



**Shetland Islands Council Pension Fund**

Final report to the Controller of Audit for the year ended 31 March 2019

Issued 30 August 2019 for the meeting on 25 September 2019

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# Partner introduction

## The key messages in this report

I have pleasure in presenting our final report for the 2019 audit of Shetland Islands Council Pension Fund (“the Fund”). The areas of significant risk identified in that report have remained consistent throughout our testing and have been focal to the performance of our audit. I would like to draw your attention to the following key messages:

### Audit quality is our number one priority.

We plan our audit to focus on audit quality and have followed 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.

### Significant audit risk and areas of audit focus

In our planning report we identified management override of controls as our significant risk. Further details of the audit procedures on the significant audit risk can be found on page 6.

The audit procedures on the areas of focus can be found on pages 8 to 10.

### Status of the audit

We are currently progressing the audit towards completion. We have detailed the procedures still to be completed in appendix 4 and our final opinion is subject to completion of these items.

### Audit Quality & Insight

We have completed our audit in line with our planning report dated February 2019.

We have committed to delivering a robust challenge of the key judgements taken in the preparation of the financial statements; to gain a strong understanding of your internal control environment; and to deliver a well planned audit that raises findings early with those charged with governance.

A detail of unadjusted misstatements can be found in appendix 3.

Subject to the satisfactory receipt and the completion of the items in appendix 4 we expect to issue an unmodified audit opinion on the financial statements.

# Materiality

## Our approach to materiality - Fund

### **Basis of our materiality benchmark**

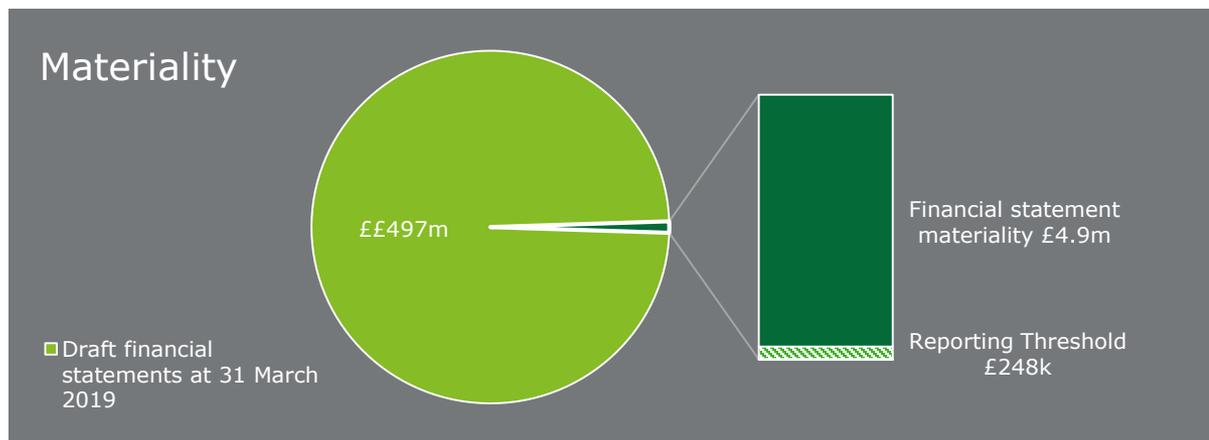
- We have determined financial statement materiality to be £4.97m based on professional judgement, the requirement of auditing standards, and the net assets of the Fund. During the audit we have considered, together with the Shetland Islands Council audit team, whether any reduction is required to the level of materiality applied to the Fund.
- We have used 1% of Fund net assets.

### **Reporting to those charged with governance**

- We will report to you all misstatements found in excess of 5% of financial statement materiality. We will report to you misstatements below this threshold if we consider them to be material by nature.

### **Materiality calculation**

Although materiality is the judgement of the audit partner, the Audit and Pension Fund Committee members must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.



# Significant audit risks and other areas of audit focus

## An overview

Risk Identified	Material Balance	Management Judgement	Proposed Approach	Fraud Risk	Further Details
 <b>Significant risk</b> Management override of controls			<b>D&amp;I</b>		Pg. 7
 <b>Other Focus Area</b> Completeness of investments			<b>D&amp;I</b>		Pg. 9
 <b>Other Focus Area</b> Accuracy and timeliness of contributions			<b>D&amp;I</b>		Pg. 10

 Significant risk	 Low levels of management judgement/complexity	<b>D&amp;I</b> Design and Implementation
 Other area of audit focus	 Medium levels of management judgement/complexity	<b>OE</b> Operating Effectiveness
	 High degree of management judgement/complexity	

# Significant audit risk

# Significant risks

## Management override of controls



### Risk identified

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In accordance with ISA 240 (UK) management override is a presumed 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.

### Response of those charged with governance

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The financial reporting process in place has an adequate level of segregation of duties.

### Deloitte response to significant risk identified

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

- Used our Excel data analytics tool in our journals testing to interrogate the journals posted across the Fund. This selects journals meeting specific pre-determined parameters determined during our audit planning;
- Made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Performed a walkthrough of the financial reporting process to identify the controls over journal entries and other adjustments posted in the preparation of the financial statements;
- Assessed whether that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
- Tested the design and implementation of controls around the journals process;
- Reviewed related party transactions and balances to identify if any inappropriate transactions have taken place; and
- Reviewed the significant and unusual transactions and 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.

### Findings

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There are no issues arising from our testing performed that would indicate that there have been any instances of management override of controls during the year.

# Audit focus areas

# Audit focus areas

## Completeness of investments



Focus Area

D&I



### Area of focus identified

The Fund holds a large and highly material portfolio of investments, which is diversified with several investment managers. As a result of this we consider the existence of these investments to be an area of audit focus.

### Response of those charged with governance

The Fund appoints various investment managers and Northern Trust as custodian for these investments. These parties have strong control environments in place.

### Findings

We did not note any significant issues from our testing performed.

### Deloitte response to the focus area identified

In order to address this area of audit focus, we have performed the following audit procedures:

- Reviewed the design and implementation of key controls over the completeness and valuation of investments by obtaining the investment manager internal control reports (where applicable) and evaluating the implications for our audit of any exceptions noted;
- Agreed year end valuations, sales and purchases amounts in the accounts to the reports received directly from the investment managers;
- Performed valuation testing on the valuation of the investments held at 31 March 2019 by using a range of techniques depending on the type of investment.
  - Where the investment was not directly quoted on an exchange we confirmed if it is a registered fund and obtained an independent price.
  - Where this was not the case we confirmed if the fund was structured as a unitised insurance policy or used sales transactions close to year end as an estimate of the price.
  - Where none of these options are available we obtained audited financial statements and compared the price per the statement to the audited accounts.
- Performed a unit reconciliation in which the opening investment balances and unit quantities are reconciled to the closing investment balances and unit quantities by taking into account the movement that occurred during the year, (i.e. sales, purchases, change in market value); and
- Tested the completeness of investments by agreeing a sample of sales and purchases transactions to underlying documentation.

# Audit focus areas



Focus Area

## Accuracy and timeliness of contributions

D&I



### Area of focus identified

There is some complexity surrounding the completeness and accuracy of employer and employee contributions received by the Fund. The employer primary and secondary contribution rates are dictated by the actuarial valuation and these vary between the contributing employers. Employee contributions are based on varying percentages of employee pensionable pay, this can vary month to month and the Fund has no oversight of the individual employer payrolls.

In addition, while no opinion is issued on timely payment of contributions, it remains an area of focus, as LGPS Regulations stipulate due dates for payment. Late payments could cause reputational damage.

As a result of this we would expect the accuracy and timeliness of contributions to be an area of audit focus.

### Response of those charged with governance

The administration team monitors the due dates of contributions and that the correct amounts are received into the Fund bank account to ensure that payments are in accordance with the actuarial valuation.

Employers must also complete a contributions return confirming that the contributions paid during the year are accurate and complete.

### Findings

From our audit testing, we have noted the following control deficiency:

- In our sample of payslip testing, we noted that for one employee, both employer and employee contributions were calculated incorrectly, due to unauthorised sick leave. When an employee gets reduced pay due to authorised sick leave, he/she gets flagged on the system, as contributions are based on actual pay. As the sick leave was unauthorised, the employee was not flagged and contributions were calculated on the wrong amount of pay. We recommend that a monthly control is put in place to check that employees who have taken unauthorised sick leave are flagged, so that contributions are amended accordingly.

We did not note any other issues from our testing performed.

### Deloitte response to the focus area identified

In order to address this area of audit focus, we performed the following audit procedures:

- Considered the design and implementation of key controls over the contribution process;
- Performed an analytical review of the employer and employee normal contributions received in the year, basing our expectation on the prior year audited balance, adjusted for the movement in active member numbers, contribution rate changes and any average pay rise awarded in the year;
- Tied a sample of employer contributions received during the year back to the contribution rates stipulated in the 31 March 2017 actuarial valuation;
- Tested that the correct definition of pensionable salary was being used per the LGPS Regulations to calculate contribution deductions;
- For a sample of monthly contributions, checked that they were paid within the time limits stipulated in the Local Government Pension Scheme (Scotland) Regulations 2014 ("LGPS Regulations"); and
- For a sample of active members across the Fund, we recalculated individual contribution deductions to confirm that these were calculated in accordance with the rates stipulated by the Scottish Public Pensions Agency and in the 31 March 2017 actuarial valuation;

# Audit dimensions

# Wider Scope Requirements

## Audit Dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. We have considered how the Pension Fund addresses these areas as part of our audit work as follows:

Audit dimension	Audit work completed	Audit conclusion
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the Pension Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"><li>• We reviewed the financial planning systems in place by the Pension Fund to ensure that its services can continue to be delivered.</li><li>• We also reviewed the arrangements in place to address any funding gaps.</li><li>• We looked at the affordability and effectiveness of funding and investment decisions made.</li></ul> <p>This included:</p> <ul style="list-style-type: none"><li>• a review of the latest actuarial valuation of the Pension Fund (dated 31 March 2017) and the plans in place to reduce the deficit over the shorter and medium term; and</li><li>• A review of the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy 2014-2027 ("Investment Strategy"), which aims to ensure the long-term solvency of the Pension Fund, so that there are sufficient funds available to meet all benefits as they fall due.</li></ul>	<p>From our work completed we are satisfied the Fund has sufficient plans in place to continue to be financially sustainable in the medium and long term. We did not identify any issues regarding non-payment of contributions due from the Scheduled and Admitted Bodies which would have an impact on the financial sustainability of the Fund.</p> <p>In addition from our review of the Investment Strategy 2014-2027, the Fund has taken investment advice on how best to use its resources appropriately to ensure future benefits can be settled when the liability arises and the Fund will be 100% funded by 2027.</p>

# Wider Scope Requirements

## Audit Dimensions

Audit dimension	Audit work completed	Audit conclusion
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<ul style="list-style-type: none"> <li>• We reviewed the budget and monitoring reporting by the Pension Fund during the year to assess whether financial management and budget setting is effective;</li> <li>• We ensured that there is a proper officer who have sufficient status to be able to deliver good financial management, that monitoring reports contain information linked to performance as well as financial data, and that members have the opportunity to provide a sufficient level of challenge around variances and under-performance; and</li> <li>• We reviewed the design and implementation of the Pension Fund and third party advisers controls in place to ensure they were operating effectively.</li> </ul>	<p>From our testing completed we can confirm that an Executive Manager – Finance has been appointed who has the appropriate status to act in that role and complies with the five principles outlined in the CIPFA guidance.</p> <p>From our review of the budget process we are satisfied that appropriate financial reports are provided to both the Audit and Pension Fund Committee to challenge variances and underperformance and that this is performed.</p> <p>Although for our audit purposes, we did not perform operating effectiveness testing, our implementation walkthroughs of controls in place did not show evidence of failing controls. In addition, our review of the investment managers’ published controls reports did not raise any matters.</p>

# Wider Scope Requirements

## Audit Dimensions

Audit dimension	Audit work completed	Audit conclusion
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> <li>• We reviewed the Pension Fund Committee meeting minutes to assess the effectiveness and scrutiny of governance arrangements.</li> <li>• We reviewed other aspects of governance around the Pension Fund including Codes of Conduct for officers and members, fraud and corruption arrangements, and arrangements for reporting regulatory breaches to the Pensions Regulator.</li> <li>• In addition we reviewed the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issued by Scottish Ministers.</li> </ul>	<p>From our testing performed we have no issues to note. The Annual Governance Statement and Governance Compliance Statement contains the required information.</p> <p>The procedures and policies around governance, Codes of Conduct, etc. are clear and transparent and available for all Members to read on the Shetland Island Council website.</p>
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> <li>• We gained an understanding of how the Pension Fund demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.</li> <li>• We reviewed the scrutiny that is in place to challenge the Pension Fund's investment managers on fees and performance.</li> </ul>	<p>From our review of the budget process we are satisfied that there is sufficient scrutiny over expenditure of the Fund, in particular investment management fees.</p> <p>In addition the Investment Strategy document outlines how the Fund will achieve value for money in where the assets are invested, ultimately aiming for 100% funding by 2027.</p>

# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to help the Audit Committee and the Pension Fund Committee discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Our internal control observations
- Other insights we have identified from our audit

### 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.

This report has been prepared for the Audit Committee and Pension Fund Committee, 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.

### Other relevant communications

We will update you if there are any additional findings resulting from the concluding of the outstanding audit procedures.

**Pat Kenny**

for and on behalf of Deloitte LLP  
Glasgow | XX August 2019

# Appendices

# 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 Audit and Pension Fund Committees, 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 as the key audit risk 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 Audit and Pension Fund Committees:**

- 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 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 Audit and Pension Fund Committees 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 Audit and Pension Fund Committees**

- How the Audit and Pension Fund Committees 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 Audit and Pension Fund Committees have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of the Audit and Pension Fund Committees 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:

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<b>Independence confirmation</b>	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.
<b>Fees</b>	Our audit fee for the year ended 31 March 2019 is £29,100 for the Fund. The above fees exclude VAT and include out of pocket expenses.
<b>Non-audit fees</b>	There are no non-audit fees.
<b>Independence monitoring</b>	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.
<b>Relationships</b>	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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# Appendix 3: Audit adjustments

## Unadjusted misstatements and disclosure deficiencies

We have identified the following misstatements and disclosure deficiencies from our audit work to date, most of which have been corrected by management but we nonetheless bring to your attention.

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	Debit/ (credit) in Fund Account £	Debit/ (credit) in net assets £	If applicable, control deficiency identified
<b>Uncorrected misstatements</b>			
None			
<b>Corrected misstatements</b>			
None			
<b>Total</b>			

### Disclosure deficiencies

Auditing standards require us to highlight significant disclosure misstatements to enable Audit Committees to evaluate the impact of those matters on the financial statements. The table below highlights those areas of disclosure that we consider require consideration by the Audit and Pension Fund Committee.

- 1) We have not identified deficiencies from our work.

## Appendix 4: Outstanding items

Items outstanding at the date of draft report and still being worked on

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- Clearance of queries raised from various reviews on various sections, notably on contributions and investments
  - Finalisation of our internal quality control procedures
  - Final partner and technical review clearance
  - Receipt of signed management representations letter
  - Satisfactory completion of our post year-end events review
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