

Essex Pension Fund

Audit Planning Report: Year ended 31 March 2022

Report to the Audit, Governance and Standards Committee

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Welcome

Introduction

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We have pleasure in presenting our Audit Planning Report to the Audit, Governance and Standards Committee. 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 2022, comprising materiality; key audit risks and the planned approach to these; together with audit timetable.

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.

This report contains matters which should properly be considered by the Council as a whole. We expect that the Audit, Governance and Standards Committee will refer such matters to the Council, together with any recommendations, as it considers appropriate.

We look forward to discussing this plan with you at the Audit, Governance and Standards Committee meeting on 31 October 2022 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.

David Eagles, Partner
for and on behalf of **BDO LLP**, Appointed Auditor

14 October 2022

This report has been prepared solely for the use of the the Audit 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. For more information on our respective responsibilities please see the appendices.



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The numbers

Executive summary

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This summary provides an overview of the audit scope and materiality for the year ended 31 March 2022.

Audit scope

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

There has been no significant changes to the scope of the audit on prior year.

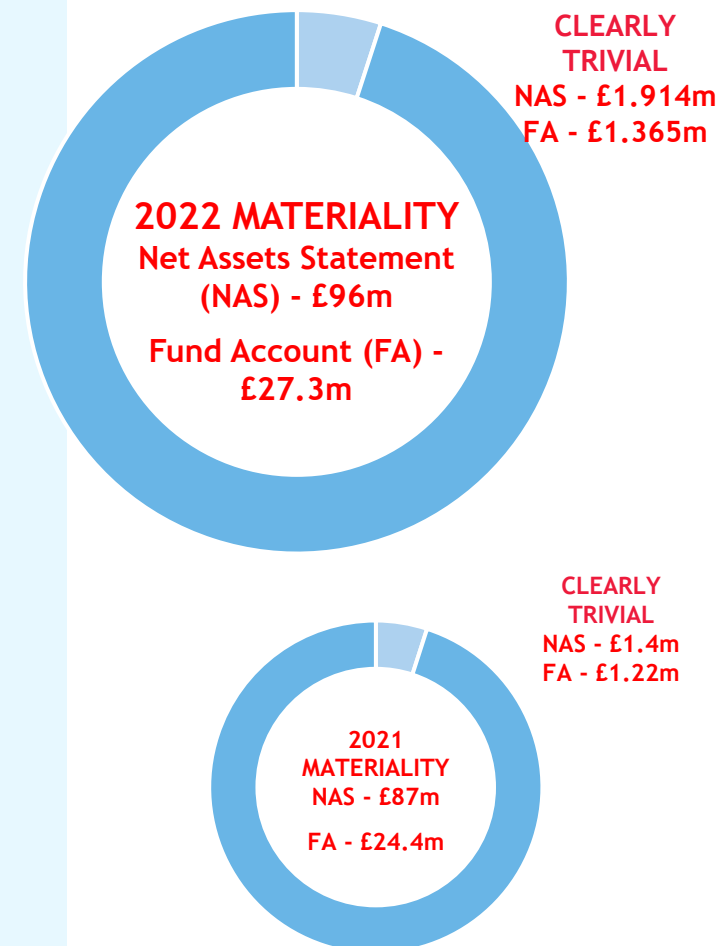
Planning materiality for the Pension Fund will be based on and is outlined in the chart to the side. Overall materiality is based on 1% of net assets, and the Fund Account specific materiality is based on 7.5% of gross pension fund expenses.

Although materiality is the judgement of the audit partner, the Audit, Governance and Standards Committee is obliged to satisfy themselves that the materiality chosen is appropriate for the scope of the audit.

Responsibilities of the Executive Director, Corporate Services, and Essex County Council (“the Council”) as administering authority of the pension fund

Executive Director, Corporate Services, is responsible for the preparation of the Statement of Accounts, which comprises the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that the financial statements give a true and fair view.

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.



Independence and fees

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Independence

We confirm that the firm, and the engagement team conducting the audit comply with relevant ethical requirements including the Financial Reporting Council's (FRC's) Ethical Standard as appropriate and are independent of the Company.

We also confirm that we have obtained confirmation of independence from non BDO auditors and external audit experts involved in the audit comply with relevant ethical requirements including, as a minimum, the FRC's Ethical Standard and the National Audit Office's (NAO) Auditor Guidance Note 01 (AGN01), and are independent of the Pension Fund.

There were no non-audit services provided by us to the Pension Fund during the period and up to the date of this Audit Planning Report.

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

Fees

The 2021 audit is not yet finalised, so the outturn position is marked TBC.

The 2022 audit is ongoing, so fees represent our best estimate, including additional income and IT controls requirements.

	Fees (£)		Independence safeguards	Impact on independence
	2022	2021		
Statutory audit	44,500	TBC	N/A	N/A
Additional fee for IAS 19 assurance requests	7,875	7,500	N/A	N/A
Additional audit fee: COVID remote working	-	TBC	N/A	N/A



Overview

Audit scope and objectives

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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.

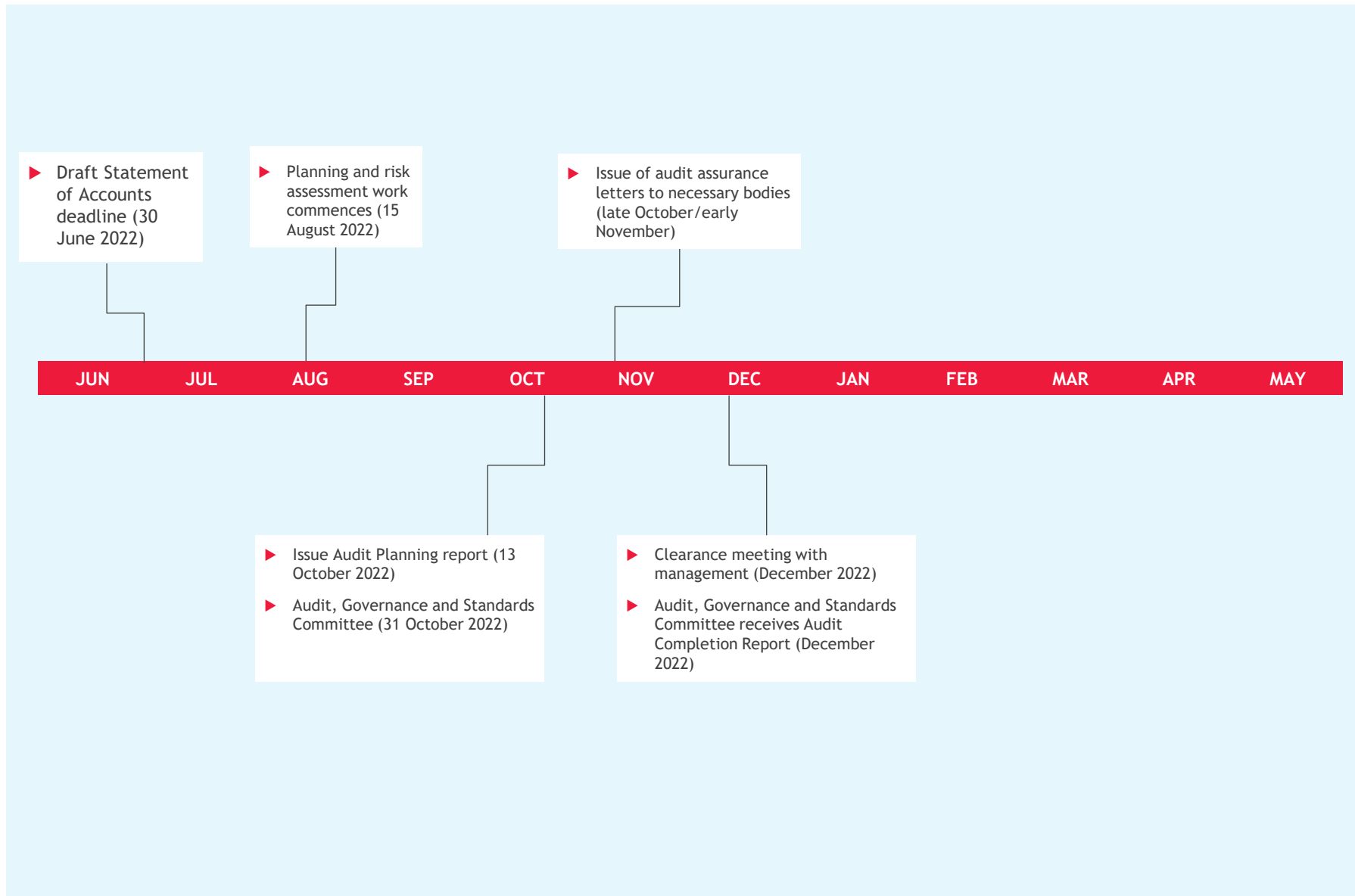
We will communicate any significant changes to our audit strategy, should the need for such change arise.

Reporting	Objectives
Auditing standards	We will perform our audit in accordance with International Standards on Auditing UK (ISAs (UK)) and Practice Note 10 and any relevant guidance published by the National Audit Office.
Financial statements	We will express an opinion on the Pension Fund's financial statements (which are included within the Council's overall Statement of Accounts), prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting 2021/22 and other directions.
Annual report	In addition to our objectives regarding the financial statements, we will also read and consider the 'other information' contained in the Annual Report (the narrative sections of the overall Statement of Accounts) 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.
Report to the Audit, Governance and Standards Committee	Prior to the approval of the financial statements, we will discuss our significant findings with the Audit, Governance and Standards Committee. 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

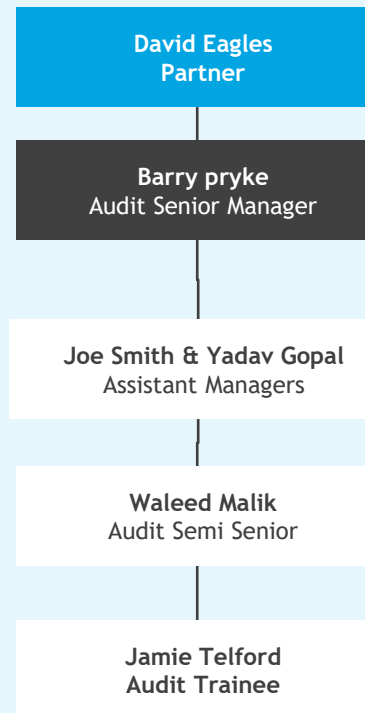
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Team organisation

Our structure

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Overview of risks

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Our Audit Strategy is built 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 business, 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. We will continue to update this assessment throughout the audit.

Please note, our risk based approach will be focused over 5 BDO assertion. These assertions include:

- C - Completeness
- E - Existence
- A - Accuracy
- V - Valuation
- P - Presentation

#	Risk identified	Key audit matter	Risk rating	Fraud risk present	Testing approach	Impact of significant judgements and estimates
1	Management override	No	Significant	Yes	Substantive	High
2	Valuation of investments (Unquoted and direct property investments)	No	Significant	Yes	Substantive	High
3	Valuation of Pension liability	No	Significant	No	Substantive	High
4	Valuation of investments (Pooled investments)	No	Normal	No	Substantive	Low
5	Contributions receivable	No	Normal	No	Substantive	Low
6	Management expenses	No	Normal	No	Substantive	Low

Risk 1

Management override of controls

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	C	E	A	V	P	2022	2021
Management override	x	x	x	x	x	N/A	N/A

Risk detail

Management has the ability to manipulate accounting records and override controls that otherwise appear to be operating effectively. We are required to consider this as a significant risk of material misstatement due to fraud.

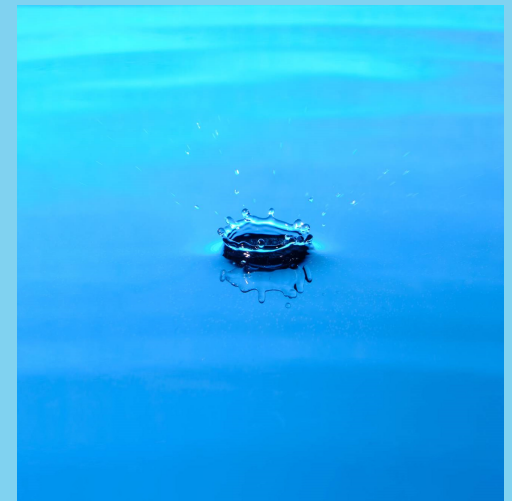
Planned audit approach

Our audit procedures will include the following:

- A review and verification of large and unusual journal entries made in the year, agreeing the journals to supporting documentation. We will determine key risk characteristics to filter the population of journals. We will use our IT audit specialists to assist with the journal extraction;
- Evaluation of risks arising from automated journals
- Evaluate findings from evaluation of design and implementation of IT general controls
- A critical review of the consolidation and, in particular, manual or late journals posted at consolidated level;
- A 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.

● Significant risk
Normal risk
● Fraud risk
● Related controls identified to mitigate risk
● Significant Management estimates & judgements
Controls testing approach
● Substantive testing approach



Risk 2

Valuation of investments (Unquoted and direct property investments)

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	C	E	A	V	P	2022	2021
Change in Market Value			x			£(828.6)m	£(2,008.3)m
Investments				x		£9,601.8m	£8,674.5m

Risk detail

The investment portfolio includes unquoted private equity, debt, infrastructure and timberlands, which are valued by the fund managers. The pension fund also makes direct investments in freehold and leasehold properties which are based on valuations received from the fund managers. 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. Due to significance of these valuations, even a small change in assumptions and estimates could have a material impact on the financial statements.

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. Due to current market volatility the valuation received can quickly become outdated.

As a result, we consider there to be a significant risk that investments are not appropriately valued in the financial statements.

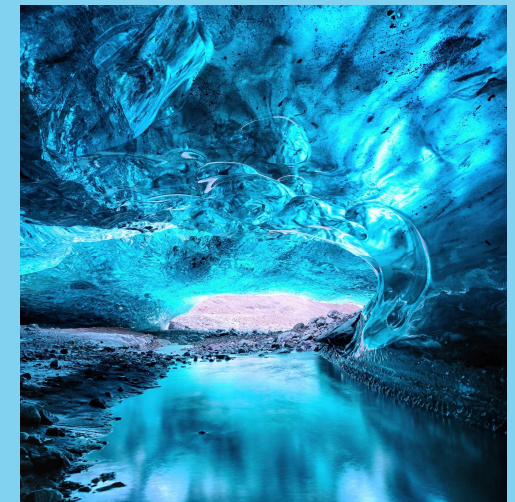
Planned audit approach

Our audit procedures will include the following:

- Obtain direct confirmation of investment valuations from the fund managers and request copies of the audited financial statements (and member allocations) from the fund;

- Review the valuation completed by the fund manager and any significant assumptions made in the valuation;
- For property valuations, we will agree input data used by the valuer such as agreeing rental information to the underlying rental agreements, and will review the rental yields against the comparable data and indices for reasonableness;
- Where the financial statement date supporting the valuation is not coterminous with the pension fund's year end, confirm that appropriate adjustments have been made to the valuations in respect of additional contributions and distributions with the funds; and
- Ensure investments have been correctly valued in accordance with the relevant accounting policies.

● Significant risk
Normal risk
Fraud risk
● Related controls identified to mitigate risk
● Significant Management estimates & judgements
Controls testing approach
● Substantive testing approach



Risk 3

Valuation of Pension liability

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	C	E	A	V	P	2022	2021
Pension Disclosure	x	x	x	x	x	N/A	N/A

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 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.

The most recent actuarial valuation of the pension fund liability was carried out during the 2019/20 year to calculate the liability as at 31 March 2019. This involved the provision of membership and cash flow data from the pension fund to the actuary, data cleansing by the actuary and re-setting the financial and actuarial assumptions related to the valuation. The estimate of the pension fund liability at 31 March 2022 is based on a roll-forward of data from the 2019 triennial valuation, updated where necessary.

There is a risk the valuation disclosed in the notes to the Pension Fund accounts is not based on appropriate membership data (where there are any significant changes) or uses inappropriate assumptions to value the liability.

Planned audit approach

Our audit procedures will include the following:

- Reviewing the controls in place to ensure that the data provided from the fund to the actuary is complete and accurate;

- Test a sample of transfers and cash flow data sent to the actuary for existence and accuracy;
- Reviewing the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data. We will use the PwC consulting actuary report for the review of the methodology of the actuary and reasonableness of the assumptions;
- Check whether any significant changes in membership data have been communicated to the actuary; and
- Agreeing the disclosure to the information provided by the actuary.

● Significant risk
Normal risk
Fraud risk
● Related controls identified to mitigate risk
● Significant Management estimates & judgements
Controls testing approach
● Substantive testing approach



Risk 4

Valuation of Investments (Pooled investments)

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	C	E	A	V	P	2022	2021
Change in Market Value			x			£(356.9)m	£(1,699.5)m
Investments				x		£6,573.9m	£5,916.8m

Risk detail

The fair value of funds (principally pooled investments) is provided by individual fund managers and reviewed by the Custodian (Northern Trust). These valuation are reported on a monthly/ quarterly basis although there may be amendments to the 'flash' valuations initially provided and subsequent 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 fund managers including any subsequent final valuations to 'flash' valuations in the draft accounts;
- Ensure that investments have been correctly valued in accordance with the relevant accounting policies; and
- Obtain independent assurance reports over the controls operated by both the fund managers and custodian for valuations and existence of underlying investments in the funds.

	Significant risk
●	Normal risk
	Fraud risk
●	Related controls identified to mitigate risk
	Significant Management estimates & judgements
	Controls testing approach
●	Substantive testing approach



Risk 5

Contributions Receivable

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	C	E	A	V	P	2022	2021
Contributions	x	x	x			£(292.3)m	£(313.7)m

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 and paying over the full amount due to the pension fund.

Planned audit approach

Our audit procedures will include the following:

- Test a sample of normal contributions due (and test where a combined rate including deficit applies) 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; 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.

Significant risk
● Normal risk
Fraud risk
Related controls identified to mitigate risk
Significant Management estimates & judgements
Controls testing approach
● Substantive testing approach



Risk 6

Management expenses

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	C	E	A	V	P	2022	2021
Management expenses	x	x	x			£81.4m	£58.2m

Risk detail

The Pension Fund are required to pay investment management and performance related fees to the Fund Managers. The investment management fee is typically derived from the value of the portfolio invested in each fund manager and the type of investment undertake. The performance related fees are based on the return generated yearly and is the more volatile aspect of management expenses.

There has been a significant increase in management fees year on year (44%) while the value of the investments under management has only increased by 11%. Where as investments under management in the increased by more than 20% in 2020/21. This indicates a risk that expenditure cut-off has not been correctly applied for 2021/22.

Planned audit approach

Our audit procedures will include the following:

- Test a sample of management expenses agreeing them back to supporting documentation from the custodian or Fund Managers.
- Review the significant movements in management expenses to confirm they are reasonable and in line with supporting documentation.

Significant risk
● Normal risk
Fraud risk
Related controls identified to mitigate risk
Significant Management estimates & judgements
Controls testing approach
● Substantive testing approach



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Fraud

Whilst Management 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 have not been made aware of any actual alleged or suspected incidences of fraud. We request confirmation from the Audit, Governance and Standards Committee on fraud and a discussion on the controls and processes in place to ensure timely identification and action.

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 the CIPFA code of practice on Local Government Accounting 2021-22.

Significant accounting estimates and judgements

We will report to you on significant accounting estimates and judgements.

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

Internal audit

We do not plan to review the audit work of the Company's internal audit function and anticipate that we will not be able to place reliance on their work in respect of their assessment of control processes.

Laws and regulations

We will consider compliance with laws and regulations. The key elements are:

- Local Government Superannuation Regulations 1974
- Public Service Pensions Act 2013.

The Fund is administered in accordance with the following secondary legislation:

- Local Government Pension Scheme (LGPS) Regulations 2013 (as amended);
- LGPS (Transitional Provisions, Savings and Amendment) Regulation 2014 (as amended); and
- LGPS (Management and Investment of Funds) Regulations 2016.

We will make enquiries of Management and review correspondence with the relevant authorities.

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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 Board.

Financial statement disclosures

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

Contingencies

We request input from the Audit, Governance and Standards Committee on recent claims.

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.

Audit of revenue

As part of our ongoing commitment to enhancing audit quality, we have recently introduced some amendments to our audit approach in relation to revenue.

The revisions to our audit approach are designed to encourage fresh-perspective thinking in relation to the way we audit revenue and is intended to ensure that our approach is tailored to the audited entity.

We plan to ensure a deep and thorough understanding of all of the audited entity's revenue streams, a focus on the accounting policies and application of judgements and estimates and taking time to fully explore and document management's system of internal control in place over each revenue stream. This will include considering how IT is used as part of the system of internal control.

The audit team will then consider in detail the circumstances that may mean that revenue may not be captured, processed, controlled or reported as expected and will consider whether those circumstances represent or coalesce as a risk of material misstatement. Should any resultant risk be identified as significant, the audit team will focus their audit effort on those risks, considering specific controls that management may have designed and implemented to prevent material misstatement, test those controls if feasible, report and control deficiencies and consider what other evidence may be necessary to be able to form our conclusions in this area.

We report details of risks arising in relation to revenue in the section on "audit risk" elsewhere in this Report.

As part of these changes, you may notice that the audit team spends more time on this area of the audit than you might expect. We will be pleased to discuss the reasons for this, our findings and where appropriate, any recommendations that we might have for management.

Understanding your IT environment

Overview

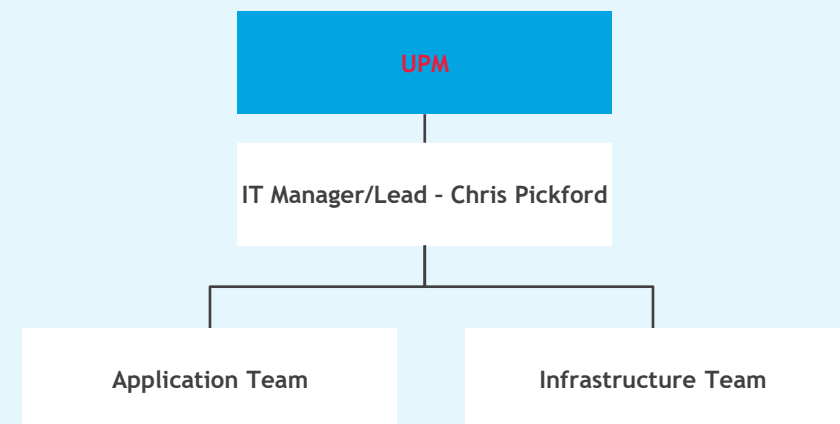
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Understanding your entity's IT environment is a component of the system of internal control which we must evaluate during risk assessment procedures in accordance with ISA 315 (Revised 2019), Identifying and Assessing Risks of Material Misstatement

The objective of understanding your IT environment is to identify potential risks arising from the use of IT, through identifying key IT applications and processes relevant to the audit. This information will then assist in identifying IT general controls (ITGCs) that address those risks and creating specific audit responses to address those risks, as applicable. We follow the same process for your business cycles and identifying related control activities relevant to the audit.

The IT environment consists of the IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes that an entity uses to support business operations and achieve business strategies.

Our Understanding of your IT Function and Systems



Our Approach

IT Audit Scope and Methodology

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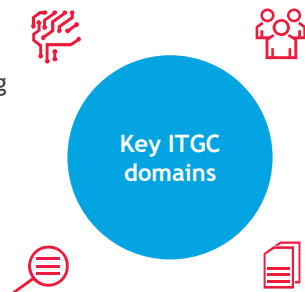
Based on our understanding of your IT control environment and key business cycles, we will perform procedures over the design and implementation (D&I) of your IT General Controls for the applications and underlying databases, considered to be in scope for the audit. The results of these procedures will determine whether we perform operating effectiveness testing over those ITGCs, with the intention of placing audit reliance upon those controls. This approach has been outlined below:

Access management

- User access provisioning
- Excessive Access
- Generic accounts and Privilege access
- User access de-provisioning
- User access review

Program changes

- Change evaluation
- Change authorization
- Existence of different environments
- Segregation of duties.

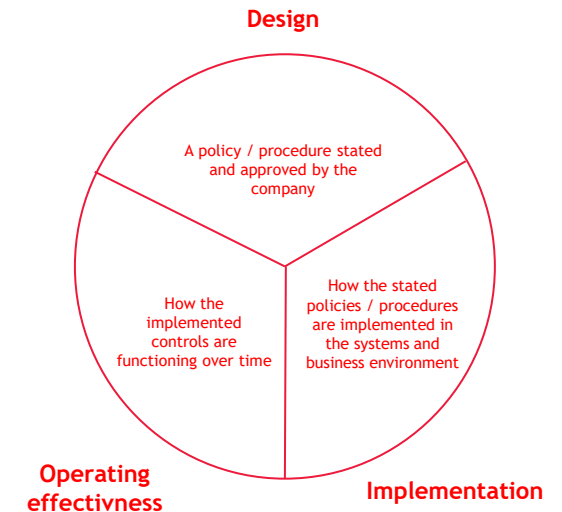


Data processing management

- Completeness and accuracy of data movement
- Modification of schedules and jobs
- Exception handling workflow in case of job/interface failure

Program development

- - Governance over system change, including evaluation of design and testing of controls in the new environment
- Data migration



Based on our initial understanding of your IT environment, we consider the following applications likely to be in scope for the audit, however we may revise the scope of our work as we proceed further through the planning and execution phases of the audit.

Application in scope	Underlying Database	Business function	Brief Description
UPM	N/A	Membership data & Pensions	
Oracle (Cloud based)	N/A	Main Financial system	

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Those Charged with Governance (TCWG)

References in this report to Those Charged With Governance are to the Board of Councillors as a whole. For the purposes of our communication with those charged with governance you have agreed we will communicate primarily with the Audit, Governance & Standards Committee

In communicating with the Audit, Governance & Standards Committee, representing TCWG of the parent and the Group, we consider TCWG of subsidiary entities to be informed about matters relevant to their subsidiary. Please let us know if this is not appropriate.

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.

Audit Planning Report

The Audit 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 signed and dated prior to issue of the Audit Opinion.

New Accounting Standards, Auditing Standards and Other Financial Reporting Developments

Audit scope and objectives

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We would like to draw to your attention the following summary of key changes to standards, regulations and other financing reporting developments, their effective dates and an indication, based on preliminary

discussions with management and our sector understanding, of their possible effect on the annual report.

New Accounting Standards, Auditing Standards and Other Financial Reporting Developments	Expected effect				Effective for periods beginning on or after 1 January	
	None	Low	Medium	High	2021	2022
[IBOR Reform Phase 2 Amendments]		●			●	
Amendments to IFRS 16: Covid-19 related Rent Concessions beyond 30 June 2021		●			● 1 April 2019	
Amendments to IAS 37 Onerous Contracts - Costs of Fulfilling a Contract		●				●
ISA (UK) 240 (Revised May 2021) - The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements			●			● 15 December 2021
ISA (UK) 315 (Revised July 2020) - Identifying and Assessing the Risks of Material Misstatement				●		● 15 December 2021

Other information

Audit requirements - other information in the annual report

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As we note in the 'Overview - Audit Scope and Objectives' section, we have responsibilities in relation to going concern and the other information (including statutory other information) in the Statement of Accounts.

In order to allow us to fulfil these obligations we ask that you please make available to us the following information as soon as is practicable:

Other Information	A final draft of the other information with relevant supporting documentation, sufficiently far in advance of the date on which the audit report is expected to be signed to give us adequate time to complete our work.
Information not directly derived from the financial statements or accounting records	For information not directly derived from the financial statements or otherwise from the accounting records of the Pension Fund, details of the source of that information.
Principal Risks - assessment of risks	A copy of the risk register or equivalent together with details of directors' consideration of risks including completeness of risks recorded in the register.
Managements' assessment of going concern	In the public sector, the assessment of going concern is driven by the principle of "continuing service provision".

Quality Assurance

Our Quality Ethos

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Bdo's quality ethos: bringing audit quality to life

We take audit quality extremely seriously and embrace our responsibility for providing the highest quality assurance and acting in the public interest. Quality assurance is given the highest priority in the firm and is an integral part of the way we work.

All of our employees are bound by our quality assurance policies, which set out common standards for delivery of all our services. These are designed to ensure that your audit meets all applicable professional standards, regulatory requirements and that the firm issues reports that are appropriate in the circumstances.

Where your highest audit quality comes from

- ▶ All members of the team are subject to external and internal Audit Quality Reviews
- ▶ Our team is supplemented with technical and audit quality specialists. We have a Quality and Risk Management team responsible for managing, reviewing and communicating on Quality Assurance policies, procedures, controls and reviews. We use these mechanisms to ensure that we manage internal and external work to a high standard.
- ▶ Our well-established quality control procedures and systems support compliance with relevant standards and regulations.

Audit quality cornerstones

A key driver of audit quality is our focus on the component parts required to consistently achieve robust assurance.

We summarise below our four cornerstones of audit quality which underpin our audits:

Access management

- ▶ User access provisioning
- ▶ Excessive Access
- ▶ Generic accounts and Privilege access
- ▶ User access de-provisioning
- ▶ User access review

Program changes

- ▶ Change evaluation
- ▶ Change authorization
- ▶ Existence of different environments
- ▶ Segregation of duties.

Data processing management

- ▶ Completeness and accuracy of data movement
- ▶ Modification of schedules and jobs
- ▶ Exception handling workflow in case of job/interface failure

Program development

- ▶ - Governance over system change, including evaluation of design and testing of controls in the new environment
- ▶ Data migration

Key ITGC domains

AQR results 2021/22 for corporate audits - An Overview

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Overview

The FRC released their Audit Quality Review results for the seven largest accountancy firms in July 2022 for the review period 2021/22. A copy of all of the reports can be found on the [FRC website](#).

Firm's Results

In total, twelve of BDO's audits with year ends between June 2020 and March 2021 were reviewed.

The AQR found that:

- ▶ Seven were deemed good with limited improvements required (grades 1 and 2)
- ▶ One required improvements (grade 3)
- ▶ Four required significant improvements (grade 4).

Our Response

Ensuring we consistently deliver high-quality audits is our top priority. We are disappointed this year's grades do not meet the standards expected by the regulator and our Leadership Team, and will continue to work hard to fully address the FRC's findings.

We have made significant investments in resourcing our audit practice over the last year, including the addition of 350 people to take our overall UK audit team headcount to 2,800. Further investments in audit quality initiatives include recent enhancements to our methodologies and technology. However, these actions take time to embed, and are therefore not reflected in this year's reviews.

Our entire audit practice remains focussed on being able to demonstrate sustained quality improvements over the coming years to restore our leading position in the AQR rankings.

Investment in Audit Quality

As part of our commitment to audit quality, we are investing heavily. This has included the following:

- ▶ Significant recruitment (14% increase headcount in the past year) and appointment of a Head of Resourcing partner who sits on the Audit Executive
- ▶ Significant expansion of our central audit quality and technical support functions, alongside expansion of our Root Cause Analysis (RCA) function, recruiting three additional partners within the Audit Quality Directorate (including a partner to lead the newly established Audit Quality Improvement Team ("AQIT") and a partner focused on root cause analysis) and other senior individuals across these areas. £8m has been allocated to fund this recruitment, and there has already been an expansion in excess of 30% in our audit quality and technical support function.
- ▶ Our Technology Risk Assurance Team ("TRA") has been strengthened with four additional partners and a 25% expansion in the team, as the initial phase of a significant investment project.
- ▶ Investment in 20 new partners within the audit stream, including sector specialists, and around 300 additional professional roles within the audit stream

All of the Pension Fund audit senior team have already taken part in our activities to drive audit quality, having attended our Audit Summer School programme, which is mandatory training for all audit employees and partners. The Summer School covers training on the findings from the FRC, such as driving consistent and effective challenge of management.



AQR results 2021/22- Audit quality plan

Driving audit quality - our strategic priority

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Audit Quality Plan

Our AQP is underpinned by seven key 'building blocks' to support consistent high quality audits. These are reinforced by our four audit quality risk areas (four 'Big Rocks') which form key focus areas for audit quality action plans to drive consistent high quality. Our strategic priorities within the AQP are controlled growth, investment in central audit quality support infrastructure, enhancements to methodologies and guidance and fostering a culture of challenge and scepticism.

Building Blocks of Audit Quality

The building blocks to sustain audit quality are the themes identified by the Audit Executive as being areas which are critical to achieving our commitment to consistent high quality audits.

Culture of challenge

The right work by the right people at the right time

Resource led responsible & sustainable growth

Central audit quality support

Highly effective training and development

Committed to technology and digital innovation

Focus on horizon scanning

Continuous improvement

4 Big Rocks

When not audited robustly the Big Rocks pose the most significant threat of corporate failure and reputational damage to BDO.

01



Audit of revenue

01



Effective challenge of management

03



Going concern and viability

03



Detecting material fraud



AQR results 2021/22- An Overview

Summary of the key elements of our response to firm-wide findings

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In response to the FRC's AQR findings at a firm-wide level, we have taken the following actions:

Firm-wide

Audit Quality Initiatives:

- Undertaken a full review of and enhanced our AQP
- Invested in resourcing, increasing the size and capability of our Technical Team and central support functions, with £8m allocated to fund this
- Strengthened formality of oversight - Head of Audit Quality reports progress against the AQP and we have revised our executive and governance bodies
- Emphasised our commitment to highly controlled growth with 5 Year National Audit Stream Revenue and Resourcing Plans, with central monitoring. To support this, we have implemented a critical analysis of the firm's existing a portfolio and established a new tender approval platform to control the volume and shape of our portfolio growth
- Implemented enhanced portfolio review procedures, including review of all public interest audits with targeted allocation of central audit quality support
- Continued to reform the performance review process for our people to strengthen the linkage between audit quality behaviours, recognition and reward.

Monitoring - Internal quality monitoring:

- Review of internal quality assurance review process conducted by the Audit Executive to enhance internal quality assurance monitoring
- Updated guidance for reviews of high risk and complex areas as part of those internal quality assurance reviews
- We have commenced a review of AQAR inspection findings and resultant gradings in respect of PIE audits to evaluate whether the difference in results between the external inspection population and wider internal inspection population indicates further revisions to enhance the effectiveness of the AQAR process are required. Additional root cause analysis will be undertaken as necessary following conclusion of the initial review.

Root Cause Analysis ("RCA") process:

- Undertaken a review of the RCA function, including enhancements to the framework for identifying casual factor themes and reporting to drive audit quality action plans in the AQP.
- Recruited a partner to lead the RCA function, together with investment in dedicated resourcing.
- Monthly reporting on RCA findings to the Audit Executive and Leadership Team.

Engagement Performance - EQCR, consultations and audit documentation:

- Review of the EQCR function has been undertaken considering the allocation, training and performance thereof and key proposals have been approved by the Audit Executive which are to be implemented in FY23
- We will implement controls to ensure that report release dates are recorded accurately and that there are no completed engagements without a report release date being entered in the audit tool.

Implementation of the FRC's Revised Ethical Standard (2019):

- Enhanced procedures regarding documentation of Objective Reasonably and Informed Third Party (ORITP) test
- Annual ethics training included dedicated module addressing application of the ORITP test
- Enhanced guidance for network firms and non-network firms involved as component auditors providing minimum expected procedures
- Training sessions delivered to the audit practice.

Audit methodology:

- Initiated a comprehensive review of audit methodologies, policies and procedures
- Developed new audit guidance in relation to IFRS 13 in 2021
- A project is underway to enhance and expand this guidance further in 2022 as well as IFRS 9 and the payments process, particularly in their application to audits in the financial services sector
- Recruited an additional banking partner who specialises in IFRS 9.

AQR results 2021/22- An Overview (continued)

Summary of the key elements of our response to engagement level findings

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In response to the FRC's AQR findings at an engagement level, we have taken the following actions:

Engagement level

Audit of Revenue:

- Established a new approach to the audit of revenue based on the revised ISA (UK) 315, detailed end-to-end understanding of revenue streams and the use of 'What Could Go Wrong' analysis for all December 2021 year ends onwards. This was supplemented with sector-based case studies for engagement teams focused on application guidance and best practice examples
- Reviewed and enhanced audit methodologies and support materials in key areas including the audit of long-term contracts and are continuing to enhance those in the financial services sector
- The enhanced methodology and requirements for the audit of revenue was supported by a mandatory training day for the audit stream and further embedded through training in the 2022 Summer School
- Established a Revenue Centre of Excellence, expanded central review teams and methodology support for engagement teams
- Expanded our Technology Risk Team by c25%, including recruitment of new partners
- We are developing guidance and materials for each sector to drive detailed understanding of revenue systems and tailored audit strategies, together with a 'controls and digital first' mindset.

Scepticism and challenge in key areas of judgement:

- Embedding the BDO Professional Judgement Framework within our APT tool, practice aids materials and behavioural based coaching, which supports effective challenge of management
- We are developing a National Audit People and Culture Program, including 'encouraging and supporting a culture of challenge' as a key pillar
- Developing guidance and practice aids to support the audit of forecasts and uncertainty which includes impairment, deferred tax assets, going concern and provisions
- We have engaged external data providers to provide ready access to data and information to support challenge of management forecast assumptions.

Audit work on financial services entities:

- Recruitment of additional specialist banking and insurance partners and investment in the financial services team
- Developed new audit guidance in relation to IFRS 13 in 2021
- A project is underway to enhance and expand this guidance further in 2022 as well as IFRS 9 and the payments process, particularly in their application to audits in the financial services sector
- Enhancing audit of revenue methodologies and support materials in the financial services sector.

Audit testing over journals in response to the risk of management override of controls:

- Developed a policy for involvement of forensics at the audit outset to identify fraud risk factors and responses, supported by expansion of the specialist audit support function within our forensics practice
- Implemented policies that enhance central methodology and specialist support when fraud is identified at a client (auditor or management identified fraud)
- Delivered in-depth training to IT assurance specialists
- Summer School 2022 had a focus on the four principle areas of the AQP including detecting material fraud.

Independence assessments:

- Introduced a new consultation memorandum for consultation with the Ethics Team for PIEs and OEPIs to drive consistent capturing of independence considerations.

For more information:

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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 company and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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