Fife Council Pension Fund

2015/16 Annual audit report to Members and the Controller of Audit

Date September 2016

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The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies (www.audit-scotland.gov.uk/about/ac/). Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General (www.audit-scotland.gov.uk/about/).

Gillian Woolman is the engagement lead for the audit of Fife Council Pension Fund for the period 2011/12 to 2015/16.

This report has been prepared for the use of Fife Council Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• An unqualified auditor's report has been issued on the 2015/16 financial statements.
Financial management and sustainability	• Net assets increased by 1.2% to £1,853.6 million. • The estimated pension liability has reduced since March 2015, primarily due to the increase in gilt yields which have pushed down liability values. • The fund currently receives more in contributions from employers and members than it pays in benefits to pensioners. • The Investment Strategy objective is for the Fund to be fully funded in 20 years.
Governance and transparency	• New governance arrangements have operated effectively during 2015/16 with the Superannuation Fund and Pensions Sub-Committee and Pension Board meeting concurrently, with meetings open to the public. • The systems of internal control operated effectively. • Arrangements for the prevention and detection of fraud and corruption are satisfactory. • Improved internal audit arrangements have been introduced.
Best Value	• The Fund underperformed against its benchmark for the year and over the longer term (5 year). • Administration performance is mixed with only 4 of 8 performance targets being achieved.

Outlook

- The global investment outlook remains volatile due to political and economic challenges including Brexit, a slowdown in the Chinese economy, weak growth in the Eurozone, recession in emerging markets and uncertainty about further interest rate rises in the USA.
- The outlook remains challenging as funding cuts continue to impact on staff numbers across local government.
- There are ongoing administrative pressures associated with severance and with changes to the Local Government Pension Scheme and state pension arrangements.
- Investment performance and scheme management costs are likely to come under increasing scrutiny. Scottish Ministers have already expressed an interest in the views of the national Scheme Advisory Board on fund structure and asset pooling. The Scheme Advisory Board has convened a working group with a view to producing an options paper in December.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Fife Council Pension Fund (the Fund). The report is divided into sections which reflect our public sector audit model.

2. 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.

3. Our responsibility, as the external auditor of the Fund, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.

5. Appendix III is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Fife Council Pension Fund understands its risks and has arrangements in place to manage these risks. The Standards and Audit Committee should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

6. 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.

7. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of the Fund will be Brian Howarth (Audit Scotland). In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditor as part of this transition.

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

Audit of the 2015/16 financial statements

Audit opinion	• We have completed our audit and issued an unqualified independent auditor's report.
Going concern	• The financial statements of the Fund have been prepared on the going concern basis. We are unaware of any events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern.
Other information	• We review the other information published within the Fund annual report, including the management commentary, annual governance statement, governance compliance statement and the remuneration report. We have nothing to report as a result of our review.

Submission of financial statements for audit

9. We received the unaudited financial statements on 30 June 2016, in accordance with the agreed timetable. The working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit to deadline.

10. A number of the other statements contained in the draft Annual Report e.g. the Management Commentary, the Market Commentary and the Performance Commentary would have benefited from a 'quality assurance review as the draft versions require improvement in the content.

11. We requested that management reconsider the content of Annual Report which has resulted in some changes. No change was made to either the Market Commentary or the Performance Commentary however, but management has agreed to reconsider the content of these in 2016/17.

Refer action plan, point 1.

Overview of the scope of the audit of the financial statements

12. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Standards and Audit Committee in February 2016.

13. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2015/16 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

14. The concept of audit risk is of central importance to our audit approach. 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 and consequently had the greatest effect on the audit strategy, resources and effort.

15. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix I sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

16. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

17. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons e.g. an item contrary to law.

18. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

19. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of Fife Council Pension Fund we set our planning materiality for 2015/16 at £8.7 million (10% of contributions receivable per the 2014/15 financial statements).

20. Performance materiality was calculated at £6.5 million, to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our planning materiality level.

21. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original calculation remained appropriate. We report all misstatements greater than £87,000 (1% of planning materiality).

Evaluation of misstatements

22. A number of presentational adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements.

Significant findings from the audit

23. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:

- The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

24. There are no such matters, other than those set out elsewhere in this report, to which we wish to draw to your attention.

Future accounting and auditing developments

Code of Audit Practice

25. A new Code of Audit Practice will apply to all audits from financial year 2016/17. There will be a focus on four areas:
    - Financial sustainability.
    - Financial management.
    - Governance and transparency.
    - Value for money.

26. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition, as well as the annual audit report, other significant outputs, such as the annual audit plan, will be published on Audit Scotland's website. This is irrespective of whether the body meets in public or makes documents such as Audit Committee papers routinely available on its own website.

Code of Practice on Local Authority Accounting

27. The financial statements of pension funds are prepared in accordance with the Code of Practice on Local Authority Accounting in the UK which interprets and adapts International Financial Reporting Standards (IFRS) to the local authority context.

28. From 2016/17, the following changes to the Code will apply:
    - Amendments to the format of the accounts to be consistent with the new Financial Reports of Pension Schemes – A Statement of Recommended Practice 2015.
    - New disclosure requirements for investments measured at fair value.
    - Recommendations for a new disclosure on investment management transaction costs in line with CIPFA's revised guidance on management costs.

Financial management and sustainability

Increase in fund assets	Decrease in Present Value of Promised Retirement Benefits	Funding level	Investment performance
£22.7 million 1.2%	£147 million 5.9%	87.8% 2014 Funding valuation	0.2% Return on investments 2015/16
Closing fund assets £1,853.6 million	Closing Value £2,476 million	82.4% 31 March 2016 roll forward (per actuary's estimates)	6.6% Return on investments over 5 years

Financial management

29. In this section we comment on the Fund's financial outcomes and assess its financial management arrangements.

30. Pension fund finances are independently assessed every three years by the fund actuary. This assessment determines the employer contribution rates and deficit funding payments for the upcoming 3 year period and takes account of the strength of employer covenants and the Fund's investment strategy.

31. Setting the Fund's investment strategy and monitoring performance against it are key aspects of financial management and sustainability. Investment strategy is a complex area and has to take account of factors such as the overall fund deficit, cash flows from dealing with members and the maturity of fund membership. Balancing the risks and rewards from various asset types and

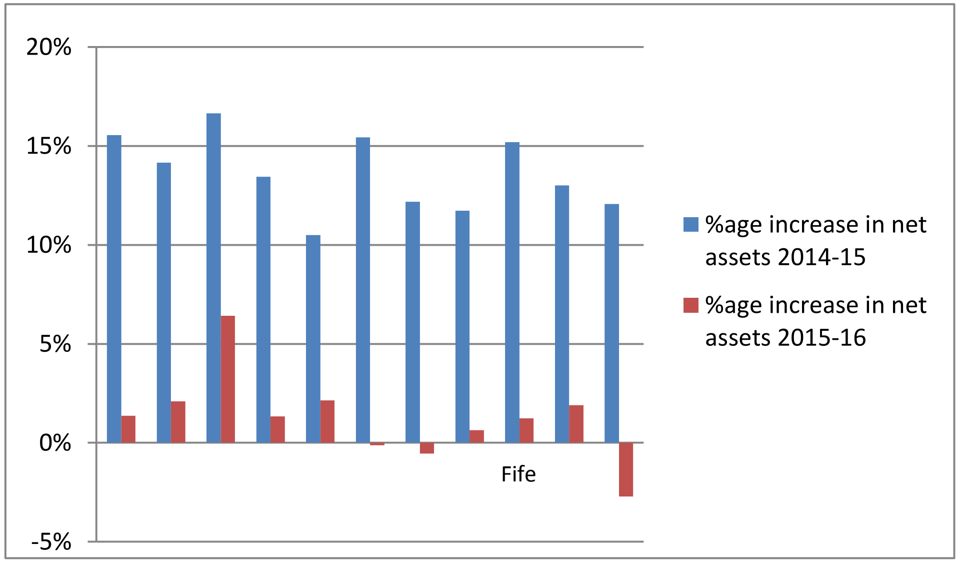
approaches is something that the Fund takes advice on from Hyman Robertson, Investment Consultants. The Fund has been proactive in the year and has rebalanced the portfolio, disinvesting from an unconstrained global equities manager and reinvesting the monies with fund managers who have mandates to passively manage their funds, thus reducing the funds exposure to global equity movements.

32. Getting the investment strategy right for the Fund is vitally important and often overshadows other aspects of financial management in relation to areas such as administration cost, for example. However, with financial pressures on councils and other employers these areas are coming under increased scrutiny.

Financial outcomes

33. The Fund reported an increase of £22.7 million (1.2%) to £1,853.6 million in 2015/16. The increase is significantly less than that achieved in 2014/15 (15%) and is not dissimilar to the experience of all the funds across Scotland as represented at exhibit 1.

Exhibit 1: Percentage increase in Net Assets across all Scottish funds for 2014/15 and 2015/16

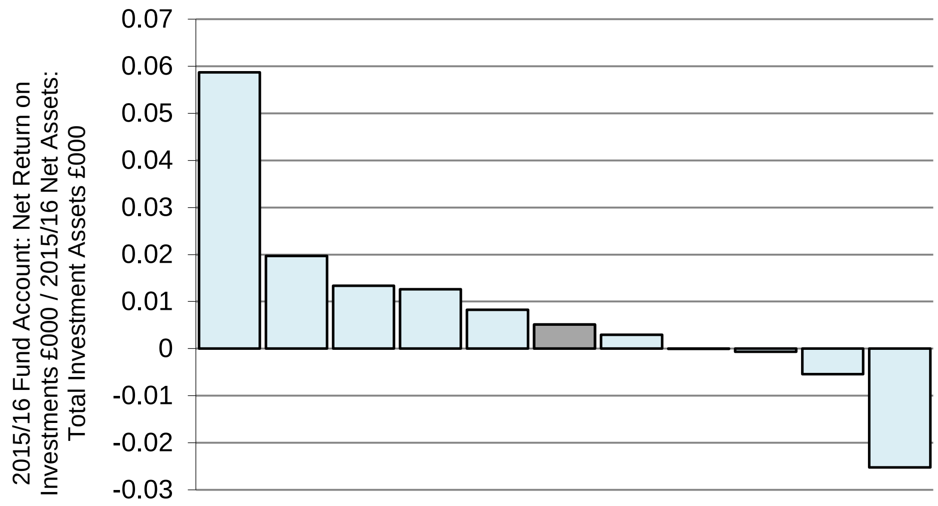


Source – Scottish LGPS Unaudited Annual Report and Accounts.

34. Investment performance is the main constituent on movements in net assets. Pension funds set a benchmark locally for investment returns based on their Statements of Investment Principles. 2015/16 has been a relatively poor year for investment returns with many funds earning returns below their benchmark level.

35. Relative investment performance for the Scottish funds is shown in Exhibit 2, which demonstrates that the Fund is near the midpoint of the range across Scotland.

Exhibit 2: Net return on investments 2015/16

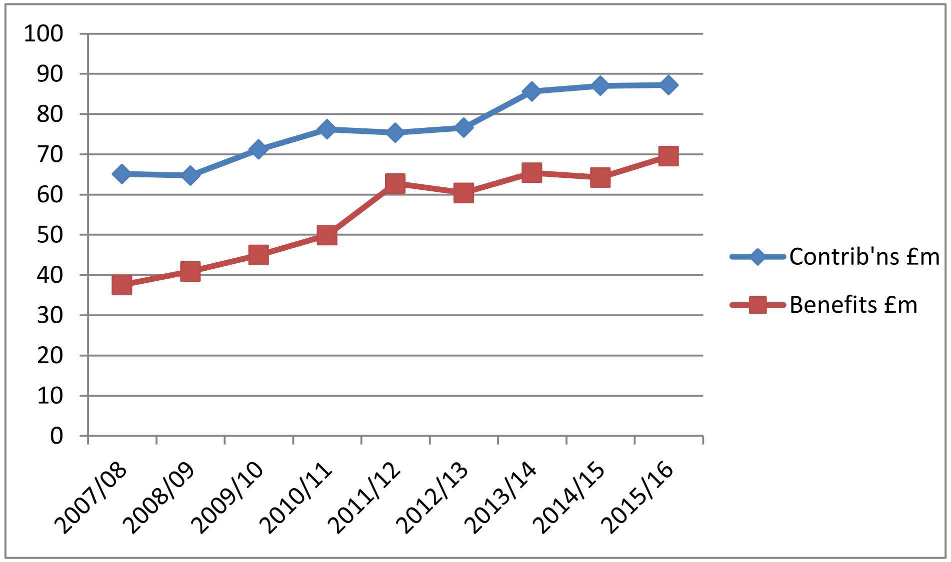


Source: Scottish LGPS Unaudited Annual Report and Accounts

36. In addition to growth from investments, the net assets of the Fund are increased by the excess of contributions over benefit payments. The gap between the income received by way of pension contributions and the amounts payable to members gives an indication of when the Fund will need to find other sources of income to fund members' benefits.

37. The Fund received more income from its dealings with members than it paid out in benefits in 2015/16, however as can be seen in Exhibit 3 the funding gap is closing with contributions remaining relatively static whilst the benefits payable have increased in the year. In 2014/15 the gap was £22.8 million however this has reduced in 2015/16 to £17.7 million.

Exhibit 3: Contributions and Benefits



Source: Annual Report and Accounts 2007/08 to 2015/16

38. With the current financial challenges in the public sector and the prospect of further reductions in staff, this gap will inevitably reduce further over the coming years. This will have to be taken into account in future investment strategies.

Financial management arrangements

39. As auditors, we need to consider whether the Fund has established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- Financial regulations are comprehensive, current and adhered to.
- Reports monitoring performance against budgets are accurate and provided regularly to members.
- Monitoring reports do not just contain financial data but are linked to information about performance.
- Members provide a good level of challenge on significant variances and under performance.

40. We assessed the role and status of the proper officer against CIPFA's "Statement on the role of the Chief Financial Officer in Local Government" and concluded that the proper officer (the Executive Director Finance and Corporate Services) has sufficient status to deliver good financial management for the Fund. The post holder for the Executive Director Finance and Corporate Services changed during the year with the retirement and replacement of the Executive Director in February 2016.

41. The financial regulations of Fife Council as administering authority apply to the Fund. We consider these to be sufficiently comprehensive and current.

42. Budgetary control processes for those costs which the Fund are able to control were introduced in 2015. Budget monitoring reports are now presented to the Superannuation Fund and Pensions Sub-Committee (the Sub-Committee) twice yearly, with the first report presented in June 2015.

43. Investment and administration performance reports are provided to every meeting of the Sub-Committee and Pension Board. In 2015/16 budget information on the Fund was also provided to members, this is a new development and increases the level of scrutiny provided by the members.

44. We have concluded that the Fund's financial management arrangements are sound.

Financial sustainability

45. The Fund is a multi-employer fund with 6 scheduled bodies and 24 admitted bodies. Given the nature of these employers the funding risk associated with default is seen as relatively low and the Fund currently plans to recoup deficits over a 20 year period for most employers.

46. The new Local Government Pension Scheme (LGPS) includes a cost sharing arrangement which will cap employer costs in relation to current service and help ensure that the scheme remains affordable for employers. Additionally, the retirement age for most LGPS members going forward is linked to the state retirement age and this may also act to limit scheme liabilities for active members.

47. The triennial review as at 31st March 2014 reported a funding level of 87.8%. Following the 2014 triennial valuation the Actuary agreed employer contribution rates with individual employers for the period 2015 to 2018. An element of these employer costs includes deficit recovery contributions to aid employers to return to a stable position. These have been allocated on a set percentage or fixed sums based on the affordability and risk profile of each employer.

48. The assets of the fund as at March 2016, compared to 31 March 2015, have increased by 1.2% and estimated pension liabilities have reduced by 5.6%. The reduction in estimated pension liabilities is due to movements in the value of the real discount factor, used to estimate the current value of future pensions; the real discount factor has increased from 0.8% at March 2015 to 1.3% at March 2016. As a higher real discount rate results in a lower value for pension liabilities, the increased rate from March 2015 has had a positive impact on the Fund's net liability.

49. Contribution rates and deficit payments will be considered by the Actuary at the next triennial funding valuation scheduled for March 2017.

50. The investment strategy has remained as a low-risk strategic allocation of 80% in growth assets (equities, property, infrastructure and absolute return) and 20% in non-growth assets (bonds). A lower risk strategy is generally reflected in lower investment returns.

51. In 2015/16 the Fund has disinvested from one fund manager and has spread the monies released across three existing fund managers with a better performance history in an attempt to achieve improved investment performance.

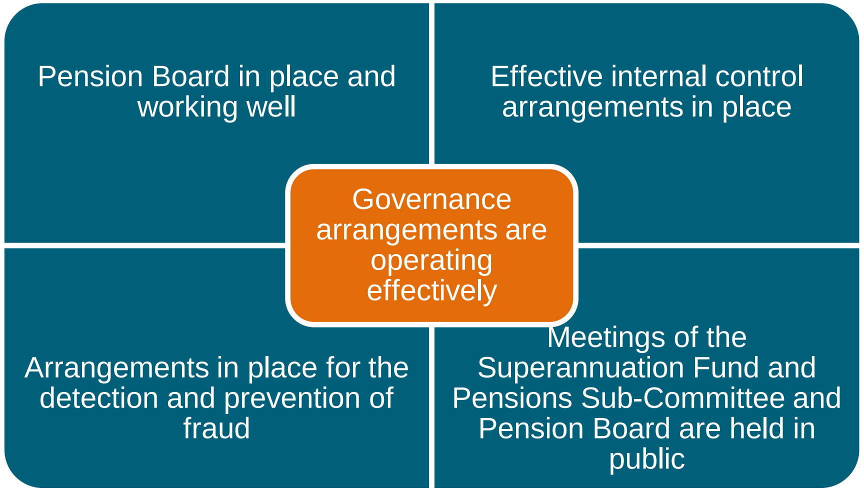
52. With relatively low investment returns and continuing volatility in the financial markets comes increasing financial pressures on the Fund which could ultimately necessitate higher contributions.

Outlook

53. The financial outlook across the public sector and in local government in particular remains challenging. Recent revisions to the LGPS should help ensure that the scheme is affordable to employers going forward whilst the scheme remains attractive to employees.

54. It is inevitable that management costs and investment performance will come under increasing scrutiny given the financial pressures faced by employers and employees alike and pension funds may need to be more radical in their approaches to administration and investment going forward.

Governance and transparency



55. Members and management of Fife Council, as the administering authority, supported by the Pension Board, are responsible for establishing arrangements to ensure the proper conduct of the affairs of the Fund in accordance with the law and proper standards and for monitoring the adequacy and effectiveness of these arrangements.

56. As part of our work we reviewed various aspects of governance that apply to the Fund including standing orders, financial regulations, Codes of Conduct for officers and members and anti-fraud and corruption arrangements. We also reviewed the arrangements for reporting to the Pension Regulator on breaches of regulation.

57. Overall, we have concluded that there are open and transparent arrangements in place.

Governance structure

58. The Public Service Pension Act 2013 introduced new governance arrangements for LGPS pension funds from 1 April 2015 and funds were required to introduce local pension boards. The remit of the Fife Pension Board is to support the Sub-Committee in compliance with regulations and with requirements imposed by the Pension Regulator. The Sub-Committee and Pension Board met together throughout 2015/16.

59. The Pension Board consists of 4 employer representatives and 4 union representatives and each side appoints a joint secretary. The Chair is alternated and is currently a union representative. If at least half the members of the Pension Board disagree with a decision of the Sub-Committee then they can request in writing that the Sub-Committee review that decision. There has been one occasion in 2015/16 where a decision was passed back to the Sub-Committee for review.

Pension Regulator public service code

60. The Pension Regulator issued a Code of Practice for public service pension schemes in April 2015, which covered scheme governance, managing risks, scheme administration and resolution of issues. In

regard to scheme administration, officers are conscious of the need for greater transparency and accurate record keeping and are currently assessing the Fund's processes and strategies and working closely with employers on the quality and accuracy of data provided. A report on progress was presented to the Sub-Committee in August 2016 and work in this area is ongoing.

61. No breaches of the Code have been reported to the Pension Regulator for 2015/16.

Internal control

62. As auditors we concentrate on significant systems and the key controls within them to provide us with assurance on the accuracy and reliability of figures generated by those systems. The Fund uses a number of the financial systems of the administering authority, Fife council. Based on our testing of these systems as part of our 2015/16 audit of the council, along with testing of the Fund's pensions administration and investment systems, there were no material weaknesses in the accounting and internal control systems.

Internal audit

63. Internal audit provides members and management of the council with independent assurance on risk management, internal control and corporate governance processes for the Fund. The Fund's internal audit service is provided by Fife Council's Audit and Risk Management Services (ARMS).

64. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work.

65. In our 2014/15 Annual Audit Report we noted that the Standards and Audit Committee had not received an Annual Assurance Report from the Head of ARMS to provide assurance over the adequacy and effectiveness of the system of internal controls. We are pleased to note that an Annual Assurance Report for 2015/16 was presented to the Standards and Audit Committee in May 2016.

66. We also note further improvements in the internal audit process with a five year strategic plan and operational plan, specific to the internal audit of the Fund, introduced with effect from 2016/17. The Plans were submitted to the Standards and Audit Committee in April 2016 and to the Sub-Committee in May 2016. These are significant improvements in the internal audit process.

67. From our review of ARMS, we concluded that Internal Audit was provided in accordance with Public Sector Internal Audit Standards which enabled us to take assurance from their documentation and reporting procedures. However, in 2015/16 Internal audit did not complete any work specific to the Fund that we placed reliance on.

Standards of conduct and arrangements for the detection and prevention of fraud and corruption

68. The financial regulations, standing orders, codes of conduct for officers and members and the anti-fraud & corruption strategy of Fife Council as the administering authority apply to the Fund. We

reviewed these as part of our audit of the council and other than the matter noted at paragraph 69 below, there are no matters in respect of these arrangements that we require to draw to the attention of members.

69. Three of the nine members of the Sub-Committee have not updated the Members' Register of Interests since they were elected in May 2012. It is not possible therefore to assess if there are any conflicts of interests in relation to those members or to determine whether there are related parties transactions or balances that should be disclosed in the financial statements.

Refer action plan, point 2

70. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police and fire, health bodies and other agencies, to identify circumstances (matches) that might suggest the existence of fraud or error. The Fund actively follows up the results of the NFI exercises and work on investigating the pension matches identified progresses well.

Transparency

71. The pension fund has a separate website which includes the various policies and strategies of the Fund.

72. Meetings of the Sub-committee and the Pension Board are held in public and papers and minutes are available on the website.

73. The annual report and accounts are also published on the website and these are of a reasonable standard. We have commented earlier on the quality of the Market Summary and Performance Summary which could be improved to increase financial scrutiny and accountability arrangements.

74. Overall, we have concluded that the Fund has put in place arrangements that support transparency, although there is some scope for improvement.

Correspondence referred to the auditor by Audit Scotland

75. We received correspondence from a member of the public which set out concerns about the employment of Hymans Robertson for both actuarial advice and investment consultancy and the potential for conflict of interest.

76. In our view the provision of investment advice as well as actuarial valuation services has the potential for conflict of interest, most specifically in relation to the triennial valuation of the scheme. As a result we would expect that arrangements would be in place so that the investment advice and actuarial services are provided by distinctly different arms of the firm. Furthermore we would expect the Fund to consider how they are assured that such arrangements are in place. This may include ensuring that separate procurement arrangements are in place.

77. As part of our review of the correspondence presented to us, we sought confirmation of the tendering for actuarial advice and investment consultancy services. It is good practice to tender for

expert services at set intervals in order to test the market and ensure that providers deliver value for money.

78. We were advised that the actuarial contract had not been recently tendered but had been reviewed and has been extended to September 2017. We have been unable to obtain any documentation for the tendering of the investment consultants contract.

Refer action plan, point 3

Outlook

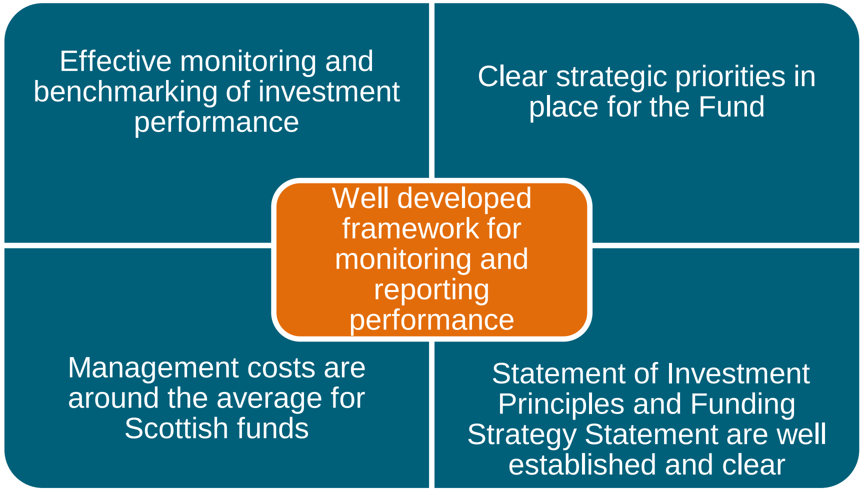
79. The introduction of the career average pension scheme (CARE) and new governance arrangements have been major changes for the Fund, which demand ongoing investment in terms of governance and administration.

80. New developments such as freedom and choice and the new single state pension (from April 2016) continue to add to administrative staff's workload. Moreover, local government is operating in a difficult financial climate where staff reductions are seen as a means of reducing costs. Inevitably this leads to a higher number of retirements and requests for pension projections. These will only add to the pressures facing pension staff.

81. Going forward the operation of cost sharing mechanisms may well increase levels of interest and scrutiny in pension fund business. We understand that the Government's Actuary Department (GAD) is currently undertaking a review in relation to cost sharing on behalf of Scottish Ministers.

82. There has been a move to the pooling of fund assets through collective investment vehicles in England and Wales and Scottish Ministers have already indicated that this is an area where the views of the national Scheme Advisory Board will be requested in due course.

Best Value



83. Administering authorities have 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.

84. Overall, the Fund has sound arrangements for supporting best value. There are clear strategic priorities in place for the Fund and there is a focussed approach to monitoring and reporting performance.

Performance Management

85. 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 Sub-Committee meeting and actual levels of performance are clearly measured against agreed targets.

86. The main mechanism for measuring investment performance is through an analysis of the returns achieved by each of the fund's external fund managers. The managers' performance, in terms of achieving benchmarks, is subject to independent verification by the Fund's custodian, Northern Trust, and is regularly reported to the Sub-Committee.

87. During the year fund managers are also required to present to the Sub-Committee on their performance. At the year end an annual report on overall performance is produced and reported to the Sub-Committee.

88. The performance of the administration section of the Fund is focussed on key administration performance indicators which are reported in the Annual Report and Accounts. Performance is also reported to members of the Sub-Committee and, if requested, on an annual basis to employers.

Investment performance

89. The Fund has underperformed against its benchmark in 2015/16 and over the longer term (represented by the 5 year benchmark). This is demonstrated at exhibit 4.

Exhibit 4: Investment performance

	2015/16 % per annum	3 years % per annum	5 years % per annum
Fund return	0.19	6.69	6.59
Benchmark return	0.43	6.23	6.97
(Under)/Over performance	(0.24)	0.46	(0.38)

Source: Northern Trust Executive Report

90. 2015/16 has been a very challenging year for investment managers due to a combination of factors including a slowdown in the Chinese economy, sluggish growth within the Eurozone, depressed oil prices and low yields on fixed interest securities.

91. As noted in the Performance Commentary contained in the Fund's Annual Report, the performance of fund managers has been varied in 2015/16. Individual fund manager performance is reported on a quarterly basis to the Sub-Committee. The Fund makes use of professional investment advisors to help with a more comprehensive review of performance on an annual basis.

Administrative performance

92. The Fund reports mixed performance against administration performance targets. The challenges of the introduction of the new scheme and the resulting need to provide additional help and support to employers has impacted on the Fund's administrative performance in the year.

93. The Fund has reported on eight indicators in the annual report, of which only four have been achieved (new starts, transfers in, frozen refunds, and correspondence). The four remaining indicators which have not been achieved are:

- Refunds (97.0% achieved; target 99%).
- Ill health/age retirals (93.2% achieved; target 95%).
- Retirement estimates (89.9% achieved; target 97%).
- Calculation of deferred benefits (21.0% achieved; target 80%).

94. The poorest indicator is that for the calculation of deferred benefits. Officers recognise that this is an area where significant improvement is required and are currently reviewing their processes and introduced further training for team members on the calculations.

95. The Fund continues to benchmark administration costs using the Chartered Institute of Public Finance and Accountancy (CIPFA) benchmarking survey. The unit cost per member for the last reported period (2014/15) fell slightly from £25.44 to £24.33 but this was significantly higher than the club average of £19.17 and the outsourced average of £21.06.

96. The Fund has noted in the Scheme Administration Report that "the difference is due, in part to significantly higher indirect costs".

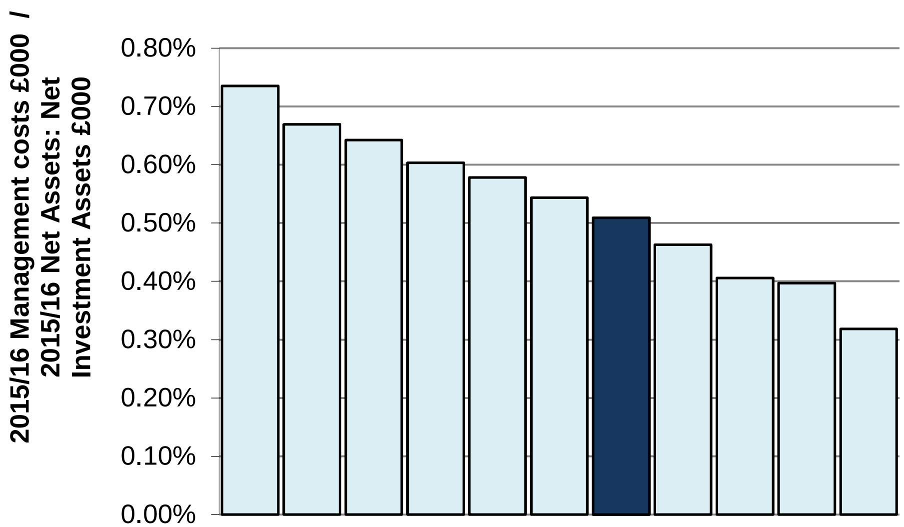
Management expenses

97. There are three main categories of management expense, with the largest being investment management costs. Other expenses are the cost of the administration services provided by the council and the governance fees for actuarial and audit services.

98. In 2015/16 the investment management costs of the Fund decreased from £9.7 million to £9.4 million.

99. Exhibit 5 shows figures the total management costs as a percentage of net assets across the Scottish Local Government Pension Funds, with investment management costs for the Fund highlighted.

Exhibit 5: Total Management Costs as a Percentage of Net Assets



Source – Scottish LGPS Unaudited Annual Report and Accounts.

100. Following the introduction of guidance from CIPFA in 2014, the disclosure of investment management expenses is now more consistently reported across the LGPS. This enables Funds to review the level of expenses of investment managers, benchmark performance and assist with management's evaluation of whether value for money is being achieved.

Refer action plan, point 4

Outlook

101. With financial austerity within the public sector set to continue and increased pressure from employers to keep costs and contributions down makes it imperative for funds to be able to demonstrate best value and continued improvement.

102. In England and Wales there is a move towards the pooling of funds through collective investment vehicles. This is to take advantage of the economies of scale and investment opportunities that large pension funds benefit from. Scottish Ministers have already indicated that this is an area where the views of the national Scheme Advisory Board may be requested in future. Pension funds may need to reconsider the costs and benefits of shared services, procurement exercises and asset pooling.

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk.

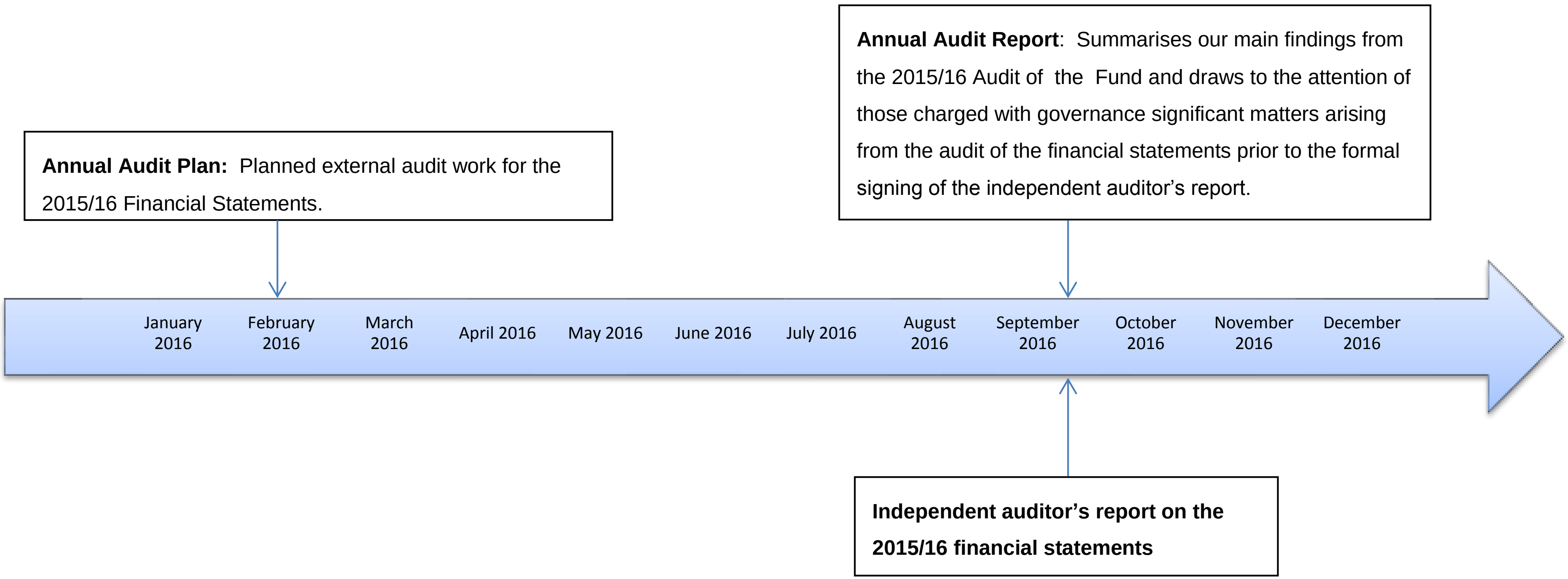
Audit Risk	Assurance procedure	Results and conclusions
Financial Statement issues and risks		
Income recognition Auditing standard ISA 240 *The auditor's responsibility to consider fraud in an audit of financial statements,* requires auditors to presume a risk of fraud where income streams are significant. The Fund receives a material amount of income from a variety of sources including pension contributions and investment income. **Risk**: The extent of income means there is an inherent risk that income could be materially misstated.	• Internal controls for key revenue systems are subject to review by Audit and Risk Management Services. • A range of measures are in place to prevent and detect fraud, including Standing Financial Instructions, Standing Orders, a Code of Conduct for Staff, a Fraud Prevention and Detection Strategy and a Whistleblowing Guide. • Service auditor reports are reviewed. • Pension contributions reconciliations performed for individual employers.	• Evaluated the effectiveness of systems of internal control for income recognition and recording, including the analytical review of income streams and testing of controls. • Monitored fraud investigation work conducted by Audit and Risk Management Services. • Reviewed the content of service auditor reports. **We did not identify any instances of income being materially misstated.**
Risk of management override of control ISA 240 also requires auditors to consider, on all audits, management's ability to manipulate accounting records and prepare fraudulent or biased financial statements by overriding	• Audit and Risk Management Services review a range of financial systems and related controls and provide an opinion on the control environment. • A range of measures are in place to prevent and detect fraud, including	• Carried out detailed testing of journal entries. • Undertook analytical review of income and expenditure streams. • Reviewed accounting estimates for bias.

Audit Risk	Assurance procedure	Results and conclusions
controls that otherwise appear to be operating effectively. **Risk** Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls.	Standing Financial Instructions, Standing Orders, a Code of Conduct for Staff, a Fraud Prevention and Detection Strategy and a Whistleblowing Guide.	• Evaluated significant transactions to identify any that are outside the normal course of business. **We found no evidence of fraud from our detailed testing of journal entries and our review of accounting estimates for bias and no instances of transactions outside the normal course of business.**
Restructuring of Financial Services The council is in the process of restructuring its Financial Services which could impact on staff responsible for the Fund. 2015/16 has already seen the retiral of two key members of finance staff, team leaders for both the Investment and Pensions & Payroll sections, both of whom had management responsibilities for the Fund. **Risk**: the loss of key financial personnel from the service may impact on the Fund's ability to produce its financial statements to a high standard and by the statutory deadline. Changes also pose a risk to the wider control environment.	• The restructuring is being phased over three years and takes cognisance of the requirement to retain appropriately skilled staff to maintain the sound financial management of the Council and the production of financial statements. • Senior management continue to monitor the position on a regular basis.	• Reviewed systems of control including impact of reductions in staff. • Reviewed standard of working papers provided to support the financial statements. **We did not find any significant issues with the wider financial control environment. The standard of working papers was good.**

Audit Risk	Assurance procedure	Results and conclusions
Annual Governance Statement The 2014 Regulations bought in a requirement from 2014/15 for an annual review of the system of internal control which is to be reported in an annual governance statement and published as part of the annual financial accounts. The requirement was not met in the 2014/15 unaudited financial statements but was amended for the audited version. **Risk:** the Fund may not comply with the requirements of the new regulations.	• Management are aware of the changes to the regulations and have plans to meet the requirements of the new regulations.	• Reviewed compliance with the 2014 accounting regulations. • Reviewed the assurance statements for the Fund, including the annual assurance statement provided by the Head of Audit and Risk Management Services. **The draft accounts included an Annual Governance Statement which complied with regulations.**
Investment management expenses Following publication of CIPFA's Accounting for local government pension scheme management costs, the Fund amended its accounting treatment of management costs in 2014/15 in line with the Guidance. Our review of investment management costs across Scottish Local Government Pension Funds places Fife at the lower end of the scale for investment management expenses (as a proportion of net assets). **Risk**: the 2014/15 financial statements may not	• Management are aware of the requirements of the guidance and disclosures needed. • Requests for the required expenses information have again been issued to the investment managers by the council's banking and investments team.	• Reviewed the calculation of the investment management costs and confirmed to supporting evidence and records. **Management expenses have been appropriately disclosed.**

Audit Risk	Assurance procedure	Results and conclusions
be prepared in line with the CIPFA guidance on investment management expenses. Not all investment management expenses may be included.		

Appendix II: Summary of local audit reports 2015/16



Appendix III: Action plan

No. Page/ para.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1. 7/ 11	A number of the other information statements contained in the draft Annual Report did not read well. This would suggest that there was no 'quality check' of the Annual Report prior to submission to the external auditors. **Risk:** Key information may not have been understandable to readers of the Annual Report and Accounts. **Recommendation:** A quality review of the other information published in the Annual Report, along with the financial statements, should be undertaken prior to issue of the draft Annual Report to external audit.	Sufficient time will be built into the process to ensure the appropriate checks and reviews are carried out.	Finance Operations Manager (Laura Robertson) March 2017

No. Page/ para.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2. 17/ 69	**Register of Members' Interests** Three of the nine members of the Sub-Committee have not updated the members' register of Interests since they were elected in May 2012. **Risk**: Without up to date records of members' interests, potential conflicts of interest may go unnoticed. In addition, the financial statements disclosures on related parties may be incomplete. **Recommendation:** Up to date disclosures of members' interests should be included in the Register of Members' Interests.	In terms of the Councillors' Code of Conduct, elected members are required to update their entries in the Register within one month of their circumstances changing, including the receipt of gifts and hospitality. All councillors are reminded twice annually to update their entries but if there have been no changes of circumstance then their previous entries may remain unchanged.	Head of Democratic Services (Linda Bissett) Ongoing

No. Page/ para.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3. 17/ 75-78	**Actuarial advice and investment consultancy** Hymans Robertson provides both actuarial advice and investment consultancy to the Fund, which exposes the Fund to a potential conflict of interest. We have also been unable to obtain evidence that any recent formal tendering process has been carried out for these services. **Risk**: In the absence of appropriate safeguards, there is potential for a conflict of interest when actuarial advice and investment consultancy is provided by the same firm. There is also a risk that providers do not deliver value for money if the market is not regularly tested by tendering. **Recommendation**: The Fund should seek assurance that safeguards are in place to prevent conflicts of interest over actuarial and investment advice where the services are provided by the same firm. The Fund should also consider re-tendering for the actuarial advice (when the contract ends) and investment consultancy services.	It is not uncommon for Pension Funds to obtain actuarial advice and investment consultancy from the same provider. In relation to the Fife Pension Fund there is a "hard" spilt between the two disciplines, different staff from the organisation work on actuarial matters and on investment issues. This division of tasks helps ensure there are no conflicts of interest. Fife Pension Fund issued a tender for actuarial services in 2010 when 3 providers were interviewed and Hymans Robertson was appointed. The appointment was based on a number of criteria including level of fees. Officers will consider whether it is appropriate to re-tender for actuarial and investment services. Offices believe that more significant financial savings on external advisors fees are available through active collaboration between Pension Funds. Work is at an early stage and will be progressed over the next few months.	Executive Director of Finance and Corporate Services (Eileen Rowand) March 2017

No. Page/ para.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4. 21/ 100	**Investment management expenses** There is no regular value for money review reported to members in relation to the investment management expense incurred. **Risk:** There is a risk that poor performance in investment management expenditure may adversely impact on investment returns. **Recommendation:** The Fund should regularly monitor investment management expenses to assess whether these are providing value for money for members.	Officers spend a significant amount of time reviewing the level of investment manager fees with our investment consultant. Over the last two years this has included discussions with investment managers some of these discussions have resulted in fee reductions. At present officers are implementing changes to the fee structure for the fund's two bond mandates. This proposal was worked up by the Fund's investment consultant and officers and subsequently approved by the Pensions sub-committee. The proposal will save around £250k per annum in investment fees. It is accepted that members could be updated more regularly on the benchmarking of fees which is carried out by officers/investment consultant and how this can translate into lower fees. Officers will progress this matter.	Head of Finance (Keith O'Donnell) March 2017