KPMG

External Audit Report 2017/18

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Spelthorne Borough Council

—

28 March 2019

Content

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This report is addressed to Spelthorne Borough Council (the Authority) and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. PSAA issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on PSAA's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Joanne Lees, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (0207 694 8981, andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3H.

Important notice

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This report is presented in accordance with our PSAA engagement. Circulation of this report is restricted. The content of this report is based solely on the procedures necessary for our audit. This report is addressed to Spelthorne Borough Council (the Authority) and has been prepared for your use only. We accept no responsibility towards any member of staff acting on their own, or to any third parties. The National Audit Office (NAO) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the Authority. External auditors do not act as a substitute for the Authority's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

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

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

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

Status of our audit: Our audit is substantially complete and matters communicated in this Report may change pending signature of our audit report. We will provide an oral update on the status of our audit at the Audit Committee meeting. The following work is ongoing:

- Financial statements audit: Review of the narrative sections of the financial statements, including the AGS and final casting and internal consistency checks
- Value for money conclusion: Our work on the value for money conclusion is not yet complete

Summary

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Financial statements audit – see section 2 for further details

Subject to all outstanding queries and procedures being satisfactorily resolved we intend to issue an unqualified audit opinion on the Authority's financial statements.

We have completed our audit of the financial statements. Our key findings are:

- There is one unadjusted audit difference, explained in section 2 and appendix 2.
- We agreed presentational changes to the accounts with Finance, mainly related to compliance with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
- We did not receive any queries or objections from local electors this year.

The audit cannot be formally concluded and an audit certificate issued as we are completing our work on the value for money conclusion. Until we have completed our work, we are unable to certify that we have completed the audit of the accounts in accordance with the requirements of the Local Audit and Accountability Act 2014.

Other matters

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

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

We identified two prior year recommendations that require further action by Management, these have been re-raised in 2017/18. We have made six new recommendations as a result of our 2017/18 work. They key recommendations relate to the Knowle Green Estates Ltd accounts and bank reconciliations. All recommendations are shown in appendix 1.

The fees for this work is explained in section two.

Financial statements audit

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We audit your financial statements by undertaking the following:

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

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

1. Business understanding	In our 2017/18 audit plan we assessed your operations to identify significant issues that might have a financial statements consequence. We confirmed this risk assessment as part of our audit work. We provide an update on each of the risks identified later in this section.
2. Assessment of the control environment	We assessed the effectiveness of your key financial system controls that prevent and detect material fraud and error. We found that the financial controls on which we seek to place reliance are operating effectively. We have made six recommendations which relate to the audit of Knowle Green Estates Ltd, bank reconciliations, the methodology for completing valuations, the notification of accruals to the Finance Team, payroll reconciliations and the recognition of grants. We believe that these recommendations (see appendix 1) will strengthen your control environment.
3. Prepared by client request (PBC)	We produced the PBC to summarise the working papers and evidence we ask you to collate as part of the preparation of the financial statements. We discussed and tailored our request with the Chief Accountant and this was issued as a final document to the finance team.

Financial statements audit

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4. Accounting standards	We work with you to understand changes to accounting standards and other technical issues. For 2017/18 these changes related to: • Updates to the presentation of the Comprehensive Income and Expenditure Statement and the Movements in Reserves Statement and the introduction of the new Expenditure and Funding Analysis; • Amended guidance on the Annual Governance Statement.
5. Accounts Production	We received complete draft accounts by 31 May 2018 in accordance with the deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18. We thank Finance for their cooperation throughout the visit.
6. Testing	We have summarised the findings from our testing of significant risks and areas of judgement in the financial statements on the following pages. have identified presentational changes to the accounts along with a number of audit adjustments which we have presented in appendix 2.
7. Representations	We will provide a draft of our management representation letter when our work on both the financial statements and VFM has been concluded.

Financial statements audit

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

— Significant difficulties encountered during the audit;

— Significant matters arising from the audit that were discussed, or subject to correspondence with Management;

— Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and

— Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, opening balances, public interest reporting, questions/objections, etc.).

There are no others matters which we wish to draw to your attention at this stage in addition to those highlighted in this report or our previous reports relating to the audit of the Authority's 2017/18 financial statements.

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

- The results of the procedures we performed over the valuation of investment properties and land and buildings and the valuation of pension assets and liabilities which were identified as significant risks within our audit plan and which will form a part of our audit opinion;
- The results of our procedures to review the required risks of the fraudulent risk of revenue recognition and management override of control; and
- Our view of the level of prudence applied to key balances in the financial statements.

Financial statements audit

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Authority significant audit risks

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

SIGNIFICANT audit risk	Account balances effected	Summary of findings
Valuation of land and buildings	PPE £57.8m PY £45.6m	The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees land and buildings revalued over a five year cycle. As a result individual assets may not be revalued for four years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. We reviewed the approach that the Authority has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach. We considered movement in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values have moved materially over that time. In relation to those assets which have been revalued during the year we assessed the valuer's qualifications, objectivity and independence to carry out such valuations and review the methodology used (including testing the underlying data and assumptions). As a result of this work we determined that improvements can be made to the way in which the valuations are carried out, however, no exceptions related to the valuation of the investment properties.
Investment properties	Investment properties £635.7m PY £392.1m	The Authority purchased a number of investment properties during the 2017/18 financial year, in addition to the BP Campus which was purchased in 2016/17. There is a risk that such assets, which are outside the Authority's core operations are overvalued and not accounted for correctly within the financial statements. We reviewed the approach that the Authority has adopted to assess the risk that the valuation of investment assets are not materially misstated and consider the robustness of that approach. We assessed the valuer's qualifications, objectivity and independence to carry out such valuations and review the methodology used (including testing the underlying data and assumptions). We reviewed the accounting entries to understand whether the purchase of the properties has been recorded correctly in the accounts. We challenged management around whether there any indicators of impairment. We have identified misstatements related to the way that a rent free period was accounted for related to Hammersmith Grove, however, no exceptions related to the valuation of the investment properties.

Financial statements audit

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SIGNIFICANT audit risk	Account balances effected	Summary of findings
Pension assets and liabilities	Net liability £44.8m PY £44.1m	The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of the Surrey Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018. Valuation of the Local Government Pension Scheme relies on assumptions, most notably actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. Assumptions should reflect the profile of the Authority's employees and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements. As part of our work we reviewed controls that the Authority has in place over the information sent directly to the Scheme Actuary. We liaised with the auditors of the Pension Fund to gain an understanding of the effectiveness of controls operated by the Pension Fund. This included consideration of the process and controls with respect to the assumptions used in the valuation. We reviewed the appropriateness of key assumptions in the valuation, compared them to expected ranges, and consider the need to make use of a KPMG actuary. We reviewed the methodology applied in the valuation by the actuary. In addition, we reviewed the overall Actuarial valuation and consider the disclosure implications in the financial statements. No exceptions were identified. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 13.

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SIGNIFICANT audit risk	Summary of findings
Faster close	In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 draft accounts are required by 31 May and final signed accounts by 31 July. These changes represent a significant change to the timetable that the Authority has previously worked to. The time available to produce draft accounts is reduced by one month and the overall time available for completion of both accounts production and audit is two months shorter than in prior years. To meet the revised deadlines, the Authority needed to make greater use of accounting estimates. In doing so, consideration needed to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. We liaised with officers in preparation for our audit to understand the steps the Authority is taking to meets the revised deadlines. Where there was greater reliance upon accounting estimates we considered the assumptions used and challenge the robustness of those estimates. The financial statements produced for audit in 2017/18 were improved from the prior year, and a timetable had been produced to allow faster close. We have raised one recommendation in relation to ensuring that the close timetable allows for updates to areas of estimate in the accounts, such as accruals (see Appendix 1). At the time of the 2017/18 audit, work was still ongoing on the 2016/17 accounts and VFM conclusion, and work remains ongoing on the 2017/18 VFM conclusion. We note that the Authority did not appoint subsidiary auditors to audit Knowle Green Estates Ltd, instead choosing to take the small companies exemption, which is not permitted for Local Authorities.

Financial statements audit

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Authority other areas of audit focus

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

Other areas of audit focus	Account balances effected	Summary of findings
Group accounts	Group CIES, Group Balance Sheet	The Authority has a wholly owned subsidiary, Knowle Green Estates Ltd and was required to prepare Group Accounts in 2017/18 on the basis of materiality. There is a risk that the assets within the subsidiary are not valued appropriately and that the related party entries disclosed within the Authority accounts are materially misstated. There is also a risk that the disclosures required per applicable Accounting Standards and Code Guidance are not made appropriately within the financial statements. We reviewed the valuation of the assets held within Knowle Green Estates Ltd, including assessing the professional competence of the valuer engaged and reviewing the instructions sent to the valuer. We reviewed and checked the disclosures made within the Authority accounts for accuracy, presentation and compliance with applicable Accounting Standards and Code guidance. As a result of this work we determined that the Authority had incorrectly applied the small company exemption to KGE Ltd in 2017/18. We reviewed transactions related to KGE Ltd and confirmed these had been correctly consolidated into the Group accounts.

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Risks that ISAs require us to assess in all cases	Why	Our findings from the audit
Fraud risk from revenue recognition	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. We do not consider this to be a significant risk for the majority of the Authority's income as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk for Council Tax, Business Rates, Housing rents, annual central Government grants and social services income and do not incorporate specific work into our audit plan in these areas over and above our standard fraud procedures. However, we do consider it for income relating to rental income and grant income with conditions.	We have identified a recommendation around the recognition of government grants.
Fraud risk from management override of controls	Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. We have not identified any specific additional risks of management override relating to this audit.	During our testing of journals we did not identify any issues.

Financial statements audit

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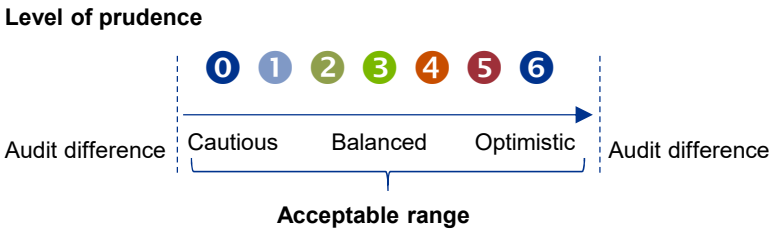
Judgements in your financial statements

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



Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance (£m)**	**KPMG comment**
Provisions (excluding NDR)	3	3	£150k PY: £150k	We consider the provision disclosures to be balanced (excluding the NDR provisions).
NDR provisions	3	4	£2.1m PY: £1.6m	In 2013/14, local authority funding arrangements meant that the Authority is now responsible for a proportion of successful rateable value appeals. The Authority has provided for a fixed percentage of outstanding appeals in accounting for the potential liability, based on historical appeals success rates. In 2017/18 the Authority used an expert to place a value on the NDR appeals which represents a more balanced approach than in previous years when this was done in house. When subject to sensitivity analysis, the appeals provision did not differ materially from the value included within the financial statements which is a positive change to the prior year when a misstatement was identified.
Pension liability	2	3	£44.8m PY: £44.1m	The pension liability has been assessed on an actuarial basis using the projected unit method, an estimate of the pensions that will be payable in future years dependent on assumptions about mortality rates, salary levels, etc. discounted to present values. We have reviewed the accounting entries for pensions supplied by the Surrey Pension Fund actuary, Hymans Robertson, and consider the disclosures to be appropriate. The actual assumptions adopted by the actuary fell within the cautious side of our expected ranges.

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Assessment of subjective areas				
Asset / liability class	**Current year**	**Prior year**	**Balance (£m)**	**KPMG comment**
PPE: asset lives	3	3	No changes noted	Vehicles, plant, furniture and equipment is allocated over the useful life of the asset as defined by a suitably qualified officer. Our work on PPE has not indicated any significant losses on disposal or assets no longer in working order which would indicate that asset lives used are no longer appropriate.
Debtors provisioning	2	2	£1.9m PY: £2.1m	The council had opening balances of £1.9m and has increased its provision by £0.2m This is a result of an increase in the outstanding business rates and housing benefit overpayments. We consider the provision disclosures to be acceptable, though this remains cautious.
PPE	4	4	£46.3m PY: £45.6m	A full valuation took place in 2014/15 before the adoption of a five year rolling valuation programme in 2015/16. 20% of land and buildings were revalued in the current year with no material movements noted. We consider the revaluation basis to be appropriate. The Authority continues its use of the beacon methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. The Authority has utilised an external valuation expert, Kempton Carr Croft, to provide valuation estimates for council assets. We reviewed instructions provided to Kempton Carr Croft and deem that the valuation exercise was generally completed in line with the instructions. We have raised a further recommendation to try and strengthen this process at Appendix One.

Financial statements audit

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Group audit

As the Authority did not employ an auditor to audit the transactions within the Knowle Green Estates Ltd financial statements, to gain assurance over the Authority's group accounts, we tested transactions related to the Authority's subsidiaries:

— Knowle Green Estates Ltd, turnover £0.28m;

A recommendation has been raised relating to this process. There were no issues to note in relation to the consolidation process.

Narrative report of the Authority

We have not yet reviewed the Authority's narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Authority.

Queries from local electors

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

Audit certificate

In order for us to issue an audit certificate, we are required to have completed all our responsibilities relating to the financial year. We are not in a position to issue our audit certificate with the audit opinion as we have not yet completed the work on the value for money conclusion.

Whole of Government Accounts (WGA)

The Authority is required to confirm with HM Treasury whether a WGA return is required to be submitted

Other grants and claims work

We do not undertake other grants and claims work for the Authority that does not fall under the PSAA arrangements.

Audit fees

Our planned fee for the audit was £48,128 excluding VAT (£48,128 excluding VAT in 2016/17). As a result of the complexity of our VFM work relating to the purchase of investment properties subsequent to the BP purchase, we have incurred significant overruns on our audit costs. We will agree an additional fee with the Authority and the PSAA in due course.

Our work on the certification of Housing Benefits (BEN01) is complete. The scale fee for this work was £7,102 excluding VAT (£7,568 excluding VAT in 2016/17).

We have not completed any additional non-audit work at the Authority in the 2017/18 year.

Appendix one

Recommendations raised and followed up

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

Priority rating for recommendations					
1	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.	2	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.	3	Priority three: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

#	Risk	Recommendation	Management Response / Officer / Due Date
Financial statements			
1	1	**Bank reconciliation** Bank reconciliations were not completed on a consistent basis throughout 2017/18. There is no system in place for the preparation of the bank reconciliation on a periodic basis - the year end bank reconciliation had a number of adjustments which could have been avoided if reconciliations were prepared on a monthly basis throughout the year. In addition the bank reconciliation is not completed on an individual bank account basis – the bank reconciliation at year end was completed for all four bank accounts in aggregate, resulting in differences arsing on each bank account which could not be fully reconciled (with an unexplained difference of £12,653). Given the bank reconciliation is a core control, we recommend that a formal process is put in place for the completion of the bank reconciliation on a monthly basis. This should include back up procedures for when key members of staff are out of the office, for example, on annual leave or sick leave. We also recommend that the reconciliation is reviewed by the Chief Accountant each month, and evidence of the review retained. We recommend that bank accounts are reconciled on an individual basis, and not in aggregate.	

Recommendations raised and followed up

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#	Risk	Recommendation	Management Response / Officer / Due Date
Financial statements			
2	1	**Audit of subsidiary** The Authority's subsidiary Knowle Green Estates Limited (KGE) has exercised the Small Company audit exemption. A Local Authority subsidiary is unable to take this exemption as it is not able to meet the Companies Act 2006 requirements. As KPMG are Group auditors and KGE is consolidated, we performed procedures to ensure that the balances relating to KGE were not materially misstated in the Council's Group accounts. As we have not been appointed the auditor of KGE we have no responsibility to the company or its directors, however, as Group Auditors we consider that there is a need to ensure the Council and its subsidiaries comply with relevant legislation. We strongly recommend that the Council appoints an auditor for KGE as a matter of priority for all periods going forward.	
3	2	**Year-end notification of accruals** As part of our testing of post year-end expenses, we identified £221,000 of expenditure incurred in April and May 2018 which related to the 2017-18 financial year. Inquiries of management established that services were given a deadline of early April to notify amounts requiring accrual to Finance, meaning that invoices received after this deadline were omitted. With the faster closedown period now required by LG bodies, there is a risk that the volume of unaccrued expenditure may exist, so giving an inaccurate view of the Council's general fund balance. We recommend that the Council makes greater use of Purchase Order data to identify amounts that may require accruing, and to consider - where possible - giving services additional time to notify accruals to Finance. This could involve, for instance, a second submission at the end of April.	

Recommendations raised and followed up

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#	Risk	Recommendation	Management Response / Officer / Due Date
Financial statements			
4	2	**Valuation of assets** SBC only revalues 20% of PPE each year as per the policy of revaluing assets every five years. As a result of this, there are the total PPE with book values of £44 million which were not revalued this year. This is inconsistent with the accounting standard. We noted that majority of the assets that were not revalued were community assets resulting in possible misstatement of only £433k by non-revaluation. However, it is best practice to revalue all the assets every year or to apply an indexation uplift to the assets not formally valued	
5	2	**Payroll reconciliations** Payroll reconciliations have not been prepared and reviewed on a timely basis throughout the year. This increases the risk of reconciling items not been identified and appropriately followed up. Although we understand that there were no material differences on the year-end payroll reconciliation this risk increases if reconciliations are not prepared and reviewed in a timely manner. We recommend that a formal process is put in place for the completion of the payroll reconciliation on a monthly basis. This should include back up procedures for when key members of staff are out of the office, for example, on annual leave or sick leave. We also recommend that the reconciliation is reviewed by the Chief Accountant each month, and evidence of the review retained.	
6	3	**Categorisation of grants** During our audit, we noted that there is no proper control in place to identify the correct classification of grants between ringfenced and non-ringfenced grants. One grant was misclassified because it had been notified to the Council late by the grant paying body, and there was insufficient time to review the grant and account for it correctly. We recommend that the Council implements procedures to monitor and properly account for grants. This may include a grants register which details current and anticipated grants for categorisation purposes.	

Appendix two

Materiality and reporting of audit differences

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

- Material errors by **value** are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements;
- Errors which are material by **nature** may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff; and
- Errors that are material by **context** are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2017/18, presented to you in March 2018.

Materiality for the Authority's accounts was set at £1 million which equates to around 1.45% of gross expenditure in 2016/17.

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

Reporting to Audit 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 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 £50k 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 Committee to assist it in fulfilling its governance responsibilities.

Audit differences

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Unadjusted audit differences – Authority

Under UK auditing standards (ISA (UK) 260) we are required to provide the Audit Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. In line with ISA (UK) 450 we request that you correct uncorrected misstatements. However, they will have no effect on the opinion in our auditor's report, individually or in aggregate. As communicated previously with the Audit Committee, details of all adjustments greater than £50K are shown.

Authority unadjusted audit differences (£'000)						
#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
1	Dr Cost of Services (Expenditure) £221k	Dr MIRS – General Fund £221k		Cr Short Term Payables £221k	Cr General Fund £221k	During the testing of payments made after 31 March 2018, we identified payments relating to the 2017/18 financial year but recorded in the 2018/19 financial year. We were informed that these transactions relate to expenses that were incurred after the cut-off date for accruals to be notified by services to Finance. The decision on whether this is to be adjusted is still under discussion with management.
Total	**Dr £221k**	**Dr £221k**		**Cr £221k**	**Cr £221k**	**Total impact of uncorrected audit differences**

Unadjusted audit differences – Group

There are no unadjusted audit differences relating to the group accounts not already captured above.

Audit differences

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Adjusted audit differences – Authority

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

We have not reported adjustments to opening balances identified as a result of the 2016-17 audit, which due to timing result in adjustments to the opening balances and some "change/movement in" lines (for instance in the Collection Fund) in the 2017-18 accounts. For further details refer to our report to the Audit Committee dated February 2019.

Authority adjusted audit differences (£'000)						
#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
1	Cr Surplus/Deficit on the revaluation of PPE £732k	Dr Movement in Reserves – Revaluation Reserve £732k	Dr PPE – Land and Buildings £732k		Cr Revaluation Reserve £732k	A portion of the revaluation gain was mixed with an opening balance adjustment for Property, Plant and Equipment (PPE). This adjustment was made through the 2016/17 unaudited accounts.
2			Dr Cash £500k Cr Short Term Investments £500k			The Authority (correctly) reclassified its Short Term Investments as a cash equivalent however in applying the reclassification £500,000 of investments were erroneously not recoded.
3			Cr Short Term Receivables £1,503k	Dr Short Term Payables £1,503k		In applying agency accounting rules to the collection fund balances, some balances with precepting bodies were shown as gross rather than net. This resulted in the Council showing both a debtor and a creditor with itself for its own contribution to the Collection Fund deficit, and other precepting bodies being incorrectly shown gross of provisions and allowances for appeals and bad debts.

Audit differences

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Authority adjusted audit differences (£'000)						
#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
4	Cr Cost of Services (Income) £325k Dr Taxation and Non-Specific Grant Income £325k					A Government grant relating to homelessness was erroneously categorised as a non-ringfenced grant when it is instead reserved only for use of the housing department. We were informed this misstatement arose because of the late notification of the grant to Finance.
5		Dr Movement in Reserves – Capital Adjustment Account (Revaluation) £70k Cr Movement in Reserves – Capital Adjustment Account (Disposals) £70k			Dr Capital Adjustment Account (Revaluation) £70k Cr Capital Adjustment Account (Disposals) £70k	The portion of the revaluation movement in the Capital Adjustment Account and Adjustments between Accounting and Funding Basis notes included a portion relating to the disposal of an asset. These amounts should be entered as two separate rows in each note, leading to no overall impact to either the Movement in Reserves statement or the Capital Adjustment Account.
6	Dr Financing and Investment I&E £8,723k	Cr Movement in Reserves – Earmarked Reserves £8,723k		Cr Short Term Payables £8,723k	Dr Earmarked Reserves £8,723k	The tenants of the Hammersmith Grove building purchased by the Authority have a rent free period which was topped up by the vendor. The correct in-year element of the top up was recognized as income in the year, however the future year element was erroneously credited to revenue rather than receipts in advance when preparing the manual adjustments table.
Total	**Dr £7,991k**	**Cr £7,991k**	**Cr £771k**	**Cr £7,220k**	**Dr £7,991k**	**Total impact of corrected audit differences**

Audit differences

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Adjusted audit differences – Group

To assist the Audit Committee in fulfilling its governance responsibilities we present in the tables below a summary of adjusted audit differences identified during the course of our audit. The adjustments below have been included in the Group MIRS, Balance Sheet and CIES of the financial statements. These adjustments are in addition to those relating to the Authority only.

Note that the first draft of the accounts did not include the Group Accounts but instead a simplified consolidation note. Below we set out the adjustments compared to the first version of the group accounts we received.

Group adjusted audit differences (£'000)						
#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Comments
1	Cr Cost of Services £171k Dr Taxation and Non-Specific Grant Income £21k Dr Surplus/Deficit on revaluation of PPE £1,168k	Cr Movement in Reserves – Income and Expenditure relating to KGE £1,168k Dr Movement in Reserves – Adjustments between KGE and SBC £30k	Cr Property, Plant and Equipment £848k Dr Short Term Receivables £12k	Cr Short Term Payables £50k	Cr Usable Reserves £269k Dr Unusable Reserves £1,154k	A number of differences were identified between the Council's work papers for the consolidation and the published, unaudited accounts for Knowle Green Estates Ltd (KGE). We have raised a recommendation separately relating to the audit of KGE. The most significant movement related to a fair value adjustment of KGE's building. The Council obtained a valuation from its valuer however had not applied this upon consolidation. The majority of the impacts shown to the left reflect the revaluation of the asset and the corresponding impact to unusable reserves.
Total	**Dr £1,018k**	**Cr £1,018k**	**Cr £836k**	**Cr £50k**	**Dr £885k**	**Total impact of corrected audit differences**

Audit differences

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Presentational adjustments

We identified presentational adjustments required to ensure that the Authority's financial statements for the year ending 31 March 2018 are fully compliant with the Code of Practice on Local Authority Accounting in the United Kingdom 2017-18 ('the Code'). Whilst the majority of these adjustments were not significant, we identified a number of adjustments of a more significant (i.e. material) nature and details of these are provided in the following table. All the below matters have been corrected.

Presentational adjustments	
#	**Basis of audit difference**
1	**Group Accounts (Knowle Green Estates Ltd.):** Disclosures related to the subsidiary company were not in line with the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom. This included the provision of more detailed balances related to the subsidiary. The misstatement noted above is in comparison to the first version of the more detailed balances presented to us.
2	**Operating Leases (Council as Lessor):** Due to a formula error, the 2-5 year band was overstated by £31,478k and the 5+ year band was understated by a corresponding amount.
3	**Expenditure and Funding Analysis:** The Council has chosen to re-present the EFA showing the General Fund balance excluding Earmarked Reserves. The 2016-17 comparatives were not restated to make the note consistent. The value of Earmarked Reserves in 2016-17 post-audit were £10,102k.
4	**Financial Instruments:** Due to a combination of the above misstatements and other errors, numerous errors were identified in the Financial Instruments note. The most significant movements were a £3.1m increase in the carrying value of trade receivables, a £2.8m decrease in the carrying value of trade payables, a £1.9m decrease in the fair value of trade receivables, a £42.4m decrease in the fair value of trade payables, and a £2.7m increase in the fair value of long term borrowings
5	**Trade Payables:** Analysis of a specific creditor marked as "Other Entities and Individuals" established that a portion was misclassified. £35k was reclassified from "Other Entities and Individuals" to "Central Government Bodies" and £2,646k was reclassified from "Other Entities and Individuals" to "Other local authorities".
6	**Trade Receivables:** Analysis of a specific debtor **partially** marked as "Other Entities and Individuals" established that a portion was misclassified. The Authority had, unlike with #5 above, did partially classify the debtor correctly. "Central Government bodies" increased by £2,022k. "Other local authorities" fell by £307k. "Other entities and individuals" fell by £1,715k. There was no change to the provision for doubtful debts.

We did not identify any presentational matters which only affected the Group Accounts.

Audit independence

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ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF SPELTHORNE BOROUGH COUNCIL

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

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

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

General procedures to safeguard independence and objectivity

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

The conclusion of the audit engagement leader as to our compliance with the FRC Ethical Standard in relation to this audit engagement is subject to review by an engagement quality control reviewer, who is a partner not otherwise involved in your affairs.

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

Audit independence

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

Summary of fees

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

	2017-18 £
Audit of the Authority (scale fee)	48,102*
Total audit services	**48,102**
Allowable non-audit services	-
Audit related assurance services	-
Mandatory assurance services (housing benefit claim)	7,102
Total Non Audit Services	**55,204**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. There were no non-audit services carried out in year.

* Please note, as a result of the work required to support our VFM conclusion, significant overruns are being incurred. We will discuss the final fee level with management once we have concluded our work.

Audit independence

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

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Allowable non-audit services				
None			0	0
Audit-related assurance services				
None			0	0
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	7,102	7.568
Certification of the housing benefit subsidy return	Required by PSAA so no independence threats identified.			

Audit independence

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Independence and objectivity considerations relating to other matters

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

Confirmation of audit independence

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

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

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

KPMG LLP

Appendix four

Audit quality framework

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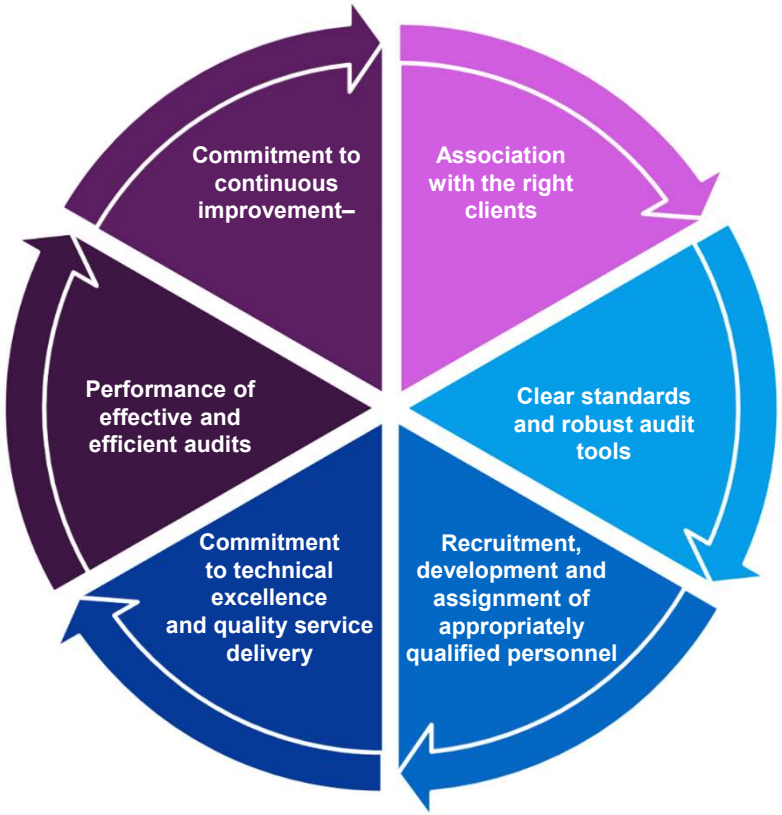
Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent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

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

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



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

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

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

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

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