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Report to those charged with governance (ISA 260) 2010/11

Surrey Heath Borough Council

28 September 2011

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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 Greg McIntosh, 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, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to complaints@audit-commission.gov.uk. Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421.

This report summarises:

- the key issues identified during our audit of Surrey Heath Borough Council's ('the Authority's) financial statements for the year ended 31 March 2011; and
- our assessment of the Authority's arrangements to secure value for money (VFM) in its use of resources.

Financial statements

Our audit of the financial statements can be split into four phases:



Our interim visit took place in March 2011. This covered the following work:

| | |
|---------------------------|--|
| Control evaluation | <ul style="list-style-type: none"> ■ Review of your general control environment, including IT systems. ■ Testing of certain controls over key financial systems with the help of internal audit. ■ Assessment of the internal audit function ■ Review of your accounts production process, including work to address prior year audit recommendations and specific risk areas we have identified this year. ■ Review of the Authority's work to restate the 2009/10 financial statements under International Financial Reporting Standards. |
|---------------------------|--|

Our final accounts visit on site took place between 6 July and 9 September. During this period, we carried out the following work:

| | |
|-------------------------------|---|
| Substantive Procedures | <ul style="list-style-type: none"> ■ Planning and performing substantive audit procedures. ■ Concluding on critical accounting matters. ■ Identifying audit adjustments. ■ Reviewing the Annual Governance Statement. |
|-------------------------------|---|

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

| | |
|-------------------|---|
| Completion | <ul style="list-style-type: none"> ■ Declaring our independence and objectivity. ■ Obtaining management representations. ■ Reporting matters of governance interest. ■ Forming our audit opinion. |
|-------------------|---|

VFM conclusion

We have also now completed our work in respect of the 2010/11 VFM conclusion. This included:

- work to address the specific risk areas identified in our 2010/11 Audit Plan;.

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 2010/11 financial statements.
- Section 4 outlines the 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 year recommendations and will report separately to management on this work.

Acknowledgements

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



Section two Headlines

This table summarises the headline messages. The remainder of this report provides further details on each area.

| | |
|--|--|
| Proposed audit opinion | We anticipate issuing an unqualified audit opinion by 30 September 2011. We will also report that the wording of your Annual Governance Statement accords with our understanding. |
| Audit adjustments | <p>Our audit did not identify any material adjustments to the main financial statements. We did identify some adjustments that the authority has corrected. The impact of adjustments is to:</p> <ul style="list-style-type: none"> ■ Decrease total comprehensive income by £64k; ■ Decreased net assets by £64k; and ■ Decreased total reserves by £64k. <p>These adjustments have a £64k impact on the General Fund balance.</p> <p>All but one adjustment identified was adjusted by the Authority. We have provided details of this adjustment in appendix two. We are satisfied that error does not have a material impact on the financial statements for the period but are required to report it in line with ISA260 requirements.</p> |
| Critical accounting matters | We have worked with officers throughout the year to discuss specific risk areas, including the transition to IFRS. The Authority addressed the majority of issues appropriately. |
| Accounts production and audit process | We were provided with a draft set of accounts for the first day of our audit. We have noted the good quality of the supporting work papers provided to us. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. |
| Work of internal audit | We have placed reliance upon the work of internal audit in all areas of our controls work. We are satisfied with the adequacy of the work undertaken by internal audit in relation to core financial systems. |
| Completion | <p>At the date of this report our audit of the financial statements is substantially complete.</p> <p>Before we can issue our opinion we require a signed management representation letter.</p> <p>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.</p> |
| VFM conclusion | We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. |



Section three – financial statements

Proposed opinion and audit differences

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

Proposed audit opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion by 30 September 2011.

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. We identified a number of presentational issues that have been adjusted by management.

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 in June 2007; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

We have made one comment in respect of its content which the Authority has agreed to amend where significant.

| Movements on the General Fund 2010/11 | | | |
|--|----|------------|------------|
| | £m | Pre-audit | Post-audit |
| Surplus or (deficit) on the provision of services | | 8.1 | 8.0 |
| Adjustments between accounting basis & funding basis under Regulations | | 7.6 | 7.6 |
| Transfers to/ from earmarked reserves | | 0.6 | 0.6 |
| Decrease in General Fund | | 0.1 | 0.2 |

| Balance Sheet as at 31 March 2011 | | | |
|-----------------------------------|----|-------------|-------------|
| | £m | Pre-audit | Post-audit |
| Property, plant and equipment | | 29.6 | 29.6 |
| Other long term assets | | 12.0 | 13.1 |
| Current assets | | 23.4 | 22.3 |
| Current liabilities | | 3.5 | 3.5 |
| Long term liabilities | | 19.2 | 19.2 |
| Net worth | | 42.3 | 42.3 |
| General Fund | | 1.3 | 1.3 |
| Other reserves | | 41.0 | 41.0 |
| Total reserves | | 42.3 | 42.3 |

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

In our *Financial Statements Audit Plan 2010/11*, presented to you in April 2011, we identified the key risks affecting the Authority's 2010/11 financial statements.

We have now completed our testing of these areas and set out our final evaluation following our substantive work.

The table below sets out our detailed findings for each risk.

| Key audit risk | Issue | Findings |
|----------------|--|---|
| | <p>We have reviewed the process that you undertook in order to restate your 2009/10 accounts and present your 2010/11 accounts in compliance with IFRS.</p> <p>We reviewed the controls that you put in place to ensure that changes in accounting treatment, for items such as leases, were sufficient. We also compared the financial statements you prepared to the requirements of the CIPFA Code.</p> | <p>During the year you undertook reviews of your fixed assets to ensure that they were correctly restated for IFRS. You also analysed your grant receipts since 1 April 2009 to ensure that they were analysed correctly in accordance with the Code.</p> <p>We did not find any issues with the restatement work that had been performed in these areas, however the audit work was delayed due to the lack of formal documentation around the fixed asset conversion process. We have noted in Appendix one that issues remain with the approach to fixed asset accounting at the client, and although no adjustments were required this year, we would encourage the Council to continue improving processes in this area.</p> |
| | <p>IFRS has different criteria for the recognition of a finance lease. The Authority may, therefore, have to reclassify leases from operating to finance leases as a result of the transition to IFRS.</p> | <p>You performed a review of all identified leases, both as lessee and lessor, during the year to identify whether any of them qualified to be finance leases. This was done in accordance with the Code criteria for recognising a finance lease.</p> <p>We have reviewed this work and did not identify any differences to your treatment of leased assets.</p> |

| Key audit risk | Issue | Findings |
|---|--|--|
|  <p>Employee benefits</p> | <p>Under IFRS you must recognise a liability where you are required to pay salaries, bonuses and holiday pay.</p> <p>We have reviewed your calculation of the accrual for these entitlements.</p> | <p>The Council requested staff to provide details of their entitlements as at 31 March 2011. You have calculated the liability for employee benefits on an individual basis where returns were compiled by staff and on a pro-rated basis for staff who did not make a return. Our review of your work confirmed that you had a sufficient number of returns received to make an appropriate estimate.</p> <p>We did not find any significant issues in re-performing your calculation of the liability for employee benefits.</p> |
|  <p>Valuation of council assets</p> | <p>Due to current market conditions there is a risk that the valuation of your fixed assets is not representative of their market value.</p> | <p>We have reviewed the assumptions used in valuing your fixed assets and ensured that there has been sufficient consideration of potential impairments that have occurred during the year.</p> <p>We have not found any exceptions during our substantive testing of asset valuations.</p> |
|  <p>Provisions & impairments</p> | <p>Market conditions may lead to impairments to the value of assets that requires an impairment. We will review your processes to ensure that there is consideration of the signals that an impairment may be likely to your assets.</p> | <p>We have reviewed the provisions that were disclosed within your financial statements as part of our year end audit. As a result of this the provision has been removed from the accounts. This was not material.</p> <p>You have undertaken a valuation exercise and recorded revaluations appropriately. We are satisfied that the revaluations and impairments recognised value is appropriate.</p> |

We were provided with a complete set of supporting working papers in the first week of our audit.

Officers were prompt in dealing with any queries that arose during our audit.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the 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 uses an adequate financial reporting process which involves review by management. There is scope for improvement and this will come now you have appointed permanently to the financial accounting post in your finance team. We consider that accounting practices are appropriate. |
| Completeness of draft accounts | We received a complete set of draft accounts on 4 July. The accounts were complete and of a good standard, allowing the audit to progress as planned. |
| Quality of supporting working papers | Our Prepared by Client (PBC) list was issued to you in advance of our audit, setting out our working paper requirements. The quality of working papers provided was good and met the standards expected from our PBC list. |
| Response to audit queries | Officers resolved audit queries in a reasonable time. |



Section three – financial statements 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 2011, 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 3 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 Kelvin Menon, Head of Corporate Finance. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- material weaknesses in internal control identified during the audit;
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. issues relating to fraud, compliance with laws and regulations, subsequent events etc.);
- other audit matters of governance interest.

There are no others matters which we wish to draw to your attention.

We follow a new VFM audit approach this year.

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.

Overview of the new VFM audit approach

For 2010/11, 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 VFM audit draws heavily on other audit work which is relevant to our VFM responsibilities and the results of last year's VFM audit

The key elements of the VFM audit approach are summarised in the diagram below.



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 | ✓ |

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 these recommendations next year.

| Priority rating for recommendations | | |
|---|---|--|
| <p>● 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.</p> | <p>● 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.</p> | <p>● 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.</p> |

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|------------|--|---|
| 1 | ● (two) | <p>Ledger close arrangements</p> <p>The Council does not close ledger periods during the year, leaving each period open until year end. The Council has consistently applied this process in the past based on the rationale that errors can be corrected after a period more easily and there is no impact on the data transactions are recorded or profiling.</p> <p>However, without a soft close process in place there is a risk of inappropriate back posting which could be used to hide fraudulent transactions, and there is a risk that key control arrangements are undermined, for example in year reconciliations and monthly budgetary control if the ledger balances for a specific period can change at a later date.</p> <p>We recommend that the Council reviews this process, considers the appropriateness of the arrangement and ensures that all control arrangements are effectively designed to ensure that any back-posting is monitored and reviewed.</p> | <p>Agreed</p> <p>We currently keep periods open so that any errors can be corrected in the month in which they arose. However in the light of your comments we are happy to review this process.</p> <p>Head of Corporate Finance 31 December 2011</p> |

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|--------------------|---|--|
| 2 | <p>● (two)</p> | <p>Purchasing control arrangements</p> <p>The Council does not have a formal purchase ordering system in place and does not perform three way matching on purchase invoices. The Council is implementing purchase ordering disciplines through the use of a stand-alone purchase order generating database which will ensure all orders made using the system are in consistent format, however there are no plans to integrate this process with the financial control arrangements and move towards pre-authorisation of purchasing and three-way matching.</p> <p>There are a number of risks presented to the Council due to the lack of a purchase ordering process. Given the challenging financial times, the Council needs to ensure that they have adequate controls on ordering of items and ensures that procurement is operating as efficiently as possible. The current arrangements mean that there is no mechanism by which the Council can ensure that orders are placed within appropriate authorised limits or to gain efficiencies through economies of scale that can be derived from ensuring that purchasing of similar goods across the business is consolidated.</p> <p>The Council should evaluate the benefits of introducing a formal purchase ordering system. This evaluation should consider whether the Council can realise benefits from ensuring that all orders are placed have prior authorisation and through streamlining suppliers. The Council should also consider introducing prospective credit checks on all suppliers as part of adopting any purchase order system, or at least suppliers where the value of orders placed are over a pre-determined threshold.</p> | <p>Agreed</p> <p>This has been recognised as an issue for a number of years but the cost of implementing an integrated purchase ordering system with the current computerised accounting system has in the past been prohibitive.</p> <p>Goods received are certified by a different officer to the one approving the invoice and there are regular audit checks to ensure that authorisation limits are being adhered to. Budget holders regularly review their budgets to ensure that they are not overspent and we are not aware of any specific issues that have arisen</p> <p>The council's medium term aim is to replace the current accounting system to one that would have an integrated purchase order system controlled through workflow processes. This would allow greater control of the whole purchasing function.</p> |

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|--------------|--|--|
| 3 | ● (two) | <p>Journal authorisation and audit trail</p> <p>Our audit work this year has identified a number of journals where there was no authorisation by an officer other than the preparer and where there is limited documentation provided to explain the rationale for the journal. This is principally for journals posted within the finance team, however it is unclear from our review about where formal authorisation is required for specific journal types</p> <p>Whilst it is clear that many journals do not require additional authorisation, for example accrual journals and other accounting adjustment journals posted in year, the lack of consistent documentation means that it is not always possible to confirm whether journals should have required authorisation.</p> <p>We recommend that the Council adopts a formal policy on journal authorisation, with specific rules on different types of journals posted. To support this it is important that the Council also ensures that journal documentation clearly demonstrates the type of journal in each case, so retrospective checks on appropriate approval can be conducted and issues investigated.</p> | <p>Agreed</p> <p>Since the year end as a result of internal audit recommendations all journals over £20,000 are countersigned by the Head of Corporate Finance. We are happy to include extra explanations on journals where appropriate.</p> <p>Head of Corporate Finance 30 September 2011</p> |
| 4 | ● (three) | <p>Review of inactive users on Oracle</p> <p>The Council has undertake exercises in the past to review the access rights of Oracle users who do not use the system. However, there is no arrangement in place to ensure that this review occurs regularly.</p> <p>We recommend that the Council perform this review formally and at set intervals, for example once each year, so that they can gain assurance that the users with access to the ledger system are still appropriate and that their level of access is suitable.</p> | <p>Agreed</p> <p>Most of the users outside the finance department are read only users and as a consequence do not present any particular risk if left on the system. HR inform finance of staff leaving and they are then removed however we are happy to undertake an annual cleaning exercise as suggested</p> <p>Systems Accountant 31 December 2011</p> |

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|--------------------|--|---|
| 5 | <p>● (two)</p> | <p>Payroll system IT controls</p> <p>Our review of IT general controls over the payroll system identified a number of areas where control arrangements could be enhanced. Our work identified that:</p> <ul style="list-style-type: none"> - there is no formal control in place for adding new users to the payroll system and no documentation is maintained to demonstrate authorisation of allocation of or changes to access rights; - segregation of duties are not enforced in the payroll system as the HR team were given edit access to the payroll modules in order to deal with queries raised; and - there are no minimum password criteria for the passwords on the payroll application, meaning simple passwords can be used and there is no requirement for this be updated. <p>The issues identified mean that there is a potential risk that controls over access to the payroll system do not operate effectively.</p> <p>We recommend that the Council:</p> <ul style="list-style-type: none"> - Introduces a standard form to be completed by the Head of HR in order to set up or make changes to payroll system access rights; - removes the HR team's edit access rights to the payroll system; and - Introduces a minimum password criteria that include minimum length of the password, how often it is changed and use of alpha-numeric characters and should be consistent with the IT Security Policy. | <p>Agreed</p> <p>These issues were also raised by internal audit and changes are being implemented currently.</p> <p>Head of Corporate Resources</p> <p>31 December 2011</p> |

| No. | Risk | Issue and recommendation | Management response/ responsible officer/ due date |
|-----|--------------|--|---|
| 6 | ● (two) | <p>Payroll system IT controls</p> <p>There is no audit trail to demonstrate the testing and authorisation of program changes on the payroll application. Testing is performed by the Payroll & HR Systems Manager, however this is not documented, therefore we are unable to verify what testing was performed for any of the changes made during the year.</p> <p>Authorisation is provided following the testing to the IT team to make the update live, however this is done verbally, therefore the only audit trail is an updates log, which states verbal authorisation was received. We could not, therefore, perform testing of the program changes made on the payroll system.</p> <p>We recommend that the Council introduces a formal authorisation process for changes to the payroll system and that documentary audit trail is maintained to demonstrate the process undertaken.</p> | <p>Agreed</p> <p>These issues were also raised by internal audit and are currently being addressed.</p> <p>Head of Corporate Resources</p> <p>31 December 2011</p> |
| 7 | ● (three) | <p>Year end Investment reconciliation</p> <p>The investment reconciliation was prepared and reviewed at the year end, however, an adjustment to the investment accounts was made after the reconciliation had been completed, in respect of impairments to Icelandic deposits.</p> <p>Although the Treasury Accountant was able to demonstrate reconciliation after the adjustment, a revised investment reconciliation had not been prepared.</p> <p>We recommend that revised reconciliations are prepared after adjustments are made to ensure that the ledger and investment records continue to reconcile.</p> | <p>Agreed</p> <p>The Icelandic adjustment is a one off adjustment at the year end and was dependent on the issuing of LAAP 82. We will ensure that reconciling paperwork is provided in future where required.</p> <p>Senior Accountant</p> <p>30 September 2011</p> |



Appendices

Appendix 2: Audit differences

We did not identify any material adjustments during the course of this audit

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 Policy 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

We did not identify any material adjustments during the course of this audit that require reporting.

Uncorrected audit differences

The following table sets out the uncorrected audit differences identified by our audit of Surrey Heath Borough Council's financial statements for the year ended 31 March 2011.

| Income and expenditure statement | Adjustments btw. accounting basis & statute | Impact | | | Basis of audit difference |
|----------------------------------|---|--------|-------------------------|----------------|---|
| | | Assets | Liabilities | Reserves | |
| Cr Council Tax Income £126k | Dr CFAA £35k | | | | The authority has not adjusted the income attributable to the authority from Council Tax per the Collection Fund for the share of the surplus/deficit which relates to other precepting authority when reporting the relevant income in the I&E. This was a change adopted by CIPFA in 2009/10 and needs to be adjusted for future periods. |
| | | | Dr CF Creditors £126 | Cr CFAA £35 | |
| Cr £126k | Dr £35k | - | Cr £126 | Cr £35 | Total impact of adjustments |

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.

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 Policy 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.

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 2011, we confirm that there were no relationships between KPMG LLP and the 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 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 Authority financial statements of Surrey Heath Borough Council ("the Authority"), for the year ended 31 March 2011, for the purpose of expressing an opinion as to whether these:

- i. give a true and fair view of the financial position of the Authority as at 31 March 2011 and of the Authority's income and expenditure for the year then ended; and
- iii. have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

These financial statements comprise the Authority Movement in Reserves Statements, the Authority Comprehensive Income and Expenditure Statements, the Authority Balance Sheets, the Authority Cash Flow Statements, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and the Collection Fund and the related notes.

The Authority confirms that the representations it makes in this letter are in accordance with the definitions set out in the Appendix to this letter.

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 2011 and of the Authority's income and expenditure for the year then ended; and
 - have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

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 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.



Appendices

Appendix 4: 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.

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.
7. 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.
8. 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 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 Authority financial statements communicated by employees, former employees, analysts, regulators or others.
11. 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. Further, 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 all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.
12. 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 2010/11.
13. 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.
14. 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
 - b) all settlements and curtailments have been identified and properly accounted for.

This letter was tabled and agreed at the meeting of the Policy and Audit Scrutiny Committee on 28 September 2011.

Yours faithfully,

Kelvin Menon, Head of Corporate Finance



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