

Fife Pension Fund

2018/19 Annual Audit Report



 AUDIT SCOTLAND

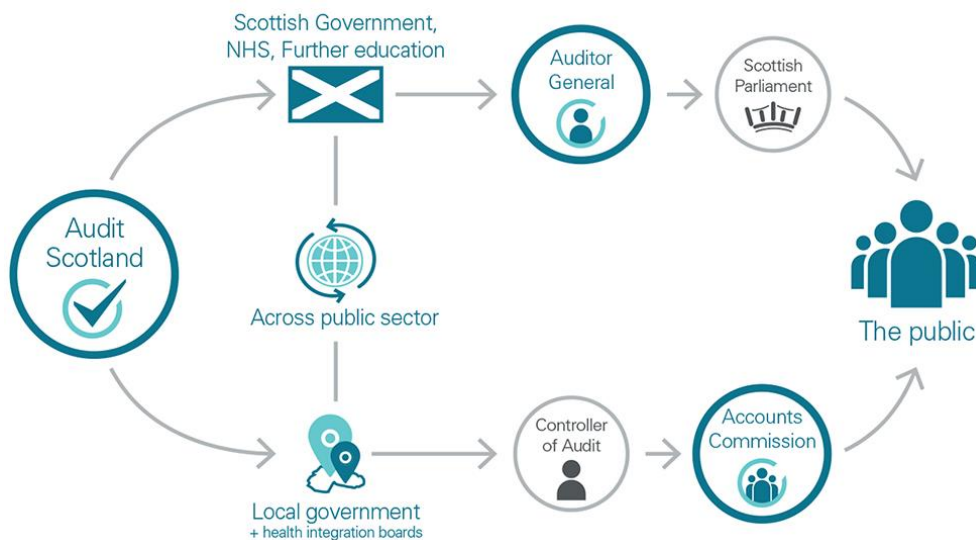
To Members of the Fife Council Standards and Audit Committee and the Controller of Audit

30 September 2019

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.

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Key messages

2018/19 annual report and accounts

- 1 Our audit opinions on the Fund's annual report and accounts were unqualified.
- 2 The present value of promised retirement benefits has increased by £18 million following decisions by the UK Supreme Court in June 2019.

Financial management and financial sustainability

- 3 Fund assets increased by £190 million but estimated liabilities (on an IAS19) basis rose by £421 million in 2018/19.
- 4 The Fund achieved a positive cashflow from dealings with members and investment performance compares favourably to other Scottish schemes with 3-year and 5-year returns outperforming their targets.
- 5 Financial management arrangements are good.
- 6 The Fund remains overweight in equities compared to its Investment Strategy.
- 7 The fund continues to be able to pay pensions out of member contributions.

Governance, transparency and value for money

- 8 Governance arrangements have been strengthened and the Pension Board and Superannuation Fund and Pensions Sub-Committee work well together.
- 9 The Fund is working collaboratively on investment with other funds. The Fund's investment performance is subject to regular review and scrutiny by the Sub-Committee.
- 10 The level of investment management fees is similar to other funds.

Introduction

1. This report is a summary of our findings arising from the 2018/19 audit of Fife Pension Fund (the Fund). The scope of our audit was set out in our Annual Audit Plan presented to the February 2019 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

2. The main elements of our audit work in 2018/19 have been:
 - a review of the Fund's main financial systems
 - an audit of the Fund's 2018/19 annual accounts including the issue of an independent auditor's report setting out our opinions
 - consideration of the four audit dimensions of public audit.

Added Value

3. We add value to the Fund through the audit by:
 - identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that have been accepted by management

- sharing intelligence and good practice through our national reports ([Appendix 4](#)) and good practice guides
 - providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.
4. 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.

Responsibilities and reporting

5. 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. During 2018/19 the Superannuation Fund and Pensions Sub-Committee was not required to review the effectiveness of internal control arrangements and approve the annual accounts; this responsibility was delegated to the Council's Standards and Audit Committee. With effect from 2019/20 the Sub-Committee will however, take responsibility for all matters relating to the Fund.
6. Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973, the Code of Audit Practice 2016, and supplementary guidance, and International Standards on Auditing in the UK. As public sector auditors we give independent opinions on the annual accounts. Additionally, we conclude on the effectiveness of the Fund's performance management arrangements, the suitability and effectiveness of corporate governance arrangements, the financial position and arrangements for securing financial sustainability. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the Code of Audit Practice 2016 and supplementary guidance.
7. 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. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.
8. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.
9. 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 therefore the 2018/19 audit fee of £34,930 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.
10. This report is addressed to both the members of the Standards and Audit Committee and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course. We would like to thank all management and staff for their cooperation and assistance during the audit.

Part 1

Audit of 2018/19 annual accounts



Main judgements

The financial statements are unqualified.

The present value of promised retirement benefits has increased by £18 million following decisions by the UK Supreme Court in June 2019.

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

The annual accounts received unqualified opinions

11. The annual accounts for the year ended 31 March 2019 were approved by the Fife Council Standards and Audit Committee on 27 September 2019. We reported, within the independent auditor's report that:
 - the financial statements give a true and fair view and were properly prepared
 - the management commentary, annual governance statement and governance compliance statement are consistent with the financial statements and properly prepared in accordance with the guidance.
12. We have nothing to report in respect of those matters which we are required by the Accounts Commission to report by exception.

No objections were received on the annual accounts

13. 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. The Fund complied with the regulations and there were no objections.

Finance staff provided good support to the audit team

14. We received the unaudited annual accounts on 27 June 2019, in line with the audit timetable set out in our 2018/19 Annual Audit Plan. The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team.

We identified and addressed risks of material misstatement

15. [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and any wider audit dimension risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance over the outcome of these risks.

Overall, we are satisfied that there are no material misstatements arising from the risks identified in our 2018/19 Annual Audit Plan.

Our materiality values were increased from our plans

- 16.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement.
- 17.** Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and is summarised in Exhibit 2. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively. On receipt of the annual accounts we reviewed our planning materiality calculations and concluded that they should be increased based on net assets. Materiality still represents 1% of the net assets of the pension fund, with performance materiality being 60% of this. Our specific transaction performance materiality in relation to contributions and benefits remained unchanged at £0.6 million.

Exhibit 2 Materiality values

| Materiality level | Amount |
|-------------------------------------|---------------|
| Overall materiality | £26 million |
| Performance materiality | £15.6 million |
| Reporting threshold on assets | £250,000 |
| Transaction performance materiality | £0.6 million |
| Reporting threshold on transactions | £25,000 |


Source : Audit Scotland


We report significant issues with the present value of promised retirement benefits following the McCloud judgement

- 18.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. The significant findings are summarised 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.

Exhibit 3

Significant findings from the audit of financial statements

| Issue | Resolution |
|---|---|
| <p>1. Present value of promised retirement benefits – McCloud</p> <p>On 27 June 2019 the Supreme Court ruled, in support of a previous Court of Appeal ruling, that the Government had discriminated against judges and firefighters on the grounds of age, race and equal pay in relation to 2015 changes to their pensions. Under the 2015 changes, older workers were protected from a downgrade in their retirement benefits.</p> <p>The ruling is likely to result in a requirement to compensate certain members for any discrimination suffered as a result of the transitional protections.</p> <p>HM Treasury (HMT) announced their intention to address the discrimination across all public sector schemes with similar protections.</p> <p>The remedy has not yet been decided, but one option would include the extension of the protection or statutory underpin to all members of the LGPS at 1 April 2012. The PV of promised retirement benefits has been recalculated on this basis.</p> <p>The actuary has also included an estimate of the increased cost of further indexation associated with guaranteed minimum pensions beyond 2021 in line with HMT policy intention.</p> | <p>This issue has been adjusted in the audited annual accounts</p> <p>The Fund revised the estimate of the present value of promised retirement benefits disclosed in note 16 to the accounts and removed the reference to a contingent liability at note 21. The estimated PV of promised retirement benefits increased by £18 million (0.5% increase in liabilities)</p> |
| <p>2. Overstatement of contribution income</p> <p>Audit testing of contributions receivable by the Fund identified £690,000 relating to teachers' contributions which had been included in error (teachers are not part of the LGPS and have their own separate pension fund).</p> | <p>This issue has been adjusted in the audited annual accounts</p> |
| <p>3. Valuation and impairment of investments at 31 March 2019</p> <p>The value of investments in the unaudited accounts was based on the latest available information from the custodian, not all of which were to 31 March 2019. As updated information became available, during our audit, we identified that this estimate was under-stated by £3.7 million.</p> | <p>No amendment has been made to the audited annual accounts</p> <p>On the basis of our audit work and audit evidence from events occurring after 31 March and up to the date of the auditor's report, we found the year end estimate of the valuations to be reasonable.</p> <p> Recommendation 1 (refer appendix 1, action plan)</p> |

| Issue | Resolution |
|---|---|
| <p>4. Impairment of investment values following liquidation</p> <p>Audit testing of investment values at 31 March found two investments with a combined value of £5.7 million had gone into liquidation. The custodian confirmed that they do not monitor these investments as this is the Fund's responsibility. It is not clear when the liquidation occurred. The Fund had not been advised of this by the Investment Fund Manager and no revaluation at 31 March 2019 or impairment had been considered.</p> | <p>No amendment has been made to the audited annual accounts. This is included as an unadjusted misstatement at Appendix 3.</p> <p> Recommendation 2 (refer appendix 1, action plan)</p> |
| <p>5. Investment management expenses</p> <p>Investment management expenses should only be grossed up for costs the Fund is contractually required to meet. Audit testing found £0.6 million expenses for indirect costs, relating to Partners Group investments, had been grossed up in error.</p> | <p>No amendment has been made to the audited annual accounts. This is included as an unadjusted misstatement at Appendix 3.</p> |

There were no material adjustments made to the audited financial statements

19. The two adjustments made to the audited financial statement were below our overall materiality levels. Amendments were made for £690,000 contribution income accrued in error and a revision of £18 million for the present value of promised retirement benefits, following the McCloud judgement.
20. In each case we considered whether further audit procedures were necessary, as the amounts exceeded our performance materialities. In the case of the McCloud judgement we requested that the Council obtain a revised IAS19 valuation from the actuary reflecting this judgement. We also encouraged group auditors to do the same for their audits. The estimate of the total effect was identified in the revised IAS 19 report. We extended our testing of contribution income and confirmed no other unfunded contributions were included in the accounts.
21. A number of individual misstatements exceeded our overall reporting thresholds. Our overall reporting threshold is £250,000 and our reporting threshold for dealings with members and employers is £25,000. Where these have not been amended, they are included as unadjusted misstatements in [Appendix 3](#). It is our responsibility to request that all misstatements above the reporting threshold are corrected.

Data analytics enhanced audit procedures

22. In 2018/19 we used data analytics in Fife Pension Fund as part of our planned audit approach. Data analytics is defined by the International Auditing and Assurance Standards Board (IAASB) as *“the science and art of discovering and analysing patterns, deviations and inconsistencies.... in the data underlying.... an auditfor the purpose of planning and performing the audit”*. Such techniques provide ways of dealing with high volumes of transactions as well as complexity. They also enhance audit quality and efficiency.
23. We obtained and analysed transactions on the general ledger in 2018/19 and the mapping of the ledger from the trial balance to the balance sheet was confirmed via 100% re-performance. We also used the investment transaction, income and valuation lists from the global custodian to inform our testing.

The Fund is making good progress in implementing prior year audit recommendations

- 24.** The Fund has made good progress in implementing our prior year audit recommendations. For actions not yet implemented, revised responses and timescales have been agreed with management and are set out in [Appendix 1](#).

Part 2

Financial management



Main judgements

Fund assets increased by £190 million but estimated liabilities (on an IAS19 basis) rose by £421 million in 2018/19.

The Fund achieved a positive cashflow from dealing with members. The investment performance compares favourably to other Scottish schemes and 3- and 5-year returns are outperforming the target.

Financial management arrangements are good.





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

Fund assets increased by £190 million but estimated liabilities (on an IAS19 basis) rose by £421 million in 2018/19

25. Pension fund finances are independently assessed every three years by an actuary. This assessment 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. This was last completed in March 2017. An interim valuation is undertaken each year end (in accordance with IAS19), but this is on a different basis to the triennial valuation.
26. [Exhibit 4 shows that](#) the net assets of the Fund increased to £2,612 million at 31 March 2019 from £2,421 million at 31 March 2018. This increase of £190 million (7.9 per cent) was due to returns on investments of £166 million, investment income of £23 million and a small surplus on dealings with members.
27. Over the same period, the Fund's Actuary, Hymans Robertson, estimated that pension liabilities (valued on an IAS 19 basis) rose from £2.983 billion at 31 March 2018 to £3.404 billion at 31 March 2019 (£421 million increase). The main cause of the increase is the actuarial discount rate used to value future liabilities, which reduced from 2.7% to 2.4%.

Exhibit 4

Assets, liabilities, funding level and investment performance

| Increase in net assets | Increase in estimated liabilities | Funding level | Investment performance |
|---|--|---|---|
|  £190 million (+7.9%) |  £421 million (+14.1%) |  81.1% 31 March 2018 Interim valuation |  7.3% Return on investments 2018/19 |
| £2,612 million Closing net assets | £3,404 million Closing liabilities | 77.1% 31 March 2019 Interim valuation | 9.6% Return on investments over 5 years |

Source: 2018/19 FPF Annual Accounts

The Fund achieved a positive cashflow from dealing with members

28. During 2018/19 contributions to the Fund were £100 million. This was greater than the benefits paid out (£87 million) and fees and overheads (£12 million). This positive cashflow from dealing with members allowed £1 million for investment.

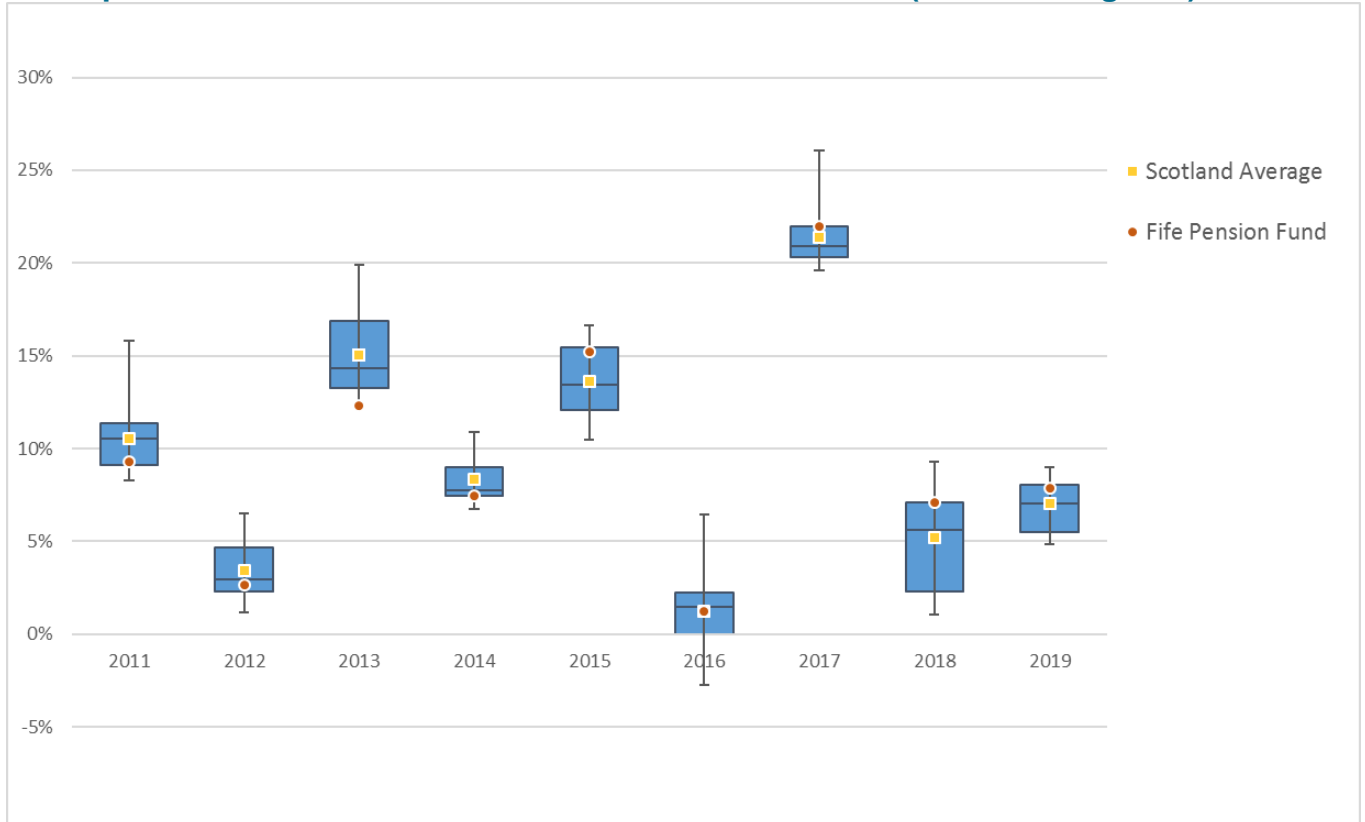
Financial management arrangements are good

29. 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.

30. It has been a relatively good year for investment performance for most LGPS pension funds across Scotland as illustrated in [Exhibit 5](#), where net assets increased by 6.6 per cent on average, compared to 7.9 per cent at Fife Pension Fund.

Exhibit 5

LGPS pension funds – annual return on net assets 2018/19 (unaudited figures)



Source: 2018/19 LGPS pension fund unaudited financial statements

Recent investment performance is behind target but 3- and 5-year returns are outperforming the target

31. In 2018/19, Fife Pension Fund achieved a 7.3 per cent return on investments ([Exhibit 6](#)). This is behind the investment target of 7.9 percent for 2018/19. Three- and five-year performance returns are 11.4 per cent and 9.2 per cent respectively, which are above target.

Exhibit 6

Return on investments against benchmark

| | 1 year | 3-year annual returns | 5-year annual returns | Since inception 30/06/2003 |
|---------------------------|--------|-----------------------|-----------------------|----------------------------|
| Fund Performance | 7.3% | 11.4% | 9.6% | 8.3% |
| Target (benchmark + 1.5%) | 7.9% | 10.2% | 9.2% | 9.5% |
| Excess over target | -0.6% | 1.2% | 0.4% | -1.2% |

Source: Northern Trust Investment Report at 31 March 2019

Foot note 1 The investment performance growth is slightly lower than the net return of 7.9% in [Exhibit 5](#) as investment performance does not include the cumulative effect of cash re-invested from income and contributions

Systems of internal control operated satisfactorily

- 32.** 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. Our objective is to gain assurance that Fife Pension Fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.
- 33.** We concluded that the financial controls put in place by management operated satisfactorily. We identified a few control weaknesses in relation to the timely completion of bank and feeder system reconciliations. We undertook additional audit procedures during our final accounts work to confirm that the internal control weaknesses identified did not result in a material misstatement in the financial statements.



Recommendation 3

All bank and feeder reconciliations should be reviewed on a timely basis to ensure they are complete and accurate.

Internal audit complies with standards

- 34.** Fife Council's Audit and Risk Management Service (ARMS) provides the Fund with independent assurance on the Fund's overall risk management, internal control and corporate governance processes. We reviewed the internal audit arrangements in accordance International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) and concluded that ARMS generally operate in accordance with the Public Sector Internal Audit Standards (PSIAS) and has appropriate documentation standards and reporting procedures in place.

Part 3

Financial sustainability



Main judgement

The fund remains overweight in equities compared to its Investment Strategy.

The Fund continues to be able to pay pensions out of member contributions.

Contributions rates have been set at 24.5 per cent for the main employer.

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.

The Fund's triennial funding position improved in 2017

35. The March 2017 triennial valuation reported that on a long-term basis, assets were sufficient to meet 93 per cent of the Fund's liabilities. This was an improvement compared with 88 per cent at the 2014 triennial valuation. The actuary estimated that for the fund's largest employer, Fife Council, there was a 66 per cent chance of meeting the funding target over 18 years.

The Fund remains overweight in equities

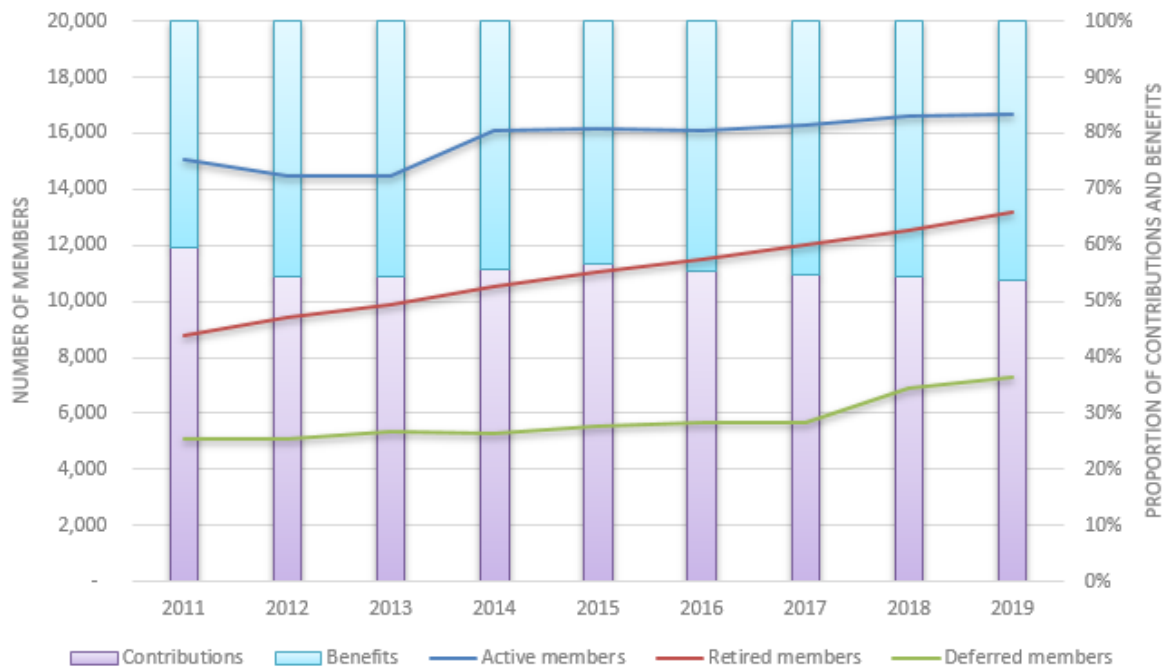
36. The new Statement of Investment Principles (SIP) identified a target allocation to equities of 50 per cent (with a maximum exposure of 65 per cent). At the 31 March 2019, 61 per cent of the Fund's assets were in equities, which is within the agreed range but above the target. This is a slight drop from the 62 per cent reported last year and we will continue to monitor the Fund's application of the SIP.

The Fund continues to be able to pay pensions out of member contributions

37. The Fund's ability to generate a positive cashflow from dealing with members is decreasing as more of the membership retires (see [Exhibit 7](#)). The number of active members has risen in recent years, largely as a result of auto enrolment, but pensioner numbers have risen faster. As the fund membership changes then the fund "matures" and is less able to pay pensions from contributions and has to resort to using investment income and eventually realising investments to meet future liabilities.

Exhibit 7

Fife Pension Fund membership and cash flow



Source: Fife Pension Fund 2018/19 unaudited financial statements

Foot note - 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.

Contributions rates have been set at 24.5 per cent for the main employer

38. 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 8](#). Fife Council is the main employer, making around 85 per cent of contributions and having a significant part of the overall deficit. The Council's pension contribution is 19.9 per cent of salaries plus a deficit funding of historic liabilities at 4.6 per cent, making a total annual contribution of 24.5 per cent of pensionable salaries. The actuary has stabilised the Council's contributions at this rate for the next two years.

Exhibit 8

Contributions in 2018/19

| | Administering authority £m | Other scheduled bodies £m | Admitted bodies £m | Total £m |
|------------------------|-------------------------------|------------------------------|-----------------------|-------------|
| Employer contributions | 64.5 | 5.0 | 6.4 | 77.9 |
| Employee contributions | 15.6 | 1.4 | 1.8 | 18.8 |
| Strain Contributions | 2.6 | 0.1 | 0.0 | 2.7 |
| Total | 82.7 | 6.5 | 8.2 | 97.4 |

Source: Fife Pension Fund 2018/19 unaudited financial statements

Part 4

Governance and transparency



Main judgements

Governance arrangements have been strengthened.

The Pension Board and Superannuation Fund and Pensions Sub-Committee work well together.

The Fund is working collaboratively on investment with other funds.

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.

Governance arrangements have been strengthened to further support good governance and accountability

39. 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.
40. There was a division of responsibility between the Superannuation Fund and Pensions Sub-Committee and the Standards and Audit Committee.
41. We have raised concerns about this mixed line of communication in previous reports highlighting the risk that those in charge of pension fund affairs may not have access to full information, particularly the Pensions Board. In June 2019, this anomaly was addressed when the Superannuation Fund and Pensions Sub-Committee became a full committee of the Council and its remit was expanded to cover audit reports and accounts. A Common Good and Trusts Investment sub-committee was also established ensuring a clearer reporting structure on investments.
42. During the year the Fund formalised arrangements for an officer's governance group, chaired by the Head of Finance and meeting on a quarterly basis. This should help ensure that governance remains strong going forward. The group has been key to strengthening risk management arrangements and ensuring that compliance with the Pension Regulator Code is assessed.

The Fund does not regularly report compliance with the Pensions Regulator Public Service Code

43. The Fund recognises and aims to comply with The Pension Regulator Code of Practice 14. A compliance exercise has been completed along with an action plan but this has yet to be reported to the Sub-Committee and Pension Board.
44. There were no breaches of regulations reported to the Pension Regulator by the Fund in 2018/19, and we are not aware of any reportable issues.

The Pension Board and Superannuation Fund and Pensions Sub-Committee work well together

45. The Fife Pension Board was established under the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 to assist the administering authority in securing compliance with the 2014 Regulations and other legislation and securing compliance with requirements imposed by the Pensions Regulator. The Sub-Committee and Fife Pension Board meet concurrently. There is a single agenda and minutes prepared for these meetings. We reviewed the work of the Pension Board during the year to confirm whether it was operating in accordance with the CIPFA guide for local pension boards. We found that:
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 require the Pension Board to meet concurrently with the pension committee but do permit the Board to meet separately with the committee's permission. Currently the Pension Board members meet before and after the sub-committee. Consideration could be given to formalising these arrangements.
 - Although the Board is aware that its remit extends to any matter concerning pensions that are deemed relevant it is not involved in setting the agenda for the sub-committee meetings and to date the Board has not considered issues or undertaken work at the request of the sub-committee. Going forward the revision to committee arrangements means that all pension fund business will go to the Superannuation Fund Committee and Pension Board.
 - During 2018/19 the Board raised a number of governance and transparency issues with the sub-committee in their role as critical friend. This included concerns over decisions taken when meetings are inquorate and the documentation of discussions at the meetings.

The Fund is working collaboratively on investment with other funds

46. During the year the Fund entered into a new collaborative arrangement with Lothian and Falkirk pension funds for the development and implementation of an investment strategy. The Fund has a new Statement of Investment Principles (SIP) and under the new arrangement officers will be supported by the Joint Investment Strategy Panel (JISP) in the implementation of the strategy. The Fund receives investment advice via the JISP and also retains an investment advisor in case any additional advice is required.

Risk management arrangements have been strengthened with the development of a risk management manual

47. A detailed fund-specific risk register covering investment, governance and administration risks was established in 2017 in accordance with The Pensions Regulator's Code of Practice and is monitored by the Pension Governance Group. In May 2019, the Superannuation Fund and Pensions Sub-Committee approved a risk management manual which set out the Fund's approach to risk management, including its policy and strategy along with full details of the risk management process.

There is reasonable progress in investigating National Fraud Initiative matches

48. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different

financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

49. NFI activity is summarised in [Exhibit 9](#). As at 5 September 17.5% of the matches had been completed and there is a commitment to complete the exercise by the end of September. The Fund's policy is to focus on high risk cases and there were 221 of identified. An update on the outcome of the NFI exercise will be provided to the Superannuation Fund and Pensions Committee once the exercise is complete.

Exhibit 9 NFI activity



543

Matches



95 (17.5%)

Completed/closed
investigations (as at 5/9/19)



10

In progress

Source: NFI secure website: www.nfi.gov.uk

There are appropriate standards of conduct for prevention and detection of fraud and error

50. We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on Fife Council's arrangements and these include the code of conduct for members and officers, a whistleblowing policy and an anti-fraud strategy. Where service organisations are used for investment management and custody of assets, the Fund makes use of controls reports and assurances from service auditors.
51. We are not aware of any specific issues we require to bring to your attention.

The Fund continues to monitor the risks identified relating to EU withdrawal

52. There remains significant uncertainty surrounding the UK's withdrawal from the European Union (EU). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:
- Workforce – the extent to which potential changes to migration are likely to affect the availability of the people and skills needed to deliver services.
 - Funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports.
 - Regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.
53. The main implications for the Fund relate to investment market volatility, longer term domestic growth outlook and financial regulation. The potential impact of Brexit is monitored on a quarterly basis by the Joint Investment Strategy Panel (JISP). The Fund also relies on the preparation actions taken by Fife Council.

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.

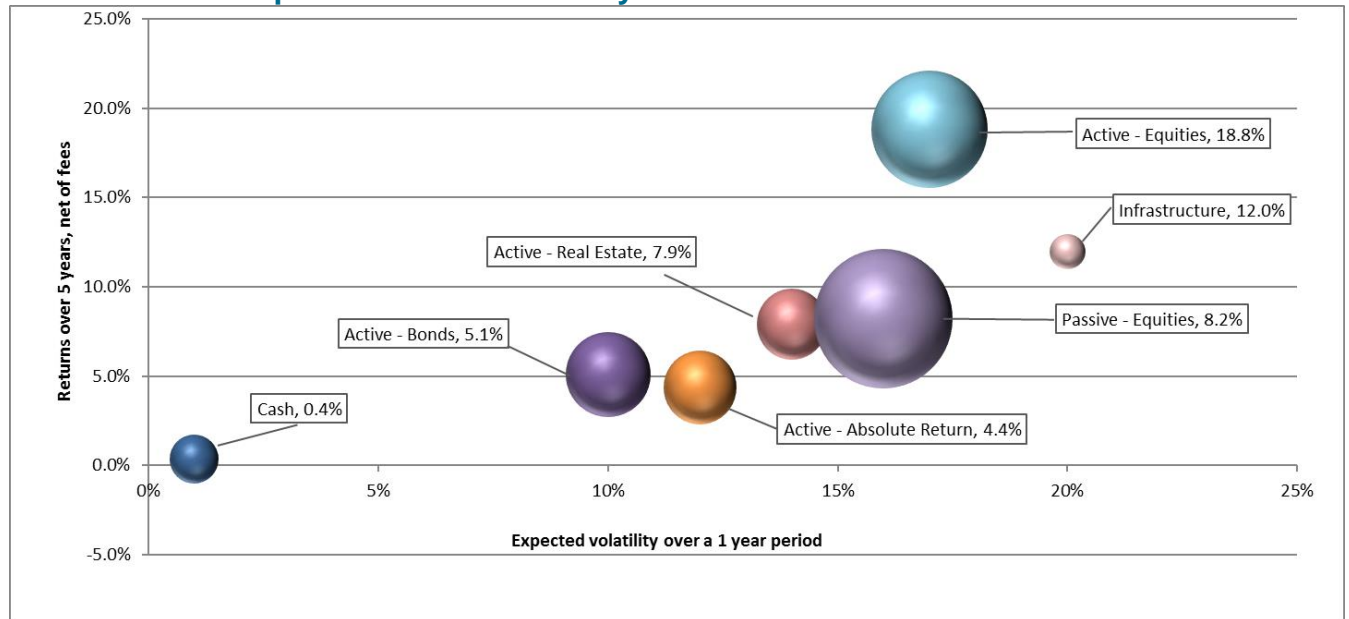
The level of investment management fees is similar to other funds

Value for money is concerned with using resources effectively and continually improving services.

Investment performance is monitored by committee

54. 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.
55. The remit of the sub-committee changed following the collaboration with Lothian and Falkirk pension funds on investment management via the Joint Investment Strategy Panel (JISP). Investment strategy is still the responsibility of the sub-committee, but implementation is now delegated to the Head of Finance, with the support of the JISP.
56. The Fund has 11 investment mandates, managed by 9 Investment managers with significant mandates in equities. During the year an additional allocation of £50m was made to Baillie Gifford's Diversified Growth Fund (absolute return).
57. [Exhibit 10](#) shows investment performance by asset group over the last 5 years and volatility (risk) of the asset group. The size of each bubble represents the relative size of investment in each asset category. Return from active equities was 18.8% over the last 5 years above the benchmark of 14.8%.

Exhibit 10 Fund investment performance over five years



Source: Fife Pension Fund – Northern Trust annual performance summary 2019

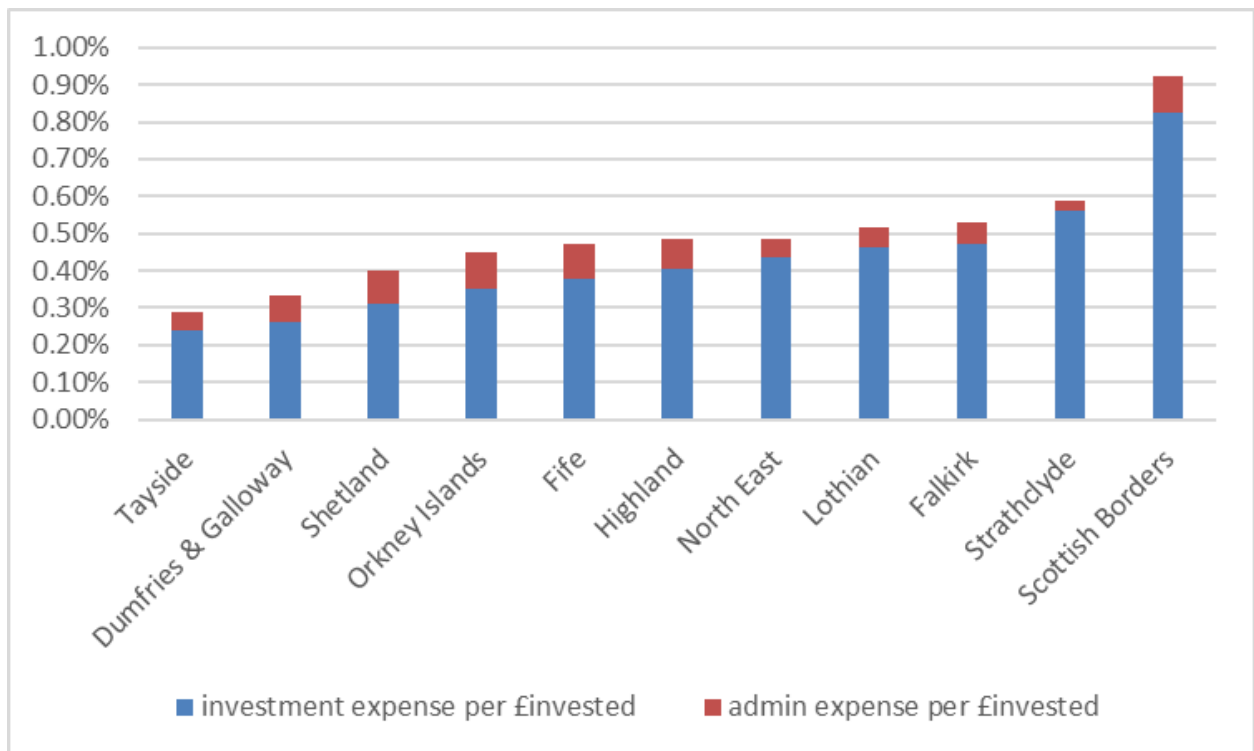
- 58.** Equities continue to be a major contributor to the fund’s overall performance. The challenge facing the Fund is how to move out of growth assets like equities and into more defensive assets or alternative assets (such as infrastructure) in line with the investment strategy at a time when bond yields are low and the availability of alternative assets may be limited.

The level of investment management fees is similar to other funds

- 59.** 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.
- 60.** CIPFA published revised guidance on local government pension scheme management expenses (LGPS). 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. The reporting of investment management fees has improved, and a clearer picture is beginning to emerge across the LGPS. Although fees and expenses incurred within a pooled investment vehicle (where the vehicle invests in other pooled funds) will not be shown. Fife Pension Fund invests in a mix of passive funds with low fees and active ones whose level of fees is higher and varies according to performance. Note 9 and 9a in the financial statements identify that total management expenses for Fife Pension Fund were £11.9 million in 2018/19, with investment management expenses making up £9.5 million of this total. The cost of investment and administration represents 0.47 per cent of the average fund investments. Fife Pension Fund is ranked 5th lowest of the eleven LGPS funds in 2019/20 on this measure.

Exhibit 11

Investment and administrative costs compare to average investment values for each LGPS Fund 2018/19



Source: 2018/19 LGPS pension fund unaudited financial statements

61. Now that the additional information on the cost of LGPS investment management services is available, the Fund should continue to review the level of management expenses. This includes the development of benchmarking information and in the context of returns achieved, ensure that value for money is being secured.



Recommendation 4

As investment cost transparency frameworks develop the Fund should keep management costs under review to ensure value for money.

The review of the structure of the Scottish Local Government Pension Scheme is ongoing

62. The Scottish Scheme Advisory Board (SSAB) is undertaking a review of the future structure of the Local Government Pension Scheme in Scotland and have identified four potential options:
- Option 1: retain the current structure of eleven funds
 - Option 2: promote cooperation in investment and administration between the eleven funds
 - Option 3: pool investments between the eleven funds, or
 - Option 4: merge the eleven funds into one or more funds.

63. The SSAB commissioned the Pensions Institute to consult with a range of stakeholders, including employers and employee representative groups between June and December 2018. Fife Pension Fund's response to the consultation stated that the Fund's preference was option 2.
64. The outcome of this first phase of the structural review was considered by the SSAB on 24 April 2019 and it is likely that further research will be commissioned before any decision is reached.

Relevant national performance audit reports have been considered by the Standards and Audit Committee

65. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2018/19, we published reports which might be of direct interest to the Fund. These are outlined in [Appendix 4](#) accompanying this report.
66. Some of these reports appear in the papers considered by the Standards and Audit Committee.

Appendix 1

Action plan 2018/19

| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-----|--|---|---|
| 1 | <p>Valuation of investments</p> <p>Audit testing of valuation dates for level 3 investments found a number had not been updated to 31 March 2019 values. This resulted in investments being understated by £3.7 million. Although the year end estimate was reasonable, this may not always be the case.</p> <p>Risk: That future estimated valuations for level 3 investments are materially incorrect.</p> | <p>Up to date valuations for level 3 investments should be obtained as a routine part of closedown procedures and amendments made to the unaudited accounts where valuations differ materially.</p> | <p>Closure of Accounts procedures will be updated to include; requesting Level 3 investment valuations, Review of these valuations and the appropriate accounting entries will be processed if required.</p> <p>Finance Operations Manager</p> <p>31 March 2020</p> |
| 2 | <p>Impairment of investment valuations</p> <p>The Fund had not been notified that two level 3 investments with a value of £5.7 million had gone into liquidation. No impairment had been undertaken as a result.</p> <p>Risk: Impairments could become material to the accounts if not routinely identified.</p> | <p>Investment fund managers should be required to notify the Fund when investments go into liquidation and an impairment review should be undertaken as a routine part of the annual accounts closedown procedures.</p> | <p>Closure of Accounts procedures will be updated to include requesting information from Fund Managers on the liquidity of investments. The procedure will reflect a review of this information and the appropriate accounting entries will be processed.</p> <p>Discussion will also take place with the Custodian.</p> <p>Finance Operations Manager</p> <p>31 March 2020</p> |



| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-----|--|---|---|
| 3 | <p>Bank and feeder system reconciliations</p> <p>We tested a sample of bank (11) and feeder (3) reconciliations and found that a third had not been subject to supervisory checks by a second officer.</p> <p>Risk: Fraudulent or erroneous entries may not be detected.</p> | <p>All bank and feeder reconciliations should be reviewed on a timely basis to ensure they are complete and accurate.</p> <p>Paragraph 33</p> | <p>An agreed timetable will be implemented to ensure bank reconciliations are checked by a supervisor on a timely basis.</p> <p>Service Manager, Shared Services Centre</p> <p>30th September 2019</p> |
| 4 | <p>Management expenses</p> <p>CIPFA guidance on investment management costs recommends that only expenses that can be directly controlled by the Fund should be included. This transparency is not yet fully developed across the LGPF.</p> <p>Risk: Indirect investment management costs are charged to the Fund.</p> | <p>As investment cost transparency frameworks develop the Fund should keep management costs under review to ensure value for money.</p> <p>Paragraph 61</p> | <p>A review of the classification of expenses will be undertaken.</p> <p>Further work on cost transparency will be progressed in terms of CEM Benchmarking and development of Cost Transparency templates in conjunction with other funds.</p> <p>Head of Finance</p> <p>31 March 2020 – review of disclosure arrangements</p> <p>Ongoing – Cost Transparency.</p> |

Follow up of prior year recommendations

| | | | |
|-------|------------------------------------|--|---|
| b/f 1 | Membership reporting | <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>Completed</p> <p>The 2018/19 annual report and accounts clearly states at Note 1 that the details of membership relate to roles and not individuals. From 2019/20 this will show the number of individuals.</p> |
| b/f 2 | Monitoring impact of Brexit | <p>The Fund should review its asset allocation more frequently than usual during the period of uncertainty.</p> | <p>On-going</p> <p>The potential impact of Brexit is monitored on a quarterly basis by the Joint Investment Strategy Panel (JISP). The Fund also relies on the</p> |

| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-------|---|---|---|
| | | | preparation actions taken by Fife Council. |
| b/f 3 | Sub-committee remit - Governance | The sub-committee should review its remit. | <p>Completed</p> <p>In June 2019 the Council agreed to amend the remit of the Superannuation Fund and Pensions Sub-Committee. This will now be a full Committee and will take responsibility for all things pension related including audit reports and accounts.</p> |
| b/f 4 | Transparency – Web-site | The Pensions site should be expanded to include all current publications, as well as the minutes of sub-committee / board meetings. | <p>Completed</p> <p>A new FPF website was launched in 2018/19. The site is maintained by Hymans Robertson who update the site with rules and regulations etc. The FPF Pensions Team are responsible for updating with Fund specific publications including annual accounts. Sub-Committee papers are held on the Fife Council website and a link to this is included.</p> |
| b/f 5 | Cyber-essentials | We recommend the Fund encourages the supplier of Altair to adopt the Cyber Essentials standard. | <p>On-going</p> <p>The Heywood system is being reviewed and is likely to be replaced via a joint procurement exercise with Lothian Pension Fund on behalf of all the LGPS pension funds within Scotland. The Invitation to Tender template and data processing agreement for new contracts makes reference to notification, technical standards and ongoing review of security arrangements. This will be reviewed</p> |

**No.****Issue/risk****Recommendation****Agreed
management
action/timing**

further as part of the Council's review of the Scottish Government Public Sector Action Plan on Cyber Resilience, in relation to supply chain management.

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 |
|--|---|--|
| Risks of material misstatement in the financial statements | | |
| <p>1 Risk of management override of controls</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> | <ul style="list-style-type: none"> • Data analytics risk assessment of ledger transactions (including journals) and testing of these • Review of accounting estimates. • Focused testing of accruals and prepayments. • Evaluation of significant transactions that are outside the normal course of business. | <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 of management override of controls.</p> |
| <p>2 Risk of fraud over income and expenditure</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 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 Fund also makes a high volume of payments, including high value payments, which</p> | <ul style="list-style-type: none"> • Review of custodian arrangements and completion of 'review of work by service auditors' in accordance with ISA 402 for the global custodian. • Analytical procedures on income and expenditure streams, including investigating deviations from the expected pattern of contributions. • Agree income to third party confirmation. • Substantive testing of expenditure. • Evaluation of progress in relation to the 2018/19 National Fraud Initiative. | <p>The movement of significant items of income and expenditure was consistent with changes in staff numbers, pay rates and contribution rates.</p> <p>Our testing of expenditure revealed no material errors.</p> <p>The review of fund manager service auditor reports highlighted two qualified reports, which we brought to the attention of management. We do not consider the issues raised indicate material error.</p> <p>Reasonable progress has been made on NFI matches.</p> <p>We found no evidence of fraud over income or expenditure.</p> |

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|--|
| <p>can constitute a risk of misstatement of expenditure.</p> | <ul style="list-style-type: none"> Review of internal audit report on pension contributions and 2017/18 report on pension payments. | |
| <p>3 Estimation and judgements</p> <p>There is a significant degree of subjectivity in the measurement and valuation of investments and the actuarial valuation.</p> <p>Investments include level 3 investments such as unquoted property investment companies, where valuations involve the significant application of judgement in determining appropriate amounts.</p> <p>The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>This subjectivity entails a risk of misstatement in the financial statements.</p> | <ul style="list-style-type: none"> Completion of 'review of work by service auditors' in accordance with ISA 402 for the global custodian who provides estimated valuations for unquoted investments. Establishing expectations for the yield of level 2 and level 3 investments based on the yield of level 1 investments of the same asset class and following up deviations. Confirmation of valuations to valuation reports and/ or other supporting documentation. Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary. Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2018/19. | <p>Our review of service auditor reports helped establish the validity of valuation arrangements.</p> <p>A number of 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 consulting actuary report.</p> <p>We concluded that figures in the accounts that are subject to estimates and judgements are reasonably stated</p> |

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

| | | |
|---|--|--|
| <p>4 Governance and transparency – Fife Pension Board</p> <p>The Fife Pension Board was established under the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015 to assist the administering authority in securing compliance with the 2014 Regulations and other legislation and securing compliance with requirements imposed by the Pensions Regulator. The Sub-Committee and Fife Pension Board meet concurrently. There is a single agenda and minutes prepared for these meetings. A review of governance from the perspective of the Board has not been undertaken.</p> <p>There is a risk that the Pension Board is not operating in</p> | <ul style="list-style-type: none"> Review of Superannuation Fund and Pensions Sub-Committee and Fife Pension Board minutes/ papers. Attendance at Superannuation Fund and Pensions Sub-Committee and Fife Pension Board meetings. Review of the operation of the Pension Board with reference to the CIPFA guide. | <p>We reviewed the Superannuation Fund and Pensions Sub-Committee and Fife Pension Board minutes/ papers and attended several meetings throughout 2018/19.</p> <p>We reviewed the operation of the Pension Board (refer paragraph 45).</p> <p>We concluded that the Board and Committee work well together.</p> |
|---|--|--|

| Audit risk | Assurance procedure | Results and conclusions |
|---|--|---|
| <p>accordance with the CIPFA guide for local pension boards.</p> | | |
| <p>5 Financial management – EU withdrawal</p> <p>The UK is planning to leave the European Union on 29 March 2019, and this could have a significant impact on the pension fund.</p> <p>As we have not seen any supporting evidence to confirm that this risk has been considered/evaluated by officers or the sub-committee, or that appropriate action has been identified to address any risk then there is a risk that the Fund is not adequately prepared for EU withdrawal.</p> | <p>Monitor the action being taken through a review of the Joint Investment Strategy Panel minutes/ papers and obtain additional documentation / assurances as appropriate.</p> | <p>We reviewed the Joint Investment Strategy Panel minutes.</p> <p>We concluded that the Fund continues to monitor the risks identified relating to EU withdrawal.</p> |

Appendix 3

Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £250k and request they be corrected.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in [Exhibit 2](#). We are satisfied that these errors do not have a material impact on the financial statements.

| No. | Account areas | Fund Account | | Net Assets Statement | |
|----------|---------------------------------------|--------------|------------|----------------------|--------------|
| | | Dr £000 | Cr £000 | Dr £000 | Cr £000 |
| 1 | Management expenses | | 628 | | |
| | Change in market value of investments | 628 | | | |
| 2 | Contribution Income | 120 | | | |
| | Current Assets | | | | 120 |
| 3 | Investment Assets | | | | 5,700 |
| | Change in market value of investments | 5,700 | | | |
| | Net impact | 5,820 | | | 5,820 |

Notes:

1. Indirect investment management expenses grossed up in error.
2. SPA contributions accrued in error
3. Investment assets not impaired following liquidation

Appendix 4

Summary of national performance reports 2018/19

| | |  2018/19 Reports | |
|---|---|--|---|
| Local government in Scotland: Challenges and performance 2018 |  | Apr | |
| Councils' use of arm's-length organisations |  | May |  Scottish Fire and Rescue Service: an update |
| Scotland's colleges 2018 |  | Jun | |
| | | Jul |  The National Fraud Initiative in Scotland 2016/17 |
| Forth Replacement Crossing |  | Aug |  Major project and procurement lessons |
| Children and young people's mental health |  | Sept |  Superfast broadband for Scotland: further progress update |
| NHS in Scotland 2018 |  | Oct | |
| Health and social care integration: update on progress |  | Nov |  Local government in Scotland: Financial overview 2017/18 |
| | | Dec | |
| | | Jan | |
| | | Feb | |
| | | Mar |  Local government in Scotland: Challenges and performance 2019 |

Reports of relevant interest

[Local government in Scotland: Challenges and performance 2018](#) – April 2018

[Councils' use of arm's-length organisations](#) – May 2018

[Local government in Scotland: Financial overview 2017/18](#) – November 2018

[Local government in Scotland: Challenges and performance 2019](#) – March 2019

Fife Pension Fund

2018/19 Annual Audit Report

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