

Highland Council Pension Fund

Financial year ended 31 March 2021

Prepared for the Pensions Committee and the Controller of Audit

Final External Audit Report



Contents



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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our external audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Highland Council Pension Fund or all weaknesses in your internal controls. This report has been prepared solely for your benefit and Audit Scotland (under the Audit Scotland Code of Practice 2016). 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.

Key messages

This is our final report to the Pensions Committee and the Controller of Audit and concludes our audit on the financial year ended 31 March 2021. We have issued an unmodified audit opinion on the annual report and accounts. We thank management for all their assistance during the audit process.

03 Other audit matters

Our final report summarises a number of other audit matters, including:

- We have concluded that The Highland Council Pension Fund ('the Pension Fund') meets the definition of a going concern, reflecting on FRC Practice Note 10 considerations.
- The accounts contain areas of estimation and judgement. Significant estimates relate to the valuation of level 3 investments. Our testing over these did not identify any indication of management bias or error.
- We set out our roles and responsibilities on fraud. During the course of our work we did not identify fraud and/or material error.

There were a number of disclosure adjustments. These are detailed in Appendix 1 and not considered material to the accounts.

01 Materiality

We re-calculated our materiality based on the unaudited annual report and accounts. The benchmark of 1% of gross investments remained the same. This resulted in:

- Materiality of £24.040 million and a performance materiality (75% of materiality) of £18.030 million
- All audit adjustments above £250,000 were reported to management and captured in this report.
- Lower materiality of £920,000 was applied to contributions receivable, benefits payable and transfers in and transfers out.

04 Wider Scope Audit

In accordance with the Code we determined that the Pension Fund meet the definition of a smaller body. This is based on Pension Fund's income and expenditure transactions and balances held being relatively smaller than other public bodies and the financial statements are considered less complex.

In accordance with the Code we have concluded in this report on your governance statement and Pension Fund's financial sustainability arrangements. During our audit we did not identify any further areas of wider scope risk.

02 Financial statement audit risks

At planning, in accordance with the ISAs (UK) and FRC Practice Note 10 we have identified the following significant financial statement audit risks:

- Management override of controls (ISA UK 240)
- Valuation of level 3 investments as at 31 March 2021.

We have no matters to bring to your attention arising from our work over these significant audit risks.

05 Our Audit Fee

Our audit fee, set out in our audit plan, of £32,500 was our final audit fee. There were no non-audit services (fees) during the year and we did not need to vary our agreed fee.

Introduction

Scope of our audit work

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2021 at the Pension Fund. The scope of our audit was set out in our External Audit Plan communicated to the Pensions Committee on the 18 March 2021 and finalised and submitted to Pension Committee on the 30 April 2021.

The main elements of our audit work in 2020/21 have been:

- An audit of the Pension Fund's annual report and accounts for the financial year ended 31 March 2021; and
- Consideration of the Pension Funds financial sustainability and the Governance Statement disclosures, as required under the smaller body classification, within the Audit Scotland Code of Practice (2016).

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

This report is addressed to the Accountable Officer and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Responsibilities

The Pension Fund is responsible for preparing an annual report and accounts which show a true and fair view and that are in accordance with the accounts direction from Scottish Ministers. The Pension Fund is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable it to successfully deliver its objectives.

The recommendations or risks identified in this report are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Adding value through our audit work

We aim to add value to the Pension Fund throughout our audit work. In delivering our audit we use a dedicated public sector audit team. This ensures our team have a comprehensive understanding of Pension Fund and the wider public sector to focus on key areas of risk relevant to your financial statements.

As a result of the social distancing and travel restrictions implemented in response to the Covid-19 pandemic our audit work was delivered remotely. We continue to share recommended practices with management, where relevant, and contribute to wider discussions at the Pensions Committee during the year.

Audit of the annual report and accounts

Key messages and judgements

We have issued an **unmodified** audit opinion on the annual report and accounts.

There were no adjustments to the primary financial statements. There were no unadjusted differences to the financial statements. We raised a number of minor disclosure adjustments identified from our review of the annual report and accounts. We do not consider these to be material. Further details are provided in [Appendix 1](#).

We would like to thank management for all their assistance during the year in ensuring the delivery of the audit, to the timescales agreed at the start of the financial year.

Our audit opinion

For the financial year ended 31 March 2021 we have issued an **unmodified opinion** on the annual report and accounts. As reported in the independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2020/21 (the 2020/21 Code)
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2020/21 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 information given in the Management Commentary, Annual Governance Statement and the Governance Compliance Statement for the financial year is consistent with the financial statements and have been prepared with statutory guidance issued under the Local Government in Scotland Act 2003; Delivering Good Governance in Local Government: Framework (2016) and The Local Government Pension Scheme (Scotland) regulations 2018 respectively.

The audit process

In accordance with our annual external audit plan, our audit work commenced in July 2021. We received the draft primary financial statements in line with our agreed timetable. There were no audit adjustments to the draft primary financial statements. There were no unadjusted differences to the draft financial statements. We also identified a number of disclosure adjustments in respect of the draft financial statements. A full listing of disclosure misstatements is detailed in [Appendix 1](#). We do not consider these to be material to the financial statements.

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 updated our audit materiality to reflect the 2020/21 draft financial statements. It is set at £24.040 million, representing 1% of gross investments. Performance materiality was set at £18.030 million, representing 75% of our calculated materiality. We report to management any difference identified over £250,000 (Being the maximum trivial threshold allowable under Audit Scotland planning guidance).

We applied a lower materiality threshold for contributions receivable, benefits payable, and transfers (in and out) of the fund (being £920,000) to ensure appropriate testing over these transactions.

Responding to significant financial statement risks

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

This section provides commentary on the significant audit risks communicated in the Audit Plan.

Risks identified in our Audit Plan	Commentary
<p data-bbox="114 448 618 480">Management override of controls</p> <p data-bbox="114 504 808 767">As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override Pension Fund's controls for specific transactions.</p> <p data-bbox="114 775 808 1082">We consider those key judgements that are most susceptible to significant audit risk of management override are those over the valuation of investments. These are areas where management has the potential to influence the financial statements through estimate and judgement. This includes manual journals as well as critical judgements or estimates.</p>	<ul data-bbox="824 448 2119 1002" style="list-style-type: none">• We considered the design of controls in place over key accounting estimates and judgements through performance of walkthrough procedures.• We reviewed accounting estimates for management bias / indication of fraud that could result in material misstatement. This included review of estimates as at 31 March 2021. <p data-bbox="824 608 1193 639">Journals testing including:</p> <ul data-bbox="824 647 2119 1002" style="list-style-type: none">• Assessment of the design of controls in place over journal entries, including journal preparation, authorisation and processing onto the financial ledger;• Risk assessment of the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We tested these journals to ensure they are appropriate and suitably recorded in the financial ledger;• Target testing of transactions around the financial year end, reviewing large journals and those which appear unusual to understand the rationale for the transaction. <p data-bbox="824 1018 992 1050">Conclusion</p> <p data-bbox="824 1058 2119 1198">Through our audit procedures performed we found that there was no evidence of management override in our testing of transactions tested. We did not identify indication of fraud or inappropriate management bias in accounting estimates that could result in a material misstatement.</p>

Risks identified in our Audit Plan

Valuation of level 3 investments (valuation)

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. Investments are valued on a fair value hierarchy. Level 1 investments are those for which quoted market price information is available to validate fair value. Level 2 investment are these where there is no quoted market value but for which observable inputs are available based on information to support the valuation of investments. Subsequently, there is limited estimation or judgement in the valuation of these assets. Level 3 investments are those assets and liabilities at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. As at 31 March 2020 the Pension Fund held £334 million of Level 3 investments. Of the level 3 investments, the Pension Fund held investments which given their nature and market conditions, contain increased levels of volatility in valuation. As a result we consider these assets to be of more significant risk of material misstatement. In 2020, due to the impact of the global pandemic on price information and other market data, the Pension Fund reported a material uncertainty in relation to the valuation of property investments, totalling £180 million. Given the ongoing uncertainty due to the impact of Covid-19, there continues to be increased risk around the valuation of these investments. In addition, the Pension Fund holds equity options (derivatives), including exotic derivatives. Given the judgement and complexity around the valuation of these investments we attach a significant risk of material misstatement. We therefore have significant risk of misstatement over:

- Pooled property valuations (valuation)
- Complex derivative investments (valuation)

Commentary

- We performed walkthroughs of the controls and procedures over the valuation of investments, including understanding of controls in place at Fund Managers over valuations through obtaining their latest ISAE 3402 controls report or equivalent;
- We considered the competence and expertise of the Fund Managers as experts to value investments at the year end;
- We agreed Fund Manager investment confirmations as at 31 March 2021 and reconciled these to Custodian Report at 31 March and the Pension Fund accounts;
- We considered the Fund Manager reports as at 31 March 2021 to identify any reported uncertainty in relation to the investment values;
- We obtained valuations as at 30 June 2021 and performed roll back procedures to obtain assurance over valuations as at 31 March 2021.
- For other investments with observable market data (level 2 and level 1) we independently verified the valuation of a sample of these investments providing assurance over valuation approach from Fund Manager.

Conclusion

As at 31 March 2021, the Pension Fund held £368.11 million of investments within level 3 investments. These are primarily unit Trust pooled property investments, private equity and property debt. Through our audit procedures performed we did not identify any exceptions in our review and testing over level 3 pension assets held. Level 3 investments were agreed to third party Fund Manager confirmations and custodian reports. Our audit procedures did not indicate any errors in the valuation applied.

We did not identify any further areas of significant risk through the course of our audit work.

Significant estimates and judgements

The Pension Fund's annual report and accounts contain limited areas of estimation and judgement. The one material area of estimation is in relation to level 2 and level 3 investment. This has been confirmed by Senior Officers (Management) and confirmed in our audit testing including review of disclosures.

judgement or estimate	Summary of officer's approach	Audit Comments	Assessment
Level 2 and Level 3 Investments	The Pension Fund appoint a range of external fund managers to manage their investments based on agreed investment criteria. The valuation in the accounts reflects that provided by the Pension Fund Custodian, Northern Trust. Northern Trust provide performance information throughout the year which allows Officers to review and scrutinise performance throughout the year. The Pension Fund asset performance is reviewed quarterly at the Investment Sub Committee (ISC) and the Fund's investment advisors Aon provide an analysis of changes in asset values. Also in the year end accounts there is an analysis of movements in investments during the year which act as a review on previous account estimates as movements must be explained. Source data from the Custodian is reconciled by Officers to date from the Fund Managers. Any anomalies are investigated as part of the monthly reconciliation process. For Level 3 Assets valuations are provided by Fund Managers alongside the method of Valuation which is reviewed by Officers.	For Level 2 investments we have reviewed the approach and assumptions used in valuing the assets and are satisfied these are appropriate. For Level 3 Investments we are satisfied that the Pension fund's approach to valuing the investments, including the use of independent Fund Managers are appropriate. We have considered the ISAE 3402 controls report (or equivalent) at the Fund Managers to gain assurance around the controls in place to arrive at a valuation.; We did not identify any indication of management bias in the underlying assumptions applied in the estimate and found that Management have disclosed the key sensitivities surrounding these in the draft financial statements.	[Light purple]

Assessment

- Dark Purple We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- Blue We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- Grey We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- Light Purple We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Others areas of estimation

judgement or estimate	Summary of management's approach	Audit Comments	Assessment
IAS 26 Defined benefit pension liabilities	<p>CIPFA's Code of Practice on Local Authority Accounting 2020/21 requires administering authorities of LGPS Funds that prepare Pension Fund accounts to disclose what IAS 26 refers to as the actuarial present value of promised retirement benefits.</p> <p>The Pension Fund engage Hymans Robertson provide an annual IAS 26 actuarial valuation of the Pension Fund's defined benefit pension liabilities. There are a number of assumptions contained within the valuation, including: discount rate; mortality rates; and, future salary projections. These key assumptions are discussed with the actuary to inform the report. These are predominantly informed by the actuaries recommended assumptions. Management review the draft actuarial valuation.</p>	<p>The IAS 26 represents a disclosure requirement in the account rather than a primary financial statement. Using the work of PricewaterhouseCoopers (PwC) we reviewed the key assumptions underpinning the actuarial valuation.</p> <p>We are satisfied that the assumptions adopted were appropriate for Pension Fund and that those applied were considered reasonable i.e. within our acceptable tolerances.</p> <p>We did not identify any indication of management bias in the underlying assumptions applied in the estimate and found that Management have disclosed the key sensitivities surrounding these in the draft financial statements.</p>	[Light purple]

Internal control environment

In accordance with ISA requirements we have developed an understanding of the control environment in place within the Pension Fund. Our audit is not controls based and we have not placed reliance on controls operating effectively as our audit is fully substantive in nature. We did this through a walkthrough of key controls within the Pension Fund including investment valuations, benefits paid, contributions and journals. We identified no material weaknesses or areas of concern from this work which would have caused us to alter the planned approach as documented in our plan.

Detecting Irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, to detect material misstatements in respect of irregularities, including fraud. Owing to the inherent limitations of an audit, there is an unavoidable risk that material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs (UK).

The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Pension Fund and determined that the most significant which are directly relevant to specific assertions in the financial statements are those related to the reporting frameworks; International Financial Reporting Standards and the CIPFA Code of Practice on Local Authority Accounting 2020/21 (the 2020/21 Code).
- We enquired of Officers and the Pensions Committee, concerning the Pension Fund's policies and procedures relating to the identification, evaluation and compliance with laws and regulations; the detection and response to the risks of fraud; and the establishment of internal controls to mitigate risks related to fraud or non-compliance with laws and regulations.
- We enquired of Officers (Management) and the Pensions Committee, whether they were aware of any instances of non-compliance with laws and regulations or whether they had any knowledge of actual, suspected or alleged fraud.
- We assessed the susceptibility of the Pension Fund's financial statements to material misstatement, including how fraud might occur, by evaluating management's incentives and opportunities for manipulation of the financial statements. This included the evaluation of the risk of management override of controls. We determined that the principal risks were in relation to journal entries that altered the Pension Fund's financial performance for the year and potential management bias in determining accounting estimates. Our audit procedures involved are documented within our response to the significant risk of management override of controls on Page 6.
- These audit procedures were designed to provide reasonable assurance that the financial statements were free from fraud or error. However, detecting irregularities that result from fraud is inherently more difficult than detecting those that result from error, as those irregularities that result from fraud may involve collusion, deliberate concealment, forgery or intentional misrepresentations. Also, the further removed non-compliance with laws and regulations is from events and transactions reflected in the financial statements, the less likely we would become aware of it.
- The team communications in respect of potential non-compliance with relevant laws and regulations, included the potential for fraud in expenditure recognition and significant accounting estimates.
- In assessing the potential risks of material misstatement, we obtained an understanding of:
 - The Pension Fund's operations, including the nature of its operating revenue and expenditure and its services and of its objectives and strategies to understand the classes of transactions, account balances, expected financial statement disclosures and business risks that may result in risks of material misstatement.
 - The Pension Fund's control environment, including the policies and procedures implemented to ensure compliance with the requirements of the financial reporting framework.

Other key elements of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. Whilst not considered a significant risk, these are areas of focus either in accordance with the Audit Scotland Code of Audit Practice or ISAs or through due to their complexity or importance to the user of the accounts.

Issue	Commentary
Matters in relation to fraud and irregularity	It is the Pension Fund's responsibility to establish arrangements to prevent and detect fraud and other irregularity. As auditors, we obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error. We obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement. We have also made inquires of internal audit around internal control, fraud risk and any known or suspected frauds in year. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures.
Accounting practices	We have evaluated the appropriateness of Pension Fund's accounting policies, accounting estimates and financial statement disclosures. Disclosures and accounting policies are in line with the FReM and we have no matters to report.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
Matters in relation to laws and regulations	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
Other information	<p>We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.</p> <p>No inconsistencies have been identified and we plan to issue an unmodified opinion in this respect.</p>
Opinion on other aspects of the annual report and accounts	The information given in the Management Commentary is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003. The information given in the Annual Governance Statement is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016). The information given in the Governance Compliance Statement is consistent with the financial statements and has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.

Issue	Commentary
Matters on which we report by exception	<p>We are required by the Auditor General for Scotland to report to you if, in our opinion: adequate accounting records have not been kept; or the financial statements are not in agreement with the accounting records; or we have not received all the information and explanations we require for our audit there has been a failure to achieve a prescribed financial objective. We have nothing to report in respect of these matters.</p>
Annual Governance statement	<p>The governance statement outlines the governance framework in place at the Pension Fund. The Annual Governance Statement is consistent with the financial statements and the report is prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).</p> <p>There was no matters arising from our review of the governance statement that we want to draw attention to.</p>
Written representations	<p>A letter of representation has been requested from the Executive Chief Officer, Resources and Finance, including specific representations, which is included in the Pensions Committee papers. Specific representations have been requested from officers in line with prior years and confirms as auditors all records have been made available to us.</p>
Going concern	<p>In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector. Practice Note 10 provides that clarification for audits of public sector bodies.</p> <p>Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by Pension Fund meets this criteria, and so we have applied the continued provision of service approach. In accordance with Audit Scotland guidance: Going concern in the public sector, we have therefore considered Officer’s assessment of the appropriateness of the going concern basis of accounting and conclude that:</p> <ul style="list-style-type: none"> • a material uncertainty related to going concern has not been identified • Officer’s (Management’s) use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Wider scope audit – Smaller body

As set out in our Audit Plan, Pension Fund meets the definition of a smaller body in accordance with the Audit Scotland Code of Practice (2016). Therefore, as auditors we are required to include in our annual report commentary on arrangements as they relate to financial sustainability and the Annual Governance Statement. Our work on the Annual Governance Statement, and conclusions are set out on page 12 of this report. Below we have captured our commentary and conclusions on financial sustainability and other matters of interest during the year.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	Grant Thornton conclusion
Governance arrangements (Audit Scotland planning guidance consideration)	No significant risks identified within our audit planning.	<p>Governance</p> <p>During 2020/21 Pension Fund’s governance arrangements continued to operate as intended, and as in prior year. As administering authority, the Highland Council established emergency governance arrangements in March 2020 as a result of COVID-19 outbreak. This included temporary governance arrangements. During this period there were no decisions made that impacted upon the Pension Fund. During 2020/21, Pension Board and Committee and Investment Sub Committee meetings continued to be held remotely via video conferencing.</p> <p>The Pension Fund is required to report annually a Governance Compliance Statement in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018 outlining how the Council has complied with best practice. One area Officers have highlighted as not operating within best practice is around the frequency of meetings where best practice would be for the administering authority’s main committee / committees to meet at least quarterly. The Pensions Committee and Pensions Board meet twice a year. Officers have reviewed the business covered at the Pensions Committee and benchmarked against other governance structures in places and are satisfied that business is covered adequately in two meetings. In addition, the Investment Sub committee meet quarterly to ensure there is adequate oversight of Fund Manager performance in a timely manner.</p>	We did not identify any concerns around Pension Fund’s governance arrangements or disclosures within the draft Governance Statement.

Wider scope dimension

Wider scope risk identified in our audit plan

Wider scope audit response and findings

Grant Thornton conclusion

Financial Sustainability, (as applicable to a smaller body)

No significant risks identified within our audit planning.

For the year to 31 March 2021, the Pension Fund reported a return on investments (ROI) of 27%. This saw the Pension Fund's investments increase in value from £1.885 billion to £2.387 billion. The ROI outperformed the Pension Fund's annual benchmark of 23.8%. The positive performance reflected the improved position across global markets, particularly global equities which recovered following the initial market reaction to Covid-19 pandemic in March 2020. Over the longer term, the Pension Fund's reported investment performance has been strong, outperforming the benchmark by approximately 1% per annum over the last five years to 31 March 2021.

During the year the actuarial valuation (triennial valuation) took place as at 31 March 2020. This showed that the Pension Fund was 100% funded. While the Pension Fund reported a strong financial position, ongoing market uncertainty and a weaker outlook for future investment returns means there is increasing upwards pressure on primary contribution rates of the fund. 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 9 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.

During March 2021 the Pension Fund invested £116 million in alternative risk premia hedge fund (multi asset absolute return) with the Man Group. This reflected the Pension Fund's continued approach to balance investment portfolio to provide a diverse portfolio supporting delivery of targeted returns within appropriate risk appetite. Fund Performance is reviewed by the Investment Sub committee with oversight from the Pension Committee and Board.

Through our audit procedures we have not identified any significant risks in relation to Pension Fund's financial sustainability.

The Pension Fund's performance during 2021 exceeded benchmark, reporting a 27% return on investments. While performance has been strong, Officers recognise that there continues to be risks around the Pension Fund with weakening forecasts investment returns as well as wider economic risks impacting participating bodies. Managing these risks continues to be a focus of the Pension Fund in shaping investment strategy.

Appendices

1. 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. We are pleased to report that there were no corrected or uncorrected misstatements to the primary financial statements.

Misclassification and disclosure changes

The table below provides details of substantive misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure	Auditor recommendations	Adjusted?
Annual Report	Minor presentational disclosures to enhance information provided in the Management commentary including: including contribution rates (per the 2020 triennial valuation for a forward look perspective); narrative around increased management expenses and other presentational adjustments.	Partly – Minor presentational changes have been made to the draft Annual report. There is an opportunity for the Pension Fund to review the performance of the report to potentially have greater focus on overall fund performance throughout the year. Note presentational recommendation only.
Hedge fund disclosures	The Pension fund hold investments of £116 million in a hedge fund (alternative risk premia fund), multi asset return investment with the Man Group. The notes to the financial statements required updating to reflect the valuation basis of this investment.	✓
Accounting policies - Pensions	Clarification around accounting treatment for non-LGPS scheme contributions.	✓
Fair Value basis of valuation	Note 14 defines the fair value basis of valuation for investment. The disclosure in the draft accounts required amendment to provide explanation around fair value hierarchy and the valuation and estimation techniques used. There is an opportunity to enhance the disclosure around the key sensitivities of investments held and what the key aspects / drivers are around these and ultimately how Officers have identified the range considered appropriate to highlight these sensitivities.	Partly - The financial statements have been updated to enhance narrative around investments valuation basis. The sensitivity analysis is informed through the Pension Fund's investment advisors. However, there is an opportunity to enhance the disclosure in the accounts to allow the reader greater understanding of the key elements that drive the sensitivity in the estimate and how the range has been derived. As auditors we are satisfied this does not represent a material disclosure misstatement.

Disclosure	Auditor recommendations	Adjusted?
Critical judgements	<p>International Financial Reporting standards prescribe the required disclosures in relation to critical judgements. It also requires separate consideration of accounting estimates.</p> <p>The Pension Fund should disclose judgements that Management makes when applying its accounting policies that have the most significant effect on carrying amounts in the financial statements. The most significant accounting estimate is in relation to investment assets, in particular the assumptions underpinning Level 3 investments.</p> <p>The draft accounts contained areas described as critical judgements which we would not consider as areas of material judgement and were more closely related to describing estimates.</p> <p>Significant Estimates relate to assumptions and estimates at 31 March that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In the draft accounts, Management have disclosed valuation of investments and the actuarial present value of pension obligations. There is an opportunity to enhance the disclosure to focus on those key areas of estimation that may have a significant risk of material misstatement in the next 12 months. This should focus on those key areas of assumptions such as pension fund discount rate or key assumptions in the valuation. In addition we would not consider the IAS 26 valuation of liabilities to be a critical estimate as it does not impact on the primary financial statements.</p>	<p>Partly – Officers have reviewed critical judgements disclosure and have concluded there were no critical judgements that would have a material impact on the accounts. We concur with this conclusion.</p> <p>However, there are further opportunities to enhance the disclosures in relation to significant estimates in accordance with the accounting standards. In particular we would expect a specific note to inform the reader of the accounts around the estimates and judgements in the financial statements. The focus in relation to pension scheme investments should be those estimates where there is a significant risk of material misstatement in the next 12 months. As auditors we are satisfied that this does not represent a material disclosure misstatement in the financial statements and Officers have agreed to review as part of the 2021/22 financial statements.</p>
Cash and cash equivalents	<p>As at 31 March the Pension Fund held cash and cash equivalent balances of £47.7 million. Of this £45.6 million related to investments in money market funds. While we are satisfied the recognition as cash and cash equivalent is correct in the primary statement, Note 15.1 incorrectly classifies these balances as held at amortised costs. Instead they should be classified as Fair Value Through Profit and Loss (FVTPL). The prior year Note 15.1 disclosure will also require restatement to separately report investments in money market funds as at 31 March 2020 as FVTPL.</p>	✓

There were minor presentational (rounding / formatting) changes recommended to Management. These are not considered material to the accounts.

2. Follow up of 2019/20 recommendations

We are pleased to report there were no audit recommendations arising from our audit work in the current year. We set out below our follow up of our 2019/20 recommendation and this is reflected below for information.

(Follow up of 2018/19 Recommendation) Recognising the impact of Covid and publication of the future strategy

The Pension Fund and administering authority established emergency Covid-19 governance arrangements were implemented whereby meetings of the Council and its committees were suspended unless there was an urgent business requirement. This resulted in the cancellation of the Pensions Committee scheduled for 19 March. The Investment Sub Committee held a meeting on 13 March but a scheduled meeting on 12 June was cancelled. Officers have continued to engage with investment advisors and the fund managers and governance arrangements have been re-established with the Pensions Committee meeting on 23 September. Given the absence of Committee meetings, it is important that the Pensions Committee has clear understanding of any significant business or decisions taken in the period where governance arrangements were suspended. Officers should ensure these are clearly reported to the Committee to ensure retrospective consideration and approval of actions taken.

Follow up: **Closed**

As the 12 June ISC meeting was cancelled, the ISC Chairperson instead met with Head of Corporate Finance and Commercialisation, Finance Manager and Investment advisor on 19 June to discuss the Fund's performance report which would have been considered at ISC had the meeting taken place: no decisions were taken.

Following this discussion an email was circulated to members of the ISC along with the (confidential) performance report and they were advised that the discussion on 19 June had concluded that the current asset strategy (approved at Pension Committee February 2018) was still considered to be appropriate in light of Covid-19 and the current economic outlook. This was reported to the Pensions Committee on 23 September 2020.

3. Audit fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	28,430
Pooled Costs	2,580
Contribution to Audit Scotland costs	1,490
Contribution to Performance Audit and Best Value	-
2020/21 Fee	32,500

Fees for other services

Service	Fees £
We confirm that for 2020/21 we did not receive any fees for non-audit services	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 Financial Reporting Council'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 Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.
- 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.

Transparency

Grant Thornton publishes an annual Transparency Report, which sets out details of the action we have taken over the past year to improve audit quality as well as the results of internal and external quality inspections. For more details see [Transparency report 2020](https://www.grantthornton.co.uk/transparency-report-2020) ([grantthornton.co.uk](https://www.grantthornton.co.uk))

4. Communication of audit matters

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 below.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
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	•	•
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	•	•
Significant matters in relation to going concern	•	•
Views about the qualitative aspects of the Pension Fund's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
Significant findings from the audit		•
Significant matters and issues arising during the audit and written representations that have been sought		•
Significant difficulties encountered during the audit		•
Significant deficiencies in internal control identified during the audit		•
Significant matters arising in connection with related parties		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
Non-compliance with laws and regulations		•
Unadjusted misstatements and material disclosure omissions		•
Expected modifications to the auditor's report, or emphasis of matter		•



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