

# Audit Progress Report and Sector Update

Herefordshire Council  
Year ending 31 March 2018

31 March 2018



# Contents

Section	Page
Introduction	3
Progress at 31 March 2018	4
Audit Deliverables	5
Results of Interim Audit Work	6
Sector Update	11
Links	13
Appendix 1 – Action plan	14

# Introduction



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This paper provides the Audit Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a local authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)



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Members of the Audit and Governance Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications. Click on the Grant Thornton logo to be directed to the website [www.grant-thornton.co.uk](http://www.grant-thornton.co.uk).

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.



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# Progress at 31 March 2018

## Financial Statements Audit

We have completed our interim visit for the 2017/18 financial statements audit and this paper sets out the position at closure of this visit.

The findings from our interim audit are summarised at page 6 to 10. Recommendations are included in the action plan at Appendix 1. Overall good progress was made at our interim against our plan. However, we highlight in this report that there are some matters that are outstanding at the completion of our interim visit. Clearly considering new technical matters or undertaking outstanding testing from the interim, at final, could provide some risk to the completion of our work by the deadline.

The final accounts audit is due to begin on the 11 June with findings reported to you in the Audit Findings Report by the earlier deadline of 31 July 2018. The Audit and Governance Committee is timetabled for 30 July. The Council requires, in order that papers are issued to the committee under its normal publication requirements, a draft Audit Findings Report by 20 July 2018. There are some procedures that are ongoing up to the issue of the opinion such as post balance sheet events. Consistent with arrangements at all councils in this exceptional year, we will provide the committee with a verbal update or addendum of work completed and matters cleared between 20 and 30 July, so that members are fully appraised of the position on the audit prior to their approval of the accounts.

## Value for Money

The scope of our work is set out in the guidance issued by the National Audit Office. The Code requires auditors to satisfy themselves that; "the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources".

The guidance confirmed the overall criterion as: "in all significant respects, the audited body 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 made our initial risk assessment to determine our approach in December 2017 and reported this to you in our Audit Plan. We are required to keep this assessment under review. There are two new matters that have come to our attention:

- the recent legal judgment in relation to compliance with the provisions of Section 20 of the Children Act 1989. We will consider whether this poses a risk to our value for money conclusion.
- feedback from the Peer Review has now been received. We will need to consider whether there are any findings that pose a risk for our value for money conclusion.

We will report our work in the Audit Findings Report and give our Value For Money Conclusion by the deadline in July 2018.

## Other areas

### Finalisation of the 2016/17 audit.

As highlighted in the 2016/17 Audit Findings Report we are requesting a fee variation in relation to the additional work undertaken in respect of the 2016/17 accounts. We are proposing a fee variation of £15,500. The fee has been agreed as reasonable by the Head of Corporate Finance and we are awaiting final approval from Public Sector Audit Appointments Ltd.

### Certification of claims and returns

We are required to certify the Council's annual Housing Benefit Subsidy claim in accordance with procedures agreed with the Department for Work and Pensions. This certification work for the 2017/18 claim will be concluded by November 2018. The results of the certification work are reported to you in our certification letter.

### Meetings

Six weekly meetings are scheduled with the Head of Corporate Finance and the Corporate Finance Manager, as the lead officers for the accounts, where progress and technical matters are discussed and actions agreed.

### Other matters discussed

Officers have shared with us the proposed change to the capitalisation policy. We have fed back our views and have sought clarification on some areas.

The Council is proposing to adopt agency accounting in relation to the funding of the university. We have asked that officers formally demonstrate the accounting justification for adopting this approach.

# Audit Deliverables

## 2017/18 Deliverables

### Fee Letter

Confirming audit fee for 2017/18.

Planned Date

April 2017

Status

Complete

### Accounts Audit Plan

We are required to issue a detailed accounts audit plan to the Audit Committee setting out our proposed approach in order to give an opinion on the Council's 2017-18 financial statements.

January 2018

Complete

### Informing the risk assessment

This is a key document that demonstrates the communication between auditors, management and 'Those Charged with Governance on risk.

March 2018

Complete

### Interim Audit Findings – within Progress Report

We will report to you the findings from our interim audit and value for money work to date within our Progress Report in May.

May 2018.

Complete

### Audit Findings Report

The Audit Findings Report is planned to be reported to the July Audit Committee.

July 2018

Not yet due

### Auditors Report

This is the opinion on your financial statement, annual governance statement and value for money conclusion.

July 2018

Not yet due

### Annual Audit Letter

This letter communicates the key issues arising from our work.

September 2018

Not yet due

### Annual Certification Letter

This letter reports any matters arising from our certification work carried out under the PSAA contract.

January 2019

Not yet due

# Results of Interim Audit Work

The findings of our interim audit work, and the impact of our findings on the accounts audit approach, are summarised in the table below:

	Work performed	Conclusions and recommendations
Internal audit	<p>We have completed a high level review of internal audit's overall arrangements. Our work has not identified any issues which we wish to bring to your attention.</p> <p>We have also reviewed internal audit's work on the Council's key financial systems to date. We have not identified any significant weaknesses impacting on our responsibilities. The remaining internal audit reports will be considered at our final visit.</p>	<p>Overall, we have concluded that the internal audit service provides an independent and satisfactory service to the Council and that internal audit work contributes to an effective internal control environment.</p> <p>Our review of internal audit work has not identified any weaknesses which impact on our audit approach.</p>
Entity level controls	<p>We have obtained an understanding of the overall control environment relevant to the preparation of the financial statements including:</p> <ul style="list-style-type: none"><li>• Communication and enforcement of integrity and ethical values</li><li>• Commitment to competence</li><li>• Participation by those charged with governance</li><li>• Management's philosophy and operating style</li><li>• Organisational structure</li><li>• Assignment of authority and responsibility</li><li>• Human resource policies and practices</li></ul>	<p>Our work has identified no material weaknesses which are likely to adversely impact on the Council's financial statements</p>

	Work performed	Conclusions and recommendations
<b>Review of information technology controls</b>	<p>Our information systems specialist performed a high level review of the general IT control environment, as part of the overall review of the internal controls system.</p> <p>IT (information technology) controls were observed to have been implemented in accordance with our documented understanding.</p>	<p>Our work has identified no material weakness which is likely to adversely impact on the Council's financial statements. Some minor weaknesses have been reported to management who have responded appropriately.</p>
<b>Walkthrough testing</b>	<p>We have completed walkthrough tests of the Council's controls operating in areas where we consider that there is a risk of material misstatement to the financial statements.</p> <p>Our work has not identified any issues which we wish to bring to your attention. Internal controls have been implemented by the Council in accordance with our documented understanding</p>	<p>Our work has not identified any weaknesses which impact on our audit approach.</p>

	Work performed	Conclusions and recommendations
<b>Journal entry controls</b>	<p>We have reviewed the Council's journal entry policies and procedures as part of determining our journal entry testing strategy and have not identified any material weaknesses which are likely to adversely impact on the Council's control environment or financial statements.</p> <p>To date we have undertaken detailed testing on journal transactions recorded for the first nine months of the financial year, by extracting 'unusual' entries for further review. No issues have been identified that we wish to highlight for your attention.</p>	<p>We have noted that journals clearing payroll suspense codes have been regularly posted to the ledger without accompanying journal descriptions. Journals should be posted with a description which explains the purpose of the transaction to ensure transparency; enable management review; and provide an audit trail.</p>
<b>Early substantive testing</b>	<p><b>Income</b></p> <p>We have obtained primary evidence of significant grants receivable by the Council in 2017/18.</p> <p>We have commenced testing of a sample of fees and charges revenue transactions for months 1-9.</p> <p>We have obtained primary evidence to support our review of collection fund amounts receivable in 2017/18 for Council tax and NNDR.</p>	<p>No issues have been identified at this stage that we wish to highlight for your attention.</p> <p>The sample request was issued on day 2 of the 3 week visit. Initial evidence provided by Council officers to support our transaction testing was not sufficient in all areas to complete all audit tests by the end of our interim visit. Officers feel that supply of the sample on day 2 of the visit was a factor in officers ability to provide the sample within the onsite visit.</p> <p>We will complete this outstanding testing and testing of months 10-12 at our final visit.</p>
	<p><b>Expenditure</b></p> <p>We have compared actual pay costs for months 1 - 9 to an expectation we have formed in reference to staffing levels throughout the year.</p> <p>We have commenced testing of a sample of non-pay operating expenses transactions for months 1-9.</p> <p>We have commenced testing of a sample of capital expenditure transactions for months 1-9.</p> <p>We have commenced testing of a sample of housing benefit payments for months 1-11.</p>	<p>The initial evidence provided by Council officers to support our transaction testing was not sufficient in all areas to complete all audit tests by the end of our interim visit. Officers are continuing to provide further evidence to support the incomplete items and matters are being resolved as far as possible prior to the final visit. This relates to our operating expenses testing, capital expenditure testing, payroll (month 10 pensions submission to administrator) and welfare benefits. Due to the incomplete responses to the sample testing and matters not being resolved by 23 March, the Audit Manager escalated matters to the Head of Corporate Services. As a consequence many of the outstanding responses were subsequently provided. There are still some incomplete areas as at the date of the report in particular responses to the capital expenditure testing.</p> <p>Testing in incomplete areas and testing of the remaining months will be undertaken at our final accounts visit.</p>



	Work performed	Conclusions and recommendations
<b>Early substantive testing- continued</b>	<p><b>Property, Plant &amp; Equipment</b></p> <p>We have inquired about the Council's plans to engage valuation specialists for 2017/18. We have assessed the qualifications of the valuation specialists engaged and reviewed the instructions and terms of engagement issued. This has been done for 2 of the 4 valuers used by the Council. Appointment of valuers for the PFI scheme is being led by Worcestershire County Council. We understand that the internal valuers are being used for an immaterial proportion of the asset holding.</p>	<p>We note that the engagement of a valuation specialist for the Waste PFI asset has not yet been agreed, and we have therefore been unable to perform work in this area at this stage.</p> <p>The Council has relatively recently appointed new valuers and valuations are not yet complete for the majority of the asset holdings and consequently the asset register has yet to be updated. We did not plan nor have we been able to test valuations or accounting entries in relation to property, plant and equipment at this stage.</p> <p>In 2016/17 there were particular issues around:</p> <ol style="list-style-type: none"> <li>1) Assets not valued in year- approach and evidence to demonstrate that these were not materially miss-stated (reviewed at interim in 16/17 year)</li> <li>2) reclassification of assets and critical judgments in relation to the classification and valuation of some assets</li> <li>3) PFI valuations – valuers have recently been appointed by Worcestershire County Council to undertake this work</li> </ol> <p>We would also expect that the new valuer provides evidence to support an impairment review.</p> <p>It is vital that proper attention is given to these areas as part of the preparation of the 2017/18 accounts to minimise the risk to completion of the audit by the deadline.</p>
<b>Group Accounts Assessment</b>	<p>We have reviewed the Council's assessment of whether the requirement to produce consolidated accounts has been triggered in 2017/18.</p>	<p>We requested further evidence to support the Council's assessment that consolidated accounts are not required in respect of Hoople Limited and Connexus Group Limited (formerly Herefordshire Housing). This evidence is outstanding at this stage. The Council have not previously consolidated Hoople's accounts on the basis of materiality, however there is a risk that the Hoople pensions liability could be a material amount in 2017/18 therefore we have asked for assurance this will not be the case.</p> <p>We have inquired whether Connexus Group Limited represents an Associate of the Council's for accounting purposes. We are awaiting assurance that no investment was made in the company by the Council to be satisfied the accounting for associates rules do not apply.</p> <p>We reviewed the skeleton version of the draft 2017/18 accounts and fed back to officers that increased disclosure of the Council's group accounts assessment is required.</p> <p>Management should ensure there is appropriate disclosure within critical judgments in the year-end accounts.</p>
<b>Minimum Revenue Provision (MRP) policy and calculation</b>	<p>We have reviewed the Council's revised MRP policy against the latest relevant guidance.</p> <p>We have tested the calculation of MRP for 2017/18.</p>	<p>We are satisfied that the policy applied is prudent and meets requirements set out in current guidance. We are satisfied that the calculation presented to us appears to be in line with the agreed policy.</p> <p>Appropriate disclosure should be made in the accounts in accordance with code requirements of methodology, the financial impact and significant assumption. Reference should be made within accounting policies of the 2017/18 accounts including the financial impact of the change in policy.</p>

	Work performed	Conclusions and recommendations
<b>Pension Guarantees and Hoople Pensions accounting treatment</b>	We have discussed with officers the need to formally document the position and proposed accounting treatment of any pension guarantees. This review was to be made available at interim.	<p>Pension guarantee is a matter that has been highlighted by the National Audit Office as a risk area for 2017/18.</p> <p>We agreed that officers would undertake a review of all historic TUPE transfers and consider whether there are any on-going pension guarantees in relation to these. For any ongoing pension guarantees, the Council needs to set out its accounting treatment of these guarantees and disclose appropriately in the 2017/18 accounts. We already know that a pension guarantee exists for Hoople and a properly documented assessment of the accounting treatment has yet to be prepared.</p> <p>A review as described above, was not available at interim. This review should be prepared and provided for the final accounts audit. Clearly there would have been a benefit for us reviewing the assessment at interim so that any queries could be resolved well in advance of the opinion visit.</p> <p>In 2016/17 the draft accounts included Hoople pensions on Herefordshire Council's balance sheet. We highlighted that there was insufficient evidence to support this treatment and the position was reversed in the final version of the accounts. This took some time to resolve. We understand that this continues to be an area being progressed by officers. No information on this has been provided at interim and our working assumption is that there would be no change for the 2017/18 accounts. This is a relatively technical and complex area and such a change could pose a risk to completion of our audit by the deadline.</p>
<b>PFI liability</b>	We have held discussions with Council officers to update our knowledge of the PFI schemes and officers' proposed accounting treatment for 2017/18.	We have been unable to review updates to the PFI accounting models at this stage, as they require updates post- year end.
<b>Review of draft accounting policies and draft narrative report</b>	We obtained and reviewed the accounting policies and narrative report which were issued to us at a draft stage.	<p>Comments were shared with officers around compliance with the CIPFA Code which should be addressed in subsequent drafts. The final accounts working papers should include a paper cross referencing code requirements to where this is covered in the narrative foreword. All financial cross references should be supported by a working paper or the note in the accounts</p> <p>The foreword should reflect the key features of the 2017/18 accounts and thus the final version of the foreword will need to be updated to reflect this. We would expect to see explanation for key features in the accounts including variance from budget at a service level and in capital programme. Other references we would expect to see would include as a minimum, the MRP policy change including the reasoning and impact, accountable body status for the new university and implications and a critical accounting judgement regarding the agency arrangement, reference to the development partner and the position on major commitments such as the new bypass.</p> <p>The proposed critical judgments statement should adequately reflect matters discussed above including accounting for groups, classification of property assets, treatment of pension guarantees and the introduction of agency accounting for the Council's role as accountable body for the university.</p>

# Sector Update

Local government finances are at a tipping point. Councils are tackling a continuing drive to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

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Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider NHS and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- **Grant Thornton Publications**
- **Insights from local government sector specialists**
- **Reports of interest**
- **Accounting and regulatory updates**

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website

# Financial sustainability of local authorities 2018

This National Audit Office report reviews financial sustainability across Local Government and examines whether the MHCLG, along with other departments with responsibility for local services, understands the impact of funding reductions on the financial and service sustainability of local authorities.

The report concludes that current pattern of growing overspends on services and dwindling reserves exhibited by an increasing number of authorities is not sustainable over the medium term. The financial future for many authorities is less certain than in 2014, when the NAO last looked at financial sustainability. It also notes that the financial uncertainty created by delayed reform to the local government financial system risks longer-term value for money.

The NAO's view is that the sector has done well to manage substantial funding reductions since 2010-11, but financial pressure has increased markedly since the 2014 review.. Services other than adult social care are continuing to face reducing funding despite anticipated increases in council tax. Local authorities face a range of new demand and cost pressures while their statutory obligations have not been reduced. Non-social-care budgets have already been reduced substantially, so many authorities have less room for manoeuvre in finding further savings. The scope for local discretion in service provision is also eroding even as local authorities strive to generate alternative income streams.

## Key findings include:

Financial resilience varies between authorities, with some having substantially lower reserves levels than others. Levels of total reserves in social care authorities as a whole are higher now than in 2010-11. However, there is variation in individual authorities' ability to build up their reserves and differences in the rate at which they have begun to draw them down. Some 10.6% of single-tier and county councils would have the equivalent of less than three years' worth of total reserves (earmarked and unallocated combined) left if they continued to use their reserves at the rate they did in 2016-17.

A section 114 notice has been issued at one authority, which indicates that it is at risk of failing to balance its books in this financial year. In February 2018, the statutory financial officer for Northamptonshire County Council issued a section 114 notice, indicating that it was at risk of spending more in the financial year than the resources it has available, which would be unlawful.

MHCLG's work to assess the sector's funding requirements as part of the 2015 Spending Review was better than the work it undertook for the 2013 Spending Review. The Department's advice to ministers in 2015 drew on a more comprehensive evidence base, including data returns from 12 departments.

The government has announced multiple short-term funding initiatives in recent years and does not have a long-term funding plan for local authorities. In 2016-17, the Department offered a four-year settlement to all authorities to enable better financial planning. However, there have been many changes to funding streams outside this core offer. The funding landscape following the 2015 Spending Review has been characterised by one-off and short-term funding initiatives.

There is also uncertainty over the long-term financial plan for the sector. The absolute scale of future funding is unknown until the completion of the next Spending Review. The government has confirmed its intention to implement the results of the Fair Funding Review in 2020-21 and to allow local authorities to retain 75% of business rates. However, the implications of these changes are not yet clear.

There is a lack of ongoing coordinated monitoring of the impact of funding reductions across the full range of local authority services.

**49.1%**

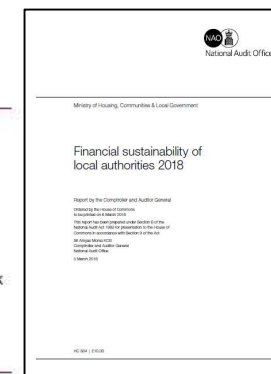
real-terms reduction in government funding for local authorities, 2010-11 to 2017-18

**28.6%**

real-terms reduction in local authorities' spending power (government funding plus council tax), 2010-11 to 2017-18

**1**

number of authorities since 2010-11 where a section 114 notice has been issued that indicates they are at risk of spending more than the resources they have available



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# Links

## Grant Thornton website links

<https://www.grantthornton.co.uk/>  
<http://www.grantthornton.co.uk/industries/publicsector>  
<http://www.grantthornton.co.uk/en/insights/commercial-healthcheck-in-local-authorities/>  
<http://www.cfoinsights.co.uk/>  
<http://supplychaininsights.grantthornton.co.uk/>

## PSAA website links

<https://www.psaa.co.uk/audit-quality/reports-on-the-results-of-auditors-work/>

## MHCLG website links

<https://www.gov.uk/government/consultations/proposed-changes-to-the-prudential-framework-of-capital-finance>  
<https://www.gov.uk/government/publications/capital-finance-guidance-on-local-government-investments-second-edition>  
<https://www.gov.uk/government/publications/capital-finance-guidance-on-minimum-revenue-provision-third-edition>

## CIPFA website link

<http://www.cipfa.org/policy-and-guidance/publications/t/the-prudential-code-for-capital-finance-in-local-authorities-2017-edition-book>

## National Audit Office link

<https://www.nao.org.uk/report/financial-sustainability-of-local-authorities-2018/>  
<https://www.nao.org.uk/report/the-adult-social-care-workforce-in-england/>

# Appendix 1 – Action plan

## Priority

**High** - Significant effect on control system

**Medium** - Effect on control system

**Low** - Best practice

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
1	We have noted that journals clearing payroll suspense codes have been regularly posted to the ledger without accompanying journal descriptions. All journals should be posted with a description which explains the purpose of the transaction to ensure transparency; enable management review; and provide an audit trail.	medium	Agreed, this is the process to be followed, a reminder has been issued.	Implemented, Head of Corporate Finance.
2	<p><b>Substantive (sample) testing:</b> as trailed with the Audit and Governance Committee previously, this year represents a significant challenge for all councils' finance teams and their external auditors. Whilst we have now made good progress regarding our sample testing and have also reengineered our audit strategy to 'front load' the work required, our experience at the interim audit suggests that we need to improve the efficiency of our combined approach. To that end, we will ensure that we work through the Council's designated officer in coordinating our requests for information and in return will require a prompt response to any further samples, with supporting evidence for every item of the sample meeting the quality standards of external invoices or other primary evidence to support the basis of the amount and the year to which the activity relates. Screen shots of ledger entries do not suffice in this case.</p> <p>We have agreed with the Chief Finance Officer the importance of a flexible, responsive and pragmatic approach that builds on the good relationships between our respective front-line teams. We will both be paying particular attention to this in the early stages of the final audit to ensure we stay on course to meet the July opinion deadline.</p>	high	Agreed, We look forward to working with the audit team to build upon the good progress made during the interim audit to enable the necessary checks and reviews to be carried out as efficiently as possible.	June, Chief Finance Officer, Corporate finance manager

# Appendix 1 – Action plan

## Priority

**High** - Significant effect on control system

**Medium** - Effect on control system

**Low** - Best practice

66

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
3	<b>Waste plant PFI:</b> officers continue to liaise with Worcestershire County Council to obtain assurance that the PFI valuations will be completed and undertaken by appropriately qualified professionals in time. Evidence should be provided that Herefordshire Council has appropriately considered the basis and challenged all information provided by Worcestershire County Council for material transactions in Herefordshire Council financial statements,	high	Agreed, this process has started	April, Head of Corporate Finance
4	<b>Group accounts:</b> information as requested is made available in relation to the group assessment, for Hoople and Connexus. Further disclosure on group accounting should be made in the 2017/18 accounts as a critical accounting judgement	high	To be as transparent as possible group accounts will be prepared	May, Head of Corporate Finance
5	<b>MRP:</b> appropriate disclosure should be made in the accounts in relation to the change in policy implemented in 2017/18. Reference would be made within the accounts to the reasoning and the financial impact.	high	Agreed	May, Head of Corporate Finance
6	<b>Pension guarantees:</b> Officers complete the work on identifying pension guarantees and prepare a paper setting out the basis of accounting in the financial statements.	high	Agreed, this work has started	May, Head of Corporate Finance
7	<b>Narrative foreword:</b> The working papers should include a paper providing a clear cross reference between the code and where the area is addressed in the foreword. Working papers or a clear cross reference to the note in the accounts should be provided for all financial references The foreword should include a relatively detailed and specific explanation of the financial events of the year and matters, financial commitments and risks in the coming year. Narrative should support the table on budget variances for both revenue and capital and how the risks are being managed going forward.	High	Agreed	May, Head of Corporate Finance

# Appendix 1 – Action plan

## Priority

**High** - Significant effect on control system

**Medium** - Effect on control system

**Low** - Best practice

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
8	<b>Critical judgements</b> should include reference to agency accounting for the university, group accounts and other matters significant to the application of accounting policies.	high	Agreed	May, Head of Corporate Finance
9	An audit fee variation was agreed with the Head of Corporate Finance in October 2017 of £15,500 to reflect the additional work involved in completing the audit of the 2016/17 accounts.. We had previously highlighted in the Audit Findings Report that there would be an additional fee and in October we were able to make an accurate assessment of the additional days put in by the audit team. A summary of this was shared with the Head of Corporate Finance prior to her confirming the fee.	high	The Chief Finance Officer has asked us to formally request approval from the Audit and Governance committee	





