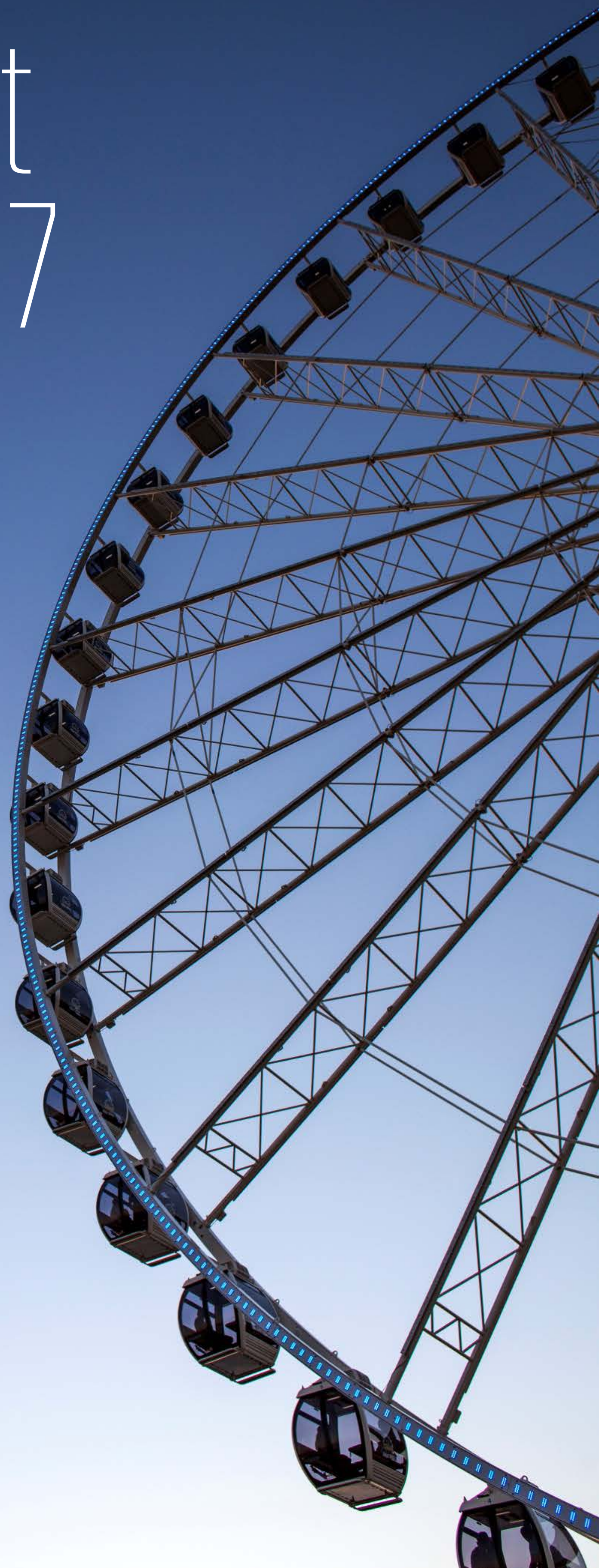
KPMG

External audit report 2016/17



Dorset County Pension Fund

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September 2017

Summary for Pension Fund Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Dorset County Pension Fund ('the Pension Fund').

This report focuses on our on-site work which was completed in June 2017 on the Pension Fund's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on pages 4 – 9.

We issued an unqualified audit opinion in relation to the Pension Fund's financial statements on 24 July 2017.

There was one audit adjustment identified as a result of our audit work related to disclosure between UK and Overseas equities. This is detailed in Appendix 2.

Based on our work, we have raised one recommendation. Details of our recommendations can be found in Appendix 1.

Acknowledgements

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

We ask the Pension Fund Committee to note this report.

The key contacts in relation to our audit are:

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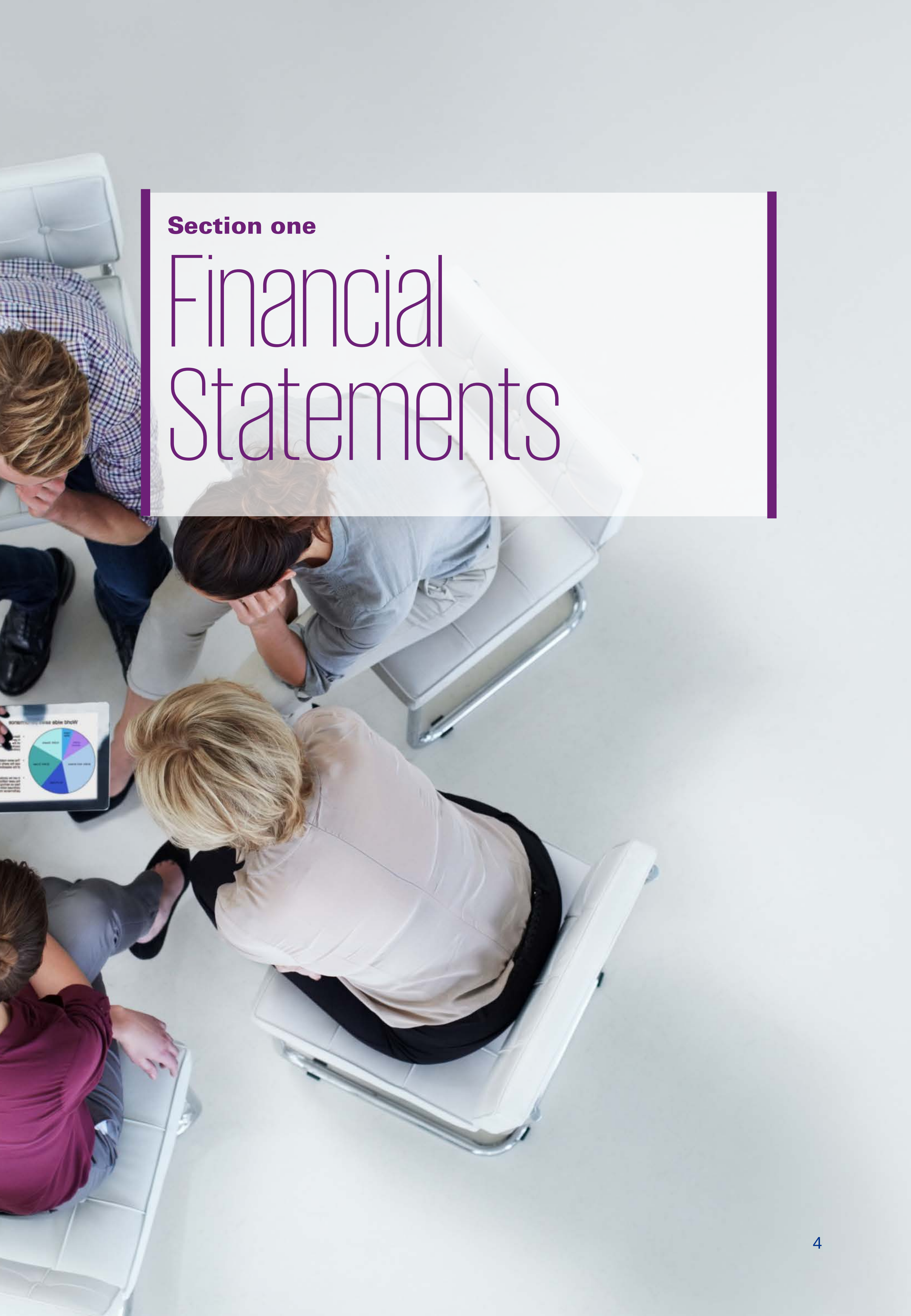
Contents

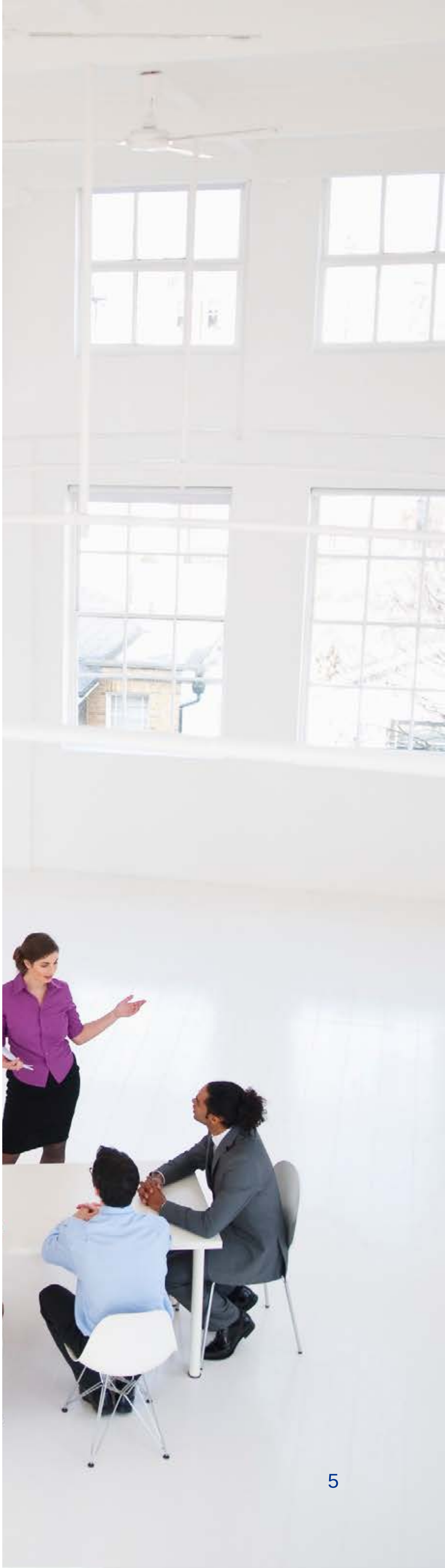
Section one

Financial Statements



We issued an unqualified audit opinion on the Pension Fund financial statements on 24 July 2017.

We have reviewed the Pension Fund Annual Report. The financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.



Considerations required by professional standards

Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our *External Audit Plan 2016/17* 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.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

There are no matters arising from this work that we need to bring to your attention.

The Pension Fund

We issued an unqualified audit opinion on the Fund's 2016/17 financial statements following approval of the financial statements by the Audit and Governance Committee on 24 July 2017.

Pension fund audit

For the audit of the Fund we used a materiality level of £30 million. Audit differences below £1.5 million are not considered significant.

Our audit of the Fund also did not identify any material misstatements. We did identify one classification adjustment required, which is detailed in Appendix 2.

We also identified a small number of presentational and disclosure amendments required to ensure that the accounts are compliant with the Code. The Fund has addressed these where significant.

As a result of our work we have raised one recommendation in relation to notification of deferred members as outlined in more detail in Appendix 1.

Annual report

We have reviewed the Pension Fund Annual Report and identified some minor amendments required. We confirm that:

— The financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

The statutory deadline for publishing the document is 1 December 2017.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on the significant qualitative aspects of the Authority's accounting practices and financial reporting.

We also assessed the Authority's process for preparing the accounts and its support for an efficient audit. The efficient production of the financial statements and good quality working papers are critical to meeting the tighter deadlines.

Accounting practices and financial reporting

The Authority has recognised the additional pressures which the earlier closedown in 2017/18 will bring. We have been engaging with the Authority in the period leading up to the year end in order to proactively address issues as they emerge.

The Authority has strengthened its financial reporting by finalising the accounts in a shorter timescale. This puts the Authority in a good position to meet the new 2017/18 deadline.

We consider the Authority's accounting practices to be appropriate.

Completeness of draft accounts

We received a complete set of draft accounts on 18 May 2017, which is in line with our expectations for this year's audit.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in May 2017 which outlines our documentation request. This helps the Fund to provide audit evidence in line with our expectations. We also discussed specific requirements of the document request list with Management.

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that this has resulted in good quality working papers with clear audit trails.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's 2016/17 financial statements.

Before we issued our opinion we received a signed management representation letter.

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

Declaration of independence and objectivity

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

In relation to the audit of the financial statements of Dorset County Council and Dorset County Pension Fund for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Dorset County Council and Dorset County Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 3 in accordance with ISA 260.

Management representations

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

Other matters

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

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Fund's 2016/17 financial statements.

Appendices

Appendix 1

Key issues and recommendations

Our audit work on the Fund's 2016/17 financial statements identified one issue. We have listed this issue in this appendix together with our recommendation which we have agreed with Management. We have also included Management's responses to this recommendation.

The Authority should closely monitor progress in addressing the risk, including the implementation of our recommendations. We will formally follow up on this recommendation next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority — 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.

Medium priority — 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.

Low priority — Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

2016/17 recommendations summary

Priority	Total raised for 2016/17
High	-
Medium	-
Low	**1**
Total	**1**

Low priority

1. Notification of deferred members

When testing controls over the membership data in Altair, we noted that the pension fund is reliant upon receiving the notice of termination in a timely manner from the payroll department of the admitted body. Our sample testing identified that a notice of termination form was not always received and so the system was not updated until the pensions team carried out the year end check, to ensure that all deferred members have been removed from their system.

Recommendation

We understand that the pension fund will be moving to a new process whereby contributions received on a monthly basis will be identified by individual. We recommend that the pension fund specifically request that admitted bodies flag any changes in membership as part of this process to ensure that new starters and leavers are identified on a timely basis.

Management Response

Accepted. We will review membership numbers on a more frequent basis throughout the year.

Owner

Karen Gibson

Deadline

31 March 2018

Materiality and reporting of audit differences

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

Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2016/17, presented to the Audit and Governance Committee in March 2017.

Materiality for the Pension Fund was set at £30 million which is approximately 1.1 percent of gross assets.

Reporting to the Audit and Governance 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 and Governance 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 Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £1.5 million for the Pension Fund.

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

Adjusted audit differences

The following table sets out the significant audit differences identified by our audit of the Pension Fund's financial statements for the year ended 31 March 2017.

Table 1: Adjusted audit differences (£'000)

No.	Fund account: Dealings with members	Fund account: Returns on investments	Net assets statement: Investment assets	Net assets statement: Net current assets	Basis of audit difference
1	-	-	Dr UK equities (quoted) £42,700 Cr Overseas equities (quoted) (£42,700)	-	£42.7m of UK equities was incorrectly classified within the Overseas Equities balance. This has now been corrected in the Net Assets Statement and Note 11 to be classified within UK investments.
	-	-	**£0**	-	**Total impact of uncorrected audit differences**

There were no significant unadjusted audit differences.

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

> *"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."*

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd Terms of Appointment ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 Integrity, Objectivity and Independence ('Ethical Standards').

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

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our Annual Audit Letter.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from his. These matters should be discussed with the Audit and Governance Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Dorset County Pension Fund for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Dorset County Pension Fund, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Independence breach

In March 2008 and March 2010, the KPMG EU Funds Tax team entered into an agreement to provide tax services relating to the recovery of tax credits on foreign income dividends and overseas dividends and recovery of withholding tax on manufactured overseas dividends respectively to Dorset County Pension Fund. These engagements were on a contingent fee basis and at that time contingent fees on such services for audit clients were permitted.

In late 2010 the UK APB Ethical Standards for Non-Audit Services were revised, significantly restricting the ability for audit firms to deliver tax services to their UK audit clients on a contingent fee basis where the uncertainty surrounding the claim related to tax law which was uncertain or had not been established. Grandfathering provisions allowed existing contingent fee engagements entered into before 31 December 2010 with existing UK audit clients to continue unaffected until 31 December 2014. By that point in time the regulator (the APB) expected the services to be delivered and the fees settled.

From 1 January 2015 the services would not have been permissible under Para 95 of the APB's Ethical Standard which prohibited contingent fee based tax engagements where the tax matter was uncertain or unestablished. This prohibition remains under the current FRC Revised Ethical Standard although the wording differs slightly.

Given the timeframe this matter has been under discussion with HM Revenue & Customs ('HMRC'), we consider that this factor alone would, to a third party, be indicative of a tax matter which was contentious in nature and would be likely to be viewed as 'uncertain or unestablished' and we have treated this as such. Consequently, the contingent fee arrangements for recovery of tax credits on foreign income dividends and overseas dividends and recovery of withholding tax on manufactured overseas dividends are not permissible for audit clients and as a result the continuation of this contingent fee arrangement is a breach of our firm's independence. In late 2014 we should have identified this service and either brought the engagement to a close or replaced the fee arrangement with an alternative time and materials fee basis to ensure compliance with the UK Ethical Standards by 1 January 2015.

We note that since September 2010 there had been no advice provided by KPMG as Pinsent Masons have been pursuing these claims through the Courts under a direct engagement. No further fees have been raised for the work since the initial work was completed in 2008 and 2010 (and the corresponding fees were raised in September 2008 and 2010 respectively).

We have considered the facts and do not believe the breach to be significant in terms of our overall consideration of independence and objectivity as your auditor. The factors we have taken into account include:

— The audit team were not aware of the existence of the service until April 2017 and as a result this would not have impaired their objectivity for the audit periods up to 31 March 2016.

— No fees in relation to this tax engagement have been billed to Dorset County Pension Fund since the change (effective from 1 January 2015) to UK APB Ethical Standards for Non-Audit Services were revised significantly restricting the ability for audit firms to deliver tax services to their UK audit clients on a contingent fee basis.

— The amount of the tax repayments under dispute the level of fees would not be material to either party.

— At no point would the outcome of the tax matters under dispute have been material to the financial statements. In addition as the matter is still unsettled the potential tax repayment has not been recognised in the accounts of the pension fund.

Based on the above, in our professional judgement, we have concluded that our objectivity as auditor has not been compromised and the firm and the engagement team maintained their independence of Dorset County Pension Fund. Finally, we can confirm that we have now terminated these engagements with immediate effect. We have also formally notified Public Sector Audit Appointments Limited of this matter.

Appendix 4

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit of the pension fund is £25,146 plus VAT *(£25,146 in 2016/17)*.

PSAA fee table		
Component of audit	**2016/17** *(planned fee)* £	**2015/16** *(actual fee)* £
Accounts opinion and use of resources work		
Pension Fund audit	25,146	25,146
Additional fee in relation to work on behalf of admitted body auditors*	2,227	2,227
Total fee for the Authority set by the PSAA	**27,373**	**27,373**

All fees are quoted exclusive of VAT.

*As in previous years, we have been requested to carry out additional work on the Pension Fund by the auditors of Dorset Fire Authority, the Crime Commissioner for Dorset and Chief Constable of Dorset Police, Bournemouth Borough Council, Borough of Poole, Christchurch Borough Council, East Dorset District Council, North Dorset District Council and Purbeck District Council. The Pension Fund is able to recharge these costs back to the admitted bodies. Our fee for this additional work is £2,227 and has been approved by Public Sector Audit Appointments Ltd.