

February 2013



# **Durham County Council Pension Fund – Audit Strategy Memorandum 2012/13 -**



# Contents

p3	Purpose and background
p5	Independence
p6	Audit approach
p9	Significant risks and key judgements
p12	Value for money
p14	Audit timeline
p16	Fees for audit and other services
p18	Your audit team
p20	Appendices

Our reports are prepared in the context of the Audit Commission's 'Statement of responsibilities of auditors and audited bodies'. Reports and letters prepared by appointed auditors and addressed to members or officers are prepared for the sole use of the Authority and we take no responsibility to any member or officer in their individual capacity or to any third party.

Mazars LLP is the UK firm of Mazars, the international advisory and accountancy organisation. Mazars LLP is a limited liability partnership registered in England with registered number OC308299.

# 01

## Purpose and background

This document communicates to you the scope of our audit, the risks we have identified and the procedures we will perform to deliver the audit.



# Purpose and background

## **Purpose of this document**

This document sets out our audit plan in respect of the external audit of Durham County Council Pension Fund (the Fund) for the year ending 31 March 2013. This document forms the basis for discussion at the Audit Committee meeting on 4 April.

The Plan sets out our proposed audit approach and is prepared to assist you in fulfilling your governance responsibilities. The responsibilities of those charged with governance are defined as to oversee the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process.

Our communication with you is important in:

- reaching a mutual understanding of the scope of the audit and the responsibilities of the auditor and those charged with governance;
- sharing information to assist both the auditor and those charged with governance to fulfil their respective responsibilities;
- providing to those charged with governance constructive observations arising from the audit process; and
- ensuring as part of the two-way communication process that we, as external auditors, gain an understanding of the attitude and views of those charged with governance of the internal and external operational, financial, compliance and other risks facing the Fund which might affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

## **Scope of engagement**

We are appointed to perform the external audit of Durham County Council Pension Fund for the year to 31 March 2013. The scope of our engagement is laid out in the Audit Commission's Code of Audit Practice for Local Government bodies.

## **Respective responsibilities**

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

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and we undertake our audit work to meet these responsibilities.

We comply with the statutory requirements governing audit work, in particular the:

- Audit Commission Act 1998; and
- Code of Audit Practice for Local Government bodies.

We, as auditors to the Fund, are responsible for forming and expressing an opinion on the financial statements.

Our audit does not relieve management or the Audit Committee, as those charged with governance, of their responsibilities.

# 02

## Independence

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. If at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with the engagement lead.

We are required by the Audit and Assurance Council (previously the Auditing Practices Board - APB), which has issued ethical standards for auditors, to confirm we have complied with relevant ethical standards requirements regarding independence. This is to ensure our objectivity and independence is maintained.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement there are no relationships between us and any of our related or subsidiary entities and you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We include in Appendix 1 our analysis of the principal threats to our objectivity and independence and the safeguards we have put in place.



# 03

## Audit approach

We work with you to ensure our audit approach is efficient, effective and limits the impact on your staff.



# Audit approach

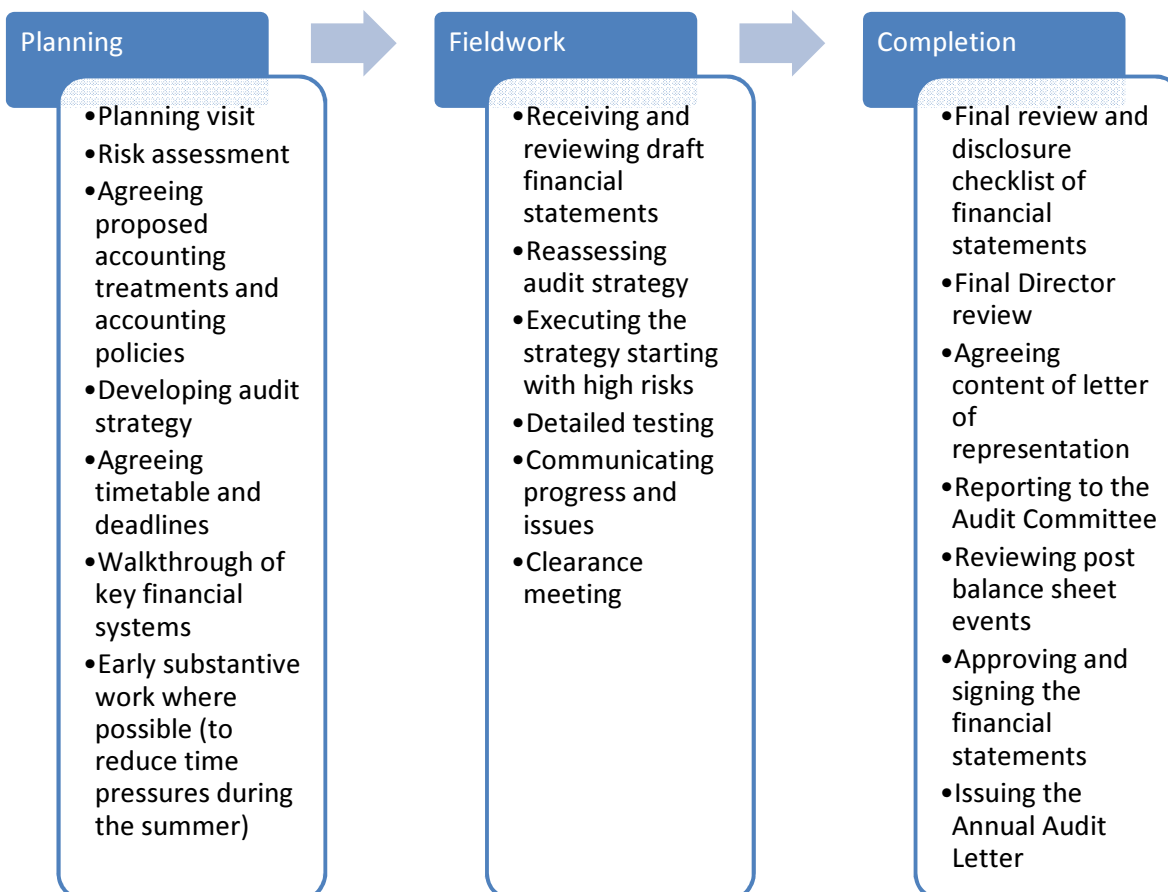
Our audit approach is designed to provide you with an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards of Auditing (UK and Ireland) issued by the Audit and Assurance Council (previously the APB). Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement such as judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past. We raise and discuss these with you on a regular basis, not just at the time of the audit fieldwork. We shall expect to obtain appropriate evidence as we consider sufficient to enable us to draw reasonable conclusions therefrom and will use a combination of controls and substantive testing procedures as appropriate.

We plan our audit to have a reasonable expectation of detecting fraud where the potential effects would be material to the financial statements. We will consider the control procedures in place to prevent and detect fraud, whether there are any significant risks of fraud that may have a material impact on the financial statements and adapt our procedures accordingly. We also plan our audit to negate the risk of management overriding controls by testing year-end journal entries and the major judgements and estimates that management make.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view.

We outline the key stages of the audit in the diagram below.





# Audit approach

## Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

## Reliance on experts

We plan to place reliance on the following work of experts.

Area	Expert engaged by:	
	You	Us
Actuarial Present Value of Future Retirement Benefits.	Actuary – Aon Hewitt	Audit Commission – PwC
Nature and extent of risk arising from financial instruments	P-Solve	None.

## Service organisations

We are required to assess whether there are any material entries in your financial statements where the Fund is dependent on an external organisation. We call these entities service organisations. The Fund has two categories of service organisation, investment managers and global custodian. The global custodian is JP Morgan and the investment managers who have provided services during the year are:

AllianceBernstein

Barings Asset Management

BlackRock

CBRE

Edinburgh Partners

Royal London Asset Management

We will substantively test transactions undertaken by the service organisations during the year, and the valuations applied to investments at the year end.



# 04

## Significant risks and key judgement areas

We plan our audit to focus on the risk of material misstatement in your financial statements.



# Significant risks and key judgement areas

We met with senior management as part of the audit planning process. We discussed the risks that, in management's opinion, you face and considered the impact on our audit risk. Set out below are the audit risks and the areas of management judgement to which we will pay particular attention to reduce the risk of material misstatement in the financial statements.

Significant audit risk	How we will address this risk
<p><b>Management override of controls</b> Auditing standards state that management is in a unique position to perpetrate fraud, because of management's ability to directly or indirectly manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>While the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in <i>all</i> entities and is therefore a significant risk of material misstatement because of fraud.</p>	<p>We have updated our understanding and evaluation of internal controls procedures as part of our audit planning, including completion of a fraud risk assessment.</p> <p>As part of this, we will seek written assurances from the Audit Committee and management on their controls and processes for assessing the risk of fraud in the financial statements and arrangements in place to identify, respond to and report fraud.</p> <p>Our testing strategy for this significant risk due to fraud will include:</p> <ul style="list-style-type: none"> <li>• general ledger journal testing;</li> <li>• consideration and review of material accounting estimates;</li> <li>• consideration and review of any unusual or significant business transactions; and</li> <li>• consideration of any other local factors.</li> </ul>
<p><b>Valuation of unquoted investments</b> The fair value of investments in the Net Assets Statement includes unquoted investments, the fair value of which totaled £244m (12.9% of total assets) as at 31 March 2012.</p> <p>The values of these investments are not quoted in an active market for securities and unlisted investments. The values used in the accounts are those provided by fund managers based on forward looking estimates and judgements involving many factors.</p> <p>This results in an increased risk of material misstatement.</p>	<p>We will discuss with key contacts involved in the valuation of unquoted investments. We will:</p> <ul style="list-style-type: none"> <li>• evaluate management controls over the valuation process;</li> </ul> <p>For investments managed by fund managers who fall within the remit of the global custodian, we will:</p> <ul style="list-style-type: none"> <li>• agree holdings from fund manager reports to the global custodian's report; and</li> <li>• agree the price to independent evidence.</li> </ul> <p>For investments managed by Alliance Bernstein, who are not within the remit of the global custodian, we will:</p> <ul style="list-style-type: none"> <li>• obtain a reconciliation of opening holding of units (and £) to closing holding of units (and £), taking account of purchases and sales during the year and agree to quarterly reports from the investment managers;</li> <li>• agree allocation of total fund allocated to DCCPF; and</li> <li>• agree the price to independent evidence.</li> </ul>

# 05

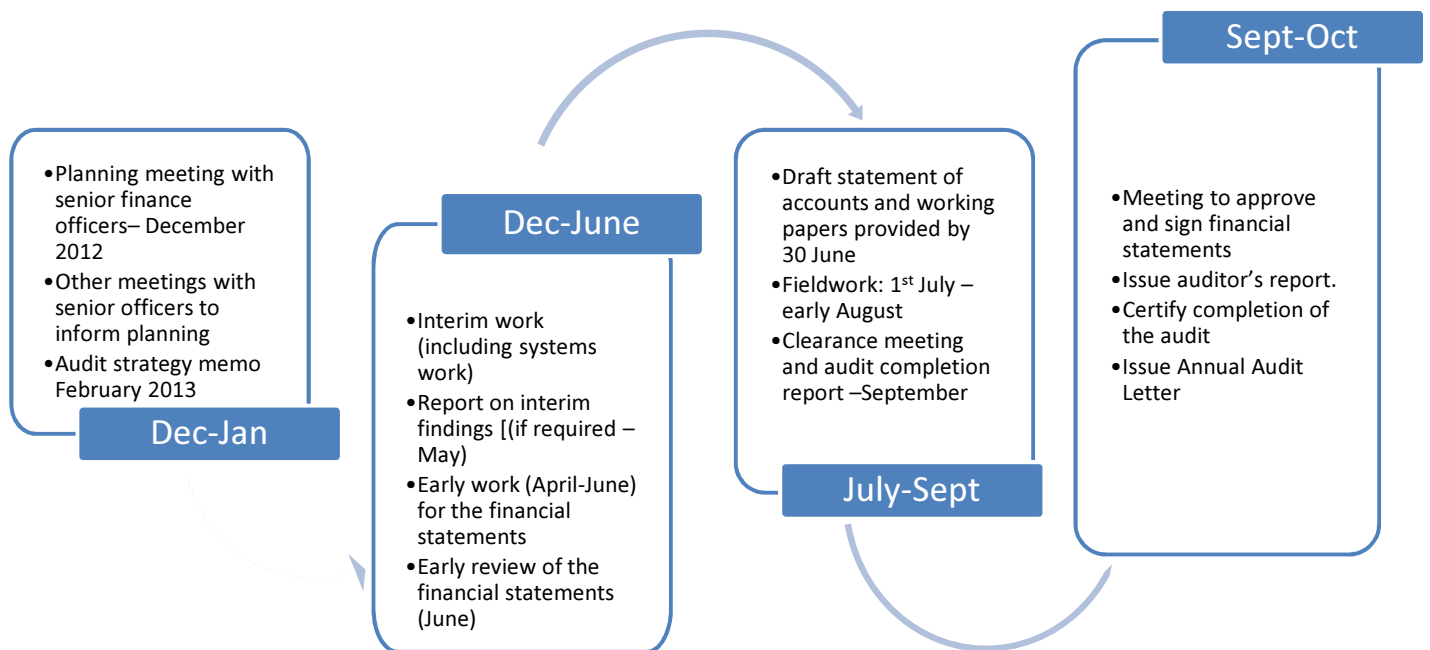
## Audit timeline

We work closely with you to agree an audit timeline that enables us together to meet statutory target dates.



# Audit timeline and deadlines

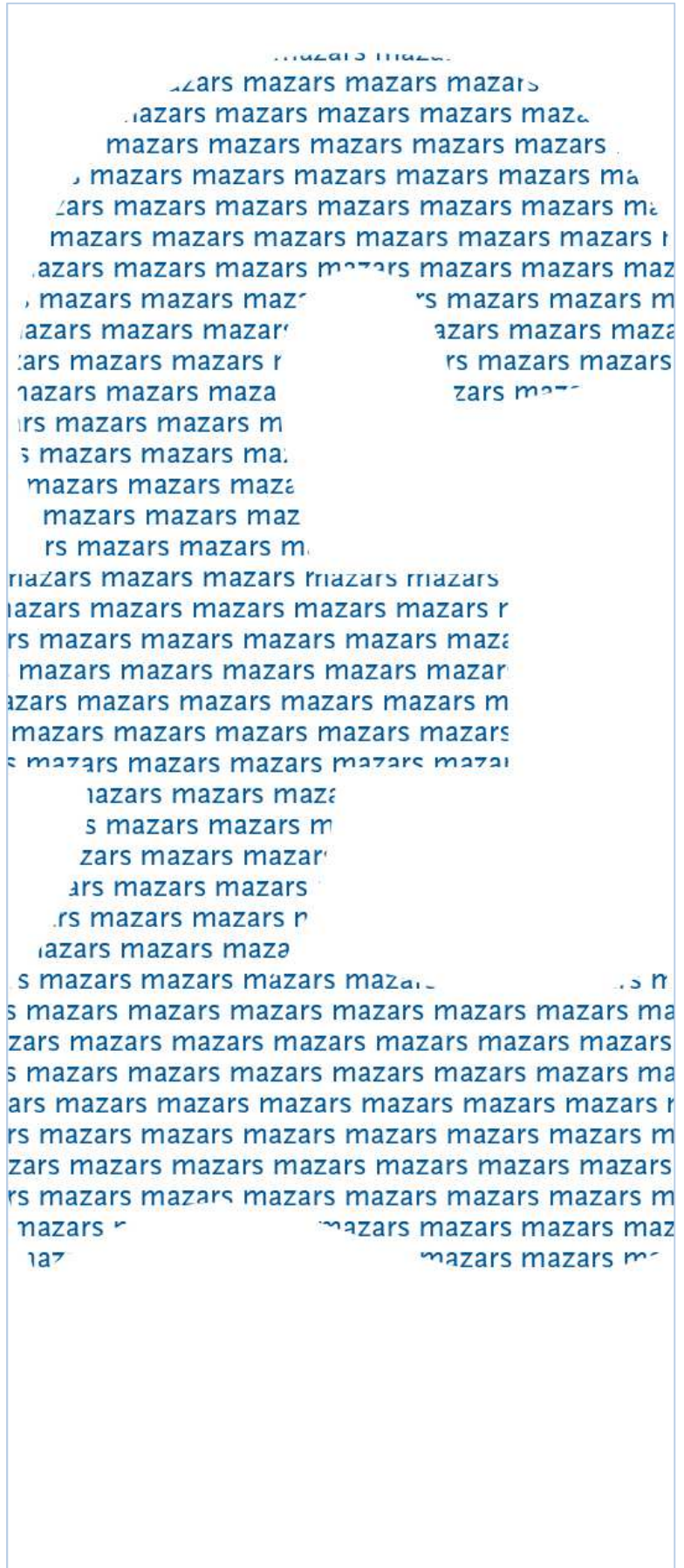
The diagram below sets out the timing of the key phases of our audit work. We will communicate with management throughout the audit process to facilitate a two way process of updates and identifying issues. We will continue to communicate outside of these dates to ensure that all parties understand developments and issues as they arise and to help in providing timely and appropriate solutions.



# 06

## Fees for audit and other services

The Audit Commission has established a scale audit fee for our work. We will keep you informed if we need to make any changes.



# Fees for audit and other services

## **Audit fees**

As communicated to you in our letter dated 5 October 2012, the Audit Commission has set a scale fee of £25,919. Our audit fee for Durham County Council Pension Fund is in line with this scale fee of £25,919 (2011/12 £42,551).

## **Non-audit services**

We do not currently plan any non-audit services, and no audit or non-audit services are currently provided to the Fund by Mazars LLP associated entities.



# 07

## Your audit team

We know that you value a team who understands the environment you operate in, understands your systems and controls and has a good working relationship with your staff and internal auditors. Your team meets all these criteria.





# Your audit team

Name and contact	Role	Experience and responsibilities
Cameron Waddell Tel: 0191 383 6314 Email: <a href="mailto:cameron.waddell@mazars.co.uk">cameron.waddell@mazars.co.uk</a>	Engagement Lead	Cameron has over 20 years external audit experience of a wide range of public sector bodies. He is responsible for the overall delivery of the audit, including the quality of audit reports. Cameron will sign the auditor's report.
Alistair Fraser Tel: 020 7063 4272 Email: <a href="mailto:Alistair.fraser@mazars.co.uk">Alistair.fraser@mazars.co.uk</a>	Independent Partner	Alistair has over 25 years external audit experience of a wide range of bodies. He is responsible for the independent review of the audit.
Catherine Banks Tel: 0191 383 6410 Email: <a href="mailto:catherine.banks@mazars.co.uk">catherine.banks@mazars.co.uk</a>	Engagement Manager	Catherine has managed the Durham County Council Pension Fund audit for a number of years. She will manage and coordinate the different parts of the audit and be the key point of contact.
Sharon Liddle Tel: 0191 383 6410 Email: <a href="mailto:sharon.liddle@mazars.co.uk">sharon.liddle@mazars.co.uk</a>	Team Leader	Sharon is an experienced team leader having worked on pension fund audits for a number of years.

# 08

## Appendices

A – Independence

B – Materiality

C – Required  
communication



# Appendix A - Independence

Independence is an on-going consideration and as such we monitor it throughout the audit process. The principal types of threats to the auditor's objectivity and independence are:

- self-interest threat - exists when the auditor has financial or other interests which might cause the auditor to be reluctant to take actions that would be adverse to the interests of the audit firm or any individual in a position to influence the conduct or outcome of the audit;
- self-review threat - exists when the results of a non-audit service performed by the engagement team or by others within the audit firm are reflected in the amounts included or disclosed in the financial statements;
- management threat - exists when the audit firm undertakes work that involves making judgments and taking decisions that are properly the responsibility of management;
- advocacy threat - exists when the audit firm undertakes work that involves acting as an advocate for an audited entity and supporting a position taken by management in an adversarial context;
- familiarity (or trust) threat – exists when the auditors are predisposed to accept or are insufficiently questioning of the client's point of view (for example, where they develop close personal relationships with client personnel through long association with the client); and
- intimidation threat – exists when the auditor's conduct is influenced by fear or threats (for example, when they encounter an aggressive and dominating individual).

Prior to the provision of any non-audit services the engagement partner will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

No principal threats to our independence have been identified:

# Appendix B - Materiality

'Materiality' is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole.

Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. It is reasonable for us to assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We will consider materiality whilst planning and performing our audit.

Whilst planning, we will make judgements about the size of misstatements which we will consider to be material and which will provide a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We will revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

We will include in our Audit Completion Report all unadjusted errors we have identified above those which are clearly trivial.

# Appendix C – Required communication

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require the auditor to communicate a number of matters with those charged with governance. These matters are set out below along with our proposed approach.

Required communication	When and how we will communicate with you
<p>Respective responsibilities of auditor and those charged with governance.</p> <p>Our responsibility for performing the audit in accordance with ISAs (UK and Ireland), which is directed towards forming and expressing an opinion on the financial statements.</p> <p>The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.</p>	<p>Section 3 of this report and the Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies.</p>
<p>Communication of the planned scope and timing of the audit.</p> <p>Matters communicated include:</p> <ul style="list-style-type: none"> <li>▪ significant audit risks and how we will address them;</li> <li>▪ our approach to internal control relevant to the audit;</li> <li>▪ the application of the concept of materiality in the context of an audit;</li> <li>▪ our use of the work of internal audit;</li> <li>▪ your approach to internal control and how you oversee the effectiveness of internal control procedures;</li> <li>▪ the attitude, awareness and action of those charged with governance concerning the detection or possibility of fraud; and</li> <li>▪ your response to new accounting standards, corporate governance practices and related matters.</li> </ul>	<p>Included in this document.</p> <p>These matters were discussed at the planning meeting and responses incorporated into this document as appropriate.</p>
<p>Our views on significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures.</p> <p>When applicable, why we consider a significant accounting practice not to be appropriate to the entity.</p>	<p>We will communicate these in our Audit Completion Report, orally as they arise and at the Audit Committee.</p> <p>Depending on the extent of the issue, either orally at the Audit Committee, in our Audit Completion Report or immediately we become aware of the issue.</p>

# Appendix C – Required communication (continued)

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require the auditor to communicate a number of matters with those charged with governance. These matters are set out below along with our proposed approach.

Required communication	When and how we will communicate with you
<p>Significant difficulties, if any, encountered during the audit.</p> <p>Significant difficulties encountered during the audit may include such matters as:</p> <ul style="list-style-type: none"> <li>▪ Significant delays in management providing required information;</li> <li>▪ An unnecessarily brief time within which to complete the audit;</li> <li>▪ Extensive unexpected effort required to obtain sufficient appropriate audit evidence;</li> <li>▪ The unavailability of expected information;</li> <li>▪ Restrictions imposed on the auditor by management; and</li> <li>▪ Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern.</li> </ul>	<p>We will communicate these in our Audit Completion Report, orally as they arise and at the Audit Committee meeting.</p>
<p>Details of significant matters discussed with, or subject to correspondence with management.</p>	<p>We will communicate these in our Audit Completion Report, orally as they arise and at the Audit Committee meeting.</p>
<p>Details of written representations we require for our audit.</p>	<p>We will communicate this in our Audit Completion Report.</p>
<p>Any other matters which we consider to be significant to the oversight of the financial reporting process.</p> <p>Other significant matters arising from the audit that are directly relevant to those charged with governance in overseeing the financial reporting process may include such matters as material misstatements of fact or material inconsistencies in information accompanying the audited financial statements that have been corrected.</p>	<p>As any matters arise which we consider should be communicated to you and within the Audit Completion Report.</p>

# Appendix C – Required communication (continued)

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require the auditor to communicate a number of matters with those charged with governance. These matters are set out below along with our proposed approach.

Required communication	When and how we will communicate with you
<p>Statement that the engagement team and the firm have complied with relevant ethical requirements regarding independence.</p> <p>Written disclosure of relationships which have a bearing on our independence and safeguards we have put in place, details of non audit services provided and written confirmation of our independence.</p>	<p>Section 4 and Appendix 1 of this document and as any new matters arise.</p>
<p>Form, timing and general content of communications.</p>	<p>We will issue our Audit Completion Report which will conclude upon our audit and the issues presented in this document. Should you require us to communicate in a different way please inform us of your preferred method.</p>
<p>Our evaluation of the adequacy of the communication process between ourselves and those charged with governance. This may include:</p> <ul style="list-style-type: none"> <li>• observations on appropriateness and timing of action taken by you in response to matters we have raised;</li> <li>• the openness of your communication with us</li> <li>• your willingness and capacity to meet with us without management being present;</li> <li>• your opportunity to fully comprehend matters we have raised</li> <li>• the extent to which you probe issues raised and our recommendations;</li> <li>• any communications we have had in establishing with you the form, timing and general content of communications; and</li> <li>• your awareness of how our discussions impact on your governance and management responsibilities and whether your communication with us meets legal and regulatory requirements.</li> </ul>	<p>Should we consider it necessary to raise any of these issues, we will consider the most appropriate method and the most appropriate person. The nature of our observation will determine the method and timing of our communication.</p> <p>We may consider that any inadequacy in the communication process is indicative of an unsatisfactory control environment and increase our assessment of audit risk. We will also consider whether we need to reassess our audit strategy. We will discuss with you any additional procedures we consider necessary as a result of these observations.</p> <p>If we consider the communication between you and us to be inadequate and we are unable to agree additional procedures which we consider necessary, we may modify our audit opinion, obtain legal advice, discuss with other third parties as we consider appropriate or may, if permitted under applicable law or regulation, withdraw from the engagement.</p>



# Appendix C – Required communication

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require the auditor to communicate a number of matters with those charged with governance. These matters are set out below along with our proposed approach.

Required communication	When and how we will communicate with you
<p>Any significant deficiencies in internal control that we have identified during the audit.</p>	<p>We will communicate these to you in our Audit Completion Report. Should it be appropriate, we will discuss significant deficiencies with management as they arise.</p> <p>Our written communication will include a description of the deficiencies with sufficient explanation for you to understand the context of the deficiency and an explanation of the potential effects.</p> <p>We are required to communicate all significant deficiencies to you, irrespective of whether you are already aware of them or have chosen not to take remedial action for cost or other reasons. We will continue to communicate deficiencies previously communicated to you until remedial action has been taken. We will consider whether failure to act, or lack of rational explanation itself represents a significant deficiency.</p>
<p>Other deficiencies in internal control that we have identified during the audit.</p>	<p>We will consider whether other deficiencies should be reported to you, taking into account the likelihood and potential magnitude of misstatements that may arise. We will also determine whether we report these to you orally or in writing.</p>