



The Highland Council Pension Fund

Annual Audit Plan
2015/16

Prepared for Members of the Highland Council as
Administering Authority for the Highland Council
Pension Fund

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The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies (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/about/).

The Accounts Commission has appointed Stephen Boyle as the external auditor of the Highland Council Pension Fund for the period 2012/13 to 2015/16.

This report has been prepared for the use of 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.

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Summary

Introduction

1. Our audit is focused on the identification and assessment of the risks of material misstatement in the Highland Council Pension Fund's (the Pension Fund's) financial statements.
2. This report summarises the key challenges and risks facing the Pension Fund and sets out the audit work that we propose to undertake in 2015/16. Our plan reflects:
 - the risks and priorities facing the Pension Fund
 - current national risks that are relevant to local circumstances
 - the impact of changing international auditing and accounting standards
 - our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland and the Accounts Commission for Scotland
 - issues brought forward from previous audit reports.

Summary of planned audit activity

3. Our planned work in 2015/16 includes:
 - an audit of the financial statements and provision of an opinion on whether:
 - they give a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2016, and of the amount and disposition at that date of its assets and liabilities
 - the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2015/16 Code of Practice on Local Authority Accounting in the United Kingdom (the Code)
 - a review and assessment of the Pension Fund's governance and performance arrangements in a number of key areas to support the annual governance statement and information in the annual report and annual accounts
 - provision of the annual report on the audit addressed to elected members and the Controller of Audit.

Responsibilities

4. The audit of the financial statements does not relieve management or the Pensions Committee, as the body charged with governance, of their responsibilities.

Responsibility of the appointed auditor

5. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.
6. Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements set in place by the audited body to ensure the proper conduct of its financial affairs and to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

Responsibility of the Director of Finance

7. It is the responsibility of the Director of Finance, as the appointed 'proper officer', to prepare the financial statements in accordance with relevant legislation and the Code. This means:
 - maintaining proper accounting records
 - preparing financial statements which give a true and fair view of the financial transactions of the Pension Fund during the year ended 31 March 2016, and of the amount and disposition at that date of its assets and liabilities.

Format of the accounts

8. The financial statements should be prepared in accordance with the Code, which constitutes proper accounting practice.

Audit approach

Our approach

9. Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of the Pension Fund. We also consider the key audit risks and challenges in the local government sector generally. This approach includes:
 - understanding the business of the Pension Fund and the risk exposure which could impact on the financial statements
 - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
 - identifying major transaction streams, balances and areas of estimation and understanding how the Pension Fund will include these in the financial statements
 - assessing and addressing the risk of material misstatement in the financial statements
 - determining the nature, timing and extent of the audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements give a true and fair view.
10. We have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus audit testing on higher risk areas during the audit of the accounts. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Planned management actions being relied on for 2015/16 are:
 - comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff
 - clear responsibilities for the preparation of the financial statements and the provision of supporting working papers
 - delivery of unaudited financial statements to agreed timescales with a comprehensive working papers package
 - completion of the internal audit programme for 2015/16.
11. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an early assessment of the internal audit function. Our review concluded that the Highland Council's internal audit section, which provides internal audit services to the Pension Fund, 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 at least every five years. Plans are in place for West Dunbartonshire Council to independently assess the council's internal audit service during 2016/17.

12. Internal audit is currently experiencing staff shortages which will result in slippage against its 2015/16 annual plan and a reduction in the number and scope of reviews planned for 2016/17. We plan to place formal reliance on internal audit's review of Pension Contributions, and the work they undertake to support the Head of Audit and Risk Management's opinion on the Pension Fund's system of internal control as part of our audit of the 2015/16 financial statements.

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, the failure to achieve a statutory requirement or, an item contrary to law). In the event of such an item arising, its materiality has to be viewed in a narrower context; such matters would normally fall to be covered in an explanatory paragraph in the independent auditor's report.
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. Based on our knowledge and understanding of the Pension Fund we have set our planning materiality at 10% of contributions receivable. For 2015/16 planning materiality is £5.1 million.
16. We set a lower level, known as performance materiality, when defining our audit procedures. This is to ensure that uncorrected and undetected audit differences do not exceed our planning materiality. This level depends on professional judgement and is informed by a number of factors including:
- extent of estimation and judgement within the financial statements
 - nature and extent of prior year misstatements
 - extent of audit testing coverage.
17. For 2015/16 performance materiality has been set at £2.5 million. We will report, to those charged with governance, all misstatements identified which are greater than £100,000.

Reporting arrangements

18. The Local Authority Accounts (Scotland) Regulations 2014 require that the unaudited annual accounts are submitted to the appointed external auditor no later than 30 June each year. The Pensions Committee is required to consider the unaudited annual accounts at a meeting by 31 August. The Pension Fund must also publish the unaudited accounts on its website and give public notice of the inspection period.

19. The 2014 regulations require the Pensions Committee to meet by 30 September to consider whether to approve the audited annual accounts for signature. Immediately after approval, the annual accounts require to be signed and dated by specified members and officers and then provided to the auditor. The Controller of Audit requires audit completion and issue of an independent auditor's report (opinion) by 30 September each year.
20. The Pension Fund is required to publish on its website its signed audited annual accounts, and the audit certificate, by 31 October. The annual report on the audit is required to be published on the website by 31 December.
21. An agreed timetable for the audit of the 2015/16 financial statements is included at Exhibit 1 below which takes account of submission requirements and the planned dates of Pensions Committee meetings.
22. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to relevant officers to confirm factual accuracy. Responses to draft reports are expected within three weeks of submission. A copy of all final agreed reports will be sent to the Chief Executive, Director of Finance, relevant senior manager, the Head of Audit and Risk Management, and Audit Scotland's Performance Audit and Best Value Group.

Exhibit 1: Financial statements audit timetable

Key stage	Date
Meetings with officers to clarify expectations of working papers and financial system reports	31 March 2016
Testing and review of internal control systems and transactions	31 May 2016
Submission of unaudited pension fund financial statements with working papers package	20 June 2016
Consideration of unaudited financial statements by those charged with governance	23 June 2016 (Full Council)
Progress meetings with lead officers on emerging issues	As required
Latest date for final clearance meeting with Director of Finance/Finance Manager, Corporate Budgeting, Taxation and Treasury	12 August 2016
Agreement of audited unsigned financial statements, and issue of Annual Audit Report which includes the ISA 260 report to those charged with governance	13 September 2016
Pensions Committee meet to approve the audited financial statements for signature	22 September 2016
Independent auditor's report signed	By 30 September 2016

- 23. We will provide an independent auditor's report to members of the Highland Council, as administering authority for the Highland Council Pension Fund, and the Accounts Commission that the audit of the financial statements has been completed in accordance with applicable statutory requirements. The combined ISA 260 and Annual Audit Report will be issued by 30 September.
- 24. All annual audit reports produced are published on Audit Scotland's website: www.audit-scotland.gov.uk.
- 25. Planned outputs for 2015/16 are summarised at [Appendix 1](#).

Quality control

- 26. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established as part of financial audit procedures. This is to provide reasonable assurance that those professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Accounts Commission. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews and has been subject to a programme of external reviews by the Institute of Chartered Accountants of Scotland (ICAS).

- 27. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We do, however, welcome feedback at any time and this may be directed to the engagement lead, Stephen Boyle.

Independence and objectivity

- 28. Auditors appointed by the Accounts Commission must comply with the Code of Audit Practice. When auditing the financial statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB) and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual 'fit and proper' declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland's Ethics Partner.
- 29. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. In significant cases we would change the audit team, however, where there are potential issues that are not fundamental to the delivery of the audit we advise the Director of Finance of the circumstances and of the steps we have taken to manage this. We are not aware of any such relationships pertaining to the audit of the Pension Fund.

Audit issues and risks

Audit issues and risks

30. Based on our discussions with staff, attendance at Pensions Committee meetings and a review of supporting information we have identified the following main risk areas for the Pension Fund. We have categorised these risks into financial risks and wider dimension risks. In most cases, actions to manage these risks are either planned or already underway. Details of the sources of assurance that we have received for each of these risks and the audit work we plan to undertake is set out in [Appendix 2](#).

Financial statement issues and risks

31. **New corporate financial management system:** the Pension Fund's 2015/16 accounts will be produced from the Highland Council's new corporate financial management system (INTEGRA) which was introduced on 1 April 2015. The effective operation of this new system is fundamental to the preparation of the 2015/16 financial statements and our audit opinion. As with any new system, there is a risk that it is not operating as expected. Finance staff will need to review and revise any working papers which rely on ledger reports generated from the system to ensure that they continue to produce accurate figures for inclusion within the 2015/16 accounts.
32. **Prior year issue (management review of the unaudited accounts):** the 2014/15 financial statements submitted for audit did not comply with the requirements of the Local Authority Accounts (Scotland) Regulations 2014. In our opinion, a more robust and challenging review process needs to be put in place to improve the quality of the financial statements submitted for audit. We have been advised that the review process will be improved and working papers will be reviewed by a senior member of staff prior to the submission of the 2015/16 accounts for audit.
33. **Stock lending:** the Pension Fund plans to enter into a stock lending relationship with the Northern Trust. By lending on its investment portfolio the Pension Fund expects to increase its return beyond that available by holding the investments themselves. Current estimates are that additional income of £0.350 million per annum will be generated by stock lending. There is a risk that the Pension Fund's stock lending arrangements may not be properly accounted for and disclosed within the 2015/16 financial statements.
34. **Local Government Pension Scheme 2015:** the Public Service Pension Act 2013 and associated regulations replaced a final salary scheme with a career average revalued earnings (CARE) scheme from 1 April 2015. The calculation of benefits payable and contributions receivable under the CARE scheme are more complex increasing the risks of material misstatement in these key account areas. We will test the calculation of benefits payable and contributions receivable to ensure they are correctly calculated.

35. Workforce planning: the council is currently seeking to significantly reduce its workforce in order to help balance its 2016/17 budget. This approach can be an effective way of reducing costs, but it may not ensure that the right people are retained in the right place. There is a risk that the council will not retain sufficiently qualified and experienced staff to ensure that the Pension Fund is adequately administered and that the financial statements are prepared to the required quality and by the agreed timescales. Workforce reductions will also impact on the membership profile within the Pension Fund resulting in changes to the numbers of active, deferred and pensioner members.

Wider dimension issues and risks

36. Pension Board: the Local Government Pension Scheme (Governance) Scotland Regulations 2015 required the Pension Fund to establish a Pension Board to assist it in complying with the scheme regulations and requirements of the pensions' regulator. It will take time for these new arrangements to bed in and become effective, and training and support will be necessary for board members to enable them to adequately fulfil their role. We will continue to monitor the Pension Fund's governance arrangements through attendance at Pension Board meetings.

37. Pension liberation: from 6 April 2015 members of defined contribution pension schemes who are aged 55 and over have more freedom over how they can access their pension savings. Although these provisions do not apply to members of defined benefit pension schemes, a member who ceases to be a member of the Local Government Pension Scheme (LGPS) can transfer the value of their LGPS benefits to a defined contribution scheme and then exercise these new freedoms. If the value of the defined benefits to be transferred exceeds £30,000 the member is required by law to take independent financial advice before transfer is made. The Pension Fund also has a legal duty to ensure that this advice has been obtained before transfer is made. There is a risk that the Pension Fund will make transfer payments to defined contribution schemes without ensuring that the member has taken independent financial advice.

Fees and resources

Audit fee

38. Over the past four years, Audit Scotland has reduced audit fees by 24% in real terms, exceeding our 20% target. Due to further refinement of our audit approach we have been able to maintain audit fees for 2015/16 at the same level as last year. This represents an additional real term fee reduction of 1.6%.
39. In determining the audit fee we have taken account of the risk exposure of the Highland Council Pension Fund, the planned management assurances in place, and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of a complete set of unaudited financial statements and comprehensive working papers package by 20 June 2016.
40. The agreed audit fee for the 2015/16 audit of the Highland Council Pension Fund is £48,830. (£48,830 2014/15). Our fee covers:
 - the costs of planning, delivering and reporting the annual audit including auditor's attendance at Pension Committee meetings
 - the Pension Fund's allocation of the cost of national performance studies and statutory reports by the Auditor General for Scotland
 - a contribution towards functions that support the local audit process (e.g. technical support and coordination of the National Fraud Initiative), support costs and auditors' travel and subsistence expenses.

41. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

Audit team

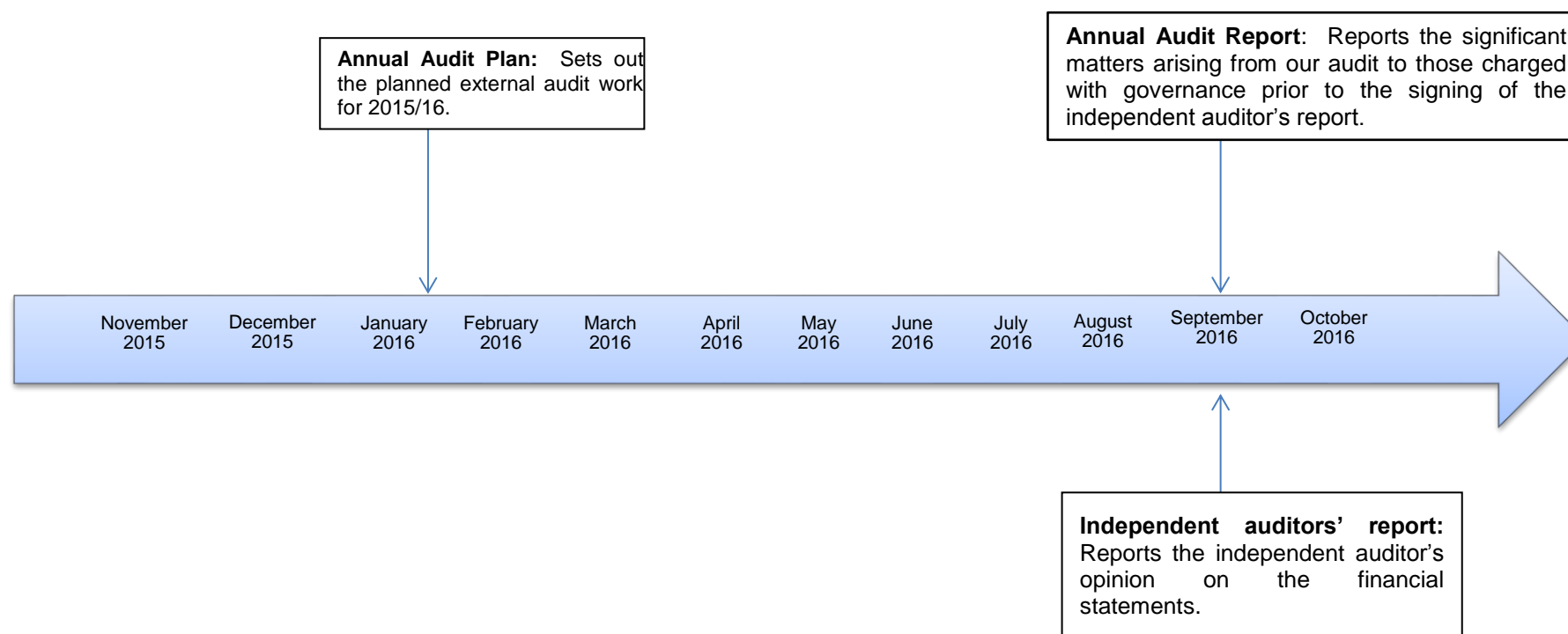
42. Stephen Boyle, Assistant Director, Audit Services is your appointed auditor. The local audit team will be led by Maggie Bruce, Senior Audit Manager who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience and skills of our team are provided in Exhibit 2. The core team will call on other specialist and support staff as necessary.

Exhibit 2: Audit team

Name	Experience
Stephen Boyle Assistant Director (and certifying auditor)	Stephen has 19 years experience of public sector finance. He trained as an accountant with a Big 4 firm prior to joining Audit Scotland in 2002. He later worked as Head of Finance and Corporate for Cube Housing Association, before spending three years with Glasgow Housing Association as Assistant Director of Finance. He re-joined Audit Scotland in June 2013.
Maggie Bruce Senior/Audit Manager	Maggie has over 20 years experience of public sector audit with Audit Scotland covering the local government, health and further education sectors. Prior to joining Audit Scotland Maggie trained as an auditor in the private sector.
Jim Convery Senior Auditor	Jim has over 25 years experience of public sector audit with Audit Scotland covering the local government, health and further education sectors. Prior to joining Audit Scotland Jim worked in internal audit in local government and for a private accountancy practice.
Alistair Turner Auditor	Alistair joined Audit Scotland in 2002 having previously worked in local authority finance for five years. During his time with Audit Scotland Alistair has mainly worked within the local government sector across a number of local authorities, but has also experience in the further education and health sectors.
Nicholas McShane Professional Trainee	Nicholas joined Audit Scotland in 2012 as a professional trainee and is currently studying for the ICAS accountancy qualification. Prior to joining Audit Scotland Nicholas was a student at Glasgow University.

Appendix 1: Planned audit outputs

The diagram below shows the key outputs planned for the Highland Council Pension Fund in 2015/16.



Appendix 2: Significant audit risks

The table below sets out the key audit risks, the related sources of assurance received and the audit work we propose to undertake to address the risks during our audit work.

#	Audit Risk	Source of assurance	Audit assurance procedure
Financial statements issues and risks			
1	New corporate financial management system: the Pension Fund's 2015/16 accounts will be produced from the Highland Council's new corporate financial management system (INTEGRA) which was introduced on 1 April 2015. The effective operation of this new system is fundamental to the preparation of the 2015/16 accounts and our audit opinion. As with any new system, there is a risk that it is not operating as expected. Finance staff will need to review and revise any working papers which rely on ledger reports generated from the system to ensure that they continue to produce accurate figures for inclusion within the 2015/16 accounts.	<ul style="list-style-type: none"> daily trial balance reports are produced from INTEGRA which are checked to ensure that the system is in balance. Error reports are also reviewed on a daily basis and corrective action taken where necessary. Daily transaction reports are taken from control accounts and reconciled to the nominal ledger and we are working towards bringing all reconciliations up to date. 	<ul style="list-style-type: none"> early financial statements planning meeting increased audit testing of opening balances review of controls operating within the new system review of intercompany accounts reconciliations review of revised working papers early discussion of emerging issues.

#	Audit Risk	Source of assurance	Audit assurance procedure
2	Prior year issue (management review of the unaudited accounts): the 2014/15 financial statements submitted for audit did not comply with the requirements of the Local Authority Accounts (Scotland) Regulations 2014. In our opinion, a more robust and challenging review process needs to be put in place to improve the quality of the financial statements submitted for audit.	<ul style="list-style-type: none"> the review process will be improved and working papers will be reviewed by a senior member of staff. 	<ul style="list-style-type: none"> early financial statements planning meeting early discussion of emerging issues.
3	Stock lending: the Pension Fund plans to enter into a stock lending relationship with the Northern Trust. By lending on its investment portfolio the Pension Fund expects to increase its return beyond that available by holding the investments themselves. Current estimates are that additional income of £0.350 million per annum will be generated by stock lending. There is a risk that the Pension Fund's stock lending arrangements may not be properly accounted for and disclosed within the 2015/16 financial statements.	<ul style="list-style-type: none"> the example accounts compiled by CIPFA will be followed and disclosures for stock lending will be in line with these. 	<ul style="list-style-type: none"> early financial statements planning meeting review of stock lending arrangement against the requirements of the Local Authority Pension Scheme (Management and Investment of Funds) Regulations 2010 review of stock lending disclosures within the 2015/16 financial statements for compliance with the guidance early discussion of emerging issues.

#	Audit Risk	Source of assurance	Audit assurance procedure
4	Local Government Pension Scheme 2015: the Public Service Pension Act 2013 and associated regulations replaced a final salary scheme with a career average revalued earnings (CARE) scheme from 1 April 2015. The calculation of benefits payable and contributions receivable under the CARE scheme are more complex increasing the risks of material misstatement in these key account areas.	<ul style="list-style-type: none"> the software used to calculate benefits and contributions was tested and signed off prior to implementation Internal Audit have included work on pension contributions in their 2016/17 audit plan 	<ul style="list-style-type: none"> early financial statements planning meeting audit testing of benefits awarded calculations audit testing of employee and employer contributions calculations reliance on Internal Audit's work on contribution income early discussion of emerging issues.
5	Workforce planning: the council is currently seeking to significantly reduce its workforce in order to help balance its 2016/17 budget. This approach can be an effective way of reducing costs, but it may not ensure that the right people are retained in the right place. There is a risk that the council will not retain sufficiently qualified and experienced staff to ensure that the Pension Fund is adequately administered and that the financial statements are prepared to the required quality and by the agreed timescales. Workforce reductions will also impact on the membership profile within the Pension Fund resulting in changes to the numbers of active, deferred and pensioner members.	<ul style="list-style-type: none"> the Director of Finance, along with the Chief Executive have delegated authority to review staffing structures and ensure that sufficient resources are in place to deliver the outputs from the Service. 	<ul style="list-style-type: none"> review of revised staffing structures early financial statements planning meeting review disclosures within the financial statements early discussion of emerging issues.

#	Audit Risk	Source of assurance	Audit assurance procedure
Wider dimension issues and risks			
6	Pension Board: the Local Government Pension Scheme (Governance) Scotland Regulations 2015 required the Pension Fund to establish a Pension Board to assist it in complying with the scheme regulations and requirements of the pensions' regulator. It will take time for these new arrangements to bed in and become effective, and training and support will be necessary for board members to enable them to adequately fulfil their role.	<ul style="list-style-type: none"> the Scottish Government and Governance Group will be organising training for members twice yearly members have access to the Pension Regulator's Trustees Toolkit for comprehensive self-serve online training a training needs assessment will be undertaken with members of the Pensions Board to identify future training requirements. 	<ul style="list-style-type: none"> continue to monitor the Pension Fund's governance arrangements through attendance at Pension Board meetings review of the training and support provided to Pension Board members report results in the annual report to members and the Controller of Audit.
7	Pension liberation: from 6 April 2015 members of defined contribution pension schemes have more freedom over how they can access their pension savings. Although not applying directly to LGPS members, a member can transfer the value of their LGPS benefits to a defined contribution scheme and then exercise these new freedoms. If the value of the defined benefits to be transferred exceeds £30,000 the member is required by law to take independent financial advice. The Pension Fund also has a legal duty to ensure that this advice has been obtained before transfer is made.	<ul style="list-style-type: none"> the requirement to obtain independent financial advice for transfers exceeding £30,000 is publicised on the Pension Fund website a standard letter is sent in response to all enquiries received advising of the legal requirements and best practice payment will only be made once officers are satisfied that independent financial advice has been obtained. 	<ul style="list-style-type: none"> review of any transfers made to defined contributions schemes to ensure evidence of independent financial advice was obtained prior to payments in excess of £30,000 being made.

