

REPORT TO: SCRUTINY COMMITTEE–18 April 2012

**REPORT ON: EXTERNAL AUDIT REPORT – TAYSIDE SUPERANNUATION FUNDS
AUDIT STRATEGY OVERVIEW AND PLAN 2011/12**

REPORT BY: KPMG LLP

REPORT NO: 160-2012

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 Superannuation Funds for 2011/12.

2 RECOMMENDATIONS

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

3 MAIN TEXT

- 3.1 Following our 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 Superannuation Fund and Tayside Transport Superannuation Fund (“the Superannuation Funds”) for the year ending 31 March 2012. The document sets out the statutory and professional responsibilities in terms of the Code of Audit Practice and also outlines our key audit objectives.
- 3.2 The report sets out information on the proposed audit approach focussing on the key issues and risks facing the Superannuation 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.

**DAVID WATT
DIRECTOR
KPMG LLP**

**MICHAEL WILKIE
MANAGER
KPMG LLP**

28 MARCH 2012



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Tayside Superannuation Funds

Audit strategy overview and plan
Year ending 31 March 2012

12 March 2012

The audit strategy overview and plan is presented under the terms of our appointment by Audit Scotland.

The contacts at KPMG in connection with this report are:

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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 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 the Tayside Superannuation 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 Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@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.

This document describes how we will deliver our audit for Tayside Superannuation Funds (“the Superannuation Funds”) for the year ending 31 March 2012.

This includes the opinions on the financial statements 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.

Under the Local Government (Scotland) Act 1973 (“the Act”), the Accounts Commission has appointed KPMG LLP as auditors of Dundee City Council and therefore of the Tayside Superannuation Fund and Tayside Transport Superannuation Fund administered by the Council (“the Superannuation Funds”). 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 2012 and our intended approach to issues impacting the Superannuation Funds’ 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 Council.

We conduct our audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland), taking into account the UK Auditing Practices Board’s Practice Note 10 (revised). 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 2010-11 (“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 Board (“LASAAC”).

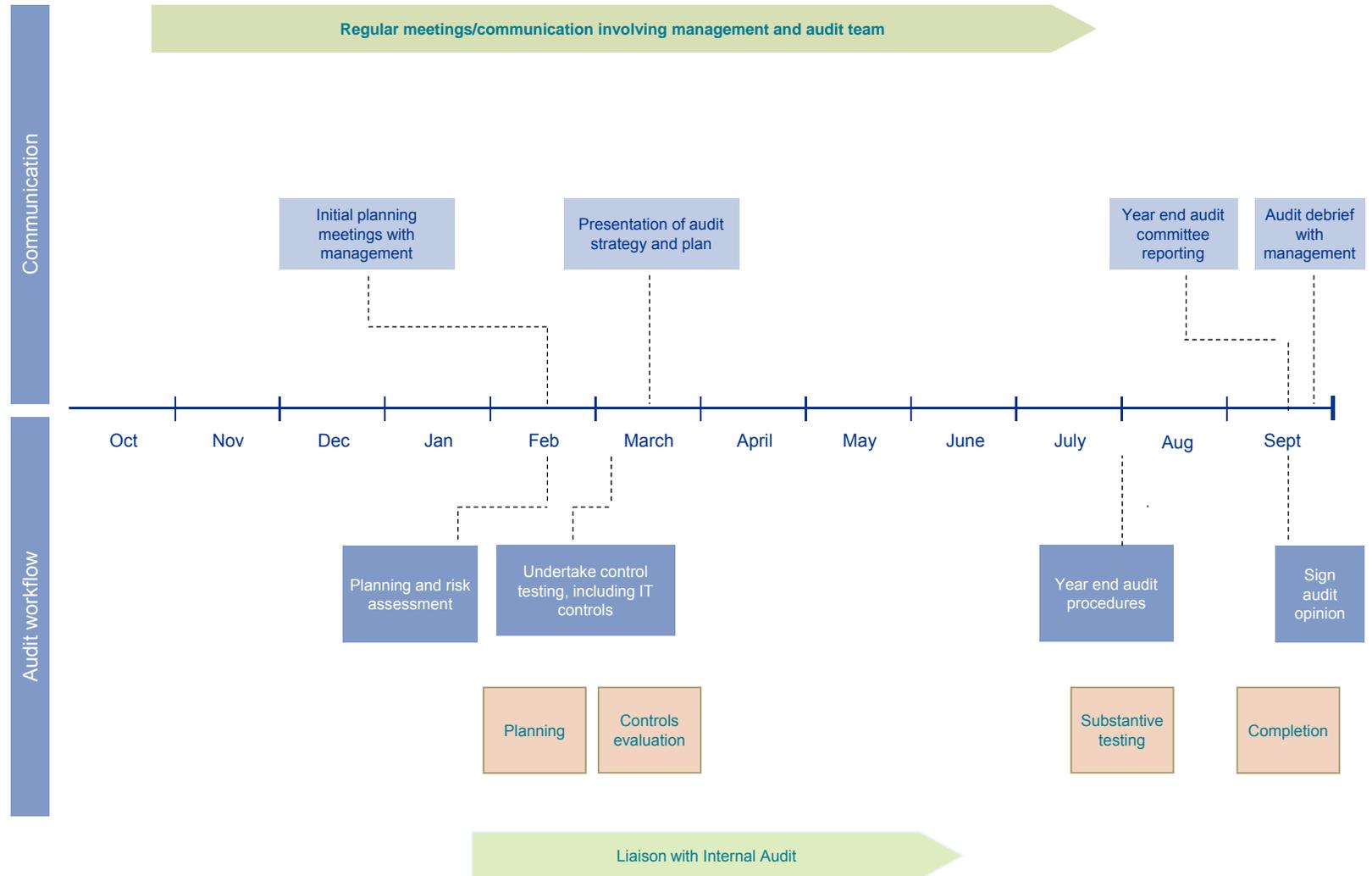
As part of our audit we also review the financial information contained in the foreword and introduction to ensure that it is consistent with the financial statements. We also review the governance compliance statement to ensure it has been prepared in accordance with guidance from the Scottish Ministers,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

International Standard on Auditing (UK and Ireland) 240: *The auditor’s responsibility to consider fraud in an audit of financial statements* applies to our work. In particular, this Standard requires us to consider directly the possibility that management may choose to override the system of internal controls that otherwise may appear to be operating effectively. The Standard requires the auditor to maintain an attitude of professional scepticism, recognising the possibility that a material misstatement due to fraud could exist – notwithstanding the auditor’s experience with regard to the honesty and integrity of management and those charged with governance.

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.

We have developed a proposed timetable to discharge our responsibilities based on initial discussions with management.

We will consider judgements in key areas before the audit fieldwork begins.





Audit approach and communication

Core audit focus areas

We have performed initial risk assessment procedures to identify focus areas for the 2011-12 audit.

Our audit will focus on the core areas of:

- **governance;**
- **ownership and valuation of investments;**
- **completeness and timing of contribution receipts;**
- **processing and authorisation of benefit payments; and**
- **regulatory and accounting compliance.**

We have developed an understanding of your key audit risk areas based on our initial risk assessment procedures, including discussions with management. Key areas identified are detailed below.

Issue	Key risk and implications	Our planned audit approach
Governance	<p>The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 require the Council to measure its governance arrangements against standards set by the Scottish Ministers. The Council's assessment of its compliance with the standards during 2010-11 indicated full compliance in most areas.</p> <p>Day-to-day responsibility for the activities of the Superannuation Funds rests with the Council's statutory officer for finance (S.95 officer).</p>	<p>Our audit will focus on the key areas of Superannuation Funds governance; for example, operation of the pension section and investment sub-committee, provision and use of management information, the risk assessment and monitoring process, and, compliance with key areas of legislation and regulation. We will also consider management's actions in response to the Audit Scotland's recommendations in their report on the Superannuation Funds' corporate governance arrangement.</p> <p>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 emerging pensions technical and accounting matters.</p>
Funding position, policy context and investment strategy	<p>In accordance with Regulation 76 of the Local Government Pension Scheme (Scotland) Regulations 1998, an actuarial valuation was carried out as at 31 March 2011. The valuation showed a funding level of 98%. The next triennial valuation is due in March 2014 and will be reported in 2015.</p> <p>The Independent Public Sector Pension Commission (Hutton) reported in March 2011 and the resulting recommendations have been accepted by the UK government.</p> <p>The Superannuation Fund's assets are under the management of six external fund managers. Hymans Robertson LLP are appointed as investment advisers. Northern Trust Corporation provide monthly fund valuations and income reports.</p>	<p>Through discussions with senior officers, we will assess the implications of any changes in pensions regulations on the policies of the Superannuation Funds, including funding requirements and implications for the Funds' investment strategy.</p>



Audit approach and communication

Audit focus areas (continued)

Issue	Key risk and implications	Our planned audit approach
Opening balances	<p>International Standard on Auditing (UK and Ireland) 510: <i>Initial audit engagements – opening balances</i> requires us as auditors to obtain sufficient appropriate audit evidence about whether:</p> <ul style="list-style-type: none">■ opening balances contain misstatements that materially affect the current period's financial statements; and■ appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes are appropriately accounted for, presented and disclosed in accordance with the applicable financial reporting framework.	<p>We will undertake a number of specific procedures to allow us to confirm opening balances. We have already had discussions with your previous auditors to consider issues from the 2010-11 audit. In addition, we will review your accounting policies from 2010-11, the annual audit report, certain work papers and may also review certain areas of prior year audit files if considered relevant.</p> <p>We will consider the year-end journals posted for financial year 2010-11 to understand the process and operation of controls and consider the presentation of information in the financial statements.</p>
Ownership and valuation of investments	<p>The investment assets of the Superannuation Funds are managed by a number of external and internal managers. Northern Trust is the global custodian for the Superannuation Funds' assets and is responsible for the safekeeping of those assets, including transactions processing.</p>	<p>Our audit will focus on the key controls in place over the security of investments, including the controls and interfaces between the Council's accounting system and investment records.</p> <p>We will seek to understand any changes to the Superannuation Funds' investment portfolio in terms of asset allocation or new investment classes employed.</p> <p>We will assess the appropriateness of the value placed on the Superannuation Funds' investments by reference to externally quoted prices and by obtaining investment confirmations in relation to the pooled investment vehicles.</p>

Issue	Key risk and implications	Our planned audit approach
Completeness and timing of contribution receipts	<p>Under regulation 35 of The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 it is the responsibility of employing bodies to 'contribute to the appropriate fund each year.... the amount appropriate for that authority' and 'must make payments to the appropriate fund.... of the amount required for the whole year.' From 1 April 2009 the regulations introduced variable contribution rates for employees depending on their salary banding. This makes checking contribution rates more complex and may increase the risk of incomplete contributions.</p>	<p>Our audit will review the monthly reconciliation of receipts from scheduled and admitted bodies and the Council's own payroll system and assess the effectiveness of the contribution monitoring arrangements. This will include carrying out re-performance checks on a selection of member deductions by reference to their pensionable salary. Contributions for scheduled and admitted bodies will be assessed for reasonableness by analytical review.</p>
Membership data	<p>There is a risk that discrepancies will exist between the contributions and data returned to the Superannuation Funds. The Funds include a number of scheduled and admitted bodies.</p>	<p>Our audit will consider the procedures established to ensure the accuracy of data held by the Superannuation Funds, including reconciliation controls between the Funds' records and those of the Council, scheduled bodies and admitted bodies.</p>
Processing and authorisation of benefit payments	<p>The Fund Accounts include benefits payable to members, including pensions and lump sum / death benefits. The calculation of benefits is determined by the local government pension scheme regulations and can be complex.</p>	<p>Our audit will focus on the controls over the calculation and authorisation of benefit payments and the processing of the pensioner payroll, including any annual pension increase. We focus on the key controls in place over benefit administration of the Superannuation Funds and check that benefit expenditure is supported by authorised administration records, including a high level review of a selection of the underlying calculations for consistency with the applicable regulations. We will assess the effectiveness of these controls and test their application in practice.</p>



Audit approach and communication

Mandatory communications

Auditing Standards specify a number of matters for communications with those charged with governance. Matters relating to fraud and related party transactions are given here.

Mandatory communications in relation to our independence have been given in the audit strategy overview and plan submitted separately to the Council's audit committee.

Area	Issue	KPMG response
Fraud risks	<ul style="list-style-type: none">It is the responsibility of the Council and 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.	<ul style="list-style-type: none">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 director of finance, internal audit and senior management.Our risk assessment procedures will include a number of interviews with senior personnel concerning processes to identify and respond to risks of fraud, including the director of finance.
Related party transactions	<ul style="list-style-type: none">All material related party transactions must be disclosed in the financial statements.Management has processes to identify related party transactions and related party transactions with the Council were disclosed in the 2010-11 financial statements.	<ul style="list-style-type: none">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.

Our audit is geared to identify material errors in the financial statements.

We are required by Auditing Standards to report to the audit committee unadjusted audit differences other than non-trivial items.

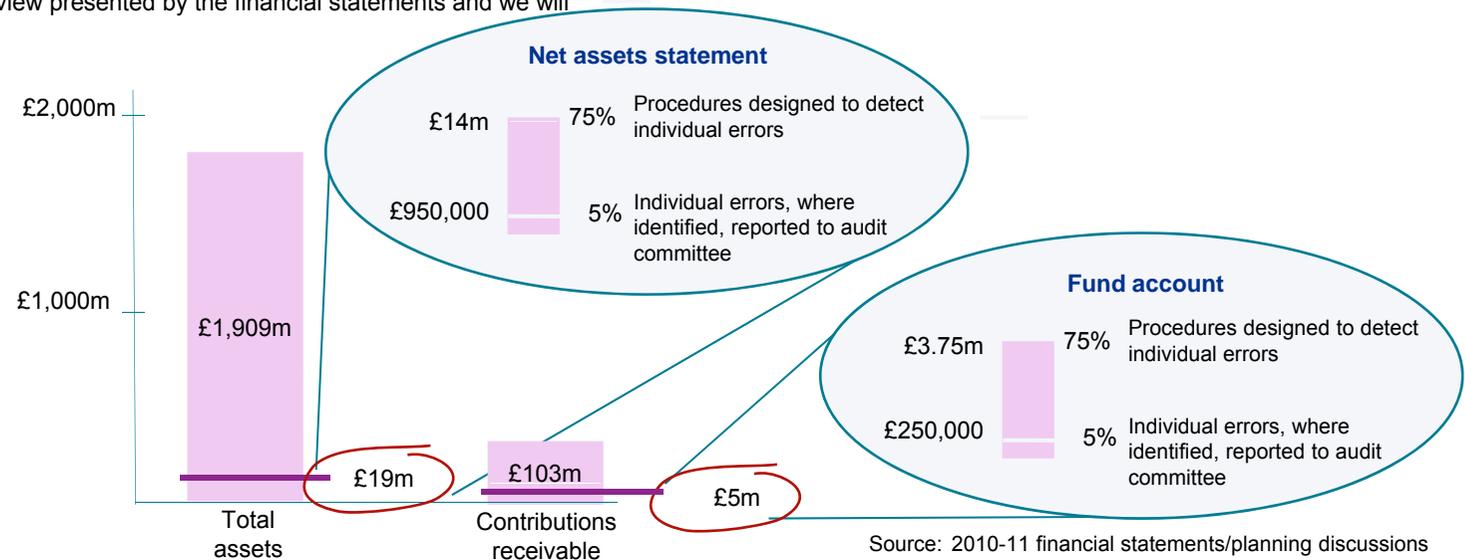
In accordance with International Standard on Auditing (UK and Ireland) 320 *Materiality in planning and performing an audit*, we plan and perform our audit to be able to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view. The assessment of what is material is a matter of professional judgment and includes consideration of both the amount (quantity) and nature (quality) of misstatements.

Audit materiality is both a quantitative and qualitative measure and the figures below are a guide only and are based on total planned expenditure. We realise that the tolerance for error in certain disclosures in the financial statements is lower and therefore, whilst not auditing to a lower materiality, we will report to the audit committee smaller errors in areas such as related party transactions.

In applying materiality, the overriding objective is to preserve the true and fair view presented by the financial statements and we will

consider any audit differences, individually and cumulatively, in that context.

For planning purposes, materiality for the audit of the Tayside Superannuation Fund net assets statement has been calculated on the basis of total assets and for the fund account on the basis of contributions receivable, both in accordance with the 2010-11 financial statements. On this basis, our procedures will be designed to detect individual errors over £14 million in the net assets statements and £3.75 million in the fund account. In respect of the Tayside Transport Superannuation Fund, the equivalent levels are £340,000 in the net assets statement and £42,000 in the fund account. Our final materiality will be based on the draft financial statements presented for audit and we will inform you of any changes to our planning materiality.



We distinguish between fraud and error and use our sector knowledge to inform specific control testing.

Fraud versus error

The term 'error' refers to an unintentional misstatement in the reporting of an entity. The term 'fraud' refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception or misconduct to obtain an unjust or illegal advantage.

There are two types of misstatements relevant to an auditor's consideration of fraud:

- misstatements resulting from fraudulent financial reporting, which involves intentional misstatements or omissions of amounts or disclosures in financial reporting to ultimately deceive financial statement users; and
- misstatements resulting from misappropriation of assets, which typically involve theft of an entity's assets and is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

We use our knowledge of the sector to inform specific control testing in respect of fraud controls.

We will liaise with your internal audit function to minimise duplication of effort.

Internal audit arrangements

International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect, if any, on external audit procedures;
- obtain a sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach;
- perform a preliminary assessment of internal audit when it appears that internal audit is relevant to our audit of the financial statements in specific audit areas; and
- evaluate and test the work of internal audit, where use is made of that work, in order to confirm its adequacy for our purposes.

We have begun liaison with the internal audit function and will maintain an understanding of their approach to ensure duplication of effort is minimised. We will review the internal audit work proposed or completed during our interim audit visit to determine the extent of assurance that can be taken from the work performed.

The general programme of work will be reviewed for significant issues to support our general work in assessing the superannuation funds' governance compliance statements.

2011-12 internal audit plan

We will read the reports and consider the results of all internal audit work. We will read the reports and consider the results of all internal audit work, and intend to place specific reliance on some areas of work. The table opposite highlights areas where we intend to place reliance and how this affects our planned audit approach (subject to a lack of significant risks being identified by internal audit).

Internal audit area

Pension fund payments

Impact on our planned audit approach

We will review internal audit findings and reduce our control testing on Council pension fund payments, subject to lack of significant risks being identified.



Logistics

Audit team; fee proposals; reporting

Our senior audit team brings strong experience of both local government and the wider public sector, together with pensions audit expertise.

Audit team

The senior members of the audit team are detailed below. The team has significant experience in the audit of local government bodies and pension funds and will bring this to bear in your audit.

Team member	Role	Contact
David Watt	Engagement director	0141 300 5695 david.watt@kpmg.co.uk
Michael Wilkie	Manager	0141 300 5890 michael.wilkie@kpmg.co.uk
Alan Smith	Senior manager – pensions audit	0141 300 5680 alan.smith@kpmg.co.uk

Fee proposals

Our fee for the audit of the financial statements of the Superannuation Funds 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 Superannuation Funds' financial statements. As with the audit of the Council's financial statements, our proposals are based on the following assumptions to ensure an efficient audit process: draft report, financial statements and full electronic file of supporting work papers available for the start date for our on site visit agreed with you; agreed prepared by client schedules available for the start of our audit, preferably in electronic format; reliance on your internal controls; availability of key members of staff during the audit fieldwork; and completion within the agreed timetable.

Reporting

Through regular meetings at appropriate levels, there will be open and regular discussion between management and auditors. As a result, accounting and control issues can be identified and reported to allow you to manage them throughout the year.

The *Code of Audit Practice* requires us to communicate to management findings arising as a result of the audit work completed. 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.



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