Appendix A

KPMG
cutting through complexity

External Audit Plan 2014/15

East Sussex County Council Pension Fund

March 2015

Contents

The contacts at KPMG in connection with this report are:

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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 has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.audit-commission.gov.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.

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 appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 1st Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.

Introduction

This document describes how we will deliver our audit work for East Sussex County Council Pension Fund.

Scope of this report

This document supplements our *Audit Fee Letter 2014/15* presented to you on April 29 2014. It describes how we will deliver our financial statements audit work for East Sussex County Council Pension Fund (‘the Pension Fund’).

We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We use a risk based audit approach.

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

Statutory responsibilities

Our statutory responsibilities and powers are set out in the *Audit Commission Act 1998* and the Audit Commission’s *Code of Audit Practice*.

The Audit Commission will close at 31 March 2015. However, our audit responsibilities under the *Audit Commission Act 1998* and the *Code of Audit Practice* in respect of the 2014/15 financial year remain unchanged.

The *Code of Audit Practice* summarises our responsibilities, requiring us to audit/review and report on your financial statements, providing an opinion on your accounts.

The Audit Commission’s *Statement of Responsibilities of Auditors and Audited Bodies* sets out the respective responsibilities of the auditor and the Authority.

The Audit Commission will cease to exist on 31 March 2015. Details of the new arrangements are set out in Appendix 4. The Authority can expect further communication from the Audit Commission and its successor bodies as the new arrangements are established. This plan restricts itself to reference to the existing arrangements.

Structure of this report

This report is structured as follows:

- Section 2 includes our headline messages, including any key risks identified this year for the financial statements audit.
- Section 3 describes the approach we take for the audit of the financial statements.
- Section 4 provides information on the audit team, our proposed deliverables, the timescales and fees for our work.

Acknowledgements

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

Headlines

Audit approach	Our overall audit approach remains similar to last year with no fundamental changes. Our work is carried out in four stages and the timings for these, and specifically our on site work, have been agreed with Marion Kelly, Chief Finance Officer and her team. Our audit strategy and plan remain flexible as risks and issues change throughout the year. We will review the initial assessments presented in this document throughout the year and should any new risks emerge we will evaluate these and respond accordingly.
Key financial statements audit risks for the Pension Fund	Our initial risk assessment for the Pension Fund's financial statements audit has identified the following additional significant risk: ■ LGPS reform and corresponding accounting treatment We have described this in more detail on page 10. We will assess the Pension Fund's progress in addressing these risk areas as part of our interim work and conclude this work at year end.
Audit team, deliverables, timeline and fees	We have refreshed our audit team this year with Philip Johnstone replacing Tamas Wood as the Engagement Director and Charlotte Goodrich replacing Grant Slessor as the Engagement Manager. Scott Walker will continue as the Assistant Manager for the audit. The same engagement team also undertake the audit of the Authority. Our main year end audit is currently planned to commence on 8 June 2015. Upon conclusion of our work we will present our findings to you in our *Report to Those Charged with Governance (ISA 260 Report)*. The planned fee for the 2014/15 audit £26,607 for the Pension Fund financial statements. This is unchanged from the position set out in our *Audit Fee Letter 2014-15*.

Our audit approach

We undertake our work on your financial statements in four key stages during 2015:

- **Planning (February to March).**
- **Control Evaluation (March).**
- **Substantive Procedures (June to July).**
- **Completion (July).**

We have summarised the four key stages of our financial statements audit process for you below.

Jan Feb Mar Apr May Jun Jul Aug

1 Planning

- Update our business understanding and risk assessment.
- Assess the organisational control environment.
- Determine our audit strategy and plan the audit approach.
- Issue our *Accounts Audit Protocol*.

2 Control evaluation

- Evaluate and test selected controls over key financial systems.
- Review the internal audit function.
- Review the accounts production process.
- Review progress on critical accounting matters

3 Substantive procedures

- Plan and perform substantive audit procedures.
- Conclude on critical accounting matters.
- Identify audit adjustments.
- Review the Annual Governance Statement.

4 Completion

- Declare our independence and objectivity.
- Obtain management representations.
- Report matters of governance interest.
- Form our audit opinion.

Our audit approach – planning (continued)

During February and March 2015 we complete our planning work.

We assess the key risks affecting the Fund's financial statements and discuss these with officers.

We assess if there are any weaknesses in respect of central processes that would impact on our audit.

Our planning work takes place in February and March 2015. This involves the following aspects:

Planning

- Update our business understanding and risk assessment including fraud risk.
- Assess the organisational control environment.
- Determine our audit strategy and plan the audit approach.
- Issue our *Accounts Audit Protocol*.

Business understanding and risk assessment

We update our understanding of the fund's operations and identify any areas that will require particular attention during our audit of the fund' financial statements.

We identify the key risks including risk of fraud affecting the Pension Fund's financial statements. These are based on our knowledge of the Fund, our sector experience and our ongoing dialogue with fund staff. Any risks identified to date through our risk assessment process are set out in this document. Our audit strategy and plan will, however, remain flexible as the risks and issues change throughout the year. It is the Fund's responsibility to adequately address these issues. We encourage the Fund to raise any technical issues with us as early as possible so that we can agree the accounting treatment in advance of the audit visit.

We liaise regularly with the finance team to consider issues and how they are addressed during the financial year end closedown and accounts preparation.

Organisational control environment

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would impact on our audit.

In particular risk management, internal control and ethics and conduct have implications for our financial statements audit. The scope of the relevant work of your internal auditors also informs our risk assessment.

Audit strategy and approach to materiality

Our audit is performed in accordance with International Standards on Auditing (ISAs) (UK and Ireland). The Engagement Lead sets the overall direction of the audit and decides the nature and extent of audit activities. We design audit procedures in response to the risk that the financial statements are materially misstated. The materiality level is a matter of professional judgement and is set by the Engagement Lead.

In accordance with ISA 320 (UK&I) '*Audit materiality*', we plan and perform our audit to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. Information is considered material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

Further details on assessment of materiality is set out on page 6 of this document.

Our audit approach –planning (continued)

When we determine our audit strategy we set a monetary materiality level for planning purposes.

For 2014/15 we have set this at £49 million for the Pension Fund based on the prior year financial statements.

We will report all audit differences over £2.5 million for the Pension Fund to the Scrutiny Committee for Audit, Best Value and Community Services.

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.

Materiality for planning purposes has been set at £49 million, which equates to approximately 2 percent of gross expenditure.

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

Reporting to the Audit 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(UK&I) *'Communication with those charged with governance'*, we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) 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 (UK&I), *'Evaluation of misstatements identified during the audit',* requires us to request that uncorrected misstatements are corrected.

In the context of the Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £2.5 million.

If 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.

Our audit approach – control evaluation

During March 2015 we will complete our interim audit work.

We work with your finance team and the pensions team to enhance the efficiency of the accounts audit.

We will report any significant findings arising from our work to the Scrutiny Committee for Audit, Best Value and Community Services.

Our on site interim visit will be completed during March. During this time we will complete work in the following areas:

Control Evaluation	
	▪ Evaluate and test controls as appropriate over key financial systems identified as part of our risk assessment. ▪ Review the work undertaken by the internal audit function on controls relevant to our risk assessment. ▪ Review the accounts production process. ▪ Review progress on critical accounting matters.

Controls over key financial systems

We update our understanding of the Fund's key financial processes where our risk assessment has identified that these are relevant to our final accounts audit and where we have determined that this is the most efficient audit approach to take. We confirm our understanding by completing walkthroughs for these systems. We then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Review of internal audit

During our audit we will seek to place reliance on the Fund's high level controls, and as part of our assessment of the overall control environment we will review and discuss the work carried out by Internal Audit.

Where any internal audit findings suggest weaknesses in key controls that could impact on significant account balances, we will adjust our approach to reflect these findings and where necessary perform additional testing to ensure that we can gain sufficient, appropriate audit evidence over those significant associated balances. We don't plan to rely directly on the work of Internal Audit.

Critical accounting matters

We will discuss the work completed to address the specific risks we identified at the planning stage. Wherever possible, we seek to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

If there are any significant findings arising from our interim work we will report these to the Authority in advance of the year end financial statements audits of the Pension Fund.

Our audit approach – substantive procedures

During June and July 2015 we will be on site for our substantive work. We will conduct our work on the Authority at the same time.

We complete detailed testing of accounts and disclosures and conclude on critical accounting matters, such as specific risk areas. We then agree any audit adjustments required to the financial statements.

We will present our *ISA 260 Report* for the Pension Fund to the Scrutiny Committee for Audit, Best Value and Community Services in September 2015.

Our final accounts visit on site has been provisionally scheduled for June and July for the Pension Fund. During this time, we will complete the following work:

Substantive Procedures

- Plan and perform substantive audit procedures over the significant balances contained within the Pension Fund financial statements.
- Conclude on critical accounting matters.
- Identify and assess any audit adjustments.

Substantive audit procedures

We complete detailed testing on significant balances and disclosures. The extent of our work is determined by the Engagement Lead based on various factors such as our overall assessment of the Fund's control environment, the effectiveness of controls over individual systems and the management of specific risk factors.

Critical accounting matters

We conclude our testing of key risk areas identified at the planning stage and any additional issues that may have emerged since.

We will discuss our early findings of the Fund's approach to address the key risk areas with Marion Kelly, Chief Finance Officer, and her team in July 2015, prior to reporting to the Scrutiny Committee for Audit, Best Value and Community Services.

Audit adjustments

During our on site work, we will meet with Ola Owolabi, Head of Accounts and Pensions on a weekly basis to discuss the progress of the audit, any differences found and any other issues emerging.

At the end of our on site work, we will hold a closure meeting, where we will provide a schedule of audit differences and agree a timetable for the completion stage and the accounts sign off.

To comply with auditing standards, we are required to report uncorrected audit differences to the Scrutiny Committee for Audit, Best Value and Community Services. 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.

Pension Fund Annual Report

We also issue an opinion on the consistency of the Pension Fund's accounts included in the *Pension Fund Annual Report* with those included in the Statement of Accounts. We intend to issue this opinion at the same time as our opinion on the accounts.

Our audit approach – other matters

We will communicate with you throughout the year, both formally and informally.

Independence and objectivity confirmation

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Governance Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 *Integrity, Objectivity and Independence* requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Appendix 1 provides further detail on auditors' responsibilities regarding independence and objectivity.

Confirmation statement

We confirm that as of February 2015 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with Chief Finance Officer, the Head of Accounts and Pensions and the Scrutiny Committee for Audit, Best Value and Community Services. Our deliverables are included on page 12.

Key financial statements audit risks

In this section we set out our assessment of the significant risks to the audit of the Pension Fund's financial statements for 2014/15.

For each key risk area we have outlined the impact on our audit plan.

As for the Fund's financial statements, professional standards require us to consider two standard risks for all Pension Funds. As before, these are:

- Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for pension funds as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

The table below sets out the significant risks we have identified through our planning work that are specific to the audit of the Pension Fund's financial statements for 2014/15.

We will revisit our assessment throughout the year and should any additional risks present themselves we will adjust our audit strategy as necessary.

Key audit risks	Impact on audit
LGPS Reform **Audit areas affected** - Contributions - Benefits	**The risk** From 1 April 2014, all members of the LGPS have automatically joined the new career average defined benefit scheme. The new scheme provides more flexibility on when members can take their pension and also how much they pay in. There is a risk that pension administration systems have not been set up to correctly reflect the changes resulting from LGPS 2014 and will therefore not accurately calculate the pension benefits due to members. While any errors in the system are unlikely to result in material misstatements in 14/15, the possible cumulative effect in future years means that specific audit work is needed on ensuring that the changes required to the system have been accurately reflected. **Our audit work** We will review the controls and processes that the Pension Fund have put in place to accurately capture the data required by LGPS 2014. Our work will also focus on testing that the system has been set up to accurately calculate future benefit entitlement.

Key financial statements audit risks

In this section we set out our assessment of the significant risks to the audit of the Pension Fund's financial statements for 2014/15.

For each key risk area we have outlined the impact on our audit plan.

Significant risks that ISAs require us to raise	Impact on audit
	The risk ISA 240 requires us to communicate the fraud risk from management override of controls as significant, because management is typically in a unique position to perpetrate fraud due to their 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. **Our proposed audit work** Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we will 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.

Key financial statements audit risks

This section sets out the significant risks that ISA's require us to raise for the Authority.

Significant risks that ISAs require us to raise	Impact on audit
Fraud risk from revenue recognition **Audit areas affected** ■ Fund account	**The risk** Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. **Our proposed audit work** We do not consider this to be a significant risk for local authority pension funds as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.
Fraud risk from management override of controls **Audit areas affected** ■ All	**The risk** ISA 240 requires us to communicate the fraud risk from management override of controls as significant, because management is typically in a unique position to perpetrate fraud due to their 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. **Our proposed audit work** Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we will 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.

Audit team

Your audit team has been drawn from our specialist public sector assurance department. Contact details are shown on page 1.

The audit team will be assisted by other KPMG specialists as necessary.

"My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion.

I will be the main point of contact for the Pensions and the Scrutiny Committee for Audit, Best Value and Community Services and Executive Directors."

Philip Johnstone

Director

"I am responsible for the management, review and delivery of the whole audit and providing quality assurance for any technical accounting areas. I will work closely with Philip to ensure we add value. I will liaise with Marion Kelly Chief Finance Officer and Ola Owolabi, Head of Accounts and Pensions."

Charlotte Goodrich

Manager

"I will be responsible for the on-site delivery of our work. I will liaise with the Finance and Internal Audit Teams. I will also supervise the work of our audit assistants."

Scott Walker

Assistant Manager

Audit deliverables

At the end of each stage of our audit we issue certain deliverables, including reports, statements and opinions.

Our key deliverables will be delivered to a high standard and on time.

We will discuss and agree each report as appropriate with the Fund's officers prior to publication.

Deliverable	Purpose	Committee dates
Planning		
External Audit Plan	■ Outlines our audit approach. ■ Identifies areas of audit focus and planned procedures.	**March 2015**
Control evaluation and Substantive procedures		
Report to Those Charged with Governance (ISA 260 Report) – Pension Fund	■ Details the resolution of key audit issues. ■ Communicates adjusted and unadjusted audit differences. ■ Highlights performance improvement recommendations identified during our audit.	**July 2015**
Completion		
Auditor's Report	■ Provides an opinion on the Pension Fund accounts	**July 2015**
Pension Fund Annual Report	■ We provide an opinion on the consistency of the Pension Fund annual report with the Pension Fund accounts	**July 2015**
Annual Audit Letter	■ Summarises the outcomes and the key issues arising from our audit work for the year.	**November 2015**

Audit timeline

We will be in continuous dialogue with you throughout the audit.

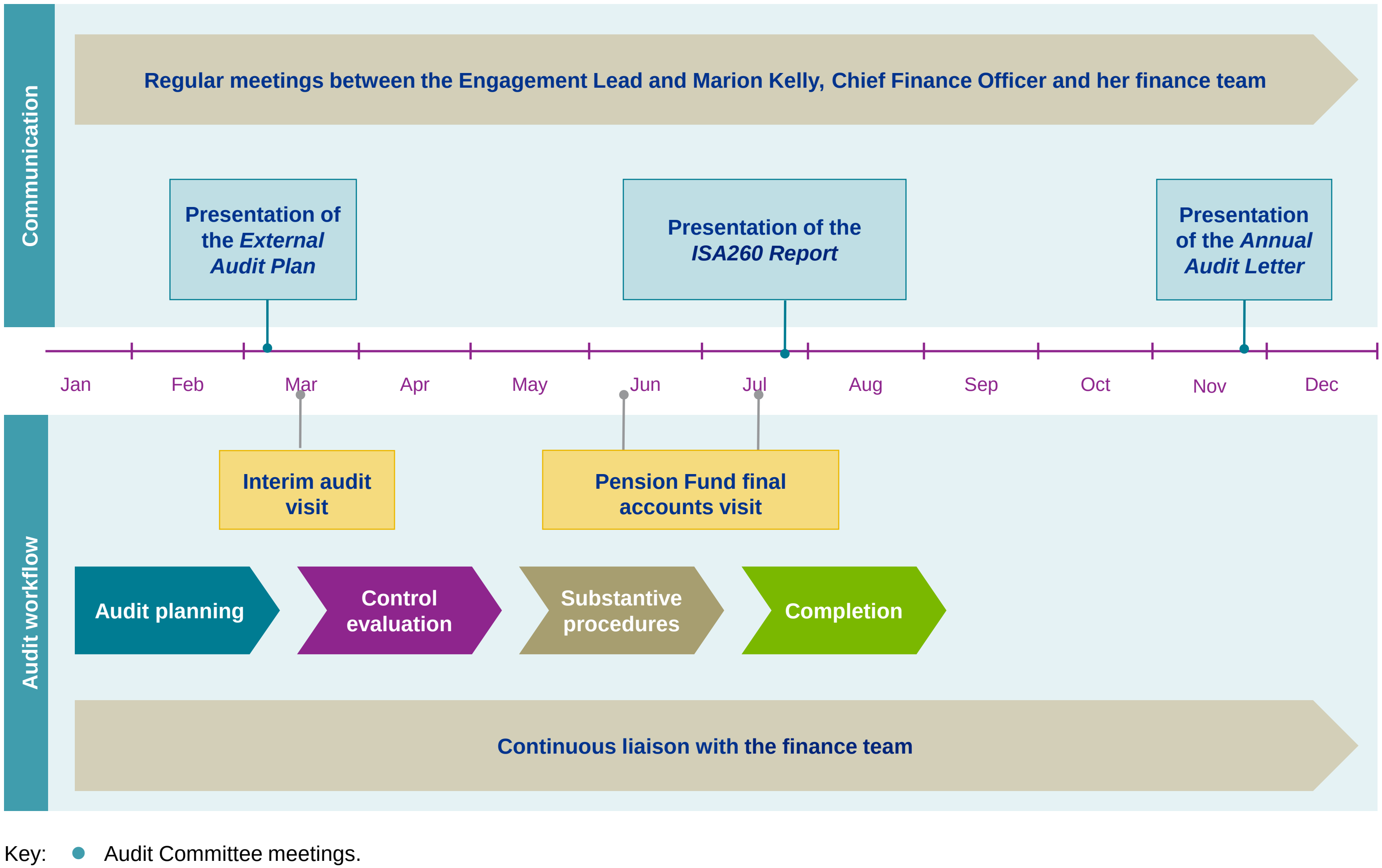
Key formal interactions with the Scrutiny Committee for Audit, Best Value and Community Services are:

- March – External Audit Plan;
- July – ISA 260 Report;
- November – Annual Audit Letter.

We work with the finance team throughout the year.

Our main work on site will be our:

- Interim audit visits during March.
- Final accounts audit during June and July for the Pension Fund.



Audit fee

The main fee for 2014/15 audit of the Pension Fund is £26,607. The fee has not changed from that set out in our *Audit Fee Letter 2014/15* issued in April 2014.

Our audit fee remains indicative and based on you meeting our expectations of your support.

Meeting these expectations will help the delivery of our audit within the proposed audit fee.

Audit fee

Our *Audit Fee Letter 2014/15* presented to you on April 29 2014 first set out our fees for the 2014/15 audit. We have not considered it necessary to make any changes to the agreed fees at this stage.

Element of the audit	2014/15 (planned)	2013/14 (actual)
Pension Fund audit fee	£26,607	£26,607

The fee for 2014/15 is £26,607. This is unchanged from the 2013/14 fee.

Audit fee assumptions

The fee is based on a number of assumptions, including that you will provide us with complete and materially accurate financial statements, with good quality supporting working papers, within agreed timeframes. It is imperative that you achieve this. If this is not the case and we have to complete more work than was envisaged, we will need to charge additional fees for this work. In setting the fee, we have assumed:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2013/14;
- you will inform us of any significant developments impacting on our audit;
- you will identify and implement any changes required under the *CIPFA Code of Practice on Local Authority Accounting in the UK 2014/15* within your 2014/15 financial statements;
- you will comply with the expectations set out in our *Accounts Audit Protocol*, including:
  - the financial statements are made available for audit in line with the agreed timescales;
  - good quality working papers and records will be provided at the start of the final accounts audit;
  - requested information will be provided within the agreed timescales;
  - prompt responses will be provided to queries and draft reports;
- internal audit meets appropriate professional standards;
- internal audit adheres to our joint working protocol and completes appropriate work on all systems that provide material figures for the financial statements and we can place reliance on them for our audit; and
- additional work will not be required to address questions or objections raised by local government electors or for special investigations such as those arising from disclosures under the Public Interest Disclosure Act 1998.

Meeting these expectations will help ensure the delivery of our audit within the agreed audit fee.

The Audit Commission requires us to inform you of specific actions you could take to keep the audit fee low. Future audit fees can be kept to a minimum if the Authority achieves an efficient and well-controlled financial closedown and accounts production process which complies with good practice and appropriately addresses new accounting developments and risk areas.

Changes to the audit plan

Changes to this plan and the audit fee may be necessary if:

- new significant audit risks emerge;
- additional work is required of us by the Audit Commission or other regulators; and
- additional work is required as a result of changes in legislation, professional standards or financial reporting requirements.

If changes to this plan and the audit fee are required, we will discuss and agree these initially with Marion Kelly, Chief Finance Officer.

Appendix 1: Independence and objectivity requirements

This appendix summarises auditors' responsibilities regarding independence and objectivity.

Independence and objectivity

Auditors are required by the Code to:

- carry out their work with independence and objectivity;
- exercise their professional judgement and act independently of both the Commission and the audited body;
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest; and
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Authority invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of Commission-related work, and senior members of their audit teams should not take part in political activity.
- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Firms are expected to comply with the requirements of the Commission's protocols on provision of personal financial or tax advice to certain senior individuals at audited bodies, independence considerations in relation to procurement of services at audited bodies, and area wide internal audit work.
- Auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission.
- Auditors are expected to comply with the Commission's policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the standing guidance.

Appendix 2: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

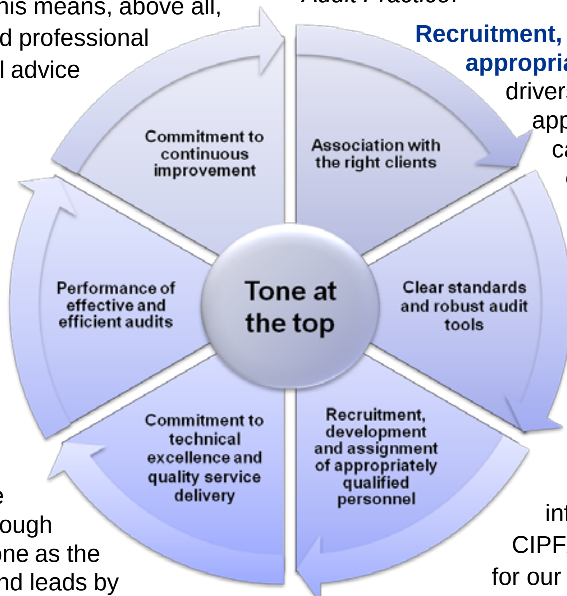
This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

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 2: 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.

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

We are able to evidence the quality of our audits through the results of Audit Commission reviews. The Audit Commission publishes information on the quality of work provided by KPMG (and all other firms) for audits undertaken on behalf of them (http://www.audit-commission.gov.uk/audit-regime/audit-quality-review-programme/principal-audits/kpmg-audit-quality).

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

Appendix 3 : Assessment of fraud risk

We are required to consider fraud and the impact that this has on our audit approach.

We will update our risk assessment throughout the audit process and adapt our approach accordingly.

Managements responsibilities

- Adopt sound accounting policies.
- With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.
- Establish proper tone/culture/ethics.
- Require periodic confirmation by employees of their responsibilities.
- Take appropriate action in response to actual, suspected or alleged fraud.
- Disclose to Scrutiny Committee for Audit, Best Value and Community Services and auditors:
  - any significant deficiencies in internal controls.
  - any fraud involving those with a significant role in internal controls.

KPMG's identification of fraud risk factors

- Review of accounting policies.
- Results of analytical procedures.
- Procedures to identify fraud risk factors.
- Discussion amongst engagement personnel.
- Enquiries of management, Scrutiny Committee for Audit, Best Value and Community Services, and others.
- Evaluate controls that prevent, deter, and detect fraud.

KPMG's response to identified fraud risk factors

- Accounting policy assessment.
- Evaluate design of mitigating controls.
- Test effectiveness of controls.
- Address management override of controls.
- Perform substantive audit procedures.
- Evaluate all audit evidence.
- Communicate to Scrutiny Committee for Audit, Best Value and Community Services and management.

KPMG's identified fraud risk factors

- We will monitor the following areas throughout the year and adapt our audit approach accordingly.
  - Revenue recognition.
  - Management override of controls.

Appendix 4: Transfer of the functions of the Audit Commission

The Audit Commission will be writing to audited bodies and other stakeholders in the coming months with more information about the transfer of the Commissions' regulatory and other functions.

From 1 April 2015 a transitional body, Public Sector Audit Appointments Limited (PSAA), established by the Local Government Association (LGA) as an independent company, will oversee the Commission's audit contracts until they end in 2017 (or 2020 if extended by DCLG). PSAA's responsibilities will include setting fees, appointing auditors and monitoring the quality of auditors' work. The responsibility for making arrangements for publishing the Commission's value for money profiles tool will also transfer to PSAA.

From 1 April 2015, the Commission's other functions will transfer to new organisations:

- responsibility for publishing the statutory Code of Audit Practice and guidance for auditors will transfer to the National Audit Office (NAO) for audits of the accounts from 2015/16;
- the Commission's responsibilities for local value for money studies will also transfer to the NAO; and
- the National Fraud Initiative (NFI) will transfer to the Cabinet Office.

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