





## Shetland Islands Council Pension Fund

Final report to the Pension Fund Committee and the Controller of Audit on the 2021/22 audit

Issued on 24 October 2022 for the meeting on 2 November 2022

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# Final report

# Executive summary

## The key messages in this report



### 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.

I have pleasure in presenting our Final Report to the Shetland Islands Council Pension Fund Committee and Controller of Audit (the “Committee”) for the 2021/22 audit of Shetland Islands Council Pension Fund (the “Fund”).

I would like to extend my thanks to Fund management for their assistance during the audit. The regular communication we have had with management and the use of technology is allowing us to continue to deliver the audit.

### Audit scope

Our reporting responsibilities as auditor of the Fund and Authority are to:

- Form an opinion on the statutory financial statements of the Fund and Authority. The financial statements are prepared under the Code of Practice on Local Authority Accounting 2021/22 (“the Code”) issued by CIPFA and LASAAC;
- Report to “those charged with governance” on certain additional matters, including any unadjusted errors over our reporting threshold (“RT”), our independence and any other issues we consider should be brought to their attention.

### Independence

We confirm we are independent of the Fund and that our objectivity has not been compromised for the year ended 31 March 2022.

### Status of the audit

Our audit work is complete.

### Non-compliance with laws and regulations, including fraud

We are required to directly report on the extent to which the audit was considered capable of detecting irregularities, including fraud and other matters of non-compliance with laws and regulations.

We have not identified any issues of non-compliance with laws and regulations, including fraud from our audit testing.

### Russian invasion of Ukraine

The Russian invasion of Ukraine is impacting upon global financial markets. To date the most significantly affected investments have been those directly linked to Russia and Ukraine – government bonds issued by those countries and companies based there or with significant operations there. Many emerging markets funds also have some exposure to Russia.

As a result of this, we have reviewed the impact of this event during the course of our audit with a particular focus on valuation and liquidity risk, reputational risk and disclosure. We are satisfied that the impact on the Fund and any exposure to these investments is minor in nature.

**Pat Kenny**  
Audit Director

# Materiality

## Our approach to materiality

### BASIS OF OUR MATERIALITY BENCHMARK

- We set materiality for our opinion on the financial statements as £6,599k (2021: £5,899k), based on professional judgement, the requirements of auditing standards and the net assets of the Fund. These figures are based on the 31 March 2022 financial statements.
- We have used 1% of Fund net assets as the benchmark for determining our materiality levels.
- Performance materiality was set at 90% of our materiality level above as £5,939k (2021: £5,309k).

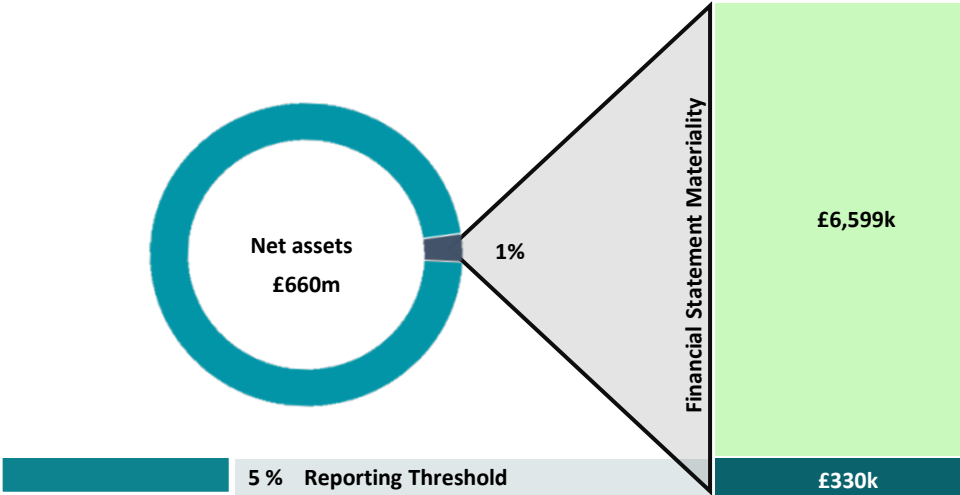
The basis for our materiality calculations is the same as the previous year.

### REPORTING TO THOSE CHARGED WITH GOVERNANCE

- Within this report, as part of our audit of the financial statements, we communicate all misstatements found in excess of our reporting threshold (“RT”) of £330k (2021: £250k). This threshold is set at 5% of our materiality level above.
- Misstatements below this threshold are reported if we consider them to be material by nature.
- We refer to appendix 1 for our proposed unadjusted misstatements.

### 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.












# Risk Dashboard

## Significant Risk + Audit Focus Areas

Risk Identified	Material Balance	Management Judgement	Proposed Approach	Fraud Risk	Further Details
 <b>Significant Risk</b> Management override of controls					Pg. 8
 <b>Audit Focus Area</b> Completeness of investment transactions and valuation of pooled property funds					Pg. 10
 <b>Audit Focus Area</b> Accuracy and timeliness of contributions					Pg. 11

 Significant Risk	 Low levels of management judgement/complexity	 Design and Implementation
 Other area of audit focus	 Medium levels of management judgement/complexity	 Operating Effectiveness
	 High degree of management judgement/complexity	





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



### Deloitte comment

We have concluded our testing and we have not identified any issues.



### Deloitte response and challenge

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

- Tested the design and implementation of key controls in place around journal entries, key management estimates and the investment and disinvestment of cash during the year.
- 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;
- Ensured that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
- Used 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;
- Reviewed the 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, indicated a possible bias on the part of management;
- Substantively tested 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 performed an analysis of journal entries which enabled us to focus on journals meeting specific pre-determined parameters determined during our audit planning.





# Audit Focus Areas

# Audit Focus Areas (1/2)

## 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 have paid particular focus to the pooled property funds.



### Deloitte response and challenge

We performed the following procedures to address this audit focus area:

- Reviewed 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 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; and
- Performed valuation testing by using a range of techniques depending on the type of investment. For the pooled property funds, we obtained audited financial statements and assessed the year end price against the audited financial statements, and benchmarked movements where the date of the audited financial statements was not coterminous with the Fund's financial year.



### Conclusion

We have concluded our testing in this area.

The alternative investments (which includes pooled property funds) are often subject to stale pricing, due to infrequent pricing and the availability of up to date valuation when Northern Trust produce their monthly reporting. Most of these investments were included in the 31 March 2022 draft financial statements at 31 December 2021 prices. Accounting standards allow stale pricing, provided no more up-to-date information is available. During our testing, we identified an immaterial stale price adjustment of £1.9m.

The Octopus Healthcare Fund (£1.1m) has been omitted from the year end valuation, as an in specie transfer from Schroder Real Estate Real Income Fund to Octopus Healthcare Fund was not taken into account by the custodian until after the year end.

As both adjustments noted above are not material they have not been adjusted in the Fund financial statements.

# Audit Focus Areas (1/2)

## 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.



### Deloitte response and challenge

We performed the following procedures to address this audit focus area:

- 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 were 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 was 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 were paid within the due dates per the LGPS Regulations.



### Conclusion

We have concluded our testing.

The current control in place regarding the timeliness of contributions is a detective control, which does not prevent the contributions payments being received after the statutory deadlines. We would recommend that a preventative control is implemented that will ensure timely collection of contributions.

We have not identified any other issues to report to the Committee as a result of our audit testing.

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## Wider Scope Requirements

# Wider Scope Requirements (1/2)

## 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 2020) 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 (2/2)

## 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. We note that the Executive Manager – Finance (Jamie Manson) end date is 6 November 2022 and there is an Acting Executive Manager. The recruitment process to appoint new Executive Manager has taken place with appropriate HR checks being currently carried out.</p> <p>From our review of the budget process we are satisfied that appropriate financial reports are provided to 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>
<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>

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## Other Risks

# Other Risks (1/1)

Other risk	Area of Focus	Risk and procedures
<p><b>Going Concern</b></p>	<p>As auditors, we are required to confirm in our audit report that the going concern basis of the financial statements is appropriate. In line with Practice Note 10, the auditor’s assessment of going concern should take account of the statutory nature of the entity and the fact that the financial reporting framework for local government bodies presume going concern in the event of anticipated continuation of provision of the services provided by the entity. Therefore, the public sector auditor applies a ‘continued provision of service approach’, unless there is clear evidence to the contrary.</p>	<p>Our testing to address this risk included:</p> <ul style="list-style-type: none"> <li>• Reviewed the going concern assessment prepared by the Committee;</li> <li>• Examined the latest publicly available information regarding the financial position of the principal employer;</li> <li>• Liaised with the corporate audit team regarding the financial position of the principal employer;</li> <li>• Analysed the latest funding position of the Fund; and</li> <li>• Reviewed minutes of key meetings.</li> </ul> <p>Following the Government’s policy announcement on 23rd September 2022 the financial markets experienced a period of volatility, in particular the UK Government Bond markets. For many Schemes using a Liability Driven Investment (LDI) strategy, this has prompted calls for collateral to top up their LDI, often at short notice, which can cause liquidity problems. The Shetland Islands Council Pension Fund does not have a Liability Driven Investment Strategy so was not affected by the fall in bond prices. The Pension Fund monitors all issues which could create volatility and may affect the Pension Fund’s investments.</p>
<p><b>Fraud</b></p>	<p>In our Audit Report in the financial statements we are required to directly report on the extent to which the audit was considered capable of detecting irregularities, including fraud and other matters of non-compliance with laws and regulations.</p>	<p>Our testing to address this risk included:</p> <ul style="list-style-type: none"> <li>• Performed procedures to assess the risk of management override as detailed on page 8;</li> <li>• Reviewed the controls in place surrounding fraud risks including disinvestments;</li> <li>• Agreed 100% of investments to third party investment confirmations;</li> <li>• Reviewed the financial statement disclosures by testing to supporting documentation to assessing compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;</li> <li>• Performed analytical procedures to identify unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;</li> <li>• Enquired of the Committee and pension and authority management concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and</li> <li>• Reviewed minutes of Pension Fund Committee meetings and reviewed correspondence with the Pensions Regulator.</li> </ul> <p>We have nothing to bring to the attention of the Committee.</p>
<p><b>GMP Equalisation</b></p>	<p>The Fund must take action to implement the High Court’s October 2018 and November 2020 rulings on the requirement to equalise benefits built up between 17 May 1990 and 6 April 1997 to take account of unequal Guaranteed Minimum Pensions (“GMP”) set out in legislation.</p>	<p>Our testing to address this risk included:</p> <ul style="list-style-type: none"> <li>• Confirmed with the Fund Actuary any changes in the assessment of the impact of GMP Equalisation on the Fund, impact of the transfers ruling; and</li> <li>• Confirmed that appropriate disclosures have been made in the financial statements.</li> </ul> <p>We have nothing to bring to the attention of the Committee.</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 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.
- 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 and Authority accounts.

We described the scope of our work in our audit plan circulated to you on 8 February 2022.

### Use of this report

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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

### What we don't report

As you will be aware, our audit was 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, our views on internal controls and Fund risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the Fund accounts and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

Our topical matters provide the Pension Fund Committee with some insight in to relevant topical events in the pensions industry.

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



**Pat Kenny**

For and on behalf of Deloitte LLP

Glasgow | 30 November 2022



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# Topical Matters

## Key audit matters



# Topical matters

## New, consolidated and simplified enforcement policy and updated prosecution policy published by TPR



### KEY DETAILS

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On 4 May 2022, The Pensions Regulator (TPR) published for consultation its new, consolidated and simpler draft enforcement policy and an updated prosecution policy to help stakeholders understand the regulator's approach.

The enforcement policy simplifies and consolidates previous policies for public sector and occupational pension schemes of all types i.e. defined benefit, hybrid and defined contribution pension schemes. Both policies have been updated to include the new powers granted to the regulator in the Pensions Schemes Act 2021 and to reflect knowledge and experience gained by TPR using the existing enforcement powers. The principal aim is for TPR to be clearer about all its enforcement powers through more streamlined policy documents.

The new powers aim to strengthen the TPR's regulatory framework, allowing it to gather evidence more efficiently and respond to events or conduct that could affect schemes. The Pensions Scheme Act 2021 also introduced several sanctions and deterrents against conduct that could put members' pensions at risk or impede the regulator's investigations. **Deloitte have previously provided a topical update slide on the The Pensions Scheme Act 2021 and this can be provided again on request.**

Speaking about the policy updates David Fairs, TPR's Executive Director of Regulatory Policy, said: "We want to be clear with the pensions industry about our approach to enforcement and prosecution. With our new powers to help us ensure savers' money is secure, we felt it was timely to review our existing policies and consolidate them where possible, so they are easier to navigate. These two policies explain what targets or those affected by enforcement action should expect from TPR, from the point of our opening an investigation through to the conclusion of any enforcement action. We've simplified, consolidated and clarified the way in which our regulated community accesses important information about enforcement."

Enforcement policies for automatic enrolment, master trust authorisation and upcoming CDC schemes are not included in new draft enforcement and prosecution policies discussed above.

**Deloitte view:** The above consultation closed on **24 June 2022**. The Pension Fund Committee should familiarise themselves with the draft policy documents and the powers available to the TPR around enforcement and prosecution and consider responding to the consultation should they consider this appropriate to do so.

*Article source: TPR website*

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# Appendices

## Key audit matters

# Appendix 1: Audit Adjustments

## Uncorrected audit adjustments

Detail	Debit/ (credit) Fund Account £k	Debit/ (credit) Net Asset Statement £k
<b>Uncorrected</b>		
[1] Stale price adjustment (see page 10)	(1,916)	1,916
[2] Omission Octopus Healthcare Fund from valuation (see Page 10)	(1,218)	1,218
<b>Total</b>	<b>(3,134)</b>	<b>3,134</b>
<b>Uncorrected disclosure deficiencies</b>		
None		

# Appendix 2: Our other responsibilities explained

## Fraud responsibilities



### Your responsibilities:

- The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, 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 for the Fund.
- We will explain in our audit report how we considered the audit capable of detecting irregularities, including fraud. In doing so, we will describe the procedures we performed in understanding the legal and regulatory framework and assessing compliance with relevant laws and regulations.



### 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.



### 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 Trustee 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 Pension Fund Committee

- How the Pension Fund Committee 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 Pension Fund Committee has knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of the Pension Fund Committee on the most significant fraud risk factors affecting the entity.



# 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 Authority and will reconfirm our independence and objectivity to the Pension Fund Committee for the year ended 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
<b>Total proposed fee</b>	<b>31,250</b>

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.





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