

# Falkirk Council Pension Fund

Year ending 31 March 2017

Annual Audit Plan

Pensions Committee and Board – 16 March 2017



Building a better  
working world

## Public sector audit framework

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The Code of Audit Practice (the Code) <http://www.audit-scotland.gov.uk/report/code-of-audit-practice-2016> sets out the responsibilities of audited bodies, in accordance with statute and other relevant guidance, in respect of the preparation of financial statements.

We issue our audit opinion on the 'truth and fairness' of the Pension Fund's financial statements in accordance with management's timetable, and by 30 September 2017.

The nature of public sector audit means that the focus of audit work is broader than just the financial statements of the Pension Fund. We consider the four dimensions of public sector audit as set-out jointly by the Accounts Commission and the Auditor General for Scotland. Judgements in respect of Best Value are formed from the findings in respect of each of the four dimensions.

## Understanding the Pension Fund

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2015/16 was noted as a challenging year for the Fund's investments. Investment management continues to be a key strategic focus, including both monitoring externally managed funds and the strategic investment decisions being made by the Fund.

The Fund's funding policy is to achieve a fully funded status over a 20 year period whilst keeping contribution rates as constant as possible.

A new payroll module was introduced during the year and we will factor this into obtaining our understanding of the operations of the Pension Fund.

## Financial statements audit

Pages 8-13

### Materiality

Planning Materiality for the audit has been determined at £18.0 million, representing 1% of net assets based on the prior year financial statements. Tolerable Error is set at £9.0 million. Our Summary of Audit Differences (SAD) nominal amount, set in line with the Code, is £250,000.

### Risk assessment

In line with auditing standards we identify significant risks in respect of the risk of management override of controls, and a significant risk in respect of the valuation of complex investments.

At this stage of our audit planning, we have not identified any other significant financial statement risks. We will confirm our updated risk assessment as part of our Annual Audit Report.

We follow Audit Scotland's protocol for handover from previous auditors and have already held discussions with your former external auditor to understand their judgements and audit findings in respect of the 2015/16 audit of the Pension Fund financial statements.

### Audit approach

Management, through the Chief Finance Office and Pensions Manager has primary responsibility for the prevention and detection of fraud. We design appropriate audit procedures in response to identified fraud risk factors, for the purpose of detecting material misstatements.

There are a number of changes to the Accounting Code of Practice in 2016/17, including changes to the disclosure of management expenses and rents from properties, and inclusion of fair value measurement disclosure requirements. We will discuss the impact of these on the Pension Fund financial statements with management in advance.

We obtain an understanding of your internal control arrangements, both as they apply across the Pension Fund, but also in terms of key processes. We consider the design and implementation of key controls where appropriate. In addition where appropriate, we plan to apply data analytics to capture and analyse whole populations of financial data.

We liaise with internal audit to ensure our approach takes account of risks identified and findings reported in the course of their work.

## Wider scope audit and other work

Pages 14-15

The wider scope audit as set out in the Code plays a key role in the public sector audit framework in Scotland.

We undertake work in respect of the four audit dimensions annually. At this time, we have not identified any Wider Scope Audit Focus Areas impacting on the Pension Fund for 2016/17.

Key to the assessment and judgement in the wider scope audit areas is the quality of the Pension Committee's arrangements for self-evaluation to be able to demonstrate the quality and effectiveness of its arrangements.

## Team, fees and deliverables

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Careen Gray is responsible for the quality of the audit and for signing the financial statements. Careen is responsible for EY's pensions assurance practice in Scotland. She is supported by Keith Macpherson and Rob Jones, who will manage the financial statements audit and be the key day-to-day contact for the Pensions Manager and Pensions Accountant

We have agreed an auditor remuneration fee element of £17,190. This results in a total fee, inclusive of pooled costs, central performance audit and Best Value costs and central support costs, of £19,720 (2015/16: £23,010).

## Appendices

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We confirm our independence to act as your external auditor.

We provide you with details of the key communications we are required to provide you with in accordance with Auditing Standards.

### About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Accounts Commission has appointed us as external auditor of Falkirk Council Pension Fund (the Pension Fund) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Local Government (Scotland) Act 1973 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

This report is for the benefit of the Pension Fund and is made available to the Accounts Commission, the Controller of Audit and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) 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, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

### Complaints

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

# **1. Public sector audit framework**

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as Falkirk Council Pension Fund's (the Pension Fund) external auditor for the five year period 2016/17 to 2020/21.

We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; relevant Auditing Standards and applicable Practice Notes issued by the Auditing Practices Board; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Plan, prepared for the benefit of Pension Fund management and the Pensions Committee and Board, sets out our proposed approach for the audit of the Pension Fund financial statements for the financial year ending 31 March 2017, in accordance with the responsibilities placed on us through the public sector audit framework in Scotland.

## Financial statements audit

### *The Administering Authority's responsibilities*

Falkirk Council, as the Administering Authority is ultimately responsible for the preparation of financial statements which give a true and fair view of the financial transactions of the Pension Fund and of the amount and disposition of its assets and liabilities, in accordance with the applicable financial reporting framework and relevant legislation. The Code also sets out the Administering Authority's responsibilities for maintaining accounting records and supporting working papers that have been prepared to an acceptable professional standard. In practice the Administering Authority has delegated this responsibility to the Pensions Committee and secured the Chief Finance Office of Falkirk Council as the proper officer for responsibility of the Pension Fund's financial affairs.

The Pensions Committee is also required to prepare and publish, along with the financial statements, an annual governance statement, governance and compliance statements and management commentary that are consistent with the disclosures within the financial statements. Management, with the oversight of the Pensions Committee, should ensure communication of relevant information to users about the Pension Fund and its financial performance.

### *Our responsibilities*

We are responsible for conducting an audit of the financial statements of the Pension Fund. We will provide an opinion on the financial statements as to whether:

- ▶ they give a true and fair view of the transactions of the Pension Fund during the year ended 31 March 2017 and of the amount and disposition at that date of its assets and liabilities.
- ▶ they have been properly prepared in accordance with International Financial Reporting Standards as adopted by the EU and interpreted by the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom and properly prepared in accordance with requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) regulations 2014 and the Local Government in Scotland Act 2003.

We also review and report on the consistency of the other information in the Annual Report and Accounts prepared and published by the Pension Fund along with its financial statements.

### *The Local Authority Accounts (Scotland) Regulations 2014 (the Regulations)*

In accordance with the Regulations 2014, the signed unaudited annual financial statements should be submitted to the external auditor no later than 30 June 2017. Furthermore, the unaudited annual financial statements should be considered by an appropriate committee of the Pension Fund by 31 August 2017.

The Regulations also set out the requirements for approval of the audited financial statements. The Pension Fund, or relevant committee, is required to approve the audited annual financial statements for signature no later than 30 September 2017. In making their consideration, the Regulations require elected members to have regard to any report made, or advice provided by the proper office of the Pension Fund and the auditor. To support the Pensions Committee in discharging these responsibilities, we will report to the Committee the findings of our audit in our Annual Audit Report.

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## Key messages

The Code of Audit Practice (the Code) <http://www.audit-scotland.gov.uk/report/code-of-audit-practice-2016> sets out the responsibilities of audited bodies, in accordance with statute and other relevant guidance, in respect of the preparation of financial statements.

We issue our audit opinion on the 'truth and fairness' of the Pension Fund's financial statements in accordance with management's timetable, and by 30 September 2017.

Together the Accounts Commission and the Auditor General for Scotland agreed the four dimensions set out in the Code which comprise the wider scope audit for public sector in Scotland. These are:

- financial management;
- financial sustainability;
- governance and transparency; and
- value for money.

In local government, audit work over the four dimensions leads to an overall assessment of Best Value.

## Wider scope audit


### The Pensions Committee's responsibilities

The Code sets out the broader responsibilities of the Pensions Committee in respect of ensuring proper financial stewardship of public funds. The Pensions Committee should establish proper arrangements:

- ▶ For the proper conduct of its affairs, including the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements.
- ▶ For the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct.
- ▶ To ensure that their financial position is soundly based having regard to, for example, balances and reserves including strategies about levels held and their future use and how they plan to deal with uncertainty in the medium and longer term.
- ▶ For securing Best Value in accordance with the statutory duty on local authority bodies.

### Our responsibilities

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the four dimensions of wider-scope public audit. Our audit work over the wider scope audit dimensions complements our financial statements audit.

|  <b>Financial management</b>  |  <b>Financial sustainability</b>   |  <b>Governance and transparency</b>   |  <b>Value for money</b>  |
|--|---|--|---|
| <p>We conclude on the effectiveness of financial management arrangements. This includes considering whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p> | <p>We consider the medium and longer term outlook to determine if planning is effective to support service delivery. This will focus on the arrangements to develop viable and sustainable financial plans.</p> | <p>We review the adequacy of governance arrangements. In particular, we consider and report on; whether these are appropriate and operating effectively and that there is effective scrutiny, challenge and transparency on decision-making.</p> | <p>We consider whether value for money can be demonstrated in the use of resources. This includes the extent to which there is an alignment between spend, outputs and outcomes delivered and that there is a clear focus on improvement.</p> |

## Key messages

The nature of public sector audit means that the focus of audit work is broader than just the financial statements of the Pension Fund.

We consider the four dimensions of public sector audit as set-out jointly by the Accounts Commission and the Auditor General for Scotland.

Judgements in respect of Best Value are formed from the findings in respect of each of the four dimensions.

## **2. Understanding the Pension Fund**

## 2. Understanding the Pension Fund



In accordance with the principles of the Code, our audit work is designed to be proportionate and risk based. It is based on an understanding of the strategic environment in which the Pension Fund operates.

Through our knowledge and experience, plus our assessment of how the wider environment impacts on individual local authorities and pension schemes, we tailor our approach to risk assessment.

Through discussion with the Pensions Manager, review of Pensions Committee and Pension Board documents, and other investment reports, we develop an understanding of your priorities and the specific challenges which the Pension Fund faces.

### Understanding the Pension Fund's priorities

The responsibility for the governance of the Pension Fund sits with the Pensions Committee as delegated by Falkirk Council, the Administering Authority. The Pensions Committee is supported by a Pensions Board to ensure that decisions are made with the terms of the Fund rules and with good practice.

In addition to Fund employers, key partners include local authorities, actuaries, banks, government agencies, fund managers, legal advisers, communications specialists, corporate governance and litigation specialists, and various other financial institutions.

2015/16 was noted as a challenging year for the Fund's investments. A return of 1.5% was achieved over the year which was 1.2% above the Fund benchmark for cash investment but significantly below the Fund's long term strategic funding requirement of 6% per annum.

The majority of the Fund's activities are managed in-house by the Council's Pensions Section. Investment management continues to be a key strategic focus, including both monitoring externally managed funds and the strategic investment decisions being made by the Fund. The fund continues to pursue a joint investment ventures with one other local authority fund. It is also conscious of meeting the developing fiduciary duties expected from local authorities in its investments.

In 2015/16 the Pension Fund reviewed and updated its Fund Investment Strategy. The main changes were to increase the proportion of Fund assets allocated to infrastructure and property, and to undertake factor based investing (often called "Smart Beta"). These were designed with the intention of reducing the Fund's level of risk in its investments.

The Fund's funding policy is to achieve a fully funded status over a 20 year period whilst keeping contribution rates as constant as possible. The Funding Strategy Statement was updated in 2014/15, the main changes being to provide greater clarity around the setting of employer contribution rates and options available should admission bodies be seeking to withdraw from the Fund. The Fund's longer term strategy is to reduce its exposure to more volatile assets.

Other Government initiatives such as Auto-Enrolment, Freedom and Choice the new Single State Pension continue to impact on the work of the Pensions Section, as does the financial climate in which local authorities are operating which means that high numbers of retirements and retirement estimates are prevalent.

In July 2016 a new payroll module went live for the Pension Fund. As part of our planning, we will discuss the impact of this on the Fund's operations and what assurance was obtained internally in respect of the transfer of data between systems.

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### Key messages

2015/16 was noted as a challenging year for the Fund's investments. Investment management continues to be a key strategic focus, including both monitoring externally managed funds and the strategic investment decisions being made by the Fund. The Fund's funding policy is to achieve a fully funded status over a 20 year period whilst keeping contribution rates as constant as possible.

A new payroll module was introduced during the year and we will factor this into obtaining our understanding of the operations of the Pension Fund.

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### **3. Financial statements audit**

We provide an opinion on the financial statements as to whether they give a true and fair view of the financial transactions of the fund during the year and of the amount and disposition of the assets and liabilities at the reporting date, and whether they have been properly prepared in accordance with applicable law and the relevant financial reporting framework. We also review and report on the consistency of the other information prepared and published by the Pension Fund along with its financial statements.

We undertake our financial statements audit work in accordance with the four phases of EY's Global Audit Methodology: *Planning; Identification and assessment of risk; Design and execution of our response to those risks; and Conclude and communicate.*

## Planning our audit work

### **Initial planning, independence and quality assurance**

Our initial planning for any audit engagement includes client and engagement acceptance, which includes our documentation of the service requirements. We did not identify any specific audit risks arising from these procedures.

Part of these procedures are designed to ensure compliance with all relevant ethical standards, including independence which we assess for both EY as a firm and the individuals assigned to the audit. We set out more information on our independence in Appendix A.

We identify the team with primary responsibility for performance of the audit. Careen Gray is the audit partner-in-charge.

### **Materiality**

In accordance with ISA 320 we apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion. Materiality is the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. We determine:

- ▶ Planning materiality (PM) – this is set for the financial statements as a whole, and is used to set the scope for our audit. We have determined this to be £18.0 million, representing 1% of net assets reported in the prior year accounts. We will consider the need to update our planning materiality when the accounts at 31 March 2017 are available.
- ▶ Tolerable Error (TE) – materiality at an individual account balance, which is set so as to reduce to an acceptably low level that the aggregate of uncorrected and undetected misstatements exceeds PM. We have set this at 50% of PM, being £9.0 million.
- ▶ Summary of Audit Differences (SAD) Nominal amount – this is the amount below which misstatements, whether individually or accumulated with other misstatements, would not have a material effect on the financial statements. The Code requires that auditors report at no more than £250,000.

Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition. Factors which we consider include the perspectives and expectations of users of the financial statements as well as our risk assessment as to the likelihood of material misstatements arising in the financial statements.

The amount we consider material at the end of the audit may differ from our initial determination. At the end of the audit we will form, and report to you, our final opinion by reference to all matters that could be significant to users of the financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

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## Key messages

Planning Materiality for the audit has been determined at £18.0 million, representing 1.0% of net assets reported with the prior year financial statements.

Tolerable Error is set at £9.0 million.

Our SAD nominal amount, set in line with the Code, is £250,000.

We outline our initial assessment of the financial statement risks facing the Pension Fund, identified through our knowledge of the environment in which the Pension Fund operates; discussion with those charged with governance and officers; and through handover and transition arrangements with your previous auditor.

Our risk assessment is ongoing throughout the conduct of our audit and we will report to you any notable changes in our risk assessment during the course of our work.

Risk assessment includes the requirement to consider whether the financial statements as a whole are free of material misstatements whether caused by fraud or error.

## Financial statement risks

Auditing standards require us to consider whether any of the risks identified are 'significant' risks to our audit of the Pension Fund. Financial statement significant risks are defined as those with a higher likelihood of occurrence and, if they were to occur, a higher magnitude of impact which could result in a material misstatement of the financial statements.

We are required to perform specific procedures over those risks. These include the identification and assessment of the design and implementation of key controls designed to address the risks plus performance of additional substantive procedures in response to the specific risk. We are also required to specifically highlight these significant risks to 'those charged with governance' i.e. the Pensions Committee.

| Significant risks (including fraud risks)   | Our audit approach  |
|---|---|
| <b>Risk of management override of controls</b>  |   |
| <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>We identify and respond to this fraud risk on every audit engagement.</p>  | <p>Our approach will focus on:</p> <ul style="list-style-type: none"> <li>▶ Testing the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.</li> <li>▶ Reviewing accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates.</li> <li>▶ Evaluating the business rationale for any significant unusual transactions.</li> </ul>  |
| <b>Valuation of complex investments</b>   |   |
| <p>The Fund's investments include complex unquoted pooled investment vehicles, including infrastructure and property funds, and private equity funds. Judgements are taken by the Investment Managers to value those investments whose prices are not publically available. The material nature of investments means that any error in judgement could result in a material valuation error. Current market volatility means such judgments can quickly become outdated, especially when there is a significant time period between the latest available audited information and the fund year end. Such variations could have a material impact on the financial statements.</p> <p>We have therefore identified the valuation of this type of Pension Fund investments as a significant risk, as even a small movement in these assumptions could have a material impact on the financial statements.</p> | <p>Our approach will focus on:</p> <ul style="list-style-type: none"> <li>▶ Obtain third party confirmations of the investments at the Pension Fund's year end.</li> <li>▶ Where available, review relevant controls' reports for qualifications or exceptions that may affect the audit risk and scope.</li> <li>▶ Review the basis of valuation for unquoted investments to be satisfied that it is in line with the accounting policy and CIPFA requirements.</li> <li>▶ Perform tests of valuation such as reviewing transactions around the year end, performing 'look through' testing or obtaining latest available audited accounts and auditing any subsequent cash movements between the date of the audited accounts and the Fund's year end.</li> </ul> |

## Key messages

In line with auditing standards we identify significant risks in respect of the risk of management override of controls, and a significant risk in respect of the valuation of complex investments.

At this stage of our audit planning, we have not identified any other significant financial statement risks. We will confirm our updated risk assessment as part of our Annual Audit Report.

In accordance with Auditing Standards, we perform specific procedures on opening balances as this is the first year of our audit.

We take into account the findings of your predecessor auditor in their annual audit report and findings in 2015/16.

## First year audit procedures

As a first year audit, we also have additional procedures to perform in respect of opening balances. We follow Audit Scotland's protocol for handover from previous auditors and have already held discussions with your former external auditor. Our additional procedures cover in this respect will cover all net asset statement items, including prior year investment valuations. As part of our work we will, where appropriate,:

- ▶ Review the work of the predecessor auditor, to identify any issues that may impact upon the opening balances.
- ▶ Review the work of the predecessor auditor to ensure the audit has been completed to an appropriate standard to allow us to place reliance on their audit opinion.
- ▶ Substantively test opening balances to ensure they agree to the prior year audited accounts and closing trial balance.

We will follow up on the status of any significant audit findings from the predecessor auditor in 2015/16. For the Pension Fund we have identified two prior year findings in respect of the timely completion of year end data returns.

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## Key messages

We follow Audit Scotland's protocol for handover from previous auditors and have already held discussions with your former external auditor to understand their judgements and audit findings in respect of the 2015/16 audit of the Pension Fund financial statements.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. We assess the fraud risk factors affecting the audit of the financial statements.

We remain aware of changes to the Accounting Code of Practice which impact on the preparation of financial statements. Our aim is to discuss such changes with the Pensions Manager and Pensions Accountant in advance, to assist in the smooth conduct of the audit.

## Responsibilities in respect of fraud and error

Management, through the Chief Finance Office and Pensions Manager, has primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- ▶ Identifying fraud risks during the planning stages.
- ▶ Enquiry of management about risks of fraud and the controls to address those risks.
- ▶ Understanding the oversight given by those charged with governance of management's processes over fraud.
- ▶ Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- ▶ Determining an appropriate strategy to address any identified risks of fraud.
- ▶ Performing mandatory procedures regardless of specifically identified risks.

## Changes to the Accounting Code of Practice in 2016/17

There are a number of changes to the Accounting Code of Practice in 2016/17 which impact on the preparation of the Pension Fund's financial statements. These include:

- ▶ Changes to the disclosure of management expenses in line with the recent CIPFA guidance and rents from properties which should be shown gross.
- ▶ Changes in the basis of classifying investment assets and liabilities into fair value hierarchies to follow the recommendations contained in *Practical Guidance on Investment Disclosures* issued by PRAG in June 2016.
- ▶ Inclusion of disclosures covering the remuneration of key management personnel in the related party transactions note.

We will seek to agree the principles of any required changes in the financial statements with management in advance of our audit of the year end financial statements.

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## Key messages

Management, through the Chief Finance Office and Pensions Manager has primary responsibility for the prevention and detection of fraud. We design appropriate audit procedures in response to identified fraud risk factors, for the purpose of detecting material misstatements.

There are a number of changes to the Accounting Code of Practice in 2016/17, including changes to the disclosure of management expenses and rents from properties, and inclusion of fair value measurement disclosure requirements. We will discuss the impact of these on the Pension Fund financial statements with management in advance.

Our approach is designed to develop an audit strategy that is responsive to the Pension Fund's risks of material misstatement for transactions and account balances in the financial statements.

In addition, we plan and perform certain general audit procedures on every audit to address areas that are not directly related to financial statement account assertions.

Examples of such procedures include aspects of audit work which are not directly related to the financial statements, such as compliance with applicable laws and regulations, litigation and claims and related parties.

## Overview of audit approach

We determine which accounts, disclosures and relevant assertions could contain risks of material misstatement based on our understanding of the Pension Fund's operations, understanding of entity-level controls and our determination of planning materiality.

### Processes

Our initial assessment of the key processes across the Pension Fund has identified the following where we will seek to understand the design and implementation of controls as part of our detailed planning work:

- ▶ Calculation and payment of pensions and other benefits.
- ▶ Receipt of contribution payments from participating employers.
- ▶ Cash receipting and payments.
- ▶ Recording of investment transactions and valuation of complex investments.
- ▶ Understanding the financial statement close process.

In completing this work, we will take into account the introduction of the new payroll module in July 2016 and the impact this had on the processing of Pension Fund information.

### Data analytics

Where appropriate we plan to use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular covering journal entries and expenditure. These tools:

- ▶ Help identify specific exceptions and anomalies to direct more traditional substantive audit tests.
- ▶ Give greater likelihood of identifying errors than random sampling techniques.

We have held initial planning discussions with the Council's IT and systems accountants to agree the practicalities of data provision, and will take this forward specifically for the Pension Fund data.

### Internal audit

We will review internal audit plans and the results of their work, including the discussion of audit findings at the Audit Committee and management's response to findings.

As this is the first year of our appointed, our assessment of internal audit will be more detailed to enable the possibility of greater reliance on the work of internal audit to be integrated into our audit in subsequent years.

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## Key messages

We obtain an understanding of your internal control arrangements, both as they apply across the Pension Fund, but also in terms of key processes. We consider the design and implementation of key controls where appropriate. In addition where appropriate, we plan to apply data analytics to capture and analyse whole populations of financial data.

We liaise with internal audit to ensure our approach takes account of risks identified and findings reported in the course of their work.

## **4. Wider scope audit and other work**

## 4. Wider scope audit framework



Together the Accounts Commission and the Auditor General for Scotland agreed the four dimensions set out in the Code which comprise the wider-scope audit for public sector in Scotland. These are: financial sustainability, financial management, governance and transparency, and value for money.

The Code sets out an expectation that 'significant' risks identified through our planning process that relate to the wider scope dimensions will be communicated with you. In undertaking our risk assessment in respect of the wider scope audit areas, we distinguish between the definition of 'significant risks' which apply to the audit of the financial statements, by referring in our report to 'Wider Scope Audit Focus Areas'.

The focus areas represent where we have identified that we will direct most of our audit effort in the year.

### Risk Assessment

We undertake work in respect of the four audit dimensions but have not at this time scoped these as having a need for higher audit focus. Our five-year appointment will provide the opportunity to revisit our considerations across our engagement.

- ▶ **Financial sustainability** – Ensuring the long term sustainability of the Fund is of key strategic importance. This includes ensuring contributions, investment income and ability to liquidate investments are sufficient to cover benefits over the short term and the fund as a whole can meet its estimated liabilities as they crystallise over the longer term.
- ▶ **Financial management** - With the significant financial challenges facing public sector bodies, it is essential that the Pension Fund has robust financial management arrangements to ensure that it can continue to deliver on its responsibilities. This dimension has more focus therefore maintaining a sound system of internal control to support the Fund in delivery of its long term financial responsibilities.
- ▶ **Governance and transparency** - The Pensions Committee and Chief Finance Officer have delegated authority for establishing robust governance arrangements in respect of the Pension Fund. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations.
- ▶ **Value for Money** – this dimension is focused on how the Pension Fund effectively utilises its resources and the arrangements in place to ensure the Fund performance is as robust as possible over the short, medium and longer term.

We have not identified any Wider Scope Audit Focus Areas impacting on the Pension Fund for 2016/17.

Key to the assessment and judgement in the wider scope audit areas is the quality of the Pension Committee's arrangements for self-evaluation to be able to demonstrate the quality and effectiveness of its arrangements.

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### Key messages

The wider scope audit as set out in the Code plays a key role in the public sector audit framework in Scotland.

We undertake work in respect of the four audit dimensions annually. At this time, we have not identified any Wider Scope Audit Focus Areas impacting on the Pension Fund for 2016/17.

Key to the assessment and judgement in the wider scope audit areas is the quality of the Pension Committee's arrangements for self-evaluation to be able to demonstrate the quality and effectiveness of its arrangements.



## **5. Team, fees and deliverables**

## 6. Team, fees and deliverables



We identify an audit team with the relevant skills and experience. In the case of the Pension Fund, we identify a team with a mix of experience between pension fund accounting and the local government sector.

The audit fee is determined in line with Audit Scotland's fee setting arrangements, set out in recent communications to all audited bodies in line with their publication on 'Our Approach to setting audit fees' ([http://www.audit-scotland.gov.uk/uploads/docs/um/audit\\_fee\\_approach.pdf](http://www.audit-scotland.gov.uk/uploads/docs/um/audit_fee_approach.pdf)).

### Audit team

The engagement team is led by Careen Gray, who is responsible for EY's pensions assurance practice in Scotland with nearly 30 years of pensions auditing experience. She is supported by Keith Macpherson, our Head of Government & Public Sector Audit in Scotland, whose primary role is to set the direction and consistency of our audit work across our audit portfolio, in particular in respect of the wider scope audit. Rob Jones will be the manager for the financial statements audit and will be the key day-to-day contact for the Pensions Manager and Pensions Accountant.

| Individual       | Contact details                           |
|------------------|---|
| Careen Gray      | T: 0141 226 9598 E: cgray2@uk.ey.com      |
| Keith Macpherson | T: 07831 136 496 E: kmacpherson@uk.ey.com |
| Rob Jones        | T: 0141 226 7396 E: rjones9@uk.ey.com     |

### 2016/17 Audit fee

The expected fee for each body, set by Audit Scotland, assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and meets the agreed timetable for the audit. It also assumes there is no major change in respect of the scope of work in the year.

| Expected Fee Element      | 2016/17        | 2015/16*       |
|---------------------------|----------------|----------------|
| Auditor remuneration      | £17,190        | n/a            |
| Pooled costs              | £1,500         | n/a            |
| Audit support costs       | £1,030         | n/a            |
| <b>Total expected fee</b> | <b>£19,720</b> | <b>£23,010</b> |

\* The breakdown of the prior year fee into these components is not available from Audit Scotland.

The auditor remuneration element of the fee can be increased by up to 10% dependent on circumstances in the audited body. For 2016/17, we have agreed the auditor remuneration element of £17,190, being in line with the expected auditor remuneration set by Audit Scotland.

### Key messages

Careen Gray is responsible for the quality of the audit and for signing the financial statements. Careen is responsible for EY's pensions assurance practice in Scotland. She is supported by Keith Macpherson and Rob Jones, who will manage the financial statements audit and be the key day-to-day contact for the Pensions Manager and Pensions Accountant

We have agreed an auditor remuneration fee element of £17,190. This results in a total fee, inclusive of pooled costs, central performance audit and Best Value costs and central support costs, of £19,720 (2015/16: £23,010).

## 6. Team, fees and deliverables (cont.)



We agree a timetable with management, in line with the Pension Committee's internal reporting requirements, and in accordance with Audit Scotland's planning guidance.

There are a number of deliverables required during the year, as set out in the table.

As part of our transparency to you, and to allow you to assess the performance of your external auditor, we will report to you annually on how we have performed against the timetable for audit deliverables.

### Timeline and deliverables

| Audit activity  | Deliverables   |
|---|--|
| <b>Planning, identification and assessment of risks: October – April 2017</b>   |  |
| <ul style="list-style-type: none"> <li>▶ Introductory meetings with Pensions Manager and Pensions Accountant / handover discussions with outgoing auditor</li> <li>▶ Review of Pensions Committee and Pensions Board papers and documentation</li> <li>▶ Onsite fieldwork, documentation and walkthrough of key accounting processes</li> <li>▶ Testing of key financial controls as appropriate</li> </ul> | <ol style="list-style-type: none"> <li>1. Annual Audit Plan, presented to Pensions Committee, 16/03/2017</li> </ol>  |
| <b>Design and execute response to risks: July – August 2017</b>   |  |
| <ul style="list-style-type: none"> <li>▶ Performance of year-end substantive audit fieldwork on unaudited accounts (from June)</li> </ul>   |  |
| <b>Conclude and communicate: September 2017</b>   |  |
| <ul style="list-style-type: none"> <li>▶ Conclude on results of audit procedures</li> <li>▶ Audit clearance meeting with Pension Fund management, and report findings to those charged with governance</li> <li>▶ Issue opinion on the Pension Fund's financial statements</li> </ul>   | <ol style="list-style-type: none"> <li>2. Annual Audit Report – to Pension Committee and Board (date tbc)</li> <li>3. Certify Financial Statements – by 30/9/2017</li> </ol> |

# Appendices

**A – Auditor Independence**

**B – Required Communications**

The APB Ethical Standards and ISA (UK and Ireland) 260 'Communication of audit matters with those charged with governance', requires us to communicate with you on a timely basis on all significant facts and matters that bear on our independence and objectivity.

The Ethical Standards require that we do this formally both at the planning stage and at the conclusion of the audit, as well as during the audit if appropriate.

The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

## Required communication

### Planning stage

- ▶ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between you, your affiliates and directors and us.
- ▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality Review.
- ▶ The overall assessment of threats and safeguards.
- ▶ Information about the general policies and process within EY to maintain objectivity and independence.

### Final stage

- ▶ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed.
- ▶ Details of non-audit services provided and the fees charged in relation thereto.
- ▶ Written confirmation that we are independent.
- ▶ Details of any inconsistencies between APB Ethical Standards, Audit Scotland's Terms of Appointment and your policy for the supply of non-audit services by EY and any apparent breach of that policy.
- ▶ An opportunity to discuss auditor independence issues.

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, for example when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future contracted services, and details of any written proposal to provide non-audit services;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period are disclosed, analysed in appropriate categories.

### Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including any principal threats. However we have adopted the safeguards below to mitigate these threats along with the reasons why they are considered to be effective.

#### Self-interest threats

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with the Pension Fund.

At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services, and we will comply with the policies that the Pension Fund has approved and that are in compliance with Audit Scotland's Terms of Appointment. At the time of writing, no non-audit services have been provided.

## **Self-interest threats (cont.)**

A self-interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to the Pension Fund. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in compliance with Ethical Standard 4.

There are no self-interest threats at the date of this report.

## **Self-review threats**

Self-review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no other self-review threats at the date of this report.

## **Management threats**

Partners and employees of EY are prohibited from taking decisions on behalf of management of your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions based on that work.

There are no management threats at the date of this report.

## **Other threats**

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

The 2016/17 audit year is the first year that Careen Gray has led the audit of Falkirk Council Pension Fund. We assessed this relationship prior to the commencement of the audit period and concluded that there are no considerations that compromise, or could be perceived to compromise, Careen Gray's independence or objectivity.

## **Overall Assessment**

Overall we therefore confirm that EY is independent and the objectivity and independence of Careen Gray, the Audit Engagement Lead and the audit engagement team have not been compromised.

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details of the key policies and processes within EY for maintaining objectivity and independence can be found in our annual Transparency Report, which the firm is required to publish by law. The most recent version of this report is for the year ended June 2016 and can be found here:

<http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2016>

There are certain additional communications that we must provide to the Audit Committee, which are set out below.

| Required communication  | Reference  |
|---|--|
| <p><b>Planning and audit approach</b></p> <ul style="list-style-type: none"> <li>▶ Communication of the planned scope and timing of the audit including any limitations.</li> </ul>   | <p>▶ Annual Audit Plan</p>                           |
| <p><b>Significant findings from the audit</b></p> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> <li>▶ Findings and issues regarding the opening balances on initial audits</li> </ul> | <p>▶ Annual Audit Report</p>                         |
| <p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ In writing, corrected misstatements that are significant</li> </ul>   | <p>▶ Annual Audit Report</p>                         |
| <p><b>Fraud</b></p> <ul style="list-style-type: none"> <li>▶ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>   | <p>▶ Annual Audit Plan<br/>▶ Annual Audit Report</p> |
| <p><b>Related parties</b></p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>  | <p>▶ Annual Audit Report</p>                         |
| <p><b>External confirmations</b></p> <ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>   | <p>▶ Annual Audit Report</p>                         |

## B. Communications (cont.)



| Required communication   | Reference  |
|--|--|
| <b>Significant deficiencies in internal controls identified during the audit</b>   | <ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>                              |
| <b>Consideration of laws and regulations</b> <ul style="list-style-type: none"> <li>▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>                              |
| <b>Independence</b> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats, and any safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul> | <ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> <li>▶ Annual Audit Report</li> </ul> |
| <b>Going concern</b> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>                              |
| <b>Fee information and confirmation of additional certification work</b> <ul style="list-style-type: none"> <li>▶ Details of the audit fee</li> <li>▶ Summary of additional audit certification work undertaken</li> </ul>   | <ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> <li>▶ Annual Audit Report</li> </ul> |



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