



London Borough of Tower Hamlets Pension Fund Final Report to the Audit Committee on the 2018/19 audit

Issued on 17th January 2022 for the meeting on 27th January 2022

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1. Key messages

Introduction

The key messages in this report:

We have pleasure in presenting our Final Report to the Audit Committee for the 2018/19 audit of the London Borough of Tower Hamlets Pension Fund (the "Fund"). We would like to draw your attention to the key messages of this report:

Audit scope

Our reporting responsibilities as auditor of the Fund are to:

- Form an opinion on the financial statements of the Fund as included in the Statement of Accounts of the London Borough of Tower Hamlets, which are prepared under the Code of Practice on Local Authority Accounting 2018/19 ("the Code") issued by CIPFA;
- Form an opinion on the consistency of those financial statements of the Fund, included within the Authority's Statement of Accounts, with those included in the Pension Fund's Annual Report;
- 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; and
- Report to the main authority audit team to in relation to their IAS 19 audit procedures.

Audit status and findings to date

The audit timetable as presented in our planning report has not been met as a result of delays experienced in receiving complete draft financial statements and supporting documentation as a result of staff pressures within the Fund administration team. This led to challenges in rescheduling the audit from a Deloitte staffing perspective. The audit process was further delayed by the impact of the Covid-19 pandemic on the staff at both the Council and Deloitte.

Our audit is nearing completion and the current list of open matters required to complete the audit are noted in Appendix 5. Subject to the satisfactory receipt and the completion of the items in Appendix 5, we expect to issue an unqualified audit opinion on the financial statements of the Fund.

Significant audit risk

Our significant audit risk is unchanged from that identified in our planning report which is management override of controls.

Please refer to page 8 for further details in respect of our testing of the significant risk.

Introduction

The key messages in this report (continued):

Audit Quality

We have committed to delivering a robust challenge of the key judgements taken in the preparation of the financial statements; to gain a strong understanding of your internal control environment; and to deliver a well-planned audit that raises findings early with those charged with governance.

We have supplemented our core pension audit team with the following specialists:

1. *Actuarial specialists*, who assessed the IAS 26 liability; and
2. *IT specialists* who documented our understanding of the IT environment and reviewed the general access and change management controls associated with the administration system. This work is still in progress and forms part of the list of outstanding items within Appendix 5.

Going concern

We are required to comment on the going concern basis of preparation of the financial statements in our audit report. As part of this process, details of the work we perform around the going concern assessment are detailed below:

- considered the statutory basis of the Fund;
- considered the results of the triennial valuation; and
- considered the value and liquidity of the investment assets within the fund and its ability to continue to meet benefit payments without further contributions.

We have concluded that there are no material uncertainties to report in respect of going concern.

Our conclusion

The current list of open matters required to complete the audit are noted in Appendix 5. Subject to the satisfactory receipt and the completion of the items in Appendix 5, we expect to issue an unqualified audit opinion on the financial statements of the Fund.

In reaching our conclusions we considered the results from our testing on pages 7 to 10. In addition, we noted that the significant accounting judgements and estimates appear reasonable.

Jonathan Gooding, Audit Partner

Materiality

Our approach to materiality

Basis of our materiality benchmark

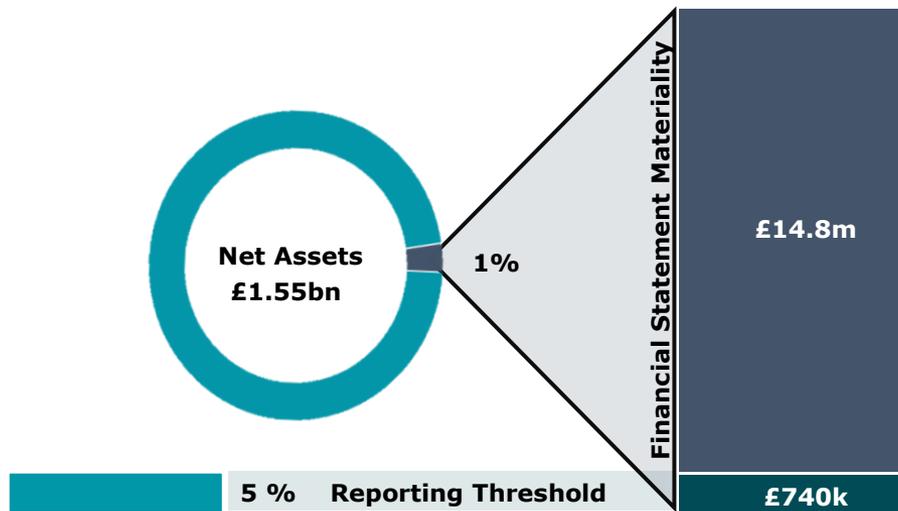
- We set materiality for our opinion on the financial statements at 1% of the net assets of the Fund.
- For the year ended 31 March 2019, we determined financial statement materiality to be £14.8m. This was determined using the first draft of the financial statements which reported a lower net assets figure than that in the current version. Following updates to the investment valuations to reflect stale prices the net assets increased. We elected to retain our original materiality figure, rather than recalculating using the updated net assets.

Reporting to those charged with governance

- We report to you all misstatements found in excess of 5% of financial statement materiality. We report to you misstatements below this threshold if we consider them to be material by nature.
- For the year ended 31 March 2019, we determined the reporting threshold for the financial statements to be £740k.
- Auditing standards also require us to highlight any corrected and uncorrected misstatements and disclosure deficiencies to enable the Audit Committee to evaluate the impact thereof.

Materiality calculation

Although materiality is the judgement of the audit partner, the Audit Committee must be satisfied the level of materiality chosen is appropriate for the scope of the audit.



2. Significant Risks

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 Audit 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 comment

During our walkthrough of the journal review process, we noted that one journal was reviewed 13 months after it was raised. We note that this was a result of the Head of Pensions and Treasury position being vacant during the reporting period, this post has subsequently been filled. No other matters noted.

Deloitte response to significant risk identified

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

- Used Spotlight, our data analytics software, in our journals testing to interrogate 100% of journals posted across the Fund. This uses intelligent algorithms that identify higher risk and unusual items;
- 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;
- Reviewed related party transactions and balances to identify if any inappropriate transactions had taken place;
- Reviewed the accounting estimates for bias, such as the valuation of unlisted investments, that could result in material misstatement due to fraud;
- Performed a walkthrough of the financial reporting process to identify the controls over journal entries and other adjustments posted in the preparation of the financial statements;
- Assessed whether there is an appropriate level of segregation of duties over processing journal entries to the financial statements throughout the year; and
- Tested the design and implementation of controls around the journals process during the year.

3. Audit Focus Area

Audit focus area

Completeness, valuation and presentation of investments

Risk identified

The Fund holds a highly material portfolio of investments. Within the portfolio, there are a number of holdings in alternative investment funds. These funds do not have publicly available prices and are infrequently priced, increasing the risk of stale pricing.

Response of those charged with governance

The Fund appoints various investment managers and Northern Trust as custodian for these investments who have sufficient resources to value and safeguard the Fund's investment assets.

Deloitte response to focus area identified

In order to address this focus area, our audit procedures consisted of the following:

- Tested the design and implementation, and the operating effectiveness where applicable, of key controls over the completeness and valuation of investments by obtaining the investment manager internal control reports (where applicable) and evaluating the implications for our audit of any exceptions noted;
- Agreed the year end valuations and sales and purchases totals in the accounts to the reports received directly from the investment managers and Northern Trust as custodian, and reconciled these to the individual confirmations received from the investment managers;
- Agreed holdings in unit linked insurance policies to confirmations from the policy providers;
- Performed independent valuation testing for a sample of year-end alternative investment holdings by rolling forward the valuation as per the latest audited accounts using cash flows and an appropriate index as a benchmark;
- Ensured appropriate stale price adjustments have been posted to the financial statements;
- On a sample basis, tested cash reconciliations for investments – including tracing the source of the cash;
- Performed a unit reconciliation in which the opening investment balances and unit quantities are reconciled to the closing investment balances and unit quantities by taking into account the movement that occurred during the year (i.e. purchases, sales, change in market value); and
- Reviewed the classifications of investments throughout the investment notes to ensure these were accurately presented.

Deloitte comment

Our testing over the valuation of all investment assets was undertaken satisfactorily, with no issues noted.

All investment holdings were reconciled to both the year end custodian and investment manager independent confirmations, with a £1.18m overstatement noted in relation to the Bespoke Schroders Fund. As this is below our materiality, this has been included in our schedule of uncorrected misstatements per Appendix 1.

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 Audit 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.
- Our internal control observations.
- Other insights we have identified from our audit.

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 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, 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.

The scope of our work

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

We described the scope of our work in our proposed audit plan circulated to you.

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

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.



Deloitte LLP

Statutory Auditor

St Albans | 17 January 2022

4. Appendices

Appendix 1: Audit adjustments and observations

Current year and prior year audit adjustments

Detail	Debit/ (credit) Fund Account £'000	Debit/ (credit) Net Asset Statement £'000
Uncorrected misstatements identified in current year		
Investment Valuation - Stale prices have been used by the custodian to value the Schroder Bespoke Matching Plus fund held by the Fund, resulting in a total difference of £1.18m in the valuation of this asset.	1,180	(1,180)
In calculating the actuarial liability of the plan in accordance with IAS 26, the actuary has not allowed for the McCloud / Sargeant ruling. Incorporating this factor would result in an increase of c.£1.8m of the actuarial liability	N/A – impacts disclosure in note 20	N/A – impacts disclosure in note 20
Corrected misstatements identified in current year – none	-	-

Disclosure deficiencies

2017/18 Comparative Figures - The Fund Account 2017/18 comparative amounts for investment income and accrued investment income as an investment asset do not reconcile to our records and subsequent notes to the financial statements to the value of £0.8m. We recommend that a robust review of the draft financial statements is performed to avoid this recurring in the future.

Appendix 1: Audit adjustments and observations

Continued

Observations

We are required to communicate the matters below to the audit committee as per ISA 260:

- Funding – Based on the work of our in-house actuarial team the funding level has been reported as £1.8m lower than their estimates. This difference relates to an allowance for the McCloud/Sargeant ruling which has not been included in the valuation.
- Timeliness of Journal Review - During our walkthrough of the journal review process we noted that one journal was reviewed 13 months after it was raised. We note that this was a result of the Head of Pensions and Treasury position being vacant during the reporting period, this post has subsequently been filled.
- Use of Council bank account in relation to the pension fund - Whilst having a separate account for the Fund as per applicable regulations, the Fund has also used the bank account of the Council itself for transactions. This is not in line with regulations which require that only the Fund bank account is used. We note that this practice ceased in May 2019. We recommend that this breach of the regulations is reported to the Pension Regulator (TPR).
- Monthly Salary Exceptions Report – This control is operated by the council payroll team and utilises salary thresholds that have not been updated since they were first introduced, as a result they are not reflective of the current salaries in place. Due to this, similar employees are selected every time the exception report is run, while not representing actual exceptions. This has led to a basic "tick-off" exercise and could potentially distract from relevant issues.
- Delay in the production of the audited financial statements – Due to the matters discussed earlier in this report the audited financial statements of the Fund have been prepared outside of the timelines required by the regulations. We recommend that this breach of the regulations is reported to the Pension Regulator (TPR).

Appendix 2: 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, places 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.

Auditor's 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-led 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 and result of our testing
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 8.
Fraudulent valuation of investment assets - incentive to overstate asset values	We have outlined our approach to the mitigation of this risk on page 10.
Misappropriation of cash or Fund holdings from the investment portfolio	In response to this risk, we performed a unit reconciliation and a cash reconciliation for the Fund's investments.
Creation of fictional pensioner records and payments to non Fund members	In response to this risk, we assessed 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.
Circumvention of the review process within Altair	In response to this risk, we assessed the design and implementation of controls around the processing of retirement and transfers out cases to ensure there is segregation of duties. We also evaluated the controls around user access level reviews to ensure there is appropriate segregation between those performing a process and those reviewing the process and ensured that the same process cannot be performed and reviewed by the same person.
Pensioner existence – payment of pensions to deceased members	In response to this risk, assessed the design and implementation of controls around the existence of pensioners to ensure the timely suspension of pensions to deceased members.

Appendix 3: Fraud responsibilities and representations

Responsibilities explained



Your responsibilities:

The primary responsibility for the prevention and detection of fraud rests with management and the AC, 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 AC:

- 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 allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Appendix 3: Fraud responsibilities and representations (continued)

Inquiries

We have made 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 Audit Committee ('AC') 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 Audit Committee

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

Appendix 4: Independence and fees

Agreed 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 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.
Fees	<p>The original 2018/19 scale fee set by PSAA was £16,170. The above fee excludes VAT.</p> <p>Due to the issues encountered during the course of the audit we anticipate charging additional fees. This will need to be approved by PSAA.</p>
Non audit services	<p>No non-audit fees have been charged by Deloitte in the period in respect of services to the Fund.</p> <p>We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.</p>

Appendix 5: Outstanding items

Items outstanding at the date of this report

Our final opinion is subject to completion of the items listed below.

- Receipt of final version of the full annual report and financial statements for our review;
- Completion of our reporting to the Council audit team regarding testing of the IAS 19 disclosures;
- Completion of our fraud enquiries as part of the Council audit;
- Finalisation of our internal quality control procedures;
- Partner and technical review clearance;
- Receipt of signed representation letter; and
- Satisfactory completion of our post year-end events review.



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