Fife Pension Fund

2019/20 Annual Audit Report

To the Members of Fife Superannuation Fund and Pensions Committee and the Controller of Audit

26 November 2020

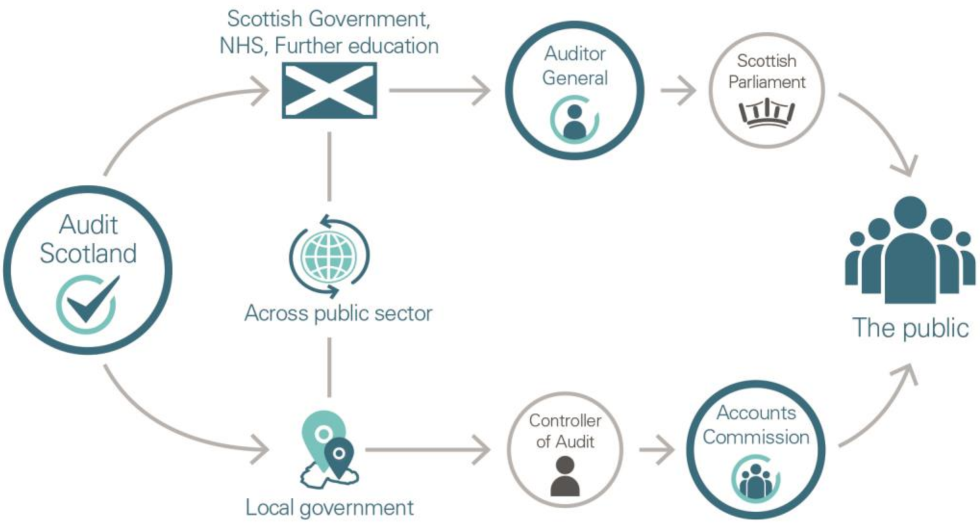
Who we are

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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2019/20 annual accounts

1 **Our audit opinions on the annual accounts are unmodified although we have included an emphasis of matter paragraph drawing the reader's attention to the material valuation uncertainty disclosure relating to level 3 investments (a sector wide issue arising as a result of Covid 19).**

Financial management and sustainability

2 **Globally, investment values were significantly affected by COVID-19 in the quarter to 31 March 2020. The fund's assets decreased by £76 million (3 per cent) over the year, but the fund still outperformed the applicable investment market benchmark and many of the other LGPS funds in Scotland.**

3 **The fund took steps to change its investment portfolio in accordance with its strategy but is still overweight in equities.**

4 **Employer contribution rates will be reviewed as part of the triennial valuation in 2020. These rates have been relatively high in recent years.**

Governance, transparency and value for money

5 **Pension fund responsibilities are now focused in one Committee of the Council. Services were maintained during COVID-19 restrictions.**

6 **Overall the fund has effective governance arrangements but there remains scope to improve the review of service organisation control reports and to better evidence review of reconciliations.**

7 **A benchmarking exercise identified that the fund's investment management expenses were lower than those of a comparison group, and that assets had lower volatility. The Joint Investment Strategy Panel arrangement has helped identify opportunities to reduce investment management expenses.**

8 **The Fund's admin and oversight costs, relative to its size, were the second highest in Scotland in 2019/20.**

Introduction

1. This report is a summary of our findings arising from the 2019/20 audit of Fife Pension Fund (the Fund).

2. The scope of our audit was set out in our Annual Audit Plan presented to the Superannuation and Pension Fund Committee on 17 March 2020. This report comprises the findings from our audit work in 2019/20 including:

- an audit of the Fund's 2019/20 annual accounts including the issue of an independent auditor's report setting out my opinions
- consideration of the wider dimensions that frame the wider scope of public audit set out in the *Code of Audit Practice 2016* (Exhibit 1.)

Exhibit 1
Audit dimensions

Source: Code of Audit Practice 2016

3. Subsequent to the publication of the Annual Audit Plan, in common with all public bodies, the Fund has had to respond to the global coronavirus pandemic. For the financial year 2019/20, only the final few weeks were affected, however the effects will have significant impact into 2020/21. We have carried out our planned audit work remotely to comply with travel restrictions and physical distancing.

Added Value

4. We add value to the Fund through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- 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.

5. 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

6. Fife Council is the administering authority for the Fife Pension Fund. The council delegates this responsibility to the Superannuation Fund and Pensions Committee (the Committee). The committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The Committee is required to review the effectiveness of internal control arrangements and for the first time in 2019-20 to approve the annual accounts of the Fund.

7. 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.

8. As public sector auditors we give independent opinions on the annual accounts. Additionally, we also conclude 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.

9. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016* and supplementary guidance.

10. 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.

11. 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 any outstanding actions from last year and progress against these.

Auditor Independence

12. Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

13. 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 2019/20 audit fee of £35,700 as set out in our Annual Audit Plan remains unchanged.

14. This report is addressed to both the members of the Superannuation Fund and Pensions Committee and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

15. We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2019/20 annual accounts

Main judgements

Our audit opinions on the annual accounts are unmodified although we have drawn attention to the material valuation uncertainty of level 3 investments (a sector wide issue arising as a result of Covid 19).

Despite the difficulties caused by COVID 19, officers produced the unaudited accounts in line with the normal timetable. The COVID-19 restrictions did however increase the time taken to complete the audit.

The annual accounts are the principal means of accounting for the stewardship of resources and performance

Our audit opinions on the annual accounts are unmodified

16. The annual accounts for the year ended 31 March 2020 were approved by the Fife Superannuation and Pension Fund Committee on 26 November 2020. We reported, within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared in accordance with guidance.

The Fund identified uncertainty in level 3 investments due to COVID-19

17. Our Independent Auditor's Report refers to the disclosure at note 13 to the annual accounts, which identifies a material valuation uncertainty in respect of level 3 investments.

18. Level 3 investments include those investments in property, infrastructure and private equity. These make up around £270m or 10.6% of the fund's total investments at 31 March 2020.

19. There is no market data to support the valuation of level 3 investments and valuations require the application of techniques and judgements, by the general partners of the investment funds in which the pension fund is invested. These valuations included material valuation uncertainty disclosures this year, due to COVID-19, which had not been picked up and referred to in the accounts as the fund manager reports had not been reviewed.

Recommendation 1

Ensure that quarterly investment manager reports are reviewed and that any valuation issues are identified as part of closedown.

Despite the challenges of Covid-19 the annual accounts were submitted for audit on time. The COVID-19 restrictions did however increase the time taken to complete the audit

20. The Scottish Government considers that provisions in Schedule 6 of the Coronavirus (Scotland) Act 2020 are sufficient to allow each local authority to determine its own revised timetable for the Annual Accounts.

21. Fife Pension Fund annual report and accounts were produced in line with normal timescales: by the 30 June 2020.

22. Staff provided working papers during the accounts closedown process for audit, and in advance of when we would normally receive them to help ensure that the audit progressed. We were able to conduct the audit remotely. In July 2020 we asked the Fund to consider a later reporting timetable for the audit this year as we considered the most realistic approach would be to work towards sign-off and publication of the accounts by 30 November 2020. In August 2020, some issues with audit testing were identified, due to COVID 19 lock down, but this didn't further affect the timetable.

23. Audit Scotland's Covid-19: Guide for audit and risk committees (August 2020) recommends that members consider whether there is sufficient capacity to deal with competing pressures, such as preparing annual accounts, at a time when working practices are having to be adapted due to Covid-19.

There were no objections to the accounts

24. 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.

Overall materiality is £25 million

25. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of any misstatement.

26. We calculate overall materiality for the financial statements based on the net assets of the fund and set a lower materiality for contributions and benefits.

27. On receipt of the unaudited annual accounts we reviewed our materiality calculations and subsequently revised our assessment of overall materiality downwards slightly (Exhibit 2).

Exhibit 2
Materiality values

Materiality level	Amount
Overall materiality	£25 million
Overall performance materiality	£15 million
Overall reporting threshold	£250,000
Specific materiality – contributions and benefits	£1 million
Specific performance materiality – contributions and benefits	£0.6m

Materiality level	Amount
Specific reporting threshold – contributions and benefits	£25,000

Appendix 2 identifies the main risks of material misstatement and our audit work to address these

28. 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 in relation to these risks.

We have a number of significant findings to report from the audit

29. 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, accounting estimates and financial statements disclosures. These significant findings are outlined in Exhibit 3.

Exhibit 3
Significant findings from the audit of financial statements

Issue	Resolution
1. Material valuation uncertainty disclosures in investment manager reports The unaudited accounts did not include any reference to the increased valuation uncertainty for level 3 investments as identified in the investment manager reports (Paragraph 17). Investment manager reports were not being reviewed at year end and compared with the values in the custodian's records. Our comparison identified that values in investment manager reports were £4.7m lower in total than the valuations in the custodian records. The difference is due to different pricing software used for level 1 investments and valuation lags in relation to some level 2 and level 3 investments where investment manager reports are not available to the custodian in time for closedown.	Additional disclosures were included in the accounts and the Management Commentary was updated to refer to the uncertainty. Recommendation 1 (refer appendix 1, action plan)
2. The Annual Governance Statement did not cover the significant changes to arrangements due to COVID 19. The unaudited annual governance statement did not include significant changes to the governance arrangements due to COVID-19 global pandemic. The Statement should include any significant issues that have arisen up to the point that the accounts are approved for signature.	The Annual Governance Statement was updated to reflect the changes to governance arising due to COVID 19. Recommendation 2 (refer appendix 1, action plan)
3. Investment fair value hierarchy £41.8m of investments had been incorrectly included as level 2 when they should have been level 3.	Following confirmation from the custodian the note to the accounts was amended. Recommendation 3 (refer appendix 1, action plan)

Issue	Resolution
The analysis of investments in line with the IFRS fair value hierarchy is based on information provided by the custodian. Our review of this classification identified a number of level 2 investments for which up to date values were not available, suggesting that the investments should more appropriately be included as level 3 investments.	
4. Impairment of investments £5.7m of investments remain in the accounts which were impaired by the Investment manager a number of years ago on the basis of stale pricing.	The accounts remain unadjusted on the basis that the error is not material. Recommendation 1 (refer appendix 1, action plan)
5. Investment management expenses Investment management expenses of around £0.446m were notified to the fund after the accounts had been closed down and were not therefore grossed up the accounts. There is no impact on the bottom line as income and expenditure are affected.	The accounts remain unadjusted on the basis that the error is not material. Recommendation 4 (refer appendix 1, action plan)
6. Present value of promised retirement benefits During the audit the remedy relating to the McCloud ruling and the extension of the statutory underpin became clearer. A revised report was obtained from the fund's actuary showing that present value of promised retirement benefits had fallen by £9m as a result.	The accounts were amended.

Identified misstatements of £5.7 million remain unadjusted in the accounts, these are less than our performance materiality and we did not need to further revise our audit approach

30. Total misstatements identified were £5.7m million (Appendix 3). These mainly consist of investments which have not been impaired. We have concluded that the misstatements identified arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. Management have not adjusted for the items in Appendix 3, on the basis of materiality.

A number of the recommendations we made last year have not been implemented

31. The Fund has made limited progress in implementing our prior year audit recommendations due to disruption caused by the COVID 19. 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

Globally, investment values were significantly affected by COVID-19 in the quarter to 31 March 2020. The fund's assets decreased by £76 million (3 per cent) over the year, but the fund still outperformed the applicable investment market benchmark and many of the LGPS funds in Scotland

Estimated pension liabilities fell by 10 per cent, due to revised actuarial assumptions for life expectancy and the discount rate.

Financial management arrangements are appropriate and effective.

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

The fund's assets decreased by £76 million (- 3 per cent) with estimated (IAS19) liabilities falling too, by £347 million, in 2019/20

32. The Fund's performance in 2019/20 is summarised in Exhibit 4.

Exhibit 4
Key statistics

Decrease in net assets	Decrease in liabilities	Improved funding level (IAS19)	Investment performance
£2.536 billion	**£3.048 billion**	**83%**	**-3.32%**
Closing net assets at 31 March 2020	Estimated value retirement benefits at 31 March 2020	Net assets vs promised retirement benefits 31 March 2020	Return on investments 2019/20
(- 3%)	**(-10%)**	**(+ 6 %)**	
£2.612 billion	**£3.404 billion**	**77.1%**	**6.01%**
Opening net assets at 1 April 2019	Opening PV or promised retirement benefits	Opening net assets as a proportion of promised retirement benefits	Annualised returns over 5 years

Source: Annual report and Accounts 2019-20

Globally, investment values were significantly affected by COVID-19 in the quarter to 31 March 2020

33. Despite strong investment performance to 31 December 2019, at which point investment values were up 9 per cent, the fund finished the year down 3 per cent in overall terms (Exhibit 4). The global impact of COVID-19 pandemic eliminated investment gains in the first three quarters and increased market volatility.

Fife pension fund still outperformed the applicable investment market benchmark and a number of the LGPS funds in Scotland

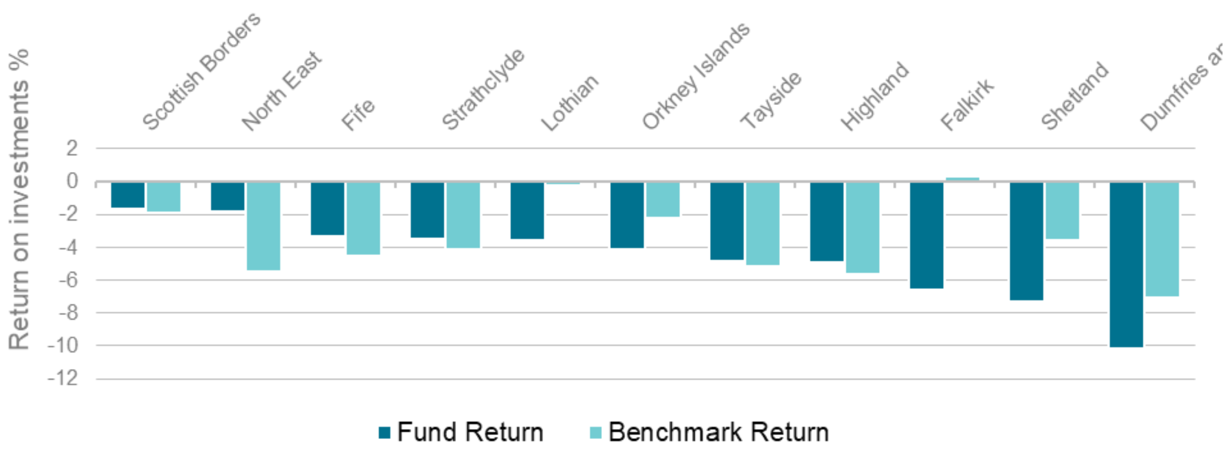
34. Fife Pension Fund delivered an annual investment return of -3 per cent. This was better than its benchmark target for the whole fund of -4.53 per cent (based on weighted benchmark for each mandate in the fund plus 1.5 percent).

35. This outturn was better than many LGPS funds, with only 5 of the other 10 funds achieving their annual benchmark / target Exhibit 5.

Exhibit 5

LGPS pension funds – Net return on investment 2019/20 (unaudited figures)

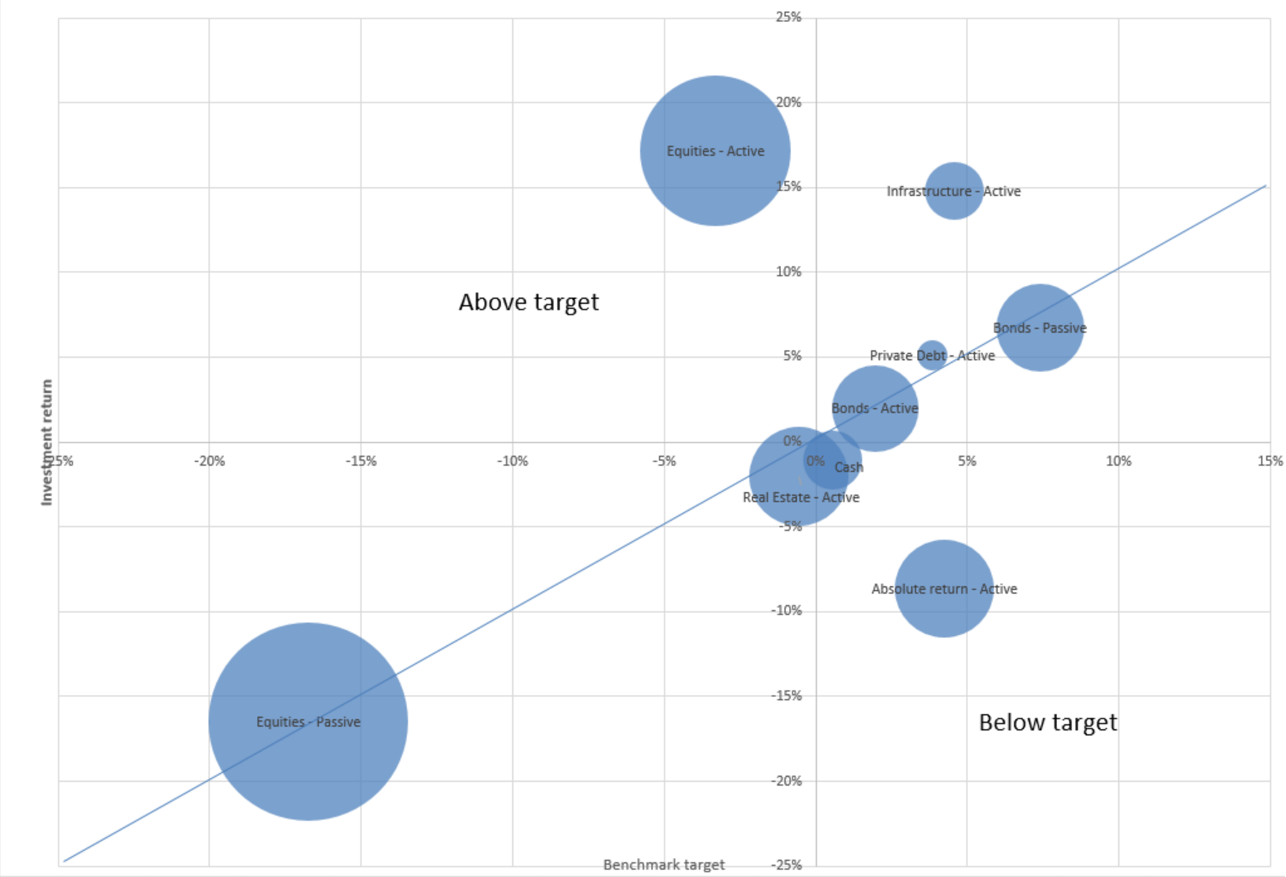
Fife fared better than many funds in Scotland and finished the year ahead of its own benchmark.



Source: Unaudited financial statements 2019-20

36. Fife's return on investments was buoyed by the performance of its Long Term Global Growth Equity mandate which returned 17% on the year. Many mandates finished the year below target. The relative performance of the fund's investment mandates is shown at Exhibit 6.

Exhibit 6
Investment returns and targets by fund manager 2019/20



Source: Fife Pension Fund records and reports

38. Passively managed mandates will generally perform in line with their benchmark and target whilst actively managed funds have targets in excess of defined market averages. Benchmarks are set and agreed with investment managers.

Estimated pension liabilities reduced due to revised assumptions

39. The present value of promised retirement benefits at 31 March 2020 (based on IAS 19) has fallen to £3.1 billion from £3.4 billion last year. This is mainly as a result of a higher net discount rate (discount rate less CPI) and reduced longevity assumptions used by the actuary to calculate the present value of promised retirement benefits. The main actuarial assumptions are shown at Exhibit 7.

Exhibit 7
Main actuarial assumptions

	2018/19	2019/20	Difference
Pension Increase Rate (CPI)	2.5%	1.9%	-0.6 ppt
Discount Rate	2.4%	2.3%	-0.1 ppt
Salary Increase Rate	3%	2.3%	-0.7 ppt

	2018/19	2019/20	Difference
Current pensioner longevity – male - years	21.2	20.5	-0.7 years
Current pensioner longevity – female - years	23.8	23.0	-0.8 years
Future pensioner longevity – male - years	22.6	21.6	-1.0 years
Future pensioner longevity – female - years	25.8	24.6	-1.2 years

40. The actuary is currently working on the formal funding valuation for 31 March 2020 which will set employer contribution rates for the next 3 years.

Financial management arrangements are appropriate and effective

41. The Executive Director of Financial 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 Fund. We consider these to be comprehensive, and current, and promote good financial management.

42. Investment and administration performance reports are submitted to the Superannuation Fund and Pensions Committee on a quarterly basis. Through, our attendance at the Pension Fund Committee we have observed a good level of review and scrutiny by members.

Financial systems of internal control operated effectively

43. 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. 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.

44. We concluded that the key controls were operating effectively. However, we again noted that review of bank and feeder system reconciliations was not always evidenced (Appendix 1

Standards of conduct and arrangements for prevention and detection of fraud and error were appropriate

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

46. The ongoing 2018-19 NFI exercise has identified a number of overpayments that have arisen as a result of pensioner deaths not being notified to the pension fund. The Pension fund has recently subscribed to a 6 monthly mortality screening service to help prevent unrecoverable overpayments building up in future.

47. We have concluded that appropriate arrangements are in place.

Part 3

Financial sustainability

Main judgement

The fund took steps to change its investment portfolio in accordance with its strategy, but remained overweight in equities.

Employer contribution rates will be reviewed as part of the triennial valuation in 2020. These rates have been relatively high in recent years.

The Government Actuary's Department review did not identify any issues in Fife Pension Fund.

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 took steps to change its investment portfolio in accordance with its strategy, but is still overweight in equities

48. In previous years we have commented that the fund's investment in equities is above its target allocation of 50 per cent. Some steps were taken by the Fund this year to implement the fund's investment strategy, with new allocations of £40 million to private debt and infrastructure, and over £200 million switched between equity managers and into a new global low volatility equity mandate. However, assets allocated to equity still remained towards the top of the strategy range, at around 63% of total investments.

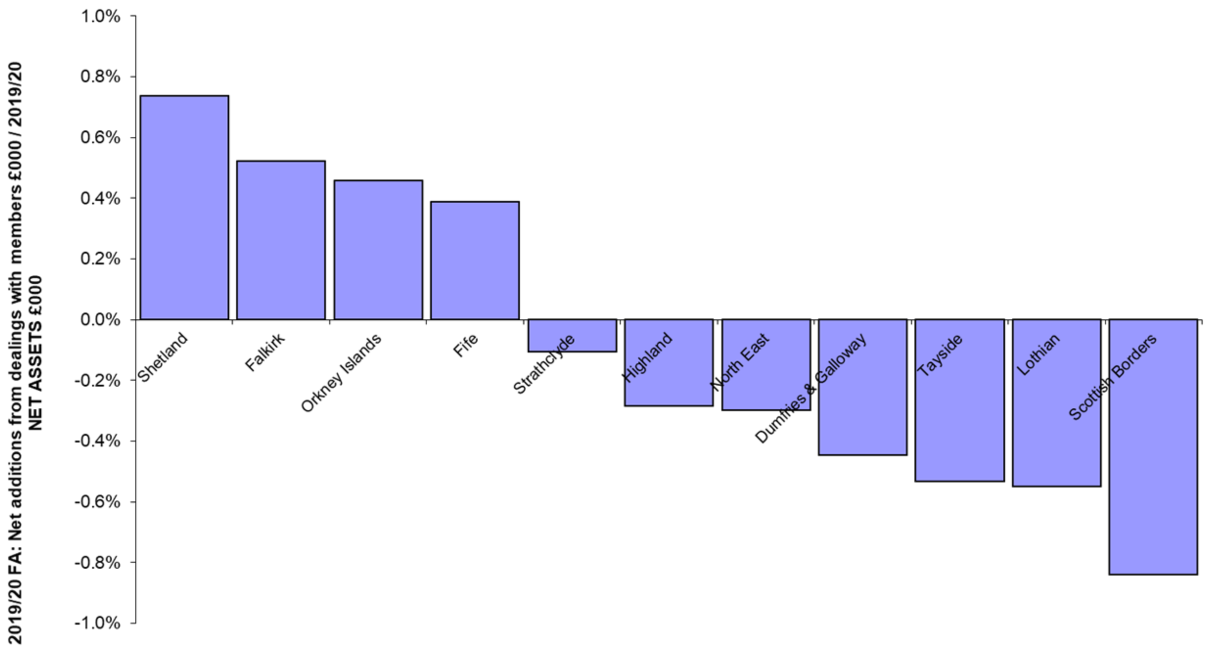
The fund continues to be able to pay pensions out of member contributions

49. The number of pensioner members of the fund increased again in 2019/20 and benefit payments increased by more than contribution income. However, the fund continues to receive more income from contributions than it pays out in pensions each year as shown in Exhibit 8.

Exhibit 8

Net cashflow from dealing with members as a proportion of net assets

Fife continues to receive more contributions than it pays out in pensions



Source: Unaudited financial statements 2019-20

50. The trend in recent years has been for LGPS pension funds to receive less from contributions and pay more in pensions. All funds are currently forecast to become cash flow negative at some point. In the longer run the cash flow position will impact on investment strategy: as income from investments will be needed to pay pensions. There is no significant impact on the fund's strategy at this time.

Fife council is by far the largest employer in the fund which reduces exposure to employer default

51. A key risk to pension funds is employer solvency. If an employer has a funding deficit then this can expose other employers in the scheme to a risk of employer default. Fife Pension Fund is less exposed to employer default risks than many LGPS schemes, as the council is by far the largest employer. Exhibit 9 shows contribution income for 2019-20.

Exhibit 9
Contribution income 2019-20
Around 85% of contribution income comes from Fife Council

	Fife Council £m	Other bodies £m	Total £m
Employer contributions	67.357	11.433	78.790
Employee contributions	16.270	3.148	19.418
Strain Contributions	1.972	0.160	2.132
Total	**85.599**	14.741	100.340

Source: Financial statements 2019-20 and supporting records

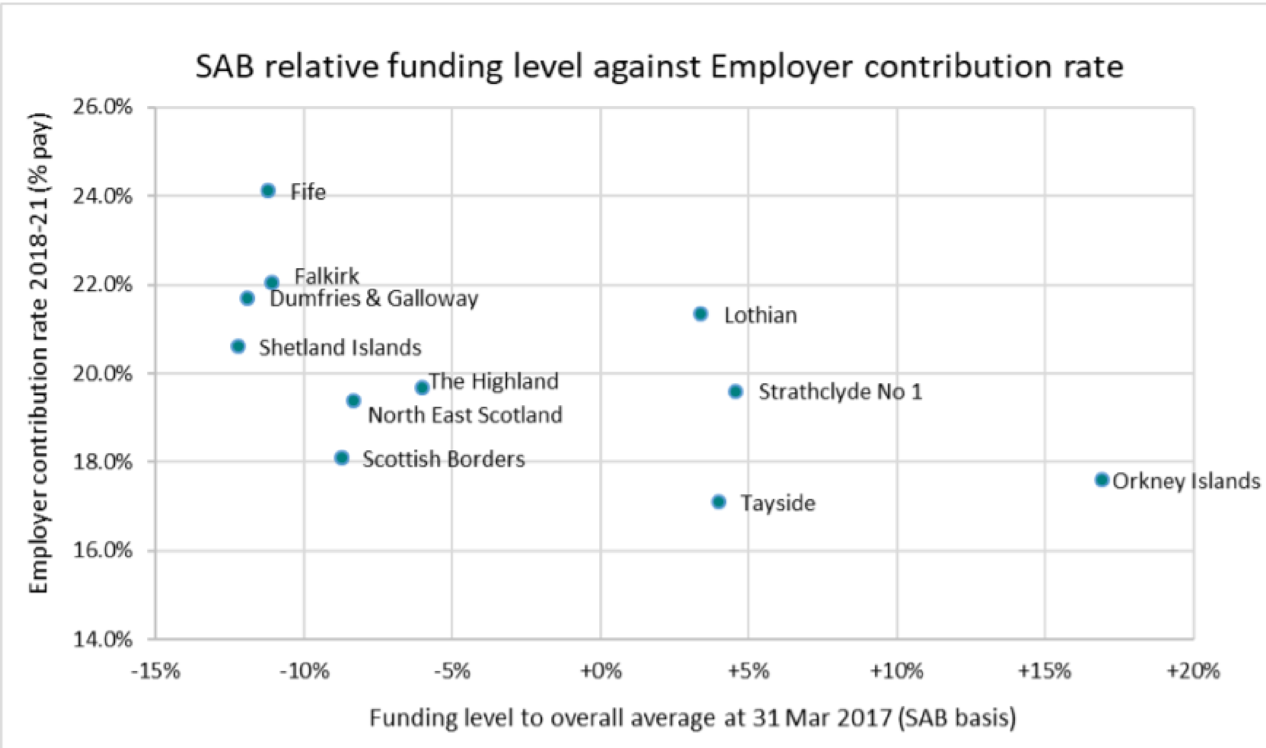
Employer contribution rates will be reviewed as part of the triennial valuation in 2020.

52. Employee contribution rates are set by regulation for the whole LGPS in Scotland. The employee contribution rate paid depends on the salary of the member. Individual employer contribution rates are set by the Fund actuary once every three years. With the last triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for the 3 years from 2018/19 to 2020/21. Employer contribution rates will be reviewed again as part of the triennial valuation in 2020.

Fife employer contribution rates have been relatively high

53. Employer contribution rates vary across funds based on previous triennial valuations. As shown at Exhibit 10 Fife has the highest whole fund employer contribution rate.

Exhibit 10
Employer contribution rates and funding levels



Source: Government Actuary's Department Section 13 report November 2019

54. Fife's relatively high whole fund contribution rate may insulate employers from further increases following the 2020 triennial funding valuation. However, there are a number of new variables that may need to be taken into account in the 2020 funding valuation including new liabilities arising from the McCloud case and the potential impact of the cost cap mechanism.

The McCloud judgement and remedy will increase liabilities and complicate administration

55. The transitional protections included in public service schemes when pension moved from final salary to career average in 2015 were ruled unlawful in 2018 and the UK Government was refused leave to appeal in 2019. The proposed remedy sees the protections being extended to all members of the LGPS in 2012 as opposed to only those within 10 years of retirement at that time. This will increase

the liabilities of the fund, at the next triennial valuation, as some employees would have been better off under the previous final salary scheme. The fund's actuary estimates the increase will be an increase of around 0.2% in liabilities. This could contribute to upward pressure on employer contribution rates.

The Cost Cap mechanism could lead to improved member benefits and increased employer costs

56. The Public Service Pension Act 2013 introduced a cost-sharing mechanism for public service pension schemes. For the LGPS in Scotland a sub-set of costs relating to current service was defined, and a baseline set for subsequent comparison with actual costs as patterns of benefits change. If this current service cost rises or falls by more than 2% of pay, then member benefits or contributions would be adjusted.

57. Early indications from valuations undertaken by GAD, in other jurisdictions, were that the cost floor had been breached, indicating that member benefits should be improved, or contributions reduced. However, the cost cap mechanism was paused following the McCloud case whilst a remedy was sought.

58. The cost cap valuations have now been un-paused and the UK government advice is that the additional costs of McCloud cases should be included in the cost cap. This may mitigate the impact of increased liabilities on employer contributions to some extent. It is unclear when the cost cap results will be available for Scotland.

The Government Actuary's Department did not identify any issues in Fife Pension Fund

59. The Government Actuary's Department has been appointed by Scottish Ministers to report under section 13 of the Public Service Pensions Act 2013 in connection with the actuarial valuations of the LGPS funds in Scotland.

60. The GAD report, under Section13, considers compliance with regulations; consistency of approach by actuaries to the triennial funding valuations; and the solvency and the long term cost efficiency of funds. The report did not identify any red flags in respect of the Fife Pension Fund.

Part 4

Governance and transparency

Main judgements

Pensions responsibilities are now focused in one Committee of the Council and services were maintained during COVID-19 restrictions

Overall the fund has effective governance arrangements. But there remains scope to improve the review of service organisation control reports and to better evidence review of reconciliations.

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.

Pensions responsibilities are now focused in one committee and services were maintained during COVID-19 restrictions

61. In 2019/-20 the Superannuation Fund and Pensions Sub-Committee was made a full committee responsible for all pension fund business, including the accounts and audit. This last element used to be part of the Council's Audit and Risk Committee responsibilities.

62. The Superannuation Fund and Pensions Committee met on the 17 March 2020, before committees were suspended following lockdown. Committee arrangements commenced again in August with committees meeting virtually.

63. The Fund continued to provide services during lockdown and pensions statements have been made available to members in accordance with the regulatory timetable by the end of August 2020.

This is the first full year of operation of the Joint Investment Strategy Panel

64. This was the first full year of operation of the new Joint Investment Strategy Panel. The Fund's investment strategy is set by the Superannuation fund and Pensions Committee. Fund officers are now supported through a collaborative arrangement with Lothian and Falkirk pension funds and by the fund's own investment advisors.

Overall the fund has effective governance arrangements, but review of service organisation control reports could be improved

65. Overall the fund has effective governance arrangements in place. However, arrangements could be improved further through the routine review of service organisation controls reports provided by the fund's custodian and investment managers.

66. Northern Trust, as fund custodian, identifies in its service organisation controls report a number of complementary user entity controls that it would expect pension funds to have in place. For example, the consideration of investment values by officers. As there have been issues this year with officers identifying the greater uncertainty in level 3 investments, we believe that the pension fund could do more to review its complementary user entity controls. This could form part of the

governance assurance framework for the Committee and the Annual Governance Statement.

67. Investment managers also provide the fund with controls reports which include arrangements for valuation of investments in some cases. The fund should be satisfied that arrangements and controls are adequate.

Recommendation 5

Complementary user entity controls specified by the custodian should be reviewed as part of the governance assurance framework.

Whilst bank and feeder system reconciliations had been undertaken their review was not always evidenced

68. Our review of internal controls identified that whilst bank and feeder system reconciliations had been undertaken there was not always evidence that they had been reviewed on a timely basis. In some cases, this was due to home working arrangements at the year end.

Recommendation 6

Arrangements for the review bank and feeder system reconciliations under homeworking should be clarified and review better evidenced.

A new training policy was approved in May 2019 which formalises training arrangements for Committee members

69. A new training policy approved in May 2019 should help ensure that training needs for members are identified and addressed. However, monitoring and reporting arrangements have yet to be put in place and individual training plans have yet to be developed. We note that internal audit will be undertaking a review of arrangements in 2020/21.

There are no breaches of regulation to report

70. The Pensions Regulator took on responsibility for the oversight of governance arrangements for the LGPS in 2015 and any significant breaches of regulation are required to be reported to the Pensions Regulator. We are not aware of any breaches which require reporting.

Part 5

Value for money

Main judgements

A benchmarking exercise identified that the fund's investment management expenses were better than a comparison group and that assets had lower volatility.

The Joint Investment Strategy Panel arrangement has helped identify opportunities to reduce investment management expenses.

The Fund's admin and oversight costs, relative to its size, were the second highest in Scotland in 2019/20.

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

A benchmarking exercise identified that the fund's investment management expenses were better than a comparison group and assets had lower volatility

71. The Fund commissioned a review of investment management expenses by CEM Benchmarking Inc. The review compared the funds costs with 39 other LGPS schemes and a wider global comparison group of 333 pension funds. Fund benchmarks were established from a subset of funds based on size.

72. CEM found that the Fife Pension Fund costs were around 0.41% of assets and this was slightly below the benchmark of 0.44%. Fife pension fund was found to be paying less than its peers in the sample group for similar services.

73. The benchmarking review also indicates that the fund was exposed to less asset volatility than its peers in the sample group.

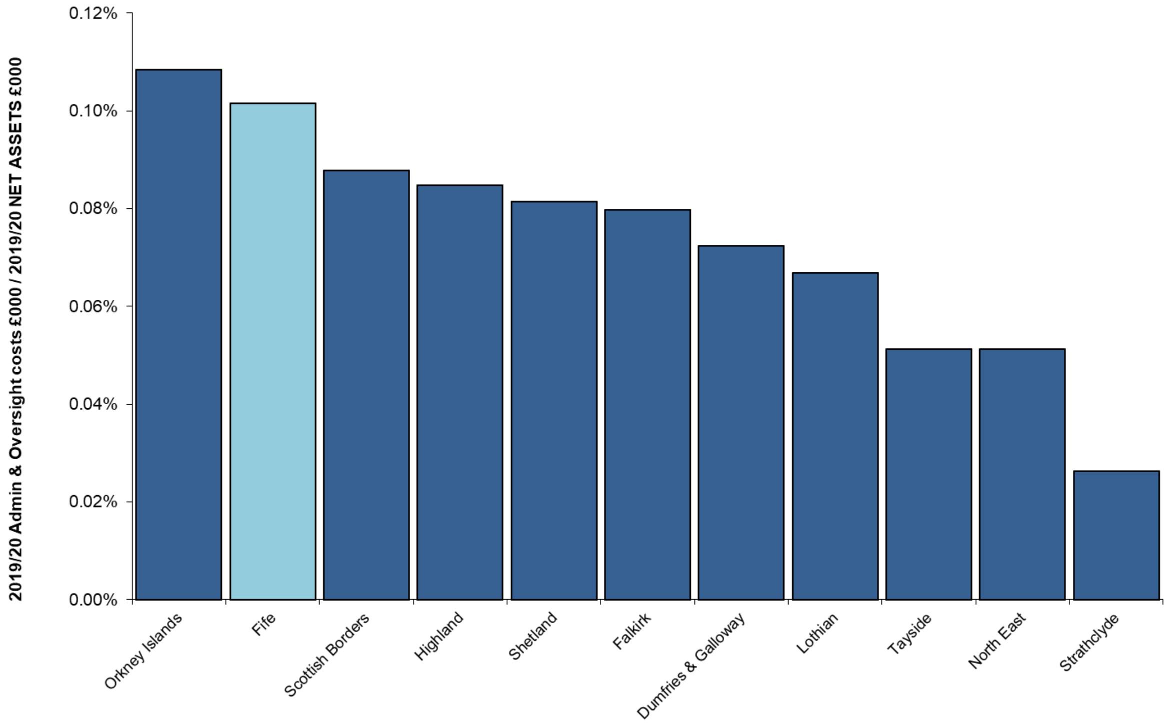
The fund has reduced investment management costs with the help of the Joint Investment Strategy Panel arrangement

74. Working with the advice of the Joint Investment Strategy Panel arrangement the fund has reduced investment management expenses by taking advantage of infrastructure investment opportunities in partnership with other funds, and by making changes to the frequency with which some mandates are rebalanced by fund managers. The fund estimates a saving of around £2 million over the first full year of the arrangement.

The funds administration and oversight costs were the second highest in Scotland in 2019-20

75. When compared with the scale of investment management costs, administration and oversight costs are significantly lower at £2.5 million or 0.1% of assets. However, in 2019-20 the fund's costs were the second highest in Scotland as shown in Exhibit 11.

Exhibit 11
Admin and oversight costs as a proportion of closing net assets



Source: Unaudited financial statements 2019-20

76. Costs include recharges from the council plus actuarial, consultancy (including cost of collaboration) and audit costs for example. Costs increased by 8.6% on the previous year.

The fund actively scrutinises investment manager performance

77. All investment managers are subject to review as part of the Joint Investment Strategy Panel arrangement and in 2019/20 the Fund has revised mandates held by a number of investment managers and revoked the mandate with one provider completely.

National performance audit reports

78. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2019/20, we published reports which may be of interest to the Fund. These are outlined in Appendix 4 accompanying this report.

Appendix 1

Action plan 2019/20

No.	Issue/risk	Recommendation	Agreed management action/timing
1	**Review of investment manager reports** Investment manager reports are not being reviewed and reconciled with custodian reports. **Risk – Custodian reports could include valuations which are out of date or otherwise inaccurate, and significant disclosures around investment valuation uncertainty.**	As part of the accounts preparation process, investment manager reports are reviewed and reconciled with custodian reports so that significant valuation issues are identified and actioned including: • Material valuation uncertainty disclosures • Valuation lag in relation to level 3 investments • Impaired investments. Paragraphs 17 & 29	Review of investment manager reports will be built into Closure of Accounts process and actioned at that time. Finance Operations Manager 31 March 2021
2	**Significant changes to governance arrangement due to COVID 19** The Annual Governance Statement is required to reflect any significant changes to governance to the point the accounts are approved for signature. **Risk- The Annual Governance Statement is not compliant with the applicable framework if significant governance changes have not been covered.**	As part of the accounts preparation process, ensure that the Annual Governance Statement includes coverage of significant governance developments up to the date the accounts are approved for signature. Paragraph 29	Annual Governance statement has been updated to reflect the events of COVID19 at the end of 2019/20. Pensions Team Leader Complete
3	**Investment fair value hierarchy** £41.8m of investments had been incorrectly disclosed as level 2 when they should have been shown as level 3. **Risk- The fair value hierarchy disclosure is important for the reader's understanding of valuation risk.**	As part of the accounts preparation process, ensure that custodian classification of new investments is consist with that of the investment manager. Paragraph 29	Following discussion with the Custodian, investments have been reclassified, Action to review will be built into Closure process Finance Operations Manager Complete

No.	Issue/risk	Recommendation	Agreed management action/timing
4	**Investment Management Expenses** Around £0.446m of investment management expenses were not notified by the investment manager in time for closedown of the accounts and were not therefore included as income and expenditure. **Risk- That cost transparency is not properly reflected in the accounts.**	As part of the accounts preparation process, ensure that investment managers are complying with the voluntary code on cost transparency and that they provide information to the fund on a timely basis. Paragraph 29	A full review of the progress in relation to Cost Transparency and associated disclosure is being undertaken and will be reported to Committee in March 2021Finance Operations Manager March 2021
5	**Service organisation control reports and complementary user entity controls** The Fund's wider governance assurance framework does not include the review of service organisation control reports and consideration of complementary user entity controls specified by the custodian. **Risk- The controls put in place and operated by the custodian require user entities to have complementary controls of their own.**	Include the review of service organisation control reports and complementary user entity controls specified by the custodian as part of the governance assurance framework. Paragraph 65	Review of service organisation control reports will be built into Closure of Accounts process and actioned at that time. Finance Operations Manager 31 March 2021
6	**Bank and feeder system reconciliations** Whilst bank and feeder system reconciliations had been undertaken there was not always evidence that they had been reviewed on a timely basis. In some cases, this was due to home working arrangements. **Risk- That errors and anomalies arising with reconciliations are not escalated appropriately.**	Arrangements for the review bank and feeder system reconciliations under homeworking should be clarified and reviews better evidenced. Paragraph 68	Evidencing of reviewing reconciliations is completed using software which due to licensing is not available when using your own device in home working environment. Alternative processes have been adopted using spreadsheets until a resolution can be found for licensing arrangements. Dialogue is ongoing with Business Technology Solutions. Teams have also been remined of the need to evidence reconciliations Service Manager

No.	Issue/risk	Recommendation	Agreed management action/timing
			Complete
Follow up of prior year recommendations			
7	Valuation of investments	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.	**Outstanding** Reports from investment managers are still not being routinely compared with the reports provided by the custodian. **Investment manager reports will be reviewed by officers going forward. See Rec 1 above.**
8	Impairment of investment valuations	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.	**Outstanding** The accounts again included £5.7million of investments which were written down to nil by the investment manager. **The recommendation is carried forward. Rec 1 above.**
9	Bank and feeder system reconciliations	All bank and feeder reconciliations should be reviewed on a timely basis to ensure they are complete and accurate.	**Outstanding** We again found that reconciliations had not always been reviewed on a timely basis. In some cases, this could be attributed to difficulties arising from the new home working arrangements. **Recommendation carried forward. Rec 6 above.**
10	Management expenses	As investment cost transparency frameworks develop the Fund should keep management costs under review to ensure value for money.	**Ongoing** A review has been undertaken for 2019-20 with fuller disclosure of investment management costs. However, not all investment managers are providing cost information on a timely basis. **See Rec 4 above.**

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*.

Significant Audit Risk	Assurance Procedure	Results and conclusions
Risks of material misstatement in the financial statements		
1 Risk of material misstatement caused by management override of controls Auditing Standards require that audits are planned to consider the risk of material misstatement due to fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls that result in fraudulent financial statements.	Reviewed the appropriateness of journal entries and other adjustments recorded in the general ledger and financial statements. Reviewed accounting estimates for biases. Focussed testing of accruals and prepayments. Evaluation of significant transactions that are outside the normal course of business.	We reviewed all ledger transactions for reasonableness. We confirmed the validity of selected journals posted in the year and established the extent and nature of routine journal processing. We confirmed that estimates are supported by third party evidence. Our testing of accruals and prepayments revealed no material errors. We considered no transactions to be outside the normal course of business. **There was no evidence of management override of controls.**
2 Estimation and judgements There is a significant degree of subjectivity in the measurement and valuation of investments and actuarial valuation. Investments include **level 3 investments** such as unquoted property investment companies, where the valuations involve the significant application of judgement in determining appropriate amounts. The **actuarial valuation** depends on a number of assumptions about the future. These include financial and demographic assumptions which can have a significant impact on the present value of promised retirement benefits disclosed in the accounts.	Review of user entity controls in relation to the use of service organisations. Confirmation of valuations to reports and / or other supporting information. Review the competence of the actuary and the reasonableness of the assumptions used to estimate the present value of promised retirement benefits.	**Level 3 investments** Review of service organisation controls reports was not part of the Fund's wider governance arrangements. However, our review of these reports identified that no control issues had been identified in relation to valuation. We noted that material valuation uncertainty disclosures had been included in valuations of many level 3 investments held by the fund. Investment values included in the accounts, based on custodian records, were £4.7m higher than those included in investment manager reports. This was due in part to valuation lag on level 3 investments. **Actuarial valuation**

Significant Audit Risk	Assurance Procedure	Results and conclusions
		We reviewed the results of the actuary's work together with the reasonableness of their assumptions using our own consulting actuary. The present value of promised retirement benefits included a conservative allowance for the increased costs arising from the McCloud ruling of around £10m. During the audit the basis for extending the statutory underpin was announced and a revised actuarial report was obtained. The PV of promised retirement benefits was reduced by £9m as a result. **We concluded that figures in the accounts that are subject to estimates and judgements are fairly stated although we have drawn attention to the material valuation uncertainty disclosures covering level 3 investments.**

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 £250,000 (£25,000 for contributions and benefits) 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	Comprehensive income and expenditure statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
1	Investment costs	446			
	Change in market value of investments		446		
2	Pension Benefits	45			
	Current Assets Cash				45
3	Creditors			417	
	Debtors				417
4	Change in market value of investments	5,700			
	Investments				5,700
Net impact		**5,745**		**(5,745)**	

Notes:
Entry 1 – Investment management costs notified late and not grossed up
Entry 2 – Lump sum payments processed but not posted to the ledger correctly at the year end
Entry 3 – Unexplained accruals
Entry 4 – Investments impaired by the Investment Manager not impaired in accounts

Appendix 4

Summary of national performance reports 2019/2020

2019/20 Reports

	Apr	
Social security: Implementing the devolved powers	May	
Scotland's colleges 2019	Jun	Enabling digital government
	Jul	
NHS workforce planning - part 2	Aug	
Finances of Scottish universities	Sept	
NHS in Scotland 2019	Oct	
	Nov	
Local government in Scotland: Financial overview 2018/19	Dec	
Scotland's City Region and Growth Deals	Jan	Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models
	Feb	
	Mar	Early learning and childcare: follow-up

Fife Pension Fund

2019/20 Annual Audit Report

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