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The Pensions Committee  
The Highland Council as administering body for the Highland  
Council Pension Fund

24 September 2015

## The Highland Council Pension Fund Annual Audit Report

1. International Standard on Auditing (UK and Ireland) 260 (ISA 260) requires auditors to report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action. We are drawing to your attention matters for your consideration before the financial statements are approved and certified. We also present for your consideration our draft annual audit report on the 2014/15 audit which identifies significant findings from the financial statements audit. The section headed 'significant findings' in the attached annual audit report sets out the issues identified. This report will be issued in its final form after the financial statements have been certified.
  2. Our work on the financial statements is now substantially complete. Subject to the satisfactory conclusion of any outstanding matters and receipt of a revised set of financial statements for final review, we anticipate being able to issue an unqualified auditor's report on 24 September 2015. The proposed report is attached at Appendix A. There are no anticipated modifications to the audit report.
  3. In presenting this report to the Pensions Committee we seek confirmation from those charged with governance of any instances of any actual, suspected or alleged fraud; any subsequent events that have occurred since the date of the financial statements; or material non-compliance with laws and regulations affecting the entity that should be brought to our attention.
  4. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature and request that these misstatements be corrected. We have no unadjusted misstatements to bring to your attention.
  5. As part of the completion of our audit we seek written assurances from the Director of Finance on aspects of the financial statements and judgements and estimates made. A draft letter of representation under ISA580 is attached at Appendix B. This should be signed and returned by the Director of Finance with the signed financial statements prior to the independent auditor's opinion being certified.
-

## Outstanding matters

6. There are some areas where we still require additional information and these are identified below:

**Letter of representation.** This letter, otherwise known as the ISA 580 letter, is required immediately before the certification of the final accounts on 24 September 2015

## **APPENDIX A: Proposed Independent Auditor's Report**

### **Independent auditor's report to the members of The Highland Council as administering body for the Highland Council Pension Fund and the Accounts Commission for Scotland**

I certify that I have audited the financial statements of the Highland Council Pension Fund for the year ended 31 March 2015 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Pension Fund Account, the Net Assets Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 (the 2014/15 Code).

This report is made solely to the parties to whom it is addressed in accordance with the Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

### **Respective responsibilities of the Director of Finance and auditor**

As explained more fully in the Statement of Responsibilities for the Statement of Accounts, the Director of Finance is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report and Annual Accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit.

If I become aware of any apparent material misstatements, irregularities, or inconsistencies I consider the implications for my report.

### **Opinion on financial statements**

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2014/15 Code of the financial transactions of the Highland Council Pension Fund during the year ended 31 March 2015, 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 2014/15 Code; and
  - 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.
-

## **Opinion on other prescribed matter**

In my opinion the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

## **Matters on which I am required to report by exception**

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Annual Governance Statement has not been prepared in accordance with Delivering Good Governance in Local Government; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

Stephen Boyle  
Assistant Director  
Audit Scotland  
4th Floor South Suite  
The Athenaeum Building  
8 Nelson Mandela Place  
GLASGOW  
G2 1BT

24 September 2015

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## Appendix B: ISA 580 - Letter of Representation

Stephen Boyle  
Assistant Director  
Audit Scotland  
4th Floor, South Suite  
The Athenaeum Building  
8 Nelson Mandela Building  
Glasgow G2 1BT

24 September 2015

Dear Stephen

### **The Highland Council Pension Fund**

#### **Annual Accounts 2014/15**

1. This representation letter is provided in connection with your audit of the financial statements of the Highland Council Pension Fund for the year ended 31 March 2015 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view of the financial position of the Highland Council Pension Fund, as at 31 March 2015 and its comprehensive net expenditure for the year then ended.
2. I confirm to the best of my knowledge and belief, and having made appropriate enquiries of the officers of the Pension Fund, the following representations given to you in connection with your audit of the Highland Council Pension Fund for the year ended 31 March 2015.

#### **General**

3. I acknowledge my responsibility and that of the Highland Council Pension Fund for the financial statements. All the accounting records requested have been made available to you for the purposes of your audit. All material agreements and transactions undertaken by the Highland Council Pension Fund have been properly reflected in the financial statements. All other records and information have been made available to you, including minutes of all management and other meetings.
  4. The information given in the Annual Report and Statement of Accounts, including the Management Commentary, presents a balanced picture of the Highland Council Pension Fund and is consistent with the financial statements.
  5. I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those identified in the auditor's report to those charged with governance (ISA260).
-

## **Financial Reporting Framework**

6. The financial statements have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15, and 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.
7. Disclosure has been made in the financial statements of all matters necessary for them to show a true and fair view of the financial transactions of the Highland Council Pension Fund during the year ended 31 March 2015, and the amount and disposition at that date of its assets and liabilities.

## **Accounting Policies & Estimates**

8. All material accounting policies adopted are as shown in Note 3 (Summary of Significant Accounting Policies) included in the financial statements. The continuing appropriateness of these policies has been reviewed since the introduction of IAS 8 and on a regular basis thereafter, and takes account of the requirements set out in the Code of Audit Practice on Local Authority Accounting in the United Kingdom 2014/15.
9. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. There are no changes in estimation techniques which should be disclosed due to their having a material impact on the accounting disclosures.

## **Related Party Transactions**

10. All transactions with related parties have been disclosed in the financial statements. I have made available to you all the relevant information concerning such transactions, and I am not aware of any other matters that require disclosure in order to comply with the requirements of IAS24, as interpreted by the Code of Practice in Local Authority Accounting in the United Kingdom 2014/15.

## **Events Subsequent to the Net Assets Statement date**

11. There have been no material events since the date of the Net Assets Statement which necessitate revision of the figures in the financial statements or notes thereto including contingent assets and liabilities other than as set out in Note 20.
12. Since the date of the Net Assets Statement no events or transactions have occurred which, though properly excluded from the financial statements, are of such importance that they should be brought to your notice.

## **Corporate Governance**

13. I acknowledge as Section 95 Officer my responsibility for the corporate governance arrangements. I confirm that I have disclosed to the auditor all deficiencies in internal control of which I am aware.
  14. The corporate governance arrangements have been reviewed and the disclosures I have made are in accordance with the Code of Practice in Local Authority Accounting in the United Kingdom 2014/15. There have been no changes in the corporate governance arrangements or issues identified, since 31 March 2015, which require disclosure.
-

## **Fraud**

15. I have considered the risk that the financial statements may be materially misstated as a result of fraud. I have disclosed to the auditor any allegations of fraud or suspected fraud affecting the financial statements. There have been no irregularities involving management or employees who have a significant role in internal control or that could have a material effect on the financial statements.

## **Assets**

16. The assets shown in the Net Assets Statement at 31 March 2015 were owned by the Highland Council Pension Fund, other than assets which have been purchased under operating leases. Assets are free from any lien, encumbrance or charge except as disclosed in the financial statements.

## **Liabilities**

17. All liabilities have been provided for in the books of account, including the liabilities for all purchases to which title has passed prior to 31 March 2015.

## **Carrying Value of Assets and Liabilities**

18. The assets and liabilities have been recognised, measured, presented and disclosed in accordance with the Code of Practice in Local Authority Accounting in the United Kingdom 2014/15. There are no plans or intentions that are likely to affect the carrying value of classification of the assets and liabilities within the financial statements.

## **Actuary Assumptions**

19. The pension assumptions made by the actuary in the International Accounting Standard 19 (Employee Benefits) report on the Highland Council Pension Fund have been reviewed and I confirm that they are consistent with management's own view.
20. The pension assumptions made by the actuary in the 2014 Triennial Valuation were reviewed and I confirm that they are consistent with management's own view.

## **Other matters**

21. Except as disclosed in the financial statements, the results for the period were not materially affected by:
  - transactions of a sort not usually undertaken by the Pension Fund
  - circumstances of an exceptional or non-recurrent nature
  - charges or credits relating to prior periods
  - any change in the basis for accounting.

Yours sincerely

Derek Yule  
Director of Finance & Section 95 Officer

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# The Highland Council Pension Fund 2014/15 Audit

Proposed annual audit  
report to Members of The  
Highland Council  
Pensions Committee and  
the Controller of Audit



The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies. ([www.audit-scotland.gov.uk/about/ac](http://www.audit-scotland.gov.uk/about/ac))

Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk))

The Accounts Commission has appointed Stephen Boyle as the external auditor of The Highland Council Pension Fund for the period 2011/12 to 2015/16.

This report has been prepared for the use of The Highland Council as administering authority for The Highland Council Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the Council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

## Key contacts

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# Contents

<b>Key messages</b> .....	<b>4</b>	<b>Best Value</b> .....	<b>23</b>
<b>Introduction</b> .....	<b>6</b>	<b>Appendix I</b> .....	<b>25</b>
<b>Audit of the 2014/15 financial statements</b> .....	<b>7</b>	<b>Appendix II</b> .....	<b>32</b>
<b>Financial management and sustainability</b> .....	<b>13</b>	<b>Appendix III</b> .....	<b>33</b>
<b>Governance and transparency</b> .....	<b>18</b>		

# Key messages

 <p>Audit of financial statements</p>	<ul style="list-style-type: none"> <li>• The independent auditor’s report on the 2014/15 financial statements of the Highland Council Pension Fund is unqualified.</li> <li>• The financial statements submitted for audit did not fully meet the requirements of the new accounting regulations. A more robust review process is required to improve the quality of the financial statements submitted for audit.</li> <li>• The Pension Fund complied with the new guidance on accounting for local government pension scheme management costs.</li> </ul>
 <p>Financial management and sustainability</p>	<ul style="list-style-type: none"> <li>• The Pension Fund’s financial management arrangements require improvement. An annual budget is not prepared for the Pension Fund’s administration costs or management fees, as such only limited financial information is available to members.</li> <li>• The Pension Fund’s financial position is secure for the medium to longer term. The 2014 triennial actuarial valuation concluded that the Pension Fund was 96.2% funded and set revised employers’ contribution levels to recover the shortfall over the next 20 years.</li> </ul>
 <p>Governance and transparency</p>	<ul style="list-style-type: none"> <li>• The Pension Fund was well prepared for the introduction of the new Local Government Pension Scheme from 1 April 2015.</li> <li>• Appropriate systems of internal control were in place during 2014/15 except for those relating to the operation of the intercompany accounts with the Council although there have been some improvements in this area.</li> <li>• A Pension Fund risk register has been prepared and a risk management policy and statement has been drafted for approval by the Pensions Committee.</li> <li>• Sound anti-fraud arrangements are in place.</li> </ul>

	<ul style="list-style-type: none"><li>• The Pension Fund has a well developed framework in place for monitoring and reporting investment performance.</li><li>• Investment returns in 2014/15 were below the customised benchmark but have outperformed the Pension Fund's benchmark over a three and five year period.</li></ul>
	<ul style="list-style-type: none"><li>• In accordance with regulations, a Pensions Board has been established and held its inaugural meeting on 4 September 2015. It will take time for the new governance arrangements to bed in.</li></ul>

# Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of the Highland Council Pension Fund. The report is divided into sections which reflect our public sector audit model.
2. The management of The Highland Council, as administering authority for the Highland Council Pension Fund, is responsible for:
  - preparing financial statements which give a true and fair view
  - implementing appropriate internal control systems
  - putting in place proper arrangements for the conduct of its affairs
  - ensuring that the financial position is soundly based.
3. Our responsibility, as the external auditor of the Highland Council Pension Fund, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements. This does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. **Appendix II** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that the Highland Council Pension Fund understand their risks and have arrangements in place to manage these. The Council, as administering authority, and the Director of Finance, as the Proper Officer should ensure that they are satisfied with the proposed action and have a mechanism in place to assess progress and monitor outcomes.
6. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures. Consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
7. We are grateful for the cooperation and assistance we received during the course of the audit.

# Audit of the 2014/15 financial statements

<p><b>Audit opinion</b></p>	<p>We have completed our audit and our independent auditor’s report is unqualified.</p>
<p><b>Going concern</b></p>	<p>As the funding position is calculated every three years by the actuary, the financial statements of the Pension Fund have been prepared on a going concern basis. We are unaware of any other events or conditions that may cast significant doubt on the Pension Fund ’s ability to continue as a going concern.</p>
<p><b>Other information</b></p>	<p>We review and report on other information published with the financial statements, including the management commentary, annual governance statement and governance compliance statement. We had nothing to report in respect of these statements in our independent auditor’s report.</p>

## Submission of financial statements for audit

8. We received the unaudited financial statements on 19 June 2015 in accordance with the agreed timetable. The working papers were of a good standard. The unaudited accounts did not, however, fully meet the requirements of the new Local Authority Accounts (Scotland) Regulations 2014. A more robust review process needs to be put in place in future years to improve the quality of the financial statements submitted for audit (see paragraph 20, issue 1 for details).

**Action plan no. 1**

## Overview of the scope of the audit of the financial statements

9. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Pensions Committee on 19 February 2015.
10. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. As such, the 2014/15 agreed fee for the audit, set out in the Annual Audit Plan, remains unchanged.

11. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.
12. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

## Materiality

13. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).

14. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
15. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of the Highland Council Pension Fund, we set our planning materiality at 10% of contributions receivable. For 2014/15 planning materiality was set at £5.1 million.
16. We report all misstatements greater than £100,000. Performance materiality was calculated at £2.5 million to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our planning materiality level.
17. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that they should be revised to the levels outlined in Exhibit 1:-

**Exhibit 1: Final Materiality levels**

	Materiality	Performance materiality	Clearly Trivial
	£'000	£'000	£'000
Pension Fund	4,997	2,500	100

**Evaluation of misstatements**

18. All misstatements identified during the audit, which exceeded our misstatement threshold, have been amended in the audited financial statements. The main adjustment was to include long term debtors for strain on the fund costs which the Pension Fund has agreed employers can pay over a number of years, instead of as one lump sum. The impact of this adjustment was to increase Contributions Receivable in the Pension Fund Account and Net Assets Statement by £1.428 million in the audited accounts (see Significant Findings, issue 3 below).

**Significant findings from the audit**

19. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
  - the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures
  - significant difficulties encountered during the audit
  - significant matters arising from the audit that were discussed, or subject to correspondence with management
  - written representations requested by the auditor
  - other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
20. During the course of the audit we identified the following significant issues that, in our view, require to be communicated to you.



## Significant findings from the audit

Issue	Resolution
<p><b>1. Local Authority Accounts (Scotland) Regulations 2014:</b> the annual accounts submitted for audit did not fully comply with the requirements of the new accounting regulations:</p> <ul style="list-style-type: none"> <li>• a management commentary had been prepared but the content did not fully comply with the guidance issued by Scottish Ministers</li> <li>• an annual governance statement, a statement on the system of internal financial control and a governance compliance statement were all included in the unaudited accounts. The guidance issued by Scottish Ministers recommended that only one governance statement be included. The annual governance statement did not comply with the CIPFA guidance ‘Delivering good governance in local government’.</li> <li>• the statement of responsibilities had not been amended to reflect the new responsibilities set out in the new regulations</li> <li>• the unaudited accounts did not recognise the changes to the officers and members required to sign the key statements.</li> </ul> <p>Also, the advertisement of the unaudited accounts for public inspection did not refer to the new regulations, instead giving notice under the previous (1985) regulations.</p> <p>In our opinion, there was an absence of a robust and comprehensive review of the accounts prior to their submission for audit.</p>	<p>The management commentary, statement of responsibilities and annual governance statement included in the audited accounts have been revised to comply with the 2014 regulations and guidance issued by CIPFA and Scottish Ministers. The statement on the system of internal financial control has been removed. The annual accounts have been updated to include the names of the key officers and members who are required to sign them.</p>

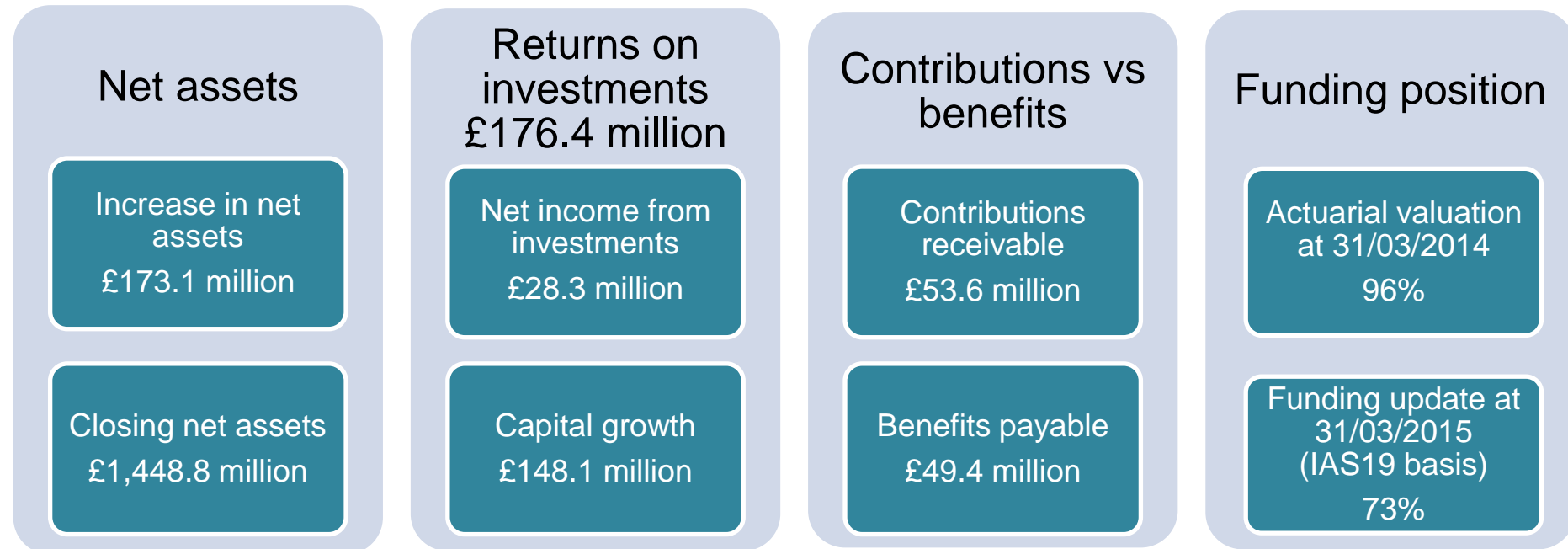
Issue	Resolution
<p><b>2. Intercompany accounts:</b> in last year's audit we highlighted weaknesses with the administration of the intercompany accounts between the Pension Fund and the Council. Finance staff continued to work on the reconciliation of these accounts throughout 2014/15. A number of areas requiring transfer of funds were identified but amounts were not paid across before the end of the financial year. A net creditor of £2.687 million has been included in the audited accounts to be paid to the Council in 2015/16.</p>	<p>We reviewed the reconciliation during 2014/15 and are satisfied that the amount included in creditors (£2.687 million) is due to the Council. Procedures have been revised during 2014/15 to simplify the intercompany accounting between the Pension Fund and the Council.</p>
<p><b>3. Accounting for strain on the fund contributions from employers:</b> the unaudited accounts did not contain any long term debtors for strain on the fund costs due from employers who had elected to pay these contributions in a number of instalments. The Pension Fund should account for the income due in full in the year in which the liability on the employer arises. Any amount due in the year but unpaid should be classified as short term debtors and amounts not due until future years as a long term debtors.</p>	<p>The audited accounts have been amended to include £1.428 million of strain on the fund costs due to be paid by employers over the next 4 years. The impact of this adjustment was to increase contributions receivable by £1.428 million, long term debtors by £0.567 million and short term debtors by £0.861 million.</p>

## Future accounting and auditing developments

### Revisions to the Code of Practice

21. The financial statements of the Pension Fund are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which interprets and adapts International Financial Reporting Standards (IFRS) to the local authority context. There are no significant changes to accounting requirements introduced by the 2015/16 Code which impact on Pension Fund accounts.

# Financial management and sustainability



## Financial management

22. As auditors, we need to consider whether pension funds have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
- the Proper Officer has sufficient status to be able to deliver good financial management
  - financial regulations are comprehensive, current and promoted within the Pension Fund
  - reports monitoring performance against budgets are accurate and provided regularly to budget holders
  - monitoring reports do not just contain financial data but are linked to information about performance
  - members provide a good level of challenge and question budget holders on significant variances.
23. The Director of Finance, as section 95 officer for the Council and a member of the Council's Executive Leadership Team, has sufficient status to oversee the financial management of the Pension Fund .
24. The financial regulations of the administering authority, The Highland Council, apply to the Pension Fund. These are reviewed regularly and are available on the Council's website. We reviewed the regulations, as part of our 2014/15 audit of the Council, and concluded that they were comprehensive.

25. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management. The Pension Fund does not prepare a separate annual budget for its administration costs or management fees. These are instead subsumed within the Finance Service's revenue budget and monitored as part of the overall Finance budget. As a result, only limited financial information is provided to Pensions Committee members at their quarterly meetings.

### Action plan no. 2

26. Investment performance reports are submitted to the Investment Sub-Committee. These reports are comprehensive, providing performance information against benchmarks at both a Pension Fund and investment manager level.

## Conclusion of financial management

27. The Pension Fund's financial management arrangements require improvement. The absence of agreed budgets for administration costs and management fees means that regular monitoring of expenditure and income against agreed budgets does not take place.

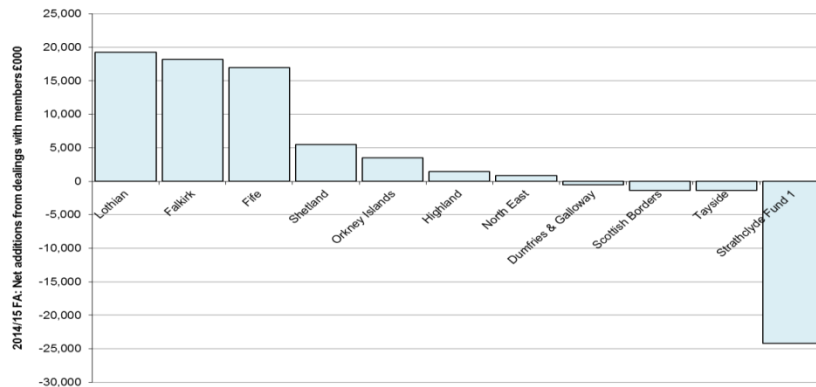
## Financial performance and sustainability

28. In this section we comment on the Pension Fund's financial outcomes and assess its financial position.

## Financial outcomes

29. The net assets of the Pension Fund grew by £173 million during 2014/15 to £1,449 million as at 31 March 2015. Only £4.2 million of this increase came from dealings with members (Exhibit 2).

### Exhibit 2: Net additions from dealings with members 2014/15

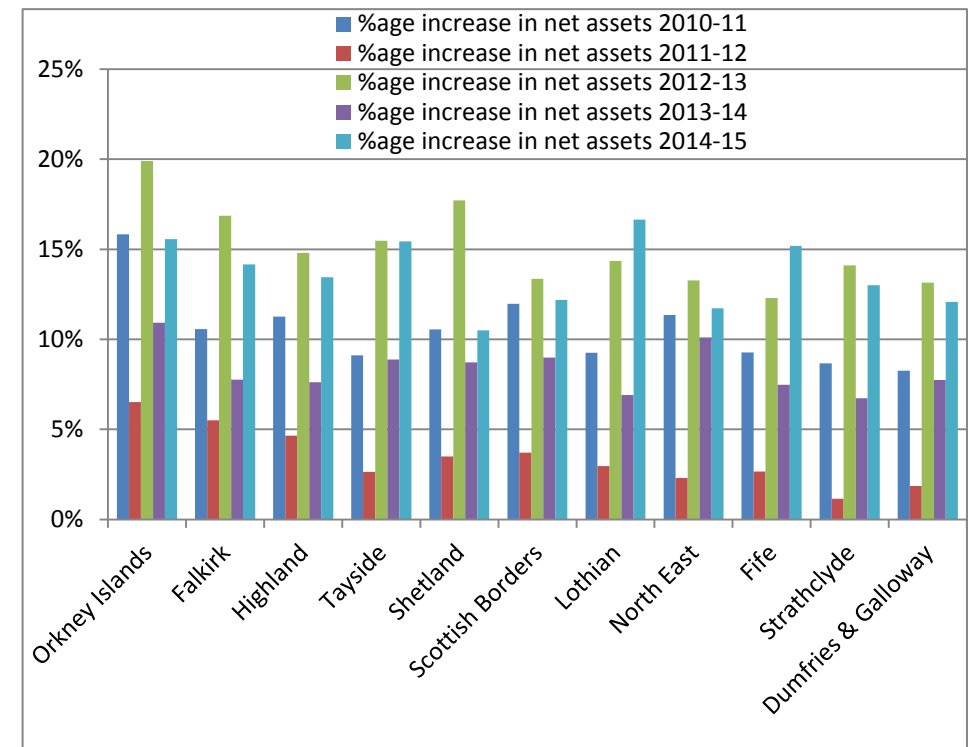


Source: Audit Scotland analysis of unaudited pension fund accounts

30. Dealings with members are down £2.7 million from last year, due mainly to a £4.3 million increase in benefits payable. Contributions, however, continued to exceed benefits payable in 2014/15.

31. During 2014/15, the market value of the Pension Fund grew by 13.6%, which is below its customised benchmark (14.4%). Growth over the five year period, however, exceeded benchmark by 0.6%. Exhibit 3 shows how the Pension Fund compares to the year on year increase in net assets for all Scottish funds.

### Exhibit 3 – Year on year increases in net assets over time



Source: Audit Scotland analysis of unaudited pension fund accounts

## Funding position

32. The result of the latest triennial valuation of the Pension Fund as at 31 March 2014 was reported to the Pension Committee in February 2015. Exhibit 4 sets out the movements since the previous triennial valuation as at 31 March 2011. This shows that, overall, there has been a slight reduction in the Pension Fund's funding position since the last triennial valuation. The actuary's report highlights that this is mainly due to the decrease in the real gilt yield which increased the value placed on the Pension Fund's liabilities.

### Exhibit 4: Movement between triennial valuations

	2014 Valuation	2011 Valuation
	£m	£m
<b>Assets</b>	1,279	991
<b>Liabilities</b>	1,331	1,024
<b>Net surplus/(liability)</b>	(52)	(33)
<b>Funding Level</b>	96.2%	96.8%

Source: The Highland Council Actuarial Valuation as at 31 March 2014

33. Experience since the 2014 triennial valuation has been worse than expected as real bond rates have fallen dramatically and the effect of this has only been partially offset by the effect of strong asset returns. As a result, funding levels are likely to have deteriorated and deficits increased over the period.
34. The funding level set out in the 2014/15 financial statements (Exhibit 5) is an interim valuation for accounting purposes which uses different actuarial assumptions from those used in the triennial valuation to estimate the present value of the Pension Fund's liabilities.

### Exhibit 5: Snap-shot of assets and liabilities (IAS19 basis)

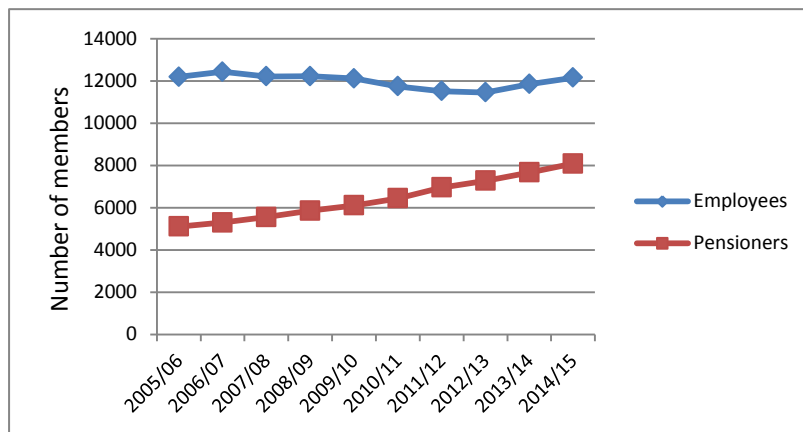
	2015	2014
	£m	£m
<b>Assets</b>	1,447	1,276
<b>Liabilities</b>	1,988	1,779
<b>Net surplus/(liability)</b>	(541)	(503)
<b>Funding Level</b>	73%	72%

Source: Highland Council Pension Fund financial statements

35. This shows that valued on an IAS19 basis the funding level is relatively static when compared to the previous year.

36. The Pension Fund's membership profile shows a small increase in pensioners whilst the proportion of active members remains relatively stable (Exhibit 6). As noted at paragraph 30, contributions receivable continue to exceed benefits payable and so there is net investment into the Pension Fund.

#### Exhibit 6: trends in membership



Source: Highland Council Pension Fund financial statements

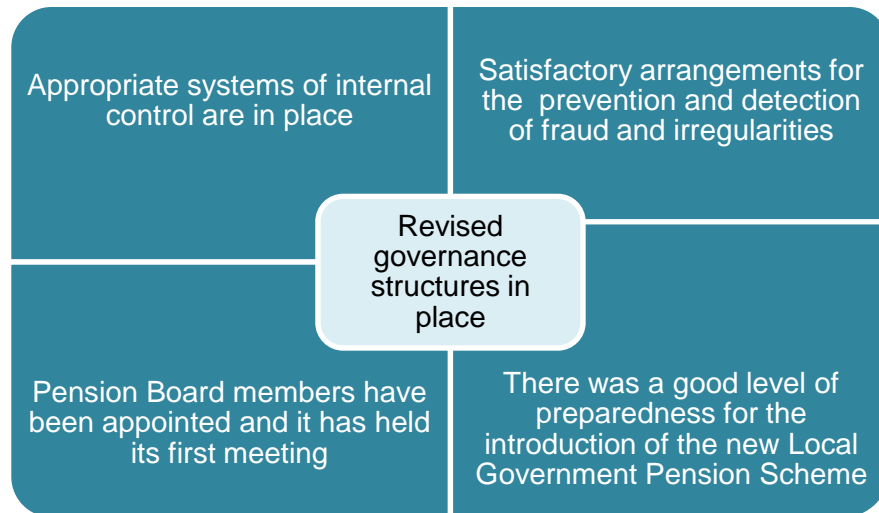
### Conclusion on financial sustainability

37. The Pension Fund's financial position is secure for the medium to longer term. Regular triennial valuations set the employers' contributions level to recover any deficit over the following 20 years. In addition, the membership profile of the Pension Fund means that contributions continue to exceed pension payments enabling more investment into the Pension Fund.

38. As the scheme matures, and the value of pensions in payment continues to rise, there will come a point when the investment strategy may have to be altered to stabilise income. This is likely to be many years in the future. For now, the higher than benchmark exposure to equities provide protection from inflation, although this also exposes the Pension Fund to volatility in annual net assets valuations.



# Governance and transparency



39. Members of The Highland Council, as administering authority, and the Director of Finance are responsible for establishing arrangements for ensuring the proper conduct of the affairs of the Pension Fund and for monitoring their adequacy and effectiveness.

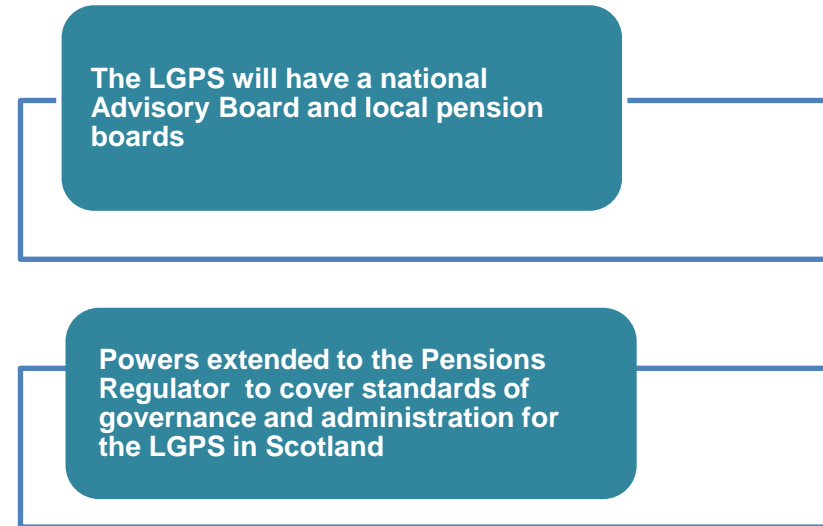
## Corporate governance

40. The Pension Fund's corporate governance framework is determined by the Council, as administering authority. The Council has delegated overall responsibility for the strategic direction of the Pension Fund to the Pensions Committee supported by the Investment Sub-Committee.
41. From 1 April 2015, the Local Government Pension Scheme (Scotland) Regulations 2014 changed the basis for calculating pension benefits from final salary to Career Average Revalued earnings, known as the CARE scheme. Under the CARE scheme:
  - benefits from 1 April 2015 will build up on a career average basis at the rate of 1/49th of annual pensionable earnings
  - normal pension age will be aligned with each member's own State Pension Age.
42. During 2014/15, pension administration staff continued to build on work commenced in 2013/14 in preparation for the introduction of the new CARE scheme. As a result, the Pension Fund was well prepared for the introduction of the new scheme on 1 April 2015.

## Revised governance arrangements

43. The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 (2015 Regulations) set out the new governance arrangements required from 1 April 2015 (Exhibit 7). At a national level this established a Scheme Advisory Board to provide advice to:
- Scottish Ministers on proposed changes to the LGPS (Scotland)
  - scheme managers or the scheme’s pension boards on the effective and efficient administration of the scheme and any funds within the scheme.
44. The 2015 Regulations also introduced the requirement for pension funds to set up a Pensions Board which would be responsible for assisting the administering authority in complying with scheme regulations and the requirements of the Pensions Regulator.
45. The inaugural meeting of Highland Council Pensions Board was held on 4 September 2015 with the first joint meeting with the Pensions Committee scheduled for 24 September 2015. The Pensions Board, in line with the model constitution issued by Scottish Ministers, will consist of equal numbers of scheme employer representatives and trade unions (4 from each side).

### Exhibit 7: 2015 governance arrangements



Source: *Local Government Pension Scheme (Governance) (Scotland) Regulations 2015*

## Internal control

46. The Pension Fund’s financial systems are provided by the administering authority and its financial ledger, accounts payable and payroll systems are used to process its transactions. We were able to take assurance from our audit of the Council that high level financial controls that impact on the Pension Fund’s financial statements operated effectively during the year.

47. We also reviewed key controls relating to the pension administration systems. Our overall conclusion was that the Pension Fund had appropriate systems of internal control in place during 2014/15 except for those relating to the operation of the intercompany accounts with the Council (refer paragraph 20, issue 2 for details).
48. Audit testing identified that two payments were made from the Highland Council bank accounts rather than Pension Fund bank accounts in error during the year. The first occurred when the new BACS software was set up and the pensions payroll was erroneously linked to the Council's bank account number. The second was incorrectly processed by the Council's IT provider. Both these errors were picked up by the Council's Treasury team and arrangements were made to reimburse the Council's bank account.

## Internal audit

49. Internal audit provides members and the Director of Finance with independent assurance on the overall risk management, internal control and corporate governance processes for the funds. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on their work.
50. Our review of internal audit concluded that the Pension Fund's internal audit service operates in accordance with the majority of the Public Sector Internal Audit Standards. In order to achieve full compliance an external assessment is required to take place every five years or less. The Scottish Local Authorities Chief Internal Auditors Group has developed a framework for this assessment and plans are in place for West Dunbartonshire Council to assess the Council's internal audit service, who also audit the Pension Fund, during 2015/16.
51. We placed formal reliance on internal audit's work on pension investments, and on the focused testing undertaken to support the Head of Audit and Risk management's opinion on the internal control system.

## Risk management

52. Risk management is an essential part of the Fund's approach to corporate governance. The Pension Fund's Financial Strategy Statement identified the key risks which could impact on the achievement of the Pension Fund's objectives.
53. A risk register has been prepared for the Pension Fund based on the CIPFA guidance '*Management of Risks in the Local Government Pension Scheme*'. Plans are in place to submit a risk management policy and statement for approval to the September 2015 meeting of the Pensions Committee. The updated risk register will also be considered at that meeting.

## Arrangements for the prevention and detection of fraud

54. The Pension Fund's arrangements for the prevention and detection of fraud and irregularities are satisfactory. No issues have been identified by us for inclusion in this report.

## Arrangements for maintaining standards of conduct and the prevention and detection of corruption

55. The Pension Fund's arrangements for the prevention and detection of corruption are satisfactory and we are not aware of any specific issues that need to be recorded in this report.

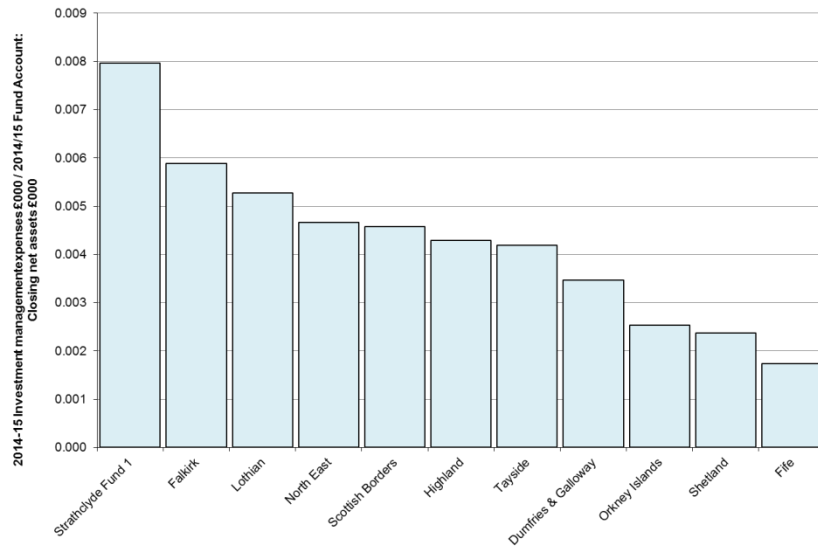
## Transparency

56. Meetings of the Pensions Committee are advertised on the Council's website and agendas, supporting papers and minutes are made available in advance of all meetings. Pensions Committee meetings are filmed and broadcast over the internet on the Highland Council website, and available for viewing for 12 months after the date of the meeting.
57. The Pension Fund has a website for communication and interaction with members. A newsletter is also produced.

## Management costs

58. The cost of administering pension funds has come under increasing scrutiny in recent years. In order to enable the sector to consider the effectiveness of pensions administration, there was a need to improve the transparency of reporting through better data comparison and more complete reporting of costs.
59. In response, CIPFA's new guidance on accounting for local government pension scheme management costs set out a common methodology for the classification and accounting of management costs. This included guidance for dealing with the more complex investment areas where fees have been hidden in the past. For example, fees in fund of funds were previously included within the value of the asset rather than being separately identified in the Pension Fund account.
60. The guidance was applied from 2014/15 and should provide a framework for better data comparison. Exhibit 8 sets out a comparison of the management fees across the Scottish funds as set out in their 2014/15 unaudited accounts. This will provide a useful trigger for further discussion as it will take time to resolve the technical aspects which invariably come to light when new guidance is first applied in practice.

**Exhibit 8: Management fees**



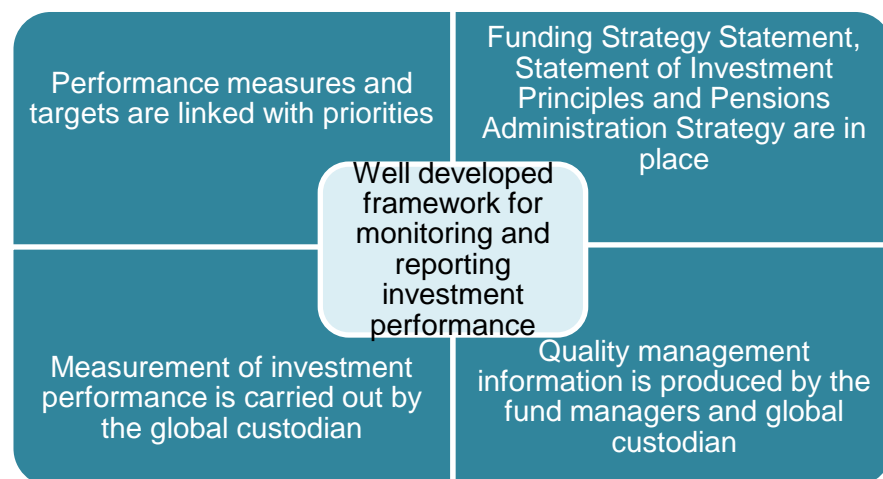
Source: Technical Services Unit Pension Fund Database

61. We are satisfied with the Pension Fund’s approach to applying the new CIPFA guidance this year.

**Outlook**

62. Meeting the requirements of the new regulations has been a significant workload for Pension Fund staff. With a new scheme in place, and the establishment of the Pension Board, there is an opportunity to review implementation and make any necessary changes. The governance framework has been strengthened but to operate effectively it needs to become embedded and include appropriate challenge from management and members.

# Best Value



63. Administering authorities have a specific responsibility to ensure arrangements have been made to deliver best value in the services they provide. This requires continuous improvement while maintaining a balance between quality and cost and having regard to value for money, equal opportunities and sustainability. There is also the duty to report performance publicly so that stakeholders know what quality of service is being delivered and what they can expect in the future.
64. The Pension Fund has a Pensions Administration Strategy which includes service level standards for the performance of the administering authority based on industry standard performance indicators. Performance against these targets is set out in the 2014/15 financial statements.

65. A Statement of Investment Principles is also in place which sets out the operational framework for the Pension Fund's investments and a Funding Strategy Statement which details how the Pension Fund intends to meet its financial obligations. These documents link the Pension Fund's investment strategy to long term funding needs and define performance criteria.
66. The main mechanism for measuring investment performance is through the analysis of the returns achieved by the Pension Fund's five external fund managers. The managers' performance, in terms of achieving benchmarks, is subject to independent verification by the appointed advisers (AON Hewitt) and managed through the investment mandates held by the specialist fund managers.
67. Performance monitoring is provided by the Pension Fund's global custodian, Northern Trust. Performance against benchmarks is reviewed each quarter by Finance staff and is reported quarterly to the Investment Sub-Committee.

## Exhibit 9: Investment performance

	Year 1	Year 3	Year 5
<b>Pension Fund</b>	13.6%	11.9%	9.9%
<b>Benchmark</b>	14.4%	11.5%	9.3%

Source: Highland Council Pension Fund financial statements

68. Exhibit 9 shows the one, three and five year results against benchmarks for the Pension Fund . Investment returns have outperformed the Pension Fund 's benchmark over a three and five year period. Returns over the year to 31 March 2015 fell below the benchmark at 13.6%.

## National performance audit reports

69. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and Auditor General for Scotland. During 2014/15 no reports were issued which directly related to pension funds. A number of local government reports were, however, issued during the year and some of the topics covered may be of interest to members including:
- Scotland's public finances – a follow up: Progress in meeting the challenges (June 2014)
  - Update on developing financial reporting (March 2015)
  - An overview of local government in Scotland (March 2015).
70. These and other Audit Scotland reports are available on Audit Scotland's website ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)).

# Appendix I

## Significant audit risks

The table below sets out the audit risks we included in our annual audit plan and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Management assurance and audit procedures	Results and conclusions
<b>Financial Statements Opinion Risks</b>		
<p><b>Intercompany accounts:</b> our 2013/14 audit identified a number of concerns regarding the operation and management of the intercompany accounts used to manage transactions between the Council and the Pension Fund which required considerable additional audit input to enable us to agree what revisions were required to the unaudited financial statements.</p>	<p><b>Management Assurance</b></p> <p>The intercompany accounts have been reviewed up to December 2014 with a view to identifying and resolving issues prior to the year end. Plans are in place to share this work with external audit so that any emerging issues can be identified and resolved prior to the preparation of the financial statements.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• early financial statements planning meeting</li> <li>• increased audit testing in this area</li> <li>• early discussion of emerging issues.</li> </ul>	<p>Finance staff continued to work on the reconciliation of the intercompany accounts throughout 2014/15. We reviewed the work done on the reconciliation during 2014/15 and are satisfied that the amount included in creditors (£2.687 million) is due to the Council. Procedures have been revised during 2014/15 to simplify the intercompany accounting between the Pension Fund and the Council.</p>



Audit Risk	Management assurance and audit procedures	Results and conclusions
<p><b>Management and supervision of the accounts preparation process:</b> the Council's current financial management system is being replaced with effect from 1 April 2015. Implementation of this major project is being managed by the Finance Manager who has taken over responsibility for delivery of the Pension Fund's accounts for the first time this year. There is a risk that the Finance Manager will not have sufficient capacity to deliver both the project, and the Pension Fund accounts to the required quality and agreed timescales.</p>	<p><b>Management Assurance</b></p> <p>The Finance Manager will be involved in the accounts closedown process but, if required, will draw on support from the Head of Service and the Finance Manager (Accounts and Central Services).</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• early financial statements planning meeting</li> <li>• early discussion of emerging issues.</li> </ul>	<p>The financial statements submitted for audit did not fully comply with the requirements of the new accounting regulations. In addition, some of the notes to the financial statements had not been updated for changes to the prior year comparative figures for management fees included within the Pension Fund Account. The accounts contained several references to the 2011 actuarial valuation despite the 2014 valuation being completed prior to the year end and presented to members of the Pensions Committee in February 2015. In our opinion, a more robust review process needs to be put in place in future years to improve the quality of the financial statements submitted for audit.</p>

Audit Risk	Management assurance and audit procedures	Results and conclusions
<p><b>Management costs:</b> the cost of administering the LG PS has come under increasingly intense scrutiny in recent years, and in June 2014, CIPFA issued guidance '<i>Accounting for local government pension scheme management costs</i>' setting out recommended best practice in this area. The Pension Fund plans to adopt this guidance and revise how it discloses management costs within its 2014/15 accounts.</p>	<p><b>Management Assurance</b></p> <p>Management costs will be disclosed in line with the CIPFA guidance within the 2014/15 financial statements. Disclosures for 2013/14 have been restated to comply with the guidance and this work has been shared with external audit so that emerging issues can be identified and resolved prior to the preparation of the financial statements</p> <p>Administration costs are reported against budget to the Pension Committee.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• early financial statements planning meeting to discuss the CIPFA guidance</li> <li>• review of revised disclosures (including prior year comparatives) within the 2014/15 accounts for compliance with the guidance</li> <li>• early discussion of emerging issues.</li> </ul>	<p>Finance staff did some early work on restating the prior year comparatives for management costs. We reviewed the methodology they employed prior to the preparation of the 2014/15 financial statements and this helped smooth the final accounts audit process. Overall, we are satisfied with the Pension Fund 's approach to applying the new CIPFA guidance.</p>

Audit Risk	Management assurance and audit procedures	Results and conclusions
<p><b>Annual governance statement:</b> the revised Local Authority Accounts Regulations require authorities to undertake an annual review of their system of internal control and report this in an Annual Governance Statement. The Pension Fund has previously included a statement on the system of internal financial control instead of a wider annual governance statement within its accounts.</p>	<p><b>Management Assurance</b></p> <p>An Annual Governance Statement will be included in the unaudited financial statements. This will include the results of Internal Audit's review of the adequacy and effectiveness of the Pension Fund's framework of governance and control as set out in the Head of Audit's Statement on Internal Control.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• early financial statements planning meeting</li> <li>• early discussion of emerging issues.</li> </ul>	<p>The unaudited accounts submitted for audit include a document entitled 'Annual Governance Statement' but this did not comply with the CIPFA guidance 'Delivering good governance in local government'. It has since been updated to reflect the requirements of the guidance.</p>

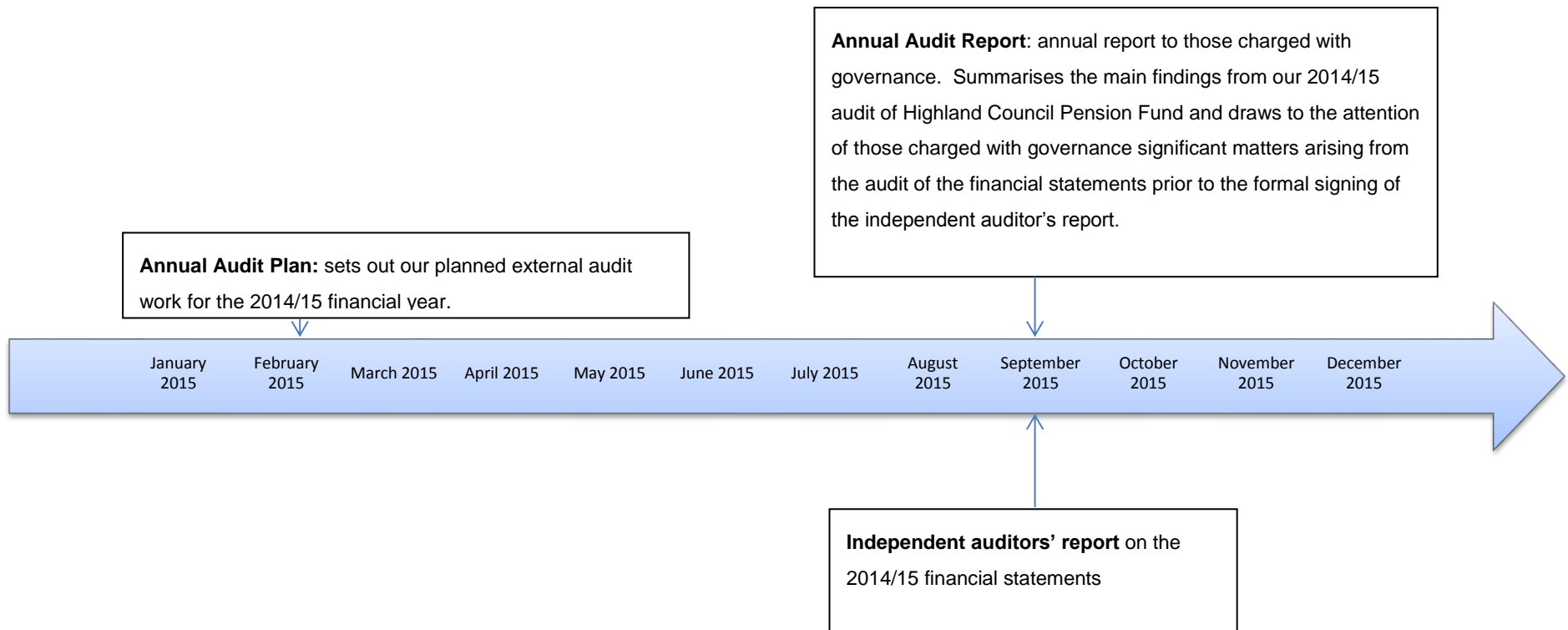
Audit Risk	Management assurance and audit procedures	Results and conclusions
<p><b>Management override of controls:</b> as stated in ISA 240, management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p>	<p><b>Management Assurance</b></p> <p>There is no history of reported fraud within the Pension Fund</p> <p>Each year Internal Audit considers and tests the adequacy and effectiveness of the Pension Fund's framework of governance and control, including arrangements for the prevention and detection of fraud.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• detailed testing of journal entries</li> <li>• review of accounting estimates for bias</li> <li>• evaluating significant transactions that are outside the normal course of business.</li> </ul>	<p>We undertook detailed testing of journal entries as part of our audit of debtors and creditors and the intercompany accounts. We found no evidence to suggest that management were overriding controls.</p> <p>We also reviewed accounting estimates included in debtors, creditors, and private equity balances and found no evidence of bias in these accounting estimates.</p> <p>Audit testing did not find any evidence of transactions outwith the scope of the Pension Fund .</p>
<p><b>Valuation of private equity investments:</b> the Pension Fund's investment portfolio includes private equity funds which are much more complex to value than independently quoted investments. As private equity funds are a material balance within the Pension Fund's accounts, we have identified the valuation of these funds as a specific risk to our opinion on the financial statements.</p>	<p><b>Management Assurance</b></p> <p>Private equity funds will continue to be valued in line with industry standards.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• review the approach adopted in the valuation of such investments</li> <li>• inspect documentation relating to data sources used by the Pension Fund.</li> </ul>	<p>We reviewed the approach adopted to value private equity investments and examined supporting documentation including fund manager internal control reports and the private equity fund's financial statements. Using the private equity fund's management accounts to 31 March 2015 we calculated the Pension Fund 's share of their net asset value which gave us assurance over the private equity figure included in the accounts. We concluded that we could place reliance on the Fund manager's valuation.</p>

Audit Risk	Management assurance and audit procedures	Results and conclusions
<p><b>Local Authority Accounts (Scotland) Regulations:</b> the audited accounts require to be considered and approved for signature by the Pensions Committee by 30 September. Last year, we were unable to meet the audit timetable set out in our Annual Audit Plan due to delays in responding to audit queries raised and the additional audit work required on intercompany accounts and year end journals.</p>	<p><b>Management Assurance</b></p> <p>Officers are aware of the requirements of the new accounting regulations and are planning ahead to ensure full compliance with these</p> <p>Early sight of the detailed audit plan will assist the Finance Team meet the new deadlines.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• early financial statements planning meeting</li> <li>• early discussion of emerging issues.</li> </ul>	<p>A meeting of the Pensions Committee is scheduled for 24 September 2015 to allow members to consider the audited accounts for approval and signature prior to the deadline. Working papers supporting the unaudited accounts were of a good standard which enabled the audit to progress smoothly.</p>
<p><b>Wider Dimension Risks</b></p>		
<p><b>Pension Reform (LGPS 2015):</b> the Public Service Pension Act 2013 and associated regulations replaces the current final salary scheme with a career average revalued earnings scheme with effect from 1 April 2015. The new scheme is more complex and will require systems and processes to be updated during 2014/15 in preparation for 1 April 2015.</p>	<p><b>Management Assurance</b></p> <p>The Pensions Team fully understands and is well prepared for the changes to the LGPS.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• discuss progress and implementation of LGPS 2015 with officers</li> <li>• review changes to the pension administration control environment in response to LGPS 2015 data requirements.</li> </ul>	<p>We monitored the Pension Fund 's preparations for the introduction of the new career average revalued earnings scheme with effect from 1 April 2015 through discussions with officers and review of Committee reports and concluded that the Pension Fund was well prepared for its introduction.</p>

Audit Risk	Management assurance and audit procedures	Results and conclusions
<p><b>Governance arrangements:</b> the Highland Council is the administering authority of the Pension Fund. Pensions matters are currently delegated to a Pensions Committee and an Investment Sub-Committee which has responsibility for management and investment of the assets of the Pension Fund. The Public Service Pension Act 2013 Act introduces more prescriptive governance arrangements for pension schemes including the requirement for administering authorities to establish a Pensions Board responsible for compliance with legislation and requirements imposed by the Pensions Regulator.</p>	<p><b>Management Assurance</b></p> <p>A report on changes to the Pension Fund's governance arrangements will be presented to the Council in March.</p> <p><b>Audit procedures</b></p> <ul style="list-style-type: none"> <li>• continue to monitor the arrangements for governance of the Pension Fund.</li> </ul>	<p>We monitored the progress made by the Pension Fund in preparing for the new governance arrangements, including the establishment of a Pensions Board. The Pensions Board met for the first time on 4 September 2015 and will hold its first joint meeting with the Pensions Committee on 24 September 2015. The Board will, in line with the model constitution issued by Scottish Ministers, consist of equal numbers of scheme employer representatives and trade unions (4 from each side).</p>

# Appendix II

## Summary of The Highland Council Pension Fund local audit reports 2014/15



# Appendix III

## Action plan

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
1 8/8	<p><b>Issue</b></p> <p>The financial statements submitted for audit did not fully comply with the requirements of the new accounting regulations. In addition, some of the notes to the accounts had not been updated for changes to the prior year comparative figures for management fees included within the Pension Fund Account. The accounts contained several references to the 2011 actuarial valuation despite the 2014 valuation being completed by the year end.</p> <p><b>Risk</b></p> <p>The financial statements do not give a clear view of the Pension Fund's governance arrangements or financial position.</p> <p><b>Recommendation</b></p> <p>A more robust review process needs to be put in place in future years to improve the quality of the financial statements submitted for audit.</p>	<p>There are timing pressures on finance staff to meet the deadlines required for the submission of the accounts for audit.</p> <p>Reviews of the unaudited accounts were undertaken, however, it is accepted that in several areas the guidance was not fully complied with.</p> <p>The 2014 valuation sets the direction of the Pension Fund and the employer contribution rates for financial years 2015/16 to 2017/18 and therefore the most relevant valuation for the 2014/15 accounts is 2011.</p> <p>Every effort will be made to improve the review process in future years.</p>	Finance Manager	30 June 2016



No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
2 14/25	<p><b>Issue</b></p> <p>The Pension Fund does not prepare a separate annual budget for its administration costs or management fees. These are instead subsumed within the Finance Service's revenue budget and monitored as part of the overall Finance budget. As a result, only limited financial information is provided to Pensions Committee members at their quarterly meetings.</p> <p><b>Risk</b></p> <p>Members are not able to adequately scrutinise the Pension Fund's financial performance.</p> <p><b>Recommendation</b></p> <p>A separate budget should be set for administration costs and management fees and progress against budget reported to each Pensions Committee meeting.</p>	<p>The Council's budgetary control system requires the Council's budget to be broken down into cost centres and for those costs centres to be managed by a budget holder.</p> <p>The pensions investment team and the pensions administration team form part of the Head of Corporate Finance's budget responsibilities.</p> <p>A budget holder has the flexibility to vire between the cost centres under their control, therefore, a significant change to the Council's budgetary control arrangements would be required to separate out these two budget headings so no change is proposed to the current budgetary control arrangements.</p> <p>A finance report will be developed for members of the Pensions Committee.</p>	Head of Corporate Finance	31 March 2016