CITY OF LONDON PENSION FUND

AUDIT FINDINGS REPORT

Audit for the year ended 31 March 2016 - Issued to the Audit and Risk Management Committee - 07 September 2016

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PURPOSE AND USE OF THIS REPORT

We present our Audit and Risk Management Committee Report which details the key findings arising from the audit for the attention of those charged with governance. It forms a key part of our communication strategy with you, a strategy which is designed to promote effective two way communication throughout the audit process.

We have updated the report and highlighted changes in green compared to the report we issued to the Audit and Risk Management Committee on 18 July 2016.

As auditors we are responsible for performing our audit in accordance with International Standards on Auditing (UK & Ireland) which provide us with a framework which enables us to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management nor those charged with governance of their responsibilities for the preparation of the financial statements.

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the pension fund financial statements. As the purpose of the audit is for us to express an opinion on the financial statements, you will appreciate that our audit cannot necessarily be expected to disclose all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist. As part of our work, we considered internal control relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. This work was not for the purpose of expressing an opinion on the effectiveness of internal control.

This report has been prepared solely for the use of the Audit and Risk Management Committee. In preparing this report we do not accept or assume responsibility for any other purpose or to any other person.

We would like to thank staff for their co-operation and assistance during the audit to date and throughout the period.

CONTENTS

SUMMARY

AUDIT SCOPE AND OBJECTIVES

- We have completed our audit procedures in accordance with the planned scope and our objectives have been achieved, subject to the completion of the remaining work set out in the outstanding matters section of this report.
- There were no significant changes to our planned audit approach nor were any restrictions placed on our work.
- No additional significant audit risks were identified during the course of our audit procedures subsequent to our audit planning report to you dated February 2016
- Our materiality levels have not required reassessment since our audit planning referred to above.
- Our observations on the quality of the audit and our audit independence and objectivity and related matters are set out in Appendix IV and II below.

AUDIT OPINION

- Subject to the successful completion of the outstanding work we anticipate issuing an unqualified opinion on the pension fund financial statements for the year ended 31 March 2016
- Our review of the Annual Report is in progress. We will provide a verbal update on the findings from the review to the Audit and Risk Management Committee as part of September 2016 meeting.

KEY AUDIT AND ACCOUNTING MATTERS

The key matters that have arisen in the course of our audit are summarised below:

i. We have recommended that audit evidence is retained at the time of producing the accounts to ensure that that there is a sufficient audit trail to support the disclosure of membership numbers.

ii. We have recommended that management liaise with fund managers as soon as possible to encourage them to implement the necessary steps in order for them to provide relevant management expense information for the 2016/17 accounts.

iii. Fund manager fee expenses in 2015/16 are overstated by £350,000 because the 2014/15 final quarter fee has been included in the 2015/16 accounts because it was not accrued for in the prior period in respect of Carnegie pooled equity fund manager.

iv. Management has confirmed that the accounting policy will be updated to clearly state the period to which fund manager fees relate.

v. All private equity fund valuations provided agree to the accounts except for two which have understated the valuations by £531,000 due to errors in deriving the year end balances. This will be corrected in the next version of the financial statements.

vi. Although there will be no impact on the year-end investment valuation disclosed in the accounts, total distribution (sales) of £1.46 million from standard life private equity and total purchases of £274,000 from Veritas pooled funds were incorrectly classified. Management are currently reviewing the original transactions made in order to correct the treatment.

vii. We have identified a small number of disclosures that should be included in the accounts as set out in the CIPFA disclosure checklist in respect of the funded obligation of the overall pension fund. We have also identified some discrepancies between a number of the assumption figures disclosed in the accounts compared to the actuary report. Management will include/correct the disclosures in the next version of the financial statements.

KEY AUDIT AND ACCOUNTING MATTERS

SIGNIFICANT AUDIT RISKS

We reported our risk assessment, which brought to your attention areas that require additional or special audit consideration and are considered significant audit risks, in the 2015/16 audit planning report dated February 2016. These significant risks have been highlighted in red and findings have been reported in the following table.

We have since undertaken a more detailed assessment of risk following the completion of our review of the Authority's internal control environment and draft financial statements, and we have not identified any additional significant risks.

NATURE OF RISK	RELATED CONTROLS / RESPONSE TO RISK	HOW THE RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION AND RECOMMENDATION
MANAGEMENT OVERRIDE OF CONTROLS	Auditing standards presume that a risk of management override of controls is present in all entities. By its nature, there are no controls in place to mitigate the risk of management override	We are required to respond to this risk by testing the appropriateness of accounting journals and other adjustments to the financial statements, reviewing accounting estimates for possible bias and obtaining an understanding of the business rationale of significant transactions that appear to be unusual.	Our audit work in relation to journals and estimates is in progress. Work to date has not identified any significant issues. We will update the Audit and Risk Management Committee at the meeting on 13 September with the results of our testing.
REVENUE RECOGNITION	Auditing standards presume that income recognition presents a fraud risk. For pension funds, the risk can be identified as affecting the completeness, accuracy and existence of contributions income.	We have carried out audit procedures to gain an understanding of the pension fund's internal control environment for receiving and recording contributions income in accordance with the schedule of contributions, including how this operates to prevent loss of income and ensure that income is recognised in the correct accounting period.	Our review of key controls in respect of contributions receivable found no significant weaknesses. However, we have identified differences between payroll listings and the accounts in relation to contribution amounts for both employee and employer contributions for the City of London and Museum of London. Management has carried out a reconciliation exercise and corrected mis-coding of contributions between the City of London and Museum of London. The corrections are below our reporting threshold and other differences originally identified have been resolved.

KEY AUDIT AND ACCOUNTING MATTERS
Continued

NATURE OF RISK	RELATED CONTROLS / RESPONSE TO RISK	HOW THE RISK WAS ADDRESSED BY OUR AUDIT	CONCLUSION AND RECOMMENDATION
REVENUE RECOGNITION (CONTINUED)		We have performed an examination, on a test basis, of evidence relevant to the amounts and timing of contributions receivable to the fund including checking to employer payroll records, where relevant. We have checked a sample of contributions receivable from the Corporation to the payroll records to ensure that the correct amounts have been paid by the employee and employer. For other significant admitted and scheduled bodies, we have selected a sample of bodies and requested confirmation from that organisation that the correct amounts have been paid to the pension fund for selected employees.	Our testing has not identified any issues with the timings of contributions receivable to the fund or the accuracy of the amounts paid by the employer or employee.

KEY AUDIT AND ACCOUNTING MATTERS
Continued

OTHER AUDIT RISKS AND ACCOUNTING ISSUES

We report below our findings of the work designed to address all other risks identified in our 2015/16 audit planning report and any other relevant audit and accounting issues identified as a result of our audit.

NATURE OF RISK	WORK PERFORMED AND FINDINGS	CONCLUSION
INVESTMENT MANAGEMENT EXPENSES	Local Government Pension Fund Accounts are required to disclose investment management expenses. Management expenses included in the pension fund accounts represents the fee for the service provided by and any performance related fees in relation to the fund manager. However, fund managers do not ordinarily provide information on any 'hidden' fees included in investing contributions. These fees are deducted when the investment is made by the fund manager and hence is included in realised gains or losses or the change in market value of investments. The Financial Conduct Authority criticised the investment management industry for not reporting charges to investors sufficiently clearly. In particular, it criticised the annual management charge as failing 'to provide investors with a clear, combined figure for charges.' Last year, CIPFA issued guidance on obtaining and separately presenting these additional charges in the fund accounts. While not mandatory to report these costs separately, there is a clear expectation that LGPS fund accounts do observe this guidance. We have reviewed investment management expenses and have found that fund managers have not provided the relevant information for management to separate out these fees in the financial statements.	We recommend that management liaise with fund managers as soon as possible to encourage them to implement the necessary steps in order for them to provide relevant management expense information for the 2016/17 accounts.

KEY AUDIT AND ACCOUNTING MATTERS
Continued

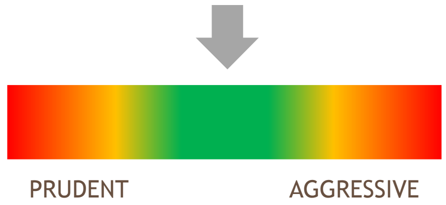
NATURE OF RISK	WORK PERFORMED AND FINDINGS	CONCLUSION
MEMBERSHIP DISCLOSURE	Membership information including the number of current contributors, deferred beneficiaries and pensioners by employer is required to be disclosed. There is a risk that the membership database may not be accurate and up to date to support this disclosure. We have identified differences between payroll listings and the accounts in relation to membership numbers. We have discussed these differences with management who have explained that because the report provided to support the numbers in the financial statements was ran after the 31 March 2016 it will not reconcile to the accounts. This is because the system is updated on a daily basis with more current information that could be backdated to the 2015/16 financial year. The report used to support membership numbers was not retained at the time of producing the accounts. The differences we have identified between the payroll listing provided and the accounts is as follows: current contributors understated by 20, beneficiaries in receipt of pension overstated by 71 and deferred benefits understated by 10, total headcount overstated by 41.	Our testing has been based on the payroll listings and we have not identified any issues in respect of transactions recorded in the fund. We recommend that audit evidence is retained at the time of producing the accounts to ensure that that there is a sufficient audit trail to support the disclosure of membership numbers.
CONSIDERATION OF RELATED PARTY TRANSACTIONS	We consider if the disclosures in the financial statements concerning related party transactions are complete and adequate and in line with the requirements of the accounting standards.	Our testing has not identified any issues.
ACCRUED FUND MANAGER PERFORMANCE FEES	Our testing of fund manager performance fees has identified that amounts have not been accrued to the correct year but instead have been recorded when the amounts fall due.	Management has reviewed correspondence with its fund managers and identified an amount of £300,000 to be accrued for the final quarter of 2015/16 in respect of Carnegie pooled equity fund manager fees. Management will amend the next version of the financial statements to include this accrual. This will mean that fund manager fee expenses are overstated by £350,000 because the final quarter of 2014/15 has been included in the 2015/16 accounts because it was not accrued for in the prior period. This adjustment will mean only 12 months (including a year end accrual) worth of fund manager fees are included in the accounts going forward. All other fund manager performance fees are accounted for when they fall due (see the accounting policy finding for further details of this issue).

KEY AUDIT AND ACCOUNTING MATTERS
Continued

ACCOUNTING ESTIMATES

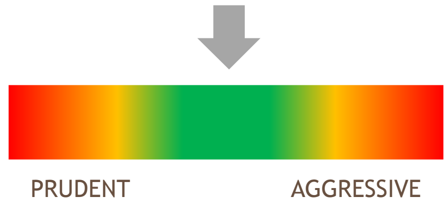
Our views on significant estimates, including any valuations of material assets and liabilities, arrived at the preparation of your financial statements are set out below:

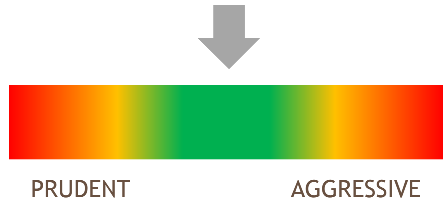
ESTIMATES	AUDIT FINDINGS AND CONCLUSIONS
FAIR VALUE OF INVESTMENTS (PRIVATE EQUITY) The investment portfolio includes unquoted private equity holdings valued by the fund manager. The valuation of private equity assets may be subject to a significant level of assumption and estimation and valuations may not be based on observable market data. In some cases, the valuations are provided at dates that are not coterminous with the pension fund's year end and need to be updated to reflect cash transactions (additional contributions or distributions received) since the latest available valuations. As a result, we consider there to be a significant risk that investments are not appropriately valued in the financial statements.	Year-end valuations for all private equity and underlying assets and fund valuations are as at 31 December 2015. Appropriate adjustments to reflect cash transactions (additional contribution or distributions received) between January and March have been made to the 31 December year-end position to bring the valuation in line with a 31 March 2016 close. All fund valuation confirmations agree to the accounts except for two which have understated the investment balance by a net £531,000 due to errors in deriving the year end balances. This will be corrected in the next version of the financial statements. Although there will be no impact on the year-end investment valuation disclosed in the accounts, total distribution (sales) of £1.46 million from standard life private equity funds were incorrectly classified as a net loss. This will be corrected in the next version of the financial statements.



KEY AUDIT AND ACCOUNTING MATTERS
Continued

ESTIMATES	AUDIT FINDINGS AND CONCLUSIONS
FAIR VALUE OF INVESTMENTS (POOLED INVESTMENTS) The fair value of funds (pooled investments) is provided by individual fund managers and reported on a quarterly basis. These funds are quoted on active markets. There is a risk that investments may not be appropriately valued and correctly recorded in the financial statements.	All direct confirmations have been received and agreed to the accounts with no exceptions. Although there will be no impact on the year-end investment valuation disclosed in the accounts, total purchases of £274,000 from the Veritas pooled fund were incorrectly classified as a net gain. This will be corrected in the next version of the financial statements. Our work did not identify any issues in respect of agreeing the valuations to readily available data (such as Bloomberg).
PENSION LIABILITY ASSUMPTIONS An actuarial estimate of the pension fund liability to pay future pensions is calculated by an independent firm of actuaries with specialist knowledge and experience. The estimate is based on the most up to date membership data held by the pension fund and has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation when calculating the liability. There is a risk the valuation uses inappropriate assumptions to value the liability.	Pension disclosures are required in line with IAS 26 (Accounting and reporting of retirement benefit plans). The information required for the disclosures is provided by the actuary (Barnet Waddingham). The information provided is calculated using a number of estimates and assumptions. We have compared the assumptions and estimates used by the actuary with the expected ranges provided by the independent consulting actuary. We are satisfied that the assumptions used are not unreasonable or outside of the expected ranges.





KEY AUDIT AND ACCOUNTING MATTERS
Continued

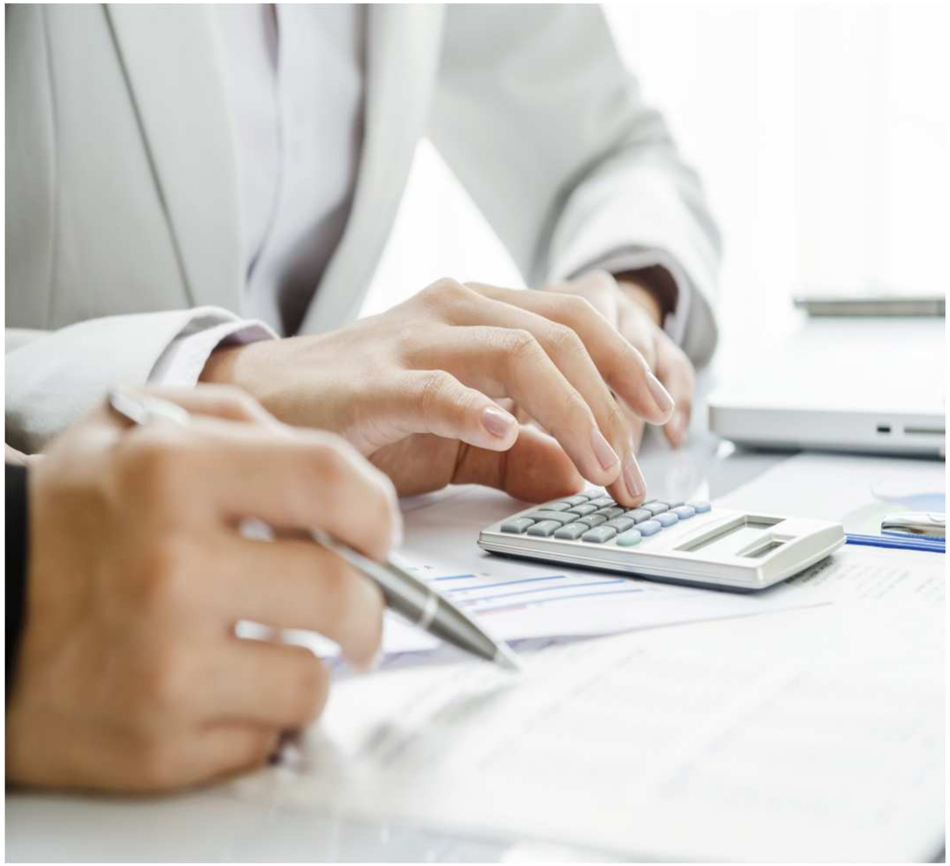
FINANCIAL STATEMENT DISCLOSURES	
Our views on the sufficiency and content of your financial statements' disclosures are set out below:	
DISCLOSURE AREA	**AUDIT FINDINGS AND CONCLUSIONS**
ACCOUNTING POLICIES	There is no formal process or control over the review of investment management expense for private equity investments to ensure that changes are in line with the mandate of the fund manager. There is no process to review and accrue for estimated performance fees where fund managers year end is not conterminous with the year end of the fund. Where fund manager has not provided data for investment expense for the full year there is no process by management to determine or estimate the expense for the period not covered by the fund manager data. Since reporting this to the Audit and Risk Management committee on 18 July 2016 management has reviewed correspondence with its fund managers and accrued an amount for the final quarter of 2015/16 for Carnegie pooled equity fund manager (see accrued fund manager performance fees finding above for details of this adjustment). All other fund manager performance fees are accounted for when they fall due. It has been concluded that because there are four quarters worth of expenses in the accounts at any time (albeit the first quarter relates to the final quarter of the last financial year), for the remaining fund managers there is unlikely to be a significant difference between the amounts relating to the prior financial year the final quarter of the current financial year if it were to be accrued. Management has confirmed that the accounting policy will be updated to clearly state the period to which management fees relate.
PENSION LIABILITY DISCLOSURE	We have identified a small number of disclosures that should be included in the accounts as set out in the CIPFA disclosure checklist in respect of the funded obligation of the overall pension fund. We have also identified some discrepancies between a number of the assumption figures disclosed in the accounts compared to the actuary report. Management will include/correct the disclosures next version of the financial statements.

OUTSTANDING MATTERS

We have substantially completed our audit work in respect of the risk areas identified for financial statements for the year ended 31 March 2016, and anticipate issuing an unqualified opinion on the financial statements if no significant issues are identified in the work that remains to be completed.

The following matters are outstanding at the date of this report. We will provide a verbal update on these matters to the Audit and Risk Management Committee as part of September 2016 meeting:

1. Completion of the review of journals.
2. Review of the amended financial statements and annual report.
3. Subsequent events review.
4. Management representation letter to be approved and signed.



CONTROL ENVIRONMENT
Significant deficiencies

We are required to report to you, in writing, significant deficiencies in internal control that we have identified during the audit. These matters are limited to those which we have concluded are of sufficient importance to merit being reported to you.

As the purpose of the audit is for us to express an opinion on the pension fund's financial statements, you will appreciate that our audit cannot necessarily be expected to disclose all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist. As part of our work, we considered internal control relevant to the preparation of the financial statements such that we were able to design appropriate audit procedures. This work was not for the purpose of expressing an opinion on the effectiveness of internal control.

No significant control deficiencies have been identified.

APPENDICES

APPENDIX I: MATERIALITY

MATERIALITY - FINAL AND PLANNING

	FINAL	PLANNING
Pension fund overall materiality	£8,200,000	£8,200,000
Fund account specific materiality	£1,500,000	£1,500,000
Clearly trivial threshold	£160,000	£160,000

Planning materiality for the pension fund financial statements was based on 1% of prior year net assets. Specific materiality was set of 5% at prior year contributions for the fund accounts. The clearly trivial amount is based on 2% of the overall materiality level.

We had no reason to revise our final materiality level.

APPENDIX II: INDEPENDENCE

INDEPENDENCE - ENGAGEMENT TEAM ROTATION		
SENIOR TEAM MEMBERS	**NUMBER OF YEARS INVOLVED**	**ROTATION TO TAKE PLACE IN YEAR ENDED**
LEIGH LLOYD-THOMAS - Audit engagement partner	1st year	31 March 2021
KERRY BARNES - Audit manager	1st year	31 March 2026

APPENDIX II: INDEPENDENCE

Continued

INDEPENDENCE - THREATS TO INDEPENDENCE AND APPROPRIATE SAFEGUARDS
We have confirmed that we have not provided any non audit services. We are not aware of any financial, business, employment or personal relationships between the audit team, BDO and the Authority. We confirm that the firm complies with the FRC's Ethical Standards and, in our professional judgement, is independent and objective within the meaning of those Standards. In our professional judgement the policies and safeguards in place ensure that we are independent within the meaning of all regulatory and professional requirements and that the objectivity of the audit engagement partner and audit staff is not impaired. Should you have any comments or queries regarding this confirmation we would welcome their discussion in more detail.

APPENDIX III: FEES SCHEDULE

	CURRENT YEAR £	THREATS TO INDEPENDENCE ARISING	SAFEGUARDS APPLIED AND WHY THEY ARE EFFECTIVE
Scale audit fee	21,000	N/A	No safeguards required
Additional fee	-		
TOTAL AUDIT	21,000		
Audit related assurance services	-		
Other assurance services	-		
TOTAL ASSURANCE SERVICES	21,000		

APPENDIX IV: AUDIT QUALITY

BDO is totally committed to audit quality. It is a standing item on the agenda of BDO's Leadership Team who, in conjunction with the Audit Stream Executive (which works to implement strategy and deliver on the audit stream's objectives), monitor the actions required to maintain a high level of audit quality within the audit stream and address findings from external and internal inspections. BDO welcome feedback from external bodies and is committed to implementing a necessary actions to address their findings.

We recognise the importance of continually seeking to improve audit quality and enhancing certain areas. Alongside reviews from a number of external reviewers, the AQR (the Financial Reporting Council's Audit Quality Review team), QAD (the ICAEW Quality Assurance Department) and the PCAOB (Public Company Accounting Oversight Board who oversee the audits of US firms), the firm undertake a thorough annual internal Audit Quality Assurance Review and as member firm of the BDO International network we are also subject to a quality review visit every three years. We have also implemented additional quality control review processes for all listed and public interest audits.

We seek to make improvements and address weaknesses identified from both external and internal quality reviews. Where issues have been identified an action plan is put in place. These plans may relate to individual assignments, individual offices to be firm-wide and in each instance the outcome of these actions is subject to monitoring and have been the subject of our analysis of root causes. The actions may include, but are not necessarily limited to , one or more of the following:

- The implementation, where appropriate, of relevant training for the engagement team where the issue is team specific;
- The revision and production of additional guidance in connection with the firm's audit approach where we identify that an issue is more wide-spread;
- The development and delivery of firm-wide training;
- Amendments and/or enhancements to stream policies and procedures.

FOR MORE INFORMATION:

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