Grant Thornton

# The Audit Findings for Shropshire County Pension Fund

**Year ended 31 March 2019**

**24 July 2019**

# Contents

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

# Headlines

This table summarises the key findings and other matters arising from the statutory audit of Shropshire County Pension Fund ('the Pension Fund') and the preparation of the Pension Fund's financial statements for the year ended 31 March 2019 for those charged with governance.

| | | |
|---|---|---|
| **Financial Statements** | Under International Standards of Audit (UK) (ISAs) and the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion, the Pension Fund's financial statements:<br>• give a true and fair view of the financial position of the Pension Fund and its income and expenditure for the year; and<br>• have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014. | Our audit work was completed on site during June and July. Our findings are summarised on the following pages. We have not identified any required adjustments to the financial statements and therefore there is no adjustment to the Pension Fund's reported financial position following our audit. We have agreed a small number of disclosure changes with the team, which are detailed later on in the report. Our follow up of recommendations from the prior year's audit are detailed in Appendix A.<br>Our work is substantially complete and there are no matters of which we are aware that would require modification of our audit opinion or material changes to the financial statements, subject to the following outstanding matters;<br>- receipt of management representation letter;<br>- receipt and review of the Annual Report and<br>- review of the final set of financial statements.<br>Our anticipated audit report opinion will be unmodified. |

**Acknowledgements**

We would like to take this opportunity to record our appreciation for the very good assistance provided by the Treasury & Pensions team and other staff during our audit.

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# Summary

### Overview of the scope of our audit

This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents will be discussed with the Pensions Committee.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK) and the Code, which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

### Audit approach

Our audit approach was based on a thorough understanding of the Pension Fund's business and is risk based, and in particular included:

- An evaluation of the Pension Fund's internal controls environment, including its IT systems and controls; and
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks

We have not had to alter or change our audit plan, as communicated to you on 15 March 2019

### Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Pensions Committee meeting on 24 July 2019, as detailed in our opinion

### Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

Materiality calculations remain the same as reported in our audit plan. We detail in the table below our determination of materiality for Shropshire County Pension Fund.

| | Pension Fund Amount (£m) | Qualitative factors considered |
|---|---|---|
| Materiality for the financial statements | 18.0 | We determined materiality for the audit of the Fund's financial statements as a whole to be £18m, which is approximately 1% of the Fund's net assets. This benchmark is considered the most appropriate because we consider users of the financial statements to be most interested in security and value of its assets. |
| Performance materiality | 12.6 | We have determined £12.6m (70% of materiality) to be an appropriate level for Performance Materiality. The Fund has historically had a stable, experienced team with no history of accounting issues. However, we also took into consideration that this was the first full year of the new principal accountant in arriving at our figure. |
| Trivial matters | 0.9 | We deem matters below 5% of materiality to be sufficiently trivial not to warrant drawing to the attention of the Committee. |

# Significant findings – audit risks

| | Risks identified in our Audit Plan | Commentary |
|---|---|---|
| 1 | **Improper revenue recognition**<br>Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.<br><br>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. | **Auditor commentary**<br>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Pension Fund, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:<br>• there is little incentive to manipulate revenue recognition<br>• opportunities to manipulate revenue recognition are very limited<br>• The culture and ethical frameworks of local authorities, including Shropshire Council as the administering authority, mean that all forms of fraud are seen as unacceptable<br>Therefore we do not consider this to be a significant risk for Shropshire County Pension Fund. Our work did not find any significant issues relating to improper revenue recognition. |
| 2 | **Management override of controls**<br>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.<br>We identified management override of controls as a risk requiring special audit consideration. | **Auditor commentary**<br>We have undertaken the following work in relation to this risk:<br>• review of accounting estimates, judgements and decisions made by management<br>• testing of journal entries<br>• review of unusual significant transactions.<br>Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.<br>At the date of drafting this report our audit work in this area is not complete. |
| 3 | **The valuation of Level 3 investments is incorrect**<br>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.<br><br>We identified the valuation of level 3 investments as a risk requiring special audit consideration. | **Auditor commentary**<br>We have undertaken the following work in relation to this risk:<br>• gained an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls<br>• reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments.<br>• consideration of the competence, expertise and objectivity of any management experts used.<br>• for a sample of investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconcile those values to the values at 31 March 2019 with reference to known movements in the intervening period.<br>Our work did not find any significant issues in the valuation of level 3 investments. |

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# Significant findings - other issues

| Issue | Commentary | Auditor view |
|---|---|---|
| **Potential impact of the McCloud judgement** | | |
| The Court of Appeal has ruled that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members.<br>The Government applied to the Supreme Court for permission to appeal this ruling, but this permission to appeal was unsuccessful. The case will now be remitted back to employment tribunal for remedy.<br>The legal ruling around age discrimination (McCloud - Court of Appeal) has implications not just for pension funds, but also for other public sector pension schemes where they have implemented transitional arrangements on changing benefits i.e. the 2012 underpin for the LGPS. | Discussion is ongoing in the sector regarding the impact of the ruling on the financial statements of Local Government bodies.<br>The Fund has requested a updated statement from the actuary to take account of the latest findings and updates to the assessment of the impact of the McCloud ruling and this will be appended to the final set of accounts. | Since the fund adopts option C in relation to disclosing the actuarial present value of retirement benefits, this issue forms part of our assessment of the 'Other Information' issued alongside the accounts, as opposed to being covered by our audit opinion on the accounts.<br>We anticipate that the potential impact of the McCloud judgment will be reflected within the wording of the updated actuary's statement. We will need to review the statement but we anticipate that the wording will be such that a reader of the accounts will understand the impact of this issue.<br>The 2019 Triennial Valuation of the actuarial present value of promised retirement benefits is expected to include the impact of the McCloud judgment. This should be available following the conclusion of the 2019 actuarial funding valuation and be available for the 2019/20 financial statements.<br>At the time or writing, we still need to review the updated statement within the final draft accounts in order to determine that the wording is consistent with our understanding. |

# Significant findings – matters discussed with management

This section provides commentary on the significant matters we discussed with management during the course of the audit.

| | Significant matter | Commentary | Auditor view |
|---|---|---|---|
| 1 | Significant events or transactions that occurred during the year. | During the year the Fund effected a transfer of a significant value of assets into the local pool, managed by LGPS Central. That is transferring the ownership of the assets in their current form.<br><br>Owing to the public interest in this arrangement and the relative newness of LGPS Central as an organisation, a higher level of scrutiny was attached to this transaction. | • We have considered the status of LGPS Central as an investment manager and determined that it is compliant with regulatory requirements. We have also been able to take assurance over this transaction from third party sources such as the transition manager and custodian.<br>• Whilst we have no concerns over the occurrence of the transaction and continued existence and ownership of the assets by the Fund, we note that LGPS Central are yet to produce a completed controls report. We consider that management should look to obtain a completed controls report from the Pool at the earliest opportunity in order to gain sufficient positive assurance over controls around the management of their assets.<br>• Similarly to the above, we note that one of your Fund Managers Majedie also do not provide a formal controls report, instead responding to Fund questions via a questionnaire. It may also be worth exploring the possibility of obtaining such a report from the Investment manager in future (although we note no concerns around valuation or existence of these assets in the current year). |

# Significant findings – key judgements and estimates

| | Summary of management's policy | Audit Comments | Assessment |
|---|---|---|---|
| **Level 3 investments** | The Pension Fund has investments in unquoted investments and pooled investments that in total are valued on the balance sheet as at 31 March 2019 at £274m. These investments are not traded on an open exchange/market and the valuation of the investment is highly subjective due to a lack of observable inputs. In order to determine the value, management rely on the valuations provided by the general partners to the private equity funds which the Fund invests in. The value of the investments has increased by £71m in 2018/19, largely due to a combination of new investments and improvements in market conditions. | Management determine the value of Level 3 Investments through placing reliance on the expertise of the investment managers. As such we have sought confirmations of year end valuations from all main mandate managers. We have also tested a sample of level 3 investments to audited accounts to determine if the values estimated are reasonable. We have found no issues with this testing and are satisfied that the estimate is appropriately disclosed in the accounts. | Green |
| **Level 2 investment** | The Pension Fund have investments in unquoted bonds and pooled investments that in total are valued on the balance sheet as at 31 March 2019 at £183m. The investments can not be easily reconciled to valuations recorded on an open exchange / market as the valuation of the investments involves some subjectivity. In order to determine the value, management rely on the information which they are given from the various fund managers. The value of the investment has decreased by £104m in 2018/19 as a result of disinvestment and realignment of assets. | Management determine the value of Level 2 Investments through placing reliance on the expertise of the various fund managers. As such we have sought independent confirmations of year end valuations from all main mandate managers and also tested a sample of unit values used to value level 2 investments to externally quoted information sources, or where not quoted, to unit values provided by the investment manager's own independent custodian. We have found no issues with this testing and are satisfied that the estimate is appropriately disclosed in the accounts. | Green |

**Assessment**

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process and key assumptions to be reasonable

# Significant findings - Going concern

### Our responsibility

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

### Going concern commentary

| Management's assessment process | Auditor commentary |
|---|---|
| Officers have a reasonable expectation that the services provided by the Fund will continue for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements. | • We are satisfied that management's assessment that the going concern basis is appropriate for the 2018/19 financial statements. |
| **Work performed** | **Auditor commentary** |
| We have assessed the judgment made by management as well as the forecasted financial information which they have provided us which supports the assessment that the Fund will continue as a going concern for at least 12 months from the date of our audit opinion. | • The Net Assets of the Fund at 31/3/19 were £1.9bn. This is significantly higher than the annual benefit payments due.<br>• The Fund has more than £1bn of Level 1 assets. These assets are liquid and can be accessed quickly for cashflow purposes if required.<br>• The Local Government Pension Scheme is a statutory scheme and there are no events or conditions that would indicate the winding up of the scheme.<br>• No issues have been identified from the work performed |
| **Concluding comments** | **Auditor commentary** |
| | We are satisfied that management's assessment that the going concern basis is appropriate for the 2018/19 financial statements and that we have nothing to report on in relation to going concern. |

# Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

| | Issue | Commentary |
|---|---|---|
| 1 | **Matters in relation to fraud** | • We have previously discussed the risk of fraud with the Pensions Committee. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures. |
| 2 | **Matters in relation to related parties** | • We are not aware of any related parties or related party transactions which have not been disclosed. |
| 3 | **Matters in relation to laws and regulations** | • You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work. |
| 4 | **Written representations** | • A letter of representation has been requested from the Pension Fund which is included in the Pension Fund Committee papers. At this point in time we will not be requesting additional representations. |
| 5 | **Confirmation requests from third parties** | • We requested direct confirmations from the custodian and all main mandate fund managers, plus a sample of managers for alternative investments for investment balances. We have received confirmations from most managers and management are assisting us to chase those confirmations that remain outstanding. |
| 6 | **Disclosures** | • Our review found no material omissions in the financial statements. |
| 7 | **Audit evidence and explanations/significant difficulties** | • All information and explanations requested from management was provided. |
| 8 | **Matters on which we report by exception** | • We are required to give a separate opinion for the Pension Fund Annual Report on whether the financial statements included therein are consistent with the audited financial statements. We propose to issue our 'consistency' opinion on the Pension Funds Annual Report along with our opinion on the accounts. |

# Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed are below.

| Audit Fees | Proposed fee | Final fee |
|---|---|---|
| Pension Fund Audit | £18,039 | £18,039 |
| Additional work performed in relation to McCloud judgment & revised actuarial statement | £2,000 | TBC |
| **Total audit fees (excluding VAT)** | **£20,039** | **TBC** |

### Audit and Non-audit related services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Pension Fund. There are no non-audit services provide by us.

These services are consistent with the Fund's policy on the allotment of non-audit work to your auditors. None of the services provided are subject to contingent fees

# Follow up of prior year recommendations

We identified the following issue in the audit of Shropshire County Pension Fund's 2017/18 financial statements, which resulted in 1 recommendation being reported in our 2017/18 Audit Findings report. We are pleased to report that management have implemented our recommendation.

| | Assessment | Issue and risk previously communicated | Update on actions taken to address the issue |
|---|---|---|---|
| 1 | ✓ | • Entity omitted disclosures around remuneration and other benefits accrued by key management personnel in relation to their work on the Fund. | • Code compliant disclosures now included in the 2018/19 financial statements. |

**Assessment**
✓ Action completed
X Not yet addressed

# Audit Adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

### Impact of unadjusted misstatements

One unadjusted misstatement was noted per the below table which was above our trivial threshold. This is in relation to some of the Fund's level 2 holdings, the value of which is lower in the general ledger and financial statements than the valuation provided by the investment manager. This came about as a result of the timing difference between production of the financial statements and provision of valuation information by some investment managers. The misstatement is well below performance materiality and, given the nature of the valuations as an estimate, we are satisfied that it is reasonable for the Fund not to adjust; in our view the Fund's position (as the lower of the two) is the more prudent and, as these kind of issues are not unexpected owing to the shortened reporting timeframe and issuance of some valuations in arrears, does not constitute a control weakness or risk of material misstatement.

| | Detail | Pension Fund Account £m | Net Asset Statement £m | Impact on total net assets £m |
|---|---|---|---|---|
| 1 | L2 investment assets understated by £4.19m. Fund did not adjust on the basis of materiality. | 4.19 | 4.19 | 4.19 |
| | **Overall impact** | **£4.19m** | **£4.19m** | **£4.19m** |

### Misclassification and disclosure changes

The Fund made an amendment to its disclosures by inclusion of a Code compliant Key Management personnel note. This is explained in greater detail in the section relating to follow up of prior period recommendations (Appendix A, page 12).

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