cutting through complexity™

Audit plan and interim audit report 2010/11

Wiltshire Pension Fund

May 2011

Disclaimer

This report is addressed to the Fund and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.uk.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards and that public money is safeguarded and properly accounted for and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Chris Wilson, the appointed engagement lead to the Fund, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on +44 (0)16 1246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by email to complaints@audit-commission.gov.uk. Their telephone number is +44 (0)84 4798 3131, text phone (minicom) +44 (0)20 7630 0421.

Contents

The contacts at KPMG in connection with this report are:

Chris Wilson
Partner,
KPMG LLP (UK)

Tel: +44 (0)11 8964 2238
christopher.wilson@kpmg.co.uk

Gemma Broom
Senior Manager,
KPMG LLP (UK)

Tel: +44 (0)11 7905 4382
gemma.broom@kpmg.co.uk

Naomi Burnell
Assistant Manager,
KPMG LLP (UK)

Tel: +44 (0)11 7905 4042
naomi.burnell@kpmg.co.uk

This document describes how we will deliver our financial statements audit work for Wiltshire Pension Fund and summarises our key findings from our work to date.

Our statutory responsibilities and powers are set out in the Audit Commission Act 1998, the Local Government Act 1999 and the Audit Commission's *Code of Audit Practice (the Code)*.

The Audit Commission's Code summarises our responsibilities into the following objective, requiring us to review and report on your:

- *financial statements (including the Annual Governance Statement):* providing an opinion on your accounts.

The Audit Commission's statement of responsibilities of auditors and audited bodies sets out the respective responsibilities of the auditor and the Council. The table below summarises the work will do this year.

Our responsibility	Risks, proposed work and output
Financial statements and annual governance statement	Key risks identified are as follows: ■ Implementation of international financial reporting standards: All local authorities are required to implement IFRS in 2010/11, including restating prior period figures. This will result in some fundamental differences in the Statement of Accounts disclosures and will require significant planning to ensure your financial statements reflect the new standards (see page 6 for more details). ■ Valuation of Investments ■ Implementation of Altair Our work will encompass: ■ Review of the controls over the completion of the accounts, relying on Internal Audit wherever possible to avoid duplication. ■ A detailed audit of the financial statements, associated disclosure notes and the annual governance statement. ■ Review of the three key risks identified, addressed through our detailed audit work and discussions with senior finance officers. *The findings of this work support the audit opinion that we issue on your financial statements.*

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary. The remainder of this document provides details of our risk assessment, proposed work and fees for our work on the financial statements audit.

This document summarises the key findings arising from our work to date in relation to both the audit of the Fund's 2010/11 financial statements.

Scope of this report

This report summarises the key findings arising from our interim audit work at Wiltshire Pension Fund (the Fund) in relation to the 2010/11 financial statements.

Financial statements

During April 2011 we completed our planning and control evaluation work. This covered our:

- review of the Fund's general control environment, including the Authority's IT systems;
- testing of certain controls over the Fund's key financial systems;
- assessment of the internal audit function;
- review of the Fund's accounts production process, including work to address prior year audit recommendations and the specific risk areas we have identified for this year;
- review of the Fund's work to restate the 2009/10 financial statements under International Financial Reporting Standards (IFRS).

Structure of this report

This report is structured as follows:

- Section 2 Audit overview.
- Section 3 Key Financial Statement audit risk.
- Section 4 Audit plan.
- Section 5 summarises the headline messages from our interim work.
- Section 6 sets out our key findings from our interim audit work in relation to the 2010/11 financial statements.

Our recommendations are included in Appendix 5. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix 6.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

Audit overview

We undertake our work on your financial statements and Annual Governance Statement (AGS) in four key stages.

Our work results in our audit opinion on your financial statements.

We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We are required to provide an audit opinion on the accounts.

We are also required to satisfy ourselves that your AGS is consistent with our understanding of your operations. Our review of the work of internal audit and consideration of your risk management and governance arrangements are key to this opinion.

Our audit process

We have summarised the four key stages of our financial statements audit process for you below:

			Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
1	Planning	Perform risk assessment procedures and identify risks	●		●						
		Determine audit strategy		●	●						
		Determine planned audit approach			●						
2	Control evaluation	Understand accounting and reporting activities				●					
		Evaluate design and implementation of selected controls				●					
		Test operating effectiveness of selected controls				●			●		
		Assess control risk and Risk of Material Mis-statement (RoSM)				●			●		
3	Substantive procedures	Plan substantive procedures				●	●	●			
		Perform substantive procedures							●		
		Consider if audit evidence is sufficient and appropriate							●	●	●
4	Finalisation	Perform completion procedures									●
		Perform overall evaluation									●
		Form an audit opinion									●
		Audit Committee reporting					●				●

Audit overview (cont.)

We work with your finance team and internal audit team to enhance the efficiency of the accounts audit.

Our audit process (cont.)

As part of our audit process, we will work closely with the finance team to understand and continually improve the accounts production process. At the planning stage of our audit we will issue the Fund with a ‘prepared by client’ list which will include a detailed schedule of information requests to support the financial statements.

Our audit procedures also include an assessment of your arrangements to deliver your responsibilities to prevent and detect fraud. The auditing standard for fraud, ISA240 (revised), responds to the increased sensitivity to fraud and the importance given to auditors’ work on fraud. Additionally, the Fraud Act 2006 and the Government Review of Fraud 2006 may impact on your responsibilities to manage fraud.

Liaising with internal audit

We have a strong working relationship with Internal Audit and we will continue to work closely with them to maximise the effectiveness of their work on core financial systems and governance at the Council.

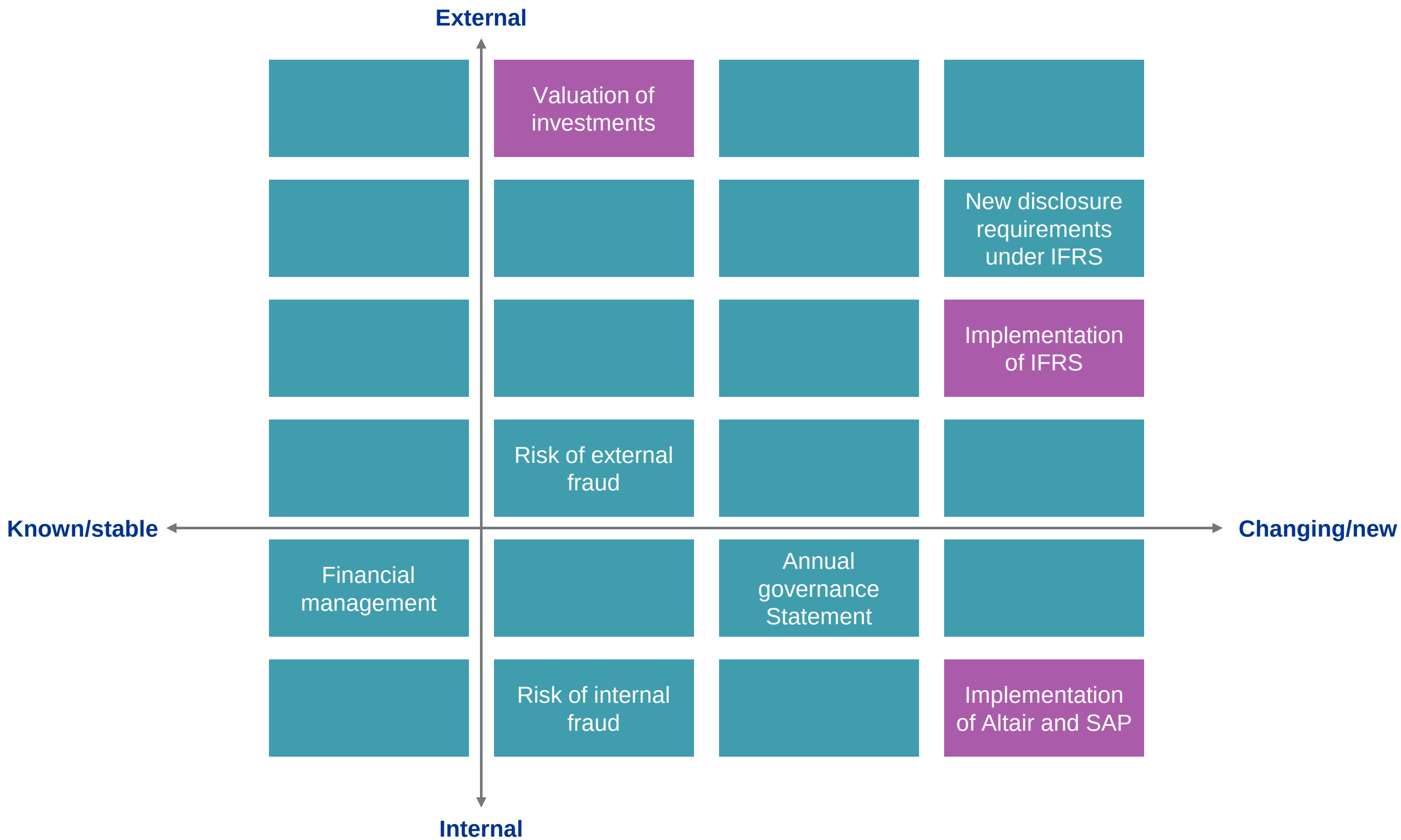
International Financial Reporting Standards (IFRS)

All Local Authorities are required to implement IFRS, moving away from UK GAAP for 2010/11 financial statements. We will continue to work closely with the finance team to ensure the smooth transition to IFRS. We will hold discussions with the pensions department prior to the final visit in order to provide early assurance on key aspects of your IFRS migration work, identify any issues on a timely basis and also ensure some accounting and audit effort is brought forward to alleviate the busy closedown and final accounts audit season over the summer.

Key financial statement audit risks

These are the key financial statement risks identified for 2010/11 and some examples of other risks that we will consider during the audit. We seek to tailor our audit approach to reflect this risk assessment.

We have increased our risk assessment in the for the Implementation of IFRS.



Key:
- Matters with potential financial statement risk.
- Matters of high audit risk discussed further on Page 7.

Key financial statement audit risks (cont.)

For each key risk audit area we have outlined the impact on our audit plan.

We will provide updates to the Audit Committee on these risk issues throughout our audit.

Transitions to IFRS represents the largest change in accounting for a number of years. We have detailed within the next slides the major implications of the new standards and how our audit work will be adapted to address these key risks.

Key audit risks		Impact on audit plan
IFRS conversion process	**Audit areas affected** Various disclosures within 2010/11 financial statements	**IFRS conversion process** *Impact of conversion process* The Fund will require a lot of planning and resources to ensure a smooth and successful transition to IFRS. *Our audit work* The main impact of IFRS on the Fund is the additional disclosures and presentation required for the investments assets held. These disclosures include a market risk sensitivity analysis and Fair value measurement hierarchy. We will keep in regular contact with the finance team during this period, discussing emerging issues and current guidelines. During the final accounts audit we will audit all figures and disclosures in line with IFRS.
Valuation of investment assets	**Audit areas affected** Investment assets	**Financial instruments** We will use our FundRADAR service to assist with auditing the valuation of the investment portfolio held. FundRADAR is a service which enables us to use market data and modelling to compare our expected pricing to the pricing provided by the custodian.
Implementation of Altair	**Audit areas affected** Membership data and benefits	**Implementation of Altair** We will use our IT specialists to ensure that data has been migrated correctly from Axis to Altair.

Materiality

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

Our materiality of this year is £6.3 million.

What do we mean by materiality?

In layman terms, materiality is the margin of error we will accept before we qualify our opinion on the accounts.

Why do we have a level of materiality?

We only have a limited time in which to complete our work. As a result, we focus our testing on a sample of transactions rather than everything. To make our sample testing most effective, our work is driven by an assessment of risk and a level of materiality. This means we sample test the transactions that are more likely to be prone to significant fraud or error.

Determining materiality

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

Materiality has been set at £6.3 million which is 0.5% of total assets.

We design our procedures to detect errors at a lower level of precision, i.e. £4.7 million. We have some flexibility to adjust this level downwards.

Reporting to Audit Committee

To comply with auditing standards, the following three types of audit differences will be presented to the Audit Committee:

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

We will not report audit and disclosure differences that are considered to be trivial.

Audit team

Contact details are shown on Page 2.

The audit team will be assisted by other specialist KPMG staff as necessary.

Chris Wilson

Engagement Lead

My role is to lead our team and ensure the delivery of a high quality external audit opinion. I will be the main point of contact for the Audit Committee and the Chief Finance Officer

Gemma Broom

Audit Senior Manager

I will direct and help coordinate the audit and will work closely with Chris Wilson to ensure we add value. I will be the main contact for the Chief Finance Officer and other officers.

Naomi Burnell

Audit Assistant Manager

I will be your day to day contact and will work closely with Gemma Broom to deliver a coordinated and efficient audit.

Independence confirmation

Our independence and objectivity responsibilities under the Code are summarised in Appendix 3.

We confirm our audit team's independence and objectivity is not impaired

Independence and objectivity confirmation

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The ISA defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Confirmation statement

We confirm that as of 12 May 2011, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Appointed Auditor and audit team is not impaired.

Audit fees

We agreed our fee for the audit with the Authority earlier this year. The fee is calculated with reference to a number of factors set by the Audit Commission and our assessment of audit risk and control environment. This year's fee represents a 3.2% decrease over last year (2009/10 = £46,950. This is due to the additional audit costs associated with the implementation of SAP in 2009/10.

[Element of the audit]	
	Fee 2010/11
Total audit fee	**£45,450**

To enable you to benchmark our fee proposal we provide below some comparative information. Please note that the nature of the locally determined work changes each year so that direct comparison between years may not be valid.

Source of fee comparative/benchmark	
Audit commission suggested fee range	£37,950- £47,440
Audit commission suggested scale fee	£33,000+ 0.0005% of 2008/9 net assets
2010/11 audit fee	£45,450

Audit fees (cont.)

Our audit fee is indicative and based on you meeting our expectations of your support.

Meeting these expectations will help to the delivery of our audit within the proposed audit fee.

Audit fee assumptions

The audit fee is indicative and is based on you meeting our agreed expectations as outlined in Appendix 1. In setting the fee, we have assumed

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2010/11:
- you will inform us of any significant developments impacting on our audit such as any changes to investment managers, administration processes etc;
- internal audit meets the appropriate professional standards;
- internal audit undertakes appropriate work on all systems that provide material figures in the financial statements sufficient that we can place reliance for the purposes of our audit;
- your financial statements will be made available for audit in line with the timetable we agree with you;
- good quality working papers and records will be provided to support the financial statements by the date we agree with you;
- requested information will be provided within agreed timescales;
- prompt responses will be provided to draft reports; and
- additional work will not be required to address questions or objections raised by local government electors, or for special investigations such as those arising from disclosures under the Public Interest Disclosure Act 1998.

Meeting these expectations will help ensure the delivery of our audit within the agreed audit fee.

Changes to the audit plan

Changes to this plan and the audit fee may be necessary if:

- new significant audit risks emerge;
- additional work is required of us by the Audit Commission or other regulators;
- additional work is required as a result of changes in legislation, professional standards or financial reporting requirements.

If changes to this plan and the audit fee are required, we will discuss and agree these initially with the Head of Pensions.

Audit timeline and deliverables

Our key deliverables will be delivered to a high standard and on time.

We will discuss and agreed each report with the Council's officers prior to publication.

Deliverable	Purpose	Timing
Planning		
Audit plan	Outline audit approach. Identify areas of audit focus and planned procedures. Confirm plan with Audit Committee.	**May 2011**
Interim		
Interim report	Details and resolution of control and process issues.	**May 2011**
Year end audit		
Report to those charged with governance (ISA 260)	Commentary on Wiltshire Council Pension Fund financial statements. Details the resolution of key audit issues. Communication of adjusted and unadjusted audit differences. Performance improvement recommendations identified during our audit.	**September 2011**
Opinion on financial statements	Independent auditors' report of Wiltshire Council Pension Fund.	**September 2011**

Headlines

This table summarises the headline messages. The remainder of this report provides further details on each area.

Organisational and IT control environment	Our IT specialists are due to perform procedures over general It controls within SAP and Altair in the coming months. We consider that your organisational controls are effective overall.
Controls over key financial systems	The controls over the majority of the they key financial system are generally sound but we noted two weaknesses in respect of individual financial systems.
Review of internal audit	Internal audit have issued their findings in draft only at the time of the report. We will communicate our findings in September 2011.
Accounts production and specific risk areas	Implementation of IFRS. Valuation of Investments. Altair Implementation

Organisational control environment

Your organisational control environment is effective overall.

Work completed

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would have implications for our audit.

We obtain an understanding of the Authority's overall control environment and determine if appropriate controls have been implemented. We do not complete detailed testing of these controls.

Key findings

We consider that your organisational controls are effective overall.

Aspect	Assessment
Organisational structure	●
Integrity and ethical values	●
Philosophy and operating style	●
Participation of those charged with governance	●
Human resource policies and practices	●
Risk assessment process	●
Information systems relevant to financial reporting	●
Communication	●
Monitoring	●

Key:
- ● (red) Significant gaps in the control environment.
- ● (amber) Minor deficiencies in respect of individual controls.
- ● (green) Generally sound control environment.

IT control environment

Work completed

The Fund relies on information technology (IT) to support both financial reporting and internal control processes. In order to satisfy ourselves that we can rely on the use of IT, we test controls over access to systems and data, system changes, system development and computer operations.

Our own testing over SAP and Altair is yet to be completed and we will communicate our findings to you in September 2011.

Controls over key financial systems

The controls over the majority of the key financial system are generally sound.

However, there are some weaknesses in respect of cash and financial reporting.

We will need to complete additional substantive work in these areas at year-end.

Work completed

We work with your internal auditors to update our understanding of the Authority's key financial processes where these are relevant to our final accounts audit. We confirm our understanding by completing walkthroughs for these systems.

We then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Our assessment of a key system will not always be in line with the internal auditors' opinion on that system. This is because we are solely interested in whether our audit risks are mitigated through effective controls, i.e. whether the system is likely to produce materially reliable figures for inclusion in the financial statements.

Key findings

The controls over the majority of the they key financial system are generally sound but we noted some weaknesses in respect of individual financial systems.

- Weakness 1: Evidence of review of the Bank reconciliation is not being performed by Corporate Finance or the Pensions department.
- Weakness 2: No review process of the manual journals being posted is being performed.

Recommendations are included in Appendix 5.

The weaknesses identified mean that we will need to complete additional substantive work at year-end.

System	Assessment
Financial reporting	Amber
Sundry income	Green
Payroll expenditure	Green
Non-pay expenditure	Green
Cash	Amber

Key:
- Red: Significant gaps in the control environment.
- Amber: Minor deficiencies in respect of individual controls.
- Green: Generally sound control environment.

Accounts production process and Specific risk areas

The Fund's overall process for the preparation of the financial statements is adequate.

The Fund has implemented some of the recommendations in our *ISA 260 Report 2009/10* relating to the financial statements.

Work completed

We continued to meet with David Antony on regular basis to support them during the financial year end closedown and accounts preparation.

As part of our interim work we specifically reviewed the Fund's progress in addressing the recommendations in our *ISA 260 Report 2009/10*.

Key findings

We consider that the overall process for the preparation of your financial statements is adequate.

The Fund has implemented some of the recommendations in our *ISA 260 Report 2009/10* relating to the financial statements in line with the timescales of the action plan. further update of these recommendations is detailed in Appendix 6.

Key audit risks		Progress
IFRS conversion process	**Audit areas affected** Various disclosures within 2010/11 financial statements	**IFRS conversion process** The pension team is in discussion with the custodian of obtaining the categorisation of assets, and the assumptions that have been used for this process. We are awaiting clarification from CIPFA over the impact of IFRS and the disclosures required in order to best advice the pension team on the next steps.
Valuation of investment assets	**Audit areas affected** Investment assets	**Financial instruments** We will use our FundRADAR service to assist with auditing the valuation of the investment portfolio held. As part of our year end procedures.
Implementation of Altair	**Audit areas affected** Membership data and benefits	**Implementation of Altair** Our IT specialists will be visiting the Council site over the coming months to complete the work over the migration of data. The Council's pension team performed its own testing of data at the time of migration

IFRS restatement

The Fund has fully restated its 2009/10 financial statements under IFRS.

Work completed

From 2010/11 local authorities are required to prepare their financial statements under the IFRS based *Code of Practice for Local Authority Accounting in the United Kingdom*. This contains a number of significant differences compared to the previous financial reporting regime.

Key findings

As all investments are held at market value there is no material impact of implementing IFRS on the Fund's accounting policies. This means that the Fund does not have to go through a restatement exercise of its 2009/10 financial statements.

The main impact of implementing IFRS to the pension fund is the level of disclosure required under IFRS 7 *Financial Instruments disclosure*. KPMG is currently in discussion with CIPFA over the application of this standard to pension schemes. If IFRS 7 is applied then the investments held by the Fund will require categorisation into a Fair value hierarchy and a market sensitivity analysis will need to be performed and presented.

Meeting your expectations

How we will conduct ourselves

Communications

We will be proactive in developing relationships with your staff where our audit work requires their input.

We will ensure that all letters and emails are answered within five working days of receipt. All telephone messages received will receive a response within 24 hours, either by the individual concerned or Naomi Burnell.

We will ensure that all recommendations and in particular those relating to our performance management work, are included within our Annual Audit Letter only after having been agreed with relevant Directors.

Chris Wilson or Gemma Broom will attend Member Committee meetings and ensure that other relevant KPMG staff are invited as appropriate.

We have been working with you throughout 2009/10 providing guidance on key issues in the transition to IFRS. We will continue working with the finance team to provide advice and review progress during 2010/11.

Working together

We will ensure that the Head of Pensions and other key members of staff are kept informed of the progress of our audit work throughout the year.

We will liaise with staff at all levels of the Council to ensure that our work is appropriately planned and completed and where recommendations are made these are agreed with the likely responsible officer.

Cooperating with the Council

We will continue to coordinate our work with that of internal audit and ensure that we provide appropriate proactive commentary to the finance function on issues that affect the Fund's accounts.

We will respond promptly to requests for comment on aspects of the Fund's operations, where appropriate.

Our expectations of your support

Audit plan

Brief our staff on key issues affecting the Council.

Review and agree the draft plan.

Interim audit

Facilitate the completion of internal audit's work (particularly on core financial systems) to timetable.

Ensure that key officers are available for the duration of our audit.

Respond to and agree our draft reports in good time.

Accounts audit

Ensure that a full draft of the accounts is available at least one week prior to the agreed start date of our audit and that only agreed adjustments are put into the accounts following receipt of this draft.

Produce the documents listed within our prepared by client request by the agreed start date of our audit.

Ensure that the mandatory content of the Annual Report is available at the agreed time of our final account audit.

Annual audit letter

Discuss and agree our draft Annual Audit Letter in good time for the Audit Committee.

Ensure that all action plans are agreed and followed up in due course.

IFRS

Ensure a full set of 2009/10 restated figures compliant with IFRS are available to audit in good time prior to the final visit.

Other work

Agree a key contact as a focal point for the study or work.

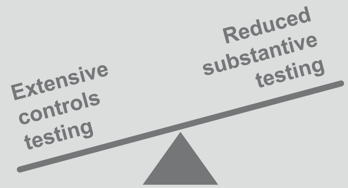
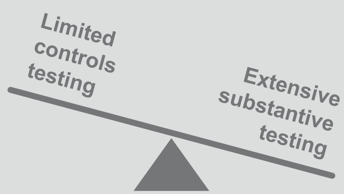
Discuss and review our findings so that action plans can be fully completed and implemented.

Appendix 2

Balance of internal controls and substantive testing

This appendix illustrates how we determine the most effective balance of internal controls and substantive audit testing.

Emphasis of testing

What we do	Accounts/transactions suited to this testing	For example KPMG's approach to:
 Extensive controls testing / Reduced substantive testing	Low value transactions High volume Homogenous transactions Little judgement	Income and debtors Purchases and payables Payroll
 Moderate controls testing / Moderate substantive testing	Low/medium value High/medium volume Some areas requiring judgement	Valuation of tangible fixed assets
 Limited controls testing / Extensive substantive testing	High value Low volume or Unusual non-recurring Accounting estimates Significant judgements	Valuation of intangibles Financial Instruments Legal provisions

Note: Assuming controls are found to operate as designed.

Independence and objectivity requirements

This appendix summarises auditors' responsibilities regarding independence and objectivity.

Independence and objectivity

Auditors are required by the Code to:

- carry out their work with independence and objectivity;
- exercise their professional judgement and act independently of both the Commission and the audited body;
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest;
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Council invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Any staff involved on Commission work who wish to engage in political activity should obtain prior approval from the Partner.
- Audit staff are expected not to accept appointments as lay school inspectors.
- Firms are expected not to risk damaging working relationships by bidding for work within an audited body's area in direct competition with the body's own staff without having discussed and agreed a local protocol with the body concerned.
- Auditors are expected to comply with the Commission's statements on firms not providing personal financial or tax advice to certain senior individuals at their audited bodies, auditors' conflicts of interest in relation to PFI procurement at audited bodies and disposal of consultancy practices and auditors' independence.
- Auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission.
- Auditors are expected to comply with the Commission's policy for the Engagement Lead to be changed on each audit at least once every five years (subject to agreed transitional arrangements). Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- The Commission must be notified of any change of second in command within one month of making the change. Where a new Engagement Lead or second in command has not previously undertaken audits under the Audit Commission Act 1998 or has not previously worked for the audit supplier, the audit supplier is required to provide brief details of the individual's relevant qualifications, skills and experience.

Quality assurance and technical capacity

We continually focus on delivering a high quality audit. This means building robust quality control procedures into the core audit process rather than bolting them on at the end and embedding the right attitude and approaches into management and staff. Quality must build on the foundations of well trained staff and a robust methodology. The diagram summarises our approach and each level is expanded upon below.

We recruit the best staff through our rigorous selection and assessment criteria. In addition, we expect that future talent to develop with our application of most effective in-house and external training support.

Our audit methodology determines that we use a standardised audit approach and pro forma work papers. We also have standards of audit evidence and working papers including requirements for working paper retention.

At critical periods of the audit we conduct both manager and engagement leader review of the work completed. Upon final completion, managers and directors complete a checklist to indicate the satisfactory conclusion of the audit under the audit methodology.

Partners who meet certain skills and experience criteria, conduct quality control reviews of individual audits depending on the level of audit risk. Their role is to perform an objective evaluation of the significant accounting, auditing and financial reporting matters with a high degree of detachment from the audit team. This provides an objective internal assessment on the quality of our audit. Peer review is undertaken across the firm, with an annual sample of our work being undertaken from a different national office. This encourages a constant focus on quality and ensures there is continuous improvement and that best practice is shared.

Our quality review results

We are able to evidence the quality of our audits through the results of National Audit Office and Audit Commission reviews. The results of the Audit Commission's annual quality review process is made publicly available each year (www.audit-commission.gov.uk/reports/). The latest report dated October 2010 showed that we performed highly against all the Commission's criteria.

Resolving accounting and financial report issues and emerging issues with the independent regulator

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director (based in our London office) who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA and the Audit Commission) as well as acting as a sounding board for our auditors.
- A national technical network of public sector audit professionals (that meets on a quarterly basis) and is chaired by our national technical director.
- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's Code of Audit Practice.
- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based bi-monthly technical training.

When dealing with the Audit Commission, as you would expect we both attend and cascade across the firm the papers considered by their various technical groups for auditors. In addition, as the Audit Commission has developed we have established a series of formal and informal relationships. These benefit both the Audit Commission and our Local Authority clients. As a result of all of these factors and combined with our overall audit approach, we seek to offer early warnings of issues arising with the independent regulator and provide pragmatic solutions.

Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Fund should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations		
Priority one: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	*Priority two*: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	*Priority three*: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Risk	Issue and recommendation	Management response/responsible officer/due date
1	2	**Review of Bank reconciliation** There is a lack of formal evidence of preparation and review of the bank reconciliation which means that this operates as a process rather than a control. There is a risk without review that any unusual reconciling items go unchecked. We recommend that the bank reconciliation is formally reviewed and signed off as reviewed by the Corporate Finance Department and Pensions Department.	Regular management reviews have been undertaken throughout the year and electronic bank reconciliation is reviewed on a daily basis and items are continually matched by the Corporate Finance Department. They also undertake an annual review of outstanding items over one year as part of the year end process and electronic copies have been kept since August. The Pension Fund is confident of the accountants in Corporate Finance expertise and experience to undertake these reconciliations and to report by exception any issues that need to be brought to the Fund’s attention. The position on the bank account is monitored by the Fund on a regular basis and daily by the Treasury Management team in the Corporate Finance Department.
2	2	**Review of manual journals** There is no review process of the manual journals being posted. Into SAP. There is a risk that without a review that any mispostings are not identified and corrected potentially leading to misstatements within the financial statements. We recommend that a monthly report is run from SAP for all manual journals over £50,000, to be then reviewed by the pensions department.	The segregation of duties is limited as the accounts team consists of only two finance staff . The journals are only undertaken and posted by one experienced member of the team and due to the number of transactions this risk is minimal with any material misposting picked up within the monthly variance analysis or year end accounts process. All year end journals are reviewed before posting.

Follow-up of prior year recommendations

The Fund has implemented all of the recommendations in our *Interim Audit Report 2009/10* with the exception of the membership data that we understand will be done in July 2011 and the correct investment accounting will be done as part of the year end process.

This appendix summarises the progress made to implement the recommendations identified in our Interim Audit Report 2009/10 and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	4
Implemented in year or superseded	2
Remain outstanding (detailed below)	2

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at 19 April 2011
1	1	The Pension Scheme Department could not provide accurate membership data that agree to the Statement of accounts. Inaccurate membership numbers make it harder for the Committee to ensure that contributions and benefits are being paid correctly and may impact on the future liability of the scheme. Membership numbers should be reconciled regularly. A listing of members to back up the totals should be maintained and regularly reviewed.	Head of Pensions Ongoing	As of August 2010 membership data has been moved across to Altair. Membership data as of 31 March 2011 was obtained as part of our interim visit. The reconciliation of the year end position to the Statement of accounts will be performed as part of our year end procedures in July 2011.
2	2	During the year under review (2009/10), a new accounting system, SAP, was implemented to replace the previous system, Aptos. During the course of implementation a number of incorrect postings were made regarding contributions, which were corrected and reposted a number of times. This resulted in significant fluctuations in the contributions figures seen on SAP, making the variance analysis control being unable to operate effectively on a monthly basis. We do not believe that this will be an issue going forward as the errors arose due to the one-off event of the introduction of SAP. However, care should be taken to ensure that contributions are posted correctly, Postings should occur monthly and errors should be investigated where they occur.	Pensions and Corporate finance department	Officers in the Pension Fund, central Finance and the Shared Service Team are now familiar with SAP. Quarterly contribution reconciliation have now recommenced and all errors are investigated.

Appendix 6

Follow-up of prior year recommendations (cont.)

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at 19 April 2011
3	2	During the prior year audit of investment balances we identified a number of discrepancies in accounting treatment. For example, investment income was posted on a cash basis instead of on an accruals basis required by the SORP. In addition, investments made in the Fauchier account had been accounted for twice. These errors arose because the investments were posted directly from the custodian reposts, there were no controls in place to ensure postings are made correctly. We recommended that a cash reconciliation, book cost reconciliation and market value reconciliation were prepared on a quarterly basis and reviewed by a second individual. These reconciliations will help to identify any incorrect postings.	Pensions department (July 2011)	The investment accounting is undertaken by the Fund's custodian, Bank of New York Mellon and these reports are used to post the investment entries into the general ledger. The investment income should have been accounted for on an accrual basis and this was a manual error. Officers are now looking at ways to incorporate the bank reconciliation with the market values and book cost ones to ensure errors are picked up prior to the year end. To be updated as part of July 2011 visit.
4	2	During our audit fieldwork during the prior year we came across a number of incidents where information was missing.	Pensions department	There were no instances in our interim work where information was missing.

KPMG

cutting through complexity™