cutting through complexity

Report to those charged with governance (ISA 260) 2015/16

East Sussex County Council

15 July 2016

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission 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.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 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, Andrew Sayers (on 0207 694 8981, or by email to 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 3HZ.

Section one

Introduction

This document summarises:

This document summarises:

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

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2015/16 presented to you in April 2016, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key objectives, requiring us to audit/review and report on your:

- *Financial statements (including the Annual Governance Statement):* Providing an opinion on your accounts; and
- *Use of resources:* Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).
- The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary

Financial statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.

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 2016 (interim audit) and June 2016 (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 Arrangements Work

Our *External Audit Plan 2015/16* explained our risk-based approach to VFM work. We are in completion stage of our work to support our 2015/16 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- 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 2015/16 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.

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Headlines

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

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements on 19 July 2016 following approval of the Statement of Accounts by the Governance Committee on 19 July 2016 and the adoption of the Pension Fund Annual Report by the Pensions Committee on 18 July 2016. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA.
Audit adjustments	In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities. We did not identify any uncorrected audit differences. We identified one corrected audit difference which relates to a reclassification of fixed assets, with no impact on the CIES or Reserves.
Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified the following key financial statements audit risks in our 2015/16 External audit plan issued in March 2016. ▪ 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) 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.
Accounts production and audit process	The Authority worked to an accelerated closedown timetable this year with the aim of having an audited set of accounts by 19 July 2016. We agreed with officers that a draft set of financial statements would be made available for audit on 6 June 2016 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 on 31 May 2016 and working papers were provided in line with the timetable. 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. 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. We anticipate any improvements identified will be of a minor nature.

Headlines

Completion	At the date of this report our audit of the financial statements is substantially complete, subject to completion of the following areas: ▪ Review and testing of the Whole of Government Accounts (WGA) consolidation pack; ▪ Journals Testing; ▪ Completion of final testing on low risk accounts and disclosures; and ▪ Final review and closedown procedures. Before we can issue our opinion we require a signed management representation letter from Management. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	We identified the following VFM risks in our External Audit Plan 2015/16 issued in March 2016: ▪ Bexhill - Hastings Link Road ▪ Better Care Fund 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. We have concluded that the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an unqualified VFM conclusion by 19 July 2016.
Annual Governance Statement	We have reviewed the Annual Governance Statement and confirmed that: ▪ It complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and ▪ It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Financial Statements
Significant risks and key areas of audit focus

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

This section sets out our detailed findings on those risks

In our *External Audit Plan 2015/16*, presented to you in March 2016, we identified the significant risks affecting the Authority's 2015/16 financial statements. We are in the completion phase of our audit and have set out our evaluation of our substantive work done so far.

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

Significant audit risk	Issue	Findings
	Risk: LAAP Bulletin 101 Accounting for School Assets used by Local Authority Maintained Schools issued in December 2014 has been published to assist practitioners with the application of the Code in regard to accounting for Local Authority maintained schools. 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. In the last financial year, management reviewed the agreements under which assets are used by VA/VC and Foundation schools and applied 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. During the audit, we 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 concluded that there was insufficient supporting evidence to confirm the ownership of the remaining 22 schools. As a result, the Council included these 22 schools in the Council's financial statements where ownership is not currently certain. At that time, we also understood that the Diocese of Chichester was 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. 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. Approach: As part of our audit, we will discuss with the Authority the latest available information on the remaining schools and review the judgements it has made in this regard. This will include considering the Authority's application of the relevant accounting standards to account for these schools and challenging its judgements where necessary.	Throughout our audit, we have discussed the treatment of the remaining 22 schools. As at the date of drafting this report, no additional information has been obtained on the remaining schools and the Council are waiting on the Diocese of Chichester to undertake the process to review these schools and to register the Diocese as the legal owners. We find that the position has not changed since last year and conclude that the accounting treatment should remain the same. We therefore agree with management to leave these assets on the Council's Balance Sheet.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

Other areas of audit focus	Issue	Findings
	Risk: In 2014/15 the Council reported Property, Plant and Equipment of £842.5m. Local authorities exercise judgement in determining the fair value of the different classes of assets held and the methods used to ensure the carrying values recorded each year reflect those fair values. Given the materiality in value and the judgement involved in determining the carrying amounts of assets we consider this to be an area of audit focus. Approach: We will understand the approach to valuation, the qualifications and reports by the Council's valuer and the judgements made by the Council in response to the information received. Where valuations are made other that at the year end we will review the Council's judgement in assessing movements from the valuation date.	We have undertaken testing of the Council's Property, Plant and Equipment within our final accounts testing with emphasis on the significant risk over Valuation. We have reviewed the valuation report received from the External Valuer including the assumptions and methodology applied, confirming that the valuation has been performed in line with the requirements outlined in The Code of Practice on Local Authority Accounting in the United Kingdom 2015/16. We have reviewed the Council's year end impairment methodology forming part of the rolling-three year valuation plan, which involves indexation based on the External valuation which is subsequently applied to the remaining assets. We consider that the methodology is appropriate and have undertaken testing to ensure the methodology has been applied correctly. We have undertaken further testing to ensure that revaluation gains and losses have been appropriately reflected in the financial statements. We have not identified any issues to note in our testing.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In our *External Audit Plan 2015/16* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. 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
Management override of controls	Audit areas affected ▪ All areas	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. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. There are no matters arising from this work that we need to bring to your attention.
Fraud risk of revenue recognition	Audit areas affected ▪ None	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. In our External Audit Plan 2015/16 we reported that we do not consider this to be a significant risk for Local Authorities or their administered Pension Funds as there is unlikely to be an incentive to fraudulently recognise revenue. This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Financial Statements (continued)
Accounts production and audit process

The Authority has a well established and strong accounts production process. This operated well in 2015/16, 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	We received a complete set of draft accounts on 31 May 2016. Given the accelerated deadline that the Authority has worked to, we considered the draft financial statements to have been prepared to a high standard. The Authority have made a small number of presentational and disclosure changes to the accounts presented for audit.
Quality of supporting working papers	We issued our *Accounts Audit Protocol* including our required working papers for the audit on 18 March 2016. The quality of working papers provided was good and met the standards specified in our *Accounts Audit Protocol*.
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	As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report. The Authority has implemented our recommendation in our *ISA 260 Report 2014/15*.

Financial Statements (continued) Completion

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

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

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of East Sussex County Council for the year ending 31 March 2016, 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.

VFM conclusion

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

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

Background

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'
The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria. These sub-criteria provide a focus to our VFM work at the Council. The full guidance is available from the NAO website at: https://www.nao.org.uk/code-audit-practice/guidance-and-information-for-auditors/. Our approach to the value for money is recorded below:

Work completed

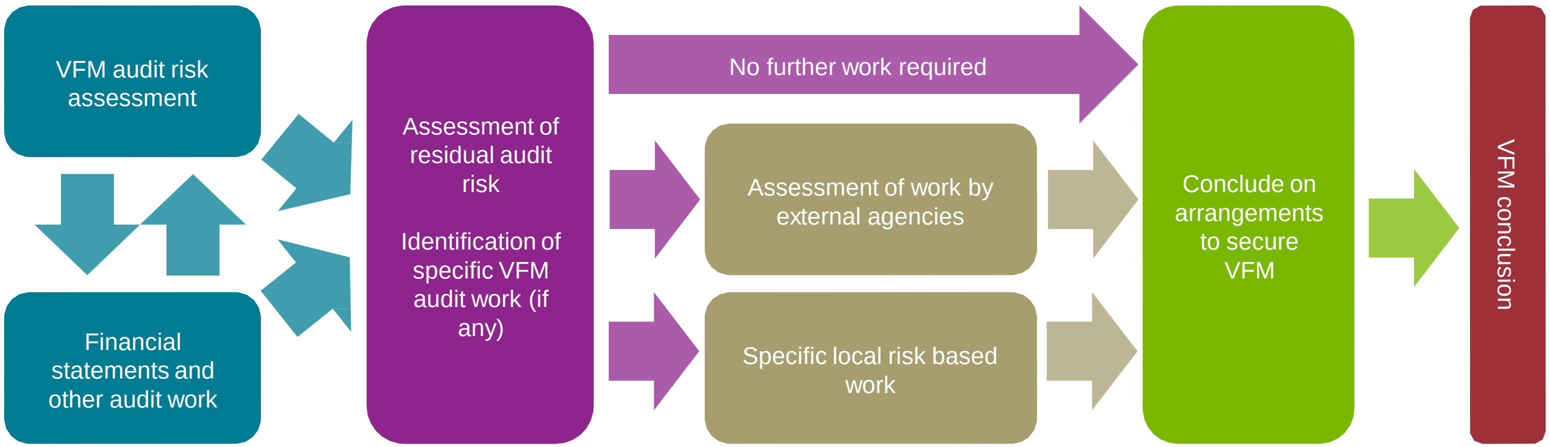
We performed a risk assessment earlier in the year and have reviewed this throughout the year.

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	✓



Specific VFM risks

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
Hastings Link Road	Risk: In 2015/16 the Authority made substantial expenditure towards the construction of the Bexhill – Hastings Link Road project, which was opened on 17th December 2015. Of this, £56.85m has been funded by the Department for Transport, and the remaining funded by the Authority. Total expenditure over the life of this project has been estimated at £125.7m. We note that we have received a formal objection from an elector regarding this scheme, in which the objector raises a concern regarding the appropriateness of the project management arrangements and approval processes within the Council, and the wider value for money of the scheme.	Bexhill-Hastings Link Road was opened on 17th December. The total final cost of the project is expected to be £125.7m. This results in an overspend of £24.6m when compared to the original budget of £101.1m. There is a remaining payment of apx. £3.7m to the contractor which has been re-profiled into 2016/17 and will be paid during the year. This is due to landscaping works which are expected to be completed in July 2016. During our audit, we have reviewed the project management and overall approval processes utilised during the planning, construction and completion 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. Based on this, we are generally satisfied that the overspend against budget is not uncommon with large capital projects of this nature, 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. There are no matters arising from this work that we need to bring to your attention. The consideration of the objection is still continuing.

Specific VFM risks (continued)

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.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Better Care Fund	Risk: The Better Care Fund was set up by Government to encourage joint work across health and adult social care to ensure local people receive better care. Joint arrangements have been established with NHS Eastbourne, Hailsham and Seaford Clinical Commissioning Group, NHS Hastings and Rother Clinical Commissioning Group and NHS High Weald Havens Clinical Commissioning Group to administer the local Better Care Fund (2015/16 expenditure £42.214m). As the arrangements are new, crossing the health and social care boundary with organisations who have different legal structures there is a risk that the governance and accounting arrangements may not be well developed to manage this partnership arrangement appropriately	The Better Care Fund was set up in April 2015 between the CCG's and the Council with the Council being the host. During our audit work we reviewed the s75 agreement between the CCG's and the Council. This agreement lays down the amount of contribution from each party and a scheme of investments for the use contributions. The agreement sets down the joint commissioning wherein individual partners contract with individual partners. The BCF pooled budget operates within the governance of the East Sussex Better Together Programme Board who are reported on a monthly basis. Regular updates are also provided to the Health and Wellbeing Board. We have reviewed the board meeting minutes and there is evidence of information being provided to the ESBT and Health and Wellbeing Board. Quarterly returns relating the Better Care Fund performance are also submitted to the NHS England. The accounting for the BCF was done under the *MFA Chapter 3- Annex 1 Accounting for the Better Care Fund: Scenario 2*. Where pooled budget members via an s75 agreement, agree that individual members will continue to contract with individual providers without reference to other members and using their own sources of funding alone will in substance will neither be joint operations nor lead commissioner transactions. These are stand-alone arrangements involving only one-to-one transactions. In this event, accounting and AoB considerations are simplified as there are only two parties to the transaction. Based on this, we are satisfied that the Better Care Fund has appropriate structures in place to review the performance and functioning of the Better Care Fund. We are also satisfied that it is being accounted for appropriately.

Appendix 1: Key issues and recommendations

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 2016/17 financial statements audit.

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

Current year recommendations

We have not identified any control findings or other recommendations in the course of our audit which we would like to bring to your attention.

Appendix 2: Follow up of prior year recommendations

We follow up on recommendations raised as part of our 2014/15 financial statements audit.

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

No.	Risk	Issue and recommendation	Action taken
1	❷	**Substantiating valuation arrangements** 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. **Recommendation** 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.	The process of mapping current year asset revaluations back to the instructions to the valuers, and the valuation reports provided by the Council's valuer was improved. Assets were revalued at the balance sheet date, and an appropriate impairment exercise was carried out for all assets that were not revalued. In response to the recommendation in the prior year, and the migration from the SAP Real Estate module to the SE7 Property Asset Management System (Atrium), management performed a full review of the fixed asset register. This exercise was undertaken in 2015/16 and sought to analyse and correct any discrepancies between the March 2015 valuation report and the fixed asset register. As a result of this exercise, management identified duplicate asset components or components that should no longer be recognised, totalling £8.7m. These have been included in disposals in the year and we concur with this accounting treatment. **Further action required** None.

Appendix 3: Audit differences

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

We are reporting all audit differences over £490 thousand.

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

Under UK auditing standards (ISA UK&I 260) we are required to provide the Audit, Best Value and Community Services Scrutiny Committee with a summary of adjusted audit differences (including disclosures) identified during the course of our audit. The adjustments below have been included in the financial statements. We have also identified a number of presentational adjustments as part of our audit, all of which have been discussed and agreed with management.

Adjusted audit differences (£m)				
No.	Detail	CIES Dr/(cr)	Balance Sheet Dr/(cr)	Comments
1	Dr PPE Cr PPE	- -	£1,404,000 (£1,404,000)	During the year the Council re-classified an asset with gross book value of £1.404m from Land and Building to Surplus Assets. Through our testing we identified that this asset was still in operation during 2015/16 and therefore no re-classification was required. The PPE note (Note 13) has been updated to reflect this re-classification.
2	When drafting the Leases note (Note 41), there was a formulae error in the clients working paper. As a result, incorrect values were pulling through into the note. The total differences were: • £1,078k overstatement of the present value of future lease payments as a lessee • £188k overstatement of the present value of future lease payments receivable as a lessor. The Note has been updated to reflect these changes.			
Total		-	-	

Appendix 4: Declaration of independence and objectivity

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.

Appendix 4: Declaration of independence and objectivity (continued)

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

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

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

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

Auditor declaration

In relation to the audit of the financial statements of East Sussex County Council for the financial year ending 31 March 2016, 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.

Appendix 5: Materiality and reporting of audit differences

For 2015/16 our materiality is £9.8 million for the Authority's accounts.

We have reported all audit differences over £490 thousand 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.

At the year end, we revised our planning materiality reported in our External Audit Plan 2015/16, presented to you in March, 2016.

Due to the final outturn in the accounts, with an increase in the County Fund balance, we increased materiality for the Authority's accounts from £8.5m to £9.8m. Our revised materiality equates to around 1 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 £490k 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 6: 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.

Appendix 6: KPMG Audit Quality Framework (continued)

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.psaa.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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