Agenda Item

Report to:	**Audit and Best Value Scrutiny Committee**
Date:	**4 March 2011**
By:	**Deputy Chief Executive and Director of Corporate Resources**
Title of report:	**External Audit Plan for East Sussex Pension Fund 2010/11**
Purpose of report:	**To inform the Committee of the content of the external audit plan the East Sussex Pension Fund for 2010/11**

RECOMMENDATION:

The Committee is recommended to consider and comment upon the External Audit Plan for the East Sussex Pension Fund for 2010/11.

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1. Financial Appraisal

1.1 The Plan confirms the external audit fee for the Pension Fund as £44,878 a reduction of c15% on 2009/10. The fee is charged to the Pension Fund and not to the Council itself.

2. Supporting Information

2.1 The Plan sets out in more detail the work the external auditors will conduct in order to audit the Pension Fund's 2010/11 accounts. The Plan now reflects any relevant issues that have arisen as a result of the audit of the 2010/11 Pension Fund accounts and other work carried out by PKF. The main risk identified by PKF is:

- The valuation of private equity and infrastructure assets held by the Pension Fund;

In addition the external auditor is requiring the Pension Fund to provide greater assurance over the accuracy of employee contributions paid by admitted and scheduled bodies to the Pension Fund. Officers are liaising with the external auditors to determine what level of assurance is required and how this can best be achieved, for example by internal audit performing the required work.

2.2 Officers will continue to liaise with PKF to ensure that their work is delivered as efficiently and effectively as possible and that internal and external audit plans are complementary and make best use of audit resources. The Plan will be reported to the Governance Committee (the parent committee for the Pension Fund) for approval on 8 March 2011.

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Deputy Chief Executive and Director of Corporate Resources

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Local Member: All

<u>BACKGROUND DOCUMENTS</u>
None

Accountants &
business advisers

East Sussex Pension Fund

Audit Plan 2010/11

December 2010



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Appendices

Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission contains an explanation of the respective responsibilities of auditors and of the audited body. Reports and letters prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.

Code of Audit Practice

Statement of Responsibilities

1 Executive summary

1.1 This Audit Plan sets out the audit work that we propose to undertake for the 2010/11 financial year. The scope of the audit is determined by the Audit Commission's Code of Audit Practice ("the Code") and PKF's risk-based approach to audit planning.

1.2 Our responsibility is to audit the financial statements of the Pension Fund, which are published alongside the financial statements of East Sussex County Council. We are also required to include a report in the Pension Fund Annual Report on our audit of the financial statements and various other matters related to the content of the Annual Report.

Significant risks

1.3 The key audit risk identified by our risk assessment relates to the accuracy of the figures included in the financial statements for private equity and infrastructure assets. Further detail is provided in section 3.

Fees

1.4 Based on our assessment of risk, we propose an audit fee of £44,878, which is chargeable directly to the Pension Fund. This remains the same as the fee proposed in our audit fee letter presented to the Audit and Best Value Scrutiny Committee in June 2010.

1.5 In our 2009/10 Annual Governance Report presented to the Audit and Best Value Scrutiny Committee in September 2010, we reported that there was no documented audit trail for any checks done by East Sussex County Council, as administering authority, on the accuracy of employee contributions from admitted and scheduled bodies into the Pension Fund. If the Pension Fund is not able to demonstrate appropriate controls or assurances in this area again this year, we will need to obtain assurance over the accuracy of employee contributions from the external auditors of the admitted and scheduled bodies. This would necessitate a revision to our proposed audit fee.

1.6 The assumptions we have made in setting the audit fee are set out in Section 3.

Key outputs

1.7 The key reports, opinions and conclusions from the audit will be:

Output	Expected timing
• Annual governance report (ISA 260 Report) • Audit opinion covering the Pension Fund financial statements, issued alongside East Sussex County Council's financial statements • Audit opinion within the Pension Fund's Annual Report, including reference to the content of the Annual Report	September 2011

1.8 Our audit responsibilities are based on current guidance issued by the Audit Commission. If the guidance is amended we will consider the impact on our work and, if necessary, update those charged with governance.

2 Introduction

2.1 This Audit Plan sets out the audit work that we propose to undertake for the 2010/11 financial year. It has been drawn up from our risk based approach to audit planning and planning meetings held. The information and fees in this Plan will be kept under review and any significant changes will be reported to the Audit and Best Value Scrutiny Committee.

2.2 The context in which we deliver our audit is set out in Appendix A.

Assessing risks

2.3 We are committed to targeting work to where it will have the greatest effect, based upon assessments of risk and performance. This means planning our audit work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fee. It also means ensuring that our work is co-ordinated with the work of other regulators, and that our work helps you to improve.

2.4 Our risk assessment process focuses on the identification of significant financial reporting risks. For each of the significant risks identified, we consider the arrangements put in place to mitigate the risk and plan our work accordingly.

Impact of introduction of Clarity International Standards on Auditing

2.5 We would like to draw to your attention to the fact that for the audit of the financial statements for years ending on or after 15 December 2010 we are required to apply the clarified (or revised and redrafted) International Standards on Auditing (UK & Ireland) (ISAs). These have increased the number of requirements that have to be met when carrying out an audit and you are likely to notice a change in our approach to the audit of certain areas. Consequently we may require additional information from you or we may request information at a different stage of the audit process than has been the case in previous years.

Examples of areas where our approach to the audit may change as a result of the additional requirements of the clarified International Standards on Auditing include (but are not limited to):

- ***Materiality* –** we are required to set, not only a materiality level against which to evaluate the effect of identified misstatements on the audit but also a second level of materiality (known as "performance materiality") which is to be used when planning and performing the audit. This has to be set at a level lower than the materiality for the financial statements as a whole so as to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. The potential impact is that areas previously unaudited on the grounds of materiality may now fall within the scope of our audit work or more work may have to be done in certain areas to reflect the lower level of materiality on the extent of work.

- ***Related parties* –** whilst under the existing ISAs we were required to obtain an understanding of the related parties of the entity, including the controls that those charged with governance have in place over the identification and accounting for related parties, the clarified ISAs place a greater emphasis on a risk based approach to the consideration of this area. We use our understanding to assess the risk of material misstatement of the financial statements in respect of related parties and design further audit procedures accordingly. Our audit work on related parties will also include consideration of transactions that have occurred, if any, outside the normal course of business and in identifying any omitted related party relationships and transactions.

- ***Accounting estimates*** – we will consider all areas of the financial statements subject to accounting estimates as we are required to obtain a greater understanding about how those estimates have been determined and consider the effects of uncertainty in assumptions used. We will identify and assess the risks of material misstatement arising from the use of accounting estimates and will focus our work on areas where the risks of material misstatement are greatest. Our audit work on accounting estimates will also focus on identification of any possible instances of management bias.

Control environment

2.6 Under the existing ISAs we were required to report to those charged with governance any significant weaknesses in the control environment identified during the audit. The clarified ISAs place an increased emphasis on the need to communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis and, in addition, to report other deficiencies in internal control identified during the audit that are of sufficient importance to merit management's attention. As a result it may be necessary for us to produce additional reports to officers of weaknesses identified in the control arrangements for the Pension Fund, in addition to the reporting cycle to those charged with governance through the Audit and Best Value Scrutiny Committee.

3 Risk assessment

Significant financial statement audit risks

3.1 Our risk assessment has identified the following significant accounts audit risk that is likely to impact on our audit:

Audit risk identified from planning	Audit response
There is a risk that private equity and infrastructure assets may not be carried at reasonably correct fair values in the financial statements, given the relatively complex manner in which such investment values are reflected in the overall valuation, as underlined by the error identified by officers in the 2008/09 valuation report. This could impact on the valuation of investments audit assertion.	We will review the reconciliation from the valuation in the financial statements to supporting accounts of the limited partnership investment vehicles and statements from the underlying fund managers.

3.2 In addition to the above, International Standards on Auditing (UK and Ireland) presumes that a risk of management override of controls is present in all entities and requires us to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual. We are also required to consider the need to perform other additional procedures. It is considered that our standard audit procedures in reviewing journals and accounting estimates will be sufficient to cover this risk.

3.3 As reported in our audit fee letter presented to the Audit and Best Value Scrutiny Committee in June 2010, International Financial Reporting Standards (IFRS) applies to local government bodies from 2010/11. We do not currently consider this to pose any significant audit risk for the Pension Fund, as implementation of IFRS is unlikely to have any material impact on the financial statements. However, we will re-consider the risks associated with implementation of IFRS in the Pension Fund when the practitioners' guidance notes become available.

3.4 Following the introduction of the Clarity ISAs, we have re-assessed the triviality level applied to the audit of the Pension Fund and we have set triviality levels of £1.1m for the Net Assets Statement and £105k for transactions other than investment movements in the Fund Account for the 2010/11 accounts audit. We will not report to you any matters arising below this level.

Other issues

3.5 In our 2009/10 Annual Governance Report presented to the Audit and Best Value Scrutiny Committee in September 2010, we reported that there was no documented audit trail for any checks done by East Sussex County Council, as administering authority, on the accuracy of employee contributions from admitted and scheduled bodies into the Pension Fund. If the Pension Fund is not able to demonstrate appropriate controls or assurances in this area again this year, we will need to obtain assurance over the accuracy of employee contributions from the external auditors of the admitted and scheduled bodies. This would necessitate an increase to our proposed audit fee.

4 Fees and billing arrangements

Fees

4.1 We have applied a risk based assessment of expected resources, taking into account work required to comply with Practice Note 15 ("The Audit of Occupational Pension Schemes in the United Kingdom"), planning and reporting requirements, and work on the Annual Report. Based on this assessment, we propose a fee of £44,878, plus VAT, which will be charged directly to the Pension Fund. This fee is at the scale fee level calculated in accordance with the Audit Commission's *Scales of fees for the audit of local government pension funds 2009/10 to 2010/11.*

4.2 The fee is the same as that proposed in our audit fee letter presented to the Audit and Best Value Scrutiny Committee in June 2010 and remains unchanged from our audit fee in 2009/10. The scale fees for 2010/11 are frozen at the 2009/10 levels and auditors are expected to absorb the extra audit costs arising from the transition to IFRS and the introduction of the Clarity ISAs within the current fee envelopes.

4.3 The fee is based on our understanding of audit requirements and risks at the time of drafting this Plan. If we need to make significant amendments to the audit fee during the course of the audit, we will first discuss this with the Director of Corporate Resources and then prepare a report outlining the reasons why the fee needs to change for discussion with the Audit and Best Value Scrutiny Committee.

4.4 The fees detailed above are based on the following assumptions:

- Internal Audit will have completed its systems testing in accordance with the plans and agreed timetable, and to an adequate standard
- we will, after re-performing a sample of Internal Audit's work, be able to place full reliance on the work of Internal Audit
- you will keep us informed of any significant changes to your financial systems or procedures
- you will provide a comprehensive, good quality set of working papers and records to support the financial statements prior to the commencement of the audit and there will be no fundamental problems with them
- you will ensure that audit reports are responded to promptly and the implementation of recommendations by the due date is actively monitored
- controls are implemented, or appropriate assurances obtained by the Pension Fund, in respect of the accuracy of employee contributions from admitted and scheduled bodies into the Pension Fund.

4.5 The fee assumes efficient co-operation as set out above and is set at the minimum level to carry out the audit. This assumption is based upon arrangements for 2010/11 and our consideration of your annual governance statement in your 2009/10 accounts.

Billing arrangements

4.6 Your audit fee is being billed in 4 equal instalments of £11,219.50 from June 2010.

5 Audit arrangements

Timetable

5.1 The following outline timetable shows the expected dates planned for key fieldwork elements of the audit to commence:

Audit Timetable	Timing
Accounts – core financial systems	28 March 2011
Accounts – financial statements	27 June 2011
Review of Governance Arrangements	July 2011
Annual Governance Report (ISA 260 Report)	August 2011
Audit opinion covering the Pension Fund financial statements, published alongside East Sussex County Council's financial statements.	September 2011
Audit opinion within the Pension Fund's Annual Report, including reference to the content of the Annual Report	September 2011

5.2 We will agree specific dates for our visits with officers in advance of each part of our programme, and we will work closely with officers during the year to ensure that all key deadlines are met. We will also meet regularly with senior officers to discuss progress on the audit and obtain an update on relevant issues.

Communication

5.3 Auditing Standards require auditors to communicate relevant matters relating to the audit to "those charged with governance". Relevant matters include issues on auditor independence, audit planning information and findings from the audit.

5.4 We have included in Appendix B to this Plan a statement to the Audit and Best Value Scrutiny Committee setting out the Audit Commission's objectivity and independence guidelines and giving our confirmation that we have complied with those guidelines.

5.5 Following our audit of the financial statements we will report to the Audit and Best Value Scrutiny Committee on the findings from our audit.

Quality of service

5.6 We aim to provide a high quality of service to you at all times. If, for any reason or at any time, you would like to discuss how we might improve the service, or if you are in any way dissatisfied, please contact your engagement partner in the first instance. Alternatively you may wish to contact our Managing Partner, Martin Goodchild. Any complaint will be investigated carefully and promptly.

5.7 If you are not satisfied you may take up the matter with the Institute of Chartered Accountants in England and Wales ("ICAEW").

5.8 In addition, the Audit Commission's complaints handling procedure is detailed in their leaflet "How to complain: What to do if you want to complain about the Audit Commission or its appointed auditors", which is available on their website http://www.audit – commission.gov.uk/complaints/

Appendix A: Audit requirements

Financial statements

The Code requires us to provide an opinion on whether your financial statements "are true and fair" and have been prepared properly, in accordance with relevant legislation and applicable accounting standards.

In carrying out this work we:

- consider the extent to which your accounting and internal control systems are a reliable basis for recording transactions in the Pension Fund
- review contributions to the scheme against payment schedules from scheme employers
- consider the robustness of the processes for preparing the Pension Fund financial statements, undertake analytical procedures, as well as tests of transactions and balances
- consider the adequacy of the disclosures in your financial statements.

We will consider the adequacy of your arrangements for closing down the ledger and producing accurate, timely and comprehensive financial statements and supporting working papers. We will provide officers with a detailed list of schedules and working papers required for the audit.

We will review the appropriateness and consistency of application of the accounting policies adopted by the Council and ensure that these are consistent with the *Code of Practice on Local Authority Accounting in the United Kingdom 2010/11*.

We will read the other information included in the financial statements and, if appropriate the annual report, to ensure this is consistent, complete and not misleading based on our overall knowledge. We will review your annual governance statement to assess whether it has been presented in accordance with relevant guidance, is adequately supported, that an effectiveness review has been completed, and it is consistent, complete and not misleading based on our overall knowledge.

Internal controls and significant financial systems

International Standards on Auditing (UK and Ireland) require auditors to obtain a detailed understanding of an organisation, its environment, risk assessment processes, the information systems, internal controls and monitoring activities. This must be sufficient to identify and assess the risks of material misstatement of the financial statements whether due to fraud or error and be sufficiently well documented to enable the auditor to design and perform further audit procedures based on identified risks.

Where the audit intends to rely on identified controls to reduce risk or the level of detailed testing the auditor must also undertake tests of the operating effectiveness of the relevant controls. The key financial systems upon which the accounts are based will therefore require additional testing and review in order to arrive at our opinion on the financial statements.

Your significant financial systems are:

- Main Accounting System
- Cash and bank
- Contributions receivable
- Benefits payable
- Membership information
- Investments and investment income

Working with Internal Audit

The Audit Commission expects appointed auditors and Internal Audit departments to work together to ensure that audit work is most effectively targeted in well-managed councils, thereby minimising duplication and the overall level of audit resource input.

Fraud risk assessment

We have a responsibility to consider specifically the potential risk of material misstatement of your financial statements as a result of fraud and error, including the risk of fraudulent financial reporting.

The primary responsibility for ensuring that your internal control frameworks are robust enough to prevent and detect fraud and corrupt practices lies with management and "those charged with governance" (the Audit and Best Value Scrutiny Committee).

We will make appropriate enquiries and review the counter fraud arrangements in place in order to identify the fraud risks, and the controls you have put in place on which we will seek to place reliance to mitigate those risks.

For all fraud risks, and for any actual frauds that have been identified and we have been informed of, we will consider the possible impact on your accounts and our audit programme.

Reliance on others

We will obtain assurances from the auditors of the custodian and the fund managers over the controls operated by them as custodians and managers of scheme assets (AAF 01/06 reports).

Pension Fund Annual Report

We are also required to include our audit opinion on the Pension Fund financial statements within the Pension Fund Annual Report. Our report contained within the Annual Report additionally includes reference to various other matters related to the content of the Annual Report:

- We are required to report whether, in our opinion, the commentary on the financial performance included within the Pension Fund Annual Report is consistent with the Pension Fund financial statements.
- We are required to review whether the Pension Fund Annual Report reflects compliance with the requirements of Regulation 34 (1) (e) of the Local Government Pension Scheme (Administration) Regulations 2008 and any related guidance issued by the Department for Communities and Local Government (CLG). There is currently draft guidance from CLG. In the event that the draft guidance becomes extant before completion of the audit, we will need to consider whether the Annual Report complies with this guidance.
- We are also required to read other information published in the Pension Fund Annual Report and consider the implications for our audit report if we become aware of any apparent misstatements or material inconsistencies with the Pension Fund financial statements.

Contributions Receivable

There is a legal obligation for participating employers to ensure that employees' contributions are paid into the fund by due dates. The administering authority should ensure that the scheme is receiving the right contributions at the right time.

We will review the arrangements in place for preparing, maintaining and monitoring the payments of contributions towards the scheme on behalf of the active members of the scheme.

Appendix B: Communication with those charged with governance

To: Audit and Best Value Scrutiny Committee and the Governance Committee, East Sussex County Council as administering authority of the East Sussex Pension Fund

Auditors appointed by the Audit Commission are subject to the *Code of Audit Practice* (the Code) which includes the requirement to comply with International Standards on Auditing (ISA) when auditing the financial statements. ISA (UK & Ireland) 260 – Communication with those charged with governance requires 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 revised ISA does not define 'those charged with governance' as there are such a diverse range of arrangements across all types of entity. However it does state that "The auditor shall determine the appropriate person(s) within the entity's governance structure with whom to communicate." In the case of East Sussex Pension Fund it has been agreed that the appropriate addressees of communications from the auditor to those charged with governance are the Audit and Best Value Scrutiny Committee and the Governance Committee of East Sussex County Council as the administering authority.

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
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors, or any firm with which an auditor is associated, should not carry out work for an audited body, which does not relate directly to the discharge of the auditors' functions if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired. If auditors are satisfied that performance of such additional work will not impair their independence as auditors, nor be reasonably perceived by members of the public to do so, and the value of the work in total in any financial year does not exceed a *de minimis* amount (currently the higher of £30,000 or 20% of the annual audit fee), then auditors (or, where relevant, their associated firms) may undertake such work at their own discretion. If the value of the work in total for an audited body in any financial year would exceed the *de minimis* amount, auditors must obtain approval from the Commission before agreeing to carry out the work.

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:

- any staff involved on Commission work who wish to engage in political activity should obtain prior approval from the Engagement Partner
- audit staff are expected not to accept appointments as lay school inspectors
- firms are expected not to risk damaging working relationships by bidding for work within an audited body's area in direct competition with the body's own staff without having discussed and agreed a local protocol with the body concerned
- auditors are expected to comply with the Commission's statements on firms not providing personal financial or tax advice to certain senior individuals at their audited bodies, auditors' conflicts of interest in relation to PFI procurement at audited bodies, and disposal of consultancy practices and auditors' independence

- 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 both the Partner and the second in command (Manager) to be changed on each audit at least once every five years
- audit suppliers are required to obtain the Commission's written approval prior to changing any Audit Partner in respect of each audited body
- the Commission must be notified of any change of second in command within one month of making the change. Where a new Partner or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.

Statement by the appointed auditor

In relation to the audit of the financial statements for East Sussex Pension Fund for the financial year ending 31 March 2010, we are able to confirm that the Commission's requirements in relation to independence and objectivity, outlined above, have been complied with.

Under the requirements of ISA (UK & Ireland) 260 – Communication with those charged with governance, we are not aware of any relationships that may bear on the independence and objectivity of the audit engagement partner and audit staff which are required to be disclosed.