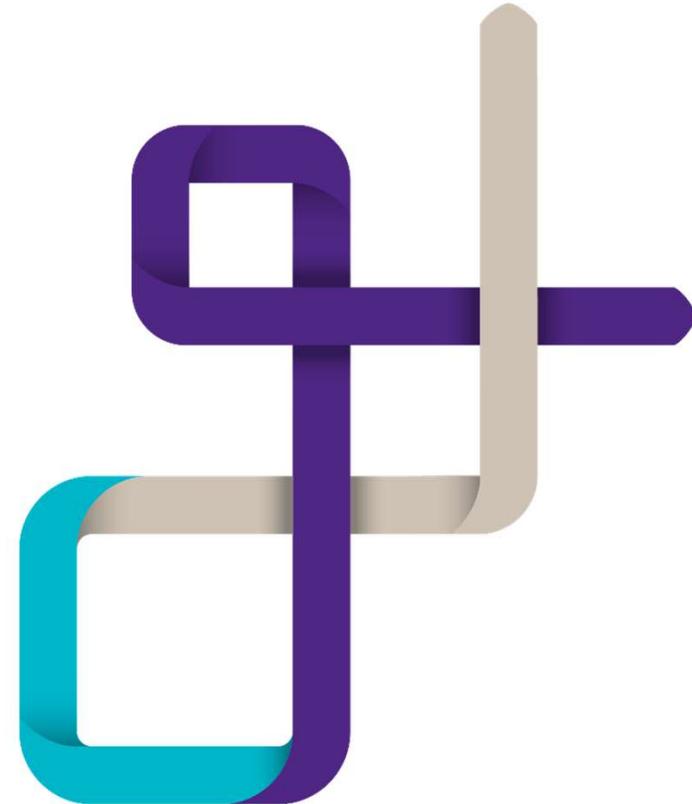


External Audit Plan

Year ending 31 March 2020

Cumbria Local Government Pension Scheme
March 2020



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Pension Scheme or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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1. Introduction & headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of Cumbria Local Government Pension Scheme ('the Pension Scheme') for those charged with governance.

Respective responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of Cumbria Local Government Pension Scheme. We draw your attention to both of these documents on the [PSAA website](#).

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the Pension Scheme's financial statements that have been prepared by management with the oversight of those charged with governance.

The audit of the financial statements does not relieve management or the Audit and Assurance Committee of your responsibilities. It is the responsibility of the Pension Scheme to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Pension Scheme is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the Pension Scheme's business and is risk based.

Significant risks

Those risks requiring special audit consideration and procedures to address the likelihood of a material financial statement error have been identified as:

- Management over-ride of controls
- Valuation of Level 3 Investments
- Valuation of Directly Held Property

We will communicate significant findings on these areas as well as any other significant matters arising from the audit, to you in our Audit Findings (ISA 260) Report.

Materiality

We have determined materiality at the planning stage of our audit to be £28.31 m (PY £26.32 m) for the Pension Scheme, which equates to 1% of your net assets as at 31/12/19. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £1.416 m (PY £1.316 m).

Audit logistics

Our interim visit will take place in March and our final visit will take place in June and July, with final sign off scheduled for November 2020. Our key deliverables are this Audit Plan and our Audit Findings Report. Our audit approach is detailed in Appendix A.

Our proposed fee for the audit will be £22,707 (PY: £23,457) for the Pension Scheme, subject to the Pension Scheme meeting our requirements set out on page 11. Provision of IAS 19 assurances to Scheme employer auditors is estimated to incur a fee of £7,000 and the Scheme may wish to pass this cost on to Scheme employers.

Independence

We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

2. Key matters impacting our audit

Factors

The wider picture and political uncertainty

- The market value of LGPS funds at end of March 2019 was £287.2 billion (an increase of £16.3 billion or 6.0%) but for the first time, the LGPS in England & Wales is now cashflow negative, with benefit payments rising to £10.4bn while contributions fell to £9.3bn. There are now over 18,000 employers.
- In January 2020 the UK government and the EU ratified the Withdrawal Agreement and the UK's membership of the EU formally ceased on 31 January. The existence of a 'transition period' to 31 December 2020 means that there will be little practical change for the Scheme until at least 2021. However, the nature of the future relationship between the UK and the EU is still to be determined and considerable uncertainty persists.

Governance

- The Scheme Advisory Board (SAB) has published the *Good Governance – Phase II Report*. Proposals include having a single named officer responsible for the delivery of LGPS related activity for a fund, an enhanced annual governance compliance statement and establishing a set of key performance indicators.
- SAB is also consulting on Responsible Investment guidance to assist and help investment decision makers. These initiatives are likely to impact the 20/21 financial year.
- tPR continues to apply pressure on pension schemes to improve the quality of scheme member data. The 2019 valuation process will likely have thrown up some data issues (large or small) that need addressing.

Financial reporting and audit – raising the bar

The Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge, and to undertake more robust testing as detailed in Appendix 1.

Our work in 2018/19 has highlighted areas where financial reporting, in particular Level 3 and Financial Instrument investment valuations and disclosures, needs to be improved, with a corresponding increase in audit procedures.

Equity Protection

The Schemes 'equity protection' overlay solution with Legal and General Investment Management will conclude at the end of the 2019/20 Financial year.

Pooling

The Scheme has moved its 20% allocation to global equity assets to the Border to Coast Pool, during 2019/20.

Triennial Valuation

The fund is in the process of completing its 2019 triennial valuation. We understand that this valuation will not specifically provide for the impact of the McCloud Judgement.

Our response

- We will consider whether your financial position leads to material uncertainty about the going concern of the Pension Scheme and will review related disclosures in the financial statements
- The Scheme will need to ensure that it is prepared for all outcomes, including those with any impact on contracts, on service delivery and its investments.
- We will continue to review the impact of the UK leaving the EU on the Pension Scheme's investments up to the conclusion of our audit.

- We will consider the Pension Scheme's responses to the SAB initiatives and whether they impact upon our risk assessment.
- We will consider the impact of any data issues raised as part of the 2019 valuation on the risks identified as part of our 2019/20 audit.

- As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and financial reporting. Our proposed work and fee, as set out further in our Audit Plan, has been agreed with the Director of Finance and is subject to PSAA agreement.

- We will review the Scheme's proposed accounting treatment for its Equity Protection product.
- We will tailor our approach to gain assurance in respect of the completeness and accuracy of the transfer of assets to the pool.
- We will review key assumptions used by the actuary in the 2019 triennial valuation and related disclosures.
- Our risk assessment on these matters will be kept under review. We will update the Audit Plan should any new audit risks be identified.

3. Significant risks identified

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
<p>The revenue cycle includes fraudulent transactions (rebutted)</p>	<p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p> <p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Scheme, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including Cumbria Local Government Pension Scheme, mean that all forms of fraud are seen as unacceptable. <p>Therefore we do not consider this to be a significant risk for Cumbria Local Government Pension Scheme.</p>	<p>This significant risk has been rebutted.</p>
<p>Management over-ride of controls</p>	<p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We will:</p> <ul style="list-style-type: none"> • evaluate the design effectiveness of management controls over journals • analyse the journals listing and determine the criteria for selecting high risk unusual journals • test unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gain an understanding of the accounting estimates and critical judgements made by management and consider their reasonableness with regard to corroborative evidence • evaluate the rationale for any changes in accounting policies, estimates or significant unusual transactions.

3. Significant risks identified (continued)

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of Level 3 Investments	<p>The Scheme revalues its investments on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date.</p> <p>By their nature Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved, at £0.519 billion as at 31 March 2019 and the sensitivity of this estimate to changes in key assumptions.</p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year-end.</p> <p>Management utilise the services of investment managers and custodians as valuation experts to estimate the fair value as at 31 March 2020.</p> <p>We therefore identified valuation of Level 3 investments as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>We will:</p> <ul style="list-style-type: none"> • evaluate management's processes for valuing Level 3 investments • review the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments; to ensure that the requirements of the Code are met • independently request year-end confirmations from investment managers • evaluate the competence, capabilities and objectivity of the level 3 investment managers as valuation experts • where available review investment manager service auditor report on design effectiveness of internal controls.
Valuation of Directly Held Property	<p>The Scheme revalues its directly held property on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved, at £161.3 million as at 31 March 2019, and the sensitivity of this estimate to changes in key assumptions.</p> <p>Management has engaged the services of a valuer to estimate the current value as at 31 March 2020.</p> <p>We therefore identified valuation of directly held property, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.</p>	<p>We will:</p> <ul style="list-style-type: none"> • evaluate management's processes and assumptions for the calculation of the estimate, the instructions issued to the valuation experts and the scope of their work • independently request year-end confirmations from the investment managers evaluate the competence, capabilities and objectivity of the valuation expert • write to the valuer to confirm the basis on which the valuations were carried out • challenge the information and assumptions used by the valuer to assess completeness and consistency with our understanding, the Fund's valuer's report and the assumptions that underpin the valuation • where available review investment manager service auditor reports on design effectiveness of internal controls.

We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings Report.

4. Other risks identified

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Actuarial Present Value of Promised Retirement Benefits	<p>The Fund discloses the Actuarial Present Value of Promised Retirement Benefits within its Notes to the Accounts. This represents a significant estimate in the financial statements.</p> <p>The Actuarial Present Value of Promised Retirement Benefits is considered a significant estimate due to the size of the numbers involved (£2.745 billion) and the sensitivity of the estimate to changes in key assumptions.</p> <p>We understand that the latest triennial valuation, as at 31 March 2019, will not specifically provide for the impact of the McCloud ruling.</p> <p>We therefore identified the valuation of the Scheme's Actuarial Present Value of Promised Retirement Benefits as an other risk,</p>	<p>We will:</p> <ul style="list-style-type: none"> • update our understanding of the processes and controls put in place by management to ensure that the Scheme's Actuarial Present Value of Promised Retirement Benefits is not materially misstated and evaluate the design of the associated controls • evaluate the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work • assess the competence, capabilities and objectivity of the actuary who carried out the Scheme's pension fund valuation; • assess the accuracy and completeness of the information provided by the Scheme to the actuary to estimate the liability • test the consistency of disclosures with the actuarial report from the actuary; and • undertake procedures to confirm the reasonableness of the actuarial assumptions made, including those about the McCloud ruling, by reviewing the report of the consulting actuary (as an auditor's expert) and performing any additional procedures suggested within the report.

5. Other matters

Other work

The Pension Scheme is administered by Cumbria County Council (the 'Council'), and the Pension Scheme's accounts form part of the Council's financial statements.

Therefore, as well as our general responsibilities under the Code of Practice a number of other audit responsibilities also follow in respect of the Pension Scheme, such as:

- We read any other information published alongside the Council's financial statements to check that it is consistent with the Pension Scheme financial statements on which we give an opinion and is consistent with our knowledge of the Council.
- We consider our other duties under legislation and the Code, as and when required, including:
 - Giving electors the opportunity to raise questions about your 2019/20 financial statements, consider and decide upon any objections received in relation to the 2019/20 financial statements;
 - Issue of a report in the public interest or written recommendations to the Scheme under section 24 of the Act, copied to the Secretary of State;
 - Application to the court for a declaration that an item of account is contrary to law under Section 28 or for a judicial review under Section 31 of the Act; or
 - Issuing an advisory notice under Section 29 of the Act.
- We carry out work to satisfy ourselves on the consistency of the pension scheme financial statements included in the pension scheme annual report with the audited Scheme accounts.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the Pension Scheme's ability to continue as a going concern" (ISA (UK) 570).

Currently, the accounts of the Pension Scheme are expected to be prepared on a going concern basis. We will review management's assessment of the going concern assumption and any material uncertainties, and evaluate the disclosures in the financial statements.

6. Materiality

The concept of materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

We have determined financial statement materiality based on a proportion of the net assets of the Pension Scheme for the financial year. In the prior year we used the same benchmark. Materiality at the planning stage of our audit is £28.31 m (PY £26.32 m) for the Pension Scheme, which equates to 1% of your net assets as at 31 December 2019.

We reconsider planning 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.

Matters we will report to the Audit and Assurance Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Assurance Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. In the context of the Pension Scheme, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £1.416 m (PY £1.316 m).

If management has corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Assurance Committee to assist it in fulfilling its governance responsibilities.



7. Audit logistics & team



Gareth Kelly, Engagement Lead

Gareth will lead the engagement. He will direct the audit team, attend Audit and Assurance committees and be your first point of contact for any issue in relation to the audit process. Gareth will be responsible for issuing our opinion on your financial statements.



Richard Anderson, Audit Manager

Richard will be responsible for the management of the audit. He will supervise and co-ordinate the team and ensure our audit work is delivered to the agreed timetable. Richard will meet regularly with the finance team to discuss audit issues.



Fay Hutchinson, Audit In-charge

Fay will be responsible for the day to day delivery of our audit fieldwork. She will work with your finance team to ensure an efficient and quality audit is achieved.

Client responsibilities

Where clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. Where the elapsed time to complete an audit exceeds that agreed due to a client not meeting its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

8. Audit fees

Planned audit fees 2019/20

Across all sectors and firms, the FRC has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing. Within the public sector, where the FRC has recently assumed responsibility for the inspection of local government audit, the regulator requires that all audits achieve a 2A (few improvements needed) rating.

Our work across the sector in 2018/19 has highlighted areas where local government pension scheme financial reporting, in particular, scrutiny of the valuation of hard to value investments needs to be improved. Combined with the FRC requirement that 100% of audits achieve a 2A rating this means that additional audit work is required. We have set out below the expected impact on our audit fee. The table overleaf provides more details about the areas where we will be undertaking further testing.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting. Our proposed work and fee at the planning stage, as set out below and with further analysis overleaf, has been agreed with the Director of Finance and is subject to PSAA agreement.

	Actual Fee 2017/18	Actual Fee 2018/19	Proposed fee 2019/20
Pension Scheme scale fee set by PSAA	£24,620	£18,957	£18,957
Audit fee variations- additional work required, see page 12	£0	£4,500	£3,750
Total audit fees (excluding VAT)	£24,620	£23,457	£22,707

Assumptions:

In setting the above fees, we have assumed that the Pension Scheme will:

- prepare a good quality set of accounts, supported by comprehensive and well-presented working papers which are ready at the start of the audit
- provide appropriate analysis, support and evidence to support all critical judgements and significant judgements made during the course of preparing the financial statements
- provide early notice of proposed complex or unusual transactions which could have a material impact on the financial statements.

Relevant professional standards:

In preparing our fee estimate, we have had regard to all relevant professional standards, including paragraphs 4.1 and 4.2 of the FRC's [Ethical Standard](#) which stipulate that the Engagement Lead (Key Audit Partner) must set a fee sufficient to enable the resourcing of the audit with staff of appropriate skills, time and abilities to deliver an audit to the required professional standard.

Audit fee variations – Further analysis

Planned audit fees

The table below shows the planned variations to the original scale fee for 2019/20 based on our best estimate at the audit planning stage. Further issues identified during the course of the audit may incur additional fees.

Audit area	£	Rationale for fee variation
Scale fee	£18,957	
Raising the bar	£1,500	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms needs to improve across local audit. This will require additional supervision and leadership, as well as additional challenge and scepticism in areas such as journals, estimates, financial resilience and information provided by the entity.
Valuation of level 3 investments	£1,500	The Financial Reporting Council (FRC) has highlighted that the quality of work by all audit firms in respect of valuations of hard to value investments needs to improve across the sector. Accordingly, we plan to enhance the scope and coverage of our work to ensure an adequate level of audit scrutiny and challenge over the assumptions and evidence that underpin the valuations of level 3 investments this year to reflect the expectations of the FRC and ensure we issue a safe audit opinion.
Directly held property – work of experts	£750	We have increased the volume and scope of our audit work to ensure an adequate level of audit scrutiny and challenge over the assumptions that underpin directly held property valuations
Revised scale fee (to be approved by PSAA)	£22,707	

9. Independence & non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons relating to our independence. We encourage you to contact us to discuss these or any other independence issues with us. We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are two significant matters that could have a real or perceived impact on our independence, objectivity and integrity, and as your auditors we are required to draw it to your attention:

- Richard McGahon was the external audit manager for Cumbria County Council, the Administering Authority, between 1 June 2018 and 9 July 2018. Richard McGahon applied for the post of Head of Internal Audit at Cumbria County Council and was successfully appointed to that post on 10 December 2018. Given Richard McGahon has no involvement in accounts preparation, and as our team does not place direct reliance on internal audit work, the real and perceived threat to independence, objectivity and integrity is low. However, there remains a perceived threat of independence, and this has been mitigated by putting in place the following safeguard, the appointment of an Engagement Quality Control Reviewer, who is another Engagement Lead who acts as an additional review partner.
- Jamie Wright was the external audit in-charge for Cumbria County Council, the Administering Authority, between December 2016 to September 2019 and the external audit manager between September 2019 to November 2019. In November 2019, Jamie applied for the post of Group Finance Manager at Cumbria County Council and was successfully appointed to the post on 19 November 2019. As the Director of Finance has confirmed that Jamie will have no involvement in the Pension Scheme, the real and perceived threat to independence, objectivity and integrity is low. However, there remains a perceived threat of independence, and this has been mitigated by putting in place the following safeguard, the appointment of an Engagement Quality Control Reviewer, who is another Engagement Lead who acts as an additional review partner. If Jamie's role changes at all to include work on the Pension Scheme, we will re-consider the safeguards put in place in relation to this issue.

We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 and PSAA's Terms of Appointment which set out supplementary guidance on ethical requirements for auditors of local public bodies.

9. Independence & non-audit services (continued)

Other services provided by Grant Thornton

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Pension Scheme. The following services was identified.

Service	£	Threats	Safeguards
Audit related:			
Provision of IAS 19 Assurances to Scheme Employer auditors	7,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £7,000 in comparison to the total fee for the audit of £22,707 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. These services are consistent with the Pension Scheme's policy on the allotment of non-audit work to your auditors. All services will be approved by the Audit and Assurance Committee. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.

None of the services provided are subject to contingent fees.

The firm is committed to improving our audit quality – please see our transparency report - <https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/annual-reports/interim-transparency-report-2019.pdf>

Appendices

A. Audit Quality – national context

Appendix A: Audit Quality – national context

What has the FRC said about Audit Quality?

The Financial Reporting Council (FRC) publishes an annual Quality Inspection of our firm, alongside our competitors. The Annual Quality Review (AQR) monitors the quality of UK Public Interest Entity audits to promote continuous improvement in audit quality.

All of the major audit firms are subject to an annual review process in which the FRC inspects a small sample of audits performed from each of the firms to see if they fully conform to required standards.

The most recent report, published in July 2019, shows that the results of commercial audits taken across all the firms have worsened this year. The FRC has identified the need for auditors to:

- improve the extent and rigour of challenge of management in areas of judgement
- improve the consistency of audit teams' application of professional scepticism
- strengthen the effectiveness of the audit of revenue
- improve the audit of going concern
- improve the audit of the completeness and evaluation of prior year adjustments.

The FRC has also set all firms the target of achieving a grading of '2a' (limited improvements required) or better on all FTSE 350 audits. We have set ourselves the same target for public sector audits from 2019/20.

Other sector wide reviews

Alongside the FRC, other key stakeholders including the Department for Business, energy and Industrial Strategy (BEIS) have expressed concern about the quality of audit work and the need for improvement. A number of key reviews into the profession have been undertaken or are in progress. These include the review by Sir John Kingman of the Financial Reporting Council (Dec 2018), the review by the Competition and Markets Authority of competition within the audit market, the ongoing review by Sir Donald Brydon of external audit, and specifically for public services, the Review by Sir Tony Redmond of local Pension Fund financial reporting and external audit. As a firm, we are contributing to all these reviews and keen to be at the forefront of developments and improvements in public audit.

What are we doing to address FRC findings?

In response to the FRC's findings, the firm is responding vigorously and with purpose. As part of our Audit Investment Programme (AIP), we are establishing a new Quality Board, commissioning an independent review of our audit function, and strengthening our senior leadership at the highest levels of the firm, for example through the appointment of Fiona Baldwin as Head of Audit. We are confident these investments will make a real difference.

We have also undertaken a root cause analysis and put in place processes to address the issues raised by the FRC. We have already implemented new training material that will reinforce the need for our engagement teams to challenge management and demonstrate how they have applied professional scepticism as part of the audit. Further guidance on auditing areas such as revenue has also been disseminated to all audit teams and we will continue to evolve our training and review processes on an ongoing basis.

What will be different in this audit?

We will continue working collaboratively with you to deliver the audit to the agreed timetable whilst improving our audit quality. In achieving this you may see, for example, an increased expectation for management to develop properly articulated papers for any new accounting standard, or unusual or complex transactions. In addition, you should expect engagement teams to exercise even greater challenge management in areas that are complex, significant or highly judgmental which may be the case for accounting estimates, going concern, related parties and similar areas. As a result you may find the audit process even more challenging than previous audits. These changes will give the audit committee – which has overall responsibility for governance - and senior management greater confidence that we have delivered a high quality audit and that the financial statements are not materially misstated. Even greater challenge of management will also enable us to provide greater insights into the quality of your finance function and internal control environment and provide those charged with governance confidence that a material misstatement due to fraud will have been detected.

We will still plan for a smooth audit and ensure this is completed to the timetable agreed. However, there may be instances where we may require additional time for both the audit work to be completed to the standard required and to ensure management have appropriate time to consider any matters raised. This may require us to agree with you a delay in signing the announcement and financial statements. To minimise this risk, we will keep you informed of progress and risks to the timetable as the audit progresses.

We are absolutely committed to delivering audit of the highest quality and we should be happy to provide further detail about our improvement plans should you require it.



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