



The Annual Audit Letter for Eden District Council

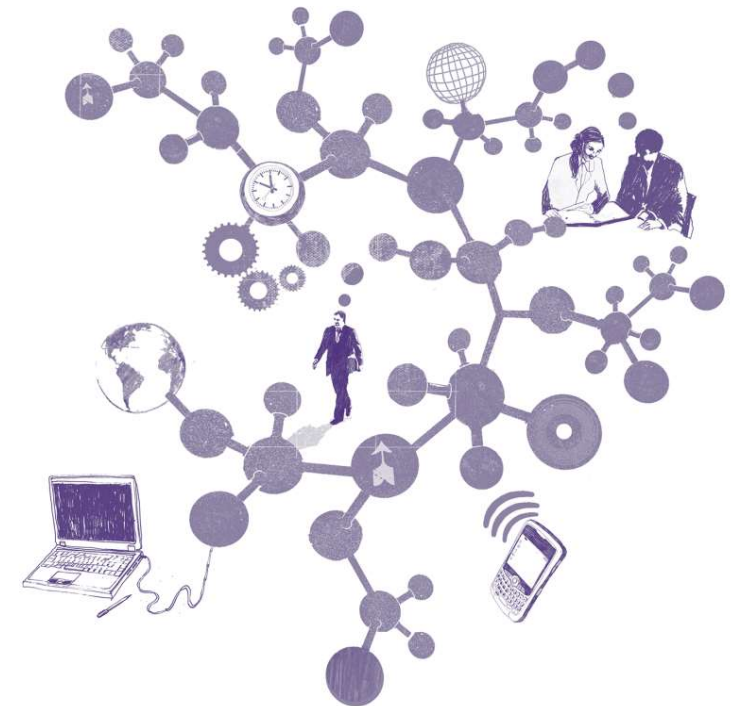
Year ended 31 March 2017

October 2017

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Contents

Section	Page
1. Executive summary	3
2. Audit of the accounts	4
3. Value for Money conclusion	8
Appendices	
A Reports issued and fees	13

Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work we have carried out at Eden District Council for the year ended 31 March 2017.

This Letter provides a commentary on the results of our work to the Council and its external stakeholders, and highlights issues we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Accounts and Governance Committee, as those charged with governance, in our Audit Findings Report on 21 September 2017.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements as set out in section two; and
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources, in forming our value for money conclusion as outlined in section three.

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Council's financial statements on 22 September 2017. Although, we did request a large number of mainly disclosure related amendments before giving this opinion.

Value for money (VfM) conclusion

In overall terms, we were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2017. Whilst we gave an unqualified VfM conclusion, there are a number of matters the Council should address to improve the corporate governance and financial modelling arrangements around the recently formed wholly owned subsidiary - Heart of Cumbria Limited when actual schemes come forward. Our Audit Findings Report made six mainly high priority recommendations to ensure members and senior officers are able to undertake fully informed decision making on Heart of Cumbria related matters and to ultimately protect the Council's short to medium term asset and liability position.

Certificate

We certified that, we had completed the audit of the accounts of Eden District Council in accordance with the requirements of the Code on 22 September 2017.

Certification of grants

We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by the statutory deadline 30 November 2017.. We will report the results of this work to the Accounts and Governance Committee in our Annual Certification Letter.

Working with the Council

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
October 2017

Audit of the accounts

Our audit approach

Materiality

In our audit of the Council's accounts, we applied the concept of materiality to determine the nature, timing and extent of our work, and to evaluate the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £466,000, which is 2% of the Council's gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from commercial activities and grants during the year.

We set a lower threshold of £22,000, above which we reported errors to the Accounts and Governance Committee in our Audit Findings Report.

We also set a lower level of specific materiality of £20,000 for disclosures of officers' remuneration, salary bandings, exit packages and related parties.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by the Director of Finance are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the Narrative Report and Annual Governance Statement to check they are consistent with our understanding of the Council and with the accounts included in the Statement of Accounts on which we gave our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks, and the results of this work.

Audit of the accounts at Eden District Council

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Valuation of pension fund net liability</p> <p>The Council's pension fund asset and liability as reflected in its balance sheet represent significant estimates in the financial statements.</p> <p>In response to the move to earlier close-down, there is a greater degree of estimation in the information provided to the actuary.</p>	<p>We completed the following work in relation to this risk:</p> <ul style="list-style-type: none"> • reviewed the controls put in place by management to ensure that the pension fund liability is not materially misstated and walkthrough tested these controls; • reviewed the competence, expertise and objectivity of the actuary who carried out your pension fund valuation. We gained an understanding of the basis on which the valuation is carried out; • undertook procedures to confirm the reasonableness of the actuarial assumptions made; and • reviewed the consistency of the pension fund asset and liability amounts and disclosures in notes to the financial statements with the actuarial report from your actuary. 	<p>Our audit work did not identified any issues in respect of the valuation of the pension fund net liability, though we did request some amendments to the related disclosures.</p>
<p>Valuation of Property, Plant and Equipment: (PPE)</p> <p>Our work addressed the risk that the Council's property, plant and equipment and investment property portfolio valuation is not materially misstated.</p> <p>The Council revalues its assets on a rolling basis, and its investment property on an annual basis in line with International Accounting Standard 40. The Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from the current value. This represents a significant estimate by management in the financial statements.</p>	<p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • reviewed management's processes and assumptions for the calculation of the estimate; • reviewed the competence, expertise and objectivity of any management experts used; • for any valuation undertaken: <ul style="list-style-type: none"> - reviewed the instructions issued to valuation experts and the scope of their work; - discussed with the valuer about the basis on which the valuation is carried out and challenged the key assumptions; - reviewed and challenged the information used by the valuer to ensure it is robust and consistent with our understanding; and • evaluated the assumptions made by management for those assets not revalued during the year and how management had satisfied themselves that these are not materially different to current value. 	<p>The Council had to request clarification to ensure that the letter, confirming the valuation of the Council's PPE, also included confirmation of investment property valuations. In future the Council should request a separate valuation of investment properties unless it can be clearly demonstrated that the carrying value is not materially different from the current value. We would expect to see clearer evidence to support this assertion.</p>

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 22 September 2017, in advance of the 30 September 2017 national deadline.

Key messages arising from our audit of the Council's financial statements are:

- the Council achieved an early closedown, with accounts authorised for issue on 31 May 2017, which is one month ahead of the specified deadlines;
- the standard of supporting papers were, in part, inadequate and response time to resolve audit queries also contributed to us not achieving an earlier audit closure;
- we have not identified any adjustments affecting the Council's reported financial results or position as recorded in the draft financial statements for the year ended 31 March 2017 with net expenditure at the Cost of Services line of £7.6 million;
- we identified an error on the Cash Flow Statement; and
- there were a relatively high number of post audit amendments made mainly to the disclosure notes.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Accounts and Governance Committee on 21 September 2017.

As highlighted above there were a relatively high number of post audit amendments made and included:

- correcting an error in the cash flow statement relating to an incorrect figure being included for the sale of short term investments;
- amending the balance sheet to remove a debtor and a creditor that had been incorrectly included within on the balance sheet;
- strengthening the 'telling the story' disclosures, including a note to set out the amendments to the Comprehensive Income and Expenditure Statement;
- updating three accounting policies; and
- amending some of the comparative information so it agreed to the 2015/16 final accounts.

To assist the Council in avoiding similar issues in the future we recommended the following key actions:

- Ensuring that there is sufficient time in the closedown plan for the review of the accounts to minimise the number of accounts and disclosure errors; and
- Ensuring that the disclosure checklist is completed during the compilation of the accounts stage signed off by the Director of Finance to improve the overall quality assurance.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement (AGS) and Narrative Report. It published them on its website with the draft accounts in line with the national deadlines.

The Annual Governance Statement was amended to improve signposting to the new principles in the 'Delivering Good Governance in Local Government: Framework (2016)'. Furthermore we noted that the Annual Governance Statement did not include any significant governance issues. It was our view that the Council has encountered some significant governance challenges during the 2016/17 financial year. These challenges include:

- The Council's wholly owned company, Heart of Cumbria Limited, needs to develop its governance and financial modelling arrangements.
- Compliance with the Confidential Reporting Code (CRC), particularly on maintaining confidentiality.

The Council updated its AGS to ensure these issues were highlighted. The Council is also in the process of updating its CRC to reflect on learning from the application of Code in 2016/17.

The narrative statement presented to audit was produced to a good standard. Minor amendments were requested to enhance the information disclosed to fully meet all of the Code requirements.

Audit of the accounts

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We did not use our other statutory duties during the course of the 2016/17 audit.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2016 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work. The key risks related to the:

- Heart of Cumbria Limited; and
- Council's medium term financial plan.

The work on the key risks we identified is set out overleaf. As part of our Audit Findings Report agreed with the Council in September 2017, we made six recommendations to address our findings. These recommendations are all linked to the Heart of Cumbria Limited (the Company).

Members need to be provided with clear and concise information on Company related matters to allow for fully informed decision making, after detailed consideration of: governance structures; financial analysis; and financial modelling. The Council as the parent of the Company, should take steps such as, but not be limited to;

- the development of a financial model to consider financial viability;
- an analysis of risks and the preparation of a risk register;
- an analysis of the different funding options;
- seeking tax advice on the implications of the tax issues; and
- developing a robust governance system.

The Council needs to consider the level of accountability and governance arrangements to be put in place between the Council and the Company.

In particular, these should focus on:

- accountability for public sector investment and/or loans to the Company;
- the risks to public sector funded assets; and
- potential public sector liabilities arising from the Company activities.

In further developing the Business Case for the affordable dwellings the Council needs to be clearer on how it has worked with other stakeholders and engaged appropriate specialists to ensure the Council is adequately safeguarding its asset and liability position, while demonstrating it is securing value for money.

The Council and the Company need to also fully consider the potential implications of the 'Right To Buy' regime extending to local Council owned housing companies.

Review the objectives and targets the Council has set Heart of Cumbria Limited to ensure objectives are SMART and targets are achievable, measurable and clear.

Overall VfM conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2017. However, there are a number of matters the Council should address to improve the corporate governance and financial modelling arrangements around the recently formed wholly owned subsidiary Company, when actual schemes come forward.

It is important to note that, we are fully supportive of the Council considering alternative delivery models to realise its priority aspirations. This includes the use of the Company and it is important that the Council has appropriate governance, legal, tax, financial analysis and financial modelling arrangements in place to adequately safeguard its asset and liability position. At the same time it is important that the Council is able to demonstrate that it is securing value for money. Fully evaluated options should be presented in advance of the Council and Members making significant decisions.

Value for money – risks and findings

We set out below our key findings against the significant risk we identified through our initial and updated risk assessment.

Significant risk	Work to address	Findings and conclusions
<p>Medium Term Financial Plan (MTFP) The MTFP from September 2016 covers the financial years 2016/17 to 2019/20.</p> <p>There are considerable uncertainties over the next few years with revenue streams, and the Council apply estimates and key judgements to compile the MTFP.</p> <p>The MTFP is updated during the course of the year and updates will be made by the Council during the period of our audit</p>	<p>We reviewed the arrangements the Council has in place to compile the MTFP. This included a review of how the Council is identifying, managing and monitoring financial information in order to regularly update the MTFP including reporting outcomes to Executive and Full Council.</p> <p>This links to the Council's arrangements for planning finances effectively to support the sustainable delivery of strategic priorities and using appropriate cost and performance information to support informed decision making</p>	<p>The Council continues to face a challenging internal and external environment in the short to medium term. The challenges are compounded by the uncertainties faced through the business rates retention scheme, the level of ongoing Central Government funding and Brexit. The MTFP approved by Council in February 2017 and updated in September 2017 demonstrated that appropriate steps are being taken to ensure a balanced budget position against a background of reduced government funding and balancing the priorities identified in the Council Plan 2016-2020.</p> <p>The MTFP for 2017/18 to 2020/21 in February 2017 identifies a cumulative surplus of £0.205 million over the 4 year period before any transfers from reserves. This is on the basis of a deficit of £0.763 million being projected for 2017/18, with 0.668 million of this being based on non-recurring expenditure, with £0.777 million of the expenditure over the 4 year period coming from non recurring expenditure schemes. During 2016/17 the Council created an earmarked business rates reduction scheme (BRSS) reserve for £0.843 million, which will be utilised during 2017/18 and 2018/19 when an anticipated reduction in BRSS income is expected, showing the forward planning the Council has in place. The general fund balance is high for the Council, with a £6.4 million balance projected for the period of the 2017/18 to 2020/21 MTFP, which is significantly above the minimum level set by the Council at £1.5 million. The general fund balance at 31 March 2017 is £8.578 million and other earmarked reserves at £5.817 million, representing a £2.477 million total increase in these reserves.</p> <p>The Council has a history of underspends in their revenue and capital budgets. The revenue budget for 2016/17 before transfers was a £0.963 million deficit, whereas a deficit of £0.173 million was achieved. This represents a £0.760 million underspend when compared to the budget in 2016/17. There are various reasons for the underspend. £0.199 million was due to higher levels of income than budgeted for business rates retention scheme and recovery of overpaid housing benefits and as already noted this has been set aside into a reserve in 2016/17. £0.2 million was also achieved from vacancy management.</p> <p>The delivery of the capital programme in 2016/17 showed a £0.433 million underspend against the £1.150 million budget, with £0.135 million of this due to slippage and the expenditure committed and re-profiled into 2017/18.</p> <p>The Council has a comprehensive approach to its medium term financial planning, budgeting and identification of plans, which are agreed at a corporate level, by senior officers and Members. The strategy is aligned to the Council's corporate priorities, highlights the key financial risks, and adopts a prudent approach to funding streams. The Council has taken this approach to allow it to have the flexibility and resilience in order to address the variable nature of future funding. The Council has good planning assumptions built into the annual and four year budget processes. The Council is responsive to changes required as the strategic planning process considers sensitivity analysis.</p> <p>Based on the review of the arrangements in place during 2016/17 for the compilation of the MTFP including identified savings we concluded that the risk was sufficiently mitigated and that the Council has proper arrangements in this area.</p>

Significant risk	Work to address	Findings and conclusions
<p>Working with Partners</p> <p>The Council has set up a limited company 'Heart of Cumbria Limited' which is an alternative service delivery vehicle. This is a new company set up in 2016/17, with the first company meeting in December 2016. The aims of the company are to provide affordable housing, seek economic growth and higher paid jobs and to seek a 3% return on any Council investment.</p>	<p>We reviewed the project management and risk assurance frameworks established by the Council in respect of 'Heart of Cumbria Limited', to establish how the Council is identifying, managing and monitoring the related risks and opportunities</p>	<p>The development of the 'Heart of Cumbria Limited' (HoCL) is an important part of delivering the priorities set out in the Council Plan. The Plan sets out 4 priorities including:</p> <ul style="list-style-type: none"> • Decent Homes for All - Providing access to good quality housing that both reflects local need and supports employment; and • Quality Council - Delivering accessible, effective and value for money services and include the commitment to ensure that there are resilient finances through sound financial management and innovative income generating activities. <p>It is with this commitment that the Council established the wholly owned vehicle, HoCL. The key objectives of the HoCL are to:</p> <ul style="list-style-type: none"> • support the provision of affordable housing; • support the creation and generation of growth and higher paid jobs within the District; and • potentially give the Council a return on its investment. <p>To date the main developments for HoCL include the:</p> <ul style="list-style-type: none"> • setting up of the company, including the appointment of its Directors including two external Non-Executive Directors; • development and approval of a Business Plan for the Company; and • preparation of the Business Case for the procurement of 86 affordable homes. <p>Given the importance of the Company to the Council, in both financial and service delivery terms for the future, we have carried out a detailed review of the initial Business Plan and outline Business Case to gain an understanding of how they compared against normal and best practice. The Council and Company are still at the early stages of evolving the relationship. Many of the items we would expect to be in a Business Plan are missing from the initial plan, which we would expect to be included in a revised plan. Similarly with the Business Case, many of the expected considerations are currently not included in the initial one and we would expect to see these in detailed business cases when presented to Members and senior management.</p> <p>It is important to note that, we are fully supportive of the Council considering alternative delivery models to realise its priority aspirations. This includes the use of the Company and it is important that the Council has appropriate governance, legal, tax, financial analysis and financial modelling arrangements in place to adequately safeguard its asset and liability position. At the same time it is important that the Council is able to demonstrate that it is securing value for money. We acknowledge that, the Council only currently receives 0.5% interest on its money in the bank at present. Fully evaluated options should be presented in advance of the Council and Members making significant decisions.</p>

Significant risk	Work to address	Findings and conclusions
		<p>We outline some of the considerations on the following two pages.</p> <p>On the basis that:</p> <ul style="list-style-type: none"> • Members were kept informed of progress through workshops and presentations; • no formal decision or commitment to spend based on the Business Plan and outline Business Case has been made; • spend during 2016/17 was limited to £10,000; • evidence was provided that demonstrated that some financial modelling had taken place; and • arrangements continue to be developed <p>We concluded that the risk was sufficiently mitigated at this stage as not much final related funding commitments have been in made in 2016/17, although further progress is required before decisions to invest significant Council resources into the HoCL schemes can be made.</p>

Sub criteria	Findings
<p>Informed decision Making</p>	<p>It has been acknowledged by the Council's senior officers that the Business Plan, presented to the Council on 12 January 2017 and the outline Business Case presented to the Council on 13 July 2017 for the purchase of 86 properties both require further detail. For example, the governance section within the initial Business Plan is brief and currently does not evidence the consideration of a robust governance structure needed both within the Company and the Council and also between the two organisations. We acknowledge that, through the recent introduction of various protocols and changes to the Articles the governance arrangements are developing. It is understood the Business Plan will be updated to cover specific projects and will consider an analysis of risks and opportunities for the individual schemes. It is important for the Council, as the sole shareholder and investor, that any significant risks are identified and risk mitigation processes are in place as projects are developed.</p> <p>The outline Business Case document, presented to the Council on 13 July 2017, does not include financial analysis of the proposed purchase of the 86 properties or the forecast returns. We noted that these will be the subject of a separate report. Both the Business Plan and outline Business Case are high-level documents and have generated some challenge from Members.</p> <p>Further evidence provided demonstrated that some initial financial modelling has taken place. We have also been made aware that there have been workshops for Members on matters involving the Heart of Cumbria, the first of these being on 12 January 2017.</p>
<p>Sustainable resource deployment</p>	<p>The initial Business Plans for HoCL does not include detailed analysis of the skills, governance and specialist expertise sought or required. We would usually expect business plan to include such analysis. The Council has indicated that when a formal proposal comes forward from the Company for funding, the Business Case will include detailed financial modelling and analysis setting out key items such as funding arrangements and expected investment returns. Given the level of investment it would be reasonable to expect this information to be available to evidence the long-term sustainability of the Company and also for the affordable housing scheme set out in the Business Case. It was noted that some initial financial modelling has taken place and the assumptions included in these have been documented.</p> <p>The initial outline Business Plan proposes that the Company will be active in buying residential and commercial property and developing schemes on both Council owned and non-Council owned land. Property and land transfer is a complex area with numerous tax and legal implications that can ultimately affect the returns and viability of an investment. The updated Business Plan, when it is produced, will need to indicate that these implications have been considered.</p> <p>The development of a company is outside of the normal course of business for local authorities and it needs the appropriate skills, experience and specialist advice. Clarity is required to demonstrate that these have been considered and there needs to be appropriate controls and procedures in place before making investment decisions. Typical factors include, but are not limited to, supply and demand, target returns, the length of investment and payback, and economic outcomes.</p> <p>The Housing White Paper released in February 2017, makes an indication that the Right to Buy (RTB) regime may be extended to capture local Council owned housing companies. The updated Business Plan will need to consider the potential future risks associated with RT) on the housing stock of the Company.</p>

Informed decision making

Sub criteria	Findings
<p>Working with partners and other third parties</p>	<p>In the initial Business Plan three objectives were set out for the Company by the Council as shareholder, which are to;</p> <ul style="list-style-type: none"> • Provide affordable housing; • Seek economic growth and higher paid jobs; and • Seek a 3% return on any Council investment. <p>In order to measure the outputs of the Company against these three objectives, the three key targets for the Company stated in the Business Plan are;</p> <ul style="list-style-type: none"> • Additional income from cash investments for the Council of up to £200,000 a year within five years as a minimum assuming the Council’s financial support is forthcoming. • To facilitate additional new higher paid jobs and employment development. • To own at least 50 affordable dwellings.” <p>We would expect targets should be ‘SMART’ (Specific, Measureable, Achievable, Relevant and Time-based). As can be seen the current targets are not ‘SMART’ and we acknowledge that the Council and Company have more work to do on this.</p> <p>Whilst some treasury management and legal advice has been received in relation to the application or not of State Aid rules, it would also be appropriate for other specialist advice to be sought, including the potential tax implications for each of the Business Case options being considered.</p> <p>To deliver the housing scheme suggested in the business case, the Company and the Council may need to work in partnership with other organisations, for example working with Registered Social Landlords in the provision of management and maintenance and it is noted that this is being currently considered.</p>

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and confirm there were no fees for the provision of non audit services

Fees

	Proposed fee £	Actual fees £	2015/16 fees £
Statutory audit of Eden District Council	41,943	53,443	41,943
Housing Benefit Grant Certification	7,898	Tbc	8,646
Total fees (excluding VAT)	49,841	Tbc	50,589

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA). We have proposed a revised fee, which has been accepted by the Council. The additional fee of £11,500 relates to the quantum of extra work required on the financial statements and in reviewing the Heart of Cumbria Limited arrangements. This fee variations is subject to approval by Public Sector Audit Appointments Ltd and can only be confirmed after their approval.

The Housing Benefit certification work will be completed by 30 November and the fee will be confirmed in our annual certification letter.

Reports issued

Report	Date issued
Audit Plan	January 2017
Audit Findings Report	September 2017
Annual Audit Letter	October 2017

Non-audit services

We can confirm that no non-audit or audited related services have been undertaken for the Council in 2016/17.



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