



cutting through complexity

Report to those charged with governance (ISA 260) 2014/15

East Sussex County Council

July 2015

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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 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 Public Sector Audit Appointment's website (www.psa.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 Philip Johnstone, 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, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@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 3HZ.

This document summarises:

This document summarises:

- the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for the Authority; and
- our assessment of the Authority's arrangements to secure value for money.

Scope of this report

This report summarises the key findings arising from:

- our audit work at East Sussex County Council ('the Authority') in relation to the Authority's 2014/15 financial statements; and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2014/15*, presented to you in March 2015, set out the four stages of our financial statements audit process.



This report focuses on the second and third stages of the process: control evaluation and substantive procedures. Our on site work for these took place during March 2015 (interim audit) and June 2015 (year end audit).

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

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work. We have now completed the work to support our 2014/15 VFM conclusion. This included:

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

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

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

This table summarises the headline messages for the Authority. Sections three and four of this report provide further details on each area.

<p>Proposed audit opinion</p>	<p>We anticipate issuing an unqualified audit opinion on the Authority's financial statements before 30 September 2015. We anticipate issuing an unqualified audit opinion following approval of the Statement of Accounts by the Governance Committee on 21 July and the adoption of the Pension Fund Annual Report by the Pensions Committee on 27 July 2015. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007.</p>
<p>Audit adjustments</p>	<p>Our audit has identified one audit adjustment, which has a total net adjustment value is £32.0 million in 2014/15, and a prior year adjustment value of £36.0 million. This relates to an amendment to the prior year restated figures for the impact of Voluntary Controlled ("VC") Schools being removed from the Council's balance sheet.</p> <p>We have raised a recommendation in relation to the matter highlighted above, which is summarised in Appendix 1.</p>
<p>Key financial statements audit risks</p>	<p>We review risks to the financial statements on an ongoing basis. We identified the following key financial statements audit risks in our 14/15 External audit plan issued in March 2015, and our June 2015 update.</p> <ul style="list-style-type: none"> ▪ Accounting for Local Authority Maintained Schools ▪ Valuation of Property, Plant and Equipment ▪ Management override of controls (required by ISA's) ▪ Fraud risk of revenue recognition (required by ISA's, but rebutted) <p>We have worked with officers throughout the year to discuss these key risks and our detailed findings are reported in section 3 of this report.</p>
<p>Accounts production and audit process</p>	<p>The Authority worked to an accelerated closedown timetable this year with the aim of having an audited set of accounts by 28 July 2015. We agreed with officers that a draft set of financial statements would be made available for audit on 5 June 2015 along with supporting working papers and that the draft financial statements would be made available for public inspection at the same time. Draft financial statements were provided to audit by this date with working papers being provided at the same time.</p> <p>The Authority invested and planned carefully for the accelerated year end timetable, has good processes in place for the production of the accounts and good quality supporting working papers. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales.</p> <p>We have worked with Officers throughout the year to discuss the specific risk areas for this year's audit, and the Council addressed the issues appropriately. We shall debrief with the Council following the audit on areas where further improvements might be made in the future.</p>


<p>Completion</p>	<p>At the date of this report our audit of the financial statements is substantially complete, subject to completion of the following areas:</p> <ul style="list-style-type: none"> ■ Review and testing of the Whole of Government Accounts (WGA) consolidation pack; and ■ Final review and closedown procedures <p>Before we can issue our opinion we require a signed management representation letter from Management.</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>
<p>VFM conclusion and risk areas</p>	<p>We identified the following VFM risks in our External Audit Plan 2014/15 issued in March 2015:</p> <ul style="list-style-type: none"> ■ Bexhill - Hastings Link Road <p>We have worked with officers throughout the year to discuss this VFM risk and our detailed findings are reported in section 4 of this report. There are no matters of any significance arising as result of our audit work in these VFM risk areas.</p> <p>We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.</p> <p>We therefore anticipate issuing an unqualified VFM conclusion before 30 September 2015. It is likely that this will be by 28 July 2015.</p>
<p>Annual Governance Statement</p>	<p>We have reviewed the Annual Governance Statement and confirmed that:</p> <ul style="list-style-type: none"> ■ It complies with <i>Delivering Good Governance in Local Government: A Framework</i> published by CIPFA/SOLACE; and ■ It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.


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


This section sets out our detailed findings on those risks

In our *External Audit Plan 2014/15*, presented to you in March 2015, we identified the significant risks affecting the Authority's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the risks that are specific to the Authority.



Significant audit risk	Issue	Findings
	<p>LAAP Bulletin 101 <i>Accounting for School Assets used by Local Authority Maintained Schools</i> issued in December 2014 has been published to assist practitioners with the application of <i>The Code of Audit Practice</i> in this respect. The challenges relate to school assets owned by third parties such as church bodies and made available to school governing bodies under a variety of arrangements. This includes assets used by Voluntary-Aided (VA) and Voluntary-Controlled (VC) Schools as well as Foundation Schools.</p> <p>Authorities will need to review the agreements under which assets are used by VA/VC and Foundation schools and apply the relevant tests of control in the case of assets made available free of charge, or risks and rewards of ownership in the case of assets made available under leases. This is a key area of judgement and there is a risk that Authorities could omit school assets from, or include school assets in, their balance sheet.</p> <p>Particular risks surround the recognition of Foundation School assets which may or may not be held in Trust. Authorities should pay particular attention to the nature of the relationship between the Trustees and the school governing body to determine whether the school controls the Trust and the assets</p>	<p>The issue of accounting for Local Authority Maintained Schools is a highly complex technical accounting area. In addition, as available documentary evidence is not always available due to the historic nature of past transactions, significant professional judgement may be required in order to ascertain the appropriate ownership of certain schools. The Council have a large number of VC schools which were included in the financial statements up until 2014/15 and represent a high value. This has been a challenging exercise due to the complex historical information and has represented a very challenging accounting issue this year as a result.</p> <p>VA schools within the Council's jurisdiction were removed from the Council's financial statements in 2008. The Council does not have any Foundation Schools within its jurisdiction.</p> <p>The draft financial statements submitted for audit on 5 June 2015 contained a £78.6m Prior Period Adjustment ("PPA") in regard to 48 VC schools which the Council reasonably considered in light of LAAP Bulletin 101 to be substantively owned by the Diocese of Chichester and the Methodist Church Diocese. This assessment was based on the Dioceses' written assertion that they own the schools. As the Council did not any hold conclusive proof to disprove this assertion the Council understandably made a PPA to remove these schools from the Council's balance sheet.</p> <p>There is one further VC school, which was built within the last 5 years and for which the Council is the named legal owner on the school's title deeds, and hence this school remained in the Council's financial statements.</p>

Significant audit risk	Issue	Findings
	<p><i>(continued from overleaf)</i></p> <p>should therefore be consolidated into their balance sheet.</p>	<p><i>(continued from overleaf)</i></p> <p>During the audit we have worked with the Authority to consider these schools fully in light of the applicable guidance and upon review of the newly acquired evidence, including additional legal documentation obtained from the Dioceses' and title deeds from the Land Registry. As part of this, the Council have concluded that:</p> <ul style="list-style-type: none"> - There is supporting documentary evidence to confirm that the Dioceses own 25 of the schools; - Supporting documentary evidence shows that 1 of the schools is owned by two individuals; - As noted above, there is supporting documentary evidence to confirm that the Council owns 1 of the schools and this has always remained on the Council's balance sheet; - There is currently insufficient supporting evidence to confirm the ownership of the remaining 22 schools. <p>As a result, the Council have considered this recent information and amended their financial statements to include these 22 schools in the Council's financial statements where ownership is not currently certain.</p> <p>We understand that the Diocese of Chichester is currently undertaking a process to review these schools and to register the Diocese as the legal owners where they can conclusively prove that they are legally theirs. It is therefore possible that some or all of these 22 schools may be removed from the Council's financial statements in future years but this will only be done where ownership is conclusively proven.</p> <p>This amendment is the material adjustment referred to on page.3 of this report and represents the adjustments contained within Appendix 2 to this report.</p>

Significant audit risk	Issue	Findings
	<p>In 2013/14 the Council reported Property, Plant and Equipment in its financial statements of £874m. The Council must exercise judgement in determining the fair value of the different classes of assets held and the methods used to ensure that the carrying values recorded each year reflect those fair values. The Council has undertaken a full valuation as at 31 March 2015, with all Council assets being revalued, with the exception of some specialised Waste and Waste PFIs which were revalued in 2012/13.</p> <p>Given the materiality in value and the judgement involved in determining the carrying amounts of assets we consider this to be a significant audit risk for 2014/15.</p>	<p>We undertook detailed testing of Property, Plant and Equipment as part of our final accounts audit, including specific detailed testing of the asset valuation. We have critically considered the valuation methodology adopted by the Council's valuers and benchmarked this against national indices in order to confirm that the valuation is reasonable. We have considered the basis on which the valuation has been carried out to ensure it is in line with <i>The Code of Practice on Local Authority Accounting in the United Kingdom 2014-15</i>. We have also carried out detailed testing to ensure that revaluation gains and losses have been correctly reflected in the financial statements.</p> <p>We have also considered an impairment review undertaken by the Council's valuer.</p> <p>We have raised a recommendation around the process of undertaking and substantiating valuations in Appendix 1.</p>

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risk	Summary of findings
 <p>Audit areas affected</p> <ul style="list-style-type: none"> ■ All areas 	<p>Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit.</p> <p>In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.</p> <p>There are no matters arising from this work that we need to bring to your attention.</p>
 <p>Audit areas affected</p> <ul style="list-style-type: none"> ■ None 	<p>Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.</p> <p>In our <i>External Audit Plan 2014/15</i> we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.</p> <p>This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.</p>

Financial Statements (continued)

Accounts production and audit process

The Authority has a well established and strong accounts production process. This operated well in 2014/15, and the standard of accounts and supporting working papers was good.

Officers dealt promptly and efficiently with audit queries and the audit process was completed within the planned timescales.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit. Overall we consider this to be a commendable performance especially in light of the accounts timetable being brought forward.

We considered the detailed following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority continues to maintain a strong financial reporting process and produce statements of accounts to a good standard. We consider that accounting practices are appropriate
Completeness of draft accounts	<p>We received a complete set of draft accounts on 5 June 2015. Given the accelerated deadline that the Authority has worked to, we considered the draft financial statements to have been prepared to a high standard.</p> <p>As detailed on page 3, the Authority has made a material amendment to the PPA reported in regard to VC schools being removed from the balance sheet. Due to its nature this impacts on several areas of the Authority's accounts, and the detailed adjustments relating to this item are set out in Appendix 2. Whilst this is considered to be a material adjustment we consider that the Council has made this in light of information that was not available to it at the time the draft financial statements were submitted on 5 June 2015.</p> <p>In addition, the Authority have made a small number of presentational and disclosure changes to the accounts presented for audit.</p>
Quality of supporting working papers	<p>We issued our <i>Accounts Audit Protocol</i> including our required working papers for the audit on 25 March 2015.</p> <p>The quality of working papers provided was good and met the standards specified in our <i>Accounts Audit Protocol</i>.</p>
Response to audit queries	Officers resolved all audit queries in a timely manner and were helpful and supportive throughout the audit process.
Prior year recommendations	<p>As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report.</p> <p>The Authority has implemented all of the recommendations in our <i>ISA 260 Report 2013/14</i>.</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.

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 East Sussex County Council for the year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and East Sussex County Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

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

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Chief Finance Officer for presentation to the Governance Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

- significant difficulties encountered during the audit;
- significant matters arising from the audit that were discussed, or subject to correspondence with management;
- other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the

financial reporting process; and

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

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

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

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

Background

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

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

We follow a risk based approach to target audit effort on the areas of greatest audit risk. We consider the arrangements put in place by the Authority to mitigate these risks and plan our work accordingly.

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

Work completed

We performed a risk assessment earlier in the year and have reviewed this throughout the year.

The following page includes further details of our VFM risk assessment our specific risk-based work.

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 identified a number of specific VFM risks.

In all cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Authority's current arrangements in relation to these risk areas are adequate.

Work completed

In line with the risk-based approach set out on the previous page, and in our *External Audit Plan* we have:


- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;

- considered the results of relevant work by the Authority, inspectorates and review agencies in relation to these risk areas; and
- completed specific local risk based work.

Key findings

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

We concluded that we needed to carry out additional work for the identified specific risk. This work is now complete and we also report on this below.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	<p>In 2014/15 the Authority has made £24m capital expenditure towards the construction of the Bexhill – Hastings Link Road project, out of a total budget of £116.4m. Of this, £56.8m has been funded by the Department for Transport, and the remaining funded by the Authority.</p> <p>Concerns have been made regarding the appropriateness of the project management arrangements and approval processes within the Council, and the wider value for money of the scheme. We note that we have received a formal objection from an elector regarding this scheme.</p> <p>This is relevant to both the financial resilience and economy, efficiency and effectiveness criteria of the VFM conclusion.</p>	<p>The total revised budget for the Link Road scheme is £116.4m as at February 2015. This is compared to the original approved budget of £101.1m, resulting in an overspend over the life of the project of £15.3m. There is also a potential future additional compensation to the Contractor of £13m, however the amount and likelihood of payout is as yet undetermined.</p> <p>During our audit we have reviewed the project management and overall approval processes utilised during the planning and construction of the Link Road. We have also considered the value of the overspend on the Link Road project as set out above, and its comparability to the Authority's other similar capital projects.</p> <p>Based on this, we are generally satisfied that the overspend against budget in 2014/15 is not material, and that based on available evidence, we have not identified any material weakness in programme or project management arrangements of what has been a highly complex scheme which impact on our Value for Money Conclusion.</p> <p>There are no matters arising from this work that we need to bring to your attention.</p>

We give each recommendation a risk rating and agree what action management will need to take. Progress against recommendations should be monitored closely during the year.

Recommendations raised will be followed up as part of our 2015/16 financial statements audit.

Priority rating for recommendations		
<p>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.</p>	<p>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.</p>	<p>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.</p>

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	2	<p>Substantiating valuation arrangements</p> <p>KPMG identified difficulty in substantiating fixed asset revaluations contained within the financial statements, and evidencing judgmental decisions made the Council in the valuation process. Such difficulties included tracking the fixed asset register to valuation reports, following up discrepancies between the valuation reports and asset values in the financial statements, and evidencing a robust impairment review had been appropriately carried out for those assets not revalued as at 31 March 2015.</p> <p>Recommendation</p> <p>It is recommended that all revaluations are clearly mapped back to the instructions to the valuers, and to the valuation reports provided by the Council's valuer. Where assets are recorded in the financial statements at a value different to the valuation provided by the Council's valuer, the explanation for why this is needs to be adequately documented to support this. In addition, the Council must ensure that where an asset has not been valued at the balance sheet date, that an appropriate impairment exercise is carried out to ensure that there is not a material difference between the carrying value and the fair value of the asset.</p>	<p>Agreed</p> <p>Future asset revaluations will be mapped back to the instructions to the valuers, and the valuation reports provided by the Council's valuer. In addition, the Council will ensure an appropriate impairment exercise is carried out where an asset has not been valued at the balance sheet date, to ensure there is no material difference between the carrying value and the fair value of the asset.</p> <p>Responsible Officer</p> <p>Head of Accounts and Pensions</p> <p>Due date</p> <p>November 2015</p>

This appendix sets out the significant audit differences identified during the audit for the year ended 31 March 2015.

We are reporting all audit differences over £0.8m.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit, Best Value and Community Services 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.

Uncorrected audit differences

We are pleased to report that there are no uncorrected audit differences.

Corrected audit differences

We have identified one significant audit difference during our audit of East Sussex County Council's financial statements for the year ended 31 March 2015. This is in relation to the treatment of Voluntary Controlled schools as discussed on page 3. As this affects the Prior Period Adjustment and a number of account balances, we have presented below the impact in each year of the adjustment for each of the three key primary statements:

Restated Balance Sheet as at 31 March 2013			
£000	Pre-audit	Post-audit	Movement
Property, plant and equipment	797,194	827,354	30,160
Net worth	276,924	307,082	30,160
Unusable reserves	54,789	84,949	30,160
Total reserves	276,922	307,082	30,160
Restated Balance Sheet as at 31 March 2014			
£000	Pre-audit	Post-audit	Movement
Property, plant and equipment	785,302	818,037	32,735
Net worth	229,555	262,290	32,735
Unusable reserves	(4,743)	27,992	32,735
Total reserves	229,555	262,290	32,735
Balance Sheet as at 31 March 2015			
£000	Pre-audit	Post-audit	Movement
Property, plant and equipment	806,458	842,541	36,083
Net worth	137,960	174,043	36,083
Unusable reserves	(78,247)	(42,164)	36,083
Total reserves	137,960	174,043	36,083

Appendix 2: Audit differences (continued)

Restated Comprehensive Income and Expenditure Statement 2013/14

£000	Pre-audit	Post-audit	Movement
Gross Expenditure - Education and Children's Services	444,660	443,365	(1,295)
Cost of Services (Net)	407,550	406,255	(1,295)
Deficit on Provision of Services	15,386	14,091	(1,295)
Surplus on Revaluation of Non-Current Assets	(20,712)	(21,992)	(1,280)
Other Comprehensive Income and Expenditure	31,981	30,701	(1,280)
Total Comprehensive Income and Expenditure	47,367	44,792	(2,575)

Comprehensive Income and Expenditure Statement 2014/15

£000	Pre-audit	Post-audit	Movement
Gross Expenditure - Education and Children's Services	431,301	432,926	1,625
Cost of Services (Net)	389,641	391,266	1,625
Other Operating Expenditure	63,592	58,749	(4,843)
Deficit on Provision of Services	45,619	42,401	(3,218)
Surplus on Revaluation of Non-Current Assets	(51,881)	(52,011)	(130)
Other Comprehensive Income and Expenditure	45,977	45,847	(130)
Total Comprehensive Income and Expenditure	91,596	88,248	(3,348)

Appendix 2: Audit differences (continued)

Movements in Reserves Statement 2014/15			
£000	Pre-audit	Post-audit	Movement
County Fund Balance			
Deficit on the provision of services	(15,386)	(14,091)	1,295
Adjustments between Funding Basis and Accounting Basis under Regulations	30,786	29,491	(1,295)
Unusable Reserves			
Prior Period Adjustment	66,705	36,545	30,160
Other Comprehensive Income and Expenditure	(31,981)	(30,701)	1,280
Adjustments between Funding Basis and Accounting Basis under Regulations	(27,551)	(26,256)	1,295
Total County Reserves	229,555	262,290	32,735
Movements in Reserves Statement 2014/15			
£000	Pre-audit	Post-audit	Movement
County Fund Balance			
Deficit on the provision of services	(45,619)	(42,401)	3,218
Adjustments between Funding Basis and Accounting Basis under Regulations	44,020	40,802	(3,218)
Unusable Reserves			
Other Comprehensive Income and Expenditure	(45,977)	(45,847)	130
Adjustments between Funding Basis and Accounting Basis under Regulations	(27,527)	(24,309)	3,218
Total County Reserves	137,960	174,043	(36,083)

The Code of Audit Practice requires us to exercise our professional judgement and act independently of both Public Sector Audit Appointments Ltd and the Authority.

Requirements

Auditors appointed by Public Sector Audit Appointments Ltd 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 Public Sector Audit Appointments Ltd *Terms of Appointment* ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* ('Ethical Standards').

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

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.

- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our *Annual Audit Letter*.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit, Best Value and Community Services 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 Engagement Lead 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 East Sussex County Council for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and East Sussex County Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

For 2014/15 our materiality is £16.5 million for the Authority's accounts.

We have reported all audit differences over £0.8 million for the Authority's accounts.

Materiality

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

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

We used the same planning materiality reported in our External Audit Plan 2014/15, presented to you in March, 2015

Materiality for the Authority's accounts was set at £16.5m which equates to around 2 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit, Best Value and Scrutiny 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, Best Value and Scrutiny 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 £0.8m 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, Best Value and Scrutiny Committee to assist it in fulfilling its governance responsibilities.

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.

We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Philip Johnstone as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly

technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.



Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.

- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.

- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery:

Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (<http://www.psa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/>).

The latest Annual Regulatory Compliance and Quality Report (issued June 2014) showed that we are meeting the overall audit quality and regulatory compliance requirements.



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