



Grant Thornton

Dumfries and Galloway Council Pension Fund

External Audit Annual Report to Pensions Sub-Committee and the Controller of Audit for the financial year ended 31 March 2018

Pensions Sub-Committee 27 September 2018

Joanne Brown
Engagement Leader

Angelo Gustinelli
External Audit Manager



Our audit at a glance



We have followed up on prior year audit recommendations and are satisfied that these have been fully implemented. We have raised no audit recommendations in the current year.



We have fulfilled our responsibilities as set out in International Standards on Auditing (ISAs) (UK) and the Code of Audit Practice throughout our work and this report is addressed to those charged with governance (Elected Members on the Pensions Sub-Committee) and the Controller of Audit.



We have performed sufficient audit testing around our identified area of significant audit risk including: management override of controls; the risk of fraud in expenditure recognition; and the valuation of level 3 investments.

An audit underpinned by quality



This report reflects our broader reporting obligations under the Code of Audit Practice. Whilst we have concluded full wider scope is not appropriate we have considered the financial management and future financial arrangements of the Fund alongside certain aspects of governance.

Overall Dumfries and Galloway Council Pension Fund are performing well and have reported an increase in the Net Asset position, increasing from opening net assets as at the start of the year of £837 million to a closing net assets as at the end of the year £856 million.



We have issued an unqualified opinion.

We have built on our relationship with Dumfries and Galloway Council Pension Fund team during the year and this has ensured an efficient audit process to allow for the audit to be concluded by agreed timescales.



We received a good complete set of financial statements including the Management Commentary, Annual Governance Statement and Governance Compliance Statement.

Officers continue to look to streamline and enhance the narrative in the front end of the Annual Report and accounts with the inclusion of tables, graphics and hyperlinks.

Contents

Section	Page
1. Introduction	4
2. Our audit of the annual report and accounts	5
3. Financial sustainability and governance	12
Appendices:	
1. Audit Adjustments	17
2. Action plan and follow up of 2016/17 recommendations	18
3. Fees, independence and fraud arrangements	19
4. Communication of audit matters	20



Adding value through External Audit

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

Through this Annual Report we seek to provide insight and commentary over certain aspects of Dumfries and Galloway Council Pension Fund's arrangements, sharing relevant practices with the Pensions Sub-Committee and officers.

We have continued to build on our working relationship with officers and our understanding of Dumfries and Galloway Council Pension Fund as an organisation. During the year we have worked closely with officers to understand the Fund's financial position.

Lastly we are committed to audit quality and to ensure our audits are of the highest standard our team attended a pensions CIPFA/Audit Scotland technical session. We also compared Dumfries and Galloway Council Pension Fund accounts to the model accounts to ensure adequacy of disclosures and best practice. Grant Thornton have extensive pension fund audit experience throughout the UK, particularly in relation to the audit of English Pension Funds' and we have utilised this expertise, where applicable, throughout the course of our audit.

Introduction

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2018.

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

Our report is addressed to the Pensions Sub-Committee of Dumfries and Galloway Council Pension Fund. In addition, in accordance with our reporting responsibilities the report is jointly addressed to the Controller of Audit.

Once finalised this report will be made publically available on the Audit Scotland website (www.audit-scotland.gov.uk)

Our report was presented jointly to the Pensions Sub-Committee on 27 September 2018.

We would like to thank Dumfries and Galloway Council Pension Fund officers and in particular the finance team for an effective year-end audit process and all their support and assistance in the audit process throughout the year.

Structure of this report

As set out in our Audit Plan (March 2018) we consider in accordance with the Audit Scotland Code of Practice that Dumfries and Galloway Council Pension Fund meets the smaller body definition. Therefore full wider scope is not considered appropriate.

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 Dumfries and Galloway Council Pension Fund's arrangements as follows:

Financial statements - Section 1

Financial sustainability and governance - Section 2



Our Opinion

For the financial year ended 31 March 2018 we have issued an **unqualified audit opinion**

- True and fair view of the financial statements
- Have been prepared in accordance with accordance with relevant legislation and standards
- Regularity – expenditure has been incurred in accordance with the purpose of Dumfries and Galloway Council Pension Fund
- Other prescribed matters



The audit process

We received a good complete set of financial statements including the including the Management Commentary, Annual Governance Statement and Governance Compliance Statement.

This was in line with the timetable we agreed.

The draft financial statements were supported by good working papers and our audit queries were responded to on a timely basis.

We identified no unadjusted differences to report to the Pensions Sub-Committee.

We identified minor disclosure adjustments within the financial statements and are satisfied these have been reflected within the financial statements. None of these were material or significant in nature.



Our audit of the annual report and accounts



Materiality has been set at £8.564 million (1% of net assets) and performance materiality was set at £6.423 million (75% of materiality). Materiality figures have been updated from the figures reported within our Audit Plan to reflect the net assets reported in the unaudited financial statements.

We reported to officers any audit difference identified over £250,000 (5% of materiality capped at £250,000), of which there were none.



The draft financial statements were of a good standard and were supported through detailed working papers. There were further improvements in the audit process this year and we will continue to work with officers to enhance the audit process.



We have issued an unqualified audit opinion on the financial statements, including the wider information contained in the financial statements.



Testing provided assurance on all identified areas of significant audit risks and there were no material audit differences arising during the course of our audit.

Audit approach and materiality

Our audit approach was set out in our annual audit plan presented to the Pensions Sub-Committee in March 2018. At planning, our materiality calculations were based on the audited 2016/17 financial statements, however we have updated our final materiality to reflect the net assets reported in the 2017/18 draft financial statements. Overall materiality has been set at £8.564 million (1% of net assets) and performance materiality is set at £6.423 million (75% of materiality). We report to officers any audit difference identified over £250,000 (Trivial as 5% of materiality).

The draft financial statements were of a good standard supported through detailed working papers. There were further improvements in the audit process this year and we will continue to work with officers to enhance the audit process and ensure we provide our wider pension fund experience and insights where relevant.

Audit opinion

Based on our audit procedures performed we have issued unqualified audit opinion on the financial statements including:

- they give a true and fair view
- they have been properly prepared in accordance with Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003
- They have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2017/18 Code
- the wider information contained in the financial statements, e.g. Management Commentary, Annual Governance Statement and Governance Compliance Statement
- regularity of expenditure

Internal control environment

During the year we sought to understand Dumfries and Galloway Council Pension Fund overall control environment (design) as related to the financial statements. In particular we have:

- Sought to understand procedures and controls around related parties, journal entries and other key entity level controls.
- Performed procedures around entity level controls and there are no significant matters that we wish to draw to your attention.
- Performed walkthrough procedures on key controls around identified risk areas including expenditure and level 3 investments.

No material weaknesses in the accounting and internal control systems were identified based on our work undertaken during the audit which could have an adverse impact on Dumfries and Galloway Council Pension Fund's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

We adopted a controls based approach to the audit of the financial statements, with the consideration of controls taking place as part of the planning and interim stages of the audit and then our final substantive audit testing being completed as part of year-end work during August 2018. A complete set of unaudited accounts were published on the Council's website before the end of June, in accordance with statutory guidance.

Internal Audit

As set out in our plan we have not placed formal reliance on the work of Internal Audit during 2017/18. Internal Audit is provided to the Pension Fund by the in-house Dumfries and Galloway Council team. The internal audit service complies with Public Sector Internal Audit Standards. We have reviewed the internal audit plan, and note that no specific pension audits were completed during the year. Internal Audit's annual opinion for the year is "reasonable assurance", which includes the work completed over a number of the Council's financial processes, of which the same arrangements are in place over the Pension Fund.

Key audit matters - Responding to significant risks

Within our annual external audit plan we identified significant audit risks and our planned approach. We have set out below a summary of the work undertaken over these risks and our audit conclusions

	Identified audit risk at planning	Work completed	Our conclusion
Risk of fraud in revenue and expenditure	<p>Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. Furthermore, for public entities, Practice Note 10 extends this presumed risk to fraud around expenditure manipulation.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue or expenditure recognition.</p>	<p>Having considered the risk factors set out in ISA240 and Practice Note 10 and the nature of the revenue and expenditure streams of the Fund, we have determined that the risk of fraud arising from revenue and expenditure recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue and expenditure recognition • opportunities to manipulate revenue and expenditure recognition are very limited • the culture and ethical frameworks of local authorities, including Dumfries and Galloway Council as the Administering Authority of the Pension Fund, mean that all forms of fraud are seen as unacceptable 	<ul style="list-style-type: none"> • We do not consider the risk of fraud in revenue and expenditure to be a significant risk for the Pension Fund and have therefore rebutted these risks.
Valuation of level 3 investments is incorrect	<p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters.</p> <p>Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p>	<ul style="list-style-type: none"> • We gained an understanding of the Fund's process for valuing Level 3 investments and evaluated the design of the associated controls. • We reviewed the nature and basis of estimated values and consider what assurance officers has over the year end valuations provided for these types of investments. • We considered the competence and expertise of the fund managers as experts to value Level 3 investments at year end and gain an understanding of how the valuation of these investments has been reached. 	<ul style="list-style-type: none"> • The funds net assets include Level 3 investments valued at £0.405 million at 31st March 2018. This is a decrease of £1.799 million as at 31st March 2017. • Although Level 3 investments are inherently risky, the total balance of these investments made by the Pension Fund are wholly immaterial, therefore the risk of material misstatement is low. • Level 3 investments have been tested through 3rd party confirmations, with no issues noted.
Management override of controls	<p>As set out in ISA 240, across all entities there is a presumed risk of fraud being perpetrated by management through its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Override of controls risk is present in all entities.</p>	<ul style="list-style-type: none"> • Developed our understanding of the entity level controls in place at Dumfries and Galloway Council Pension Fund that reduce the risk of management override. • Performed review of journal transactions for unusual transactions or balances. • Evaluated key areas of accounting estimates, judgments and decisions made by officers. • Reviewed unusual and/or significant transactions. 	<ul style="list-style-type: none"> • We did not identify any significant areas of bias in key judgements by officers. • We have not identified any unusual or significant transactions during the course of the year that would indicate management manipulation. • Assumptions in this years financial statements are in line with prior year, and still considered reasonable.

Other key areas of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. Whilst not considered a significant risk, these are areas of increased risk due to their complexity or magnitude.

Contributions

Risk Identified: Contributions from employers and employees' represents a significant percentage of the funds revenue. While not considered a significant risk, there is an increased risk that these are materiality misstated.

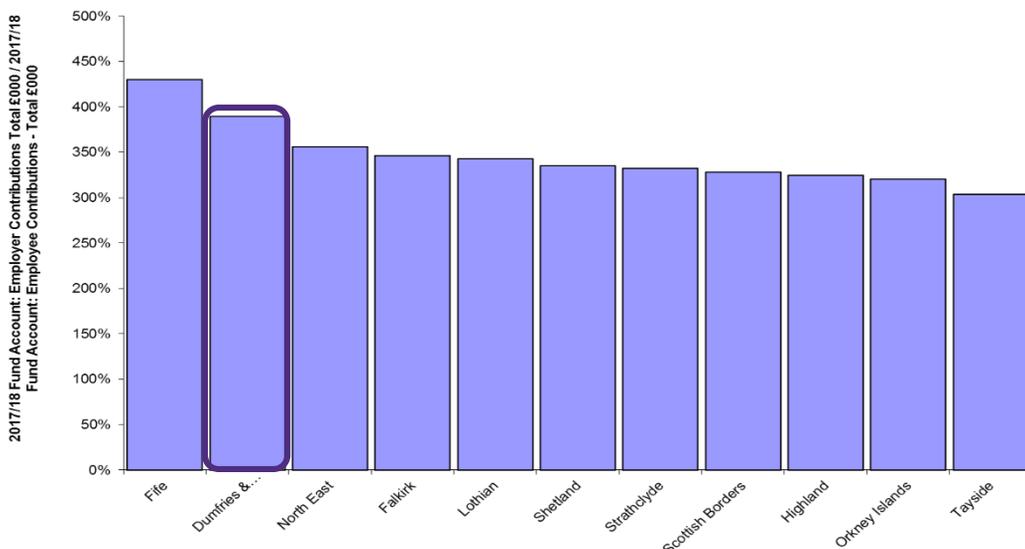
Work completed: We have evaluated the Fund's accounting policy for recognition of contributions for appropriateness; gained an understanding of the Fund's system for accounting for contribution income and evaluated the design of the associated controls; tested a sample of contributions to source data to gain assurance over their accuracy and occurrence; rationalised contributions received with reference to changes in member body payrolls and the number of contributing pensioners to ensure that any unusual trends are satisfactorily explained.

Our Conclusion: Contributions recognised in the Pension Fund account were £28.649 million compared to £29.257 million in 2016/17. We have reviewed this minor movement and are satisfied that it is consistent with changes in contribution rates and the number of active members of the pension fund.



We have carried out a walkthrough and tested the controls around the collection of contributions from Dumfries and Galloway Council and are satisfied that the controls are operating as intended (Scheduled and Admitted Bodies contributions totalled £3.692 million and therefore wholly immaterial to the Pension Fund and do not pose a risk of material misstatement, therefore we did not test controls in relation to collection of contributions from these bodies).

The graph below shows employer contributions as a proportion of employee contributions for 2017-18 and highlights that the Fund's contributions are slightly greater but still broadly in-line with other local government pension scheme (LGPS) in Scotland. Our audit work has not identified any issues in relation to contributions.



Investment purchases, sales and income

Risk Identified: Investment purchases, sales and income recorded are not valid and the investment valuation is therefore not correct.

Work completed: We completed a walkthrough of the controls and procedures around investment purchases, sales and income to consider the adequacy of the design of these controls. We have reviewed the reconciliation of the information provided by the fund managers, the custodian and the Pension Fund's own records and sought explanations for variances.

Our Conclusion: Investment income was £6.867 million in the 2017/18 compared to £10.314 million in 2016/17. The decrease mainly relate to the switch to pooled vehicles for the Legal and General assets, resulting in decreased interest and dividends. The segregated UK assets held by Legal and General were absorbed into pooled vehicles reducing investment income substantially.

 The Fund is currently structured in such a way that all investments are in pooled vehicles. As such the scope for generating income is limited, with dividends and interest from shares and bonds within the pooled vehicle not being distributed but instead absorbed in the pools and reflected in the unit price.

We have carried out a walkthrough of the controls around the recognition of investment income and confirmed that income recognised is consistent with both custodian and investment manager records. Our audit work has not identified any issues in relation to Investment Income.

Investment Purchases were £915.551 million and Investment Sales were £912.454 million in 2017/18 compared to £399.548 million and Investment Sales were £394.105 million in 2016/17. This increase again reflects the disinvestment from Alliance and Bernstein (sales) and the increased investments in Legal and General (purchases).

We have carried out a walkthrough of the controls around the recording of purchases and sales and confirmed that the reported purchases and sales in Note 14(a) of the Financial Statements are consistent with custodian and fund manager records. Our audit work has not identified any issues in relation to Investment Purchases and Sales.

Pension benefits payable:

Risk Identified: Pension benefits payable represents a significant percentage of the Funds expenditure. While not considered a significant risk, there is an increased risk that these are materially misstated.

Work completed: We evaluated the Fund's accounting policy for recognition of pension benefits expenditure for appropriateness; gained an understanding of the Fund's system for accounting for pension benefits expenditure and evaluated the design of the associated controls; tested a sample of individual pensions in payment by reference to member files; rationalised pensions paid with reference to changes in pensioner numbers and increases applied in year to ensure that any unusual trends are satisfactorily explained.

Our Conclusion: Benefits Payable recognised in the Pension Fund account were £29.837 million compared to £32.123 million in 2016/17. We have reviewed this minor movement and are satisfied that the decrease was driven by the reduction in lump sum payments made in the current year. We have completed a walkthrough and tested the controls around the calculation of new pensions and the authorisation of the pensioner payroll.

We are satisfied that these controls are operating effectively. We have re-performed the calculation of 25 new pensions and lump sums and in all cases agreed that the calculation was accurate. Our audit work has not identified any issues in relation to Benefits payable.

Valuation of level 2 investments

Risk Identified: While level 2 investments do not carry the same level of inherent risks associated with level 3 investments, there is still an element of judgement involved in their valuation as their very nature is such that they cannot be valued directly.

Work completed: We obtained an understanding of the Fund's process for valuing Level 2 investments and evaluated the design of the associated controls. We reviewed the nature and basis of estimated values and considered what assurance officers has over the year end valuations provided for these types of investments. We also considered the competence, expertise and objectivity of any management experts used including those involved in the valuation of level 2 investments for a sample of investments and tested the valuation by obtaining independent information from fund manager.

Our Conclusion: Level 2 investments disclosed in the accounts are £500.044 million compared to £482.770 million in 2016/17. These investments are the overseas pooled funds, pooled property investments, diversified growth and overseas fixed income unit trusts. During our interim audit we performed a walkthrough of the controls around the valuation of these investments and confirmed the controls were designed as expected.

Post year end we obtained valuations from the fund manager and custodian and confirmed that these were consistent with the valuations included in the account. Our audit work has not identified any issues in relation to the valuation of level 2 investments.



Narrative elements of your annual accounts

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

- We have confirmed that the information given in the Management Commentary is consistent with the financial statements.
- The Management Commentary has been prepared in accordance with the statutory guidance issued under the Local Government in Scotland Act 2003.
- Key issues and risks are well articulated and reflect the risks around changes to LGPS regulations, investment performance, funding and people.

Governance Compliance Statement

- We have confirmed that the information provided in the Governance Compliance Statement is consistent with the financial statements.
- The Governance Compliance Statement has been prepared in accordance with the Local Government Pension Scheme (Scotland) Regulations 2014.
- The statement provides an overview of the key governance arrangements and is consistent with our understanding of the fund and publically available information.

Overall observations

- We received a good complete set of financial statements including the including the Management Commentary, Annual Governance Statement and Governance Compliance Statement.
- The draft financial statements were supported by good working papers and our audit queries were responded to quickly.

Annual Governance Statement

- We have confirmed that the information provided in the Annual Governance Statement is consistent with the financial statements.
- The Annual Governance Statement has been prepared in accordance with the Delivering Good Governance in Local Government Framework (2016).
- The statement provides a good overview of the key governance arrangements in place within the fund, including the Local Code of Corporate Governance, arrangements for internal audit and the review of investment manager and custodian control procedures.



Key aspects of your financial statements

As set out in our audit plan we consider particular aspects of your financial statements in relation to officers judgements including estimates and where officers may have particular options or choices in what accounting standards or disclosure requirements to apply. We have summarised our conclusions below.

Accounting Policies:

Dumfries and Galloway Council Pension Fund's accounting policies and notes to the accounts are set out in page 59 of the accounts. These are consistent with prior year and in accordance with the Code of Practice on Local Authority Accounting in the UK 2017/18, which is based on International Reporting Standards (IFRS) as amended for the UK Public Sector.



Timing of Transactions and Uncertainties

Through our substantive audit testing we did not identify any concerns over timing of transactions or the period in which they were recorded.

No uncertainties have been identified which have an impact on the final annual report and accounts and a number of areas of risk have been identified and analysed by Officers within the annual report.

Accounting estimates and judgements

Dumfries and Galloway Council Pension Fund significant accounting estimates and judgement impacting on the annual accounts are the following:

- The Pension Fund's actuary, Hymans Robertson, undertakes a valuation of the Pensions Fund liabilities on an IAS19 basis each year. This valuation is based on financial assumptions which include pension increase rate, salary increase rate and discount rate. As at 31 March 2018, the Present Value of Promised Retirements Benefits was estimated to be £1,107 million. Our audit work has confirmed that the assumptions used by the actuary were reasonable and that they were provided with accurate membership information by Dumfries and Galloway Council Pension Fund to support their calculation.
- The Fund's property debt investments rely on estimates made by the fund managers. We have confirmed that the fund managers are suitably qualified to make these estimates and that the valuations included in the accounts are consistent with fund manager and custodian records.

Going concern

The Head of Finance and Procurement has a reasonable expectation that the services provided by the Fund will continue for the next 12 months from the date of signing, and this assessment is reflected in the accounts. We are not aware of any forthcoming pensions legislation which would impact on the Fund and its ability to continue as a going concern.

Financial sustainability and governance

There was an increase in Net assets available for benefits during the year of £19.579 million. This was driven by growth of the Fund's investments with a return of 2.3% which was slightly below the benchmark of 2.4%.



Annualised investment returns are also below benchmark over the three year period (6.8% against a benchmark of 7.3%), however, over the five year period annualised investment returns are slightly ahead of benchmark (8.3% against a benchmark of 8.2%)

Benefits payable fell by £2.286 million (after a prior year increase of £2.544 million), driven by the reduction in lump sum payments made in the current year.

As at 31 March 2018 the Present Value of Promised Retirement Benefits was estimated to be £1,107 million (projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2017). Taken with the funds net assets of £856 million, this gives a liability of £251 million.



The triennial actuarial funding valuation was completed as at 31 March 2017, and the results were reflected in the 2017/18 Pension Fund accounts alongside any updated assumptions or benchmarks including employer contribution rates.



Appendix C to the funding strategy statement, included within the fund accounts, provided a comprehensive overview of the key risks which face the fund. Risk identified include Financial Risks; Demographic Risks; Regulatory Risks and Governance Risks.



The Council has adopted a Local Code of Corporate Governance which is consistent with the principles of the CIPFA/SOLACE framework "Delivering good governance in Local Government". This code applies to the pension fund. In addition, the fund has a separate Governance Policy Statement.

Fund Account

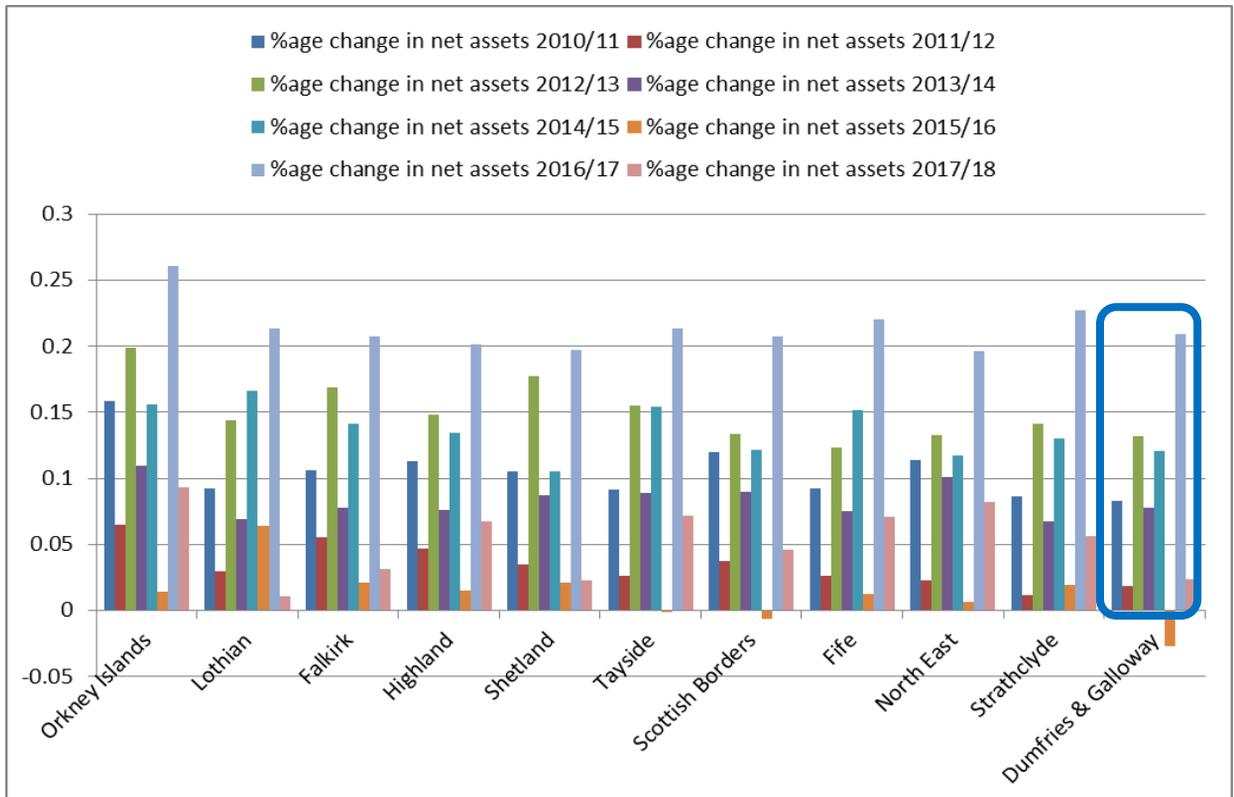
There was an increase in Net assets available for benefits during the year of £19.579 million. This was driven by growth of the Fund's investments with a return of 2.3% against its customised benchmark of 2.4%, slight underperformance against the benchmark. Contributions into the fund decreased by £0.608 million during the year, driven by a decrease in employer augmentation contributions (decrease of £0.978 million from prior year), with normal contributions and deficit recovery contributions increasing slightly.

Benefits payable fell by £2.286 million (after a prior year increased of £2.544 million), driven by the reduction in lump sum payments made in the current year when compared to the prior year due to the Council's voluntary retirement programme in 2016/17. Management Expenses also increased in year which is consistent with the growth in investments.

Net Assets Statement

Following the rise in markets during 2016/17, returns were more subdued in 2017/18. Volatility continued within global markets, and uncertainty continues in the future. As before, the impact of Brexit, is a key influence. During 2017/18 the fund have disinvested from Alliance and Bernstein, investing the funds in Legal and General (both Pooled Investments). If we consider the value of these investment together, they totalled £683.082 million in the prior year, when compared to the current year value of Pooled Investments of the £694.380 million.

The graph below shows year on year movement in net assets for the fund compared to other LGPS funds, with Dumfries and Galloway closely following the general trend but performing under the average in the current year. It should be noted that percentage changes in net assets of LGPS funds are influenced by different investment strategies.



Valuation of pension fund liabilities

The Pension Fund's actuary, Hymans Robertson, undertakes a valuation of the Pension Fund liabilities on an IAS19 basis each year. This uses the same base data as the actuarial funding valuation, taking account of changes in membership numbers. This valuation is based on financial assumptions which include pensions increase rate, salary increase rate and discount rate.

As at 31 March 2018 the Present Value of Promised Retirement Benefits was estimated to be £1,107 million (projected using a roll forward approximation from the latest formal funding valuation as at 31 March 2017). Taken with the funds net assets of £856 million, this gives a liability of £251 million.

Our audit work has confirmed that the assumptions used by the actuary were reasonable and that they were provided with accurate membership information by Dumfries and Galloway Council Pension Fund to support the calculation. The triennial actuarial funding valuation was completed as at 31 March 2017, and the results were reflected in the 2017/18 Pension Fund accounts alongside any updated assumptions or benchmarks including employer contribution rates.

Investment performance

Investment performance is measured through the analysis of returns achieved by the pension fund's seven external fund managers. The managers performance, in terms of achieving benchmarks, is subject to independent verification by the appointed advisors and managed through the investment mandates held by the specialist fund managers. Performance against agreed benchmarks is reviewed quarterly by the Council's finance team and reported to the Pensions Sub-Committee. In the financial year the pensions fund achieved a return on investment of 2.3% against its customised benchmark of 2.4%, under performing by 0.1%.

Due to the general economy and market conditions remain challenging, the annualised investment returns are below benchmark over the three year period, being 6.8% against a benchmark of 7.3%. However, over the five year period annualised investment returns are slightly ahead of benchmark being 8.3% against a benchmark of 8.2%.

A review of the Investment Strategy was undertaken by Hyman Robertson and presented to the Pensions Sub-Committee in May 2018. This review was noted by the Committee and it was agreed that the change in investment strategy from the current allocation to a modest switch from equity investments into alternative return-seeking assets to improve the risk/return profile of the Fund, closely aligning with the Lower Risk diversifying strategy but noting that specific recommendations on the detailed allocations for each component of the Fund. The risk profile of the recommended strategy will also take into account the estimated funding level at that time, and a report on the detailed asset allocation will be presented at the September 2018 meeting of the Pensions Sub-Committee.

Funds investment strategy

Setting the Fund's investment strategy is critical to the pension fund alongside monitoring performance against this investment strategy. The investment strategy is complex and needs to take into account a number of variable factors including; overall fund deficit; cash flows from dealing with members; and the maturity of the fund membership. The fund takes advice on its investment strategy from professional advisors, who are appointed and monitored by the Pensions Sub-Committee.

Financial Management arrangements

The Head of Finance and Procurement (Section 95) officer is responsible for overseeing the Pension Fund arrangements and signing the annual report and accounts. The Head of Finance and Procurement attends the meetings of the Pensions Sub-Committee along with the relevant officers who routinely report to the committee on the arrangements and performance of the Fund.

The financial regulations of Dumfries and Galloway Council, as the administering authority, apply to the Pension Fund. These are reviewed regularly to ensure they still remain appropriate and are easily accessible on the Dumfries and Galloway Council website.

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 5 scheduled bodies and 7 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 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.

Risk management

Appendix C to the funding strategy statement, included within the fund accounts, provided a comprehensive overview of the key risks which face the fund. Risk identified include:

- Financial Risks; performance of investments, pay and price inflation and impact of orphaned employers
- Demographic Risks; pensioners living longer, maturing fund and reductions in payroll
- Regulatory Risks; changes in regulations driven by pension reform or changes by Government.
- Governance Risks; administering authority not being aware of structural changes to employers, actuarial or investment advice and employers not existing in the future.

The funding strategy statement illustrates that the fund has controls in place to mitigate against risk.

Governance overview

The main legislation directing the governance requirements of the fund is the Local Government Pension Scheme (Governance) Scotland Regulations 2015. For Dumfries and Galloway Council Pension Fund governance is undertaken by a Pensions Sub-Committee and Pensions Board (who meet together at the same time). The remit of this Committee includes the appointment and monitoring of investment managers.

The Council has adopted a Local Code of Corporate Governance which is consistent with the principles of the CIPFA/SOLACE framework "Delivering good governance in Local Government". This code applies to the pension fund. In addition, the fund has a separate Governance Policy Statement.

The Pensions Sub-Committee and Board meets four times during the year. This is in line with the recommended practices, which suggest quarterly meetings. All pension fund committees are recorded and made available on the Council website alongside all minutes and supporting papers. We found this information to be clearly signposted and accessible to the public.

Appendices

Audit adjustments

Action plan and follow up of 2016/17 recommendations

Fees, independence and fraud arrangements

Communication of audit matters

Audit adjustments

Uncorrected and corrected misstatements

We are pleased to report that there were no uncorrected misstatements to the financial statements arising during our audit.

Disclosure misstatements

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow Pensions Committees to evaluate the impact of these matters on the financial statements.

There were no material/significant disclosure misstatements identified we wish to bring to your attention. Minor changes included enhancing disclosures within the financial statements and notes were made in the final version.

Action plan and follow up of 2016/17 recommendations

Based on our audit work undertaken in 2017/18, we have not identified any actions or recommendations we consider to be higher risk to Dumfries and Galloway Council Pension Fund. We have however completed follow up of our 2016/17 recommendations and this is reflected below for information.

Recommendation

Agreed management response

Reconciliation (2016/17 action)

During our interim audit in prior year, we noted that the fund does not complete a monthly bank reconciliation for its main bank account. We also noted that the intercompany reconciliation, showing amounts due or owed by the pension fund to the administering authority was not kept up to date on a regular basis.

A bank reconciliation should be completed for the pension fund's main bank account on a monthly basis.

The intercompany reconciliation should be completed and reviewed on a regular basis through the course of the year.

Management update:

Monthly bank reconciliations were carried out during 2017/18 and transfers of funds between Council and Pension Fund accounts made on three occasions.

Action owner:

Treasury Officer.

Status:

Closed.

Financial Reporting (2016/17 action)

We noted that the financial reporting process was heavily reliant on a single member of staff. It would provide great flexibility and resilience if these skills were more widely shared amongst the finance team.

Look to allocate financial reporting responsibilities more widely and provide training as required.

Management update:

The appointment of a Treasury & Capital Manager and a trainee Finance Officer both with a level of responsibility for Pension fund matters has increased the support to the financial reporting process.

Action owner:

Treasury and Capital Manager.

Status:

Closed.

Fees, independence, fraud arrangements

External Audit Fee

Service	Fees £
External Auditor Remuneration	21,140
Pooled Costs	1,880
Contribution to Audit Scotland costs	1,340
Contribution to Performance Audit and Best Value	0
2017-18 Fee	24,360

The audit fee was calculated in accordance with guidance issued by Audit Scotland and agreed with Management.

The above fee has not changed and our final fee was £24,360.

Fees for other services

Service	Fees £
We can confirm there are no non-audit fees for the 2017/18 financial year	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 Auditing Practices Board'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 Auditing Practices Board'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.

Fraud arrangements

In assessing our audit risks, the audit team was alert to the possibility of fraud at Dumfries and Galloway 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 relation to management override of controls.
- Leading a discussion with those charged of governance (for Dumfries and Galloway Council Pension Fund this is assumed to be the Pensions Committee) on their view of fraud. We did 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. – None were identified in-year

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 regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

It is **Dumfries and Galloway 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 worked with Dumfries and Galloway Council Pension Fund to review specific areas of fraud risk, including the operation of key financial controls.

We also examined certain policies in place, strategies, standing orders and financial instructions, as relevant to the fraud framework, to ensure that they provide a reasonable framework of internal control.

No suspected frauds or irregularities have been identified by Management and reported in-year.

Communication of audit matters to those charged with governance

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity We are independent of Dumfries and Galloway Council Pension Fund and have not identified any conflicts of interest.	•	•
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 We have not incurred any non-audit fees during the year and no threats to independence identified.	•	•
Significant matters in relation to going concern No significant going concern matters identified although we have identified significant financial pressures which are referenced in our report.	•	•
Views about the qualitative aspects of Dumfries and Galloway Council Pension Fund accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures Set out in the Financial statements Section.		•
Significant findings from the audit No significant findings from our audit.		•
Significant matters and issues arising during the audit and written representations that have been sought Letter of representation will be shared and signed by the Head of Finance and Procurement when signing the financial statements. This is our standard, unqualified letter of representation.		•
Significant difficulties encountered during the audit No difficulties encountered.		•
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 and/or which results in material misstatement of the financial statements None identified. A nil fraud return was submitted to Audit Scotland in April 2018 in accordance with the planning guidance.		•
Non-compliance with laws and regulations None noted.		•
Unadjusted misstatements and material disclosure omissions None noted. Minor disclosure amendments only and these were not material in nature.		•
Expected modifications to the auditor's report, or emphasis of matter None, an unqualified opinion.		•

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 above.

We communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to Dumfries and Galloway Council Pension Fund Management and the Pensions Sub-Committee.

