Highland Council Pension Fund

External Audit Annual Report to the Pensions Committee and the Controller of Audit for the financial year ended 31 March 2019

30 September 2019

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Engagement Leader

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Our audit at a glance

We have fulfilled our responsibilities per International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice throughout our work and this final report to the Pensions Committee and the Controller of Audit.

Materiality was updated to reflect the draft 2018/19 financial statements. Materiality is set at 1% of net assets (£19.9 million). We did not identify any adjustments to the draft financial statements based on our work.

Significant audit risks were: management override of controls; risk of fraud in revenue recognition; and the valuation of Level 3 investments. Our risk assessment remained unchanged and we did not identify any adjustments in these three areas in our work.

An audit underpinned by quality

A wider scope audit for the Pension Fund, as set out in our plan, was considered not appropriate. However, we have considered certain aspects of your financial sustainability and governance arrangements. We have raised one recommendation around consideration of future pension fund liabilities in the next triennial valuation. Further details in appendix 1.

Our work was undertaken in accordance with our agreed timetable. The draft financial statements produced by Officer were of a good standard with complete information and good supporting working papers. There was one unadjusted difference to the accounts relating to investment valuations due to a timing issue in receiving valuation reports. We thank management for their support and assistance during our work

Contents

Introduction

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2019.

Our work has been undertaken in accordance with International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016.

Our report is addressed to the Pensions Committee. In addition, in accordance with our reporting responsibilities the report is jointly addressed to the Controller of Audit.

Once finalised this report will be made publically available on the Audit Scotland website (www.audit-scotland.gov.uk)

Our report was presented as a draft to the Pensions Committee on 8 August 2019. Following the accounts being signed for by the Chief Finance Officer on behalf of the Highland Council Pension Fund, our report was finalised.

We would like to thank management and the finance team for an effective year-end audit process and all their support and assistance in the audit process.

Structure of this report

As set out in our Audit Plan (February 2019) we do not consider a full wider audit scope is appropriate to the Highland Council Pension Fund ("the Pension Fund"). However, in accordance with the Code of Audit Practice, we consider the Pension Fund's annual governance statement and financial sustainability. Our report concludes on our financial statements audit and certain aspects of the Pension Fund's arrangements as follows:

Financial statements – Section 2 and Appendix 1

Financial sustainability and governance statement – Section 2

Our Opinion

For the financial year ended 31 March 2019 we have issued an **unqualified** audit opinion on the financial statements and that:

- These have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2018/19 code
- These have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003
- Other information in the annual report including Annual Governance Statement
- Other prescribed matters

Basis of preparation

The Pension Funds' financial statements are prepared in accordance with the 2018/19 CIPFA Code of Practice on Local Authority Accounting ('the 2018/19 Code'). The 2018/19 Code introduced a number of changes including the adoption of new International Financial Reporting Standards (IFRS). However, the introduction of these standards and other changes within the 2018/19 Code did not have a material impact on the financial statements

The audit process

We received a complete set of financial statements in line with the agreed audit timetable, including the Management Commentary, Governance Statement and Governance Compliance Statement.

We identified no changes to the primary financial statement balances and have identified one unadjusted difference relating to investment valuations to report to the Pension Committee (Appendix 2). We identified disclosure enhancements and these have been reflected in the financial statements.

Financial statements audit

Audit approach and materiality

Our audit approach was set out in our annual audit plan presented to the Pensions Committee on 19 February 2019. As set out in our plan, our materiality calculations were based on the audited 2017/18 financial statements. We have updated our materiality assessment to reflect the Pension Fund's draft 2018/19 financial statements. Using net assets as our benchmark, overall materiality has been set at £19.99 million (1% of net assets) and performance materiality is set at £14.99 million (75% of materiality). Our materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. We report to management any audit difference identified over £250,000 (Set at Audit Scotland planning guidance maximum threshold for this balance).

The draft financial statements were of a good standard supported through detailed working papers. The audit process went well this year with our work completed in a timely manner.

Audit opinion

Based on our audit procedures performed we have issued an unqualified audit opinion on the financial statements including:

- give a true and fair view in accordance with applicable law and the 2018/19 of Practice on Local Authority Accounting in the United Kingdom 2018/19 (the 2018/19 Code). of the financial transactions of the fund during the year ended 31 March 2019 and of the amount and disposition at that date of its assets and liabilities;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2018/19 Code;
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.
- the wider information contained in the financial statements, e.g. Management Commentary, Annual Governance Statement and Governance Compliance Statement are consistent with the financial statements and have been prepared in accordance with applicable guidance.

Internal control environment

During the year we sought to understand the Authority overall control environment (design) as related to the financial statements. In particular we have:

- Sought to understand procedures and controls around related parties, journal entries and other key entity level controls
- Performed procedures around entity level controls and there are no significant matters that we wish to draw to your attention.
- Performed walkthrough procedures on key controls around identified risk areas including revenue as well as Level 3 investments

No material weaknesses in the accounting and internal control systems were identified based on our work undertaken during the audit which could have an adverse impact on the Authority's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. We adopted a substantive based approach to the audit of the financial statements and therefore our review is limited to the design of controls rather than the operating effectiveness of these.

Internal Audit

As set out in our external audit plan we have not placed formal reliance on the work of the in-house Highland Council Internal Audit Service, the Authority's internal audit provider. We reviewed the internal audit reporting to the Pension Committee during the year, to consider if any impact on our audit approach. No issues were noted that would impact on our overall audit approach or audit conclusions.

Identified audit risks and our conclusions

Within our annual external audit plan we identified significant audit risks and our planned approach. We have set out below a summary of the work undertaken over these risks and our audit conclusions

	Identified audit risk at planning	Work completed	Our conclusion
Risk of fraud in revenue	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. Furthermore, for public entities, Practice Note 10 extends this presumed risk to fraud around expenditure manipulation. For Investment income, we agree movements in the year to external third party verification through our testing of underlying investments and Fund Manager confirmations. Therefore, we do not consider risk of fraud in revenue recognition to represent a significant risk. Likewise for expenditure, operating expenses are not material in value and therefore do not represent a material risk of misstatement. Benefits paid to pensioners from the scheme are well forecasts based on pensioner numbers and consistent year on year. Other benefits paid are not material and therefore limited opportunity for manipulation. For contributions receivable from employees and employers. While contributions are well forecast there is an inherent risk around material misstatement through improper revenue recognition. We therefore attach the significant risk over revenue recognition to contributions receivable.	• We agreed monthly normal contribution totals to payroll reports and checked to the Pension Fund bank statements, to test they have been received by the Pension Fund. • A sample of defined contribution section members' normal contributions agreed to evidence that monies have been received by the investment manager in a timely manner and correctly allocated. Where material admitted/ scheduled bodies contributions agreed to third party confirmations. • The deficit funding contributions received were compared to those expected, and timing of receipt due, under the requirements set out in the Statement of contributions • Monthly contributions were compared to expectations based upon the prior year taking into account any amendments to the contributions agreed, average pay rises and the impact of membership movements using analytical review procedures • We reviewed the outstanding contributions receivable as at the balance sheet date and test the recoverability of amounts receivable post year end.	From our audit procedures performed we are satisfied that revenue is free from material misstatement. We are satisfied that revenue has been recognised in the appropriate financial year.
Management override of controls	As set out in ISA 240, across all entities there is a presumed risk of fraud being perpetrated by management through its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. override of controls is present in all entities.	• We gained an understanding of the accounting estimates, judgements applied and decisions made by management and consider their reasonableness • We obtained a full listing of journal entries and identified and tested unusual journal entries or those initiated by members of senior management for appropriateness • We considered the rationale for any changes in accounting policies or significant unusual transactions. No issues noted.	We did not identify any significant areas of bias in key judgements by management. We have not identified any unusual or significant transactions during the course of the year that would indicate management manipulation.

Valuation of Investments are incorrect	Identified audit risk at planning	Work completed	Our conclusion
	Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Investments held by the Fund are subject to market price fluctuations and a degree of estimation. Given the level of ongoing uncertainty surrounding the United Kingdom's withdrawal from the EU, there is a risk that investments in both UK and overseas investments could be subject to greater price volatility creating a risk of material misstatement at the year end.	• We gained an understanding of the Fund's process for valuing investments, in particular Level 3 investments with a greater degree of subjectivity and estimation, and evaluated the design of the associated controls • we reviewed the nature and basis of estimated values and considered what assurance management obtained over the year end valuations provided for Level 3 investments. • we considered the competence and expertise of the fund managers as experts to value investments at year end. We considered the suitability of the basis of the valuations at the year end. Through this process we also considered the impact of potential EU withdrawal on the investment values (we note that the deferral of the potential EU withdrawal reduced the potential risk as at 31 March). • To gain assurance over carrying values, for a sample of investments, we agreed the value to appropriate supporting information including observable market data, quoted prices and/or financial statements (level 3 investment where applicable). We agreed investment values to third party fund management investment statements as well as independent custodian valuation reports.	From our audit procedures performed we are satisfied that Level 3 investments are free from material misstatement in the financial statements. As at 31 March, the Pension Fund held investments of £341 million (2017/18: £323 million) in Level 3 investments, primarily through property and private equity investments.

Going concern

The Head of Corporate Finance and Commercialism of Highland Council as Chief Finance Officer for the Pension Fund 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.

At its last actuarial valuation the Fund was assessed as 101% funded, with a surplus of £13 million. As at 31 March 2019, the Pension Fund had net assets of £1.999 billion and we are not aware of any of any forthcoming pensions legislation which would impact on the Fund and its ability to continue as a going concern.

Narrative elements of your annual 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 Pension Fund and the financial statements and have set out our observations below.

Management Commentary

The information contained within the Management Commentary is consistent with the financial statements.

Key issues and risk are well articulated within the report as well as fund performance for the year.

The Management Commentary has been prepared in accordance with the statutory guidance issued under the Local Government in Scotland Act 2003.

Overall observations

The 'front end' of the accounts provides details on the overall fund performance during the year and key areas of focus looking forward.

The front incorporates the requirements and guidance continued within statute including; The Local Government in Scotland Act 2003, and Delivering Good Governance in Local Government Framework 2016.

Annual Report and accounts

Annual Governance Statement

The information contained within the Annual Governance Statement is consistent with the financial statements.

The statement has been prepared in accordance with the *Delivering Good Governance in Local Government*: Framework (2016).

Governance Compliance Statement

The information given in the Governance Compliance Statement for the year ended 31 March 2019 is consistent with the financial statements.

The statement has been prepared in accordance with the Local Government Pension Scheme (Scotland) Regulations 2018.

Adding value through our external audit work

Our overall objective is to ensure we deliver a quality external audit which fully complies with International Standards of Auditing (ISAs) UK and the Audit Scotland Code of Practice (2016). By ensuring our audit is efficient and effective, gives you assurance over our opinion.

Through this Annual Report we seek to provide insight and commentary over certain aspects of the Pension Fund's arrangements, sharing relevant practices with the Pensions Committee and Management.

In accordance with the Code of Audit Practice, where appropriate, we coordinate our audit work with other auditors working under the Audit Scotland auditing framework. During 2018/19 Audit Scotland developed a protocol for coordinating audit assurances between LGPS auditors and applicable admitted and scheduled body auditors. Under the protocol, auditors can seek additional fee from audited bodies to recover the costs associated with any additional work required to provide these assurances. During 2018/19, we have performed additional procedures to provide independent assurances to third party auditors who participate in the Highland Council Pension Fund, including Audit Scotland and Ernst & Young. We have not proposed an increase in our audit fee for this additional work and observed within our existing fee.

Our Annual External Audit Plan, presented to the Pensions Committee in February 2019, and this Annual Report, identified a number of wider areas of relevance to the Pension Fund, including changes to the CIPFA 2018/19 Accounting Code and our consideration of these.

Key aspects of your financial statements

As set out in our audit plan we consider particular aspects of your financial statements in relation to management judgements including estimates and where management may have particular options or choices in what accounting standards or disclosure requirements to apply. We have summarised where these apply, and our conclusions below.

The Pension Fund's accounting policies are in accordance with the Code of Practice on Local Authority Accounting in the UK 2018/19, which is based on International Financial Reporting Statements (IFRS) as amended for the UK Public Sector. and we consider these to be appropriate to the organisation and consistent with those adopted in prior years.

Accounting estimates and judgements

The Pension Fund's significant accounting estimates and judgement impacting on the annual accounts are the following:

- Actuarial valuation: The Pension Fund's actuary, Hymans Robertson, undertakes a valuation of the Pensions Fund liabilities on an IAS19 basis each year. This valuation is based on financial assumptions which include pension increase rate, salary increase rate and discount rate. As at 31 March 2019, the Present Value of Promised Retirements Benefits was estimated to be £2.501 billion (2018: £2.209 billion). This consists of £1.308 billion in respect of employee members, £398 million in respect of deferred pensioners and £795 million in respect of pensioners.

  In December 2018, the Court of Appeal ruled that the transitional protection offered to some members of public sector pension schemes as part of reforms to those schemes amounts to unlawful discrimination ("McCloud/Sargeant"). This ruling was subject to potential right to appeal from the UK Government, leading the Pension Fund to exclude any potential impact from the IAS 19 valuation included in the draft accounts. On 27 June 2019, the Supreme Court ruled that the government had not raised an arguable point of law, the court of appeal ruling was upheld. Consequently, given the increased certainty around future economic output arising from the ruling, the McCloud/Sargeant Case should be incorporated into the IAS 19 valuation.

  The Pension Fund's actuary has provided an estimation of the potential impact on the IAS 19 pension liabilities. The IAS 19 valuation of scheme liabilities is not within the primary statement but is a required disclosure. The IAS 19 disclosure within the draft accounts did not include provision for the impact of McCloud / Sargeant case on the Pension Fund. Given the developments of the case, Officers recognised that provision should be recognised in the draft accounts. Officers obtained a revised actuarial IAS 19 valuation and updated the accounts disclosure to include this provision.

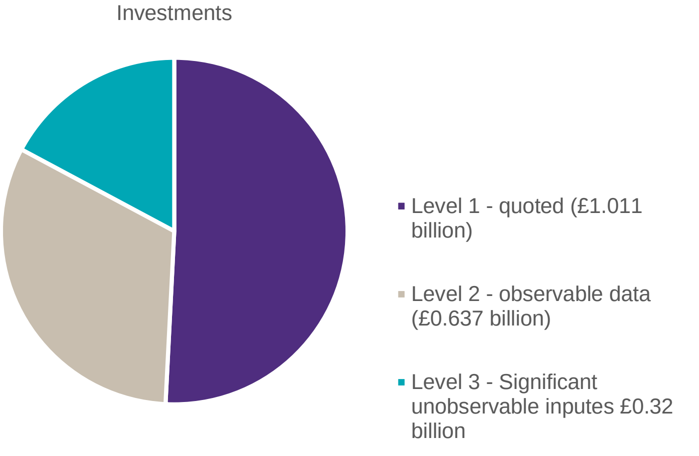
- Guaranteed Minimum Pension Review: In 2016, the Government announced that Public Sector Pension Schemes needed to review pension data which linked LGPS benefits to contracted-out employment and the State Pension. This is known as the Guaranteed Minimum Pension (GMP) data reconciliation review. The purpose of this review is to ensure that records held by the scheme and HMRC are correct. Where the data is incorrect then this could result in an overpayment or underpayment in pension. The treatment of overpayments has yet to be finalised by Scottish Ministers and the Pension Fund has therefore excluded any potential impact from the IAS 19 defined benefit pension calculation. The Pension Fund has considered the impact to be immaterial to the pension scheme as a whole, expected to be between 0.2% and 0.3% of scheme liabilities. We concur with Management's assessment and do not identify any material issues with the accounts. Looking forward, the Pension Fund should consider the potential impact of McCloud/Sargeant as well as GMP on scheme liabilities. This will be particularly important to incorporate as part of the 2020 triennial valuation to reflect scheme liabilities.

Action plan point 1

- Pension fund investments: As at 31 March 2019, the Pension Fund had investments of £1.99 billion. The Pension fund investments includes a range of different types of investment ranging from investments where there is publicly available market information (level 1) to unquoted private equity and property investments where there is limited publicly available price information.

The valuation of the Fund's private equity and property debt investments rely on estimates made by the fund managers. Within Level 3 investments, the Pension Fund holds private equity of £102 million. This relates to private equity investments which have been valued at fair value in accordance with the International Private Equity and Venture Capital Valuation Guidelines (2012). Given these are not publicly listed investments, Management require the Fund Manager to provide a reasonable estimate of the valuation in accordance with the Guidelines. We have reviewed the assumptions surrounding the investments and are satisfied that these are reasonable. We have also validated the valuation in the accounts to fund manager and custodian valuations to provide further assurance over the valuation.

The Pension Fund also holds £55 million of property debt. This is unquoted holdings in property debt (commercial real estate) as well as £184 million in unit trust property. Management, through consolidation with Investment Fund Managers, determine the fair value of these investments, using best available information. While recognising there is a degree of estimation within the carrying value, we are satisfied that the approach adopted by management is reasonable and that the carrying value of investments is free from material misstatement.



Developments to the Pension Fun and changes in regulation and legislation during 2018/19

As noted in our external audit plan, as part of our audit we follow up on key material developments in the Pension Fund during the year, including changes in applicable regulation and legislation.

Development	Impact on the audit approach
Financial position and funding As at 31 March 2018, the Pension Fund had net assets of £1.883 billion. The last triennial valuation of the fund reflected the position of the fund as at 31 March 2017 which estimated the fund was 101% funded, i.e. the assets of the scheme were sufficient to meet 101% of estimated liabilities. As employees benefits are guaranteed by the LGPS Regulations, and that these regulations define the level of employees' contributions at a fixed level, it is essential that pension funds have clearly defined investment and funding strategies to define how future obligations will be met. An important aspect of this is that all participants and admitted bodies meet their contributions as planned. At the time of planning we are not aware of any events that would impact on the ongoing contributions to the scheme or appropriateness of rates set. However, it is important that the Pension Fund continue to scrutinise the suitability of investment and funding strategies.	• We considered whether the Pension fund's financial position leads to uncertainty about the going concern assumption and will review related disclosures in the accounts • We reviewed the arrangements in place for monitoring the overall financial position of the fund and suitability of investment and funding strategies. • As part of our audit testing, we reviewed contributions received against expectation to ensure these are in line with expectation and obtain an explanation for any indication of admitted bodies not providing sufficient funding.
Conclusion We have considered the Pension Fund's financial position and are satisfied that there is no significant uncertainty about the entity's ability to continue to operate as a going concern. The Pension Fund's performance is monitored throughout the year by the highland Council Management team, as administering authority and through the Pensions Committee. This includes monitoring of overall investment and fund performance. Our audit testing has not identified any discrepancies between the contributions received to the scheme from admitted and scheduled bodies that would indicate they were not providing sufficient funding to the pension fund.	
Changes to the CIPFA 2018/19 Accounting Code CIPFA have introduced changes to the 2018/19 Code. The main change for 2018/19 is the adoption of International Financial Reporting Standard (IFRS) 9: Financial Instruments. In accordance with IFRS 9, marketable securities should be measured by the current bid price, superseding the provisions of IAS 26 which provide an option to carry securities with a fixed redemption value based on the redemption value assuming a constant rate to maturity. The Code also introduced IFRS 15, Revenue from Contracts with customers. We do not anticipate wither standard to have a material impact on the Pension Fund.	• We reviewed the draft financial statements disclosure to ensure in line with 2018/19 Code. • We reviewed Officer's assessment of the impact of IFRS 9 and IFRS 15 on the financial statements and review disclosures included within the financial statements.
Conclusion We have reviewed the draft financial statements against the disclosure requirements of the 2018/19 Accounting Code and are satisfied that the draft accounts have been prepared in accordance with the Code and applicable guidance. We have considered Officer's assessment of the impact of IFRS 9 and IFRS 15 and are satisfied that there is no material impact on the financial statements.	

Financial sustainability and governance

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 17 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 Pension fund's overall membership profile continues to change. Over the last five years the percentage of contributing members has fallen from 43% in 2014/15 to 39% in 2018/19. With employee contributions set within regulation, this puts additional strain on returns on investments and employer contributions to support pension payments.

The last full triennial valuation was undertaken as at 31 March 2017, which estimated the Pension Fund as being 101% funded. Following the actuarial valuation, the Pension Fund, through consultation with the actuary developed a funding strategy statement. The strategy aims at establishing an approach for supporting the Pension fund to continue to meet pension obligations as they fall due, through setting sustainable, affordable employers contributions. These, along with employee contributions (set within regulations) and investment returns, support the overall affordability of the scheme.

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. We have not identified any significant risks around the Pension Fund's financial sustainability. The next triennial valuation is due as at 31 March 2020 and we would anticipated that funding and investment strategies will be reviewed reflecting the outcome of this process.

Financial management and investment performance

For the year to 31 March 2019, the Pension Fund achieved a return on investments of 6.4%, slightly lower than the benchmark of 6.7%. However, over the longer term, fund performance has been strong, outperforming the benchmark by 1% per annum and 0.8% per annum over the 3 and 5 year period respectively to 31 March 2019.

The Pension Fund recognise the risks surrounding investment performance. Global uncertainty could adversely impact on investment returns and values. Similarly the uncertainty surrounding the potential impact of EU withdrawal including inflationary pressures and capital value loss on UK property, could impact on the Pension Fund's performance.

In response, the Pension Fund are exploring changes to the strategic asset allocation to help mitigate potential exposure to risks over the coming year.

Operationally, fund performance is monitored through the Investment sub-committee and Pensions Committee. We found evidence of scrutiny of fund performance during the year.

Changing landscape for public financial management

Recognising the changing landscape of Scottish public finances, including significant tax – raising powers as well responsibility for 11 social security benefits provides the Scottish Parliament with more policy choices. Subsequently, there is potentially greater volatility and complexity around Scottish budget and greater focus on the use of Scottish funds. This is likely to increase the scrutiny of public sector annual accounts and audit reports.

The financial statements place a key role in disclosing the use of public funds and how organisation's have delivered value for money. This is important to scheme members, admitted and scheduled bodies, as well as the wider public. We considered the openness and transparency around the narrative in the financial statements and are satisfied that the "Front end" of the accounts as well as the core financial statements provide transparency to the reader of the accounts as to how the Pension Fund has performed during the year and utilised resources.

Governance overview

The Pensions Committee and Pensions Board (who meet together at the same time) provide the key governance groups for the Pension Fund. 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 August 2018.

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 meetings. However, given that key investment management decisions have been delegated to the Investment sub-committee, this has been considered by management and deemed appropriate. 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.

Follow up action plan - 2

Chief Finance Officer

As administering authority, the Highland Council maintain the accounting records and prepare financial statements on behalf of the Pension Fund. In June 2019, the Highland Council's Head of Corporate Finance and Commercialism took on responsibility as Chief Finance Officer for the Pension fund.

Implications of EU Withdrawal

There are uncertainties surrounding the terms of the UK's withdrawal from the European Union in March 2019 and these are subject to ongoing negotiation between the UK government and EU. Whatever the outcome of these negotiations there is inevitably implications for devolved government in Scotland and for the Pension Fund.

Following Audit Scotland's planning guidance, we considered the extent to the which the Pension Fund are prepared for EU withdrawal and, where relevant, how the body is continuing to respond to emerging risks. Given the nature of the Pension Fund's activities, Officers have determined that the most significant risks with regards EU withdrawal are on falling gilt yields and market values of UK property as well as rising inflation. This could adversely impact on the funds future assets and liabilities. Furthermore, the uncertainty surrounding EU withdrawal can adversely impact on market value, impeding fund performance.

EU withdrawal is a number of risks that management continue to look to manage. The Pension Fund's Investment strategy continues to be developed with an investment portfolio looking to mitigate risks to both UK and global returns. The fund works closely with the Fund Managers to support investment strategy. This needs to be balanced against ensuring sufficient returns on investments. Overall, we are satisfied that the Pension Fund are well prepared for EU withdrawal. The fund recognise that it continues to be exposed to risks, particularly wider economic risks associated with it but has been proactive in looking to mitigate this risk where possible.

Consultation on the future of LGPS Funds

The Scheme Advisory Board (SAB) has completed a consultation on a Structure Review of the Scottish Local Government Pension Scheme Funds. Their are four options under consideration:

- Maintain funds arrangements as they currently are i.e. the status quo of 11 Funds in Scotland;
- Retain the 11 Funds within Scotland but with closer collaboration;
- One or more common investment pools;
- Merge the funds into 1 or more new funds.

The outcomes from the consultation are due to be published during 2019/20. While there would be significant further steps to be taken before any material restructuring of LGPS funds could take place, it is important that the Pension Fund continue to monitor the outcome of this consultation and how these may impact on the Pension Fund.

Appendices

Action plan and follow up of 2017/18 external audit recommendations

We have set out below, based on our audit work undertaken in 2018/19, those risks and recommendations we consider are of a higher risk to the Pension Fund that Officers may wish to consider in the future. We have also completed follow up of our 2017/18 recommendations and this is reflected below for information.

Recommendation	Agreed management response
Pension scheme legal cases During 2018/19 there were two ongoing developments that impact on the Pension Fund's liabilities: the McCloud/Sargeant case and the potential impact of GMP equalisation. The Pension Fund's actuary has undertaken an initial assessment of the McCloud / Sargeant case on the scheme liabilities, estimating the impact to be approximately £15 million. Further provision is likely for the impact of GMP, however this is unlikely to be material. We recommend that going forward, the Pension Fund liaise with actuaries to gain an understanding of the estimated impact of these cases on the scheme liabilities. With the next triennial valuation due as at 31 March 2020, it is important that these liabilities are factored into the valuation to ensure subsequent Investment and funding strategies are reflective of the true future obligations of the scheme.	Management response: We will liaise with the Actuaries to check that the McCloud is taking into consideration during the next triennial valuation as at 31 March 2020. Action owner: Finance Manager Timescale for implementation: 31 December 2019

Follow up of 2017/18 recommendations

Recommendation	Update
Fund valuation The valuation in the financial statements for one of the funds investment managers was understated by £2.903 million, as the actual 31 March 2017 valuations had not been used due to these being unavailable at the time of preparing the year end accounts. 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 Custodian's deadline for accounting, so was not reflected in the accounts.	Issue closed for 2018/19, Officers completed a full reconciliation of the investments' market value in the Annual Accounts to the quarterly reports received from the private equity fund material difference to ensure that there is not a material difference.
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.	Issue closed Officers completed a review of Agenda items for the Pensions Committee in June 2018. It was considered that 2 Pension Committee meetings a year covers business adequately with responsibility for monitoring investment performance and delivering the Fund's investment objectives, strategies and policies being delegated to the Investment Sub Committee which meets quarterly.

Audit adjustments

Uncorrected and corrected misstatements

There were no corrected misstatements during the audit.

We identified one uncorrected misstatement with regards investment valuations as at 31 March. This was an estimation difference of £4.73 million in the carrying value of investment. This occurred due to timing issues with regard to the valuations from the private equity investments for which the custodian makes an estimation based on December 2018 valuation for the year end, by the time the private equity fund manager has produced their valuation the custodian has closed their account. Officers have not adjusted the draft financial statements as they do not consider the difference to be material to the accounts. We concur that the impact of the uncorrected difference is not material. Going forward Officers are working with the fund manager and custodian to see it if is feasible for the Fund Manager to provide a year end outturn March report based on January and February which will be available in time for year end reporting.

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.

The Pension Fund's actuary has provided an estimation of the potential impact on the IAS 19 pension liabilities. The IAS 19 valuation of scheme liabilities is not within the primary statement but is a required disclosure. The IAS 19 disclosure within the draft accounts did not include provision for the impact of McCloud / Sargeant case on the Pension Fund. Given the developments of the case, Officers recognised that provision should be recognised in the draft accounts. Officers obtained a revised actuarial IAS 19 valuation and updated the accounts disclosure to include this provision. The impact on the IAS 19 pension disclosure was an increase of £15 million in liabilities.

Fees, independence, fraud arrangements

External Audit Fee

Service	Fees £
External Auditor Remuneration	25,740
Pooled Costs	2,500
Contribution to Audit Scotland costs	1,620
Contribution to Performance Audit and Best Value	0
2018-19 Fee	**29,860**

The audit fee was calculated in accordance with guidance issued by Audit Scotland and agreed with Management.

The above fee has not changed and our final fee was £29,860

Fees for other services

Service	Fees £
We can confirm there are no non-audit fees for the 2018/19 financial year	Nil

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 Auditing Practices Board's Ethical Standards and therefore we confirm that we 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 Auditing Practices Board's Ethical Standards.

We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.

We can confirm no independence concerns have been identified.

Client service

We take our client service seriously and continuously seek your feedback on our external audit service. Should you feel our service falls short of expected standards please contact Joanne Brown, Head of Public Sector Assurance Scotland in the first instance who oversees our portfolio of Audit Scotland work (joanne.e.brown@uk.gt.com). Alternatively, should you wish to raise your concerns further please contact Jon Roberts, Partner and Head of Assurance, 30 Finsbury Square, London, EC2A 1AG. If your feedback relates to audit quality and we have not successfully resolved your concerns, your concerns should be reported to Elaine Boyd, Assistant Director, Audit Scotland Quality and Appointments in accordance with the Audit Scotland audit quality complaints process.

Fraud arrangements

In assessing our audit risks, the audit team was alert to the possibility of fraud at the Pension Fund.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relation to management override of controls.
- Leading a discussion with those charged of governance (for the Pension Fund this is assumed to be the Audit Committee) on their view of fraud. We did this when presenting our audit plan.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit. – None were identified in-year

As auditors we obtain reasonable but not absolute assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

It is the **Highland Council Pension Fund's** responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we worked with the Pension Fund to review specific areas of fraud risk, including the operation of key financial controls.

We also examined certain policies in place, strategies, standing orders and financial instructions, as relevant to the fraud framework, to ensure that they provide a reasonable framework of internal control.

No suspected frauds or irregularities have been identified by Management and reported in-year.

Anti-Money Laundering Arrangements

As required under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 there is an obligation on the Auditor General (as set out in the planning guidance) to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. Should we be informed of any instances of money laundering at the Pension Fund we will report to the Auditor General as required by Audit Scotland.

Communication of audit matters with the Pension Fund

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and officers/those charged with governance who for the Pension Fund we deem to be the Pensions Committee	●	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	●	
Confirmation of independence and objectivity **We are independent of the Pension Fund and have not identified any conflicts of interest**	●	●
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence **We have not incurred any non-audit fees during the year and no threats to independence identified**	●	●
Significant matters in relation to going concern **No significant going concern matters identified**	●	●
Views about the qualitative aspects of the Pension Fund accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures **Set out in the Financial statements Section**		●
Significant findings from the audit **No significant findings from our audit**		●
Significant matters and issues arising during the audit and written representations that have been sought **Letter of representation will be shared and signed by the Chief Finance Officer (Head of Corporate Finance and Commercialism) when signing the financial statements. This is our standard, unmodified letter of representation.**		●
Significant difficulties encountered during the audit **No difficulties encountered**		●
Significant deficiencies in internal control identified during the audit **None identified**		●
Significant matters arising in connection with related parties **None identified**		●
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements **None identified.**		●
Non-compliance with laws and regulations **None noted**		●
Unadjusted misstatements and material disclosure omissions **None noted. Minor disclosure amendments only and these were not material in nature**		●
Expected modifications to the auditor's report, or emphasis of matter **None, an unqualified opinion**		●

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table above.

We communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to Officers and the Pensions Committee.

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