

The Audit Findings for the London Borough of Lewisham Pension Fund

Year ended 31 March 2019

September 2019



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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 the London Borough of Lewisham 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.

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 audit work is being undertaken on site during June and July 2019. Our findings are summarised on the following pages. We have identified one adjustment to the financial statements that has resulted in a £1.5m increase in the Pension Fund's reported financial Net Assets position. Audit adjustments are detailed in Appendix A.

Our work is nearing completion. As at the date of writing there are no matters of which we are aware that would require modification of our audit opinion (Appendix B) or material changes to the financial statements. Our anticipated audit report opinion will be unqualified.

The outstanding matters include the following items where we are awaiting information from you as at the date of this report:

- receipt of the amended financial statements.

Our work is subject to the following closing procedures which necessarily take place at the end of the audit:

- final senior management and quality reviews and clearance of any queries that may arise from this final process;
 - agreement of your management representation letter;
 - review of the final set of amended approved financial statements; and
 - review of the final Pension Fund Annual Report (the deadline for this is 1 December 2019)
-

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team, management 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 have been discussed with management and the Audit Panel.

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.

We have not had to alter or change our audit plan, as communicated to the Audit Panel in March 2019

Conclusion

We are nearing the completion of our audit of your financial statements and, subject to the satisfactory completion of outstanding matters and queries, we anticipate issuing an unqualified audit opinion, as detailed in Appendix B. We are unable to issue the audit opinion until we have completed our work on the Council's financial statements, the audit of which is in progress.

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.

Our materiality has been updated from our Audit Plan to reflect the draft financial statements and the increase in Net Assets.

	Pension Fund Amount (revised) (£)
Materiality for the financial statements	13,852,000
Performance materiality	9,697,000
Trivial matters	693,000

Significant findings – audit risks

Risks identified in our Audit Plan

1

The risk that revenue includes fraudulent transactions

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

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

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. The group and Fund face external scrutiny of its spending and 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 you and the Fund, which was one of the most significant assessed risks of material misstatement.

Commentary

Auditor commentary

Having considered the risk factors set out in ISA240 and the nature of your and the Fund's revenue streams, we 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; and
- the culture and ethical frameworks of local authorities, including yourselves, mean that all forms of fraud are seen as unacceptable

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

Auditor commentary

We have completed the following work in relation to this risk:

- evaluated the design effectiveness of management controls over journals;
- analysed the journals listing and determined the criteria for selecting high risk and unusual journals ;
- gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence; and
- evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions
- review of large and unusual journal entries for the last few periods of the year and year end journals for testing back to supporting documentation.

we have not identified any material issues from our work at this stage that we need to report to you.

Significant findings – audit risks

Risks identified in our Audit Plan	Commentary
<p>3 The valuation of Level 3 investments is incorrect</p> <p>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 (£119 million) and the sensitivity of this estimate to changes in key assumptions</p> <p>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.</p> <p>Management utilise the services of investment managers as valuation experts to estimate the fair value as at 31 March 2019.</p> <p>We therefore identified valuation of Level 3 investments as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>Auditor commentary</p> <p>We are in the process of completing the following work in relation to this risk:</p> <ul style="list-style-type: none"> evaluating management's processes for valuing Level 3 investments; reviewing 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; Agreeing the valuations to the fund manager confirmations at 31 March 2019; for a sample of investments, testing the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. We are reconciling those values to the values at 31 March 2019 with reference to known movements in the intervening period; and in the absence of available audited accounts, we will evaluate the competence, capabilities and objectivity of the valuation expert. <p>We have not identified any material issues from our work at this stage that we need to report to you.</p>
<p>4 Incomplete or inaccurate financial information transferred to the new general ledger</p>	<p>Auditor commentary</p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> reviewed your arrangements and controls over the transfer of data from the old system to the new system, and the controls over the completeness and accuracy of data transferred; and mapped the closing balances from the redundant general ledger (Oracle) to the opening balance position in the new ledger (Oracle Cloud) to assess accuracy and completeness of the financial information. <p>We are satisfied that the data transfer of balances from Oracle to Oracle Cloud was materially accurate and complete.</p>

Significant 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).

Going concern commentary

Management's assessment process

Management have reviewed the Fund's funding position and cash flows.

Auditor commentary

- The Pension Fund has sufficient assets to meet its liabilities as they fall due over the next 12 months. Local Government Pension schemes are effectively underwritten by the tax payer with deficits financed by increased contributions agreed with the actuary that are financed through Council, Admitted and Scheduled bodies contributions.
- There is no plan by the Ministry of Housing, Communities and Local Government to wind up the London Borough of Lewisham Council Pension Scheme.
- The Pension Fund continues to operate as usual in 2018/19. Contributions and investment income continue to be received as expected.

Work performed

Detail audit work performed on management's assessment

Auditor commentary



- We have reviewed management's assessment that the financial statements are prepared on a going concern basis.
- We are satisfied that there are sufficient assets to meet liabilities as they fall due. The last triennial actuarial valuation also demonstrated an improvement in the funding level to 78%.
- The Council continue to pay deficit funding contributions into the pension fund in 2018/19.
- The fund continues to operate as usual.

Concluding comments





Auditor commentary

- We are satisfied that it is appropriate that the Pension Fund Financial Statements are prepared on a Going Concern basis.

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Level 3 investments	<p>The Pension Fund has investments in:</p> <ul style="list-style-type: none"> HarbourVest £37.6m & M&G £0.7m - private equity/venture capital. By the nature of these investments, publicly quoted prices are unavailable and there is no active market to obtain comparable prices. Values are not based on observable market data, but price based on manager valuations. J.P. Morgan £80.6m - Infrastructure fund Investments will generally be illiquid, and not publicly traded or readily marketable. The adviser to the fund will not have access to readily ascertainable market prices when establishing valuations and there may be a relative scarcity of market comparables. The fund adviser will appoint external appraisers of valuers to determine the FV of assets on at least an annual basis. 	<p>We have completed the following work in relation to this risk:</p> <ul style="list-style-type: none"> reviewed your assessment of the estimate considering the fund managers latest audited accounts for each fund comparing your capital statements to the values at this date. Where the audited financial statements are for a period ending other than 31 March 2019 we have verified any drawdowns or disbursements from the fund, thereby assessing the reasonableness of estimates used; assessed the Fund Managers as experts and reviewed internal control reports where these are prepared; and reviewed the adequacy of disclosure of estimate in the financial statements. <p>We have not identified any issues that will require reporting to you.</p>	 Green
Level 2 investment	<p>The Pension Fund has investments that in total are valued on the balance sheet as at 31 March 2019 at £1.2bn. The investments are not traded on an open exchange/market and the valuation of the investment is subjective.</p>	<ul style="list-style-type: none"> We have triangulated the values in the pension fund accounts to the Fund Manager valuations and independent valuations from the Fund's custodian. These two independent valuations gives us assurance that the Level 2 investment values are materially fairly stated. Whilst comparing the custodian and the Fund Manager report for Partners Group, we identified that the balance in the financial statements was based on the custodian report which was using an outdated valuation. There is a £1.5m variance to the value of the Partners Group's management report as at 31 March 2019. The Pension Fund's reported financial Net Assets position is therefore understated by £1.5m. 	 Amber

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 Matters in relation to fraud	We have previously discussed the risk of fraud with the Audit Panel. We have not been made aware of any incidents in the period and no issues have been identified during the course of our audit procedures..
② Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
③ 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.
④ Written representations	A letter of representation has been requested from the Pension Fund, which will be included in the Audit Panel papers.
⑤ Confirmation requests from third parties	We requested from management permission to send confirmation requests to your custodian, fund managers and banks. This permission was granted and the requests were sent. We have received a response from all third parties.
⑥ Disclosures	Our review found no material omissions in the financial statements.
⑦ Audit evidence and explanations/significant difficulties	All information and explanations requested from management was provided.
⑧ 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 are awaiting the draft Pension Fund Annual report for review. The Annual Report has a later deadline of 1 December 2019.

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 December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are set out in the following table

	Proposed fee	Final fee
Pension Fund Audit	16,170	16,170
Total audit fees (excluding VAT)	£16,170	£16,170

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. There were no other services provided to the Pension Fund.

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

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 2019. Management has agreed to adjust the accounts for the below misstatement.

Detail	Pension Fund Account £'000	Net Asset Statement £' 000	Impact on total net assets £'000
1 The Investments for Partners Group within the Pension Fund financial statements of £40,307k were based on the custodian report which was using an outdated valuation. There is a £1.5m variance to the value of Partners Group's Fund Managers report as at 31 March 2019. The Pension Fund's reported financial Net Assets position is therefore understated by £1.5m	Credit Change in Market Value of Investments 1,469	Debit Investment assets (other) 1,469	Increase in Net assets by 1,469
Overall impact	£1,469	£1,469	£1,469

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which management has agreed to amend in the final set of financial statements.

Disclosure / Omission	Detail	Adjustment agreed?
Disclosure	The Individual Investment assets with a market value exceeding 5% of the total fund value required updating. There is no impact on the Net Assets Statement.	✓
Omission	The salary and pensions contributions of the acting Executive Director for Resources and Regeneration needs to be included within the Related Parties note.	✓
Disclosure	The Actuarial Present Value of Promised Retirement Benefits was updated to take into account the revised actuary calculations to take account of the impact of McCloud and GMP indexation. There is no impact on the Fund Account or Net assets Statement.	✓
Omission	The audit fee of £16,170 was not disclosed within the financial statements	✓

Audit Adjustments

Impact of unadjusted misstatements

There are no unadjusted misstatements above our reporting level.

Impact of prior year unadjusted misstatements

There are no adjustments impacting on the prior year.

Audit opinion

We anticipate we will provide the Pension Fund with an unmodified audit report. This is a draft version that will be updated.

Independent auditor's report to the Members of London Borough of Lewisham council on the pension fund financial statements

Opinion

We have audited the pension fund financial statements of London Borough of Lewisham (the 'Authority') for the year ended 31 March 2019 which comprise the Fund Account, the Net Assets Statement for the year ended 31 March 2019 and notes to the pension fund financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19.

In our opinion the pension fund financial statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2019 and of the amount and disposition at that date of the fund's assets and liabilities;
- have been prepared properly in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the pension fund of the Authority in accordance with the ethical requirements that are relevant to our audit of the pension fund financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Who we are reporting to

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Executive Director for Resources and Regeneration's use of the going concern basis of accounting in the preparation of the pension fund financial statements is not appropriate; or
- the Executive Director for Resources and Regeneration has not disclosed in the pension fund financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the pension fund financial statements are authorised for issue.

Other information

The Executive Director for Resources and Regeneration is responsible for the other information. The other information comprises the information included in the Annual, the Narrative Report and the Annual Governance Statement, other than the pension fund financial statements, our auditor's report thereon and our auditor's report on the Authority's financial statements. Our opinion on the pension fund financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

Audit opinion

In connection with our audit of the pension fund financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the pension fund financial statements or our knowledge of the pension fund of the Authority obtained in the course of our work or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the pension fund financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Opinion on other matter required by the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice)

In our opinion, based on the work undertaken in the course of the audit of the pension fund financial statements the other information published together with the pension fund financial statements in the Annual Accounts, the Narrative Report and the Annual Governance Statement for the financial year for which the pension fund financial statements are prepared is consistent with the pension fund financial statements.

Matters on which we are required to report by exception

Under the Code of Audit Practice we are required to report to you if:

- we have reported a matter in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have made a written recommendation to the Authority under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have exercised any other special powers of the auditor under the Local Audit and Accountability Act 2014.

We have nothing to report in respect of the above matters.

Responsibilities of the Authority, the Executive Director for Resources and Regeneration and Those Charged with Governance for the financial statements

As explained more fully in the Statement of Responsibilities, the Authority is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Executive Director for Resources and Regeneration. The Executive Director for Resources and Regeneration is responsible for the preparation of the Statement of Accounts, which includes the pension fund financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2018/19, which give a true and fair view, and for such internal control as the Executive Director for Resources and Regeneration determines is necessary to enable the preparation of pension fund financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the pension fund financial statements, the Executive Director for Resources and Regeneration is responsible for assessing the pension fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the pension fund lacks funding for its continued existence or when policy decisions have been made that affect the services provided by the pension fund.

The Audit and Performance Committee is Those Charged with Governance.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the pension fund financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these pension fund financial statements.

Audit opinion

A further description of our responsibilities for the audit of the pension fund financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Paul Grady
for and on behalf of Grant Thornton UK LLP, Appointed Auditor

London

X July 2019



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