

Audit Plan

Year end 31 March 2014

London Borough of Merton Pension Fund

March 2014

Ernst & Young LLP





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INVESTOR IN PEOPLE

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28 February 2014

Dear Members

Audit Plan

We are pleased to attach our Audit Plan, which sets out how we intend to carry out our responsibilities as auditor. The purpose of this report is to provide the General Purposes Committee with a basis for reviewing our proposed audit approach and scope for the 2013-14 audit in accordance with the requirements of the Audit Commission Act 1998, the Code of Audit Practice, the Standing Guidance, auditing standards and other professional requirements. It also ensures that our audit is aligned with the Committee's service expectations.

This report summarises our assessment of the key risks which drive the development of an effective audit for the London Borough of Merton Pension Fund, and outlines our planned audit strategy in response to those risks.

We welcome the opportunity to discuss this report with you on 12 March 2014 – and also at the Pension Fund Advisory Committee on 19 March 2014 - as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Peter O'Neill
For and behalf of Ernst & Young LLP
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1. Overview

Context for the audit

This audit plan covers the work that we plan to perform in order to provide you with our audit opinion on whether the financial statements of the London Borough of Merton Pension Fund give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2014 and of the income and expenditure for the year then ended..

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.
- ▶ Management's views on all of the above.

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

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

In part 2 of this report we provide more detail on the areas which we believe present significant risk to the financial statements audit. We also outline our plans to address these risks.

Details of our audit process and strategy are set out in Section 3.

2. Financial Statement Risks

We outline below our assessment of the financial statement risks facing you, identified through our knowledge of the entity's operations and discussion with members and officers.

We aim to validate these with you at our meeting.

There is one significant risk identified for this audit. This risk applies to all clients.

Significant risks (including fraud risks)	Our audit approach
Risk of management override	
As identified in ISA (UK & Ireland) 240, management is in a unique position to perpetrate fraud. This is because of its ability to manipulate accounting records (directly or indirectly) and to prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our approach will focus on: <ul style="list-style-type: none"> ▶ testing the appropriateness of journal entries in the general ledger and other adjustments made in the preparation of the financial statements; ▶ reviewing accounting estimates for evidence of management bias; and ▶ evaluating the business rationale for significant unusual transactions.

There are no other financial statement risks arising from our planning and work to date.

Respective responsibilities in relation to fraud and error

We would like to take this opportunity to remind you that management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements caused by either error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility of a material misstatement due to fraud, and design the appropriate procedures to consider such a risk.

Based on the requirements of auditing standards our approach will focus on:

- ▶ identifying fraud risks during the planning stages.
- ▶ asking management about the risks of fraud and controls to address those risks.
- ▶ understanding how those charged with governance oversee management's processes over fraud.
- ▶ considering the effectiveness of management's controls designed to address the risk of fraud.
- ▶ determining an appropriate strategy to address those risks.
- ▶ performing mandatory procedures, regardless of specifically identified fraud risks.

3. Our audit process and strategy

3.1 Objective and scope of our audit

Under the Audit Commission's Code of Audit Practice ('the Code'), dated March 2010, our principal objectives are to review and report on, to the extent required by the relevant legislation and the requirements of the Code, your financial statements.

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

3.2 Audit process overview

Our audit involves:

- ▶ assessing the key internal controls in place and testing the operation of these controls;
- ▶ where relevant, review and re-performance of the work of your internal auditors;
- ▶ reliance on the work of other auditors where appropriate;
- ▶ reliance on the work of experts in relation to areas such as valuation of the Pension Fund; and
- ▶ substantive tests of detail of transactions and amounts.

Processes

Our initial assessment of the key processes across the entity has identified the following key processes, both manual and IT:

- ▶ Contributions receivable
- ▶ Fund administration - Lump sum and retirement benefits
- ▶ Transfers in and out of the Pension Fund
- ▶ Cash and bank processes
- ▶ Pension payroll
- ▶ Investments; and
- ▶ Financial statements close procedures.

We will also undertake work in accordance with our IAS 19 protocol to provide information on which relevant admitted bodies of the London Borough of Merton Pension Fund can place reliance when preparing their financial statements.

Analytics

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular in respect of payroll, cash payments and receipts and journal entries. We will carry out this work in conjunction with that for the Merton Council audit. 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 General Purposes Committee.

Use of Administering Authority Payroll Data

As the majority of contributions paid to the Pension Fund are from the Council as administering authority, we would request access to salary data for the Council's employees to assist us with the audit.

Internal audit

As in prior years, we will review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from other work completed in the year, in our detailed audit plan, where issues are raised that could have an impact on the year-end financial statements.

Use of experts

In producing the financial statements, management will place reliance on the work undertaken by experts. We anticipate being able to undertake sufficient procedures such that we will be able to place reliance on the work undertaken by management's experts.

We also anticipate relying on the work of the experts commissioned by the Audit Commission in respect of the work undertaken by the pension scheme actuary appointed by Merton.

We will utilise specialist EY resource, as necessary, to help us to form a view on judgments made in the financial statements. Our plan currently includes the involvement of specialists in pensions.

Mandatory procedures required by auditing standards

In addition to the financial statement risks outlined in section 2, we must 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.

- ▶ 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.
- ▶ Auditor independence.

Procedures required by the Code

- ▶ Reviewing, and reporting as appropriate, other information published with the financial statements, including the Annual Report.
- ▶ Reviewing, and where appropriate examining, evidence relevant to your corporate performance management and financial management arrangements and reporting on these arrangements.

3.3 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 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 have determined that overall materiality for the financial statements of the Pension Fund is £9.124million based on 2% of net assets.

We will communicate uncorrected audit misstatements greater than £456,000 to you.

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 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.

3.4 Fees

The Audit Commission has published a scale fee for all authorities. This is defined as the fee required by auditors to meet statutory responsibilities under the Audit Commission Act in accordance with the Code of Audit Practice 2010. The indicative fee scale for the audit of the London Borough of Merton Pension Fund is £21,000.

3.5 Your audit team

The engagement team is led by Peter O'Neill who leads EY's pension's assurance team. Peter is supported by Michael Yeats who is responsible for the day-to-day direction of audit work, and who is the key point of contact for your finance and pension teams. Peter is planning to retire later this year at which point we will update the General Purposes Committee on the new Pensions engagement partner.

David Wilkinson leads our overall engagement with Merton Council and our relationship with the General Purposes Committee.

3.6 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the committee cycle in 2013-14. These dates are determined to ensure our alignment with the Audit Commission's rolling calendar of deadlines.

We will provide a formal report to the General Purposes Committee in September 2014, incorporating the outputs from our 2013-14 audit. We will also provide a progress report to the March and June 2014 meetings of the General Purpose Committee, and to the pension Fund Advisory Committee, on our progress on the various elements of our audit. From time to time matters may arise that require immediate communication with the General Purposes Committee and we will discuss them with the General Purposes Committee Chair, and Chair of the Pension Fund Advisory Committee, as appropriate.

Following the conclusion of our audit we will prepare an annual audit letter to communicate to you and external stakeholders, including members of the public, the key issues arising from our work.

Our audit process and strategy

Audit phase	Timetable	General Purposes Committee timetable	Deliverables
High level planning:	December 2013 / January 2014		Audit Fee letter (presented to 27 June 2013 General Purposes Committee)
Risk assessment and setting of scopes	December/ January	12 March 2014 Committee	Audit Plan Audit Progress Report
Testing of routine processes and controls	January/ February 2014	26 June 2014 Committee	Audit Progress Report
Year-end audit	July – September	25 September 2014 Committee	Report to those charged with governance Audit report (including our opinion on the financial statements) Audit completion certificate
	November	6 November 2014 Committee	Annual Audit Letter

In addition to the above formal reporting and deliverables we will seek to provide practical business insights and updates on regulatory matters.

4. Independence

4.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 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 independence and objectivity. The Ethical Standards, as revised in December 2010, require 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"> ▶ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between you, your affiliates and directors and us; ▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▶ The overall assessment of threats and safeguards; ▶ Information about the general policies and process within EY to maintain objectivity and independence. 	<ul style="list-style-type: none"> ▶ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, 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; ▶ Details of non-audit services provided and the fees charged in relation thereto; ▶ Written confirmation that we are independent; ▶ Details of any inconsistencies between APB Ethical Standards, the Audit Commission's Standing Guidance and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ▶ An opportunity to discuss auditor independence issues.

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.

4.2 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. However we have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective.

Self- interest threats

A self interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with 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 and that are in compliance with the Audit Commission's Standing Guidance

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 4.

We have considered the relevant guidance and confirm 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.

We have considered the relevant guidance and confirm 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 your entity. 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.

We have considered the relevant guidance and confirm there are no management threats at the date of this report

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

We have considered the relevant guidance and confirm there are no other threats at the date of this report

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 Peter O'Neill, your audit engagement partner and the audit engagement team have not been compromised.

4.3 Other required communications

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 year ended 28 June 2013 and can be found here:

<http://www.ey.com/UK/en/About-us/EY-UK-Transparency-Report-2013>

Appendix A Fees

A breakdown of our agreed fee is shown below.

	Planned Fee 2013-14	Actual Fee 2012-13	Explanation of variance
	£	£	
Total Audit Fee – Code work	21,000	21,000	
Non-audit work (provide details)	0	0	

Indicative fee

The agreed fee presented above is based on the following assumptions:

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ We are able to place reliance, as planned, on the work of internal audit;
- ▶ The level of risk in relation to the audit of accounts is consistent with that in the prior year (where we have prior year experience);
- ▶ Our accounts opinion being unqualified
- ▶ Appropriate quality of documentation is provided by the audited body
- ▶ 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 you in advance.

Appendix B UK required communications with those charged with governance.

There are certain communications that we must provide to the audit committee of audited clients. These are detailed here:

Required communication	Reference
<p>Planning and audit approach</p> <p>Communication of the planned scope and timing of the audit including any limitations.</p>	Audit Plan
<p>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Significant difficulties, if any, encountered during the audit ▶ Significant matters, if any, arising from the audit that were discussed with management ▶ Written representations that we are seeking ▶ Expected modifications to the audit report ▶ Other matters if any, significant to the oversight of the financial reporting process 	Report to those charged with governance
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ In writing, corrected misstatements that are significant 	Report to those charged with governance
<p>Fraud</p> <ul style="list-style-type: none"> ▶ Enquiries of the audit committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▶ A discussion of any other matters related to fraud 	Report to those charged with governance
<p>Related parties</p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the entity 	Report to those charged with governance
<p>External confirmations</p> <ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures 	Report to those charged with governance
<p>Consideration of laws and regulations</p> <ul style="list-style-type: none"> ▶ 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 	Report to those charged with governance

Required communication	Reference
<ul style="list-style-type: none"> ▶ 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 	
<p>Independence</p> <p>Communication of all significant facts and matters that bear on EY's objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence <p>For listed companies, communication of minimum requirements as detailed in the ethical standards:</p> <ul style="list-style-type: none"> ▶ Relationships between EY, the audited body and senior management ▶ Services provided by EY that may reasonably bear on the auditors' objectivity and independence ▶ Related safeguards ▶ Fees charged by EY analysed into appropriate categories such as statutory audit fees, tax advisory fees, other non-audit service fees ▶ A statement of compliance with the ethical standards ▶ The audit committee should also be provided an opportunity to discuss matters affecting auditor independence 	<p>Audit Plan</p>
<p>Going concern</p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	<p>Report to those charged with governance</p>
<p>Significant deficiencies in internal controls identified during the audit</p>	<p>Report to those charged with governance</p>
<p>Fee Information</p> <ul style="list-style-type: none"> ▶ Breakdown of fee information at the agreement of the initial audit plan ▶ Breakdown of fee information at the completion of the audit 	<p>Annual Report to those charged with governance Annual Audit Letter</p>

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