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EASTBOURNE
Borough Council

Working in partnership with **Eastbourne Homes**

25 November 2020

Dear Members

Audit and Governance Committee - 26 November 2020

I am now able to enclose, for consideration, the following report at the above meeting that was unavailable when the agenda was printed.

Item No	Item
8	**External Audit Report 2018/19 and 2019/20 (to follow) (Pages 3 - 28)** Update by Deloitte

Yours sincerely

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Report to:	**Audit and Governance Committee**
Date:	**26 November 2020**
Title:	**The External Auditors (Deloitte) report to those charged with governance on the 2018/19 Statement of Accounts**
Report of:	**Chief Finance Officer**
Ward(s):	**All**
Purpose of report:	**To review the Independent Auditor's (Deloitte) report to those charged with governance regarding the 2018/19 Statement of Accounts.**
Decision type:	**Budget and Policy Framework**
Officer recommendation(s):	**To note the ISA 260 (International Standards on Auditing) reports for the Council issued by the Council's external auditors, Deloitte.**
Reasons for recommendations:	**The Council is required to produce an annual Statement of Accounts by the Accounts and Audit Regulations.**
Contact Officer:	**Name: Ola Owolabi** **Post title: Deputy Chief Finance Officer** **E-mail: ola.owolabi@lewes-eastbourne.gov.uk** **Telephone number: 01323 415083**

1 Introduction

1.1 This report summarises the key findings arising from Deloitte final audit work in relation to the Council's 2018/19 financial statements; and on the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

1.2 The completion of the audit was been delayed, primarily due to the challenges of determining the appropriate accounting treatment, valuation and entries in respect of the Council's financial guarantee arrangements via Investment Company Eastbourne ("ICE") in the Council and Group financial statements.

2. 2018/19 Statement of Accounts

2.1 Under its terms of reference, it is the role of this Committee to review/approve the annual statement of accounts and the external auditor's report to those charged with governance, having considered whether appropriate accounting policies have been followed, and any issues raised by Deloitte from the audit of the accounts.

2.2 The Deloitte report to those charged with governance is attached as Appendix A, and the final audit of the 2018/19 Statement of Accounts by Deloitte will be completed following the resolution of the ICE accounting issues.

2.3 The auditors envisage issuing an unqualified audit opinion on the Council's financial statements. A few presentational adjustments arising from normal audit work have been noted, discussed, and resolved as stated in the report. However, the remaining outstanding areas of the audit includes:

- receipt of financial statements updated for the impact of the ICE transaction on both Council and testing of support for IIL joint venture accounting entries;
- conclusion on remaining queries on valuation of specific assets;
- completion of internal quality assurance procedures; and
- Deloitte review of events since 31 March 2019 through to signing.

2.4 Deloitte also carried out the review of the arrangements made by the Council to secure economy, efficiency, and effectiveness in the use of resources (Value for Money - VFM) and did not identify any significant VFM risks in 2018/19. Deloitte is satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019, and did not feel it necessary to report on any particular points on value for money issues.

3.0 Annual Statement of Accounts 2019/20- update

3.1 The Accounts and Audit Regulations (2015) set out the timescales to produce the Council's accounts, including the dates of the public inspection period. Following the coronavirus outbreak and in response to the pressures this has placed upon finance teams and external auditors in the production of the 2019/20 accounts, the Accounts and Audit (Coronavirus) (Amendment) Regulations came up with changes including; that the draft 2019/20 accounts must be approved and presented to the external auditors for review by 31 August 2020 and the publication date for the final, audited, 2019/20 accounts moved from 31 July 2020 to 30 November 2020.

3.2 The draft 2019/20 Statement of Accounts was submitted to the External Auditors (Deloitte) in July 2020, and the audit is yet to commence. Officers are waiting to be advised of the audit team and timings for the 2019/20 audit.

4 Corporate plan and council policies

4.1 Considered as part of the overall Accounts and Audit Regulations requirement and the timescales.

5 Financial appraisal

5.1 There are no direct financial considerations arising from this report.

6 Legal implications

6.1 Comment from the Legal Services Team is not necessary for this routine monitoring report. The Accounts and Audit (England) Regulations requires the

Statement of Accounts to be considered and approved by way of a committee resolution and thereafter published.

7 Risk management implications

7.1 There are no implications arising from this report.

8 Equality analysis

8.1 Equality issues are considered

9 Appendix

9.1 Appendix A – The Eastbourne Borough Council Report to the Audit and Governance Committee on the audit for the year ended 31 March 2019.

10 Background papers

10.1 The Background Papers used in compiling this report: Draft 2018/19 Statement of Accounts.

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Deloitte.

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Eastbourne Borough Council

Report to the Audit and Governance Committee on the audit for the year ended 31 March 2019

Issued for the meeting on 26 November 2020

Deloitte Confidential: Government and Public Services

Contents

01 Our report

Introduction

The key messages in this report

This report sets out the status of the 2018/19 audit of Eastbourne Borough Council (the Council). The scope of our audit was set out within our planning report previously presented to the audit committee.

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

Status of the audit	The completion of the audit has been delayed, primarily due to the challenges of determining the appropriate accounting treatment, valuation and entries in respect of the Council's financial guarantee arrangements via Investment Company Eastbourne ("ICE") (including joint venture accounting for the Council's interest in Infrastructure Investments Leicester Limited ("IIL")) in the Council and Group financial statements. The remaining outstanding areas of the audit are: • receipt of financial statements updated for the impact of the ICE transaction on both Council and Group (page 6); • receipt and testing of support for IIL joint venture accounting entries (whether or not booked on materiality grounds) (page 6); • conclusion on remaining queries on valuation of specific assets (page 9) • tie through of updated financial statements and disclosures to the updated trial balance, consolidation and supporting work papers; • completion of internal quality assurance procedures (including resolution of any matters arising therefrom); • receipt of signed management representation letter; and • our review of events since 31 March 2019 through to signing. We will agree timings for the 2019/20 audit with management following conclusion of this audit.
Conclusions from our testing	We have included in this paper our conclusions from testing of key areas of the financial statements. Management have made a significant number of adjustments to the financial statements during the course of the audit, including: • Accounting treatment for the investment in Infrastructure Investments Leicester Ltd (IIL); • Accounting treatment for the inception of the financial guarantee instrument; • Accounting treatment for subsequent measurement of that instrument; • Entries in relation to asset valuations and additions; and • The valuation of pension assets and liabilities. Subject to resolution of the matters noted above, we envisage issuing an unmodified audit opinion, with no reference to any matters in respect of the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources, or the Annual Governance Statement. We have considered the impact of the Covid-19 pandemic on our work – this is a non-adjusting subsequent event in relation to the 31 March 2019 financial statements. This will need to be disclosed as a subsequent event in the final 2018/19 financial statements, We have identified a number of internal control recommendations set out on page 14, initially shared with management during the original audit visit.

Introduction

The key messages in this report (continued)

Financial Sustainability and Value for Money	• Our review of the Council's arrangements has concluded that in the year to 31 March 2019, there are no material matters which we need to report in our Auditor's report on the financial statements with respect to the Council's arrangements to secure economy, efficiency and effectiveness in the use of resources ("value for money").
	• As noted on page 6, we had identified the Investment Company Eastbourne ("ICE") transaction and financial guarantee contract with Infrastructure Investments Leicester Ltd (IIL) as a significant risk. Following review of documentation and interviews with management, as well as review of the report of internal audit on the governance of the transaction, we concluded that:
	  • The authority had appropriately taken legal, property and commercial advice during the due diligence of the transaction.
	  • There were a number of areas for improvement for future transactions in terms of ensuring clarity of the accounting and budgetary impact ahead of entering into a transaction, ensuring clear consideration of downside risks, and transparent consideration of changes in transactions from initial approvals.
	  • It is not necessary to include an exception to our value for money conclusion in respect of this matter.
	• As noted on page 18, the Council has a relatively low level of General Fund reserves, increasing the risks to financial sustainability, particularly in the context of the pressures from Covid-19 on income and expenditure going forward. However, this does not impact our value for money conclusion for the 2018/19 financial year.

Narrative Report & Annual Governance Statement	• We have reviewed the Council's Annual Report & Annual Governance Statement to consider whether it is misleading or inconsistent with other information known to us from our audit work. • We have no significant matters to raise with you in respect of the Narrative Report. The timing of the work on the report means that we have asked management to include some brief subsequent events disclosures with respect to Covid-19 and its future impact on the council (relative to the 31 March 2019 financial statement date).
Duties as public auditor	• We did not receive any formal queries or objections from local electors this year. • We have not identified any matters that would require us to issue a public interest report. We have not had to exercise any other audit powers under the Local Audit and Accountability Act 2014.

Our audit explained

We tailor our audit to your organisation

Identify changes in your business and environment

In our planning report we identified the key changes in your business and articulated how these impacted our audit approach.

We obtained further information with regards to the financial guarantee contract within ICE, and have updated our risk assessment accordingly.

Scoping

The Council is the only significant component for the group audit. We have also performed procedures at group level on the property valuations within the subsidiaries.

Other findings

As well as our conclusions on the significant risks we are required to report to you our observations on the internal control environment as well as any other findings from the audit. These are set out on pages 14 to 17 of this report.

Determine materiality

When planning our audit we set our group materiality at £2.1m based on approximately 2% of forecast gross expenditure and council materiality at £2.06m.

Significant risk assessment

In our planning report we explained our risk assessment process and detailed the significant risks we have identified on this engagement. We report our findings and conclusions on these risks in this report. We have identified an additional significant risk with respect to the treatment of the Guarantee contract in relation to Investment Company Eastbourne ("ICE").

Conclude on significant risk areas

We draw to the Committee's attention our conclusions on the significant audit risks. In particular the Committee must satisfy themselves that management's judgements in relation to going concern are appropriate.

Our audit report

Based on the current status of our audit work, we envisage issuing an unmodified audit report and value for money conclusion.

Significant risks

Accounting for the ICE financial guarantee contract

Risk identified

This is an additional significant risk, identified since the planning stage, and is also a risk in relation to value for money.

The Council (through its subsidiary, ICE), agreed to provide certain guarantees with respect to a loan taken out in relation to a property investment in Leicester. This property is owned and operated by a third party.

The guarantee is two-fold, in that ICE (and the council) are guaranteeing the repayments of the bank borrowings by the third party, and also a certain level of rental income through the property.

The Council has also purchased a related option to buy up to 49% of the share capital of the property company for £1 at any time, and gains the rights to 100% of the share capital should there be an event of default.

This is a complex arrangement, and the financial statement risks include the potential for the accounting treatment to be incorrect, Additionally, we have identified a significant Value for Money risk in relation to the governance and informed decision making with regards to this significant and unusual transaction.

Deloitte response

With respect to the value for money risk, we obtained documentation as to the work that Management had performed in order to gain an understanding of the legal form of the arrangements and whether they had appropriate powers to enter into the arrangements. Additionally documentation setting out the purpose and risks of the arrangements was obtained.

However, it was clear from these, and from discussion with management that the detailed accounting implications for the Council were not adequately understood (as confirmed by the delays owing to the lack of a finalised accounting treatment) – and this reflected in part lack of clarity over the full terms of the agreements and the related risks to the Council.

Following detailed discussions with management, with our own specialists, and with management's experts, we have since performed the following:

- Concluded that the appropriate accounting treatments are as set out below (subject to management's finalisation of journals to post the accounting entries):

Area	Appropriate treatment	Notes
Investment in ICE	This is a joint operation, and is therefore equity accounted, with the Council showing its share of the results and net assets of the entity	Management's advisors had originally not considered whether the arrangement met the criteria for "joint control" or "significant influence".
Rental guarantee	Treated as a non-financial guarantee under IFRS 9. Income is recognised over the life of the guarantee, with the carrying value remeasured each year to fair value (with movements in the CIES)	Expected value on recognition c£16.7m, amortising to c£16.2m at 31 March 2019
Loan interest guarantee	This is a financial guarantee. IFRS 9 requires that this is initially recognised at fair value, and subsequently at the higher of that value (less cumulative income against the guarantee) and any determined loss allowance.	Expected value on recognition c£1.2m, amortising to just under £1.2m at 31 March 2019.
Contract receivable	There are cashflows receivable with respect to the guarantee arrangement, being an annual guarantee fee (£300k, subject to indexation), and a proportion of the value of the property at termination (100% of the first £35m, and 50% of any amount above £70m). The balance is discounted and so increases as the discounting unwinds. The exposure to property valuation movements means this is also required to be measured at fair value (movements to CIES).	The initial estimate of this receivable was not at fair value, and did not include the property valuation. This has subsequently been adjusted for. The initial value of the debtor of c£12.4m unwinds for a year's discounting to c£12.9m at 31 March 2019.

Significant risks and Value for money

Accounting for the ICE financial guarantee contract (continued)

Deloitte response (continued)

- Involved our own specialists in challenging the treatment of the contract, including accounting for the investment in ICE.
- Challenged management's valuation of the various elements of the financial instruments, including in particular, the treatment of the property valuation, discount rates, and the models used.
- Held discussions with Management's advisors, including Grant Thornton and Arlingclose, in order to fully understand the assumptions and estimates that management had made.
- Considered the nature of the transaction and whether the Council had the *vires* to make the arrangement.
- Performed sensitivity analyses of key assumptions, in order to challenge the robustness of the model, and to focus our testing on the key judgements.
- Considered any indications that the transaction had been entered into on a basis other than that of arm's length.
- Reviewed the implications of the accounting for the transaction, and the significant challenges that occurred in presenting this in the financial statements, as part of our work on Value for Money

Value for Money considerations

We identified a significant risk to our VFM conclusion in respect of the ICE financial guarantee contract, due to the complexity and size of the transaction. In response:

- We reviewed supporting documentation with regards to the advice taken by the Council prior to entering into the agreement, including legal, property and commercial advice during the due diligence of the transaction, and the internal documentation on the approval of the decisions.
- We discussed the Council's arrangements with senior operational staff – including the Chief Executive Officer and Chief Financial Officer.
- We considered the overall financial impact of the agreement, as well as the balance of risks and rewards.
- We reviewed Internal Audit's report into the governance of the transaction, which had a "Reasonable Assurance" conclusion, but noted a number of recommendations in respect of transparency around decision making, clarity of consideration of the risks of transactions, consideration of accounting requirements, and record keeping on decision making for complex transactions.
- Performed the work to support the financial statement audit.

Following review of documentation and interviews with management, as well as review of the report of internal audit on the governance of the transaction, we concluded that it is not necessary to include an exception to our value for money conclusion in respect of this matter. We note that the final contractual structure entered into in 2018 was not the same as that initially consulted on and approved by Council in 2017, and would view it as good practice for a major transaction for the updated transaction structure to have been reported. We have identified other control recommendations in respect of complex transactions in our findings on page 14 onwards.

Deloitte view

We are awaiting a final version of the financial statements which fully reflects the required accounting. However our work on these matters is now substantially complete. The group accounts also require updating for the joint venture accounting for IIL, and we will review these entries (which are expected to be immaterial) and their support when provided.

The effect of the adjustments for ICE accounting will be to reduce the £2m gain that is currently recorded in reserves, with the effect expected to be a c£1m reduction at 31 March 2019. As the transaction gives rise to significant potential risks over time, and with a significant portion of the value of the transaction only received at the end of 30 years on disposal of the property, we understand management are considering an appropriate reserves policy to ensure adequate allowance for risk in the use of proceeds of the transaction.

The Council has an option, for £1, to acquire a 49% shareholding in IIL (which is one of the key factors in determining the company should be treated as a joint venture). We recommend the Council consider when and/or under what circumstances it will exercise this option, as the Council will only receive dividends from IIL after the option is exercised.

Although the 2018/19 valuations of the elements of the transaction have assumed no significant in year fair value movements, we note that the required accounting will give rise to complex valuation estimates in future years, particularly with the impact of increased market volatility as a result of Covid-19. These movements are likely to give rise to volatility in the CIES, and we understand that management are considering their reserves policy for accounting entries arising from this transaction.

Significant risks

Cut off and completeness of expenditure via accruals and provisions

Risk identified

For 2018/19, the Council approved a budget with a net cost of service of £16.9m. As at September 2018, the Council reported a forecast overspend of £498k, but that they were working towards a balanced position which was achieved in 2017/18. Given the Council's current budget position and the pressures across the whole of the public sector, there is an inherent risk that the year-end position could be manipulated by omitting or misstating accruals and provisions.

Deloitte response

We obtained an understanding of the design and implementation of the key controls in place in relation to recording completeness of accruals and provisions.

We performed focused testing in relation to the completeness of expenditure including a detailed review of accruals and provisions.

As part of this focused testing challenged any assumptions made in relation to year-end accruals and provisions.

We reviewed the year on year movement in accruals and provisions and investigated significant movements.

We tested an enhanced sample of expenditure for late cut-off at year end.

Deloitte view

Our testing did not identify any issues in these areas.

Significant risks

Valuation of property assets

Risk identified
The Council is required to hold property assets within Property, Plant and Equipment and Investment Properties at valuation. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value.

Key judgements and our challenge of them

The Council held £275.8m of property assets at 31 March 2019, an decrease of £9m, made up of £8.2m revaluation gain, £5.9m of additions, offset by depreciation of £7.1m and disposals of £16.0m. Investment properties increased from £23.9m to £25.7m, of which £1.1m was valuation gains and the remainder additions. We draw attention to the fact that these values have all been changed subsequent to the version of the accounts provided for the initial audit.

All properties were subject to a desktop revaluation exercise in the year as part of the council's approach to the valuations.

Deloitte response

- Our testing of the desktop valuation is ongoing, involving our property valuation specialists, Deloitte Real Estate, with a small number of specific queries (including in respect of the property asset in IIL) outstanding.
- They have completed their initial review and there were a number of significant questions for the valuer and for management. Many of these have been resolved, resulting in the updated draft of the financial statements. Remaining areas are noted below.

Deloitte view
Our work on this matter is now substantially complete, awaiting final resolution of a number of matters which were identified in our review. The key matters are as follows:
- Treatment of additions between valuations, which had been added to fixed assets at cost without corresponding disposal entries. Management have agreed to adjust in respect of this, and we are agreeing whether restatement of the comparative is required.
- Assumptions in relation to the valuations of David Lloyd (Broadwater Way), Hampden Retail Park, and the property in IIL

In addition, we identified a number of instances where we consider that the valuers did not follow best practice in their approach, typically through an overly simplified approach, and where improvements could be made for future valuations. These matters were noted to the valuer during the review process.

Final conclusions on this area remain outstanding.

Significant risks

Management override of controls

Risk identified
In accordance with ISA 240 (UK) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.

Additionally, there was a significant, and unusual transaction in the year which was the setting up of the guarantee contract through Investment Company Eastbourne ("ICE"). This is covered as an additional significant risk.

Deloitte response

We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- The Council's results throughout the year showed a surplus of income over expenditure.
- Senior management's remuneration is not tied to particular financial results.

We have considered these factors and other potential sensitivities in evaluating the judgements made in the preparation of the financial statements.

Significant and unusual transactions

See separate risk in relation to ICE. There were no other significant or unusual transactions in the period.

Journals

We have performed design and implementation testing of the controls in place for journal approval.

We have used Spotlight data analytics to risk assess journals and select items for detailed follow up testing. The journal entries were selected using computer-assisted profiling based on areas which we consider to be of increased interest.

We have completed testing of the appropriateness of journal entries recorded in the general ledger. We are testing the appropriateness of other adjustments made in the preparation of financial reporting as the adjustments are made.

Accounting estimates

We have performed design and implementation testing of the controls over key accounting estimates and judgements.

The key judgements in the financial statements are those selected as significant audit risks and other areas of audit interest: valuation of the Council's estate, the pension liability, and accounting for ICE, as discussed elsewhere in this report.

We reviewed accounting estimates for biases that could result in material misstatements due to fraud.

Deloitte view

We have not identified any significant bias in the key judgements made by management.

We have not identified any instances of management override of controls in relation to the specific transactions tested.

Conclusion on arrangements to secure economy, efficiency and effectiveness from the Council's use of resources

Background

Under the National Audit Office's Code of Audit Practice, we are required to report whether, in our opinion, the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

The Code and supporting Auditor Guidance Notes require us to perform a risk assessment to identify any risks that have the potential to cause us to reach an inappropriate conclusion on the audited body's arrangements. We are required to carry out further work where we identify a significant risk - if we do not identify any significant risks, there is no requirement to carry out further work.

Our risk assessment

We set out the risk assessment procedures we had performed and our further planned procedures in our audit planning report including discussion with relevant officers and review of Council documentation including internal audit reports. We did not identify any further significant risks from our remaining risk assessment procedures. Our areas of focus included the below:

- **Investment in ICE and related financial guarantee:** We identified a significant risk with respect to the arrangements surrounding this transactions. As detailed on Page 10, we have concluded that we do not need to draw attention to this in our audit opinion on the Council's arrangements. However, there are a number of areas for improvement that we have noted.
- **Capital Plans:** As at 31 March 2019, the Council had significant capital projects planned. Our review of the Council's arrangements in respect of monitoring these schemes and mitigating associate risks did not give rise to a significant risk to our conclusion.

Deloitte view

Based on the current status of our audit work, we envisage issuing an unqualified "value for money conclusion".

The expected form of our conclusion is as follows:
On the basis of our work, having regard to the guidance issued by the Comptroller and Auditor General in November 2017, we are satisfied that, in all significant respects, Eastbourne Borough Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019

Other matters

Defined benefits pension scheme

Background

The Council participates in the East Sussex Local Government Pension Scheme, administered by East Sussex County Council.

The net pension liability has increased from £45.6m at 31 March 2018 to £56.2m at 31 March 2019 primarily as a result of asset value movements, offset by a slight decrease in the discount rates, and an increase in inflation assumption.

The Council's pension liability is affected by the McCloud legal cases in respect of potential discrimination in the implementation of transitional protections following changes in public sector pension schemes in 2015. Subsequent to year-end, the Government was denied leave to appeal the case, removing the uncertainty over recognition of a liability. The actuary has assessed the impact on the defined benefit obligation as being in the range 0.1% - 1% with a central estimate of 0.3% - an adjustment has been made of £0.8m reflecting this.

	Council	Benchmark	Comments
Discount rate (% p.a.)	2.4%	2.42	Reasonable, slightly prudent
Consumer Price Index (CPI) Inflation rate (% p.a.)	2.5%	2.19%	Prudent
Salary increase (% p.a.) (over CPI inflation)	0.4%	Council specific	Prudent – in line with CPI estimates and recent outcomes
Pension increase in payment (% p.a.)	2.5%	2.19%	In line with CPI estimates
Pension increase in deferment (% p.a.)	2.5%	2.24%	In line with CPI estimates
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	22.1	22.1	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	23.8	23.8	Reasonable

Deloitte response

- We obtained a copy of the actuarial report produced by Hymans Robertson LLP, the scheme actuary, and agreed in the disclosures to notes in the accounts.
- We assessed the independence and expertise of the actuary supporting the basis of reliance upon their work.
- We reviewed and challenged the assumptions made by Hymans Robertson, including benchmarking as shown the table opposite.
- We have reviewed and challenged the calculation of the impact of the McCloud case on pension liabilities.
- We reviewed the disclosures within the accounts against the Code.
- We received assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary.
- We tested the movements in pension asset values from 31 March 2018 to 31 March 2019 via substantive analytic procedures. The updated total asset values are consistent with our expectation.

Deloitte view

The Council has adjusted the pension liability for the impact of the McCloud case, and for actual asset valuations at 31 March 2019 (having prepared the original draft financial statements on estimated values, with a net adjustment of £5.8m.

We have reviewed the assumptions and, on the whole, the set of assumptions is reasonable and lies towards the middle of the range of assumptions when compared with the Deloitte benchmarks. The assumptions have been set in accordance with generally accepted actuarial principles and are compliant with the accounting standard requirements of IAS19.

Other matters

Group Accounts

Audit considerations regarding the Group Accounts

We have not been appointed the auditor of the material subsidiary companies within the group. In order to gain sufficient assurance over significant account balances in the group accounts, we have performed further audit procedures based on a group risk assessment. The key components for audit procedures are shown in the table below (with figures based on the original consolidation pending ICE accounting).

We will test the final consolidation and eliminations/consolidation adjustments prepared after posting of the remaining required adjustments.

Components	Expenditure (Cost of Services) 2019/20 £m	Net Assets 31/3/20 £m	%age of total Group Expenditure	%age of group Net Assets	Summary of work to be performed
Council	89.8	289.1	>100%	99.7%	The Deloitte group audit team has performed full-scope audit procedures under the Code on this component. Matters arising are noted throughout this report
EHIC	(0.3)	(1.0)	<1%	<1%*	*EHIC holds £9.4m of investment property (other items are primarily intercompany which eliminate). The valuation of the investment property was therefore in scope for our group audit, and audited by the group team.
ICE	The transactions in ICE eliminate with group (as the investment in IIL in ICE's company only accounts is replaced by joint venture accounting on consolidation), and hence we have tested these at Council and Group level.				
Infrastructure Investments Leicester (IIL) Ltd	IIL is accounted for as a Joint Venture under the equity method. We have considered whether elements of the IIL accounts could have a material impact on the group or Council financial statements, where the group accounts for the movement in its share of the net assets of the JV and its share of any profit or loss. The Council is preparing accounting entries for the JV accounting based on the results of IIL from acquisition onward, which are not expected to give rise to a significant share of profit or loss for the year. The key risk in respect of this is the valuation of the property in IIL, and whether any movements arise to the year-end, and so we have asked for evidence to support the judgement the valuation used in finalising the JV accounting for the year, which will be considered by the group team to group materiality level				
Others	(1.6)	2.2	<1%	<1%	These components are not significant. Desktop reviews have been performed over these entities

Group Materiality

Materiality for the group is £2.08m with the Council stand alone materiality level set at £2.06m. In order to apply meaningful specified procedures to the non-Council, in-scope group entities, component materiality has been reduced accordingly, with work on EHIC being performed to a component materiality of £0.83m. Work on IIL valuation, as a JV, has been performed to group materiality only.

Other significant findings

Internal control and risk management

During the course of our audit we have identified a number of internal control and risk management findings, initially raised in draft with management in July 2019, which we have included below for information.

Area	Observation	Priority
Quality of draft financial statements	The initial draft financial statements which were published for public inspection and presented for audit were not of the expected standard. Issues noted included: • The initial draft only included EBC figures and omitted the Group consolidated primary statements and notes • The initial draft did not include the cash flow statement or the expenditure and funding account • Accounts disclosures not updated for 2018/19 changes in the Code including in respect of the reconciliation of financial liabilities • Inconsistencies between notes and primary statements • Accounting policies not updated for the adoption of IFRS 9 and IFRS 15 • Accounts disclosures not updated for the adoption of IFRS 9 • Accounts disclosures not updated for the adoption of IFRS 15 • Accounting for the ICE financial guarantee contract not being finalised or reflected the financial statements. • Other sundry issues noted through the financial statements. Together these indicate significant deficiencies in the financial reporting and close process. We recommend the Council review the year-end reporting and close process, including: • preparation of a skeleton draft of the financial statements ahead of year-end, reviewed against the Code for any changes in the year and for the disclosure requirements for any new or changed activities of the Council • documentation and quantification of judgments in respect of materiality of disclosure requirements in preparing the accounts • documented and reviewed use of CIPFA disclosure checklists • documented and reviewed internal checks of arithmetic accuracy and internal consistency • completion of the CIPFA "pre-audit checks on draft year-end accounts" checklist • documented and reviewed internal tie back and referencing of the draft financial statements to supporting working papers.	●

The purpose of the audit was for us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you.

Low Priority

Medium Priority

High Priority

Other significant findings

Internal control and risk management

Area	Observation	Priority
Determination of accounting treatments for complex transactions and preparation of accounting papers	Management accounting papers were not available in relation to ICE prior to the preparation of the financial statements. We note that at a paper on ICE had been commissioned from Grant Thornton at the time of preparation of the financial statements, but: • this was not complete at the time of the preparation of the financial statements or for a number of months thereafter; • was therefore not reflected in the accounting of the accounts published for inspection; and • this work was commissioned significantly after the transaction had been entered into. This meant that in entering into the ICE transaction, the Council was fully not sighted on the accounting, and so budgetary, consequences of the transaction. We would expect organisations undertaking complex accounting transactions to have undertaken an appropriate accounting analysis (either internally or with suitable external accounting advice), so that the accounting and budgetary consequences were fully understood. While Arlingclose provided brief comments on some accounting matters in their Investment Reports, these were by reference to earlier proposed transactions structures rather than the final transaction structure that was entered into. It is good practice (and the expectation of the Financial Reporting Council) for organisations to prepare accounting papers in respect of key matters in the application of accounting standards, in particular for matters of judgement or of estimation complexity. Typically these would include consideration of the relevant requirements of the accounting standards and the Code, the fact pattern (including details of relevant terms of contracts etc), an assessment of how the standards apply in this context, consideration of potential alternative treatments, the proposed approach to measurement/calculation of accounting entries required, and the required disclosures. The preparation of accounting papers both supports accurate financial reporting, including facilitating both internal and external review and challenge, and provides a resource to ensure institutional knowledge in the organisation. We recommend the Council adopt an approach of preparing papers for any key accounting judgements or issues arising.	
Governance arrangements on approval of significant or unusual transactions	As set out on page 11, although we do not anticipate qualifying our value for money conclusion in respect of this transaction, we did identify areas for improvement in the Council's arrangements around this transaction, and note that the Council has previously set up other innovative structures such as Clear Sustainable Futures (albeit with limited transactions). We recommend the Council consider whether there are further actions that may be appropriate to put in place in respect of decision making around commercial, innovative or otherwise significant or unusual transactions, even if these do not require immediate borrowings, for example embedding additional controls over both the governance and accounting arrangements with respect to significant or unusual transactions.	

Other significant findings

Internal control and risk management

Area	Observation	Priority
Institutional knowledge and documentation of complex arrangements	One of the challenges of determining the accounting treatment for the ICE transaction was that there were gaps in the understanding of the transaction as a whole and of the interaction of the various income streams, potential costs, and risks that the Council was exposed to, which was affected by the key officer involved having left during the year. For complex transactions, particularly those with an impact over long time periods, it is important to create adequate internal documentation to explain the transaction, the interrelationship of documentation and provisions in agreements, the potential risks and mitigations available, and any actions required for on-going monitoring of the position, as well as consideration of the accounting.	
New accounting standards – IFRS 9 and 15	The Council did not prepare accounting papers on the transition to IFRS 9 and 15 in advance of preparation of the draft account. The initial draft accounts were not updated for changes in disclosure requirements from IFRS 9 and 15. Although our work on IFRS 9 and 15 did not identify any material changes to the financial statements, we highlight that this has been done as a year-end exercise to assess and calculate the impact of GAAP differences, without embedding into the Council's underlying systems, processes and controls. This presents a risk that new contracts or transaction may give rise to unanticipated impacts in future, or not be detected. We recommend the Council review how to update its day to day accounting processes, including any necessary system and control changes, to reflect the requirements of IFRS 9 and 15 and the process to be followed in assessing new and unusual transactions.	
Preparation for IFRS 16	The implementation of IFRS 16, Leases, is expected to have a greater and more complex impact upon most Councils than the adoption of IFRS 9 and 15. The scope and potential complexity of work required, which may require system or process changes to underpin correct accounting under the standard, will require work to be completed at a significantly earlier stage than has been the case for IFRS 9 and 15 to allow for financial reporting timetables to be met. The timing of implementation of IFRS 16 is currently being discussed by HM Treasury and it is possible this will again be delayed to 1 April 2022 – however, this is currently planned for 2021/22. We recommend the Council targets completion of its IFRS 16 impact analysis during 2020/21, and to calculate an adjusted opening balance sheet position for audit. We recommend early consideration following the impact analysis of actions required to embed IFRS 16 accounting in the Council's underlying accounting systems.	

Other significant findings

Internal control and risk management

Area	Observation	Priority
Information technology	Our IT specialists raised a number of insights with regards to the Council's systems, including: • Password lockout and lockout duration were not defined; • No use of formal classification systems for potentially sensitive data; • No data leakage risk assessment analysis had recently been performed; and • New joiners created using previous user accounts as templates (which could lead to propagation of inappropriate access levels). Whilst these matters had no impact on our audit approach, they are areas in which the Council could make improvements to the functionality of their systems and to reduce risks.	
Journal authorisation	It was noted during our D&I testing for controls over journal posting, that there is no control in place within Civica (the accounting system used) which prevents a user from posting a journal with has not been authorised. Only finance staff are able to post journals and are given instructions to seek approval for journals which are posted for amounts greater than £100k. We note that this is dependent on the journal preparer communicating this to the senior accountant (i.e. they are still able to post journals without authorisation). Higher level reviews provide a mitigating control, however embedding the authorisation policy would improve the control environment.	

Financial sustainability

COVID-19's impact on financial sustainability

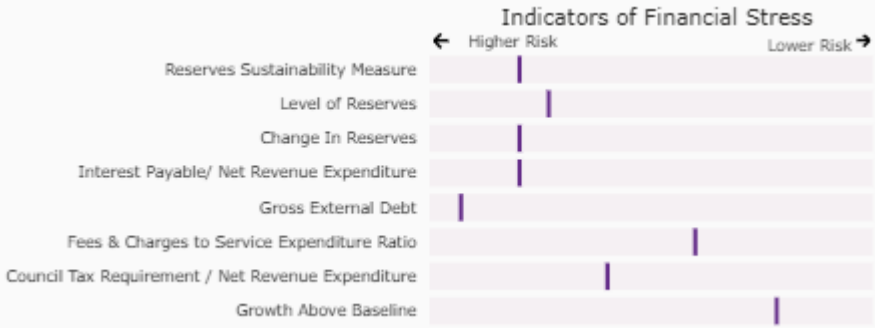
Due to the timing of the COVID 19 pandemic:

- For 2018/19, there is a non-adjusting subsequent event to disclose.
- For 2019/20, there was limited impact on the Council's income and expenditure for the financial year.

However, as the committee will be well aware it is having a significant impact on the Council's operations and performance in 2020/21. Based on the Ministry of Housing, Communities & Local Government ("MHCLG") *Local authority COVID-19 financial management information reporting data*, during August Local Authorities were forecasting to incur additional COVID-19 related expenditure of £5.24bn in 2020/21 and to suffer a loss in income of £5.99bn over the same period. In relation to the cost increases, the largest expected pressure was in Adult Social Care which comprised £2.30bn to the total. For lost income the three main components were Business rates (£1.61bn), Council Tax (£1.56bn) and Sales, fees and charges (£2.01bn). To date the government has allocated £3.7bn of emergency funding to local authorities but this still leaves a significant gap which will present a challenge for the Council and will likely be an area which we need to focus upon in our value for money work in 2020/21.

Eastbourne's position

At the start of the 2019/20 year, when compared to comparable authorities in the CIPFA Financial Resilience Index, Eastbourne was considered to be relatively higher risk in relation to the level of financial reserves. (Note that this is prior to the adjustments in respect of ICE accounting discussed earlier in the report). (We note that management are discussing with CIPFA some of the figures used in their index, as this reflects a snapshot position).



Indicator	Min	Indicator Value	Max
Reserves Sustainability Measure	5.81	48.53	100.00
Level of Reserves	23.28%	66.50%	261.90%
Change In Reserves	-34.07%	-5.82%	190.25%
Interest Payable/ Net Revenue Expenditure	0.19%	23.25%	38.03%
Gross External Debt	£1,250k	£123,734k	£216,985k
Fees & Charges to Service Expenditure Ratio	3.50%	29.58%	38.34%
Council Tax Requirement / Net Revenue Expenditure	37.90%	61.43%	75.49%
Growth Above Baseline	10.00%	28.00%	78.00%

During the year to 31 March 2020, the draft 2019/20 financial statements (prior to ICE accounting) show a net £3.5m reduction in the General Fund (including a £1.2m transfer to Earmarked Reserves).

The pandemic has affected 2020/21 budgets, and the Council has considered various updates during the year to date, including actions that can be taken to mitigate the impact on the Council's income and costs. The Council was already in a relatively weak financial position, and COVID-19 presents additional significant financial challenges in 2020/21 and beyond. The Council's response will be an area we focus upon in our value for money work going forward and which we would expect to comment upon in our narrative commentary in the Auditor's Annual Report.

Your annual report

We are required to report by exception on any issues identified in respect of the Annual Governance Statement.

	Requirement	Deloitte response
Narrative Report	The Narrative Report is expected to address (as relevant to the Council): - Organisational overview and external environment; - Governance; - Operational Model; - Risks and opportunities; - Strategy and resource allocation; - Performance; - Outlook; and - Basis of preparation - Future sustainability and risks to this posed by Covid-19.	We have assessed whether the information given in the Narrative Report meets the disclosure requirements set out in guidance, is misleading, or is inconsistent with other information from our audit. We fed back some improvements that could be made in various areas of the report to improve drafting and understandability. We have considered the sustainability narrative including the requirement to discuss and evaluate the impact of Covid-19 within this assessment. We note that for the 31 March 2019 accounts, only a reference to Covid-19 as a subsequent event is required. Overall we concluded satisfactorily in this matter.
Annual Governance Statement	The Annual Governance Statement reports that governance arrangements provide assurance, are adequate and are operating effectively.	We have assessed whether the information given in the Annual Governance Statement meets the disclosure requirements set out in guidance, is misleading, or is inconsistent with other information from our audit. Overall we concluded satisfactorily in this matter.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Audit Committee and the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the Narrative Report.

What we don't report

As you will be aware, our audit was not designed to identify all matters that may be relevant to the Council.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.

Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

The scope of our work

Our observations are developed in the context of our audit of the financial statements. We described the scope of our work in our audit plan and again in this report.

This report has been prepared for the Audit Committee and Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP

for and on behalf of Deloitte LLP
25 November 2020

Deloitte.

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