



Shetland Islands Council Pension Fund

Planning report to the Audit Committee on the audit for the year ended
31 March 2018

7 February 2018

Deloitte Confidential: Public Sector

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Planning report



Director introduction

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 the Audit Committee.

I have pleasure in presenting our planning report to the Audit Committee for the 2017/18 audit of the Shetland Islands Council Pension Fund ("the Fund"). I would like to draw your attention to the key messages of this paper:

Fund changes

Following discussions with the Fund's finance team we have not identified any significant changes to the Fund itself during the year, other than changes to some of the sponsoring employer contribution rates as outlined in the latest triennial valuation. 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 UK ("the 2017/18 Code") applies in the current year.

Significant audit risk

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.

Areas of audit focus

The following areas of focus have not been identified as significant audit risks but will be considered as part of our audit:

1. Accuracy of contributions payable to the Pension Fund; and
2. Valuation of investments.

Further details of the areas of audit focus, including our proposed testing are outlined on pages 14 to 15.

Director introduction (continued)

The key messages in this report (continued)

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 the Audit Committee.

Audit Dimensions

The 2016 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 2018. 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 Audit Committee papers and attendance at Audit 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

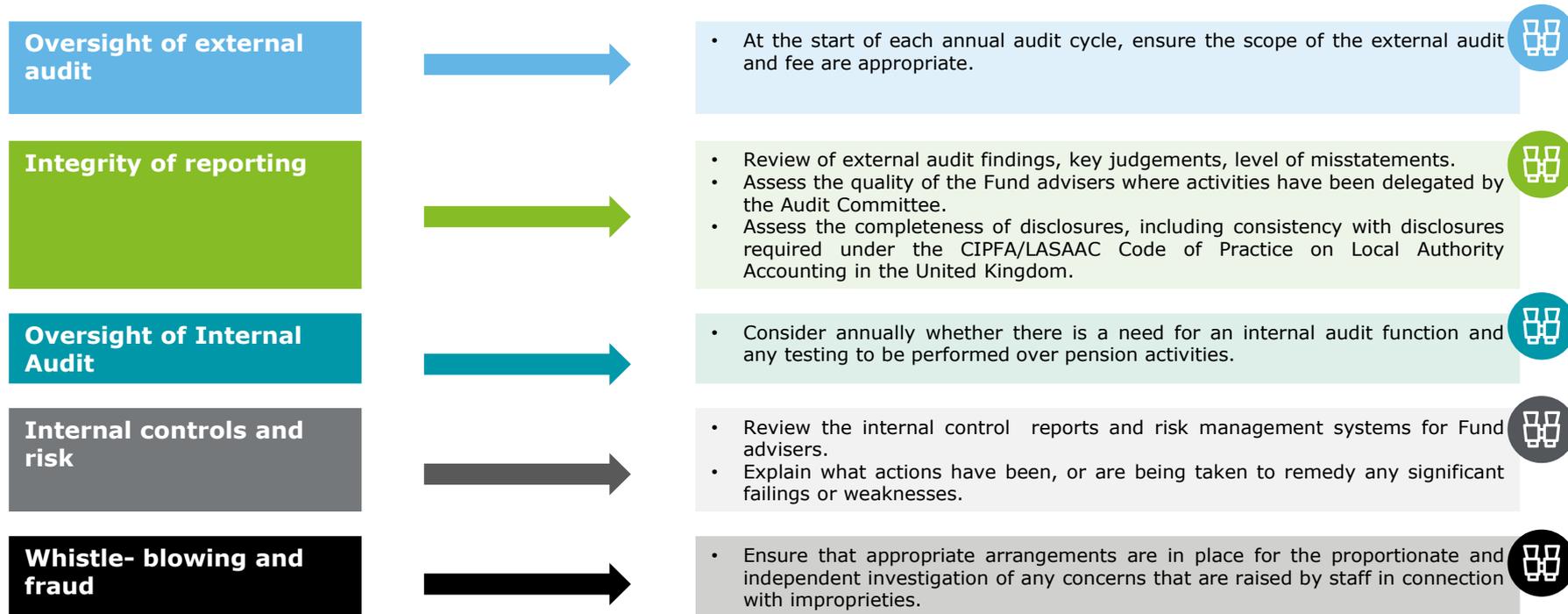
Responsibilities of the Audit Committee

Helping you fulfil your responsibilities

As a result of regulatory change in recent years, the role of the Audit Committee has significantly expanded. We set out here a summary of the core areas of responsibilities, relating to the financial reporting process, to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit Committee in fulfilling their remit.

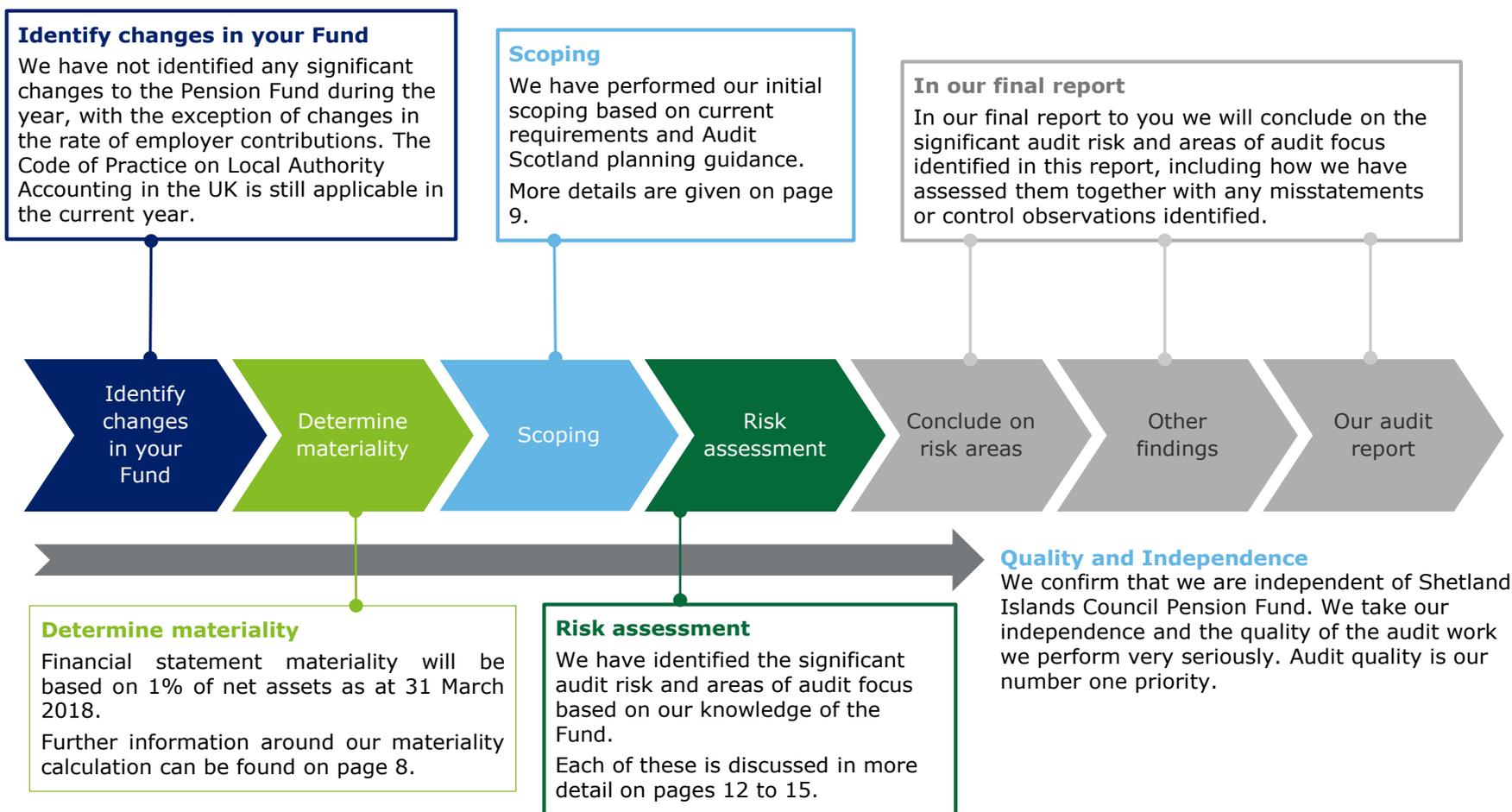
The primary purpose of the Auditor's interaction with the Audit Committee

- Provide assurance over the financial statements;
- Provide timely observations arising from the audit that are significant and relevant to the Audit Committee's responsibility for overseeing the financial reporting process; and
- In addition, we seek to provide the Audit Committee with additional information to help them fulfil their broader responsibilities.



Our audit explained

We tailor our audit to your business and your strategy



Materiality

Approach to materiality



Basis of materiality - benchmark

We set materiality for our opinion on the financial statements at 1% of net assets of the Fund and performance materiality at 90% of materiality based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the financial statements.

As a reference our materiality and performance materiality for the 2016/17 Annual Report and Accounts was determined as £4.49m and £4.041m respectively.

We will update our materiality assessment following receipt of the draft 2017-18 financial statements and will communicate this to the Audit Committee in our final report.



Reporting to the Audit Committee

We report to the Audit Committee any unadjusted misstatements greater than 5% of materiality ("reporting threshold") and other adjustments we consider to be qualitatively material. Based on the 2016-17 Annual Report and Accounts, we determined the reporting threshold ("RT") to be £224.5k.

We will report to you misstatements below this threshold if we consider them to be material in nature.

Our audit report

The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.



Although materiality is the judgement of the audit director, the Audit Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

Scoping

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 accounts;
- providing the **annual report** on the audit addressed to the Pension Fund Audit Committee;
- communicating **audit plans** to the Audit 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.

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 2018 Audit
<p>Financial sustainability 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"> • 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. 	<p>We will review the 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 2014-2027, which aims to ensure the long-term solvency of the Fund, so that there are sufficient funds available to meet all benefits as they fall due.</p>
<p>Financial management 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"> • Systems of internal control. • Budgetary control system. • Financial capacity and skills. • Arrangements for the prevention and detection of fraud. 	<p>We will review the budget and monitoring reporting by the Fund during the year to assess whether financial management and budget setting is effective.</p> <p>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.</p> <p>Our fraud responsibilities and representations are detailed on pages 19 and 20.</p>

Wider scope requirements (continued)

Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2018 Audit
<p>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.</p>	<ul style="list-style-type: none"> • Governance arrangements. • Scrutiny, challenge and transparency on decision making and financial and performance reports. • Quality and timeliness of financial and performance reporting. 	<p>We will review the Fund’s papers and use our attendance at Audit Committee meetings to assess the effectiveness and scrutiny of governance arrangements.</p> <p>We will also review other aspects of governance around the Fund including Codes of Conduct for officers and members, fraud and corruption arrangements, and arrangements for reporting regulatory breaches to the Pensions Regulator.</p> <p>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.</p>
<p>Value for money is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> • Value for money in the use of resources. • Link between money spent and outputs and the outcomes delivered. • Improvement of outcomes. • Focus on and pace of improvement. 	<p>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.</p> <p>We will also review the scrutiny that is in place to challenge the Fund’s investment managers on fees and performance.</p>

Significant Audit Risk and Areas Audit of Focus Dashboard

We welcome the Audit Committee's input into this risk assessment to ensure that any new or emerging risks or themes are considered for inclusion as a significant audit risk or area of audit focus.

Risk Area	Risk Level	Fraud Risk	Controls Approach to Testing	Level of Judgement
Management override of controls			D&I	

Areas of audit focus

Accuracy of Contributions



D&I



Valuation of Investments



OE



	Low levels of management judgement/involvement		Not a Fraud Risk		Significant Audit Risk
	Medium levels of management judgement/involvement		Fraud Risk		Area of Audit Focus
	High degree of management judgement/involvement	D & I	Design and Implementation		
		OE	Operating Effectiveness		

Significant audit risk

Management override of controls

Description

In accordance with ISA 240 (UK and Ireland), management override of controls 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.

Deloitte

Response

In order to address this significant audit risk, we will perform the following audit procedures:

- Make enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments;
 - Perform testing on the design and implementation of controls surrounding the financial reporting process and the controls over journal entries and other adjustments posted in the preparation of the financial statements;
 - 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 will perform an analysis of journal entries which will enable us to focus on journals meeting specific pre-determined parameters determined during our audit planning;
 - Review the financial statements for any accounting estimates which could contain management bias, and assess the judgements taken against supporting evidence;
 - Ensure that there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year;
 - Obtain an understanding of the rationale of any significant transactions that we become aware of that are outside the normal course of the Fund's operations or that otherwise appear to be unusual given our understanding of the Pension Fund and its environment; and
 - Make enquiries of management in relation to the identification of related party transactions.
-

Areas of audit focus

Accuracy of contributions

Description

The correct deduction of contributions depends on systems-based processing of membership data and salary details, together with a robust internal control 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 active members' payroll which can be costly to rectify and cause reputational damage.

Due to the changes in employer contribution rates in the current year, there is a risk that contributions are not paid to the Fund accurately.

Deloitte

Response

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 that 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; and
 - Test the reconciliation of the total number of active members between the membership records and the employer payroll records.
-

Other areas of audit focus (continued)

Valuation of investments

Description

There is a risk that investments are not valued accurately in the Fund's financial statements due to the potential levels of judgement involved in pricing such investments.

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

Deloitte

Response

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 the investments by obtaining investment manager internal control reports and evaluating the implications for our audit of any exceptions noted;
 - Agree year end valuations, sales proceeds and purchases in the financial statements to the reports received directly from the investment managers;
 - Perform valuation testing by using a range of techniques depending on the type of investment. Where the investment held is directly quoted on an exchange, we will obtain an independent price of the investment asset using our own internal pricing systems e.g. Bloomberg. Where the investment is not directly quoted on an exchange we will confirm if it is registered on the Financial Conduct Authority website and obtain an independent price, or use sales transactions close to year end as an estimate of the price. Where none of these options are available we will obtain audited financial statements and assess the year end price against the audited accounts.
-

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.

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 Audit 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 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

We will update you if there are any significant changes to the audit plan.

This report has been prepared for the Audit 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.

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



Pat Kenny, CPFA

for and on behalf of Deloitte LLP

Glasgow

23 January 2018

Appendices



Prior year audit adjustments

Uncorrected and disclosure misstatements

Uncorrected misstatements

There were no uncorrected misstatements identified during the course of our prior year audit.

Disclosure misstatements

There were no uncorrected disclosure misstatements identified during the course of our prior year audit.

Fraud responsibilities and representations

Responsibilities explained



Your Responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and the Audit 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 the Audit Committee 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 risk section of this document, we have identified the risk of fraud in management override of controls as a key audit risk for your Fund.

Fraud Characteristics:



- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

We will request the following to be stated in the representation letter signed on behalf of the Audit 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 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.



Fraud responsibilities and representations

Inquiries

We will make the following inquiries regarding fraud:



Management:

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance 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.



Those charged with governance

- How those charged with governance 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 those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.



Independence and fees



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 that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.

Fees

The fee for the 2017/18 audit has been agreed as £29,486 (2016/17: £30,238).

Non-audit services

In our opinion there are no inconsistencies between APB Ethical Standards for Auditors 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 in relation to any non-audit services provided 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.

We do not intend to perform any non-audit services during the 2017/18 audit.

Relationships

We have no other relationships with the Fund, the Audit Committee, or management, and have not supplied any services to other known connected parties.



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