

Highland Council Pension Fund

Report to those charged
with governance on the
2013/14 audit



Prepared for members of the Highland Council as administering body for the Highland Council Pension Fund
August 2014

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Introduction

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.
2. This report sets out for the Pension Committee's consideration the matters arising from the audit of the financial statements for 2013/14 that require to be reported under ISA 260. We are drawing to your attention those matters we think are worthy of note, so that you can consider them before the financial statements are approved and certified. An audit of the 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 prepared by management, however this does not relieve management of their responsibilities in this respect. This report has been prepared for the use of the Highland Council Pension Fund and no responsibility to any third party is accepted.

Status of the Audit

3. We received the unaudited financial statements on 9 June 2014, in accordance with the agreed timetable. The working papers were generally of a good standard and we completed our on-site fieldwork on 11 July 2014.
4. Matters arising from the presentation of the financial statements were issued to the Accountant (Corporate Budgeting, Taxation and Treasury) on 9 July with matters arising from our on-site fieldwork issued on 11 July. Additional matters arising following our review process were issued on 22 July.
5. Partial responses to the original matters arising were received on 16 and 18 July with the latest responses received to the updated matters arising on 31 July. A number of issues have yet to be resolved, including the operation and monitoring of the intercompany accounts, which summarise transactions between the Council and the Pension Fund. Until these are resolved, we are unable to complete our audit and form our opinion on the accounts.
6. Following discussion with the Director of Finance on 24 July and with the Head of Corporate Finance on 31 July it was agreed that we would submit a position statement to the Pensions Committee on 14 August. We understand that officers will ask members to delegate responsibility for consideration of the revised ISA260, including the proposed auditor's opinion, to the Chair of the Committee.
7. The Director of Finance has advised that work is ongoing to identify the make up of the unexplained balance on the intercompany account and to provide responses to our outstanding queries.

Matters to be reported to those charged with governance

Conduct and scope of the audit

8. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Annual Audit Plan circulated to the Pension Committee on 9 April 2014, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011.
9. 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 any non-audit related services. The 2013/14 agreed fee for the audit was disclosed in the Annual Audit Plan. The Annual Audit Plan highlights that where our audit cannot proceed as planned, a supplementary fee may be levied. We plan to discuss the need for an additional fee to be levied due to the number of errors we have identified and the additional work required to resolve these with the Director of Finance on conclusion of the final accounts audit process.

Fraud

10. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In presenting this report to the Pension Committee we seek confirmation from those charged with governance of any instances thereof that have arisen that should be brought to our attention. A specific confirmation from management in relation to fraud will be included in the draft letter of representation (see paragraph 13 below).

Audit opinion & representations

11. As noted at paragraph 5, we will not be in a position to conclude our audit opinion until the outstanding matters summarised in paragraphs 17 to 32 have been resolved with officers.
12. Management have agreed to amend the unaudited financial statements for the presentational and disclosure findings resulting from the audit process. A schedule of potential audit adjustments has been prepared and submitted to finance staff. Discussion on the schedule will take place over the next week and a verbal update will be provided to the Pensions Committee.
13. As part of the completion of our audit we will seek written assurances from the Director of Finance on aspects of the accounts and judgements and estimates made. A draft letter of representation under ISA 580 will be provided to the Director of Finance. This should be signed and returned prior to the independent auditor's opinion being certified.

Accounting and internal control systems

14. In previous years, we have reported that, following the setting up of separate bank accounts for the Pension Fund, the Council's processes had not been amended to ensure that all of the Pension Fund's transactions were banked / paid through the Pension Fund's bank accounts. Last year we reported that work was continuing to ensure that current year transactions were correctly accounted for and that cash was held in the correct bank account. Our audit this year identified a number of queries regarding the operation and management of the intercompany accounts used to manage transfers between the Council and the Pension Fund. These are set out in paragraphs 17 to 24 below.
15. Apart from the above, no material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Significant findings from the audit and outstanding matters

16. In our view, the following issues require to be brought to your attention regarding the appropriateness of accounting policies or accounting estimates and judgements, the timing of transactions, the existence of material unusual transactions or the potential effect on the financial statements of any uncertainties.

Intercompany accounts

17. The Council's ledger system uses intercompany accounts to complete the double entry for all transactions that cross the organisations set up within the ledger. For example, the journal to post contributions deducted from the Council's payrolls would debit salaries and wages costs in the Council's ledger and credit the Council's intercompany account, and credit the contributions account in the Pension Fund ledger and debit the Pension Fund's intercompany account. When the money for the contributions is paid across to the Pension Fund, the Council's bank account in the ledger is credited and the Council's intercompany account is debited, and the Pension Fund's bank account in the ledger is debited and its intercompany account is credited. As a result, once both sides of the transaction have been processed, the entries within the intercompany accounts will net to zero.
18. As at 31 March 2014, the Pension Fund's intercompany accounts had a net creditor balance of £1.348 million. This has been included in the accounts as a £1.402 million creditor and a £0.054 million debtor. After the year end, funds equal to the £1.402 million creditor were transferred from the Pension Fund's bank account to the Council's bank account.
19. Finance staff provided reconciliations to show how the £1.402 million creditor was made up. The majority (£1.004 million) of it related to money due to the Council for the provision of central support services during the year. This is a genuine creditor that we would expect to see in the Pension Fund's accounts.

20. The balance also included the total of Additional Voluntary Contributions (AVCs) paid to Prudential in the year (£0.982 million). AVCs do not form part of the Pension Fund and so we asked why they were included as an amount due to be paid to the Council at the year end. We were advised that a Pension Fund revenue ledger code has historically been used as a holding account for AVC monies deducted from employees until payments are made to the third party provider (Prudential).

Resolution:

We have requested further information from Finance officers as to the make up of the intercompany balance. We do not believe that this should include AVCs as the balance on the AVC revenue account (which was transferred to creditors at the year end) was only £0.080 million.

Finance staff have agreed to amend the ledger coding arrangements to ensure that these transactions are correctly reflected in both the Pension Fund and Council's records.

21. The £1.402 million intercompany creditor was net of a debit balance of £0.601 million relating to strain on the fund costs due by the Council to the Pension Fund at the year end. In our view, entries on the Net Assets Statement should be disclosed on a gross basis.

Resolution: *Finance staff have agreed to amend the accounts to show the strain on the fund costs as a debtor at the year end.*

22. We have been advised that the £0.054 million debtor included within the Pension Fund's accounts is the unexplained difference remaining on the intercompany account after the reconciling items have been accounted for. We would not expect there to be an unexplained balance on this account.
23. Our review of the amounts making up the debtors figure in the Pension Fund's accounts also highlighted that the Council's March contributions (totalling £2.436 million) were omitted, although these were not transferred into the Pension Fund's bank account until April 2014. We have checked and confirmed that these contributions are included in the Pension Fund Account and have concluded this this amount forms part of the make up of the year end balance on the intercompany accounts. This debit balance was not included in the reconciliation of the year end balance on the intercompany accounts and so this adds to the unexplained balance on the intercompany accounts.

24. A summary of the queries we have on the intercompany accounts is included in the Appendix. It shows a credit balance, after adjustment for the above issues and for items set out below which we think will impact on the intercompany accounts balance, of £3.873 million which has yet to be explained.

Resolution: *The Director of Finance has advised us that work is ongoing to identify the make up of the balance on the intercompany account.*

Duplicate strain on the fund costs

25. Audit testing identified that strain on the fund costs totalling £0.412 million had been included twice within the Pension Fund's accounts in error.

Resolution: *Finance staff have agreed to amend the accounts to correct this error although officers have yet to advise us what the corresponding correcting entry should be. We believe that this may impact on the year end balance on the intercompany accounts but this has still to be confirmed.*

Additional Voluntary Contributions (AVCs)

26. As noted at paragraph 20 above, a Pension Fund revenue ledger code has historically been used as a holding account for AVC monies deducted from employees until payments are made to the third party provider (Prudential). The balance on this code at the year end (£0.080 million) has been included in the Pension Fund's accounts in error.

Resolution: *Finance staff have agreed to amend the accounts to correct this error although officers have yet to advise us what the corresponding correcting entry should be. We believe that this may impact on the year end balance on the intercompany accounts but this has still to be confirmed.*

Agreement to the ledger

27. The debtors and creditors totals included in the Pension Fund's accounts do not agree to the ledger after adjusting for debtors and creditors included as investments in the accounts in line with the Code of Practice on Local Authority Accounting 2013/14.

Resolution: *We have asked Finance staff to explain the equal and offsetting £0.442 million difference between the ledger balances for debtors and creditors (after adjustment for those correctly included within investments in the accounts) and the debtors and creditors totals included in the accounts so that we can identify whether any adjustment is required to the Pension Fund accounts. We have included this in our schedule of potential audit adjustments for discussion with officers.*

Debtors and Creditors

28. In March 2014, cheque requests totalling £0.177 million were raised for retirement grants for employees retiring in early April 2014. These amounts were debited to revenue codes and credited to the accounts payable codes within the ledger. As these payments relate to 2014/15, the revenue codes were credited as part of the year end processes. However, the double entry was debited to debtors codes within the financial ledger. As a result, debtors and creditors are overstated by £0.177 million in the accounts.

Resolution: *We have included this in our schedule of potential audit adjustments for discussion with officers.*

29. As part of the year end processes, a journal to carry forward the AVC contributions received before the year end but not due to be paid out to retirees until the new year was posted the wrong way round. As a result, transfers in are overstated by £0.206 million, and debtors are overstated and creditors are understated by £0.103 million in the unaudited accounts.

Resolution: *We have included this in our schedule of potential audit adjustments for discussion with officers.*

30. As part of the same erroneous year end journal, debtors totalling £0.046 million were raised although there was no evidence that the AVC contributions had been received before the year end. As a result, transfers in and debtors are overstated by £0.046 million in the unaudited accounts.

Resolution: *We have included this in our schedule of potential audit adjustments for discussion with officers.*

31. There are two other entries within debtors that we have still to confirm are valid debtors - £0.045 million described as AVC Fund and £0.092 million described as a Death Grant.

Resolution: *We have requested further information from Finance officers to enable us to confirm that these are correctly included as debtors within the unaudited accounts.*

Termination / Cessation Valuations

32. **Highlands and Islands Structural Fund Partnership** - the Partnership's participation in the Fund ceased on 30 June 2012. The Pension Fund's actuaries were asked to provide an actuarial valuation of any termination value due to the Pension Fund and this was calculated at £0.840 million. We have reviewed the make up of the debtors balance included in the accounts and concluded that this amount has not been included. We understand that discussions are ongoing between the Pension Fund and the Partnership's advisors, but until they are concluded, we would expect the amounts due to the Pension Fund to be reflected in the Net Assets Statement.

Resolution: *We have included this in our schedule of potential audit adjustments for discussion with officers.*

33. **Torvean Golf Club** - the last active scheme member retired at the end of 2013, resulting in the termination of the 'closed' agreement. The Pension Fund's actuaries were asked to provide an actuarial valuation of any termination value due to the Pension Fund and this was calculated at £8,000. At their meeting on 21 February 2014, the Pensions Committee agreed not to pursue Torvean Golf Club for the £8,000. The report to Committee states that the Council, in its role as Administering Authority, has the discretion to pursue any termination payment as a result of the end of an Admission Agreement.

Resolution: *Further information has been requested as to how this has been accounted for in the Pension Fund accounts. We have also requested evidence that the Council has discretion as to whether it pursues any termination payment.*

34. **Parklands** - Parklands joined the Fund on 14 July 2013 and exited the Fund on 31 March 2014. The Pension Fund's actuaries were asked to provide an actuarial valuation of any termination value due to the Pension Fund and based on the limited information available the actuaries estimated that the employer was in surplus at the cessation date.

Resolution: *Further information has been requested as to how the Fund accounts for employers who are in surplus at the cessation date.*

Potential refund of contributions

35. Members of the Pension Fund can claim a refund of their contributions when they leave with less than 2 years service. We have been advised that there were 2,887 frozen refund records representing contributions totalling £0.713 million as at 31 March 2014. No creditor or provision has been included in the Pension Fund accounts in respect of this liability. The Pension Fund should consider reviewing the extent of historical requests for refunds from deferred members to establish a methodology for recording this potential liability in its accounts.

Resolution: *We have included this in our schedule of potential audit adjustments for discussion with officers.*

Acknowledgements

36. We would like to express our thanks to the staff of The Highland Council for their help and assistance during the audit of this year's Pension Fund financial statements.

Appendix: Summary of Intercompany Accounts Queries

Para. Ref	Narrative	£
18	Included as creditor in accounts	1,402,282.20 Cr
18 & 22	Included as debtor in accounts	53,901.88 Dr
18	Balance on intercompany accounts at year end (net of above figures)	1,348,380.32 Cr
21	Netted off in year end balance but should be shown in debtors	600,613.80 Cr
23	Netted off in year end balance but should be shown in debtors	2,435,893.08 Cr
25	Duplicate Strain on the Fund costs (to be corrected)	411,906.00 Cr
26	March AVC costs included in Pension Fund in error (to be corrected)	80,147.88 Cr
	Balance on intercompany accounts after grossing up for known items	4,876,941.08 Cr
19	Year end creditor for Central Support Charges	1,003,800.00
	Unexplained balance	3,873,141.08 Cr