



The Audit Findings for Somerset Pension Fund

Year ended 31 March 2020

24 September 2020



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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 Somerset Pension Fund ('the Pension Fund') and the preparation of the Pension Fund's financial statements for the year ended 31 March 2020 for those charged with governance.

Covid-19	<p>The outbreak of the Covid-19 coronavirus pandemic has had a significant impact on the normal operations of the Pension Fund.</p> <p>The Pension Fund have faced a number of challenges including operational capacity, remote working and delays from third parties including external confirmation.</p> <p>Authorities are still required to prepare financial statements in accordance with the relevant accounting standards and the Code of Audit Practice, albeit to an extended deadline for the preparation of the financial statements up to 31 August 2020 and the date for audited financials statements to 30 November 2020.</p>	<p>We have considered emerging guidance issued by the Financial Reporting Council (FRC), CiPFA and actively contributed to audit firm and NAO technical meetings where the impact of the virus on the financial reporting disclosures and audit approach has been discussed.</p> <p>We updated our audit risk assessment to consider the impact of the pandemic on our audit which was reflected in our Audit Plan. In the Plan we reported an additional financial statement risk in respect of Covid-19 and highlighted the impact on our VfM approach. Further detail is set out on page 6.</p> <p>Restrictions for non-essential travel has meant both the Pension Fund and audit teams have had to develop new remote access working arrangements including remote accessing financial systems, video calling and alternative procedures over the verification of completeness and accuracy of information produced by the entity. There have also been key challenges for the Pension such access to key data from external organisations and changes to governance requirements.</p>
Financial Statements	<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"> • 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. 	<p>Our audit work was completed remotely during July to September 2020. Our findings are summarised on pages 5 to 11. We have not identified any adjustments to the financial statements that have resulted in an adjustment to the to the Pension Fund's reported financial position. Audit adjustments are detailed in Appendix B. Our follow up of recommendations from the prior year's audit are detailed in Appendix A.</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"> • Confirmation of experience items; • receipt of management representation letter; • review of the Annual Report; and • review of the final set of financial statements. <p>Our anticipated audit report opinion will be unqualified including an Emphasis of Matter paragraph, highlighting asset valuation material uncertainties</p>

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance and timely collaboration provided by the finance team and other staff during these unprecedented times.

Audit approach

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.

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 our audit plan, as communicated to you on 18 June 2020, which reflected our response to the Covid-19 pandemic.

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 24 September 2020. These outstanding items include:

- Confirmation of experience items;
- receipt of management representation letter;
- review of the Annual Report; and
- review of the final set of 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.

We have revised the performance materiality percentage to reflect the increased risk due to the decrease in the asset value which is partly due to the normal trading activities of the fund but also reflects the position as at 31 March 2020. This in part is due to the fall in market values as a result of covid-19 and the reduced materiality also takes this into account.

	Pension Fund (£)	Qualitative factors considered
Materiality for the financial statements	20,558,000	This equates to 1% of total net assets for the 2019/20 financial year
Performance materiality	15,419,000	This equates to 75% of materiality
Trivial matters	1,028,000	ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria

Significant audit risks

Risks identified in our Audit Plan

Covid-19

The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expect current circumstances will have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to:

- Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation;
- Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management estimates;
- Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and
- Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties.

We therefore identified the global outbreak of the Covid-19 virus as a significant risk, which was one of the most significant assessed risks of material misstatement.

Auditor commentary

We:

- worked with management to understand the implications the response to the Covid-19 pandemic had on the organisation's ability to prepare the financial statements and update financial forecasts and assessed the implications for our materiality calculations. Changes were made to materiality levels previously reported as a result of the change in the total value of assets. The draft financial statements were provided on 17 July 2020;
- liaised with other audit suppliers, regulators and government departments to co-ordinate practical cross-sector responses to issues as and when they arose.;
- evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic;
- evaluated whether sufficient audit evidence could be obtained through remote technology;
- evaluated whether sufficient audit evidence could be obtained to corroborate significant management estimates such as assets and the pension fund liability valuations;
- evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment;
- discussed with management the implications for our audit report where we have been unable to obtain sufficient audit evidence; and
- engaged the use of auditor experts for higher risk audited bodies for asset valuations.

Our work has not identified any issues in regards to covid-19 testing

Significant audit risks

Risks identified in our Audit Plan

The Revenue cycle 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.

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 Somerset Pension Fund mean that all forms of fraud are seen as unacceptable

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

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

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 Somerset as the Administering Authority of Somerset Pension Fund, mean that all forms of fraud are seen as unacceptable

Our audit work has not identified any issues in respect of revenue recognition.

We addressed the significant risk of management override of controls by:

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

Our audit work has not identified any issues in respect of management override of controls.

Significant audit risks

Risks identified in our Audit Plan

The valuation of Level 3 investments

The Fund revalues its investments on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date.

By their nature Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements

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.

Management utilise the services of investment managers and custodians as valuation experts to estimate the fair value as at 31 March 2020.

We therefore identified valuation of Level 3 investments as a significant risk, which was one of the most significant assessed risks of material misstatement

Auditor commentary

In order to address the significant risk of valuation of level 3 investments being incorrect we performed the following;

- gained an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls;
- 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;
- considered the competence, expertise and objectivity of any management experts used;
- reviewed the qualifications of the expert to value Level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached; and
- for a sample of investments, tested 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. Reconciled those values to the values at 31 March 2019 with reference to known movements in the intervening period.

Our audit work has not identified any issues in respect of the valuation of these investments.

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 a reasonable expectation that the services provided by the Pension Fund will continue for the foreseeable future.

Auditor commentary

Management has concluded it remains a going concern and it is appropriate to continue to prepare its accounts on a going concern basis. We note that:

Given the long term nature of the pension fund management consider there is little risk of material uncertainty in respect of the going concern assumption. Future funding contributions have been set by an independent actuary which further mitigates the risk. The funding valuation covers a period of 3 years and assumes a period of 16 years for deficit recovery. The 2019 triennial review was completed during 2019/20 and comes into effect from 1 April 2020. This review sets the employer contribution rates for future service and deficit recovery payments from 1 April.

The Fund has a significant level of cash which are held by fund managers and include significant investments in marketable equities. The value of investments held provide ample potential cash to meet outflows in terms of pension payments/ or lump sums for a number of years and well past the 12 months period to the end of September 2021 used to assess going concern

Work performed

We have reviewed the Pension Funds funding valuation which covers a period of three years and given the long term nature of the pension scheme there is little risk of material uncertainty in respect of going concern assumption

- Our work confirmed that management's arrangements for assessing going concern are adequate and management's use of the going concern assumption as a basis for the preparation of the financial statements is reasonable
- We have not identified any material uncertainties that may cast significant doubt on the Pension Fund's ability to continue as a going concern for the foreseeable future.

Concluding comments



- We concur with the S151 Officer's view that there are no material uncertainties that would require disclosure under ISA 570.
- On the basis of our work, it is appropriate to issue an unmodified audit opinion on going concern.

Significant findings – matters discussed with management





This section provides commentary on the significant matters we discussed with management during the course of the audit.

Significant matter	Commentary	Auditor view
<p>Asset valuation</p> <p>The Covid-19 pandemic commenced within the last two weeks of the 2019-20 financial year and created a large uncertainty in financial markets and the market for other assets.</p> <p>Whilst the main impact is considered to be within the property market there is still an impact on investment assets given the uncertainty that existed within the market at the 31 March 2020.</p>	<p>The Covid-19 pandemic outbreak occurred within the final two weeks of the financial year and saw a sharp downturn in the markets as at 31 March 2020. The Pension Fund valuation date is as at 31 March and therefore any of these downturns were reflected in the disclosed balances within the financial statements.</p> <p>The Pension Fund does not hold any direct property and therefore the material uncertainty in relation to property valuation does not exist for the Pension Fund. The Pension Fund does hold investments in pooled property funds and a review of this has been undertaken as part of the audit testing.</p> <p>The Pension Fund has identified the uncertainty within the market and has disclosed this within the financial statements and in line with the code requirements.</p>	<p>The uncertainty around investments and market performance has been reflected appropriately within the statement of accounts and reflects the market performance as at 31 March 2020.</p>

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Level 3 investments	The Pension Fund has level 3 investments that in total are valued on the balance sheet as at 31 March 2020 at £59.941 million. The total of this balance is made up of private equity funds. The level 3 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. The basis of valuation for each category of level 3 investments is set out in note 30 to the financial statements. The overall value of level 3 investments has increased by £9.948 million in 2019/20.	<ul style="list-style-type: none"> From our review of the level 3 investments, no issues were identified in regard to the valuation basis of these Overall we consider managements process and key assumptions to be reasonable 	 Green
Level 2 investment	The Pension Fund have investments in pooled investments and property funds that in total are valued on the balance sheet as at 31 March 2020 at £1,346.485 million. The investments are not traded on an open exchange/market and the valuation of the investment is subjective. The basis of valuation for each category of level 2 investments is set out in note 30 to the financial statements. The value of the investment has increased by £203.495 million in 2019/20.	<ul style="list-style-type: none"> From our review of the level 2 investments, no issues were identified in regard to the valuation basis of these Overall we consider managements process and key assumptions to be reasonable 	 Green

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 is appropriate and key assumptions are neither optimistic or cautious

Other matters for communication

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	Auditor commentary
Matters in relation to fraud	<ul style="list-style-type: none"> We have previously discussed the risk of fraud with the Audit 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	<ul style="list-style-type: none"> We are not aware of any related parties or related party transactions which have not been disclosed.
Matters in relation to laws and regulations	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> A letter of representation has been requested from the Pension Fund, which is included in the Audit Committee papers
Confirmation requests from third parties	<ul style="list-style-type: none"> We requested from management permission to send confirmation requests to custodians and Fund Managers. This permission was granted and the requests were sent all of these requests were returned with positive confirmation.
Disclosures	<ul style="list-style-type: none"> Our review found no material omissions in the financial statements. A small number of disclosure amendments were made to the financial statements which are set out in Appendix B.
Audit evidence and explanations/significant difficulties	<ul style="list-style-type: none"> All information and explanations requested from management was provided We were provided with good working papers and support from the Pension Fund finance team throughout the audit process
Matters on which we report by exception	<ul style="list-style-type: none"> 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. Due to statutory deadlines the Pension Fund Annual Report is not required to be published until the 1st December 2019 and therefore this report has not yet been produced. We have therefore not given this separate opinion at this time and are unable to certify completion of the audit of the administering authority until this work has been completed.

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 Pension Fund'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 Pension Fund'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 C

Audit and Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Pension Fund. Grant Thornton UK LLP are the auditors of Brunel Pension Partnership Limited (BPP). This fee isn't included in the financial statements of Somerset Pension Fund as is payable by BPP.

	Fees £	Threats identified	Safeguards
Audit related			
Audit of Brunel Pension Partnership Limited (BPP)	40,000	None	<p>We do not consider that the Audit of BPP is a threat to our independence as Somerset Pension cannot exercise control over BPP.</p> <p>The audit of BPP is carried out by a specialist team, authorised by the Financial Standards Authority.</p> <p>The Fee of £40,000 is not significant compared to the audit fees of the ten participating pension funds.</p>
Provision of IAS 19 Assurances to Scheme Employer auditors	6,500	None	<p>We are required to respond to requests received from other auditors of admitted bodies for assurance in respect of information held by the Fund and provided to the actuary to support their individual IAS 19 calculations.</p> <p>Our estimate is that the fee for this will be £3,000 plus an additional £500 for each local government body which requests a letter of assurance.</p>

Follow up of prior year recommendations

We identified the following issue in the audit of Somerset Pension Fund's 2018/19 financial statements, which resulted in a recommendation being reported in our 2018/19 Audit Findings report. We are pleased to report that management have implemented our recommendation.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
✓	<p>Journals</p> <p>Testing of journals identified that officers have the ability to post and authorize their own journals. There is a risk of potentially fraudulent journals being posted.</p> <p>To reduce the risk of material error from journal adjustments made in the general ledger, the Pension Fund should include, in its journal policy, the requirement that all journals should be authorised by a second person</p>	<p>Although there is still no requirement for second authorisation of all journals, it is our view that there are sufficient mitigating controls through budget management and process review to provide assurance that no risk remains. We have carried out detailed risk rated testing of journals and have found no issues in relation to self authorisation. It is therefore considered that this recommendation has been address.</p>

Assessment

- ✓ Action completed
- X Not yet addressed

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 and unadjusted misstatements

There are no adjusted or unadjusted misstatements in the reported net expenditure for the year ending 31 March 2020.

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	Detail	Auditor recommendations	Adjusted?
Level 3 investments	Note 29 includes a sensitivity analysis which has been analysed by asset class. The Code requires that the analysis specifically identifies level 3 investments and from the disclosure with the draft statements this has not been separately identified.	Further disclosures should be included within the statement of accounts to allow the reader to easily identify the volatility analysis of level 3 investments and to ensure compliance with the code.	✓
General Disclosures	Other general amendments	A number of minor amendments have been made to the accounts to correct typographical errors and incorrect note references.	✓

Appendix C

Fees

We confirm below our final fees charged for the audit and provision of non-audit services.

Audit fees	Proposed fee	Final fee
Pension Fund	£18,371	£22,121
Total audit fees (excluding VAT)	£18,371	£22,121

The fees do not reconcile to the financial statements due to the following items

- fees per financial statements - £18,371
- Raising the bar to meet FRC quality standards leading to further testing - £2,000
- Increased testing requirements for Level 3 investments – £1,750
- total fees per above - £22,121

Non-audit fees for other services	Proposed fee	Final fee
Audit Related Services:		
Provision of IAS 19 Assurances to Scheme Employer auditors	£6,500	£6,500
Audit of Brunel Pension Partnership Limited (BPP)	£40,000	£40,000
Total non- audit fees (excluding VAT)	£46,500	£46,500



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