REPORT TO: **SCRUTINY COMMITTEE – 16 APRIL 2014**

REPORT ON: **EXTERNAL AUDIT REPORT – TAYSIDE PENSION FUNDS AUDIT STRATEGY OVERVIEW AND PLAN 2013/14**

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **176-2014**

1 PURPOSE OF REPORT

To submit to elected members the above report that provides a summary of the responsibilities and approach in respect of the Tayside Pension Funds for 2013/14.

2 RECOMMENDATIONS

It is recommended that elected members note the information included in the attached report.

3 FINANCIAL IMPLICATIONS

None

4 MAIN TEXT

4.1 Following their appointment by Audit Scotland as external auditor for the City Council for five years from 2011/12, KPMG LLP have produced the above report outlining the planned approach to the audit of Tayside Pension Fund and Tayside Transport Pension Fund ("the Pension Funds") for the year ending 31 March 2014. The document sets out the statutory and professional responsibilities in terms of the Code of Audit Practice and also outlines our key audit objectives.

4.2 The report sets out information on the proposed audit approach focussing on the key issues and risks facing the Pension Funds in terms of corporate governance arrangements, ownership and valuation of investments, regulatory and accounting compliance and other issues relevant to the opinions on the financial statements. The document also sets out the key stages of the planned audit process, together with a summary of procedures for working with internal audit, materiality considerations and arrangements for communication and reporting.

5 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

6 CONSULTATION

The Chief Executive and Head of Democratic and Legal Services.

7 BACKGROUND PAPERS

None

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **20 MARCH 2014**

Tayside Pension Funds

Audit strategy overview and plan overview

Year ending 31 March 2014

19 March 2014

Contents

The contacts at KPMG in connection with this report are:

David Watt
Director, KPMG LLP

Tel: 0141 300 5695
Fax: 0141 204 1584
david.watt@kpmg.co.uk

About this report
This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of only Dundee City Council and is made available to the Accounts Commission and Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Complaints
If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact David Watt, who is the engagement leader for our services to Tayside Pension Funds, telephone 0141 300 5695 email: david.watt@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Introduction

This document describes how we will deliver our audit for Tayside Pension Funds for the year ending 31 March 2014.

This includes the opinions on the financial statements prepared by the Council in accordance with relevant legal and accounting requirements.

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice*. This specifies a number of objectives for our audit.

The Accounts Commission has appointed KPMG LLP as auditors of Dundee City Council and therefore Tayside Pension Fund and Tayside Transport Pension Fund ("the Funds"), under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

This document summarises our responsibilities as external auditors for the year ending 31 March 2014 and our intended approach to issues impacting the Fund's activities in that year.

We carry out our audit in accordance with our statutory responsibilities under the Act and in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board ("APB") and the wider responsibilities embodied in Audit Scotland's *Code of Audit Practice.* Under this *Code of Audit Practice* auditors address and comment upon a number of objectives, together with complying with a number of obligations. The *Code of Audit Practice* also places a number of obligations on the members of Dundee City Council as administering body. These are given in Appendix 2.

Auditors' objectives in relation to the *Code of Audit Practice* are to:

- audit the financial statements and place a certificate on the statements stating that the audit has been conducted in accordance with Part VII of the Act;
- satisfy ourselves that:
  - the financial statements have been prepared in accordance with all applicable statutory requirements; and
  - proper accounting practices have been observed in the preparation of the financial statements.
- hear any objection to the financial statements lodged by an interested person.

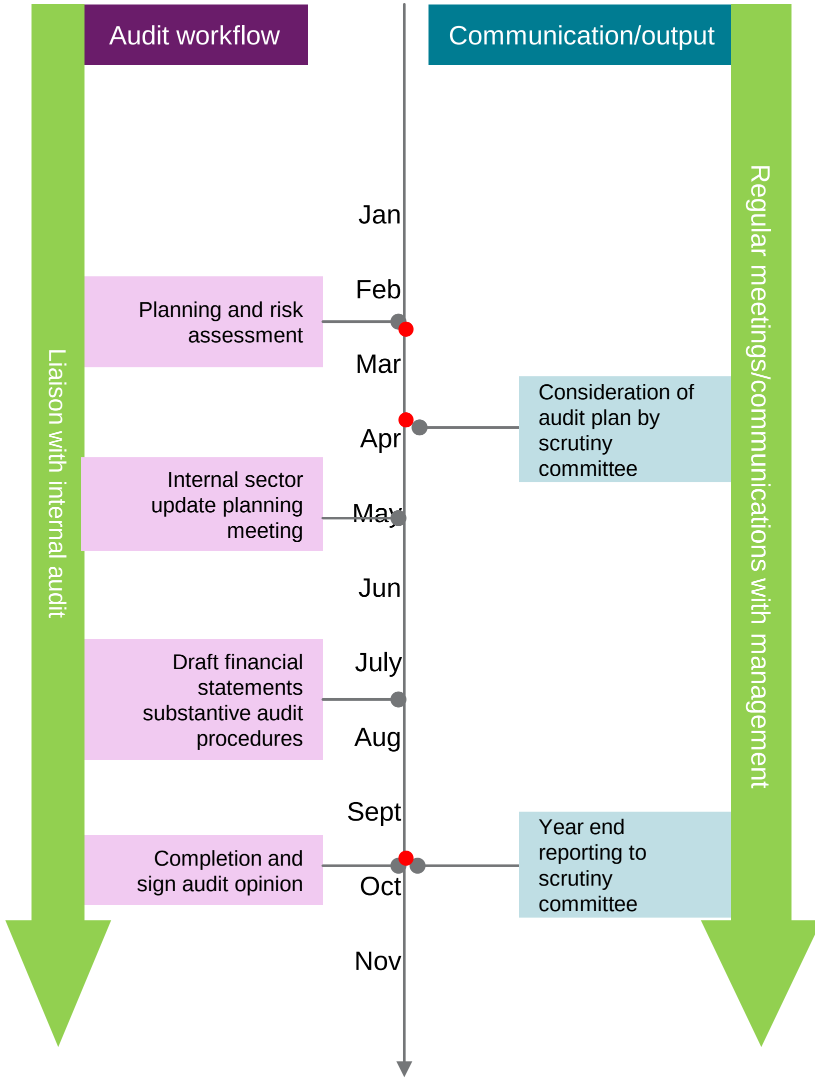
We conduct our audit of the financial statements in line with International Standards on Auditing (UK and Ireland). We have a professional responsibility to report if the financial statements do not comply, in any material respect, with the IFRS-based *Code of Practice on Local Authority Accounting in the United Kingdom 2013-14* ("the Code"), taking account of the international financial reporting standards issued by the International Accounting Standards Board and relevant guidance issued by the Chartered Institute of Public Finance and Accountability ("CIPFA") / Local Authorities (Scotland) Accounts Advisory Committee ("LASAAC").

As part of our audit we also review the financial information contained in the foreword and introduction to ensure that it is consistent with the financial statements. We also review the governance compliance statement to ensure it has been prepared in accordance with guidance from the Scottish Ministers, taking account of the financial statements and other information gained by us as auditors.

In accordance with International Standard on Auditing (UK and Ireland) 260: *Communication with those charged with governance* we will report to you all non-material, non-trivial errors, which have not been adjusted.

2013-14 audit timeline; reporting; fees

Out timetable is largely unchanged from the prior year, but will be subject to refinement through discussions with management.



Scrutiny committee meetings

Reporting

Through regular meetings at appropriate levels, there will be open and regular discussion between management, auditors and management. As a result, accounting and control issues can be identified and reported to allow you to manage them throughout the year. Audit Scotland's *Code of Audit Practice* requires us to communicate to management findings arising as a result of the audit work completed. Reports to management will be submitted, with draft reports discussed and agreed with management and action plans developed to include the recommendations, target dates for implementation and the member of staff responsible for implementation.

We envisage submission of the following report in respect of 2013-14:

- by 31 October 2013, annual audit report to the members of Dundee City Council as administering body and the Controller of Audit.

Fees

Our fee for the audit of the financial statements of the Fund is included as part of the fees set by Audit Scotland for the audit of the Council. These are set within the limits of an indicative range, depending on the assessment of risk and other factors facing the Council. We will agree a split of the agreed fee with officers for the purposes of re-charge to and disclosure in the Funds' financial statements. As with other audits, our fee proposals are based on the following assumptions to ensure an efficient audit process: draft report, financial statements and full electronic files of supporting work papers available at the start date of our on site visit; reliance on your internal controls; availability of key members of staff during the audit fieldwork; and completion within the agreed timetable. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus, or should other matters arise, we will discuss with management the impact of this on our proposed fee for the Council.

The element of the fee agreed with Dundee City Council which we propose applying to the Funds is £28,050.

Financial context and audit focus areas

Our audit approach is risk-based, and focuses on the areas most likely to lead to material misstatement in the Funds' financial statements.

We have performed initial risk assessment procedures to identify focus areas for the 2013-14 audit.

Continued areas of audit focus are:

- **investments; and**
- **governance.**

We have developed an understanding of your key audit focus areas based on our initial risk assessment procedures, including discussions with management. The key areas identified are detailed below. Our risk assessment procedures are ongoing throughout the audit, and we will update you in respect of any emerging risks as we become aware of them.

Significant risks

International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment* requires the auditor to determine whether any of the risks identified as part of our risk assessment are significant risks and therefore requiring specific audit consideration. In determining whether a risk is significant, judgement is applied in respect of the whether, for example, the risk is associated with the complexity of transactions, the degree of subjectivity involved in the measurement of financial information, whether the associated transactions are outside the normal course of business, or whether there is an associated risk of fraud.

With the exception of the required two fraud risks identified in International Standard on Auditing (UK and Ireland) 240, which are set out further below, we have not identified any significant risks of material misstatement as a result of our planning and risk assessment.

We will provide an updated list of significant risks in our annual audit report which will be reported to the scrutiny committee in September 2014.

Fraud risk from management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. Our audit methodology incorporates the risk of management override as a significant risk.

Fraud risk from income recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. However, as the income of the Funds comprises contributions receivable in accordance with levels recommended by the Funds' independent actuary and can be related to the underlying employer records, we do not regard the risk of fraud from this revenue recognition as significant. In addition, the other major source of income is earned from the independently managed investments held by the Funds. This minimises the level of judgement required in revenue recognition by management and we do not regard the risk of fraud from this revenue recognition as significant.

Financial performance

Because of the nature of the longer term nature of the Funds' activities, detailed financial reporting to the pension investment sub-committee of the Council's policy and resources committee focuses on investment performance rather than the detail of dealings between Funds members and employers. These are however expected to be broadly consistent with the prior year which had contributions receivable and transfers in of £93 million and benefits payable and payments to and on account of leavers of £83.5 million. Administration expenses were £1.2 million.

During the year the Council changed its investment adviser and recommendations on changes to investment managers are under consideration.

Financial context and audit focus areas (cont'd)

At 30 September 2013, Funds investments were £2,343 million, with the Funds outperforming their benchmark in the quarter, year, three and five years to that date. The Funds' actuary has indicated that the funding level at that date was around 104% for the Main Fund and 107% for the Transport Find liabilities (based on the triennial valuation as at 31 March 2011).

Our audit will include consideration of the process to transfer assets and the associated reconciliations are performed by management. As part of our year end audit we will also obtain independent confirmation of investment balances held and undertake appropriate tests on the underlying investment information and valuations applied as at 31 March 2014.

Fund governance

The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 require an administering authority to prepare and publish a governance compliance statement to measure their pension funds' governance arrangements against the standards set out in guidance from the Scottish Ministers. The Code requires Scottish local authorities to include a statement on the system of internal financial control (SSIFC), if they decide not to prepare an annual governance statement.

There was a lack of clarity regarding whether pension fund annual reports are required to include a SSIFC. In order to promote a consistent approach, guidance in previous years from Audit Scotland has been that, as the Code requires a SSIFC only in the absence of a governance statement, the requirement for a SSIFC did not apply to pension funds that include a governance compliance statement in the annual report. Auditors have therefore been required to read the information in the governance compliance statement to check whether it complies with the Scottish Ministers guidance and report when it does not.

However, Audit Scotland understands that the 2014-15 Code will be amended to require either the inclusion of a separate SSIFC or the extension of the governance compliance statement to reflect SSIFC disclosures. Although the change to the Code does not formally apply until 2014-15, Audit Scotland is revising its guidance in this area for auditors of authorities that voluntarily include a SSIFC or SSIFC disclosures in 2013-14. In addition to reporting whether the governance compliance statement complies with Scottish Ministers' guidance:

- if the governance compliance statement has been extended to reflect SSIFC disclosures, we will also check that those disclosures comply with the Code and report where it does not;
- if the Council includes a separate SSIFC, we will also read the information in SSIFC to check whether it complies with the Code and report where it does not.

Our audit will focus on the key areas of Funds' governance; for example, committee operations, provision and use of management information, the risk assessment and monitoring process, and, compliance with key areas of legislation and regulation.

We will carry out a high level compliance and regulatory review as part of our normal audit procedures. Our team includes a pensions audit specialist who can keep you and the audit team fully briefed on any emerging pensions technical and accounting matters.

Presentation of financial statements

The Council is required to prepare financial statements for the Funds in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2013-14* ("the Code").

While there are some changes in the content of the Code for 2013-14, the financial statements and underlying accounting policies are expected to remain substantially consistent with the previous year.

KPMG remains committed to working with management to enhance the clarity and impact of the financial statements, including the implications of the revisions to the Code.

Code of practice on Local Authority Accounting in the United Kingdom 2013-14

The 2013-14 financial statements will be prepared in accordance with the *Code of practice on local authority accounting in the United Kingdom 2013-14 ("*the Code*")* which is based on International Financial Reporting Standards ("IFRS").

The 2013-14 Code has a number of amendments from the 2012-13 version and management should reflect these changes to the reporting requirements in the draft financial statements. Consideration of the changes in the context of the Funds has identified that very few of these changes are relevant to pension fund financial statements (a note was included in the audit strategy overview for the Council's own financial statements). We will discuss the impact of the Code changes with Council officers and agree the amendments made.

From 2013-14 auditors as also required to read the narrative information given about the pension fund to identify anything that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired in the course of performing the audit. If revision of the information is necessary, and an authority refuses to make the revision, auditors require to include in the auditor's report an 'other matter' paragraph describing the matter.

Local Authority Accounts (Scotland) Regulations

The Scottish Government has been consulting on proposals to amend the Local Authority Accounts (Scotland) Regulations. The consultation period closed on 4 October 2013, but at the time of compilation of this plan, the outcome of that consultation is unknown. The proposed draft regulations include a number of changes designed to help strengthen corporate governance processes. The intention is that the proposed regulations will be applicable to 2013-14 onwards and consideration should be given to the implications for the Council's reporting arrangements in relation to the Fund arising from the content of the consultation draft and of course from the finalised Regulations once these are known.

Mandatory communications

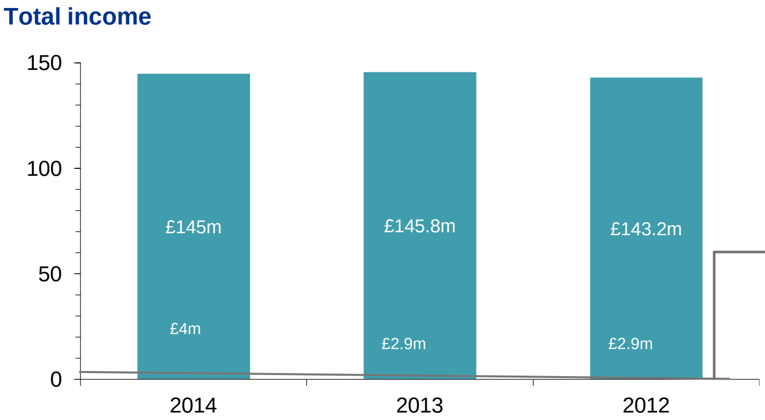
Auditing Standards specify a number of matters for communication with those charged with governance. Matter relating to fraud risks, related party transactions and independence are given here. Mandatory communication in relation to materiality are given on the next page.

Area	Issue	KPMG response
Fraud risks	■ It is the responsibility of management to implement accounting and internal control systems which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements caused by fraud or error. ■ Those charged with governance must ensure, through oversight of management, the integrity of these systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with laws. This is in the context of preparing financial statements that give a true and fair view and that do not contain material misstatements arising from fraudulent reporting (intentional misstatements/ omissions to deceive the financial statement user) or from the misappropriation of assets.	■ Our audit procedures are designed to have a reasonable chance of detecting misstatements as a result of fraud or error. The audit team will review and discuss fraud related risks and controls with the chief financial officer and senior management, and consider the work of internal audit. ■ Our risk assessment procedures will include a number of interviews with senior personnel concerning processes to identify and respond to risks of fraud.
Related party transactions	■ Management has processes in place to identify related party transactions. All material related party transactions must be disclosed in the financial statements.	■ We will ensure that there continues to be appropriate processes in place as part of the financial statements preparation process to identify any related party transactions.
Independence	■ Auditing Standards require us to consider our independence and related matters in our dealings with the members of Dundee City Council as administering body of the Funds.	■ We have provided our formal independence communication in appendix one. In respect of any non-audit services provided to Dundee City Council as administering body of the Funds we have completed internal conflict checks to confirm that the services may be provided with no threat to our audit independence.

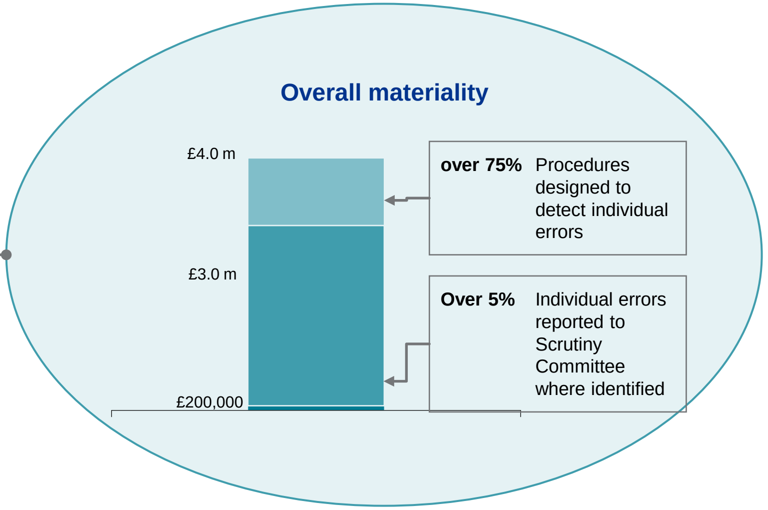
Audit materiality

Our audit work is planned to detect errors that are material to the financial statements as a whole.

Our materiality is based on income arising from dealings with members and employers and takes into account the low risk nature of the Funds.



Source: 2012-13 financial statements



Determining materiality

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

We have reassessed our level of materiality this year based on our knowledge and understanding of the Funds' risk profile and, therefore, financial statements. Materiality has been set at £4 million which is approximately 2.7% of members, employer related and investment income in 2012-13. This will be revised once draft financial statements for 2013-14 are known.

We design our procedures to detect errors at a lower level of precision, i.e. £3 million.

We will report identified errors greater than £200,000 to the scrutiny committee.

Reporting to scrutiny committee

To comply with Auditing Standards, the following three types of audit differences will be reported to the scrutiny committee:

- adjusted audit differences;
- unadjusted audit differences; and
- disclosure differences (adjusted and unadjusted).

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Appendices

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Independence

Auditing Standards require us to communicate to the scrutiny committee in writing at least annually on any matters which may reasonably be thought to bear on our independence and set out the safeguards in place in relation to these matters and confirm that we are independent.

Professional ethical standards require us to communicate to you as part of planning all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Audit Director and the audit team. This letter is intended to comply with this requirement although we will communicate any significant judgements made about threats to objectivity and independence and the appropriateness of safeguards put in place.

We are satisfied that our general procedures support our independence and objectivity, except for those detailed below where additional safeguards are in place.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

Confirmation of audit independence

We confirm that as of 19 March 2014, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the scrutiny committee and should not be used for any other purposes.

Yours faithfully

KPMG LLP

Audit Scotland code of audit practice – audited body responsibilities

Financial statements

- Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Audit Scotland code of audit practice – audited body responsibilities (cont'd)

Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

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