Strathclyde Pension Fund

Annual report on the 2013/14 audit

Prepared for Glasgow City Council as administering body for Strathclyde Pension Fund and the Controller of Audit

October 2014

Contents

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Key messages

Financial statements	• We have issued an unqualified auditor's report on the financial statements.
Financial position	• Fund No. 1 net assets reached a new high of £13.9 billion. Actuarially estimated liabilities increased to £17.5 billion resulting in a net liability of £3.6 billion. • At 31 March 2014 the estimated funding position for Fund No. 1 was 87.9%. • For the first time in a number of years benefits paid (£487 million) exceeded contributions received (£485 million). • The fund has a clear funding and investment strategy. Cash flow is regularly monitored, including ten year cash flow forecasts.
Governance & accountability	• The fund has sound governance arrangements in place. • Systems of internal control operated effectively.
Best Value, use of resources & performance	• The fund has good performance management arrangements. • The fund underperformed against five of its nine administration targets. • Total annual return on investments of 7.0% was slightly below the scheme benchmark but above actuarial assumptions.
Outlook	• The uncertainty in global financial markets and the consequent effect on the stock market means that pension funds have to remain vigilant and continually assess exposure to risk. • 2014/15 will see the introduction of the new career average pension scheme, further auto enrolment of staff and new governance arrangements. • The next triennial valuation as at 31 March 2014 will be available in 2015.

Financial Statements

1. We have given an unqualified audit opinion that the financial statements of Strathclyde Pension Fund for 2013/14 give a true and fair view of the financial transactions of the fund during the year ended 31 March 2014, and of the amount and disposition at that date of its assets and liabilities.

Financial position

2. The financial position of a pension fund can be reported as either:
   - The value of promised retirement benefits estimated by the scheme actuary for the purposes of International Accounting Standard (IAS) 26.
   - The funding position based on full valuations of the fund carried out every three years by the actuary (triennial valuation) with intervaluations prepared in the intermediate years.
3. Strathclyde Pension Fund comprises two separate funds, Fund No. 1 and Fund No. 3. Fund No. 1 had net assets of £13,945 million as at 31 March 2014. The IAS 26 value of promised retirement benefits at the accounting date was estimated as £17,527 million (£15,707 million as at 31 March 2013).
4. Fund No. 3 had net assets of £155 million as at 31 March 2014. The IAS 26 value of promised retirement benefits at the accounting date was estimated as £148 million (£138 million as at 31 March 2013).
5. The most recent triennial funding valuation was carried out by the scheme actuary as at 31 March 2011.
6. For Fund No. 1, this reported a funding position of 97.3%. An intervaluation monitoring report provided by the fund's actuary as at 31 March 2014 recorded a projected funding position of 87.9%, mainly due to the historically low level of gilt yields. The intervaluation assessment is not used to determine future contribution rates.
7. The triennial funding valuation for Fund No. 3 reported a funding position of 89%. The intervaluation assessment estimated a funding level at 31 March 2014 of 97%.
8. The Public Service Pensions Act 2013 will introduce a number of changes to the Local Government Pension Scheme, including the introduction of the 'employer cost cap' which will shift some of the risk of future rises in scheme costs onto scheme members.
9. The full triennial valuation at 31 March 2014 is currently being carried out by the fund's actuary. This will set the rates of employer contributions for the three year period beginning April 2015.

Governance and accountability

10. As administering authority, Glasgow City Council has statutory

responsibility for the administration of Strathclyde Pension Fund. The fund has sound governance arrangements that include a Pension Fund Committee responsible for the overall strategic direction of the fund and a Representative Forum which allows engagement with the fund's stakeholders.

11. Based on our testing of the main financial systems in 2013/14, we can conclude that internal control systems operated effectively.

Best Value, use of resources and performance

12. The fund has a well structured performance management framework in place. Comprehensive monitoring reports covering the performance of investments and administrative activities are regularly presented to the Pension Fund Committee.

13. Fund No. 1 achieved an annual return of 7.0% against its scheme specific benchmark of 7.1%. Although the fund slightly underperformed against its own benchmark, it out performed benchmarks for the average UK pension scheme and average local authority pension fund. Investment performance was also well above actuarial assumptions. The value of Fund No. 1 has grown to £13,945 million, the highest value in the fund's history.

14. Fund No. 3 fell below its investment performance target, recording an annual return of -0.1% against its scheme specific benchmark of 0.6%. Despite this the fund maintains a high funding level of 97%. As a result of the high funding level a strategy of de-risking was implemented in 2013/14. This resulted in significant changes to the categories of assets held by the fund.

15. Administration performance has been mixed in 2013/14 with the fund underperforming against five of its nine performance targets. The time taken to process provisional and actual retirals was significantly below target. Reductions in staffing levels and increased volumes of retirals have contributed to performance targets not being met.

Outlook

16. The Public Service Pensions Act 2013 has introduced major pension reforms to be implemented in a relatively short timescale. The fund will have to review its governance arrangements and effectively manage the transition to the new Local Government Pension Scheme 2015 to ensure the continuity of services to members. Challenges will also arise from the introduction of career average based pensions and the continued administration of the staged implementation of auto enrolment.

17. Future funding and investment strategies should be kept under review in the light of the forthcoming triennial valuation and the fund's cash flow projections.

Introduction

18. This report is a summary of our findings arising from the 2013/14 audit of Strathclyde Pension Fund (the fund). 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.

19. Our responsibility, as the external auditor of the fund, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

20. The management of the fund is responsible for:

- preparing financial statements which give a true and fair view
- implementing appropriate internal control systems
- putting in place proper arrangements for the conduct of its affairs
- ensuring that the financial position is soundly based.

21. This report is addressed to Glasgow City Council, as administering authority for the fund, and the Controller of Audit and should form the basis of discussions with the Strathclyde Pension Fund Committee as soon as possible after it has been issued. This report will be published on our website after it has been considered by those charged with governance.

22. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, shown at Appendices I and II, include recommendations for improvements. In this report we focus on the audit of the financial statements and any significant findings from our wider review of the fund.

23. 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 III 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.

24. Appendix IV 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".

25. We recognise that not all risks can be eliminated or even minimised. What is important is that the fund understands its risks and has arrangements in place to manage these risks.

The fund 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.

26. 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.

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

Financial statements

Investment performance

Fund return
+7.0%

Scheme benchmark
+7.1%

Net assets

Increase in net assets
£878.7m

Closing net assets
£13,945.0m

Return on investments

Change in market value
+£719.3m

Investment income
£182.9m

Funding position

Estimated funding position
87.9%

All information above relates to Fund No. 1

Audit opinion

28. We have given an unqualified audit opinion that the financial statements of Strathclyde Pension Fund for 2013/14 give a true and fair view of the financial transactions of the fund during the year ended 31 March 2014, and of the amount and disposition at that date of its assets and liabilities.

Other information published with the financial statements

29. Auditors review and report on other information published with the financial statements, including the foreword and governance compliance statement. We have nothing to report in respect of these statements.

Legality

30. Through our planned audit work we consider the legality of the fund's financial transactions. This includes obtaining written assurances from the Executive Director of Financial Services and Deputy Chief Executive. There are no legality issues arising from our audit which require to be reported.

Accounting issues arising

Presentational and monetary adjustments

31. A number of presentational adjustments were identified in the financial statements during the course of our audit. These were discussed with management who agreed to amend the unaudited financial statements.

32. In addition, one unadjusted error relating to an understatement in income of £69,000 was identified during the course of the audit. We consider this immaterial to the accounts as a whole and officers have not adjusted the accounts for this error.

Report to those charged with governance

33. We presented to the Strathclyde Pension Fund Committee our report to those charged with governance (ISA 260) on 22 September 2014. The primary purpose of this report is to communicate the significant findings arising from our audit prior to finalising the independent auditor's report. We referred in our ISA 260 to the issue of investment management expenses.

34. **Investment management expenses.** In June 2014, CIPFA published *Accounting for local government pension scheme management costs*. This guidance sets out a framework for the consistent reporting of local government pension scheme management costs. It recommends disclosure of specified categories of management costs in the notes to the financial statements. The guidance will apply from 2014/15.

35. Investment management expenses of £17.7 million have been disclosed in the 2013/14 financial statements (2012/13: £14.7 million). However pooled investment vehicles, private equity funds and global real estate funds also include investment management fees. These fees are charged within the fund and are reflected in the fund's net asset value. To comply with the CIPFA guidance, these expenses should be separately disclosed in the 2014/15 financial statements.

36. We are satisfied that the figure disclosed as investment management expenses is as complete as it can be for the purposes of the 2013/14 financial statements. Officers have confirmed that the 2014/15 financial statements will be prepared in accordance with CIPFA guidance.

Refer to Action Plan point 1

Outlook

37. The revised Local Authority Accounts (Scotland) Regulations 2014 apply for financial years 2014/15 onwards. The regulations set out in more detail what is required in respect of financial management and internal control, and in respect of the annual accounts themselves. One of the main changes includes the requirement for the unaudited accounts to be considered by the Pension Fund Committee. This can take place following submission to the auditor and up to 31 August if necessary. In addition the audited accounts must be considered and approved for signature by the Pension Fund Committee by 30 September with publication on the fund's website by 31 October. The fund should review the timing of its committee meetings to ensure compliance with the new regulations.

38. The financial statements of the fund are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). There are a number of new accounting standards which should be applied to the 2014/15 financial statements. These include:

    - IFRS 13 Fair Value measurement – this seeks to increase consistency and comparability in measuring the fair value of assets
    - IAS 32 Financial Instruments: Presentation – this seeks to establish principles for the classification and presentation of financial instruments.

Financial position

Budgetary control

39. The fund prepares an annual budget for its administration costs and monitoring reports are presented to the Pension Fund Committee on a quarterly basis. Total net budgeted expenditure for 2013/14 was £3.9 million and an underspend of £0.4 million was reported at the year end. This was mainly due to lower than budgeted employee and property costs.

40. Cash flow monitoring reports are prepared monthly to ensure that sufficient cash balances are held to meet ongoing pension commitments with any excess balances being added periodically to the fund's investment portfolios. These cash flows are also presented quarterly to the Pension Fund Committee. Net cash inflows exceeded expenditure by £3 million in 2013/14.

Funding position

41. The net liability of the fund represents the excess of promised retirement benefits over the value of the fund's net assets. Promised retirement benefits are calculated by the fund's actuary, for the purposes of IAS 26, based on a number of assumptions including future discount rates, the longevity of members and rates of inflation.

42. Exhibit 1 compares the net assets for Fund No. 1 and Fund No. 3 to the actuarial value of retirement benefits to establish the net asset/liability position.

Exhibit 1: Financial position at 31 March 2014

Description	Fund No. 1 £ million	Fund No. 3 £ million
Net assets	13,945	155
Promised retirement benefits	(17,527)	(148)
Net (liability)/asset	(3,582)	7

Source: Strathclyde Pension Fund 2013/14 financial statements

43. Full valuations of the fund are carried out by the actuary every three years with intervaluations prepared annually during the intermediate years. The last full triennial valuation of the fund was prepared as at 31 March 2011. This reported a net liability of £320 million and a funding level of 97% for Fund No. 1 and a net liability of £16 million and funding level of 89% for Fund No. 3.

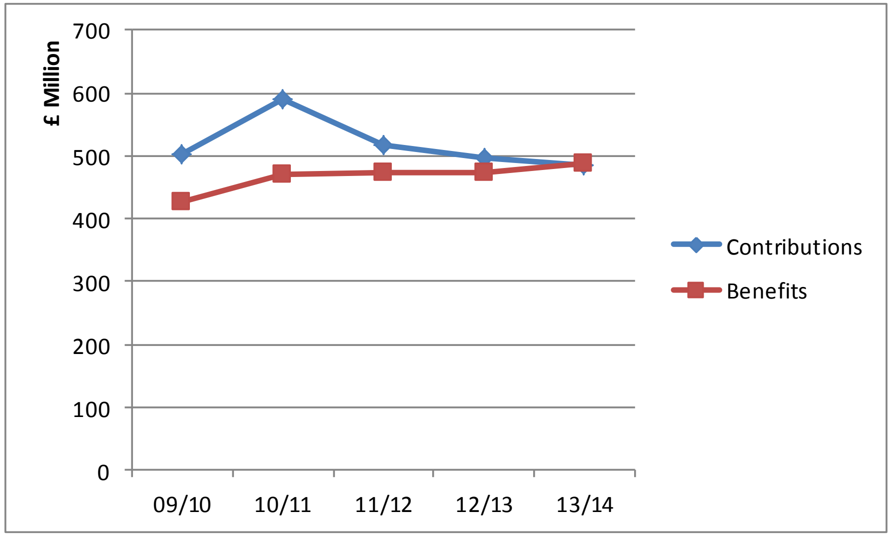
44. The intervaluation for Fund No. 1 at 31 March 2014 estimated a lower funding level from the triennial valuation of 87.9%.

This was mainly due to the current historically low level of gilt yields, which are used to value the fund's liabilities. For Fund No. 3, an increased funding level of 97% was projected.

45. The triennial valuation determines the employer contribution rates required over the next three year period. Based on the March 2011 funding level, the actuary calculated a common employer contribution rate for the period 2012 to 2015 of 19.3%. The next formal funding valuation is in the process of being carried out by the scheme actuary. This will reflect the position as at 31 March 2014 and will determine the contribution rates for the three years starting April 2015.

46. Exhibit 2 shows the trend in the levels of pension contributions and benefits paid in recent years.

Exhibit 2: Pension contributions and benefits



Source: Strathclyde Pension Fund financial statements 2009/10 to 2013/14

47. Due to the increasing number of pensioners, the value of pension contributions received from members and employers reduced by 3% in 2013/14 to £485.1 million (£497.6 million in 2012/13) whilst the value of pensions paid increased by 3% (£474.5 million to £487.2 million). For the first time in a number of years, the value of pensions paid exceeded contributions received. Although the net difference of £2 million is not material, management recognise that this position

may be an indication of the fund's changing dynamics.

48. Going forward, the Public Service Pensions Act 2013 is designed to ensure the continued sustainability of the Local Government Pension Scheme. In particular, the introduction of the 'employer cost cap' which will shift some of the risk of future rises in scheme costs onto members.

49. The continuing economic and funding pressures faced by employers have increased the risk of them defaulting on the payment of pension contributions. Management actively manage this risk by regularly monitoring the receipt of payments from employers. In instances where an employer leaves the membership of the fund, management pursues any pension liabilities through a variety of ways including claims to administrators, negotiated settlements, payment arrangements and, at times, legal action.

50. Four employers left the fund in 2013/14, resulting in a total cessation liability of £354,000. Of these, three employers have settled in full and the fund is discussing settlement with the remaining employer. In the event that liabilities cannot be recovered, the cost is spread across all remaining employers in the fund.

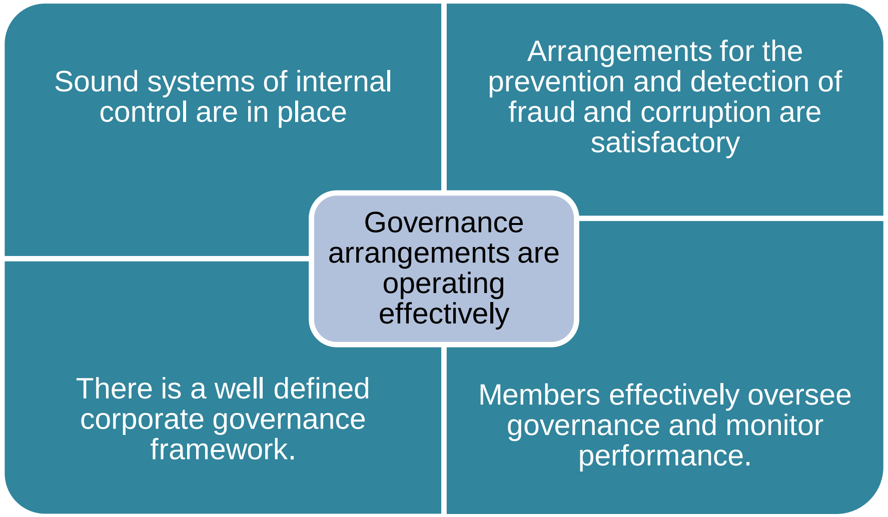
Outlook

51. It is clear that the outlook for public spending remains very challenging and the need for spending constraints and budget reductions will continue. Any further staff reduction schemes introduced by employers will place pressures on the fund from increased administration workloads and further reductions in member contribution levels.

52. The fund's current ten year cash flow statement estimates that the fund will become dependent on investment income to pay pensions within the next five years. It is important that the fund continues to closely monitor and review its investment strategy in the light of future cash flow predictions and the results of the forthcoming triennial valuation.

Refer to Action Plan point 2

Governance and accountability



53. Members of Glasgow City Council, as the administering authority, and the Executive Director of Financial Services and Deputy Chief Executive are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Strathclyde Pension Fund and for monitoring their adequacy and effectiveness.

Corporate governance

54. The corporate governance framework within the fund is centred on the Pension Fund Committee which is supported by the Investment Advisory Panel.

55. Based on our observations and audit work our overall conclusion is that the governance arrangements within Strathclyde Pension Fund are operating effectively.

56. Responsibility for the overall strategic direction of the fund is delegated by the council to the Pension Fund Committee which comprises elected members of the council. Day to day administration of the fund is carried out by the Strathclyde Pension Fund Office (SPFO) which is a division of the council's financial services department.

57. The committee meets quarterly to consider a range of reports covering areas such as investment performance, responsible investment, budget and cash flow monitoring, and administration performance. The quality of reporting to committee is good and is supported by comprehensive reports and committee papers. Members of the committee provide a good level of scrutiny and challenge.

58. The Investment Advisory Panel provides advice to the Pension Fund Committee and assists members in carrying out their responsibilities. Membership of the panel includes senior officers, actuarial consultants and investment advisers. The

functions of the panel include:

- developing investment strategy
- monitoring investment performance
- assisting in the selection and appointment of investment managers
- monitoring cash flows
- implementing the private equity programme.

59. The Representative Forum is the main mechanism for engagement with the fund's stakeholders and enables their involvement in the decision making process. The forum meets quarterly on the same cycle as the Pension Fund Committee. Forum membership is drawn from a broadly representative cross section of the fund's stakeholders including local authorities, scheduled bodies, admitted bodies, trade unions and pensioners.

60. The Public Service Pensions Act 2013 (the Act) requires the current final salary Local Government Pension Scheme (LGPS) to be replaced with a career average scheme from April 2015. The Act also introduces new governance arrangements which include the establishment of local pension boards responsible for assisting each administering authority in securing compliance with scheme regulations and any requirements imposed by the Pensions Regulator.

61. The detail of these arrangements for the LGPS in Scotland was set out in Heads of Agreement which were concluded in June 2014. The statutory regulations which underpin the new arrangements are currently being prepared by the Scottish Government and are not expected to be introduced until early 2015. To comply with the Act, the fund will have to establish a Pension Board by 1 April 2015. As reported to the Committee in September 2014, officers have drawn up a proposed implementation timetable for the new arrangements.

Refer to Action Plan point 3

Governance compliance statement

62. All administering authorities are required to prepare and publish a governance compliance statement to compare their pension fund's governance arrangements against the standards set out in the guidance issued by the Scottish Ministers. Having reviewed the fund's full governance compliance statement we are satisfied that it complies with guidance and note that the fund's governance arrangements comply with the required standards.

63. The Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 has been amended to require either the inclusion of a separate statement on system of internal financial control (SSIFC) or additional disclosures, reports or statements as necessary in order to meet the requirements of that statement. Internal audit will play an important role in

giving assurances in relation to the SSIFC or equivalent.

Internal control

64. The fund's main financial systems run alongside those of the administering authority, Glasgow City Council, and the fund uses the council's financial ledger and payroll system to process transactions, with specific pension systems being in place covering pensions administration and investments.

65. Based on the results of our review of the main financial systems in 2013/14, we concluded that the fund's systems of internal control operated effectively and could be relied upon for the preparation of the financial statements. The results of our review were reported to the Pension Fund Committee in June 2014.

66. International auditing standard (ISA) 500 requires us to review the work of an expert employed by management and whose work is used for the preparation of the financial statements. One such expert used by the fund is Northern Trust, the fund's global custodian. Northern Trust provides the fund with investment accounting and performance management services and is responsible for the safekeeping and settlement of the fund's assets. In addition the fund's financial statements are prepared from year end reports produced by Northern Trust.

67. In carrying out our reliance on an expert test we reviewed the annual report on Northern Trust's internal control environment prepared by its service auditors. We also considered the results of the assessment carried out by the council's procurement section on the performance of Northern Trust, as part of the retendering of the custodian. Our review on reliance placed on an expert gave satisfactory results.

Internal audit

68. Internal audit is an important part of the Fund's governance arrangements. The internal audit service is provided by the audit section of Glasgow City Council. As required by ISA 610 we reviewed the performance of internal audit and concluded that it operated in accordance with the Public Service Internal Audit Standards and had sound documentation and reporting procedures in place.

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

69. The fund follows the arrangements of Glasgow City Council with respect to the prevention and detection of fraud and we have reviewed these as part of our audit of the council. We are not aware of any specific issues relating to this aspect of the audit that we need to identify in this report.

70. The fund participates in the National Fraud Initiative (NFI). 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.

Outlook

71. Implementation of the Public Service Pensions Act 2013 brings a number of challenges for the fund including revised governance arrangements and the introduction of the new LGPS 2015 career average scheme. The fund will have to effectively manage the transition to ensure that service to members continues and the statutory and regulatory requirements of the new scheme are met.

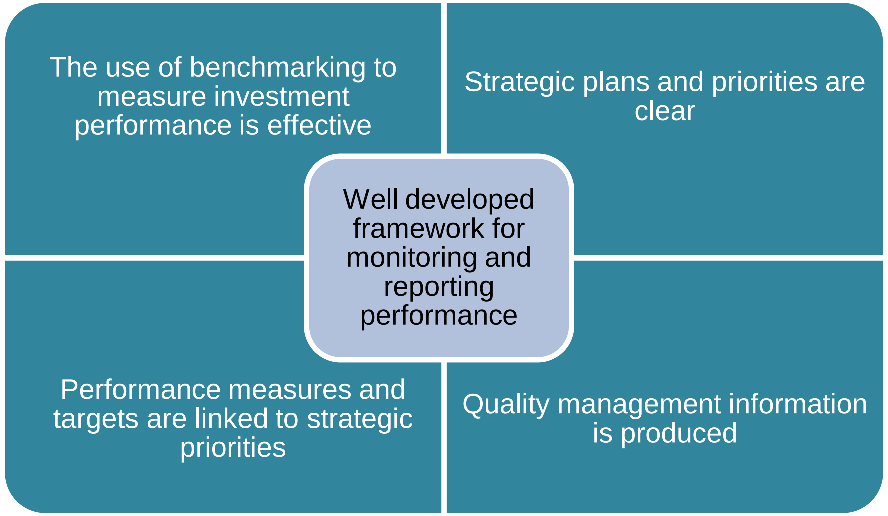
72. The fund must be well prepared for the introduction of career average pensions. The need for accurate pension records for each member will be more important than ever and the fund should continue to liaise with employers to ensure they supply correct and timely data. The change to career averages will not only increase administrative workloads initially but could generate more enquiries from fund members seeking clarification on their benefits on an ongoing basis.

Refer to Action Plan point 4

73. From 1 April 2015, responsibility for the administration of the Police and Fire pension schemes for uniformed staff will transfer from the SPFO to the Scottish Public Pensions Agency. It is important that this transfer is well managed to ensure that there is no loss of data, correct pension payments continue to be made and the service received by members of the schemes is unaffected.

Refer to Action Plan point 5

Best Value, use of resources and performance



74. The fund has a duty to ensure Best Value in the provision of services and to report performance publicly so that pension fund members, employers and other stakeholders know the quality of service being delivered and what they can expect in the future.

Best Value and use of resources

75. The key elements of any Best Value framework are clear strategic goals and priorities. The fund's current funding strategy statement was agreed in March 2012. This includes the investment objective to reduce the costs to employers of providing pension benefits by adopting a strategy and structure which produce an expected return on investments which exceeds that of a minimum risk portfolio. The funding strategy statement outlines how the conflicting priorities of affordability and stability of contributions, transparency of processes and prudence in the funding position are balanced in achieving this objective.

76. The investment strategy broadly defines the types of investment to be held by the fund and the balance between different types of investment. It is consistent with the funding strategy and is regularly reviewed by the Pension Fund Committee. It is set for the long term but is reviewed every three years, after completion of the triennial actuarial valuation, to ensure it remains appropriate to the fund's liability profile. The role of the fund's Investment Advisory Panel includes development of the investment strategy and the monitoring of performance of the fund's investments.

77. The fund has a range of benchmarks and performance indicators linked to the investment strategy which it uses to measure investment performance.

Performance management

78. The fund has a well structured framework in place for monitoring the performance of its investments and administration activities. Comprehensive reports are prepared for every committee meeting and actual levels of performance are clearly measured against agreed targets.

79. Actual performance against investment targets is reported to the Pension Fund Committee and the Investment Advisory Panel on a quarterly basis. During the year, fund managers are required to present to the panel on their performance and an annual report on overall performance is produced and reported to committee.

80. The fund's administration strategy was approved by the Pension Fund Committee in March 2011. It contains the standards which are required from participating employers to ensure that the fund meets its statutory obligations and is able to deliver services efficiently. The strategy contains a variety of performance measures against which the fund and the participating employers are assessed. Progress against the strategy is reported to the Pension Fund Committee on a quarterly basis.

81. In accordance with Regulation 60A of the LGPS (Administration) (Scotland) Regulations 2008, the fund's annual report discloses performance against the measures detailed in the administration strategy.

82. We are satisfied that appropriate arrangements for monitoring investment and administration performance were in place within Strathclyde Pension Fund for 2013/14.

Overview of performance targets in 2013/14

Investment performance

83. During 2013/14, Fund No. 1 achieved an annual return of 7.0% against its scheme specific benchmark of 7.1%. This slight underperformance was due to the mixed market conditions which impacted on the performance of the fund's investments and the underperformance of some investment managers. Although the fund underperformed against its own benchmark, it out performed benchmarks for the average UK pension scheme and average local authority pension fund. Investment performance was also significantly above the actuarial assumptions. The value of Fund No. 1 has grown to £13,945 million, the highest value in the fund's history.

84. An important assessment of performance is the level of returns against target over the longer term. Over five years, the fund return is 12.8% against a benchmark of 13.6% and over ten years, the return is 8.0% against a benchmark of 8.3%. While the rates of return are marginally below target, management consider these to be ambitious and that levels of actual performance look poorer because the benchmarks do not include cash investments which currently have a negligible return. The fund has held a relatively high cash balance in recent years (2.6% of total assets at 31 March 2014). Officers will consider reviewing the scheme benchmark following the next triennial funding valuation.

85. Fund No. 3 fell below its investment performance target for the year, recording an annual return of -0.1% against its scheme specific benchmark of 0.6%. Despite this the fund maintains a high funding level of 97%. As a result of the high funding level a strategy of de-risking was implemented in 2013/14. This resulted in the sale of most of Fund No. 3's equities and index linked securities and an increase in holdings of pooled investment vehicles.

86. Fund No. 3's three, five and ten year performance is significantly above the scheme benchmark and the actuarial rate of return assumed by the actuary.

Administration performance

87. In 2013/14, for the second year in succession, the SPFO underperformed against five of its nine administration performance targets agreed in the annual business plan. In particular, performance in the time taken to process provisional and actual retirals was poor with only 23% of provisional retirals and 37% of actual retirals being processed within target days. While results also compared badly to last year's levels of 67% and 65% where members gave sufficient notice of retirement, pensions were paid on time.

88. Officers have advised that the need to process a high volume of retirals as well as a reduction in staffing levels in the SPFO contributed to poor performance levels. However it is noted that customer satisfaction levels remain high and that performance has been improving over 2014/15; performance for provisional and actual retirals in the first quarter of 2014/15, reported to committee in September 2014, showed improved positions of 55% and 57% respectively. It is expected that administration targets will be achieved by the end of 2014/15.

Refer to Action Plan point 6

89. Employers are required to submit year end contribution returns by 20 May for the preceding 31 March year end. This is an important control over the accuracy of pension contributions received and recorded in the pensions systems. By 20 May 2014, 79% of returns had been received which is an improvement from the 76% received at the same point in time last year.

90. As part of the fund's governance assurance framework employers are also required to submit compliance certificates verifying compliance with a range of SPFO and regulatory requirements in relation to pension administration. In 2013/14 81% of compliance certificates were received, which is a slight deterioration from the 83% received in 2012/13. It has been confirmed that certificates were received from all the fund's major employers.

National performance audit reports

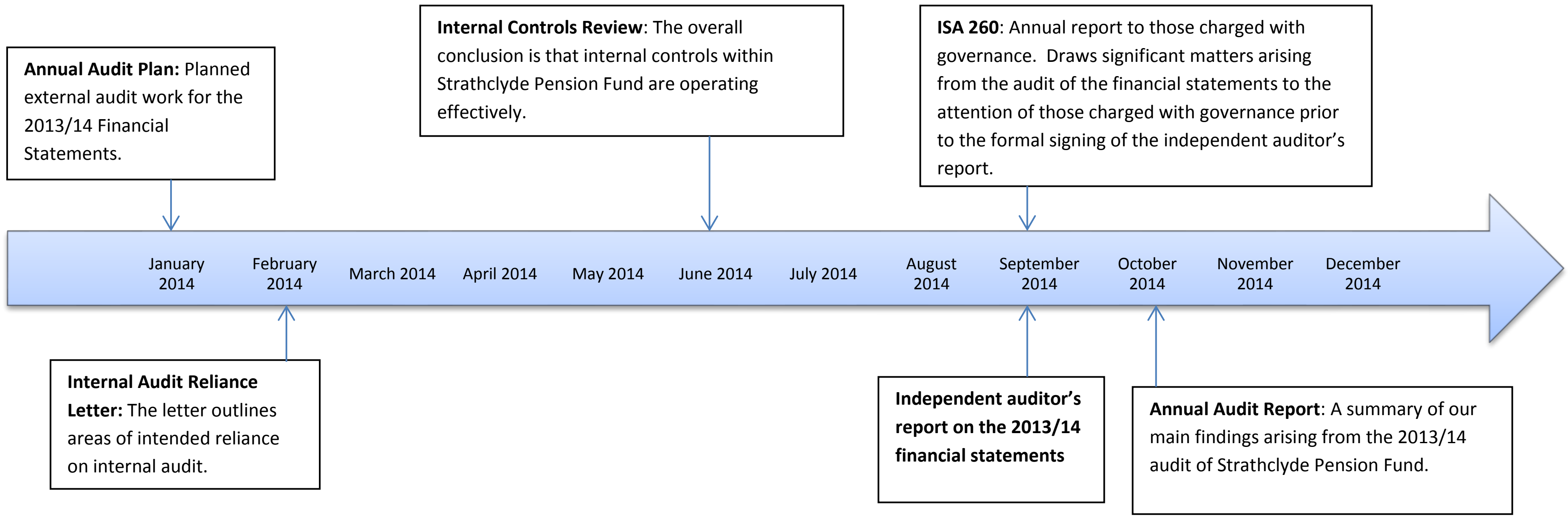
91. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. A summary of national performance audit reports, along with local audit reports, is included in Appendices I and II.

92. We suggest that officers and members review national performance reports as they become available and consider any findings which may have relevance to the fund.

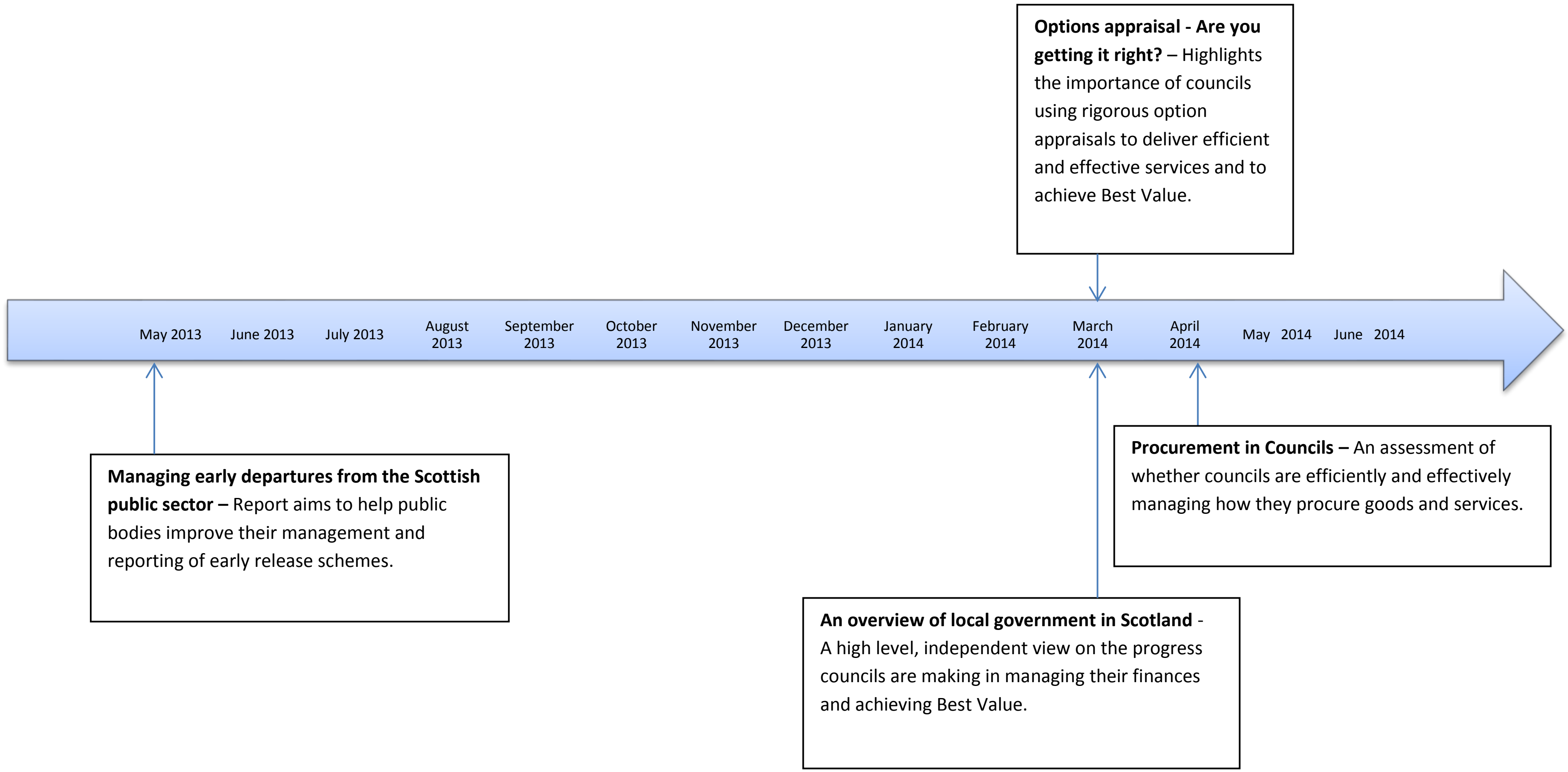
Outlook

93. The results of the next triennial funding valuation will be available by 31 March 2015. These will give a more accurate indication of funding levels and will provide new employer contribution rates. Based on the results, the fund will review its funding strategy statement and investment strategy. It will also consider whether changes are required to its performance measures and benchmark targets for investment performance.

Appendix I – Summary of Strathclyde Pension Fund local audit reports 2013/14



Appendix II – Summary of relevant Audit Scotland national reports 2013/14



Appendix III – Significant audit risks identified in the 2013/14 Annual Audit Plan

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
Financial position Historically, cash flows have been strongly positive, however the early retirement/severances schemes put in place by many of the large participating employers have put pressure on the fund's cash flows. This has also decreased the number of active members within the scheme.	We reviewed the funding and membership position of the fund. In 2013/14, the number of employee members increased by 5,203. The funding position of Fund No. 1 and Fund No. 3 at 31 March 2014 was estimated as 88% and 97% respectively. We also reviewed the ten year cash flow statement prepared for the fund. This shows that the fund will become dependent on investment income to pay pensions within the next five years. We have included a risk in our action plan (appendix IV) around the financial position of the fund (see Action Plan point 2).

Audit Risk	Assurance procedure
Investment management expenses The investment management fees for pooled investment vehicles, private equity funds and global real estate funds are not disclosed separately in the financial statements. There is therefore a lack of transparency over the level of expenses charged and consequently over which investment managers provide value for money, relative to competitors and alternative suppliers. Guidance is awaited on how to disclose, but any separate disclosure will involve the use of estimates.	We reviewed the guidance issued by CIPFA in June 2014. The guidance applies from 2014/15. We are satisfied that the figure disclosed as investment management expenses in the 2013/14 financial statements is as complete as it can be. Officers have confirmed that the 2014/15 financial statements will be prepared in accordance with the CIPFA guidance. This issue was reported in our ISA 260 and has also been included in the action plan (see Action Plan point 1).
Admitted body failures/managed exits Due to the continued economic and funding pressures on employers, together with the impact of welfare reform, there remains the potential for employer defaults and significant orphaned liabilities.	We reviewed Pension Fund Committee papers for details of any employer cessations in 2013/14. Four employers left the fund in 2013/14. The total liability for these employers was £354,000. Three employers have settled in full and the fund is discussing settlement with the remaining employer. We reviewed the fund's processes and procedures for dealing with employer cessations and also discussed these with officers. We have concluded that although there is a risk to the fund from employer cessations, this risk is adequately managed.
Administration performance Administration performance continues to fall below the targets set in the administration strategy during 2013/14.	We monitored administration performance reported to the Pension Fund Committee throughout the year. Performance continued to be behind target levels for a number of measures in 2013/14. This issue has been included in the action plan (see Action Plan point 6).

Audit Risk	Assurance procedure
The New Opportunities Portfolio The New Opportunities Portfolio (NOP) was set up to invest in a range of assets which were not previously included in the investment strategy remit. During 2013/14, there have been a number of large investments approved by the Strathclyde Pension Fund Committee under the NOP.	As part of our review of internal controls, we reviewed the process for approving NOP investments and the overall governance arrangements for the portfolio. We are satisfied that a robust process is in place for approving NOP investments and that the portfolio is well managed with regular reporting of performance to the Pension Fund Committee.
Pension reform The pension fund will be subject to a period of significant change in preparation for the recently agreed Local Government Pension Scheme reform to be implemented in April 2015.	We continued to monitor progress and the timetable for implementation of the new scheme. This included reviewing the regular updates presented to the Pension Fund Committee. We have included issues in the action plan covering implementation of the new governance arrangements required (see Action Plan point 3) and the demands of implementing the career average scheme (see Action Plan point 4).

Appendix IV – Action plan

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/9	**Investment management expenses** In June 2014, CIPFA published *Accounting for local government pension scheme management costs*. This guidance sets out a framework for the consistent reporting of local government pension scheme management costs. It recommends disclosure of specified categories of management costs in the notes to the financial statements. The guidance will apply from 2014/15. To comply with the guidance, the fund will have to separately disclose all investment management fees in the 2014/15 financial statements. **Risk** There is a lack of transparency in the financial statements over the costs of investment management fees. **Recommendation** The 2014/15 financial statements should be prepared in line with the CIPFA guidance.	Work is underway to adopt the CIPFA guidance in the 2014/15 financial statements.	Chief Pensions Officer (Finance)	30 June 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/13	**Funding position** The changing demographics of the fund's membership will make funding pension payments increasingly challenging in the medium to long term as the proportion of retired members grows. The fund's ten year cash flow statement projects that the fund will rely on investment income to pay pensions within the next five years. **Risk** A mismatch between the fund's funding and investment strategies leads to insufficient cash flow or over exposure to volatile markets. **Recommendation** The fund should review its investment strategy based on the results of the triennial funding valuation.	A review of investment strategy and structure was included in the Strathclyde Pension Fund Office 2014/15 business plan and is underway.	Head of Pensions	30 June 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
3/15	**Public Service Pensions Act 2013** The Act introduces new governance arrangements, which come into force on 1 April 2015. However, the statutory regulations which underpin these new arrangements will not be available until early 2015. Consultation with the Pension Fund Committee and Representative Forum will have to be carried out in advance of the final regulations being known. **Risk** The fund does not have appropriate governance arrangements in place by 1 April 2015. **Recommendation** Progress towards implementing the required arrangements should continue in line with the timetable proposed to members.	This is a priority item in the 2014/15 business plan. A formal proposal to establish a Pension Board will be considered by the Committee at its meeting on 1 December 2014 for implementation by 1 April 2015.	Head of Pensions	1 April 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
4/17	**Career average pensions** With the introduction of career average pensions there will be a requirement to maintain pension records for each member that may have to bring together a range of entitlements arising from benefits built up under different pension regimes. This will not only increase administrative workload initially, but may also generate more enquiries from fund members seeking clarification on their benefits on an ongoing basis. **Risk** Pensions systems and processes cannot operate effectively leading to delays or errors in calculating benefits. The increased workload for SPFO leads to members receiving an unsatisfactory level of service. **Recommendation** The fund should ensure pensions systems and processes can meet the requirements of the new scheme.	This is a priority item in the 2014/15 business plan. Arrangements including communications, employer/staff training, and system and process changes are well underway.	Principal Pensions Officer (Development) Principal Pensions Officer (Operations)	1 April 2015

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
5/17	**Administration of police and fire pension schemes** From 1 April 2015, responsibility for the administration of the Police and Fire pension schemes for uniformed staff will transfer from SPFO to the Scottish Public Pensions Agency (SPPA). It is important that this transfer is well managed. **Risk** Data is lost and incorrect pension payments are made. The target date for transition is not met. **Recommendation** The fund should continue to work with SPPA to ensure there is a timetable and clear arrangements in place for the transfer of the schemes.	This is a priority item in the 2014/15 business plan. The original timetable has been accelerated. Data was successfully transferred to SPPA during October 2014 to allow full transition of the function to be completed by November 2014.	Principal Pensions Officer (Development) Principal Pensions Officer (Operations)	30 November 2014

Action plan point/page	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
6/20	**Administration performance** For the second year in succession administration performance for five out of nine key measures was below target at the end of 2013/14. **Risk** Performance continues to decline and members receive an unsatisfactory level of service. **Recommendation** The fund continues to monitor administration performance on a regular basis and considers measures to address the situation.	Various steps were taken during 2013/14 to address this. The Committee received an update on progress each quarter. Performance has been on an upward trend since mid-year 2013/14. Further improvement will be confirmed in the December Committee report.	Principal Pensions Officer (Development) Principal Pensions Officer (Operations)	31 March 2015