

# Audit opinion plan

Lancashire Pension Fund

Audit 2010/11

**The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.**

**Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.**

**As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.**

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# Introduction

## **This plan sets out the audit work that I propose to undertake for the audit of financial statements of the pension fund.**

1 The plan is based on the Audit Commission's risk-based approach to audit planning, which assesses:

- current national risks relevant to your local circumstances; and
- your local risks.

2 I will discuss and agree this plan, and any reports arising from the audit, with the Pension Fund Committee. However, as the pension fund accounts remain part of the financial statements of Lancashire County Council as a whole, the Audit Committee will retain ultimate responsibility for receiving, considering and agreeing the audit plans, as well as receiving and considering any reports arising from the audit.

# Responsibilities

**The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to every audited body.**

**3** The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet my responsibilities.

**4** I comply with the statutory requirements governing our audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice.

**5** Specifically, the work of auditors on pension fund accounts is defined by the Auditing Practices Board practice note 15 on the audit of pension fund accounts.

## Fee for the audit

**The indicative fee for the audit is £61,795, as noted in my letter of 7 June 2010.**

6 The Audit Commission scale fee for Lancashire Pension Fund is £49,437. The fee proposed for 2010/11 is 25 per cent above the scale fee and is within the normal level of variation specified by the Commission.

7 In setting the fee, I have assumed that:

- the level of risk in relation to the audit of accounts is consistent with that for 2009/10;
- good quality, accurate working papers are available at the start of the financial statements audit; and.
- Internal Audit undertakes appropriate work on all material systems and this is available for our review by 30 April 2011.

8 Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee. Where this is the case, I will discuss this first with the Treasurer of the Pension Fund and I will issue supplements to the plan to record any revisions to the risk and the impact on the fee.

9 Further information on the basis for the fee is set out in Appendix 1.

## **Specific actions Lancashire Pension Fund could take to reduce its audit fees**

**10** The Audit Commission requires its auditors to inform audited bodies of specific actions it could take to reduce its audit fees. As in previous years, I will work with staff to identify any specific actions that the Pension Fund could take and to provide ongoing audit support.

**11** Specific actions already noted during 2010 include the effective operation of a separate bank account for the pension fund and ensuring all fund managers can provide independent confirmation of their controls over processing and valuation. Action is already in hand to have a separate bank account from April 2011.

**12** A report to the Pension Fund Committee on 10 December set out proposed changes to the Fund's Investment Strategy going forwards. These will have a significant impact on the nature of the investment portfolio and its management going forwards. Such changes are likely to increase the audit procedures needed in future and could therefore result in increased audit fees. We will work with staff to understand the detailed changes and identify any specific actions around these changes that could help to lessen the impact on audit fees.

# Auditors report on the financial statements

## **I will carry out the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).**

**13** I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view of the financial position of the Pension Fund as at 31 March 2011.

**14** I am also required to review the pension fund annual report according to the LGPS regulations 1997.

### **Materiality**

**15** I will apply the concept of materiality in both planning and performing the audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

### **Identifying opinion audit risks**

**16** I need to understand fully the audited body to identify any risk of material misstatement (whether due to fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Pension Fund, including assessing your own risk management arrangements;
- considering the financial performance of the Pension Fund;
- assessing internal control - including reviewing the control environment, the IT control environment and Internal Audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Pension Fund information systems.



# Identification of specific risks

**I have considered the additional risks that are appropriate to the current opinion audit and have set these out below.**

Table 1: **Specific risks**

Specific opinion risks identified

Risk area	Audit response
<p>Implementation of International Financial Reporting Standards (IFRS). This requires disclosure in the pension fund accounts of future pension liabilities as well as current liabilities. This will require liaison with the actuary to ensure sufficient and appropriate information is available to meet the requirements. Actuarial estimates involve a wide range of uncertainty because of the variety and range of assumptions made within the estimation process.</p>	<p>We will:</p> <ul style="list-style-type: none"><li>■ review the information provided to the actuary by the Pension Fund to support their estimation process;</li><li>■ obtain independent expert advice on our ability to rely on the actuaries estimates; and</li><li>■ ensure the actuarial information is shown correctly in the financial statements.</li></ul>
<p>Changes in key staff. This increases the inherent risk of material error or non-compliance with accounting standards within the Pension Fund financial statements.</p>	<p>Standard audit procedures on the whole should be sufficient to cover this risk including a detailed early review of the draft financial statements. In addition we will increase the level of sample testing we will undertake on individual items of account.</p>

Risk area	Audit response
<p>Pensions administration. During 2010/11 a new financial system for calculating and paying pensions has been implemented. The Pensions team has also been dealing with increased workloads following the implementation of redundancy/early retirement programmes of admitted bodies. These changes both increase the inherent risk of material error in pension payments and could also impact on the accuracy of information provided to the actuary.</p>	<p>We will:</p> <ul style="list-style-type: none"> <li>■ plan to rely on the work of internal audit around introducing the new pensions system;</li> <li>■ review the management controls in place to ensure the various changes have not resulted in a significant weakening in pensions processing</li> <li>■ carry out tests of detail on the accuracy of pension calculations and processing during the year including carrying out predictive analytical review procedures.</li> </ul>
<p>Private Equity, (PE) Investment Values. The pension fund has over £100 million invested in private equity funds. These are not traded on an open market and therefore their valuations are estimated by the private equity fund operators. The Pension Fund have agreed to complete more detailed checking of these valuations following recognised industry guidance for 2010/11. As the Pension Fund investment strategy is developing there may be an increase in other more complex investment instruments during 2010/11.</p>	<p>We will review the actions taken by the Pension Fund to gain assurance about the valuations provided and plan to place reliance on these controls if possible.</p> <p>If this does not provide sufficient assurance we will complete sample testing of PE values by reference to audited accounts and communications with relevant auditors of the Funds.</p> <p>Should other more complex investments have become more significant in 2010/11, for example the use of derivatives, we will follow a similar approach to that noted above.</p>

Risk area	Audit response
<p>Lack of a separate bank account. During 2010/11 the pension fund has continued to use the County Council's bank account. This raises a potential risk of misallocation of money between the Pension Fund and the County Council. During the period actions have been taken in to prepare for the introduction of a separate bank account by April 2011. These include reducing the amount of cash going through the Council's bank account for pension fund investments. In addition a full reconciliation of the Pension Fund cash position will be available to support the opening of the new bank account.</p>	<p>We will:</p> <ul style="list-style-type: none"><li>■ review the actions taken to implement the new bank account;</li><li>■ test in detail the year end reconciliation of the pension fund cash held within the County Council's bank account as at 31/3/2010; and</li><li>■ consider the implications of this work on the cash balance recorded during the year and its use to calculate the interest due to or from the pension fund during the year.</li></ul>

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# Testing strategy

**On the basis of risks identified above I will produce a testing strategy which will consist of testing key controls and substantive tests of transaction streams and material account balances at year end.**

**17** I can carry out the testing both before and after the draft financial statements have been produced (pre- and post-statement testing).

**18** Wherever possible, I will complete some substantive testing earlier in the year before the financial statements are available for audit. I have identified the following areas where substantive testing could be carried out early:

- estimated future pension liabilities;
- reconciliation of Pension Fund year end cash invested in Lancashire County Council; and
- investments.

Where I identify other possible early testing, I will discuss it with officers.

**19** Wherever possible, I will seek to rely on the work of Internal Audit to help meet my responsibilities. For 2010/11, I expect to be able to use the results of the following pieces of work:

- pensions payment system including the transfer of data from the old to the new pensions system;
- accounts payable;
- accounts receivable, and
- general ledger.

**20** I will also seek to rely on the work of other auditors and experts, as appropriate, to meet my responsibilities. For 2010/11, I plan to rely on the work of other auditors for the accuracy and completeness of pensions contributions from admitted bodies.

**21** I also plan to rely on the work of experts in relation to the actuarial estimates of future pension fund liabilities:

## Audit Commission IAS 19 protocol

22 To avoid unnecessary duplication, the Audit Commission requires the auditors of local government pension funds to undertake a work programme as part of a protocol to provide opinion audit assurance on admitted bodies' LGPS pension fund assets and liabilities. Auditors are then required to report the outcome of this work to the auditors of the admitted bodies. This work relates to those assets and liabilities that arise as a result of applying International Accounting Standard 19 (IAS19). This assurance work includes:

- reviewing the actuary's analysis of the pension fund's assets to establish whether the asset value attributed to the admitted bodies' accounts are consistent with the total scheme assets considered in the audit of the pension fund's accounts, and
- making enquiries of the actuary in relation to their work in calculating IAS19 assets and liabilities.

## Key milestones and deadlines

**The Pension Fund is required to prepare the financial statements by 30 June 2011. I am required to complete the audit and issue the opinion by 30 September 2011.**

**23** The key stages in producing and auditing the financial statements are in Table 2.

**24** I will agree with you a schedule of working papers required to support the entries in the financial statements. The agreed fee is dependent on the timely receipt of accurate working papers.

**25** During the audit, the audit team will meet with the key contact and review the status of all queries. The frequency of meetings will depend on the need and the number of issues arising.

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Table 2: **Proposed timetable**

Activity	Date
Control and early substantive testing	February-May 2011
Receipt of accounts	June 2011
Sending audit working papers to the auditor	June 2011
Start of detailed testing	July 2011
Progress meetings	As required
Present report to those charged with governance at the audit committee	September 2011
Issue opinion	By 30 September 2011

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## The audit team

**Table 3 shows the key members of the audit team for the 2010/11 audit.**

Table 3: **Audit team**

Name	Contact details	Responsibilities
Clive Portman District Auditor	c-portman@audit-commission.gov.uk 0844 798 7038	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion, and liaison with the Treasurer
Fiona Blatcher Senior Audit Manager	f-blatcher@audit-commission.gov.uk 0844 798 7056	Manages and coordinates the different elements of the audit work. Key point of contact for the Head of Pension Fund and Senior Accountant.

### Independence and objectivity

**26** I have identified the following relationship that might affect objectivity and independence and have put appropriate safeguards in place.

Table 4: **Relationships and safeguards**

Relationship	Safeguard
A member of our audit team is related to a member of the pensions administration team.	Our member of staff does not undertake, or is responsible for the review of, any of our work which assesses the work of the pensions team.

**27** I comply with the ethical standards issued by the APB and with the Commission's requirements in respect of independence and objectivity as summarised in Appendix 2.

### Meetings

**28** The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers. Our proposals are set out in Appendix 3.

## Quality of service

**29** I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director of Professional Practice, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and to do what he can to resolve the position.

**30** If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

## Planned outputs

**31** My team will discuss and agree reports with the right officers before issuing them to the Audit Committee.

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Table 5: **Planned outputs**

Planned output	Indicative date
Annual governance report	September 2011
Auditor's reports giving an opinion on the financial statements	30 September 2011
Final accounts memorandum [if needed]	November 2011



## Appendix 1 Basis for fee

The Audit Commission is committed to targeting its work where it will have the greatest effect, based upon assessments of risk and performance. This means planning work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees.

The risk assessment process starts with the identification of the significant financial and operational risks applying to the Pension Fund with reference to:

- my cumulative knowledge of the Pension Fund;
  - planning guidance issued by the Audit Commission;
  - the specific results of previous and ongoing audit work;
- interviews with Pension Fund officers; and
- liaison with Internal Audit.

### Assumptions

In setting the fee, I have assumed that:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform me of significant developments impacting on the audit;
- Internal Audit meets the appropriate professional standards;
- [Internal Audit undertakes appropriate work on all systems that provide material figures in the financial statements sufficient that I can place reliance for the purposes of our audit];
- you provide:
  - good quality working papers and records to support the financial statements by [date];
  - information asked for within agreed timescales;
  - prompt responses to draft reports; and
- there is no allowance for extra work needed to address questions or objections raised by local government electors.

Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee.

## Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

The main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards are summarised below.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee that the auditor has charged the client; and
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Committee. The auditor reserves the right, however, to communicate directly with the Council on matters which are considered to be of sufficient importance.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes a number of specific rules.

The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit and Inspection Plan as being 'additional work' and charged for separately from the normal audit fee.
- Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional safeguards in the last two years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.

The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

## Appendix 3 Working together

### Meetings

The audit team will ensure we have knowledge of your issues to inform our risk-based audit through regular liaison with key officers.

My proposal for the meetings is as follows.

Table 6: **Proposed meetings with officers**

Council officers	Audit Commission staff	Timing	Purpose
Treasurer	District Auditor (DA) and Senior Audit Manager (SAM)	Monthly	General update plus: January - audit plan July - accounts progress September - annual governance report
Head of Pensions and Senior Accountant	Senior Audit Manager and Teamleader	Quarterly	Update on audit, accounting and governance issues
Internal Audit	DA and SAM	Tri-annually	Update on audit issues
Audit Committee and Pension Fund Committee	DA and SAM	As determined by the Committee	Formal reporting of: Audit Plan Annual governance report Other issues as appropriate

### Sustainability

**32** The Audit Commission is committed to promoting sustainability in our working practices and I will actively consider opportunities to reduce our impact on the environment. This will include:

- reducing paper flow by encouraging you to submit documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.

## Appendix 4 Glossary

### **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by auditors in accordance with the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

### **Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor, comprising both the members of the body and its management (the senior officers of the body). Those charged with governance are the members of the audited body. (See also 'Members' and 'Those charged with governance'.)

### **Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

### **Auditing standards**

Pronouncements of the APB, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

### **Auditor(s)**

Auditors appointed by the Audit Commission.

### **Code (the)**

The Code of Audit Practice.

### **Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

### **Ethical Standards**

Pronouncements of the APB that contain basic principles that apply to the conduct of audits and with which auditors are required to comply, except where otherwise stated in the standard concerned.

## **Financial statements**

The annual statement of accounts or accounting statements that audited bodies are required to prepare, which summarise the accounts of the audited body, in accordance with regulations and proper practices in relation to accounts.

## **Internal control**

The whole system of controls, financial and otherwise, that is established in order to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

## **Materiality (and significance)**

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor’s report; likewise a misstatement is material if it would have a similar influence. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects’.

## **Those charged with governance**

Those charged with governance are defined in auditing standards as ‘those persons entrusted with the supervision, control and direction of an entity’.

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- any director/member or officer in their individual capacity; or
- any third party.



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