



Royal County of Berkshire Pension Fund

Planning report to the Corporate Overview and Scrutiny Panel for
the year ended 31 March 2020

Issued 21 May 2020 for the meeting on 27 May 2020

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Introduction

The key messages in this report:

We have pleasure in presenting our Planning Report to the Corporate Overview and Scrutiny Panel ("the Panel") for the 2020 audit of the Royal County of Berkshire Pension Fund ("the Fund"). We would like to draw your attention to the key messages of this paper:

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

Scope

Our principal audit objective is to obtain sufficient, relevant and reliable audit evidence to enable us to express an opinion on the statutory accounts of the Fund prepared under the Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 ("the Code") issued by CIPFA and LASAAC.

Key developments

As part of our audit planning procedures to date, we have held planning meetings with key members of management to develop our understanding. The key developments are:

- There have been discussions between the Fund management, the investment manager and the custodian regarding investment controls and governance. The discussions are ongoing and we await the conclusion in relation to the current year's investment reporting.
- An independent party carried out a governance review in relation to the Fund as part of the response to the prior year audit findings. The final report from this review has not yet been shared with us.
- We conducted an interim visit to the Fund's office to perform testing on the design and implementation of controls including those addressing contributions and benefits operations.
- A new pension Fund accountant took up post in early April and is receiving handover support from the previous post holder.
- The current COVID-19 pandemic has had a significant impact on a range of markets. Financial markets experienced a sharp drop in value during February and March 2020 and have continued to experience volatility with significant market swings occurring on a daily basis. Furthermore the pandemic has made it difficult to value many properties due to a lack of transactions in the market, and many property funds are now gated and are reporting a material uncertainty over their year-end valuations. It is possible that the Fund will be affected by one or both of these issues and discussions are ongoing to determine the extent of the impact. In addition, officers will need to assess the disclosures included within the annual report and accounts with respect to the risks associated with COVID-19. They will also need to consider whether there is any impact on the going concern assessment and whether additional disclosure in the annual report and accounts is required in that regard, and we will assess the officers' conclusions and the adequacy of disclosures in this area.

Introduction (continued)

The key messages in this report:

Key developments (continued)

The ongoing COVID-19 crisis continues to impact ways of working both for officers, members of the Fund and the Deloitte audit team. The situation will have an impact on financial reporting for all local government pension schemes. This includes adjustments to the central timetable for accounts submission. We include further detail on this on pages 9 to 10 of this planning paper.

Our planning procedures are still in progress. We will continue to assess the audit risks throughout the audit and we will inform you of any changes.

Significant audit risks

As we continue to accumulate knowledge of the Fund we have developed our risk assessment so that our plan reflects those areas which we believe have a greater chance of leading to material misstatement of the financial statements.

Based on procedures performed to date, we summarise below the areas of significant audit risk we have so far identified, these may be subject to change following completion of our remaining planning work. We will update the Panel on any changes to our risk assessment at the next meeting. The significant risks currently identified are:

- Management override of controls; and
- Valuation of the longevity swap.

Auditing Standards include a presumption that management override of controls and revenue recognition are significant risks for all our audits.

We have rebutted the presumption of risk of fraud in revenue recognition for the Fund, as we consider that there is little incentive or opportunity for revenue (including investment income, transfers and contributions) to be fraudulently misstated and therefore there is limited risk of material misstatement arising due to fraud in this area.

Please refer to pages 12 to 14 for full details.

Introduction (continued)

The key messages in this report:

Significant issues identified last year

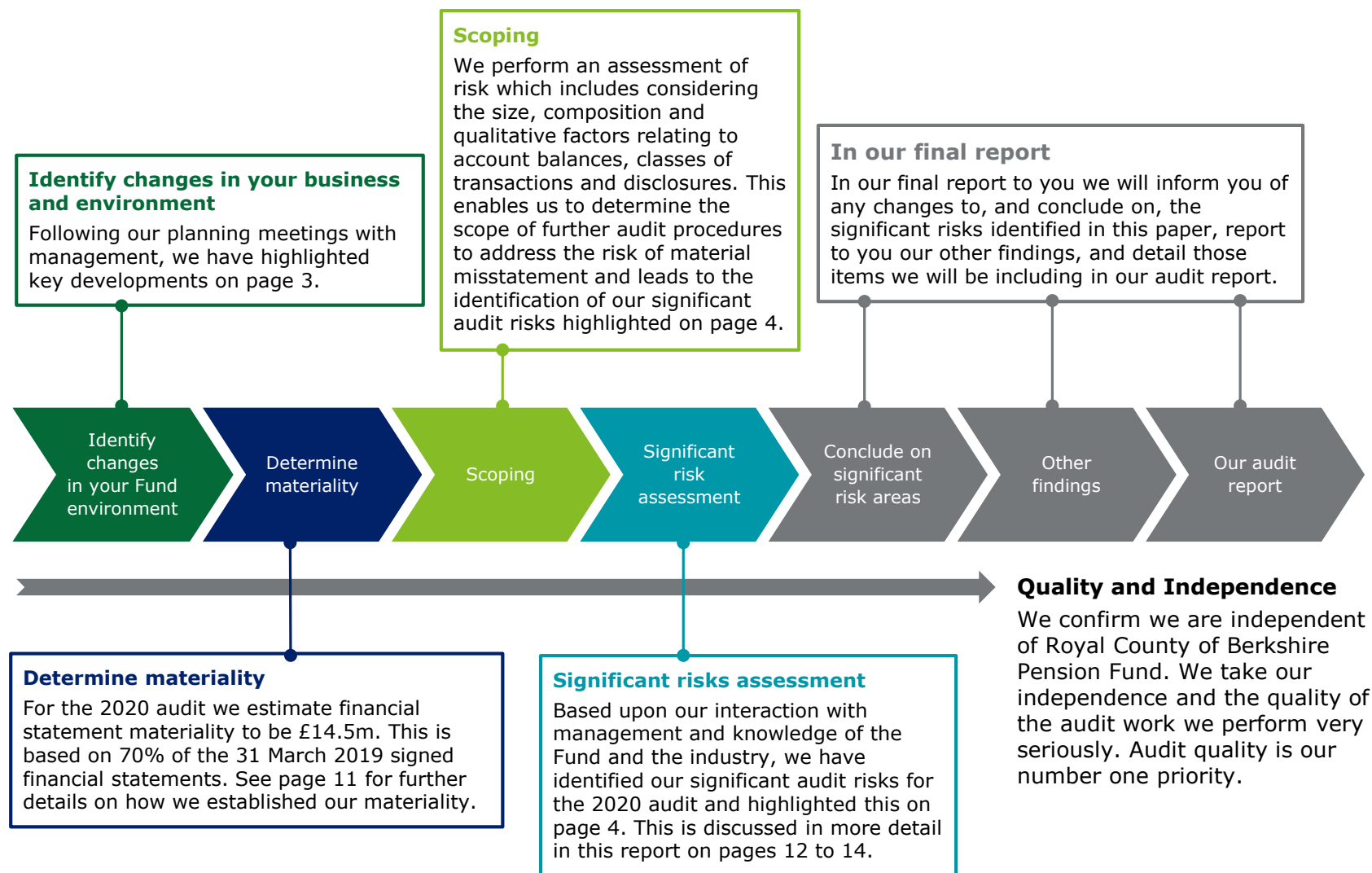
In the prior year audit we reported the following significant issues:

- A material error of £40.3m in the value of the longevity swap arising from the absence of a control to challenge the assumptions used by the actuary in producing the valuation. We recommended that the Panel ensures that the valuations provided by the actuary are reviewed and that the assumptions are challenged, understood, and agreed before inclusion of the valuation in the financial statements.
- A material error of £34.2m in the value of the convertible bond arising from a lack of understanding within the Fund of who was providing pricing and the valuation approach adopted. We also identified the absence of a control to challenge the valuation. We recommended that the Panel ensures that the valuation of all bespoke investments is understood by the investment manager and that controls are implemented to ensure an appropriate challenge is made of valuations received from any service organization.
- Unadjusted misstatements of £2.0m and £1.2m relating to alternative investment fund values arising from an absence of controls to challenge the valuation of alternative investment funds and to check existence.
- We recommended that the Fund review the terms and conditions of its relationship with all investment service providers and seek assurance that suitable controls are place.
- We also recommended that the Fund perform a review of the arrangements around pension asset investment decision making, monitoring and reporting of the valuation of those investments.

The Fund's responses to the above findings will be reviewed as part of this year's audit work.

Our audit explained

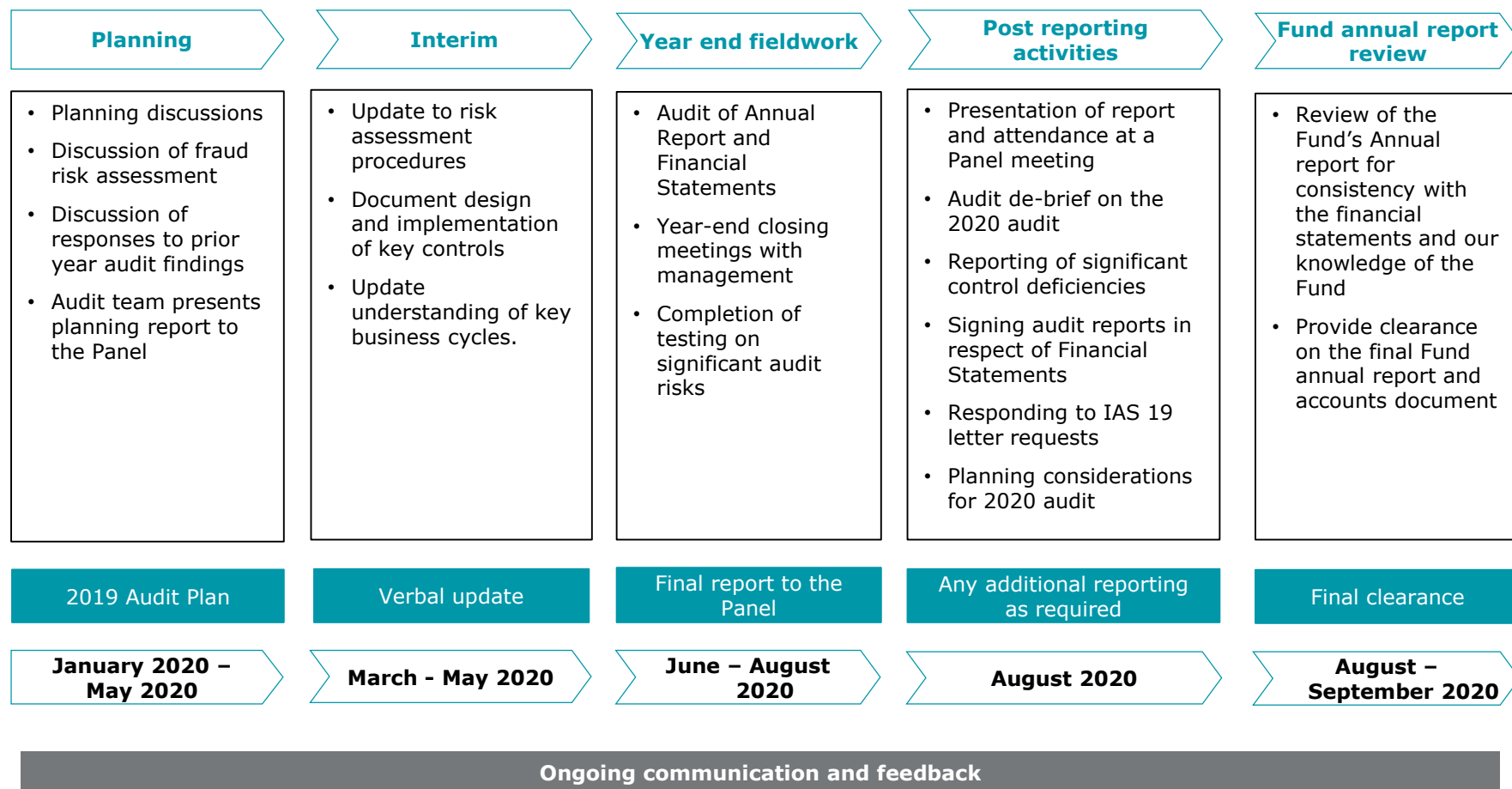
We tailor our audit to your Fund



Continuous communication and reporting

Planned timing of the audit

As the audit plan is executed throughout the year, the results will be analysed continuously and conclusions (preliminary and otherwise) will be drawn and initial comments from the interim and final visits will be shared with management as required. The following sets out the expected timing of our reporting to and communication with you.



Scope of work and approach

Our approach

Liaison with internal audit

The Auditing Standards Committee's version of ISA (UK and Ireland) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

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

Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We recommend the Fund completes the Code checklist during drafting of their financial statements.

We would welcome early discussion on the planned format of the financial statements, and whether there is scope for simplifying or streamlining disclosures, as well as the opportunity to review a skeleton set of financial statements and an early draft of the annual report ahead of the typical reporting timetable to feedback any comments to management.

Scoping and risk assessment

Our scoping and risk assessment procedures are in progress and they will be updated when year-end numbers are available. If this changes our assessment of the significant risks we will inform the panel accordingly.

Scope of work and approach

Coronavirus (Covid-19) outbreak - How is Deloitte responding?

Deloitte has been closely monitoring and managing our response to the COVID-19 situation since its inception in order to be able to respond as necessary. The health and safety of our people is paramount, but we are doing our utmost to ensure we can complete audits to required timetables. We summarise below how we are responding.

Impact on our audit and our response

We have Business Continuity Plan ('BCP') arrangements which align to ISO 22301. Our BCP for the firm has been enacted to consider and mitigate the impact of COVID-19 across our operations. The health and safety of our people and those we work with comes first. This includes the provision of advice and support to staff and associates, development of response plans, and upgrades to our IT infrastructure to increase capacity for secure remote working.

We have the capability to work remotely with our audited entities, utilising a number of collaboration tools, including Deloitte Online/Sharepoint (a tool that facilitates secure two-way dialogue between the Deloitte team and management to effectively manage engagement co-ordination) and MS Teams allowing us to collaborate and supervise activities.

We have adequate server capacity for all our people to work remotely and technological infrastructure such as our Sharepoint site that we have already been using with officers.

We are in regular contact with regulators as well as other Deloitte Member Firms to co-ordinate and understand the impact locally so we can execute global audits.

Internally, we have travel restrictions in place and the audit is therefore planned to be completed remotely. We are also reviewing team compositions to try to minimise the risk of full teams being disrupted.

Scope of work and approach

Coronavirus (COVID-19) outbreak - Impact on our audit

The first table below reflects some general considerations. The second table reflects some impacts specific to the local government context and how the Fund plans to respond to this.

Impact on the Fund	Impact on the Fund's Statement of Accounts	Impact on our audit
<ul style="list-style-type: none">• Unavailability of personnel.• Disruptions in or stoppages of non-essential business travel.• The closure of facilities• Increase in demand for some services and challenges in delivering such services	<ul style="list-style-type: none">• Principal risk disclosures• Fair value measurements based on unobservable inputs• Changes to the fair value hierarchy disclosure of some investments• Events after the end of the reporting period• Consider the impact on the Fund's going concern assessment and consider the need to enhance disclosures with respect to going concern	<ul style="list-style-type: none">• Focus on key areas of material change and uncertainty• Resource planning• Timetable of the audit• Logistics regarding travel and meetings with Fund personnel• We will review the Fund's going concern assessment and consider the adequacy of disclosures in the annual report and accounts with regards to going concern

Specific changes impacting local government and how the Fund audit plan will respond (bold text)

The publication date for final, audited, accounts has moved from 31 July to 30 November 2020 for all local authority bodies.

Discussions with management indicate an intention to adhere to the original audit scheduling (see p. 10) which aimed for the majority of work to be completed in June and July 2020. It is acknowledged that within this there may be 1-2 weeks slippage past 31 July due to potential absences of key staff on both teams and the expected inefficiencies of working remotely. This plan also assumes that third party reports such as the pension report from the actuary and investment manager reports are made available within this timeframe.

There will be disclosure requirements related to the impact of COVID-19.

Management are aware of this. We will evaluate the disclosures made by officers to determine whether they comply with the relevant disclosure requirements.

Audit is to be conducted remotely

Our team will be using technology such as Microsoft Teams to facilitate the delivery of the audit whilst working remotely. We have an established practice with the finance team of transacting information over Sharepoint, our secure information storage portal, from last year's audit where we used this tool.

Potentially heightened risks of fraud

The team have received extra training and will maintain professional scepticism. Management should also consider any gaps in the control framework under the current circumstances giving greater rise to fraud risk.

There may be material uncertainties to disclose in regard to property and other asset valuations

We will evaluate this once the final valuation reports are provided.

Materiality

Our approach to materiality

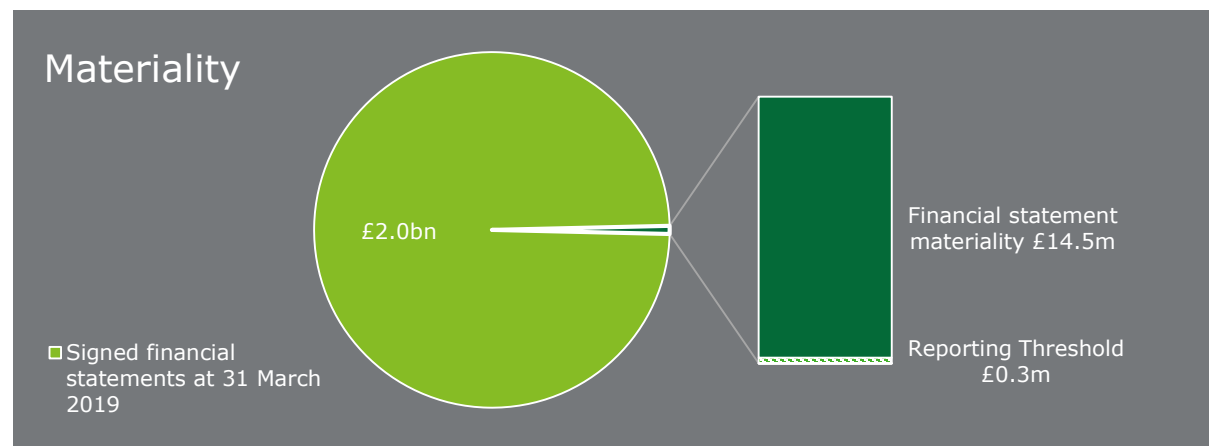
Basis of our materiality benchmark

- We have estimated financial statement materiality as £14.5m based on professional judgement, the requirement of auditing standards, and the net assets of the Fund. As we complete our remaining planning procedures, we will consider further, together with the Royal Borough of Windsor and Maidenhead audit team, whether any reduction is required to the level of materiality applied to the Fund. If any changes are made to our assessment of materiality we will communicate those to the Corporate Overview and Scrutiny Panel.
- We have applied a factor of 1% (compared with 1% for the 2019 audit) to the selected benchmark of Fund net assets. As year end information is not yet available, we have used the net assets value as at 31 March 2019, reduced by 70% as the value of the benchmark due to our expectation that the value of the investments

portfolio is likely to have decreased from the 31 March 2019 due to the impact of COVID-19 on global markets.

Reporting to those charged with governance

- We will report to you all misstatements found in excess of £300k. We will report to you misstatements below this threshold if we consider them to be material by nature.
- We will review materiality for the 2020 audit on receipt of the draft 2020 financial statements, and report any changes to those charged with governance in our subsequent audit reports.
- Materiality calculation: Although materiality is the judgement of the audit partner, the Panel members must be satisfied the level of materiality chosen is appropriate for the scope of the audit.



Significant risks

Our risk assessment process

Changes to prior year in risks identified as significant audit risks

The risks we have identified as significant audit risks are summarised on the following pages. Our risk assessment reflects the following changes from the prior year:

In the prior year, we identified a convertible bond held by the Fund as a significant risk, initially included within the draft financial statements as at 31 March 2019 at a value of £36.4m. Convertible bonds are considered more difficult to price due to the embedded optionality, the effect of multiple underlying characteristics and the use of complex calculation models. In the prior year we focused the significant risk on this part of the investment portfolio. However, following a revaluation of the instrument in response to our audit procedures during the 2019 audit, the value of the convertible bond had decreased to approximately £2.2m. In initial conversations for this year's audit, the investment manager noted that there are no indications that the value of the bond will have improved significantly. Given the expected immaterial value as at the 31 March 2020, the valuation of the bond is not considered to be a significant risk of material misstatement for the 2020 audit.

Other significant risk considerations

In the current year, we are in the process of assessing the risk arising from the potential impact on some of the Fund's investments of the COVID-19 pandemic. Property valuers have experienced difficulties in assessing the market value of properties. This is an industry wide issue. Following guidance issued by the Royal Institute for Chartered Surveyors, it is expected that all valuers will report a material uncertainty over the value of property assets held at 31 March 2020 as a result of Covid-19 factors. In response to the valuation uncertainties, many property funds were gated as at 31 March 2020.

The extent to which this issue will affect the Fund will be assessed as we receive more information about the funds. We will also consult with our Deloitte Real Estate Specialists, including consideration of the type and nature of the properties held. The authority, and we, will need to assess whether a material uncertainty clause in the property valuation is fundamental to user's understanding of the financial statements.

In doing so, we will consider the proportion of the total pension assets that are affected by the material uncertainty clause, as well as materiality when making this determination. Where it is determined to be fundamental, an emphasis of matter may be necessary in our audit opinion referring to this material uncertainty.

Currently, we have not assigned a significant risk level to property-based investments, however we will update the Panel should this position change.

Furthermore, the COVID-19 pandemic has had a significant impact on a number of global markets and many of the major indices used to measure the performance of equities and bonds fell sharply in February and March 2020. Any alternative investment funds for which stale prices are used in the year end valuation could potentially be affected as true market value may be a lot lower than the stale valuation reporting. A stale price refers to a valuation that is prepared to a date earlier than the Fund's year end. It is not yet clear the extent to which this may affect the Fund in the current year, but we will continue to assess the impact of this issue as the audit progresses. This issue may be avoided if the timetable on this part of the audit allows for stale prices to be updated. As it stands we have not assigned a significant risk level to alternative investment funds, however we will update the Panel should this position change.

Presumed risk of fraud in revenue recognition

Auditing standards also presume there is a risk of fraud in revenue recognition. Following an analysis of the Council's income streams, we have rebutted this presumption. The key factors considered include: the amount of annual income from each source; the transaction size; the extent of any estimates; and the complexity of the recognition principles. Our conclusion is the same as that reached in our audit last year.

Significant risks

Management override of controls

Risk identified

In accordance with ISA 240 (UK) management override is always a significant risk for financial statement audits. The primary risk areas surrounding the management override of internal controls are over the processing of journal entries and the key assumptions and estimates made by management.

Deloitte response management override of controls risk identified

In order to address the significant risk our audit procedures will consist of the following:

- Use Spotlight, our data analytics software, in our journals testing to interrogate 100% of journals posted by the Fund. This uses intelligent algorithms that identify higher risk and unusual items;
- Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Understand the financial reporting process to identify the controls over journal entries and other adjustments posted in the preparation of the financial statements;
- Check whether there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
- Test the design and implementation of controls around the journals process and investment and disinvestment of cash during the year;
- Review of related party transactions and balances to identify if any inappropriate transactions have taken place; and
- Review the accounting estimates for bias, that could result in material misstatement due to fraud, including whether any differences between estimates best supported by evidence and those in the financial statements, even if individually reasonable, indicate a possible bias on the part of management.
- We will consider whether the conditions resulting from COVID-19 impact the level of risk associated with potential frauds and adjust our procedures accordingly.

Significant risks

Valuation of the longevity swap

Risk identified

The Fund holds a material longevity swap to hedge longevity risk. A longevity swap is designed to insure the Fund against the risk that pensioners live longer than the current mortality assumptions. Valuation of longevity swaps are sensitive to relatively small movements in the key assumptions used in the actuarial calculations. The setting of these assumptions involves judgement. Based on last year's audited accounts the value was (£103.8m) and we expect the value to be material in size this year.

As a result of this we consider the valuation of the longevity swap to be a significant risk.

Deloitte response to the risk identified

In order to address this area of significant audit risk, we will perform the following audit procedures:

- Perform an assessment of the actuarial expert in respect of their knowledge and experience in this area;
- Test the design and implementation of the key controls with respect to the valuation of the longevity swap;
- Obtain a valuation report directly from the actuary and reconcile this to the financial statements disclosure;
- Review the underlying documentation for the policy, including the population covered, the assumptions and other key inputs used in the calculation, and the agreed cash flows;
- Engage in-house actuarial specialists to challenge and assess the reasonableness of the valuation of the policy based on the underlying terms of the contract and the forecast cash flows; and
- Compare our expectation of the value with that reported by the actuary, investigating any differences identified that are outside the range of results that we consider to be reasonable.

Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our respective responsibilities are set out in "PSAA Statement of responsibilities of auditors and audited bodies: Principal Local Authorities and Police Bodies." The responsibilities of auditors are derived from statute, principally the Local Audit and Accountability Act 2014 and from the NAO Code of Audit Practice. The responsibilities of audited bodies are derived principally the Local Audit and Accountability Act 2014 and from the Accounts and Audit Regulations 2015.

Our report is designed to communicate our preliminary audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes our preliminary audit plan, including key audit judgements and the planned scope.

Use of this report

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

What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Fund.

Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by officers or by other specialist advisers.

Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the statement of accounts and the other procedures performed in fulfilling our audit plan.

Other relevant communications

We will update you if there are any significant changes to the audit plan.



Jonathan Gooding

for and on behalf of Deloitte LLP
St Albans | 21 May 2020

Appendix 1: Fraud responsibilities and representations

Responsibilities explained



Your Responsibilities:

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



Our responsibilities:

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



Fraud Characteristics:

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

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

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

Appendix 1: Fraud responsibilities and representations (continued)

Inquiries

We will make the following inquiries regarding fraud:



Management:

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to the Panel regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.
- We plan to involve management from outside the finance function in our inquiries.



Internal audit

- Whether internal audit has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.



The Panel

- How the Panel exercise 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.
- Whether the Panel has knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of the Panel on the most significant fraud risk factors affecting the entity.

Appendix 2: Independence and fees

A Fair and Transparent Fee

As part of our obligations under International Standards on Auditing (UK), we are required to report to you on the matters listed below:

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Fund and will reconfirm our independence and objectivity to the Panel for the year ended 31 March 2020 in our final report to the Panel.
Fees	<p>The scale fee for the Pension Fund audit is £19.120. Following recent discussions with both the Council and PSAA, there are expected to be increases in this fee for both 2019/20 and 2020/21. We will confirm final fee levels to the Panel once these have been agreed.</p> <p>Our fees for issuing IAS 19 assurance letters to other auditors in respect of participating employers are not included in the above audit fee and will be communicated separately.</p> <p>The above fees exclude VAT and include out of pocket expenses.</p>
Non-audit fees	There are no non-audit fees.
Independence monitoring	<p>In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Fund's policy for the supply of non-audit services or any apparent breach of that policy.</p> <p>We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.</p>
Ethical Standard 2019	The FRC has recently released the Ethical Standard 2019. The standard classes pension schemes as 'other entities of public interest' where assets are greater than £1bn and there are 10,000 members. As a result, non audit services will be limited primarily to reporting accountant work, audit related and other regulatory and assurance services. All other advisory services to these entities, their UK parents and world-wide subs will be prohibited.
Relationships	We have no other relationships with the Authority, its members, officers and affiliates, and have not supplied any services to other known connected parties.



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