Audit Scotland

North East Scotland Pension Funds

Annual Report on the 2013/14 audit

Prepared for the Members of Aberdeen City Council's Pensions Committee and the Controller of Audit

October 2014

Contents

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Key messages

Financial statements	• Unqualified auditor's report on the 2013/14 financial statements of the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund.
Financial position	• The main fund was 88% funded at the last actuarial valuation. • Fund growth is largely generated by investment returns, with only £2m arising from members' net contributions. • The transport fund investment strategy has recently been changed to reflect that it is a maturing fund.
Governance & accountability	• Fund governance has been the responsibility of the administering authority. There will be change with the introduction of a Pensions Board required by regulations from April 2015 to assist the authority. • These changes in the overall governance framework prioivide an opportunity to review fund scrutiny arrangements and to ensure there is sufficient accountability for the funds by the Pensions Committee to the administering authority. • Systems of internal financial control operate effectively.
Best Value, use of resources & performance	• Positive Investment return over 12 months for the main fund but slightly behind benchmark over a five-year period. • Auto-enrolment boosted membership of the main fund as a higher number of staff than expected remained in the fund.
Outlook	• The initial results from the 2014 triennial actuarial review are due soon. • New regulations effective from April 2015, will implement a new career average pension scheme which will have implications for employers' record keeping as well as those of the fund.

Financial Statements

1. We have given an unqualified audit opinion on the 2013/14 financial statements of North East Scotland Pension Fund and the Aberdeen City Council Transport Fund.
2. While the main fund grew by £263m which is an increase of 10.2% in the year, only £1.8m arose from members' net contributions. The transport fund decreased in value by £0.9m in the year and is in a negative funding position. The cost of pensions and benefits exceeds income from contributions by around £1m each year.

Financial position

3. The main fund was in deficit at the 2011 valuation when its assets amounted to 88% of its future liabilities. An up-to-date actuarial valuation will be finalised by 31 March 2015.
4. A new strategy has been approved for the Transport Fund to reflect that the fund is closed to new members and is maturing in nature. With the number of pensioners exceeding active members, the strategy aims to reduce risk over time and provide assets to meet liabilities.

Governance and accountability

5. The pensions committee has recently replaced the pensions panel. This change will provide another opportunity to review membership against governance best practice. The statutory requirement for a pensions board from April 2015 and its interface with the pensions committee will need to be established and implemented.
6. The pensions panel was previously the body charged with governance in respect of the pension funds. With the wider changes in the governance framework, the opportunity should be taken to review the scrutiny arrangements for the pension funds and ensure that there is sufficient accountability for the funds to the administering authority.
7. In other respects the funds' governance arrangements are sound and supported by systems of internal control.

Best Value, use of resources and performance

8. Main fund performance is above benchmark for the 12 month period but over 5 years, it falls slightly below the benchmark.

Outlook

9. New regulations from 2015 will see the introduction of a new scheme based on career average revalued earnings. This will require significant changes in employers' and fund records.

Introduction

10. This report is a summary of our findings arising from the 2013/14 audit of the North East Scotland Pension Funds (NESPF). The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.

11. This report is addressed to the members of the Pensions Committee of Aberdeen City Council, as the administering authority of the funds, and the Controller of Audit and will be considered by the Pensions Committee on 24 November 2014. Reports should be made available to stakeholders and the public, as audit is an essential element of accountability and the process of public reporting.

12. This report will be published on our website after it has been considered by the administering authority. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

13. The concept of audit risk is of key importance to the audit process. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. We set out in our annual audit plan the related source of assurances and the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix I sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

14. Appendix II is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response".

15. We recognise that not all risks can be eliminated or even minimised. What is important is that the North East Scotland Pension Funds understand their risks and have arrangements in place to manage these risks. The council, as administering authority, and the Proper Officer should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and monitor outcomes.

16. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

17. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Financial statements

Combined dealings with employers and members - net income £0.8m
- Contribution income £113.1m
- Pension costs £112.3m

Combined returns on investments £261.8m
- Net income from investments £46.3m
- Capital growth £215.5m

Combined asset value increased 9.9%
- Main Fund investments up 10.3%
- Transport Fund investments down 1.1%

Combined net assets £2,913.4m
- Increase in the year £262.7m

Audit opinion

18. We have given an unqualified opinion that the financial statements of NESPF for 2013/14 give a true and fair view of the financial transactions of the funds during the year and of the amount and disposition of their assets and liabilities.

Other information published with the financial statements

19. Auditors review and report on other information published with the financial statements, including the Explanatory Foreword, the Statement on the System of Internal Financial Control and the Governance Compliance Statement. We have nothing to

report in respect of these statements.

Legality

20. Through our planned audit work we consider the legality of the pension funds' financial transactions. This includes obtaining written assurances from the Proper Officer. There are no legality issues arising from our audit which require to be brought to the attention of those charged with governance.

Accounting issues arising

21. Our '*Report to those charged with governance on the 2013/14 audit'*, was presented to the Pensions Panel on 8 September 2014. The primary purpose of that report was to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. The main items are summarised in the following paragraphs.

Presentational and monetary adjustments

22. The unaudited accounts reflected private equity valuations carried out at 31 December 2013 and were considered the best estimates available to officers when preparing the annual accounts. Valuations at 31 March 2014 were received in June 2014 and were of sufficient difference to merit amending the accounts. The effect of the adjustments was to increase the Return on Investments (Fund Account) and Net Investment Assets (Net Assets Statement) by £3.872m. A number of presentational amendments were also processed to improve the disclosures within the accounts.

23. Adjustments were not made for other misstatements identified during the audit. These misstatements are immaterial to the accounts as a whole. Had an adjustment been made, the net impact of the misstatements would have increased the Net Additions from Dealings with Members (in the Fund Account) and Net Assets by £0.355m.

Investment management fees

24. Investment management expenses are included in the Fund Accounts with fuller information disclosed in a note to the accounts. At 31 March 2014, the main fund disclosed management fees of £10.4m compared with £5.3m the previous year. In line with an agreed action in our 2012/13 Annual Report, officers took action to identify private equity management fees which had previously been included in the value of the investments in the net asset statements and account for them in accordance with the Code of Practice on Local Authority Accounting in the UK (the Code).

25. In recognition of the fact that this is a complex area, CIPFA has issued further guidance, accounting for local authority pension scheme management costs, which is recommended practice from 2014/15. The guidance aims to provide a framework for consistent accounting in dealing with some of the common

areas of uncertainty e.g. performance related fees, pooled fund management fees and private equity and hedge funds.

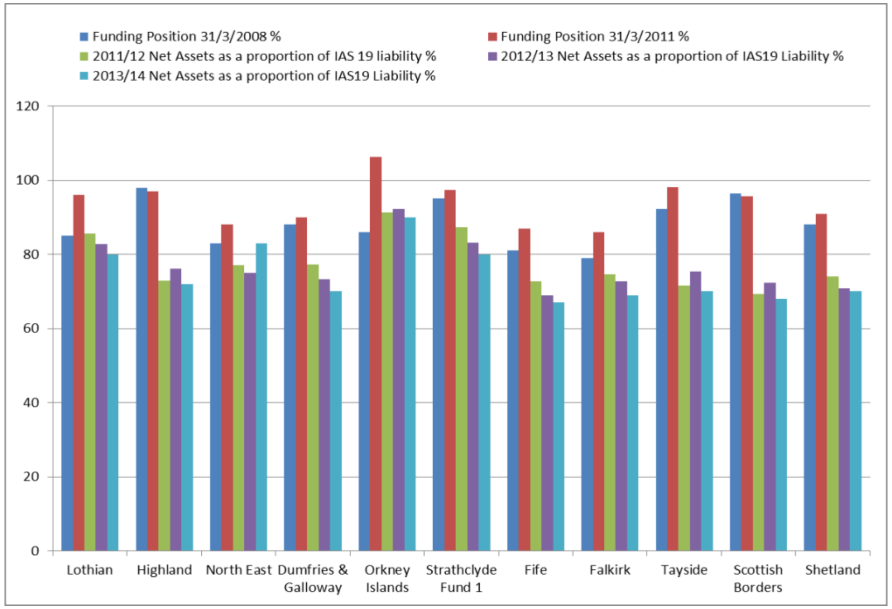
26. During the audit of the financial statements, we identified a potential understatement in performance fees. A fee was likely to be payable to one of the fund manager's, Baillie Gifford, in respect of the 12 month period ended 30 September 2014, however as uncertainty remained until the performance period was complete, it was difficult to calculate a reasonable estimate at 31 March 2014. While a contingent liability was included in the audited accounts, this was an area which needed to be addressed to ensure the appropriate accruals are recognised at the year end. Arrangements have now been put in place to align the performance period with the financial year to enable earlier identification of reasonable estimates for performance fee accruals.

Pension fund liability

27. The actuarial value of promised retirement benefits in line with IAS 19 assumptions is £3,423m which represents a £12m reduction from the liability stated at 31 March 2013. This considers the long term view for the pension fund in meeting its future commitments having taken employers' contribution rates and revenues generated from investments into account. The deficit arising from this valuation does not require an immediate cash injection but is intended to be funded by increased contributions over the long term. The assumptions within the IAS19 valuation are determined by the actuary. The main movement is the actuary's use of a discount rate of 4.5% at 31 March 2014 to reflect improvement in the markets. This is a higher discount rate than the previous year when the actuary used a rate of 4.2%. The use of a higher discount rate in the actuary's assumptions generally produces a lower pension liability.

28. This year, the actuary widened the definition of 'AA rated' bonds in the calculation used to derive the discount rate. Following the downgrade of the UK sovereign credit rating in 2013, the number of bonds within the actuary's model fell significantly. In order to improve the robustness of the dataset and with the aim of providing greater stability over time, the actuary widened the definition of 'AA rated' bonds in the calculation used to derive the discount rate. The discount rate reflects the pension fund's tolerance of risk and with the change in the number of bonds used in the calculation, we noted an increase this year from 4.2% to 4.5%. This places the North East Fund in a different position to other Scottish funds in that it is the only fund showing a decrease in the IAS19 liability at 31 March 2014 (Exhibit 1).

Exhibit 1 – Funding Position



Source:

Impairment losses

29. At 31 March 2014, the accounts continued to include a provision for the potential non-collection of £2.6m from a former admitted body of the pension fund. The debt has been the subject of a longstanding dispute between the pension fund and the admitted body. In June 2013, after little progress, the matter was referred to the council's external legal advisors. In June 2014, formal legal action was postponed when the admitted body authorised its auditors to share financial information with council officers with a view to reaching settlement.

30. While progress has been made during 2013/14 in bringing this longstanding matter to a conclusion, we had anticipated that it would have been resolved before the financial statements audit was concluded in September 2014. Officers have however advised us that agreement has been reached on the matter and both parties concerned are working towards a favourable outcome.

Refer Recommendation 1

Outlook

31. The financial statements of NESPF are prepared in accordance with the Code. The main new standards adopted in 2014/15 include:

- IFRS 13 Fair Value Measurement
- IAS 32 Financial Instruments: Presentation
- Annual Improvements to IFRSs 2009-2011 cycle.

32. The revised Local Authority Accounts (Scotland) Regulations apply for financial years 2014/15 onwards. The regulations set out in detail what is required in respect of financial management, internal control, and the annual accounts themselves. The existing timetable for the NESPF in terms of members' consideration of draft and audited accounts largely already meets the timescales specified in the new regulations.

33. The regulations require pension funds to have a governance compliance statement. From 2014/15, the Code requires inclusion of a statement on the system of internal financial control. The new accounts regulations recommend that only one governance statement is published within the pension fund annual report and accounts but that it satisfies the requirements of both sets of regulations.

34. While the 2013/14 draft accounts were submitted to the pensions panel on 16 June, it was some three weeks later before the working paper package was submitted for audit. As we had planned to commence the audit on 9 June, the delay significantly impacted on our workplan and required a reallocation of resources to ensure delivery of our audit plan.

35. The additional time was required by officers to rectify errors in the year end position provided by the custodian in relation to private equity transactions. This problem had been ongoing for some time and plans are in place to review the service provider.

Financial position

36. NESPF consists of two funds, the North East Scotland Pension Fund (the main fund) and the Aberdeen City Council Transport Fund (the transport fund).

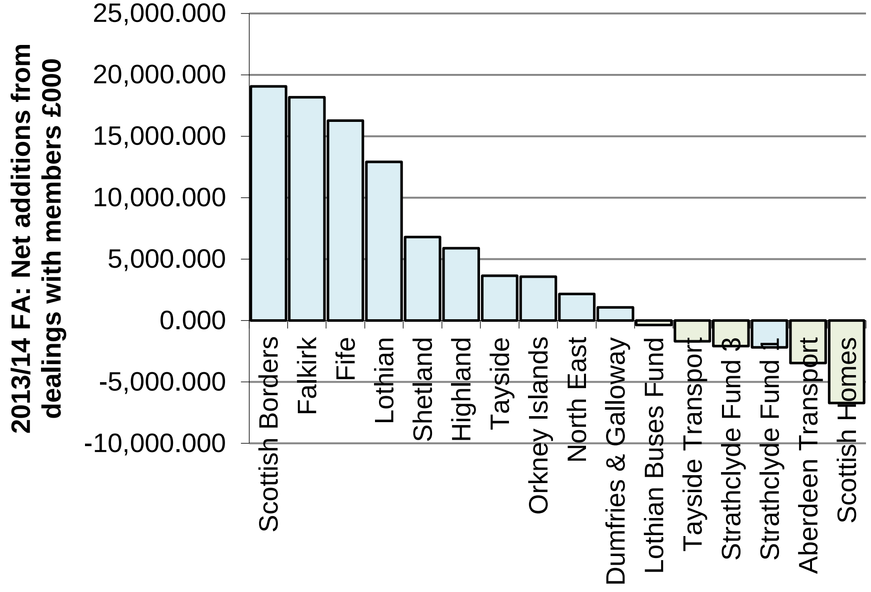
37. Although both funds benefit from shared governance and administrative arrangements, their assets and liabilities are accounted for separately. The main fund provides pensions for a number of employer organisations and has more than 22,000 active members. The transport fund, which is closed to new members, has only 85 active members and more than 400 pensioners. Both funds are part of the Local Government Pension Scheme.

Main fund

38. The net assets of the main fund grew by £263.6m to £2,834m, which is an increase of 10.2% in the year. While only £1.8m of this came from dealings with members, this is a better position than the previous year as a result of the positive impact of the implementation of auto-enrolment in 2013/14 by the larger employers in the fund. (Exhibit 2)

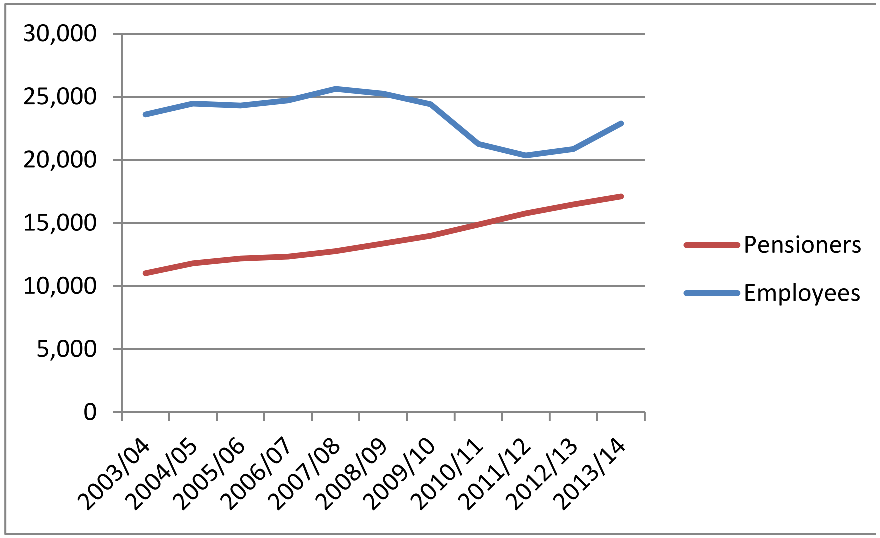
39. Introduced by the Pensions Act 2011, auto-enrolment, requires employers to enrol their workers into 'a qualifying workplace scheme' by prescribed staging dates. Take-up and retention of auto-enrolled members in NESPF was greater than expected, leading to a positive boost to membership this year (Exhibit 3). The staging dates of smaller employers fall in future years, though the impact is unlikely to be as significant.

Exhibit 2 – Net Additions from dealing with Members



Source: Technical Services Unit Pension Fund Database

Exhibit 3: Main fund: trends in membership



Source: NESPF financial statements

Exhibit 4: Snap-shot of assets and liabilities

	North East Scotland Pension Fund		
	2011 Valuation £m	**2013 Roll-forward estimate £m**	**2014 Roll-forward estimate £m**
Assets	2,218	2,568	2,834
Liabilities	2,512	3,489	3,423
Net surplus/(liability)	(294)	(865)	(589)
Funding Level	88%	75%	83%

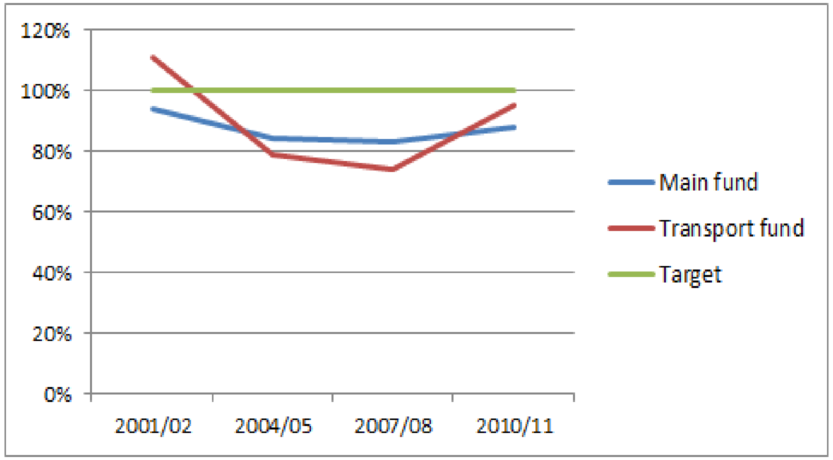
Source: NESPF financial statements

40. The growth in market value of the fund was 10.4%. This compares well with the benchmark of 9.0% over one year. Over the longer term five year period, growth of 13.9% was achieved but this remains a fraction behind the benchmark of 14.1%.

41. While the growth of investment assets is encouraging, the overall funding position is such that the scheme's assets do not cover its liabilities and if the fund was wound up immediately, employers would be left with an estimated funding gap of around £589m. (Exhibit 4).

42. The fund is however considered to be a going concern, with its funding position calculated every three years by an actuary. The last full valuation in 2011 showed that the fund's assets amounted to 88% of the fund's liabilities (Exhibits 4 and 5) and the current funding gap is currently being assessed by the actuary as part of the March 2014 actuarial valuation.

Exhibit 5: Actuarial funding level of the two funds



Source: Actuarial valuation reports

Exhibit 6: Snap-shot of assets and liabilities

	Transport Fund		
	2011 Valuation £m	2013 Roll-forward estimate £m	2014 Roll-forward estimate £m
Assets	67.9	80.3	79.5
Liabilities	71.5	88.2	85.2
Net surplus/(liability)	(3.6)	(7.9)	(5.7)
Funding Level	95%	91%	93%

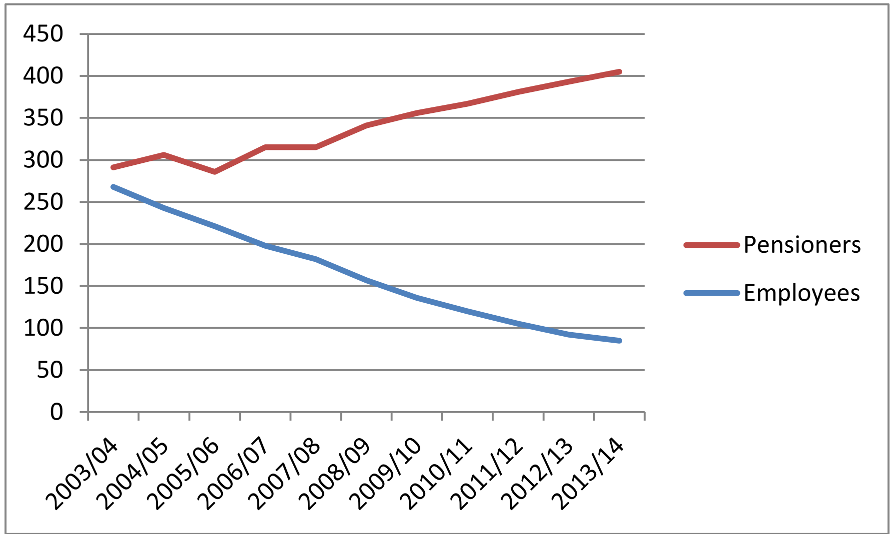
Source: NESPF financial statements

Transport fund

43. The net assets of the transport fund fell by £0.9m (1.1%) but remain at around £80m. The fund has been in a deficit funding position for several years in that the annual cost of pensions and benefits is around £1.0m more than contributions received from members. Exhibit 6 shows the position from the actuary's perspective.

44. The membership profile of the transport fund is shown in Exhibit 7. As the fund is closed, the proportion of active employees is falling each year and is now 13% of the membership. The proportion of bonds in the fund's portfolio at 32% reflects the need for increasing certainty over asset values as the fund matures.

Exhibit 7: Transport fund: trends in membership



Source: NESPF financial statements

Outlook

45. Both funds have an increasing number of pensioners and people are generally living longer. The proportion of active members in the main fund is now 40%, down from 56% ten years ago. This is a contributor to funding pressures as payment of pensions consume the income from contributions, reducing the surplus for investment.

46. Due to the closed and maturing nature of the transport fund, a strategy will shortly be implemented which is aimed at reducing risk over time and providing assets to match the fund's liabilities.

47. The 2014 actuarial valuation is currently being carried out by the actuary with an initial valuation and indication of the likely impact on employers 'contributions rates due in December 2014.

Governance and accountability

48. Members of Aberdeen City Council as administering authority, and the Head of Finance are responsible for establishing arrangements for ensuring the proper conduct of the affairs of the NESPF and for monitoring the adequacy and effectiveness of these arrangements.

Corporate governance

49. The corporate governance framework of the NESPF is determined by the council, as administering authority. The council has delegated responsibility for pension fund matters to the Pensions Panel. For 2013/14, the panel consisted of five elected members, an increase of one from the previous year. From October 2014, as part of a wider review of the council's committees, arrangements have been strengthened by the introduction of a Pension Committee with a membership of nine to replace the Pensions Panel.

50. In 2013/14, the Joint Investment Advisory Committee (JIAC) included the members of the Pensions Panel together with ten others drawn from member organisations and including trade union representation. The JIAC evaluates and advises on fund manager appointments and performance.

51. We have previously commented on the absence of formal reporting between JIAC and the pension panel. During 2013/14, we noted that an Investment and Accounting report was presented to each meeting of the Panel which provided a summary of investment issues. While this demonstrates regular reporting of investment matters to the Pensions Panel, it does not provide explicit assurances or recommendations about the JIAC's view of fund manager performance. Our concern is a lack of evidence of accountability. If a significant

under performance issue were to arise, we feel that exiting minutes and supporting papers would not provide a sufficient audit trail to demonstrate concerns raised by the committee and decisions taken along the way.

52. Furthermore, we note that Local Government Pension Scheme Governance guidance describes that all key stakeholders should have an opportunity to be represented within the committee structure, with equal access to papers. The remit of the JIAC is restricted to investment matters and therefore oversight of other areas of administrative performance and the funding position is carried out entirely by the administering authority.

53. The best practice principles in the guidance also encourages the governing committees to include within their representation: employing authorities (as is the case), scheme members (including deferred and pensioner members), independent professional observers and expert advisors. Voting rights may be determined by individual authorities, but should be clear and transparent and include the justification for not extending voting rights to each body or group represented.

54. From 1 April 2015, the Local Government Pension Scheme (Scotland) Regulations 2014 introduces new arrangements for scheme governance. A key change is the creation of a new Pensions Board which will sit alongside the existing Committee functions of the administering authority. The board will:

- be responsible for assisting the administering authority in relation to compliance with scheme regulations and the requirements of the Pensions Regulator
- consist of equal numbers of scheme employer representatives and trade unions (4 from each side)

55. The Scottish Public Pensions Agency (SPPA) issued draft regulations for consultation on 30 September 2014, with a closing date of 11 November 2014. While administering authorities have been working from the Heads of Agreement ahead of draft regulations, there is limited time available for pension funds to set up new boards to meet the required timetable.

56. The introduction of local pension boards marks a sea change in the governance of LGPS funds. In recognition of these developments, Aberdeen City Council's new pension committee is continuing with the remit of the former pensions panel but this will be kept under review as the new arrangements evolve and these are likely to gather pace in the next few months.

57. This complete change in governance provides an opportunity for the funds to review the operation of the committee and the JIAC and to consider extending membership to fund members and other stakeholders.

Refer Recommendation 2

Accountability

58. When the requirement for a separate audit opinion was introduced, we supported a change in the body charged with governance in respect of the pension funds. It made sense that governance and financial matters would be discussed by the pensions panel. The role of the panel is to set the policy framework for the funds and to oversee and monitor investment management having considered the recommendations of the JIAC. However, as there is common membership between the panel and JIAC, this governance model is not as robust as it could be. In order to separate scrutiny from decision making, and given the other governance changes taking place within the LGPS, it is timely to consider the robustness of the challenge role.

59. In common with service committees, a pensions committee should fit within a council's governance and accountability arrangements and be able to demonstrate good governance across activities. Options for improved accountability might include regular reporting to full council or for the Audit, Risk and Scrutiny Committee (ARSC) to take an additional oversight role of pension activities on behalf of the administering authority. Existing reports would continue to be considered by the pensions committee but in addition, full council or ARSC would receive additional reports in their scrutiny role.

Refer Recommendation 2

Internal control

60. The funds' financial systems are provided by the administering authority. We were able to take assurance from our audit of the council that high level financial controls that impact on the pension funds' financial statements operated effectively during the year.

61. We also reviewed controls relating to the pension investment and administration transaction systems. Our overall conclusion was that the NESPF had appropriate systems of internal control in place in 2013/14.

Internal audit

62. Internal audit provides Members and the Proper Officer with independent assurance on the overall risk management, internal control and corporate governance processes for the funds. Relevant internal audit plans and reports were presented direct to the pensions panel for the first time during 2013/14. Positive assurances were reported to the panel in respect of internal audits on the pension payroll and pension fund financial controls.

63. Generally, we seek to rely on the work of internal audit wherever possible and, as part of our 2013/14 planning process, we concluded that the internal audit service operates in accordance with relevant Public Sector Internal Audit Standards (PSIAS) which enables us to take assurance from their documentation and reporting procedures.

64. From 2014/15, the new accounts regulations require the Pension Committee to undertake an annual review of the internal audit function as it relates to pension fund matters.

Arrangements for the prevention and detection of fraud

65. The pension funds complied with the relevant fraud and irregularity policies of Aberdeen City Council during 2013/14. Following a review of the council's arrangements, there are no matters we need to draw to members' attention.

66. The NESPF participates in the National Fraud Initiative (NFI) as part of the council wide exercise. The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems to identify data matches that might indicate the existence of fraud or error. Overall, we concluded that the council has satisfactory arrangements in place for investigating and reporting data matches identified by the NFI.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

67. The arrangements for the prevention and detection of corruption in the NESPF are satisfactory and we are not aware of any specific issues that we need to record in this report.

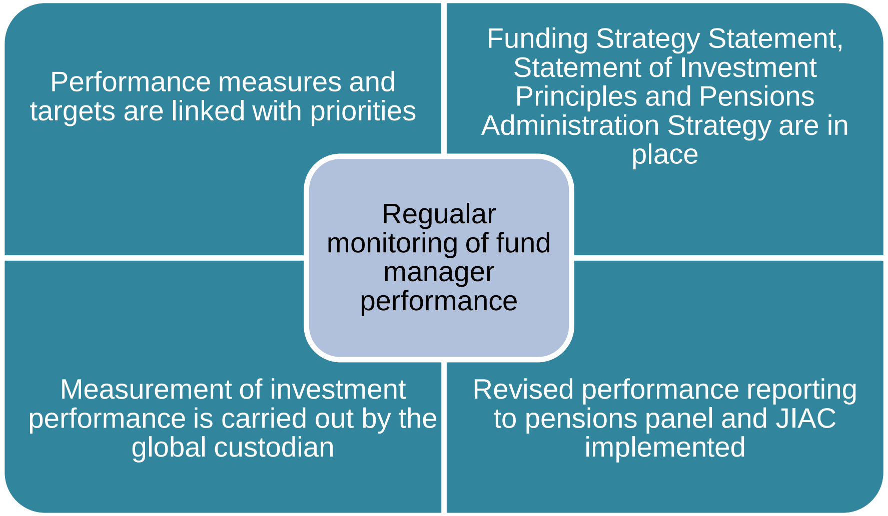
Outlook

68. The Local Government Pension Scheme (Scotland) Regulations 2014 apply from 1 April 2015. These introduce a new pension scheme which replaces the current LGPS as constituted by the Local Government Pension Scheme (Scotland) Regulations 2008 (as amended), "the 2008 Scheme".

69. In contrast to the 2008 Scheme, which was a final salary pension scheme in which unreduced benefits were payable to members from the age of 65, the new scheme provides for members to accrue pension on a career average revalued earnings basis and for unreduced benefits to be payable from their state pension age.

70. The Pensions Panel has considered reports on the implications of the new regulations and the fund is well prepared having published information about the 2015 Scheme in a new section of the NESPF website, and provided training for employers on the new scheme and the information they need to provide.

Best value, use of resources and performance



71. Administering authorities have a specific responsibility to ensure arrangements have been made to deliver best value in the services they provide. This requires continuous improvement while maintaining a balance between quality and cost and having regard to value for money, equal opportunities and sustainability. There is also the duty to report performance publicly so that local people and other stakeholders know what quality of service is being delivered and what they can expect in the future.

72. The NESPF has a Pensions Administration Strategy which includes targets for the measurement of performance. From April 2014, workflow systems have been used to report performance with a summary presented quarterly to the Pensions Panel.

73. The fund also has a Funding Strategy Statement which is supported by the Statement of Investment Principles and the Investment Policy. These documents link investment strategy to long term funding needs and define performance criteria.

Investment performance

74. Nine external fund managers provide quarterly updates on their performance, and these are summarised for presentation to committee. A variety of benchmarks are used depending on the mandate, and an overall composite benchmark is calculated by the global custodian.

75. Performance against benchmark targets is regularly reported to the Pensions Panel and JIAC. Exhibits 8 and 9 show the one, three and five year results against benchmark for NESPF and the Transport Fund.

Exhibit 8: Investment performance – main fund

	Year 1	Year 3	Year 5
Main fund	10.39	9.97	13.91
Benchmark	9.06	8.49	14.13

Source: NESPF financial statements

Exhibit 9: Investment performance – transport fund

	Year 1	Year 3	Year 5
Transport fund	0.13	6.94	13.21
Benchmark	3.13	8.06	12.72

Source: NESPF Financial Statements

76. The growth in market value of the fund was 10.4%. This compares well with the benchmark of 9.0% over one year, but over the 5 years, growth was 13.9% which is behind the benchmark of 14.1%.

77. The transport fund is maintaining a positive position in the longer terms but is falling behind benchmark in the shorter term. The aim of the new strategy is to turn this position around.

Appendix I – Significant audit risks

The table below sets out the key audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance Procedure
Employer contributions The main pension fund includes a number of scheduled and admitted bodies, each contributing to the pension fund on a monthly basis. Effective data verification and monitoring arrangements require to be in place. *Risk: employers have not correctly deducted contributions from staff and therefore the data held on the funds' systems is inaccurate or incomplete.*	Pension fund officers carry out monthly reasonableness checks on employers' contributions and timeliness of payments made to the funds. On an annual basis, assurance is requested from key employers and in addition, from January 2013 Employer Services required employers to provide up-to-date employee information via the internet e.g. notification of starters, leavers and amendments. Both employer services and i-connect are available to employers for the processing of starters, leavers and other amendments. However, i-connect is geared more toward multiple event processing and is used by the larger employers in the fund. As part of the audit process, employee and employer contributions are verified for a sample of employees across a sample of employers. At the year end, reconciliations between the different systems are carried out by pension fund officers and verified as part of the audit process. Covenants are held in respect of admitted bodies to safeguard against any impact on the funds if small bodies experiencing financial difficulties can no longer afford their contributions. Where an admitted body does not have sponsor, the fund requires bodies to have contingency plans in place.

Audit Risk	Assurance Procedure
Impairment losses A significant debt in respect of a termination agreement due from a former admitted body has been the centre of a dispute for some time. This matter needs to be effectively concluded. *Risk: the fund is not effectively managing collection of outstanding debt.*	Assurances were provided by the Head of Finance that the debt would be pursued. The council's external legal advisers to the council reviewed the case and entered into discussions with representatives for the former admitted body. The case is progressing through a legal process and it is expected that a favourable outcome will be reached. ***Refer page 9***
Investment management fees Investment management fees in respect of private equity investments are reflected in the valuation of investments. The Code requires that management fees are separately accounted for. *Risk: the fund is not complying with the Code.*	Fund manager statements were reviewed to identify fees which had formed part of investment values and those which could be easily identified have been disclosed within investment management fees. ***Refer pages 7 and 8***
Scrutiny Membership of the pensions panel has increased from 4 to 5 and a training plan exists to support members. The JIAC is responsible for the scrutiny of investment performance but reporting arrangements from the committee to the panel need to be strengthened. *Risk: given the complexity and nature of investments, there may be insufficient capacity for robust scrutiny.*	While it was agreed there would be clearer assurances from the JIAC to the Pensions Panel, in our view there is more to do. ***Refer pages 15 to 17***

Audit Risk	Assurance Procedure
Internal management The pensions section organisational structure needs to be reviewed to ensure it is fit for purpose and meets the needs of the administering authority. In particular, action is required to ensure there is sufficient capacity and responsibility at senior level to act for the long term benefit of the funds. *Risk: the long term governance of the fund is weakened by uncertain management arrangements.*	A revised structure had been prepared which was going to be benchmarked with NAPF before finalisation and implementation. However, this plan has been overtaken by events within Aberdeen City Council. A management restructuring commenced in March 2014. Stage 3 is now in process for staff below heads of service and as part of this process, the structure of the pensions fund section will be considered.
Investment performance Investment performance has been below the benchmark. *Risk: in the longer term, poor returns may not provide sufficient funds to meet pension payments. In the shorter term, there may be increased demands on fund employers through additional contributions.*	The governance framework includes the following comprehensive documentation: • Statement of Investment Principles • Funding Strategy Statement • Presentations and feedback from fund managers • Regular performance reports • Performance measured on a rolling 3 or 5 year basis. • Action taken by JIAC and Pensions Panel. These were reviewed during the year to collate assurances on the work being undertaken by officers and members. ***Refer pages 19 and 20***

Appendix II– Action plan

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/9	A significant debt in respect of a termination agreement due from a former admitted body has been the centre of a dispute for some time. ***Risk: the Fund is not effectively managing collection of outstanding debt.*** ***Recommendation:*** This matter needs to be effectively concluded.	Representatives for both the pension fund and the admitted body are working to achieve a favourable outcome.	Head of Finance	31 March 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/ 16-17	With the significant changes taking place around the governance of pension funds, it is timely to consider the effectiveness of the scrutiny and accountability roles in relation to the North East funds including the operation and membership of JIAC. With common membership of the panel and JIAC, the model is perhaps not as robust as it should be. In terms of accountability to the administering authority, there is perhaps an oversight role for the Audit, Risk & Scrutiny Committee. ***Risk: there is insufficient accountability and scrutiny on the administration and performance of the funds***. ***Recommendation:*** With the implementation of the new Pensions Committee, there is a timely opportunity for the administering authority to review the adequacy of the scrutiny and accountability arrangements it has in place including the operation and membership of JIAC.	An options paper for the future remit, membership and operation of JIAC will be considered by the Pensions Committee in November 2014. As the arrangements for the Pensions Board evolve, the remit and operation of the Pension Committee will be reviewed, as appropriate**.**	Pensions Manager	Options Paper – November 2014 Implementation of approved option – by 31 March 2015