

Portsmouth City Council

Annual Audit Letter for the year ended 31 March 2017

February 2018

Ernst & Young LLP



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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.

A close-up photograph of a hand holding a blue pen and writing on a document. The hand is positioned on the right side of the frame. In the background, a calculator and a laptop are visible on a desk. A white mug is on the left side. A yellow rectangular box is overlaid on the left side of the image, containing the text "Executive Summary".

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Portsmouth City Council following completion of our audit procedures for the year ended 31 March 2017.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2017 and of its expenditure and income for the year then ended. The Opinion was issued on 22 January 2018, after the 30 September 2017 deadline.
▶ 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 Council's arrangements for securing economy, efficiency and effectiveness	We concluded that the Council has put in place proper arrangements to secure value for money in its use of resources.

Area of Work	Conclusion
Reports by exception: ▶ Consistency of Governance Statement	The Annual Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, 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.

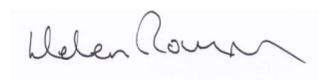
Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	A draft version of the Audit Results Report was presented to the 27 October 2017 Governance and Audit and Standards Committee. Following the signing of our opinion on 22 January 2018, the final version of the report was issued to officers and the chair of the Governance and Audit and Standards Committee.
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 22 January 2018.

In February 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken on the 2016/17 housing benefits subsidy claim.

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



Helen Thompson

Associate Partner
For and on behalf of Ernst & Young LLP

Purpose



Purpose

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 Council.

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report to the Governance and Audit and Standards Committee, representing those charged with governance, on 27 October 2016, with a final version of the report issued on 22 January 2018. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.



Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued in February 2017 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 2016/17 financial statements; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council 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 Council;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by thy 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 the Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the Annual Governance Statement, the Council 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 Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

A blurred office desk with a laptop, glasses of water, and financial documents. The scene is brightly lit, likely from a window with blinds in the background. A yellow rectangular box is overlaid on the left side of the image, containing the text 'Financial Statement Audit'.

Financial Statement Audit

Financial Statement Audit

Key Issues

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

We audited the Council'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 22 January 2018.

Our detailed findings were reported to the 27 October 2016 Governance and Audit and Standards Committee, with a final version of our audit results report issued on 22 January 2018.

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

Significant Risk	Conclusion
<p>Management override of controls</p> <p>A risk present on all audits is that 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.</p> <p>Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p> <p>For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.</p>	<p>To address the risk of management override, we:</p> <ul style="list-style-type: none"> • tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements; • reviewed accounting estimates for evidence of management bias; • evaluated the business rationale for significant unusual transactions; • reviewed the entries in the Movement in Reserves Statement; and • reviewed capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised. <p>We did not identify any:</p> <ul style="list-style-type: none"> • Inappropriate journal entries or adjustments made in the general ledger or the preparation of the financial statements. • Instances of management bias from our review of accounting estimates. • Significant unusual transactions for which there is not an appropriate business rationale. • Unusual transactions within the Movement in Reserves Statement. • Expenditure on property, plant and equipment which has been inappropriately capitalised. <p>Overall, our audit work did not identify any evidence of management override of controls.</p>

Other Key Findings	Conclusion
<p>Format of comprehensive income and expenditure statement</p> <p>Amendments were made to the CIPFA Code of Practice on Local Authority Accounting for 2016/17 and it now requires that the service analysis is based on the organisational structure under which the Council operates.</p>	<p>We reviewed the new analysis against requirements of the CIPFA Code in detail. During the exercise to re-analyse line items, the Council identified that in previous years, Revenue Expenditure Funded from Capital Under Statute income and expenditure had been netted off against one another instead of being accounted for separately. This mainly affected Solent Local Enterprise Partnership where gross income and expenditure should have been £34 million higher and to a lesser degree: Children & Education (£1.3million), Health & Social Care (£0.02 million) and Housing (£1.5 million).</p> <p>This only affected analysis between prior year gross expenditure and prior year gross income. Both were restated this year by £37 million as a prior year adjustment. The overall prior year net surplus on the provision of services was unaffected by this change. We tested the prior period adjustment calculations in detail and we were satisfied that the adjustment was correctly calculated and disclosed. We requested additional disclosures to be included in relation to the statement; with this amendment, we were satisfied that the format of the comprehensive income and expenditure account was appropriate.</p>
<p>PFI and similar arrangements</p> <p>Portsmouth City Council has two relatively high value PFI and similar agreements (highways and waste) which have been in place for a number of years. The models were last reviewed in detail by the Council's previous auditor, the Audit Commission. We undertook a number of specific procedures to provide assurance that the accounting models produce materially correct information in the Council's accounts.</p>	<p>We noted that the draft accounts presented for audit include a prior period adjustment to correct the methodology used to calculate minimum lease rental payments under the Highways Maintenance agreement. The EY Financial Accounting Advisory team tested the assumptions supporting that adjustment and our audit also included checks on the accuracy of calculations supporting the adjustment. We agreed with the Council's conclusion that liabilities to the highways maintenance contractor had been overstated by £7.1 million and associated assets at 31 March 2016 had been undervalued by £6.1 million. Payments made and liabilities due under PFI (and similar) agreements have been correctly accounted for and disclosed in the 2016-17 financial statements</p> <p>As part of our work we noted that the Highways Maintenance contract is being renegotiated. We recommend that the supporting model is revisited by Portsmouth City Council when the deed of variation is signed, with checks to confirm that total liabilities and the classification between operating costs and finance costs under any new contract terms remain in line with the CIPFA Code.</p>

Other Key Findings	Conclusion
<p>EU Investigation An EU investigation is currently underway into whether transactions between Portsmouth City Council and MMD (Shipping Services) Ltd have breached state aid regulations.</p>	<p>Evidence reviewed as part of our audit is consistent with Portsmouth City Council's assessment that liabilities in connection with this case are unquantified and remote.</p> <p>There were no further developments up until the issue of our audit opinion and certificate. We will continue to keep this issue under review as part of continuous audit planning in future years.</p>
<p>Harbour Accounts The Department for Transport has indicated that the Council should submit Harbour Accounts for the Commercial Port within nine months of the balance sheet date. To date the Council has not received official communication of the requirement, and therefore has not produced accounts. If the requirement is confirmed, accounts covering the financial years 2012/13 to 2016/17 will need to be prepared and subject to external audit.</p>	<p>We confirmed with the Director of Finance and Information Services that, to date, the Council has still not received official communication from the Department for Transport of the duty to produce accounts, and it therefore has not produced accounts.</p> <p>We have not received any further clarification from the NAO around our responsibilities as auditor. We will continue to discuss this requirement with officers as part of our 2017/18 audit.</p>
<p>Pension valuations and disclosures The Code and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. 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 liaised with the auditors of the Hampshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Portsmouth City Council. We assessed the conclusions drawn on the work and assumptions used by Aon Hewitt (the Pension Fund actuary), by using and reviewing the work of the Consulting Actuary commissioned by the NAO for all Local Government sector auditors (PwC). Furthermore, we reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.</p> <p>We are satisfied the assumptions used by the actuary and adopted by the Council are considered to be generally acceptable. No other issues were identified in completing our work.</p>

Other Key Findings	Conclusion
<p>Accounting for Property, Plant and Equipment</p> <p>Property, Plant and Equipment represent a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Material judgmental inputs and estimation techniques are required to calculate the year-end fixed assets balances held in the balance sheet.</p> <p>The Council engages its own internal expert valuers who apply a number of complex assumptions. Annually, assets are assessed to identify whether there is any indication of impairment.</p> <p>As the Council's asset base is significant, and the outputs from the valuer are subject to estimation, there is a risk fixed assets may be under/overstated or the associated accounting entries incorrectly posted. 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 undertook a range of procedures, including:</p> <ul style="list-style-type: none"> • Consideration of the work performed by the Council's valuers, including the adequacy of the scope of the work performed, professional capabilities and the results of their work. This included the use of our EY estates specialists who undertook a review of assumptions used by the valuers; • Review and sample testing over the key asset information used by the internal expert in performing their valuation; • Review of the desktop review and valuations performed by management's internal valuer over assets not subject to external valuation in 2016/17 to confirm that the remaining asset base is not materially misstated; • Consideration of external evidence of asset values via reference to the specific Local Government Gerald Eve report commissioned by the NAO for auditor use. • Considered whether asset categories held at cost have been assessed for impairment and are materially correct; and • Testing that the accounting entries have been correctly processed in the financial statements, including the treatment of impairments. <p>As a result of the above testing, we identified a number of issues. All were corrected by management in the final version of the financial statements, with one low value exception. We also recommend the Council's policy for revaluing Investment Properties needs to be revised in future years.</p> <p>Overall we did not identify any material issues in the valuations based on our work performed.</p>

In addition to the matters noted above, we challenged the Council's accounting treatment for a significant lease arrangement, resulting in material adjustments to the financial statements. We also identified a number of errors in disclosures, which were corrected by management.

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 £10.93 million (2015/16: £10.77 million), which is 2% of gross expenditure reported in the accounts of £546.4 million</p> <p>We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Governance and Audit and Standards Committee that we would report to the Committee all audit differences in excess of £0.55 million (2015/16: £0.54 million)</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 (with lower testing thresholds) specific to these areas. The areas identified include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits;
- Related party transactions; and
- Members' allowances.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations. One uncorrected misstatement was reported in our Audit Results Report. Whilst this was above our reporting threshold, it was not material to our audit and as such did not impact our overall audit opinion.

A close-up, shallow depth-of-field photograph of a stack of coins. The coins are stacked vertically, with the edges of several coins visible. The coins have a textured, ridged edge and some have markings on them, such as 'L M C', 'Y F', and 'W Y F'. A bright yellow rectangular box is overlaid on the left side of the image, containing the text 'Value for Money' in a black, sans-serif font.

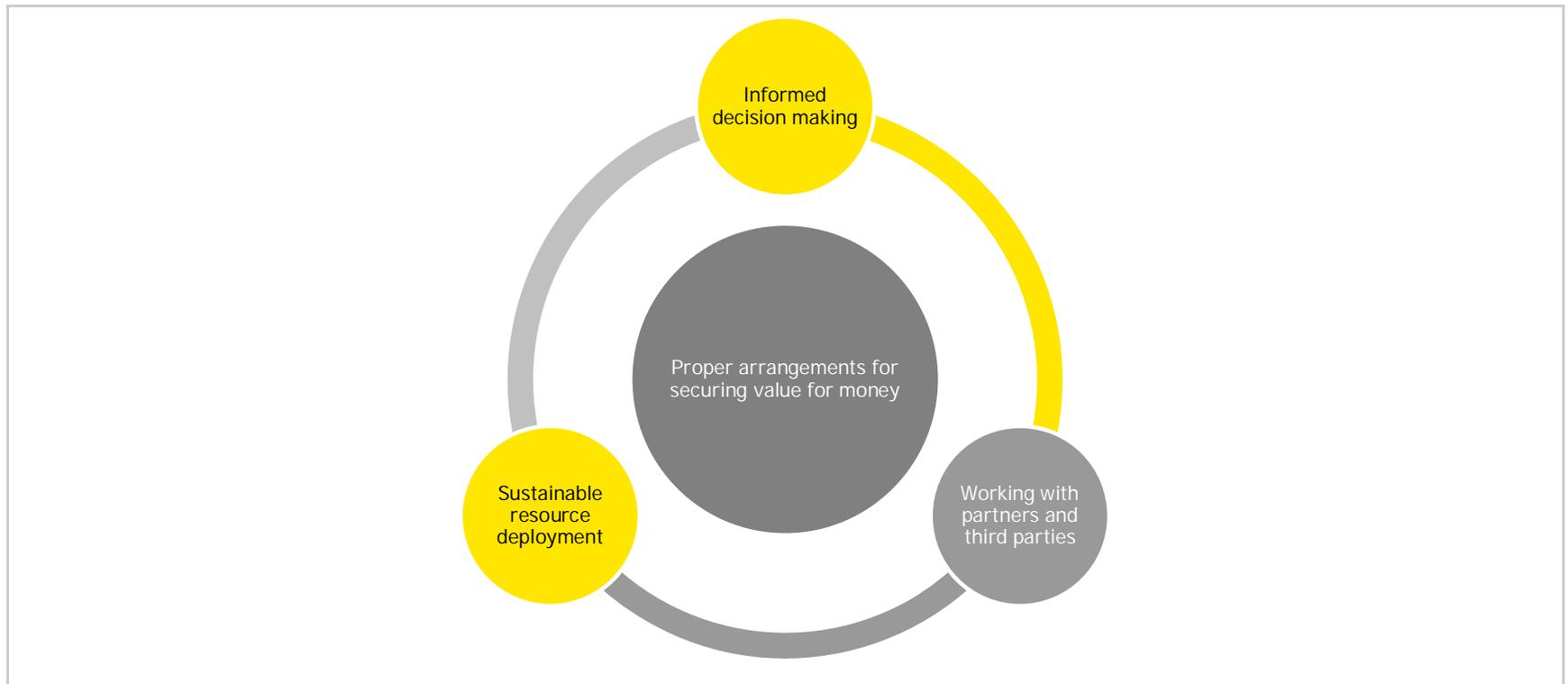
Value for Money

Value for Money

We are required to consider whether the Council 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 the Council's arrangements to:

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



We identified one significant risk in relation to these arrangements. We have performed the procedures outlined in our audit plan and the table below presents the findings of our work.

We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions.

We therefore issued an unqualified value for money conclusion on 22 January 2018.

Significant Risk	Work Undertaken, and Conclusions
<p>Informed Decision Making</p> <p>Portsmouth City Council's strategic priorities are evolving. At the same time, the Council is actively seeking more commercial ways of working, to reduce its' dependency on central government grants and to help deliver a significant savings plan.</p> <p>We recognise that risk management processes are already under review by the Council but we note that Portsmouth's senior management team took on additional responsibilities in relation to two other Councils this year. This could reduce management's capacity for effective oversight at Portsmouth. We note that for 2015/16, Internal Audit's Annual Opinion gave limited assurance on internal control and noted that internal control has declined/ not improved in recent years.</p> <p>There is a risk that as the nature of the Council's work changes, associated required changes may not be made in a timely fashion to financial and performance information and internal control systems. This could undermine the Council's ability to demonstrate sound governance and informed decision making.</p> <p>We note that the strategic and operational changes occurring within Portsmouth City Council are set against a backdrop of changes</p>	<p>Obtain and review Portsmouth City Council's newly formatted Corporate Risk Directory. Document and assess the effectiveness of risk escalation procedures</p> <p>The Corporate Risk Directory is maintained by the Corporate Performance Manager and updated quarterly using template returns from the directorates. The format of the Register was revised in February 2017 at the request of the Governance and Audit and Standards Committee. The new format aims to present data on performance and major projects and risks for each directorate separately and uses RAG rating to highlight areas of concern. We noted that full use of RAG rating has not yet been adopted by every directorate and that the Register does not currently include any data for the Port and for the Property Directorate. However, we also noted that the Committee flagged these concerns and action is being taken to expand coverage to all directorates and improve consistency and rigour around use of RAG ratings.</p> <p>Document and assess Cabinet, Committee and senior management reporting procedures In most respects, appropriate reporting arrangements are in place and we have concluded that we have no matters to report in relation to the timing, data quality or mechanisms for Council decision making. However, we noted that an Investment Property Strategy was approved by the Cabinet in July 2015, which required that a full report on fund performance be submitted annually to the Cabinet. At the time of our audit, no such report had been prepared, but officers confirmed this was due to the low level of activity in 2016/17. As the Council's investment property portfolio expands, it will be important that reporting to Cabinet is monitored closely. The Council has noted this point and a report will be taken to Cabinet during 2017/18.</p> <p>Monitor role changes and evolving responsibilities within the senior management team and decision-making by the Corporate Governance Group</p> <p>From our review of senior management's changing roles and responsibilities and of the control environment maintained throughout the year, we found no evidence that the control</p>

Significant Risk	Work Undertaken, and Conclusions
<p>to the wider environment. These include continued and increasing pressure on the costs of providing children's and adult social care across the UK and consultations within the Solent area to join three Councils into one Mayoral Authority.</p>	<p>environment has so far been undermined or weakened by the wider roles that the senior leadership team are taking on. As well as the control environment remaining stable, staff satisfaction levels also appear to be reasonable.</p> <p>Track reported service performance levels in performance reports to the Governance and Audit and Standards Committee in Quarters 2 to 4 Through our attendance at the meetings of the Governance and Audit and Standards Committee, we note that officers have continued to update the quality of the performance information provided by directorates. We reviewed performance data submitted to the Committee throughout the year, and we noted the scrutiny given to these issues by Members, and the action taken in response to queries or concerns expressed over performance. There are no observations arising from our work.</p> <p>Review Portsmouth City Council's performance against savings plans for 2016-17 and assess the robustness of planned savings for 2017-18 and beyond We tested Efficiency Plans, Budget and Council Tax and Savings Proposals from February 2016 to February 2017 and assumptions contained therein. The Council is on track to achieve planned savings of £11 million in 2016/17 and £9 million in 2017/18. In February 2016 the Council had expected further savings of £15 million would be required in 2018/19 and 2019/20. However, by February 2017 the Council assessed that the budget shortfall over that period would be some £7 million lower than had previously been supposed. The Council has a strong track record of achieving planned savings and the reduced target of £8 million for those two years seems achievable. We assessed the assumptions and planned actions underpinning the identified savings and consider them to be appropriately supported.</p> <p>Compare Internal Audit's 2016-17 programme of work with the risk profile of the organisation and monitor internal audit findings We concluded that the Internal Audit programme of work is appropriately risk focused and we have reviewed their findings to inform our own risk assessments. Although Internal Audit has significant, and increasing, commitments to other local authorities, a recruitment programme is in place to expand the team and there is no evidence to date that the core Portsmouth programme of work has been compromised.</p>



Other Reporting
Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

Following significant amendments to the draft consolidation pack as a result of issues identified during our audit, we had no matters to report to the NAO. We issued our report to the NAO on 22 January 2018, after the 29 September 2017 deadline for this work.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council'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 Council 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 Council 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 2016/17 financial statements from member 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.

Independence

We communicated our assessment of independence in our Audit Results Report to the Governance and Audit and Standards Committee on 27 October 2017, with a final version of the report being issued on 22 January 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.

Our audit did not identify any significant control issues to bring to the attention of the Governance and Audit and Standards Committee. We noted a number of areas where there was the potential to strengthen existing controls, all of which management has agreed to consider for our 2017/18 audit.

Appendix A

Audit Fees



Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our 22 January 2018 Audit Results Report.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work	149,438	149,438	149,438	162,900*
Total Audit Fee – Certification of claims and returns	17,196	17,196	17,196	17,797

*The final fee for 2015/16 includes a scale fee variation of £13,462 in respect of additional audit work performed to address an objection to the statement of accounts from a local elector. This additional fee has been agreed with the Director of Finance; it remains subject to final agreement with PSAA.

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

No scale fee variation is proposed in respect of the 2016/17 Code audit. Although a number of significant issues were identified with the draft financial statements which required additional audit work to resolve, resourcing issues for the audit team contributed to the opinion being given after the statutory deadline.

For our 2017/18 audit, we have engaged in early discussions with officers, and are working co-operatively with them to implement a number of actions intended to avoid a repeat of the issues arising in 2016/17.

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ED None

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