

# Falkirk Council Pension Fund

Year ending 31 March 2018

Annual Audit Plan

Pensions Committee and Board – 15 March 2018



Building a better  
working world

## Public sector audit framework

Pages 3-5

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 2018.

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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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 and balancing the competing aims of prudence and affordability.

## Financial statements audit

Pages 8-14

Risk / area of focus	Risk identified	Change from PY	Details
Management override of controls	Fraud risk	No change in risk or focus	As identified in ISA 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 would otherwise appear to be operating effectively.
Valuation of complex investment (unquoted)	Inherent risk	Risk now incorporated into our consideration of management override above.	Valuation of complex investments was identified as an area of higher inherent risk during the 2016/17 audit. This year we have refined our approach and will consider this risk as part of our consideration of the fraud risk around management override

## Materiality

**Net Assets per 2016/17 financial statements**  
£2.2 billion

**Planning materiality**  
£44m

**Planning materiality (PM)** – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements. We have determined this to be £44.0 million (2016/17: £18 million), representing 2% of net assets reported in the 2016/17 financial statements. The increase from prior year reflects auditing standards requiring lower materiality levels to be set in the first year of audit engagements, which no longer apply to the Pension Fund in 2017/18.

**Tolerable Error**  
£22m

**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 £22.0 million (2016/17: £9 million).

**Summary of Audit Differences**  
£250,000

**Summary of Audit Differences (SAD) Nominal amount** – the amount below which misstatements whether individually or accumulated with other misstatements, would not have a material effect on the financial statements. In line with the Code of Audit Practice we will report all adjusted and unadjusted differences more than £250,000.

## Financial Statements audit (continued)

Pages 8-14

### Audit approach

Management, through the Chief Finance Officer 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.

We will engage with management to consider their assessment and incorporation of changes to the 2017/18 Accounting Code. There are no significant changes anticipated to the 2017/18 Accounting Code.

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.

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

## Wider scope audit and other work

Pages 15-16

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 2017/18. We will continue to review this throughout the audit cycle.

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

## Team, fees and deliverables

Pages 17-19

Hassan Rohimun is responsible for the quality of the audit and for signing the financial statements audit opinion. Hassan is an Associate Partner within our GPS audit team and will replace Careen Gray in 2017/18. He is supported by Rob Jones and Olga Potapova, 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 £17,360. This results in a total fee, inclusive of pooled costs, central performance audit and Best Value costs and central support costs of £20,000 (2016/17: £19,720).

## Appendices

Pages 20-24

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 Diane McGiffen, 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 April 2017; 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 2018.

## 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 Officer 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 2018 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 2017/18 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 2018. Furthermore, the unaudited annual financial statements should be considered by an appropriate committee of the Pension Fund by 31 August 2018.

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 2018. 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 which will be presented to the September Pension Committee and Board's meeting.

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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 2018.

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# 1. Public Sector Audit Framework (continued)

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

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

## **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 meeting minutes and papers, 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.

The Fund achieved a return of 20% during 2016/17 which was 1.6% above the Fund benchmark of 18.4%. The return compared favourably with 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 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.

The Pension Fund last substantially updated its Fund Investment Strategy in 2015/16. The main changes were to increase the proportion of Fund assets allocated to infrastructure and property investments, 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 Fund's longer term strategy is to reduce its exposure to more volatile assets. The Funding Strategy Statement was last materially revised 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. A revised Funding Strategy Statement has been consulted upon and is being considered for adoption at the March 2018 Pensions Committee. Management's focus has been to introduce a more risk based approach in setting employer contribution rates, recognising in particular the relative covenant strengths of Fund employers.

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.

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### Key messages

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 and balancing the competing aims of prudence and affordability.

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

# 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.*

## Audit opinion

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 financial position of the Pension Fund as at 31 March 2018 and its expenditure and income for the year then ended; and
- whether they have been properly prepared in accordance with the 2017/18 Code of Practice on Local Authority Accounting in the United Kingdom.

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

## Audit approach

We determine which accounts, disclosures and relevant assertions could contain risks of material misstatement. Our audit involves:

- ▶ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- ▶ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control.
- ▶ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ▶ Concluding on the appropriateness of management's use of the going concern basis of accounting.
- ▶ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- ▶ Obtaining sufficient audit evidence regarding the financial information of the entity or business activities within the Pension Fund to express an opinion on the financial statements. Reading other information contained in the financial statements, and reporting to the Pensions Committee and Board whether it is materially consistent with our understanding and the financial statements.
- ▶ Maintaining auditor independence.
- ▶ Substantive tests of detail of transactions and amounts. For 2017/18 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

# 3. Financial statements audit (continued)



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.*

## Materiality

For the purposes of determining whether the accounts are free from material error, in accordance with ISA (UK) 320 we define materiality as 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. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements. We will consider the need to update our planning materiality when the accounts at 31 March 2018 are available.

**Net Assets per 2016/17 financial statements**  
**£2.2 billion**

**Planning materiality**  
**£44m**

**Planning materiality (PM)** – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements. We have determined this to be £44.0 million (2016/17: £18 million), representing 2% of net assets reported in the 2016/17 financial statements. The increase from prior year reflects our audit methodology requiring consideration of setting lower materiality levels to be set in the first year of audit engagements

**Tolerable Error**  
**£22m**

**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 £22.0 million (2016/17: £9 million).

**Summary of Audit Differences**  
**£250,000**

**Summary of Audit Differences (SAD) Nominal amount** – the amount below which misstatements whether individually or accumulated with other misstatements, would not have a material effect on the financial statements. In line with the Code of Audit Practice we will report all adjusted and unadjusted differences 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.

## Key messages

Planning Materiality for the audit has been determined at £44.0 million, representing 2.0% of net assets reported with the prior year financial statements. Tolerable Error is set at £22.0 million. In line with the Code we will report any audit differences identified above £250,000.

### 3. Financial statements audit (continued)



We have set out the significant risks (including fraud risks) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

#### 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 and Board.

Significant risks (including fraud risks)	Our audit approach
<p><b>Risk of management override of controls</b></p> <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>Risk of valuation of complex investments (unquoted) now incorporated into our consideration of management override. Valuation of complex investments was identified as an area of higher inherent risk during the 2016/17 audit. This year we have refined our approach and will consider this risk as part of our consideration of the fraud risk around management override.</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> <li>▶ Obtain third party confirmations of the Fund’s externally held investment balances at the Pension Fund’s year end 31 March 2018.</li> <li>▶ Review relevant controls’ reports for qualifications or exceptions that may affect the audit risk and scope, and obtain bridging letters for the period between report dates and financial statements date where they differ.</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> <li>▶ Consider turnaround effect of the prior year adjustment for the current year financial statements, including its impact on the overall materiality of any audit differences identified in 2017/18.</li> </ul>

#### Key messages

In line with auditing standards we identify significant risks in respect of the risk of management override of controls. 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.

# 3. Financial statements audit (continued)



In accordance with the Auditing Standards, we take into account any audit findings and recommendations made to management from the 2016/17 audit cycle.

## Prior year audit recommendations

We have made a number of recommendations in our Audit Results Report presented to the Pension Committee and Board in 2016/17, which were accepted by management with actions agreed:

- ▶ We raised an audit difference of £6.2 million in relation to the valuation of private equity investments at year end. This has occurred where management prepared the financial statements based on all information available at the time of preparation but updated valuation information was subsequently available during the onsite audit. We have agreed with management to review the scale of similar assets held at 31 March 2018 in advance of the yearend audit to consider the possible scale of a similar difference this year, and the possible implications on the yearend audit.
- ▶ We noted through discussions with management and review of the year end returns and reconciliations submitted by member bodies that some issues remained with the timeliness and quality of information being provided to the fund. We will continue to monitor the quality and timeliness of this information as part of our yearend audit work.
- ▶ We considered management's disclosures included in the 2016/17 financial statements in respect of sensitivity analysis and note the disclosures do not meet the strict definitions of the code. Management agreed to consider the disclosure requirements for 2017/18. We will consider any revisions to the disclosures in 2017/18.
- ▶ We have noted the Fund's business continuity arrangements are based on the Council's arrangements. There is a risk that bespoke arrangements required are not considered. We will follow up on management's progress in installing bespoke arrangements going forward as part of the 2017/18 audit.

We will report on the status of these recommendation and any new audit findings in 2017/18.

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## Key messages

We will follow up on the status of audit recommendation and significant audit findings identified during 2016/17 audit and reported in our Audit Results Report to the Pensions Committee and Board on 21 September 2017.

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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 Officer 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 2017/18

We will engage with management to consider their assessment and incorporation of changes to the 2017/18 Accounting Code. There are currently no significant changes to the Accounting Code for 2017/18 that will impact Pension Fund accounts, and no new template accounts have been prepared. We will continue to agree key disclosure and presentational requirements with management up front.

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## Key messages

Management, through the Chief Finance Officer 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 currently no significant changes to the Accounting Code for 2017/18 that will impact Pension Fund accounts, and no new template accounts have been prepared. We will continue to agree key disclosure and presentational requirements with management up front.

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.

## Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;

Assess the reasonableness of the assumptions and methods used;

Consider the appropriateness of the timing of when the specialist carried out the work; and

Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

Management may use their own specialists in the preparation of the financial statements.

## Data analytics

Wherever possible we seek to use our bespoke computer-based analytics analysers to throughout the audit engagement. These analysers enable us to capture whole populations of the Fund's financial data, providing the following enhancements to the audit:

- ▶ Helping to identify specific exceptions and anomalies in the financial data to direct more traditional substantive audit testing.
- ▶ Giving greater likelihood of identifying adjusting items than random sampling techniques through more targeted direction of audit procedures.

Given the nature of the Pension Fund financial statements our main audit procedures are around the valuation of externally held investments, which tend to rely on obtaining and reviewing external confirmations rather than data analysis, however we will continue to review and refine our audit approach where possible.

## Internal audit

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

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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.

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## **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. This is of particular significance to the Pension Fund in 2017/18 in the light of the 2017 triennial valuation and its impact on future contributions and investment strategies.
- ▶ **Financial management** - With the financial challenges facing public sector bodies and the Fund employers, it is essential that the Pension Fund has robust financial management arrangements to ensure that it can continue to deliver on its financial and regulatory responsibilities.
- ▶ **Governance and transparency** - The Pensions Committee and Board 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 2017/18. Key to the assessment and judgement in the wider scope audit areas is the quality of the Pension Committee and Board'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 2017/18.

Key to the assessment and judgement in the wider scope audit areas is the quality of the Pension Committee and Board'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 Hassan Rohimun, who is responsible for EY's pensions assurance practice in Manchester. He is supported by Rob Jones, senior manager responsible for the financial statements audit. Olga Potapova will be the key day-to-day contact for the Pensions Manager and Pensions Accountant and will be leading the audit team onsite. Both Rob and Olga are in continuity for Pension Fund audit from prior year.

Individual	Contact details
Hassan Rohimun	T: 0118 928 1507 E: <a href="mailto:hrohimun@uk.ey.com">hrohimun@uk.ey.com</a>
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Olga Potapova	T: 0131 777 2426 E: <a href="mailto:opotapova@uk.ey.com">opotapova@uk.ey.com</a>

### 2017/18 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	2017/18	2016/17*
Auditor remuneration	£17,360	17,190
Pooled costs	£1,540	1,500
Audit support costs	£1,110	1,030
<b>Total expected fee</b>	<b>£20,000</b>	<b>£19,720</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 2017/18, we have agreed the auditor remuneration element of £17,360, being in line with the expected auditor remuneration set by Audit Scotland.

### Key messages

Hassan Rohimun is responsible for the quality of the audit and for signing the financial statements. He is supported by Rob Jones and Olga Potapova, 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 £17,360. This results in a total fee, inclusive of pooled costs, central performance audit and Best Value costs and central support costs, of £20,000 (2016/17: £19,720).

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



We deliver our audit in accordance with the timeline set by the Pension Fund, in accordance with guidance from Audit Scotland. Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

### Timeline and deliverables

Audit activity	Deliverables
<b>Planning, identification and assessment of risks: October 2017 – April 2018</b>	
<ul style="list-style-type: none"> <li>▶ Audit Planning meeting with Pensions Manager and Pensions Accountant</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, 15/03/2018</li> </ol>
<b>Design and execute response to risks: July – August 2018</b>	
<ul style="list-style-type: none"> <li>▶ Performance of year-end substantive audit fieldwork on unaudited accounts (from June)</li> </ul>	<ol style="list-style-type: none"> <li>2. Annual Audit Report – to Pension Committee and Board (20/09/2018)</li> </ol>
<b>Conclude and communicate: September 2018</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>3. Annual Audit Report – to Pension Committee and Board (20/09/2018)</li> <li>4. Certify Financial Statements – by 30/09/2018</li> </ol>

# Appendices

**A – Auditor Independence**

**B – Required Communications**

The FRC Ethical Standard and ISA (UK) 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 upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of 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	Final Stage
<ul style="list-style-type: none"> <li>➤ The principal threats, if any, to objectivity and independence identified by Ernst &amp;Young (EY) including consideration of all relationships between you, your affiliates and directors and us;</li> <li>➤ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;</li> <li>➤ The overall assessment of threats and safeguards;</li> <li>➤ Information about the general policies and process within EY to maintain objectivity and independence.</li> <li>➤ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard.</li> </ul>	<ul style="list-style-type: none"> <li>➤ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose 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;</li> <li>➤ Details of non-audit services provided and the fees charged in relation thereto;</li> <li>➤ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us;</li> <li>➤ Written confirmation that all covered persons are independent;</li> <li>➤ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent reach of that policy;</li> <li>➤ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and</li> <li>➤ An opportunity to discuss auditor independence issues.</li> </ul>

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.

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 2017/18 audit year is the first year that Hassan Rohimun 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, Hassan Rohimun's independence or objectivity.

## **Overall Assessment**

Overall we therefore confirm that EY is independent and the objectivity and independence of Hassan Rohimun, 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 2017 and can be found here:

<http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2017>

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>	<ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> </ul>
<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> </ul>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report to be issued on completion of audit work</li> </ul>
<p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion, , unless prohibited by law or regulation</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>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report</li> </ul>
<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>	<ul style="list-style-type: none"> <li>▶ Annual Audit Plan</li> <li>▶ Annual Audit Report (to be issued on completion of audit work)</li> </ul>
<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>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report (to be issued on completion of audit work)</li> </ul>
<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>	<ul style="list-style-type: none"> <li>▶ Annual Audit Report (to be issued on completion of audit work)</li> </ul>

## B. Communications (continued)



Required communication	Reference
<p><b>Internal controls</b></p> <ul style="list-style-type: none"> <li>▶ Significant deficiencies in internal controls identified during the audit</li> </ul>	▶ Annual Audit Report
<p><b>Consideration of laws and regulations</b></p> <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 Pensions and Board 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>	▶ Annual Audit Report
<p><b>Independence</b></p> <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>
<p><b>Going concern</b></p> <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>	▶ Annual Audit Report
<p><b>Representations</b></p> <ul style="list-style-type: none"> <li>▶ Written representations we are requesting from management and/or those charged with governance</li> </ul>	▶ Audit Results Report (to be issued on completion of audit work) or as occurring if material.
<p><b>Material inconsistencies</b></p> <ul style="list-style-type: none"> <li>▶ Material inconsistencies or misstatements of fact identified in other information which management has refused to revise</li> </ul>	▶ Audit Results Report (to be issued on completion of audit work) or as occurring if material.
<p><b>Fee information and confirmation of additional certification work</b></p> <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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**About EY**

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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