

The Audit Plan for Lancashire County Pension Fund

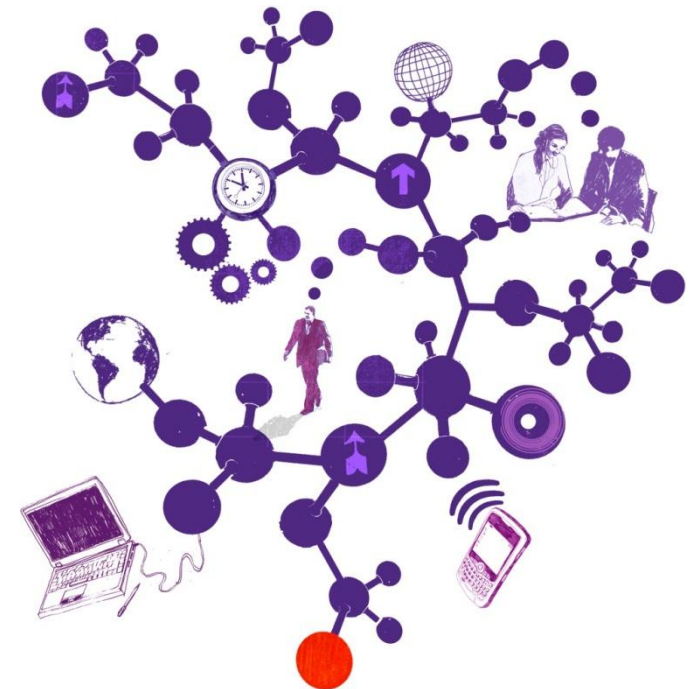
Year ended 31 March 2013

11 March 2013

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Understanding the business of your pension fund

In planning our audit we need to understand the challenges and opportunities the Pension fund is facing. We set out a summary of our understanding below.

Challenges/opportunities

1. Change in fund managers

- In response to the need to improve financial returns for the pension's fund, the fund has appointed 5 new managers with an unconstrained global equity mandate. £1.5bn has been transferred from existing equity mandates to these managers during 2012/13.



2. Increasing complexity of investments within internally managed fund

- As part of the diversification of investments, the internally managed funds are being targeted towards more fixed income and credit instruments including senior secured loan debt, (£130m), emerging markets local currency, (£230m), absolute return funds (£230m) and credit opportunities funds (£230m).



3. Investment in new infrastructure company

- During 2012/13 the fund has invested in a coal mining company (£24m), using the Red Rose infrastructure company structure to do so.



4. Bank reconciliation

- A potential mis-classification of monies between the County Council and the Pension Fund was identified in 2011/12 and detailed work has been undertaken by the Fund during 2012/13 to investigate the unexplained variance within the bank reconciliation.



Our response

We will:

- review the reconciliation of funds transferred from 3 existing fund managers to the transition fund manager and on to the 5 new fund managers to gain assurance over the completeness of the transfer
- obtain and review independently produced controls assurance reports for the new fund managers.

We will:

- review the nature of these investments and the methods being used to estimate the fair value of those investments at 31/3/2013
- we will assess the appropriateness of the valuation bases and assumptions being used to arrive at a fair value.

We will:

- review the contractual arrangement between the pension fund and mining company and the impact this has had on the company structure for Red Rose Infrastructure Ltd
- assess the appropriateness of the valuation of this investment within the context of the contractual terms.

We will:

- review the arrangements for regular bank reconciliations to gain assurance that pension fund transactions are being correctly reflected in its bank account and accounting records.
- review the exercise completed to assess the reasons for the previous difference and any resultant accounting adjustments.

Developments relevant to your pension fund and the audit

In planning our audit we also consider the impact of key developments in the sector and take account of national audit requirements as set out in the Code of Audit Practice and associated guidance.

Developments and other requirements

1. Financial reporting

- CIPFA have published a revised set of example accounts for pension funds in 2013.

2. LGPS 2014

- Planning for the impact of the implementation of career average re-valued earnings scheme (CARE) from 1 April 2014.
- Planning for the proposed changes in governance and regulation of pension funds.

3. Financial Pressures – scheduled and admitted bodies

- Where contributing bodies are offering early retirement and redundancies there is additional work for the pension fund administration team in dealing with the severance arrangements.

4. Financial Pressures – Pension fund

- Pension funds are increasingly needing to withdraw from investment assets to fund the demand on benefits payable that is not covered by contributions in year. Pension fund investment strategies need to be able to respond to these demands as well as the changing nature of investment markets.

5. Triennial valuation

- The need to provide information to and have a regular dialogue with the actuary in respect of the triennial revaluation of the fund will create additional work for the pension fund staff.

Our response

- We will ensure that the Pension Fund complies with the requirements of the CIPFA Code of Practice through our substantive testing

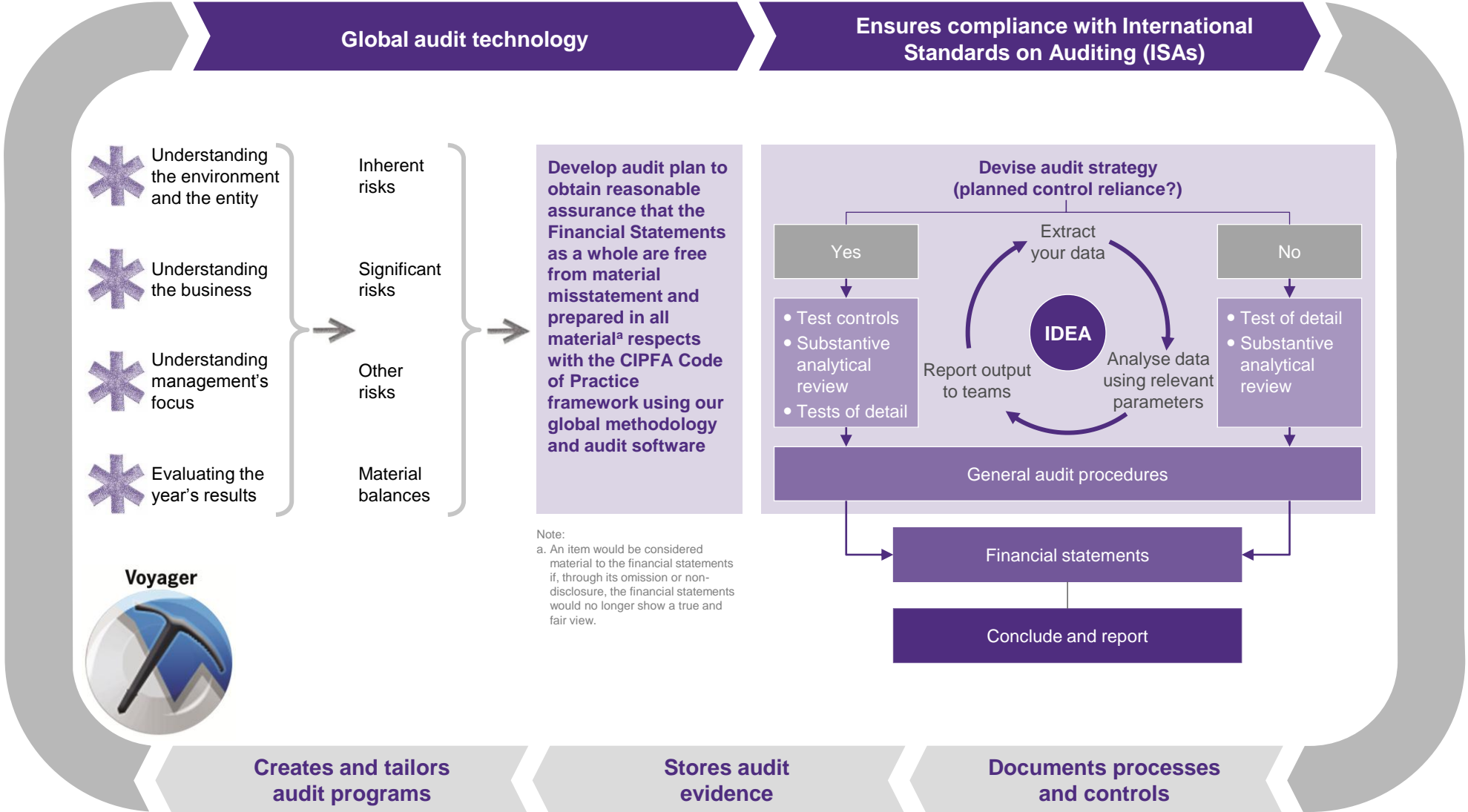
- We will discuss the impact of the changes with the Pension Fund through our regular meetings with senior management and those charged with governance, providing a view where appropriate.

- We will maintain regular dialogue with management to assess the impact this may have on the administration of the Pension fund. We will raise any concerns with those charged with governance.

- We will monitor the changes being made to the pension fund investment strategy through our regular discussions with senior management and those charged with governance.
- We will consider the impact of changes on the nature of investments held by the pension fund and adjust our testing strategy as appropriate.

- We will maintain regular dialogue with management to assess the impact this may have on the administration of the Pension fund. We will raise any concerns with those charged with governance.

Our audit approach



An audit focused on risks

We undertake a risk based audit whereby we focus audit effort on those areas where we have identified a risk of material misstatement in the accounts. The table below shows how our audit approach focuses on the risks we have identified through our planning and review of the national risks affecting the sector. Definitions of the level of risk and associated work are given below:

Significant – Significant risks are typically non-routine transactions, areas of material judgement or those areas where there is a high underlying (inherent) risk of misstatement. We will undertake an assessment of controls (if applicable) around the risks and carry out detailed substantive testing.

Other – Other risks of material misstatement are typically those transaction cycles and balances where there are high values, large numbers of transactions and risks arising from, for example, system changes and issues identified from previous years audits. We will assess controls and undertake substantive testing, the level of which will be reduced where we can rely on controls.

None – Our risk assessment has not identified a risk of misstatement. We will undertake substantive testing of material balances. Where an item in the accounts is not material we do not carry out detailed substantive testing.

	Material (or potentially material) balance?	Transaction Cycle	Inherent risk	Material misstatement risk?	Description of Risk	Planned control reliance?	Substantive testing?
Contributions receivable	Yes	Scheme Contributions	Medium	Other	Recorded contributions not correct. Completeness and accuracy of contributions may be mis-stated.	Yes	✓
Transfers in	Yes	Transfers in to the scheme	Low	None		No	✓ If material
Pensions payable (including lump sums)	Yes	Benefit payments	Medium	Other	Accuracy, completeness and validity of payments to members may be mis-stated.	Yes	✓
Payments to and on account of leavers (including death benefits)	Yes	Benefit payments	Low	None		No	✓ If material
Administrative expenses	No	Administrative expenses	Low	None		No	X
Investment income	Yes	Investments	Medium	Other	Investment activity not valid	No	✓

An audit focused on risks (continued)

	Material (or potentially material) balance?	Transaction Cycle	Inherent risk	Material misstatement risk?	Description of Risk	Planned controls assurance?	Substantive testing?
Profit and loss on disposal of investments and changes in value of investments	Yes	Investments	Medium	Other	Investment activity not valid	No	✓
Taxes on income	No	Investments	Low	None		No	×
Investment management expenses	Yes	Investments	Low	None		No	✓
Investments	Yes	Investments	Medium	Other	Valuation of investments is misstated. Evidence of existence and ownership may not be available. Incorrect or insufficient disclosure.	No	✓
Current assets	No	Scheme Contributions, investments and cash	Low	None		No	X
Current liabilities	No	Benefit payments, investments	Low	None		No	x

Significant risks identified

'Significant risks often relate to significant non-routine transactions and judgemental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgemental matters may include the development of accounting estimates for which there is significant measurement uncertainty' (ISA 315).

In this section we outline the significant risks of material misstatement which we have identified. There are two presumed significant risks which are applicable to all audits under auditing standards (International Standards on Auditing – ISAs) which are listed below:

Significant risk	Description	Substantive audit procedures
Revenue	Under ISA 240 there is a presumed risk that revenue (which for the purposes of Lancashire County Pension Fund we have considered as investment income, transfers into the scheme and contributions) may be misstated due to the improper recognition of revenue.	<p>We have rebutted this presumption and therefore do not consider this to be a significant risk for Lancashire County Pension Fund because:</p> <ul style="list-style-type: none"> • The nature of the pension fund's revenue is, in many respects, relatively predictable and does not generally involve cash transactions. • The split of responsibilities between the Pension Fund, its fund managers and the custodian, provides a very strong separation of duties to reduce the risk around investment income. • Revenue contributions are made by direct salary deductions and direct bank transfers from admitted bodies. They are supported by separately sent schedules and are directly attributable to gross pay. This makes any improper recognition unlikely. • Transfers into the scheme are all supported by an independent actuarial valuation of the amount which should be transferred. This is then subject to agreement between the transferring and receiving funds. <p>We will complete our normal substantive testing procedures around the Pension Fund's material revenue streams.</p>
Management over-ride of controls	Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities.	<ul style="list-style-type: none"> • Review of accounting estimates, judgements and decisions made by management • Testing of journals entries • Review of unusual significant transactions

Other risks

The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures (ISA 315).

Other reasonably possible risks	Description	Planned audit procedures
Investments	Investment activity not valid. Valuation of investments is mis-stated. Evidence of existence and ownership may not be available. Incorrect or insufficient disclosure.	<p>We will:</p> <ul style="list-style-type: none"> review the reconciliation between information provided by the fund managers, the custodian and the pension fund's own records and seek explanations for any variances. select a sample of the individual investments held by the Scheme at the year end and test the valuation by agreeing prices to third party sources where published (quoted investments) or by critically assessing the assumptions used in the valuation for unquoted investments and direct property investments. The existence of investments will be confirmed directly with independent custodians or by agreement to legal documentation. test a sample of sales and disposals during the year back to detailed information provided by the custodian and fund managers. review the latest controls assurance reports for each fund manager and the custodian review the detailed investments disclosures for compliance with code requirements and agreement to underlying records.
Benefit Payments	Benefits improperly calculated /claims liability understated	<p>We will</p> <ul style="list-style-type: none"> select a sample of individual transfers, pensions in payment (new and existing), lump sum benefits and refunds. We will test, by reference to the member files, to ensure appropriate documentation is held and that internal control procedures operated by Lancashire County Pension Fund have been followed. rationalise pensions paid with reference to changes in pensioner numbers and increases applied in the year together with comparing pensions paid on a monthly basis to ensure that any unusual trends are satisfactorily explained. The movements on membership statistics will also be compared to transactions in the accounting records.
Contributions	Recorded contributions not correct. Completeness and accuracy of contributions may be mis-stated.	<p>We will</p> <ul style="list-style-type: none"> test the controls the pension fund operates to ensure that it receives all expected contributions from member bodies. rationalise contributions received with reference to changes in member body payrolls and numbers of contributing pensioners to ensure that any unexpected trends are satisfactorily explained.

Interim audit work

Scope

Our interim audit work is due to take place in March 2013. This will include our consideration of:

- internal audit's work on the Pension fund's key financial systems
- walkthrough testing to confirm whether controls are implemented in line with our understanding in areas where we have identified a risk of material misstatement
- a review of the Information Technology (IT) controls environment
- testing of controls relating to the receipt of contributions and the payments of pension benefits (taking assurance from the work of internal audit where possible)
- review of the reconciliation of the transfer of investments from the existing equity mandates to the transition manager and then onto the 5 new fund managers
- review of the reconciliation of the pension fund bank account and clearance of the unexplained difference reported last year
- review of the contractual arrangements for the new infrastructure investment, its impact on company structures and the planned method of valuation
- review of the new style investments entered into within the internally managed portfolio and the planned method of valuation
- review of the work undertaken by the pension fund on its private equity portfolio, in particular to assess whether this review provides an additional source of assurance over the valuation of such investments.

Reporting

If we identify any significant risks of material mis-statement as a result of this work we will adjust our testing strategy accordingly and report this to management immediately.

Our progress report to the meeting of the Audit and Governance Committee in June 2013, will update members on the outcome of our interim work and any resultant changes in testing strategy if a change has been made.

Logistics and our team



Date	Activity
November	Planning meeting
March	Interim site work
March	The audit plan presented to the Audit and Governance Committee
June	The audit plan presented to Pension Fund Committee
July	Year end fieldwork commences
August	Audit findings clearance meeting
September	Audit and Governance Committee meeting to report our findings
November	Pension Fund Committee meeting to report our findings
Sept	Issue opinion of the financial statement and annual report

Our team

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<p>Fiona Blatcher Manager T 0161 234 6393 M 0788 045 6196 E [fiona.c.blatcher@uk.gt.com</p>	<p>We will seek advice from our financial services team as necessary.</p>
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Fees and independence

Fees

	£
Pension fund audit	41,505

Our fee assumptions include:

- Our fees are exclusive of VAT
- Supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- The scope of the audit, and the Pension fund and its activities have not changed significantly
- The Pension fund will make available management and accounting staff to help us locate information and to provide explanations.

The fee is above the scale fee of £34,169 set by the Audit Commission and reported to you in our fee letter of 16/12/2012. Changes in the investment portfolio and its increasing complexity give rise to additional audit risks for which we need to complete additional work .

The revised fee is £25,495 less than the 2011/12 audit fee of £67,000 and represents a 38% reduction on the previous year's fee.

Fees for other services

Service	Fees £
None	Nil

Independence and ethics

Ethical standards and International Standards on Auditing (ISA) 260 require us to give you full and fair disclosure of matters relating to our independence. In this context, we disclose the following to you:

- the in-charge member of our team has a family member who works within the Pension Fund's benefits administration team. To avoid any potential conflicts, this member of our team does not undertake any work on the benefits payable elements of the accounts and is not responsible for the planning or supervision of such work. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Audit Findings report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

Communication of audit matters with those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while The Audit Findings will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to those charged with governance.

Respective responsibilities

This plan has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council and Pension fund's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Pension Fund's key risks when reaching our conclusions under the Code.

The audit of the Pension fund's financial statements does not relieve management or those charged with governance of their responsibilities.

Our communication plan	Audit plan	Audit findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issue arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence.	✓	✓
Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged.		
Details of safeguards applied to threats to independence		
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓



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