

The Highland Council Pension Fund

External audit annual report to Those Charged with Governance and the Controller of Audit

2016/17 Financial Year



31 August Pension Committee

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Summary of our audit plan:

Materiality has been updated based on the unaudited financial statements to £17.649 million (1% of net 2016/17 assets)

Performance materiality is set at £11.472 million and we have reported to management everything identified over £176,000 (1% of materiality)

We rebutted the risk of fraud in revenue recognition. However, we identified a range of audit risks including management override of controls; the valuation of level 3 investments; and investment income is not accurate

We determined that the Highland Council Pension Fund fell under the smaller body classification in relation to wider scope so focused on going concern; financial sustainability; the “front end” of the accounts and governance

We can confirm we are independent of the Highland Council Pension Fund and our objectivity is not compromised in accordance with International standards on Auditing (UK & Ireland) and APB ethical standards for Auditors. No non-audit services have been provided to the Pension Fund in 2016/17 and our fee was as agreed and set out in our audit plan as £28,560.

Key Messages

We have issued an unqualified opinion on:

- True and fair view of the financial statements
- Other prescribed matters

This report is a summary of our findings from our external audit work for the financial year ended March 2017. Our work has been undertaken in accordance with International Standards on Auditing (UK & Ireland) and the Code of Audit Practice (2016).

Our report is addressed to those charged with governance (Elected Members on the Pension Fund Board and Sub-Committee) and the Controller of Audit. This report will be published on the Audit Scotland website at: www.audit-scotland.gov.uk

This report has been discussed and agreed with Council Officers, and presented to the Pensions Committee on 31 August 2017 alongside the final version of the annual report and accounts.

We would like to thank Officers for their co-operation and assistance throughout our audit work.

Our work included:

- An audit of the 2016/17 Annual report and accounts
- A review of the Management Commentary, Annual Governance Statement and Governance Compliance Statement.

Overall we believe an efficient audit process was achieved, with a good unaudited annual report and accounts being received in line with our agreed timetable. Suitable working papers were available to support the accounts. One adjustment was identified and has been processed in the final accounts. In addition we recommended a number of disclosure enhancements which were agreed and reflected in the final annual report and accounts. These are summarised in an appendix to this report.

We set out in our audit plan that the Highland Pension Fund fell under the smaller body classification in the Code of Audit Practice and therefore the wider scope audit requirements do not apply. This has not changed. However, we have provided commentary in this report around certain aspects of the pension fund arrangements including consideration of going concern and future financial sustainability. We have also included commentary in respect of the key movements from prior years, linked to the Funds activities.

For and behalf of Grant Thornton UK LLP

31 August 2017



The Financial Statements Audit



Our audit plan was presented to the Pensions Committee in February 2017. We have not altered our planned audit approach as set out in the plan. However, we have updated our final materiality figures based on the unaudited 2016/17 accounts (was £14.693 million in our plan, and based on the unaudited accounts for 2016/17 materiality was calculated as £17.649 million – calculated as 1% of total assets).

Our audit work commenced in two phases, with controls work being undertaken in April 2017 related to benefit payments and member data, and then our final substantive audit testing in late June and July 2017. A complete set of unaudited accounts were published on the Council’s website before the end of June, in accordance with statutory guidance.

The supporting working papers were clearly set out and our queries were answered promptly. The annual report and accounts are prepared by the Council’s pensions finance team and are then subject to review before being signed by the Director of Finance. The accounts are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 which is based upon International Reporting Standards (IFRS) as amended for the UK public sector. The accounts were in line with the CIPFA LGPS model accounts.

We have one unadjusted difference which is set out in Appendix 1, alongside agreed adjustments and disclosure changes.

Internal Control Environment

During the year we have sought to understand the Pensions overall control environment as related to the annual report and accounts. In particular we have:

- Considered procedures and controls around related parties, journal entries and other key entity level controls
- Performed certain procedures around IT general controls
- Performed walkthrough procedures on key controls around investments, member data, contributions and benefit payments.

No material weaknesses in the accounting and internal control systems were identified during the audit which could have an adverse impact on the Pension Funds ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Under the relevant ISA’s we are required to report to those charged with governance the main issues arising from our audit of the annual accounts and report.

This report discharges our obligations under the relevant ISA’s.

Internal Audit

As set out in our plan we have not placed formal reliance on the work of Internal Audit during 2016/17. Internal Audit is provided to the Pension Fund by the in-house Highland Council team. The Internal Audit programme is risk based and covers a number of Council system and processes. The internal audit service complies with Public Sector Internal Audit Standards, and has been subject to independent review in year by the Scottish Local Authority internal audit reciprocal review arrangements.

We have reviewed the internal audit plan, and note that no specific pension audits were completed during the year.

Internal Audit’s annual opinion for the year is “substantial assurance”, which includes the work completed over a number of the Council’s financial processes, of which the same arrangements are in place over the Pension Fund.

Our identified audit risks

Our audit plan identified a number of significant and other audit risks and our planned approach. We have set out below a summary of the work undertaken over these risks and our conclusions.

Audit plan identified risk and work completed	Our conclusion
<p>Risk of Fraud in Revenue recognition</p> <p>Under ISA (UK&I) 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 that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Highland Council Pension Scheme, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • 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 Highland Council as the administering authority, mean that all forms of fraud are seen as unacceptable. <p>Therefore we do not consider this to be a significant risk for Highland Council Pension Fund</p>
<p>Management override of controls</p> <p>Under ISA (UK&I) 240 there is a presumed risk that management over-ride of controls is present in all entities (fraud risk).</p> <p>Work undertaken:</p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> • review of accounting estimates, judgments and decisions made by management; • review of journal entry process and selection of unusual journal entries for testing back to supporting documentation; and • review of unusual significant transactions. 	<p>Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues.</p> <p>The highest value journals posted by the fund relate to investment transactions. We reviewed all journals over our performance materiality of £11.472 million and are satisfied that they were all in the ordinary course of business. We have also used our audit software, IDEA, to evaluate all journals posted in year and have not identified any unusual entries.</p>

Audit plan identified risk and work completed	Our conclusion
<p>Level 3 Investments (Valuation is incorrect)</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>Work undertaken:</p> <p>We have updated our understanding of your process for valuing Level 3 investments through discussions with relevant personnel from the Pension Fund during the interim audit.</p> <p>We have performed walkthrough tests of the controls identified in the process.</p> <p>We have tested valuations by obtaining and reviewing the audited accounts at latest date for individual investments and agreed these to the fund manager reports at that date. In addition reconciling those values to the values at 31st march with reference to known movements in the intervening period.</p> <p>Reviewed the qualification of the fund managers as experts to value the level 3 investments at year end and gained an understanding of how the valuation of these investments has been reached.</p> <p>Reviewed the nature and basis of estimated values and considered what assurance management has over the year end valuations provided for these types of investments.</p> <p>Reviewed the competence, expertise and objectivity of management experts used.</p>	<p>The funds net assets include level 3 investments valued at £278.7 million at 31st March 2017. This is up from £258.1 million as at 31st March 2016. This increase reflects continued fundraising in Private Equity. These investments also include the funds Unit Trust (property) and Property Debt investments</p> <p>During our interim audit we performed a walkthrough of the controls around the valuation of these investments and confirmed the controls were designed as expected.</p> <p>Post year end we obtained valuations from the fund managers and custodian and confirmed that these were consistent with the valuations included in the account. We reviewed the valuations provided, including audited fund accounts, and confirmed the nature and basis of estimated values were reasonable. We also confirmed that the investment managers were suitably qualified and independent to provide valuations.</p>

Audit plan identified risk and work completed	Our conclusion
<p>Investment income</p> <ul style="list-style-type: none"> Investment activity not valid. Investment income not accurate. (Accuracy) <p>Work undertaken:</p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> We have reviewed the reconciliation of information provided by the fund managers, the custodian and the Pension Fund's own records and sought explanations for variances Completed a walkthrough of the controls and procedures around investment income. 	<p>Investment Income recognised in the Pension Fund account was £31.144 million in the 2016/17 compared to £28.375 million in 2015/16. The increase is consistent with the growth of the funds investment assets, with increased market value meaning higher dividends.</p> <p>We have carried out a walkthrough of the controls around the recognition of investment income and confirmed that income recognised is consistent with both custodian and investment manager records.</p> <p>Our audit work has not identified any issues in relation to Investment Income.</p>
<p>Investment purchases and sales</p> <p>Investment activity not valid. Investment valuation not correct</p> <p>Work undertaken:</p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> Gained an understanding of the processes for investment sales and purchases through discussions with relevant personnel from the Pension Scheme; Performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding; and Reviewed the reconciliation of information provided by the Scheme managers, the custodian and the Pension Scheme's own records and sought explanations for variances. 	<p>Investment Purchases were £713.04 million and Investment Sales were £710.71 million in 2016/17 compared to £224.9 million and £198.4 million in 2015/16. This increase reflects increased activity in volatile markets during 2016/17.</p> <p>We have carried out a walkthrough of the controls around the recording of purchases and sales and confirmed that the reported purchases and sales in note 13.1 are consistent with custodian and fund manager records.</p> <p>Our audit work has not identified any issues in relation to Investment Purchases and Sales</p>
<p>Investment values – Level 2 investments</p> <p>Valuation is incorrect. (Valuation)</p> <p>Work undertaken:</p> <p>We have undertaken the following work in relation to this risk:</p> <p>gained an understanding of the process for valuing level 2 investments through discussions with relevant personnel from the Pension Scheme;</p> <p>performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding;</p> <p>we have reviewed the reconciliation of information provided by the Scheme managers, the custodian and the Pension Scheme's own records and sought explanations for variances;</p>	<p>Level 2 investments disclosed in the accounts are £13.04 million compared to £10.94 million as at 31/3/16. These investments are the funds Unit Trust (equities) holding.</p> <p>During our interim audit we performed a walkthrough of the controls around the valuation of these investments and confirmed the controls were designed as expected.</p> <p>Post year end we obtained valuations from the fund manager and custodian and confirmed that these were consistent with the valuations included in the account.</p> <p>Our audit work has not identified any issues in relation to the valuation of level 2 investments.</p>

Audit plan identified risk and work completed	Our conclusion
<p>Contributions Recorded contributions not correct. (Occurrence)</p> <p>Work undertaken: We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> gained an understanding of the process for contributions through discussions with relevant personnel from the Pension Scheme; performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding; controls testing over occurrence, completeness and accuracy of contributions; and rationalised contributions received with reference to changes in member body payrolls and numbers of contributing pensioners and ensured that any unexpected trends were satisfactorily explained. 	<p>Contributions recognised in the Pension Fund account were £57.3 million compared to £55.23 million in 2015/16. We have reviewed this movement and are satisfied that it is consistent with changes in contribution rates and the number of active members of the pension fund.</p> <p>We have carried out a walkthrough and tested the controls around the collection of contribution from The Highland Council, Scheduled and Admitted Bodies and are satisfied that the controls are operating effectively.</p> <p>Our audit work has not identified any issues in relation to contributions.</p>
<p>Member data Member data not correct. (Rights and Obligations)</p> <p>Work undertaken: We have undertaken the following work in relation to this risk;</p> <ul style="list-style-type: none"> gained an understanding of the process for member data administration through discussions with relevant personnel from the Pension Fund; performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding, controls testing over annual verifications with individual members, and sample tested changes to member data made during the year to source documentation. 	<p>Member numbers are disclosed in Note 8 to the accounts. We have agreed this disclosure to reports from the Pension Fund member data system.</p> <p>To gain assurance over the accuracy of member data held by the fund we have carried out a walkthrough and controls testing of the annual benefit statement process.</p> <p>We have carried out sample testing of 25 changes to member data, ensuring the change to the member data system were consistent with source documentation.</p> <p>Our audit work has not identified any issues in relation to Member Data.</p>
<p>Benefits payable Benefits improperly computed/claims liability understated. (Completeness, accuracy and occurrence)</p> <p>Work undertaken: We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> gained an understanding of the process for benefits payable through discussions with relevant personnel from the Pension Fund; performed a walkthrough to gain assurance that the in-year controls were operating in accordance with our documented understanding; performed controls testing over, completeness, accuracy and occurrence of benefit payments; tested a sample of individual pensions in payment by reference to member files; and rationalised pensions paid with reference to changes in pensioner numbers and increases applied in the year and ensured that any unusual trends were satisfactorily explained. 	<p>Benefits Payable recognised in the Pension Fund account were £56.9 million compared to £51.6 million in 2015/16. We have reviewed this movement and are satisfied that it is consistent with changes in pensioner numbers.</p> <p>We have completed a walkthrough and tested the controls around the calculation of new pensions and the authorisation of the pensioner payroll. We are satisfied that these controls are operating effectively.</p> <p>We have re-performed the calculation of 25 new pensions and lump sums and in all cases agreed that the calculation was accurate.</p> <p>Our audit work has not identified any issues in relation to Benefits payable.</p>

The narrative elements of your annual report and accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding of the Highland Pension Fund and the financial information set out in the accounts and have set out our observations below. We have considered your report in comparison to the Local Authority Accounting Code of Practice 2016/17 and the model LGPS accounts.

Management Commentary

- We have confirmed that the information given in the Management Commentary is consistent with the financial statements.
- The Management Commentary has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003.
- Key issues and risks are well articulated and reflect the risks around: changes to LGPS regulations, investment performance, funding and people.
- The commentary is consistent with our understanding of the Fund and publically available information

Annual Governance Statement

- We have confirmed that the information given in the Annual Governance Statement is consistent with the financial statements.
- The Annual Governance Statement has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).
- It presents a good overview of the key governance arrangements in place within the Fund, including the Local Code of Corporate Governance, arrangements for internal audit, and review of investment manager and custodian control procedures.
- Some minor amendments were made to the annual governance statement following audit. To improve readability and the nature of the disclosures.

Governance Compliance Statement

- We have confirmed that the information given in the Governance Compliance Statement is consistent with the financial statements.
- The Governance Compliance Statement has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2014.
- The statement provides an overview of key governance arrangements.
- The statement is consistent with our understanding of the fund and publically available information.



Judgements and estimates

We consider other aspects of your annual report and accounts, in particular key areas of judgement. We have summarised below our observations in these key areas:

Accounting Policies

- The Accounting policies and notes to the accounts are set out on page 37 of the accounts. These are consistent with prior year and in accordance with the Code of Practice on Local Authority Accounting in the UK 2016/17, which is based on International Reporting Standards (IFRS) as amended for the UK Public Sector.
- Following audit, accounting policies were added for Contingent Assets, Income from stock lending and Prior Year Adjustments.

Accounting estimates and judgements

- The Pension Fund's actuary, Hymans Roberston, undertakes a valuation of the Pension Fund liabilities on an IAS19 basis each year. This valuation is based on financial assumptions which include pensions increase rate, salary increase rate and discount rate. As at 31 March 2017 the Present Value of Promised Retirement Benefits was estimated to be £2,471,000,000. Our audit work has confirmed that the assumptions used by the actuary were reasonable and that they were provided with accurate membership information by Highland Council Pension Fund to support their calculation.
- The valuation of the fund's private equity and property debt investments rely on estimates made by the fund managers. We have confirmed that the fund managers are suitably qualified to make these estimates and that the valuations included in the accounts are consistent with fund manager and custodian records.

Going Concern

- The Director of Finance has a reasonable expectation that the services provided by the Fund will continue for the next 12 months from the date of signing, and this assessment is reflected in the accounts. We are not aware of any forthcoming pensions legislation which would impact on the fund and its ability to continue as a going concern.

Timing of transactions and period in which they are recorded (Cut off assertion)

- Through our substantive audit testing we did not identify any concerns over timing of transactions or the period in which they were recorded.

Impact on the financial statements of any uncertainties

- No uncertainties have been identified which have an impact on the final annual report and accounts and a number of areas of risk have been identified and analysed by Officers within the annual report.

Overview of the Highland Council Pension Fund's arrangements



Financial Performance for 2016/17

Fund Account

There was an increase in Net assets available for benefits during the year of £295,634,000. This was driven by growth of the Fund's investments with a return of 20.4% for the year against its customised benchmark of 20.9%.

Contributions into the fund increased by £2,064,000 during the year, with employer contributions going up as a result of increased contribution rates following the 2014 Valuation and employee contributions falling slightly as a result of member retirements.

Benefits payable increased by £5,328,000, driven by the Council's voluntary retirement programme.

Investment income and Management Expenses also increased in year which is consistent with the growth in investments.

Two prior period adjustments were made by the fund. Management Expenses were restated by (£1,348,000) so that only direct management expenses were disclosed, in line with the revised CIPFA guidance. Investment Income was restated by £465,000 to disclose fee rebates as income rather than as a management expense.

Net Assets Statement

The Fund's global and UK equities have performed well in volatile markets. The fund's net assets included £92.613 million, of quoted equities lent out as part of the stock lending arrangements as at 31 March 2017 compared to nil as at 31 March 2016.

Unitised Insurance Policies bonds and Unit Trust OEIC equities and bonds have also performed reasonably in good market conditions, whilst the funds unit trust property has performed in line with benchmark. The fund's investment in venture capital and partnerships has continued to increase in year, with an increase in Private Equity investments of £20.202 million.

Valuation of pension fund liabilities

The Pension Fund's actuary, Hymans Roberston, undertakes a valuation of the Pension Fund liabilities on an IAS19 basis each year. This uses the same base data as the actuarial funding valuation, taking account of changes in membership numbers. This valuation is based on financial assumptions which include pensions increase rate, salary increase rate and discount rate.

As at 31 March 2017 the Present Value of Promised Retirement Benefits was estimated to be £2,471,000,000. Taken with the funds net assets of £1,764,903,000, this gives a liability of £706,097,000.

Our audit work has confirmed that the assumptions used by the actuary were reasonable and that they were provided with accurate membership information by Highland Council Pension Fund to support the calculation. The next triennial actuarial funding valuation is due to take place in March 2017, and the results of this will be reflected in the 2017/18 Pension Fund accounts alongside any updated assumptions or benchmarks including employer contribution rates.

Funds investment strategy

Setting the Fund's investment strategy is critical to the Pension Fund alongside monitoring performance against the agreed strategy. The Investment strategy is complex and needs to take into account a number of variable factors including: overall fund deficit; cash flows from dealing with members; and the maturity of fund membership. The Pension Fund takes advice on its investment strategy from professional advisors.

Financial Management arrangements

The Director of Finance (Section 95) officer is responsible for overseeing the Pension Fund arrangements and signing the annual report and accounts. The Director of Finance attends the meetings of the Pension Committee along with the relevant officers who routinely report to the committee on the arrangements and performance of the Fund.

The financial regulations of Highland Council, as the administering authority, apply to the Pension Fund. These are reviewed regularly to ensure they still remain appropriate and are easily accessible on the Highland Council website.

Financial sustainability

The pension fund gives its members a guarantee that in exchange for contributions during their employment, the pension fund will pay a pension until the end of each member's life. There is a timing difference of many years between the receipt of contributions and the payments of pensions. The pension fund needs to maintain capacity to meet current and future needs of its members, despite changes over time in investment performance and demographics (life expectancy).

The pension fund is a multi-employer fund with 12 scheduled bodies and 20 admitted bodies. Given the public sector nature of these employers the funding risk associated with default is viewed as relatively low by the Pension Fund and the fund plans to recoup deficits over a twenty year period for most employers.

The local government pension scheme (LGPS) includes a cost sharing arrangement which will cap employer costs in relation to current service and helps ensure that the scheme remains affordable for employers. The retirement age for most LGPS members is linked to the state retirement age, which is increasing, which may also act to limit scheme liabilities for active members.

Investment performance

Investment performance is measured through the analysis of returns achieved by the pension fund's seven external fund managers. The managers performance, in terms of achieving benchmarks, is subject to independent verification by the appointed advisors and managed through the investment mandates held by the specialist fund managers. Performance against agreed benchmarks is reviewed quarterly by the Council's finance team and reported to the Investment Sub-Committee. In the financial year the pension fund achieved a return on investments of 20.4% against the customised benchmark of 20.9%. Resulting in a small underperformance of the fund, but given the general economy and market conditions this is considered a good outcome for 2016/17.

Risk management

A risk register is maintained and reported regularly to the Pensions Committee. This risk register is publicly available on-line and reflects the strategic risks facing the pension fund over the medium to longer term. Alongside identified risks is the mitigating controls and actions in place to manage the risk, where this is in the direct control of the pension fund. Risks identified include:

1. Ongoing risk of members and officers being unaware of changes to the LGPS governance, administration and investment matters
2. If the investment strategy is inconsistent with funding plans it can lead to setting inaccurate employer contribution rates
3. Volatility in markets created by events such as Brexit could adversely impact returns leading to increasing deficits and additional costs.

Governance overview

The main legislation directing the governance requirements of the fund is the Local Government Pension Scheme (Governance) Scotland Regulations 2015. For the Highland Council Pension Fund governance is undertaken by a Pensions Committee and Pensions Board (who meet together at the same time). The remit of this Committee includes the appointment and monitoring of investment managers, which is delegated to the Pensions Investment Sub-Committee.

The Council has adopted a Local Code of Corporate Governance which is consistent with the principles of the CIPFA/SOLACE framework “Delivering good governance in Local Government”. This code applies to the pension fund. In addition, the fund has a separate Governance Policy Statement which was approved by the Pensions Committee in September 2016.

The Pensions Committee meets twice during the year but can hold special meetings during the year should reason arise. This is not in line with the recommended practices, which suggest quarterly. See action point 2. All pension fund committees are recorded and made available on the Council website alongside all minutes and supporting papers. We found this information to be clearly signposted and accessible to members of the public.

Appendices

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Audit adjustments

Set out below is a summary of uncorrected and corrected misstatements.

Uncorrected misstatements

There is one misstatement we identified during the course of our audit which has not been corrected by Officers.

The valuation in the financial statements for one of the funds investment managers (Partners Group) was understated by £2.903 million, as the actual 31 March 2017 valuations had not been used. An estimate had been used by the custodian for the 31 March 2017 position, using known cash movements. It is usual practice for certain types of investment to have longer lead times in the reporting to the Fund and Custodian. More up to date information was available before the accounts were authorised for issue but this was after the Custodians deadline for accounting, so was not reflected in the accounts. Officers have not corrected this, as is considered not material to the accounts and would result in a number of other statements and notes to be updated.

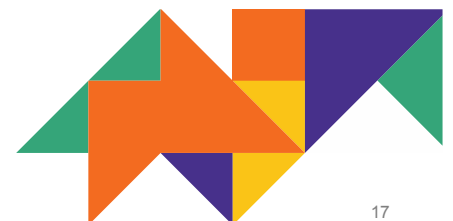
Corrected misstatements

There was one corrected misstatement which has been reflected in the final audited annual report and accounts:

	Pension Fund Account	Net Asset Statement	Impact on total net assets
	£000	£000	£000
Management expenses			
Management Expenses in the draft accounts included transaction costs for a trade that was cancelled. An adjustment was required to credit management expenses £315,000 and debit Profit and losses on disposal of investments and changes in values of investments by £315,000. This adjustment had no impact on the total net assets of the fund. This adjustment also impacted Note 13.1 Reconciliation of Movements in Investments and Derivatives and Note 11 Management Expenses	(315)		
Management Expenses Profit and losses on disposal of investments and changes in values of investments	315		

Disclosure misstatements

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow audit committees to evaluate the impact of these matters on the financial statements. During the course of our audit process we identified some disclosure enhancements throughout the annual report and accounts, predominantly to bring the accounts in line with the CIPFA good practice note. The key disclosure changes are set out overleaf and all have been amended in the final version of the accounts.



Summary of disclosure amendments

Account balance	Impact on financial statements
Description of the fund	Information previously disclosed in the Annual Report (Management Commentary) has been moved to Note 1 Description of the Fund to ensure the financial statements include all of the required disclosures.
Accounting policies	The draft accounts did not include accounting policies for contingent assets, income from stock lending and prior year adjustments. These accounting policies have been added to the audited accounts.
Fair Value disclosures	<p>The CIPFA Code of Practice 2016/17 included a number of new requirements, resulting from IFRS13 disclosure requirements. A number of disclosure changes have been made relating to these requirements:</p> <ul style="list-style-type: none"> - The draft accounts did not include a Reconciliation of Fair Value Measurements within Level 3 Investments. This note has been added to Note 14.4 in the audited accounts - In the draft accounts the Fair Value Hierarchy disclosure had only been provided by categorisation i.e. assets/liabilities held at fair value. As different risks may be expected for the different types of investment, this has been further disaggregated in note 14.3 of the audited accounts. - In the draft accounts “Pooled Investments- property fund which are not listed” were categorised as level 2 investments in Note 13.1 and the 31/3/16 table in Note 13.2. Note 14.1 and Note 14.3 in the audited accounts show Pooled Investments- property funds as level 3 investments consistently. - In Note 14.1, the basis of valuation of “Unquoted Commercial real estate” has been updated to clarify that this has been valued at Fair Value. - The Currency risk- sensitivity analysis in note 16 has been updated in the audited account to show a sensitivity analysis for the different foreign currencies held by the fund.
Critical judgements	Note 5 “Critical Judgements” has been updated to include judgements in relation to unquoted private equity instruments and unquoted property debt instruments.
Assumptions made about the future	Note 6 “Assumptions Made About the Future and Other Major Sources of Estimation Uncertainty” has been updated to include a sensitivity analysis for Private Equity and Property Debt.
Stock lending	Disclosure added to note 13.6 “Stock Lending” to clarify the amount of income recognised in respect of stock lending.
Actuarial present value of promised retirement benefits	Note 17 did not disclose the net assets of the fund. It has been updated to show the relationship between Net Assets and the Present Value of Promised Retirement Benefits.
Payments to and account of leavers	Note 10 did not include Individual Transfers £822,000. This has been updated.
Unit Trust Property	In Note 13.2 Unit Trust Property was classified as an unquoted investment in 2016/17 but quoted in 2015/16. In the audited accounts Unit Trust Property is shown as unquoted in 2016/17 and 2015/16.
Financial instruments	The value of Fidelity Unit Trust bonds in the Interest rate risk disclosure in Note 16 was understated by £328,000. This has been corrected.

Action Plan for 2016/17

During the course of our 2016/17 audit work we have identified the following actions for management., which we will follow up during our 2017/18 external audit.

	Area	Issue & Risk	Priority	Recommendation
1	Fund Valuation	The valuation in the financial statements for one of the funds investment managers (Partners Group) was understated by £2.903 million, as the actual 31 March 2017 valuations had not been used. An estimate had been used by the custodian for the 31 March 2017 position, using known cash movements. It is usual practice for certain types of investment to have longer lead times in the reporting to the Fund and Custodian. More up to date information was available before the accounts were authorised for issue but this was after the Custodians deadline for accounting, so was not reflected in the accounts.	Low	<p>Review the actual 31 March position for any investment manager portfolios where the 31 March position is estimated to reflect any updated material information available prior to the authorised for issue date.</p> <p>Action owner: Finance Manager</p> <p>Timetable: June 2018</p>
2	Meeting frequency	The only area where the Fund does not currently comply with the best practice arrangements set out in the Governance compliance statement is in relation to meeting frequency. The best practice guidance suggests quarterly but the Pensions Committee and Board currently only meet half yearly. Based on our attendance at these meetings and review of matters presented we agree that half yearly is sufficient to deal with the business arising currently	Low	<p>As set out in the governance structure special meetings can be held if required, and therefore Officers and Committee members should continue to review arrangements and make use of this should it be required during the year.</p> <p>Action owner: Finance Manager</p> <p>Timetable: throughout the year in accordance with the guidance and to revisit at end of the year. June 2018</p>

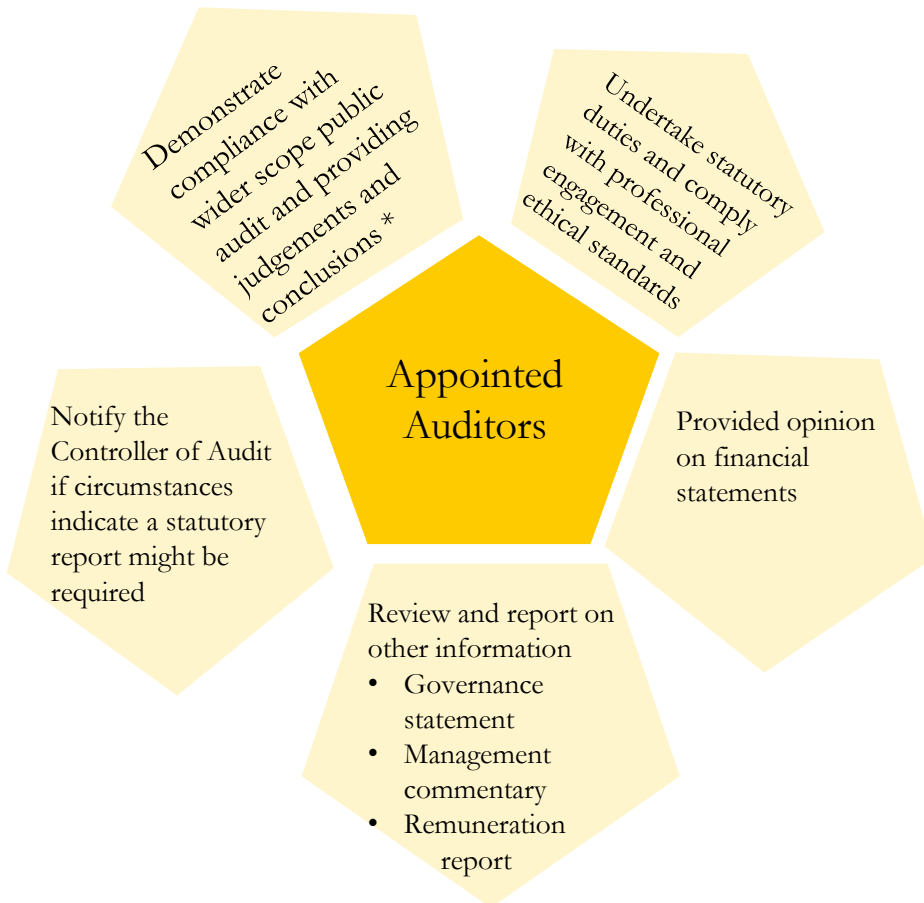
Follow up of 2015/16 external audit recommendations

In 2015/16 Audit Scotland (the Council’s previous external auditors), made the following recommendation which has been actioned by the fund.

	Area	Issue & Risk Previously Communicated	Update on Actions taken to address the issue
1	Intercompany Reconciliation	<p>The intercompany accounts reconciliation was not kept up to date during 2015/16 and identified differences were not fully investigated until after the accounts had been submitted for audit. The nature of the transactions making up the unexplained difference reinforces the importance of keeping these reconciliations up to date and promptly investigating all unexplained differences.</p> <p>Risk</p> <p>Transactions between the pension fund and the council are not correctly disclosed in their respective financial statements or bank accounts.</p> <p>Recommendation</p> <p>The intercompany accounts should be reconciled on a monthly basis. Differences should be promptly investigated and appropriate correcting entries processed.</p>	<p>In 2016/17 Intercompany reconciliations have been carried out regularly. Pension Fund costs are compared to budget and reported to Committee via the Pensions Admin report.</p> <p>Action closed</p>

Reminder of Responsibilities

The Code of Audit Practice sets out responsibilities of the audited body (pages 10, 11 and 12) across: Corporate governance; financial statements and related reports; standards of conduct for prevention and detection of fraud and error; financial position; and value for money (as described in the Scottish Public Finance Manual). As appointed auditors our responsibilities are set out on page 13 and are summarised below.



An audit of the financial statements is not designed identify all matters that may be relevant to those charged with governance. Weaknesses or risks are only those that have come to our attention during our normal audit work in accordance with ISA's and the Code and may not be all that exist

Communication of the matters arising from our audit work does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control

** Our audit of the Highland Council Pension Fund was undertaken under the smaller body exemption in the Code of Audit Practice. However, we have still considered the performance and accountability reports in the annual report and accounts; considered going concern and financial sustainability and included relevant commentary in this report to support the Pension Fund arrangements going forward.*





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