



Highland Council Pension Fund

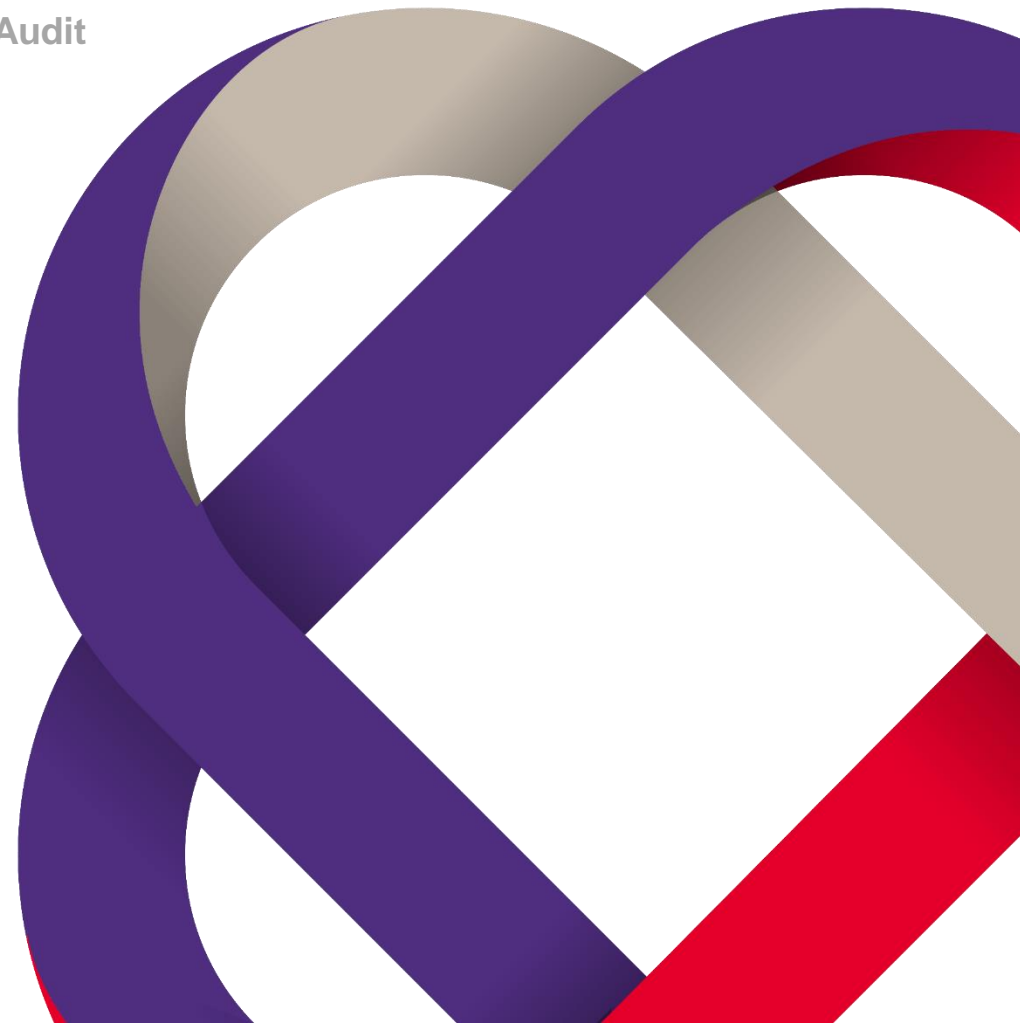
External Audit Report for the financial year ended 31 March 2020

Annual Report to the Pensions Committee and the Controller of Audit
– 23 September 2020

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Financial statements at a glance



The unaudited Annual Report and Accounts were presented for public inspection on 25 June 2020. In accordance with our annual external audit plan our audit work commenced on 27 July 2020. Due to the travel restrictions and social distancing measures introduced by the government in response to the Covid-19 pandemic, we have delivered the audit remotely. We thank management for their support and assistance throughout the audit.



The Management Commentary is in line with our understanding of the Pension Fund and in particular their vision and strategic priorities. The Governance Statement, included within the Accountability Report, outlines the governance framework.

The Remuneration report has been prepared in accordance with the Local Authority Accounts (Scotland) regulations 2014.



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

An audit
underpinned by
quality and adding
value to you



We [plan to] issue an unmodified audit opinion on the annual report and accounts. Our audit opinion includes an emphasis of matter paragraph in relation to the material uncertainty over the valuation of property investments arising as a result of Covid and the forecasted economic downturn.



Significant audit risks are: management override of controls and the risk of fraud in revenue recognition as set out in International Standards on Auditing (ISAs UK) and the valuation of level 3 investments as at 31 March 2020. An additional significant audit risk was identified in relation to Covid-19 which caused significant disruption to all public sector entities in the later half of March 2020.



We updated our audit materiality to reflect your 2019/20 draft financial statements setting materiality £18.922 million being approximately 1% of net assets. We apply a lower materiality of £920,000, being 1.5% of total income (contributions and transfer income) to cover specific Pension Fund Account balances and short term creditors, debtors and cash account. This is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements.

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Adding value through our external audit work

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

As appointed auditors of the Highland Council, the Pension Fund’s administrators, we have utilised our knowledge and understanding of key business processes to support our audit work of the Pension Fund. This has been beneficial to the audit process particularly when undertaking audit procedures remotely. Our audit work has involved engagement and challenge of the Pension Fund’s Fund Managers throughout the process to gain assurance around the valuation process and balances held at 31 March 2020.

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Introduction

Reporting

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2020.

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

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

Once the signed annual report and accounts is laid in parliament this report will be made publicly available on the Audit Scotland website (www.audit-scotland.gov.uk).

Our report will be presented as a draft to the Pensions Committee on 23 September 2020 and will be finalised following signing of the accounts.

We would like to thank Pension Fund Officers for an effective year-end audit process and all their support and assistance in the audit process.

Status of the audit as at 2 September 2020

Our audit procedures over the Pension Fund accounts are substantially complete subject to the following audit procedures:

- Final disclosure review of the financial statements;
- Updated IAS 26 valuation to reflect McCloud remedy;
- Subsequent events (up to the date of signing);
- Pension Fund representations;
- Engagement leader file review

Structure of this report

As set out in our Audit Plan, In accordance with the Audit Scotland Code of Practice 2016, we consider the Pension Fund meets the smaller body definition. Therefore full wider scope is not considered relevant.

However, as required in the Code of Audit Practice our report concludes on our audit of the annual report and accounts and certain aspects of the Pension Fund's arrangements as follows:

Financial statements including the Management Report and governance statement (including the governance compliance statement) – Section 1

Disclosures in the governance statement and financial sustainability of the Pension Fund – Section 2 and 3.

Our Opinion

For the financial year ended 31 March 2020 we plan to issue an **unmodified audit opinion**:

- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2019/20 code
- prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003
- Other information in the annual report including Annual Governance Statement
- Other prescribed matters

Emphasis of matter – property valuation

We draw attention to the Pension Fund's annual accounts Note 6 to the financial statements, which describes the basis for valuing level 3 property investments. The Pension Fund use external fund managers to value their investments. The expert's valuation included a 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently less certainty and a higher degree of caution should be attached to Officer's valuation than would normally be the case. Our opinion is not modified in respect of this matter.

Materiality

Our audit approach was set out in our audit plan presented to the Pensions Committee on 19 March 2020 and finalised on 31 March 2020. We updated our audit materiality to reflect your 2019/20 draft financial statements setting materiality £18.922 million being approximately 1% of net assets. We apply a lower materiality of £920,000, being 1.5% of total income (contributions and transfer income) to cover specific Pension Fund Account balances including , being 1.5% of total contributions paid to cover specific transactions and balances including: contributions to the scheme; transfers in to the scheme; benefits paid or payable including payments to leavers; management expenses; short term debtors, creditors and bank accounts where we have recognised an increased risk of misstatement. This is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements.

We report to Officers and those charged with governance any difference identified over £250,000 (Trivial capped at £250,000 by Audit Scotland).

Internal Audit

As set out in our external audit plan our audit approach is to comply with the ISAs and we did not place formal reliance on the work of the Pension Fund's internal audit service during the year. The Highland Council's internal audit functions to provide internal audit services on behalf of the Pension Fund.

The overall annual internal audit opinion concludes that "reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems for the year to 31 March 2020." From our consideration of IA reports during the year, we did not identify any issues that would impact on our audit approach or require disclosure in the accounts.

Pensions protocol

In accordance with Audit Scotland planning guidance and pension auditor assurance protocols, as auditors of the Pension Fund we have provided independent assurances to Ernst and Young LLP (as auditors of Lewis Castle College, Inverness College, North Highland College and University of the Highlands and Islands) and Audit Scotland (as auditors of the Western Isles Council). We have received assurances from the auditors of scheduled and admitted bodies over contributions to the fund. These have included Audit Scotland (as auditors of Western Isles Council) and Saffery Champness (as auditors of Highlife Highland). As appointed auditors of the Highland Council we leverage of our audit work at these bodies.

The audit process

The unaudited accounts were published on 25 June 2020. In accordance with our annual external audit plan our audit work commenced on 27 July 2020. Due to the travel restrictions and social distancing measures introduced by the government in response to the Covid-19 pandemic, we have delivered the audit remotely.

There was one adjusted misstatement to the financial statements in relation to classification of investment income. There were no unadjusted misstatements either individually or cumulatively above our reporting threshold. (subject to completion of outstanding testing).

We identified disclosure adjustments in respect of the draft financial statements including updating the IAS 26 Actuarial present value of promised retirement benefits to reflect the proposed remedy to the "McCloud ruling", a court judgement that pension schemes were unlawful on the grounds of age discrimination that impacts on future liabilities of LGPS schemes.

See detail set out in Appendix 1.

Internal control environment

Throughout our audit planning and fieldwork we will continue to develop our understanding of the overall control environment (design) as related to the financial statements. In particular we will:

- Consider procedures and controls around related parties, journal entries and other key entity level controls, being those in place at the administering authority.
- Perform procedures around IT general controls.
- Perform walkthrough procedures on key controls around identified risk areas as well as those where there is a significant class of transaction being contributions payable, benefits payable and the recognition and valuation of investments
- Interim testing around the design of key controls in place over the pension fund.

Highland Council are the administering authority of the Pension Fund. We utilised our audit knowledge and understanding of the Council's controls over key financial processes to inform our audit work.

Responding to significant risks

Risk area	Identified audit risks at planning
Risk of fraud in Revenue recognition	<p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>For Investment income, we agree movements in the year to external third party verification through our testing of underlying investments and Fund Manager confirmations. Therefore, we do not consider risk of fraud in revenue recognition to represent a significant risk. Likewise for expenditure, operating expenses are not material in value and therefore do not represent a material risk of misstatement. Benefits paid to pensioners from the scheme are well forecast based on pensioner numbers and consistent year on year. Other benefits paid are not material and therefore limited opportunity for manipulation.</p> <p>For contributions receivable from employees and employers. While contributions are well forecast there is an inherent risk around material misstatement through improper revenue recognition. We consider the risk most prevalent to transactions around the year end where there may be greatest incentive of fraudulent misstatement. We therefore attach the significant risk over revenue recognition to contributions receivable.</p>

Work completed

- We developed an understanding of the design of controls in place at the Pension Fund for the recognition and recording of contributions received.
- We agreed monthly normal contribution totals to payroll reports and checked to the Pension Fund bank statements, to test they have been received by the Pension Fund for Highland Council contributions, and sample tested admitted and scheduled bodies contributions over a sample of months to gain assurance over amounts received.
- For a sample of Highland Council employees we recalculated contributions and confirmed the contribution rates were in accordance with LGPS regulations.
- We obtained independent assurances from Saffery Champness, the Auditors of Highlife Highland, and Audit Scotland, the Auditors of Western Isles Council around processes and controls in place over contributions payable to the fund. For other bodies we have sample tested contributions for all other bodies to confirm contributions received in year were materiality consistent with the required contribution rates per the most recent actuarial valuation (March 2017).
- Contributions were compared to expectations based upon the prior year taking into account any amendments to the contributions agreed, average pay rises and the impact of membership movements using analytical review procedures
- We reviewed the outstanding contributions receivable as at the 31 March 2020 and challenged the recoverability of amounts receivable post year end. Our testing will be performed at a significant risk level.

Our conclusion

Based on our testing we conclude **(subject to testing being complete and reviewed)**:

- We did not identify any deficiencies in the design of controls in place over contributions in year. There were no issues raised by either Audit Scotland or Saffery Champness around the arrangements in place at Western Isles Council and Highlife Highland over contributions payable to the scheme.
- We did not identify any exceptions in our cut-off testing of year end income.
- We did not identify any exceptions in the recoverability of contributions receivable at the year end.

Risk area

Identified audit risks at planning

Management override of controls

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 (Senior Officers) to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions.

We consider those key judgements that are most susceptible to significant audit risk of management override are those over the valuation of level 3 investments (see Significant risk – valuation of level 3 investments) and defined benefit pension scheme liability disclosures under IAS 26.

Work completed

Accounting estimates:

We assessed the risk of management override, consider those key accounting estimates and judgements that could impact on the organisations financial results and where there is an inherently increased risk of fraudulent misstatement or where management (Senior Officer) bias could result in a material misstatement. In particular we focused on estimates around material provisions, accruals and defined benefit obligations. In response to the significant audit risk we:

- considered the design of controls in place over key accounting estimates and judgements including: the valuation of level 3 investments and the valuation of defined benefit pension scheme obligations;
- Reviewed accounting estimates for management bias / indication of fraud that could result in material misstatement.

Journals testing:

We performed data interrogation procedures to identify journals that, based on our planning assessment, presented a higher risk of fraud or error. In response to the significant risk we:

- Assessed the design of controls in place over journal entries, including how these are prepared, authorised and processed onto the financial ledger;
- We risk assessed 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 that suitably recorded in the financial ledger;
- We performed targeted testing of transactions around the financial year end reviewing those journals are large or otherwise appear unusual to understand the rationale for the transaction.

Our conclusion

Based on our testing we conclude **(subject to review and conclusion of testing)**:

- There was no evidence of management override in our testing.
- The Council's draft financial statements identify significant areas of estimation and judgement including; valuation of investments and defined benefit pension scheme obligations disclosed in accordance with IAS 26. While we agree that Level 3 investments represent a critical areas of estimation uncertainty we do not consider this to apply to level 1 and level 2 investments where there is comparable market information available at 31 March 2020. We are satisfied that the disclosure does not materially impact the user of the account. We have not identified any indication of management bias or fraud in the estimates applied.
- During the audit the IAS 26 defined benefit pension liability disclosure required updating to reflect the UK Government proposed remedy to the pension obligations arising due to unfair discrimination case which is applicable to LGPS schemes (the McCloud case). The proposed remedy results in a lower than initially estimated liability to the Pension Fund. Officers obtained a revised IAS 26 actuarial valuation and this has been reflected in the revised accounts disclosure (appendix 1)
- We have not identified any unusual or inappropriate transactions during the course of the year that would indicate management manipulation of the financial results.

Risk area

Identified audit risks at planning

Level 3 Investments

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 2019 the Pension Fund held £342 million of Level 3 investments. Given the level of estimation and judgement around the valuation of these investments there is a significant risk of material misstatement.

Work completed

- We reviewed the Pension Fund's processes for valuing Level 3 investments and evaluate the design of the associated controls
- we have challenged the nature and basis of estimated values and considered what assurance senior officers have over the year end valuations provided for Level 3 investments.
- we assessed the competence and expertise of the fund managers as experts to value investments at year end and basis of the valuations at the year end.
- We reconciled the valuations reported in the draft financial statements to the Fund Manager valuation reports and the custodian report.
- We obtained independent assurances around the controls in place at the fund managers in undertaking the valuation of level 3 investments, including those in place up to 31 March 2020.
- We challenged the valuation reported as at 31 March 2020 by undertaking a comparison to valuations obtained as at 30 June 2020 to gain assurance that the balances held were in line with expectation.

Our conclusion

Based on our testing we conclude **(subject to review of testing)**:

- The controls in place at the Pension Fund were appropriately designed to ensure level 3 investments were appropriately recorded in the Pension Fund Accounts.
- Independent assurances were obtained on the controls in place at the Fund Managers in valuing the investments held
- The Royal Institute of Chartered Surveyors (RICS) have issued a valuation practice note regarding material uncertainties in valuations as a result of impacts to the market caused by Covid-19. The RICS Red Book defines material uncertainty as 'where the degree of uncertainty in a valuation falls outside any parameters that might normally be expected and accepted. Due to the impact of Covid-19 on markets, including reduced level of data points to support valuations, the Pension Fund's Fund Managers have reported their valuation advice for level 3 investments on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global Standards. Consequently, less certainty, and a higher degree of caution, should be attached to the valuation advice than would normally be the case. The Pension Fund have disclosed the material uncertainty within note 6 (Accounting policies). We have included an emphasis of matter paragraph within our independent audit report to highlight the matter to the reader of the accounts. Our audit opinion is not modified in respect of this matter.

Risk area

Covid-19

Identified audit risks at planning

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

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

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

Work completed





- Worked with Senior Officers to understand the implications the response to the Covid-19 pandemic has had on the organisation's ability to prepare the financial statements and update financial forecasts, and assessed the implications for our materiality calculations;
- Evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic;
- Evaluated whether sufficient audit evidence could be obtained through remote technology;
- Evaluated whether sufficient audit evidence could be obtained to corroborate significant estimates such as recovery of receivable balances; and
- Evaluated Senior Officer's assumptions that underpin the revised financial forecasts and the impact on Officers's going concern assessment.

Our conclusion




Based on our testing we conclude **[subject to final engagement leader review]**:

- Covid-19 and remote working did not restrict the Pension fund's ability to prepare the financial statements or restrict the audit evidence required to complete the audit.
- The potential risk of Covid-19 on the Pension Fund did not impact on our assessment of materiality.
- Officer's assumptions underpinning financial forecasts and the going concern assessment have adequately considered the potential impact of Covid-19.
- The Fund Managers reported a material valuation uncertainty relating to the valuation of Level 3 investment properties. The Pension Fund have disclosed this material valuation uncertainty within the accounts (see Significant Financial Statements Risk: Level 3 Investments).
- We have not identified any significant impact on the Pension Fund's debtor recovery, although acknowledge that the majority of these are with other public bodies
- During the audit we raised a disclosure adjustment for Officers to recognise the impact of Covid-19 within the governance statement and other sections of the annual report and accounts commentary on Covid and the impact on the governance arrangements (appendix 1).

Accounting policies

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	Contributions and transfer from other schemes	The Pension Fund is funded through funding contributions from members and employers and are accounted for on an accruals basis based on contribution rates as set by the fund actuary. Transfers from other schemes represent the amounts receive and paid during the year for members who have either joined or left the Fund during financial year and are calculated in accordance with the Local government Pension Scheme Regulations 2013. We are satisfied that these have been appropriately recorded in the financial statements.	 Green
Estimates	Assumptions made about future and other Major sources of Estimation uncertainty	The Pension Fund disclose areas of major sources of estimation uncertainty within the accounts. The Pension Fund disclose the following areas of estimation uncertainty around the actuarial valuation of pension liabilities as well as the valuation of investments (private equity, property debt and property). The financial statements include disclosure around the material valuation uncertainty surrounding the valuation of property investments.	 Green
Critical Judgements	Critical judgements	The Pension Fund includes disclosures around critical judgements made in applying accounting policies. These include: unquoted private equity investments; unquoted property debt investments; and, the judgements in the net pension fund liability calculated through the triennial valuation. In accordance with IAS, there are opportunities to enhance the disclosure to ensure to provide the reader greater clarity around the judgements made and impact of these. We are satisfied that these are not material to the accounts.	 Amber
Going concern	Financial statement prepared on a going concern basis	As set out in the Pension Fund's Accounting Policies, the financial statements have been prepared on a going concern basis. At its last formal actuarial valuation (31 March 2017) the Pension Fund was 101% funded with a surplus of £13 million. The Pension Fund has closing net assets of £1.89 billion with the present value of promised retirement benefits estimated at £2.247 billion. The Pension Fund continues to receive funding contributions from scheduled and admitted bodies, with Highland Council being the largest employer in the scheme. We are satisfied with the Pension Fund's conclusion that it represents a going concern.	 Green

Assessment

-  Marginal accounting policy which could potentially be open to challenge
-  Accounting policy appropriate but scope for improved disclosure
-  Accounting policy appropriate and disclosures sufficient

Narrative elements of your annual accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding and the financial statements and have set out our observations below. We have also audited the required information in the remuneration report (marked audited) and have no matters we wish to bring to your attention.

Management commentary

The information contained within the Management Commentary is consistent with the financial statements. Key issues and risk are well articulated within the report as well as fund performance for the year.

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

Overall Observations

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

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

Annual report

Annual Governance Statement

The information contained within the Annual Governance Statement is consistent with the financial statements. Following Audit review, Officers updated the Annual Governance statement to reflect the impact of Covid-19 on governance arrangements at the Pension Fund and the Council.

The administering authority has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles of the CIPFA/SOLACE framework 'Delivering Good Governance in Local Government'.

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

Governance Compliance Statement

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

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

The Pension Fund's financial arrangements

Financial management and investment performance

For the year to 31 March 2020, the Pension Fund reported a negative return on investments of -4.9%. This saw the Pension Fund's investments decrease in value from £1.991 billion to £1.885 billion. The Pension Fund has reported that this reflected continued uncertainty in the global economy and volatility in the financial markets. The ROI slightly outperformed against the Pension Fund's annual benchmark of -5.9%. The position for the year was significantly impacted by the downturn in the market in quarter four as a result of the global pandemic with the Fund delivering a negative performance of -12.2% in the final quarter to March 2020.

Over the longer term, the Pension Fund has reported investment performance has been strong, outperforming the benchmark by 1% per annum over the last five years to 31 March 2020. The Pension Fund recognise the risks surrounding investment performance. The current global uncertainty, particularly acute due to the uncertainty surrounding the longer term impact of covid-19. Similarly, the uncertainty surrounding the potential impact of EU withdrawal including inflationary pressures and capital value loss on UK property, could impact on the Pension Fund's performance. In response, the Pension Fund continue to explore changes to the strategic asset allocation to help mitigate potential exposure to risks over the coming year. Operationally, fund performance is monitored through the Investment sub-committee and Pensions Committee. We found evidence of scrutiny of fund performance during the year.



Financial sustainability

The pension fund gives its members a guarantee that in exchange for contributions during their employment, the pension fund will pay a pension until the end of each member's life. There is a timing difference of many years between the receipt of contributions and the payments of pensions. The pension fund needs to maintain capacity to meet current and future needs of its members, despite changes over time in investment performance and demographics (life expectancy). The pension fund is a multi-employer fund with 12 scheduled bodies and 17 admitted bodies. Given the public sector nature of these employers the funding risk associated with default is viewed as relatively low by the Pension Fund and the fund plans to recoup deficits over a twenty year period for most employers.



The last full triennial valuation was undertaken as at 31 March 2017, which estimated the Pension Fund as being 101% funded. The next actuarial valuation is due as at 31 March 2020 and is due to be finalised in the coming months. The actuarial valuation estimates the Pension fund's future obligations. The actuarial valuation sets the applicable contribution rates to the scheme and these will be applicable from 1 April 2021. The contributions received and investment returns are critical in supporting the Pension fund to continue to meet pension obligations as they fall due. The economic uncertainty due to the impact of Covid-19 as well as EU withdrawal, has a dual impact on the pension fund going forward. It puts at risk investment returns where market performance has declined. In addition, the economic uncertainty may see scheduled and admitted bodies face significant financial challenges. It is therefore important that the Pension Fund has a robust investment performance that continues to generate sufficient funding to enable the Pension Fund to continue to set, sustainable, affordable employers contributions. These, along with employee contributions (set within regulations) and investment returns, support the overall affordability of the scheme. The local government pension scheme (LGPS) includes a cost sharing arrangement which will cap employer costs in relation to current service and helps ensure that the scheme remains affordable for employers. The retirement age for most LGPS members is linked to the state retirement age, which is increasing, which may also act to limit scheme liabilities for active members.

Covid-19 response and governance arrangements

The outbreak of Covid-19 has had significant impact on the Pension Fund, in particular investment performance. Operationally, Officers have been able to work remotely and there has been minimal disruption to the core pensions operations including pensioners' payroll administration and pension fund accounting. In addition, Fund Managers have established remote working arrangements and there has been limited disruption to service delivered.



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.

Action Plan Point 1

Appendices

- Audit adjustments
- Action plan and recommendations
- Follow up of prior year recommendations
- Audit fees and independence
- Fraud arrangements
- Communication of audit matters

Audit adjustments

Uncorrected and corrected misstatements

We are pleased to report we did not identify any unadjusted misstatements to the financial statements that were either individually or cumulatively above our reporting threshold (£250,000)

During our audit Officers corrected one misstatement to the primary financial statements:

Item		Dr (£'000)	(Cr) (£'000)	Description
1	Investment Expenses	153		<i>Being grossing up of Investment income and expenditure</i>
	Investment Income		(153)	

During our audit Officers corrected one disclosure adjustment in relation to the IAS 26 actuarial valuation of the present value of promised retirement benefits:

Item		Dr (£'000)	(Cr) (£'000)	Description
1	Actuarial gains		6,000	<i>Being disclosure adjustment within Note 17 within the financial statements of the IAS 26 Actuarial present value of promised retirement benefits to reflect the proposed remedy to the "McCloud ruling", a court judgement that pension schemes were unlawful on the grounds of age discrimination that impacts on future liabilities of LGPS schemes. The revised actuarial valuation reduces the overall liability.</i>
	IAS 26 PV of future obligations	(6,000)		

During the course of our audit work we identified a number of disclosure adjustments required to the draft financial statements. The following are those adjustments that have been adjusted for in the updated draft accounts.

Item	Description	Adjusted
1	Annual governance statement	Disclosure adjustment to disclose the impact of Covid-19 on wider governance arrangements
2	Management Commentary	Minor changes to enhance disclosure information contained within the report
3	Financial statements	Some minor disclosure changes to the financial statements including casting errors
4	Accounting policies	Estimation uncertainty disclosures updated

Disclosure misstatements – uncorrected

The following disclosure misstatements have not been corrected by Officers. We do not consider these to be material to the accounts and Officers have agreed to review during the preparation of next years financial statements:

Critical Judgements: The Pension Fund currently disclose significant estimates and judgements within Note 1 to the financial statements. There is an opportunity to enhance the disclosure in line with IAS 1. Where a judgement is to be disclosed these should clearly define the judgement, how the judgement has been considered by officers and the impact on the accounts. The Pension Fund should disclose information to allow the reader to fully understand the nature of the estimation uncertainty and how assumptions may impact on the value of the asset / liability.

Action plan and recommendations

We have set out below, based on our audit work undertaken in 2019/20, the significant recommendation arising from our audit work.

Recommendation

Agreed Senior Officer response

1. Governance

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.

Response:

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 will be reported to the Pensions Committee on 23 September.

Action owner: Head of Corporate Finance and Commercialism

Timescale for implementation:
23 September 2020

Follow up of 2018/19 recommendations

We set out below our follow up of our 2018/19 recommendation and these are reflected below for information.

Recommendation

1. Pension scheme legal cases

During 2018/19 there were two ongoing developments that impact on the Pension Fund's liabilities: the McCloud/Sargeant case and the potential impact of GMP equalisation. The Pension Fund's actuary has undertaken an initial assessment of the McCloud / Sargeant case on the scheme liabilities, estimating the impact to be approximately £15 million. Further provision is likely for the impact of GMP, however this is unlikely to be material.

We recommend that going forward, the Pension Fund liaise with actuaries to gain an understanding of the estimated impact of these cases on the scheme liabilities. With the next triennial valuation due as at 31 March 2020, it is important that these liabilities are factored into the valuation to ensure subsequent Investment and funding strategies are reflective of the true future obligations of the scheme.

Initial officer response

We will liaise with the Actuaries to check that the McCloud is taking into consideration during the next triennial valuation as at 31 March 2020.

Follow up - Closed

The Pension Fund has obtained an updated IAS 26 report to incorporate the ongoing developments in the McCloud case. This has included an updated estimate to reflect the Government's proposed 'remedy' to the accounts.

Audit fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	26,340
Pooled Costs	2,560
Contribution to Audit Scotland costs	-
Contribution to Performance Audit and Best Value	1,580
2019-20 Fee	30,480

Fees for other services

Service	Fees £
We confirm that for 2019/20 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 Standards.
- We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.
- We can confirm no independence concerns have been identified.

Client service

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

Fraud arrangements

The term fraud refers to intentional acts of one or more individuals amongst management (Senior Officer), those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is alert to the possibility of fraud at Highland Council Pension Fund.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relations to management override of controls.
- Leading a discussion with those charged of governance (for Highland Council Pension Fund this is assumed to be the Pensions Committee) on their view of fraud. Typically we do this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit.

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

We will obtain annual representation from management (Senior Officers) regarding their assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

Anti-Money Laundering Arrangements

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

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance including establishing and maintaining internal controls over the reliability of financial reporting effectiveness and efficiency of operations and compliance with applicable laws and regulations.

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

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

Throughout the audit we work with Highland Council Pension Fund to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on a quarterly basis.

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 (senior officers) /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 Confirmed, no matters to report.	•	•
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 None identified although commentary included on financial sustainability alongside going concern commentary.	•	•
Views about the qualitative aspects of Highland Pension Fund's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures Included within the report.		•
Significant findings from the audit Included within the report		•
Significant matters and issues arising during the audit and written representations that have been sought Included in this report and letter of representation obtained at date of signing.		•
Significant difficulties encountered during the audit None identified.		•
Significant deficiencies in internal control identified during the audit None identified.		•
Significant matters arising in connection with related parties None identified.		•
Identification or suspicion of fraud involving management (Senior officers) and/or which results in material misstatement of the financial statements. None identified.		•
Non-compliance with laws and regulations None identified		•
Unadjusted misstatements and material disclosure omissions Reported in Appendix 1 of this report.		•
Expected modifications to the auditor's report, or emphasis of matter. None identified		•



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 audit reporting 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 entity or all weaknesses in your internal controls.

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