



External Audit Report 2017/18

East Sussex County Council Pension Fund

13 July 2018

Content

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

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

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

Important notice

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

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

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

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

Status of our audit: Our audit is still in progress, and we will provide an oral update on the status of our audit at the Audit Committee meeting. The following work is ongoing:

- Final sample and transactional testing
- Final investments testing
- Review of disclosures within the financial statements
- Final review and closure procedures
- Receipt of the signed management representation letter

Section One

Summary

Financial statements audit – see section 2 for further details

Subject to all outstanding queries and procedures being satisfactorily resolved we intend to issue an unqualified audit opinion on the Pension Fund's financial statements for the deadline of 31 July 2018, following the Audit Committee adopting them and receipt of the management representations letter. We have completed our audit of the financial statements. We have read the Pension Fund Annual Report. Our key findings are:

- There are no unadjusted or adjusted audit differences identified during our audit.
- We agreed presentational changes to the accounts with the Finance Team, mainly related to compliance with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
- We are not asking for any additional requests for management representations with respects of the Pension Fund in addition to our routine requests.
- We reviewed the Pension Fund Annual Report and have no matters to raise with you.

We are now in the completion stage of the audit. We intend to issue our 2017/18 Annual Audit Letter in August 2018. The audit cannot be formally concluded and an audit certificate issued as we are considering elector queries relating to 2016/17. Until we have completed our consideration of these, we are unable to certify that we have completed the audit of the accounts in accordance with the requirements of the Local Audit and Accountability Act 2014.

Other matters

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

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

We have a duty to consider whether to issue a report in the public interest about something we believe the Pension Fund should consider, or if the public should know about. We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014. There are no other matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Pension Fund's 2017/18 financial statements. We have not made any recommendations as a result of our audit of the Pension Fund 2017/18.

This year we have been requested to undertaken enhanced procedures on behalf of a number of the admitted and scheduled bodies to the Pension Fund. Work is ongoing in relation to this, and an additional fee will be agreed with management on behalf of the Pension Fund, which can be recharged on to those bodies.

Section Two

Financial statements audit

We audit your financial statements by undertaking the following:

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

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

1. Business understanding	In our 2017/18 audit plan we assessed your operations to identify significant issues that might have a financial statements consequence. We confirmed this risk assessment as part of our audit work. We provide an update on each of the risks identified later in this section.
2. Assessment of the control environment	We assessed the effectiveness of your key financial system controls that prevent and detect material fraud and error. We found that the financial controls on which we seek to place reliance are operating effectively. We reviewed work undertaken by your internal auditors, in accordance with ISA 610 and used the findings to inform our work. We have chosen not to place reliance on their work due to the approach we adopted for the financial statements audit.
3. Prepared by client request (PBC)	We produced the PBC to summarise the working papers and evidence we ask you to collate as part of the preparation of the financial statements. We discussed and tailored our request with the Head of Finance and this was issued as a final document to the finance team. This resulted in audit working papers which were of appropriate quality for the purposes of the audit.
4. Accounting standards	We work with you to understand changes to accounting standards and other technical issues. For 2017/18 these changes primarily related to the Pension Fund, amendments to section 6.5 (Accounting and Reporting by Pension Funds) to require a new disclosure of investment management transaction costs and clarification on the approach to investment concentration disclosure.

Section Two

Financial statements audit

5. Accounts Production	<p>We received complete draft accounts by 31 May 2018 in accordance with the deadline. The accounting policies, accounting estimates and financial statement disclosures are in line with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.</p> <p>This is the fourth year that the Pension Fund has completed its accounts and audit process to an accelerated deadline, and we consider that the overall process for the preparation of your financial statements is adequate. We thank Finance for their cooperation throughout the visit which allowed the audit to progress and complete within the allocated timeframe.</p>
6. Testing	<p>We have summarised the findings from our testing of significant risks and areas of judgement in the financial statements on the following pages. During the audit. We have identified presentational changes to the accounts which we have agreed with the Finance Team.</p>
7. Representations	<p>You are required to provide us with representations on specific matters such as your going concern assertion and whether the transactions in the accounts are legal and unaffected by fraud. We provided a draft of this representation letter to the Chief Financial Officer on 3 July 2018. We draw attention to the requirement in our representation letter for you to confirm to us that you have disclosed all relevant related parties to us. We are not requesting any new management representations this year in addition to our routine requests.</p>

Section Two

Financial statements audit

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

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

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

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

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

Section Two

Financial statements audit

Pension Fund significant audit risks

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

SIGNIFICANT audit risk	Account balances affected	Summary of findings
Valuation of hard to price investments	Level 2 investments: £1.9billion Level 3 investments: £566m	<p>The Pension Fund invests in a wide range of assets and investment funds, some of which are inherently harder to value or do not have publicly available quoted prices, requiring professional judgement or assumptions to be made at year end. The pricing of complex investment assets may also be susceptible to pricing variances given the number of assumptions underlying the valuation.</p> <p>In the prior year financial statements, £751.7million out of a total of £3.2billion of investments, or 23%, were in this harder to price category. For year ended 31 March 2018, £2.4billion out of a total of £3.2billion of investments, or 75%, were in this harder to price category.</p> <p>As part of our audit of the Pension Fund, we independently verified a selection of investment asset prices to third party information and obtained independent confirmation on asset existence. We also tested the extent to which the Pension Fund had challenged the valuations reported by investment managers for harder to price investments and obtained independent assessment of the figures.</p> <p>As a result of this work we have no matters to raise with you.</p>

Section Two

Financial statements audit

Risks that ISAs require us to assess in all cases	Why	Our findings from the audit
Fraud risk from revenue recognition	<p>Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.</p> <p>In our External Audit Plan 2017/18 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.</p>	<p>In our External Audit Plan 2017/18 we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.</p> <p>This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.</p>
Fraud risk from management override of controls	<p>Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk.</p> <p>In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.</p> <p>We have not identified any specific additional risks of management override relating to this audit.</p>	<p>There are no matters arising from this work that we need to bring to your attention.</p>

Section Two

Financial statements audit

Judgements in your financial statements

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



Assessment of subjective areas				
Asset/liability class	Current year	Prior year	Balance	KPMG comment
Valuation of hard to price investments	③	③	Level 2 investments: £1.9billion Level 3 investments: £566m	<p>The Pension Fund invests in a range of funds designed to achieve the maximum return for the Pension Fund. These funds are classified as either Level 1, Level 2, or Level 3, categorised based on the quality and reliability of information used to determine fair values. Level 1 investment assets are those where the fair values are based on unadjusted quoted prices in active markets. By contrast, Level 2 and Level 3 investments are investments which may, for example, not be publicly traded, or where valuation techniques are used to determine fair value.</p> <p>Our procedures here involved reconciling the accounts figures to the Custodian report, and selecting a sample of investments to agree to publicly quoted sources, or to the audited accounts of Fund Managers. All the items tested could be appropriately agreed back to third party evidence sources and hence on this basis we are satisfied that the judgements made in the valuation process are reasonable.</p> <p>There are no matters arising from this work which we wish to bring to raise with you.</p>

Section Two

Financial statements audit

Pension fund annual report

We reviewed the consistency of the Fund's financial statements in the Fund's Annual Report and the financial statements included in East Sussex County Council's financial statements. We confirm that the Fund's financial statements are consistent with the pension fund financial statements included in the accounts of East Sussex County Council. We read the information in the Fund's Annual Report to identify material inconsistencies with the Fund's financial statements. We can confirm it is not inconsistent with the financial information contained in the audited financial statements. As such we anticipate issuing an unqualified consistency opinion on the pension fund financial statements.

Audit certificate

In order for us to issue an audit certificate, we are required to have completed all our responsibilities relating to the financial year for both the Council and the Pension Fund. We are not in a position to issue our audit certificate with the audit opinion as:

- As previously noted we have an ongoing objection outstanding.
- HM Treasury has recently issued its guidance for completing the WGA on the Authority accounts and issued the consolidation packs that authorities need to complete. The audit deadline is 31 August 2018.

Audit fees

Our fee for the audit was £26,607 excluding VAT (£26,607 excluding VAT in 2016/17). This fee was in line with that highlighted in our audit plan approved by the Audit Committee in March 2018.

During the year we were asked by auditors of the Pension Fund's admitted and scheduled bodies to undertake an enhanced suite of testing, which we are required to complete under the terms of the PSAA contract. Work is ongoing in relation to this and a fee will be agreed with management [and the PSAA through the PSAA fee variation process](#), which the Pension Fund is able to recharge on to the admitted bodies to which the work relates.

Appendix 1

Recommendations raised and followed up

Priority rating for recommendations			
1 Priority one: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2 Priority two: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3 Priority three: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.	

We are pleased to report that there are no recommendations arising from our audit in 2017/18. There were no recommendations arising from our audit in 2016/17 for follow up.

Materiality and reporting of audit differences

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

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

We used the same planning materiality reported in our External Audit Plan 2017/18, presented to you in March 2018. Materiality for the Pension Fund's accounts was set at £33 million which equates to around 1% of assets.

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

Reporting to Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £1.65m for the Pension Fund.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.

Appendix 3

Audit differences

Audit differences

Under UK auditing standards (ISA (UK&I) 260) we are required to provide the Audit Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements. In line with ISA (UK&I) 450 we request that you correct uncorrected misstatements. However, they will have no effect on the opinion in our auditor's report, individually or in aggregate. As communicated previously with the Audit Committee, details of all adjustments greater than £1.65m are shown below.

Unadjusted audit differences

We are pleased to report there are no unadjusted audit differences.

Adjusted audit differences

We are pleased to report there are no adjusted audit differences.

Audit independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF EAST SUSSEX COUNTY COUNCIL PENSION FUND

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

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

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

General procedures to safeguard independence and objectivity

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

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

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

Audit independence

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

Summary of fees

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

	2017-18 £	2016-17 £
Audit of the Pension Fund	26,607	26,607
Total audit services	26,607	26,607
Allowable non-audit services	0	0
Audit related assurance services	0	0
Mandatory assurance services	0	0
Total Non Audit Services	0	0

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Authority under the Code of Audit Practice for the year. There were no non audit fee services provided to the Pension Fund in 2017/18.

During the year we were asked by auditors of the Pension Fund's admitted and scheduled bodies to undertake an enhanced suite of testing, which we are required to complete under the terms of the PSAA contract. Work is ongoing in relation to this and a fee will be agreed with management and the PSAA through the PSAA fee variation process, which the Pension Fund is able to recharge on to the admitted bodies to which the work relates.

Appendix 4

Audit independence

Independence and objectivity considerations relating to other matters

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

Confirmation of audit independence

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

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

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

KPMG LLP

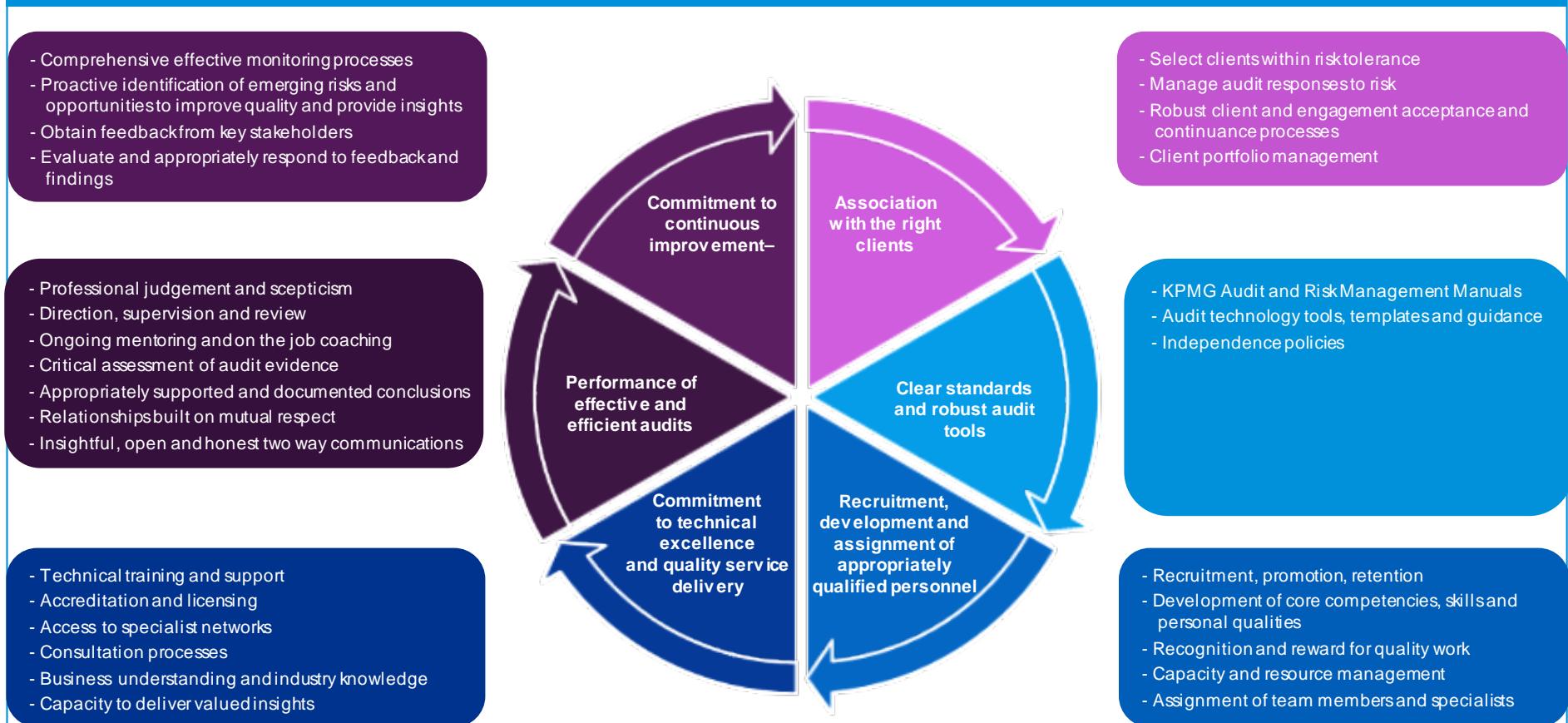
13 July 2018



Appendix 5

Audit quality framework

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





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