutory overrides on your budgets?

LEP Governance

Is your local authority part of a LEP? If so, what arrangements are in place to ensure that the authority has sufficient assurance over the governance of the LEP?

Social Care

Given the spending pressures on social care and the sustainability of funding sources, what is the authority's strategy to ensure the sustainability of social care? How does the authority ensure that it maximises value for money from its social care services and ensures that the quality of care provided is appropriate?

Social Housing

What plans does your local authority have to ensure that there is sufficient social housing in the area? Has your authority responded to the Government's green paper consultation?

Transformation

Is your local authority considering or does your local authority have plans to transform its business? If so, how will the audit committee exercise good governance over these arrangements? Have you used the NAO transformational guidance?

EY cybersecurity strategies

Is your organisation still thinking about cybersecurity as a defensive approach or a source of transformation and distinct advantage?

Find out more

EY Item Club

<https://www.ey.com/uk/en/issues/business-environment/financial-markets-and-economy/item---forecast-headlines-and-projections>

Brexit

<https://www.publicfinance.co.uk/news/2018/06/government-failing-engage-over-brexit>

<https://www.publicfinance.co.uk/news/2018/07/brexit-will-hit-public-finances-conference-hears>

<https://www.local.gov.uk/about/news/lga-responds-brexit-white-paper>

CIPFA consultation on its proposed local authority financial resilience index

<https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-launches-consultation-on-new-index-to-measure-councils%E2%80%99-financial-resilience>

Consultation on the adoption of IFRS 16

<https://www.cipfa.org/policy-and-guidance/technical-panels-and-boards/cipfa-lasaac-local-authority-code-board/local-authority-leasing-briefings>

Consultation on proposed statutory overrides for IFRS 9

<https://www.gov.uk/government/consultations/local-authority-budget-setting-mitigating-the-impact-of-fair-value-movements-on-pooled-investment-funds>

LEP Governance Guidance

<https://www.cipfa.org/policy-and-guidance/reports/principles-for-section-151-officers-working-with-leps>

Social care

<https://www.publicfinance.co.uk/news/2018/08/england-lags-behind-other-countries-social-care>

<https://www.local.gov.uk/about/news/lga-responds-age-uk-report-care-funding-comparison>

<https://economia.icaew.com/news/august-2018/lga-proposes-tax-increase-to-support-social-care>

<https://www.theguardian.com/society/2018/jun/12/adult-social-care-services-collapse-survey-england-council>

Social Housing

<https://www.local.gov.uk/about/news/lga-responds-social-housing-green-paper>

<https://www.publicfinance.co.uk/news/2018/08/social-housing-paper-fails-provide-cash-needed-homes1>

Transformation Guidance (from the NAO)

<https://www.nao.org.uk/report/transformation-guidance-for-audit-committees/>

EY cybersecurity strategies

<https://www.ey.com/uk/en/services/advisory/cybersecurity/ey-four-cybersecurity-strategies>

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, More London Place, London, SE1 2AF.

© 2018 Ernst & Young LLP. Published in the UK.
All Rights Reserved.

ED None

EY-000074815.indd (UK) 09/18. Artwork by Creative Services Group London.

Information in this publication is intended to provide only a general outline of the subjects covered. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. Ernst & Young LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.

ey.com/uk