

Report to the Pensions Committee and Board

# LONDON BOROUGH OF HARINGEY PENSION FUND

Audit Planning: year ending 31 March 2019

IDEAS | PEOPLE | TRUST



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# WELCOME

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We have pleasure in presenting our Audit Planning Report to the Pensions Committee and Board of London Borough of Haringey Council (the 'Council'). This report 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 with those charged with governance.

It summarises the planned audit strategy for the year ending 31 March 2019 in respect of our audit of the financial statements of the Pension Fund comprising materiality, key audit risks and the planned approach to these, together with timetable and the BDO team.

The planned audit strategy has been discussed with management to ensure that it incorporates developments in the business during the year under review, the results for the year to date and other required scope changes.

We look forward to discussing this plan with you at the Pensions Committee and Board meeting on 14 March 2019 and to receiving your input on the scope and approach.

In the meantime if you would like to discuss any aspects in advance of the meeting please contact one of the team.



Leigh Lloyd-Thomas

28 February 2019



**Leigh Lloyd-Thomas**

**Engagement Partner**

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**Audit Manager**

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**Assistant Manager**

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This report has been prepared solely for the use of the Pensions Committee and Board and Those Charged with Governance 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. For more information on our respective responsibilities please see the appendices.

# SCOPE AND MATERIALITY

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This summary provides an overview of the key audit matters that we believe are important to the Pensions Committee and Board in reviewing the planned audit strategy for the Pension Fund for the year ending 31 March 2019.

It is also intended to promote effective communication and discussion and to ensure that the audit strategy appropriately incorporates input from those charged with governance.

### Audit scope

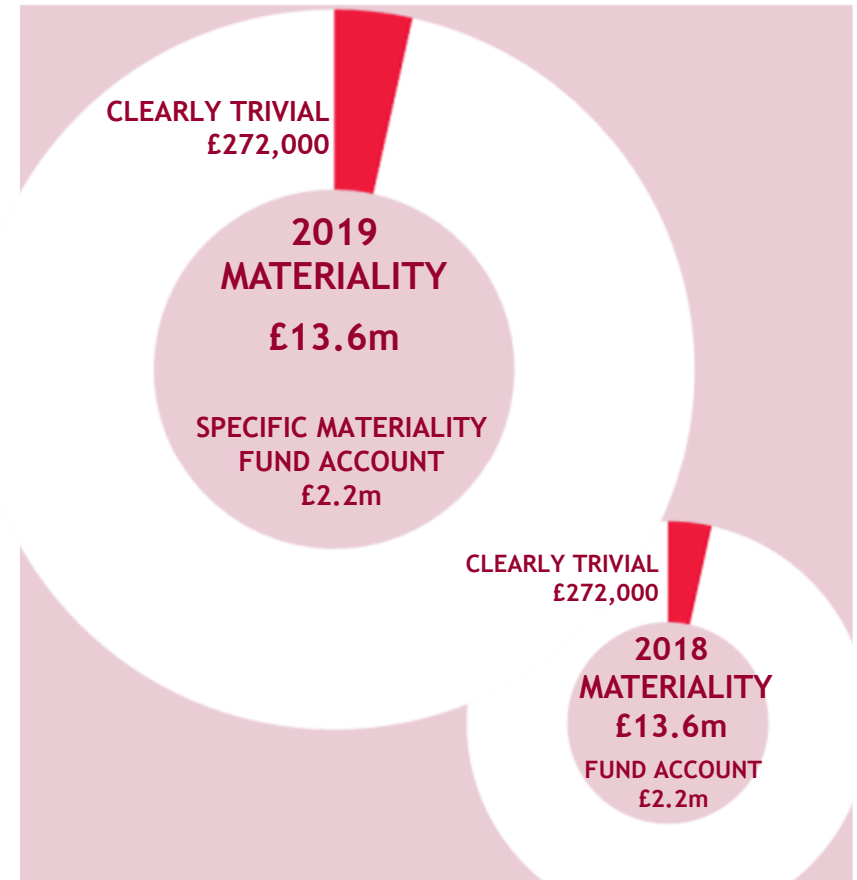
The scope of the audit is determined by the NAO's Code of Audit Practice that sets out what local auditors are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. This includes: auditing the financial statements, ensuring that other information published together with the audited financial statements is consistent with the financial statements and our knowledge obtained during the audit, and reviewing the pension fund to check the consistency of the pension fund financial statements within the annual report with the pension fund financial statements in the statement of accounts.

Our approach is designed to ensure we obtain the requisite level of assurance in accordance with applicable laws, appropriate standards and guidance issued by the NAO.

### Materiality

Planning materiality for the pension fund financial statements will set at 1% of the valuation of investment 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. This will be revisited when the draft financial statements are received for audit.

Although materiality is the judgement of the engagement lead, the Pensions Committee and Board is obliged to satisfy themselves that the materiality chosen is appropriate for the scope of the audit.



# AUDIT STRATEGY

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Our Audit Strategy is predicated on a risk based approach, so that audit work is focused on the areas of the financial statements where the risk of material misstatement is assessed to be higher.

We have discussed the changes to the organisation, systems and controls in the year with management and obtained their own view of potential audit risk in order to update our understanding of the pension fund's activities and to determine which risks impact on the numbers and disclosures in the financial statements.

A lower level of materiality is applied to the areas of the financial statements that are considered to be sensitive, such as senior management remuneration disclosures, auditor's remuneration disclosures and related party disclosures.

We will continue to update this assessment throughout the audit.

The table on the next page summarises our planned approach to audit risks identified.

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<b>Risk identified</b>	<b>Risk rating</b>	<b>Fraud risk present</b>	<b>Testing approach</b>	<b>Impact of significant judgements and estimates</b>
Management override of controls	Significant	Yes	Substantive	Medium
Pension liability valuation	Significant	No	Substantive	High
Membership disclosure	Normal	No	Substantive	Low
Valuation of investment assets	Normal	No	Substantive	Medium
Benefits payable	Normal	No	Substantive	Low
Classification of financial instruments (IFRS 9)	Normal	No	Substantive	Medium
Contributions receivable	Normal	No	Substantive	Low

# INDEPENDENCE AND FEES

## Executive summary



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### Independence

We confirm that the firm complies with the Financial Reporting Council's Ethical Standard for Auditors and, in our professional judgement, is independent and objective within the meaning of those Standards.

### Fees

	2018/19 £	2017/18 £
PSAA scale fees	<sup>(1)</sup> 16,170	21,000
<b>Total audit fees</b>	<b>16,170</b>	<b>21,000</b>

<sup>(1)</sup> PSAA has set the 2018/19 fee scale at £16,170 on the basis that individual fees for all opted-in bodies have been reduced by 23 per cent from the fees applicable scale fee for 2017/18 of £21,000. This gives opted-in bodies the benefit of the cost savings achieved in the recent audit procurement, and continues the practice of averaging firms' costs so that all bodies benefit from the same proportionate savings, irrespective of the firm appointed to a particular audited body. It also passes on the benefit of economies which PSAA is making in its own operating costs.

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Key components of our audit objectives and strategy for the pension fund are highlighted and explained on the following pages.

Audit planning is a collaborative and continuous process and our audit strategy, as reflected here, will be reviewed and updated as our audit progresses.

We will communicate any significant changes to our audit strategy, should the need for such change arise.

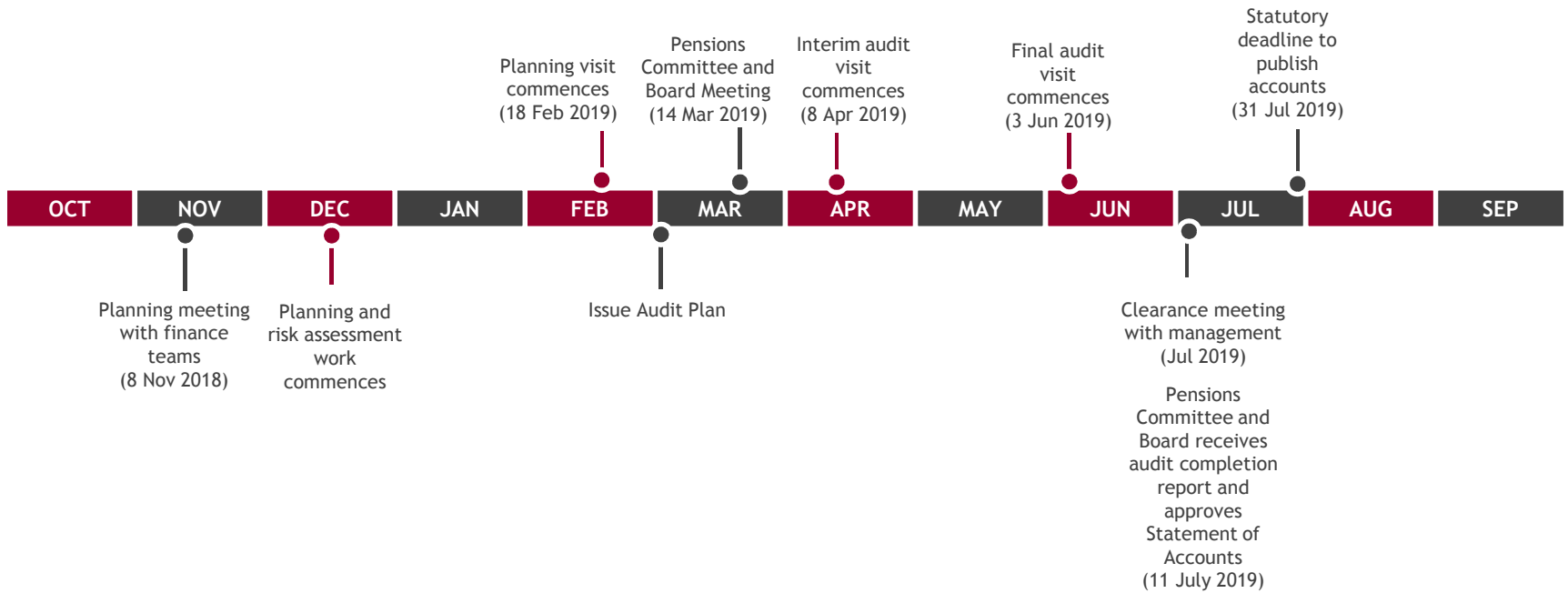
Reporting	Objectives
Auditing standards	We will perform our audit in accordance with International Standards on Auditing UK (ISAs (UK)) and relevant guidance published by the NAO.
Financial statements	We will express an opinion on the pension fund’s financial statements, prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting 2018/19 and other directions.
Pension fund report	We will 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.
Report to the Pensions Committee and Board	Prior to the approval of the financial statements, we will discuss our significant findings with the Pensions Committee and Board. We will highlight key accounting and audit issues as well as internal control findings and any other significant matters arising from the audit.





# AUDIT TIMELINE

An overview of the key dates



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# BDO TEAM

## Team responsibilities



**Leigh Lloyd-Thomas**  
**Engagement Lead**

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As audit engagement lead I have primary responsibility to ensure that the appropriate audit opinion is given.

In meeting this responsibility I 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, and to report on the financial statements and communicate as required by the ISAs (UK), in accordance with our findings.

I am responsible for the overall quality of the engagement and am supported by the rest of the team as set out here.



**Simiso Ngidi**  
**Audit Manager**

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I will lead on the audit of the pension fund.

I work closely with Leigh to develop and execute the audit strategy. I will be a key point of contact on a day to day basis for the Pension Fund and will ensure that timelines are carefully managed to ensure that deadlines are met and matters to be communicated to Management and the Pensions Committee and Board are highlighted on a timely basis.

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# OVERVIEW

We have assessed the following as audit risks. These are matters assessed as most likely to cause a material misstatement in the financial statements and include those that will have the greatest effect on audit strategy, the allocation of audit resources and the amount of audit focus by the engagement team.

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Description of risk	Significant risk	Normal risk	Overview of risk
1. Management override of controls			ISA (UK) 240 presumes that management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.
2. Pension liability valuation			There is a risk the valuation is not based on appropriate membership data where there are significant changes or uses inappropriate assumptions to value the liability.
3. Membership disclosure			There is a risk that the membership database may not be accurate to support the disclosure in the accounts.
4. Valuation of investment assets			There is a risk that investments may not be appropriately valued and correctly recorded in the financial statements.
5. Benefits payable			There is a risk that benefits payable may not be correct based on accrued benefits of members or may not be calculated in accordance with the scheme regulations.
6. Classification of financial instruments (IFRS 9)			There is a risk that financial instruments are not classified and measured in accordance with new financial reporting standard.
7. Contributions receivable			There is a risk that employers may not be calculating contributions correctly and paying over the full amount dues (on normal and deficit rates) or that the pension fund does correctly charge costs arising on pension strain for early retirements and augmented pensions.

# MANAGEMENT OVERRIDE OF CONTROLS

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**ISA (UK) 240 presumes that Management is in a unique position to perpetrate fraud.**

- Significant risk
- Normal risk
- Fraud risk
- Assess design & implementation of controls to mitigate
- Significant Management estimates & judgements
- Controls testing approach
- Substantive testing approach
- Risk highlighted by the pension fund

## Risk detail

- ISA (UK) 240 - The auditor's responsibilities relating to fraud in an audit of financial statements requires us to presume that the risk of management override of controls is present and significant in all entities.

## Planned audit approach

Our audit procedures will include the following:

- Review and verification of large and unusual journal entries made in the year and agreeing the journals to supporting documentation. We will determine key risk characteristics to filter the population of journals;
- Review of estimates and judgements applied by management in the financial statements to assess their appropriateness and the existence of any systematic bias; and
- Review of unadjusted audit differences for indications of bias or deliberate misstatement.



# PENSION LIABILITY VALUATION

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**There is a risk that the membership data and cash flows provided to the actuary in the roll-forward valuation may not be correct, or the valuation uses inappropriate assumptions to value the liability.**

Significant risk  
Normal risk  
Fraud risk  
Assess design & implementation of controls to mitigate  
Significant Management estimates & judgements  
Controls testing approach  
Substantive testing approach  
Risk highlighted by pension fund

## Risk detail

- 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 a roll-forward of data from the 2016 triennial valuation, updated where necessary, and has regard to local factors such as mortality rates and expected pay rises along with other assumptions around inflation when calculating the liability.
- Following a ruling on gender discrimination on a Lloyds case, the courts found that UK defined benefit schemes must equalise Guaranteed Minimum Pensions (GMP). Actuaries estimate that this could result in an increase in pension liabilities by up to 0.5% (material) but are not expected to include this in the 31 March 2019 valuation as Government has extended the 'interim solution' from December 2018 through to April 2021 to potentially fund this through an alternative long-term methodology known as 'conversion'.
- Following the ruling on age discrimination on the McCloud case, where members approaching retirement age received protected benefits moving to the CARE scheme from the final salary scheme, Government will have to remedy the discrimination in the LGPS. Government intends to seek leave to appeal this case to the Supreme Court.
- There is a risk the valuation is not based on appropriate membership data where there are significant changes, uses inappropriate assumptions to value the liability or fails to include the potential additional liabilities arising from the GMP and McCloud rulings.

## Planned audit approach

Our audit procedures will include the following:

- Agree the disclosures to the information provided by the pension fund actuary;
- Review the reasonableness of the assumptions used in the calculation against other local government actuaries and other observable data;
- Review the controls for providing accurate membership data to the actuary;
- Check whether any significant changes in membership data have been communicated to the actuary; and
- Discuss with the actuary how the impact of the GMP gender discrimination and McCloud age discrimination judgements have been taken into account in the liability assumptions at 31 March 2019 and whether a contingent liability disclosure is required.

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**There is a risk that the membership database may not be accurate and up to date to support the disclosure in the accounts.**

- Significant risk
- Normal risk
- Fraud risk
- Assess design & implementation of controls to mitigate
- Significant Management estimates & judgements
- Controls testing approach
- Substantive testing approach
- Risk highlighted by pension fund

### Risk detail

- Membership information including the number of current contributors, deferred beneficiaries and pensioners by employer is required to be disclosed in the financial statements.
- There is a risk that the membership database may not be accurate and up to date to support the disclosure in the accounts.

### Planned audit approach

Our audit procedures will include the following:

- Obtain membership records and review the controls over the maintenance of these records; and
- Test a sample of movements of members to transactions recorded in the fund account and other underlying supporting documentation

# VALUATION OF INVESTMENT ASSETS

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**There is a risk that investments may not be appropriately valued and correctly recorded in the financial statements.**

- Significant risk
- Normal risk
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- Risk highlighted by pension fund

## Risk detail

- The investment portfolio includes private equity (31 March 2018 £67m) valued by the General Partner or fund manager using valuations obtained from the underlying partnerships. Valuations are provided at 31 December and need to be updated and adjusted to reflect cash transactions (additional contributions or distributions received) up to 31 March.
- The fair value of other funds (31 March 2018 1,217m) comprising unit trusts, unitised insurance policies and pooled investments is provided by individual fund managers and reviewed by the custodian (Northern Trust). These valuation are reported on a quarterly basis although there may be amendments to the final valuations that may be received after the draft accounts have been prepared.
- There is a risk that investments may not be appropriately valued and correctly recorded in the financial statements.

## Planned audit approach

Our audit procedures will include the following:

- Obtain direct confirmation of investment valuations from the General Partner or fund managers including any subsequent final valuations to ‘flash’ valuations in the draft accounts; and
- Obtain independent assurance reports over the controls operated by the fund managers for valuations and existence of underlying investments in the funds.

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**There is a risk that benefits payable may not be correct based on accrued benefits of members or may not be calculated in accordance with the scheme regulations.**

Significant risk

Normal risk

Fraud risk

Assess design & implementation of controls to mitigate

Significant Management estimates & judgements

Controls testing approach

Substantive testing approach

Risk highlighted by pension fund

## Risk detail

- Benefits payable may not be correct based on accrued benefits of members or may not be calculated in accordance with the scheme regulations.
- Payment to wrong or non-existent members will result in loss of assets and risk of reputational damage.

## Planned audit approach

Our audit procedures will include the following:

- For members leaving the scheme and deferring their pension and members becoming entitled to receive pension during the year, substantively test a sample of calculations of pension entitlement;
- Check the correct application of annual pension uplift for members in receipt of benefits;
- Check a sample of pensioners in receipt of pensions to underlying records to confirm the existence of the member and also review the results of the checks undertaken by ATMOS on the existence of pensioners;
- Review the results of the latest National Fraud Initiative (NFI) data matching exercise of members in receipt of benefits with the records of deceased persons and what actions have been taken to resolve potential matches;
- Review any life certification exercises undertaken for members that are excluded from the National Fraud Initiative; and
- Agree amounts recorded in the ledger for benefits paid to the pensioner payroll reports.



# CLASSIFICATION OF FINANCIAL INSTRUMENTS (IFRS 9)

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**There is a risk that financial instruments are not classified and measured in accordance with new financial reporting standard.**

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Normal risk  
Fraud risk  
Assess design & implementation of controls to mitigate  
Significant Management estimates & judgements  
Controls testing approach  
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## Risk detail

- IFRS 9 financial instruments has been implemented for 2018/19 and requires all relevant financial instrument assets (principally investments and receivables) and liabilities (principally payables) to be categorised under new criteria based on their business model and contractual cash flows that will determine their classification and basis of valuation.
- As investment assets in the pension fund are already carried at fair value through profit and loss (FVTPL) this is unlikely to require reclassification of these financial assets. Management will need to determine whether the £150,000 investment in the London CIV represents a direct equity holding and could be classified as FVTPL or fair value through other comprehensive income (FVOCI), or whether this is a loan to the London CIV and held at amortised cost.
- Some receivables carried at amortised cost will require an expected credit loss impairment (ELC) review rather than an incurred credit loss impairment review as in previous years, taking into account future potential losses. This is not required for contributions due from other local authorities and Government bodies as the Code states that these cannot have credit impairments. Therefore, this is likely to impact only on receivables for non-government admitted and scheduled bodies contributions due.
- There is a risk that financial instruments are not classified and measured in accordance with IFRS9 and the new disclosures required by these new standards are omitted.

## Planned audit approach

Our audit procedures will include the following:

- Review the work performed by the pension fund, once undertaken, to assess the impact of IFRS 9 on the financial statements; and
- Review the disclosures required relating to the adoption of the new accounting standard.

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**There is a risk that employers may not be calculating contributions correctly or the pension fund does correctly charge costs arising on pension strain for early retirements and augmented pensions.**

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## Risk detail

- Employers are required to deduct amounts from employee pensionable pay based on tiered pay rates and to make employer normal and deficit contributions in accordance with rates agreed with the actuary.
- Additional contributions are also required against pension strain for unreduced pensions for early retirements and augmentation of pensions.
- There is a risk that employers may not be calculating contributions correctly, not paying over the full amount due to the pension fund or failing to charge employers the capital cost of pension strain due to early retirement.

## Planned audit approach

Our audit procedures will include the following:

- Test a sample of normal contributions due (and additional deficit contributions where included in a higher employer rate) for active members including checking to employer payroll records;
- Review contributions receivable and ensure that income is recognised in the correct accounting period where the employer is making payments in the following month;
- Perform tests over capital cost due from employers for pension strain due to early retirement; and
- Carry out audit procedures to review contributions income in accordance with the Actuary's Rates and Adjustments Certificate, including specified increased rates to cover the minimum contributions to be paid as set out in the Certificate.

# OTHER MATTERS REQUIRING FURTHER DISCUSSION

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## Fraud

Whilst the Pensions Committee and Board as those charged with governance have ultimate responsibility for prevention and detection of fraud, we are required to obtain reasonable assurance that the financial statements are free from material misstatement, including those arising as a result of fraud. Our audit approach includes the consideration of fraud throughout the audit and includes making enquiries of management and those charged with governance.

We request confirmation from the Pensions Committee and Board on fraud and a discussion on the controls and processes in place to ensure timely identification and action.

## Significant estimates

We will report to you on significant estimates. We will seek to understand and perform audit testing procedures on accounting estimates and judgements including consideration of the outcome of historic judgements and estimates. We will report to you our consideration of whether management estimates and judgements are within an acceptable range.

## 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 review relevant reports as part of our audit and consider whether to place any reliance on internal audit work as evidence of the soundness of the control environment.

## Laws and regulations

We will consider compliance with Laws and regulations. The most significant of these for the Pension Fund includes the Local Government Pension Scheme Regulation 2013. We will make enquiries of Management and review correspondence with the relevant authorities.

## Accounting policies

We will report to you on significant qualitative aspects of your chosen accounting policies. We will consider the consistency and application of the policies and we will report to you where accounting policies are inconsistent with CIPFA Code of Practice on Local Authority Accounting 2018/19, applicable accounting standards or other direction under the circumstances.

## Related parties

Whilst you are responsible for the completeness of the disclosure of related party transactions in the financial statements, we are also required to consider related party transactions in the context of fraud as they may present greater risk for management override or concealment or fraud. Our audit approach includes the consideration of related party transactions throughout the audit including making enquiries of management and the Pensions Committee and Board.

## Financial statement disclosures

We will report to you on the sufficiency and content of your financial statement disclosures.

## Any other matters

We will report to you on any other matters relevant to the overseeing of the financial reporting process. Where applicable this includes why we consider a significant accounting practice that is acceptable under the financial reporting framework not to be the most appropriate.

# IT GENERAL CONTROLS

IT General Controls (ITGCs) are the policies and procedures that relate to many IT applications and support the effective functioning of application controls by helping to ensure the continued proper operation of information systems. They commonly include controls over data centre and network operations; system software acquisition, change and maintenance; access security; and application system acquisition, development, and maintenance.

ITGCs are an important component in systems of internal control, and sometimes have a direct impact on the reliability of other controls.

IT assurance is embedded in our audit strategy to ensure the IT systems provide a suitable platform for the control environment and is undertaken in conjunction with our IT Assurance team. Our testing strategy includes a tailored range of IT environment testing.



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**Under ISAs (UK) and the FRC’s Ethical Standard we are required, as auditors, to confirm our independence.**

We have embedded the requirements of the Standards in our methodologies, tools and internal training programmes. Our internal procedures require that audit engagement partners are made aware of any matters which may reasonably be thought to bear on the integrity, objectivity or independence of the firm, the members of the engagement team or others who are in a position to influence the outcome of the engagement. This document considers such matters in the context of our audit for the year ending 31 March 2019. Details of rotation arrangements for key members of the audit team and others involved in the engagement are set out in the appendices.

Details of other threats and safeguards applied are given in the appendices.

We have not identified any other relationships or threats that may reasonably be thought to bear on our objectivity and independence.

We confirm that the firm, the engagement team and other partners, directors, senior managers and managers conducting the audit comply with relevant ethical requirements including the FRC’s Ethical Standard and are independent of the Pension Fund.

We also confirm that we have obtained confirmation of independence external audit experts involved in the audit comply with relevant ethical requirements including the FRC’s Ethical Standard and are independent of the pension fund.

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

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### Fees summary for year ending 31 March 2019

	2018/19 £	2017/18 £
PSAA scale fees	<sup>(1)</sup> 16,170	21,000
<b>Total audit fees</b>	<b>16,170</b>	<b>21,000</b>

<sup>(1)</sup> PSAA has set the 2018/19 fee scale at £16,170 on the basis that individual fees for all opted-in bodies have been reduced by 23 per cent from the fees applicable scale fee for 2017/18 of £21,000. This gives opted-in bodies the benefit of the cost savings achieved in the recent audit procurement, and continues the practice of averaging firms' costs so that all bodies benefit from the same proportionate savings, irrespective of the firm appointed to a particular audited body. It also passes on the benefit of economies which PSAA is making in its own operating costs.





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# PENSION FUND'S RESPONSIBILITIES

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### Financial reporting

The Pension Fund is expected to have effective governance arrangements to deliver its objectives. To this end, the publication of the financial statements is an essential means by which the pension fund accounts for its stewardship.

The form and content of the financial statements should reflect the requirements of the relevant accounting and reporting framework in place and any applicable accounting standards or other direction under the circumstances.

The Section 151 Officer is responsible for preparing and publishing the Statement of Accounts (including the financial statements) and Pension Fund Annual Report which show a true and fair view in accordance with CIPFA Code of Practice on Local Authority Accounting 2018/19, applicable accounting standards or other direction under the circumstances.

Our audit of the financial statements does not relieve management nor those charged with governance of their responsibilities for the preparation of the financial statements.



# OUR RESPONSIBILITIES

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### Our responsibilities and reporting

We are responsible for performing our audit under International Standards on Auditing (UK) to form and express an opinion on the pension fund's financial statements. We report our opinion on the financial statements to the members of the Council.

We read and consider the 'other information' contained in the Statement of Accounts and Pension Fund Annual Report such as the additional narrative reports. We will consider whether there is a material inconsistency between the other information and the financial statements or other information and our knowledge obtained during the audit.

### What we don't report

Our audit is not designed to identify all matters that may be relevant to the pension fund and the Pensions Committee and Board and cannot be expected to identify all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist.



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# COMMUNICATION WITH YOU

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## Those charged with governance

References in this report to Those Charged With Governance are to the Council (as the administrating authority of the pension fund) as a whole. For the purposes of our communication with those charged with governance you have agreed we will communicate primarily with the Pensions Committee and Board.

## Communication, Meetings and Feedback

We request feedback from you on our planning and completion report to promote two way communication throughout the audit process and to ensure that all risks are identified and considered; and at completion that the results of the audit are appropriately considered. We will meet with management throughout the audit process. We will issue regular updates and drive the audit process with clear and timely communication, bringing in the right resource and experience to ensure efficient and timely resolution of issues.

## Planning Report

The Planning Report sets out all planning matters which we want to draw to your attention including audit scope, our assessment of audit risks and materiality.

## Internal Controls

We will consider internal controls relevant to the preparation of financial statements in order to design our audit procedures and complete our work. This is not for the purpose of expressing an opinion on the effectiveness of internal control.

## Audit Completion Report

At the conclusion of the audit, we will issue an Audit Completion Report to communicate to you key audit findings before concluding our audit opinion. We will include any significant deficiencies in internal controls which we identify as a result of performing audit procedures. We will meet with you to discuss the findings and in particular to receive your input on areas of the financial statements involving significant estimates and judgements and critical accounting policies.

Once we have discussed the contents of the Audit Completion Report with you and having resolved all outstanding matters we will issue a final version of the Report.

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These tables indicate the latest rotation periods normally permitted under the independence rules for the terms of appointment by PSAA.

In order to safeguard audit quality we will employ a policy of gradual rotation covering the team members below as well as other senior members of the engagement team to ensure a certain level of continuity from year to year.

### Independence - engagement team rotation

Senior team members	Number of years involved	Rotation to take place before
Leigh Lloyd-Thomas Engagement Lead	4	5 years (last year will be 2019/20)
Simiso Ngidi Audit Manager	2	10 years

### Independence - audit quality control

Role	Number of years involved	Rotation to take place before
Engagement Quality Control Reviewer	2	7 years

# MATERIALITY: DEFINITION AND APPLICATION

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## 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).

International Standards on Auditing (UK) 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 industry 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.

## 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.

# MATERIALITY: DEFINITION AND APPLICATION



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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

We will communicate to you 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 Pensions Committee and Board 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.

We will request that you correct all uncorrected misstatements. In particular we would strongly recommend correction of errors whose correction would affect compliance with contractual obligations or governmental regulations. Where you choose not to correct all identified misstatements we will request a written representation from you setting out your reasons for not doing so and confirming that in your view the effects of any uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as whole.

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## BDO's audit quality cornerstones underpin the firm's definition of audit quality.

BDO is committed to audit quality. It is a standing item on the agenda of the Leadership Team, who in conjunction with the Audit Stream Executive, monitors the actions required to maintain a high level of audit quality within the audit stream and address findings from external and internal inspections. We welcome feedback from external bodies and are committed to implementing 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 regulators, the firm undertakes a thorough annual internal Audit Quality Assurance Review and as a member firm of 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 entities.

More details can be found in our Transparency Report at [www.bdo.co.uk](http://www.bdo.co.uk)



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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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