Audit Strategy Memorandum

Durham County Council Pension Fund – year ended 31 March 2014

April 2014

MAZARS

Mazars LLP
The Rivergreen Centre
Aykley Heads
Durham
DH1 5TS

Members of the Audit Committee
Durham County Council Pension Fund
County Hall
Durham
DH1 5UE

April 2014

Dear Sirs/Madams

Audit Strategy Memorandum for the year ending 31 March 2014

We are delighted to present our Audit Strategy Memorandum for Durham County Council Pension Fund for the year ending 31 March 2014.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. It is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, and Appendix A summarises our considerations and conclusions on our independence as auditors.

We value two-way communication with yourselves and we see this document, which has been prepared following our initial planning discussions with management, as being the basis for a discussion through which we can also understand your expectations.

This document will be presented at the Audit Committee meeting on 20 May 2014. If you would like to discuss any matters in more detail please do not hesitate to contact me on 0191 383 6314.

Yours faithfully

Cameron Waddell

Mazars LLP

Contents

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 Council 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, an international advisory and accountancy group. Mazars LLP is registered by the Institute of Chartered Accountants in England and Wales.

01 Purpose and background

Purpose of this document

This document sets out our audit plan in respect of the audit of the financial statements of Durham County Council Pension Fund (the Fund) for the year ending 31 March 2014, and forms the basis for discussion at the Audit Committee meeting on 20 May 2014.

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.

We see a clear and open communication between ourselves and you as important in:

- Reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- Sharing information to assist each of us to fulfil our respective responsibilities;
- Providing you with 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 your attitude and views in respect 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.

Appendix C outlines the form, timing and content of our communication with you during the course of the audit. Appendix D sets out forthcoming accounting and other issues that will be of interest.

Scope of engagement

We are appointed to perform the external audit of Durham County Council Pension Fund for the year to 31 March 2014. The scope of our engagement is laid out in our engagement letter the Audit Commission's Code of Audit Practice for Local Government bodies.

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.

The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK and Ireland) we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as whole are free from material misstatement, whether caused by fraud or error. However our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

02 Audit scope, approach and timeline

Audit scope

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) and in accordance with the Code of Audit Practice for Local Government Bodies. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement such as those impacted by management 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.

Audit approach

Our audit approach is a risk based approach primarily driven by the risks we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment we develop our audit strategy and design audit procedures in response to this assessment. The work undertaken can include a combination of the following as appropriate:

- testing of internal controls;
- substantive analytical procedures; and
- detailed substantive testing.

If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing.

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. Materiality and misstatements are explained in more detail in Appendix B.

The diagram below outlines the procedures we perform at the different stages of the audit.

Planning

- Planning visit
- Risk assessment
- Considering proposed accounting treatments and accounting policies
- Developing audit strategy
- Agreeing timetable and deadlines
- Preliminary analytical review

Interim work and final fieldwork

- **Interim work**
- Document systems and controls
- Perform walkthroughs
- Interim controls testing
- **Final fieldwork**
- Receiving and reviewing draft financial statements
- Reassessment of audit plan and revision if necessary
- Executing the strategy starting with significant risks and high risk areas
- Communicating progress and issues
- Clearance meeting

Completion

- Final review and disclosure checklist of financial statements
- Final engagement lead review
- Final independent partner review
- Agreeing content of letter of representation
- Reporting to the Audit Committee
- Reviewing post balance sheet events
- Signing the auditor's report
- Issuing the Annual Audit letter

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.

Service organisations

There are material entries in your financial statements where the Council is dependent on an external organisation. We call these entities service organisations. The table below outlines our approach to understanding the services the Authority receives from each organisation and the effectiveness of controls in place to reduce the risk of material misstatement in the financial statements.

Nature of services provided and items of account	Names of service organisations	Audit approach to be adopted
Investment managers provide information for the following areas of the accounts: • Investment values • Purchases and sales • Classification of assets into levels 1,2 and 3 for the financial instrument disclosure note.	AllianceBernstein Barings Asset Management BlackRock CBRE Royal London Asset Management	At the year end fund managers provide confirmation of the purchases and sales in year, and the market value of investments at the year end. We will substantively test transactions undertaken by the service organisations during the year, and the valuations applied to investments at the year end.
Custodian does not provide any information which feeds directly into the financial statements. Their role includes transaction settlement, collection of income, exercising corporate actions and cash management	JP Morgan	At the year end the custodian provides a report showing the holding and market value of investments held. This will be compared to the fund manager market valuation reports to provide assurance on holding and value of investments.

Reliance on experts

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

Items of account	Management's expert	Our expert
Defined benefit liability and associated IAS 19 entries and disclosures	Aon Hewitt	Audit Commission's consulting actuary (PWC)
Disclosures on the nature and extent of risk arising from financial instruments	River & Mercantile (following merger with P-Solve)	None
Valuation of unquoted investments not traded on active markets	Barings	None
Purchases and sales of investments	AllianceBernstein Barings Asset Management BlackRock CBRE Royal London Asset Management	None

Reliance on other auditors

There are material entries in your financial statements where we will seek to place reliance on the work of other auditors.

We plan to rely on the work of PWC to provide assurance on the accuracy of pension contributions calculated by Darlington Borough Council. This work falls within the Audit Commission's IAS19 Protocol in accordance with ISA (UK&I) 600 and Appendix 2 to Appendix 7 4 of the Audit Commission's Standing Guidance to Auditors in Local Government.

Timeline

The diagram below sets out the timing of the key phases of our audit work. We will communicate with management throughout the audit process and will ensure significant issues identified are communicated to those charged with governance on a timely basis.

Dec 2013 to May 2014

- Planning meetings with officers
- Walkthroughs of key systems and controls
- Issue Audit Strategy Memorandum
- If required, report interim findings February 2014

June to Sept 2014

- Start fieldwork in June 2014
- Issue Audit Completion Report
- Clearance meeting on September 2014

By 30 Sept 2014

- Meeting to approve and sign financial statements
- Issue representation letter
- Finalise financial statements review and issue auditor's report
- Issue auditors report
- Issue Annual Audit Letter

03 Significant risks and key judgement areas

We have performed our planning procedures, including risk assessment, as detailed in section 2. In addition, we met with management as part of the audit planning process to discuss the risks that, in management's opinion, the Council faces and have considered the impact on our audit risk. The risks that we identify as significant for the purpose of our audit are the risks of material misstatement that in our judgement require special audit consideration.

We set out below the significant audit risks and the areas of management judgement identified as a result of these meetings and planning procedures which we will pay particular attention to during our audit in order to reduce the risk of material misstatement in the financial statements.

Audit risks

Management override of controls

Description of the risk

Auditing standards state that management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on *all* audits.

How we will address this risk

We have updated our understanding and evaluation of internal controls procedures as part of our audit planning, including completion of a fraud risk assessment. 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.

We will address this risk by performing audit work covering:

- Accounting estimates impacting amounts included in the financial statements;
- Consideration of identified significant transactions outside the normal course of business; and
- Journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Valuation of unquoted investments for which a market price is not readily available

Description of the risk

The fair value of investments in the Net Assets Statement includes unquoted investments, the fair value of which totalled £1,088 million (52.2% of total assets) at 31 March 2013, of which £301.2 million were regularly traded. £787 million of these investments are not quoted in an active market for securities and unitised investments. The values used in the accounts are those provided by fund managers mostly based on Net Asset Value statements, although in some cases based on forward looking estimates and judgements involving many factors. This results in an increased risk of material misstatement.

How we will address this risk

We will address this risk by undertaking the following audit procedures:

- evaluate management controls over the valuation process;
- agree holdings from fund manager reports to the global custodian's report; and
- agree the price to independent evidence.

04 Your audit team

Below are your audit team and their contact details.

Engagement lead / Director	• Cameron Waddell • cameron.waddell@mazars.co.uk • 0191 383 6314
Engagement Senior Manager	• Catherine Banks • catherine.banks@mazars.co.uk • 0191 383 6410
Team leader (Assistant Manager)	• Sharon Liddle • sharon.liddle@mazars.co.uk • 0191 383 6410

In addition, an independent partner has been appointed for this engagement.

Independent Partner	• Alistair Fraser • Email: alistair.fraser@mazars.co.uk • 020 7063 4272

05 Fees for audit and other services

Audit fees

As communicated to you in our letter dated 18 September 2013, the Audit Commission has set a scale fee for your audit and our proposed fee is in line with this. The Audit Commission scale fee and our proposed fee for the audit of your financial statements is shown below.

Area of work	2013/14 Proposed Fee	2013/14 Scale Fee	2012/13 Actual Fee
Code audit work	£25,918	£25,918	£25,919

Non-audit services

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

Appendix A – Independence

We are required by the Financial Reporting Council to confirm to you at least annually in writing that we comply with the Auditing Practices Board's Ethical Standards. In addition we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

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 have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- All partners and staff are required to complete an annual independence declaration;
- All new partners and staff are required to complete an independence confirmation and also complete computer based ethical training;
- Rotation policies covering audit engagement partners and other key members of the audit team who are required to rotate off a client after a set number of years; and
- Use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement lead.

We wish to confirm that in our professional judgement, as at the date of this document, we are independent and comply with UK regulatory and professional requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with the Engagement Lead.

Prior to the provision of any non-audit services the Engagement Lead 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 and associated safeguards 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. In making our assessment we 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 consider materiality whilst planning and performing our audit.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides 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 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 discuss with management any significant misstatements or anomalies that we identify during the course of the audit and we report in our Audit Completion Report all unadjusted misstatements we have identified other than those which are clearly trivial, and obtain written representation that explains why these remain unadjusted.

Appendix C – Key communication points

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require us to communicate a number of points with you.

Relevant points that need to be communicated with you at each stage of the audit are outlined below.

Form, timing and content of our communications

We will present to the Audit Committee the following reports:

- Our Audit Strategy Memorandum;
- Our Audit Completion Report; and
- Annual Audit Letter.

These documents will be discussed with management prior to being presented to the Audit Committee and their comments will be incorporated as appropriate.

Key communication points at the planning stage as included in this Audit Strategy Memorandum

- Our responsibilities in relation to the audit of the financial statements;
- The planned scope and timing of the audit;
- Significant audit risks and areas of management judgement;
- Our independence;
- Responsibilities for preventing and detecting errors;
- Materiality; and
- Fees for audit and other services.

Key communication points at the completion stage to be included in our Audit Completion Report

- Significant deficiencies in internal control;
- Significant findings from the audit;
- Significant matters discussed with management;
- Our conclusions on the significant audit risks and areas of management judgement;
- Unadjusted misstatements;
- Management representation letter;
- Our proposed draft audit report; and
- Independence.

Appendix D – Forthcoming accounting and other issues

The 2013/14 CIPFA Code of Practice on Local Authority Accounting (the Code) has made several changes, of which you should be aware. Officers from the Fund's finance function have been invited to workshops that will provide full details of the changes in the 2013/14 Code as well as a forward look to potential future accounting changes that may be of relevance to the Fund. If you require detailed information on any of these changes or any other emerging issues, please contact any member of the engagement team.

There are no forthcoming accounting or other issues to report at this stage.