

# Annual Audit Letter

City of York Council – for the year ended 31 March 2017



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# Executive summary

## Purpose of this report

Our Annual Audit Letter summarises the work we have undertaken as the auditor for City of York Council ('the Council') for the year ended 31 March 2017. Although this letter is addressed to the Council, it is designed to be read by a wider audience including members of the public and other external stakeholders.

Our responsibilities are defined by the Local Audit and Accountability Act 2014 ('the 2014 Act') and the Code of Audit Practice issued by the National Audit Office ('the NAO'). The detailed sections of this letter provide details on those responsibilities, the work we have done to discharge them, and the key findings arising from our work. These are summarised below.

Area of work	Summary
Financial statements opinion	On 28 September 2017, we issued our opinion that the financial statements give a true and fair view of the Council's financial position as at 31 March 2017 and of its financial performance for the year then ended.
Opinions on other matters	On the same date we issued our opinion that the Narrative Report published with the financial statements, is consistent with those financial statements.
Value for Money conclusion	On 28 September 2017, we issued our conclusion that the Council had proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources.
Whole of Government Accounts	In line with instructions issued by the NAO, on 28 September 2017, we issued our assurance certificate which reported that the Council's consolidation pack was consistent with the audited financial statements.
Matters that we report by exception	<p>We have not identified any matters to report in relation to:</p> <ul style="list-style-type: none"> <li>• whether the Annual Governance Statement is in line with our understanding of the Council and the requirements of the Delivering Good Governance in Local Government Framework 2016;</li> <li>• reports in the public interest or written recommendations made under s24 of the 2014 Act;</li> <li>• exercise of other powers under the 2014 Act.</li> </ul>

We have not yet formally concluded the audit for 2016/17 as we are considering an objection to two items of account raised by a local elector in accordance with our responsibilities under the 2014 Act. We carried out sufficient work on these two items of account to satisfy ourselves that there were no risks of material misstatement or implications for our value for money conclusion.

# Audit of the financial statements

## Financial statements opinion

Unqualified

### The scope of our audit and the results of our work

The purpose of our audit is to provide reasonable assurance to users that the financial statements are free from material error. We do this by expressing an opinion on whether the statements are prepared, in all material respects, in line with the financial reporting framework applicable to the Council and whether they give a true and fair view of the Council's financial position as at 31 March 2017 and of its financial performance for the year then ended.

Our audit was conducted in accordance with the requirements of the Code of Audit Practice issued by the NAO, and International Standards on Auditing for the UK and Ireland (ISAs). These require us to consider whether:

- the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management in the preparation of the financial statements are reasonable; and
- the overall presentation of the financial statements provides a true and fair view.

### Our approach to materiality

We apply the concept of materiality when planning and performing our audit, and when evaluating the effect of misstatements identified as part of our work. We consider the concept of materiality at numerous stages throughout the audit process, in particular when determining the nature, timing and extent of our audit procedures, and when evaluating the effect of uncorrected misstatements. An item is considered material if its misstatement or omission could reasonably be expected to influence the economic decisions of users of the financial statements.

Judgements about materiality are made in the light of surrounding circumstances and are affected by both qualitative and quantitative factors. As a result we have set materiality for the financial statements as a whole (financial statement materiality) and a lower level of materiality for specific items of account (specific materiality) due to the nature of these items or because they attract public interest. We also set a threshold for reporting identified misstatements to the Audit and Governance Committee. We call this our trivial threshold.

The table below provides details of the materiality levels applied in the audit of the financial statements for the year ended 31 March 2017:

Financial statement materiality	£7.74m
Specific materiality	We have applied a lower level of materiality to the following items of account: <ul style="list-style-type: none"> <li>• Senior officer remuneration</li> <li>• Members' allowances</li> <li>• Exit packages</li> </ul>
Trivial threshold	£0.23m

### Our response to significant risks

As part of our continuous planning procedures we considered whether there were risks of material misstatement in the Council's financial statements that required special audit consideration. We reported significant risks identified at the planning stage to the Audit and Governance Committee within our Audit Strategy Memorandum and provided details of how we responded to those risks in our Audit Completion Report. The table below outlines the identified significant risks, the work we carried out on those risks and our conclusions.

Significant risk	How we addressed the risk	Audit conclusion
<p><b>Management override of control</b> In all entities, management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Due to the unpredictable way in which such overrides could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.</p>	<p>We carried out a range of audit procedures that included the following:</p> <ul style="list-style-type: none"> <li>• Challenging the reasonableness and appropriateness of accounting estimates used by management in the process of preparing the financial statements;</li> <li>• Identifying and challenging any unusual or significant transactions outside the Council's normal course of business; and</li> <li>• Carrying out a risk-based review of journals recorded in the general ledger and other adjustments made in preparation of the financial statements.</li> </ul>	<p>Our audit procedures did not identify any material errors or uncertainties in the financial statements, or other matters that we needed to bring to members' attention, in relation to management override of control.</p>
<p><b>Valuation of the defined benefit pension liability</b> The financial statements contain material entries in a number of primary statements as well as material disclosure notes in relation to the Council's participation in the Local Government Pension Scheme.</p> <p>These entries arise from complex estimates used by the Council's actuary as well as information provided to the actuary from the Council and North Yorkshire Pension Fund.</p> <p>The valuation of pension liabilities involves significant judgement to be applied involving a number of</p>	<p>We considered the Council's arrangements for making estimates in relation to pension entries within the financial statements. This included considering and challenging the reasonableness of the actuary's valuation through the use of our own expert as commissioned on our behalf by the National Audit Office.</p> <p>As the actuary's work is dependent on the quality of data in respect of cash flows and membership, we considered the arrangements that the Council has in place to ensure that the Fund and actuary are</p>	<p>Our audit procedures did not identified any material errors or uncertainties in the financial statements in relation to the valuation of the defined benefit pension liability.</p>

<p>variables and as a result, there is high degree of estimation uncertainty. We have therefore identified this to be an area of risk.</p>	<p>kept informed of events that may impact on the valuation of pension liabilities.</p> <p>We also agreed a programme of work to be undertaken on our behalf by the Fund's auditor. This included testing a number of key information flows between the Council, Fund and actuary, as well as undertaking specific testing in relation to the Fund's triennial valuation as at 31 March 2016.</p>	
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### Internal control recommendations

As part of our audit we considered the internal controls in place that are relevant to the preparation of the financial statements. We did this to design audit procedures that allow us to express our opinion on the financial statements, but this did not extend to us expressing an opinion on the effectiveness of internal controls. We identified the following deficiencies in internal control as part of our audit.

<p><b>Description of deficiency</b></p>	<p><b>Accounting for PFI liabilities</b></p> <p>The Council is party to a PFI scheme for the design, build and operation of three schools. The scheme commenced in the 2006/07 financial year and the accounting policies adopted at that time for the scheme, were those required by UK GAAP as adapted by CIPFA's Statement of Recommended Practice.</p> <p>On transition to the IFRS-based Code, the Council undertook work to revise the accounting treatment for the scheme which was considered and subsequently amended by the Council's auditor at the time, the Audit Commission. We have reviewed this accounting treatment in 2016/17 on the basis that it is a number of years since a detailed review has been carried out due to the scheme's liabilities being non-material. Our work identified that, in our view, the Council's accounting treatment in respect of elements of the scheme is not in line with the underlying requirements of the Code.</p> <p>Because of the passage of time since the scheme was brought onto the Council's Balance Sheet in 2008/09, there is nobody in the Council that has a detailed knowledge of the accounting treatment being applied, which is based on a model produced by an external advisor.</p>
	<p><b>Potential effects</b></p>

<b>Recommendation</b>	<p>We recommend that the Council:</p> <ul style="list-style-type: none"> <li>• Reviews its accounting treatment for the scheme as part of its preparation of the 2017/18 financial statements;</li> <li>• Puts in place arrangements to ensure that detailed knowledge of the accounting treatment does not rest with a single individual; and</li> </ul> <p>Discusses and agrees any required revision to its treatment with us as early as possible.</p>
<b>Management response</b>	<p>This is a highly specialised area of accounting and, as such, it is not possible to retain all the knowledge and expertise in house. As a result, the Council relied on external expertise to ensure compliance with the Code and have continued to maintain this detailed model having not been made aware of any inconsistencies with Code compliance by each subsequent Audit since 2010. The Council clearly recognises that the current accounting treatment needs to be amended and has committed to review this. We will continue to use external specialist advice where we consider it appropriate to do so. We also agree that the issue has not been examined by the external auditor since 2010 as the scheme's liabilities are non-material.</p>

<b>Description of deficiency</b>	<p><b>Related party disclosures</b></p> <p>As part of our audit procedures on related party disclosures, we noted a small number of omissions that management has corrected in the final financial statements. We noted:</p> <ul style="list-style-type: none"> <li>• One instance of a Councillor failing to declare an interest as a Director of City of York Trading Ltd; and</li> <li>• One instance of a Director failing to declare an interest as a Director of a company with which the Council traded in 2016/17, although the relationship with this company ended in August 2016</li> </ul> <p>The Council has made amendments to its financial statements to correct the related party disclosure note.</p> <p>We have not identified any indications that these omissions are indicative of fraud.</p>
<b>Potential effects</b>	<p>Failure to properly declare and disclose interests in related parties can give rise to an erosion of public trust in circumstances where failures are widespread or systemic.</p>
<b>Recommendation</b>	<p>We recommend that the Council:</p> <ul style="list-style-type: none"> <li>• Reminds relevant officers and members of the need to make appropriate declarations in line with its internal policies; and</li> <li>• Considers whether any checks can be carried out in the preparation of the financial statements to identify potential missing declarations (for example, checks of Companies House records).</li> </ul>

Management response	The Council recognises there were some minor omissions from the related parties note. We will review the process to ensure that some checks are carried out prior to the completion of the financial statements.
Description of deficiency	<p><b>Impact of converting academies on the valuation of the Council's pension liabilities</b></p> <p>As part of our audit procedures on the valuation of the Council's pension liabilities arising from its involvement in the local government pension scheme, we have noted that the arrangements in place to ensure that the actuary is informed of any schools that convert to academies did not result in the actuary removing these schools from the Council's valuation. In 2016/17, there were 6 maintained schools that moved to academy status that the actuary incorrectly included as part of the Council's IAS 19 valuation.</p>
Potential effects	Failure to ensure the actuary removes transferring academies may lead to a material overstatement of the Council's pension liabilities.
Recommendation	<p>We recommend that the Council puts in place procedures to:</p> <ul style="list-style-type: none"> <li>• Ensure the process whereby the actuary is notified of any schools transferring to academy status is adhered to ; and</li> <li>• Ensure that the actuary has correctly removed transferred schools for the Council's IAS 19 valuation.</li> </ul>
Management response	The Council has discussed this issue with NYPF. They have raised this issue with the actuary to ensure that, in future, the actuary removes from the Council's IAS19 valuation those schools converting to academy status during the year. The actuary has stated that it is not their standard practice to explicitly allow for any academy conversions occurring between 1 April 2016 and 31 March 2017 under the "roll forward" approach used. The impact of the academy conversions over the period from the 2013 actuarial valuation to the 2016 actuarial valuation is included in the actuarial gains/losses due to liability experience item on the balance sheet (along with other experience items allowed for as part of the 2016 actuarial valuation).

# Value for Money conclusion

## Value for Money conclusion

Unqualified

### Summary of our work

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

The overall criterion is that, 'in all significant respects, the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.' To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are set out by the NAO:

- Informed decision making
- Sustainable resource deployment
- Working with partners and other third parties

The following table provides commentary of our findings in respect of each of the sub-criteria and an indication as to whether proper arrangements are in place.

Sub-criteria	Commentary	Arrangements in place?
Informed decision making	<p><u>Acting in the public interest, through demonstrating and applying the principles and values of sound governance</u></p> <p>The Council has put in place a significant management restructure over the last few years and has seen changes in a number of senior posts, including the Chief Executive, over that time. 2016/17 has been a period of relative stability in this respect.</p> <p>The Audit and Governance Committee is the body that we determine to be 'those charged with governance' as defined by International Auditing Standards. The committee is responsible for the oversight of the Council's governance framework which includes considering reports from internal and external audit providers, and approving the financial statements. The Committee had a busy agenda in 2016/17 and addressed some significant risk issues including internal and external audit reports on procurement.</p>	Yes

	<p>The Council's internal audit function is provided by Veritau, who carried out an annual review of the effectiveness of the system of internal control in place at the Council. For 2016/17, Veritau gave a substantial assurance opinion.</p> <p><u>Using appropriate and reliable financial and performance information to support informed decision making and performance management</u></p> <p>As part of our on-going work in assessing risk and updating our understanding of the Council, we review minutes for Executive, Council and committee meetings, as well as meeting regularly with senior officers such as the Chief Executive and s151 Officer. We have not identified any evidence of material decisions being taken that are not supported by reports that outline appropriate option appraisal, suitably supported recommendations and all other relevant considerations.</p> <p><u>Reliable and timely financial reporting that supports the delivery of strategic priorities</u></p> <p>The Council's financial performance appears well-controlled and is reported appropriately to members on a quarterly basis. Any significant financial consequences of options presented to members for decision appear to be supported by an appropriate level of financial commentary to allow proper decision making.</p> <p>The financial outturn for 2016/17 was positive resulting in an underspend of around £0.5m together with an unspent contingency of a similar amount.</p> <p><u>Managing risks effectively and maintaining a sound system of internal control</u></p> <p>As noted above, the Council's internal audit provider provided a substantial assurance opinion in relation to the system of internal control for 2016/17. The results of our work have not identified any matters that would cause us to challenge this opinion.</p> <p>Regular reporting of corporate risk is undertaken with periodic reports being presented to the Audit and Governance Committee for consideration and discussion. We have noted changes in the presentation of the reports in 2016/17 as a result of suggestions from members.</p>	
Sustainable resource deployment	<p><u>Planning finances to support the sustainable delivery of strategic priorities and maintain statutory functions</u></p> <p>The Council continues to make good progress in meeting the challenges that it faces as a result of reductions in central government funding. As noted above, the 2016/17 outturn position was positive which follows a number of years of relatively strong performance in terms of delivery to budget.</p> <p>We have carried out work in relation to the Council's arrangements to deliver its programme of savings for the period up to 2019/20, in response to the significant risk we identified in our Audit Strategy Memorandum, and have concluded that arrangements are in place for the 2016/17 financial year.</p>	Yes

	<p><u>Managing and utilising assets effectively to support the delivery of strategic priorities</u></p> <p>A number of the individual savings programmes that form part of the Council's overall savings plans for the period to 2019/20, involve driving efficiencies and revenue maximisation from the use of both operational and commercial property holdings. Progress on these programmes has been good to date, and the Council will need to continue this positive start if it is to meet all of its targets in this area, particularly in the 2018/19 and 2019/20 financial years.</p> <p><u>Planning, organising and developing the workforce to deliver strategic priorities</u></p> <p>The Executive approved a revised approach to workforce development, the People Plan, in Q1 of 2016/17. Since that time, we have noticed a range of initiatives that have been introduced under the Plan that have brought about potential increases in staff engagement. Progress on delivery of the Plan has been reported to the Executive as part of the quarterly finance and performance update reports.</p>	
Working with partners and other third parties	<p><u>Working with third parties effectively to deliver strategic priorities</u></p> <p>As part of our Audit Completion Report in 2015/16, we reported that one of the Council's most important partnerships in terms of meeting strategic priorities, was that with the Vale of York Clinical Commissioning Group ('the CCG').</p> <p>The Council and the CCG work together in a range of areas but the most significant of these is the operation of the Better Care Fund, which seeks to reduce emergency admissions to hospital and provide as much support as possible in a social care setting.</p> <p>There has been a challenging relationship between the Council and CCG in recent years. The financial position of the CCG has led to difficulties in the operation of the Better Care Fund since its introduction. Arrangements to deliver the 2016/17 Better Care Fund from a budget standpoint appear to have been in place and we are not aware of a repeat of the potential issues that arose in 2015/16 where there was a concern that the CCG may withhold funding from the Fund, and thus the Council.</p> <p>Following the delayed receipt of detailed technical guidance from NHS England, a plan for the operation of the Better Care Fund for the period 2017-2019 has been developed. This sees the proposed future contributions from the CCG and Council increasing to an overall £15.3m in 2017/18. The Council's overall share of contributions will increase in 2017/18.</p> <p>Performance against the Fund's objectives is developing but arrangements to date have not been successful in delivering priorities. This is a picture that is seen in many parts of the England and is not necessarily isolated to York, and there are clear challenges that the partners need to address in order to meet both national and local priorities.</p>	Yes

Commissioning services effectively to support the delivery of strategic priorities

We have considered the information in VFM profiles published by PSAA, in relation to commissioning activity. These provide data that compares the Council's performance against a range of metrics with those of its statistical nearest neighbours or other comparative groups.

Although there are variations in the costs within and between services, overall, the Council's performance against relevant metrics indicates that arrangements are in place to efficiently commission services when compared to its comparator group.

Procuring supplies and services effectively to support the delivery of strategic priorities

We have considered the Council's arrangements for procuring supplies and services as part of work on a significant risk to our Value for Money conclusion as previously reported in our Audit Strategy Memorandum.

A number of concerns were raised about the Council's arrangements following an objection to the 2015/16 statement of accounts. This led to specific reports on the issue from us and the Council's internal auditors.

Since this time, the Council has responded to the recommendations made by internal audit which we have considered as part of our work on the significant risk.

**Significant Value for Money risks**

As part of our continuous planning processes, we carry out work to identify whether or not a risk to the VFM conclusion exists. In our Audit Strategy Memorandum, we reported that we had identified two significant VFM risks. The work we carried out in relation to significant risks is outlined below.

Value for Money conclusion risk	Work undertaken	Conclusion
<p><b>Responding to financial pressures</b></p> <p>The Council faces financial pressures from reduced funding and continues to identify plans to deliver future savings. The Council also has some significant programmes and projects to deliver. Without robust budgetary control and delivery of its action plans, the Council's financial resilience and service performance could deteriorate.</p>	<p><u>Overall arrangements for budget monitoring and reporting</u></p> <p>We have reviewed the Council's arrangements for monitoring progress against budget and reporting that progress to members. We have noted the strong outturn position for 2016/17 and the corrective actions taken in the second half of the year to turn around a forecast deficit of around £0.48m at Q2 to a forecast surplus of £0.16m in Q3 and the eventual outturn surplus of £0.54m.</p>	<p>We concluded that there were no indications that a modification to our Value for Money conclusion was required as a result of the Council failing to respond to financial pressures.</p>

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Reporting to members appears robust, with sufficient detail to allow for proper oversight of the financial position and performance of the Council on a quarterly basis.

Review of arrangements for delivering savings programmes

As part of the 2016/17 budget setting process, the Council outlined an ambitious but realistic programme of savings in the region of £21m to the end of 2019/20. We have considered the arrangements in place to monitor achievement of these individual programmes by reviewing relevant document, reports to members and through meetings with key officers.

We have reviewed a number of individual savings programmes to assess whether the current RAG rating given to these appears appropriate both for 2016/17 and future years' delivery.

Consideration of the Council's financial position

As well as considering the financial performance of the Council and its delivery to budget, outlined above, we have also considered the Balance Sheet position to assess its financial position. We have done this through review of a number of key financial ratios and comparison to other local authorities.

Review performance reports

Managing the budget and delivering savings is just one aspect of responding to financial pressures. This needs to be balanced with continuing to meet the needs of service users and delivering sound statutory services. We have considered the quarterly performance reports presented to the Executive, as well as a number of other reports that provide an assessment of the Council's performance. We have also considered the work of inspectorates and regulators relevant to our conclusion (such as OFSTED and the Care Quality Commission), and information available to us from PSAA's value for money profiles.

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<p><b>Responding to prior year procurement issues</b></p> <p>In response to an objection to the accounts in the 2015/16 audit, a number of breaches of financial regulations were identified by Veritau in relation to procurement of a local consultant.</p> <p>Although this related to a specific instance where a senior manager had apparently not followed procedures and was no longer an employee of the Council, the need to strengthen procedures was identified and management developed an action plan.</p> <p>If the action plan is not addressed, the Council might not be able to demonstrate that it achieves best value from its procurement.</p>	<p><u>Review of progress against the action plan</u></p> <p>We have considered management's response to the action plan agreed as part of the initial response to internal audit's findings. This has been considered through discussions with relevant officers and the gathering of information and evidence to support the current position.</p> <p>From our review of relevant documentation, we are not aware of any substantial elements of the action plan that remain outstanding and have been pleased to note that there has been a marked increase in attempts to raise awareness of procurement policies and procedures to relevant directorate groups.</p> <p><u>Peer review</u></p> <p>As part of management's response to the findings, an independent peer review of its procurement function was commissioned from the Local Government Association. The peer review team concluded that 'the Council has a good corporate procurement function and that the compliance issues are being addressed'.</p>	<p>We concluded that there were no indications that a modification to our Value for Money conclusion was required as a result of the Council failing to respond to previous year procurement issues.</p>
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# Other reporting responsibilities

<b>Exercise of statutory reporting powers</b>	<b>No matters to report</b>
<b>Annual Governance Statement</b>	<b>No matters to report</b>
<b>Whole of Government Accounts return consistency with the financial statements</b>	<b>Consistent</b>
<b>Other information published alongside the financial statements</b>	<b>Consistent</b>

The NAO's Code of Audit Practice and the 2014 Act place wider reporting responsibilities on us, as the Council's external auditor. We set out below, the context of these reporting responsibilities and our findings for each.

## **Matters which we report by exception**

The 2014 Act provides us with specific reporting powers where matters come to our attention that require reporting to parties other than the Council. We have the power to:

- report in the public interest; and
- make statutory recommendations to the Council, which must be responded to publicly.

In addition we must respond to any objections or questions on items contained within the accounts raised by a local government elector. We received an objection relating to two items of account and we are considering our response to these.

We are also required to report if, in our opinion, the Annual Governance Statement does not comply with the guidance issued by CIPFA in 'Delivering Good Governance in Local Government; Framework 2016' or is inconsistent with our knowledge and understanding of the Council.

We did not exercise any of our reporting powers during our 2016/17 audit and had no matters to report to the Council in relation to the Annual Governance Statement.

## **Reporting to the NAO in respect of Whole of Government Accounts**

The NAO requires us to report to them whether consolidation data that the Council has submitted is consistent with the audited financial statements, and to undertake specified procedures on that data. We have concluded and reported that the consolidation data is consistent with the audited financial statements.

**Other information published alongside the financial statements**

The Code of Audit Practice requires us to consider whether information published alongside the financial statements is consistent with those statements and our knowledge and understanding of the Council. In our opinion, the information in the Narrative Report is consistent with the audited financial statements.

# Our fees

## Fees for work as the Council's appointed auditor

We reported our proposed fees for the delivery of our work in the Audit Strategy Memorandum, presented to Audit and Governance Committee in April 2017. Having almost completed our work for the 2016/17 financial year, we set out the fees for the year, as follows:

Area of work	2016/17 proposed fee	2016/17 final fee
Code audit work	101,607	101,607
Certification of Housing Benefit Subsidy claim	11,415	11,415

We confirm that the proposed fees set at the planning stage of the audit are in line with the scale fee set by Public Sector Audit Appointments Ltd. At the time of issuing this letter, we are yet to complete our work on the objection to the accounts and certification of the Council's Housing Benefit Subsidy claim. As such, the final fees quoted above are subject to change.

We also confirm that we have not undertaken any non-audit services for the Council for the 2016/17 audit year.