



## **Shetland Islands Council Pension Fund**

Final report to the Pension Fund Committee and the Controller of Audit on the 2020 audit

Issued 11 September for the meeting on 23 September 2020

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# Executive introduction

## The key messages in this report:

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We have pleasure in presenting our Final Report to the Pension Fund Committee for the 2020 audit of Shetland Islands Council Pension Fund (the 'Fund'). We would like to draw your attention to the key messages of this paper:

### Status of the audit

We are currently progressing towards completion. We have detailed the procedures still to be completed in appendix 4. Subject to the satisfactory receipt and completions of the items in Appendix 4, we expect to issue an unmodified audit opinion on the financial statements of the Fund.

### Significant audit risks

In our planning report, we identified management override of controls as our significant audit risk. Auditing standards require us to assume that management override of controls is an audit risk for all of our audits.

Further details of this significant risk, including our proposed testing can be found on page 8.

There has not been a change to our risk assessment.

### Audit Quality

We have completed our audit in line with our planning report dated 14 February 2020.

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.

Details of the unadjusted misstatements can be found in appendix 3.

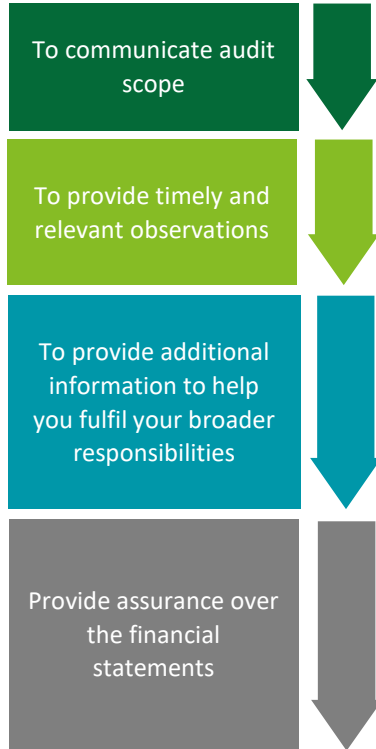
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**Pat Kenny**  
Audit Director

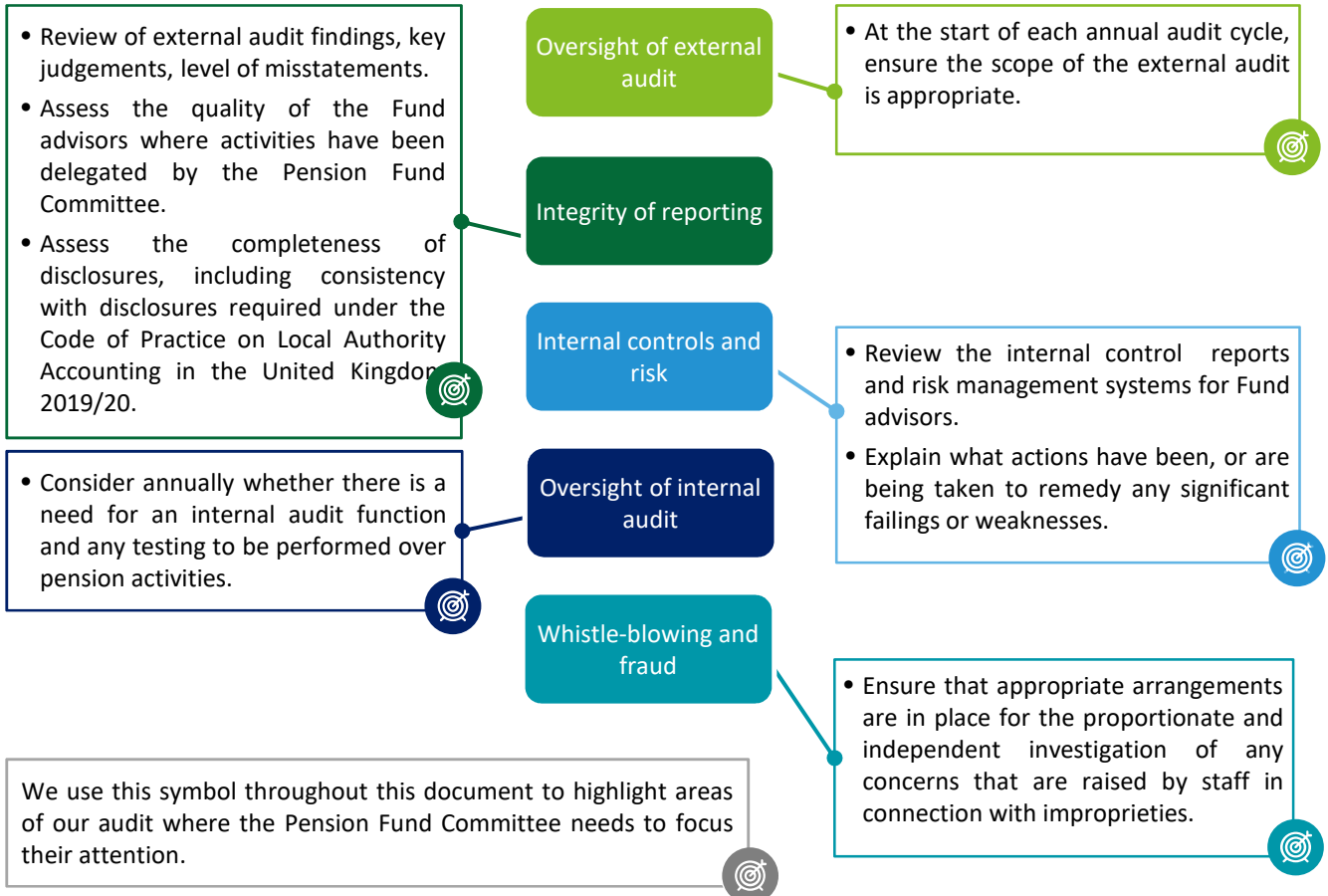
# Responsibilities of the Pension Fund Committee

## Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Pension Fund Committee:



As a result of regulatory change in recent years, the role of the Pension Fund Committee has significantly expanded. We set out here a summary of the core areas of Pension Fund Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps those charged with governance in fulfilling their remit.



# Materiality

## Our Approach to Materiality

### Basis of our materiality benchmark

- We set materiality for our opinion on the individual financial statement as £4,607k (PY: £4,971k), based on professional judgement, the requirement of auditing standards, and the net assets of the Fund.
- We have used 1% of Fund net assets.

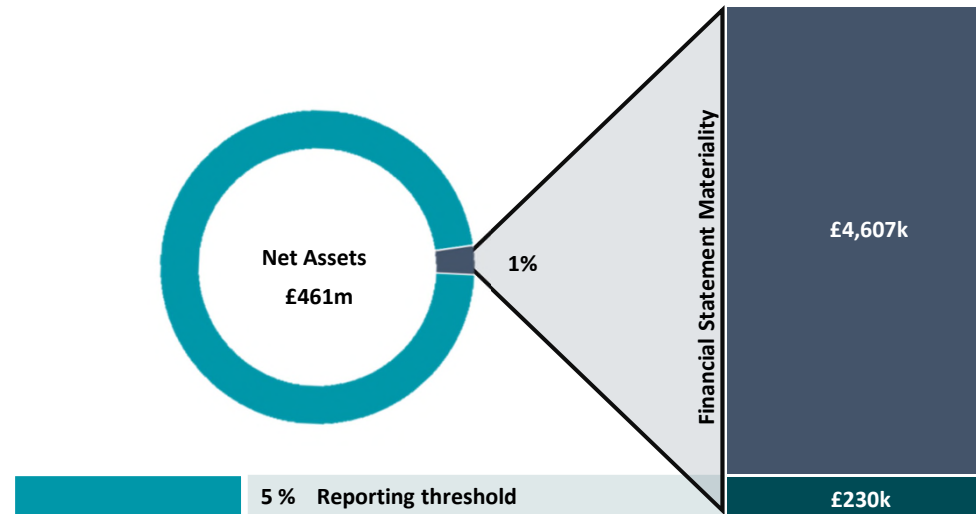
The basis for our materiality calculations is the same as the previous year.

### Reporting to those charged with governance

- We will report to you all misstatements found in excess of 5% of financial statement materiality. We 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 director, the Pension Fund Committee must be satisfied the level of materiality chosen is appropriate for the scope of the audit.



# Scoping

## Risk dashboard



Risk Area	Risk Type	Fraud Risk	Judgement	Controls approach?	Approach to testing
Management override of controls				D&I	See page 8.
Accuracy and timeliness of contributions				D&I	See page 10.
Completeness of investments				D&I + OE	See page 11.

**Significant risk:** risk which require a tailored, elevated audit response in terms of the nature, timing and extent of audit testing. Significant risks are based on professional judgment and the results of the risk assessment procedures we have performed.

**Audit focus areas:** risks which require additional audit consideration beyond that of normal risks, but where the potential for material misstatement or the likelihood is lower than that of a significant risk.

**D&I:** Design and implementation of controls

**OE:** Operating effectiveness

- |   |                  |
|---|------------------|
| Low levels of management judgement/involvement    | Significant risk |
| Medium levels of management judgement/involvement | Audit focus area |
| High degree of management judgement/involvement   |                  |





**Significant  
audit risk**

# Significant risks

## Management override of controls

### Risk identified

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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.

### Response of those charged with governance

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The Pension Fund Committee does not have access to the Fund accounting system and does not process any journals in respect of the Fund.

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

### Findings

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

### 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 in our journals testing to interrogate 100% of journals posted across the Fund;
- 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;
- Reviewed the accounting estimates for bias, such as year-end creditor and debtor postings and the valuation of unlisted investments, 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;
- Ensured that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
- Reviewed related party transactions and balances to identify if any inappropriate transactions have taken place;
- Tested the design and implementation of controls around the investment and disinvestment of cash during the year; and
- Made enquiries of management in relation to the identification of related parties.





**Audit focus  
areas**

# Audit focus areas

## Accuracy and timeliness of contributions

### Risk identified

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The correct deduction and timely payment of contributions depends on system-based processing of membership data and salary details, together with a robust internal controls framework. Errors in processing contributions can lead to issues such as non-compliance with the Local Government Pension Scheme Regulations 2014 (“LGPS Regulations”) and the recommendations of the actuary, and deducting incorrect amounts from the active members’ payroll, which can be costly to rectify and cause reputational damage.

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.

There is a risk that contributions are not paid to the Fund accurately or in a timely manner.

### Response of those charged with governance

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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

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We did not note any issues from our testing performed to date.

### Deloitte response to risk identified

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

- Reviewed 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;
- For a sample of active members, we recalculated individual contribution deductions to ensure these are being calculated in accordance with the rates stipulated in the LGPS Regulations for employee contributions and the recommendations of the actuary for employer contributions;
- Tested that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions;
- Tested the reconciliation of the total number of active members between the membership records and the employer payroll records; and
- For a sample of monthly contributions paid, checked that they have been paid within the due dates per the LGPS Regulations.

# Audit focus areas

## Completeness of investments

### Risk identified

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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 completeness of these investments to be an area of audit focus.

The Fund holds investments primarily in pooled funds, pooled property unit trusts and fixed income unit trusts with a range of investment managers.

### Response of those charged with governance

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

### Findings

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We have identified inconsistencies with the fair value hierarchy and related disclosures in the financial statements, and we understand that this is in the process of being addressed.

We are in the process of finalising our procedures and will report to the Pension Fund Committee if any further issues are identified.

### Deloitte response to risk identified

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

- Reviewed the design and implementation of key controls over the valuation and completeness of investments by obtaining the investment manager internal controls reports and evaluating the implications for our audit of any exceptions noted. We reviewed the operating effectiveness of controls over the completeness of investments by obtaining the custodian internal controls report and evaluating the implications for our audit of any exceptions noted in respect of reconciliations and reporting of transactions;
- Independently requested confirmations from all investment managers and the global custodian for balances held per the financial statements;
- Agreed year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers;
- Performed a full unit reconciliation of investments held during the year;
- Performed valuation testing 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 registered on the Financial Conduct Authority website and obtain an independent price, or used sales transactions close to the year end as an estimate of the price.
  - Where the investment was a unit linked insurance policy, we confirmed that the investment is held under the form of a unit linked insurance policy, that the insurance provider is authorised to provide insurance services and obtained confirmation that the provider would be willing to transact at the unit price stated on the confirmation received.
  - Where none of these options was available we obtained audited financial statements and assessed the year end price against the audited accounts, and benchmark movements where the date of the audited financial statements was not coterminous with the Fund's financial year.





**Wider scope  
requirements**

# 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 Pension Fund Committee and the Controller of Audit 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.
- Our internal control observations.
- Other insights we have identified from our audit.

## The scope of our work

Our observations are developed in the context of our audit of the Fund financial statements.

We described the scope of our work in our proposed audit plan circulated to you on 14 February 2020.

The audit insights and other control findings of this report provide details of additional work we have performed alongside the audit of the Fund financial statements.

This report has been prepared for the 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.

## 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 Pension Fund Committee.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, the views on internal controls and Fund 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 Fund financial statements and the other procedures performed in fulfilling our audit plan.


We welcome the opportunity to discuss our report with you and receive your feedback.



**Pat Kenny**

for and on behalf of Deloitte LLP

Glasgow | 11 September 2020



# Appendices

Key audit matters

# 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 Pension Fund Committee, 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 management override of controls as a 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 Pension Fund Committee:

- 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 Fund 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 Fund'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 Fund.
- Management's communication, if any, to the Pension Fund Committee regarding its processes for identifying and responding to the risks of fraud in the Fund.
- 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 Fund.
- 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 Fund, and to obtain its views about the risks of fraud.



### The Pension Fund Committee

- How the Pension Fund Committee exercises oversight of management's processes for identifying and responding to the risks of fraud in the Fund and the internal control that management has established to mitigate these risks.
- Whether the Pension Fund Committee has knowledge of any actual, suspected or alleged fraud affecting the Fund.
- The views of the Pension Fund Committee on the most significant fraud risk factors affecting the Fund.



# 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:

<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 for the year ended 31 March 2020.
<b>Fees</b>	<p>The fee for the 2019/20 audit has been agreed as:</p> <p>Auditor remuneration: £24,387 Pooled costs: £2,510 Contributions to Audit Scotland costs: £1,550 <b>Total: £28,447</b></p> <p>There are no non-audit services fees proposed for the period.</p>
<b>Non audit services</b>	<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>
<b>Relationships</b>	We have no other relationships with the Fund, the Pension Fund Committee, or management, and have not supplied any services to other known connected parties.

# 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 Pension Fund 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) There are currently discrepancies in the disclosure of the fair value hierarchy of the investments, where there is currently no funds categorised as level 3, and no further level 3 disclosures have therefore been made in the financial statements. We understand that this is currently being looked into.
- 2) Further disclosures are required to explain the gating/ suspension and/or material uncertainty attached to the valuation of the pooled property funds held.

## Appendix 4: Outstanding items

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

Our final opinion is subject to completion of these items.

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- Pension payroll controls testing
  - Going concern review
  - Finalisation of substantive analytical procedures on investment movements over the year
  - Receipt of final version of the financial statements for our review
  - 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
-



# Appendix 5: Our approach to quality

## AQR team report and findings

Audit quality remains our number one priority and we have a relentless commitment to it. We continue to invest in and enhance our Audit Quality Monitoring and Measuring programme.

In July 2020 the Financial Reporting Council (“FRC”) issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review (“AQR”) team for the 2019/20 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm-wide quality control systems, a key aspect of evaluating our audit quality.

We are pleased with our results for the inspections of FTSE 350 entities achieving 90% assessed as good or needing limited improvement, which included some of our highest risk audits. Our objective is for 100% of our audits to be assessed as good or needing limited improvement and we know we still have work to do in order to meet this standard. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm-wide actions.

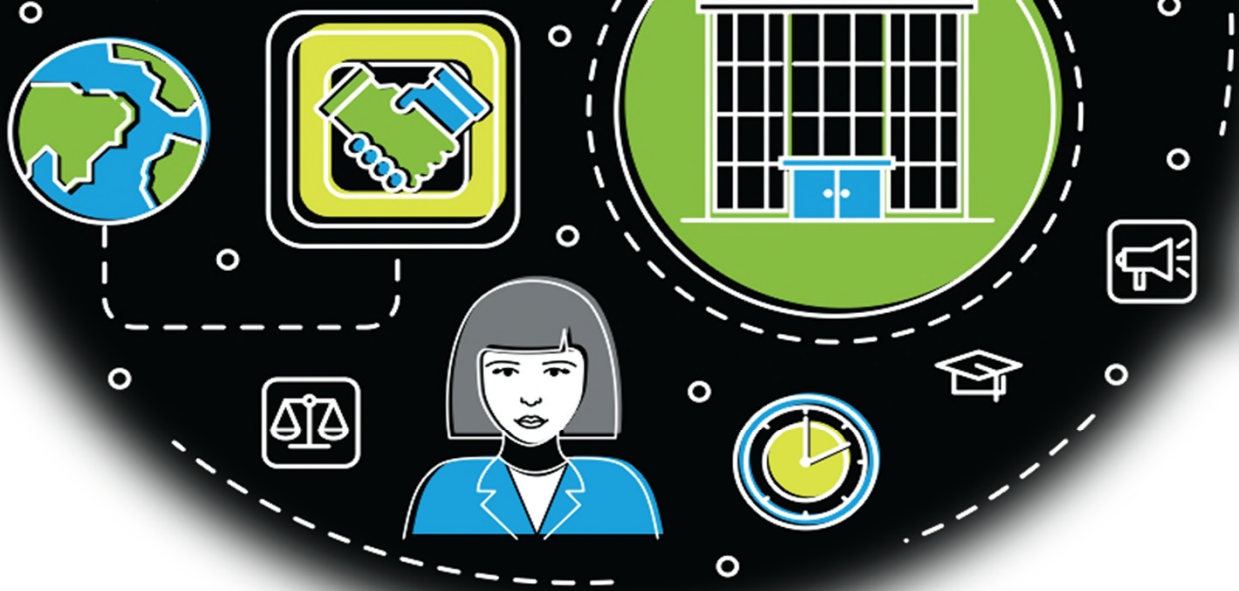
We are also pleased to see the impact of our previous actions on prior year adjustments is reflected in the results of current year inspections with no findings in this areas. In addition the FRC identified good practice examples including in: risk assessment, group oversight, our comprehensive IFRS9 expected credit loss audit programme and our audit committee reporting.

Embedding a culture of challenge in our audit practice underpins the key pillars of our audit strategy. We invest continually in our firm-wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website.

<https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

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