

Test Valley Borough Council

Annual Audit Letter for the year
ended 31 March 2020

February 2021

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

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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).

This 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 April 2018)' 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 Hywel Ball, 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.



Section 1

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Test Valley Borough Council (the Council) following completion of our audit procedures for the year ended 31 March 2020.

Covid-19 had an impact on a number of aspects of our 2019/20 audit. We set out these key impacts below.

Area of impact	Commentary
Impact on the delivery of the audit	
▶ Changes to reporting timescales	As a result of Covid-19, new regulations, the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 No. 404, have been published and came into force on 30 April 2020. This announced a change to publication date for final, audited accounts from 31 July to 30 November 2020 for all relevant authorities. We worked with the Council to deliver our audit in line with the revised reporting timescale.
Impact on our risk assessment	
▶ Valuation of Property Plant and Equipment and Investment Properties	The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty have been included in the year-end valuation reports produced by the Council's internal valuer. We consider that the material uncertainties disclosed by the valuer impacted our identified risks, therefore, we engaged with our valuation specialists to review a sample of valuations and reviewed disclosures on the valuation of property, plant and equipment and investment properties.
▶ Disclosures on Going Concern	Financial plans for 2020/21 and medium term financial plans will need revision for Covid-19. We considered the unpredictability of the current environment gave rise to a risk that the council would not appropriately disclose the key factors relating to going concern, underpinned by managements assessment with particular reference to Covid-19 and the Council's actual year end financial position and performance.
Impact on the scope of our audit	
▶ Information Produced by the Entity (IPE)	We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We undertook the following to address this risk: <ul style="list-style-type: none">▶ Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and▶ Agree IPE to scanned documents or other system screenshots.
▶ Consultation requirements	Additional EY consultation requirements concerning the impact on auditor reports. The changes to audit risks and audit approach changed the level of work we needed to perform.

Executive Summary (cont'd)

The tables below set out 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 2020 and of its expenditure and income for the year then ended.
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
▶ Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the 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.

Executive Summary (cont'd)

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £500m. Therefore, we did not perform any detailed audit procedures on the consolidation pack.

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.	Our Audit Results Report was issued on 25 January 2021
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 12 February 2021

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

Kevin Suter
Associate Partner
For and on behalf of Ernst & Young LLP

Section 2

Purpose and Responsibilities



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 2019/20 Audit Results Report to the 10 February 2021 General Purposes Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities of the Appointed Auditor

Our 2019/20 audit work has been undertaken in accordance with the Audit Plan that we issued on 4 March 2020 and the updates as set out on page 4 to take into account the impact of the Covid-19 pandemic. It is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2019/20 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 the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, 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.

Section 3

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 other guidance issued by the National Audit Office and issued an unqualified audit report on 12 January 2021.

Our detailed findings were reported to the 10 February 2021 General Purposes Committee.

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

Significant Risk	Conclusion
<p>Misstatements due to fraud or error</p> <p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation.</p> <p>We did not identify any material weaknesses in controls or evidence of material management override.</p> <p>We did not identify any instances of inappropriate judgements being applied.</p> <p>We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.</p> <p>We did not identify any inappropriate journal entries.</p>
<p>Risk of fraud in revenue and expenditure recognition</p> <p>Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation.</p> <p>We have identified an opportunity and incentive to capitalise expenditure under the accounting framework, to remove it from the general fund. This would result in funding expenditure that should properly be defined as revenue, through inappropriate sources such as capital receipts, capital grants, or borrowing.</p>	<p>We documented our understanding of the controls relevant to this significant risk and considered they have been appropriately designed.</p> <p>We tested the appropriateness of journal entries recorded in the general ledger between revenue and capital codes.</p> <p>We amended our sample sizes when testing capital additions to reflect this risk, agreeing samples to source documentation to ensure the classification was reasonable.</p> <p>Our testing did not identify any material misstatements from capitalising revenue spend.</p>

Financial Statement Audit (cont'd)

Other financial statement risk

Valuation of land & buildings

The value of land and buildings included within Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Authority's accounts. Within the accounts presented for audit they totalled £82,431,000 and £99,259,000. Movements during 2019/20 included valuation changes, impairment reviews and depreciation charges.

Management is required to use material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. The valuation date for 2019/20 was 31 January 2020 and most assets were valued by the Council's external valuer Vail Williams, with some valuations carried out by the internal commissioning team.

In the wake of the Covid-19 pandemic, the Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty have been included in the year-end valuation reports produced both by the Authority's internal valuers and by the external valuers Vail Williams.

Other areas of focus for the audit were the roll forward of valuations to year end; valuer reliance on data provided by the Council; and use of variables and assumptions.

Work undertaken:

- As part of our work on disclosure in the draft financial statements, we reviewed disclosures on the valuers' material uncertainty over valuation of property, plant and equipment and investment property. We increased our samples due to this disclosure.
- For a sample of six properties, we engaged EY Real Estate valuations specialists to review in detail the methodology, data and assumptions supporting valuations. The properties selected for this detailed review comprised four investment properties with a combined year end valuation of £37,520,000 and two other PPE properties with a combined year end valuation of £4,100,000.
- Further testing was undertaken on land and buildings by the audit team.
- We considered the adequacy of the scope of valuer work performed; their professional capabilities; and sampling techniques they employed.
- We conducted sample testing of key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre).
- We considered the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for Property, Plant and Equipment and annually for Investment Property. We also considered if there are any specific changes to assets that have occurred and whether these are reflected in valuations.
- We reviewed the effectiveness of arrangements for rolling forward valuations undertaken previous to 31 March 2020, to the year end.
- We reviewed assets not subject to formal valuation in 2019/20 to confirm that the remaining asset base is not materially misstated.
- We considered any changes to useful economic lives as a result of the most recent valuation.
- Tested to confirm that accounting entries have been correctly processed in the financial statements.

Financial Statement Audit (cont'd)

What did we conclude?

The most significant of the findings related to disagreement over the Council's valuation of the Walworth Business Park, specifically the head-leases initially valued at £24.85m. We disagreed with the valuation, predominantly due to the inclusion of an assumption of 7.75% yield. Yield increases when risk increases, and the evidence provided to us identified a low level of risk relating to the income from this asset. We judged a more appropriate to a range of 4.5% to 5.5%. The Council commissioned Vail Williams to undertake a detailed valuation, arriving at a revised value of £46.4m. Based on the evidence provided from the new valuation including of recent or similar market evidences, we agreed this valuation was reasonable and within our estimated range.

Due to the findings the council subsequently reviewed the valuation of the East and West Portway assets, which contained similar characteristics. Amendments of £4.997m and £12.882m were made respectively for these assets.

The discussion and resolution of these material issues was the primary reason why our audit could not be concluded within the original expected period before 30 November 2020.

There were no reportable differences from the other assets selected for our specialists review.

We additionally completed further work by the audit team, taking into account information from our specialists findings. We identified further issues including:

- Inaccurate calculations; and
- Inconsistencies of valuations to the amounts recorded in the accounts.

Management had not initially undertaken a review this year of the material accuracy of assets not revalued. At our request this review was completed for the assets valued using a Depreciated Replacement Cost (DRC) method. This demonstrated the material accuracy of the valuations. We extended this review ourselves to any other property assets, again finding no indication of material variation to the recorded values.

There are no other findings to report. In all other respects, assumptions, accounting entries and disclosures are appropriate.

Financial Statement Audit (cont'd)

Other financial statement risk

Pension liability valuation

The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council.

The Council's pension fund liability is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2020 the net pension liability totalled £28.610m.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council.

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.

Going concern

The Council prepares its accounts on the assumption that it will continue as a going concern. The current and future uncertainty over government funding and loss of income as a result of Covid-19 increases the need for the Council to revisit its financial planning and undertake an updated detailed assessment to support its going concern assertion. From an audit perspective, the auditor's report going concern concept is a 12-month outlook from the approval of the accounts, rather than the balance sheet date.

Conclusion

We:

- Liaised with the auditors of Hampshire Pension Fund to obtain assurances over the information supplied to the actuary. The pension fund auditor has raised that, based on the Pension Fund accounts and actual rate of return, the Council's share of the pension fund assets was estimated to be understated by £590k. Management did not adjust for this difference.
- Assessed the work of the Pension Fund actuary including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team. There were no issues regarding the actuary's assumptions, including those related to ongoing developments in the McCloud and Goodwin rulings affecting public sector pensions.

We reviewed the proposed going concern disclosures for inclusion in the financial statements and the Council's forecast cash flows.

The key issues we reflected on for our assessment relate to a combination of the Council's liquidity and its level of General Fund reserves. Management's assessment demonstrated that reserves should be maintained above the minimum level set by the s151 officer for the foreseeable future, and the Council will have access to sufficient working capital without an identified need to borrow.

The Council updated its disclosures in the accounts to reference these factors and we were satisfied that the revised disclosure sufficiently disclosed the key elements of management's assessment and no material uncertainties exist.

Financial Statement Audit (cont'd)

Other financial statement risk

Financial Statements presentation - Expenditure and Funding Analysis and Comprehensive Income and Expenditure Statement

Test Valley Borough Council's internal reporting structure changed during 2019/20. The classifications on the Expenditure and Funding Analysis and of the Comprehensive Income and Expenditure Statement will need to reflect the new reporting structure, both for 2019/20 and for 2018/19 amounts.

Conclusion

We reviewed proposed changes to the format of accounts during the interim audit visit,

We confirm that the prior year reclassification was correctly disclosed, and

We tested correctness extraction from the ledger and consistency of that extraction with the internal reporting structure for all other items on the Income Statement and Expenditure and Funding Analysis.

There are no issues to report.

Financial Statement Audit (cont'd)

Other key findings	Conclusion
Audit differences (adjusted)	<p>In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and the disclosures and amounts actually recorded. These differences are classified as “known” or “judgemental”. Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.</p> <p>We highlight the following misstatements greater than £0.070m identified during the course of our audit which management corrected:</p> <p>We have identified audit differences in the draft financial statements which management has chosen to adjust. The most significant is the valuation of Investment Properties as discussed on pages 12 and 13 of this Letter.</p> <p>Other amendments included:</p> <ul style="list-style-type: none">• Correction of Business Rate values in the CIES from net to gross basis.• Amendment to Note 13, Senior Officer Remuneration for one officer due to a split role.
Audit differences (unadjusted)	<p>Management chose not to correct the following judgemental misstatement as it was not material to the financial statements:</p> <ul style="list-style-type: none">▸ The Council’s estimated pension fund asset was judged to be overstated by £0.59m , based on the audited accounts and final rate of return.

Financial Statement Audit (cont'd)

Our application of materiality

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

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £1.408m (2019: £1.368m), which is 2% of gross revenue expenditure reported in the draft accounts.</p> <p>We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	We agreed that we would report to the Committee all audit differences in excess of £0.070m

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

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits.
- ▶ Related party transactions.

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

A close-up photograph of a woman's face, focusing on her eyes and nose. She has light brown hair and green eyes. A bright yellow rectangular overlay is positioned on the left side of the image, partially covering her face. The text 'Section 4' and 'Value for Money' is written on this yellow area.

Section 4

Value for Money

Value for Money

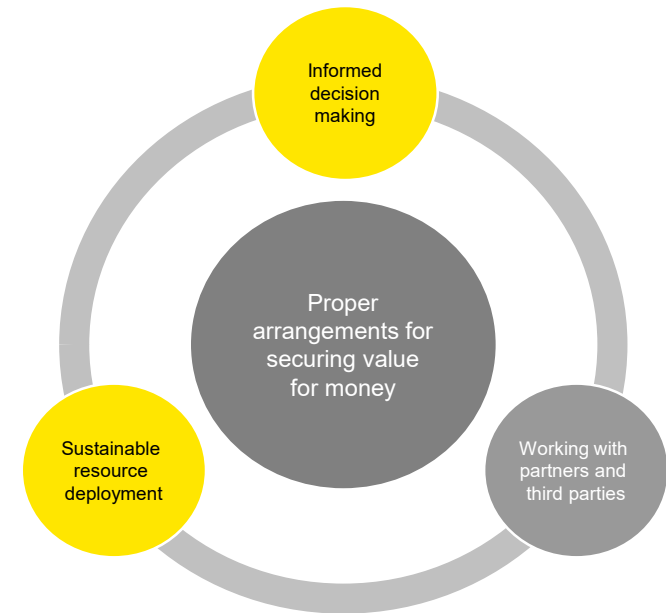
We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. This is known as our value for money conclusion.

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

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

On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19. This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider Local Government bodies' response to Covid-19 only as far as it relates to the 2019-20 financial year; only where clear evidence comes to the auditor's attention of a significant failure in arrangements as a result of Covid-19 during the financial year, would it be appropriate to recognise a significant risk in relation to the 2019-20 VFM arrangements conclusion.

We did not identify any significant risks in relation to these criteria. We therefore issued an unqualified value for money conclusion on 12 February 2021.



A photograph of a business meeting in progress. Several people are gathered around a large wooden conference table, looking at documents. A woman with blonde hair is leaning forward, resting her chin on her hand, looking intently at the papers. Other people's hands and arms are visible, some pointing at the documents. The background is slightly blurred, showing a bright, modern office environment with large windows and greenery.

Section 5

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

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

The Council is below the specified audit threshold of £500m. Therefore, we were not required to perform any detailed audit procedures on the consolidation pack.

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 2019/20 financial statements from members of the public.

Other Powers and Duties

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

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 27 October 2020. 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.

Other Reporting Issues (cont'd)

Control Themes and Observations

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

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



Appendix A

Audit Fees

Audit Fees

Our final fee for 2019/20 has been impacted by a range of factors which has resulted in additional work as reported in our Audit Results Report.

Description	Final Fee 2019/20 £	Planned Fee 2019/20 £	Scale Fee 2019/20 £	Final Fee 2018/19 £
Total Audit Fee - Code work	40,679	40,679	40,479	41,061
Scale Fee Rebasing: Changes in work required to address professional and regulatory requirements and scope associated with risk.	20,488			N/A
Revised proposed scale fee	61,167			
CIES/EFA restatement	777	776		
IAS19 Pension fund procedures	813			
Impact assessment for tribunal rulings on pension fund liabilities	466			
Additional fee to address Covid-19 related risks and impacts including Going Concern/Financial Sustainability	6,502			
Additional fee in connection with audit of Property, Plant and Equipment and Investment Properties valuations	8,885			
Total Audit Fee	78,610	41,455	40,479	41,061

Further detail on the Scale Fee Rebasing and the other additional fee elements for 2019/20 were included within our Audit Results Report, presented to the 10 February 2021 General Purposes Committee. The fees are subject to approval by PSAA.

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