

## North Yorkshire Pension Fund

Report to the Audit  
Committee on the 2011/12  
Local Government Pension  
Scheme Audit

Planning Report

# Contents

Executive summary	1
1. Scope of work and approach	5
2. Key audit risks	6
3. Consideration of fraud	9
4. Internal control	11
5. Timetable	13
6. Client service team	14
7. Responsibility statement	15

# Executive summary

We have pleasure in setting out in this document details of our proposed audit scope for the North Yorkshire Pension Fund ("the Fund") for the year ended 31 March 2012. The Financial Reporting Council (FRC) has made it clear, in its 'Update for Audit Committees – November 2010', that it expects audit committees to focus activity on assessing and communicating risks and uncertainties and reliance on estimates, assumptions and forecasts. This report has described the work we undertake in order to support this activity.

Description	Detail
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<b>Audit scope</b>	<p>Based on guidance issued by the Audit Commission, auditors have been requested, for audit purposes, to treat the Local Government Pension Scheme (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.</p> <p>Our audit of the Fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension schemes. However, this only extends to the audit of the accounts and there is no requirement for a separate value for money conclusion on the pension fund accounts. Aspects of the Value for Money framework will inform the Value for Money conclusion for North Yorkshire County Council and will cover, to the extent necessary, issues relating to the Fund.</p> <p>North Yorkshire County Council is the administering authority for the Fund. As the administering authority the Code requires North Yorkshire County Council to include the Fund's accounts in their Statement of Accounts. The LGPS Regulations require administering authorities to prepare an annual report for the Fund, which should incorporate the Fund's annual accounts. Our audit report on North Yorkshire County Council's Statement of Accounts will continue to cover the pension fund section of that document. In addition, we are asked by the Audit Commission to issue a separate audit report for inclusion in the annual pension fund report and to conclude whether the accounts contained in the Fund report are consistent with North Yorkshire County Council's Statement of Accounts and that other information is not inconsistent.</p>	Page 5
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# Executive summary (continued)

<b>Key audit risks</b>	<p>The key audit risks which we have identified as part of our overall 2011/12 audit strategy for the pension fund are:</p> <ol style="list-style-type: none"><li>1. <b>Contributions:</b> Unlike the position in the private sector, we are not required to issue a separate statement on contributions for the Fund. Nevertheless, in view of the complexity arising from the participation of different employers within the Fund, the fact that members pay a tiered contribution rate depending on their pensionable pay and that additional complexities were introduced to the employer contributions rates from 1 April 2011, we have included the calculation and payment of contributions as an area of significant risk;</li><li>2. <b>Benefits:</b> Following the amendments made from April 2008 benefits are accrued under two different bases. This adds complexity to the benefits paid which increase annually in accordance with the Pension Increases Act but also include an element of member choice. As such we have identified benefits in payments as an area of significant risk;</li><li>3. <b>Investments:</b> The pension fund holds investments in derivative financial instruments which can give rise to complexities in measurement. As such we have identified the valuation of these investments as an area of significant risk;</li><li>4. <b>Management override of control:</b> We are required by ISA 240 'The auditors responsibility to consider fraud in an audit of the financial statements' to presume there is a significant risk of management override of the system of internal control; and</li><li>5. <b>Revenue recognition:</b> We are also required by ISA 240 to presume there is a significant risk of fraud in revenue recognition and conduct our audit testing accordingly, unless the presumption is rebutted. For the Fund the risk of fraud in revenue recognition has been rebutted.</li></ol>	Pages 6 – 8
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# Executive summary (continued)

<b>Materiality</b>	<p>We normally calculate our audit materiality on the basis of the net assets of the Fund but in this case it is capped to meet the scope requirements of other scheduled and admitted bodies. We estimate materiality based on net assets (per March custodian report of £1,559 million (2010/11: £1,493 million) would have been £46.7 million (2010/11: £44.8 million). However we have capped materiality preliminarily at £12.8 million (2010/11: £14.0 million) pending confirmation from the Audit Commission and other Authorities audited by Deloitte of materiality to be applied at the other scheduled and admitted bodies. We will update you if our materiality changes following these confirmations. Based on our preliminary assessment we will report to the Audit Committee on all unadjusted misstatements greater than £257,000 (2010/11: £280,000), being 2% of materiality, and smaller misstatements that are qualitatively material.</p> <p>Further details on the basis used for the calculation of materiality are given in Section 1 of this report.</p>	Page 5
<b>Prior year uncorrected misstatements</b>	<p>There were no significant unadjusted misstatements or uncorrected disclosure deficiencies reported to you in respect of the 2010/11 accounts.</p>	
<b>Timetable</b>	<p>The timetable is set out in Section 5. The fieldwork will be carried out during late June and July 2012 in advance of the field work for North Yorkshire County Council's Statement of Financial Activity in order our reporting to other scheduled and admitted bodies of the Fund in accordance with the timetables set for those other local authorities by the Audit Commission.</p> <p>We encourage the Authority to plan to prepare its Pension Fund Annual Report in good time so that we can review this and finalise our audit report for the Fund alongside that for North Yorkshire County Council's Statement of Accounts by 30 September 2012.</p>	Page 13
<b>Independence</b>	<p>Deloitte have developed important safeguards and procedures in order to ensure our independence and objectivity.</p> <p>These are set out in the "Independence policy and procedures" section of our "Briefing on audit matters" circulated to you with this report.</p> <p>We will reconfirm our independence and objectivity to the Audit Committee of North Yorkshire County Council, as Administering Authority, for the year ended 31 March 2012 in our final report to the Audit Committee.</p>	

# Executive summary (continued)

<b>Fees</b>	<p>We set out an estimate of our fees in a letter to the Audit Committee issued in April 2011. There is no change to our previously advised fee estimate of £40,695 (2010/11: £37,858) which is in line with the Audit Commission's fee scales.</p>	
<b>Matters for those charged with governance</b>	<p>Our "Briefing on audit matters" circulated with this report, identifying those additional items which we are required to report upon in accordance with International Standards on Auditing (UK &amp; Ireland). We will report to you at the final audit stage any matters arising in relation to those requirements.</p>	
<b>Demise of the Audit Commission</b>	<p>On 6 March 2012 the Audit Commission announced the results of the procurement exercise to outsource the work of the Commission's in-house audit practice. Work is now ongoing to appoint auditors to individual audited bodies and we understand that the Audit Commission are proposing to confirm Deloitte as auditors to the County Council and Pension Fund for the period to 31 March 2017. The Audit Commission has a statutory duty to consult on the appointment of auditors. Consequently, all current audit appointments in relation to the 2012/13 financial year are interim appointments covering the period 1 April 2012 to 31 August 2012 and 'permanent' auditors will be appointed in advance of 1 September 2012 when the appointment takes effect.</p> <p>Interim auditors are required to maintain a 'watching brief' only and should not undertake any work in relation to 2012/13. Only in exceptional circumstances where matters come to the auditors attention, which may reasonably require the exercise of any of the following statutory powers before 1 September 2012, may the auditor undertake such work:</p> <ul style="list-style-type: none"> <li>• a report in the public interest (section 8 of the Act);</li> <li>• recommendations to the audited body (sections 11 and 11A of the Act);</li> <li>• an application to the court for a declaration that an item of account is contrary to law (section 17 of the Act); or</li> <li>• to consider whether to issue, and if appropriate, issue an advisory notice or make an application for judicial review (sections 19A, 19B and section 24 of the Act).</li> </ul>	

# 1. Scope of work and approach

## Overall scope and approach

Based on guidance issued by the Audit Commission, auditors have been instructed, for audit purposes, to treat the Local Government Pension Scheme (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.

Local LGPS schemes administered by administering authorities are not statutory bodies in their own right. Therefore, it is not possible for separate audit appointments to be made for LGPS audits. We are therefore appointed to the audit of the LGPS through the existing Audit Commission appointment arrangements.

Our audit of the Fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Audit Commission in relation to the audit of pension schemes. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the Value for Money framework will inform our Value for Money conclusion which will form part of our audit report on the Authority's annual accounts and will cover, to the extent necessary, issues relating to the Fund.

The audit opinion we intend to issue as part of our audit report on the Authority's Statement of Accounts will reflect the financial reporting framework adopted by the pension fund. This is the Code of Practice on Local Authority Accounting 2011/12.

For the separate Fund accounts, we have initially considered the net assets of the scheme as the benchmark for our materiality assessment as this benchmark is deemed to be a key driver of business value, is a critical component of the accounts and is a focus for users of those statements.

We have applied a factor of 3% (2010/11: 3%) to this benchmark to determine a planning materiality of £46.7 million (2010/11: £44.8 million). This percentage takes into account our knowledge of the Fund, our assessment of audit risk and the reporting requirements for the financial statements. As we are performing work on behalf of the auditors of other scheduled and admitted bodies, in order to ensure that the scope of work is sufficient we have provisionally capped materiality at £12.8 million (2010/11: £14.0 million) pending confirmation from the Audit Commission and other Authorities audited by Deloitte of the materiality to be applied at these other bodies. We will update you if our materiality changes following these confirmations. The concept of materiality and its application to the audit approach are set out in our "Briefing on audit matters" document, circulated with this report.

The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.

The Audit Commission has also determined that auditors should give an opinion in accordance with auditing standards on the financial statements included in the Fund's annual report. This entails the following additional work over and above giving an opinion on the pension scheme accounts included in the Authority's Statement of Accounts:

- comparing the accounts and related information included in the Fund's annual report with those included in North Yorkshire County Council's Statement of Accounts;
- reading the other information published within the Fund's annual report for consistency with the Fund's accounts;
- where the pension fund annual report is not available until after the auditor reports on the financial statements, undertaking appropriate procedures to confirm that there are no material post-balance sheet events arising after giving the opinion on the pension fund accounts included in the Authority's Statement of Accounts;
- the financial statements included in the Fund's annual report are prepared on the basis of the same proper practices - the Code of Practice on Local Authority Accounting 2011/12 - as the financial statements included in the Authority's Statement of Accounts; and
- the annual report has been prepared in accordance with Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

## 2. Key audit risks

Based upon our initial assessment, we will concentrate specific effort on the significant audit risks set out below:

### Contributions

#### Audit Risk

Unlike the position in the private sector, we are not required to issue a separate statement on contributions for the Fund. Nevertheless, this remains a material income stream and in view of the complexity arising from the participation of different employers within the Fund, the fact that members pay a tiered contribution rate depending on their pensionable pay and that additional complexities were introduced to the employer contribution rates from 1 April 2011, we have included the calculation and payment of contributions as an area of significant risk.

#### Deloitte response

We will:

- request that Officers provide an analysis of contribution rates by employer and signed annual statements from each scheduled and admitted body;
- perform tests of detail to test whether each material income stream has been calculated in accordance with the recommendations of the Actuary;
- select a sample of scheduled and admitted bodies and review breakdowns by individual of pensionable pay, employee and employer contributions. On a sample basis we will agree this information to individual payslips to test accuracy of the calculation of pensionable pay and confirm whether the contributions tested have been calculated correctly in all material respects; and
- perform an analytical review to gain assurance over the completeness of contributions.

In addition you have asked us to consider whether contributions have been paid in accordance with the recommendations of the Actuary and received within 19 days in accordance with best practice.

We note that North Yorkshire County Council as the administering authority is not responsible for the calculation of contributions, and will therefore seek to perform such tests where necessary with the assistance of the scheduled and admitted bodies.



## 2. Key audit risks (continued)

### Benefits

#### Audit Risk

Changes were made to the Fund from April 2008 which introduced complexities into the calculation of both benefits in retirement and ill health and death benefits.

In respect of benefits in retirement, benefits are accumulated on two different bases for service pre and post 1 April 2008. The calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement. Also individuals enjoy greater flexibility in their choice of the mix of pensions and lump sum.

In respect of ill health and death benefits, the calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement.

Some employers may not have retained the necessary records to enable these calculations to be undertaken by the Fund.

The Government has completed the process to amend the revaluation and index factors for statutory minimum uplift from the Retail Price Index to the Consumer Price Index. This change has further increased the complexity of benefit calculations.

#### Deloitte response

We will:

- request that Officers provide us with a schedule of benefits paid and supporting calculations and test whether benefits were paid in accordance with the appropriate rules;
- develop an expectation based on changes in membership numbers and pension increases to analytically review the benefits paid in the year;
- perform tests of details on a sample of benefits paid, by agreement to supporting documentation, to test whether benefits have in all material respects been correctly calculated, by reference to their qualifying service, scheme rules and benefit choices made; and
- consider on a test basis whether any changes in benefit rates were applied on a timely basis and correctly calculated.

### Investments

#### Audit Risk

The Pension Fund invests in derivative financial instruments. These investments are more complex to measure, account and disclose for. Accordingly we have treated the appropriateness of the accounting and disclosure of these investments as a specific risk.

#### Deloitte response

We will:

- review the design and implementation of controls present at the Authority for ensuring derivative financial instruments are valued appropriately;
- understand the rationale for the use of the derivative financial instruments;
- work with internal Deloitte specialist to recalculate the value of any material derivative financial instruments by reference to the underlying contracts, assumptions and valuation techniques and compare these to the year end value in the year end investment managers report; and
- test the disclosure of the derivative financial instruments against the accounting, measurement and disclosure requirements of Code of Practice on Local Authority Accounting in the United Kingdom 2011/12: Based on International Financial Reporting Standards.

## 2. Key audit risks (continued)

### Management override of Controls

**Audit Risk** We are required by ISA 240 'The auditors responsibility to consider fraud in an audit of the financial statements' to presume there is a significant risk of management override of the system of internal control.

**Deloitte response** We will:

- request that Officers provide us with an analysis and supporting documentation for journal entries, key estimates and judgements;
- perform substantive testing on journal entries to confirm that they have a genuine, supportable rationale;
- review ledgers for unusual items and investigate the rationale for any such postings identified;
- review significant management estimates and judgements such as year end accruals and provisions and consider whether they are reasonable; and
- make enquiries of the Audit Committee (refer to Section 3 of this report).

### Revenue recognition

**Audit Risk** We are required by ISA 240 'The auditors responsibility to consider fraud in an audit of the financial statements' to presume there is a significant risk of fraud in revenue recognition and conduct our audit testing accordingly, unless the presumption is rebutted.

**Deloitte response** We have considered the risk of fraud in revenue recognition in respect of the Fund and no significant risks have been identified. Revenue in respect of a pension scheme relates to contributions income and we have concluded that there is no incentive to misstate contributions in this Fund.

For the Fund the risk of fraud in revenue recognition has therefore been rebutted.

# 3. Consideration of fraud

## Characteristics

Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We are aware that Pension Fund Officers at North Yorkshire County Council (“Officers”) have the following processes in place in relation to the prevention and detection of fraud which include:

- Anti-fraud and corruption policy
- Codes of conduct
- Whistle-blowing procedures

## Responsibilities

The primary responsibility for the prevention and detection of fraud rests with Officers and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

## Fraud inquiries

We will make the following inquiries regarding fraud:

Officers	Internal Audit	Those charged with governance
<p>Officers assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments;</p> <p>Officers process for identifying and responding to the risks of fraud in the entity;</p> <p>Officers communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity;</p> <p>Officers communication, if any, to employees regarding its views on business practices and ethical behaviour; and</p> <p>Whether Officers have knowledge of any actual, suspected or alleged fraud affecting the entity.</p>	<p>Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.</p>	<p>How those charged with governance exercise oversight of Officers processes for identifying and responding to the risks of fraud in the entity and the internal control that Officers have established to mitigate these risks; and</p> <p>Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.</p>

## 3. Consideration of fraud (continued)

We will make inquiries of others within the Authority as appropriate. We will also inquire into matters arising from your whistling blowing procedures.

### Process and documentation

We will gather this information through meetings and review of relevant documentation, including meeting minutes.

### Representations

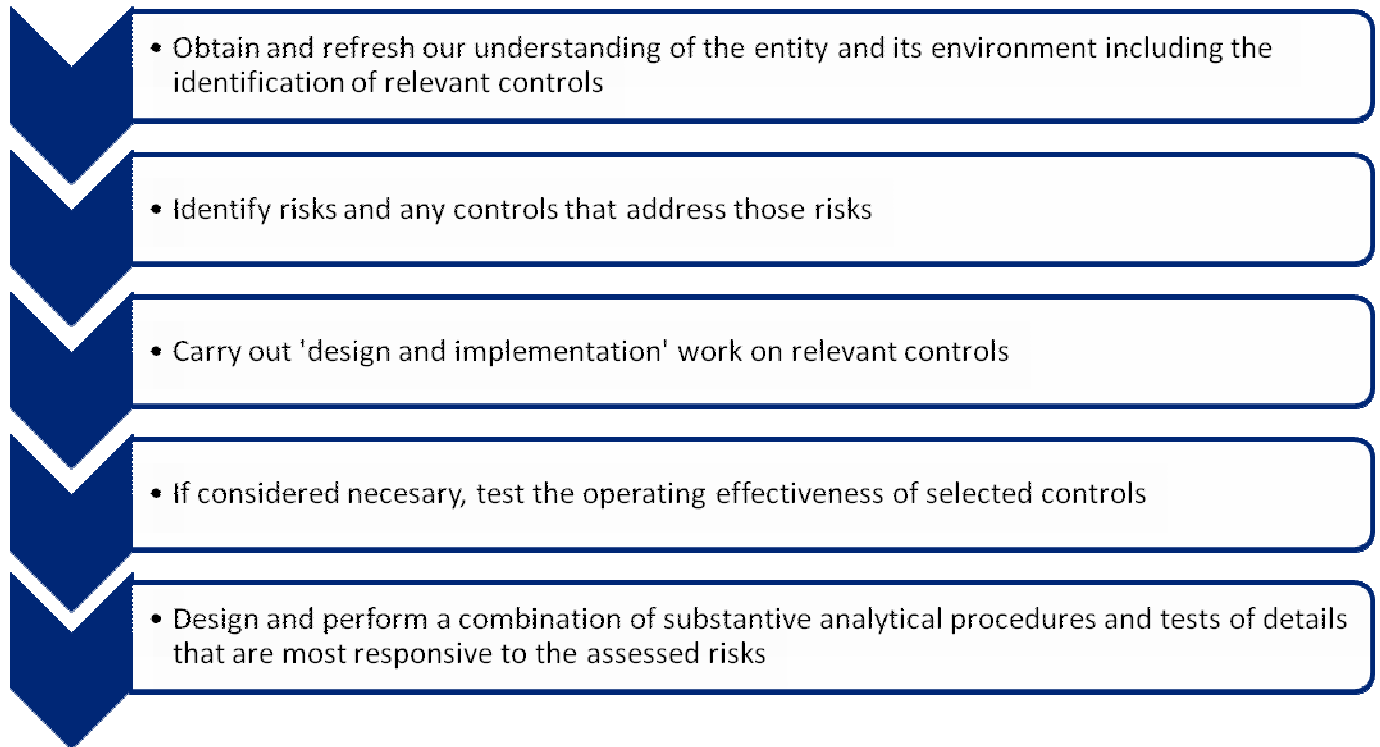
We will ask for you and Officers to make the following representations towards the end of the audit process:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity and involves:
  - officers;
  - employees who have significant roles in internal control; or
  - others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

# 4. Internal control

## Obtaining an understanding of internal control relevant to the audit

As set out in "Briefing on audit matters" circulated to you with this report, our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I"). Our audit approach consists of the following:



The results of our work in obtaining an understanding of controls will be collated and the impact on the extent of substantive audit testing required will be considered. At this stage, we do not propose to carry out tests on the operating effectiveness of controls and will obtain our assurance wholly from substantive testing procedures. We have selected this approach as the most efficient.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Fund, although we will report to Officers any recommendations on controls that we may have identified during the course of our audit work.

## 4. Internal control (continued)

### Liaison with internal audit

We have again agreed with the Head of Internal Audit, that in the coming year, the external auditors will liaise with the North Yorkshire County Council's internal audit function on a constructive and complementary basis to maximise our combined effectiveness and eliminate duplication of effort. This co-ordination will enable us to derive full benefit from the North Yorkshire County Council's internal audit functions, its systems documentation and risk identification during the planning of the external audit.

The audit team, following an assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function, review the findings of internal audit and adjust the audit approach as is deemed appropriate. This normally takes a number of forms:

- discussion of the work plan for internal audit;
- specific reliance is placed in certain areas subject to review and testing. As we expect our approach to be largely or fully substantive (see above), we expect this aspect of reliance to be limited;
- where internal audit identifies specific material deficiencies in the control environment, we consider adjusting our testing so that the audit risk is covered by our work; and
- review of any fraud investigations to determine their potential effect on our work.

# 5. Timetable

		2012											
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Audit	Early discussion of Authority's approach to risks areas												
	Prepare plan based on discussions w with Officers												
	Presentation of audit plan to Audit Committee												
	Audit fieldwork												
	Audit close meeting												
	Preparation of report to those charged with governance on 2011/12 audit												
	Deadline for signature of the Fund accounts included in North Yorkshire County Council's Statement of Account												
	Deadline for signature of the Pension Fund Annual Report												
Audit Committee	Report to the Audit Committee on the 2011/12 accounts audit - planning report												
	Report to the Audit Committee on the 2011/12 accounts audit - final report												

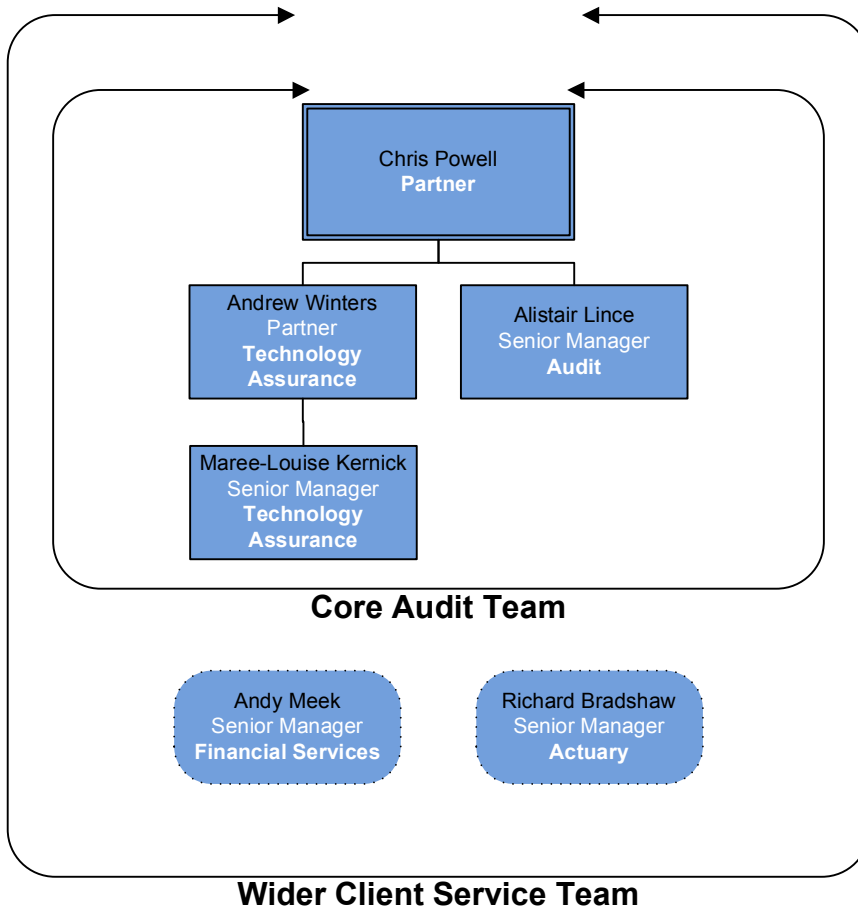
## Key dates

Audit fieldwork – 2 weeks commencing 25 June 2012.

Signing of Fund accounts included in North Yorkshire County Council's Statement of Accounts – by 30 September 2012.

Signing of Pension Fund annual report – by 1 December 2012.

## 6. Client service team





# 7. Responsibility statement

The Audit Commission published a 'Statement of responsibilities of auditors and of audited bodies' alongside the Code of Audit Practice. The purpose of this statement is to assist auditors and audit bodies by summarising, in the context of the usual conduct of the audit, the different responsibilities of auditors and of the audited body in certain areas. The statement also highlights the limits on what the auditor can reasonably be expected to do.

Our report has been prepared on the basis of, and our work carried out in accordance with, the Code and the Statement of Responsibilities.

While our report includes suggestions for improving accounting procedures, internal controls and other aspects of your business arising out of our audit, we emphasise that our consideration of North Yorkshire Pension Fund's system of internal financial control was conducted solely for the purpose of our audit having regard to our responsibilities under Auditing Standards and the Code of Audit Practice. We make these suggestions in the context of our audit but they do not in any way modify our audit opinion, which relates to the financial statements as a whole. Equally, we would need to perform a more extensive study if you wanted us to make a comprehensive review for weaknesses in existing systems and present detailed recommendations to improve them.

We view this report as part of our service to you for use, as Members, for corporate governance purposes and it is to you alone that we owe a responsibility to its contents. We accept no duty, responsibility or liability to any other person as the report has not been prepared, and is not intended, for any purpose. It should not be made available to any other parties without our prior written consent.

If you intend to publish or distribute financial information electronically or in other documents, you are responsible for ensuring that any such publication properly presents the financial information and any report by us thereon, and for the controls over and security of the website. You are also responsible for establishing and controlling the process for electronically distributing accounts and other information.



## **Deloitte LLP**

Chartered Accountants  
Leeds  
15 June 2012

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