ANNEX B

External Audit Report 2016/17

Surrey Heath Borough Council

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DRAFT: 1 November 2017

Content

Contacts in connection with this report are:

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This report is addressed to Surrey Heath Borough Council (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. PSAA 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 PSAA'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 Neil Hewitson, 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 (0207 694 8981, 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.

Important notice

This report is presented in accordance with our PSAA engagement. Circulation of this report is restricted. The content of this report is based solely on the procedures necessary for our audit. This report is addressed to Surrey Heath Borough Council (the Authority) and has been prepared for your use only. We accept no responsibility towards any member of staff acting on their own, or to any third parties. The National Audit Office (NAO) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the Authority. External auditors do not act as a substitute for the Authority'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.

Basis of preparation: We have prepared this External Audit Report (Report) in accordance with our responsibilities under the National Audit Office Code of Audit Practice (the Code) and the terms of our Public Sector Audit Appointments Ltd (PSAA) engagement.

Purpose of this report: This Report is made to the Authority's Audit and Standards Committee in order to communicate matters as required by International Audit Standards (ISAs) (UK and Ireland) and other matters coming to our attention during our audit work that we consider might be of interest and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone (beyond that which we may have as auditors) for this Report or for the opinions we have formed in respect of this Report.

Limitations on work performed: This Report is separate from our audit opinion and does not provide an additional opinion on the Authority's financial statements nor does it add to or extend or alter our duties and responsibilities as auditors. We have not designed or performed procedures outside those required of us as auditors for the purpose of identifying or communicating any of the matters covered by this Report. The matters reported are based on the knowledge gained as a result of being your auditors. We have not verified the accuracy or completeness of any such information other than in connection with and to the extent required for the purposes of our audit.

Status of our audit: Our audit is not yet complete and matters communicated in this Report may change pending signature of our audit report. We will provide an oral update on the status of our audit at the Audit and Standards Committee meeting. The following work is ongoing:

- Receipt of group reporting from the subsidiary auditor;
- Final audit procedures on the consolidated group financial statements;
- Testing of January – March 2017 material revenue and cash transactions for the subsidiary;
- Final review and closedown procedures; and
- Receipt of the final cast group financial statements and management representation letter.

Summary

Financial statements audit – see section 2 for further details

Subject to all outstanding queries and procedures being satisfactorily resolved we intend to issue an unqualified audit opinion on the Authority's financial statements following the Council adopting them and receipt of the management representations letter.

We have completed our audit of the financial statements apart from review of the consolidated accounts and review of the final version of the draft statements.

We have read the Narrative Report and reviewed the Annual Governance Statement (AGS). Our key findings are:

- There is one unadjusted audit difference, explained in section 2 and appendix 2 of this report.
- We agreed presentational changes to the accounts with Finance, mainly related to compliance with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.
- In additional to our routine requests we are asking for management representations over the following, which are explained in section 2:

  - Valuation of Land and Buildings; and

  - Consolidation of the subsidiary in the Authority's financial statements.
- We will report that your AGS complies with delivering Good Governance guidance issued by CIPFA / SOLACE in April 2016.
- We reviewed the narrative report and have no matters to raise with you.
- We did not receive any queries or objections from local electors this year.

Pending completion of the above outstanding items we anticipate issuing our completion certificate alongside our audit opinion. Subject to this, we intend to issue our 2016/17 Annual Audit Letter in November 2017.

Value for money – see section 3 for further details

Based on the findings of our work, we have concluded that the Authority has adequate arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified value for money conclusion.

Summary

Other matters

The 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 other matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority’s 2016/17 financial statements.

We are satisfied that the Authority has addressed the recommendations raised in our ISA260 report in 2015/16. We have made one new recommendation as a result of our 2016/17 work. The recommendation relates to the accounts production timetable in 2017/18. All recommendations are shown in appendix 1.

We also undertake other grants and claims work for the Authority which falls under the PSAA arrangements. The status of our grants and claim work is summarised below:

- Housing Benefits – this work is currently ongoing and has a reporting deadline of 30 November 2017.

The fees for this work is explained in section two.

Financial statements audit

We audit your financial statements by undertaking the following:

Work Performed	Accounts production stage: Before	During	After
1. Business understanding: review your operations	✓	✓	–
2. Controls: assess the control framework	✓	–	–
3. Prepared by Client Request (PBC): issue our prepared by client request	✓	–	–
4. Accounting standards: agree the impact of any new accounting standards	✓	✓	–
5. Accounts production: review the accounts production process	✓	✓	✓
6. Testing: test and confirm material or significant balances and disclosures	–	✓	✓
7. Representations and opinions: seek and provide representations before issuing our opinions	✓	✓	✓

We have completed the first six stages and report our key findings below:

1. Business understanding	In our 2016/17 audit plan we assessed your operations to identify significant issues that might have a financial statements consequence. We confirmed this risk assessment as part of our audit work. We provide an update on each of the risks identified later in this section.
2. Assessment of the control environment	We assessed the effectiveness of your key financial system controls that prevent and detect material fraud and error. We found that the financial controls on which we seek to place reliance are operating effectively. We have made a recommendation which relates to the accounts production timetable. We believe that this recommendation will strengthen your control environment. We reviewed the work undertaken by your internal auditors, in accordance with ISA 610 and used the findings to inform our work. We have chosen not to place reliance on their work due to the approach we adopted for the financial statements audit.
3. Prepared by client request (PBC)	We produced the PBC to summarise the working papers and evidence we ask you to collate as part of the preparation of the financial statements. We discussed and tailored our request with the Director of Finance and this was issued as a final document to the finance team. We are pleased to report that this has resulted in good-quality working papers with clear audit trails.

Financial statements audit

4. Accounting standards	We work with you to understand changes to accounting standards and other technical issues. For 2016/17 these changes related to: • Updates to the presentation of the Comprehensive Income and Expenditure Statement and the Movements in Reserves Statement and the introduction of the new Expenditure and Funding Analysis: this resulted in material changes year on year to the presentation of the financial statements. We have audited the presentation and content of the current and prior year restated disclosures, and are satisfied they are materially accurate; and • Amended guidance on the Annual Governance Statement. We reviewed the Annual Governance Statement against the updated requirements in the CIPFA code and are satisfied the content is compliant.
5. Accounts Production	We received complete draft authority accounts, excluding the subsidiary, by 30 June 2017 in accordance with the deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17. We will debrief with Finance to share views on the final accounts audit which hopefully will lead to further efficiencies in the 2017/18 audit process. Although the accounts deadline has remained the same as in prior year, the finance team have moved some of their internal deadlines forward in order to prepare for the early close required for 2017/18. The Authority acknowledge that they have to consider how they will prepare for the earlier deadline next year, including brining preparatory work forward and taking a different approach to non-material accounting issues. We thank Finance for their cooperation throughout the audit, subject to the consolidation of the subsidiary accounts, allowed the audit to progress and complete within the allocated timeframe.
6. Testing	We have summarised the findings from our testing of significant risks and areas of judgement in the financial statements on the following pages. We identified presentational changes to the accounts along with an audit adjustment to the accruals balance in the accounts of £979k, which we detailed in Appendix 2.
7. Representations	You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Executive Director of Finance. We draw attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We have specifically requested management to provide representation in relation to: • Valuation of land and buildings; and • Consolidation of the subsidiary in the Authority's financial statements.

Financial statements audit

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, opening balances, public interest reporting, questions/objections, etc.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Authority’s 2016/17 financial statements.

To ensure that we provide a comprehensive summary of our work, we have over the next pages set out:

- The results of the procedures we performed over the Pension Liability; Valuation of Land and Buildings; Valuation and Consolidation of Subsidiaries. These were identified as significant risks within our audit plan;
- The results of our procedures to review the required risks of the fraudulent risk of revenue recognition and management override of control; and
- Our view of the level of prudence applied to key balances in the financial statements.

Financial statements audit

SIGNIFICANT audit risk	Account balances effected	Summary of findings
Significant changes in the pension liability due to LGPS Triennial Valuation	Pension Liability: £39,074k (PY £30,530k)	We have undertaken work on a test basis to agree the data provided to the actuary back to the systems and reports from which it was derived and to understand the controls in place to ensure the accuracy of this data. This included checking data provided to the actuary back to underlying payslips. We performed an evaluation of the actuary's expertise using our own KPMG specialists. We performed benchmarking of the assumptions used in the valuation against KPMG benchmarks and against those used by other Surrey District Councils. Finally we ensured that numbers included in the actuary's report had been correctly reflected in the Authority's financial statements. No issues were identified as part of the testing of the pension scheme balances.
Valuation of Land and Buildings	Property, Plant and Equipment: £46,212k (PY £48,841k)	We have undertaken an assessment of the expertise of the Authority's valuers, Wilks Head and Eve (WHE). This involved confirmation of their professional experience, qualifications and independence. For this we used our own KPMG specialist to evaluate the work of WHE. We reviewed the instructions provided by the Authority to WHE to confirm they are complete and accurate, i.e. that they include the Authority's full estate and are appropriate for the purposes of the valuation. We checked that the instructions are in line with the Code. We reviewed the valuation provided by the valuers and assessed whether it has been reflected accurately in the Fixed Assets Register and in the financial statements, and considered the accuracy of information provided by the Authority to the valuers. We reviewed the revaluation basis and were satisfied the approach was appropriate. In doing so we have drawn on national benchmarks outlined in the Gerald Eve report, which provides an overview of national property market performance. We engaged our property team experts to undertake an assessment of the revaluation. We tested the floor space inputs into the valuations (combination of Gross Internal Area, Net Internal Area and Site Area depending on the operational use of the asset). This included ensuring that information supplied by the Authority to WHE had been used correctly in the valuations. We have identified one issue where, due to a change in market conditions between the initial valuation date and the year end review of the valuations to PPE, an uplift of £471k should have been applied to two assets. This is a non-material change, and therefore the Authority has decided not to adjust for this error. We have provided further detail of this uncorrected misstatement in Appendix 3

Financial statements audit

SIGNIFICANT audit risk	Account balances effected	Summary of findings
Group accounts (subsidiary consolidation)	Investment Property (consolidated accounts): £144,096k	We reviewed and compared the disclosures made by the Council in its financial statements to confirm the consolidation has been included in line with the Trust's management accounts and financial statements. We confirm the disclosures are in line with the Code requirements for group accounting and have reviewed the presentation of the consolidated Group accounts. We have undertaken work to understand the basis upon which any assumptions have been made including estimations for the periods of the Trust's audited financial statements and the period up to the Council's financial statement year end. We reviewed any discrepancies for reasonableness. In addition, we have gained assurance over the professional qualifications, experience and independence of the Trust's auditor and inquired about any significant audit findings. To date no issues have been identified as part of our testing on the consolidation approach, however, as noted on page 3 work is still ongoing in the following areas: • Receipt of group reporting from the subsidiary auditor; • Final audit procedures on the consolidated group financial statements; and • Testing of January – March 2017 material revenue and cash transactions for the subsidiary.

Financial statements audit

Other areas of audit focus

We identified one other area of audit focus. These are not considered to be significant risks as they are less likely to give rise to a material error. Nonetheless these are areas of importance where we carry out audit procedures to ensure that there is no material misstatement.

Other areas of audit focus	Account balances effected	Summary of findings
New format of the core financial statements	Comprehensive Income and Expenditure Statement, Expenditure and Funding Analysis, and Movement in Reserves Statement	We assessed how the Authority actioned the revised disclosure requirements for the CIES, MiRS and the new EFA statement as required by the Code; and We reviewed the restated numbers and associated disclosures for accuracy, correct presentation and compliance with applicable Accounting Standards and Code guidance. We performed audit testing on the restated figures. This involved ensuring that the presentation of the notes was in line with the Authority's internal reporting and monitoring structure. We agreed prior year figures back to the audited 2015/16 accounts and gained an understanding of the adjustments that were posted in order to restate the prior year figures. We ensured that the presentation of the new format notes was in line with the presentational requirements outlined in the CIPFA 2016/17 Code of Practice. We did not identify any issues with the restatement.

Financial statements audit

Risks that ISAs require us to assess in all cases	Why	Our findings from the audit
Fraud risk from revenue recognition	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 2016/17 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.	We have not conducted any specific procedures in relation to the risk of fraud in recognition, as we have rebutted this risk as part of our audit plan.
Fraud risk from management override of controls	Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry 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. We have not identified any specific additional risks of management override relating to this audit.	There are no matters arising from this work that we need to bring to your attention.

Judgements in your financial statements

We consider the level of prudence in key judgements in your financial statements. We summarise our view below using the following scale:

Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance (£'000)**	**KPMG comment**
Provisions (excluding NDR)	3	3	£NIL (PY:£60k)	We discussed provisions figures with Management. There are no ongoing legal claims which need to be provided for, or other areas where the Authority may need to recognise a provision. We conclude that this is a balanced estimate
NDR provisions	3	3	£1,562 (PY:£1,760)	The Authority is responsible for a proportion of successful rateable value appeals. The Authority has provided for a fixed percentage of outstanding appeals in accounting for the potential liability, based on historical appeals success rates. We reviewed calculations the Authority performed, based on historic success rates for appeals. We tested this and found that the Authority have made appropriate judgements in deriving and assessing the appeals percentage. We conclude this is a balanced judgement.
Accruals de minimis level	3	3	£1k (PY:£1k)	The Authority has kept its de minimis level the same as in prior year. The £1,000 limit is reasonable for an organisation of its size and is comparable to other councils. We therefore conclude this is a balanced judgement. The Authority should consider its financial reporting process throughout the year. Many transactions associated with the closedown process, such as accounting for accruals, will need to become part of quarterly or monthly reporting. The Authority should review of its approach to identify these important transactions and embed them into quarterly or monthly closedown processes, see recommendation one.

Financial statements audit

Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance (£'000)**	**KPMG comment**
Accruals	2	3	£13,940k (PY: £11,430k)	Accruals have remained largely static year on year, with the exception of Central Government accruals which has increased by £2.6m. We found an error in the accruals figure of £979k, caused by accruing for expenditure which had already been paid in 2016/17 – see appendix 3 for details. The remainder of the balance is due to the timing of services delivered prior to year end, with more services resulting in a higher accruals figure. As the Authority over-accrued by £979k in 2016/17 it has been more cautious than in the prior year, hence the change in scoring. It is still well within the acceptable range.
Bad debt provision	4	3	£947k (PY:£1,080k)	The provision for bad debts is consistent with prior year, although the balance for Sundry Debtors has increased. We performed audit testing on the calculation of the bad debt provision, and found no issues. The provision is based on the analysis of aged debtors at year end; although debtors have increased, these are all short term debtors that are not past due. Therefore the provision has not increased. However, given that Sundry Debtors have increased from £1,170k to £3,055k we have concluded that the Authority is being more optimistic, although still well within the acceptable range, in not providing for a larger element of this compared to the prior year.
Pension liability	3	3	£39,074k (PY:£30,530k)	The year on year increase is due to the triennial valuation of the scheme. We performed detailed audit procedures over the pension liability. This included agreeing the amounts disclosed back to the actuary's report, substantively testing the information provided to the actuary, and performing a review of the key assumptions that affect the balance. In addition, we reviewed the PWC report of the Local Government Pension Scheme, and communicated with Grant Thornton, the auditors responsible for the Surrey Pension Scheme. We found that the assumptions were reasonable and the underlying data was accurate. We found that the assumptions applied by the Authority were in line with other Surrey Authorities, and with our own internal benchmarks. We have therefore concluded this is a balanced assumption.

Financial statements audit

Group audit

To gain assurance over the Authority's group accounts, we placed reliance on the work completed by PWC on the financial statements of the Authority's subsidiaries:

- The Main Square Camberley Unit Trust, with turnover of £7m, and assets £106m. This is the first year the Authority have been required to produce group accounts. The reason for this is the acquisition of the Unit Trust on 11 November 2016. From this point, as the Authority acquired all the units in the Trust, we determine that the authority took control. Under IFRS, the Authority is therefore required to consolidate the Trust from that point. This involves incorporating the income and expenditure, asset and liabilities of the Trust into the Authority's financial statements.

To date there are no specific matters to report pertaining to the group audit, however, as noted as noted on page 3 work is still ongoing in the following areas:

- Receipt of group reporting from the subsidiary auditor;
- Final audit procedures on the consolidated group financial statements; and
- Testing of January – March 2017 material revenue and cash transactions for the subsidiary.

Narrative report of the Authority

We reviewed the Authority's narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Queries from local electors

We did not receive any questions or objections from members of the public this year.

Audit certificate

We have completed all our responsibilities in relation to the audit of the accounts for the year end 31 March 2017 and anticipate issuing our audit certificate with our audit opinion.

Financial statements audit

Whole of Government Accounts (WGA)

We have completed our review of your WGA pack and not identified any issues.

Other grants and claims work

We undertake other grants and claims work for the Authority which fall under the PSAA arrangements. The status of our grants and claim work is presented below:

- We are currently completing the certification of your Housing Benefits claim with the certification deadline on 30 November 2017.

Audit fees

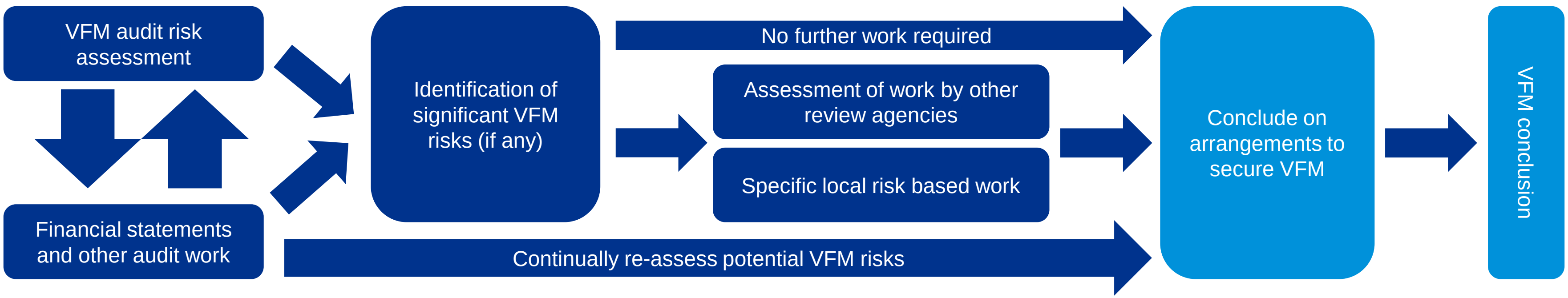
Our fee for the audit was £41,900 excluding VAT (£41,900 excluding VAT in 2015/16). This fee was in line with that highlighted in our audit plan approved by the Audit and Standards Committee in March 2017. In addition we have requested an additional fee of £6,026 excluding VAT in relation to this being the first year we are auditing your group accounts.

Our work on the certification of Housing Benefits (BEN01) is in progress. The planned scale fee for this is £8,430 excluding VAT (£11,411 excluding VAT in 2015/16).

We have completed non-audit work at the Authority in 2016/17 delivering a high level tax awareness session to Mole Valley District Council, with Surrey Heath Borough Council in attendance, and have included in Appendix 4 confirmation of the safeguards that have been put in place to preserve our independence.

Value for money

Our VFM work follows NAO guidance. It is risk based and our approach is summarised below. We identified one significant VFM risk which is reported below. We are satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2017, based upon the criteria of informed decision making, sustainable resource deployment and working with partners and third parties.



Significant risk based VFM audit work

Below we set out the detailed findings of our significant risk based VFM work. This work was completed to address the residual risks remaining after our assessment of the higher level controls in place to address the VFM risks identified in our planning and financial statements audit work.

Significant VFM risk	Why this risk is significant	Our audit response and findings
Capacity, capability and structure of the finance team	The 2014/15 VFM conclusion was qualified in light of capacity and capability challenges within the finance function which were compounded by pressures in the resource model of the team. These challenges resulted in late submission of the draft accounts and the Whole of Government Accounts pack as well as the Council missing the filling deadline for its 2014/15 annual report and accounts, this resulted in us raising 10 recommendations.	We held discussions with Management about the approach to producing the financial statements throughout our audit work for 2016/17. We reviewed early working papers for 2016/17 to confirm their quality and ensure that procedures implemented in 2015/16 continue to be in place and effective for 2016/17. We followed up on the two remaining recommendations from 2014/15 to confirm if they have been implemented. We have concluded that the capacity, capability and structure of the finance function does not give rise to concerns that impact on our value for money conclusion.

Value for money

Other areas of audit focus

Below we set out the detailed findings against other areas of audit focus for our VFM work.

VFM: other area of audit focus	Our audit response and findings
Financial resilience	**Approach** • We have consider Management's assessment of the Council's ability to continue as a going concern; • We have reviewed the progress of the Council against the Medium Term Financial Strategy; • We have reviewed ongoing monitoring of the annual budget, including how the Council recovers any areas which are in deficit; and • We have assessed the responsiveness to increasing costs of demand led services **Findings** We have analysed the Authority's historical borrowing rates and reserves patterns dating back to 2012/13. Useable reserves have remained static over the period, remaining between £20-£21m. Net assets fluctuates, but remains within the £40-50m bracket. This is despite SHBC significantly increasing its level of borrowing. This is because the borrowing has been used to finance capital expenditure, thereby matching and offsetting liabilities and assets in the balance sheet Gearing has increased significantly (take as short and long term borrowing over useable reserves). However, this is due to deliberate decisions by the council to borrow from the PWLB and other councils in order to finance the capital expenditure. We have seen a significant jump in the level of borrowing in 2016/17, but this is due to the Authority's decision to purchase the Unit Trust and hold this as investment property.

Recommendations raised and followed up

Recommendations raised as a result of our work in the current year are as follows:

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.

#	Risk	Recommendation	Management Response / Officer / Due Date
1	❶	**Preparation for early close in 2017/18** Whilst the Authority was able to produce the draft parent financial statements, there were delays in producing the consolidated accounts. These delays were largely outside of the Authority's control, but meant that draft consolidated accounts were not received until after the 30 September opinion deadline for the Authority. In 2017/18, the accounts deadline is moving to submission by 31 May 2018, with the audit sign-off deadline moving forward to 31 July 2018. There is still significant progress to be made in order for the Authority to meet this deadline. The Authority needs to bring forward internal accounting deadlines to ensure the accounts are produced on time. The Authority should consider the possibility of a hard close audit performed on a full draft set of Period 1-10 financial statements, which will improve the year-end accounts production and audit process. In addition, the Authority needs to consider how it will obtain the required information for the consolidated accounts from its Jersey subsidiary in sufficient time for the deadline.	**Agreed** SHBC intends to have a hard close audit performed on a full set of period 1-10 financial statements and is in the process of reviewing internal deadlines to ensure that the timeline is met. There is continuing communication with the Jersey Subsidiary to ensure that it provides the required information for the 2017/18 consolidated accounts to be prepared to meet the deadline. **Responsible Officer:** Adrian Flynn (Chief Accountant) **Due Date:** 31 January 2018

Appendix 1

Recommendations raised and followed up

We have followed up the recommendations from the prior year's audit, in summary:

Total number of recommendations	Number of recommendations implemented	Number outstanding (repeated below):
1	1	0

#	Risk	Recommendation	Management Response / Officer / Due Date	Status at August 2017
1	2	**Restructuring the finance function** Our work identified that there has been a significant amount of work completed to implement enhanced processes and procedures compared to last year. This included implementing 8 out of 10 recommendations we raised in 2014/15 to strengthen financial process. The recruitment of an Interim Accountant was key to the success of the revised approach for 2015/16. The interim is no longer at the Council. We understand that Management plans to restructure the finance function over summer. Hiring a permeant Chief accountant to maintain the new systems and processes introduced in 2015/16 is recommended. Management should document the new approach and carefully consider how the changes made can be preserved as part of the restructuring.	**Agreed** A restructuring programme is currently underway with a consultation paper recently submitted to the Corporate Management team and staff in August 2016, outlining the business case and proposed restructure which includes the provision of a Chief Accountant. It is anticipated that this will be completed by the end of October 2016. **Due date** 31 October 2016	**Implemented** The restructure is complete

Materiality and reporting of audit differences

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects:

- 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; and
- 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 2016/17, presented to you in March 2017.

Materiality for the Authority's accounts was set at £900k for the Group accounts and £900k for the Authority accounts. This equates to around 1.9% of gross expenditure.

We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to Audit and Standards 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 Standards 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 £45k 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 Standards Committee to assist it in fulfilling its governance responsibilities.

Appendix 3

Audit differences

Unadjusted audit differences

Under UK auditing standards (ISA (UK&I) 260) we are required to provide the Audit and Standards Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. In line with ISA (UK&I) 450 we request that you correct uncorrected misstatements. However, they will have no effect on the opinion in our auditor's report, individually or in aggregate. As communicated previously with the Audit and Standards Committee, details of all adjustments greater than £45k are shown below.

Authority unadjusted audit differences (£'000)

#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
1	0	0	Dr PPE £471k	0	Cr Reserves £471k	Management's valuation experts have valued SHBC's assets at 31/12/2016, and at year end provided an up to date market summary in relation to any changes. They advised that no change in market value is needed as the difference between December 2016 values and year end was not significant. Our review confirmed using the updated market indicators at 31/03/2017, the same calculations would result in the Theatre and Leisure Centre valuation being uplifted by £471k in total.
	0	**0**	**Dr £471k**	**0**	**Cr £471k**	**Total impact of uncorrected audit differences**

Audit differences

Adjusted audit differences

To assist the Audit and Standards Committee in fulfilling its governance responsibilities we present in the tables below a summary of adjusted audit differences (including disclosures) identified during the course of our audit. The adjustments below have been included in the financial statements.

Authority adjusted audit differences (£'000)						
#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
1	0	0	Cr Cash £979k	Dr Accruals £979k	0	Due to late processing of the bank reconciliation, one item was posted twice. This resulted in an overstatement of cash and creditor accruals. As this item is above materiality, SHBC have agreed to make the correction to the accruals figure.
	0	**0**	**CR £979k**	**Dr £979k**	**0**	**Total impact of corrected audit differences**

Appendix 4

Audit independence

This appendix communicates all significant facts and matters that bear on KPMG LLP's independence and objectivity and informs you of the requirements of *ISA 260 (UK and Ireland) Communication of Audit Matters to Those Charged with Governance.*

Integrity, objectivity and independence

We are required to communicate to you 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 KPMG LLP's independence and the objectivity of the Engagement Lead and audit team. We have considered the fees paid to us by the Authority for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies all KPMG LLP audit partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings. Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: instilling professional values; communications; internal accountability; risk management; and independent reviews. We would be happy to discuss any of these aspects of our procedures in more detail. There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed.

Audit matters

We are required to comply with *ISA (UK and Ireland) 260 Communication of Audit Matters to Those Charged with Governance* when carrying out the audit. ISA 260 requires that we consider the following audit matters and formally communicate them to those charged with governance:

- Relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement lead and audit staff;
- The general approach and overall scope of the audit, including any expected limitations thereon, or any additional requirements;
- The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the Authority's financial statements;
- The potential effect on the accounts of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements;
- Audit adjustments, whether or not recorded by the entity that have, or could have, a material effect on the Authority's financial statements;
- Material uncertainties related to events and conditions that may cast significant doubt on the Authority's ability to continue as a going concern;
- Disagreements with Management about matters that, individually or in aggregate, could be significant to the Authority's financial statements or the auditor's report. These communications include consideration of whether the matter has, or has not, been resolved and the significance of the matter;
- Expected modifications to the auditor's report;

Audit independence

- Other matters warranting attention by those charged with governance, such as material weaknesses in internal control, questions regarding management integrity, and fraud involving management; and
- Any other matters agreed upon in the terms of the audit engagement.

We continue to discharge these responsibilities through our attendance at Audit and Standards Committees, commentary and reporting and, in the case of uncorrected misstatements, through our request for management representations.

Auditor declaration

In relation to the audit of the financial statements of Surrey Heath Borough Council for the financial year ending 31 March 2017 we confirm that there were no relationships between KPMG LLP and Surrey Heath Borough Council, their directors and senior management and their affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity. We summarise below the non-audit services that we have provided, the fee, the potential threats to auditor independence and the associated safeguards in place.

Description of non audit services	2016-17 fees	Potential threat to auditor independence	Associated safeguards in place
High level tax awareness session delivered to Mole Valley District Council, with Surrey Heath Borough Council in attendance.	£200 recharge to Surrey Heath of a £3,000 fee for the course.	Self-Interest	The tax awareness session was undertaken by a separate team from the audit team. There was no communication between teams. The fee for the session (of which only £200 was recharge to Surrey Heath) is a trifling percentage of our audit fee, so the self-interest threat is acceptably insignificant.
Total fees	£200		
Total fees as a % of the external audit fees	<1%		

We considered the ratio of audit to non-audit fees as required by the APB Ethical Standards. The principal threat which arises from fees from non-audit services which are large in absolute terms relative to the audit fee is the perception of self-interest and advocacy. In this regard, we do not consider that the above ratio creates such a self-interest or advocacy threat since the absolute level of non-audit fees is not significant to our firm as a whole and neither the audit partner nor members of the audit team are incentivised on, or rewarded in respect of, the provision of non-audit services to you. We believe that the question of perception is best addressed through appropriate disclosure as to use of the auditor for the provision of non-audit services in the Authority's annual report and accounts.

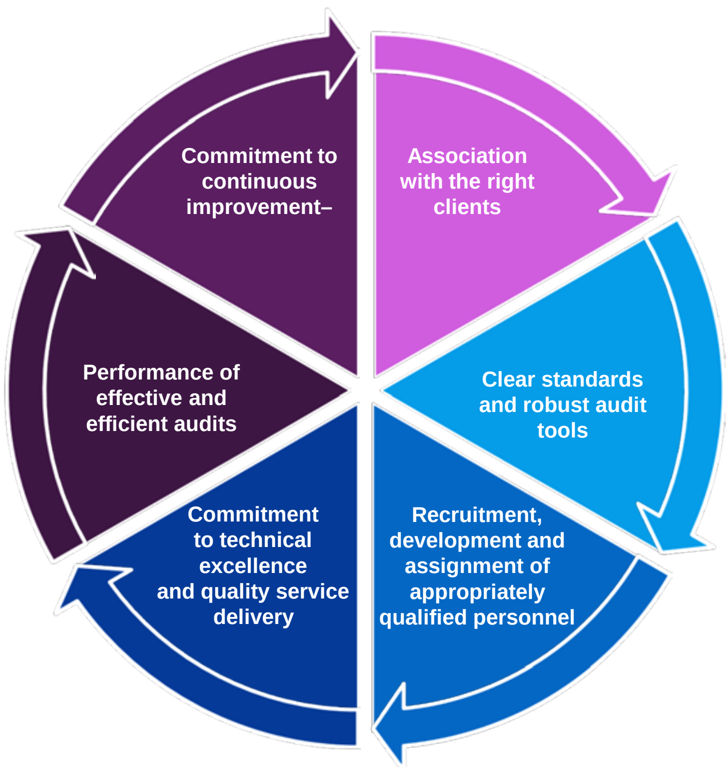
Appendix 5

Audit quality framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework

- Comprehensive effective monitoring processes
- Proactive identification of emerging risks and opportunities to improve quality and provide insights
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

- Select clients within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management



- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Relationships built on mutual respect
- Insightful, open and honest two way communications

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- Independence policies

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists

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