

Audit Strategy Memorandum

Transport for the North

Year ending 31 March 2020





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This document is to be regarded as confidential to Transport for the North. It has been prepared for the sole use of the Audit and Governance Committee as the appropriate sub-committee charged with governance. No responsibility is accepted to any other person in respect of the whole or part of its contents. Our written consent must first be obtained before this document, or any part of it, is disclosed to a third party.

Audit and Governance Committee
Transport for the North
2nd Floor,
4 Piccadilly Place,
Manchester,
M1 3BN

Dear Sirs / Madams

Audit Strategy Memorandum – Year ending 31 March 2020

We are pleased to present our Audit Strategy Memorandum for Transport for the North (TfN) for the year ending 31 March 2020

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. As it is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, Section 8 of this document also summarises our considerations and conclusions on our independence as auditors.

We consider two-way communication with you to be key to a successful audit and important in:

- reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- sharing information to assist each of us to fulfil our respective responsibilities;
- providing you with constructive observations arising from the audit process; and
- ensuring that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks facing TfN which may affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

This document, which has been prepared following our initial planning discussions with management, is the basis for discussion of our audit approach, and any questions or input you may have on our approach or role as auditor.

This document also contains specific appendices that outline our key communications with you during the course of the audit, and forthcoming accounting issues and other issues that may be of interest.

Client service is extremely important to us and we strive to continuously provide technical excellence with the highest level of service quality, together with continuous improvement to exceed your expectations so, if you have any concerns or comments about this document or audit approach, please contact me on 0161 238 9248.

Yours faithfully



Karen Murray
Mazars LLP

1. ENGAGEMENT AND RESPONSIBILITIES SUMMARY

Overview of engagement

We are appointed to perform the external audit of TfN for the year to 31 March 2020. The scope of our engagement is set out in the Statement of Responsibilities of Auditors and Audited Bodies, issued by Public Sector Audit Appointments Ltd (PSAA) available from the PSAA website: <https://www.psaa.co.uk/managing-audit-quality/statement-of-responsibilities-of-auditors-and-audited-bodies/>

Our responsibilities

Our responsibilities are principally derived from the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (NAO), as outlined below:

Audit opinion

We are responsible for forming and expressing an opinion on the financial statements.

Our audit is planned and performed so to provide reasonable assurance that the financial statements are free from material error and give a true and fair view of the financial performance and position of TfN for the year.

Value for Money

We are required to conclude whether TfN has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. We discuss our approach to Value for Money work further in section 5 of this report.

Electors' rights

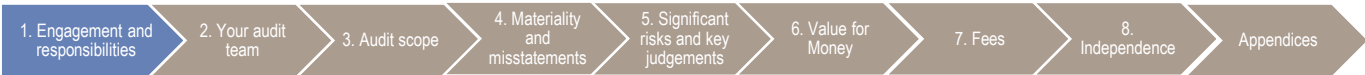
The 2014 Act requires us to give an elector, or any representative of the elector, the opportunity to question us about the accounting records of TfN and consider any objection made to the accounts. We also have a broad range of reporting responsibilities and powers that are unique to the audit of local authorities in the United Kingdom.

Our audit does not relieve management or those charged with governance, of their responsibilities. The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK), we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. However our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

TfN is required to prepare its financial statements on a going concern basis by the Code of Practice on Local Authority Accounting. As auditors, we are required to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements and the adequacy of disclosures made.

For the purpose of our audit, we have identified the Board and Audit and Governance Committee as those charged with governance.



2. YOUR AUDIT ENGAGEMENT TEAM

**Partner and
Engagement
Lead**

Karen Murray

Email: Karen.murray@mazars.co.uk

Tel: 0161 238 9248

**Senior
Manager**

Chris Whittingham

Email : Chris.Whittingham@mazars.co.uk

Tel: 07909 982497

**Engagement
Senior**

Alex Lawrence

Email: alex.lawrencie@mazars.co.uk

Tel: 07792 864206

3. AUDIT SCOPE, APPROACH AND TIMELINE

Audit scope

Our audit approach is designed to provide an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards on Auditing (UK), relevant ethical and professional standards, our own audit approach and in accordance with the terms of our engagement. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement, such as those affected by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

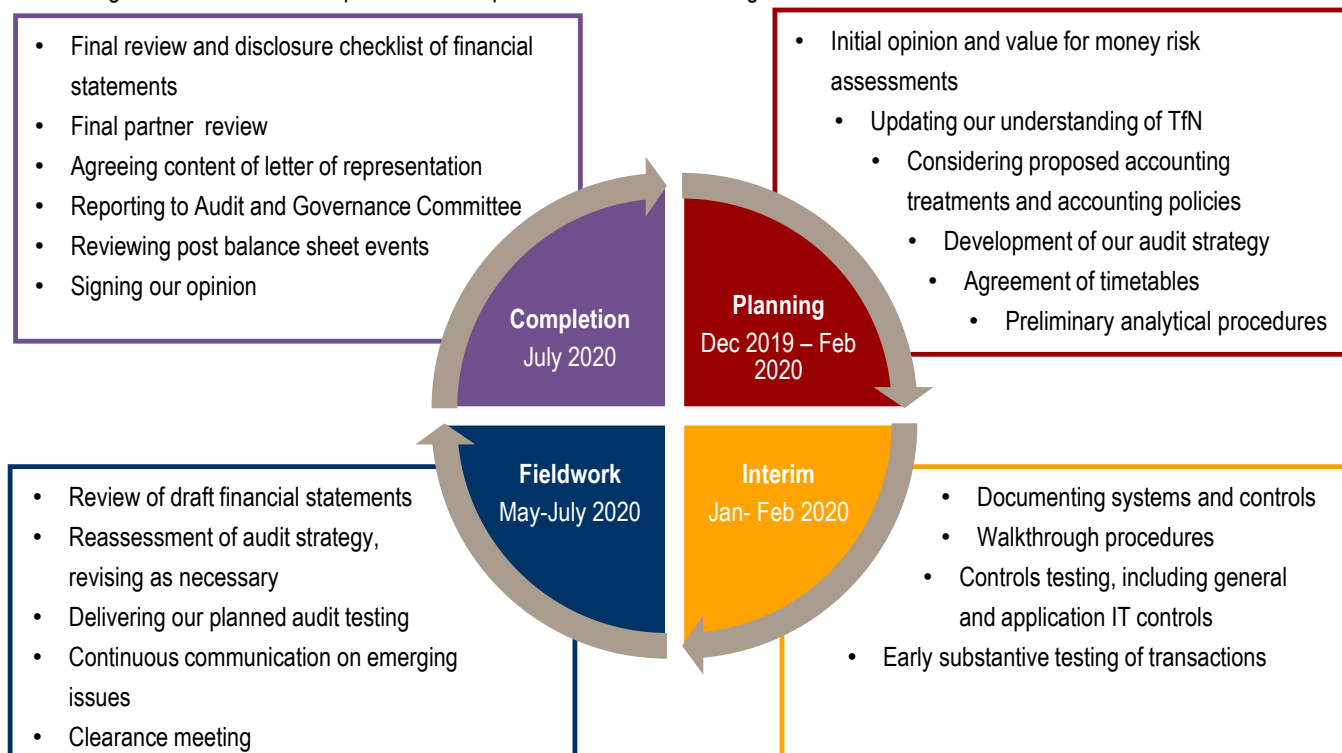
Audit approach

Our audit approach is a risk-based approach primarily driven by the risks we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment, we develop our audit strategy and design audit procedures in response to this assessment.

If we conclude that appropriately-designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing. Substantive procedures are audit procedures designed to detect material misstatements at the assertion level and comprise tests of details (of classes of transactions, account balances, and disclosures) and substantive analytical procedures. Irrespective of the assessed risks of material misstatement, which take into account our evaluation of the operating effectiveness of controls, we are required to design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. The concept of materiality and how we define a misstatement is explained in more detail in section 8.

The diagram below outlines the procedures we perform at the different stages of the audit.



3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to inform the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Management's and our experts

Management makes use of experts in specific areas when preparing the TfN financial statements. We also use experts to assist us to obtain sufficient appropriate audit evidence on specific items of account.

Items of account	Management's expert	Our expert
Defined benefit pension liability valuation and disclosures	Hymans Robertson <i>Actuary for the Greater Manchester Pension Fund</i>	National Audit Office, prepared by PwC.
Intangible asset valuation	PwC	Not applicable at this stage as audit team will review and challenge the accounting treatment applied.

Service organisations

International Auditing Standards (UK) define service organisations as third party organisations that provide services to TfN that are part of its information systems relevant to financial reporting. We are required to obtain an understanding of the services provided by service organisations as well as evaluating the design and implementation of controls over those services. The table below summarises the service organisations used by TfN and our planned audit approach.

Items of account	Service organisation	Audit approach
Payroll	Hawsons	We plan to obtain assurance by understanding the process and controls that TfN has in place to assure itself that transactions are processed materially correctly. Our testing will include sample testing of transactions.



4. MATERIALITY AND MISSTATEMENTS

Summary of initial materiality thresholds

Threshold	Initial threshold (£'000s)
Overall materiality	897
Performance materiality	718
Trivial threshold for errors to be reported to the Audit Committee	27

Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit based on quantitative and qualitative factors.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.



4. MATERIALITY AND MISSTATEMENTS (CONTINUED)

We consider that gross expenditure remains the key focus of users of the financial statements and, as such, we base our materiality levels on this. Our assessment of materiality is usually based on a benchmark using gross expenditure at the surplus/deficit on the provision of services level. However, because of the nature of your operations, at the planning stage, we have used your 2019/20 Budget, subsequent financial monitoring reports and latest forecast year end expenditure in calculating our materiality.

We have set our materiality threshold at 2% of the benchmark based on your latest forecast of 2019/20 revenue expenditure.

Based on your latest 2019/20 budget forecast we anticipate the overall materiality for the year ending 31 March 2020 to be in the region of £0.897m. After setting initial materiality, we continue to monitor it throughout the audit to ensure that it is set at an appropriate level. On receipt of your draft financial statements we will review our materiality assessment and should we decide to change our materiality figure we will bring that to your attention.

We have calculated a headline figure for materiality and have also identified separate levels for procedures designed to detect individual errors, and also a level above which all identified errors will be reported to the Audit and Governance Committee.

Performance Materiality

Performance materiality is the amount or amounts set by the auditor at less than materiality for the financial statements as a whole to reduce, to an appropriately low level, the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. We have set performance materiality at 80% of our overall materiality. As with overall materiality, we remain aware of the need to change this performance materiality level throughout the audit to ensure it remains to be set at an appropriate level.

Specific items of lower materiality

We have also calculated materiality for specific classes of transactions, balances or disclosures where we determine that misstatements of a lesser amount than materiality for the financial statements as a whole, could reasonably be expected to influence the decisions of users taken on the basis of the financial statements. We have set specific materiality for the following item of account that we expect TfN to disclose:

- Officer remuneration Bandings - £5,000 (reflecting the published salary bandings)

Misstatements

We aggregate misstatements identified during the audit that are other than clearly trivial. We set a level of triviality for individual errors identified (a reporting threshold) for reporting to the Audit and Governance Committee that is consistent with the level of triviality that we consider would not need to be accumulated because we expect that the accumulation of such amounts would not have a material effect on the financial statements. Based on our preliminary assessment of overall materiality, our proposed triviality threshold is £19k based on 3% of overall materiality. If you have any queries about this please do not hesitate to raise these with Karen Murray.

Reporting to the Audit and Governance Committee

To comply with International Standards on Auditing (UK), the following three types of audit differences will be presented to the Audit Committee:

- summary of adjusted audit differences;
- summary of unadjusted audit differences; and
- summary of disclosure differences (adjusted and unadjusted).



5. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS

Following the risk assessment approach discussed in section 3 of this document, we have identified relevant risks to the audit of financial statements. The risks that we identify are categorised as significant, enhanced or standard, as defined below:

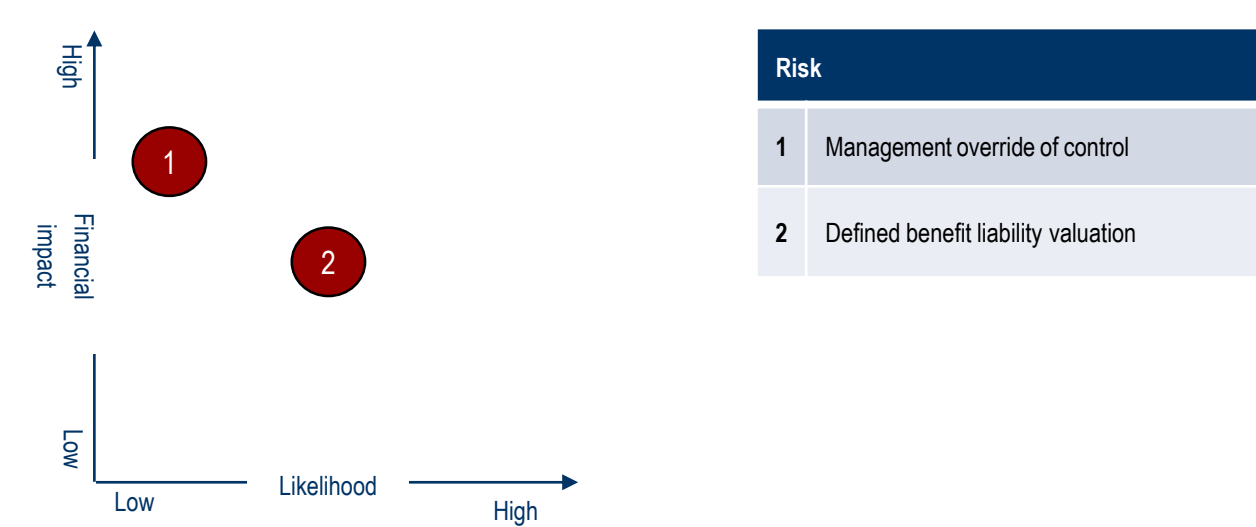
- Significant risk

A significant risk is an identified and assessed risk of material misstatement that, in the auditor’s judgment, requires special audit consideration. For any significant risk, the auditor shall obtain an understanding of the entity’s controls, including control activities relevant to that risk.
- Enhanced risk

An enhanced risk is an area of higher assessed risk of material misstatement at audit assertion level other than a significant risk. Enhanced risks incorporate but may not be limited to:
 - key areas of management judgement, including accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement; and
 - other audit assertion risks arising from significant events or transactions that occurred during the period.
- Standard risk

This is related to relatively routine, non-complex transactions that tend to be subject to systematic processing and require little management judgement. Although it is considered that there is a risk of material misstatement, there are no elevated or special factors related to the nature, the likely magnitude of the potential misstatements or the likelihood of the risk occurring.

The summary risk assessment, illustrated in the table below, highlights those risks which we deem to be significant. We have summarised our audit response to these risks on the next page.



5. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (CONTINUED)

We provide more detail on the identified risks and our testing approach with respect to significant risks in the table below. An audit is a dynamic process; should we change our view of risk or approach to address the identified risks during the course of our audit, we will report this to the Audit and Governance Committee.

Significant risks

	Description of risk	Planned response
1	Management override of controls <p>Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.</p>	<p>We plan to address the risk through performing audit procedures that cover a range of areas, including:</p> <ul style="list-style-type: none"> • Material accounting estimates; • Journal entries, focussing on those that we determine to contain certain risk characteristics; and • Any significant transactions outside the normal course of business or otherwise unusual
2	Defined benefit liability valuation <p>The net pension liability is likely to represent a material element of TfN's balance sheet. TfN is an admitted body of Greater Manchester Pension Fund, which had its last triennial valuation completed as at 31 March 2019.</p> <p>The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in TfN's overall valuation.</p> <p>Financial assumptions and demographic assumptions will be used in the calculation of TfN's valuation, such as the discount rate, inflation rates and mortality rates. The assumptions should also reflect the profile of TfN's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>There is a risk that the assumptions and methodology used in valuing TfN's pension obligation are not reasonable or appropriate to TfN's circumstances. This could have a material impact to the net pension liability in 2019/20.</p>	<p>In relation to the valuation of TfN's defined benefit pension liability we will:</p> <ul style="list-style-type: none"> • Critically assess the competency, objectivity and independence of the Greater Manchester Pension Fund's Actuary, Hymans Robertson; • Liaise with the auditors of the Greater Manchester Pension Fund to gain assurance that the controls in place at the Pension Fund are operating effectively. This will include the processes and controls in place to ensure data provided to the Actuary by the Pension Fund for the purposes of the IAS19 valuation is complete and accurate; • Test payroll transactions at TfN to provide assurance over the pension contributions which are deducted and paid to the Pension Fund by TfN; • Review the appropriateness of the Pension Asset and Liability valuation methodologies applied by the Pension Fund Actuary, and the key assumptions included within the valuation. This will include comparing them to expected ranges, utilising information provided by PWC, consulting actuary engaged by the National Audit Office; and • Agree the data in the IAS 19 valuation report provided by the Fund Actuary for accounting purposes to the pension accounting entries and disclosures in TfN's financial statements.

5. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (CONTINUED)

Revenue recognition

International Standard on Auditing (ISA) 240 includes a rebuttable presumption that the fraud risk from revenue recognition is a significant audit risk.

We recognise that the nature of revenue in local government differs significantly to the sources of income in the private sector. We also consider that there are limited incentives and opportunities to manipulate the way income is recognised in local government. Based on our understanding of TfN's revenue streams we have rebutted the presumption that revenue recognition is a significant risk at TfN. Our testing of revenue is focused on our standard procedures and does not incorporate specific work on the risk of fraud in recognising revenue.

Key areas of management judgement and enhanced risks

Key areas of management judgement include accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement. These areas of management judgement represent other areas of audit emphasis.

	Area of management judgement / enhanced risk	Planned response
1	<p>Intangible Asset valuation – Integrated and Smart Travel (IST)</p> <p>TfN is responsible for leading the development and implementation of a scheme to facilitate easier travel and payment. The project was planned to take a number of years to implement and was split into 3 phases and has lead to the development of an intangible asset.</p> <p>The valuation of the intangible asset has required application of assumptions and estimates relating to material levels of expenditure. TfN will need to continue to ensure that the intangible asset is accounted for in accordance with the CIPFA Code of Practice and IAS 38 Intangible Assets. TfN commissioned PwC to provide advice on the potential accounting treatment that will apply.</p> <p>There is a risk that assumptions and estimates are not appropriate nor in line with accounting standards.</p>	<p>We plan to address this risk by:</p> <ul style="list-style-type: none"> • assessing the competency, objectivity and independence of PwC; • reviewing the basis of the valuation of the intangible asset and challenging the assumptions made; • testing transactions to ensure valuation has been appropriately applied; and • considering the appropriateness of the accounting treatment applied.
2	<p>Intangible Asset valuation – Integrated and Smart Travel (IST) – Phase 3</p> <p>During 2019/20 TfN acknowledged that due to insufficient bus operator support for the IST proposals an “active pause” was implemented in relation to Phase 3 of the IST project. Consequently, some £4.3m of previously capitalised expenditure has been reversed and the costs charged to revenue. TfN had previously secured Department for Transport agreement that DoT would fund the revenue implications in the event of the scheme not progressing as planned.</p> <p>There is a risk over the completeness and accuracy of the transactions that have now been accounted for as revenue expenditure.</p>	<p>We plan to address this risk by:</p> <ul style="list-style-type: none"> • reviewing the process undertaken by TfN to establish that the value of previously capitalised costs attributable to Phase 3 is materially correct; • testing a sample of transactions reversed and charged to revenue; and • reviewing the appropriateness of the accounting treatment and associated disclosures.

6. VALUE FOR MONEY

Our approach to Value for Money

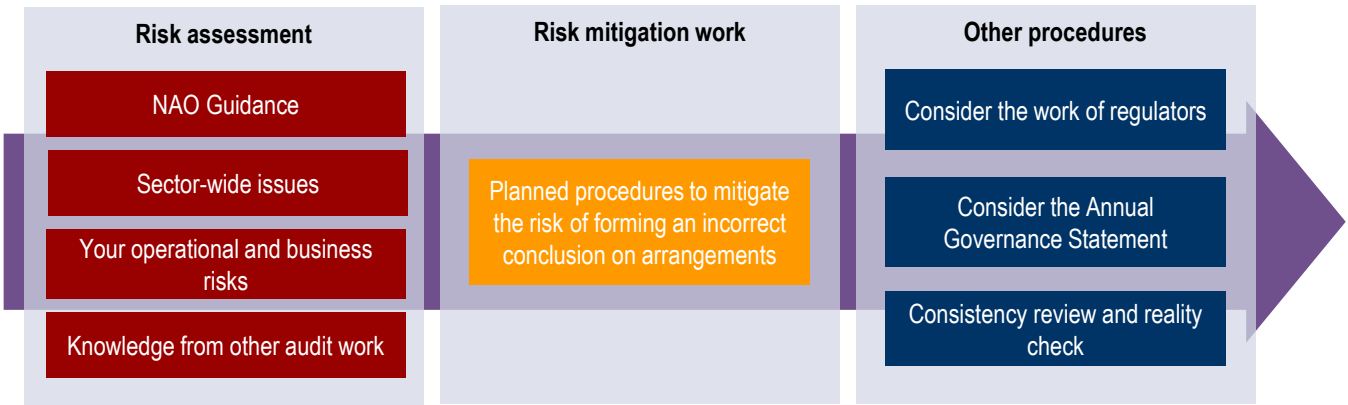
We are required to form a conclusion as to whether TfN has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out, and sets out the overall criterion and sub-criteria that we are required to consider.

The overall criterion is that, ‘in all significant respects, TfN had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.’

To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

A summary of the work we undertake to reach our conclusion is provided below:



Significant Value for Money risks

The NAO’s guidance requires us to carry out work at the planning stage to identify whether or not a Value for Money (VFM) exists. Risk, in the context of our VFM work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at TfN being inadequate. As outlined above, we draw on our understanding of TfN and its partners, the local and national economy and wider knowledge of the public sector.

For the 2019/20 financial year, we have identified the following significant risk to our VFM work:

Description of significant risk	Planned response
During 2019/20 TfN concluded that Phase 3 of the Integrated and Smart Ticket project, to develop an information system to manage accounts-based ticketless transport transactions should not progress as the bus operators confirmed that they were unwilling to accept the system based on the proposal at that time. Consequently, in July 2019 the TfN Board agreed to an “active pause” as it became clear that the project could not continue in its current form.	To inform our VFM assessment we will review the governance and decision making arrangements that lead to TfN concluding that the project could not proceed in line with existing project plans.

7. FEES FOR AUDIT AND OTHER SERVICES

Fees for work as TfN's appointed auditor

At this stage of the audit we are not planning any divergence from the scale fees set by PSAA. Any proposed variations to the fee to address, for example, changes to identified risks or additional work required by regulators will be discussed and agreed with Management before approval is sought from PSAA.

Service	2018/19 fee	2019/20 fee
Code audit work	£33,000	£33,000

Fees for non-PSAA work

We have not been engaged by TfN to carry out any additional work over and above the statutory audit.

Should we be engaged to undertake any additional work we will consider whether there are any actual, potential or perceived threats to our independence. Further information about our responsibilities in relation to independence is provided in section 8.

8. OUR COMMITMENT TO INDEPENDENCE

We are committed to independence and are required by the Financial Reporting Council to confirm to you at least annually, in writing, that we comply with the Financial Reporting Council’s Ethical Standard. In addition, we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement there are no relationships between us and any of our related or subsidiary entities, and you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

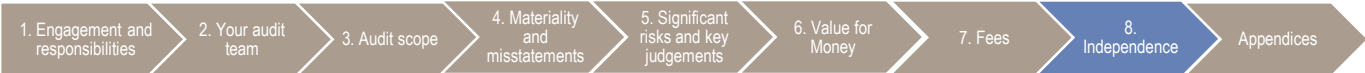
- all partners and staff are required to complete an annual independence declaration;
- all new partners and staff are required to complete an independence confirmation and also complete computer-based ethics training;
- rotation policies covering audit engagement partners and other key members of the audit team;
- use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement partner.

We confirm, as at the date of this document, that the engagement team and others in the firm as appropriate, and Mazars LLP are independent and comply with relevant ethical requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Karen Murray in the first instance.

Prior to the provision of any non-audit services Karen Murray will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence. Included in this assessment is consideration of Auditor Guidance Note 01 as issued by the NAO, and the PSAA Terms of Appointment.

No threats to our independence have been identified.

Any emerging independence threats and associated identified safeguards will be communicated in our Audit Completion Report.



APPENDIX A – KEY COMMUNICATION POINTS

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specifically require us to communicate the following:

Required communication	Audit Strategy Memorandum	Audit Completion Report
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Our commitment to independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality and misstatements	✓	✓
Fees for audit and other services	✓	
Significant deficiencies in internal control		✓
Significant findings from the audit		✓
Significant matters discussed with management		✓
Our conclusions on the significant audit risks and areas of management judgement		✓
Summary of misstatements		✓
Management representation letter		✓
Our proposed draft audit report		✓

APPENDIX B – FORTHCOMING ACCOUNTING AND OTHER ISSUES

Financial reporting changes relevant to 2019/20

There are no significant changes in the Code of Practice on Local Authority Accounting for the 2019/20 financial year.

Financial reporting changes in future years

Accounting standard	Year of application	Commentary
IFRS 16 – Leases	2020/21	<p>The CIPFA/LASAAC Code Board has determined that the Code of Practice on Local Authority Accounting will adopt the principles of IFRS 16 Leases, for the first time from 2020/21.</p> <p>IFRS 16 will replace the existing leasing standard, IAS 17, and will introduce significant changes to the way bodies account for leases, which will have substantial implications for the majority of public sector bodies.</p> <p>The most significant changes will be in respect of lessee accounting (i.e. where a body leases property or equipment from another entity). The existing distinction between operating and finance leases will be removed and instead, the new standard will require a right of use asset and an associated lease liability to be recognised on the lessee’s Balance Sheet.</p> <p>In order to meet the requirements of IFRS 16, all local authorities will need to undertake a significant project that is likely to be time-consuming and potentially complex. There will also be consequential impacts upon capital financing arrangements at many authorities which will need to be identified and addressed at an early stage of the project.</p>