External Audit Report 2015/16

Surrey Heath Borough Council

—

September 2016

Contents

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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.

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Introduction

This document summarises:

- **The key issues identified during our audit of the financial statements for the year ended 31 March 2016 for the Authority; and**
- **Our assessment of the Authority's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- Our audit work at Surrey Heath Borough Council ('the Authority') in relation to the Authority's 2015/16 financial statements; and
- The work to support our 2015/16 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2015/16* provided to management in April 2016, set out the four stages of our financial statements audit process.

Planning → Control Evaluation → Substantive Procedures → Completion

This report focuses on the third stage of the process: substantive procedures. Our onsite work for this took place between July and August 2016.

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

VFM Conclusion

Our External Audit Plan 2015/16 explained our risk-based approach to VFM work. We have now completed the work to support our 2015/16 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 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 our key findings from our audit work in relation to the 2015/16 financial statements of the Authority and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations which have been detailed on page 24 onwards.

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 for the Authority. Sections three and four of this report provide further details on each area.

Proposed opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.
Audit adjustments	Our audit has identified a total of ten audit adjustments. One audit adjustment has an impact on the bottom line of the CIES and Balance Sheet which also requires an adjustment to the General fund: • Decrease of £178k in CIES • Increase of £178k of Creditors in Balance Sheet • Increase of £178k of MIRS • Decrease of £178k in General Fund We have included a list of significant audit adjustments in Appendix two. All were adjusted by the Authority.
Key financial statements audit risks	We identified the following key financial statements audit risks in our 15/16 External audit plan issued to management in April 2016. — Auditing standards require us to make a rebuttable presumption of a risk of fraudulent revenue recognition. We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures. — Management override of controls: Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud due to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. — Valuation of land and buildings: The material nature of these and the judgment involved in the carrying amounts of property assets. Borrowings: The Authority took out four new borrowings in the 2015/16 financial year, with a total value of £17.9m. As this is the first time the Authority have taken out such an amount we considered this a significant risk in relation to the disclosure requirements on the financial statements. We have worked with officers throughout the year to discuss these key risk(s) and our detail findings are reported in section 3 of this report. There are no matters of any significance arising as a result of our audit work in these key risk areas.

Headlines

Accounts production and audit process	We received a complete set of draft accounts on 29 June 2016 in accordance with the DCLG deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code. We noted a significant improvement in the quality of the accounts and the supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. The Authority has improved its process for drafting the accounts and the quality of associated supporting working papers has increased, including the implementation of eight out of 10 prior year recommendations. An interim appointment was made to manage these processes. We understand that a permanent appointment will be made to maintain the step change that benefitted the 2015/16 accounts production. Our queries were dealt with efficiently by officers and the audit process has been completed within the planned timescales. As in previous years, we will debrief with the closedown team to share views on the final accounts audit. Hopefully this will lead to further efficiencies in the 2016/17 audit process. In particular we thank officers who were available throughout the audit visit to answer our queries.
VFM conclusion and risk areas	We identified the following VFM risks in our 2015/16 external audit plan issued to management in April 2016: — Capacity, capability and structure of the finance team: The 2014/15 VFM conclusion was qualified in light of capacity and capability challenges within the finance function which were compounded by pressures in the resource model of the team. These challenges resulted in late submission of the draft accounts and the Whole of Government Accounts pack as well as the Authority missing the filling deadline for its 2014/15 annual report and accounts. Due to this we agreed ten recommendations in our 2014/15 ISA260 report, including six high priority recommendations. We therefore raised this as a risk for the 2015/16 audit. We have raised a medium priority recommendation going forward which we have detailed in Appendix one. We worked with officers throughout the year to discuss the VFM risk (see section 4). Although the implementation of new processes reduced this as a matter for 2015/16, we raised a recommendation in respect of the planned Finance restructure and the need to maintain the enhancements secured during the 2015/16 accounts production process. 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 2016.
Completion	Our audit is now complete. You are required to provide representations on matters such as going concern and whether transactions in your accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Section 151 Officer on 22 August 2016. We draw your 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 for specific representations on: — Land and Buildings valuation: We have requested that the Board provide specific representation on the valuation of Land and Buildings (£43.6m) included in the financial statements and confirms it is appropriate and reflects all relevant factors impacting upon valuation. 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.

Proposed opinion and audit differences

Our audit has identified a total of ten audit adjustments.

The impact of these adjustments is to:

- **Decrease the balance on the general fund account as at 31 March 2016 by £178k;**
- **Increase the deficit on the provision of services for the year by £178k; and**
- **Decrease the net worth of the Authority as at 31 March 2016 by £178k.**

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the financial statements following approval of the Statement of Accounts by the Audit and Standards Committee on 19 September 2016.

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. There are no uncorrected adjustments.

The final materiality (see Appendix two) level for this year's audit was set at £900k. Audit differences below £45k are not considered significant.

Our audit identified a total of ten audit differences, we have detailed all significant adjustments in Appendix two. It is our understanding that these will be adjusted in the final version of the financial statements.

The tables on the right illustrate the total impact of audit differences on the Authority's movements on the General Fund for the year and balance sheet as at 31 March 2016.

The net impact on the General Fund as a result of audit adjustments is to increase the balance as at 31 March 2016 by £178k.

Movements on the general fund 2015/16

£m	Pre-audit	Post-audit	*Ref (App.2)*
Deficit on the provision of services	3,792	3,970	*1*
Adjustments between accounting basis and funding basis under Regulations	(4,460)	(4,460)	*1*
Transfers to/from earmarked reserves	(973)	(973)	*1*
Decrease in General Fund	**(2,398)**	**(2,220)**	

Balance sheet as at 31 March 2016

£m	Pre-audit	Post-audit	*Ref App.2*
Property, plant and equipment	48,841	48,841	*1*
Other long term assets	37,289	37,289	
Current assets	23,130	23,130	
Current liabilities	(11,883)	(12,061)	
Long term liabilities	(49,720)	(49,720)	
Net worth	**47,657**	**47,479**	*1*
General Fund	(2,398)	(2,220)	
Other usable reserves	(45,259)	(45,259)	
Unusable reserves	(27,253)	(27,253)	
Total reserves	**(47,657)**	**(47,479)**	

Proposed opinion and audit differences

We anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts by 30 September 2016.

The wording of your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.

Of the other audit adjustments we have identified, the most significant in monetary value are as follows:

— Vehicles, Plant & Equipment: Cost / Valuation At 31 March 2016: To be changed from £8,258k to £4,402k.

— Vehicles, Plant & Equipment: Accumulated Depreciation and Impairment At 31 March 2016: To be changed from (£5,906k) to (£2,050k)

— Note 34.4: Fair value of assets and liabilities – Borrowings Liabilities for which fair value is not disclosed: The total value in the balance sheet is £43,569k. The value in the note should state this value. The variance is £1.76m.

The adjustments above are presentational only and have no effect on the bottom line of the core financial statements.

In addition we identified presentational adjustments which were required to ensure that the accounts are compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 ('the Code'). We understand that the Authority will be addressing these.

Annual governance statement

We 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.

Significant audit risks

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus.

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2015/16*, presented to management in April 2016, we identified the significant risks affecting the Authority's 2015/16 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 of the risks that are specific to the Authority.

Significant Risk 1

— Valuation of Land and Buildings: £43.6m (PY £48.5m)

Local Authorities exercise judgement in determining the fair value of the different classes of assets held and the methods used to ensure the carrying values recorded each year reflect those fair values. In accordance with the suggested accounting policies provided by the CIPFA code of practice, the Authority achieves this by performing: an annual review for impairment; a full annual valuation over Investment Property; and a full valuation in not more than five yearly intervals over all other land and buildings. The Authority undertake a 20% valuation of assets each year to ensure all assets are valued within a five year cycle.

As part of our work we:

- reviewed the revaluation basis and consider its appropriateness;
- reviewed management's challenge to any of the valuations and differences between the valuation report and the financial statements;
- undertook work to understand the basis upon which any impairments to land and buildings have been calculated and test associated assumptions;
- assessed the independence and objectivity of the external valuers engaged by Management; and
- assessed the review undertaken by the Authority including the assurances they obtained from their valuers (Wilks Head and Eve) to confirm that there were no material changes in the fixed asset values from the date of valuation (December 2015) to the Authority's reporting year end date.

Our review confirmed there was no matters arising from our work which we would like to bring to your attention.

Significant audit risks

Significant Risk 2

— Borrowings: £17.9m (PY £0.0m)

The Council undertook four new loans for the 2015/16 financial year. Three were from the PWLB and one from M3 LEP. The loans were taken out in relation to the Authority investing in the development of economic growth for the future. As this was the first time the Authority have taken loans we considered this to be a significant risk due to its material nature and ensuring they were correctly disclosed in the financial statements.

As part of our work we:

- Confirmed the PWLB loans to the PWLB website;
- Obtained third party confirmation for the fourth loan; and
- Reviewed the disclosure for the borrowings in the financial statements to confirm it was included in line with statutory guidance.

Our review of the value of the loans and the treatment the Authority followed when including them in their financial statements confirmed we have not identified any significant issues or matters which which we are required to report on.

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Fraud risk of 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 2015/16 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. This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of 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. We have not identified any specific additional risks of management override relating to this audit. In line with our methodology, we carried 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. There are no matters arising from this work that we need to bring to your attention.

Judgements

We always consider the level of prudence within key judgements in your financial statements. We have summarised our view below using the following range of judgement:

Level of prudence

0 1 2 3 4 5 6

Audit difference | Cautious | Balanced | Optimistic | Audit difference

Acceptable range

Assessment of subjective areas			
Asset/liability class	**View**	**Balance (£m)**	**KPMG comment**
Provisions (includes Business Rate Appeals)	3	£1.8 million *(PY: £1.3 million)*	The 2015/16 provision includes an amount in respect of an increase in the NNDR provision (£480k) which relates to the estimated value of successful appeals that were probable at the Balance Sheet date but where the timing and amount were uncertain.
Accruals	3	£9.4 million *(PY: £9.6 million)*	There has been a small change in the number of accruals for 2015/16. We identified an error in the treatment of a creditor, where income for a grant was over accrued for. This was in relation to an adjustment made by DCLG. We have considered this an isolated error as no further similar errors were identified. The value of this error was £178k.
Deferred income	3	£2.3 million *(PY: £2.8 million)*	We consider the related disclosures to be proportionate, and deferred income has been calculated on a consistent basis.
Property, Plant and Equipment (valuations)	3	£43,625 million *(PY: £48,464 million)*	The Authority uses an external valuer (Wilks Head & Eve) which reviewed and valued assets using a five year rolling approach, ensuring that all assets are revalued every five years. For 2015/16 there has been a decrease in the value of Land and Buildings by £4.3 million. Additionally there has been disposals of £350k. The approach is consistent with last year.

Accounts production and audit process

We noted an improvement in the quality of the draft accounts and supporting working papers.

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

The Authority has implemented the majority of the recommendations in our ISA 260 Report 2014/15.

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 strengthened its financial reporting process through implementing the majority of the recommends raised in the previous year and hiring an interim accountant to oversea the accounts production process. There is scope to improve this further by implementing all remaining recommendations and ensuring that the step change in processes and procedures implemented by the interim accountant are maintained.
Completeness of draft accounts	We received a complete set of draft accounts on 29 June 2016.
Quality of supporting working papers	Our *Accounts Audit Protocol*, which we issued in April 2016 and discussed with the interim accountant, set out our working paper requirements for the audit. The quality of working papers provided has improved compared to last year and in the vast majority of the cases met standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved audit queries in a reasonable time.

Prior year recommendations

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

The Authority has implemented the majority of the recommendations in our *ISA 260 Report 2014/15*.

Appendix one provides further details.

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 2016, 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 Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix four 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 in the accounts are legal and unaffected by fraud. We provided a template to the Executive Head of Finance for presentation to the Audit and Standards Committee. We require a signed copy of your management representations before we issue our audit opinion.

We have requested a specific representation over the valuation of Land and Buildings in the management representation letter.

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.).

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

VFM Conclusion

Our VFM conclusion considers whether the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

We concluded that the Authority has made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Background

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.'

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria.

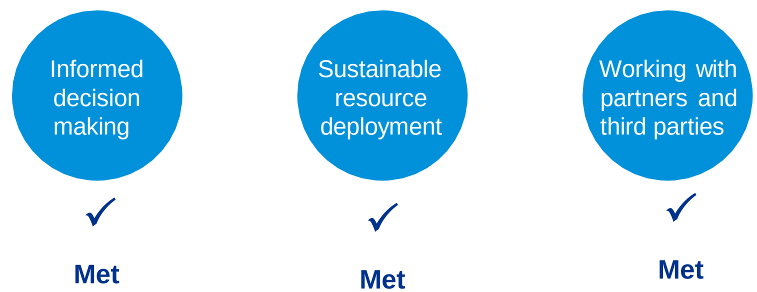
These sub-criteria provide focus to our VFM work.

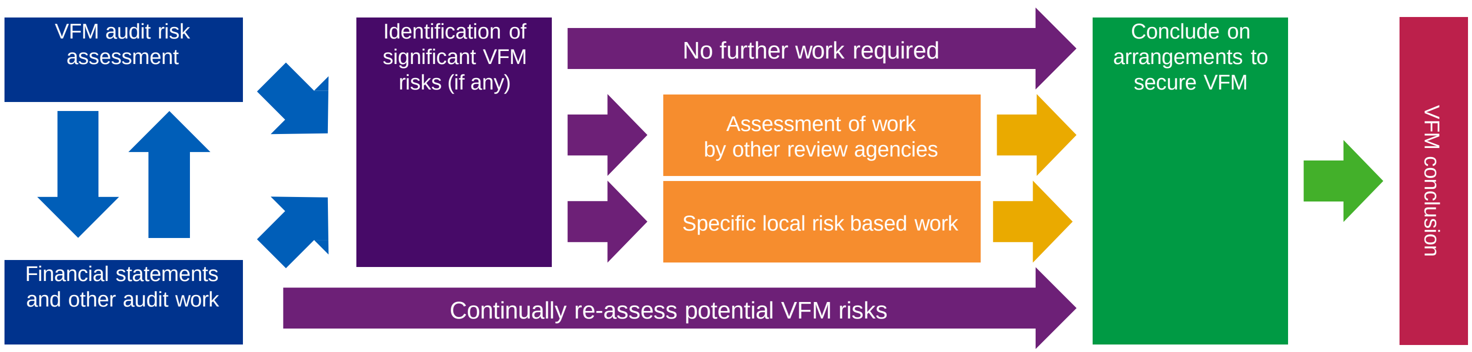
Conclusion

We have concluded that the Authority has made proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Overall criterion

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.





Specific VFM Risks

We identified one specific VFM risk.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* 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; and
- Considered the results of relevant work by the Authority, inspectorates and review agencies around these risk areas.

Key findings

Below we set out the findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion.

We concluded that we did not need to carry out additional work for these risks as there was sufficient relevant work completed in relation to these risk areas.

Specific VFM risk:	Assessment
Capacity, capability and structure of the finance team Our work in 2014/15 raised 10 recommendations, of which 6 were high priority. We identified a significant number of material errors which raised concern over the procedures and processes in place in Finance to prepare materially accurate draft financial statements and deliver their statutory responsibilities. In 2014/15 we qualified the VFM conclusion in light of capacity and capability challenges within the finance function which were compounded by pressures in the resource model of the team. These challenges resulted in late submission of the draft accounts and the Whole of Government Accounts pack as well as the Authority missing the filling deadline for its 2014/15 annual report and accounts.	As part of our work we held discussions with Management over the implementation of our 2014/15 recommendations. 8 out of 10 have been implemented, including all 6 high priority recommendations. The Authority appointed an Interim Accountant to manage the draft accounts production process in a timely fashion, enhance the preparation of supporting working papers, undertake quality assurance reviews and facilitate the accounts and audit process as part of a Finance team-wide effort. This individual was temporary and is no longer working at the Authority. The 2015/16 draft accounts and associated working papers were considerably better. The draft accounts and Whole of Government return were submitted on time. This step change in the control and quality of the accounts process has contributed significantly to the unqualified VFM conclusion for 2015/16 compared to the qualified 2014/15 VFM conclusion. Per Management a restructuring of the finance function will occur over the summer. As part of this exercise we understand that a permeant appointment will be made to maintain the step change that benefitted the 2015/16 accounts production. We have raised a medium priority recommendation in light of this to ensure the Authority consider the impact of the restructure going forward, in particular the need to maintain the new processes and procedures implemented for 2015/16.

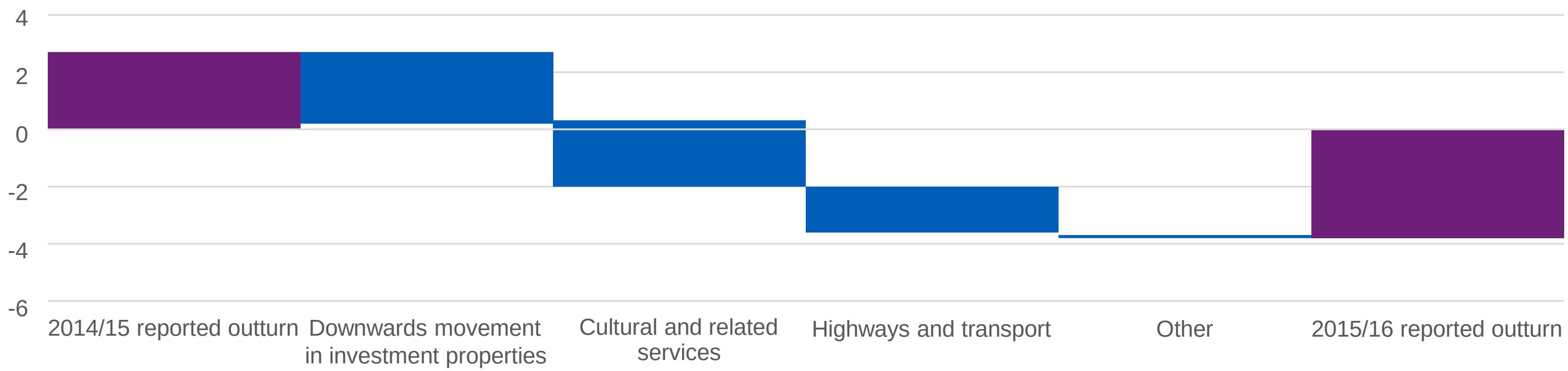
2015/16 outturn and 2016/17 budget

In considering the Authority's arrangements for securing financial resilience, we reviewed the outturn position against original plans, as well as identifying specific one off transactions to understand the 2015/16 normalised position. Surrey Heath's net portfolio expenditure for the year was £11.8M, a £0.6M adverse variance on the budgeted position of £11.1M. The Authority made an overall surplus of £2.7M due to a gain on the net defined benefit liability of £9.0M, but a deficit on the provision of services of £3.8M, £6.5M below the surplus on the provision of services of £2.7M from the prior period.

This is due to a downwards revaluation of £2.5M in investment properties, which is charged straight to he surplus/deficit on provision of services. There have also been significant movements in Cultural and Related Services (increase in net expenditure of £2.3M), and Highways and Transport services (increase in net expenditure of £1.6M).

The Authority has taken significant steps to decrease its reliance on government funding due to the planned reductions in this area. It has invested in £17.0M of investment property to generate rental income of £1.8M (up 138% on prior year income of £0.8M) and it has diversified its investment portfolio, which means interest income has increased 100% to £0.5M (PY: £0.2M).

The Authority also made savings through underspends in six of the seven departments. The largest underspend was in Community (£0.6M) due to reduced contract costs in Recycling and Waste. Work is ongoing to reduce the overspend within Cultural and related services where the Authority incurred a deficit of £0.8M.



The Authority's position continues to tighten due to cuts made by Government. The total revenue support grant will fall 68% to £0.4M in 2016/17 before being completely withdrawn in 2017/18. The Authority plans to offset this through £0.3M savings in the net cost of services. Among other factors, the Authority still needs to find £0.3M of savings in 2016/17. This requires services to absorb contractual increases or uplift in wages through increases to NI or pension contributions.

The 2016/17 budget requirement (as approved by the Council in February 2016) is £11.5M, an increase of 3.6% on the prior year budget of £11.1M.

Although Government announced that Local Authorities will keep 100% of business rates from 2019/20 there is uncertainty over how this will operate in practice, meaning there is still uncertainty over the Authority's future income streams. The extent of the risks to the Authority's finances were highlighted by the Section 151 Officer in February 2016, where the Council noted comments about the financial forecasts in respect of the budget gap and the potential impact on future sustainability.

Appendices

Key issues and recommendations

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

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up this recommendations next year.

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

Follow up of prior year recommendations

The Authority implemented 8 out 10 recommendations raised in our *ISA 260 Report 2014/15*.

We reiterate the importance of the outstanding recommendations and recommend that these are implemented as a matter of urgency.

Number of recommendations raised in 2014/15 that were:	
Included in original report	10
Implemented in year or superseded	8
Remain outstanding (reiterated below)	2

#	Risk	Recommendation	Original management response and deadline	Status as at 15 August 2016
1	2	**Documenting budget monitoring** The Authority's budget monitoring process during 2014/15 involved asking service areas to compare actuals vs year end forecast outturn on a quarterly basis. However, some budget monitoring discussions undertaken between finance staff and officers in service areas is not documented. Rather, it is done through conversation only. This raises the risk that crucial budgeting information or explanations are not retained, with no record or audit trail to refer back to at a later date. We recommend that all budget monitoring discussions are formally documented. A standard template could be developed for this to ensure that all pertinent details are always recorded in meetings, to ensure that information is retained in a complete and consistent manner.	**Responsible Officer** Kelvin Menon, Executive Head of Finance	**Ongoing** Budget discussions, although now recorded, are always documented within a standard template which captures the details discussed during meetings in a comprehensive and consistent manner. Management is currently considering a number of different templates, however they are working to standardise where possible. **Revised due date** 30 September 2016

Follow up of prior year recommendations

#	Risk	Issue and recommendation	Original management response and deadline	Status as at 15 August 2016
2	2	**Debriefing major projects to identify lessons learnt** The Authority implemented the new Civica ledger system on 1 April 2014. Full functionality was not implemented within the original timescales and this has resulted in a delay in implementing a 'business as usual' state. This increased pressure on the finance team's already challenging resource model and impacted on the quality of outputs, as the finance team had to concurrently manage both ledger implementation difficulties and day to day tasks. We recommend that Finance undertake a debrief workshop to learn lessons from the Civica implementation, to ensure that opportunities to improve future project implementations are identified and taken forward appropriately. This should be undertaken within an appropriate timeframe, with sufficient time to have lapsed between the end of the project and the debrief, to allow for staff reflection and consideration before the workshop. Such debrief workshops should be held after all significant project implementations to ensure that all such opportunities for learning are identified to enhance the Authority's project management and delivery arrangements.	**Responsible Officer** Kelvin Menon, Executive Head of Finance	**Overdue** A debrief workshop in relation to the Civica implementation project has yet to be conducted. Per Management, a formal debrief will be carried out once the 2015/16 financial statements have been signed off. **Revised due date** 31 December 2016

Audit differences

This appendix sets out the significant audit differences identified during the audit for the year ended 31 March 2016.

We have detailed the adjustments which affect the bottom line of the core financial statements on this page, all other misstatements to note have been detailed overleaf.

There is a net impact on the General Fund which equates to an increase of £178k.

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 your case is the Audit and Standards 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.

Uncorrected audit differences

There are no uncorrected audit differences.

Corrected audit differences

Our audit identified one misstatement which affected the Authority's prime financial statements, which has been detailed below. The Authority has confirmed it will amend for this misstatement.

	Impact					
No.	**Income and expenditure statement**	**Movement in reserves statement**	**Assets**	**Liabilities**	**Reserves**	**Basis of audit difference**
1	Dr Non Domestic Rate Income and Expenditure £178k	Cr Surplus/Deficit Provision Services £178k		Cr Central Government Creditors £178k	Dr General Fund (Useable reserves) £178k	The Authority incorrectly included £178k of income in their financial statements in relation to adjustment made by DCLG for the S31 grant.

Furthermore, we identified three other material misstatements which affected the financial statements, these are presentational only and are detailed below:

Two of the misstatements related to discrepancies between the fixed asset register and Note 11.3 in the financial statements:

- Vehicles, Plant & Equipment: Cost / Valuation At 31 March 2016: To be changed from £8,258k to £4,402k.
- Vehicles, Plant & Equipment: Accumulated Depreciation and Impairment At 31 March 2016: To be changed from (£5,906k) to (£2,050k).

Audit differences contd.

The financial statements have been amended for all of the errors identified through the audit process.

One material misstatement identified was related to the incorrect inclusion of the borrowings figure in note 34.4.

— Note 34.4: Fair value of assets and liabilities – Borrowings Liabilities for which fair value is not disclosed: The total value in the balance sheet is £43,569k. The value in the note should state this value. The variance was £1.76m.

Other errors

We identified non-material presentational errors in the financial statements. These have been discussed with Management and the financial statements have been amended.

Materiality and reporting of audit differences

For 2015/16 our materiality is £900k for the Authority's accounts.

We have reported all audit differences over £540k for the Authority's accounts.

Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

- 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.
- 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 2015/16, presented to management in April 2016.

Materiality for the Authority's accounts was set at £900k which equates to around 75 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit and Standards Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Standards Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £45k for the Authority.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Standards Committee to assist it in fulfilling its governance responsibilities.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice.

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."

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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd 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. Public Sector Audit Appointments Ltd 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 Audit and standards 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 Engagement Lead and the audit team.

Declaration of independence and objectivity contd.

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.

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.

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 2016, 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 Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Audit Independence

Audit fees

Our scale fee for the audit was £41,900 exc. VAT in 2015/16. This fee was in line with that highlighted within our audit plan and was agreed by management in April 2016. Our scale fee for certification for the HBCOUNT was £8,430 exc. VAT (£8,430 in 2015/16).

We are currently waiting on confirmation from the PSAA in relation to the 2014/15 fee variation request.

Non-audit services

We have not provided any non-audit services to the Authority in relation to 2015/16.

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