

Audit Strategy Memorandum

Durham County Council Pension Fund



For the year ended 31 March 2017



Contents

Executive summary	3
Purpose of this report	3
Audit scope and approach	4
Significant risks and key judgements	6
Timetable and communication	7
Fees	9
Our team	10
Appendix A – Service organisations and experts	11
Appendix B – Independence	12
Appendix C - Materiality	13
Appendix D – Our added value	14

Executive summary

Purpose of this report

The Audit Strategy Memorandum sets out our audit plan in respect of the audit of Durham County Council Pension Fund 'the Fund' for the year ending 31 March 2017, and forms the basis for discussion at the Audit Committee meeting on 24 February 2017.

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 overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process. We have determined that the Audit Committee] is those charged with governance for the purpose of our audit.

Timing of our work

Our audit will be delivered in four main phases as outlined in page 8 of this report. The statutory deadline for the completion of our audit work is 30 September 2017.

In 2018 the statutory deadline for preparation of draft accounts will move forward from 30 June to 31 May, and the statutory deadline for completion of audit work will move forward from 30 September to 31 July. To help prepare them for the 2018 revised deadlines, officers are aiming for 31 May deadline for preparation of the accounts. As agreed with officers and on the basis that all necessary working papers and third party confirmations are received as requested, we are aiming to issue the Audit Completion Report and audit opinion by 31 July.

Financial Statements audit

Significant risks

We have identified the following areas in which we will carry out specific audit procedures to mitigate the risks of material misstatements:

- management override of controls;
- valuation of unquoted investments for which a market price is not readily available; and
- disclosure of funding arrangements.

Materiality

At the planning stage of the audit we have set materiality for the financial statements as a whole at £11.04m.

In reporting the results of our work we do not report identified misstatements below a clearly trivial level. We have set this level at £0.33m.

Independence

We have considered any actual, potential or perceived threats to our independence on page 14. We have not identified any such threats at this stage of the audit.

Audit scope and approach

The scope of our work

The detailed scope of our work as your appointed auditor for 2016/17 is set out in the National Audit Office's (NAO) Code of Audit Practice. Our responsibilities and powers are derived from the Local Audit and Accountability Act 2014 ('the 2014 Act') and are summarised below.

Opinion on the financial statements

We are responsible for forming and expressing an opinion on the financial statements. Our audit is planned and performed so to provide reasonable assurance that the financial statements are free from material error and give a true and fair view of the financial performance and position of the Fund for the year.

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

Electors' rights

The 2014 Act requires us to give an elector, or any representative of the elector, the opportunity to question us about the accounting records of the Fund and consider any objection made to the accounts by an elector. We also have a broad range of reporting responsibilities and powers that are unique to the audit of local authorities in the United Kingdom.

Our response to the risk of fraud

International Standards on Auditing (ISAs) require us to obtain reasonable assurance that the financial statements are free from material fraud and/or error. There are a range of ways in which fraud may arise in the context of your financial statements and we formally consider the risk of fraud as part of our planning work and design appropriate procedures to mitigate risks identified. We maintain an appropriate level of professional scepticism throughout the audit and are mindful that a material misstatement due to fraud is possible, however our audit should not be relied upon to identify all such misstatements.

Management and the Audit Committee, as those charged with governance also have responsibilities in respect of fraud. They are responsible for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with laws and regulations.

Our enquiries will focus on:

- what role the Audit Committee has in relation to fraud and how it is kept informed of fraud related matters by management;
- what anti-fraud measures you have in place and how your policies and procedures are monitored; and
- whether you are aware of any actual, alleged or suspected fraud.

We will formally write to you, in your role as those charged with governance, making the enquiries above, during our audit.

Our approach to obtaining assurance over service organisations

There are material entries in your financial statements where the Fund is dependent on an external organisation. We call these entities service organisations. In Appendix A, we outline our approach to understanding the services received from each organisation and the approach we intend to take to obtain sufficient appropriate evidence over items of account that derive from them.

Our use of experts and other auditors

Management and auditor experts

There are material entries in your financial statements which are provided by management experts. For some of these entries, we will use our own expert to provide us with the assurance we require in relation to the work of your expert.

In addition to setting out information in respect of service organisations, Appendix A also summarises management's experts and our planned audit approach to obtaining assurance over their work.

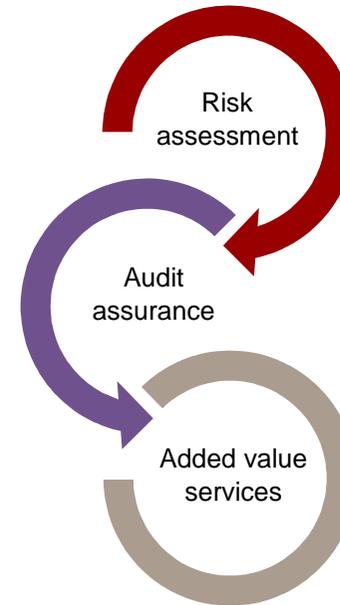
Internal audit

Where appropriate, we will seek to rely on work performed by internal audit where it provides us with the required assurance. We will meet with internal audit to discuss their work programme and findings, and factor this in when determining the most efficient testing strategy.

Where we intend to rely on the work of internal audit, we will evaluate their work and perform our own audit procedures to determine its adequacy for our audit.

Audit efficiency and our use of IT

Innovative and integrated use of IT drives the efficiency and effectiveness of our audit. Your audit team uses the latest IT-based audit solutions and is supported by a team of IT auditors each of who have extensive knowledge of providing assurance and advisory services across the public sector.



We know that all organisations are different and face different risks. Our audit platform is modern and flexible and allows us to tailor our audit approach to the specific risks relevant to the Fund, while ensuring compliance with underlying auditing standards.

We focus on the risks that give rise to a risk of material misstatement in the financial statements. Your audit team has access to a full suite of data analytics tools which allow them to determine the most effective and efficient testing strategy using IT-audit techniques where appropriate.

Significant risks and key judgements

Identified significant risks

As part of our planning procedures we have considered whether there are risks of material misstatement in the Fund's financial statements that require special audit consideration. Although we report identified significant risks at the planning stage of the audit, our risk assessment is a continuous process and we regularly consider whether new significant risks have arisen and how we intend to mitigate these risks. Where we identify any significant risks in addition to those set out below, we will report these to the Audit Committee as part of our Audit Completion Report.

Significant risk	How we will mitigate the risk
<p>Management override of control</p> <p>In all entities, 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 overrides could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.</p>	<p>We will address this risk by performing audit work in the following areas:</p> <ul style="list-style-type: none"> • accounting estimates affecting 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.
<p>Valuation of unquoted investments for which a market price is not readily available</p> <p>As at 31 March 2016 the fair value of investments which were not quoted on an active market was £154m, which accounted for 6.7 per cent of net investment assets. The values used in the accounts are those provided by fund managers which are based on Net Asset Value statements. This results in an increased risk of material misstatement.</p>	<p>In addition to our standard program of work we will:</p> <ul style="list-style-type: none"> • evaluate management controls over the valuation process; • agree holdings from fund manager reports to the global custodian's report; • agree the valuation to supporting documentation including investment manager valuation statements and cashflows for any adjustments made to the investment manager valuation; • agree the investment manager valuation to audited accounts. Where these are not available, agree the investment manager valuation to other independent supporting documentation; • where audited accounts are available, check that they are supported by a clear opinion; and • agree the price to independent evidence, for those valuations not supported by valuation statements.

Timetable and communication

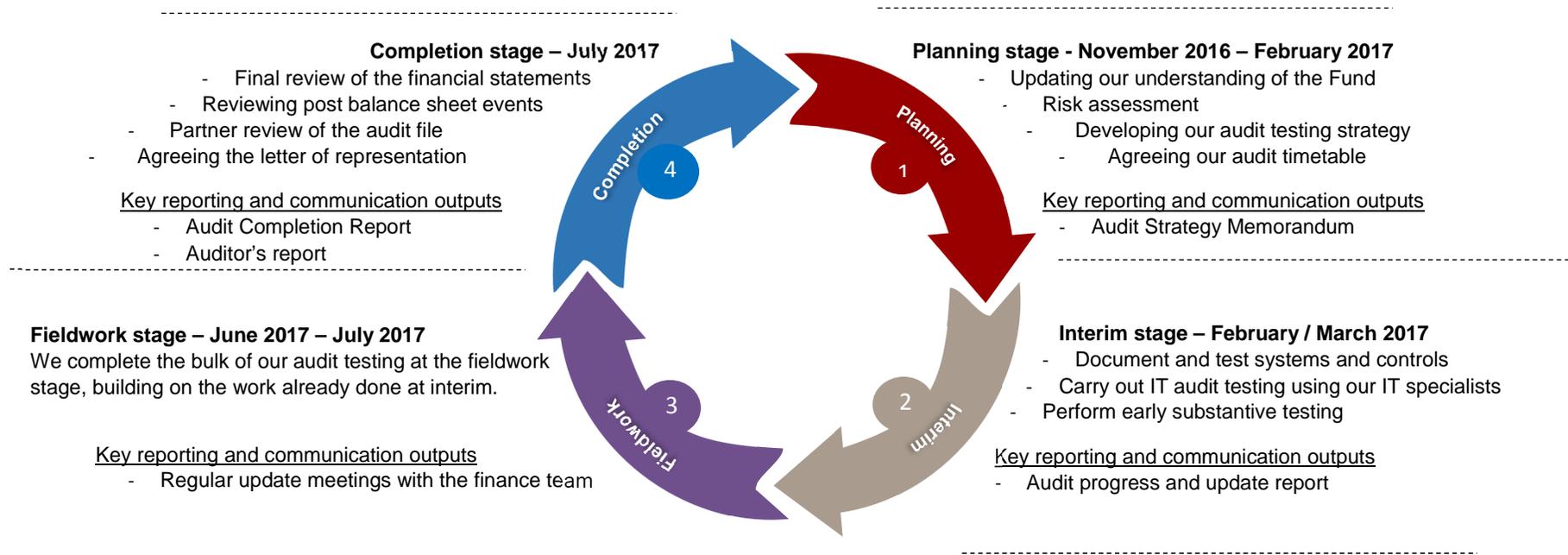
Our approach to communication

International Standards on Auditing require us to communicate a number of matters with you at various points during the audit cycle. Later in this section we outline exactly how we will communicate with the Audit Committee as those charged with governance. As well as being an integral part of our responsibilities under auditing standards, we see two-way communication with the Audit Committee and officers as being critical to building a robust knowledge of your operations, the risks and challenges you face and the plans you have in place to meet those challenges.

Audit timetable

The diagram below outlines the main phases of your audit, when each will be carried out and the outputs that you will receive at each stage. This is underpinned by a 'no surprises' approach to communication that ensures management and the Audit Committee are kept aware of significant issues on a timely basis. We intend to issue our Audit Strategy Memorandum in February 2017, our Audit Completion Report in July 2017 and our Annual Audit Letter in September 2017.

The timetable is based on the Fund providing a complete statement of accounts and supporting working papers by the end of May 2017. Where this is not the case we will communicate to the Audit Committee.



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 matters to you. These matters are set out below.

Matter to be communicated	Audit Strategy Memorandum	Audit Completion Report
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Confirmation of our independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality	✓	✓
Fees for audit and other services	✓	
Significant deficiencies in internal control		✓
Significant findings from the audit		✓
Significant matters discussed with management		✓
Conclusions on the significant audit risks and areas of management judgement		✓
Summary of unadjusted misstatements		✓
Management representation letter		✓
Our proposed audit report		✓

In addition to the matters outlined above which we are required to communicate under auditing standards, we also communicate regularly with the Audit Committee through our Audit Progress Reports, presented on a quarterly basis. We also report to the Council on an annual basis to summarise our work and main conclusions through our Annual Audit Letter.

Fees

Fees for work as the Fund's appointed auditor

At this stage of the audit we are not planning any divergence from the scale fees set by Public Sector Audit Appointments Ltd (PSAA) as communicated to you in our fee letter dated 15 April 2016.

Area of work	2016/17 proposed fee	2015/16 final fee
Code audit work	25,918	25,918

Fees for non-PSAA work

We do not currently plan to carry out any non-PSAA work.

Our team



Mark Kirkham – Engagement Lead

mark.kirkham@mazars.co.uk

0191 383 6350

This is Mark's first year as engagement lead at the Fund. Mark has been an external audit engagement lead since 2002.



Sharon Liddle – Engagement Manager

sharon.liddle@mazars.co.uk

0191 383 6311

Sharon has been manager at the Fund since 2015. Prior to this she was the team leader on the audit. Sharon will manage and coordinate the different parts of the audit. She will be the key point of contact for the finance team



Chris Kneale – Team Leader

chris.kneale@mazars.co.uk

0191 383 6337

Chris has been team leader on the audit since 2015. Chris will be a key contact for the finance team, leading the day-to-day audit, reviewing the work of more junior members of the team and performing the audit work in more specialised areas.

In accordance with our internal policies for audit quality and risk management, we consider the audit of the Fund to be a 'major audit'. As a result, and in line with the requirements of International Standards on Quality Control (ISQC) 1, the firm's Risk Management Partner has appointed an Engagement Quality Control Reviewer to the Fund's audit who will bring an additional level of quality control to the engagement team.

Appendix A – Service organisations and experts

Service organisations

As we outline in the main body of this report, the Fund makes use of service organisations. ISA 402 defines a service organisation as one that provides services to another entity that form part of that entity's information systems relevant to financial reporting. The table below sets out the service organisations that we have identified as part of our planning work together with a description of how we intend to obtain assurance over the entries in your financial statements that are derived from them.

Service organisation	Services provided	Planned audit approach
AB BlackRock CBRE Royal London Asset Management Mondrian Investment Partners Aberdeen Asset Management BNY Mellon Water Scott	Investment managers	We will substantively test transactions undertaken by the service organisations during the year and the valuations applied to investments at the year end.
JP Morgan	Custodian	

Experts

The Fund also uses experts to provide entries in its financial statements. The table below outlines the areas of the financial statements where we expect the Fund to use experts and an explanation of the approach we will take to obtaining assurance over those entries.

Financial statement area	Management's expert	Planned audit approach
Disclosure notes on the funding arrangements and actuarial present value of promised retirement benefits.	Actuary Aon Hewitt	Review and consideration of work undertaken by the NAO's consulting actuary (PWC).
Disclosure notes on the nature and extent of risk arising from financial instruments	Mercer Limited	Consider the reasonableness of Mercer's output and assess expertise and experience of expert.

Appendix B – 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 partner.

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 either Mark or Sharon.

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 threats to our independence have been identified.

Appendix C - 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 our audit, 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 D – Our added value

Our primary responsibilities as the Fund’s external auditor are outlined in the main body of this report. As your external auditor we are ideally placed to provide added value in delivering those responsibilities and the diagram below provides a summary of how we do this.

Insight

Analysis of emerging issues shared regularly with you through our Audit Progress Reports.

Sharing knowledge from our membership of a range of professional networks including those hosted by the ICAEW and NAO.

Regular updates from our public services advisory team on lessons learned from its work across the UK public sector.

Access to our public sector governance forum allowing free and open discussion of governance issues.

Expertise

Specialist public sector financial reporting advisory service, providing expert analysis of emerging accounting issues.

A dedicated IT audit and advisory team, with expertise and experience of providing services across the public sector.

Provision of annual accounting workshops attended by your finance team.

Support for continuous improvement

Clear and open communication, allowing for a sensible basis of resolving emerging issues.

Internal control recommendations and follow-up work in conjunction with internal audit.