



Fife Council Pension Fund

**Annual Report on the Audit to Fife
Council, as administering authority, and
the Controller of Audit
2010/11**

November 2011



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Executive Summary

Financial statements

Local authorities responsible for administering a pension fund (administering authorities) forming part of the local government pension scheme (LGPS) are required by a recent amendment to the *Local Government Pension Scheme (Administration) (Scotland) Regulations 2008* to publish a pension fund annual report from 2010/11. The pension fund annual report includes the financial statements of the pension fund. As auditors to the pension fund we are required to provide an audit opinion on the financial statements in the pension fund annual report.

We are pleased to report that our independent auditors' report contains an unqualified audit opinion on the financial statements for the year ended 31 March 2011. We also certify that the accounts have been properly prepared in accordance with applicable law, accounting standards and other reporting requirements.

Fife Council Pension Fund reported a net increase in the fund of £108.786m in 2010/11 (9.3%). The opening net assets brought forward at 1 April 2010 of £1,174.151m increased to an accumulated net fund of £1,282.937m at 31 March 2011. The actuarial present value of promised retirement benefits was £1,701m at 31 March 2011 (£1,904m at 31 March 2010).

Governance

In accordance with the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, the council, as administering authority, has published a governance compliance statement. The statement sets out the extent to which the pension fund governance arrangements comply with best practice. We have reviewed the pension fund governance compliance statement and confirmed that it complies with guidance from Scottish Ministers. Areas of 'partial' compliance have been identified and reported by the council in its governance compliance statement.

Conclusion

This report concludes our audit of Fife Council Pension Fund for 2010/11. We have performed our audit in accordance with the Code of Audit Practice published by Audit Scotland, International Standards on Auditing (UK and Ireland) and Ethical Standards.

This report has been discussed and agreed with Fife Council's Executive Director of Finance and Resources. We would like to thank all management and staff for their co-operation and assistance during our audit.

Scott-Moncrieff
November 2011

Introduction

1. Local authorities responsible for administering a pension fund (administering authorities) forming part of the local government pension scheme (LGPS) are required by a recent amendment to the *Local Government Pension Scheme (Administration) (Scotland) Regulations 2008* to publish a pension fund annual report from 2010/11. The pension fund annual report includes the financial statements of the pension fund.
2. Pension fund financial statements have previously been included as part of the administering authority's financial statements and were therefore covered by the audit opinion on those accounts. From 2010/11, however, pension fund financial statements are no longer included in the administering authority's accounts, and auditors are therefore required to provide a separate audit opinion on the financial statements in the pension fund annual report.
3. This report summarises the findings from our 2010/11 audit of Fife Council Pension Fund. The scope of the audit was set out in our External Audit Annual Plan, which was presented to the Standards and Audit Committee at the outset of our audit. The key issues arising from our work during the year are summarised in this annual report.
4. The report is addressed to Fife Council, as administering authority and the Controller of Audit and will be published on Audit Scotland's website, www.audit-scotland.gov.uk.

Financial Statements

Introduction

5. Financial statements are a principal means of accounting for the stewardship of the resources available to it. In this section we summarise the key outcomes from our 2010/11 audit of Fife Council Pension Fund financial statements.

Our Responsibilities

6. We audit the financial statements and give an opinion on:
 - Whether they give a true and fair view in accordance with applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom (the 2010/11 Code) of the financial transactions of the fund during the year ended 31 March 2011, and of the amount and disposition at that date of its assets and liabilities;
 - Whether they have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2010/11 Code; and
 - Whether they have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.
7. We also required to report by exception on certain matters including, whether the Governance Compliance Statement complies with guidance from Scottish Ministers.

Independence

8. International Standard on Auditing 260 – Communication of Audit Matters with those Charged with Governance – requires us to communicate on a timely basis all facts and matters that may have a bearing on our independence.
9. We provided no additional services to Fife Council Pension Fund during the year and can confirm that we have complied with the Auditing Practices Board Ethical Standard 1 – Integrity, Objectivity and Independence. In our professional judgement the audit process has been independent and our objectivity has not been compromised.

Legality

10. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the financial statements. Our audit procedures included the following:
 - Reviewing minutes of relevant meetings
 - Enquiring of senior management and the fund's solicitors the position in relation to litigation, claims and assessments
 - Performing detailed testing of transactions and balances

11. We are pleased to report that we did not identify any instances of concern with regard to the legality of transactions or events.

Overall conclusion

12. Our audit report is included on pages 33 and 34 of the annual accounts and is addressed to members of Fife Council as administering body for Fife Council Pension Fund and the Accounts Commission for Scotland. The report was issued on 1 November 2011 and is unqualified. We also certify that the accounts have been prepared properly in accordance with applicable law, accounting standards and other reporting requirements.
13. Under Regulation 4 of the Local Authority Accounts (Scotland) Regulation 1985 a copy of an abstract of the accounts is required to be submitted to the Controller of Audit by 30 June. We can confirm that the unaudited Fife Council Pension Fund financial statements were submitted to the Controller of Audit by the deadline of 30 June.
14. The quality of the financial statements is of a high standard. This is a demonstration of the council's finance officials' commitment to consistently improve the disclosure of financial and accounting information to stakeholders. Our thanks go to staff at Fife Council for their assistance with our work.

Format of the Accounts

15. *The Local Government Pension Scheme Amendment (Scotland) Regulations 2010* amend the *Local Government Pension Scheme (Administration) (Scotland) Regulations 2008*. The Regulations now require an administering authority to publish a pension fund annual report. The Regulations specify what the report must contain, when it must be published and that the administering authority should have regard to guidance issued by Scottish Ministers when preparing and publishing the report. The pension fund annual report must include, for each pension fund, a fund account and net asset statement with supporting notes and disclosures prepared in accordance with proper practices.
16. Finance circular 1/2011 clarifies that pension fund financial statements should be prepared in accordance with proper accounting practices set out in the Code of Practice on Local Authority Accounting in the UK (the Code). The financial statements within the pension fund annual report are treated as an additional abstract of accounts and therefore continue to be subject to the arrangements as set out in the Local Government (Scotland) Act 1973 and any regulation issued under section 105 of this Act.
17. As part of our 2010/11 audit we considered the arrangements the council, as administering body for the Fife Council Pension Fund, had in place to ensure compliance with the requirements of the Code. Overall we concluded that the council has complied with these.

Audit and Risk Management Services

18. Effective co-ordination between internal audit and external audit is essential in order to minimise duplication of effort and maximise the benefits of audit. As required by the Code of Audit Practice, we have established appropriate working arrangements with the council's audit and risk management services which provide internal audit services to Fife Council Pension Fund.
19. Audit and Risk Management Services has adopted a cyclical approach to auditing the pension fund. In line with its strategic plan, Audit and Risk Management Services review pension contributions and the superannuation fund once every 5 years. The last review was carried out in 2009/10. The findings of this review were issued in September 2010. The detailed testing carried out covered the financial year 2009/10.

Table 1: Summary of internal audit findings

Good practice points

- Transfers into and out of the scheme and refunds are correctly and timeously undertaken
- Contributions are set in accordance with the actuarial valuation which is undertaken on a regular basis
- Pension Fund Investment Managers are appropriately appointed
- The performance of Investment Managers is monitored
- The performance of the Pension Fund is monitored

Areas for improvement

- Documented procedures do not cover all parts of the system
- Employee pension contributions are not always accurately calculated by admitted bodies
- Authorised signatory lists have not been received from all admitted and scheduled bodies
- Employee and employer contributions due from scheduled and admitted bodies are not timeously handed over to the pension scheme
- Pension fund monies are not kept separate from council money
- Members of staff who take early retirement are not always timeously transferred onto the pension payroll

Source: Audit and Risk Management Services report – Pension Contributions and Superannuation Fund systems review (September 2010)

20. An action plan has been agreed with the pensions team to take forward Audit and Risk Management Services recommendations. We considered the findings above during our planning stage and tailored our audit approach accordingly.

Audit Adjustments

21. We identified no major errors or weaknesses during our audit. Adjustments to the financial statements arising from the audit related mainly to changes in disclosure and presentation and have been agreed with the Executive Director of Finance and Resources.

Issues arising from the audit

22. We are required by international auditing standards to report to the council, as administering authority, the main issues arising from our audit of the financial statements. The most significant issues are noted below.

IAS 19 disclosure requirements

23. A key area of change from previous years is the requirement to disclose the actuarial present value of promised retirement benefits. The Code requires that this is based on IAS 19 'Employee Benefits' requirements, rather than the funding assumptions that may be used in determining employer contribution rates (normally undertaken every 3 years). In particular this may require the use of a different discount rate to determine 'present value'. Fife Council Pension Fund has disclosed this as a note to the accounts. The actuarial present value of promised retirement benefits was £1,701m at 31 March 2011 (£1,904m at 31 March 2010).

Contributions

24. The fund account presents employer and employee contributions for the year. Under *The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008*, responsibility for calculating the contributions lies with the employing authority rather than the pension fund. It is considered good practice, however, for each pension fund to review the figures received from employing authorities to identify any discrepancies. Table 2 details 2010/11 employer and employee contributions as presented in the fund account.

Employer	Employer contributions (normal) £m	Employee contributions (normal) £m
Fife Council	46.174	15.878
Scheduled bodies (6 in total)	2.931	0.985
Admitted bodies (22 in total)	3.109	0.973
Total	52.214	17.836

Source: Annual Report and Accounts of the Pension Fund 2010/11

25. During our audit we carried out detailed testing on pension contributions. The testing considered whether contributions are received and accounted for correctly. Overall we identified no errors in our sample testing.

Separate banking arrangements

26. The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 provide that pension fund money must, by 1 April 2011, be kept in a separate bank account held by the administering authority for that purpose. During our audit we confirmed that such arrangements have been put in place. The council is still in the progress of transferring the year end balances to the pension fund bank account. It was however used for pension fund transactions during 2011.

Financial performance 2010/11

27. Fife Council Pension Fund reported a net increase in the fund of £108.786m in 2010/11. The opening net assets brought forward at 1 April 2010 of £1,174.151m increased to an accumulated net fund of £1,282.937m at 31 March 2011.
28. During 2010/11, seven investment managers were delegated responsibility to invest the assets of the Fund in accordance with agreed mandates. Northern Trust Company, the pension fund's custodians, are responsible for providing regular reports to the investment sub-committee on the investment performance of the fund managers. In 2010/11, Fife Council Pension Fund had under-performed the benchmark over the twelve months to March 2011 by 1.09% in relative terms but over the longer term the total plan falls below the benchmark since inception (2003) by 0.36% per annum. A review of the Fund strategy and investment management arrangements was completed during the year and revised arrangements are now in place.

Funding position

29. To assess the extent to which the funding objectives are being met and to identify the contributions payable in the future to meet the funding objectives, a full actuarial valuation is carried out every three years. The most recent full actuarial valuation was carried out at 31 March 2008.
30. In assessing whether the funding objectives are being met the actuary assesses whether the fund has sufficient assets to meet the assessed cost of members' past and future service benefits (funding level). A funding level of 100% would correspond to the assets being exactly sufficient to meet the cost of members past and future service benefits. At 31 March 2008 the funding level for the Fife Council Pension Fund was 81% with the shortfall of assets to the assessed cost of members' benefits amounting to £254m. This compared to a funding level of 86% at 31 March 2005. At the time, the funding level of 81% represented the second lowest funding level of the 11 superannuation funds in Scotland.
31. At the time of the 2008 valuation, the pension fund introduced additional rules to help stabilise contributions for the major employers in the fund. These rules limited contribution increases and decreases to 15% of employees' contributions each year. This stabilisation mechanism will be reviewed as part of the 2011 valuation.

Governance

Introduction

32. Governance is about direction and control of organisations. It is concerned with structures and processes for decision making and accountability. Good governance can be defined as *“the way authorities operate is based on sound decision-making and effective processes are in place to support it”*.
33. We have reviewed the pension fund’s governance arrangements during the year. This section sets out the main findings from our review.

Governance arrangements

34. Fife Council, as the administering authority, has delegated responsibility for the management of the pension fund to its superannuation fund and pensions sub committee. The terms of reference from the sub committee are ‘to arrange for the supervision of the management and administration of the investments of the superannuation fund’ and ‘to make decisions in regard to the appointment of fund managers; and to consider and determine (except insofar as delegated to the Executive Director, Finance and Resources or any other officer) all matters relating to the council’s functions in regard to pensions administered by the council’. The sub committee comprises nine elected members. There are also two employee observer representatives who are non-voting. The sub committee meets quarterly to consider both pension and investment matters. With the exception of a small residual venture capital portfolio, which is administered in house, the Fund’s assets are managed by external fund managers who have delegated authority to carry out all day to day investment decisions including acquisition and realisation of investments within the constraints of agreed benchmarks. The Northern Trust Company, the Fund’s custodian, is responsible for providing regular reports to the sub committee on the investment performance of the fund managers. Hymans Robertson has been appointed as investment consultants to the pension fund. Hymans Robertson is also the appointed actuary to the pension fund.
35. During 2010/11 the investment manager structure was reviewed and three new mandates tendered for. The first mandate was Partners Group, an infrastructure mandate. Funds were made available to Partners Group on 25 March 2011. The remaining two investment firms, Baillie Gifford and Standard Life have been given absolute return mandates however funding for these did not commence until the financial year 2011/12.

Admitted Bodies

36. The Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (“the Regulations”) identify two types of admitted body; community admission bodies and transferee admitted bodies. In summary, community admission bodies are those bodies having a

community of interest with local authority employers, while transferee admission bodies are companies that undertake work on behalf of local authorities.

37. The Fife Council Pension Fund has only one transferee admitted body *Forth and Oban*. In accordance with the Regulations, the admitted body has entered into a bond agreement, with a third party, to reflect the level of risk arising on premature termination of the provision of the service or assets through insolvency, winding up or liquidation of the body. A risk assessment was undertaken by the council during the year to ensure that the level of the bond remained appropriate.
38. The remaining 21 admitted bodies are community admission bodies. Should one of these bodies default then the remaining liability would fall with either the local authority or central government. As approximately 97% of the total scheme members are employed by the council, the council does not consider any potential risk of default to be significant. In addition, through the triennial valuation a high level evaluation is undertaken by the pension fund to assess the affordability of the scheme for each organisation when establishing employer contribution rates. Furthermore, the Regulations require admitted bodies to notify the council, as administering authority, of any significant changes in circumstances that may indicate that they will not be able to meet their pension liabilities as and when they fall due. Included in the table below we provide comments on the financial position for those admitted bodies who have lodged annual accounts for 2010/11 at Companies House:

Table 3: Commentary on the financial position on a sample of admitted bodies			
Admitted Body	Audit Opinion (2010/11)	Net assets/(liability) £	Commentary
Byre Theatre	Emphasis of matter	254,460	Excludes IAS 19/FRS 17 pension liability - treated as defined contribution scheme
Clued Up Project	Unqualified	81,588	Excludes IAS 19/FRS 17 pension liability - treated as defined contribution scheme
Fife Alcohol Support Service	Unqualified	183,568	Includes pension liability of £171,000
Fife Arts and Theatres Trust	Unqualified	(243,173)	Includes pension liability of £473,000
Fife Intensive Rehabilitation and Substance Misuse	Unqualified	167,872	Includes pension asset of £37,000
Forth and Oban	Unqualified	110,130	Includes pension liability of £78,480
Home-Start Levenmouth	Emphasis of matter	14,156	Excludes IAS 19/FRS 17 pension liability - treated as defined contribution scheme
Impact 21	Unqualified	596,031	Includes pension liability of £128,000
St Andrews Links Trust	Unqualified	84,004	Unclear whether includes IAS 19/FRS 17 pension liability

39. Whilst there are arrangements in place to ensure that admitted bodies will continue to meet their pension fund liabilities as and when they fall due, the table above shows that the net asset position of a number of the admitted bodies is weak. The council should undertake to investigate this further to gain assurance that admitted bodies will continue to meet liabilities as and when they fall due.

Action plan point 1

Admission agreements

40. The Regulations require administering authorities to have in place admission agreements with bodies admitted to the scheme. Admission agreements have not been established for a number of admitted bodies within the Fife Council Pension Fund. This is primarily due to the historic admission approval process. The council's legal team are currently preparing draft admission agreements for these bodies. We recommend that the council, as scheme administrator, ensures that formal admission agreements are established with all admitted bodies to ensure compliance with the Regulations.

Action plan point 2

Governance compliance statement

41. The Regulations require an administering authority to prepare and publish a governance compliance statement setting out whether they delegate their function in relation to maintaining a pension fund and details relating to that delegation. Administering authorities are also required to measure their governance arrangements against the standards set out in guidance from the Scottish Ministers. Where compliance does not meet the published standard, there is a requirement for the administering authority to set out reasons for non-compliance in the governance compliance statement.
42. Fife Council, as administering authority, has included a governance compliance statement in its annual report and accounts of the pension fund. The statement sets out the extent to which the pension fund governance arrangements comply with best practice. The statement does not report any areas of non-compliance. It does however identify areas of 'partial' compliance as noted in the table below:

Table 4: Areas of partial compliance in the Fife Council Pension Fund governance compliance statement		
Principle	Best practice	Fife Council Pension Fund position
Structure	Representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee	The sub committee is made up of 9 councillors from Fife Council and 2 non voting representatives selected by the Joint Negotiating and Consultative Forum. Further representation is being

Table 4: Areas of partial compliance in the Fife Council Pension Fund governance compliance statement		
Principle	Best practice	Fife Council Pension Fund position
		progressed as agreed at the August 2011 committee.
Representation	All key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure	Further representation is being progressed as agreed at the August 2011 committee meeting.
Training	The administering authority considers the adoption of annual training plans for committee members and maintains a log of all such training	Training is offered on an ad hoc basis as needs are identified. A log of attendance is held. Tools to carry out a needs assessment are being investigated and will be in place for the new committee following the 2012 elections.
Scope	Administering authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Further representation is being progressed as agreed at the August 2011 sub committee meeting.
Source: Fife Council annual report and accounts of the pension fund 2010/11		

43. We have reviewed the pension fund governance compliance statement and confirmed that it complies with guidance from Scottish Ministers. Areas of partial compliance have been identified and reported by the council in the governance compliance statement.
44. Should the sub committee decide to change representation on the committee, we would expect the terms of reference to be updated. We also noted that the terms of reference do not currently refer to the non voting representatives.

Action plan point 3

Looking forward

45. Following on from an initial pathfinder project (carried out between three pension funds, Lothian, Scottish Borders and Fife) there was agreement by COSLA leaders to a further phase of work to undertake a detailed options appraisal to compare the governance, risks, costs and benefits of alternative models and maintenance of the current pension arrangements within the Local Government Pension Schemes (LGPS) across Scotland.

46. Deloitte was procured to undertake a detailed analysis of the investment and administration arrangements across the LGPS, including exploring the case for merging the eleven funds. Deloitte's Interim Report concluded that no change should be made to Funds' existing investment structures. This is because the potential savings generated from investment management fees within a merged structure do not appear to be significant enough to justify a change. Benefits however could be gained from improved, cost-effective investment governance arrangements including a central resource to provide technical advice on complex investment issues and the removal of the restrictions on how much a pension fund can invest in a single fund.
47. Following approval by COSLA, the Improvement Service has taken forward work in the areas recommended in the Deloitte Interim Report. This work is expected to be completed by end November 2011 with final recommendations to be made thereafter.
48. In 2011, Lord Hutton published his final report on behalf of the Independent Public Services Pension Commission. The report sets out proposals for comprehensive, long term structural reform of the public service pension schemes. It sets out a number of detailed recommendations to the Government on how public service pensions can be made sustainable and affordable in the future, while providing an adequate level of retirement income. The main recommendation of the report is that existing final salary public service pension schemes should be replaced by new schemes, where an employees pension entitlement is still linked to their salary but is related to their career average earnings with appropriate adjustments in earlier years so that benefits maintain their value. The report suggests that it should be possible to introduce these new schemes before the end of 2015.

Action Plan

Our action plan details the key weaknesses and opportunities for improvement that we have identified during this review. To assist the council, as administering authority, in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated.

Our rating structure has been revised to ensure consistency with the structure used by Audit and Risk Management Services. The rating structure was approved by the Standards and Audit Committee in 2008.

The rating structure is as follows:

Significant	Weaknesses in existing controls leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high for the matter to be reported specifically in the Annual Assurance and Corporate Governance Statements
Substantial	Weaknesses in existing controls leaving the Council or Service open to high risk of error, fraud, financial loss or reputational damage
Routine	Weaknesses in existing controls leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage
Minor	Administrative weaknesses in existing controls posing little risk of error, fraud, financial loss or reputational damage

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist.

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
1	39	<p>While arrangements are in place to ensure that admitted bodies will continue to meet their pension fund liabilities as and when they fall due, we recommend that the council, as the administering authority, should undertake to investigate this further to gain assurance that admitted bodies will continue to meet liabilities as and when they fall due.</p> <p>Substantial</p>	<p>The admitted bodies make up a small percentage of the scheme's membership and the majority of their funding comes from central and local government. This will be reviewed as part of the triennial valuation and individual employers contribution rates revised accordingly. The Pension Fund regulations require changes in circumstance for any organisation to be notified to the Council and this would be reviewed by the Actuary. The transferee admission body has a bond in place to guarantee they can meet their liabilities should they cease to exist. This bond acts as a safeguard and is reviewed routinely.</p>	Payroll/Pensions Team Leader	Ongoing
2	40	<p>We recommend that formal admission agreements are established with all admitted bodies to ensure compliance with the Regulations.</p> <p>Substantial</p>	<p>The Pension Section is currently liaising with the Legal Department to review all admitted bodies' admission agreements.</p>	Payroll/Pensions Team Leader	June 2012

Action Plan Point	Para Ref	Recommendation and Rating	Management comments	Responsible Officer	Agreed Completion Date
3	44	<p>Should the sub committee decide to change representation on the committee, we would expect the terms of reference to be updated. We also recommend that the existing terms of reference are updated to reflect the composition of the committee (9 councillors and 2 non voting representatives)</p> <p>Routine</p>	<p>The Council's Scheme of Administration, which will be amended in May 2012 following the Local Government Elections and submitted to an early meeting of the new Council, will take account of the employee and employer representatives appointed to the sub-committee in a non-voting capacity.</p>	<p>Committee Administrator, Committee services</p>	<p>September 2012</p>



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