ANNEX 1

KPMG

External Audit Report 2017/18

DRAFT

Surrey Heath Borough Council

—

23 July 2018

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.

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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:

- PPE (review of classification of movement between investment properties to OLAB)
- Journals
- I&E testing
- Debtors
- AGS review
- Collection fund
- Financial instruments

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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 for the deadline of 31 July 2018, following the Council adopting them and receipt of the management representations letter.

We have completed our audit of the financial statements. We have read the Narrative Report and reviewed the Annual Governance Statement (AGS). Our key findings are:

- There were no unadjusted audit differences.
- 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 2017/18.
- 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
- 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.

We are now in the completion stage of the audit and anticipate issuing our completion certificate by 31 July 2018. We intend to issue our 2017/18 Annual Audit Letter shortly after.

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 for the deadline of 31 July 2018.

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Summary

Other matters

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

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

We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about.

We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014

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 2017/18 financial statements.

We are satisfied that the Authority has addressed the recommendations raised in our ISA260 report in 2016/17. We have not made any new recommendations as a result of our 2017/18 work.

We undertake the audit of your Housing Benefit grant claim (HBEN01), which has a certification deadline of November 2018. We have not yet commenced our fieldwork but plan to do so in August 2018.

The fees for this work is explained in section two.

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Section Two

Financial statements audit

We audit your financial statements by undertaking the following:

	Accounts production stage		
Work Performed	**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 2017/18 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 reviewed work undertaken by your internal auditors, in accordance with ISA 610 and used the findings to inform our work.
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 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.

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Financial statements audit

4. Accounting standards	We work with you to understand changes to accounting standards and other technical issues. For 2017/18 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: No issues identified as a result of this change; • Amended guidance on the Annual Governance Statement: No issues identified as a result of this change; and • Changes in the format of the Pension Fund accounts: No issues identified as a result of this change;
5. Accounts Production	We received complete draft accounts by 31 May 2018 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 2017/18. The Authority incorporated measures into its closedown plan to manage this complex process. The Authority recognised the additional pressures which the earlier closedown brought and we engaged with officers in the period leading up to yearend to proactively address issues as they emerge. We consider that the overall process for the preparation of your financial statements is adequate. We consider the Authority's accounting practices to be appropriate. We thank Finance for their cooperation throughout the visit which 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 have identified presentational changes to the accounts along with audit adjustments to the investment income balance on the CIES which we have presented 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 Director of Finance on 12 July 2017. 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 are asking Management to provide specific representations on the valuation of land and buildings.

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Section Two

Financial statements audit

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— 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 2017/18 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 valuation of land and buildings, the valuation of investment properties and pension liabilities which 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.

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Authority significant audit risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error in relation to the Authority.

SIGNIFICANT audit risk	Account balances effected	Summary of findings
Valuation of land and buildings	£139,581k, PY £40,580k	The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. In addition, as the valuation is undertaken as at 31 December 17, there is a risk that the fair value is different at the year end. For the Authority the total revaluation decrease recognised in the revaluation reserve was £1,561k during the financial year. There was a significant increase in land and buildings as the Authority reviewed its asset base and confirmed that there were four investment properties and a significant portion of their subsidiary PPE asset base which is to be used for regeneration in 2017/18 and therefore was moved from the investment property line. We reviewed the approach that the Authority adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach. In addition, we considered movements in market indices between revaluation dates and the year end to determine whether these indicate that fair values had moved materially over that time. In relation to those assets which have been revalued during the year we reviewed the accounting entries made to record the results of the revaluation in order to ensure that they were appropriate. We assessed your valuer's (Wilks Head & Eve) qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions). As a result of this work we determined that the figures stated in relation to the valuation of land and buildings is not materially misstated.

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SIGNIFICANT audit risk	Account balances effected	Summary of findings
Valuation of investment properties	£46,551k, PY £43,912k	The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. Investment properties are revalued every year in line with the CIPFA code. The Authority exercises judgement in ensuring the carrying values recorded each year reflect those fair values. Given the materiality in value, and the judgement involved in determining the fair value of the assets, we consider this to be an area of significant risk. For 2017/18 the Investment properties increased in valuation by £3,254k We reviewed the approach taken by the Authority for undertaking its valuation of investment properties which included reviewing the accounting entries made to record the results of the revaluation to ensure that they were appropriate. We assessed your valuer's (Wilks Head & Eve) qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions). As a result of this work we determined that the Investment property revaluation amounts are free from material error.

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SIGNIFICANT audit risk	Account balances effected	Summary of findings
Pension liabilities	£39,527K, PY £39,074K	The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of Surrey Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. There are financial and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements. As part of our work we reviewed the controls that the Authority has over the information sent to the Scheme Actuary, including the Authority's process and controls with respect to the assumptions used in the valuation. We also evaluated the competency, objectivity and independence of Hymans Robertson. We reviewed the appropriateness of the key assumptions included within the valuation. We also reviewed the methodology applied in the valuation by Hymans Robertson. We reviewed the overall Actuarial valuation and considered the disclosure implications in the financial statements. As a result of this work we determined that Pension liabilities are not materially misstated.

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Financial statements audit

Authority other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Other areas of audit focus	Account balances effected	Summary of findings
Faster close	N/A	In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July. These changes represent a significant change to the timetable that the Authority has previously worked to. The time available to produce draft accounts has been reduced by one month and the overall time available for completion of both accounts production and audit is two months shorter than in prior years. We liaised with officers in preparation for our audit in order to understand the steps that the Authority was taking in order to ensure it met the revised deadlines. We advanced audit work into the interim visit in order to streamline the year end audit work. We received draft financial statements on the statutory deadline of 31 May 2018. The quality of this draft was consistent with that of prior years and as a similar number of audit and presentational adjustments were identified. In a number of areas the Authority made increased use of estimates. In these areas we considered the assumptions used and challenged the robustness of those estimates. As a result of this work we determined that the Authority has not had any significant issues in completing its financial statements for the earlier deadline.
Consolidation of investments	£39m PY £143m	In 2016/17 The Authority has undertaken the purchase of the Jersey Unit Trust. This is the second year the Authority consolidated the subsidiary as part of group accounts in their financial statements, and the first year in which a full year's transactions of the Trust was reflected in the group accounts. We note the significant change is due to the Authority reclassifying the investment as PPE as it is now considered as a regeneration project and not an investment project only. We liaised with the Jersey Trust auditor (PWC) and confirm their professional qualification, experience and independence. We issued them with group audit instructions to ensure that their audit is conducted to an acceptable level of scope and precision. The subsidiary auditors confirmed there were no issues in relation to their audit. We compared the accounting transactions between the subsidiary and the Authority and confirmed that all inter-group transactions have been correctly adjusted for. We tested the classification and accuracy of the investments and the presentation of the consolidated group accounts in the accounts and did not identify any issues.

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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 2017/18 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. - TBC

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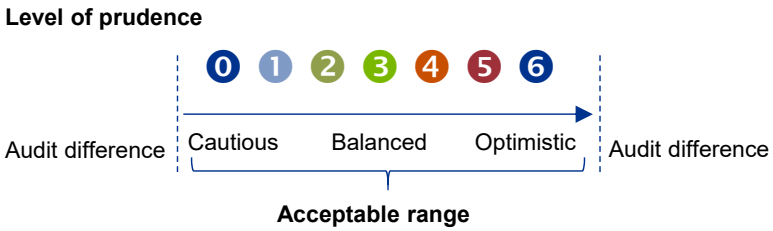
Financial statements audit

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 (£m)**	**KPMG comment**
NDR provisions	3	3	£2,712 (PY:£1,562)	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. For 2017/18 the Authority reviewed their historic information and had additional provisions of £1m which led to an increase in the provision required. 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	£1 (PY:£1)	The Authority has increased its de minimis accruals level in response to the shorter closedown period from £1k to £3k. We have been actively engaging with Management to understand the impact of this. Our review has not identified any issues and therefore we have considered this approach balanced.
Accruals	3	3	£11,129 (PY:£13,940)	Accruals have remained largely static year on year apart from a drop in central government accruals by £1m. We have not identified any issues in relation our testing of your accruals. The Authority has recognised the earlier closedown period and made relevant plans to ensure information relating to expenditure is received in advance. We have therefore concluded this is a balanced assumption

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Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance (£'000's)**	**KPMG comment**
Debtors provisioning	3	4	£1,018 (PY:£974)	The provision for bad debts is consistent with prior year. 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. In the prior year there was an increase in Sundry debtors, which although was within the acceptable range, did not result in an increase in bad debts. There is no such issue this year and therefore we have therefore concluded this is a balanced assumption.
Pension liability	3	3	£39,527 (PY:£39,074)	In the previous year, the Local Government Pension Scheme for Surrey County Council (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2016 in line with the Local Government Pension Scheme (Administration) Regulations 2013. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation. The pension liability numbers to be included in the financial statements for 2017/18 are based on the output of the triennial valuation rolled forward to 31 March 2018. For 2018/19 the actuary will then roll forward the valuation for accounting purposes based on more limited data. Our procedures here focussed on ensuring that the information provided to Surrey County Council Pension Fund were complete and accurate, and ensuring that the assumptions applied by the expert actuary Hymans Robertson were appropriate. From our work we have assessed the judgements made in the valuation of pensions to be balanced.

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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 subsidiary:

— Main square Camberley Unit Trust which had a turnover of £36.2m;

There are no specific matters to report pertaining to the group audit. There were no issues to note in relation to the consolidation process.

Narrative report of the Authority

We have 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 2018 and anticipate issuing our audit certificate with our audit opinion.

We have not received any objections to the accounts from local electors, therefore we expect to issue our audit certificate in July 2018 following completion of the above.

Whole of Government Accounts (WGA)

We reviewed your WGA consolidation pack and there are no issues to report. We anticipate issuing an unqualified consistency report. - TBC.

Other grants and claims work

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

- Housing benefits grant claim: This audit is planned for August 2018. Our fee for this work is £11,411 (£8,430 in 2016/17).

Audit fees

Our fee for the audit was £45,905 excluding VAT (£47,926 excluding VAT in 2016/17**).** This is in line with the scale fees published by PSAA and includes an additional £4,005 which is pending approval from the PSAA for the audit of the group accounts.

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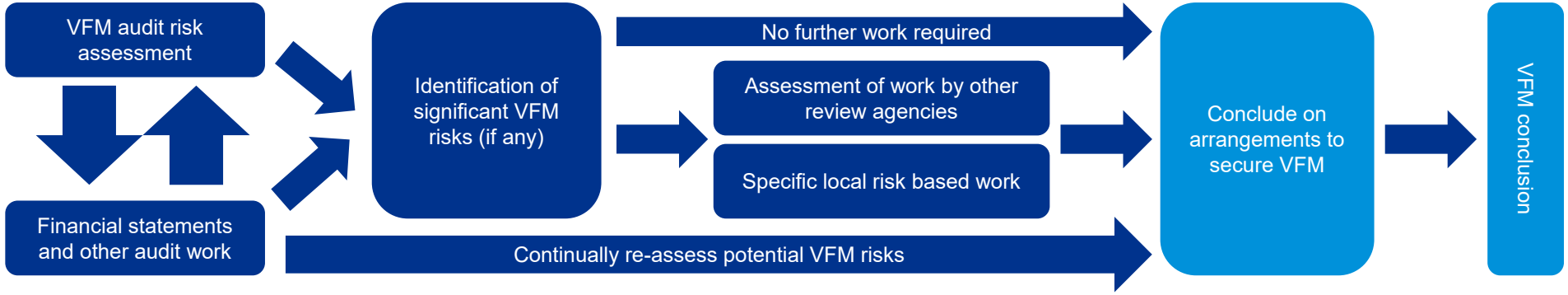
The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

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

We follow a risk based approach to target audit effort on the areas of greatest audit risk as summarised below:



We identified one significant VFM risks which are reported overleaf . 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 2018, based upon the criteria of informed decision making, sustainable resource deployment and working with partners and third parties.

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Value for money

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
Financial resilience	Local Authorities are subject to an increasingly challenged financial regime, with reduced funding from Central Government, whilst having to maintain a statutory and quality level of services to local residents therefore it is important the Authority is robust in setting its budgets and ensuring it can deliver the services it plans for.	As part of its 2017/18 budget setting process, the Authority identified the need to make savings of £1m in 2017/18. The budget for 2017/18 was £0.54m less than the budget for 2016/17. The gross budget for 2017/18 was £40m, and a net budget of £10.6m. The Authority achieved a underspend of £1m against its 2017/18 budget. The Authority's budget for 2018/19 was approved at the Council meeting on 21 February 2018 and showed an increase of £542k on prior year. The approved budget included individual proposals to support the delivery of the overall savings requirement. In addition, further savings of £3m will be required by the Authority over the period of 2018/19 to 2020/21. This will be to address the Authority's expected future reductions to local authority funding alongside service cost and ongoing demand pressures. As a result, the need for savings will continue to have a significant impact on the Authority's financial resilience. Like most of local government, the Authority faces a challenging future driven by funding reductions and an increase in demand for services. The Authority reported an overall underspend position on its net expenditure budget for 2017/18 after the net contribution enabled the General Fund balance to increase at £4 million as of 31 March 2018. The Authority's draft MTFP details a balanced budget for 2018/19 including savings of £1.5m in year over the next two years, some of which have been identified. In addition, the Medium Term Financial Plan details the increasingly difficult financial challenges faced each year, resulting in the need for ever rising savings and increased income which the Authority will continue to plan for and discuss as part of their senior management meetings. We carried out testing a number of the Authority's saving and income schemes and have found that whilst overall there are good-quality schemes and robust reporting, the Authority should continue to focus on identifying savings and additional income and ensure it meets the ongoing demand for its services.

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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

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Appendix 2

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 2017/18, presented to you in March 2018.

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

Materiality for the group accounts was set at £900k which 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 and less than £45k for the group accounts.

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.

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Appendix 3

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	Dr Investment income £400k Cr Legal income £400k					The investment income was overstated by £400k

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, we provide details of all adjustments greater than £45K.

We have not identified any unadjusted audit differences.

Presentational adjustments

We identified presentational adjustments required to ensure that the Authority's financial statements for the year ending 31 March 2018 are fully compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code'). Whilst the majority of these adjustments were not significant, we identified a limited number of adjustments of a more significant nature and details of these are provided in the following table. It is our understanding that these will be adjusted. However, we have not yet received a revised set of financial statements to confirm this.

Presentational adjustments	
#	Basis of audit difference
1	Exit packages – The 2017/18 accounts included four people who related to 2016/17 and should not have been included in the exit packages note. This resulted in a change from £148k to £24k.

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Appendix 4

Audit independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF SURREY HEATH BOROUGH COUNCIL

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses: general procedures to safeguard independence and objectivity; breaches of applicable ethical standards; independence and objectivity considerations relating to the provision of non-audit services; and independence and objectivity considerations relating to other matters.

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 partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through: instilling professional values; communications; internal accountability; risk management; and independent reviews.

The conclusion of the audit engagement leader as to our compliance with the FRC Ethical Standard in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate.

We are satisfied that our general procedures support our independence and objectivity

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Appendix 4

Audit independence

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority and its controlled entities for professional services provided by us during the reporting period. We have detailed the fees charged by us to the authority and its controlled entities for significant professional services provided by us during the reporting period on the next page, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 £	**2016-17 £**
Audit of the Authority	45,905	47,926
Total audit services	**45,905**	**47,926**
Mandatory assurance services	11,411	8,430
Total Non Audit Services	**11,411**	**8,430**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. We have only completed mandatory assurance services for 2017/18. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole. We confirm that all non-audit services were approved by the Audit and Standards Committee or equivalent.

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Appendix 4

Audit independence

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the table below:

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	0	11,411

Contingent fees

We have not agreed any contingent fees with the Authority.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit and Standards Committee.

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit and Standards Committee of the authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

[add electronic signature to be added to finalised document]

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Appendix 5

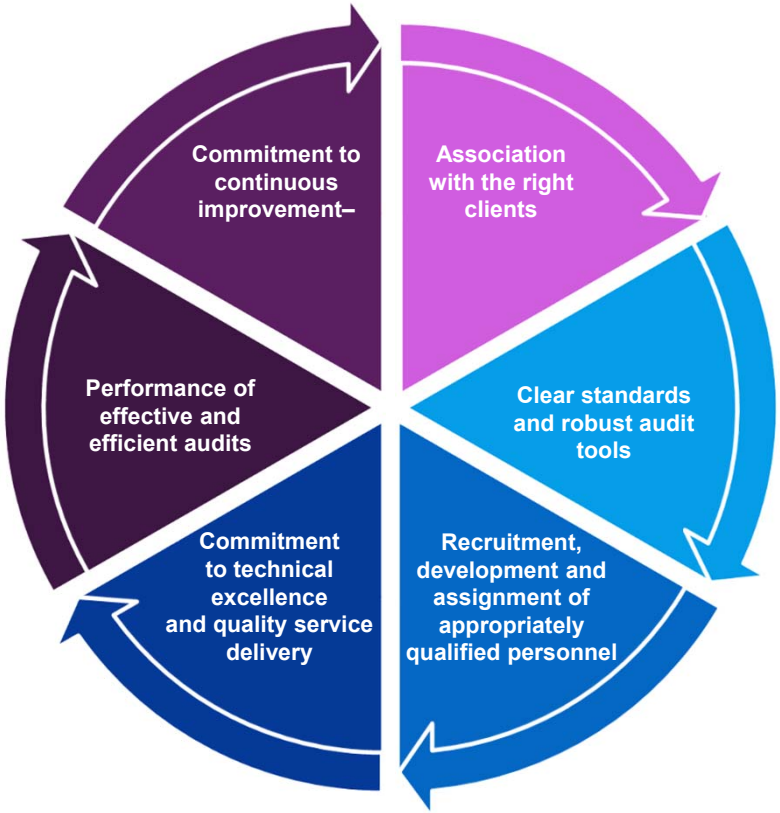
Audit quality framework

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

- 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

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



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

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

- 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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