

Annual Regulatory Compliance and Quality Report

KPMG LLP June 2015

Audit 2014/15

Public Sector Audit Appointments Limited (PSAA) is an independent company limited by guarantee incorporated by the Local Government Association in August 2014.

The Secretary of State for Communities and Local Government delegated statutory functions (from the Audit Commission Act 1998) to PSAA by way of a letter of delegation issued under powers contained in the Local Audit and Accountability Act 2014.

The company is responsible for appointing auditors to local government, police and local NHS bodies, for setting audit fees and for making arrangements for the certification of housing benefit subsidy claims.

Before 1 April 2015, these responsibilities were discharged by the Audit Commission.

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Summary report

Introduction

- 1 Public Sector Audit Appointments Limited (PSAA) monitors the performance of all its audit firms. The results of our monitoring provide audited bodies and other stakeholders with assurance that auditors within our regime are delivering high-quality audits.
- 2 There are two strands to our monitoring:
 - audit quality- applying our annual quality review programme (QRP) to the audit work undertaken for the year ending 2013/14; and
 - regulatory compliance- reporting quarterly on audit firms' compliance with our 2014/15 regulatory requirements as set out in the Terms of Appointment^I.
- 3 The audit quality and regulatory compliance monitoring for 2014/15 incorporated a range of measurements and checks comprising:
 - a review of each firm's latest published annual transparency reports;
 - the results of reviewing a sample of each firm's audit quality monitoring reviews (QMRs) of its financial statements, Value for Money (VFM) conclusions, Whole of Government Accounts (WGA) and housing benefit (HB COUNT) work. Our review included assessing compliance with the HB COUNT guidance;
 - an assessment as to whether we could rely on the results of each firm's systems for quality control and monitoring^{II};
 - a review of the Financial Reporting Council's (FRC) published report on the results of its inspection of firm audits in the private sector;
 - the results of our inspection of each firm by the FRC's Audit Quality Review team (AQR) as part of our commissioned rolling inspection programme of financial statements and VFM work;
 - the results of each firm's compliance with 17 key indicators relating to Terms of Appointment requirements^{III};
 - a review of each firms' systems to ensure they comply with our regulatory requirements^{IV}; and
 - a review of each firm's client satisfaction surveys for 2013/14 work.
- 4 This report summarises the results of our monitoring work for KPMG LLP (KPMG).

^I Previously these requirements were set out in the Standing Guidance for Auditors issued by the Audit Commission.

^{II} These assessments were undertaken by the Audit Commission prior to 1 April 2015.

^{III} Results of compliance against the 17 indicators were published by the Audit Commission prior to 1 April 2015.

^{IV} These assessments were undertaken by the Audit Commission prior to 1 April 2015.

Overall performance

5 The firm is meeting our standards for overall audit quality and our regulatory compliance requirements. We calculated the red, amber, green (RAG) indicator for overall audit quality and regulatory compliance using the principles detailed in Appendices 1 and 2. For 2014/15, KPMG's combined audit quality and regulatory compliance rating was amber.

Figure 1: 2015 Comparative performance for audit quality and regulatory compliance

BDO	DT	EY	GT	KPMG	Mazars	PwC
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6 The firm has maintained its performance against the regulatory compliance indicators since last year, with all but one of the 2014/15 indicators scored as green. However, the firm's overall weighted audit quality score has decreased slightly from last year.

7 The satisfaction survey results show that audited bodies are satisfied with the performance of KPMG as their auditor.

Detailed report

Quality review programme

FRC Inspection

8 Every year each firm provides a self-assessment in the form of a statutory transparency report. Our review of the KPMG transparency report did not highlight any significant issues of note.

9 Annually, the FRC publishes reports on the audit firms subject to full scope FRC inspections (including firms in our regime), as well as an overall annual report. We place reliance on the work of the FRC, which reviews the firms' systems and processes for ensuring audit quality and reviews a sample of their audits of public interest entities. In its latest public report (May 2015) on the firm, the FRC concluded that audit procedures were performed to a good or acceptable standard for 19 of the audit engagements reviewed, with one audit requiring significant improvement.

10 In addition, the FRC produces an annual overview report on the profession based on its audit quality inspection activities in the year. The FRC's overall conclusion in this report was that '*...the 2014/15 inspection results are consistent with our overall judgment that audit quality is improving.*' (FRC Annual Report 2014/15, 29 May 2015).

11 The FRC have identified key issues in its annual report which, profession wide, should be addressed in order to improve audit quality. These were:

- a need for auditors to improve their scepticism in challenging the appropriateness of assumptions in key areas of audit judgment such as impairment testing and property valuation;
- a need for an improvement in the sufficiency and appropriateness of audit procedures being performed. This is common to many audit areas including revenue recognition; and
- a need to adequately identify the threats and related safeguards to auditor independence and to appropriately communicate these to audit committees.

12 We have raised these issues with KPMG and with all other firms in our regime; and we will continue to monitor progress in these areas.

13 We also commissioned inspections of all firms by the FRC for this year's QRP. The AQR inspected two 2013/14 audit files and one VFM conclusion file from KPMG's PSAA work and did an updated commentary on the applicability of firm-wide procedures to our audits. Having considered the review points raised by the AQR, we assessed the audits inspected as acceptable with limited improvements required and acceptable overall with improvements required for the financial statements audits and as acceptable overall with improvements required for the VFM conclusion work.

14 The improvement points raised by the AQR, from across the firms, following this year's programme of work for PSAA were:

- a continuing need to review, challenge and consider the reasonableness of management's documents and assumptions with respect to evidence obtained for the VFM conclusion, particularly in relation to increasing funding gaps at local government organisations; and in relation to the consideration of savings plans, the levels of reserves and budgetary controls;
- a need to clearly justify and document materiality considerations and not default automatically to the top of the materiality range;
- a need to consider property valuations as significant risk areas, particularly to ensure that when using external valuers in this respect they review and challenge management valuations. In addition, audit teams needs to verify the completeness and accuracy of source data used by

experts and to evidence the consideration of ensuring that assets are revalued on the appropriate cycle in accordance with accounting policies; and

- a need to evidence journals selected for testing by audit teams, while improving procedures to ensure the completeness of the population of journals considered for testing and following up on any identified control weaknesses.

15 Specifically for KPMG, last year the AQR asked KPMG to reconsider its approach to increasing the maximum permitted materiality level to 3 per cent of gross revenue or expenditure; and to its consideration of significant accounts and significant risks.

16 The AQR has noted that some actions have been taken with respect to redressing these issues, such as the maximum materiality level now being 2 per cent of gross revenue of expenditure; however some matters raised in the prior year continue to recur. The firm has been asked by the AQR to consider its approach to ensuring that audit teams adequately respond to findings arising from regulatory reviews in relation to PSAA work.

17 In addition the AQR has noted that the firm is considering amending its Engagement Quality Control Review (EQCR) arrangements for PSAA work to a policy that would be out of line with other firms in our regime. The firm should reconsider this policy for PSAA work.

18 We have combined our scores for the AQR inspections for PSAA with the firm's QMR scores in the relevant sections in the rest of this report. These improvement points are included in Appendix 4.

QMR programme

19 PSAA sets quality standards for its appointed auditors and monitors their performance against them. The principal means of monitoring and evaluating the quality of auditors' work is the annual QRP. For 2014/15 we relied on each firm's own quality monitoring arrangements.

20 All firms agreed to follow PSAA's methodology and reporting format for their QMRs for WGA returns, VFM conclusions and HB COUNT audit work and use their own methodology for assessing work on the financial statements (converting the financial statements results to our scoring system). We concluded that KPMG's QMRs were sufficiently detailed and rigorous for us to place reliance on all of the reviews provided by the firm.

21 Each firm scored their QMRs using a common four-point scale, with 3 being the highest and 0 being the lowest. A score of 1 is our benchmark for acceptable performance. The full assessment scale is detailed in Table 1 and we calculated the score for overall audit quality on a weighted assessment using the weightings detailed in appendix 1.

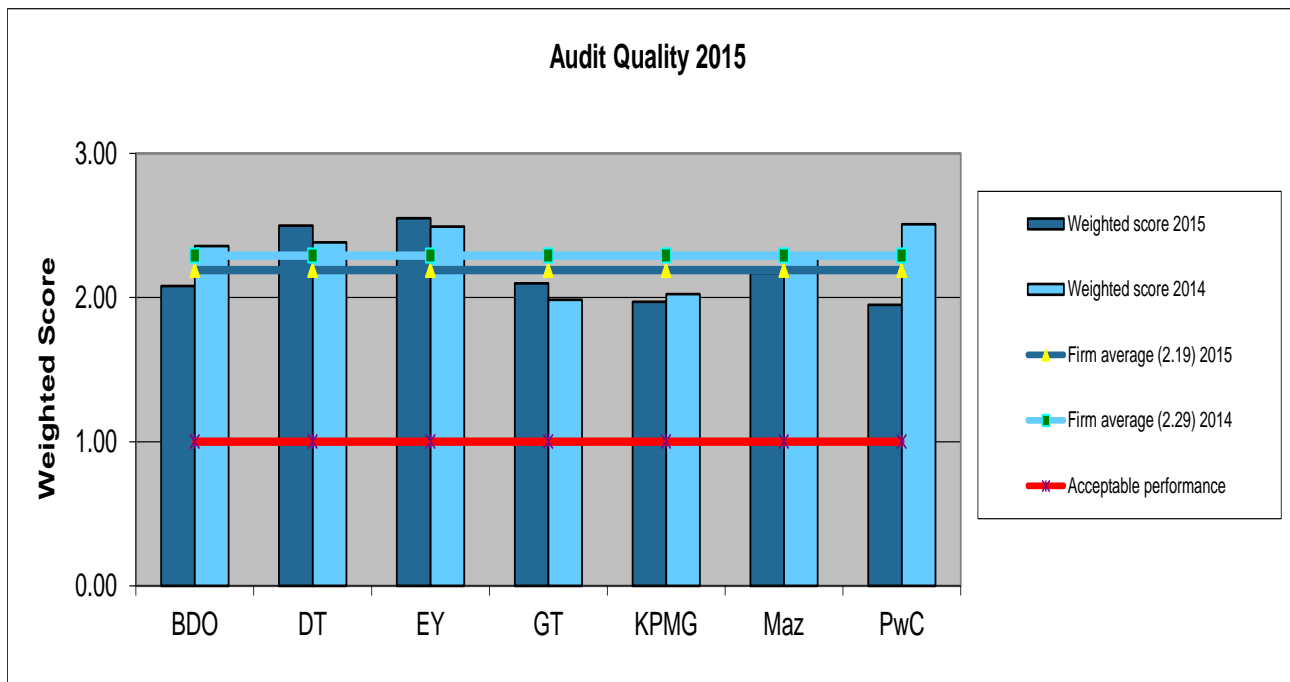
Table 1- PSAA assessment scale

Score	Descriptor
3	Good, no improvement required
2	Acceptable with limited improvements required
1	Acceptable overall with improvements required
0	Improvements required which are individually or collectively significant

22 KPMG’s score was 1.97, compared to an all firm average of 2.19. This was a reduction on last year’s score of 2.03, although this year we used a slightly amended scoring base¹.

23 Figure 2 shows the assessment of KPMG's overall audit quality performance in comparison to other firms.

Figure 2: 2015 Comparative performance for audit quality



24 Our QRP methodology is designed to highlight any specific weaknesses at individual file level, specifically where our benchmark score of 1 is not met, which may have ordinarily been masked behind a high average score across the various elements (Financial statements, VFM, WGA and HB COUNT) of the QRP.

25 We have calculated a red, amber, green (RAG) indicator for each element of the QRP, using the principles detailed in Appendix 2, as well as for overall audit quality. Where a firm scores an average of less than 2, or has any scores of 0, a rating higher than amber in that element is not possible.

26 For 2014/15, KPMG’s overall rating for audit quality was amber as the overall audit quality score was below 2. We consider each of the individual elements making up this rating below.

Figure 3: 2015 Comparative performance for audit quality

BDO	DT	EY	GT	KPMG	Mazars	PwC
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¹ The prior year assessment included consideration of Health Quality Accounts and Certification work which are not included in the current year assessment.

Financial statements audit work

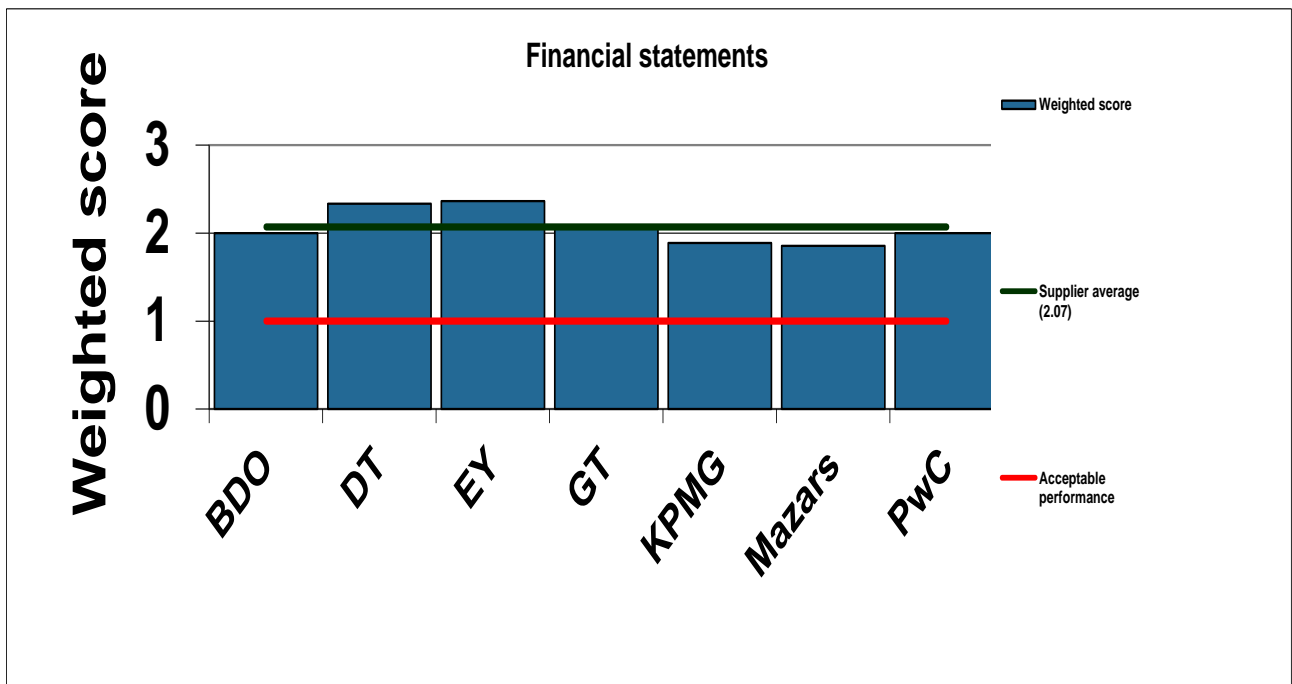
27 The firm provided the results of seven QMRs for financial statement audit files. We reviewed these and agreed with all the firm assessments. In addition, the AQR review for PSAA provided a score for two additional financial statements assessments.

28 The improvement areas from these individual QMRs and the AQR review included:

- ensuring clearer documentation on file over the classification of risks and audit work undertaken;
- ensuring there is sufficient documentation on file to support materiality judgements;
- ensuring that when undertaking sample testing that an appropriate and reliable basis is applied upon which the entire population is capable of selection for testing;
- ensuring that sufficient audit procedures are undertaken in relation to payroll and depreciation balances and the accounts payable cycle.

29 Figure 4 shows the comparative performance for financial statement audit work based on the results of the QMRs and AQR review. KPMG's average score was 1.89 compared to an all firm average of 2.07.

Figure 4: 2014 Comparative performance on financial statements work



30 For 2014/15, KPMG's rating for financial statements work was amber because of the relatively low score (average less than 2) on financial statements audit work.

Figure 5: 2015 Comparative performance for financial statements audit work



Whole of government accounts returns

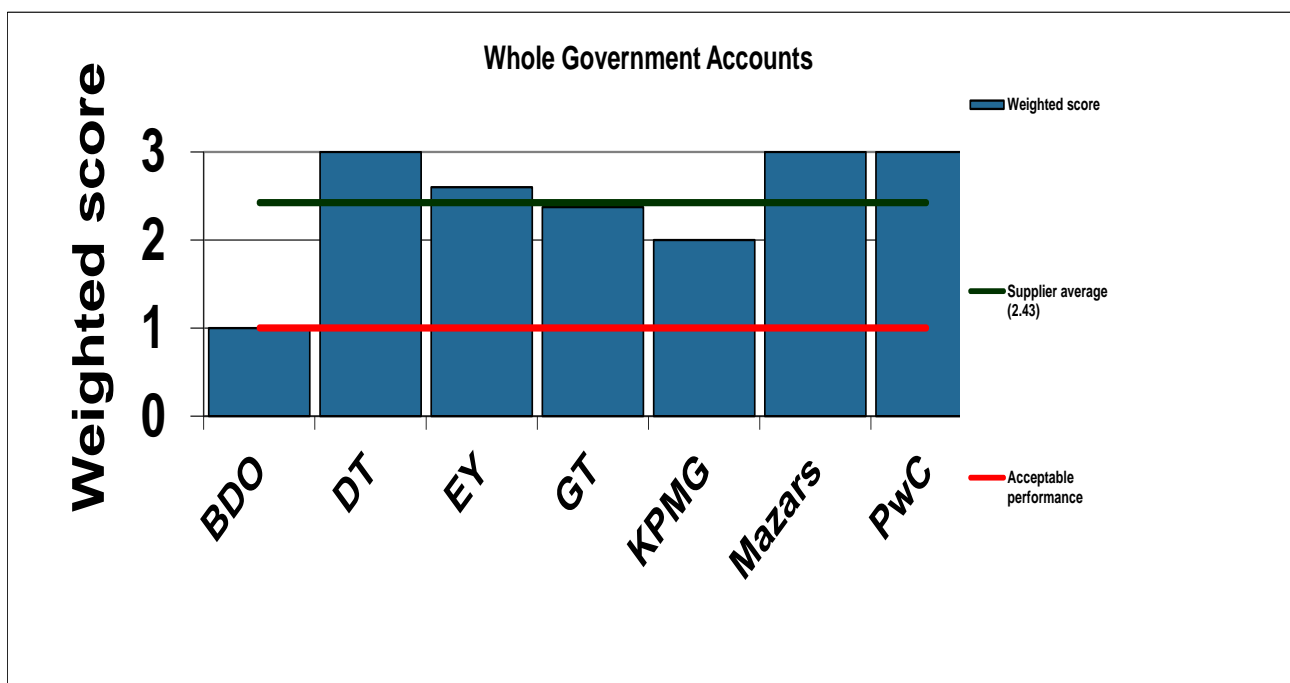
31 The firm provided the results of four QMRs for WGA returns. We reviewed these and agreed with all but one of the assessments. In one case, we scored an assessment lower by one grade, from a 2 to a 1. This was because of the nature and number of improvement needs identified by the reviewer.

32 The improvement areas from these individual QMRs included:

- ensuring that the WGA pack is reconciled to opening balances in the primary statements and to the prior year audited WGA pack; and
- ensuring that all unadjusted errors as included in the ISA 260 are properly included in the WGA unadjusted errors schedule.

33 Figure 6 shows the comparative performance for WGA return audit work based on the results of the QMRs. KPMG's average score was 2.00 compared to an all firm average of 2.43.

Figure 6: 2015 Comparative performance on WGA work



34 For 2014/15, KPMG's rating was green for WGA work.

Figure 7: 2015 Comparative performance for WGA work



VFM conclusion audit work

35 The firm provided the results of seven QMRs for VFM conclusion audit files. We reviewed the results and agreed with all but one of the assessments. In one case, we scored the assessment lower by one grade, from a 3 to a 2. This was because limited improvement needs, specifically around better evidencing of timely engagement lead review of VFM work, were identified by the reviewer.

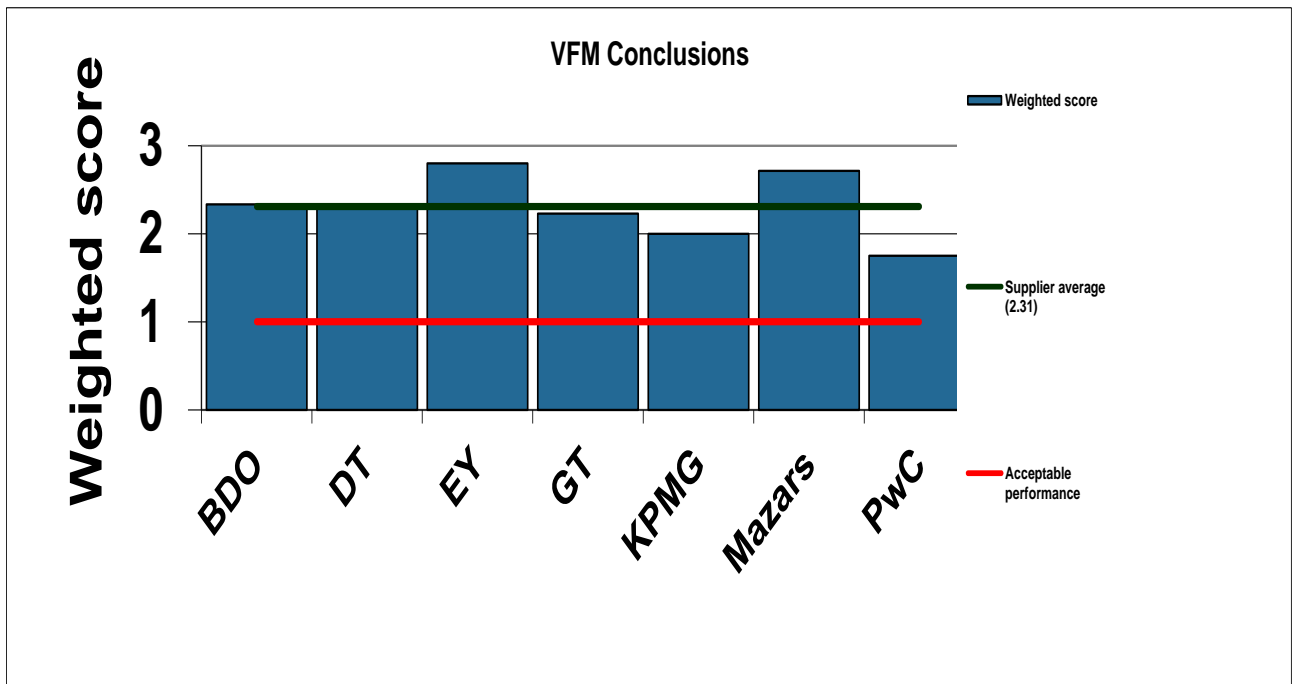
36 In addition, the AQR review for PSAA provided a score for one additional VFM conclusion assessment.

37 The improvement areas from these individual QMRs and the AQR review included:

- ensuring better evidencing of timely review of work by the engagement lead;
- ensuring clearer documentation on file on the consideration of risks; and
- ensuring clear and accurate reporting of VFM conclusion work to the Audit Committee.

38 Figure 8 shows the comparative performance for VFM audit work based on the results of the QMRs and AQR review. KPMG's score was 2.00 compared to an all firm average of 2.31.

Figure 8: 2015 Comparative performance for VFM conclusion audit work



39 For 2014/15, KPMG’s rating was green on VFM conclusion work.

Figure 9: 2015 Comparative performance for VFM conclusion audit work



Housing benefit work

40 Each year auditors certify local authority claims for housing benefit subsidy to the Department for Work and Pensions (DWP). They are required to undertake this work using specific guidance and tools (HB COUNT) which are agreed annually with the DWP. HB COUNT sets out the approach and work needed to certify the subsidy claim form. It includes a requirement to test a sample of cases to check that benefits have been awarded in accordance with benefit regulations and that subsidy has been properly claimed.

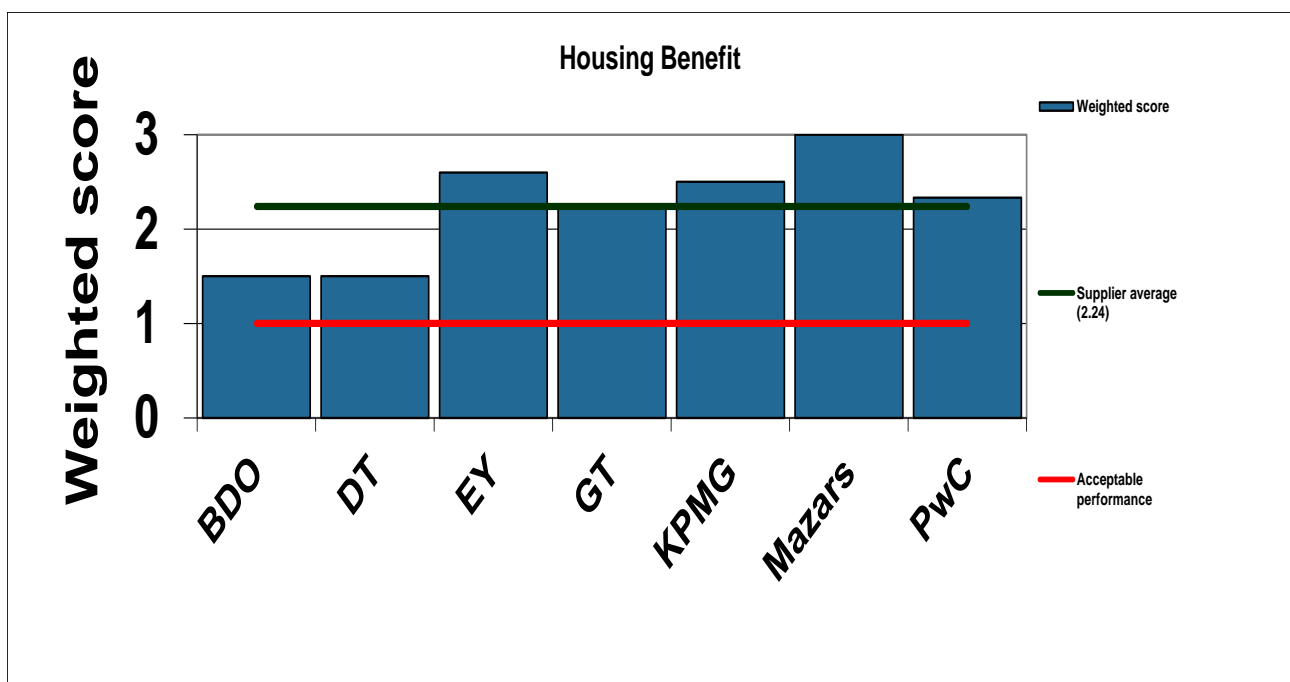
41 The firm provided the results of eight QMRs for HB COUNT audit work. We reviewed the results of these and we agreed with all of the firm's assessments.

42 The improvement areas from these individual QMRs included:

- ensuring compliance with the certification instructions on housing benefit work, particularly around mapping and evidencing conclusions against the specific test requirements;
- ensuring that any amendments made to the claim relate to isolated errors only.

43 Figure 10 shows the comparative performance of each firm based on the QMRs. KPMG's average score was 2.50 compared to an all firm average of 2.24.

Figure 10: 2015 Comparative performance for HB COUNT audit work



44 For 2014/15, KPMG's rating was green for HB COUNT audit work.

Figure 11: 2015 Comparative performance for HB COUNT audit work

BDO	DT	EY	GT	KPMG	Mazars	PwC
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Regulatory compliance

Systems for compliance with our regulatory requirements

45 In 2013/14 the Audit Commission (the Commission) reviewed the systems and procedures at KPMG for ensuring compliance with our regulatory requirements. The Commission's conclusion was that it could place reliance on the firm's systems and procedures for monitoring compliance with its regulatory requirements.

46 For the 2014/15 review, KPMG confirmed to the Commission that the systems and procedures for regulatory compliance and information assurance arrangements were the same as those in the previous year. Nothing came to the Commission's attention in year to suggest this is not correct, and it concluded that it could continue to rely on KPMG's systems. We have placed reliance on the work undertaken by the Commission for this assessment.

Quarterly monitoring of our regulatory requirements

47 The Commission reported the details in the quarterly monitoring reports issued to the firm during the year, including fee variation request and requests for non-audit services from the firm. Figure 12 details the firm's overall regulatory compliance RAG rating compared to other firms as report by the Commission.

Figure 12: 2015 Comparative performance for regulatory compliance

BDO	DT	EY	GT	KPMG	Mazars	PwC
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48 The firm performed well across all of the regulatory compliance requirements, with all but one of the 17 indicators being rated as green. The firm has performed poorly on the timely resolution of objections and has been rated as red in this area, although it has had to deal with some issues handed over from a previous auditor. The firm should act to resolve all longstanding objections as soon as possible.

49 We have included a summary at Appendix 3 of the results of the 2014/15 regulatory compliance monitoring RAG ratings, comparing the firm's performance against the overall performance for all firms.

Client satisfaction surveys

50 All firms agreed to undertake client satisfaction surveys for 2013/14 audits, and to report the results to PSAA. We specified questions to be included in the survey and asked firms to provide us with an analysis of the results.

51 The firm received results from a sample of audited bodies (30% of its portfolio of audits) on completion of their 2013/14 audit. Table 1 details the questions and the average score.

Table 2- Satisfaction survey results

Question	Average score (max. 10)*
How satisfied are you overall with your audit?	8.9
How satisfied are you with the amount of contact with your Engagement Lead?	8.4
How satisfied are you with the amount of contact with your Audit Manager?	8.6
How satisfied are you with the technical competence and skills of your audit team?	8.3
How satisfied are you with your auditor's performance at committee meetings?	8.9
How satisfied are you with your auditor's understanding of the key issues and risks specific to your organisation?	8.3
How satisfied are you with the usefulness of your auditor's reports?	7.6
How satisfied are you with the timeliness of your auditor's reports?	8.4

*the KPMG scoring system has a maximum rating of 5. The survey results have been ratioed against a maximum score of 10 to make the results comparable with other firms.

52 These results show that audited bodies are, on the whole, satisfied with the level of service received from KPMG and for 2014/15, KPMG's rating for client satisfaction was green.

Figure 13: 2015 Comparative performance for client satisfaction

BDO	DT	EY	GT	KPMG	Mazars	PwC
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53 The firm has undertaken an analysis of any improvements points raised in the survey and has committed to action any individual improvement points identified.

Recommendations

Recommendations arising from the 2014/15 quality review programme

54 The key areas for improvement identified this year from file reviews are noted below, as taken from the body of this report:

Financial statements

- ensuring clearer documentation on file over the classification of risks and audit work undertaken;
- ensuring there is sufficient documentation on file to support materiality judgements;
- ensuring that when undertraining sample testing that an appropriate and reliable basis is applied upon which the entire population is capable of selection for testing; and
- ensuring that sufficient audit procedures are undertaken in relation to payroll and depreciation balances and the accounts payable cycle.

WGA

- ensuring that the WGA pack is reconciled to opening balances in the primary statements and to the prior year audited WGA pack; and
- ensuring that all unadjusted errors as included in the ISA 260 are properly included in the WGA unadjusted errors schedule.

VFM

- ensuring better evidencing of timely review of work by the engagement lead;
- ensuring clearer documentation on file on the consideration of risks; and
- ensuring clear and accurate reporting of its VFM conclusion work to the Audit Committee.

HB

- ensuring compliance with the certification instructions on housing benefit work, particularly around mapping and evidencing conclusions against the specific test requirements; and
- ensuring that any amendments made to the claim relate to isolated errors only.

55 Appendix 4 provides details of the actions the firm has, or intends to take to address these improvement areas. We understand the findings from the QMR will be considered by the firm's top management team and then communicated to staff.

Appendix 1 – Weightings to calculate overall quality score

Table 3- weightings

Audit element	Local government	NHS
	%	%
Financial statements	60	70
WGA	5	-
VFM Conclusions	25	30
HB	10	-
Total	100	100

Appendix 2 - Audit quality and regulatory compliance RAG rating

Table 4- QRP elements of financial statements, VFM conclusions, WGA assessments, health quality accounts, certification instructions and housing benefit work.

Rating	Firm level: Overall Audit Quality score	Firm level: Individual QRP element
Green	Firm audit quality score ≥ 2 and no scores of '0' at file review level	Average element score ≥ 2 and no scores of '0' at file review level
Amber	Firm audit quality score ≥ 1 with up to two scores of '0' at file review level	Average element score ≥ 1 with up to one score of '0' at file review level
Red	Firm audit quality score < 1 , or Firm audit quality score ≥ 1 but three or more scores of '0' at file review level	Average element score < 1 , or Average element score ≥ 1 but two or more scores of '0' at file review level

Table 5- Regulatory compliance RAG rating based on 17 quarterly monitoring indicators

Rating	Overall firm level score- indicators
Green	12 or more at green and no more than two at red.
Red	Six or more indicators at red.
Amber	Neither green nor red.

Table 6- Combined audit quality and regulatory compliance RAG

		QRP RAG		
		Red	Amber	Green
Regulatory compliance RAG	Red	R	R	A
	Amber	R	A	A
	Green	A	A	G

Table 7- RAG rating the results of satisfaction survey results

Firm 0-10 assessment (average)	Firm unsatisfactory – satisfactory assessment (average)	PSAA RAG rating
0-3	very dissatisfied / dissatisfied / unsatisfactory	R
4-6	reasonable / good / satisfied	A
7-10	very good / very satisfied / outstanding	G

Appendix 3 - Results of 2014/15 regulatory compliance monitoring

Activity	Target	All firms % (no).	KPMG % (no).	Red, amber, green (RAG) status
Number of planning letters issued – all sectors.	100% issued by 30 April 2014 (all sectors).	95.8 (34)	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of audit opinions issued – NHS.	100% issued by 6 June 2014 (CCG) and 9 June 2014 (NHS Trusts).	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of VFM conclusions issued – NHS.	100% issued by 6 June 2014 (CCG) and 9 June 2014 (NHS Trusts).	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Confirmation of final fee reported to audited body – NHS.	100% by 31 July 2014.	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of annual audit letters issued – NHS.	100% by 31 July 2014.	100	100	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of audit opinions issued– local government.	100% issued by 30 September 2014.	98.2 (9)	99.2 (1)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of VFM conclusions issued - local government.	100% issued by 30 September 2014.	97.9 (11)	97.5 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of WGA returns issued.	100% issued by 3 October 2014.	96.4 (16)	97.1 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.

Activity	Target	All firms % (no).	KPMG % (no).	Red, amber, green (RAG) status
Confirmation of final fee reported to audited body – local government.	100% by 31 October 2014.	98.6 (7)	97.5 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of annual audit letters issued - local government.	100% by 31 October 2014.	99.0 (5)	97.5 (3)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Number of certified claims and returns.	100% submitted by the relevant deadlines.	98.3 (9)	97.2 (4)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Submission of data returns to the Commission by the required deadline.	100% submitted by the relevant deadlines.	97.7 (105)	98.7 (14)	G >95.01% delivered or 1 missed. A 90.01 - 95.00% delivered or 2 missed. R <90.00% delivered or 3 missed.
Assessment of the quality of the submitted data returns.	Quality and accuracy of submitted data returns.	97.8 (100)	96.9 (33)	G >95.01% or 1 not at required quality level. A 90.01 - 95.00% or 2 not at required quality level. R <90.00% or 3 not at required quality level.
Number of complaints upheld against auditors.	No complaints upheld against auditors.	1	0	G = 0 upheld A = 1 R = 2 or more
Instances of non-compliance with standing guidance requirements on independence issues.	No instances of non-compliance with standing guidance.	1	0	Firm G = up to 1 A = 2 R = 3 or more Regime G = up to 7 A = 8 R = 9 or more.

Activity	Target	All firms % (no).	KPMG % (no).	Red, amber, green (RAG) status
Objections decided upon within nine months.	100% of objections decided upon within nine months.	11	6	Firm G = up to 1 A = 2 R = 3 or more Regime G = up to 7 A = 8 R = 9 or more.
Attendance of Contact Partners (or appropriate representative) at Auditors' Group, Auditors' Group sub groups/technical groups.	No meetings missed.	2	2	Firm G = up to 2 A = 3 R = 4 or more Regime G = up to 7 A = 8 R = 9 or more.

Appendix 4 - Summary of regulatory compliance and QRP improvement areas

Table 8- improvement areas

Area	Improvement required	Firm response
<p>Profession wide FRC annual report</p>	<p>A need for auditors to improve their scepticism in challenging the appropriateness of assumptions in key areas of audit judgment such as impairment testing and property valuation.</p> <p>A need for an improvement in the sufficiency and appropriateness of audit procedures being performed. This is common to many audit areas including revenue recognition; and</p> <p>A need to adequately identify the threats and related safeguards to auditor independence and to appropriately communicate these to audit committees.</p>	<p>We note that the points highlighted by the FRC in its annual report are of a general nature from its reviews across the profession, and do not arise from a review of KPMG’s work on audit engagements under our contract with PSAA. However, as a firm we take note of all regulatory reports when preparing action plans to further enhance the quality of our audit work. Our comments below reflect how we are strengthening further our arrangements on a firm-wide basis.</p> <p>Professional scepticism</p> <p>We have an ongoing focus on applying professional scepticism and appropriate challenge in our audits and ensuring this challenge is documented on our audit files. We have reinforced this through a number of actions over the last couple of years, such as:</p> <ul style="list-style-type: none"> • Providing updated guidance to our teams on using KPMG’s ‘critical thinking framework’. This framework is already embedded in KAM and is used to document the application of professional judgement in eAudIT. We issued a template working paper to help teams structure and document their thought process using the critical thinking framework when auditing critical areas of judgment such as impairment and cash flows.

		<ul style="list-style-type: none"> • We have continued to run the Professional Judgement courses for Managers and Assistant Managers. • Professional Judgement and scepticism continues to be embedded into the Audit Foundations training program for more junior staff. • Our mandatory quarterly technical training for all staff has included messaging in respect of demonstrating appropriate professional scepticism where relevant. • The importance of demonstrating the appropriate challenge to the client and professional scepticism were key messages included in Audit Quality Workshop attended by engagement leads. <p>Sufficiency and appropriateness of audit procedures</p> <p>The summarised comment from the FRC’s Annual report is broad and covers a procedures across a wide range of audit activities. We analyse all findings from the AQR’s reviews to look for common themes, understand root causes and develop specific responses. These may include specific actions to highlight practical implementation issues, clarify the necessary evidential standards, and address areas where methodology is misunderstood or needs refinement. Typically the response will be a mixture of focussed training, new or modified guidance, updates to methodology or coaching through targeted workshops or the sharing of examples to highlight the application issues seen. This is contained in a detailed action plan response to the AQR’s findings which is developed issue by issue.</p>
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		<p>Auditor independence</p> <p>We have comprehensive arrangements to identify possible threats and related safeguards to auditor independence and to appropriately communicate these to audit committees. However, we continually review these arrangements and seek to strengthen them, including in response to regulatory reports. For example:</p> <ul style="list-style-type: none"> • We have revised the ethics and independence checklist completed on all audit files to better capture the documentation of threats and safeguards arising from non-audit services provided to audit clients. • Our last Annual Independence training reiterated the requirements to consider and document the threats and safeguards arising from the provision of non-audit services. Appropriate documentation of these is required in the checklist and in a written communication to Those Charged With Governance.
<p>AQR review on PSAA work (across all firms)</p>	<p>Review, challenge and consider the reasonableness of management’s documents and assumptions with respect to evidence obtained for the VFM conclusion, particularly in relation to increasing funding gaps at local government organisations; and in relation to the consideration of savings plans, the levels of reserves and budgetary controls.</p> <p>Clearly justify and document materiality considerations and not default automatically to the top of the materiality range.</p>	<p>In line with our usual practice, we have performed an annual review and refresh of our audit approach and guidance for public sector clients. This takes account of the findings from external regulatory reviews and discussions with the AQR team, internal quality monitoring reviews and other relevant technical matters. Whilst not all of the general matters reported by AQR were relevant to the review of KPMG audit work, we take account of these also. Any changes to our audit approach and guidance are communicated to our teams.</p>

	<p>Consider property valuations as significant risk areas, particularly to ensure that when using external valuers in this respect they review and challenge management valuations. In addition, audit teams needs to verify the completeness and accuracy of source data used by experts and to evidence the consideration of ensuring that assets are revalued on the appropriate cycle in accordance with accounting policies.</p> <p>Evidence journals selected for testing by audit teams, while improving procedures to ensure the completeness of the population of journals considered for testing and following up on any identified control weaknesses.</p> <p>In addition, specifically for KPMG:</p> <p>Consider its approach to ensuring that audit teams adequately respond to findings arising from regulatory reviews in relation to PSAA work; and</p> <p>Reconsider the firm's EQCR policy for PSAA work.</p>	<p>Specifically, this year we have:</p> <ul style="list-style-type: none"> refined our VFM audit programmes to ensure a greater focus on obtaining and evaluating evidence supporting the VFM conclusion; updated our guidance on determining materiality on public sector audits; and updated our public sector guidance on the application of our EQCR policy. <p>Journal testing is also a topic covered centrally by updated guidance from our Department of Professional Practice.</p> <p>We always take feedback from AQR and other regulators seriously and consider what action is necessary both for the engagements reviewed and more widely. This year our response includes commissioning an independent review of our local government audit approach by our Department of Professional Practice. Where timing allows, any improvement points arising from this review will be taken account of during the delivery of 2014/15 local government audits, although the focus is predominantly on informing our audit approach and guidance for 2015/16 audit work. We are also ensuring that the local government audit engagement reviewed by AQR this year is subject to an independent in-flight review at both the planning and reporting stages of the 2014/15 audit.</p>
Financial statements	The firm should ensure clearer documentation on file over the classification of risks and audit work undertaken.	The internal quality monitoring of our financial statements audit work this year demonstrated that good quality standards are achieved overall, but a

	<p>The firm should ensure there is sufficient documentation on file to support materiality judgements</p> <p>The firm should ensure that when undertaking sample testing that an appropriate and reliable basis is applied upon which the entire population is capable of selection for testing.</p> <p>The firm should ensure that sufficient audit procedures are undertaken in relation to payroll and depreciation balances and the accounts payable cycle</p>	<p>number of isolated learning points were identified.</p> <p>We respond positively to all matters arising from quality monitoring reviews. For example:</p> <ul style="list-style-type: none"> • a summary of our quality findings is communicated to our Partners, Directors and audit staff to highlight learning points for future audits; and • we share the findings with our technical teams to consider when developing future audit guidance and material. <p>These communications cover the specific points highlighted. Furthermore, we continue to explore ways in which we can use powerful data and analytical (D&A) tests, including areas such as payroll and depreciation. Further guidance has been issued to our teams on this recently and we are seeking to embed D&A functionality more explicitly into our sector-based audit guidance in the future.</p>
WGA	<p>The firm should ensure that the WGA pack is reconciled to opening balances in the primary statements and to the prior year audited WGA pack.</p> <p>The firm should ensure that all unadjusted errors as included in the ISA 260 are properly included in the WGA unadjusted errors schedule.</p>	<p>The small numbers of identified points were isolated, but nevertheless we communicate these to our staff as learning points.</p>
VFM conclusions	<p>The firm should ensure better evidencing of timely review of work by the engagement lead.</p> <p>The firm should ensure clearer documentation on file on the consideration of risks.</p>	<p>As with the areas above, we ensure that messages on improvement points such as these are fed back to our staff.</p> <p>We have also issued a reminder to our engagement leads on the need to appropriately evidence their</p>

	The firm should ensure clear and accurate reporting of its VFM conclusion work to the Audit Committee	involvement in, and review of, VFM audit work, and to do so on a timely basis.
Housing benefit	<p>The firm should ensure compliance with the certification instructions on housing benefit work, particularly around mapping and evidencing conclusions against the specific test requirements.</p> <p>The firm should ensure that any amendments made to the claim relate to isolated errors only.</p>	<p>We recognise the need to continually review our arrangements to ensure our staff are sufficiently trained and have access to appropriate support and guidance on this very technical and prescriptive area of work. We have focused on this area of work significantly in recent years to ensure our arrangements continually improve, as demonstrated by our strong quality monitoring results.</p> <p>As with other areas, we ensure that messages on improvement points such as these are fed back to our staff.</p>
Regulatory compliance	The firm has performed poorly on the timely resolution of objections and should act to resolve all longstanding objections as soon as possible.	<p>We always aim to conclude on objections on a timely basis, but their complex nature can sometimes mean that this is not possible within the nine month target date set by PSAA. Where delays are unavoidable, for example to allow sufficient evidence to be obtained and considered or for objectors or other interested parties to be consulted, then we always take the time required.</p> <p>As recognised by PSAA, we have a number of longstanding objections which pre-date our appointment as auditor of the bodies concerned, some of which cover multiple audit years. We are focused on completing these as soon as possible, but as noted above their complexity has necessitated a longer timeframe than is typically the case.</p> <p>We have had a number of other complex objections that have taken some time to resolve or remain ongoing. We are committed to concluding objections</p>

		<p>as quickly and efficiently as possible, where circumstances surrounding the objection allow this. We are enhancing our monitoring processes, based around PSAA's new monthly reporting regime. This will include active monitoring of progress on a monthly basis and the escalation to KPMG's Contact Partner of objections considered to be 'at risk' of not meeting the nine month target, to consider the circumstances surrounding individual objections and whether there are steps that can be taken to conclude them on a timely basis.</p>
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