# CAMBRIDGESHIRE COUNTY COUNCIL PENSION FUND

## PLANNING REPORT TO THE AUDIT AND ACCOUNTS COMMITTEE

**Audit for the year ended 31 March 2018**

27 March 2018

# CONTENTS

# 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 Cambridgeshire County Council Pension Fund for the year ended 31 March 2018. 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 Accounts Committee and Pension Fund Committee. In preparing this report, we do not accept or assume responsibility for any other purpose, or to any other person, 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.

# YOUR BDO TEAM

**Core team**

David Eagles
Engagement Lead

Archie Rwavazhinji
Engagement Manager

Paul Stafford
Senior

| Name | Contact details | Key responsibilities |
|---|---|---|
| **David Eagles**<br>**Engagement Lead** | Tel: 01473 320728<br>david.eagles@bdo.co.uk | Oversee the audit and sign the audit report |
| **Archie Rwavazhinji**<br>**Engagement Manager** | Tel: 01473320738<br>Archie.Rwavazhinji@bdo.co.uk | Management of the audit |
| **Paul Stafford**<br>**Senior** | Tel: 01473 320 850<br>Paul.stafford@bdo.co.uk | Day to day supervision of the on-site audit |

David Eagles is the Engagement Lead and has the primary responsibility to ensure that the appropriate audit opinion is given on the financial statements.

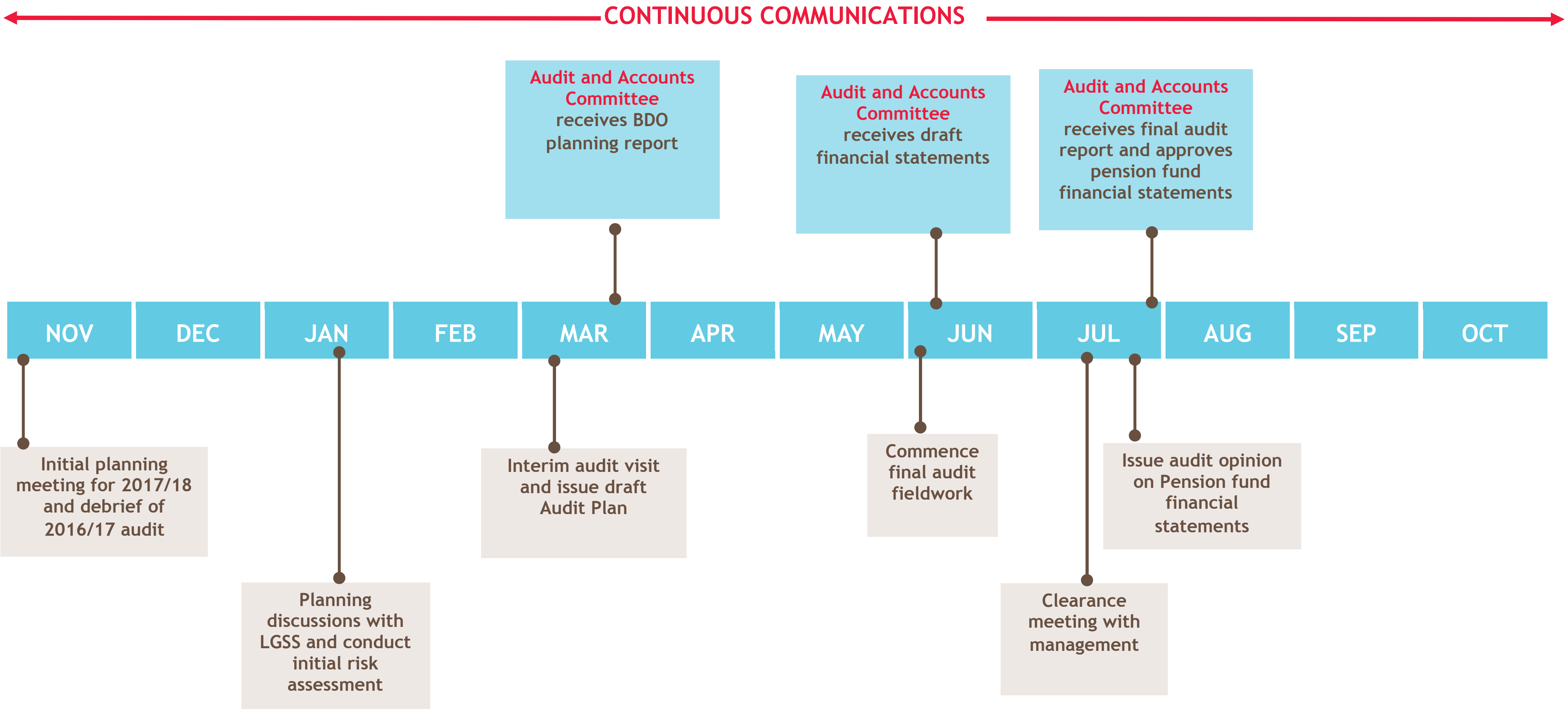
In meeting this responsibility, he will ensure that the audit has resulted in obtaining sufficient and appropriate evidence to provide reasonable, but not absolute, assurance that the financial statements are free from material misstatement, whether due to fraud or error.

David is also responsible for the overall quality of the engagement.

# 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 National Audit office (NAO) Code of Audit Practice, International Standards on Auditing (UK) and other guidance issued by the NAO.

Our audit objective is to form an opinion on whether:

| FINANCIAL STATEMENTS | | OTHER INFORMATION | ADDITIONAL REQUIREMENTS |
|---|---|---|---|
| 1 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. | 2 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. | 3 Other information published together with the audited financial statements is consistent with the financial statements. | 4 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 | £28,500,000 | £570,000 |
| Specific materiality for other financial statement areas: | | |
| - Contributions | £6,272,000 | £125,000 |
| - Other fund account balances | £9,297,000 | £185,000 |

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 contributions at 5% of contributions receivable and for other fund account balances at 7.5% of the total expenditure.

At this stage, the above figures are based on the prior year net assets and income and expenditure figures. 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.

### Management assessment of fraud

We have discussed with management its assessment of the risk that the financial statements may be materially misstated due to fraud and the processes for identifying and responding to the risks of fraud.

Management believe that the risk of material misstatement due to fraud in the pension fund financial statements is low. Potential fraud could include failure to receive all contributions due from employers or paying for fictitious pensioners or continuing to pay pensions to deceased pensioners. Management consider that controls in operation would prevent or detect material fraud in these areas. We are informed by management that there have not been any cases of significant or material fraud to their knowledge.

The Pension Committee and Board has oversight of management's 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. This is discharged through the reviews undertaken by internal audit.

To corroborate the responses to our inquiries of management, please let us know if there are any other actual, suspected or alleged instances of fraud of which you are aware.

### New Auditing Standards from 2017/18

This is the first year of application of a revised set of ISAs applicable to the UK. These include enhanced requirements in respect of the audit of disclosures, other information published with the accounts and of going concern, as well as changes to the structure and content of the audit opinion.

# KEY AUDIT RISKS AND OTHER MATTERS

Key: ■ Significant risk ■ Normal risk

| AUDIT RISK AREAS - FINANCIAL STATEMENTS | | | |
|---|---|---|---|
| RISK | DESCRIPTION | PLANNED AUDIT RESPONSE | EXTERNAL DATA TO BE USED TO CORROBORATE AUDIT EVIDENCE |
| Management override | Under ISA (UK) 240 “The Auditor’s responsibility to consider fraud in an audit of financial statements”, there is a presumed significant risk of management override of the system of internal controls.<br>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 as a deterrent. We consider the manipulation of financial results through the use of journals and management estimates as a significant fraud risk.<br>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. | Not applicable. |
| Fair value of investments (unquoted investments - excluding Cambridge & Counties Bank) | The investment portfolio includes unquoted investment holdings valued by the fund manager. The valuation of these assets may be subject to a significant level of assumption and estimation and valuations may not be based on observable market data.<br>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.<br>As a result, we consider there to be a significant risk that investments are not appropriately valued in the financial statements.<br>The valuation of Cambridge & Counties Bank is considered separately as a non-significant risk below. | 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.<br>Where the financial statement date supporting the valuation is not conterminous 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.<br>We will review the methods and assumptions used and consider whether investments have been correctly valued in accordance with the relevant accounting policies. | Direct confirmation of fund valuation and audited financial statements for private equity investments. |

# 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** | 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 previous 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.<br><br>There is a risk that the membership data and cash flows provided to the actuary as at 31 March may not be correct, or the valuation uses inappropriate assumptions to value the liability. | We will review the controls in place to ensure that the data provided from the fund to the actuary is complete and accurate.<br><br>We will review the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data.<br><br>We will agree the disclosure to the information provided by the actuary. | We will use the PwC consulting actuary report for the review of the methodology of the actuary and reasonableness of the assumptions. |
| **Revenue recognition (CCC contributions)** | Under ISA (UK) 240 there is a presumption that income recognition presents a fraud risk. We have rebutted this presumed significant risk as the majority of income is from contributions, which is a highly controlled stream (with limited subjectivity or opportunity for manipulation), and levels of contributions are set by the scheme actuary.<br><br>However, the majority of contributions are from a single employer, Cambridge County Council (CCC). Therefore, there is a risk that manipulation may occur within the CCC contributions, but this is not regarded as significant. We have scoped out from this specific risk the contributions received from other bodies, as it would require significant manipulation of multiple bodies for any misstatement to be material. | We will undertake substantive testing of contributions receivable by the fund from CCC, on a sample basis, to verify the monthly contributions received by the pension fund and trace these back to returns issued to the pension fund and the employer payroll records.<br><br>For a sample of individual members, we will verify their inclusion in the employer payroll and seek to confirm that employer contribution rates are in line with the latest rates set by the actuary, and member rates are in accordance with the LGPS contributions table. | We will check a sample of contributions receivable from the Council to the Council's payroll records to ensure that the correct amounts have been paid by the employee and employer. |

# 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** |
| **Fair value of investments (Cambridgeshire and Counties Bank)** | The investment in Cambridge & Counties Bank (CCB) is unquoted and is valued by an external valuer appointed by the fund (Grant Thornton). The valuation of the investment is in based upon the unquoted results of the bank and includes an element of assumption and estimation.<br><br>There is a risk that investments may not be appropriately valued and correctly recorded in the financial statements. However, from our experience gained by reviewing the valuation basis in the prior year, and our expectation that the same basis will be applied this year, we have concluded this does not present a significant risk of misstatement. | We will review the valuation of the bank completed by the external valuer and the significant assumptions made in this valuation. As part of this we will consult with a valuation specialist within the firm to help assess the reasonableness of the valuation.<br><br>We will ensure that investments have been correctly valued in accordance with the relevant accounting policies. | External market comparators to Pension Fund's valuation drivers. |
| **Consideration of related party transactions - key management personnel disclosures** | We consider if the disclosures in the financial statements concerning related party transactions are complete, accurate and in line with the requirements of the accounting standards. | We will document the related party transactions identification procedures in place and review relevant information concerning any such identified transactions.<br><br>We will discuss with management and review members' and Senior Management declarations to ensure that 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. | 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 Accounts 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 2018.

Our appointment by the Audit Commission (and confirmed by Public Sector Audit Appointments Limited) covers both the Council 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.

## INDEPENDENCE - ENGAGEMENT TEAM ROTATION

| SENIOR TEAM MEMBERS | NUMBER OF YEARS INVOLVED | ROTATION TO TAKE PLACE IN YEAR ENDED |
|---|---|---|
| David Eagles - Engagement lead | 3 | 31 March 2021 |
| Archie Rwavazhinji - Engagement manager | 2 | 31 March 2027 |

# INDEPENDENCE

| INDEPENDENCE – AUDIT QUALITY CONTROL | | |
|---|---|---|
| **ROLE** | **NUMBER OF YEARS INVOLVED** | **ROTATION TO TAKE PLACE IN YEAR ENDED** |
| Engagement Quality Review Partner | 3 | 31 March 2021 |

# FEES

## FEES SUMMARY

Our proposed fees, excluding VAT, for the year ended 31 March 2018 are:

| | £ |
|---|---|
| Code audit fee (pension fund) | 22,410 |
| **TOTAL FEES** | 22,410 |

Fee invoices have been raised as set out below:

- First instalment £11,205 in July 2017
- Second instalment £11,205 in January 2018.

The fee set out above is the base Scale fee. It has not been adjusted to reflect any ongoing risks and consequent additional audit resource requirements to address such. This position will be closely monitored and any additional risk work that we consider necessary will be discussed and agreed with the Pension Fund.

### 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 Accounts 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 Accounts 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.

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