

Pensions Committee

2.30pm, Monday, 24 March 2014

External Audit – Annual Audit Plan 2013-14

Item number	5.2
Report number	
Wards	All

Links

Coalition pledges	
Council outcomes	CO26
Single Outcome Agreement	

Alastair Maclean

Director of Corporate Governance

Contact: John Burns, Pensions & Accounting Manager

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

Executive summary

External Audit – Annual Audit Plan 2013-14

Summary

Audit Scotland, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2013/14. This is shown at Appendix 1 - "Audit Scotland Annual Audit Plan 2013-14".

Stephen O'Hagan, Senior Audit Manager, Audit Scotland, will present the Annual Audit Plan 2013-14 to committee.

Progress against the Annual Audit Plan 2013-14 will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee.

The proposed audit fee for 2013/14 has been maintained at the previous year's total of £47,190. This sum can be met from within the approved budget.

Recommendations

Pensions Committee is requested to:

1. Note the Annual Audit Plan 2013-14, as submitted by Audit Scotland;
2. Note the formal reliance placed on the work of Internal Audit;
3. Note that suitable provision has been made in the approved budget 2013/14 for the audit fee; and
4. Note that progress against the Annual Audit Plan 2013-14 will be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee.

Measures of success

Progress against the Annual Audit Plan 2013-14 will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee. The prime objective of the Council, as administering authority of the Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund, is to ensure an unqualified audit opinion of the Annual Report 2013-14. This will be determined in due course.

Financial impact

The proposed audit fee for 2013/14 of £47,190 is the same as the previous year, 2012/13. Suitable provision has been made in the budget for 2013/14, against which the audit fee will be charged.

Equalities impact

There are no adverse equalities impacts arising from this report.

Sustainability impact

There are no adverse sustainability impacts arising from this report.

Consultation and engagement

The Consultative Panel for the Lothian Pension Funds, comprising employer and member representatives, is integral to governance. Consideration of future progress reports against this Annual Audit Plan 2013-14 by the Pensions Audit Sub-Committee should provide financial and risk management assurance.

Background reading / external references

The responsibilities of Audit Scotland, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, as approved by the Auditor General for Scotland and the Accounts Commission. Appropriate cognisance is also taken of ethical guidance of the auditing profession.

Links

Coalition pledges	
Council outcomes	CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.
Single Outcome Agreement	
Appendices	Appendix 1 - Audit Scotland Annual Audit Plan 2013-14

Lothian Pension Funds

Annual Audit Plan

2013/14



Prepared for members of the Pensions Committee
March 2014

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Summary	4
Introduction	4
Summary of planned audit activity	4
Responsibilities	5
Responsibility of the appointed auditor	5
Responsibility of the Pensions and Accounting Manager	5
Format of the accounts	5
Audit Approach	6
Our approach	6
Materiality	7
Reporting arrangements	7
Quality control	8
Independence and objectivity	9
Audit issues and risks	10
Audit issues and risks	10
Wider issues and risks	11
Fees and resources	12
Audit fee	12
Audit team	12
Appendix A - Financial statements audit timetable	13
Appendix B - Audit team	14

Summary

Introduction

Our audit is focused on the identification and assessment of the risk of material misstatement in Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (collectively referred to as The Funds) financial statements. This report summarises our assessment of the key challenges and risks facing the Funds and sets out the audit work that we propose to undertake in 2013/14. Our plan reflects:

- the risks and priorities facing the Funds
- current national risks relevant to local circumstances
- the impact of changing international auditing and accounting standards
- our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland
- issues brought forward from previous audit reports.

Summary of planned audit activity

Our planned work in 2013/14 includes:

- an audit of the financial statements and provision of an opinion on whether:
 - they give a true and fair view in accordance with applicable law and the 2013/14 Code of practice on local authority accounting in the United Kingdom (the Code), of the financial transactions of the Funds during the year ended 31 March 2014, and of the amounts and dispositions at that date of their assets and liabilities
 - they have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the Code
- provision of the annual report on the audit addressed to elected members (i.e. members of the Council's Pensions Committee and more widely the members of the City of Edinburgh Council as the administering authority for the Funds) and the Controller of Audit
- a review and assessment of the Funds' governance and performance arrangements in a number of key areas to support the governance compliance statement and information in the annual report.

Responsibilities

1. The audit of the financial statements does not relieve management or the Pensions Committee as the body charged with governance, of their responsibilities.

Responsibility of the appointed auditor

2. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.
3. Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

Responsibility of the Pensions and Accounting Manager

4. It is the responsibility of the Pensions and Accounting Manager, as the appointed "proper officer", to prepare the financial statements in accordance with relevant legislation and the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). This means:
 - acting within the law and ensuring the regularity of transactions by putting in place appropriate systems of internal control
 - maintaining proper accounting records
 - preparing financial statements timeously which give a true and fair view of the transactions of the Funds during the year ended 31 March 2014 and of the amounts and dispositions at that date of their assets and liabilities.

Format of the accounts

5. The financial statements should be prepared in accordance with the Code which constitutes proper accounting practice.

Audit Approach

Our approach

6. Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of the Funds. We also consider the key audit risks and challenges in the local government sector generally. This approach includes:
 - understanding the business of the Funds and the risk exposure which could impact on the financial statements
 - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
 - identifying major transaction streams, balances and areas of estimation and understanding how the Funds will include these in the financial statements
 - assessing and addressing the risk of material misstatement in the financial statements
 - determining the nature, timing and extent of the audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements give a true and fair view.
7. We have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus audit testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Management action being relied on for 2013/14 includes:
 - comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff
 - clear responsibilities for preparation of financial statements and the provision of supporting working papers
 - delivery of unaudited financial statements to agreed timescales with a comprehensive working papers package
 - completion of the internal audit programme for 2013/14.
8. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an early assessment of the internal audit function. Internal audit is provided on a co-sourced basis between PricewaterhouseCoopers (PwC) and the council. Overall, we concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.
9. We plan to place formal reliance on aspects of the work of internal audit in the following areas, to support our audit opinion on the financial statements:

- Pension payroll
 - HR / Payroll
 - Accounts payable
 - Accounts receivable
 - ICT data security
 - Annual governance statement
10. In respect of our wider governance and performance audit work we also plan to review the findings and consider other areas of internal audit work including:
- ICT procurement
 - National Fraud Initiative

Materiality

11. International Standard on Auditing 320 provides guidance on the concept of materiality. We consider materiality and its relationship to audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
12. When considering, in the context of a possible qualification, whether the misstatement of an item, or a number of items taken together, is material in terms of its monetary value, we use professional judgement and experience and internal guidelines from peers. An item may be judged material for reasons other than its monetary value. An inaccuracy, which would not normally be regarded as material, may be important for other reasons. When such an item affects a critical point in the accounts, its materiality has to be viewed in a narrower context (for example the failure to achieve a statutory requirement, or an item contrary to law). Such matters would normally fall to be covered in an explanatory paragraph in the independent auditor's report.

Reporting arrangements

13. The Local Government (Scotland) Act 1973 requires that unaudited financial statements are presented to the council and Controller of Audit within three months of the end of the financial year. The Controller of Audit requires audit completion and issue of an independent auditor's report (opinion) by 30 September each year. A high level timetable is included at Appendix A of this plan, which takes account of submission requirements and planned Pensions Committee and Pensions Audit Sub-Committee dates. A more detailed timetable will be agreed with the Pensions and Accounting Manager in due course.
14. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the responsible head of service and relevant officers to confirm factual accuracy. Responses to draft reports are expected within two weeks of submission. A copy of all final agreed reports will be sent to the Director of

Corporate Governance, Investment and Pensions Services Manager, Pensions and Accounting Manager (as Proper Officer), Internal Audit and Audit Scotland's Best Value & Scrutiny Improvement Group. In addition key findings will be submitted to the Pensions Audit Sub-Committee and Pensions Committee for their consideration.

15. We will provide an independent auditor's report to elected members, in their role as quasi trustees of the Funds, and the Accounts Commission that the audit of the financial statements has been completed in accordance with applicable statutory requirements. After completion of the audit we will provide Members and the Controller of Audit with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the course of the audit. All annual reports produced are published on Audit Scotland's website: (www.audit-scotland.gov.uk).
16. Planned outputs for 2013/14 are summarised at Exhibit 1.

Exhibit 1: Planned outputs

Planned outputs	Final report issued by
Governance	
Annual Audit Plan (including the review of adequacy of internal audit)	31 March 2014
Financial statements	
Report to Pensions Audit Sub-Committee and the Pensions Committee in terms of ISA 260 (Communication of audit matters to those charged with governance)	September (exact dates to be confirmed)
Independent auditor's report on the financial statements	30 September 2014
Annual report to Members and the Controller of Audit	31 October 2014

Quality control

17. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Accounts Commission. To ensure that we achieve the required quality standards Audit Scotland conducts peer review, internal quality reviews and has engaged the Institute of Chartered Accountants of Scotland (ICAS) to conduct a programme of external review.

18. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We do, however, welcome feedback at any time and this may be directed to the engagement lead, David McConnell.

Independence and objectivity

19. Auditors appointed by Audit Scotland must comply with the Code of Audit Practice. When auditing the financial statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB) and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.
20. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. Audit Scotland is an admitted body within Lothian Pension Fund, and represents around 1% of fund membership. Staff involved in the audit are members of the fund. While this merits disclosure, it is not considered to represent a conflict of interest for the organisation or individuals involved. We are not aware of any relationships pertaining to the audit of the Funds.

Audit issues and risks

Audit issues and risks

21. Based on our discussions with staff, attendance at committee meetings and a review of supporting information, we have identified the following main financial statements risk areas for your organisation.
22. **Investment Management Expenses:** As set out in the example accounts prepared by CIPFA, it is good practice to disclose investment management expenses separately from other administrative expenses. However, investment management expenses disclosed in the Pension Funds' accounts and supporting notes do not currently reflect the full amount of investment management fees charged. This matter does not relate solely to Lothian Pension Funds but also applies to other pension funds in Scotland.
23. While some management expenses are separately identified and invoiced, private equity fund management expenses are typically incorporated in bid and sell prices and are therefore included within the change in market value line in the fund accounts. The calculation of the fees is a complex area, particularly in regard to pooled investment funds, and it is not always possible to separately identify these fees. CIPFA guidance suggests that where investment management expenses are presented in a separate line, in the interests of transparency and consistency they should include a reasonable estimate of all fees, including private equity fund fees. If a reliable estimate cannot be made of these fees, a note should be disclosed explaining why that is the case.
24. We note that the Investment and Pensions Service Manager will aim to improve the transparency of management fees in accordance with CIPFA's stated requirements by consulting with CIPFA, other Local Authority Pension Funds, the Funds' investment managers and custodian. We will review the investment management expenses disclosed in the accounts as part of our audit work to obtain evidence that investment management expenses are free from material misstatement.
25. **Pension payroll system:** In prior years, differences were identified between the council's Trent payroll and the Altair pension administration systems. Reconciliation controls were implemented to identify and resolve the variances. The risk was to be mitigated by the procurement of an integrated pension payroll and pension administration system. The business case to migrate to an integrated pension payroll system was approved and the procurement of this service was completed during 2012 with Altair winning the tender. The new Altair payroll system went live in September 2013 with data being input to payroll over the transition until the merger of systems was completed in December 2013. The integrated system should reduce the scope for previous issues re-occurring. Internal Audit has conducted a pre and post implementation review of the new system and its controls. Where appropriate, we will place reliance on their work. We will document the key controls within the new system as part of our work for 2013/14. We will also undertake work, or place reliance

on internal audit work, on the previous key controls in place (between Trent and Altair) prior to the new pension payroll system being introduced.

Wider issues and risks

26. **Fund Sustainability:** As a result of widespread severance schemes, recruitment freezes and low salary growth across participating employer bodies, it is likely that the membership profile of the Lothian Pension Fund will increasingly have a higher proportion of pensioner members compared to active members. Auto enrolment may lessen the impact on the profile of the Fund although Fund officers noted in their Pension Committee update in December 2013 that the *'full impact of auto-enrolment will not be known until at least 2017 as the Fund's largest employers have delayed the full introduction of auto-enrolment until 2017'*.
27. The Lothian Pension Fund has recently introduced a contribution stability mechanism, designed to provide certainty of pension contributions by certain Fund employers for future years, whilst still maintaining appropriate funding levels to the Fund. The modelling work undertaken as part of the contribution stability mechanism provided updated cash flow projections based on Fund membership at 31 March 2013. This work confirms that the Fund is expected to move to a negative cash flow position in the near future. The Fund will use investment income to pay pensions when this occurs, rather than reinvesting. Financial planning for the Fund continues to be reviewed regularly and appropriate cognisance is taken of actual and anticipated changes in membership profile. The Fund will continue to monitor and manage cash flows. We note the actions in place by the pensions administration team and will continue to monitor the membership profile over the long term.

Fees and resources

Audit fee

28. In determining the audit fee we have taken account of the risk exposure of the Funds, the management assurances in place and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of a complete set of unaudited financial statements and comprehensive working papers package by 30 June 2014.
29. The agreed audit fee for the 2013/14 audit of the Funds is £47,190 as summarised in Exhibit 2. Our fee covers:
- all of the work and outputs described in this plan
 - a contribution towards the costs of national performance studies and statutory reports by the Controller of Audit and the work of the Accounts Commission
 - attendance at Pensions Committee and Pensions Audit Sub-Committee meetings as appropriate
 - access to advice and information on relevant audit issues.

Exhibit 2: Audit fee

Description	Audit fee 2010/11	Audit fee 2011/12	Audit fee 2012/13	Audit fee 2013/14
Total audit fee	£57,740	£49,080	£47,190	£47,190
% cash reduction on prior year	-	15.0	3.9	0.0

30. Where our audit cannot proceed as planned through, for example, late receipt of the unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

Audit team

31. David McConnell, Assistant Director of Audit, Audit Services is your appointed auditor. The local audit team will be led by Stephen O'Hagan who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience and skills of our team are provided at Appendix B. The core audit team will call on other specialist and support staff, as necessary.

Appendix A - Financial statements audit timetable

Key stage	Date (by)
Meetings with officers to clarify expectations of detailed working papers and financial system reports	31 March 2014
Planned Pensions Committee approval of unaudited financial statements	27 June 2014
Submission of unaudited council financial statements with working papers package	30 June 2014
Testing and review of internal control systems and transactions	30 June 2014
Progress meetings with lead officers on emerging issues	Ongoing through the audit
Latest date for final clearance meeting with Pensions and Accounting Manager	25 August 2014
Agreement of unsigned financial statements for Pensions Audit sub-Committee and Pensions Committee agendas, and issue of report to the Pensions Audit Sub-Committee and Pensions Committee on the audit of financial statements (ISA 260)	29 August 2014
Pensions Audit Sub-Committee and Pensions Committee Dates	September 2014 (exact dates to be confirmed)
Independent auditors report signed	30 September 2014
Annual report to Members and the Controller of Audit	31 October 2014

Appendix B - Audit team

A summarised curriculum vitae for each core team member is set out below:

David McConnell, CPFA
Assistant Director of Audit

David has worked in public sector audit since 1981, firstly with the National Audit Office and, since 1985, with the Accounts Commission/Audit Scotland. He therefore has extensive experience of audit in Central Government, Local Government and the NHS. David is currently Audit Scotland's lead on financial management issues.

Stephen O'Hagan, CPFA
Senior Audit Manager

Stephen has over 17 years experience of public sector audit with Audit Scotland, covering local government, central government, health and the education sector. Prior to joining Audit Scotland, Stephen worked in local government finance for 5 years.

Brian Battison, CA
Senior Auditor

Brian has worked with Audit Scotland for over 13 years. He has audited a variety of organisations across central government and associated agencies, local government (including pension funds) and the NHS. Previously Brian worked in the National Audit Office and the private sector on a wide range of public sector audits.

Ross McDonald
Auditor

Ross joined Audit Scotland's Health and Local Government Team in October 2011 and will be embarking on his final year of the ICAS training programme in 2014.