



## **London Borough of Tower Hamlets Pension Fund** Status Report to the Audit Committee on the 2019/20 audit

Issued on 17<sup>th</sup> January 2022 for the meeting on 27<sup>th</sup> January 2022

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# 1. Key messages

# Introduction

## The key messages in this report:

We have pleasure in presenting our Status Report to the Audit Committee for the 2019/20 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 2019/20 ("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 4. Subject to the satisfactory receipt and the completion of the items in Appendix 4, 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;
2. *Real estate valuation specialists*, who assisted in assessing the valuation of the property funds within the investment portfolio; and
3. *IT specialists* who 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 4.

### COVID-19

We have considered the impact of COVID-19 throughout the audit, including the impact on operations, going concern, resourcing, and valuation of the investments. Other than the disclosure regarding the material valuation uncertainty clause relating to the property fund, as detailed in Appendix 1, we have noted no concerns regarding the impact of COVID-19 on the Fund.

### 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.

**Jonathan Gooding, Audit Partner**

# Materiality

## Our approach to materiality

### Basis of our materiality benchmark

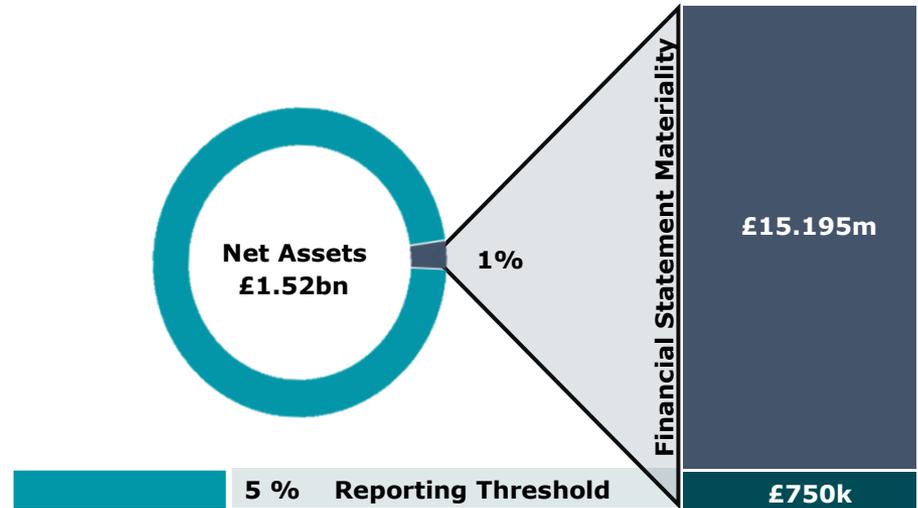
- We set materiality for our opinion on the financial statements at 1% of the net assets of the Fund.
- For the year ended 31 March 2020, we determined financial statement materiality to be £15.2m. This was determined using the first draft of the financial statements which reported a lower net assets 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 2020, we determined the reporting threshold for the financial statements to be £750k.
- 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. These items are included within Appendix 1 of this report.

### 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.



### Impact of the prior year audit

We have incorporated our findings raised to date from the ongoing 2018/19 audit in our scoping and risk assessment process for this audit. As the prior year audit is ongoing we have kept our risk assessment under constant review to ensure that any relevant matters are captured and considered for the 2019/20 audit.

## 2. Significant Risks

# Significant risk

## Management override of controls

### Risk identified

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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

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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

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We are finalising our testing of the journals identified by our analytics software, and await receipt of evidence of the implementation of the financial reporting controls before we can conclude on this matter.

### Deloitte response to significant risk identified

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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 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

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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

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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 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;
- On a sample basis, tested cash reconciliations for investments, including tracing the source of the cash;
- Performed a unit reconciliation in which the opening, purchases sales and closing investment balances and unit quantities to independent investment confirmations; and
- Reviewed the classifications of investments throughout the investment notes to ensure these were accurately presented.

### Deloitte comment

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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.

We are awaiting receipt of two investment manager confirmations in order to complete the unit reconciliations for those holdings.

# 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
<b>Uncorrected misstatements identified in current year</b>		
In calculating the actuarial liability of the plan in accordance with IAS 26, the actuary has not allowed for the Goodwin ruling. Incorporating this factor would result in an increase of £4m (0.2%) of the actuarial liability.	<b>N/A – impacts disclosure in note 20</b>	<b>N/A – impacts disclosure in note 20</b>
<b>Corrected misstatements identified in current year – none</b>	-	-

### Disclosure deficiencies

The material valuation uncertainty clause included within the valuation statement for the Nuveen Retail Warehouse Fund as at the year-end should be disclosed in the financial statements. The fund value at the year-end is c.£2.1m, which is not material.

# Appendix 1: Audit adjustments and observations

## Continued

### Observations

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

- IAS 26 liability – Based on the work of our in-house actuarial team, when calculating the actuarial liability of the plan in accordance with IAS 26 the Fund actuary has not allowed for the Goodwin ruling. Incorporating this factor would result in an increase of £4m of the actuarial liability.
- Underpayment of contributions due to employer payroll system error – The automation of pension auto-enrolment within the council payroll system launched in June 2019 and caused any newly enrolled active members using that system to have their 3rd party deductions omitted from the BACS report on the first month upon their enrolment and therefore not paid into the bank for this month. This has caused an underpayment in the contributions for the year of £611k. We recommend that the contributions which have been deducted but that have not been paid across to the Fund are transferred to the Fund as soon as is practical. We further 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, we 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 risk 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: Outstanding items

## Items outstanding at the date of this report

Our final opinion is subject to completion of these items:

- 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.

# Appendix 5: 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:

<b>Independence confirmation</b>	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.
<b>Fees</b>	<p>The original 2019/20 scale fee set by PSAA was £16,170. The 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>
<b>Non audit services</b>	<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>



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