Report to those charged with governance (ISA 260) 2012/13

Surrey Heath Borough Council

September 2013

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.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.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Fleur Nieboer, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

Section one

Introduction

This report summarises:

- **the key issues identified during our audit of the financial statements of Surrey Heath Borough Council (the Authority) financial statements for the year ended 31 March 2013; and**
- **our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.**

Financial statements

Our *External Audit Plan 2012/13* presented to you in March 2013 set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work took place in two tranches during March 2013 (interim audit) and July to August 2013 (year end audit). We carried out the following work:

Control Evaluation

- Evaluated and tested selected controls over key financial systems.
- Reviewed the internal audit function.
- Reviewed the accounts production process.
- Reviewed the progress on critical accounting matters.

Substantive Procedures

- Planned and performed substantive audit procedures.
- Concluded on critical accounting matters.
- Identified audit adjustments.
- Reviewed the Annual Governance Statement.

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

Completion

- Declaring our independence and objectivity.
- Obtaining management representations.
- Reporting matters of governance interest.
- Forming our audit opinion.

VFM conclusion

Our *External Audit Plan 2012/13* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have completed our work to support our 2012/13 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion; and
- considering the results of any relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2012/13 financial statements.
- Section 4 outlines the key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

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

Headlines

This table summarises the headline messages, including details on:

- our purposed unqualified audit opinion;
- the level of audit adjustments; and
- the Authority's control environment.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion by 30 September 2013 following the Performance and Audit Scrutiny Committee (P&ASC) adopting the accounts, and our receipt of your management representation letter. We have read your Annual Governance Statement and it is consistent with our understanding of the Authority.
Audit adjustments	We are pleased to report that our audit of your financial statements did not identify any material adjustments. The Authority made two non-trivial adjustments. For completeness, we have included a list of these non-trivial audit differences in Appendix 3. The Authority has agreed that both of these will be adjusted. We have raised six recommendations arising from our work, which are summarised in Appendix 1.
Accounts production and audit process	The Authority generally has adequate processes in place for the production of the accounts and supporting working papers. However, additional time was required to reconcile the financial statements to the ledger. We have recommended that the Authority improves this process for next year's audit. We have worked with Officers throughout the year to discuss the specific risk areas for this year's audit. This identified risks over financial resilience and Actuarial Present Value of Retirement Benefits, which were communicated to the Authority in our External Audit Plan. The Authority addressed the issues appropriately.
Control environment	The Authority's control environment is effective, and controls over the key financial systems are generally sound, with the exception of four recommendations. The most significant of these are: • Annual declarations had not been sought from senior officers to support the related party transactions note until completion of the audit. • Sample testing of journals highlighted a lack of supporting documentation and authorisation in some instances. • Finance reports to Executive do not detail actual spend to date, only forecast spend. We recommend actual spend is included in the report to allow the Executive to scrutinise the accuracy of the forecast. We also noted that explanations from service heads for budget variances are not always updated each month and recommend that this process is strengthened.
Completion	At the date of this report our audit of the financial statements is substantially complete. Before we can issue our opinion we require a signed management representation letter. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion	We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 30 September 2013. We have made one recommendation concerning the strengthening arrangements for the scrutiny and approval of exit packages.

Proposed opinion and audit differences

We have identified no issues in the course of the audit that are considered to be material.

The wording of your Annual Governance Statement is consistent with our understanding of the Authority.

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2013.

Audit differences

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

We did not identify any material misstatements.

Our audit identified a total of two audit differences, which we set out in Appendix 3. It is our understanding that these will be adjusted in the final version of the financial statements.

There is net increase of £114,000 on the General Fund as a result of audit adjustments.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *CIPFA/LASAAC Code of Practice on Local Authority Accounting the United Kingdom 2012/13*. We understand that the Authority will be addressing these.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

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

Critical accounting matters

We have worked with Officers throughout the year to discuss specific risk areas. The Authority addressed the issues appropriately.

Our findings for each risk are detailed in the table.

In *our External Audit Plan 2012/13*, presented to you in February, we identified the key risks affecting the Authority's 2012/13 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work. The table below sets out our detailed findings for each risk,

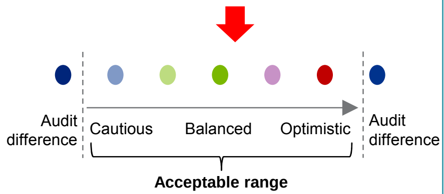
Key audit risk	Issue	Findings
Financial resilience	As at August 2012, the Authority was forecasting that it would deliver its 2012/13 budget in overall terms. This includes a savings programme totalling £366,000. The Authority estimated in the Annual Plan that another £446,000 in savings will need to be achieved during 2013/14 to address the further reductions to local authority funding. Against a backdrop of continued demand pressures in it will become increasingly difficult to deliver these savings in a way that secures longer term financial and operational sustainability.	Despite the challenging savings programme, the Authority has underspent against its budget by £328,000 whilst maintaining its useable reserves at £21 million, which is 48% of gross expenditure. We have reviewed the medium term financial plan and confirmed it includes appropriate scenario planning and takes account of future funding cuts. We have concluded that the Authority had sufficient arrangements in place to secure value for money in 2012/13. As part of our financial statements audit, we reviewed accruals and considered the completeness of the provisions. No issues were identified.
Actuarial present value of retirement benefits	The Authority is required to provide the value of the pension fund asset/liability as at the reporting date, taking into account numerous and complex assumptions. This creates a risk that the financial statements may be materially misstated. Small changes to these assumptions can have a large effect on the reported value and the Authority should ensure that the information provided to the Actuary is up to date and complete to ensure the values reported in the accounts take into account all requisite information.	We agreed the pension liabilities and pension disclosure notes to the report received from the actuary. We also obtained independent assurance over the expertise of the actuary which included review of the assumptions used in calculating pension liabilities. We have also obtained assurances from the external auditor at Surrey Pension Fund that the source data used by the actuary to calculate the pension liability has been passed on accurately and completely. Further details provided on page 7.

Significant judgments and estimates

We have assessed the significant judgements and estimates disclosed in the financial statements to gain assurance that they are within an acceptable range.

Our findings for each judgement and estimate are detailed in the table.

During the audit we have considered a number of significant judgements and estimates affecting the Authority and have summarised our findings below to give the P&ASC a view as to whether we believe these judgement are reasonable and within an acceptable range.

<table>
<tr><th colspan="2">Areas of significant audit judgment</th><th>Summary of findings</th></tr>
<tr><td>Valuation of Property, Plant and Equipment</td><td>


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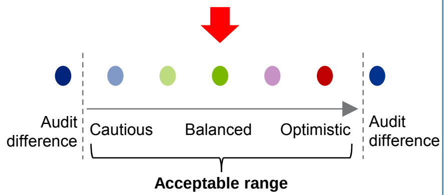
The Authority’s financial statements include £39,870k relating to Property, Plant and Equipment. These assets are externally valued with the Council engaging Hampshire County Council as valuers.
We have obtained the instructions to the valuers, and reviewed to ensure:

Assets included in the valuers report are those listed in the instructions;
The valuers are RICs qualified and can demonstrate the required expertise and independence to undertake the work;
The valuation basis is compliant with the CIPFA Code.

We have sample tested the Property, Plant and Equipment balance and agreed the revalued assets to the asset register to gain assurance that they have been correctly disclosed in the financial statements.
We identified one matter over the depreciation method used and have raised a recommendation that the Authority review whether the reducing balance method remains an appropriate depreciation method for vehicles.
With the exception of the above matter we have assessed that the valuation of Property, Plant and Equipment is reasonable.

</td></tr>
<tr><td>Accruals</td><td>


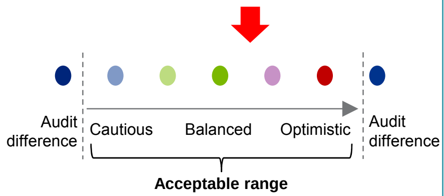
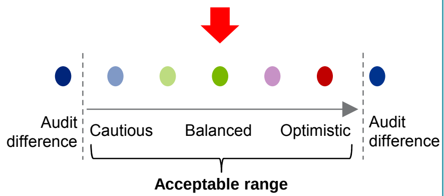
</td><td>

The Authority applies accruals accounting by recording transactions in the year in which they take place, not simply when the cash payments are made or received. To gain assurance over the amounts accrued in the financial statements we sample tested significant creditor balances to determine if they related to accruals and agreed their calculation back to supporting documentation.
Additional testing was undertaken on post year end expenditure to identify whether any balances had not been correctly accounted for in the 2012/13 financial statements. We found all expenditure had been classified in the correct period.
We have assessed that the valuation of accruals within the financial statements is reasonable, with review of payment of prior year accrued balances giving assurance that accruals had been reasonably stated.

</td></tr>
</table>

Significant judgments and estimates

Our findings for each judgement and estimate are detailed in the table.

<table>
<tr><th colspan="2">Areas of significant audit judgment</th><th>Summary of findings</th></tr>
<tr><td>Provisions</td><td></td><td>■ The Authority’s financial statements disclose nil provisions in 2012/13. To gain assurance that there are no financial liabilities which the Authority has not disclosed we have undertaken the following procedures:
– Discussions with management to confirm there are no undisclosed financial liabilities which the Authority should provide against;
– Review of committee minutes to check for any matters arising which would result in potential financial loss to the Authority, including planned restructuring and redundancies;
– Review of legal services expenditure in 2012/13 to assess whether there are any significant legal costs arising in year which would indicate potential liability which the Authority should provide against.
■ We have assessed that the nil valuation of provisions is reasonable, with the balance disclosed on the optimistic side of balanced to cover any non significant provisions not identified by the Authority.</td></tr>
<tr><td>Actuarial present value of retirement benefits</td><td></td><td>■ The Authority has disclosed a pension liability of £28,973k within the financial statements. To gain assurance over this liability we have placed assurance in the Authority’s actuary. Carrying out an independent assurance exercise over the expertise of the actuary including a review of the assumptions used in calculating the pension liabilities.
■ We have also obtained assurances from the external auditor at Surrey Pension Fund that the source data used by the actuary to calculate the pension liability has been passed on accurately and completely.
■ We have assessed that the valuation of the pension liability within the financial statements reasonable.</td></tr>
</table>

Accounts production and audit process

The Authority has adequate processes in place for the production of the accounts and supporting working papers.

Officers dealt efficiently with audit queries and the audit process could be completed within the planned timescales.

The Authority implemented all but one of the recommendations raised in our *ISA 260 Report 2011/12*, with the exception of the compromise agreement signoff recommendation detailed in Appendix 2.

Accounts production and audit process

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

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has adequate financial reporting arrangements in place. There is scope to improve this further by ensuring adequate working papers are held to support the financial statements preparation, in particular the mapping of the Balance Sheet and Comprehensive Income and Expenditure Statement to the ledger (**recommendation 2**). We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 28 June 2013.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued on 12 March 2013 and discussed with the finance team, set out our working paper requirements for the audit. The quality of working papers provided met the standards specified in our *Accounts Audit Protocol*.
Critical accounting matters (key audit risks)	We have discussed with officers throughout the year the areas of specific audit risk and undertaken specific audit procedures. There are no matters to draw to your attention.

Element	Commentary
Response to audit queries	Officers resolved the majority of audit queries promptly. In some cases we experienced delays, specifically where staff who prepared the working papers were not available during the audit.

Prior year recommendations

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

The Authority has fully implemented eight, and partially implemented two of the recommendations in our *ISA 260 Report 2011/12*, with the exception of a recommendation raised on compromise agreements which has been superseded. Our review in 2012/13 found there were still areas for improvement over the governance arrangements in place for compromise agreements and a further recommendation has been included in Appendix 1.

Organisational and control environment

Your organisational control environment is effective overall, although a number of issues were identified and are detailed under key findings.

The key area for further improvement is over related party declarations.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

We also review the outcome of internal audit's work on the financial systems to influence our assessment of the overall control environment, which is a key factor when determining the external audit strategy. This has also been complemented by our own testing on selected systems.

Key findings

We consider that your organisational controls are effective overall.

We did note the following issues in respect of individual systems:

- It is important that the Authority obtain related party declarations, including nil returns, on an annual basis from all senior officers. This is to ensure no party has the ability to exercise significant influence over senior officers in making financial and operating decision. The Authority last obtained declarations in 2011/12 and assumes where a return is not made there are no interests to declare. As a result of the audit the Authority has obtained updated declarations for 2012/13 (**recommendation 1**).
- Sample testing of journals highlighted that the Authority did not retain adequate supporting documentation for all journals posted, and there were cases where journal authorisation had not occurred in line with the Authority's procedures. Eight out of 40 journals tested did not have adequate supporting documentation. Seven of the journals tested that were over £20,000 had not been signed off by the Head of Corporate Finance, as required by the Authority's procedures (**recommendation 3**).
- Finance reports to Executive do not detail actual spend to date, only forecast spend. Without reporting actual spend, budget holders forecasts could be based an optimistic view of the remaining period, and this would not be clear to the readers of the report. We also noted that explanations from service heads for budget variances are not always updated each month as they should be (**recommendation 4**).
- Vehicles are currently depreciated on a 20% reducing balance method. However, the justification for using this method is not clear and is unusual for this type of asset. The Authority should review whether this method remains appropriate (**recommendation 5**).

Recommendations are included in Appendix 1.

Aspect	Assessment
Organisational controls:	
Management's philosophy and operating style	3
Culture of honesty and ethical behaviour	3
Oversight by those charged with governance	3
Risk assessment process	3
Communications	3
Monitoring of controls - see recommendation 1	2

Key:
1 Significant gaps in the control environment.
2 Deficiencies in respect of individual controls.
3 Generally sound control environment.

Completion

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

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

Once we have finalised our opinions and conclusions we will prepare our *Annual Audit Letter* and close our audit.

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of Surrey Heath Borough Council for the year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and Surrey Heath Borough Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 4 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Executive Head of Finance, a draft of which is reproduced in Appendix 5. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report relating to the audit of the Authority's 2012/13 financial statements.

VFM conclusion

Our VFM conclusion considers how the Authority secures financial resilience and challenges how it secures economy, efficiency and effectiveness.

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Background

Auditors are required to give their statutory VFM conclusion based on two criteria specified by the Audit Commission. These consider whether the Authority has proper arrangements in place for:

- securing financial resilience: looking at the Authority's financial governance, financial planning and financial control processes; and
- challenging how it secures economy, efficiency and effectiveness: looking at how the Authority is prioritising resources and improving efficiency and productivity.

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly. Our approach was set out in more detail in our *External Audit Plan 2012/13*.

Work completed

In line with the risk-based approach, and in our *External Audit Plan 2012/13* we have :

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- considered the results of relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas.

Key findings

Our risk assessment concluded that the Authority has adequate arrangements in place to manage value for money. We did not identify the need for additional work, other than following up prior year recommendations.

Our work on the follow-up of prior year recommendations did identify that arrangements could be further improved in respect of scrutinising and authorising exit packages (**recommendation 6**).

Further details of the risk assessment we carried out in respect of value for money can be seen on page 5 next to 'financial resilience'.

Conclusion

We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

VFM criterion	Met
Securing financial resilience	✓
Securing economy, efficiency and effectiveness	✓

Appendix 1: Key issues and recommendations

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

We will formally follow up these recommendations next year as part of our 2012/13 programme of audit work.

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

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❶	**Senior officers' related party interests** The last reminder for declarations of related party interests from senior officers was sent out 2011/12. The template declaration does not require officers to make a return, stating no response will be interpreted as there being no related party declaration. It is a vital part of the Authority's governance arrangements to require positive confirmation via returns each year from all senior officers. Without this there is a risk that the Authority will not identify all senior officer related party interests. The Authority should mandate annual senior officer declarations, and remove the instructions that officers do not have to respond to ensure all forms are returned.	Returns have now been supplied for all senior officers. The Monitoring Officer will ensure officers are required to make an annual return as part of the year end audit process. Karen Limmer March 2014

Appendix 1: Key issues and recommendations (continued)

We will formally follow up these recommendations next year as part of our 2012/13 programme of audit work.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
2	2	**Agreement of the financial statements to the ledger** The Authority did not prepare an adequate working paper to map the Balance Sheet and Comprehensive Income and Expenditure Statement to the ledger. As a result additional work was required during the audit by both the Council and the audit team to agree the financial statements to the ledger. The Authority should prepare and retain working papers that show how the financial statements have been derived from the ledger, providing an audit trail tracking the ledger balances, manual adjustments, and financial statements entries. This should be prepared as part of the closedown process prior to the audit commencing and should be subject to quality review.	More detailed working papers will be provided as part of the 2013/14 closure process. Katherine Jobling March 2014
3	2	**Journal authorisation** Our audit work had identified that not all journals are authorised in line with the Authority's authorisation procedures, and there was a lack of documentation retained to support and explain the rational for some journals. Without strong disciplines concerning the raising and authorisation of journals, there is an increased risk of errors in the financial statements. The journal process should be strengthened by: • reviewing a journal listing report of all high value journals to ensure they have been appropriately authorised; and • retaining documentation for all journals to explain the purpose of the journal.	We have put new procedures in place in 2013/14 to ensure all journals are authorised. Sarah Parmenter March 2014

Appendix 1: Key issues and recommendations (continued)

We will formally follow up these recommendations next year as part of our 2012/13 programme of audit work.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
4	2	**Budgetary control** Our review of budgetary control noted that: • finance reports to the Executive compare the forecast year end position against the budget. There is no detail of actual spend to date which would allow better to challenge the forecast; and • budget variance explanations from service heads are not always received in a timely manner, meaning explanations are sometimes rolled forward from the prior month without update. Without strong financial management disciplines there is an increased risk of unforeseen overspends, particularly as funding cuts take effect. We recommend that finance reports to the Executive should detail actual spend to date as well as the forecast outturn. The Authority should also require all service heads to provide updated budget variance commentary on a monthly basis.	Portfolio holders already receive reports of actual expenditure on a monthly basis so that they can discuss these with service managers. Our current financial system is not flexible enough to provide this information in a useful format and so this will be addressed as part of the implementation of the new financial system in 2014/15. Any missing returns for variance explanations will now be escalated to the Chief Executive for action. Kelvin Menon March 2015
5	3	**Property, plant and equipment** From our review of the Property Plant and Equipment disclosures and working papers we identified that vehicles are depreciated on a 20% reducing balance method, but there is no justification of this method which appears unusual for the type of asset. The Authority should also review whether the reducing balance method is an appropriate depreciation method for vehicles.	Straight line depreciation would appear to be the more appropriate method of depreciation for vehicles. Sheen Adrian March 2015

Appendix 1: Key issues and recommendations (continued)

We will formally follow up these recommendations next year as part of our 2012/13 programme of audit work.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
6	2	**Authorisation of exit packages** In 2011/12 we recommended that compromise agreements should be authorised by the chief executive which the Authority agreed to implement. In 2012/13 we tested five exit packages, of which two were 'managed exits' which involved compromise agreements. One had been authorised by the Chief Executive, but the second had been authorised by the Head of Human Resources (value of £9,390). Two further packages in our sample were voluntary redundancies, and for one of these the Authority was unable to demonstrate how the amount was calculated, though we do acknowledge it was less than statutory entitlement (value of £25,500). If exit package payments are not subject to a robust scrutiny and approval process, there is an increased risk that payments are made that do not demonstrate value for money. The Authority should clarify arrangements for scrutiny and approval of exit packages. It would be good practice to ensure payments that are not contractual are signed off by more than one officer. Arrangements are currently detailed in the Employment Stability Policy which was last reviewed in March 2010. Arrangements could involve different levels of approval dependent on the type and amount of the exit package.	Packages will be signed by the head of Human Resources and the Chief Executive unless they are purely contractual. Louise Livingstone Immediate

Appendix 2: Follow up of prior year recommendations

The Authority has made good progress in implementing the eleven recommendations raised in 2011/12.

Eight have been addressed in full, one relating to exception reporting and one relating to componentisation have been actioned in part, but one relating to signoff arrangements for compromise agreements has been re-raised this year.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2011/12* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	11
Implemented in year	8
Partially implemented	2
Remain outstanding	1

No.	Risk	Recommendation	Management response, Officer responsible and due date	Status as at September 2013
1	2	**Componentisation of non-current assets** We recommend that the valuers are instructed to apply componentisation to assets revalued in 2012/13 and beyond.	Valuers will be instructed to consider componentisation as part of valuation performed in 2012/13. Executive Head of Finance December 2012	**Partially Implemented** Management have set out their componentisation policy under their accounting policies. However the instructions to valuers were agreed prior to the recommendation being issued and do not specifically include the basis for componentisation.
2	2	**Budget setting accuracy** Restructuring costs were not in the budget and capital expenditure was significantly below budget. We encourage the Authority to ensure that the budget setting process is aligned to the strategy and business planning processes.	We do not budget for restructuring costs as they are considered to be one off and cannot be quantified when the budget is set since we cannot prejudge who will be made redundant. Capital expenditure is usually below budget since requirements can change after they had been originally approved and the Council is always seeking ways to minimise its capital spend thereby protecting resources for future projects. Executive Head of Finance March 2013	**Implemented.** The budget has been achieved without and significant variances noted.

Appendix 2: Follow up of prior year recommendations (continued)

Not implemented recommendation for compromise agreement sign off is detailed in the table.

No.	Risk	Recommendation	Management response, Officer responsible and due date	Status as at September 2013
3	2	**Compromise agreement sign off** We recommend that compromise agreements are counter signed by the Chief Executive to ensure that there is a clear audit trail of involvement and pre-approval of the payments.	In future an audit trail will be kept throughout the negotiations. HR Manager March 2013	**Not implemented.** The recommendation has been re-raised in 2012/13 in appendix 1.
4	3	**Risk management strategy** We recommend that the risk management strategy is reviewed and updated in the financial year 2012/13 following the restructure to ensure that it reflects the evolving risks in the local government environment.	Following the restructure in September 2012, the strategy has been updated. Executive Head of Finance September 2012	**Implemented.** The risk management strategy has been updated.
5	3	**Risk ratings on the risk register** We recommend the risk register includes definitions of both the likelihood and scoring mechanismsuch that scores are meaningful to the decision maker and action can be agreed and prioritised.	Agreed. Executive Head of Finance December 2012	**Implemented.** The risk register includes a clear scoring methodology.

Appendix 2: Follow up of prior year recommendations (continued)

All recommendations detailed in the table implemented.

No.	Risk	Recommendation	Management response, Officer responsible and due date	Status as at September 2013
6	3	**Financial reporting** Through our VFM work and review of the Council's finance reports, we noted that the authority could include financial ratios as key performance indicators. This would improve the Council's understanding of financial performance in areas such as working capital.	We already use a number of performance indicators to monitor however the use of financial ratios will be considered if they are relevant and enhance understanding and we have adequate resources Executive Head of Finance December 2012	**Implemented.** The Authority has considered the need for financial ratios and considered its current reporting adequate. As reporting does contain detailed analysis of financial information, including aged debt analysis, we are not minded to challenge this.
7	3	**Benchmarking** It would be best practice for the Authority to consider sources of benchmarking data and how this could be used to evaluate whether services are cost-efficient, whilst maintaining quality. This needs to be proportionate to the benefit that will be derived from any investment required to benchmark.	Benchmarking can be a good tool to demonstrate value for money however in our experience it can be difficult to compare authorities because of the variation in underlying assumptions such as the treatment of central costs. It can also take a lot of resource. Services already participate in Surrey wide benchmarking exercises as available. Willing to consider CIPFA benchmarking again but costs likely to outweigh benefits. Executive Head of Finance December 2012	**Implemented.** The Authority has assessed the value of CIPFA benchmarking and concluded this is not value for money.

Appendix 2: Follow up of prior year recommendations (continued)

Partially implemented recommendation for exception reporting is detailed in the table.

No.	Risk	Recommendation	Management response, Officer responsible and due date	Status as at September 2013
8	2	**Benefit payments** We recommend that the Benefits team implement cover arrangements for key controls in the event that the staff performing the controls are absent.	The notification of new payments is in addition to accuracy testing of claims processed. Arrangements have been put in place to ensure that all first payments are checked and the team notification email sent. Revenues and Benefits team leader December 2012	**Implemented** The Authority now has arrangements in place to cover for staff absenses.
9	2	**Benefit claimant checks** We recommend that sample checking includes an element of unpredictability and frequently selects users for which there are no identified performance issues.	Future checks will include the suggested element of unpredictability. Revenues and Benefits team leader December 2012	**Implemented** The Authority undertakes sample checks and have ensured these include elements of unpredictability and cover all users.
10	3	**Management review of benefits exception reporting** All exception reports should be subject to management review to verify that a segregation of duties existed and that exceptions have been appropriately followed up.	A monthly management check will be introduced subject to the resources being available. Revenues and Benefits Manager December 2012	**Partially Implemented** Although management undertake review of benefits exception reporting due to staff constraints this did not cover all exception reports produced during the year.
11	3	**Recurrent journal postings** We recommendation that the Council review the appropriateness of their recurrent postings for continued relevance.	Agreed. Executive Head of Finance December 2012	**Implemented** Our journal testing did not identify any further issues with recurrent postings.

Appendix 3: Audit differences

This appendix sets out the non-trivial audit differences.

It is our understanding that both of these will be adjusted.

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

Corrected audit differences

The following table sets out the significant audit differences identified by our audit of Surrey Heath Borough Council's financial statements for the year ended 31 March 2013.

	Impact					
No.	Income and Expenditure Statement	Movement in Reserves Statement	Assets	Liabilities	Reserves	Basis of audit difference
1		CR General Fund £114,000			DR Capital Adjustment Account £114,000	Errors in the movement in the Capital Adjustment Account relating to revaluation losses and capital grants and contributions applied.
2	CR Collection Fund £123,000 DR Collection Fund £123,000					Collection Fund income collectable and payment to the pool were both overstated by the same amount due to incorrect treatment of discretionary reliefs and costs of collection.
	-	**CR £114,000**	**-**	**-**	**DR £114,000**	**Total impact of adjustments**

Appendix 4: Declaration of independence and objectivity

The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of both the Commission and the Authority.

Requirements

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the Code) which states that:

"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission's Standing guidance for local government auditors (Audit Commission Guidance) and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* (Ethical Standards).

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

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our Annual Audit Letter.

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

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

General procedures to safeguard independence and objectivity

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

Appendix 4: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of Surrey Heath Borough Council for the financial year ending 31 March 2013, we confirm that there were no relationships between KPMG LLP and Surrey Heath Borough Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

Appendix 5: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

We require a signed copy of your management representations before we issue our audit opinion.

Dear Sirs

This representation letter is provided in connection with your audit of the financial statements of Surrey Heath Borough Council ("the Authority") for the year ended 31 March 2013, B for the purpose of expressing an opinion:

i. as to whether these financial statements give a true and fair view of the financial position of the Authority as at 31 March 2013 and of the Authority's expenditure and income for the year then ended; and

ii. whether the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

These financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement and the Collection Fund and the related notes.

The Authority confirms that, to the best of its knowledge and belief, having made such inquiries as it considered necessary for the purpose of appropriately informing itself:

Financial statements

1. The Authority has fulfilled its responsibilities, as set out in regulation 8 of the Accounts and Audit (England) Regulations 2011, for the preparation of financial statements that:
   - give a true and fair view of the financial position of the Authority as at 31 March 2013 and of the Authority's expenditure and income for the year then ended; and
   - have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

   The financial statements have been prepared on a going concern basis.

2. Measurement methods and significant assumptions used by the Authority in making accounting estimates, including those measured at fair value, are reasonable.

3. All events subsequent to the date of the financial statements and for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 require adjustment or disclosure have been adjusted or disclosed.

Information provided

4. The Authority has provided you with:
   - access to all information of which it is aware, that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
   - additional information that you have requested from the Authority for the purpose of the audit; and
   - unrestricted access to persons within the Authority from whom you determined it necessary to obtain audit evidence. [ISA (UK&I) 210 6b(iii)]

5. All transactions have been recorded in the accounting records and are reflected in the financial statements.

6. The Authority acknowledges its responsibility for such internal control as it determines necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, the Authority acknowledges its responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

   The Authority has disclosed to you the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Appendix 5: Draft management representation letter

We ask you to provide us with representations on specific matters such as whether the transactions within the accounts are legal and unaffected by fraud.

The wording for these representations is prescribed by auditing standards.

We require a signed copy of your management representations before we issue our audit opinion.

7. The Authority has disclosed to you all information in relation to:
   a) Fraud or suspected fraud that it is aware of and that affects the Authority [and the Group] and involves:
      - management;
      - employees who have significant roles in internal control; or
      - others where the fraud could have a material effect on the financial statements; and
   b) allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, analysts, regulators or others.
8. The Authority has disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.
9. The Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.
10. The Authority has disclosed to you the identity of the Authority's related parties and all the related party relationships and transactions of which it is aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13. Further, the Authority has confirmed there are no related party relationships and transactions that have not been appropriately accounting for and disclosed.

Included in the Appendix to this letter are the definitions of both a related party and a related party transaction as the Authority understands them and as defined in IAS 24, except where interpretations or adaptations to fit the public sector are detailed in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

11. The Authority has disclosed to you and has appropriately accounted for and/or disclosed in the financial statements in accordance with IAS 16 Property, Plant and Equipment, each part of an item of property plant and equipment with a cost that is significant in relation to the total cost of an item, and consulted valuers to identify significant components during the 2012/13. The Authority has not unduly influenced the values in determining the valuation of property, plant and equipment.
12. On the basis of the process established by the Authority and having made appropriate enquiries, the Authority is satisfied that the actuarial assumptions underlying the valuation of pension scheme liabilities are consistent with its knowledge of the business.

    The Authority further confirms that:

    a) all significant retirement benefits, including any arrangements that:
       - are statutory, contractual or implicit in the employer's actions;
       - arise in the UK and the Republic of Ireland or overseas;
       - are funded or unfunded; and
       - are approved or unapproved,

    have been identified and properly accounted for; and

    a) all settlements and curtailments have been identified and properly accounted for.

This letter was tabled and agreed at the meeting of the Performance and Audit Scrutiny Committee on 11th September 2013.

Yours faithfully,

John May, Chair of the Performance and Audit Scrutiny Committee

Kelvin Menon, Head of Corporate Finance

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