



## **Southend-on-Sea Borough Council**

### **Report to the Audit Committee on the audit for the year ended 31 March 2019**

Issued on 17 July 2019 for the meeting on 25 July 2019

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# Introduction

## The key messages in this report

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.

I have pleasure in presenting our update report to the Audit Committee of Southend on Sea Borough Council (the Council) for the 2019 audit. The scope of our audit was set out within our planning report presented to the committee in March 2019.

### **Status of the audit**

Our audit is at an advanced stage at the date of issue of this report with the following key matters still outstanding:

- receipt and evaluation of information from Essex Council Pension Fund auditors;
- receipt of final financial statements;
- completion of a limited number of normal risk procedures;
- completion of internal quality assurance procedures;
- receipt of signed management representation letter; and
- our review of events since 31 March 2019 through to signing.

We have included a section in this report providing observations arising from the work we have so far carried out on the areas of significant risk and other areas of audit focus reported to you in our audit planning report.

We will provide an oral update on these matters including an update regarding the status of the audit at the meeting.

Our housing benefit subsidy assurance field work is substantially complete. As the reporting timeline for this is to report by 30 November, we will complete our procedures and report back to the outcome to this committee over the summer.

### **Conclusions from our testing**

- We have not identified any significant audit adjustments or disclosure deficiencies. As our audit work is ongoing, further misstatements may be identified through the completion of our remaining work. We will provide an oral update regarding any such matters in the meeting.
- Based on the current status of our audit work, 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 do not have any significant findings or internal control deficiencies to raise at the date of issue this report but will update the Audit Committee should any arise.

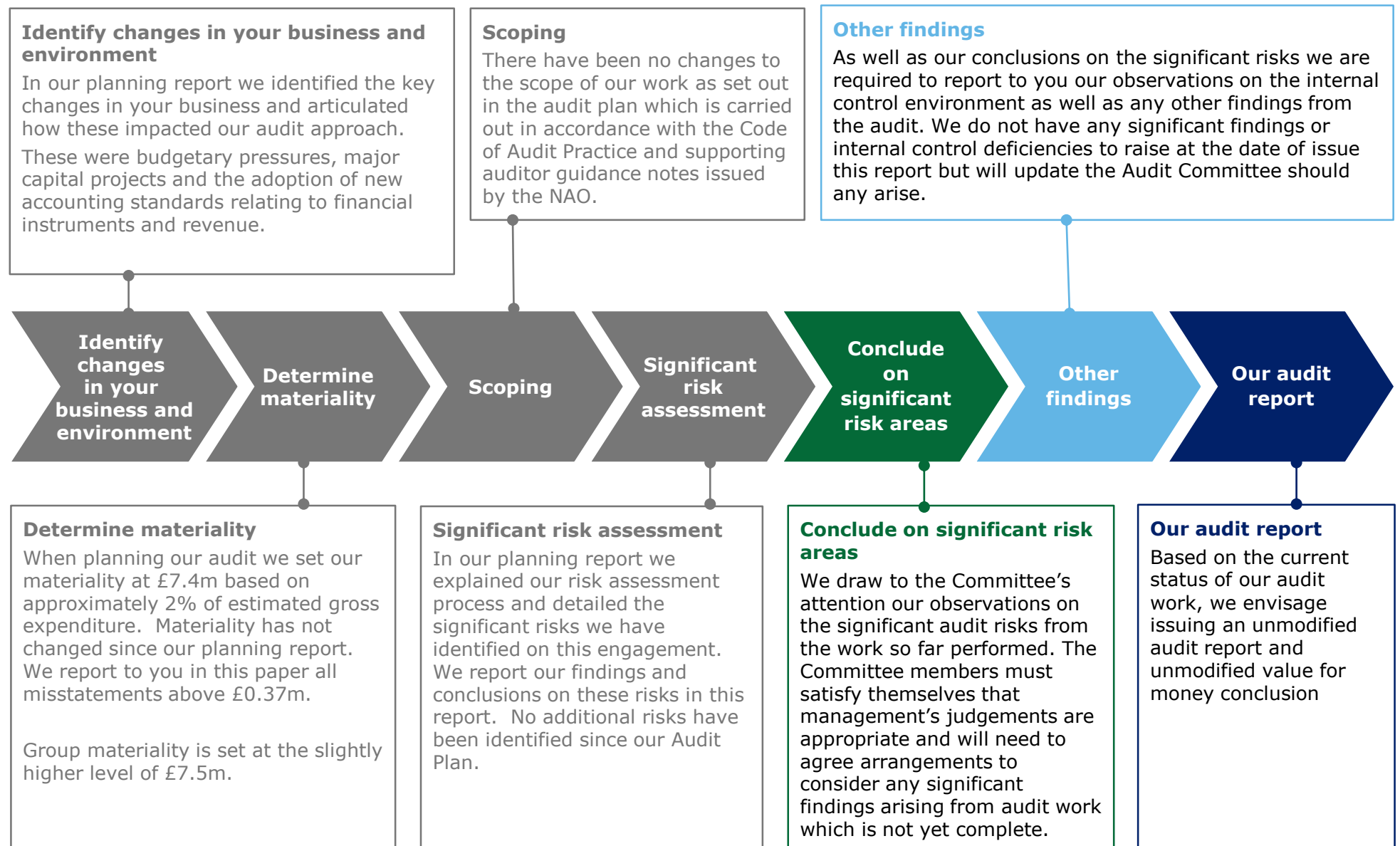
# Introduction

## The key messages in this report (continued)

<b>Financial Sustainability and Value for Money</b>	<ul style="list-style-type: none"><li>• In the CIES, the Council reported an accounting surplus of £10.7m for the year which included net gains of £26.1m in respect of property revaluation and gains due to remeasurement of the pension liability of £31.8m. At year end the Council had usable reserves of £154.9m (31 March 2018: £140.8m) and unusable reserves of £346.1m (31 March 2018: £349.5m).</li><li>• Cash and cash equivalents held by the Council increased by £19.8m to £46.4m as at 31 March 2019.</li><li>• A funding gap has been identified in the Medium Term Financial Plan that totals £18.6m to the end of 2023/24. This reflects ongoing budgetary pressures from reductions in funding and increasing costs of delivering services. Our review of arrangements has concluded that the Council's arrangements in respect of monitoring and managing this funding gap are adequate. This is discussed in further detail on page 12.</li><li>• As discussed on page 12, we considered arrangements around the Council's capital schemes and its response to areas flagged by Ofsted as requiring improvement. Overall, the Council had adequate governance arrangements in these areas.</li><li>• We did not identify any significant risk related to Value for Money and we do not anticipate reporting any matters within our audit report in respect of the Council's arrangements for securing the economy, efficiency and effectiveness of the use of resources.</li></ul>
<b>Narrative Report &amp; Annual Governance Statement</b>	<ul style="list-style-type: none"><li>• We have reviewed the Council's Annual Report &amp; Annual Governance Statement to consider whether it is misleading or inconsistent with other information known to us from our audit work. We have not matters to raise with you in respect of the Annual Governance Statement</li><li>• We have no matters to raise with you in respect of the Narrative Report</li></ul>
<b>Duties as public auditor</b>	<ul style="list-style-type: none"><li>• We did not receive any queries or objections from local electors this year.</li><li>• 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.</li></ul>
<b>Whole of Government Accounts</b>	<ul style="list-style-type: none"><li>• The Council is below the threshold for WGA reporting.</li></ul>

# Our audit explained

## We tailor our audit to your organisation



# 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.

### 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 did project both positive and negative divergences from budgets in operational areas. This was closely monitored and whilst some areas projected overspends, the underlying reasons were understood. The contingency budget was not drawn on.
- 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

We did not identify any significant transactions outside the normal course of business or any transactions where the business rationale was not clear.

### 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 tested the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting. No issues were noted.

### Deloitte view

We have not identified any significant bias in the key judgements made by management based on work performed.

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

### 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, correct treatment of capital spend and the valuation of the pension liability, as discussed elsewhere in this report.

We reviewed accounting estimates for biases that could result in material misstatements due to fraud. We note that overall the areas more subject to estimation in the period were balanced and did not indicate a bias to achieve a particular result.

We tested accounting estimates and judgements, focusing on the areas of greatest judgement and value. Our procedures included comparing amounts recorded or inputs to estimates to relevant supporting information from third party sources.

# Significant risks (continued)

## 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 £640.9m of property assets at 31 March 2019, a decrease of £23m principally driven by disposals of £32.8m from Other Land and Buildings due to schools turning to academies. The movement also includes £17.8m revaluation gain and £9.8m of additions.

Investment properties had immaterial movements due to additions and transfers of £0.6m and a revaluation reduction of £0.3m giving a carried forward valuation of £41.3m (31 March 2018: £41m).

The financial year to 31 March 2019 represented one year of the five year rolling programme in which 20% of the portfolio was revalued at 1 April 2018. In addition, the Council commissioned its valuer to perform a market review providing information on market changes across 2018/19. On the basis of information in this report, the Council elected to adjust the valuation of properties to account for market changes during 2018/19.

### Deloitte response

- We tested the design and implementation of key controls in place around the property valuation, including how the Council assures itself that there are no material impairments or changes in value for the assets not covered by the annual valuation.
- We obtained an understanding of approach adopted to the valuation, including assessing the valuer's qualifications, objectivity and independence and reviewing the methodology used.
- We tested a sample of inputs to the valuation.
- We used our valuation specialists, Deloitte Real Estate, to review and challenge the appropriateness of the assumptions used in the valuation of the Council's property assets including considering the assumptions made of movements between the valuation being performed at earlier stages in the year and the year-end.
- We tested a sample of revalued assets and reperformed the calculation of the movement to be recorded in the financial statements to check correctly recorded.
- We considered the impact of uncertainties relating to the UK's exit from the EU upon property valuations in evaluating the property valuations and related disclosures.

### Deloitte view

Overall, we have concluded that the net book value of property assets is not materially misstated. The Council's valuation assumptions are generally reasonable, in line with other Councils and fall within the expected range highlighted by Deloitte Real Estate.

# Significant risks (continued)

## Capital expenditure

### **Risk identified**

The Council has a substantial capital programme of £233m over the next five years. The capital programme included £50.9m spend in 2018/19.

Determining whether or not expenditure should be capitalised can involve judgement as to whether costs should be capitalised under International Financial Reporting Standards.

The Council has greater flexibility over the use of revenue resource compared to capital resource. There is also, therefore, an incentive for officers to misclassify revenue expenditure as capital.

### **Deloitte response**

- We tested the design and implementation of controls around the capitalisation of costs.
- We selected a sample of capital items (including REFCUS) in the year to test whether they have been appropriately capitalised in accordance with the accounting requirements.

### **Deloitte view**

Our work in this area has been completed satisfactorily with no issues noted.



# Other matters

## Defined benefits pension scheme

### Background

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

The net pension liability has decreased from £168.9m at 31 March 2018 to £151.8m at 31 March 2019 primarily as a result of movements in asset values and some changes in discount rate and inflation assumptions. This total includes the impact of the McCloud adjustments.

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 Council's liability as £4.7m which has been posted to the statement of accounts.

### Deloitte response

We obtained a copy of the actuarial report produced by Barnett Waddingham, 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 Barnett Waddingham, including benchmarking as shown the table opposite.
- We obtained assurance from the auditor of the pension fund over the controls for providing accurate membership data to the actuary.
- We assessed the reasonableness of the Council's share of the total assets of the scheme with the Pension Fund financial statements for the year.
- 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.

	Council	Benchmark	Comments
Discount rate (% p.a.)	2.48	2.39	Reasonable, slightly optimistic
Consumer Price Index (CPI) Inflation rate (% p.a.)	2.40	2.23	Reasonable, slightly prudent
Salary increase (% p.a.) (over CPI inflation)	1.50	Council specific	Reasonable
Pension increase in payment (% p.a.)	2.40	2.28	Reasonable, slightly prudent (in line with CPI)
Pension increase in deferment (% p.a.)	2.40	2.23	Reasonable, slightly prudent (in line with CPI)
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	21.30	21.20	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	22.90	23.00	Reasonable

### Deloitte view

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 (continued)

## Implementation of IFRS 9 and IFRS 15

<b>Matter identified</b>	<p>The Council is required to adopt the new accounting standards IFRS 9 <i>Financial Instruments</i> and IFRS 15 <i>Revenues from contracts with customers</i> in the year ended 31 March 2019. In both cases, the Council is using a modified retrospective approach to implementation where effectively the cumulative impact of transition to 1 April 2018 is posted as an adjustment to reserves.</p> <p>The scope of IFRS 9 and IFRS 15 is limited to balances arising on “exchange” transactions. Non-exchange debtors, such as council tax and rates and levies are outside of the scope of IFRS 9 and IFRS 15.</p> <p>The Council has posted no retrospective adjustments with regard to IFRS 9 or IFRS 15 as there is no material impact on the financial statements.</p>
<b>Response</b>	<p>Management held internal discussions regarding the accounting impact of the new standards for the period and determined that the impact is immaterial. Regarding IFRS 9, a management paper was prepared for the audit team to evaluate as part of interim procedures. For IFRS 15, there were not considered to be material transactions impacted so no management paper was provided. We concur with this assessment and include further detail on both standards below:</p> <p><b>IFRS 9:</b> The key element impacted by IFRS 9 is the accounting for the bad debt provision for debtors, which must move to a methodology of expected credit losses. We have reviewed the revised calculation methodology and considered the assumptions in light of past experience. We have concluded that IFRS 9 has been applied appropriately and no material adjustment is needed.</p> <p>In addition, the presentation and classification of the Council’s financial instruments is affected with “loans and receivables” reclassified to being held at amortised cost with no change in carrying value. An immaterial change has been made to reclassify “available for sale” instruments to “fair value through profit and loss”.</p> <p><b>IFRS 15:</b> Regarding IFRS 15, officers were satisfied that no transitional adjustments would be required as the Council’s larger sources of income including grant income, rents and taxation are outside of the scope of the standard and in other income streams which fall within the scope of IFRS 15 there are not material performance obligations which span the year end. This is consistent with a general expectation for local authorities which have not entered into material unusual transactions.</p> <p>We have reviewed and challenged management’s assumptions in light of the Council’s contractual arrangements and the disclosures made in the financial statements with no issues noted.</p>

### Deloitte view

We concur with management’s conclusion that the new accounting standards do not have a material impact for the Council and have been adequately disclosed

# Other matters (continued)

## Group Accounts

### Audit considerations regarding the Group Accounts

We have not been appointed the auditor of the material subsidiary trusts and companies within the group. In order to gain sufficient assurance over significant account balances in the group accounts, we have performed further audit procedures of the material components. The key components for audit procedures are shown in the table below.

Components	Expenditure (Cost of Services) 2018/19 £m	Net Assets 31/3/19 £m	%age of total Group Expenditure	%age of group Net Assets	Summary of work to be performed
Council	379.9	501	94.5%	97.6%	The Deloitte group audit team has performed full-scope audit procedures under the Code on this component. Matters arising are noted throughout this report
Trust Funds	3.6	23.3	0.9%	4.47%	The Trust Funds are audited separately by a different firm on a longer timeline. For the purpose of the group audit opinion, material Trust funds will have specified tests performed by the group team focused on assets held. This work is still in progress at the date of issue of this report and we will provide an oral update in the meeting
South Essex Homes Limited	11.7	(5.0)	2.9%	(1.0%)	SEHL is audited separately by a different firm on a longer timeline. For the purpose of the group audit opinion, SEHL will have specified tests performed by the group team. This work is still in progress at the date of issue of this report and we will provide an oral update in the meeting
Southend Care Limited	6.6	(5.5)	1.7%	(1.1%)	SCL is audited separately by a different firm on a longer timeline. For the purpose of the group audit opinion, SCL will have specified tests performed by the group team. This work is still in progress at the date of issue of this report and we will provide an oral update in the meeting

### Group Materiality

Materiality for the group is £7.5m with the Council stand alone materiality level set at £7.4m. In order to apply meaningful specified procedures to the non-Council, in-scope group entities, component materiality has been reduced accordingly based on the percentage of the group represented by each subsidiary and will be no more than 40% of the group materiality figure of £7.5m.

# 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:

- **Financial Sustainability:** The 2019/20 budget is balanced i.e. there is sufficient funding for the £125.6m budget requirement for general fund net expenditure. This includes a £2.5m use of reserves. In the subsequent years however, a funding gap has been identified in the Medium Term Financial Plan that totals £18.6m to the end of 2023/24 as shown in the table below. This reflects ongoing budgetary pressures from reductions in funding and increasing costs of delivering services. Our review has concluded that the Council's arrangements in respect of monitoring and managing this funding gap and the associated risks are adequate.

### **Funding gaps per the MTFS:**

2020/21	2021/22	2022/23	2023/24
£7.5m	£4.3m	£3.5m	£3.3m

- **Capital Plans:** There are significant capital projects planned in the medium term. The principal future projects are the Better Queensway and the Seaways Leisure schemes which are at the planning stages and are to be developed over the coming periods. We also appraised the arrangements in place surrounding current major capital schemes namely the Airport Business Park and the Kent Elms development. Our review of the Council's arrangements in respect of monitoring these schemes and mitigating associated risks concluded that these arrangements are adequate.
- **Ofsted reports:** We noted areas where the authority was identified as requiring improvement (as well as areas of strong practice) in recent Ofsted reports. Our review of the Council's action plan to manage the required improvements, including working with other parties, concluded that arrangements are adequate.

### **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, Southend-on-Sea 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.*

# Our audit report

## Matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report.



### **Our opinion on the financial statements**

Our opinion on the financial statements is unmodified.



### **Material uncertainty related to going concern**

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting.



### **Emphasis of matter and other matter paragraphs**

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



### **Our value for money conclusion**

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money).

Our conclusion on the Council's arrangements is unmodified.



### **Other reporting responsibilities**

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performed and to ensure that they are fair, balanced and reasonable.

Our conclusion in this area is satisfactory.

# 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	<p>The Narrative Report is expected to address (as relevant to the Council):</p> <ul style="list-style-type: none"><li>- Organisational overview and external environment;</li><li>- Governance;</li><li>- Operational Model;</li><li>- Risks and opportunities;</li><li>- Strategy and resource allocation;</li><li>- Performance;</li><li>- Outlook; and</li><li>- Basis of preparation</li></ul>	<p>We have assessed whether the Narrative Report has been prepared in accordance with CIPFA guidance.</p> <p>We have also read the Narrative Report for consistency with the annual accounts and our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p> <p>No issues were noted from our review.</p>
Annual Governance Statement	<p>The Annual Governance Statement reports that governance arrangements provide assurance, are adequate and are operating effectively.</p>	<p>We have assessed whether the information given in the Annual Governance Statement meets the disclosure requirements set out in CIPFA/SOLACE guidance, is misleading, or is inconsistent with other information from our audit. No issues were noted from our review.</p>

# 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 quality of your Annual Report.
- Our internal control observations.
- Other insights we have identified from our audit.

### 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  
17 July 2019



# Appendices





# Audit adjustments

## Unadjusted misstatements

There are no significant unadjusted misstatements to report up to the date of this report.

## Disclosures

### **Disclosure misstatements**

No uncorrected disclosure misstatements have been identified up to the date of this report.

### **Other disclosure recommendations**

No such matters have been identified up to the date of this report.

# Fraud responsibilities and representations

## Responsibilities explained



### Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.



### Required representations:

We have asked the Council to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you have disclosed to us all information in relation to fraud or suspected fraud that you are aware of and that affects the Council and its group.

We have also asked the Council to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



### Audit work performed:

In our planning we identified capitalisation of expenditure and management override of controls as key audit risks for your organisation.

During course of our audit, we have had discussions with management and those charged with governance including the Head of Internal Audit.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements. We have reviewed the paper prepared by management for the on the process for identifying, evaluating and managing the system of internal financial control.

### Concerns:

No significant concerns have been identified from our work

# Independence and fees

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	<p>The audit fee for 2018/19, in line with the fee range provided PSAA, is £110k as broken down below. Our fee for reporting on the housing benefit subsidy claim was reported at the planning stage as £21k and our fee for the Teachers' Pension Return is expected to be £6k.</p> <p>No other non-audit fees have been charged by Deloitte in the period.</p>
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	<p>We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the Council, its members and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.</p> <p>We are not aware of any relationships which are required to be disclosed.</p>

	Proposed £ (exc VAT)	Planned £ (exc VAT)
Code audit fee*	110k	110k
<b>Total audit*</b>	<b>110k</b>	<b>110k</b>
Housing Benefit Assurance Work	21k	21k
Teachers Pension Assurance Work	6k	6k
<b>Total fees</b>	<b>137k</b>	<b>137k</b>

\*An additional fee amount is in the process of being agreed with PSAA and the authority in relation to additional work performed in relation to member queries.



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