cutting through complexity

Draft Report to those charged with governance (ISA 260) 2014/15

The Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority

September 2015

Contents

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

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

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Tim Cutler the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for the Authority; and**
- **our assessment of the Authority's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at The Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority (the Authority) in relation to the Authority's 2014/15 financial statements; and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources (VFM conclusion).

Financial statements

Our *External Audit Plan 2014/15*, presented to you in March 2015, set out the four stages of our financial statements audit process.

This report focuses on the second and third stage of the process: control evaluation and substantive procedures. Our on site work for this took place during July, August and September 2015.

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work, which follows guidance provided by the Audit Commission. We have now completed our work to support our 2014/15 VFM conclusion.

In the case of the Authority this means the scope of our work on value for money is limited to a review of your annual governance statement (AGS) unless any specific risks are identified.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out the key findings from our audit work in relation to the 2014/15 financial statements of the Authority.
- Section 4 outlines the key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1.

Acknowledgements

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

Headlines

This table summarises the headline messages for the Authority. The remainder of this report provides further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015 subject to satisfactory clearance of our closing procedures. We will also report that your Annual Governance Statement complies with extant guidance issued by CIPFA/SOLACE.
Audit adjustments	We have identified a number of issues which have led to material adjustments to the financial statements. These adjustments mainly reflect changes in the opening balances of the consolidated accounts. None of the changes resulted in an adjustment in the final retained reserves position. There were no uncorrected audit misstatements above the level that we are required to report to the Audit Committee. The corrections to the accounts are summarised at Appendix 2. The most significant amendments relate to the following issue: • The issuing of CIPFA Guidance in relation to accounting for Infrastructure has clarified that certain assets and Transport Interchanges should be accounted for as Property rather than as Infrastructure. The consequence of this is that these assets had to be revalued on a depreciated replacement cost (DRC) rather than depreciated historic cost (DHC) basis. • The draft accounts of Merseytravel were prepared showing a current year amendment for the changes in valuation. However, International Accounting Standards require these adjustments to be corrected in the earliest possible year. This resulted in significant adjustments in the Merseytravel accounts along with the disclosure of a revised balance sheet as at 1 April 2013. The impact on the Authority was to revise the opening balances as at 1 April 2014 in the Group accounts. • As a consequence, the opening balances of Property, Plant and Equipment (PPE), the revaluation reserve and the Deferred Capital Grants were amended. The closing balances were unaffected by these changes. • A further amendment was made to include the pay of senior members of Merseytravel staff in the Group accounts. We have raised one recommendation in relation to the matters highlighted above. This is summarised in Appendix 1.

Headlines

Key financial statements audit risks	We review risks to the financial statements on an ongoing basis. We identified the following key financial statements audit risks in our 2014/15 External audit plan issued in March 2015: ▪ The consolidation of the Merseytravel accounts, as there was a risk that the previous consolidation procedures applied to the Integrated Transport Authority would not be appropriate. ▪ The recognition of income from the tunnels, as significant volumes of transactions are disclosed in the accounts and there is a risk of misstatement. ▪ Override of management controls We have worked with officers throughout the year to discuss these key risks and our detailed findings are reported in Section 3 of this report. There are no matters of significance arising from our work on the above issues other than the corrections to the opening balances referred to on the previous page and we would like to recognise the work carried out by the Finance Department in connection with these.
Accounts production and audit process	The Authority has made some improvements in the quality of the accounts and the supporting working papers but more can be achieved. The issues in relation to the prior period adjustments will be encountered again in 2016/17 when full implementation of CIPFA's changes to Infrastructure accounting is required. We will work with you to help ensure that the problems which arose in the current year are not repeated. Our audit also identified a number of problems in the quality of the Movement in Reserves Statement and associated working papers. As a consequence of the additional work required to address the above issues and review several iterations of the financial statements it will be necessary to raise an additional fee for the Merseytravel audit. We will discuss this with the Director of Resources once we have completed our closing procedures.

Headlines

Completion	At the date of this report our audit of the financial statements is substantially complete subject to finalisation of our closing procedures. Before we can issue our opinion we require a signed management representation letter. Our opinion will be issued in time to meet the 30 September 2015 submission deadline. However, we have received an objection to the accounts in relation to accounting for the tunnels. We have commenced our work in response to this but the work is unlikely to be complete by 30 September so our certification of the completeness of the 2014/15 audit is likely to be delayed. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements.
VFM conclusion and risk areas	The Audit Commission determined that the scope of our work on value for money at the Authority is limited to a review of your annual governance statement (AGS) unless any specific risks are identified. We identified one specific risk in our plan: ■ The Authority's Governance Arrangements – the creation of the new Authority meant that governance arrangements needed to be revised and arrangements for securing value for money needed to be reviewed to ensure that they are fit for purpose. We have reviewed your AGS and concluded that it accurately reflects the Governance issues facing the Authority. You have made good progress in establishing the Authority's new arrangements and these now need to be embedded. We have also followed up VFM related recommendations previously made to Merseyside Integrated Transport Authority, particularly in relation to the 2012 Peer review, and note that the recommendations are now substantially implemented. This is a major achievement for the Authority and Merseytravel.

Proposed opinion and audit differences

Our audit has identified audit adjustments. The impact of these adjustments is to:

- **Restate opening balances.**
- **Restate the Group and Authority surplus with compensating adjustments being made to the MIRS.**
- **Group and Authority net assets at 31 March 2015 were unchanged as a result of the above amendments.**
- **Enhance the disclosure of information in the Notes to the Accounts.**

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on the Authority's financial statements following approval of the Statement of Accounts by the Authority on 25 September 2015.

Materiality

The final materiality level for this year's Group audit was set at £5.3m (see Appendix 4 for more information on materiality). This represents an increase from the materiality communicated to you in our plan of £4.6 million and was updated on receipt of the Authority's draft accounts. Audit differences below £265k are not considered significant. The final materiality for the Authority's own accounts was £4m and differences below £230k are not considered significant.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

There are no uncorrected misstatements.

Our audit identified a range of audit differences that have been adjusted in the accounts. These mainly arose due to amendments made to the Merseytravel accounts and all significant amendments are set out in Appendix 2.

The most significant amendments relate to the following issue:

- The issuing of CIPFA Guidance in relation to accounting for Infrastructure has clarified that certain assets and Transport Interchanges should be accounted for as Property rather than as Infrastructure. The consequence of this is that these assets had to be revalued on a depreciated replacement cost (DRC) rather than depreciated historic cost (DHC) basis.

The draft accounts of Merseytravel were prepared showing a current year amendment for the changes in valuation. However, International Accounting Standards require these adjustments to be corrected in the earliest possible year. This resulted in significant adjustments in the Merseytravel accounts along with the disclosure of a revised balance sheet as at 1 April 2013. The impact on the Authority was to revise the opening balances as at 1 April 2014 in the Group accounts.

As a consequence, the opening balances of Property, Plant and Equipment (PPE), the revaluation reserve and the Deferred Capital Grants were amended. The closing balances were unaffected by these changes.

Audit differences continued

Audit differences (continued)

The net impact on the accounts of the adjustments is:

- An increase in the surplus of the Authority by £2,496k as a consequence of separate disclosure of its valuation losses.
- A decrease in the surplus of the Group by £1,392k as a consequence the separate disclosure of Merseytravel's revaluation gains.
- A reduction in the opening Group net assets by £2,371k but no change in the opening position for the Authority. The net assets at 31 March 2015 remained unchanged as a consequence of the changes.

A further amendment was made to include the pay of senior members of Merseytravel staff in the Group accounts.

In addition, we identified a range of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 (the Code)*. These have been corrected where significant.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

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

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

This section sets out our detailed findings on those risks.

In our External Audit Plan 2014/15, presented to you in March 2015, we identified the significant risks affecting the Authority's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

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

Significant audit risk	Issue raised	Findings
Group accounts	As this is the first year of preparing Liverpool City Region group accounts there was a risk that previous consolidation procedures applied to the Integrated Transport Authority may not be appropriate.	We found your arrangements for preparing Group accounts were satisfactory. Whilst changes were made to the accounts of Merseytravel these were correctly consolidated into your accounts. We are satisfied that the treatment by the Authority is materially accurate.
Tunnels' income	Significant volumes of transactions are disclosed in the accounts and there is a risk of misstatement.	We are satisfied that tunnels' income is not materially misstated.

Section three

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

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

This section sets out our detailed findings on those risks.

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you.

These risk areas were ‘Management override of controls’ and the ‘Fraud risk of revenue recognition’.

The table below sets out the outcome of our audit procedures and assessment of these risk areas.

Areas of significant risk	Summary of findings
Management override of controls	Our audit methodology incorporates the risk of management override as a default significant risk. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual. There are no matters arising from this work that we need to bring to your attention.
Fraud risk of revenue recognition	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 2014/15 we reported that we do not consider this to be a significant risk for the Authority as there is unlikely to be an incentive to fraudulently recognise revenue. This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Financial Statements (continued)
Accounts production and audit process

We have noted an improvement in the quality of the accounts and the supporting working papers but more can be done.

Officers dealt efficiently with audit queries and the audit process was completed within the planned timescales albeit involving additional audit work.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

Element	Commentary
Accounting practices, working papers and financial reporting	The Authority has dealt effectively with a number of complex accounting issues in the year. Our *Accounts Audit Protocol*, which we discussed with the Head of Finance, set out our working paper needs for the audit. The Authority has strengthened its financial reporting process through improvements in working papers and increased management supervision. However, there is scope to improve this further – see Appendix 1.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June which meant that you met the deadline for preparing accounts.
Response to audit queries	Officers resolved audit queries in a reasonable time although processing the Merseytravel prior period adjustments did present some difficulty.

Prior year recommendations

There were no prior year recommendations to follow up.

Financial Statements (continued) Completion

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

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

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

We will not be able to close our audit until we have finalised our response to an elector's objection to an item in the accounts.

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 The Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority for the year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and The Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority, 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 have provided a template to the Head of Finance for presentation to the Authority's Audit Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

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

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

There are no others matters which we wish to draw to your attention in addition to those highlighted in this report.

Electors' rights

An elector has exercised his right to object to the accounts. He has requested that we:

- apply to the court under Section 17 of the Audit Commission Act 1998 for a declaration that there is an unlawful item of account; and
- issue a public interest report under Section 8 of the Act, to bring the matter to the attention of the public.

We are currently in the process of investigating this objection and, until our work is complete, we are unable to close the audit.

VFM conclusion

Our approach to VFM work follows guidance provided by the Audit Commission and adopted by PSAA Ltd.

Background

Auditors are required to give their statutory VFM conclusion based on criteria specified by the Audit Commission. For 2014/15, auditors of bodies such as the Authority will continue to meet their VFM duty by:

- reviewing the annual governance statement (AGS);
- reviewing the results of the work of the Commission and other relevant regulatory bodies or inspectorates, to consider whether there is any impact on the auditor's responsibilities at the audited body; and
- undertaking other local risk-based work as appropriate, or any work mandated by the Commission.

We reported our initial risk assessment in our audit plan.

There was one area of risk that we identified to investigate:

- The Authority's Governance Arrangements – the creation of the new Authority meant that governance arrangements needed to be revised and arrangements for securing value for money needed to be reviewed to ensure that they were fit for purpose.

We have reviewed your arrangements and have concluded that you have adequate arrangements in place. You have clearly identified, in your Annual Governance Statement, the areas where you consider further development is required. This assessment is consistent with our knowledge of the Authority.

We also note that Merseytravel has yet to establish its own Audit Committee and we fully support the development of this body and would encourage the involvement of independent Non-Executive Directors. We consider that such a development will increase the challenge to Merseytravel's auditors and strengthen the risk assessment process.

We would also expect that as the Authority's own Audit Committee fully establishes itself, a similar increase in challenge to its auditors and risk assessment processes will ensue.

Conclusion

We have made recommended to Merseytravel that an Audit Committee is established as a priority.

Appendix 1: Key issues and recommendation

We have given the recommendation a risk rating and set out what action management will need to take. The Authority should closely monitor progress in addressing specific risks and implementing our recommendation. We will formally follow up the recommendation next year.

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

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Accounts production** There were a number of material changes required to the draft accounts, mainly arising from the Prior Period Adjustments. Whilst the working papers were adequate, there is scope to improve the quality of the working papers that support the accounts. This was particularly the case in relation to the Movement in Reserves Statements. **Recommendation** The Authority should ensure that it produces comprehensive working papers to support the figures in the accounts. When future Prior Period Adjustments are required, the Authority should model the changes to the accounts for our consideration prior to the year end.	Agreed. **Head of Finance.** **For 2015/16 accounts.**

Appendix 2: Audit differences

This appendix sets out the significant / non-trivial audit differences that have been corrected.

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which for 2014/15 is the Authority's Audit Committee). There are no matters to report. We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

Corrected audit differences

The following table sets out the audit differences identified by our audit of the Authority's financial statements for the year ended 31 March 2015. In addition a number of cosmetic adjustments have been made to the accounts.

No.	Area of accounts	Amendments
1	Comprehensive Income and Expenditure Statement. Movement in Reserves Statements (MIRS) Opening balance sheet Cash flow statement	The draft accounts included the revaluation gains and losses within the Net Cost of Services rather than disclosing them separately. As a consequence of the resulting amendment, the Cost of Services reduced by £2,496k for the Authority and a loss on revaluation of the same amount was disclosed as Other Comprehensive Income and Expenditure. At Merseytravel, there was a revaluation gain in 2014/15 that exceeded the loss at the Authority. Consequently the Group accounts show an increased Net Cost of Services of £1,392k as a consequence of separating this surplus out. A further revaluation amendment was required for Merseytravel as part of a prior period adjustment and this led to a net reduction in the Group Surplus for 2014/15 of £2,370k. The above adjustments also affected the MIRS. As the overall impact of the Prior Period Adjustment was neutral, this £2,370k adjustment led to an increase in the Group Net Assets at 1 April 2014. This adjustment mainly affected the unusable reserves. The Group and Authority Cash Flow from Operating activities did not change but a consequence of the above alterations was to generate some offsetting adjustments on the face of the cash flow statement.
2	LCRCA and Group Balance Sheet Short term debtors – Note 24 Short term creditors – Note 26	Our audit identified the need to gross up both debtors and creditors by £252k to correct a minor disclosure error.

Appendix 2: Audit differences (continued)

This appendix sets out the significant/non-trivial audit differences. These have all been adjusted.

No.	Area of accounts	Other amendments
3	Other MIRS adjustments	The £2,370k adjustment referred to above, comprised an increase in the 1 April Revaluation Reserve of £8,613k and a reduction in Deferred Capital Grants of £6,219k. The remaining £24k adjustment was trivial in nature. These adjustments only affected the Group MIRS.
4	MIRS continued Note 4 – Adjustments under regulations Note 5 – Segmental reporting	There was a netting off in the Group MIRS in relation to the 'release of reserves re depreciation' and the 'release of reserves for asset revaluation' which led to an understated transfer from revenue reserves. £7,321k was netted off but the net effect was neutral. The above adjustments were also recognised in Notes 4 and 5.
5	Note 9 – Staff costs	The draft accounts omitted Senior Officers' Pay from the Group accounts disclosures. The table disclosing the information has now been added.
6	Note 15 – Property plant and equipment (PPE)	A number of amendments were made to the Group PPE statement. The Prior Period Adjustment, referred to earlier, led to an increase of £2,370k in the valuation as at 1 April 2014. This amount was originally shown split across four of the sub headings as 2014/15 revaluations. Further adjustments were required to reduce the cumulative depreciation to zero for all classifications other than Infrastructure by adjusting the cost or balance row of the table. This was required to show the value of the assets as a single figure at the year end due to the revaluations that were carried out. The elimination of cumulative depreciation adjustment was also made to the Authority's non-infrastructure PPE.
7	Note 24 - Debtors	The Group balance of £13,386k originally classified as 'Public corporations and trading funds was reclassified to 'Other bodies'.
8	Note 26 – Creditors	A misclassification of the balance owing by the Authority (£27,100k) to Merseytravel was corrected from the 'Other entities and individuals' row to the 'Other local authorities' row. The comparative balance was similarly corrected.

Appendix 3: Declaration of independence and objectivity

The *Code of Audit Practice* requires us to exercise our professional judgement and act independently of both Public Sector Audit Appointments Ltd and the Authority.

Requirements

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

"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."

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

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

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

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

Appendix 3: Declaration of independence and objectivity (continued)

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

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

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

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

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

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

Auditor declaration

In relation to the audit of the financial statements of The Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and The Halton, Knowsley, Liverpool, St Helens, Sefton and Wirral Combined Authority, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix 4: Materiality and reporting of audit differences

For 2014/15 our materiality is £4.0 million for the Authority's accounts and £5.3m for the Group accounts.

We have reported all audit differences over £230,000 for the Authority and over £265k for the Group.

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.

We updated our Group materiality level from that reported in our External Audit Plan 2014/15, presented to you in March 2015, from £4.6m to £5.3m.

Materiality for the Authority's accounts was set at £4.0m which equates to around 1.5 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Authority

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 Authority 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 £230k for the Authority (Group £265k).

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

Appendix 5: 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.

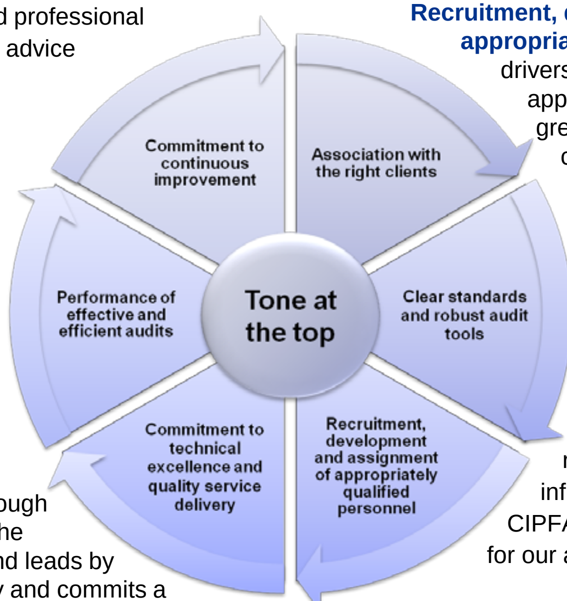
KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

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. Tim Cutler 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 5: KPMG Audit Quality Framework (continued)

We continually focus on delivering a high quality audit.

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

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery: Our professionals bring you up-to-the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report (issued June 2014/2015) showed that we are meeting the overall audit quality and regulatory compliance requirements.

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