Leicester City Council

SECOND DESPATCH

MEETING OF THE AUDIT AND RISK COMMITTEE

TUESDAY, 27 SEPTEMBER 2016

Further to the agenda for the above meeting which has already been circulated, please find attached the following:-

ADDITIONAL INFORMATION

AGENDA ITEM 5 – ANNUAL GOVERNANCE REPORT - ISO 260 REPORT TO THOSE CHARGED WITH GOVERNANCE

The External Auditor submits the ISA 260 Report to Those Charged with Governance a report which summarises the 2015/16 audit of Leicester City Council, and the requirement for Members to authorise the Director of Finance to sign the letter of representation to KPMG from the Council.

The Audit and Risk Committee are asked to note the report and approve the letter of representation.

A copy of the associated documentation is attached for Members only. Further copies are available on the Council's website at www.cabinet.leicester.gov.uk or by phoning Democratic Support on 454 6454.

Officer contact:

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Report to those charged with governance (ISA 260) 2015/16

Leicester City Council

22 September 2016

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. Public Sector Audit Appointments issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact John Cornett, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (on 0207 694 8981, or by email to andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Section one: Introduction

Introduction

This document summarises:

- The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for the Authority; and
- Our assessment of the Authority's arrangements to secure value for money.

Scope of this report

This report summarises the key findings arising from:

- Our audit work at Leicester City Council ('the Authority') in relation to its 2015/16 financial statements; and
- The work to support our 2015/16 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources (the Value for Money (VFM) conclusion).

Financial statements

Our External Audit Plan 2015/16, presented to you in March 2016, set out the four stages of our financial statements audit process.

Planning | Control Evaluation | Substantive Procedures | Completion

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during August and September 2016.

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 VFM conclusion. This included:

- Assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion; and
- Considering the results of any relevant work by the Authority in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2015/16 financial statements of the Authority.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

We would like to take this opportunity to thank officers for their continuing help and co-operation throughout our audit work.

Section two: Headlines

Section two

Headlines

This table summarises the headline messages for the Authority. Sections three and four of this report provide further details on each area.

9

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority’s financial statements by 30 September 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	Our audit did not identify any material misstatements. There were a number of minor presentational matters, which officers have agreed to amend in the final version of the financial statements.
Key financial statements audit risks	We identified the following key financial statements audit risks in our 2015/16 External Audit Plan presented to you in March 2016 — Change of banking arrangements from Co-op to Barclays; — Management override of controls; and — Fraudulent revenue recognition. Professional standards require us to consider the latter two risks as standard risks for all organisations. We have worked with officers throughout the year to discuss these risks and our detailed findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas.

Headlines (cont.)

This table summarises the headline messages for the Authority. Sections three and four of this report provide further details on each area.

Accounts production and audit process	We received a set of accounts for audit on 30 June 2016 which was the deadline day. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2014/15* relating to the financial statements. Further detail is provided in Appendix 1. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. We will debrief with the finance team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particular we would like to thank Authority officers who were available throughout the audit visit to answer our queries.
VFM conclusion and risk areas	We identified the following VFM risks in our External audit plan 2015/16 issued in March 2016. — Implementation of OFSTED's recommendations following their review of children's services; and — Financial resilience. We have worked with officers throughout the year to discuss these VFM risks and our detailed findings are reported in section 4 of this report. In respect of children's services, the Authority cannot yet demonstrate that sufficient progress has been made to allow us to conclude that it has proper arrangements in place to ensure it has deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. Regarding financial resilience, the Authority has arrangements in place to address the funding shortfall that will crystallise in 2018/19. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources except for arrangements regarding children's services. Therefore we anticipate issuing a qualified VFM conclusion by 30 September 2016.

Headlines (cont.)

This table summarises the headline messages for the Authority. Sections three and four of this report provide further details on each area.

Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: — Review of changes in the housing rents system; — Testing of journals; — WGA; and — General audit file completion and review procedures. We will provide a verbal update for the Audit and Risk Committee at the meeting on 27 September to inform them of progress against this list of outstanding work. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

Section three: Financial Statements

Proposed opinion and audit differences

We have not identified any issues in the course of the audit that are considered to be material.

We anticipate issuing an unqualified audit opinion in relation to the Authority's financial statements by 30 September 2016.

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Authority.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality level (see Appendix 2 for more information on materiality) for this year's audit was set at £15 million. Audit differences below £750k are not considered significant.

We did not identify any material misstatements. There were a number of minor presentational matters, which officers have agreed to amend.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- It complies with Delivering Good Governance in Local Government: A Framework published by CIPFA/SOLACE; and
- It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements

Section three

Significant audit risks

In our *External Audit Plan 2015/16*, presented to you in March 2016, we identified the significant risks affecting the Authority's 2015/16 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority. The table on the next page are risk areas required by professional standards.

11

Areas of significant risk	Summary of findings
Change in banking arrangements → Audit areas affected — Financial Statements	**Change in banking arrangements** — Risk The Authority began transferring banking services from Co-op to Barclays in February 2015. During our 2014/15 audit we reviewed the Authority's arrangements for ensuring the accurate transfer of bank balances, amending the general ledger and ensuring completeness of income to reflect the change in bank provider. We did not identify any issues from our work. The transfer of banking services had not been fully completed by the time our 2014/15 audit ended. — Findings We have reviewed the Authority's arrangements for ensuring the accurate transfer of bank balances for the remaining Co-op balances in 2015/16. There are no matters arising from this work that we need to bring to your attention.

Significant audit risks (cont.)

In our External Audit Plan 2015/16 we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risk		Summary of findings
Management override of controls	Audit areas affected — All areas.	Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. For the last three years we reported that although only authorised finance staff can raise journals, and that there is a degree of authorisation through granting appropriate permissions when staff take up posts, there is no check that journals processed are complete or accurate. Our testing of journals for 2015/16 has not identified any examples of erroneous journals. There are no other matters arising from this work that we need to bring to your attention.
Fraud risk of revenue recognition	Audit areas affected — None.	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. In our External Audit Plan 2015/16 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue. This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

KPMG

Other areas of focus

In our External Audit Plan 2015/16, presented to you in March 2016, we identified two areas of audit focus. These are not considered as significant risks but areas of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

We have now completed our testing. The table sets out our detailed findings for each area of audit focus.

13

Asset valuations of schools and leisure centres

— Risk

In our 2014/15 audit report to members (ISA 260) we reported that the Authority increased the values of its schools and leisure centres by £76.5 million to reflect their current value.

The fixed asset register was updated with totals for each asset category rather than at an individual asset level. The detailed updating of the register has taken place in 2015/16. The risk is that the disaggregation of information held in the fixed asset register is incorrect.

— Findings

We have reviewed the disaggregation of information for schools and leisure centres to ensure that the fixed asset register is consistent with the 2015/16 valuation information provided by the Valuer. There are no matters arising from this work that we need to bring to your attention.

Change in MRP policy

— Risk

In November 2015 members agreed to amend the Minimum Revenue Provision (MRP) policy. Until 2006/07, MRP was calculated as 4% of all outstanding borrowing. The Authority now has the flexibility to set its own policy, provided this is prudent. The new policy seeks to write down all borrowing, with reference to asset lives.

— Findings

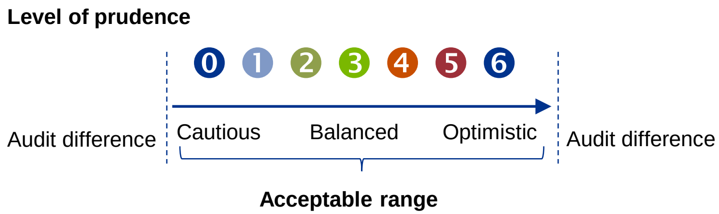
There has been no impact on income and expenditure as a voluntary set aside has been made to bring the overall revenue provision in line with the amounts charged in the previous year.

The Authority has not carried out any retrospective recalculation of MRP from previous years, nor do they intend to rebase PFI borrowing outside the timing of the PFI credits.

The Authority's Monitoring Officer was consulted, however the Authority did not seek external legal advice regarding the change to the policy.

Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:



Assessment of subjective areas				
Asset/liability class	**15/16**	**14/15**	**Balance (£m)**	**KPMG comment**
Property, Plant and Equipment (valuations and asset lives)	3	3	£2,144.6 million (PY: £2,057.6 million)	Valuations are consistent with information provided by the external valuers. The asset lives used in the calculation of depreciation are not unreasonable.
Pensions liability	3	3	£530.8 million (PY: £764.4 million)	The balance represents the deficit on the pension scheme. The reported balance, together with assumptions and disclosures for inflation, discount rate, salary growth, life expectancy etc are consistent with the report from the external actuary.

Accounts production and audit process

The Authority has satisfactory processes in place for the production of the accounts. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.

15

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's processes for preparing the accounts and their support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has satisfactory financial reporting in place. We consider that other accounting practices are appropriate.
Completeness of accounts	We received a complete set of accounts for audit on 30 June 2016, which was the deadline day. We have worked with officers throughout the year to identify and discuss potential issues that could affect the closedown process, and the Authority's response to these issues. The Authority has made a number of minor amendments to the accounts presented for audit, however there have been no changes which affect the financial position.
Quality of supporting working papers	Our Accounts Audit Protocol, which we issued in two sections, in January and February 2016, and discussed with the corporate finance team, set out our working paper requirements for the audit. The quality of working papers provided met the standard specified in our Accounts Audit Protocol.
Response to audit queries	Officers resolved all audit queries in a timely manner.

Prior year recommendations

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report.

The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2014/15*. Appendix 1 provides further details.

Findings in respect of the control environment for key financial systems

Bank reconciliation

We identified a temporary suspension of controls over bank reconciliations.

There was no evidence of review of the bank reconciliations for April 2015. We note that this was during the time of the transition of transferring of bank balances from Co-op to Barclays.

While monthly bank reconciliations for May 2015 and June 2015 had been carried out on a timely basis, we would expect controls to be applied effectively, including during periods of potential high risk such as when there is a change in banking arrangements.

As period of high risk occur infrequently, we have not made a recommendation regarding this matter,.

Accounts production and audit process (cont.)

The Authority has satisfactory processes in place for the production of the accounts. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.

IT controls

As part of our general understanding of IT at the Authority, we reviewed the following areas:

Element	Comments	Impact on the audit
Controls over starters	There is no validation that the requester is appropriate. Moreover, the requester could be different from the line manager. Hence, there is no control that the account creations are appropriately authorised	As this relates to network access, we do not have any concerns regarding the effective operations of specific application controls.
Controls over leavers	Under the current process, the accounts are disabled automatically upon the request form is completed without any further validations. There is the risk, for instance, that an employee requests an active directory account of a superior to be disabled without any check. Hence, there is no control over the requests for access revocation.	As this relates to network access, we do not have any concerns regarding the effective operations of specific application controls.
Access controls – powerful users	Access to powerful user accounts (such as those which can be used to perform user access administration or to change system configuration) in the network and database layers is restricted to a defined set of system administration personnel.	None.
Passwords	Although the password policy states that passwords should be changed every 90 days, the inspection of Windows security settings showed that it is not enforced. Likewise, although accounts are locked after three failed logon attempts, they are only locked for 15 minutes and the account lockout counter is reset after 15 minutes. Both password age and account policy are not in line with best practice.	As this relates to network access, we do not have any concerns regarding the effective operations of specific application controls.
Program changes	In the context of the new rent accounting system, KPMG discussed the process followed to approve and migrate changes to the live environment in Northgate. The change can only go live once it is approved by the authorisers defined by the Change Manager. This approval process can be retrospective for emergency changes.	This gives us assurance that migration of data from the old rents system to the new system has been carried out in a controlled manner.

Appendix 1 contains the recommendations we have made to strengthen controls in these areas where appropriate.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinion and conclusion we will prepare our Annual Audit Letter and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of Leicester City Council for the year ended 31 March 2016, we confirm that there were no relationships between KPMG LLP and Leicester City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 3 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Director of Corporate Services for presentation to the Audit and Risk Committee. We require a signed copy of the management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc.).

There are no matters which we wish to draw to your attention in addition to those highlighted in this report.

Section four: Value for Money

VFM Conclusion

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

We have concluded that the Authority has made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people except for arrangements regarding children's services.

Background

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

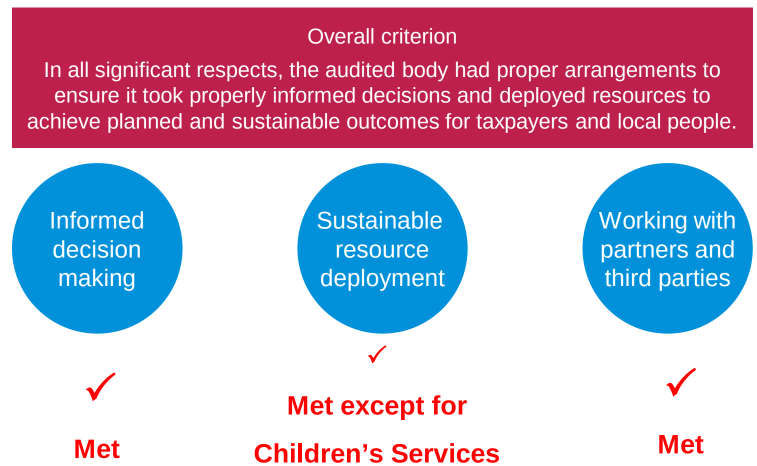
This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

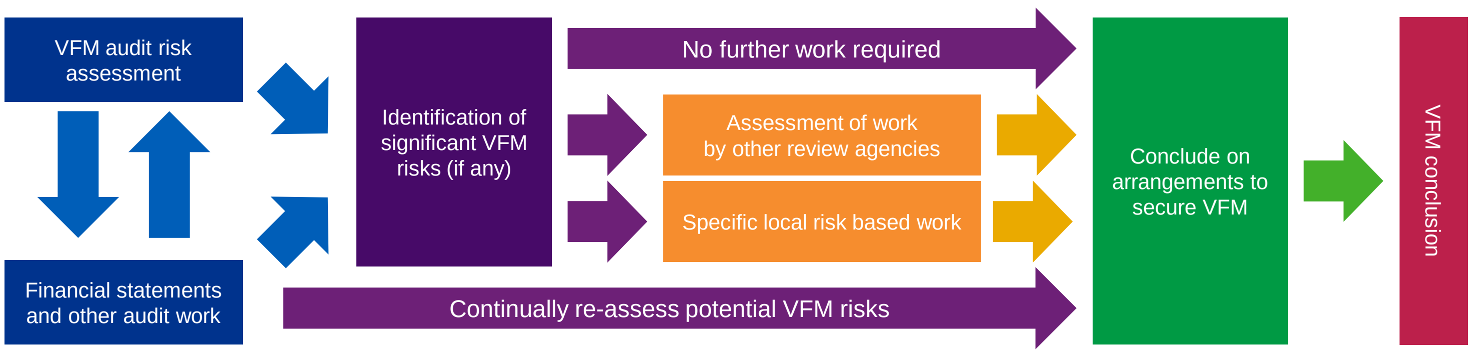
The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

These sub-criteria provide a focus to our VFM work at the Authority.

Conclusion

We have concluded that the Authority has made proper. arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people except for arrangements regarding children's services





19

Specific VFM Risks

We have identified a number of specific VFM risks.

There is insufficient evidence to demonstrate that actions taken in response to the March 2015 OFSTED report have resulted in improved outcomes for all service users. However actions taken have resulted in improved outcomes for some service users and improving outcomes for others.

In all other cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

20

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* we have:

— Assessed the Authority's key business risks which are relevant to our VFM conclusion;

— Identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;

— Considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas; and

— Completed specific local risk based work.

Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we needed to carry out additional work for these risks. This work is now complete and we also report on this below.

Specific VFM Risks (cont.)

There is insufficient evidence to demonstrate that actions taken in response to the March 2015 OFSTED report have resulted in improved outcomes for all service users. However actions taken have resulted in improved outcomes for some service users and improving outcomes for others.

21

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Children's services	In March 2015 OFSTED published a report that concluded "The overall judgement is that childrens' services are inadequate." The report included 24 recommendations for improvement. Last year we issued a qualified VFM conclusion because although the Authority had an improvement plan in place to address OFSTED's findings, these procedures had yet to be fully embedded. This service spends £50 million per annum (net) which is approximately 15% of overall net expenditure. This is a significant proportion of expenditure, the service attracts high public interest locally, the council's reputation is at risk if the service does not deliver, and there is a significant impact on the lives of children if quality standards are not achieved. In our Audit Plan for 2015/16 we set out the risk that the VFM conclusion may again be qualified this year if the Authority cannot demonstrate that sufficient progress has been made in relation to the improvement plan.	The Authority has put in place an action plan to address the OFSTED findings. Out of 24 recommendations addressed to the Authority, 15 recommendations have been signed off by Leicester City Children's Improvement Board (LCCIB) as having all key actions completed. The remaining 9 recommendations are all in progress; none is delayed or stalled. To recognise the progress being made, the Authority has moved away from the rigid Action Plan to address OFSTED recommendations. Instead, officers have introduced "12 week action plans" that focus on the priorities for the immediate period ahead, to better concentrate the efforts of staff. These are updated each month and reported to the LCCIB. There is also a "Dashboard of key indicators" that tracks progress against a range of measures. This presents a more mixed picture: the dashboard presented to the LCCIB for September shows 4 out of 19 measures still assessed as inadequate, with a further 3 still requiring improvement. Continued …

Specific VFM Risks (cont.)

There is insufficient evidence to demonstrate that actions taken in response to the March 2015 OFSTED report have resulted in improved outcomes for all service users. However actions taken have resulted in improved outcomes for some service users and improving outcomes for others.

22

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Children's services	In March 2015 OFSTED published a report that concluded "The overall judgement is that childrens' services are inadequate." The report included 24 recommendations for improvement. Last year we issued a qualified VFM conclusion because although the Authority had an improvement plan in place to address OFSTED's findings, these procedures had yet to be fully embedded. This service spends £50 million per annum (net) which is approximately 15% of overall net expenditure. This is a significant proportion of expenditure, the service attracts high public interest locally, the council's reputation is at risk if the service does not deliver, and there is a significant impact on the lives of children if quality standards are not achieved. In our Audit Plan for 2015/16 we set out the risk that the VFM conclusion may again be qualified this year if the Authority cannot demonstrate that sufficient progress has been made in relation to the improvement plan.	OFSTED have carried out interim reviews (but only of parts of the service originally inspected). Their latest feedback, received in August 2016 includes a range of positive comments about the progress made to date but also warns that "…To achieve good, alongside continued compliance, managers need to now focus on improving the quality of services. This should include offering opportunities for more reflective supervision and reducing the high caseloads of personal advisers." This is an indication that the effectiveness of the service is not yet at the desired level. A formal re-inspection by OFSTED is not scheduled to take place for two years from the date of the original inspection. There is evidence that the Authority is taking on board the comments made by OFSTED from their interim reviews, and is working closely with other 'good' local authorities, external agencies and partners to deliver children's services. Findings from OFSTED monitoring visits and external reviews will be incorporated into a refreshed Improvement plan. Despite the progress that has been made in responding to OFSTED recommendations and in making improvements to the service, the Authority cannot yet demonstrate that, in respect of children's services, sufficient progress has been made to allow us to conclude that it has proper arrangements in place to ensure it has deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We therefore propose to issue a qualified VFM conclusion to this effect.

Specific VFM Risks (cont.)

We are satisfied that external or internal scrutiny provides sufficient assurance that the Authority’s current arrangements in relation to financial resilience are adequate.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Financial resilience	On 24 February 2016 the financial position up to 2019/20 was presented to full Council. By that date: ■ Expenditure is expected to exceed income by £55 million. The current spending review programme only expects to cover just over half of the shortfall. ■ Forecast reserves (excluding ring-fenced and earmarked reserves) at March 2016 are £54 million, of which £39 million will be used to finance spending by 2018, leaving just the minimum general fund balance of £15 million going forward.	We have reviewed the 2016/17 budget reports which also cover the period up to 2019/20. There are annual savings that need to be found up to 2020 amounting to £55 million. The spending review programme has only identified £30 million so there are further annual savings still to be found amounting to £25 million. The Authority has arrangements in place to address the funding shortfall. To date 19 schemes have delivered savings amounting to £17.9 million so there is evidence that the spending review programme is effective. However, officers acknowledge “even if all the measures in this report are adopted, the gap will not be fully closed and further work will still be needed next year.” Going forward from 2019/20, our estimate is that, at best there is an annual shortfall of £11 million yet to be addressed. The worst case is that planned savings will not be achieved which will leave a funding gap of £50 million. The Authority has adopted a reserves strategy, building up reserves in 2014/15 and 2015/16 to allow time for a measured approach to identifying savings in services. There is an earmarked ‘budget strategy’ reserve: at March 2016 this stood at £40 million. By March 2018 it will be wiped out but the general fund will still have a £15 million balance which is the minimum balance recommended by the Director of Finance. Although the savings review programme has already been extended to cover services where expenditure is lower (and therefore the scope for potential savings to be found is lower), there is still time to address the shortfall (the position for 2016/17 and 2017/18 is satisfactory). We therefore expect to give an unqualified VFM conclusion in respect of financial resilience.

Appendices

Appendix one

Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations					
1	***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response
1	2	**CIPFA Code Disclosure Checklist** The Authority did not complete the disclosure checklist that we requested in our audit working paper requirements. The checklist sets out the minimum disclosure requirements in a set of local government accounts. There is a risk by not completing the formal checklist that not all disclosure requirements have been met. We completed the checklist and found no issues. **Recommendation** In future complete the disclosure checklist and make it available to audit. Completion of the checklist prior to audit may identify any non-disclosures and enable earlier resolution.	Agreed. We will ensure that completion of the Code Disclosure Checklist is factored into future timetables.

Key issues and recommendations (cont.)

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations					
❶	***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	❷	***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸	***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response
2	❷	**Leaseholder accounts - housing** Tenants of council flats who exercise their right to buy continue to make contributions towards the general upkeep of the buildings. The leaseholder accounts team in housing had not reconciled the total or the individual balances in their records(balances represent amounts received from former tenants, not yet spent on repairs) to the general ledger at the year end. The balance in the general ledger was understated by approximately £500k as some amounts had been incorrectly posted to income. The Authority has made a provision in the accounts to cover the shortfall. **Recommendation** Reconcile the total and individual leaseholder balances held on the Northgate housing system to the balances held on the general ledger on a monthly basis. Investigate any discrepancies.	Management accepts this recommendation in respect of the need for more frequent and comprehensive reconciliations. The exact frequency will need to be determined in line with business requirements, but will be regular and will ensure that the position is correctly reconciled and maintained.

Key issues and recommendations (cont.)

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

27

Priority rating for recommendations					
1	***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response
2	2	**Fixed Assets Register (FAR)** The FAR is in an excel spreadsheet format. Our review of the FAR identified a small number of assets where the depreciation calculation formulae had not been copied and therefore the depreciation charge had not been correctly calculated. The depreciation charge of these assets was £861k and the financial statements have been amended. **Recommendation** Ensure the FAR is updated and reviewed annually to ensure the depreciation charge formulae is applied for all assets.	The FAR is prepared in detail and reviewed annually but is by its nature a complex tool. Management will ensure that further checking mechanisms are built in where possible, with specific reference to this issue. In the longer term, we are exploring making greater use of the new finance system to account for fixed assets, and as part of this we will give consideration to ensuring that all elements of the accounting adjustments are included.

IT recommendations

We identified weaknesses in some of the Authority's high level IT controls.

This appendix summarises the issues we have identified in our testing of high level IT controls, together with our recommendations and officers' responses.

Priority rating for recommendations					
1	***Priority one***: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	***Priority two***: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	***Priority three***: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response
1	2	**Starters - Access provision (Network)** After the access request form is completed on the portal, the accounts are automatically created without any further validation over the appropriateness of the requests (i.e. line manager or superior to user). Without a robust starter process it is possible that users are set up with access to the network without appropriate authorisation. In addition to the risk of information being made available to inappropriate persons, there is a risk that users might have access to functions which are inappropriate given their job description, which could lead to unauthorised activities being performed. **Recommendations** Controls should be added around the starter process to ensure the access requested is appropriate. This may be complimented by a periodic access review to pick up instances in which users retain a level of access which is inappropriate to their role. System audit trails should be enabled and reviewed where feasible to ensure that all changes to user access are approved and completed appropriately.	We have now added a manual check to the access request form carried out by the ICT Service Desk. This takes place if the form has not been submitted by the manager.

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IT recommendations (cont.)

We identified weaknesses in some of the Authority's high level IT controls.

No.	Risk	Issue and recommendation	Management response/ responsible officer
2	3	**Leavers - Access removal (Network)** After the access removal request is completed on the portal, accounts are automatically disabled without any further validation over the appropriateness of the request. As a result, any user can request an account to be disabled, even if it is the account of a direct superior. Accounts could be disabled based on any user's requests, regardless of the relationship of the user with of the requestor with the user, which could result in business disruption. **Recommendations** Controls should be added around the leavers process to ensure the access revocation request is only done by an appropriate requestor (Superior/HR)	This will increase the resource requirement. I do not think this is a big enough risk, as the account isn't deleted, just moved to a holding queue pending delete in 90 days. It would take less than a couple of minutes to revert the action. There is an audit of who requested it and becomes a management issue. This has been in place since January and to date we have no reported incidents.

IT recommendations (cont.)

We identified weaknesses in some of the Authority's high level IT controls.

No.	Risk	Issue and recommendation	Management response/ responsible officer
3	2	**Leavers - Access removal (Network)** We identified 35 leavers (out of a total of 839) who have accessed their Active Directory account after leaving the organisation. The existence of enabled user accounts of leavers increases the risk of these user accounts being exploited to gain unauthorised access to the system by users who are no longer employed by the Authority and/or by current users should they gain access to leaver accounts. In the event such accounts are used, it would be difficult to establish accountability for subsequent actions carried out. There is therefore a significant risk of damage or disruption to systems or data, as well as potentially fraudulent activity. Where users change job roles, there is a risk that they retain an inappropriate level of access which is not commensurate with the requirements of their new job role. **Recommendations** When a user ceases employment, to prevent the unnecessary risk of inappropriate or fraudulent activity, user access should be revoked from all layers (application, network, and database) through which access to programs and data is possible. This should be performed immediately following each user's leaving date. Where possible, last logon dates should be retained. Additional reviews may need to be performed to complement the leaver process to ensure that the designed process is operating effectively and any inappropriate access is identified and removed. Where systems permit this, such controls should be automated to reduce the risk of control failures.	It is the manager's responsibility to inform IT of changes to a user's employment status. For leavers, there are clear guidelines to follow, which are emailed to the manager from the HR team as part of an exit checklist. The guidelines clearly inform the manager of the importance of deleting the accounts and how to do it. The guidelines link directly to the appropriate form on the self-help website where the manager can request the deletion of the leavers account. On receiving this request, we automatically disable the account for 90 days. If after 90 days there has been no further requests relating to the account it is automatically deleted. We also proactively have a monthly leavers report from the HR system that we script and place all users on the list that have not already been deleted and disable them. We also look for accounts with no activity for 90 days and move them to an on hold container. As for role changes - this is also the responsibility of the manager to inform us. However in this case, there are no prompts for the manager to do so.

IT recommendations (cont.)

We identified weaknesses in some of the Authority's high level IT controls.

31

No.	Risk	Issue and recommendation	Management response/ responsible officer
4	2	**Passwords - Authentication (Network)** Windows Active Directory is not configured to force users to change their passwords after a specified number of days. If users are not forced to change their password regularly, there is a risk that they may have their accounts compromised, which could impact upon the integrity of the system. **Recommendations** Password expiry settings should be configured to ensure that user account passwords are changed on a regular basis. It is recommended to have a password maximum age of 90 days.	CESG (the Information Security Arm of GCHQ.) recommends that we don't change passwords frequently as it makes them less secure (see article here: https://www.cesg.gov.uk/articles/problems-forcing-regular-password-expiry). If a user's password had been compromised on a third party website a hacker wouldn't be able to use it from outside the Authority as they would also need access the second factor token.

Follow up of prior year recommendations

The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2014/15*.

32

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2014/15* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	3
Fully Implemented in year or superseded	0
Remain outstanding (re-iterated below)	3

No.	Risk	Issue and recommendation	Management response/ responsible officer in 2014/15 ISA Report	Status and management response as at September 2016
1	2	**Notes to the Financial Statements** Non-trivial amendments were made to a number of notes in the financial statements. These were mainly of a presentational nature. The notes form part of the statements by giving details about entries in the primary statements. It is therefore important that the entries in the notes are fairly stated. **Recommendation** Ensure the 2015/16 accounts closedown timetable includes a robust quality review of the notes.	**Principal Accountant – Corporate Accountancy (comments):** Management accept this recommendation. A plan of work to deliver this objective is in place.	Partially implemented. The number of amendments to notes this year have reduced but there is scope for improvement. **Principal Accountant – Corporate Accountancy (comments):** Since 2014/15, we have developed a more detailed project plan for the preparation of the statement of accounts. We also introduced weekly closedown meetings for key members of staff to try and ensure that deadlines were met or managed. This timetable was successful in facilitating earlier completion of many tasks and therefore allowed more time for the content of the accounts to be reviewed and cross-checked. We are continuing to build on this process for future years.

Follow up of prior year recommendations (cont.)

The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2014/15*.

33

No.	Risk	Issue and recommendation	Management response/ responsible officer in 2014/15 ISA Report	Status and management response as at September 2016
2	2	**Related party disclosure** Assurance about related party transactions relates to the year of account and it is important that declarations are received from all members in position for that year. In 2012/13 and 2013/14 we reported that related party declarations had not been returned by three councillors and six councillors respectively, with the impact that there may be significant matters undisclosed. For 2014/15, ten councillors did not return their annual declarations. **Recommendation** Publish the names of members who fail to return related party declarations. The Chair of the Audit and Risk Committee may wish to consider what further actions are available	**Principal Accountant – Corporate Accountancy (comments):** Management feel that the response to this recommendation is a matter for the Audit & Risk Committee but is able to support any action the Committee may feel it appropriate to take. Minutes of the Audit and Risk Committee meeting on 29 September 2015 record "The Chair expressed support for the recommendation to publish the names of members who failed to return related party declarations." .	Not implemented. Two councillors have not returned their annual declaration for 2015/16, one of whom has not done so for at least two years. **Principal Accountant – Corporate Accountancy (comments):** We have repeatedly chased these up. This was an improvement from the previous year. We feel that further steps are a matter for the Audit & Risk Committee but we will be able to facilitate any actions required.

Follow up of prior year recommendations (cont.)

The Authority has not fully implemented all of the recommendations in our *ISA 260 Report 2014/15*.

34

No.	Risk	Issue and recommendation	Management response/ responsible officer in 2014/15 ISA Report	Status and management response as at September 2016
3	2	**Journal controls:** For the last three years we reported that although only authorised finance staff can raise journals, and that there is a degree of authorisation through granting appropriate permissions when staff take up posts, there is no check that journals processed are complete or accurate. Our recommendation was to produce a report of non-routine journals raised by finance staff, and provide evidence that journals are authorised by a senior member of the finance team. This was agreed by officers.	**Principal Accountant – Corporate Accountancy (comments):** There is still no established process for authorising journals. The longer-term solution to this issue will be a system-based authorisation workflow process – in order to meet the recommendation, we are including this in our specification of needs from the Council's future finance system, for which a procurement exercise is currently underway. Prior to the introduction of a new system, a number of options have been identified for controlling journals, which will be presented to the Finance Management Team. Any additional controls adopted will be incorporated into the Council's processes and rules as required.	Not implemented. There is still no established process for authorizing journals. **Principal Accountant – Corporate Accountancy (comments):** We have implemented a control whereby system reports on higher-value journals are available to colleagues at any time, and collated reports are occasionally prepared and distributed. As noted last year, a workflow-based system of authorisation for journals will be a far superior solution to this issue and is being incorporated into the development of the new finance system.

Audit differences

This appendix sets out the audit differences.

The financial statements have been amended for all of the errors identified through the audit process.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit and Risk Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Uncorrected audit differences

We confirm that there are no uncorrected misstatements, other than those that we believe are clearly trivial.

Corrected audit differences

Material misstatements

There were no material misstatements that affected any of the primary financial statements.

Non-material misstatements

Our audit identified a number of minor presentational misstatements in the financial statements. These have been discussed with management and the financial statements have been amended.

Materiality and reporting of audit differences

For 2015/16 our materiality is £15 million for the Authority's accounts.

We have reported all audit differences over £750k for the Authority's accounts to the Audit and Risk Committee.

36

Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

— Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

— Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

— Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2015/16, presented to you in March 2016.

Materiality for the Authority's accounts was set at £15 million which equates to around 1.4 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit and Risk Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Risk Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £750k for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Risk Committee to assist it in fulfilling its governance responsibilities.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice.

37

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Public Sector Audit Appointments Ltd guidance requires appointed auditors to follow the provisions of ISA (UK&I) 260 Communication of *Audit Matters with Those Charged with Governance'* that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

— Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.

— The related safeguards that are in place.

— The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Audit and Risk Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

Declaration of independence and objectivity (cont.)

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the *Ethics and Independence Manual* ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

Auditor declaration

In relation to the audit of the financial statements of Leicester City Council for the financial year ended 31 March 2016, we confirm that there were no relationships between KPMG LLP and Leicester City Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

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Appendix three

Audit Independence

Audit Fees

Our scale fee for the audit is £146,603 excluding VAT (£195,470 in 2014/15). This fee is in line with that highlighted within our audit plan agreed by the Audit and Risk Committee in March 2016. Our scale fee for certification of housing benefits subsidy is £58,505 excluding VAT (£70,380 in 2014/15).

In 2014/15 we charged additional fees of £3,633 excluding VAT in respect of additional work to address a specific VFM conclusion risk regarding the OFSTED report on looked after children.

As the Authority is still responding to the recommendations made in the OFSTED report, we included this matter as a specific VFM risk in our Audit Plan for 2015/16, along with another VFM risk regarding financial resilience, and we will be discussing additional fees with the Director of Finance before seeking PSAA approval.

In 2014/15 we also charged additional fees of £3,968 excluding VAT in respect of additional work in response to errors in the financial statements that led to material adjustments.

We anticipate charging additional fees in 201516 in respect of additional testing relating to the new housing rents system. We will discuss the additional fees with the Director of Finance before seeking PSAA approval.

39

Non-audit services

During 2015/16 we certified the following 2014/15 returns completed by the Authority:

- pooling of housing capital receipts return. We agreed a fee for this work of £5,786 excluding VAT.
- teachers pensions agency return. We agreed a fee for this work of £3,500 excluding VAT.
- homes and communities compliance reporting. We agreed a fee for this work of £3,000 excluding VAT.

We have not provided any other non-audit services in the year.