

# The Audit Findings for East Sussex Pension Fund

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Year ended 31 March 2019

12 July 2019



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## Your key Grant Thornton team members are:

Darren Wells

Engagement Lead

T: 01293 554120

E: Darren.J.Wells@uk.gt.com

Marcus Ward

Engagement Manager

T: 020 7726 3350

E: Marcus.wards@uk.gt.com

Mary Adeson

In-charge

T: 020 7865 2561

E: mary.t.Adeson@uk.gt.com

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

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# Headlines

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

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<b>Financial Statements</b>	<p>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:</p> <ul style="list-style-type: none"><li>• give a true and fair view of the financial position of the Pension Fund and its income and expenditure for the year; and</li><li>• 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.</li></ul>	<p>Our audit work was completed on site during June and July. Our findings are summarised on the following pages. We have not identified any adjustments to the financial statements which would result in an adjustment to the Pension Fund's reported financial position. Audit adjustments in relation to disclosure errors are detailed in Appendix B. We have raised recommendations for management as a result of our audit work in Appendix A. One of these recommendations has been classified as a significant risk and is in regards to management carrying out a review of who has General Ledger (SAP) access providing virtually full system rights</p>
		<p>Our work is substantially complete and there are no matters of which we are aware that would require modification of our audit opinion or material changes to the financial statements, subject to the following outstanding matters;</p> <ul style="list-style-type: none"><li>• final internal quality review;</li><li>• receipt of management's response to our findings on review of the draft accounts ;</li><li>• receipt of management representation letter;</li><li>• review of the Annual Report; and</li><li>• review of the final set of financial statements.</li></ul>
		<p>Our anticipated audit report opinion will be unqualified.</p>

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## Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

# Summary

## Overview of the scope of our audit

- This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents will be discussed with management and the Audit 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 your business and is risk based, and in particular included:
  - An evaluation of your internal controls environment, including your IT systems and controls; and
  - Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks.

We have not had to alter or change our audit plan, as communicated to you on 25 March 2019. We revised our assessment of materiality on receipt of the 2018/19 accounts. Materiality was revised to £36m for the Pension Fund which equates to approximately 1% of your net assets in 2018/19.

## Conclusion

We have substantially completed our audit of your financial statements and subject to the outstanding matters listed on page 3 being resolved, we anticipate issuing an unqualified audit opinion following the Governance Committee meeting on 16 July 2019.

## 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.

	<b>Pension Fund Amount (£)</b>
Materiality for the financial statements	36m
Performance materiality	25.2m
Trivial matters	1.8m

# Audit findings – Significant risks

## Risks identified in our Audit Plan

## Commentary

1

### Improper revenue recognition

Under ISA (UK) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.

This presumption can be rebutted if the auditor concludes there is no risk of material misstatement due to fraud relating to revenue recognition.

### Auditor commentary

Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Fund, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:

- there is little incentive to manipulate revenue recognition;
- opportunities to manipulate revenue recognition are very limited;
- the culture and ethical frameworks of local authorities, including East Sussex County Council as the Administering Authority of East Sussex Pension Fund, mean that all forms of fraud are seen as unacceptable.

Therefore we do not consider this to be a significant risk for East Sussex Pension Fund.

2

### Management override of controls

Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.

We identified management override of controls as a risk requiring special audit consideration.

### Auditor commentary

Summary of work performed and audit findings:

- We evaluated the design effectiveness of management controls over journals;
- We obtained a full listing of journal entries which was then analysed to identify and test high risk unusual journals;
- We tested unusual journals recorded during the year and post year end for appropriateness and corroboration;
- We considered the reasonableness of significant accounting estimates and critical judgements made by management;
- We evaluated the rationale for any changes in accounting policies or significant transactions.

We identified journal entries being prepared and recorded with no descriptions, increasing the potential for erroneous or fraudulent posting to go unnoticed. We have raised a recommendation in this regard, see Appendix A for more detail. Subject to final internal review our audit work has not identified any other issues in respect of management override of controls.

# Audit findings – Significant risks

## Risks identified in our Audit Plan

## Commentary

3

### Valuation of Level 3 investments

Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.

We therefore identified the valuation of level 3 investments as a significant risk.

### Auditor commentary

Summary of work performed and audit findings:

- We gained an understanding of your process for valuing Level 3 investments and evaluating the design of the associated controls;
- We reviewed the nature and basis of estimated Level 3 valuations and considered what assurance management has over the year end valuations provided for these investments;
- For a sample of investments, we tested the valuation by obtaining and reviewing the audited accounts as at 31 December 2018 for individual investments and agreeing these to fund manager reports at that date and reconciling those values to the valuations reported at 31 March 2019 with reference to known movements in the intervening period.

Subject to final internal review our audit work has not identified any issues in respect of the valuation of Level 3 investments.

# Audit findings - Going concern

## Our responsibility

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

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## Going concern commentary

### Management's assessment process

Management have assessed that the Fund has sufficient resources to meet its liabilities as they fall due for the foreseeable future.

### Auditor commentary

We are satisfied regarding the appropriateness of management's process for formulating their going concern assessment.

We have considered the financial position of the Fund and undertaken a review to identify any possible indicators of any circumstances or events that could indicate that the Fund is no longer a going concern.

### Conclusion

We have not identified any events or conditions in the course of the audit that we consider may cast significant doubt on the pension fund's ability to continue as a going concern.

We plan to issue an unmodified audit report in respect of going concern.

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# Audit findings - other issues

This section provides commentary on new issues and risks which were identified during the course of the audit that were not previously communicated in the Audit Plan and a summary of any significant deficiencies identified during the year.

Issue	Commentary	Auditor view
<p><b>1 Potential Impact of the McCloud judgement</b></p> <p>The Court of Appeal has ruled that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members.</p> <p>The expectation is that this ruling will apply to other schemes where transitional protections were given to scheme members, including the Local Government Pension Scheme.</p> <p>The Government applied to the Supreme Court for permission to appeal this ruling, but permission was unsuccessful. The case will now be remitted back to an employment tribunal for remedy.</p>	<p>Management requested an estimate from the Council's actuary of the potential impact of the McCloud ruling. The actuary's estimate was of a possible increase in pension retirement benefits of £19,000k.</p> <p>Management's view is that the impact of the ruling will be considered for future years' actuarial valuations.</p>	<p>We have reviewed the analysis performed by the actuary, and consider that the approach taken to arrive at this estimate to be reasonable.</p> <p>The value of your assets and liabilities is based on the most recent actuarial valuation at 31 March 2016 in line with IAS 26. You have included a note in your financial statements to quantify the impact of the McCloud case on the financial statements. This approach is in line with the Code.</p>

# Audit findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
<b>Level 3 investments</b>	The Pension Fund has investments in equities, pooled property investment and private equity that in total are valued on the balance sheet as at 31 March 2019 at £618m. These investments are not traded on an open exchange/market and the valuation of the investment is highly subjective due to a lack of observable inputs. In order to determine the value, management place reliance on the valuation provided by their fund managers. The value of the investment has increased by £52m in 2018/19.	<ul style="list-style-type: none"> <li>For a sample of investments, we tested the valuation by obtaining and reviewing the audited accounts as at 31 December 2018 for individual investments, agreeing these to fund manager reports at that date and reconciling those values to the valuations reported at 31 March 2019 with reference to known movements in the intervening period.</li> </ul>	
<b>Level 2 investments</b>	The Pension Fund have investments in unquoted bonds, derivatives and pooled investments that in total are valued on the balance sheet as at 31 March 2019 at £2,302m. The investments are not traded on an open exchange/market and the valuation of the investment is subjective. In order to determine the value, management place reliance on the valuation provided by both their investment managers and custodian. The value of the investment has increased by £435m in 2018/19.	<ul style="list-style-type: none"> <li>For a sample of investments, we tested the valuation by obtaining and reviewing the audited accounts as at 31 December 2018 for individual investments, agreeing these to fund manager reports at that date and reconciling those values to the valuations reported at 31 March 2019 with reference to known movements in the intervening period.</li> </ul>	

## Assessment

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

# Other communication requirements

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

Issue	Commentary
① <b>Matters in relation to fraud</b>	<ul style="list-style-type: none"> <li>We have previously discussed the risk of fraud with management and the Audit Committee. We have not been made aware of any significant incidents in the period and no issues have been identified during the course of our audit procedures.</li> </ul>
② <b>Matters in relation to related parties</b>	<ul style="list-style-type: none"> <li>We are not aware of any related parties or related party transactions which have not been disclosed.</li> </ul>
③ <b>Matters in relation to laws and regulations</b>	<ul style="list-style-type: none"> <li>You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any such incidences from our audit work.</li> </ul>
④ <b>Written representations</b>	<ul style="list-style-type: none"> <li>A letter of representation has been requested.</li> </ul>
⑤ <b>Confirmation requests from third parties</b>	<ul style="list-style-type: none"> <li>We requested from management permission to send confirmation requests to your fund managers, custodians and other institutions with which you held bank or investment balances as at the year end. This permission was granted and the requests were sent. All of these requests were returned with positive confirmation, with the exception of Newton and UBS asset management. We are continuing to chase these confirmations requests with assistance from your officers and in the meanwhile will undertake alternative procedures to verify whether these balances are materially fairly stated as at 31 March 2019.</li> </ul>

# Other communication requirements

Issue	Commentary
6 <b>Disclosures</b>	<ul style="list-style-type: none"><li>• Our review found no material omissions in your financial statements. We identified a number of immaterial disclosure adjustments which are set out later within this report.</li><li>• We have agreed an amendment to your draft Annual Report to include narrative in relation to your Annual Benefit Statements Regulatory breach (failing to provide Annual Benefit Statements to all of the relevant members of the Scheme by 31 August).</li></ul>
7 <b>Audit evidence and explanations/significant difficulties</b>	<ul style="list-style-type: none"><li>• We have experienced no significant difficulties in performing our audit work.</li></ul>
8 <b>Matters on which we report by exception</b>	<ul style="list-style-type: none"><li>• We are required to give a separate opinion for the Pension Fund Annual Report on whether the financial statements included therein are consistent with the audited financial statements. We propose to issue our 'consistency' opinion on the Pension Funds Annual Report on 16 July 2019.</li></ul>

# 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

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

Details of fees charged can be found in Appendix C

## **Audit and Non-audit related services**

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Pension Fund. No non-audit services were identified.

# Action plan

We have identified two recommendations for the Pension Fund as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2019/20 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

Assessment	Issue and risk	Recommendations
1	 <ul style="list-style-type: none"> <li><b>Access to client maintenance functionalities (SCC4) (SAP access providing virtually full system rights)</b></li> </ul> <p>13 users with firefighter ID's have access to using SCC4. Improper execution of client administration transactions could result in a loss of entire client (SAP system), including information, data and configured functionalities.</p>	<p>The profile should be reserved for use within an emergency and the number of firefighter type ID should be monitored with access being regularly reviewed.</p> <p><b>Management response</b></p> <p>A review of the number of users with firefighter ID's has been performed and as of June there are 7 users, this will be monitored (update provided by Taina Tate, Senior Security Consultant).</p>
2	 <ul style="list-style-type: none"> <li><b>Journals with no descriptions</b></li> </ul> <p>We identified journal entries being prepared and recorded with no descriptions, increasing the potential for erroneous or fraudulent posting to go unnoticed.</p>	<p>Management should consider running exception reports to identify and review journal entries with no narrative included.</p> <p><b>Management response</b></p> <p>An email will be circulated to all users as a reminder. This point was also picked up as part of a recent internal audit review.</p>

## Controls

-  High – Significant effect on control system
-  Medium – Effect on control system
-  Low – Best practice

# 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 adjusted misstatements

There were no adjusted or unadjusted misstatements for the year ending 31 March 2019.

## Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which are due to be made in the final set of financial statements.

Disclosure omission	Detail	Adjustment agreed?
<b>Note 3 – summary of significant accounting policies</b>	<ul style="list-style-type: none"> <li>Update the last sentence of investment management expenses to show current year figures.</li> </ul>	✓
<b>Note 14a – Reconciliation of movements in investments and derivatives</b>	<ul style="list-style-type: none"> <li>The prior year note the opening and closing market value year ends need to be updated.</li> </ul>	✓
<b>Note 14c – Investments analysed by fund manager</b>	<ul style="list-style-type: none"> <li>More detail on the ACCESS Pool to be provided to set out the nature of the arrangements and their impact on the financial statements, including how any resulting assets or expenses are classified, measured and presented.</li> </ul>	✓
<b>Note 16a – Fair value hierarchy</b>	<ul style="list-style-type: none"> <li>Further detail should be given as to what the different assets are and how they are valued. Level 3 investments should be separately identified and include a quantitative disclosure of significant unobservable inputs.</li> </ul>	✓
<b>Note 17 – financial instruments</b>	<ul style="list-style-type: none"> <li>There should be a note that shows how the 2018 comparatives under the old classification have been reclassified into the new IFRS 9 categorisations for 31 March 2019.</li> <li>A reconciliation should be provided between the figures used in the financial instruments note and the categories in the Net Assets Statement.</li> </ul>	✓
<b>Various</b>	<ul style="list-style-type: none"> <li>Various other minor amendments to terminology and typos.</li> </ul>	✓

# Fees

We confirm below our final fees charged for the audit, which are in line with the fee set out by PSAA. There were no fees for the provision of non audit services.

## Audit Fees

	Proposed fee	Final fee
Pension Fund Audit	20,487	20,487
<b>Total audit fees (excluding VAT)</b>	<b>£20,487</b>	<b>£20,487</b>

## Non Audit Fees

There have been no non-audit fees or audited related services undertaken for the Pension Fund.

