

# Fife Pension Fund

2017/18 Annual Audit Report



 AUDIT SCOTLAND

To Members of the Fife Council Standards & Audit Committee and the Controller of Audit  
28 September 2018

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

---

# Contents

---

Key messages	4
Introduction	5
Part 1 Audit of 2017/18 annual accounts	7
Part 2 Financial management	11
Part 3 Financial sustainability	14
Part 4 Governance and transparency	17
Part 5 Value for money	20
Appendix 1 Action plan 2017/18	23
Appendix 2 Significant audit risks identified during planning	27
Appendix 3 Summary of national performance reports 2017/18	30

# Key messages

---

## 2017/18 annual report and accounts

- 1 Our audit opinions were all unqualified.

## Financial management

- 2 The Fund has effective arrangements in place for financial management.
- 3 In recent years, the Fund has performed better in comparison to its peer group and to its benchmark.

## Financial sustainability

- 4 The triennial valuation reports a 93% funding position and the Fund has improved its position relative to other funds, but the position is still in the lower quartile.
- 5 Investments are diversified but some are exposed to the market risks of EU withdrawal.

## Governance and transparency

- 6 Division of pension responsibilities to two committees may restrict the information available to some responsible for governance. The committees share a common Chair.
- 7 Access to information on Fife Council's website should be improved.

## Value for money

- 8 The Fund has formed a Joint Investment Strategy Panel with the Lothian and the Falkirk pension funds. This is consistent with the wider strategy of the LGPS in Scotland for funds to work together to improve value for money.

---

# Introduction

---

1. This report is a summary of our findings arising from the 2017/18 audit of Fife Pension Fund (the Fund).

2. The scope of our audit was set out in our Annual Audit Plan presented to the February 2018 meeting of the Standards and Audit Committee. This report comprises:

- an audit of the Fund's annual accounts
- consideration of the wider dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

---

## Exhibit 1

### Audit dimensions



Source: Code of Audit Practice 2016

---

3. The main elements of our audit work in 2017/18 have been:

- a review of the Fund's main financial systems
- an audit of the Fund's 2017/18 annual accounts including the issue of an independent auditor's report setting out our opinions
- consideration of the four audit dimensions.

4. Fife Council is the administering authority for the Fife Pension Fund. The Council delegates this responsibility to the Superannuation Fund and Pensions Sub-Committee. It is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The Superannuation Fund and Pensions Sub-Committee is not required to review the effectiveness of internal

## 6 Introduction

control arrangements and approve the annual accounts, this responsibility is delegated to the Council's Standards and Audit Committee.

**5.** Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973, the [Code of Audit Practice 2016](#), and supporting guidance, and are guided by the auditing profession's ethical guidance.

**6.** As public sector auditors we give independent opinions on the annual accounts. We also review and provide conclusions on the effectiveness of the Fund's performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability.

**7.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).

**8.** This report raises matters from the audit of the annual accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.

**9.** Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.

**10.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and the 2017/18 audit fee of £33,920 as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

### Adding value through the audit

**11.** Our aim is to add value to Fife Pension Fund by providing insight and foresight, by identifying areas of improvement and by recommending and encouraging good practice. In so doing, we aim to help the Fund promote improved standards of governance, better management and decision making and more effective use of resources.

**12.** This report is addressed to both the members of the Fife Council Standards and Audit Committee and the Controller of Audit and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**13.** We would like to thank all management and staff who have been involved in our work for their co-operational and assistance during the audit.

# Part 1

## Audit of 2017/18 annual accounts



### Main judgements

Our audit opinions were all unqualified.

We used data analytics techniques for the second year in the audit of Fife Pension Fund and this helped identify and correct misclassifications totalling £1.4 million that were corrected before the unaudited statements were prepared.

### Unqualified audit opinions

14. The annual accounts for the year ended 31 March 2018 were approved by the Fife Council Standards and Audit Committee on 27 September 2018. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- the management commentary, corporate governance statement and governance compliance statement were all consistent with the financial statements and properly prepared in accordance with the guidance
- we have nothing to report in respect of those matters which we are required by the Accounts Commission to report by exception.

The Fund's annual accounts are the principal means by which the pension fund demonstrates effective stewardship and use of resources to its external stakeholders.

### Submission of annual accounts for audit

15. We received the unaudited annual accounts on 29 June 2018, in line with the audit timetable set out in our 2017/18 Annual Audit Plan.

16. The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team. This helped ensure the final accounts audit process ran smoothly.

### Risks of material misstatement

17. [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. We also include the wider dimension risks, how we addressed these and our conclusions in the appendix.

### Materiality

18. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement. On receipt of the annual report and accounts we reviewed our planning materiality and concluded that, the materiality levels required only minor adjustment. These are shown at [Exhibit 2](#).

## Exhibit 2

### Materiality values

Materiality level	Amount
Overall materiality	£24 million
Performance materiality	£14 million
Lower level performance materiality	£0.6 million
Reporting threshold	£230,000

### Significant findings from the audit in accordance with ISA 260

19. International Standard on Auditing 260 (UK & Ireland) requires us to communicate significant findings from the audit to those charged with governance. These are summarised below in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

20. The findings include our views about significant qualitative aspects of the Fund's accounting practices including:


- Accounting policies
- Accounting estimates and judgements
- Significant financial statements disclosures
- Timing of transactions and the period in which they are recorded
- The impact on the financial statements of any uncertainties
- The effect of any unusual transactions on the financial statements
- Misstatements in the annual accounts
- Disagreement over any accounting treatment or financial statements disclosure

## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Disclosure of prior year adjustment</b></p> <p>Accounting standards require disclosure of prior year adjustments, their cause and their impact.</p> <p>This year, accrued income was treated differently by the global custodian with the result that opening investment and debtor values were revised.</p> <p>An explanation for the adjustment was not given in the unaudited accounts, and the required notes on policy and impact were missing.</p>	<p>The audited accounts contain disclosure of the nature and impact of the prior year adjustment</p>
<p><b>2. Disclosure of member numbers</b></p> <p>During the audit it emerged that the report used to prepare the table of member numbers counted the number of pension-earning posts and not the number of individuals.</p>	<p>We obtained a report by individual, not role, and it showed that the numbers of active members in 2016/17 were probably over-stated by around 0.8% (16,173), while, in 2017/18, the likely error is 1.5% (16,372). For actuarial purposes, pensionable roles are important, not the number of individuals.</p>



Issue	Resolution
It is possible for an individual to accrue pension benefits for more than one role, and this is more common for part-time employees. It is very difficult to reconstruct member numbers historically.	We agreed with management that the figures based on roles would be accepted this year and reviewed in future  <a href="#">Recommendation 1 (refer appendix 1, action plan)</a>

Source: Audit Scotland

## How we evaluate misstatements

**21.** Other than some modifications to the notes to the accounts, there were no amendments to the amounts contained in the unaudited financial statements.

## Follow up of prior year recommendations

**22.** We have followed up actions previously reported and assessed progress with implementation, these are reported in [Appendix 1](#) and identified by the prefix b/f (brought forward).

**23.** In total, six agreed actions were raised in 2016/17. Of these:

- three have been fully implemented
- three are not actioned or have only been partly actioned.

**24.** Overall the Fund has made reasonable progress in implementing these actions. For those actions not yet implemented, revised responses and timescales have been agreed with management, as set out in [Appendix 1](#).

## Data Analytics

**25.** In 2017/18 we made use of data analytics techniques as part of our audit approach.

**26.** We obtained and analysed every general ledger transaction processed in 2017/18: There were 952 postings of which 96 were accounting adjustments. We also used the investment transaction, income and valuation lists prepared by the global custodian.

### Completeness and Accuracy: Assurances over member contributions and investment income

**27.** The monthly receipt of contributions from employers allowed us to look for outliers for investigation. Identified deviations were raised with the administration team. Two classification errors amounting to £1 million were found during the interim audit and brought to management's attention. They were corrected before the unaudited financial statements were prepared.

**28.** Income and valuation data in the custodian reports were used to calculate investment yields. Explanations were obtained for investments that lacked reported income.

### Valuation and allocation: Assurances over investments

**29.** Yield information was also used to challenge the valuation of investments in the level 2 and 3 classes, where markets are hard to observe. In general, we found yields to be consistent with the investment strategy of the mandate, and therefore the valuation to be reasonable.

### **Classification, cut-off and management bias: assurance over accounts preparation**

**30.** The mapping of the ledger from Trial Balance to the Balance Sheet was confirmed via 100% re-performance.

**31.** Risk assessment of journals revealed a classification error of £0.4 million, which was corrected before the unaudited financial statements were prepared.

### **Other findings**

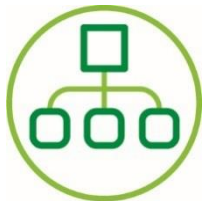
**32.** Our audit identified several presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited financial statements.

### **Pre-audit inspection and objections to the accounts**

**33.** The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The notice for Fife Pension Fund was published on the website of the administering authority (Fife Council) and complies with the regulations. No objections were received to the Fife Pension Fund accounts.

# Part 2

## Financial management



### Main judgements

The Fund has effective arrangements in place for financial management.

The Fund generated a modest surplus after costs from its dealings with members and was able to reinvest all its investment income.

In recent years, the Fund has performed better in comparison to its peer group and to its benchmark.

### Financial performance in 2017/18

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

35. The Fund's performance in 2017/18 is summarised in [Exhibit 4](#).

### Exhibit 4

Assets, liabilities, funding level and investment performance

#### Increase in net assets



**£159 million**  
(+7%)

**£2,421 million**  
Closing net assets

#### Decrease in estimated liabilities



**£211 million**  
(-6.6%)

**£2,983 million**  
Closing liabilities

#### Funding level



**93%**  
2017 Funding valuation (triennial basis)

**81.1%**  
31 March 2018 Interim valuation (IAS 19 basis)

#### Investment performance



**6.4%**  
Return on investments 2017/18

**9.36%**  
Annualised return on investments over 5 years

**36.** The net assets of the Fund increased to £2.4 billion at 31 March 2018 from £2,3 billion at 31 March 2017. This increase of £159 million (7%) was the result of capital gains, re-investment of dividend/interest income and a small surplus on dealings with members.

**37.** During 2017/18 contributions to the Fund were £100 million. This was greater than the benefits paid out which totalled £84 million. After fees and overheads of £13 million, there was £2.5 million left over for investment.

**Financial management arrangements**

**38.** The Executive Director of Finance and Corporate Services for Fife Council is the proper officer responsible for Fife Pension Fund. The financial regulations of Fife Council, as administering authority, apply to the pension fund. We consider these to be comprehensive and current, promoting good financial management.

**39.** The sub-committee receives budget and monitoring reports on the pension fund and periodic reports on administrative performance. Budgetary control reports have a consistent layout, use appropriate headings and are accompanied by variance analysis. Investment reports rely on documents provided by the global custodian and investment managers. Through our attendance at the Superannuation Fund and Pensions Sub-Committee we have observed a good level of review and scrutiny by members.

**40.** We conclude that financial management arrangements are good.

**Financial outcomes**

**41.** 2017/18 was a mixed year for investment performance for most LGPS pension funds across Scotland, as illustrated in [Exhibit 5](#).

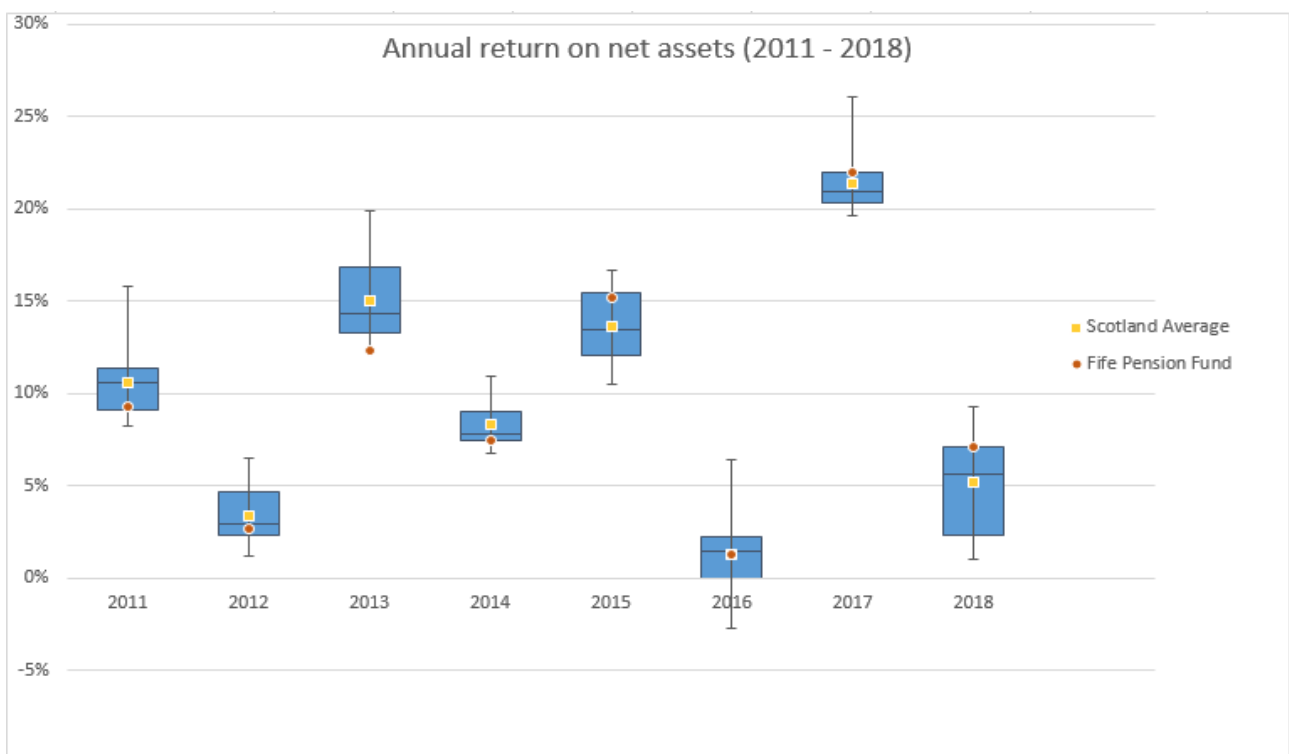
---

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

---

**Exhibit 5**

LGPS pension funds – Net return on investments 2011 to 2018 (unaudited figures)



**42.** In the last two years Fife's returns are above average and towards the upper quartile of performance. In 2017/18, Fife Pension Fund achieved a return of 6.4% on its investments ([Exhibit 6](#)). This is ahead of the investment benchmark of 2% for 2017/18 and ahead of the longer-term funding requirement of 3.5% per annum. Three- and five-year performance returns are 8.9% and 9.4% respectively.

## Exhibit 6

### Return on investment against benchmark 2017/18

	1 year	3-year annual returns	5-year annual returns	Since inception 30/06/2003
Fund Performance	6.4%	8.9%	9.4%	8.4%
Target (benchmark +1.5%)	3.5%	8.2%	9.0%	9.6%
Investment benchmark	2.0%	6.7%	7.5%	8.1%

Source: Northern Trust Investment Report at 31 March 2018

**43.** In recent years, the Fund has performed well in comparison to its peer group and to its benchmark. Sustained performance above the long-term discount rate will tend to improve the actuarial position.

## Systems of internal control

**44.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. The Fund uses several of the financial systems of the administering authority, Fife Council, as well as its own systems for administering pensions and investments.

**45.** Our findings were included in an interim audit report presented to the Standards and Audit Committee on 14 June 2018. We concluded that the controls were operating effectively. No significant control weaknesses were identified which could affect the Fund's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

## Good practice

**46.** Budgetary control reports use the same layout as the financial statement's Fund Account and contain outturn figures for the past year and projected outturn for the current year. Accompanied by explanation of the variances, they are relevant and forward looking.

# Part 3

## Financial sustainability



### Main judgement

The triennial valuation reports a 93% funding position. The Fund has improved relative to other funds but is still in the lower quartile.

The long term financial position is improving, and the Fund has a long-term plan to eliminate its deficit over 18 to 20 years.

Investments are diversified but some are exposed to the market risks of EU withdrawal.

### Funding position and financial planning

47. The March 2017 triennial valuation reports that on a long-term basis, assets were sufficient to meet 93% of the Fund’s liabilities. This is an improvement compared with 88% at the 2014 triennial valuation.

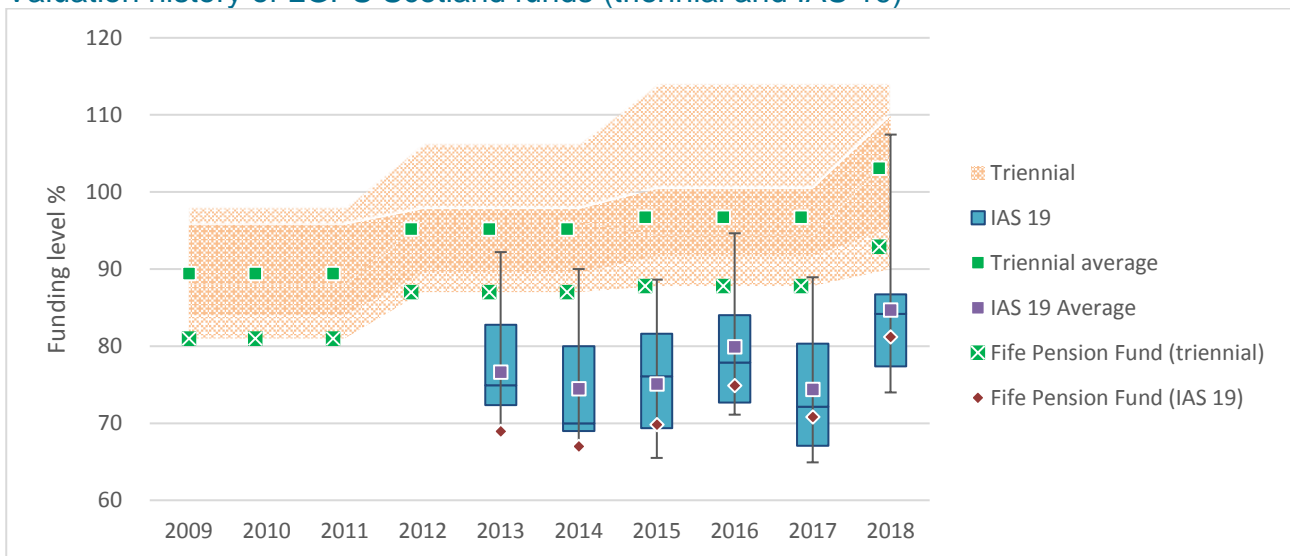
48. On the IAS 19 comparison basis, the funding ratio was 81% in 2018, compared with 71% last year. The IAS 19 basis uses a lower discount rate for long term liabilities than the one used for funding purposes, and this tends to produce a more cautious result.

49. Exhibit 7 shows the range and trend of the last four triennial valuations of Fife and the other Scottish funds (the banded ribbon) together with recent IAS 19 valuations (floating boxes with whisker lines).

Financial sustainability looks forward to the medium and longer term to consider whether the Fund maintains the capacity to meet the current and future needs of its members.

### Exhibit 7

Valuation history of LGPS Scotland funds (triennial and IAS 19)



50. Compared with previous years, Fife’s funding position has improved on both measures, but so have other funds. However, there is evidence of improvement relative to other funds, despite Fife remaining in the lower quartile.

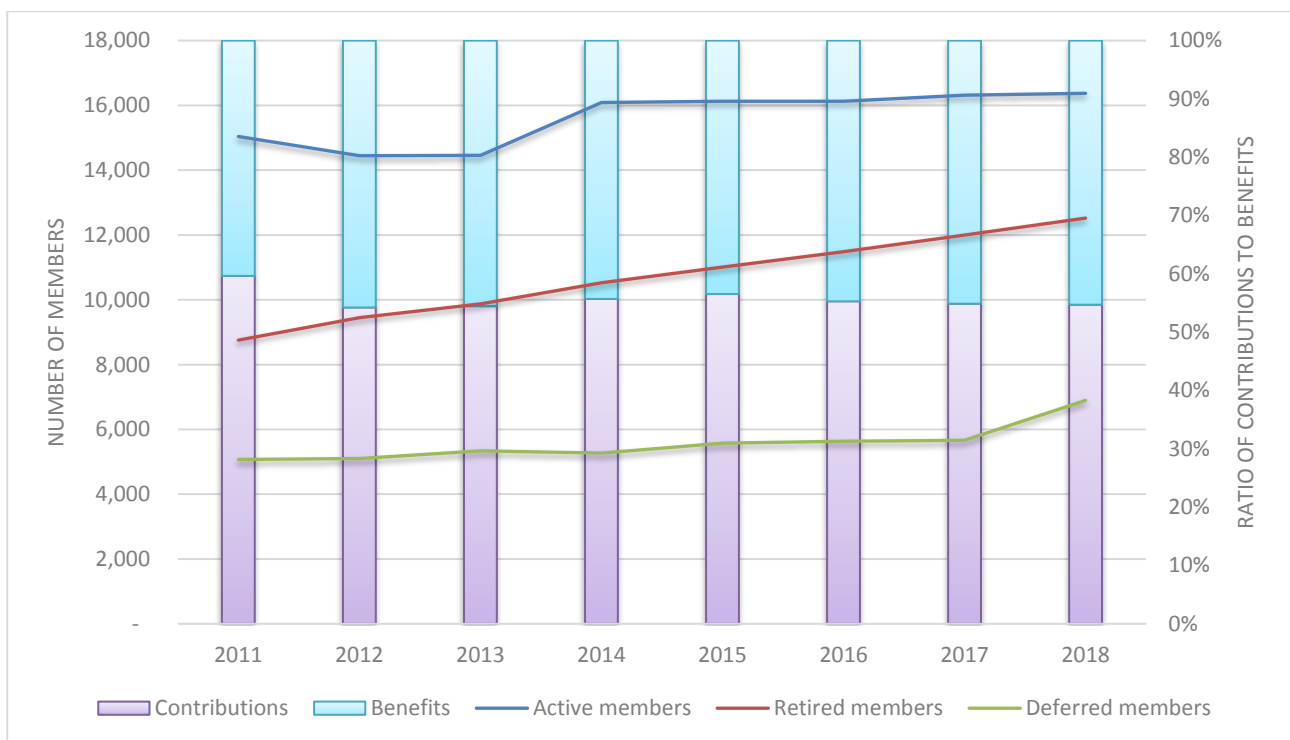
51. The Funding Strategy Statement was updated this year and describes how the Fund plans to ensure long term solvency. Compared with the 2014 valuation, the actuary has assumed a slightly higher long-term rate of return (consistent with holding more higher yielding risk assets than previously), a slightly lower assumption for salary growth (consistent with short term austerity measures), and life expectancy that is 0.7 years shorter. For the largest employer, Fife Council, the actuary estimates a 66% chance of meeting the funding target over 18 years.

### Membership levels

52. The pension fund is a multi-employer fund with 27 active employers. The current membership profile is shown at [Exhibit 8](#). The number of active members continues to outweigh the number of pensioners, but the proportion of actives is falling, while the proportion of pensioners is rising.

### Exhibit 8

Membership: effect of changing structure on cash flow



Source: Fife Pension Fund 2017/18 unaudited financial statements

53. Reported membership of the Fund increased by 2,061 to 36,036 at 31 March 2018. However, we found that this refers to the number of posts rather than the number of individual members with some people holding more than one post or receiving pension from more than one employment. Our best estimate is that actual numbers are currently 35,788.

 [Recommendation 1 \(refer appendix 1, action plan\)](#)

54. However, as also shown in [Exhibit 8](#), the ratio of contributions to benefits is stable and so the rise in the proportion of retired members has not had a significant impact on the fund’s net cash flow.

## Contributions

**55.** Following the latest triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for 2018/19 onwards. The approximate split of all contributions received in year is set out at [Exhibit 9](#).

**56.** Fife Council is the main employer, with 86% of contributions and a significant part of the overall deficit. The Council's contribution towards the pensions of current members in service is 19.9% of salaries. Deficit funding of historic liabilities is 4.6%, making a total annual contribution of 24.5% of pensionable salaries. The actuary has stabilised the Council's contributions at this rate for the next three years. Most admission bodies are fully funded in respect of historic liabilities.

### Exhibit 9

#### Contributions in 2017/18

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
<b>Employer contributions</b>	62.373	3.683	7.169	73.225
<b>Employee contributions</b>	15.091	1.779	1.168	18.038
<b>Strain Contributions</b>	4.121	0.143	0.084	4.348

Source: Fife Pension Fund 2017/18 unaudited financial statements

## EU withdrawal

**57.** There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). The pension fund is exposed through its investments to the performance of the UK and EU economy and in turn to the reaction of the financial markets during negotiations and after the withdrawal.

**58.** The Fund contracts out its investment management and fund managers have broad discretion to operate as they think best within their individual mandates. The Fund holds a diversified portfolio of asset classes and investment strategy is currently under review. As 2019 unfolds, we consider it important to keep asset allocation under review and respond appropriately if the long-term outlook for a mandate or sector changes materially.



[Recommendation 2 \(refer appendix 1, action plan\)](#)



# Part 4

## Governance and transparency



### Main judgements

**Division of pension responsibilities to two committees may restrict the information available to some responsible for governance.**

**Access to information on Fife Council's website should be improved.**

### Governance arrangements

**59.** Fife Council is the administering body for Fife Pension Fund. The Council has delegated responsibility for matters relating to pensions to the Superannuation Fund and Pensions Sub-Committee. This sub-committee, supported by the Pension Board, is responsible for establishing arrangements that ensure the proper conduct of the affairs of Fife Pension Fund. It is responsible for ensuring that decisions are made within the terms of the Local Government Pension Scheme.

**60.** The sub-committee also has responsibility for wider topics, such as the investments of the common good and trusts and for the Council's early retirements. The sub-committee remit was updated this year to include input to the Standards and Audit Committee about the audited annual accounts of the bodies within its remit.

**61.** Oversight of pension fund governance and risk management remain in the remit of Fife Council's Standards and Audit Committee (SAC). Weaknesses in pension fund governance and management arrangements are reported to the SAC, but not to the Superannuation Fund and Pensions Sub-Committee. We consider this to be a mixed line of communication which may mean that those in charge of pension fund affairs may not have access to full information, particularly the Pensions Board. The two committees share the same Chair, which ensures communication.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.



[Recommendation 3 \(refer appendix 1, action plan\)](#)

### Transparency

**62.** Transparency means that the public, in particular members have access to understandable, relevant and timely information about how the Fund is taking decisions and how it is using resources.

**63.** There is evidence from several sources which demonstrate the Fund's commitment to transparency. For example, the Superannuation Fund and Pensions Sub Committee and Pensions Board meetings are held in public with commercially sensitive information dealt with in private session and the Fund's annual accounts are available on the Council's website.

**64.** We reported in our management report to the June 2018 Standards and Audit Committee that more than half of the recommendations in the August 2017 internal audit report into pension fund governance were not completed. The Fund's website remains incomplete and documents and information required by the pensions acts

and noted in Code of Practice 14 for Public Service Schemes are missing. It is not clear that the current publication scheme is complete or up-to-date.



#### **Recommendation 4 (refer appendix 1, action plan)**

**65.** Overall, we concluded that the Committee and Board conducts its business in an open and transparent manner, but we believe that there are some areas where access to information should be improved.

### **Other aspects of governance**

**66.** We reviewed various other aspects of governance that apply to the Fund including standing orders, financial regulations and arrangements for reporting breaches of regulation to the Pensions Regulator. We highlighted in our management report issued in June 2018, that although there is a statutory deadline of 19 days for the payment of employee contributions to pension funds, the administration team do not rigorously encourage timely collection. Because of this the Fund has introduced a monthly review to ensure compliance with the statutory requirement.

**67.** Employers are required to submit year end contribution returns by May. This is an important control over the accuracy of pension contributions received and recorded in the pensions systems. It has increased importance following the introduction of CARE, as the member benefit statement requires actual salary data from all employers. All year end contribution returns relating to 2017/18 have been received.

**68.** As part of the Fund's governance assurance framework employers are also required to submit compliance certificates verifying compliance with a range of pension fund and regulatory requirements in relation to pension administration. In 2017/18 there has been an improved return rate of 89%. It has been confirmed that certificates were received from all the fund's major employers.

### **Pensions Regulator Public Service Code**

**69.** The fund recognises and aims to comply with Code of Practice 14. Internal audit noted fourteen points for improvement in August 2017. We were pleased to observe progress this year in resolving several points, but some remain open. As reported in internal audit's annual report, there is room to improve member training and, as noted above, the accessibility of the fund's key documents on the Council's website.

**70.** No breaches were reported in the year, and we are not aware of any reportable issues.

### **Internal audit**

**71.** Internal audit provides the Fund with independent assurance on the Fund's overall risk management, internal control and corporate governance processes.

**72.** The internal audit function is carried out by Fife Council's Audit & Risk Management Services. We conducted a review of the adequacy of the internal audit function and concluded that it operates accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

### **National Fraud Initiative**

**73.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland.

**74.** We reported good progress with the NFI exercise in our 2017/18 Management Report and concluded a relatively small number of errors was found (15 errors resulting in overpayments of £23,000, of which £12,000 is being recovered).

### Standards of conduct for prevention and detection of fraud and error

**75.** We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on Fife Council's arrangements for the prevention and detection of fraud and corruption. These include the Code of Conduct for members and officers, whistleblowing policy and an anti-fraud strategy.

**76.** We concluded that appropriate arrangements were in place for preventing and detecting fraud and corruption in 2017/18.

### Cyber-security

**77.** In May 2017, several health boards across NHS Scotland were affected by the Wannacry global ransomware attack. In response to this, the Scottish Government launched "A Cyber Resilience Strategy for Scotland: Public Sector Action Plan, 2017/18".

**78.** The action plan outlines various requirements that public bodies should take forward. It includes an action for public bodies to achieve a Cyber Essentials Plus certification by the end of October 2018.

**79.** The Fund currently uses Fife Council's systems for the financial ledger and can place reliance on the Council's assessment. However, the Altair pensions administration system is provided and hosted by an external supplier. There is a need to consider whether the supplier meets Cyber Essentials standards. We recommend the Fund encourages the supplier of Altair to adopt the Cyber Essentials standard.



[Recommendation 5 \(refer appendix 1, action plan\)](#)

### LGPS Regulations

**80.** Revised Local Government Pension Scheme regulations came into effect from 1 June 2018. The changes aim to consolidate all amendments since April 2015 and include amendments to the scheme rules including:

- Members of the LGPS 2015 will be able to elect to take early payment of their pension from age 55, with an actuarial reduction and will no longer need their employer's consent
- Additional flexibility for administering authorities when employers leave the scheme and the power to provide extra credit to exiting employers if appropriate
- Changes to additional voluntary contributions following the introduction of the UK government's "freedom and choice in pensions", to allow payment from age 55 as a lump sum.

# Part 5

## Value for money



### Main judgements

The Fund's investment performance is subject to regular review and scrutiny by the Superannuation Fund and Pensions Sub-Committee.

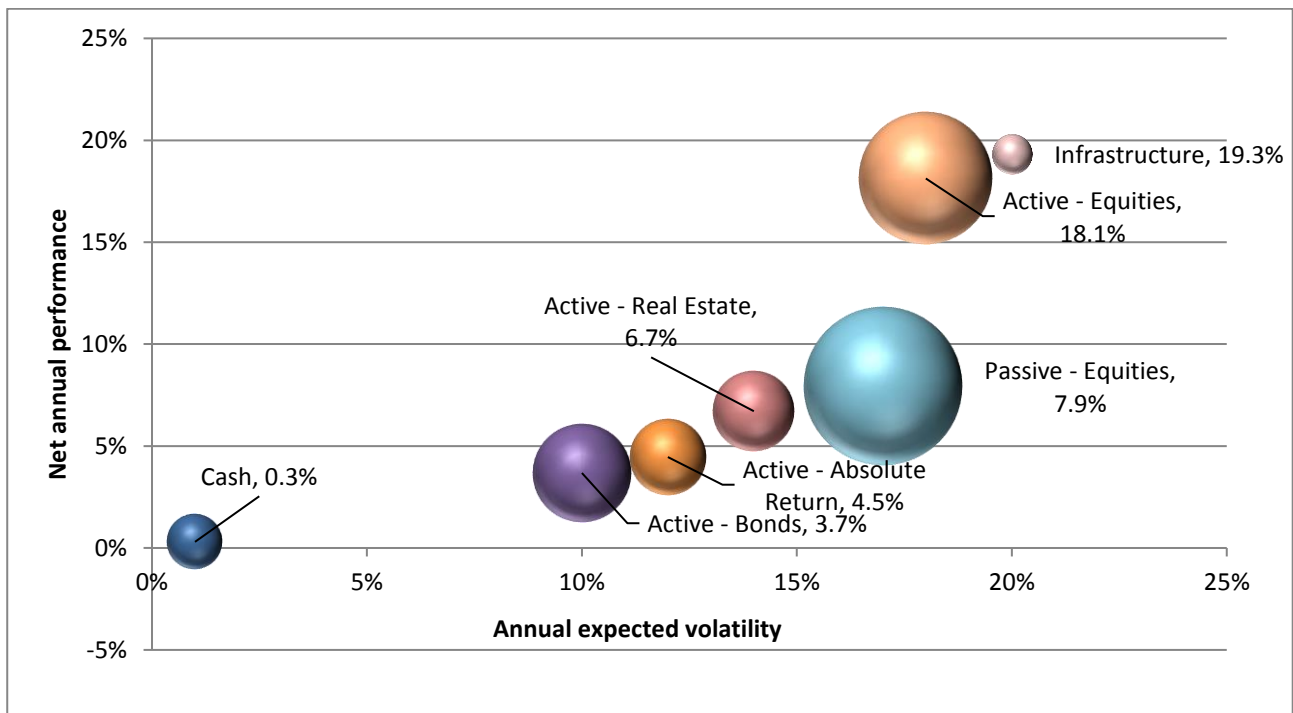
The Fund has formed a Joint Investment Strategy Panel with the Lothian and the Falkirk pension funds. This is consistent with the wider strategy of the LGPS in Scotland for funds to work together to improve value for money.

### Investment performance

81. The Superannuation Fund and Pensions Sub-Committee meets on a quarterly basis. A review of fund managers' performance is a standing item on the committee's agenda. At each meeting, committee members receive a report outlining overall fund performance including an analysis of risks and returns.

### Exhibit 10

Annualised investment returns net of fees over three years to 31 March 2018



Source: Fife Pension Fund – Northern Trust annual performance summary 2018

82. Exhibit 10 shows that over half the fund's investments are in equities (62%), and the actively managed portfolios have made high returns over the last three years. Actively managed equity mandates are a significant contributor to the fund's recent out-performance relative to other funds (Exhibit 5).

- 83.** There is a significant degree of diversification across asset classes and fund management styles. Higher risk investments such as in infrastructure make up a relatively small part of the portfolio (2%), while making high returns.
- 84.** As shown in [Exhibit 6](#), the fund has returned 8.4% per annum since June 2003. This compares with inflation since June 2003 of 3.6%, the Fund's current discount rate of 3.5% and the investment benchmark historic return of 8.1%.
- 85.** The Fund has 11 investment mandates, managed by 9 fund managers. Performance is reported quarterly to the Superannuation Fund and Pensions Sub-Committee.
- 86.** The Fund has formed a Joint Investment Strategy Panel (JISP) with the Lothian and the Falkirk Pension Funds for sharing expertise and realising benefits of scale in investment management. The JISP are conducting a review of investment strategy this year.
- 87.** The Fund has not rebalanced its mandates since last year and remains overweight in equities (62% at 31 March 2018 against a target of 55%) and underweight in bonds. This is however a current topic and is expected to be considered by the strategy review.

## Management expenses

- 88.** 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.
- 89.** CIPFA published revised guidance on local government pension scheme (LGPS) management expenses. This guidance sets out a framework for the reporting of investment management costs and was applied from 2016/17. The new guidance recommends that only expenses that can be directly controlled by the Fund should be included.
- 90.** External investment manager fees are agreed in the respective mandates governing their appointments. These are usually based on the market value of the investments under their management and therefore go up or down as the value of these investments changes.
- 91.** Investment management expenses increased from £7.3 million in 2016/17 to £11.3 million in 2017/18. The reason for the rise is the high fees of the infrastructure mandate, which carries out private equity type investments. It levied performance fees of £1.7 million and made two new investments with one-off fees of £1.6 million.
- 92.** We have concluded that the Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses. Greater fee transparency gives management new information to make informed decisions on value for money and performance of fund managers.

## Administrative expenses

- 93.** The workload of the pension administration section continues to grow partly due to the introduction of the career average pension scheme (CARE) from 1 April 2015. Other factors impacting on the administration workload include auto enrolment, freedom of choice and automatic data transfer from employers to the pension administration system.
- 94.** In our interim report in June 2018, we noted the loss since last year of five experienced staff members from the administration team and issues with reconciliations and recording of non-routine transactions. This did not impact on the

audit of the financial statements and we found staff to be knowledgeable and helpful.

**95.** The Fund's business plan sets out a range of service standards against which administration performance is monitored. These are measured on a regular basis and are reported to the Superannuation Fund and Pensions Sub-Committee quarterly. We are pleased to note that the recent report and its comparatives for the year before show that service levels are being maintained.

### **National performance audit reports**

**96.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2017/18, we published reports which might be of direct interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

**97.** Some of these reports appear in the papers considered by the Standards and Audit Committee.

### **Good practice**

**98.** The Fund has formed a Joint Investment Strategy Panel with the Lothian and the Falkirk pension funds, for sharing expertise and leveraging benefits of scale in investment management. While it is too early to assess impact, the collaboration is consistent with the wider strategy of the LGPS in Scotland for funds to work together to improve value for money.

# Appendix 1

## Action plan 2017/18

### 2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Membership reporting</b></p> <p>During the audit it emerged that the report used to prepare the table of member numbers counted the number of pension-earning posts and not the number of individuals.</p> <p>This anomaly was not corrected in the accounts due to the difficulty of working back to re-calculate historic figures. However, an alternative report was found within the system which may offer a solution, once its reliability has been tested.</p> <p><b>Risk</b></p> <p>Member numbers are significantly misstated.</p>	<p>The two kinds of reports should be compared and an assessment made of the reliability of the report based on individual members.</p> <p><a href="#">Significant findings</a></p> <p><a href="#">Paragraph 53</a></p>	<p>Reports will be compared at the end of 2018-19 to assess reliability and membership will be changed to individual members if the alternative report is considered reliable.</p> <p><b>Finance Operations Manager</b></p> <p><b>31 March 2019</b></p>
2	<p><b>Monitoring impact of Brexit</b></p> <p>There remains significant uncertainty about the detailed implications of EU withdrawal. The Fund is exposed through its investments to the performance of the UK and EU economy and in turn to the reaction of the financial markets during negotiations and after the withdrawal.</p> <p><b>Risk</b></p> <p>Long term outlooks for certain sectors and markets may change significantly, exposing the Fund to the risk of portfolio under-performance.</p>	<p>The Fund should review its asset allocation more frequently than usual during the period of uncertainty.</p> <p><a href="#">Paragraph 58</a></p>	<p>The Pension Fund Investment Strategy will be reviewed every three years and is currently under review. This process will assess overall risk, including the balance of UK versus overseas assets before determining the most appropriate asset allocation. The Joint Investment Strategy Panel will review investment markets formally, on a quarterly basis, and between those meetings if necessary. Markets operate within an uncertain environment and, by their nature, are not stable, however, investment managers will be taking risk into account in their</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
			<p>stock/sector selection and will change if required.</p> <p><b>Head of Finance</b></p> <p><b>Ongoing</b></p>
3	<p><b>Sub-committee remit - Governance</b></p> <p>There is a division of responsibility between the Superannuation and Pensions Sub-Committee and the Standards and Audit Committee so that those charged with governance may not have a complete view of pension fund matters.</p> <p><b>Risk</b></p> <p>Decisions may be made based on incomplete information.</p>	<p>The sub-committee should review its remit.</p> <p><a href="#">Paragraph 61</a></p>	<p>It is for Fife Council to determine the most appropriate governance arrangements and some minor amendments have been made in this regard. The remits will be further reviewed as part of the ongoing review of the committee structure which is scheduled to be completed later this year.</p> <p><b>Head of Finance/Head of Democratic Services</b></p> <p><b>March 2019</b></p>
4	<p><b>Transparency – Web-site</b></p> <p>The publication of pension fund documents on the Council's website is sometimes unclear or incomplete.</p> <p><b>Risk</b></p> <p>Member and the public would be unable to access information</p>	<p>The Pensions site should be expanded to include all current publications, as well as the minutes of sub-committee / board meetings.</p> <p><a href="#">Paragraph 64</a></p>	<p>Fife Council have introduced a new website, launched with the annual statements, all legislative documents will be maintained by Hymans and Fife Council will update with internal policy and procedures. Further work will be undertaken to ensure committee and board papers are also available online.</p> <p><b>Head of Revenues and Commercial Services/Head of Democratic Services</b></p> <p><b>Ongoing</b></p>
5	<p><b>Cyber-essentials</b></p> <p>The Altair pensions system is hosted externally and is a very significant system.</p> <p><b>Risk</b></p> <p>Controls required by the Cyber Essentials standard do not apply further along the supply chain.</p>	<p>We recommend the Fund encourages the supplier of Altair to adopt the Cyber Essentials standard.</p> <p><a href="#">Paragraph 79</a></p>	<p>Fife Council will raise this with Heywoods as a matter of urgency and also raise through the Scottish LGPS group all of whom use Altaire.</p> <p><b>Head of Revenues and Commercial Services</b></p> <p><b>March 2019</b></p>





No.	Issue/risk	Recommendation	Agreed management action/timing
<b>Follow up of prior year recommendations</b>			
b/f	<p><b>1. Advertisement of the draft accounts</b></p> <p>The Local Authority Accounts (Scotland) regulations 2014 make various requirements for the advertisement of accounts and accounting records.</p> <p>This year, there were two deficiencies; the name of the appointed auditor was omitted, and the Council undertook to make working papers available for 13 working days, instead of the statutory 15.</p>	<p>The name of the appointed auditor should be taken from the Annual Audit Plan.</p> <p>The period over which working papers are available to the public should be 15 days and should not include weekends and holidays.</p>	<p><b>Complete</b></p> <p>The advert this year addressed the issues raised last year.</p>
b/f	<p><b>2. Disclosure of derivatives</b></p> <p>Historically derivatives have been disclosed on the net assets statement as if futures contracts had been settled and cancelled. This is incorrect under the Code.</p>	<p>The profit or loss on derivative transactions at the year-end should be used as the basis for disclosing derivative assets and liabilities. A fuller explanation of the notional values and reasons for the contracts should be given in the notes.</p> <p>Financial Statements were amended to correct and comply with the Code last year.</p>	<p><b>Complete</b></p> <p>In 2017/18, management asked the global custodian to prepare a Code-compliant analysis of derivative transactions.</p> <p>This year's financial statements included the correct disclosures.</p>
b/f	<p><b>3. Asset allocation benchmark</b></p> <p>The Statement of Investment Principles specifies a target asset allocation for investments. We have noted actual holdings are out of line with the benchmark and that cash and venture capital are treated as identical asset classes.</p> <p><b>Risk</b></p> <p>That actual holdings do not reflect SIP benchmarks.</p>	<p>The SIP should review its benchmark allocations including the level of cash proposed for the coming year.</p>	<p><b>Ongoing</b></p> <p>Asset allocations against target and the level of cash were reported to the sub-committee in August 2018.</p> <p>A joint review of investment strategy with collaborating funds has started.</p>
b/f	<p><b>4. Sub-committee remit - Governance</b></p> <p>The agenda for sub-committee and board meetings include items which are the responsibility of the Council, while excluding aspects of governance that should relate to the pension fund.</p>	<p>The sub-committee should review its remit.</p>	<p><b>Ongoing</b></p> <p>Some minor amendments were made to the sub-committee's remit during the year, but these did not fully address the risks raised.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p><b>Risk</b></p> <p>Members are not aware of, or do not have an opportunity to consider, significant areas of governance and compliance, relating to the pension fund.</p>		<p>See 2017/18 point 3 above</p>
b/f	<p><b>5. Sub-committee remit – Administration</b></p> <p>The sub-committee do not receive information to enable them to monitor the membership of the scheme and compliance with administration targets.</p> <p><b>Risk</b></p> <p>Members are not informed about trends in administrative performance which may lead to breaches of pensions' regulations.</p>	<p>The remit of the sub-committee should reflect the importance of pensions' administration and performance monitoring.</p>	<p><b>Complete</b></p> <p>The sub-committee has agreed to take papers on administration quarterly and received the first report in August 2018.</p> <p><b>Complete</b></p>
b/f	<p><b>6. Transparency – Web-site</b></p> <p>The publication of pension fund documents on the Council's website is sometimes unclear or incomplete.</p> <p><b>Risk</b></p> <p>Member and the public would be unable to access information</p>	<p>The Pensions site should be expanded to include all current publications, as well as the minutes of sub-committee / board meetings.</p>	<p><b>Ongoing</b></p> <p>This action is still a work in progress.</p> <p><b>See 2017/18 point 4 above</b></p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of significant journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>We reviewed all ledger transactions using data analytics.</p> <p>We confirmed the validity of selected journals posted in the year and established the extent and nature of routine journal processing.</p> <p>We confirmed that estimates are supported by third party evidence.</p> <p>Our testing of accruals and prepayments revealed no material errors.</p> <p>We considered no transactions to be outside the normal course of business.</p> <p>There was no evidence for management override of controls.</p>
<p><b>2 Risk of fraud over income and expenditure</b></p> <p>ISA 240 presumes a risk of fraud over income; this is expanded to include the risk of fraud over expenditure in the public sector by the Code of Audit Practice and the Financial Reporting Council's Practice Note 10 (revised).</p> <p>The Fife Pension Fund receives a significant amount of income from third party sources. This presents a risk due to the extent and complexity of income.</p> <p>The Pension Fund also makes a high volume of payments, including high value payments, which can constitute a risk of misstatement of expenditure.</p>	<p>Analytical procedures on income and expenditure streams.</p> <p>Evaluation of the effectiveness of systems for recording income due from employers.</p> <p>Agree income to third party confirmation.</p> <p>Substantive testing of expenditure.</p> <p>Conduct a review of fund manager service auditor reports providers, where relied upon by management, in accordance with ISA402.</p> <p>Liaise with Internal Audit to evaluate outcomes of the 2017 National Fraud Investigation.</p>	<p>The movement of significant items of income and expenditure was consistent with changes in staff numbers, pay rates and contribution rates.</p> <p>Notwithstanding the roll-out of i-Connect, well-established controls over recording income remained in place, including employer reconciliations and certification.</p> <p>Our testing of expenditure revealed no material errors.</p> <p>The review of fund manager service auditor reports highlighted one qualified report, which we brought to the attention of management. We considered the issue raised to be a leading indicator of possible problems</p>

Audit risk	Assurance procedure	Results and conclusions
		<p>rather than a source of material error this year.</p> <p>NFI work found there was minimal risk to the Fund.</p> <p>We found no evidence for fraud over income or expenditure.</p>
<p><b>3 Estimation and judgements</b></p> <p>There are two areas with a significant degree of subjectivity:</p> <ul style="list-style-type: none"> <li>the measurement and valuation of investments;</li> <li>the actuarial valuation.</li> </ul> <p>Investments include unquoted property investment companies where valuations use techniques that require significant judgement in determining appropriate assumptions. The actuarial valuation depends on several assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Completion of 'review of work by service auditors' in accordance with ISA402, for significant unquoted investments.</p> <p>Confirm valuations to valuation reports and/or other supporting documentation.</p> <p>Completion of 'review of the work of an expert' in accordance with ISA500, for the work of the actuary.</p> <p>Consideration of the report by PwC in their capacity as consulting actuary to Audit Scotland on actuarial assumptions in use in 2017/18</p> <p>Consideration of GAD reports under Section 13 of the Local Government Pension Scheme (Scotland) of LGPS Scotland funding valuations and employer contribution rates. (see below)</p>	<p>Our review of service auditor reports helped establish the validity of valuation arrangements.</p> <p>Pooled fund valuations were confirmed by reference to underlying investments where possible, with an emphasis on rates of return.</p> <p>We reviewed the work of the actuary and the actuarial assumptions, with reference to the PwC report and to papers prepared as part of the triennial review.</p> <p>The GAD report on fund health for 2017/18 was not available at the time of our audit.</p> <p>We concluded that figures in the accounts that are subject to estimates and judgements are fairly stated within the bounds of the sensitivities quoted in the accounts.</p>

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice











<p><b>4 Financial sustainability</b></p> <p>Historic funding levels in the Pension Fund have led to deficit recovery payments over several years by member bodies (including Fife Council).</p> <p>In recent years lower returns in the bond market have led to reductions in the discount factor used to value future liabilities. This has increased actuaries' assessments of the value of future liabilities, although this has been partly offset by improved market returns on investments.</p> <p>The triennial valuation of the pension fund can have a significant impact on the financial position of the fund and of its member bodies and there is a risk that the 2017</p>	<p>Consideration of the findings of the 2017 Actuarial Valuation alongside the GAD report, if it is available in time for our Annual Audit Report.</p>	<p>The GAD report on fund health for 2017/18 was not available at the time of our audit.</p> <p>The triennial review showed that some prior assumptions had proved pessimistic, and investment growth was stronger than expected.</p> <p>The triennial review uses a discount rate which is around 1 per cent point lower than it needs to be to give a 50:50 chance of outperforming the investment growth target, which means there is a significant measure of prudence in the valuation.</p>
---	--	--

Audit risk	Assurance procedure	Results and conclusions
<p>valuation will cause organisations to re-assess the financial sustainability of membership.</p>		
<p><b>5 Financial management</b></p> <p>General reductions in staff in the finance team may reduce the quality of officer support to the sub-committee and pension board on issues such as investment advice and performance analysis and the sub-committee will need to rely increasingly on the direct interface with external experts on key policy and governance issues.</p> <p>There is a risk that this affects the effectiveness of financial management and governance as we consider that officers provide an essential role of guiding, challenging and interpreting advice and policy.</p>	<p>Continue to assess the level of support provided to sub-committee and pension board whether internally or by collaboration with other elements of the LGPS.</p> <p>Review financial management reporting.</p>	<p>We noted the agreement to form a Joint Investment Strategy Panel with Lothian and Falkirk Pension Funds, and that an early priority is an investment strategy review.</p> <p>We remarked in our interim report that we found a higher incidence of minor accounting errors in the year, which may have been attributable to changes of staff responsibilities.</p> <p>However, we found very few errors in the financial statements, and none above the reporting threshold, and the earlier errors were fixed.</p> <p>We concluded that financial management arrangements strengthened over the course of the year.</p>
<p><b>6 Governance and transparency</b></p> <p>In October 2017 Fife Council, as the administering authority, revised the responsibilities of the Standards &amp; Audit Committee (governance) and the Superannuation Fund and Pensions Sub-Committee (investments). This followed concerns from Audit Scotland that the role of employer should be distinguished as far as possible from the role of pension administrator.</p> <p>Previous reporting to the Pensions sub-committee and the board has tended to concentrate on investment activity, as a result reports on issues such as administration performance and the financial statements receive a minimal level of formal review at the sub-committee and Board.</p> <p>There is a risk that the sub-committee and the pension board are not sighted on the range of activity and performance that is undertaken by the Fund.</p>	<p>Consider further recommendations for changes to governance arrangements in the year especially in member administration performance.</p>	<p>From August 2018, the sub-committee has begun to receive quarterly updates on administration performance, but we again identify a risk of some of those charged with governance not being sighted on the range of pensions issues due to the division in responsibilities between two council committees.</p>

# Appendix 3

## Summary of national performance reports 2017/18



		Apr	
		May	
Common Agricultural Policy Futures programme: further update		<b>Jun</b>	 Scotland's colleges 2017
		Jul	 NHS workforce planning
Self-directed support: 2017 progress report		<b>Aug</b>	
Equal pay in Scottish councils		<b>Sept</b>	
Transport Scotland's ferry services		<b>Oct</b>	 NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		<b>Nov</b>	
		Dec	
		Jan	
Early learning and childcare		<b>Feb</b>	
Managing the implementation of the Scotland Acts		<b>Mar</b>	

# Fife Pension Fund

## 2017/18 Annual Audit Report

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)

For the latest news, reports and updates, follow us on:



Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)