



## Local Pension Board

Date: 26<sup>th</sup> March 2020

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## External Audit Plan for 2019/20 Accounts

(for information and discussion)

Report of the Head of Pensions

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1. Ernst and Young will undertake the 2019/20 external audit of the Fund.
2. Representatives from Ernst and Young will attend the meeting to brief the Local Pension Board on the audit plan.
3. The Local Pension Board is recommended;
  - to consider the presentation and the audit plan, and comment on it
  - to note the approach to the 2019/20 external audit.

## Audit Plan

4. Prior to the year-end audit of the accounts, the Fund's external auditor, Ernst and Young present an audit plan to the Council's Audit Committee, the Pensions Committee and the Local Pension Board, summarising the work to be undertaken. A copy of this plan is attached.
5. The audit plan is addressed to the Audit Committee as they are formally charged with the governance of the Council's and the Pensions Fund's accounts. However, in recognition of the fact the Local Pension Board has a role in considering such matters relating to the Fund, it is also considered appropriate that the plan and the final report from Ernst and Young is also reported here.
6. Representatives from Ernst and Young will attend the meeting to brief the Board.

## Approval Process

7. Each year the Pension Fund is required to produce a set of accounting statements for inclusion in South Tyneside Council's Report and Accounts. This is in addition to producing the Fund's Report and Accounts.
8. The Fund's accounting statements in the Council's version are exactly the same as those in the Fund's Report and Accounts, but the supporting material and background information is significantly less.
9. The statutory deadlines for the production of both the accounting statements and the Report and Accounts are different. The deadlines are set out below:
  - 31<sup>st</sup> May for the draft accounting statements for the Council and the Pension Fund
  - 31<sup>st</sup> July for the publication of the Council's Report and Accounts
  - 1<sup>st</sup> December for the Pension Fund's Report and Accounts.
10. The process for approving the accounting statements in order to achieve these deadlines is set out below.
  - the draft Fund accounting statements will be published on 31<sup>st</sup> May
  - these draft accounting statements will be presented at the Pensions Committee meeting which takes place in June, for information and comment

- the Council's Accounts, which include the Fund's accounting statements will then be formally approved at the meeting of the Audit Committee towards the end of July, ahead of the statutory deadline for publication of 31<sup>st</sup> July
- the Fund's Annual Report and Accounts, including the accounting statements, will be presented to the Pensions Committee for approval at the meeting in September. Ernst and Young will attend to go through the findings of the audit. This is ahead of the statutory deadline for the Fund's Report and Accounts which is 1<sup>st</sup> December.

### **Local Pension Board - Annual Report and Accounts 2019/20**

11. The Fund's Annual Report and Accounts for 2019/20 will be presented to the Local Pension Board at its meeting in October 2020. Ernst and Young will attend to go through the findings of the audit.

### **Recommendation**

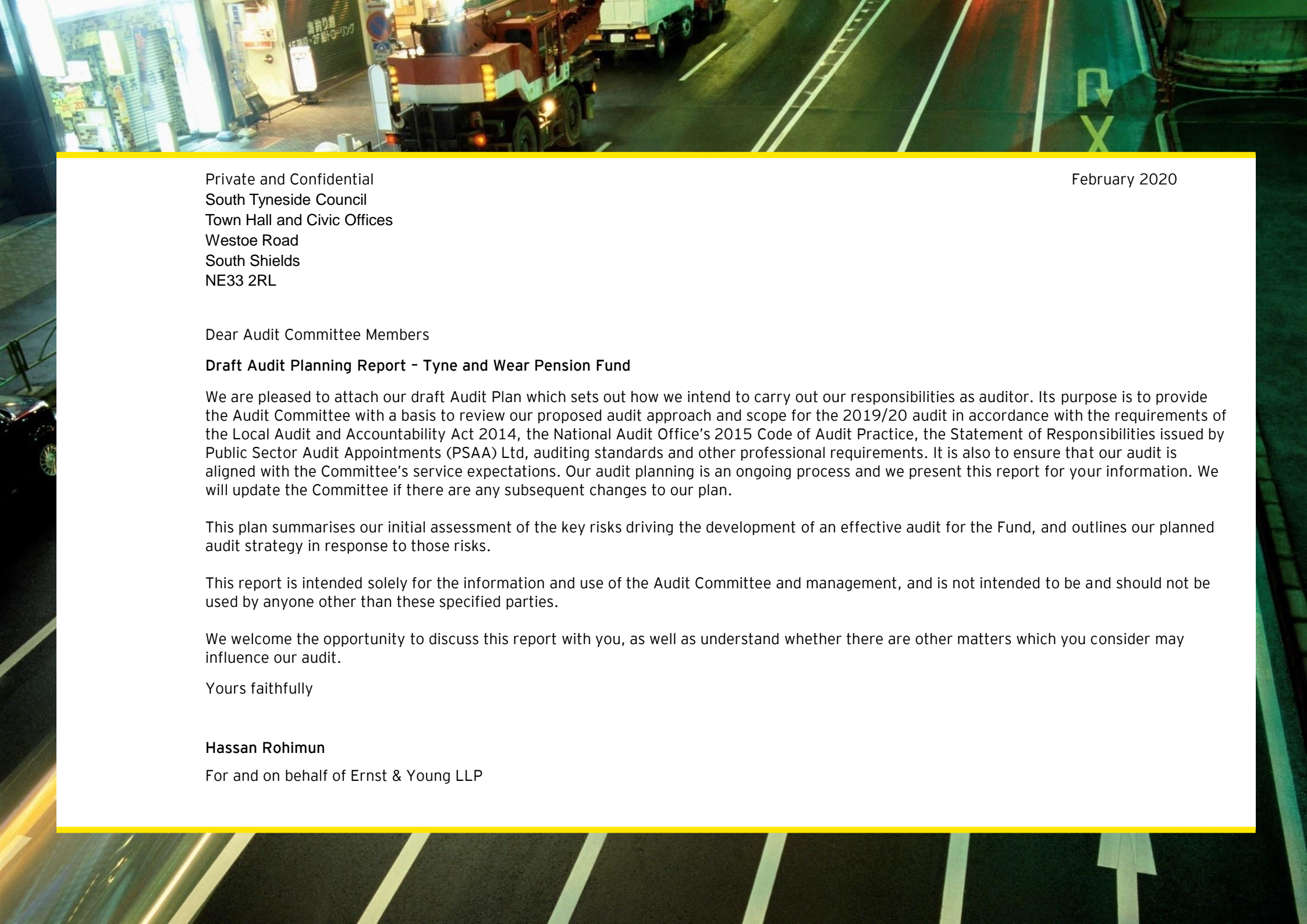
12. The Local Pension Board is recommended;
  - to consider the presentation and the audit plan and comment on it
  - to note the approach to the 2019/20 external audit.

A photograph of a meeting table with documents and hands pointing at them. The table is white, and there are several sheets of paper with text on it. A person's hand is pointing at a document on the left, and another person's hand is pointing at a document on the right. A smartphone is visible on the table. The background is slightly blurred, showing a person in a yellow shirt.

# Tyne and Wear Pension Fund Draft Audit Planning Report

Year ended 31 March 2020

February 2020



Private and Confidential  
South Tyneside Council  
Town Hall and Civic Offices  
Westoe Road  
South Shields  
NE33 2RL

February 2020

Dear Audit Committee Members

**Draft Audit Planning Report - Tyne and Wear Pension Fund**

We are pleased to attach our draft Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2019/20 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations. Our audit planning is an ongoing process and we present this report for your information. We will update the Committee if there are any subsequent changes to our plan.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Fund, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of the Audit Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you, as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

**Hassan Rohimun**

For and on behalf of Ernst & Young LLP

# Contents



Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (<https://www.psa.co.uk/audit-quality/statement-of-responsibilities/>). The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit Committee and management of Tyne and Wear Pension Fund in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee and management of Tyne and Wear Pension Fund those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Tyne and Wear Pension Fund for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



01

# Overview of our 2019/20 audit strategy



## Overview of our 2019/20 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

### Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	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 unquoted pooled investment vehicles	Significant risk	No change in risk or focus	The Fund's investments include unquoted pooled investment vehicles. Judgement is required from Investment Managers to value these investments as prices are not publicly available. The material nature of these investments means that any error in these judgements could result in a material valuation error.
Valuation of private equity investments	Significant risk	No change in risk or focus (new presentation)	The Fund's investments include private equity investments. Valuation of investments is performed under a number of different frameworks, depending upon the location and jurisdiction of the investment. Judgement is required to value these investments as prices are not publicly available and market volatility means such judgements can quickly become outdated, especially where there is a significant time period between the latest audited information and the Fund's reporting date. Any error in valuation or variation since the audited information could have a material impact upon the financial statements.
Valuation of directly held property	Significant risk	No change in risk or focus	<p>The Fund has a significant portfolio of directly held property investments. The valuation these properties is subject to a number of assumptions and judgements, small changes in which could have a significant impact upon the financial statements.</p> <p>Within the Fund's directly held property are a number of retail property assets. Current market conditions within the retail sector mean the judgements and assumptions used to value these assets are particular sensitive to market volatility.</p>

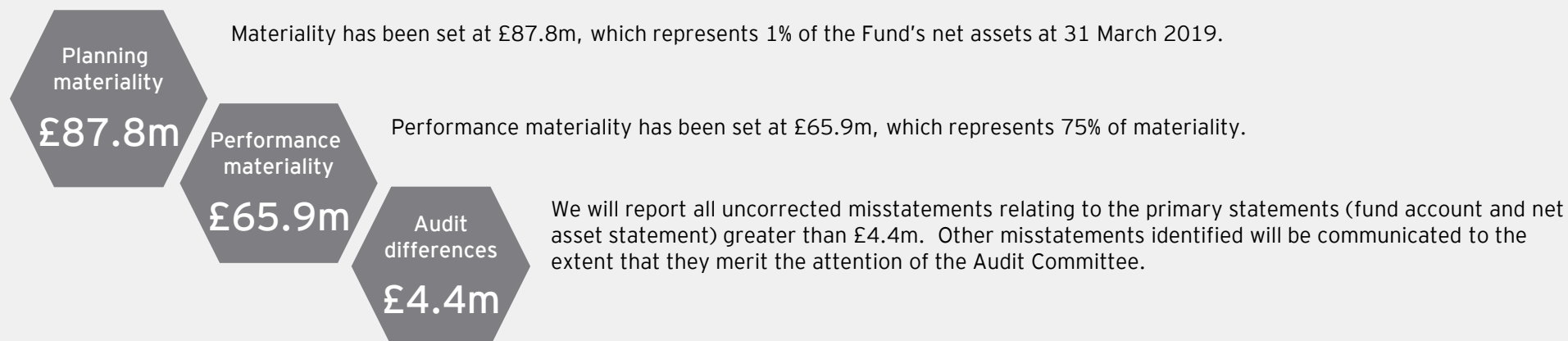


## Overview of our 2019/20 audit strategy

### Audit risks and areas of focus (continued)

Risk / area of focus	Risk identified	Change from PY	Details
IFRS 16 - Leases	Area of focus	New area of focus	Implementation of IFRS 16 will be included in the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) for 2020/21. Although the new standard will not be implemented until 2020/21, work will be necessary to secure information required to enable authorities to fully assess their leasing position and ensure compliance with the standard from 1 April 2020.

### Materiality



# Overview of our 2019/20 audit strategy

## Audit scope

This Audit Plan covers the work that we plan to perform to provide you with:

- Our audit opinion on whether the financial statements of Tyne and Wear Pension Fund give a true and fair view of the financial position as at 31 March 2020 and of the income and expenditure for the year then ended; and
- Our opinion on the consistency of the Fund's financial statements, which are included within the Fund's Annual Report, with the published financial statements of South Tyneside Council (the administering authority).

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements;
- Developments in financial reporting and auditing standards;
- The quality of systems and processes;
- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 15 in recent years as well as the expansion of factors impacting the value for money conclusion. Therefore to the extent any of these or any other risks are relevant in the context of Tyne and Wear Pension Fund's audit, we will discuss these with management as to the impact on the scale fee.



# 02

## Audit risks



# Audit risks

## Our response to significant risks

We have set out the significant risks (including fraud risks denoted by\*) 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.

	<b>What is the risk?</b>	<b>What will we do?</b>
<b>Misstatements due to fraud or error*</b>	<p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>As identified in ISA (UK) 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. We respond to this fraud risk on every audit engagement.</p> <p>We have not identified any specific fraud risks in our planning, however we will continue to update our risk assessment throughout our audit.</p>	<ul style="list-style-type: none"><li>▶ Identifying fraud risks during the planning stages of our audit;</li><li>▶ Inquire of management about risks of fraud and the controls put in place to address those risks;</li><li>▶ Understand the oversight given by those charged with governance of management's processes over fraud;</li><li>▶ Consider the effectiveness of management's controls designed to address the risk of fraud;</li><li>▶ Determine an appropriate strategy to address those identified risks of fraud; and</li><li>▶ Perform mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements.</li></ul>

## Our response to significant risks

### Valuation of unquoted pooled investment vehicles

#### What is the risk?

The Fund's investments include unquoted pooled investment vehicles. Judgement is required from Investment Managers to value these investments as prices are not publicly available. The material nature of these investments means that any error in these judgements could result in a material valuation error.

We have identified the valuation of the Fund's investments in unquoted pooled investment vehicles as a significant risk, as even a small movement in the assumptions underpinning investment manager valuations could have a material impact upon the financial statements.

#### What will we do?

- ▶ Document and walkthrough the process and design of the controls over the valuation process;
- ▶ Obtain third party confirmations of the valuation of unquoted pooled investments at the reporting date from the investment managers. We will also cross-check the investment manager confirmations to the confirmation of assets held obtained from the Fund's custodian;
- ▶ Review the relevant investment manager controls' reports for qualifications or exceptions that may affect the audit risk;
- ▶ Compare the movement in valuation of investments in unquoted investment vehicles with the returns recognised as investment income per the investment manager confirmations, and investigate any unusual variances;
- ▶ Agree a sample of purchases and sales of unquoted pooled investments during the period to supporting evidence; and
- ▶ Review the basis of valuation for unquoted investments and ensure it is in line with the accounting policy.

## Our response to significant risks

### Valuation of private equity investments

#### What is the risk?

The Fund's investments include private equity investments. Valuation of investments is performed under a number of different frameworks, depending upon the location and jurisdiction of the investment. Judgement is required to value these investments as prices are not publicly available and market volatility means such judgements can quickly become outdated, especially where there is a significant time period between the latest audited information and the Fund's reporting date. Any error in valuation or variation since the audited information could have a material impact upon the financial statements.

We have identified the valuation of the Fund's investments in private equity as a significant risk, as even a small change in assumptions could have a material impact upon the financial statements.

In the prior year we included private equity within the valuation of unquoted investments risk. Our assessment of the risk has not changed, but this year we are presenting it as a separate risk as our audit response to private equity investments is different to that of other unquoted investments.

#### What will we do?

- ▶ Document and walkthrough the process and design of the controls over the valuation process;
- ▶ Obtain third party confirmations of the valuation of private equity investments at the reporting date from investment managers;
- ▶ Review the relevant investment manager controls' reports for qualifications or exceptions that may affect the audit risk;
- ▶ Obtain the latest available audited accounts and agreeing the net asset value per the accounts to the net asset value included in the investment manager confirmations;
- ▶ Review the audit reports on the latest available audited accounts and evaluate the potential impact on the valuation of the Fund's investments of any exceptions noted;
- ▶ Where the latest available audited accounts do not have the same valuation date as the Fund's reporting date, review for reasonableness the movement in value between the date of the audited accounts and the valuation date;
- ▶ For investments held in a currency other than sterling, compare the exchange rate used to convert the investment value into sterling to historical market information on exchange rates at the reporting date; and
- ▶ Agree a sample of purchases and sales of private equity investments during the period to supporting evidence.

## Audit risks

# Our response to significant risks

### Valuation of directly held property

#### What is the risk?

The Fund has a significant portfolio of directly held property investments. The valuation of these properties is subject to a number of assumptions and judgements, small changes in which could have a significant impact upon the financial statements.

Within the Fund's directly held property are a number of retail property assets. Current market conditions within the retail sector mean the judgements and assumptions used to value these assets are particularly sensitive to market volatility.

We have identified the valuation of the Fund's directly held property as a significant risk, as even a small change in assumptions could have a material impact upon the financial statements.

#### What will we do?

- ▶ Document and walkthrough the process and design of the controls over the valuation process;
- ▶ Obtain the valuation report from the external valuer (Savills) and reconcile to the valuations used within the financial statements;
- ▶ Assess the qualifications and experience of the external valuer to ensure that they can be relied upon as management's experts; and
- ▶ Engage EY Property experts to review and challenge the assumptions used by the external valuer to ensure that they are in line with our expectations.

## Audit risks

### Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

#### What is the risk/area of focus?

##### IFRS16 - Leases

IFRS 16 Leases was issued by the IASB in 2016. Its main impact is to remove (for lessees) the traditional distinction between finance leases and operating leases. Finance leases have effectively been accounted for as acquisitions (with the asset on the balance sheet, together with a liability to pay for the asset acquired). In contrast, operating leases have been treated as “pay as you go” arrangements, with rentals expensed in the year they are paid. IFRS 16 requires all substantial leases to be accounted for using the acquisition approach, recognising the rights acquired to use an asset.

Implementation of IFRS 16 will be included in the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) for 2020/21. This Code has yet to be published, but in July 2019 CIPFA/LASAAC issued ‘IFRS 16 leases an early guide for practitioners’.

This early guidance provides comprehensive coverage of the requirements of the forthcoming provisions, including:

- ▶ the identification of leases;
- ▶ the recognition of right-of-use assets and liabilities and their subsequent measurement;
- ▶ treatment of gains and losses;
- ▶ derecognition and presentation and disclosure in the financial statements; and
- ▶ the management of leases within the Prudential Framework.

The guidance also covers the transitional arrangements for moving to these new requirements, such as:

- ▶ the recognition of right-of-use assets and liabilities for leases previously accounted for as operating leases by lessees; and
- ▶ the mechanics of making the transition in the 2020/21 financial statements (including the application of transitional provisions and the preparation of relevant disclosure notes).

#### What will we do?

IFRS 16 - Leases introduces a number of significant changes which go beyond accounting technicalities. For example, the changes have the potential to impact on procurement processes as more information becomes available on the real cost of leases.

The key accounting impact is that assets and liabilities in relation to significant lease arrangements previously accounted for as operating leases will need to be recognised on the balance sheet.

Although the new standard will not be included in the CIPFA Code of Practice until 2020/21, work will be necessary to secure information required to enable authorities to fully assess their leasing position and ensure compliance with the standard from 1 April 2020.

In particular, full compliance with the revised standard for 2020/21 is likely to require a detailed review of existing lease and other contract documentation prior to 1 April 2020 in order to identify:

- ▶ all leases which need to be accounted for;
- ▶ the costs and lease term which apply to the lease; and
- ▶ the value of the asset and liability to be recognised as at 1 April 2020 where a lease has previously been accounted for as an operating lease.

Management will need to include quantitative information on the anticipated impact of applying the new standard from 1 April 2020 within the 2019/20 financial statements.

Given the nature of the Fund, we do not expect the new standard to have a significant impact on the Fund's financial statements. We will however discuss management's evaluation of the impact of the new standard with them during the course of our 2019/20 audit.



## Other areas of audit focus

### What is the risk/area of focus?

#### Going Concern Compliance with ISA 570

This auditing standard has been revised in response to enforcement cases and well-publicised corporate failures where the auditor's report failed to highlight concerns about the prospects of entities which collapsed shortly after.

The revised standard is effective for audits of financial statements for periods commencing on or after 15 December 2019, which for the Fund will be the audit of the 2020/21 financial statements. The revised standard increases the work we are required to perform when assessing whether the Fund is a going concern. It means UK auditors will follow significantly stronger requirements than those required by current international standards; and we have therefore judged it appropriate to bring this to the attention of the Audit Committee.

The CIPFA Guidance Notes for Practitioners 2019/20 accounts states 'The concept of a going concern assumes that an authority's functions and services will continue in operational existence for the foreseeable future. The provisions in the Code in respect of going concern reporting requirements reflect the economic and statutory environment in which local authorities operate. These provisions confirm that, as authorities cannot be created or dissolved without statutory prescription, they must prepare their financial statements on a going concern basis of accounting.'

'If an authority were in financial difficulty, the prospects are thus that alternative arrangements might be made by central government either for the continuation of the services it provides or for assistance with the recovery of a deficit over more than one financial year. As a result of this, it would not therefore be appropriate for local authority financial statements to be provided on anything other than a going concern basis.'

### What will we do?

The revised standard requires:

- ▶ auditor's challenge of management's identification of events or conditions impacting going concern, more specific requirements to test management's resulting assessment of going concern, an evaluation of the supporting evidence obtained which includes consideration of the risk of management bias;
- ▶ greater work for us to challenge management's assessment of going concern, thoroughly test the adequacy of the supporting evidence we obtained and evaluate the risk of management bias. Our challenge will be made based on our knowledge of the Fund obtained through our audit, which will include additional specific risk assessment considerations which go beyond the current requirements;
- ▶ improved transparency with a new reporting requirement for public interest entities, listed and large private companies to provide a clear, positive conclusion on whether management's assessment is appropriate, and to set out the work we have done in this respect. While the Fund is not one of the three entity types listed, we will ensure compliance with any updated reporting requirements;
- ▶ a stand back requirement to consider all of the evidence obtained, whether corroborative or contradictory, when we draw our conclusions on going concern; and
- ▶ necessary consideration regarding the appropriateness of financial statement disclosures around going concern.

The revised standard extends requirements to report to regulators where we have concerns about going concern.

We will discuss the detailed implications of the new standard with finance staff during 2019/20 ahead of its application for 2020/21.



03

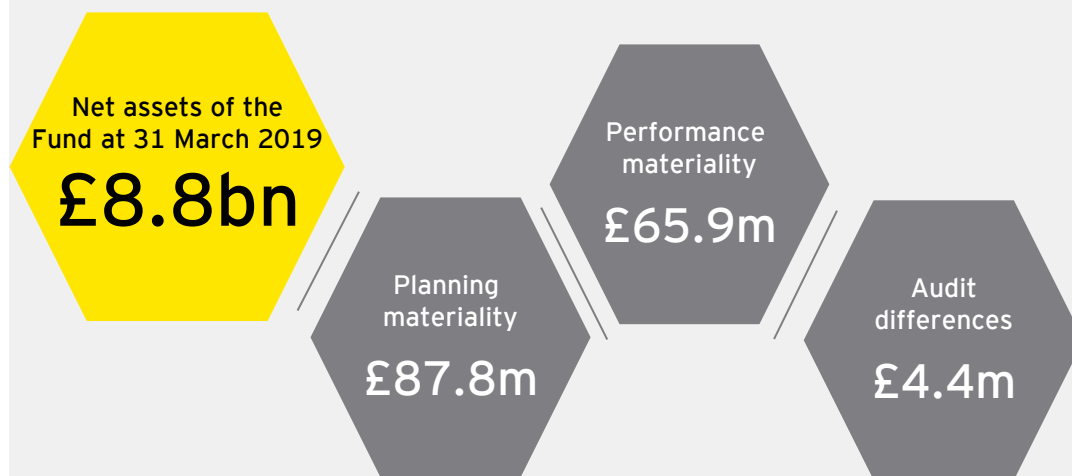
# Audit materiality



## Materiality

### Materiality

For planning purposes, materiality for 2019/20 has been set at £87.8m. This represents 1% of the Fund's net assets at 31 March 2019. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



We request that the Audit Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

### Key definitions

**Planning materiality** - the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

**Performance materiality** - the amount we use to determine the extent of our audit procedures. We have set performance materiality at £65.9m which represents 75% of planning materiality. We have used a 75% threshold as we have identified limited audit adjustments in previous years.

**Audit difference threshold** - we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the Fund Account and the Net Asset Statement.

Other uncorrected misstatements, such as reclassifications and misstatements within disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the audit committee, or are important from a qualitative perspective.



04

## Scope of our audit



## Our Audit Process and Strategy

### Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Fund's financial statements and the consistency of these financial statements with those disclosed within the Fund's Annual Report.

We issue an audit report that covers:

#### 1. Financial statement audit

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

#### Procedures required by standards

- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- Auditor independence.

#### 2. Consistency opinion

We are required to consider the consistency of the Fund's financial statements, which are included within the Fund's Annual Report, with the published financial statements of South Tyneside Council (the Administering Authority).

## Our Audit Process and Strategy (continued)

### Audit Process Overview

Our audit involves:

- ▶ Identifying and understanding the key processes and internal controls; and
- ▶ Substantive tests of detail of transactions and amounts.

For 2019/20 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.

### Analytics

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- ▶ Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- ▶ Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit Committee.

### Internal audit

We will regularly meet with Internal Audit, and review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.



05

## Audit team



## Audit team

# Audit team

The engagement team is led by Hassan Rohimun, who will have responsibility for ensuring that our audit delivers high quality and value to the Fund.

Mark Rutter will be the manager responsible for the day-to-day direction of audit work and is the key point for contact for the finance team. Mark is also the Engagement Manager for our audit of the Council.

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. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of directly held property investments	Savills (management's valuation specialists) EY Valuations Team
Pension liability disclosures	Aon Hewitt (management's actuarial specialists) EY Actuaries

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 Fund'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.





06

Audit timeline





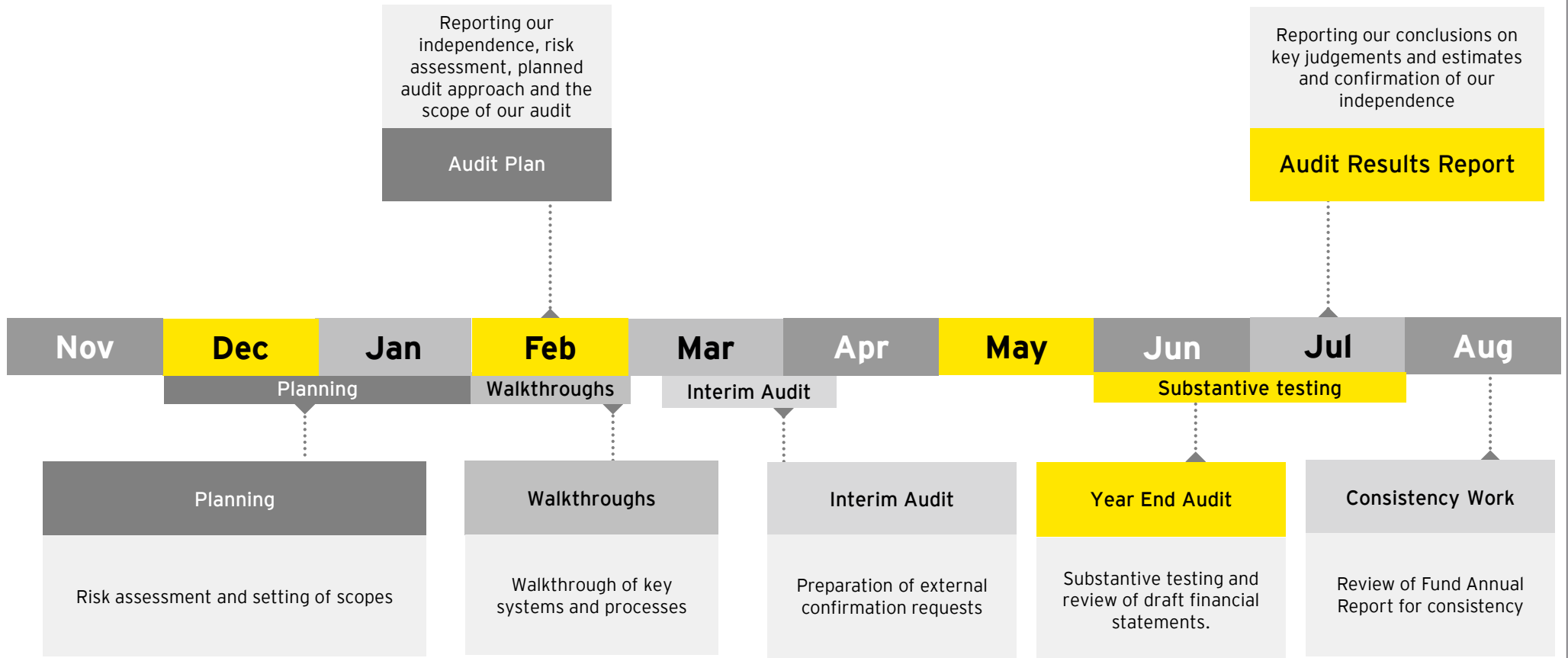
# Audit timeline

## Timetable of communication and deliverables

### Timeline

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 2019/20.

From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Audit Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.





07

Independence



## Introduction

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 communications

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; and</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 breach 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>

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, 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 services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted.

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, analysed in appropriate categories, are disclosed.

## 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 the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non-audit services if the service has been pre-approved in accordance with your policy.

### Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Hassan Rohimun, your audit engagement partner, and the audit engagement team have not been compromised.

### Self interest threats

A self interest threat arises when EY has financial or other interests in the Fund. Examples include 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 you. 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 you have approved.

None of the services are prohibited under the FRC's Ethical Standard or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, we do not provide any non-audit services to the Fund.

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 you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

There are no other 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 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 the Fund. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision 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.

## New UK Independence Standards

The Financial Reporting Council (FRC) published the Revised Ethical Standard 2019 in December and it will apply to accounting periods starting on or after 15 March 2020. A key change in the new Ethical Standard will be a general prohibition on the provision of non-audit services by the auditor (and its network) which will apply to UK Public Interest Entities (PIEs). A narrow list of permitted services will continue to be allowed.

### Summary of key changes

- Extraterritorial application of the FRC's Ethical Standard to UK PIEs and their worldwide affiliates;
- A general prohibition on the provision of non-audit services by the auditor (or its network) to a UK PIE, its UK parent and worldwide subsidiaries;
- A narrow list of permitted services where closely related to the audit and/or required by law or regulation;
- Absolute prohibition on the following relationships applicable to UK PIE and its affiliates including material significant investees/investors:
  - Tax advocacy services;
  - Remuneration advisory services;
  - Internal audit services; and
  - Secondment/loan staff arrangements;
- An absolute prohibition on contingent fees;
- Requirement to meet the higher standard for business relationships i.e. business relationships between the audit firm and the audit client will only be permitted if it is inconsequential;
- Permitted services required by law or regulation will not be subject to the 70% fee cap;
- Grandfathering will apply for otherwise prohibited non-audit services that are open at 15 March 2020 such that the engagement may continue until completed in accordance with the original engagement terms;
- A requirement for the auditor to notify the Audit Committee where the audit fee might compromise perceived independence and the appropriate safeguards;
- A requirement to report to the audit committee details of any breaches of the Ethical Standard and any actions taken by the firm to address any threats to independence. A requirement for non-network component firm whose work is used in the group audit engagement to comply with the same independence standard as the group auditor. Our current understanding is that the requirement to follow UK independence rules is limited to the component firm issuing the audit report and not to its network. This is subject to clarification with the FRC.

### Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under FRC Revised Ethical Standard 2016 which will continue to apply until 31 March 2020 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 1 April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.

We do not provide any non-audit services which would be prohibited under the new standard.

## Other communications

### EY Transparency Report 2019

Ernst & Young (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 in place 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 period ended 28 June 2019 (published September 2019):

[https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_uk/about-us/transparency-report-2019/ey-uk-2019-transparency-report.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2019/ey-uk-2019-transparency-report.pdf)



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## Appendices





## Appendix A

### Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Scale fee 2019/20	Final fee 2019/20	Final Fee 2018/19
	£	£	£
Total Fee - Code work	27,449	TBC	27,449
<b>Total audit</b>	<b>27,449</b>	<b>TBC</b>	<b>27,449</b>
Total other non-audit services	-	-	-
<b>Total fees</b>	<b>27,449</b>	<b>TBC</b>	<b>27,449</b>

#### *All fees exclude VAT*

(1) We wrote to management and the Audit Committee Chair on 10 February setting out our considerations on the sustainability of UK local public audit. A base scale fee of £27,449 has been set by PSAA for the 2019-20 audit but we will be having further discussions with management and the Committee on the level of scale fee variation to be applied. Some of the factors relevant to this discussion are set out on the next slide.

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by management; and
- The Fund has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with management in advance.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

## Fees

### Summary of key factors

1. **Audit of estimates:** There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.
2. **Regulatory environment:** Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice, are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.
3. **Resourcing:** As a result of the above, public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality. We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.





To respond to these factors we have to:

- Increase our sample sizes, seek higher levels of corroborative evidence and engage with our internal specialists on a wider array of matters;
- Increase our investment in data analytics tools to allow us to test more transactions to a greater level of detail and enhance audit quality;
- Invest in our audit quality infrastructure, as a firm our compliance costs have doubled as a proportion of revenue over the past five years.

## Appendix B





# Required communications with the Audit Committee

We have detailed below the communications that we must provide to the Audit Committee.

		 Our Reporting to you
<b>Required communications</b>	 <b>What is reported?</b>	  <b>When and where</b>
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Planning Report (this report)
Significant findings from the audit	<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; and</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> </ul>	Audit Results Report





## Appendix B

# Required communications with the Audit Committee (continued)

		 Our Reporting to you
Required communications	 What is reported?	  When and where
Going concern	<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; and</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	Audit Results Report
Misstatements	<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>▶ Corrected misstatements that are significant; and</li> <li>▶ Material misstatements corrected by management</li> </ul>	Audit Results Report
Fraud	<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; and</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	Audit Results Report
Related parties	<ul style="list-style-type: none"> <li>▶ Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</li> <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; and</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	Audit Results Report





## Appendix B

# Required communications with the Audit Committee (continued)

			 Our Reporting to you
Required communications	 What is reported?	  When and where	
Independence	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, 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;</li> <li>▶ Safeguards adopted and their effectiveness;</li> <li>▶ An overall assessment of threats and safeguards; and</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	Audit Planning Report; and Audit Results Report	
External confirmations	<ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations; and</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	Audit Results Report	
Consideration of laws and regulations	<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; and</li> <li>▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of.</li> </ul>	Audit Results Report	
Internal controls	<ul style="list-style-type: none"> <li>▶ Significant deficiencies in internal controls identified during the audit</li> </ul>	Audit Results Report; and Management Letter	

## Appendix B

# Required communications with the Audit Committee (continued)

			 Our Reporting to you
<b>Required communications</b>	 <b>What is reported?</b>	  <b>When and where</b>	
Representations	Written representations we are requesting from management and/or those charged with governance		Audit Results Report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise.		Audit Results Report
Auditors report	Any circumstances identified that affect the form and content of our auditor's report.		Audit Results Report
Fee Reporting	<ul style="list-style-type: none"> <li>▶ Breakdown of fee information when the audit plan is agreed;</li> <li>▶ Breakdown of fee information at the completion of the audit; and</li> <li>▶ Any non-audit work</li> </ul>		Audit Planning Report; and Audit Results Report

## Additional audit information

### Other required procedures during the course of the audit

In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

#### Our responsibilities required by auditing standards

- ▶ 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 Fund'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;
- ▶ Reading other information contained in the financial statements, including the Audit Committee reporting appropriately addresses matters communicated by us to the Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- ▶ Maintaining auditor independence.

## Appendix C

# Additional audit information (continued)

### Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in 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.

Materiality determines:

- ▶ The locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- ▶ The level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.



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## External Audit Plan for 2019/20 Accounts

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**The following is a list of the background papers (excluding exempt papers) relied upon in the preparation of the above report:**

<b>Background Paper</b>	<b>File Ref:</b>	<b>File Location</b>
Annual Report and Accounts File 2019/20		Investments Office, South Shields Town Hall