

The Audit Findings for London borough of Southwark Pension Fund

Year ended 31 March 2022

Southwark Council

October 2023

Southwark Council

This is an update to the Interim report previously presented to the Audit, Governance and Standards Committee in November. Updates to the Interim report have been made in red text.

January 2024



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Pension Fund or all weaknesses in your internal controls. 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.

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1. Headlines

This table summarises the key findings and other matters arising from the statutory audit of London Borough of Southwark Pension Fund ('the Pension Fund') and the preparation of the Pension Fund's financial statements for the year ended 31 March 2022 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 give a true and fair view of the financial position of the Pension Fund and its income and expenditure for the year; and
- 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 work on the Pension Fund took place concurrently with the audit of the Council. Our work was scheduled to be completed from October 2022 to January 2023. The team continued working on the audit in February and March 2023 due to some delays on the Pension Fund and Council audit.

Our work is nearing completion, and we are working towards completing our audit work by the end of the 2023 calendar year. Due to the passage of time, there have been internal changes to the staff meaning the Key Audit Partner and Senior Manager have changed. Due to the changes in team members, there is a requirement for us to rereview work and areas requiring further work to bring them to completion. To enable us to complete the work as effectively as possible we will be sharing a log of what remains left to complete the audit.

Due to us having to work on Health audit clients and other Local authorities audits due to the overall audit backlog the team began work on the Council in mid-October. Since that point there have been changes to the audit team and we have not yet started the closure of the Pension Fund 2021-22 audit. This was to allow the Pension Fund team time to prioritise updating the financial statements in relation to adjustments identified from September valuations to the 2022-23 financial statements. We therefore need to pick up with the Pension Fund team about the status of the above queries and appreciate the above list may not be fully updated

The team have now completed their review of the remaining work. From this one significant adjustment has been agreed with management in relation to the Investments held. This was due to more up to date valuation becoming available after the accounts were prepared. This led to the accounts requiring the Investments to be increased by £18.4m. This has also resulted in a number of other related notes requiring adjustment in the financial statements. Our work is now near completion, with the following work left noted below:

- Completion of final file reviews.
- receipt of management representation letter and
- review of the final set of financial statements – we are currently performing our final quality checks on this.
- Receipt of final information required to complete Member data testing for LGPS members on school payroll systems.

Our anticipated audit report opinion will be unmodified.

2. Financial Statements

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 have been discussed with management and the Audit, Governance and Standards 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

Conclusion

Our work is nearing completion following the conclusion of the outstanding matters noted on page 3 of this report.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff. We note the overall audit backlog in the sector is frustrating for both parties and we thank the team for their patience as we have worked through the audit process.

2. Financial Statements



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 levels have been updated since the audit plan to reflect the increased net assets position at the Pension Fund. We have continued to apply 1% to the net asset base in determining the materiality levels.

Pension Fund Amount (£) Qualitative factors considered

	Pension Fund Amount (£)	Qualitative factors considered
Materiality for the financial statements	21 million	This represents 1% of the Net Assets reported at 31 March 2022.
Performance materiality	14.7 million	This represents 70% of the Materiality threshold above.
Trivial matters	1.1 million	This represents 5% of the overall materiality.



2. Financial Statements - Significant risks

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

This section provides commentary on the significant audit risks communicated in the Audit Plan.

Risks identified in our Audit Plan

Commentary

Management override of controls

Under ISA (UK) 240, there is a non-rebuttable presumed risk that the risk of management override of controls is present in all entities. The Pension Fund faces external scrutiny of its spending and its stewardship of its funds, this could potentially place management under undue pressure in terms of how they report performance.

We therefore identified management override of control, in particular journals, management estimates, and transactions outside the course of business as a significant risk for the Pension Fund, which was one of the most significant assessed risks of material misstatement.

We have:

- Evaluated the design effectiveness of management controls over journals.
- Analysed the journals listing and determine the criteria for selecting high risk unusual journals.
- Tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration.
- Gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence.
- Evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.

Our work is now complete, and no issues were identified in relation to Management override of Controls.

2. Financial Statements - Significant risks

Risks identified in our Audit Plan

Commentary

Valuation of Level 3 investments (including Private Equity, Pooled properties and Infrastructure)

You value your investments on an annual basis with the aim of ensuring that the carrying value of these investments is not materially different from their fair value at the balance sheet date.

By their nature, Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions.

We therefore have identified Valuation of Level 3 Investments as a significant risk for Private Equity and Infrastructure investments.

We have:

- evaluated management's processes for valuing Level 3 investments and gain an understanding over the role of the custodian in the valuation process;
- 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; to ensure that the requirements of the Code are met;
- independently requested year-end confirmations from investment managers and the custodian;
- for the private equity (£28.12m) and infrastructure funds (£75.98m), obtained audited financial statements for the investments as at 31 December 2021 and we have reconciled any cash movements between the intervening period to 31 March 2022.
- performed additional testing for the full pooled property investments (£92.88m) by using indices obtained externally to benchmark against those used by the Fund Manager.
- evaluated the competence, capabilities and objectivity of the valuation expert; and
- review investment manager service auditor report on design and operating effectiveness of internal controls.

Following our work performed on 3 level 3 investments held there were variances identified totalling £18.4m, which indicated the Investments at the Year-end were understated. The reason for this difference was at the date the accounts were prepared these more up to date valuations were not available. In our assessment of IAS 10 we deem this an adjusting post balance sheet event and it has been agreed with management that this will be updated in the final accounts.

Our work is substantially complete, with the final quality checks being undertaken.

The valuation of Direct Property is incorrect (Level 3)

The Fund revalues its directly held property on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£230.6 million) and the sensitivity of this estimate to changes in key assumptions.

Management have engaged the services of a valuer to estimate the current value as at 31 March 2022.

We therefore identified valuation of directly held property, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement.

During the audit, we have undertaken the following work:

- evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to the valuation experts and the scope of their work
- independently request year-end confirmations from investment managers and custodian and assessed their responses as part of our work.
- evaluated the competence, capabilities and objectivity of the valuation expert
- written to the valuer to confirm the basis on which the valuations were carried out
- challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding. We have also engaged our own valuer to assess the instructions to the Fund's valuer, the Fund's valuer's report and the assumptions that underpin the valuation.
- tested, on a sample basis, revaluations made during the year to ensure they have been input correctly into the Fund's asset register/financial records
- where available, we have reviewed investment manager service auditor report on design effectiveness of internal controls.

2. Financial Statements - 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
Matters in relation to fraud	We have previously discussed the risk of fraud with the Audit, Governance and Standards Committee. We have not been made aware of any incidents in the period and no other issues have been identified during the course of our audit procedures.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
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.
Written representations	A letter of representation will be requested from the Pension Fund to be signed alongside the final draft of the financial statements in advance of the conclusion of the audit.

2. Financial Statements - other communication requirements



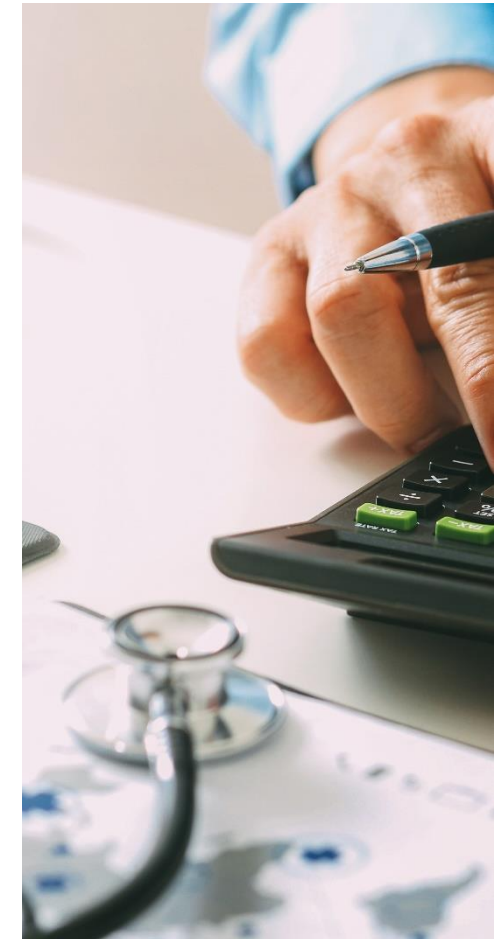
Our responsibility

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).

Issue	Commentary
Going concern	<p>In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector. Practice Note 10 provides that clarification for audits of public sector bodies. Practice Note 10 sets out the following key principles for the consideration of going concern for public sector entities:</p> <ul style="list-style-type: none"> the use of the going concern basis of accounting is not a matter of significant focus of the auditor’s time and resources because the applicable financial reporting frameworks envisage that the going concern basis for accounting will apply where the entity’s services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist, and so a straightforward and standardised approach for the consideration of going concern will often be appropriate for public sector entities for many public sector entities, the financial sustainability of the reporting entity and the services it provides is more likely to be of significant public interest than the application of the going concern basis of accounting. <p>Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by the Pension Fund meets this criteria, and so we have applied the continued provision of service approach. In doing so, we have considered and evaluated:</p> <ul style="list-style-type: none"> the nature of the Pension Fund and the environment in which it operates the Pension Fund's financial reporting framework the Pension Fund's system of internal control for identifying events or conditions relevant to going concern management’s going concern assessment. <p>On the basis of this work, we have obtained sufficient appropriate audit evidence to enable us to conclude that:</p> <ul style="list-style-type: none"> a material uncertainty related to going concern has not been identified management’s use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

2. Financial Statements - other responsibilities under the Code

Issue	Commentary
Disclosures	No inconsistencies have been identified have been identified but have been adequately rectified by management. We plan to issue an unmodified opinion in this respect.
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 have completed our review of the Pension Fund Annual Report and expect to issue our Consistency statement at the same date we issue the opinion to the financial statements.



3. 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 May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D

Transparency

Grant Thornton publishes an annual Transparency Report, which sets out details of the action we have taken over the past year to improve audit quality as well as the results of internal and external quality inspections. For more details see [Transparency report 2020 \(grantthornton.co.uk\)](https://www.grantthornton.co.uk/transparency-report-2020)

Appendices

A. Follow up of prior year recommendations

We identified the following issues in the audit of Southwark Pension Fund's 2020/21 financial statements, which resulted in 1 recommendations being reported in our 2020/21 Audit Findings report.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
TBC	<p>Issues over Member Data</p> <p>In 2016/17 we identified errors during our testing of the client's Member Data, which thus could have a potential impact on the accuracy of the data provided to the Actuary. This could then have a potential impact on the valuation provided by the Actuary to the Fund, although the risk of this is low.</p> <p>The Council has undertaken extensive data cleansing during 2017-18 and 2018-19 as part of the production of the annual benefit statements and also through the implementation of i-Connect software in all admitted bodies, scheduled bodies and schools which has significantly improved the quality of data held. The enhanced Member Self Service portal which facilitates member updates of data is now live and members will be made aware of this through newsletters. These will include activation keys which it is hoped will encourage them to log in.</p>	<p>The Pension Fund has procured new pensions administrations software to replace its current system. This is a phased project and as part of the implementation process a full data quality check will be undertaken. The new system provides for much improved Member and Employer Self-Service Portals, allowing members to log in securely and check/update basic member data.</p> <p>Employers will be able to submit monthly returns through the secure portal and see any outstanding tasks, such as outstanding leaver forms or requests for data. Forms will be able to be completed 'online' rather than paper-based which is hoped will further improve employer compliance via increased convenience.</p> <p>The fund is aware of the increased scrutiny on LGPS data by The Pension Regulator has taken measures to ensure member data is as accurate as it can be.</p> <p>We have performed testing on Member data as part of our final Accounts audit visit. The review and conclusion of this work is yet to be completed and we will provide an update on our findings and this control point in the final Audit Findings report.</p>

Assessment

- ✓ Action completed
- X Not yet addressed

B. Audit Adjustments – Main Statements

Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year ending 31 March 2022.

Detail	Fund Account £m	Net Asset Statement £m
<p>Variances identified in level 3 Investments</p> <p>Due to the timing of when the accounts were prepared and the audit period more up to date valuation information came available for 3 Investments held. This indicated Investments were understated by £18.4m. Per our consideration of IAS 10 we deem this to be an adjusting Event after the reporting period and therefore have agreed with management this will be adjusted in the final Pension Fund accounts.</p>	<p>Profit and losses on disposal of investments and changes in market value of investments CR 18.4m</p>	<p>Investment Assets</p> <p>DR – 18.4m</p>
Overall impact	CR £18.4m	DR £18.4m

B. 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 misstatements

We are still in discussion with management regarding audit queries relating to Investments balances held at the year end. To date we have not finalised our work regarding any misstatements to the Fund Account or Net Asset Statement.

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure omission	Auditor recommendations	Adjusted?
Fund Account	The Prior period figures in the Fund Account were changed for Investment Income and Management expenses in the draft accounts. Following discussions with officers it was determined this was not required and the figures have changed back to the previously audited balances.	✓
Accounting policies and Other notes –minor presentational adjustments	In our work a number of minor presentational amendments were identified and agreed with management.	✓
Note 6 Contributions receivable	The AVC balance which is significantly below materiality disclosed as a narrative has not been updated in 21-22 with the prior year figure being used of £3.6m.	X
Audit fees- Note 10	Per note 10 the audit fees were stated at £21k which is £16k different to the fee communicated per the Audit plan.	TBC
Note 12 Investments	Note 12 Investments required updates to reflect the adjustments noted on the previous page. In addition a prior period adjustment that was not deemed as required had been put through on the prior year figures and this also required updating in the final version of the accounts.	✓
Note 12 Investments	Note 12 Investments discloses £73m of other Investments. Per IAS 1 requirements the category other should not be used for material classes of transactions. From our work we have established £43m of the Investments relate to money market Investments and £30m relate to natural resource funds in this category.	✓
Note 19 –Funding Arrangements	The information in this note required updating with the more up to date information resulting from the triennial Pension Valuation.	✓
Note 20 – Actuarial Present Value of Promised Retirement Benefits	As noted earlier the Pension Fund had to consider the more up to date triggered by the triennial Pension Valuation, leading to material adjustments in the note.	✓

C. Fees

We confirm below our final fees charged for the audit and.

Audit fees	2020-21 Final Fee	2021-22 Fee
Per Audit Plan	£36,770	£36,770
Additional work relating to Triennial Pension Fund valuation	Nil	£6,000
Additional work required on Investment Valuations	Nil	3,500
Total audit fees (excluding VAT)	£36,770	£46,270

We have not identified any non-audit fees for the Pension Fund.

Status of the audit and opinion

Appendix D - Audit opinion

Our anticipated audit report opinion will be unmodified dependent on the satisfactory resolution of the matters noted in this report and no matters coming to our attention that would materially impact the Financial Statements.



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