

Teesside Pension Fund

Audit Planning Report - Addendum

Year ended 31 March 2020

July 2020

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Corporate Affairs and Audit Committee
Middlesbrough Council
Civic Centre
Middlesbrough
TS1 9GA

Dear Corporate Affairs and Audit Committee Members

Audit Planning Report - Addendum

This report seeks to provide the Audit Committee with an update on our 2019/20 audit, reflecting changes to our risk assessment as the audit has progressed.

In our audit planning report presented to the 5 March 2020 Audit Committee meeting, we provided you with an overview of our audit scope and approach for the audit of the financial statements. Following the coronavirus outbreak (Covid-19) in March 2020, we have re-assessed our audit scope and strategy. This paper provides an update to the significant accounting and auditing matters and our audit approach outlined in that audit planning report.

If you have any queries in respect of this report, please contact me.

Yours faithfully



Hassan Rohimun, Associate Partner
For and on behalf of Ernst & Young LLP



01 **Audit risks**



Our response to significant risks (updated focus of existing risk)

Valuation of unquoted pooled investment vehicles

What is the risk?

The Fund's investments include unquoted pooled investment vehicles. Judgement is required from Investment Managers to value these investments as prices are not publicly available. The material nature of these investments means that any error in these judgements could result in a material valuation error.

We have identified the valuation of the Fund's investments in unquoted pooled investment vehicles as a significant risk, as even a small movement in the assumptions underpinning investment manager valuations could have a material impact upon the financial statements.

Additional considerations for Covid-19

Unquoted assets are either level 2 or level 3 on the fair value hierarchy, which means quoted market prices are not available and valuation is reliant on the use of inputs derived from observable market data (level 2) or are not based on observable market data (level 3). The approach usually taken to value these assets, which sometimes relies on adjusting valuations or other observable information as at 31 December, has had to change because of the market volatility brought about by Covid-19 in the final quarter of 2019/20. We will need to consider the revised valuation approach taken by the Fund and relevant fund managers to gain assurance that the impact of Covid-19 on investment values has been properly accounted for in the financial statements.

What will we do?

- ▶ Document and walkthrough the process and design of the controls over the valuation process;
- ▶ Obtain third party confirmations of the valuation of unquoted pooled investments at the reporting date from the investment managers. We will also cross-check the investment manager confirmations to the confirmation of assets held obtained from the Fund's custodian;
- ▶ Review the relevant investment manager controls' reports for qualifications or exceptions that may affect the audit risk;
- ▶ Compare the movement in valuation of investments in unquoted investment vehicles with the returns recognised as investment income per the investment manager confirmations, and investigate any unusual variances;
- ▶ Agree a sample of purchases and sales of unquoted pooled investments during the period to supporting evidence; and
- ▶ Review the basis of valuation for unquoted investments and ensure it is in line with the accounting policy.

Additional procedures in response to Covid-19:

- ▶ We will enquire of management as to what steps they have taken to ensure the accuracy of valuations provided by investment managers accurately reflect the impact of Covid-19 on investments;
- ▶ We will consider whether the audit procedures detailed above provide sufficient audit assurance over the impact of Covid-19 on investments and, if necessary, perform additional audit procedures to corroborate asset values.

Audit risks

Our response to significant risks (updated focus of existing risk)

Valuation of directly held property

What is the risk?

The Fund has a significant portfolio of directly held property investments. The valuation of these properties is subject to a number of assumptions and judgements, small changes in which could have a significant impact upon the financial statements.

Within the Fund's directly held property are a number of retail property assets. Current market conditions within the retail sector mean the judgements and assumptions used to value these assets are particularly sensitive to market volatility.

We have identified the valuation of the Fund's directly held property as a significant risk, as even a small change in assumptions could have a material impact upon the financial statements.

Additional considerations for Covid-19

In-line with guidance issued by the Royal Institution of Chartered Surveyors (RICS), the Fund's property valuer has provided their valuation of the Fund's directly held property at 31 March 2020 on the assumption that there is a 'material valuation uncertainty' due to the impact of Covid-19 on the real estate market.

The extent of the additional uncertainty will depend upon the valuation approach adopted for individual assets, with higher uncertainty expected in valuations which are based upon future rental yields or sale prices and lower uncertainty in valuations which are based upon replacement cost.

Due to the nature of property assets held by the Fund, the Fund's directly held property are generally of a nature where the valuation uncertainty would be expected to be higher. We therefore consider the level of uncertainty around the Fund's property valuations to have increased.

We have already previously identified directly held property as a significant risk for our audit therefore the additional uncertainty does not change our overall risk assessment.

Management will however have to include disclosures within the financial statements to inform the users of the financial statements of the material valuation uncertainty.

What will we do?

- ▶ Document and walkthrough the process and design of the controls over the valuation process;
- ▶ Obtain the valuation report from the external valuer (Cushman and Wakefield) and reconcile to the valuations used within the financial statements;
- ▶ Assess the qualifications and experience of the external valuer to ensure that they can be relied upon as management's experts; and
- ▶ Engage EY Property experts to review and challenge the assumptions used by the external valuer to ensure that they are in line with our expectations.

Additional procedures in response to Covid-19:

- ▶ We will review the extent of involvement of our EY Property experts to ensure the additional uncertainty risks are adequately addressed. This may involve asking them to review a larger number of individual property valuations; and
- ▶ Review the accounts disclosures to ensure that appropriate disclosure has been made in the accounts concerning the material valuation uncertainty.



02

Scope of our audit



Impact of Covid-19

Other potential impacts of Covid-19

The ongoing disruption to daily life and the economy as a result of the pandemic will have a pervasive impact upon the financial statements, which will need to reflect the impact of the pandemic upon the Fund's financial position and performance. We have not identified further significant risks or areas of audit focus relating to Covid-19, other than those set out previously in this update, but wish to highlight additional ways in which Covid-19 has or could impact the financial statements and our audit. This includes, but is not limited to:

- ▶ **Going concern and post balance sheet event disclosures** - management's assessment of whether the Fund is a going concern will need to consider the impact of the current conditions on the financial sustainability of the Fund including, but not limited to:
 - ▶ the impact on the carrying value of Fund assets;
 - ▶ the continued ability of scheduled and admitted bodies to pay contributions;
 - ▶ the level of reliance on investment income to pay benefits; and
 - ▶ the ease and speed with which investment assets can be converted to cash if necessary to support liquidity.

Additional narrative disclosure will be required on the future principal risks and uncertainties, including the known impact on investment values in 2020/21 to date. Given the relatively strong financial position of the Fund, as evidenced by the 2019 triennial valuation, our existing knowledge of Fund liquidity and the composition of its investments, we do not consider this to be a significant risk.

- ▶ **EY review and consultation** - due to the increased risks of misstatement arising from factors linked to the pandemic, as set out in this update, we have strengthened our internal review procedures and introduced additional consultation processes to consider the impacts of these matters on our audit opinion

In addition to the impact on the financial statements themselves, the disruption caused by Covid-19 may impact on our ability to complete the audit as efficiently as normal. For example, it may be more difficult than usual to access the supporting documentation necessary to support our audit procedures. There will also be additional audit procedures we have to perform to respond to the additional risks caused by the factors noted above.

The changes to audit risks and audit approach will change the level of work we perform. This will impact the audit fee. We will agree changes to the audit fee with management and report back to the Audit Committee.

Impact of Covid-19

Materiality

We have reconsidered the materiality levels we reported to you in our Audit Planning Report, and whether any change to our materiality is required in light of Covid-19. Following this consideration we remain satisfied that the basis and percentages used for planning materiality, performance materiality and our threshold for audit differences reported to you in our Audit Planning Report remain appropriate. We have however updated our assessment based upon the net assets reported in the draft financial statements provided for audit.

