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Private & confidential

Brian Roberts
 Director of Corporate Resources
 Leicestershire County Council
 Leicestershire County Council Pension
 Fund
 County Hall
 Leicester
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12 October 2017

Dear Brian

Our professional standards require that where the firm has determined that a breach of an independence standard has occurred, we discuss the breach and the action we have taken/propose to take with you as soon as possible, and to communicate with you in writing all matters discussed and obtain your concurrence that action can be, or has been, taken to satisfactorily address the consequences of the breach. This letter is intended to comply with these requirements.

Independence breach

In February 2011 and April 2013, the KPMG EU Funds Tax team entered into an agreement to provide tax services relating to the recovery of withholding tax on manufactured overseas dividends to Leicestershire County Council Pension Fund (copy of the engagement letters enclosed). This engagement was on a contingent fee basis.

As you may be aware in late 2010 the UK APB Ethical Standard 5 revised (provision of non-audit services provided to audited entities) was revised significantly restricting the ability for audit firms to deliver tax services to their UK audit clients on a contingent fee basis where the outcome of the services related to tax law which was uncertain or had not been established.



The first audit period where KPMG was the auditor of Leicestershire County Council Pension Fund was financial year 2015/2016. As part of taking on a new audit we were required to review all current non-audit services to ensure independence was not impaired on 1 April 2015 – being the date KPMG were formally appointed auditors. At that time the services would not have been permissible under para 95 of the APB Ethical Standard 5 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 HMRC, 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 withholding tax on manufactured overseas dividends are not permissible for audit clients and as a result this arrangement is a breach of our firm's independence. On becoming auditor we should identified this service and either brought the engagement to a close or replaced it with an alternative time and materials fee basis to ensure compliance with the UK Ethical Standards.

Appendix 1 sets out our firm's policies and procedures to manage our independence requirements with our audit clients.

Circumstances of the breach

The sporadic nature of the engagement (i.e. for long periods there was no contact with HM Revenue & Customs ('HMRC') and the engagement was, in effect, latent in nature) was the primary reason that the non-audit service went undetected.

Since April 2013 there has 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 2011 and 2013 (and the corresponding fees were raised in April 2011 and 2013 respectively).

In addition to the above, there was some lack of continuity over these years due to several changes to the team dealing with these claims which has had an impact on the team's compliance with internal procedures that we are required to undertake on a periodic basis. The current team who took over responsibility for these claims earlier this year identified this engagement as part of their general engagement management.

Assessment of significance of the breach

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:



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- 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 services have been provided since KPMG's appointment as auditor to Leicestershire County Council Pension Fund.
- The tax claims made amount to £1,464,999.51. This is not regarded as material to the financial statements of Leicestershire County Council Pension Fund.
- The tax claims are still unsettled and consequently 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 Leicestershire County Council Pension Fund.

Accordingly, KPMG have formally notified Leicestershire County Council Pension Fund in writing that the engagement is terminated with immediate effect to ensure compliance with the UK FRC Revised Ethical Standard.

We would be pleased to provide any further information you require.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'J. Cornett', with a horizontal line underneath.

John Cornett

Director, KPMG LLP

cc:

PSAA

Chris Tambini, Leicestershire County Council



Appendix - Description of the firm's policies and procedures

General Independence

KPMG member firms and KPMG professionals are required to comply with independence standards that meet or exceed those set out in the IESBA Code of Ethics. In addition, KPMG LLP and our professionals are also required to comply with APB Ethical Standards.

Our firm has a designated Ethics and Independence Partner (EIP) supported by a core team of specialists to help ensure that we implement robust and consistent independence policies and procedures. These policies and procedures cover areas such as personal independence, firm financial independence, business relationships, post-employment relationships, partner rotation, and approval of audit and non-audit services. Ethics and independence policies are communicated through the issuance of a quality and risk manual and an annual training programme. If applicable, amendments to the ethics and independence policies in the course of the year are communicated by e-mail alerts and included in regular quality and risk communications.

Independence Training and Confirmations

Our firm provides all relevant personnel with annual independence training appropriate to their grade and function, and provides all new personnel with relevant training when they join.

Non-Audit Services

Our firm has policies as to the scope of services that can be provided to audit clients which are consistent with IESBA principles and applicable laws and regulations. KPMG International policies require the lead audit engagement partner to evaluate the threats arising from the provision of non-audit services, and the safeguards available to address those threats.

KPMG International's proprietary system, Sentinel™, facilitates compliance with these policies. Lead audit engagement partners are required to maintain group structures for their publicly traded and certain other audit clients and their affiliates in the system. Every engagement entered into by a KPMG member firm is required to be included in the system prior to starting work. The system enables lead audit engagement partners for entities for which group structures are maintained to review and approve, or deny, any proposed service for those entities worldwide.

In accordance with applicable auditor independence rules, none of our audit partners are compensated on their success in selling non-audit services to their audit clients.



Monitoring

KPMG International has an integrated monitoring programme that covers all member firms to assess the relevance, adequacy, and effective operation of key quality control policies and procedures. This monitoring addresses both engagement delivery and KPMG International policies and procedures. The results and lessons from the programmes are communicated within each member firm, and the overall results and lessons from the programmes are considered and appropriate actions taken at regional and global levels. Our internal monitoring programme also contributes to the assessment of whether each member firm's system of quality control has been appropriately designed, effectively implemented, and operates effectively.

Our monitoring procedures involve ongoing consideration of:

- compliance with KPMG International policies and procedures
- the effectiveness of training and other professional development activities
- compliance with applicable laws and regulation and member firms' standards, policies, and procedures.

Two KPMG International developed and administered inspection programmes are conducted annually across the Audit, Tax, and Advisory functions, the Quality Performance Review (QPR) Programme and the Risk Compliance Programme (RCP).

Additionally, all member firms are covered by cross-functional Global Compliance Reviews (GCRs). These programmes are designed by KPMG International and participation in them is a condition of ongoing membership of the KPMG network.

Quality Performance Reviews (QPRs)

The international QPR Programme is the cornerstone of our efforts to monitor engagement quality, and one of our primary means of ensuring that member firms are collectively and consistently meeting KPMG International's requirements and applicable professional standards. The QPR Programme assesses engagement level performance in the Audit, Tax, and Advisory functions and identifies opportunities to improve engagement quality.

All engagement partners are generally subject to selection for review at least once in a three-year cycle. The reviews are tailored to the relevant function, performed at a member firm level, overseen by a lead reviewer from outside the member firm, and are monitored regionally and globally.

We perform a root cause analysis for pervasive issues. Remedial action plans for all significant deficiencies noted are required at an engagement and member firm level. WE disseminate our findings from the QPR Programme to our professionals through written communications, internal training tools, and periodic partner, manager and staff meetings. These areas are also emphasized in subsequent inspection programmes to gauge the extent of continuous improvement.



Lead audit engagement partners are notified of less than satisfactory engagement ratings on their respective cross-border engagements. Additionally, lead audit engagement partners of parent companies/head offices are notified when a subsidiary/affiliate of their client group is audited by a member firm where significant quality issues have been identified during the Audit QPR.

Risk Compliance Programme (RCP)

The RCP is a member firm's annual self-assessment programme. The objectives of the RCP are to monitor, assess, and document member firm-wide compliance with the system of quality control established through KPMG International's quality and risk management policies and applicable legal and regulatory requirements as they relate to the delivery of professional services. The programme is overseen and monitored regionally as well as globally.

Global Compliance Review (GCR) programme

GCRs are performed by reviewers independent of the member firm, who report to Global Quality & Risk Management and are led by the Global Compliance Group. GCRs are carried out on member firms once in a three-year cycle. These reviews focus on significant governance, risk management, independence, and finance processes (including an assessment of the robustness of the firm's RCP).

In the event that a GCR identifies issues that require immediate or near-term attention, a follow-up review will be performed as appropriate. All three programmes require action plans to address identified issues, with time lines, to be developed by the member firm, and these actions to improve performance are followed up at the regional and global level to ensure that the actions address the identified issues with the objective of continuous improvement.

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