



# CITY OF LONDON PENSION FUND

PLANNING REPORT TO THE AUDIT AND RISK MANAGEMENT COMMITTEE  
Audit for the year ending 31 March 2016

26 February 2016

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# INTRODUCTION

## PURPOSE AND USE OF OUR REPORT

The purpose of this report is to highlight and explain the key issues which we believe to be relevant to the audit of the financial statements of the pension fund for the year ending 31 March 2016. 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. Planning is an iterative process and our plans, reflected in this report, will be reviewed and updated as our audit progresses.

This report has been prepared solely for the use of the Audit and Risk Management Committee and should not be shown to any other person without our express permission in writing.

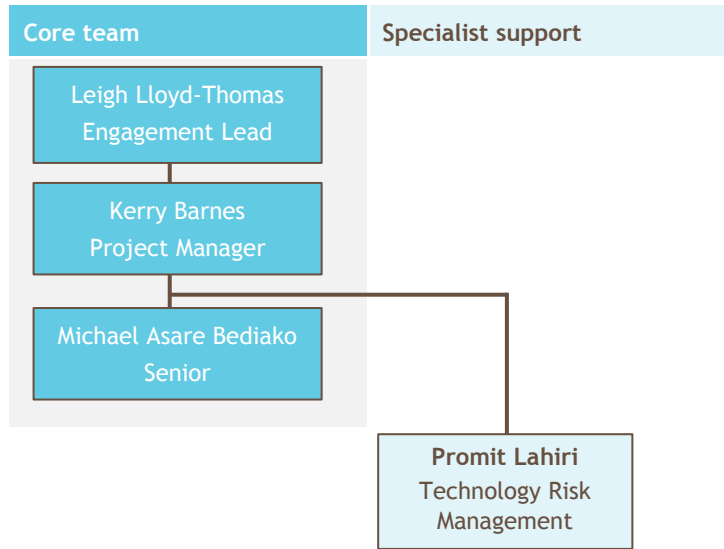
In preparing this report, we do not accept or assume responsibility for any other purpose, or to any other person to whom it is shown or into whose hands it may come, except when expressly agreed by our prior written consent. If others choose to rely on the contents of this report, they do so entirely at their own risk.

## CONTENT OF OUR REPORT

In this report, we set out the following:

- Our team and responsibilities for this year's audit
  - Our client service commitment
  - An overview of the audit timetable with key dates and deliverables
  - The audit scope and objectives
  - Our preliminary evaluation of materiality
  - Our overall audit strategy
  - Our initial assessment of the key audit risks and other relevant matters along with our planned audit approach
  - Confirmation of independence and consideration of any independence related matters
  - Our proposed fees for the audit.
-

# YOUR BDO TEAM



Name	Contact details	Key responsibilities
<b>Leigh Lloyd-Thomas</b> Engagement Lead	Tel: 020 7893 2616 leigh.lloyd-thomas@bdo.co.uk	Oversee the audit and sign the audit report
<b>Kerry Barnes</b> Project Manager	Tel: 020 7893 3837 kerry.barnes@bdo.co.uk	Management of the audit
<b>Michael Asare Bediako</b> Senior	Tel: 020 7893 3646 michael.asarebediako@bdo.co.uk	Day to day supervision of the on-site audit
<b>Promit Lahiri</b> Technology Risk Manager	Tel: 020 7893 3526 promit.lahiri@bdo.co.uk	Manage IT review for audit purposes

Leigh Lloyd-Thomas is the engagement lead and has the primary responsibility to ensure that the appropriate audit opinion is given on the financial statements.

In meeting this responsibility, he will ensure that the audit has resulted in obtaining sufficient and appropriate evidence to provide reasonable, but not absolute, assurance that the financial statements are free from material misstatement, whether due to fraud or error

Leigh is responsible for the overall quality of the engagement.

# OUR CLIENT SERVICE COMMITMENT TO YOU

## CLIENT SERVICE EXPECTATIONS

1

High quality audit service at a reasonable cost.

2

A quality team, with relevant expertise.

3

Clear communication.

4

Concentrating our work on areas of higher risk.

5

Avoiding surprises through timely reporting of issues.

6

Consulting with management to resolve matters early.

7

Meeting deadlines.

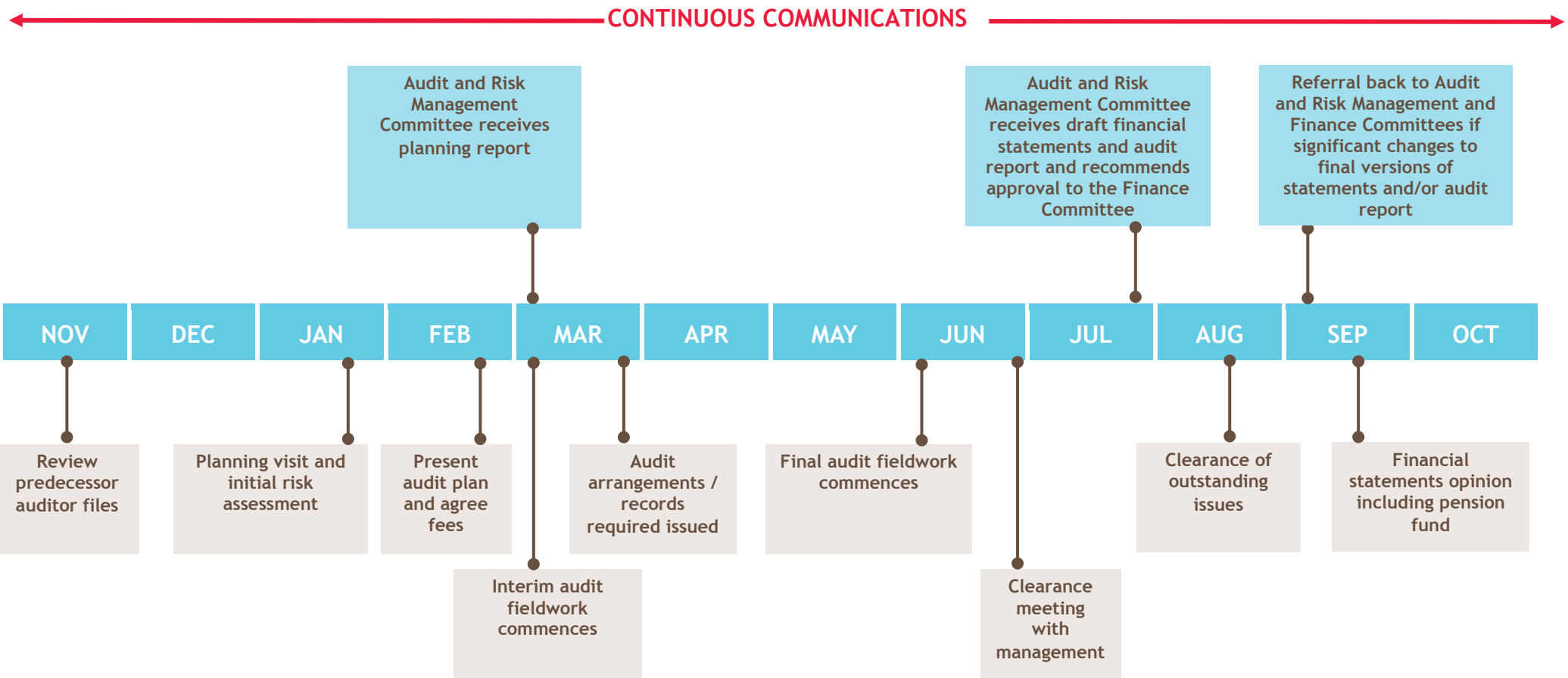
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Identifying shortcomings in controls and processes.

# ENGAGEMENT TIMETABLE

## TIMETABLE

The timeline below identifies the key dates and anticipated meetings for the production and approval of the audited financial statements.



# AUDIT SCOPE AND OBJECTIVES

## SCOPE AND OBJECTIVES

Our audit scope covers the audit in accordance with the NAO Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the NAO.

To form an opinion on whether:

FINANCIAL STATEMENTS		OTHER INFORMATION	ADDITIONAL REQUIREMENTS
<b>1</b> The financial statements give a true and fair view of the financial transactions of the pension fund for the period, and the amount and disposition at the period end of the assets and liabilities, other than liabilities to pay pensions and benefits after the period end.	<b>2</b> The financial statements have been prepared properly in accordance with the relevant accounting and reporting framework as set out in legislation, applicable accounting standards or other direction.	<b>3</b> Other information published together with the audited financial statements is consistent with the financial statements.	<b>4</b> Review the pension fund annual report and report on the consistency of the pension fund financial statements within the annual report with the pension fund financial statements in the statement of accounts.

# MATERIALITY

## MATERIALITY

	MATERIALITY	CLEARLY TRIVIAL THRESHOLD
Pension fund overall materiality	£8,200,000	£160,000
Specific materiality for other financial statement areas:		
- Fund account	£1,500,000	-

Please see Appendix I for detailed definitions of materiality and triviality.

Planning materiality for the pension fund financial statements will initially be based on 1% of net assets. Specific materiality (at a lower level) may be considered appropriate for certain financial statement areas and we set materiality for the fund account at 5% of contributions receivable.

At this stage, these figures are based on the prior year gross assets amounts and contributions receivable. This will be revisited when the draft financial statements are received for audit.

The clearly trivial amount is based on 2% of the materiality level.



# OVERALL AUDIT STRATEGY

## **We will perform a risk based audit on the pension fund financial statements**

This enables us to focus our work on key audit areas.

Our starting point is to document our understanding of the pension fund and the specific risks it faces. We discussed the changes to the fund, such as scheme regulations, and management's own view of potential audit risk during our planning visit in order to gain an understanding of the activities and to determine which risks impact on our audit. We will continue to update this assessment throughout the audit.

We also confirm our understanding of the accounting systems in order to ensure their adequacy as a basis for the preparation of the financial statements and that proper accounting records have been maintained.

We then carry out our audit procedures in response to risks.

## **Risks and planned audit responses**

Under International Standard on Auditing 315 "Identifying and assessing the risks of material misstatement through understanding the entity and its environment", we are required to consider significant risks that require special audit attention.

In assessing a risk as significant, we exclude the effects of identified controls related to the risk. The ISA requires us at least to consider:

- Whether the risk is a risk of fraud
- Whether the risk is related to recent significant economic, accounting or other developments and, therefore, requires specific attention
- The complexity of transactions
- Whether the risk involves significant transactions with related parties
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty
- Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

## **Internal audit**

We will ensure that we maximise the benefit of the overall audit effort carried out by internal audit and ourselves, whilst retaining the necessary independence of view.

We understand that internal audit reviews have been undertaken across a range of accounting systems and governance subjects. We will consider these reports as part of our audit planning and consider whether we are able to place any reliance on internal audit work as evidence of the soundness of the control environment.

# KEY AUDIT RISKS AND OTHER MATTERS

Key: ■ Significant risk ■ Normal risk ■ Other issue

AUDIT RISK AREAS - FINANCIAL STATEMENTS			
RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
Management override	The primary responsibility for the detection of fraud rests with management. Their role in the detection of fraud is an extension of their role in preventing fraudulent activity. They are responsible for establishing a sound system of internal control designed to support the achievement of the fund's policies, aims and objectives and to manage the risks facing the fund; this includes the risk of fraud.	Our audit is designed to provide reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or error. We are not responsible for preventing fraud or corruption, although our audit may serve to act as a deterrent. We consider the manipulation of financial results through the use of journals and management estimates as a significant fraud risk.	Not applicable.
	Under International Standards on Auditing (UK and Ireland) 240, there is a presumed significant risk of management override of the system of internal controls.	In every organisation, management may be in a position to override routine day to day financial controls. Accordingly, our audit has been designed to consider this risk and adapt procedures accordingly.	
Revenue recognition (contributions)	Under International Standard on Auditing 240 "The Auditor's responsibility to consider fraud in an audit of financial statements" there is a presumption 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 will carry 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.  We will perform 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 will check 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 will select a sample of bodies each year and request confirmation from that organisation that the correct amounts have been paid to the pension fund for selected employees.

# KEY AUDIT RISKS AND OTHER MATTERS

## Continued

### AUDIT RISK AREAS - FINANCIAL STATEMENTS

RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
<p>Fair value of investments (private equity)</p>	<p>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.</p> <p>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.</p> <p>As a result, we consider there to be a significant risk that investments are not appropriately valued in the financial statements.</p>	<p>We will obtain direct confirmation of investment valuations from the fund managers and request copies of the audited financial statements (and member allocations) from the fund.</p> <p>Where the financial statement date supporting the valuation is not coterminous with the pension fund's year end, we will confirm that appropriate adjustments have been made to the valuations in respect of additional contributions and distributions with the funds.</p> <p>Ensure investments have been correctly valued in accordance with the relevant accounting policies.</p>	<p>Direct confirmation of fund valuation and audited financial statements for private equity investments.</p>
<p>Fair value of investments (pooled investments)</p>	<p>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.</p> <p>There is a risk that investments may not be appropriately valued and correctly recorded in the financial statements.</p>	<p>We will obtain direct confirmation of investment valuations from the fund managers and agree valuations, where available, to readily available observable data (such as Bloomberg).</p> <p>We will ensure that investments have been correctly valued in accordance with the relevant accounting policies.</p> <p>We will obtain independent assurance reports over the controls operated by the fund managers and existence of underlying investments in the funds.</p>	<p>Direct confirmation of investment valuations from fund managers.</p> <p>Assurance report on the operating effectiveness of internal controls within each of the fund manager organisation.</p>

# KEY AUDIT RISKS AND OTHER MATTERS

## Continued

### AUDIT RISK AREAS - FINANCIAL STATEMENTS

RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
<p>Investment management expenses</p>	<p>Local Government Pension Fund Accounts are required to disclose investment management expenses.</p> <p>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 the change in market value of investments.</p> <p>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'.</p> <p>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. CIPFA intends to publish revised guidance in April.</p> <p>We consider there to be a significant risk in the presentation of investment management expenses in the fund accounts where these 'hidden' fees are not identified and separately reported.</p>	<p>We will review the arrangements put in place by management to identify all relevant investment management fees, and responses provided by fund managers, to ensure that the true costs are disclosed appropriately in the fund accounts.</p>	<p>Not applicable.</p>

# KEY AUDIT RISKS AND OTHER MATTERS

## Continued

### AUDIT RISK AREAS - FINANCIAL STATEMENTS

RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
Pension liability assumptions	<p>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.</p> <p>There is a risk the valuation uses inappropriate assumptions to value the liability.</p>	<p>We will review the controls in place to ensure that the data provided from the fund to the actuary is complete and accurate.</p> <p>We will review the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data.</p> <p>We will agree the disclosure to the information provided by the actuary.</p>	<p>We will use the PwC consulting actuary report for the review of the methodology of the actuary and reasonableness of the assumptions.</p>
Membership disclosure	<p>Membership information including the number of current contributors, deferred beneficiaries and pensioners by employer is required to be disclosed.</p> <p>There is a risk that the membership database may not be accurate and up to date to support this disclosure.</p>	<p>We will obtain membership records and review the controls over the maintenance of these records. We will undertake sample testing of movements of members to transactions recorded in the fund account.</p> <p>We will review action taken in response to findings of the National Fraud Initiative (NFI) data matching exercise of paid amounts to pensioners with the UK register of deaths, and any 'life certification' exercise undertaken.</p>	<p>Review of NFI data matching.</p>

# KEY AUDIT RISKS AND OTHER MATTERS

## Continued

### AUDIT RISK AREAS - FINANCIAL STATEMENTS

RISK	DESCRIPTION	PLANNED AUDIT RESPONSE	EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE
Consideration of related party transactions	We need to 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.	<p>We will document the related party transactions identification procedures in place and review relevant information concerning any such identified transactions.</p> <p>We will discuss with management and review Corporation members and Senior Management declarations to ensure there are no potential related party transactions which have not been disclosed. This is something we will require you to include in your management representation letter to us.</p>	Companies House searches for undisclosed interests.
Fraud and error	<p>We are required to discuss with you the possibility of material misstatement, due to fraud or error.</p> <p>We are informed by management that there have not been any cases of material fraud or error, to their knowledge.</p>	We will continue to consider throughout the audit process and discuss with management.	Not applicable.

# INDEPENDENCE

## INDEPENDENCE

Under Auditing and Ethical Standards, we are required as auditors to confirm our independence to ‘those charged with governance’. In our opinion, and as confirmed by you, we consider that for these purposes it is appropriate to designate the Audit and Risk Management Committee as those charged with governance.

Our internal procedures are designed to ensure that all partners and professional staff are aware of relationships that may be considered to have a bearing on our objectivity and independence as auditors. The principal statements of policies are set out in our firm-wide guidance. In addition, we have embedded the requirements of the Standards in our methodologies, tools and internal training programmes. The procedures require that engagement leads are made aware of any matters which may reasonably be thought to bear on the firm’s independence and the objectivity of the engagement lead and the audit staff. This document considers such matters in the context of our audit for the period ended 31 March 2016.

Our appointment by the Audit Commission (and confirmed by Public Sector Audit Appointments Limited) covers both the Corporation City Fund and pension fund. We do not consider this to be a threat to our independence and objectivity.

We have not identified any potential threats to our independence as auditors.

We have confirmed that we have not provided any non audit services.

We confirm that the firm complies with the Financial Reporting Council’s Ethical Standards for Auditors 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. These policies include partner and manager rotation. The table in appendix II sets out the length of involvement of key members of the audit team and the planned year of rotation.

Should you have any comments or queries regarding this confirmation we would welcome their discussion in more detail.

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# FEES

## FEES SUMMARY

Our proposed fees, excluding VAT, for the year ending 31 March 2016 are:

	£
Code audit fee (pension fund)	21,000
<b>TOTAL FEES</b>	<b>21,000</b>

Fee invoices will be raised as set out below, following which our firm's standard terms of business state that full payment is due within 14 days of receipt of invoice:

- instalment 1 £11,000 in July 2015
- instalment 2 £5,000 in March 2016
- instalment 3 £5,000 in June 2016.

### Our fee is based on the following assumptions

The complete draft financial statements and supporting work papers will be prepared to a standard suitable for audit. All balances will be reconciled to underlying accounting records.

Key dates will be met, including receipt of draft accounts and working papers prior to commencement of the final audit fieldwork.

We will receive only one draft of the pension fund financial statements prior to receiving the final versions for signing.

Within reason, personnel we require to hold discussions with will be available during the period of our on-site work (we will set up meetings with key staff in advance).



# APPENDIX I: MATERIALITY

## CONCEPT AND DEFINITION

- The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to monetary misstatements but also to disclosure requirements and adherence to appropriate accounting principles and statutory requirements.
- We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. For planning, we consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.
- Materiality therefore has qualitative as well as quantitative aspects and an item may be considered material, irrespective of its size, if it has an impact on (for example):
  - Narrative disclosure e.g. accounting policies, going concern
  - Instances when greater precision is required (e.g. related party transactions disclosures).
- International Standards on Auditing (UK & Ireland) also allow the auditor to set a lower level of materiality for particular classes of transaction, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

## CALCULATION AND DETERMINATION

- We have determined materiality based on professional judgement in the context of our knowledge of the pension fund, including consideration of factors such as sector developments, financial stability and reporting requirements for the financial statements.
- We determine materiality in order to:
  - Assist in establishing the scope of our audit engagement and audit tests
  - Calculate sample sizes
  - Assist in evaluating the effect of known and likely misstatements on the financial statements.

# APPENDIX I: MATERIALITY

## Continued

### REASSESSMENT OF MATERIALITY


- We will reconsider materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality if we had been aware.
- Further, when we have performed all our tests and are ready to evaluate the results of those tests (including any misstatements we detected) we will reconsider whether materiality combined with the nature, timing and extent of our auditing procedures, provided a sufficient audit scope. If we conclude that our audit scope was sufficient, we will use materiality to evaluate whether uncorrected misstatements (individually or in aggregate) are material.
- You should be aware that any misstatements that we identify during our audit, both corrected and uncorrected errors, might result in additional audit procedures being necessary.

### UNADJUSTED ERRORS

- In accordance with auditing standards, we will communicate to the Audit and Risk Management Committee all uncorrected misstatements identified during our audit, other than those which we believe are 'clearly trivial'.
  - Clearly trivial is defined as matters which will be of a wholly different (smaller) order of magnitude than the materiality thresholds used in the audit, and will be matters that are clearly inconsequential, whether taken individually or in aggregate.
  - We will obtain written representations from the Audit and Risk Management Committee confirming that in their opinion these uncorrected misstatements are immaterial, both individually and in aggregate and that, in the context of the financial statements taken as a whole, no adjustments are required.
  - There are a number of areas where we would strongly recommend/request any misstatements identified during the audit process being adjusted. These include:
    - Clear cut errors whose correction would cause non-compliance with statutory requirements, management remuneration, other contractual obligations or governmental regulations that we consider are significant.
    - Other misstatements that we believe are material or clearly wrong.
-

## APPENDIX II: INDEPENDENCE

INDEPENDENCE - ENGAGEMENT TEAM ROTATION		
SENIOR TEAM MEMBERS	NUMBER OF YEARS INVOLVED	ROTATION TO TAKE PLACE IN YEAR ENDED
LEIGH LLOYD-THOMAS - Engagement lead	1 <sup>st</sup> year	31 March 2021
KERRY BARNES - Project manager	1 <sup>st</sup> year	31 March 2026



The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of the organisation and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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