

City of London Pension Scheme

Planning Report to the Audit and Risk Management Committee

31 March 2014

the
Distinctive
audit

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I am delighted to present this planning report for the 2013/14 audit of the City of London Pension Scheme. The report sets out our audit approach and the more significant areas where we will focus our attention this year.

*(Heather Bygrave,
Engagement Partner, January 2014)*



The big picture

The Big Picture

Key developments in your business

- Two investment managers have been replaced
- There are plans to create an investment property portfolio for the scheme, but this is not expected to happen before the end of the current financial year
- There are no significant changes to the scheme rules or other arrangements.
- There are no significant changes to the financial reporting framework
- Preparations for the shift to a career average basis for the calculation of benefits from 1 April 2014
- Focus within the sector on administration and investment manager fees
- Progress on collaboration on pension scheme administration across London
- Progress on new governance arrangements for the 2014 Scheme.

Key developments in our audit

- No changes to the overall scope of the audit
- Contributions remain a risk in view of the complexity arising from the participation of different admitted bodies within the fund, together with the fact that members may pay different rates depending on their pensionable pay
- Benefits in retirement and ill health remain risks in view of complexities around their calculation.
- The pension fund in the past has made some use of investments in unquoted investment vehicles and derivatives which can give rise to complexities in accounting, disclosure and measurement and therefore this area remains a risk.
- Risk of management override of controls, as presumed by auditing standards.

Scope of work and approach

This section sets out our planned scoping for the audit of the financial statements. We discuss our determined materiality and confirm the level of unadjusted misstatements which we will report to you. We confirm the extent to which reliance will be placed on internal controls and how this decision has been reached.

Scope of work and approach

Areas of responsibility under the Audit Commission's Code of Audit Practice

Responsibilities related to the accounts

Based on guidance issued by the Audit Commission, auditors are again asked, for audit purposes, to treat the Local Government Pension Fund (LGPS) as a stand-alone body, with separate audit plan and reports to those charged with governance.

LGPS funds administered by administering authorities are not statutory bodies in their own right. Therefore, it is not possible for separate audit appointments to be made for LGPS audits. We are therefore appointed to the audit of the LGPS through the existing Audit Commission appointment arrangements.

Our audit of the pension fund is planned in accordance with the Code of Audit Practice issued by the Audit Commission and in accordance with additional guidance issued by the Commission in relation to the audit of pension funds. However, this only extends to the audit of the accounts and there is no requirement for a value for money conclusion on the pension fund accounts specifically. Aspects of the use of resources framework will inform the value for money conclusion for the Corporation and cover issues relating to the pension fund.

The audit opinion we intend to issue as part of our audit report on the Corporation's financial statements will reflect the financial reporting framework adopted by the pension fund. This is the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom (the "Code of Practice").

The Audit Commission has also determined that auditors should give an opinion in accordance with auditing standards on the financial statements included in the pension fund annual report. This entails the following additional work over and above giving an opinion on the pension fund accounts included in the statement of accounts:

- comparing the accounts to be included in the pension fund annual report with those included in the statement of accounts;
- reading the other information published within the pension fund annual report for consistency with the pension fund accounts; and
- where the pension fund annual report is not available until after the auditor reports on the financial statements, undertaking appropriate procedures to confirm that there are no material post-balance sheet events arising after giving the opinion on the pension fund accounts included in the financial statements.

The financial statements included in the pension fund annual report are prepared on the basis of the same proper practices - the Code of Practice - as the financial statements included in the statement of accounts.

Scope of work and approach (continued)

Approach to controls testing

As set out in "Briefing on audit matters" previously circulated to you, a copy of which can be made available, our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

Liaison with internal audit

The audit team, consistent with previous years, will leverage off of the work performed by internal audit wherever possible to allow efficiencies and limit a duplication of work. We will first update our assessment of the organisational status, scope of function, objectivity, technical competence and due professional care of the internal audit function. We will refer to the internal audit's self-assessment and peer review assessment in carrying out this work. Over the course of the audit, we will review the findings of internal audit and where internal audit identifies specific material deficiencies in the control environment, we will consider adjusting our testing so that the audit risk is covered by our work.

For those areas where a significant risk has been identified, no reliance will be placed on the work of internal audit and we will perform all work ourselves.

Materiality and error reporting threshold

We calculate materiality on the basis of the net assets of the fund, but have restricted this to the materiality established for the audit of the Corporation's financial statements as a whole. We estimate materiality for the year to be £4.8 million. We will report to the Audit and Risk Management Committee on all unadjusted misstatements greater than £240,000 and other adjustments that are qualitatively material.

We will update our assessment during the planning and interim visit based on latest outturn expectations

Further details on the basis used for the calculation of materiality are given in our audit plan for the audit of the Corporation's financial statements.



Significant audit risks

This section sets out our comments regarding the significant audit risks identified. We explain the nature of the risk itself, how these risks will be addressed by our audit work and any related presentational and/ or disclosure matters within the financial statements.

Risk assessment is at the heart of our integrated audit approach as it is only with proper identification of the most significant audit risks, that we are able to provide the highest quality assurance in the most efficient and effective manner.

Significant audit risks

1. Contributions

There are complexities around the calculation of contributions.

Nature of risk

Unlike the position in the private sector, we are not required to issue a statement about contributions in respect of the LGPS.

Contributions for the year ended 31 March 2013 were £26.8 million, showing that this is a material income stream for the pension fund. This is expected to continue in the current period with the continued active membership paying contributions. Due to the complexity introduced by the participation of more than one employer in the fund, together with the past introduction of a tiered contribution rates; we have identified contributions as a specific risk.

The key judgement areas and our planned audit challenge

We will evaluate the design and implementation of the City's arrangements and perform substantive audit testing in this area. This will include completing procedures to ascertain whether employer and employee contributions have been calculated and deducted correctly. Further procedures will be completed surrounding the completeness of the scheduled payments and the accuracy of the receipts against that schedule.

2. Benefits

There are complexities surrounding the calculation of both benefits in retirement and ill health and death benefits

Nature of risk

The complexities surrounding the calculation of both benefits in retirement and ill health and death benefits remains a key area of audit risk.

In respect of benefits in retirement, benefits are accumulated on two different bases for service pre and post 1 April 2008; the calculation of the pensionable pay on which benefits will depend may be varied by the individual opting to take account of pay earned in any of the 10 years prior to retirement; and individuals now enjoy greater flexibility in their choice of the mix of pension and lump sum.

In respect of ill health and death benefits, the calculation of the pensionable pay on which benefits will depend may be varied by the same options as discussed above.

The completion of the legislation leading to the change in the revaluation basis to Consumer Price Index adds a further complexity to the above calculations going forward.

In the year ended 31 March 2013, total benefits paid were £35.4 million. The material values of these benefits further indicate that this is an area or key audit risk.

The key judgement areas and our planned audit challenge

We will review the design and implementation of controls present at the Fund for ensuring the accuracy, completeness and validity of benefits through discussion with the pensions team and testing that controls were in force during the year under review. We will also:

- Obtain a schedule of benefits paid and select a sample of benefits for detailed testing through agreement to supporting documentation, and review of the calculation, by reference to the qualifying service, scheme rules and benefit choices made by the member; and
- Develop an expectation based on the prior year balance, adjusted for changes in membership numbers and pension increases to analytically review the pension benefits paid in the year.

3. Investments

There are areas of judgement involved in the valuation of investments private equity, managed funds and derivatives.

Nature of risk

The pension fund makes some use of investments in unquoted investment vehicles, like private equity houses.

Private equity funds are complex to value and include an element of judgement on the part of the investment manager. In addition, further amounts are invested in managed funds which are complex to value due to the difficulty in visibility of the underlying investments.

Given that these funds form a material balance within the pension fund accounts, we have identified the valuation of these funds as a specific risk.

The fund also holds a small number of derivative contracts.

The key judgement areas and our planned audit challenge

We will seek to understand the approach adopted in the valuation of such investments and inspect documentation relating to data sources used by the Corporation. We will tailor further procedures depending on the outcome of that work and our assessment of the risk of material error taking into account the fund's investment holding at the year end.

Derivatives can be complex in terms of accounting, measurement and disclosure requirements. We will first understand the rationale for the use of the derivatives and then test compliance with the accounting, measurement and disclosure requirements of the Code of Practice. The use of specialist advice may be required for testing these balances.

4. Management override of controls

We will focus on the testing of journals, significant accounting estimates, and any unusual transactions in the year.

Nature of risk

International Standards on Auditing requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

The key judgement areas and our planned audit challenge

Our audit work will include:

- Reviewing a sample of journal entries that characteristics that may be indicative of potential fraud and management override of controls.
- Reviewing analysis and supporting documentation of key estimates and judgements.
- Performing substantive testing on journal entries to confirm that they have a genuine, supportable rationale;
- Reviewing ledgers for unusual items and on a test basis investigated the rationale of any such postings;
- Reviewing significant management estimates and judgements such as year-end accruals and provisions and consider whether they are reasonable; and
- Making enquiries of those charged with governance as part of our planning and detailed audit processes.

Responsibility statement

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to establish our respective responsibilities in relation to the financial statement audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope and timing of our audit.
- Key regulatory and corporate governance updates, relevant to you.

What we don't report

- As you will be aware, our audit is not designed to identify all matters that may be relevant to the Court of Common Council.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

- This report should be read alongside the supplementary "Briefing on audit matters" previously circulated to you and available on request.
- We will update you if there are any significant changes to the audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP
Chartered Accountants

St Albans
16 January 2014

This report has been prepared for the Court of Common Council, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

Appendices

Appendix 1: Independence and fees

We confirm we are independent of the City of London Corporation

As part of our obligations under International Standards on Auditing (UK & Ireland) and the Audit Commission's Code of Audit Practice, we are required to report to you on the matters listed below:

Independence confirmation

We confirm we are independent of the City of London Corporation and will reconfirm our independence and objectivity to the Audit and Risk Management Committee for the year ending 31 March 2014 in our final report to the Audit and Risk Management Committee.

Fees

Details of the non-audit services fees proposed for the period have been presented separately in the appendix.

Non-audit services

In our opinion there are no inconsistencies between APB Revised Ethical Standards for Auditors and the Corporation's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

We summarise our relationships with the Corporation and explain our assessment of threats to auditor independence and safeguards in the City Fund audit plan document.

Appendix 1: Independence and fees (continued)

We summarise earned or proposed audit fees for the year

The professional fees earned or proposed by Deloitte in the period from 1 April 2013 to 31 March 2014 are as follows:

	Current year £000	Prior year £000
Audit of the City of London pension scheme	21	21

There are no non audit services provided or proposed to the City of London pension scheme for the period from 1 April 2013 to 31 March 2014.

Professional fees earned or proposed by Deloitte for services in the period from 1 April 2013 to 31 March 2014 in respect of other funds of the Corporation and other entities controlled by the Corporation are set out in our audit plan for the City Fund.

Appendix 2: Fraud: responsibilities and representations

We summarise our respective responsibilities regarding fraud

Characteristics

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

Responsibilities

Your responsibilities

- The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

Our responsibilities

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in Section 2 above we have identified the risk of fraud in management override of controls as a key audit risk for your organisation.

Appendix 2: Fraud: responsibilities and representations (continued)

We will make inquiries and obtain representations regarding fraud

We will make the following inquiries regarding fraud:

Management	Internal Audit	Those charged with governance
<p>Management's assessment of the risk that the financial statements may be materially misstated due to fraud including the nature, extent and frequency of such assessments</p> <p>Managements process for identifying and responding to the risks of fraud in the entity</p> <p>Managements communication to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity</p> <p>Managements communication, if any, to employees regarding its views on business practices and ethical behaviour</p> <p>Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity</p>	<p>Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud</p>	<p>How those charged with governance exercise oversight of managements processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks</p> <p>Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity</p>

We will the following to be stated in the representation letter signed on behalf of the Corporation:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- [We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and] that affects the entity or group and involves:
 - (i) management;
 - (ii) employees who have significant roles in internal control; or
 - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Appendix 3: Operational arrangements

We set out key members of your audit team and other operational information

The work will be led by Heather Bygrave, supported by Ender Tahsin as audit manager.

Our work will be closely co-ordinated with the work carried out on other parts of main audit of the City Fund. Details of our timetable for that work are included in the City Fund audit plan.

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