Shetland Islands Council Pension Fund

Planning report to the Pension Fund Committee on the 2022 audit

Issued 8 February 2022

Contents

Executive introduction

The key messages in this report:

We have pleasure in presenting our Planning Report to the Pension Fund Committee for the 2022 audit of Shetland Islands Council Pension Fund (the 'Fund'). We would like to draw your attention to the key messages of this paper:

Audit quality is our number one priority.

We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

A **robust** challenge of the key judgements taken in the preparation of the financial statements.

A strong **understanding** of your internal control environment.

A **well planned** and delivered audit that raises findings early with those charged with governance.

Fund Changes

Following discussions with the Fund's finance team, we have not identified any significant changes to the Fund, other than a projected restructuring of the investment portfolio that is expected to commence after the Fund year end. We will continue to liaise with the finance team to identify any changes between the date of this report and the Fund's year end, and will update our audit plan accordingly should any occur.

There have been no significant regulatory changes to the accounting of the Fund in the current year. The Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 ("the 2021/22 Code") applies in the current year.

Significant audit risks

As in the prior year, we have 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 13.

Whilst the accuracy and timeliness of contributions, completeness of investment transactions and valuation of pooled property funds have not been assessed as significant risks, they have been assessed as audit focus areas as outlined on pages 15 and 16.

Audit Quality

Our audit approach is tailored to providing the Pension Fund Committee with an audit which is designed to provide assurance and insight over the Fund control environment.

We plan and deliver an audit that raises findings early with those charged with governance. This is underpinned by mutually agreed timetables, detailed audit request lists and frequent communications with management and the Pension Fund Committee.

Executive introduction (continued)

The key messages in this report:

Audit dimensions

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how the Fund is addressing these and we will report our conclusions in our annual report to the Members and Controller of Audit in September 2022. In particular, our work will focus on:

- ***Financial sustainability –*** we will monitor the Fund's actions in respect of its medium and longer term financial plan to assess whether short term financial balance can be achieved, whether there is a long-term financial strategy and if the investment strategy is effective.
- ***Financial management –*** we will review the budget and monitoring reports of the Fund during the year to assess whether financial management and budget setting is effective.
- ***Governance and transparency –*** from our review of the Fund's Pension Fund Committee papers and attendance at Pension Fund Committee meetings, we will assess the effectiveness and scrutiny of governance arrangements. We will also share best practice examples, where it is deemed appropriate.
- ***Value for money –*** we will gain an understanding of the Fund's self-evaluation arrangements to assess how it demonstrated value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

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:

- To communicate audit scope
- To provide timely and relevant observations
- To provide additional information to help you fulfil your broader responsibilities
- Provide assurance over the financial statements

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.

Oversight of external audit

- At the start of each annual audit cycle, ensure the scope of the external audit is appropriate.
- Implement a policy on the engagement of the external auditor to supply non-audit services.

Integrity of reporting

- Review of external audit findings, key judgements, level of misstatements.
- Assess the quality of the Fund advisors where activities have been delegated by the Pension Fund Committee.
- Assess the completeness of disclosures, including consistency with disclosures required under the Code of Practice on local authority accounting in the UK.

Internal controls and risk

- Review the internal control reports and risk management systems for Fund advisors.
- Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

Oversight of internal audit

- Consider annually whether there is a need for an internal audit function and any testing to be performed over pension activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns that are raised by staff in connection with improprieties.

Timing of the audit

Continuous communication and reporting

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

Planning	Year end fieldwork	Reporting
• Planning meetings • Discussion of fraud risk assessment • Audit team issues planning report to the Pension Fund Committee (February 2022)	• Audit of Annual Report and financial statements • Test the design and implementation of the control environment at the Council • Review of investment confirmations and fair value testing of investments • Year end audit fieldwork	• Issue final annual report to the Pension Fund Committee and the Controller of Audit and presentation of report and attendance at the Pension Fund Committee meeting • Audit de-brief on the 2022 audit • Reporting of significant control deficiencies • Signing audit reports in respect of Financial Statements • Issue audit report and submission of the audited financial statements to Audit Scotland
2022 Audit Plan	Continuous reporting to Management	Final Report to the Pension Fund Committee and any additional reporting as required
February/March 2022	**June/ August 2022**	**September 2022**

Ongoing communication and weekly calls during the year end fieldwork phase

Materiality

Our Approach to Materiality

Basis of our materiality benchmark

- We have estimated materiality for our opinion on the individual financial statements as £5,899k, based on professional judgement, the requirement of auditing standards and the prior year net assets of the Fund.
- We have used 1% of Fund net assets as the benchmark for determining our materiality levels.

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

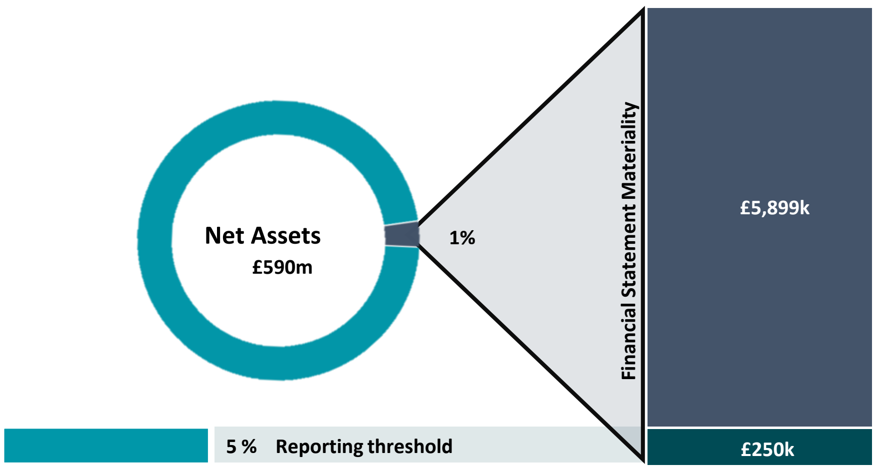
Materiality Calculation

We set performance materiality as a percentage of materiality (typically 90%) to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed materiality. We determine performance materiality, with reference to factors such as the quality of the control environment and the historical error rate. Where we are unable to rely on controls, we may use a lower level of performance materiality. It is performance materiality that is used in the determination of our audit samples.

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.

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.
- We will determine the current year materiality figure and reporting to those charged with governance figure for the Fund on receipt of the draft 2022 financial statements.



Scope of work and approach

Our key areas of responsibility under the Code of Audit Practice

Core audit

Our core audit work as defined by Audit Scotland comprises:

- Providing the **Independent Auditor's Report** on the annual financial statements;
- Providing the **annual report** on the audit addressed to the Pension Fund Committee;
- Communicating **audit plans** to the Pension Fund Committee;
- Providing **reports to management**, as appropriate, in respect of the auditor's responsibilities in the Code;
- Identifying **significant matters arising from the audit**, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required; and
- Undertaking work requested by Audit Scotland or local performance audit work.

Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability –** looking forward to the medium and longer term to consider whether the Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Financial management –** financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency –** the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money –** using resources effectively and continually improving services.

Scoping

Summary of account balances (Fund Account)

Below we have considered each of the Fund's significant account balances. We will report factually on the key audit risks that have the biggest impact on the audit, explaining why the risk is relevant within the specific circumstances of the Fund and clearly document the specific procedures we will perform to address the key audit risk. The estimated account balances below are based on the prior year signed financial statements. We will report control observations and other findings in our final report to the Pension Fund Committee on work performed on other account balances.

Contributions and transfers in– 2021: £21.4m
Contributions is a material balance. We have considered the risk in respect of accuracy as well as timeliness on page 16. We have not referred to transfers in risk in our report to the Pension Fund Committee because the balance is not material.

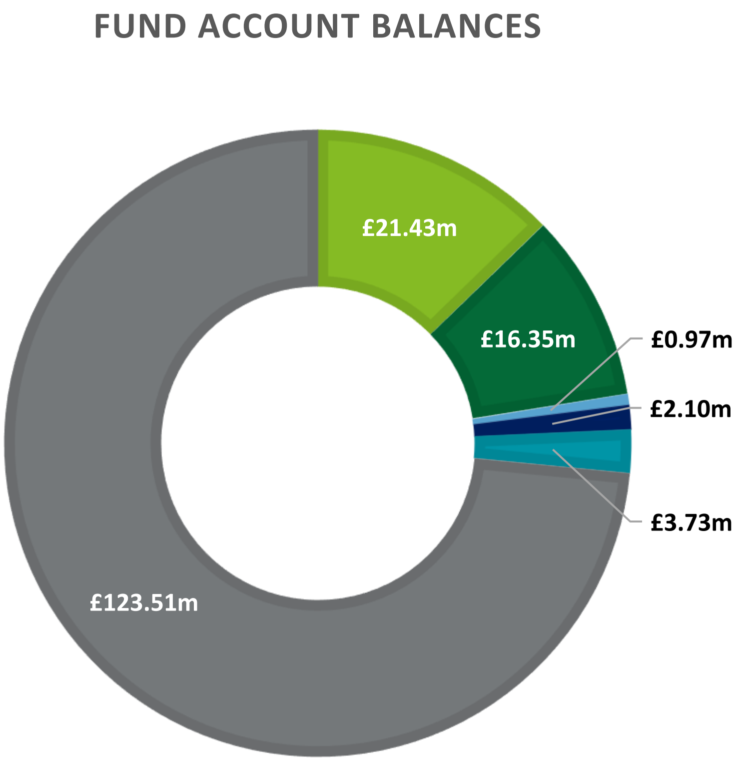
Benefits payable – 2021: £16.3m
Benefits payable consists of material pensions payable and retirement lump sums. We have not referred to this risk in our report to the Pension Fund Committee because we do not consider this to be a complex account balance that could drive material misstatement.

Payments to and on account of leavers – 2021: £1.0m
Balance consists of transfer values. We have not referred to this risk in our report to the Pension Fund Committee because the balance is considered routine in nature and immaterial.

Expenses – 2021: £2.1m
We have not referred to this risk in our report to the Pension Fund Committee because the balance is not material.

Investment Income – 2021: £3.7m
We have not referred to this risk in our report to the Pension Fund Committee because the balance is not material.

Change in market value – 2021: £123.5m
CIMV is by far the largest balance in the Fund Account. We have not referred to change in market value in our report to the Pension Fund Committee because the balance is manually recalculated as part of the investments reconciliation and is therefore considered as part of the completeness of investments procedures set out on page 15.

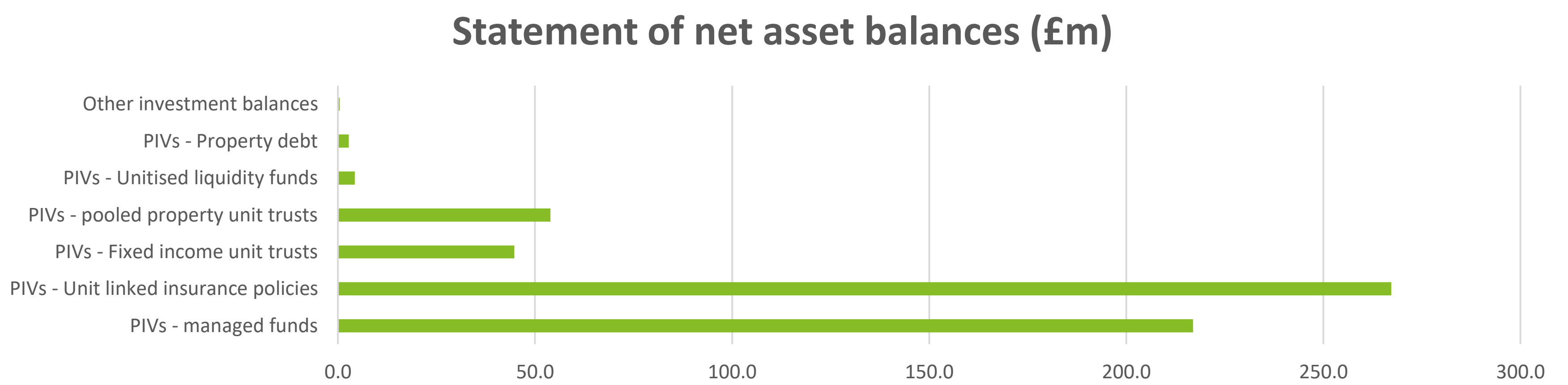


Scoping

Summary of account balances (Statement of Net Assets)

Investment Assets – 2021: £590.2

- **Pooled Investment Vehicles ("PIVs")** - The majority of PIVs consist mainly of managed funds, unit linked insurance policies, fixed income trusts, and pooled property unit trusts. Due to the continuing challenges in certain sectors of the property market, we have deemed the pooled property funds to be an area of focus, which has been discussed on page 15.



Current assets – 2021: £2.2m

We will agree the year-end cash balance to an independent confirmation as well as testing the bank reconciliations. All other current asset balances are immaterial and therefore will be scoped out of testing.

Current liabilities – 2021: £2.5m

We will also review the post year end cashbooks for evidence of any unrecorded liabilities. All other current liability balances are immaterial and therefore will be scoped out of testing.

Scoping

Significant Risk + Areas of Audit Focus Dashboard

Risk Identified	Material Balance	Management Judgement	Proposed Approach	Fraud Risk	Further Details
Significant Risk Management override of controls	✗	⚠ (orange)	**D&I**	✓	Pg. 13
Other Focus Area Completeness of investment transactions and valuation of pooled property funds	✓	⚠ (yellow)	**D&I + OE (where the investment manager produces an internal controls report)**	✗	Pg. 15
Other Focus Area Accuracy and timeliness of contributions	✗	⚠ (yellow)	**D&I**	✗	Pg. 16

Significant Risk	Low levels of management judgment/complexity	**D&I**	Design and Implementation
Other area of audit focus	Medium levels of management judgement/complexity	**OE**	Operating Effectiveness
	High degree of management judgement/complexity		

Significant audit risk

Significant risk

Management override of controls

Risk identified

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

Response of those charged with governance

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.

Deloitte response to significant risk identified

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

- Use data analytics in our journals testing to interrogate 100% of journals posted across the Fund and to identify journals or audit interest for substantive testing;
- Perform 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;
- Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
- Review 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;
- Ensure that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
- Test the design and implementation of controls around the journals process and the investment and disinvestment of cash during the year; and
- Substantively test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. As part of our work in this area, we perform an analysis of journal entries which enable us to focus on journals meeting specific pre-determined parameters determined during our audit planning.

Audit focus areas

Audit focus areas

Completeness of investment transactions and valuation of pooled property funds

Risk identified

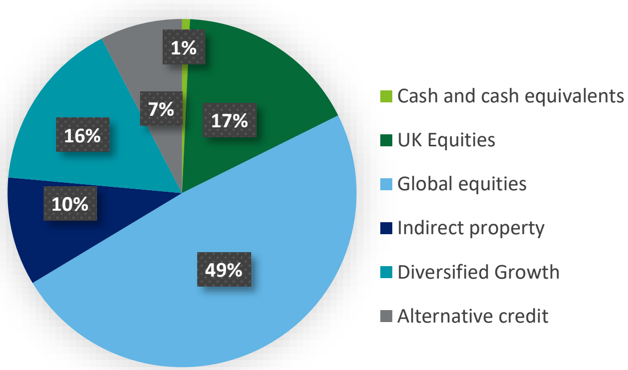
The Fund holds a large and highly material portfolio of investments, which is diversified with several investment managers. As a result of this we consider the completeness of these investments to be an area of audit focus. In addition, we have been informed of changes to the investment portfolio that may impact the year end investment holdings.

The Fund holds investments primarily in pooled funds, pooled property unit trusts and fixed income unit trusts with a range of investment managers. Due to the continuing volatility within the property sector, we will pay particular focus to the pooled property funds.

Response of those charged with governance

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

Pooled investments
As at 31/03/2021



Deloitte response to risk identified

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

- Review the design and implementation and operating effectiveness of key controls over the valuation of investments by obtaining the investment manager and custodian internal controls reports and evaluating the implications for our audit of any exceptions noted;
- Independently request confirmations from all investment managers and the global custodian for balances held per the financial statements;
- Agree year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers;
- Perform a full unit reconciliation of investments held during the year; and
- Perform valuation testing by using a range of techniques depending on the type of investment. For the pooled property funds, we will obtain audited financial statements and assess the year end price against the audited financial statements, and benchmark movements where the date of the audited financial statements is not coterminous with the Fund's financial year.

Audit focus areas

Accuracy and timeliness of contributions

Risk identified

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.

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 recommendations of the actuary.

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

Deloitte response to risk identified

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

- Review the design and implementation of key controls over the contribution process;
- Perform 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 will recalculate 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;
- Test that the correct definition of pensionable salary is being used per the LGPS Regulations to calculate contribution deductions;
- Test 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, check that they have been paid within the due dates per the LGPS Regulations.


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 will consider how the Fund addresses these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2021/22 Audit
Financial sustainability looks forward to the medium and longer term to consider whether the Fund is planning effectively to continue to deliver its services or the way in which they should be delivered.	• The financial planning systems in place across the shorter and longer terms. • The arrangements to address any identified funding gaps. • The affordability and effectiveness of funding and investment decisions made.	We will review arrangements and financial planning systems in place by the Fund to ensure that its services can continue to be delivered. This will include a review of the latest actuarial valuation of the Fund and the plans in place to reduce the deficit over the shorter and medium term. In addition, we will review the funding policy as set out in the Shetland Islands Council Pension Fund Investment Strategy, which aims to secure the long term solvency of the Fund, so that there are sufficient funds available to meet all benefits as they fall due. **Audit Risk:** The Fund's investment strategy is inconsistent with the long term solvency of the Fund. We have not identified any significant risks in relation to financial sustainability during our planning.
Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	• Systems of internal control. • Budgetary control system. • Financial capacity and skills. • Arrangements for the prevention and detection of fraud.	We will review the budget and monitoring reporting by the Fund during the year to assess whether financial management and budget setting is effective. In addition, we will also ensure that there is a proper officer and fund manager 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. Using Audit Scotland's publication "COVID-19 Emerging Fraud Risks", we will assess what action the Fund has taken to minimise risk to its control environment and internal controls. **Audit Risk:** The underlying financial performance of the Fund is not transparently reported. We have not identified any significant risks in relation to financial management during our planning. Our fraud responsibilities and representations are detailed in Appendix 1 of this report.

Wider Scope Requirements (continued)

Audit Dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2021/22 Audit
Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	• Governance arrangements. • Scrutiny, challenge and transparency on decision making and financial and performance reports. • Quality and timeliness of financial and performance reporting.	We will review the Fund's papers and use our attendance at Pension Fund Committee meetings to assess the effectiveness and scrutiny of governance arrangements. We will also review other aspects of governance around the Fund including Codes of Conduct for officers and members and fraud and corruption arrangements for reporting regulatory breaches to the Pensions Regulator. In addition, we will review the Annual Governance Statement and Governance Compliance Statement to confirm the governance arrangements observe the guidance issued by Scottish Ministers. We will review the work undertaken in relation to risk management including updates to the policies in place as a result of COVID-19 and whether these are appropriate for the longer-term. **Audit Risk:** The Fund's approach is not keeping pace with good practice. We have not identified any significant risks in relation to governance and transparency during our planning.
Value for money is concerned with using resources effectively and continually improving services.	• Value for money in the use of resources. • Link between money spent and outputs and the outcomes delivered. • Improvement of outcomes. • Focus and pace of improvement.	We will gain an understanding of the Fund's self-evaluation arrangements to assess how it demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered. We will also review the scrutiny that is in place to challenge the Fund's investment managers on fees and performance. **Audit Risk:** The Fund does not have sufficient scrutiny over the expenditure of the Fund. We have not identified any significant risks in relation to value for money during our planning.


Maintaining
audit quality

Our approach to quality

AQR team report and findings

Executing high quality audits remains our number one priority. We are committed to our critical public interest role and continue to embed our culture of quality and excellence into all of our people. This includes using new technology and tools to continue to transform our audit approach.

In July 2021 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 2020/21 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.

In that context, overall FRC inspection results, showing an improvement since last year from 76% to 79% of all inspections assessed as good or needing limited improvement, reflect the progress we are making. The overall profile of our ICAEW inspections and our internal inspection programme also show a similar overall improvement since last year.

The results for the inspections of FTSE 350 entities fell short of our overall scores, reflecting specific findings on those particular audits rather than issues pervasive across other audits. Our objective continues to be for all 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 agree with and accept the FRC's findings on the individual inspections. The FRC has recognised improvements following the actions and programmes for previous years and we welcome the good practice points raised, including in respect of impairment and revenue where individual findings continue to occur.

Overall, we are pleased that there have been no significant findings over our firm wide processes and controls over the last three inspection cycles in the areas subject to rotational review by the FRC. However, we are continually enhancing our processes and controls across our business and such changes will directly or indirectly affect audit quality.

All the AQR public reports are available on its website.
https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports

The AQR's 2020/21 Audit Quality Inspection Report on Deloitte LLP

"We reviewed 19 individual audits this year and assessed 15 (79%) as requiring no more than limited improvements. Of the 11 FTSE 350 audits we reviewed this year, we assessed eight (73%) as achieving this standard".

- "Our key findings related primarily to the need to:
- Improve the evaluation and challenge of management's key assumptions of impairment assessments of goodwill and other assets.
- Enhance the consistency of group audit teams' oversight of component audit teams.
- Strengthen the effectiveness and consistency of the testing of revenue."

"The firm has taken steps to address the key findings in our 2019/20 public report, with actions that included increasing the extent of consultations, and enhanced learning, coaching and support programmes.

We have identified improvements, for example, in the extent of challenge of management by audit teams in respect of the estimates used for model testing. This was identified as a key finding last year.

We also identified good practice in a number of areas of the audits we reviewed (including robust procedures relating to going concern and evidence to support the challenge of management in areas of key judgement) and in the firm-wide procedures (including establishing a centre of excellence focused on credit for banking audits to encourage the consistent application of the firm's methodology and guidance)."

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 establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope; and
- Key regulatory updates, relevant to you.

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 financial statements and the other procedures performed in fulfilling our audit plan.

Other relevant communications

- Our technical updates provide the Pension Fund Committee with some insight in to relevant topical events in the pensions industry.
- We will update you if there are any significant changes to the audit plan.

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.

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

Pat Kenny

Pat Kenny

for and on behalf of Deloitte LLP

Glasgow | 8 February 2022

Topical matters

Topical matters

New powers to block suspicious pension transfers

Pension providers and Trustees will have the power to block pension transfer requests if they suspect a member is being scammed, under new measures that come into force. New rules coming into force from 30 November 2021 will give Trustees and pension providers the power to block or pause a member's transfer out request if they have serious concerns about the destination of the transfer value.

Under the new powers, Trustees and administrators will be able to intervene in a transfer if the information they have gathered from the receiving scheme or any scheme member triggers a "red" or "amber" flag. These flags are detailed below.

Guy Opperman, minister for pensions said "We are tackling the scourge of pension scams in practical terms to safeguard pensioners' hard-earned savings. These measures will provide better protection for savers." The new powers are therefore widely seen as a way for Trustees to protect their members and prevent any future scams going forward. Under the rules, all transfers to master trusts, collective defined contribution (CDC) schemes and funded public sector schemes will effectively be exempt as they are regarded as safe destinations.

- The member has not responded to a request for information in relation to a suspicious transfer.
- The member indicates they have received financial advice from a company without the appropriate regulatory permissions.
- The member has requested the transfer following an unsolicited approach from an individual or firm they had no existing relationship with.
- The member has been pressured, or indicated they felt pressured, to make the transfer.

When an amber flag is raised, Trustees and their administrators will be required to direct them to Pension Wise guidance and confirm the member has received that guidance before letting the transfer go ahead.

Amber flags would be raised where:

- There are high-risk or unregulated investments included in the scheme the person is transferring to.
- The fees charged by the receiving scheme are unclear or high.
- The proposed investment structures are complicated or unorthodox The receiving scheme includes overseas investments.

*Red and amber flags source AJ Bell

Deloitte response: The Pension Fund Committee should engage with the Fund administration team at the Council to ensure that processes have been put in place to ensure that the new rules have been implemented from 30 November 2021 and that these further steps have been implemented to protect members against pension scams.

Topical matters

Pensions related fraud

Pension schemes are attractive to fraudsters. Large sums of money being held for beneficiaries, who, in most cases, have very little involvement in overseeing their accumulation, stretched over a long time period, presents a fertile opportunity. It is surprising, that even with the amount of cases that are prevalent, fraud and scams are often at the bottom of a Trustee's list when it comes to considering risks to their schemes. Please refer below few instances of pensions related fraud and some other useful information which we believe would be helpful for Trustees in risk-assessment.

Investment and misappropriation risks

A trustee was removed by the sponsoring employer for claiming fictitious expenses on account of attending Trustee meetings and other related expenses.

A fraudulent fishing email resulted in disinvestment of pension scheme funds and routed the cash to fraudsters bank accounts.

In January 2019, the former head of the Westminster City Council pension fund was jailed for seven years. He had been found guilty of stealing over £1 million from the fund by diverting monies earmarked for investments for his own personal use.

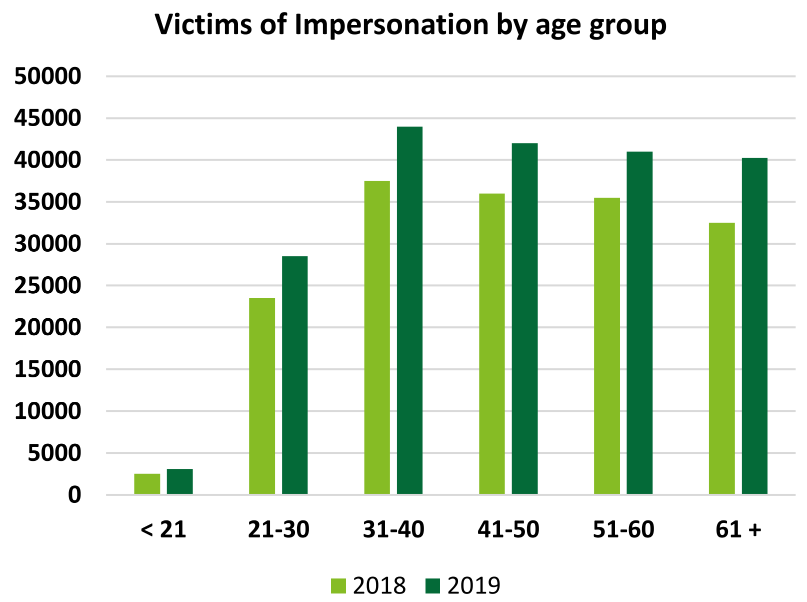
In February 2019, an accountant took over £280,000 from a pension scheme, for which he was a Trustee, to invest in one of his failing businesses. He falsified details of a meeting that approved it.

In November 2018, a Chief Executive Officer (CEO) and Trustee of a pension scheme was banned from being a Trustee after a whistle-blower highlighted he was planning to invest £1.2 million of the pension fund in the firm he was CEO of and a major shareholder in.

A pension fund based in Norfolk, UK covering 90,000 members largely from the local council, was part of a successful case to sue Los Angeles-based Puma Biotechnology and its CEO, who had made false claims which led to artificially inflating the share price. This resulted in a £50,000 loss to the pension fund (and a £100 million loss across all Defendants).

An overnight loan was granted to a related party without appropriate approval. However the loan was returned subsequently and did not cause any significant financial loss to the Scheme.

Cifas is an independent, not-for-profit organisation working to reduce fraud and related financial crime in the UK. As per their records identity fraud rose by nearly 20% in 2019, accounting for the largest number of cases recorded by Cifas members at 61%. People aged over 31 were specifically targeted by this type of fraudulent conduct, with victims aged 60 and over on the rise. The highest number of victims (68%) were recorded in the South East region.



Topical matters
Pensions related fraud

Opportunistic pension fraud

- In 2013, The Sun newspaper, using an undercover reporter, was able to secure a death certificate and an official Indian record of death. Such records are available for as little as £300 from corrupt officials.
- In Russia in 2010, the wife of the 'deceased' presented a Russian death certificate to the British embassy to enable various frauds to take place.
- In 2014, a man was jailed for attempting to claim a £1 million life insurance policy using false death certificates from India.
- In 2019, a woman was convicted of continuing to claim her father's war pension and other benefits after his death in 2004 amounting to a £740,000 loss.
- A daughter continued to claim her mother's pension for two years after her death, defrauding the pension scheme of over £7,500.

Incompetent or corrupt pension administrators

- An employee of the pension Scheme administrator was terminated by the scheme administrator for diverting benefits of dead pensioners to his spouse bank account. A similar case of creating a fictitious pensioner on the payroll was also noted.
- Due to non adherence with employee conflict of interest policies at a Scheme administrator, it was noted that a married couple were preparing and reviewing the bank reconciliations of pension schemes. The incident causes more concerns as it was identified during COIVD times when all employees were working from home.

Pension Liberations

In recent years, the pension liberation reforms have stimulated an increase in frauds targeting those with pensions. This has, in turn led to an increase in the action by authorities to tackle this problem. However, the media focus on 'pension liberation frauds' has masked a range of opportunities for fraud in the wider pensions sector. These include frauds by those running pensions schemes, inappropriate investments and the targeting of pension schemes by external fraudsters, sometimes those involved in organised crime. These risks have received less attention.

National Fraud Initiative (NFI):

Evidence from the National Fraud Initiative (NFI), where details of the deceased are matched against those receiving benefits, also illustrates this continues to be a significant problem. The most recent NFI report identified £55.5m million of payments to persons claiming the pensions of dead persons, whilst the total number of cases were 2,876 claiming average £19,289 per annum.

Comparison of pension related overpayments 2012/13 to 2018/19

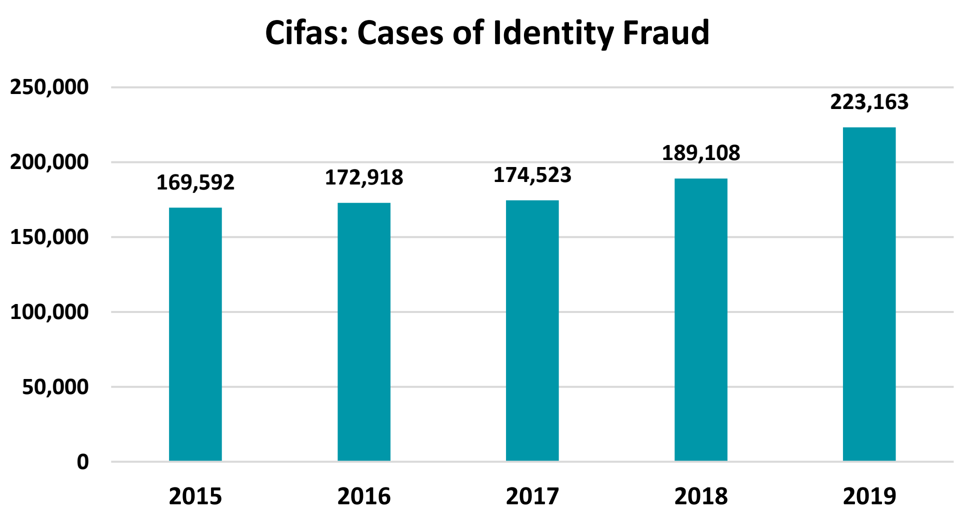
	2012/13		2014/15		2016/17		2018/19	
	Number of cases	£m	Number of cases	£m	Number of cases	£m	Number of cases	£m
	2,990	75.9	3,592	85.1	3,763	136.9	2,876	55.5
Average outcome per case	**£25,385**		**£23,692**		**£36,381**		**£19,289**	

Topical matters

Pensions related fraud

Identity fraud

Research has estimated that there are over 1.6 million 'lost' individual pension funds worth around £20 billion Pension schemes make millions of payments each year and there are a variety of risks of fraud in this area. There are risks from internal fraud where corrupt staff use their knowledge to facilitate a variety of frauds. Given some of the potential weaknesses in the counter fraud processes of pension administrators combined with the large sums available, the risk of such fraud is high. There is significant evidence that shows identity fraud has been increasing in prevalence for the last 10 years. Cifas, a fraud prevention service in the UK, produces statistics each year on the number of cases of identity fraud. Cifas define identity fraud as "when a criminal abuses personal data to impersonate an innocent party or creates a fictitious identity to open an account. Their statistics shows a sharp increase since last five years.



Cyber-security risk

The data pension scheme administrators hold would be very useful to fraudsters. There are a wide variety of risks that emerge as a result of increasing use of digital technologies to administer pension schemes. These include:

- impersonation of legitimate beneficiaries to divert payments
- hacking of systems to alter records for the purpose of fraud
- hacking of systems to secure the personal information of pension holders.

There are many other examples of cybercrime involving sophisticated hackers or corrupt insiders. Any organisation with large amounts of money and sensitive personal data is a potential target for fraudsters.

A UK man based in Berkshire hacked into the Orange County Employee Retirement Scheme in the USA and diverted payments from some members to accounts he had set up in their name. Over £15,000 in pension payments per month were at risk from his fraud.

In 2018, Equifax was hacked exposing 143 million accounts worldwide and 400,000 in the UK.

System super-users access rights granted to few employees of a Pension Scheme administrator to edit their own member records and those of each other. It was noted that Super-users edited their and each other's activity and no second formal review process or other mitigating controls were in place.

Appendices

Key audit matters

Appendix 1: ISA 240- The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the Fund and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behaviour which can be reinforced by an active oversight by those charged with governance. Oversight by those charged with governance includes considering the potential for override of controls or other inappropriate influence over the financial reporting process.

Auditors Responsibility

An auditor conducting an audit in accordance with ISAs (UK) is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs.

As part of our partner lead planning process, as an audit team we have considered the possible avenues of fraud within the Fund and have outlined our approach to each consideration below.

Consideration	Approach
Fraudulent posting of journal entries – the purposeful misstatement of the financial statements	We have outlined our approach to the mitigation of this risk on page 13.
Fraudulent valuation of investment assets - incentive to overstate assets value	We have outlined our approach to the mitigation of this risk on page 15.
Misappropriation of cash - disinvestments not processed in accordance with the investment mandate	In response to this risk we assess the design and implementation of the identified controls. We will inspect the investment mandate in place and the signed disinvestment instruction to ensure it has been processed appropriately. We then track the disinvestment proceeds to the Fund bank account.
Creation of fictional pensioner records and payments to non Fund members	In response to this risk we assess the design and implementation of controls around pensioner set up and amendments to existing Altair records to ensure there are appropriate controls and enforced segregation of duties. In addition, we perform design and implementation testing of controls associated with payments made from the Fund bank account to ensure they are authorised in accordance with payment limits and only on inspection of information received from the member.
Pensioner existence – payment of pensions to deceased members	In response to this risk we assess the design and implementation of controls around the existence of pensioners to ensure the timely suspension of pensions to deceased members.
Commission based referrals for new investment managers and related parties	In response to this risk we access the approval process for the appointment of new investment managers to ensure they have been appropriately approved by the Pension Fund Committee. In addition we review the directors of the associated investment manager for possible related party conflicts and ensure this has been appropriately declared and logged.

Appendix 2: 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 2: 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 3: Independence and fees

A Fair and Transparent Fee

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

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Fund and will reconfirm our independence and objectivity to the Pension Fund Committee for the year ending 31 March 2022 in our final report to the Pension Fund Committee.
Fees	The audit fee for 2021/22, in line with the fee range provided by Audit Scotland is £31,250, as analysed below: £ Auditor remuneration 27,000 Audit Scotland fixed charges: Pooled costs 2,810 Contribution to AS costs 1,440 **Total proposed fee 31,250** There are no non-audit services fees proposed for the period.
Non audit services	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. 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.
Relationships	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.

Deloitte.