Tayside Pension Fund

Proposed 2017/18 Annual Audit Report

AUDIT SCOTLAND

To Members of the Tayside Pension Sub-Committee and the Controller of Audit

4 September 2018

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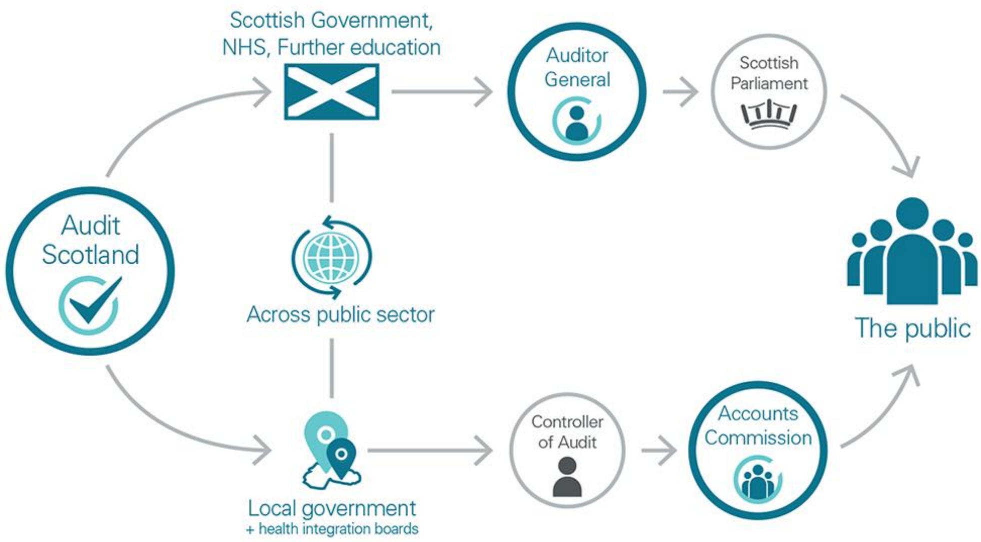

About us

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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Financial management

3 **The Fund has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.**

4 **The Fund's investment return performance in comparison to other Scottish LGPS funds has deteriorated in 2017/18 compared to 2016/17, with a move from a top 3 performer to a mid-range performer.**

Financial sustainability

5 **The Fund's actuary has assessed the Fund to be 107% funded, including a volatility reserve of 10% to protect the Fund from future volatility of investment returns. This has allowed employers' contributions to remain, in the main, at 17%.**

6 **The continued increase in pensioners in the Fund's membership will make funding pension payments increasingly challenging in the long term. Cash flow projections show that the Fund will continue to rely on investment income to pay pensions.**

Governance and transparency

7 **The Fund has effective governance arrangements in place that support scrutiny of decisions made by the Pension Sub-committee.**

8 **Although the Pension Sub-committee's responsibilities incorporate audit arrangements, internal audit arrangements remain outside its scope.**

9 **Decisions are transparent with committee papers and detailed minutes of meetings of the Pension Sub-committee available on the Dundee City Council's website.**

Value for money

10 **Adequate arrangements are in place for monitoring investment performance. The Fund's investment performance is subject to regular review and scrutiny by the Pension Sub-committee.**

11 **The Fund generated a return of 5.6% against its benchmark of 3.9%.**

12 **Six of the eight fund managers exceeded their one year benchmark returns in 2017/18 and also their 3,5 and 10 year benchmarks.**

Introduction

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

2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2018 meeting of the Pension Sub-committee of the Policy and Resources Committee (the Pension Sub-committee). This report comprises:

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

Exhibit 1
Audit dimensions

Source: Code of Audit Practice 2016

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

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

4. Dundee City Council is the administering authority for the Tayside Pension Fund. It is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The council delegates this responsibility to the Pension Sub-Committee. As part of this, the Pension Sub-Committee is required to review the effectiveness of internal control arrangements and approve the annual accounts.

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

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

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

8. This report raises matters from the audit of the annual accounts, risks or control weaknesses. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.

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

10. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and the 2017/18 audit fee of £24,390 as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could comprise our objectivity and independence.

Adding value through the audit

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

12. This report is addressed to both the members of the Pension Sub-committee and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk.

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

Part 1

Audit of 2017/18 annual accounts

Main judgements

Tayside Pension Fund's financial statements give a true and fair view and were properly prepared.

The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared.

Unqualified audit opinions

14. The annual accounts for the year ended 31 March 2018 were approved by the Pension Sub-committee on 3 September 2018. We reported, within our independent auditor's report:

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

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

Submission of annual accounts for audit

15. We received the unaudited annual accounts on 28 June 2018, in line with the audit timetable set out in our 2017/18 Annual Audit Plan.

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

Risks of material misstatement

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

Materiality

18. 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.

19. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

20. We carried out our initial assessment of materiality for the annual accounts during the planning phase of the audit. On receipt of the annual accounts we reviewed our planning materiality calculations. The revised materiality levels are summarised in Exhibit 2.

Exhibit 2

Materiality values

Materiality level	Amount
Overall materiality – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 10% of contributions receivable for the year ended 31 March 2018.	**Main Fund** £9.66 million **Transport Fund** £12,000
Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 50% of overall materiality.	**Main Fund** £4.83 million **Transport Fund** £6,000
Reporting threshold – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality (with a maximum level of £100,000)	**Main Fund** £100 thousand **Transport Fund** £1,000

Source: Audit Scotland

Evaluation of misstatements

21. There were no material adjustments to the financial statements arising from our audit. One misstatement which exceeded our reporting threshold has been identified in the audited financial statements. CIPFA guidance on investment management costs notes that investment transaction costs should be included within investment management expenses. The Fund has incurred £1.7 million of investment transaction costs which it has capitalised as part of the cost of the investments rather than including within investment management expenses. The impact of this statement is to reduce net assets from £3,690.6 million to £3,688.9 million.

22. It is our responsibility to request that all misstatements above the reporting threshold are corrected although the final decision on this lies with those charged with governance considering advice from senior officer and materiality. Management do not propose to adjust for the item above as the amount is not considered material in the context of the financial statements. We agree that the amount is not material

Significant findings from the audit in accordance with ISA 260

23. International Standard on Auditing 260 (UK & Ireland) requires us to communicate significant findings from the audit to those charged with governance. There were no significant findings arising from the audit to bring to your attention.

Follow up of prior year recommendations

24. We have followed up actions previously reported and assessed progress with implementation. These are reported in Appendix 1. Two agreed actions were raised in 2016/17, neither of which have been fully implemented. A revised response and timescales has been agreed with management for one of the agreed actions while the other is already scheduled to be complete in August 2018.

Other findings

25. Our audit identified several presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited annual accounts.

Pre-audit inspection and objections to the accounts

26. 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 Tayside Pension Fund was published on the website of the administering authority (Dundee City Council) and complies with the regulations. No objections were received to the Tayside Pension Fund accounts.

Part 2

Financial management

Main judgements

The Fund has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.

The Fund's investment return performance in comparison to other Scottish LGPS funds has deteriorated in 2017/18 compared to 2016/17, with a move from a top 3 performer to a mid-range performer.

Transport Fund Repatriation

27. Following legal, actuarial and investment opinion and full employer consultation, the Pension Sub-committee approved the repatriation of assets and liabilities of the single employer Tayside Transport Fund back to the main fund. The objective of the repatriation was to provide the single employer, Xplore Dundee, with a guaranteed actuarially calculated future contribution rate and to provide administrative efficiencies across the fund and value for money resulting from reduced costs in terms of custodial and actuarial fees, investment and management.

28. The repatriation took place on 30 June 2018 and resulted in the transfer of £70.8 million of transport fund net asset values into the main fund which had a net asset valuation of £3,490 million at that date.

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

Financial performance in 2017/18

29. 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.

30. The Fund's performance in 2017/18 is summarised in Exhibit 4. This shows that the net assets of the Fund increased to £3,691 million at 31 March 2018 from £3,445 million at 31 March 2017. This relatively small increase of £246 million (7.1%) reflected strong performance from equity managers.

Exhibit 4

Assets, liabilities, funding level and investment performance

Increase in net assets	Decrease in estimated actuarial liabilities	Funding level	Investment performance
£246 million (+7.1%)	**£145 million** (-3.4%)	**107%** 2017 Funding valuation	**5.6%** Return on investments 2017/18
£3,691 million Closing net assets	**£4,256 million** Closing liabilities	**107%** 31 March 2018 Interim valuation	**10.3%** Return on investments over 5 years

Source: Tayside Pension Fund Annual Report and Accounts 2017/18

32. During 2017/18 benefits paid out amounted to some £107.5 million. This was greater than the contributions to the Fund which totalled £99 million. Including administration expenses of £1.5 million, there was a net withdrawal from dealings with members of £10 million.

33. At the March 2017 Triennial Funding Valuation, the Fund was assessed by the actuary, Barnett Waddingham, to be 107% funded, including a volatility reserve of 10% which is in place to protect the Fund from future volatility of investment returns. The funding level means that, overall, the investment assets were higher than the liabilities. This enabled the Fund to maintain the employer’s contribution rate at 17% (for most employers) for the period 2018-2021.

34. In addition to the Triennial Funding Valuation, the Fund’s actuary also undertakes a valuation of pension fund liabilities (actuarial present value of promised retirement benefits) at the accounting date as required by International Accounting Standard (IAS) 26 and calculated in line with IAS 19 assumptions. This uses the same base data as the Triennial Funding Valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year. This valuation is not carried out on the same basis as that used for setting employer contribution rates and the Fund does not take account of liabilities to pay pensions and other benefits in the future.

35. The actuarial present value of promised retirement benefits estimates the Fund’s liabilities reducing from £4,401 million at 31 March 2017 to £4,256 million at 31 March 2018 (£145 million decrease). It should be recognised that not all funds have liabilities assessed on the same prudential scales. The use of differing actuarial firms and assumptions creates difficulties in direct comparisons. It should be noted that this valuation is an accounting estimate.

Financial management arrangements

36. The Executive Director of Corporate Services for Dundee City Council is the proper officer responsible for Tayside Pension Fund. The financial regulations of Dundee City Council, as administering authority, apply to the pension fund. We consider these to be comprehensive, and current, and promote good financial management.

37. Investment performance reports are submitted to the Pension Sub-committee on a quarterly basis. Reports are comprehensive detailing the performance of fund managers and comparing their performance against specific benchmarks. The reports also include commentaries from each fund manager. Also, through our attendance at the Pension Sub-Committee we have observed a good level of review and scrutiny by members.

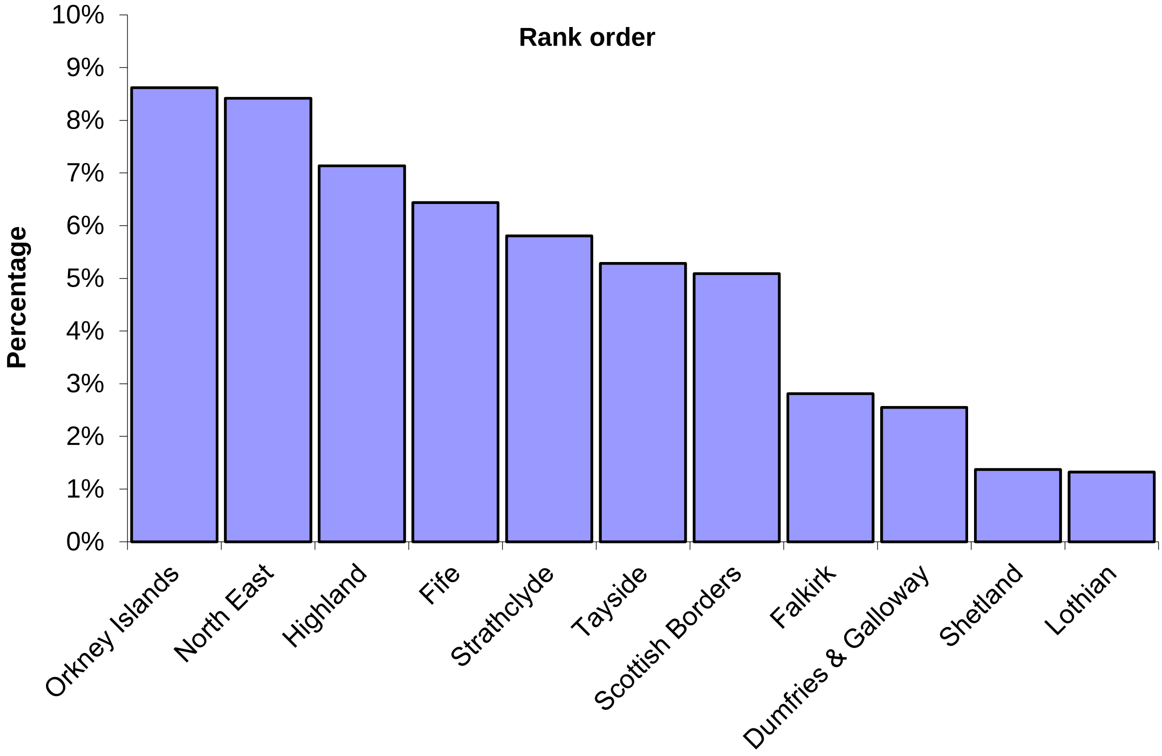
38. Based on evidence reviewed, the financial management arrangements in place were assessed as good.

Financial outcomes

39. 2017/18 has been a relatively good year for investment performance for most LGPS pension funds across Scotland as illustrated in Exhibit 5 (based on unaudited figures).

Exhibit 5

Net return on investment as a percentage of opening net assets - 2017/18



Source: 2017/18 LGPS pension fund unaudited financial statements

40. Exhibit 5 shows that Tayside Pension Fund's in year investment return is 5.6%, which compared to other Scottish LGPS funds sits in the mid-range in terms of net return on investments (based on unaudited figures for 2017/18). This is a deterioration in its position compared to 2016/17 when its investment return placed the Fund in the top 3 performers across all Scottish LGPS funds.

Systems of internal control

41. 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 Tayside Pension Fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

42. We have concluded that the controls for the Fund were operating effectively. No significant control weaknesses were identified which could affect the Fund's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Part 3

Financial sustainability

Main judgement

The Fund’s actuary has assessed the Fund to be 107% funded, including a volatility reserve of 10% to protect the Fund from future volatility of investment returns. This has allowed employers’ contributions to remain, in the main, at 17%.

The continued increase in pensioners in the Fund’s membership will make funding pension payments increasingly challenging in the long term. Cash flow projections show that the Fund will continue to rely on investment income to pay pensions.

Funding position and financial planning

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.

43. The Fund gives its members a guarantee that in exchange for contributions during their employment, the Fund will pay a pension until the end of each member's life.

44. The March 2017 triennial valuation reports that the fund assets were sufficient to meet 107% of its liabilities. The interim valuation by the Fund's actuary as at 31 March 2018, estimated that the funding level had remained at 107%.

45. Contribution rates and deficit payments were considered by the Actuary at the recent triennial funding valuation at 31 March 2017. Following this, officers reviewed and updated the Funding Strategy Statement.

46. The fund actively monitors its cash-flow position. Indications are that negative cash flows will be an ongoing trend. Auto-enrolment has had a positive impact on the cash flow position, but this may be offset by the change in pension regulations to allow Fund members to retire without employers’ consent at the age of 55.

47. The Fund is considering the strategic view of cashflow requirements longer term and asking its investment consultants to consider the actuarial maturity profile and resultant cashflow requirements when analysing the suitability of the current asset allocation. The investment consultants will be analysing whether the Fund needs to consider any specific changes to its investment portfolio at this point in time.

48. We have concluded that despite forecast cash flows being negative in the medium to long term, management has taken this into account with its investment strategy. The Fund recognises the desirability of maximising investment income within reasonable risk parameters.

49. The Fund recognises the need to ensure that it has, at all times, sufficient liquid assets to be able to pay pensions, transfer values, costs, charges and other expenses. It is the Fund's policy that such expenditure is met, in the first instance, from incoming employer and employee contributions to avoid the expense of disinvesting assets. The cash flow position is monitored on a daily basis to ensure that all cash requirements can be met.

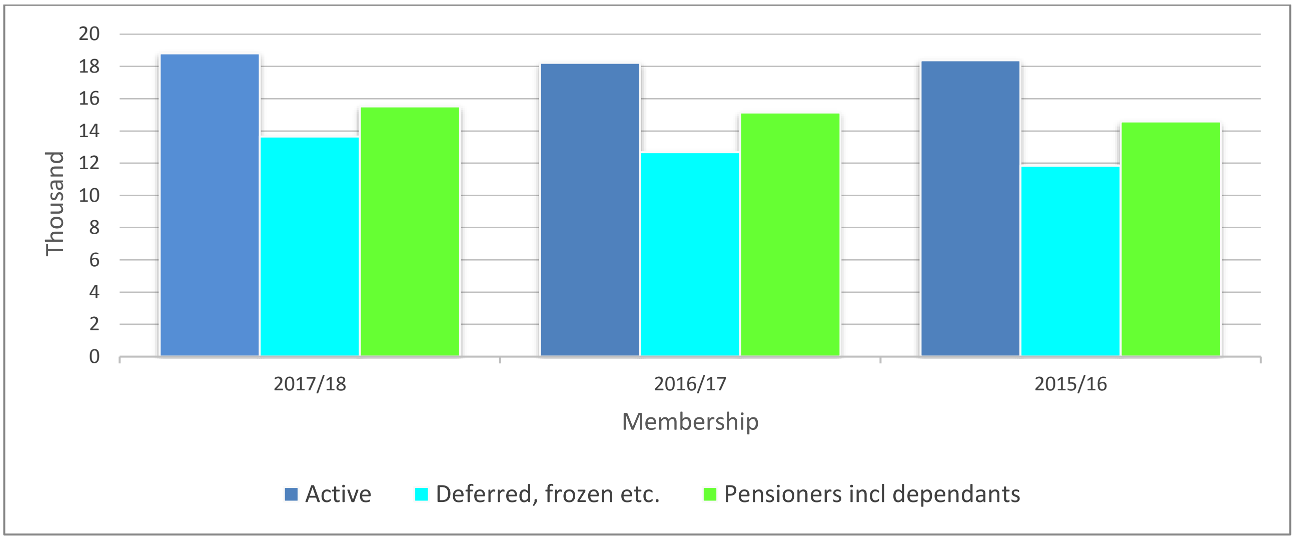
50. The Fund holds sufficient cash to meet the likely benefit payments. Additionally, the Fund holds sufficient assets in liquid or readily realisable form to meet any unexpected cash flow requirements so that the realisation of assets will not disrupt the Fund's overall policy.

Membership levels

51. The pension fund is a multi-employer fund with 46 employers. The current membership profile is shown at Exhibit 6. The number of active members continues to outweigh the number of pensioners.

Exhibit 6

Tayside Pension Fund membership



Source: Tayside Pension Fund 2017/18 Annual Report and Accounts

52. Membership of the fund increased by 1,958 to 48,002 members at 31 March 2018. The number of active members increased from 18,230 to 18,815, an increase in active members of 3.2%. The impact of auto-enrolment contributed to the increase in members.

53. It is important that the Fund maintains the capacity to meet the current and future needs of its members.

Contributions

54. The approximate split of all contributions received in 2017/18 is set out at Exhibit 7. Following the latest triennial valuation (as at March 2017), the actuary agreed employer contribution rates with individual employers up to March 2021. The rates that were applied in 2017/18 were agreed to be retained.

Exhibit 7
Contributions in 2017/18

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
Employer contributions	19.931	34.901	11.791	66.623
Employee contributions	7.129	12.448	4.354	23.931
Strain Contributions	0.351	4.925	0.368	5.644
Deficit Recovery Contributions	0	0	0.417	0.417

Source: Tayside Pension Fund 2017/18 Annual Report and Accounts

55. The Fund reported a deficit from dealings with members of £10 million in 2017/18. This means that pension payments exceeded member contributions and investment income was used to ensure pensions were paid. Although the Fund is currently well funded to meet its liabilities, the continued increase in pensioners in the Fund's membership may make funding pension payments increasingly challenging over the longer term and could ultimately result in increases in contribution levels.

Part 4
Governance and transparency

Main judgements

The Fund has effective governance arrangements in place that support scrutiny of decisions made by the Pension Sub-committee.

Although the Pension Sub-committee's delegated responsibilities incorporate audit arrangements, internal audit arrangements remain outside its scope of work.

Decisions are transparent with committee papers and detailed minutes of meetings of the Pension Sub-committee available on the Dundee City Council's website.

Governance arrangements

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.

56. Dundee City Council is the administering body for Tayside Pension Fund. The Council has delegated responsibility for governance to the Pension Sub-committee of the Policy and resources Committee. This Sub-committee, supported by the Pension Board, is responsible for establishing arrangements that ensure the proper conduct of the affairs of Tayside Pension Fund. It is also responsible for ensuring that decisions are made within the terms of the Local Government Pension Scheme.

57. In our 2016/17 Annual Audit Report we reported that although the Pension Sub-committee's responsibilities include receiving and agreeing the Annual Report and Accounts, these responsibilities were carried out instead by the council's Scrutiny Committee. We recommended that the governance processes be reviewed to ensure that the approved arrangements for the Annual Report and Accounts are adhered to and that consideration should also be given to including audit arrangements for the Fund within the remit of the Pension Sub-committee.

58. This recommendation has been partially implemented. For 2017/18 the Annual Report and Accounts have been received and agreed by the Pension Sub-committee, as has the external audit Annual Audit Plan. An Annual Internal Audit Report for the Tayside Pension Fund has not been prepared providing the internal auditor's opinion of the control environment specifically relating to the Fund. Instead the Dundee City Council (the Administering Authority) Annual Internal Audit Report has been considered by management as providing adequate assurance for the Fund.

59. This report and another internal audit report issued in January 2018 on the Pension Fund – Administration have been subject to scrutiny by the council's Scrutiny Committee. The internal audit reporting arrangements do not fully meet our recommendation that the audit arrangements should be covered by the Pension Sub-committee.

Recommendation 1

The Pension Sub-committee should receive internal audit plans and reports for scrutiny. This should include an Annual Internal Audit report with the internal auditor's opinion on the adequacy of the control environment for the Fund.

60. Following the local elections of 4 May 2017, the Fund retained much of the previous membership of the Pension Sub-committee and Pension Board. Training in 2017/18 focussed on the 2 new members of the Pension Sub-committee and the 2 mew members of the Pension Board. Training has consisted of induction training, national sessions arranged by the Local Government Pension Scheme (LGPS) Scotland Investment and Governance Group and completion of the Essential Public Sector Modules within the Pension Regulator Trustee Toolkit.

61. Further training is planned for these members in 2018/19 to address specific areas of the toolkit, as well as attendance at national and local sessions along with other Pension Sub-Committee and Pension Board members, which will coincide with their refresher training.

62. We have concluded that, subject to the need to bring internal audit into the Pension sub-committee scrutiny arrangements, appropriate and adequate arrangements are in place to support good governance and accountability.

Transparency

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

64. There is evidence from several sources which demonstrate the Fund's commitment to transparency. For example, the Pension Sub-committee and Pensions Board meetings are held in public and the Fund's annual accounts are available on the administering authority's website.

65. Overall, we concluded that the Fund conducts its business in an open and transparent manner.

Other aspects of governance

66. We reviewed various other aspects of governance that apply to the Fund including standing orders, financial regulations and arrangements for reporting breaches of regulation to the Pensions Regulator.

67. We have nothing to report in relation to these matters. No breaches of regulations have been reported to the Pension Regulator.

Internal audit

68. Internal audit should provide the Fund with independent assurance on the Fund's overall risk management, internal control and corporate governance processes. The Fund's internal audit function is carried out by Dundee City Council's internal audit service.

69. We have already noted at paragraph 58 that Internal Audit has not prepared an Annual Internal Audit Report providing the internal auditor's opinion of the control environment specifically relating to the Fund. However, two reviews have been undertaken by Internal Audit relating to Pension Fund – Administration and the Altair self-service module.

70. To avoid duplication of effort we place reliance on the work of internal audit wherever possible after carrying out an assessment of the internal audit function. A peer review of internal audit was carried out by East Lothian Council's Internal Audit Manager and concluded that the council's Internal Audit Service fully conforms with 11 of the 13 standards set out in the Public Sector Internal Audit Standards (PSIAS) and generally conforms with the remaining 2. We have also concluded that internal audit generally operates in accordance with the PSIAS and has sound documentation standards and reporting procedures in place.

71. In 2017/18 we did not place any formal reliance on internal audit reviews for obtaining direct assurance for our financial statements work. We planned to consider internal audit's report findings on the Altair self-service module as part of our wider dimension work, however at the time of writing, the report has not yet been issued.

Management commentary, annual governance statement and governance compliance statement

72. The applicable legislation and regulations require pension funds to prepare and publish, along with their financial statements, a management commentary (or equivalent), an annual governance statement, and a governance compliance statement that are consistent with the disclosures made in the financial statements. The management commentary should be fair, balanced and understandable and clearly address the longer-term financial sustainability of the body.

73. Based on our knowledge and work performed, we concluded that the management commentary, the annual governance statement and the governance compliance statement are consistent with the financial statements.

National Fraud Initiative

74. 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 error.

75. Investigation of matches identified is carried out by the administering authority on the Fund's behalf. NFI activity is summarised in Exhibit 8 and highlights that good progress has been made in investigating those matches issued to the administering authority in January 2017 that were recommended for investigation.

Exhibit 8

Total number of matches	Number recommended for investigation	Completed/closed investigations
700	246	229

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

76. 113 of the recommended matches were for matches of pension data to payroll data for potential infringement of the Pension Abatement rule. These were not investigated due to the rule no longer applying. Taking this into account the number of matches completed/closed exceeded the number of recommended matches. No significant frauds or errors were found through the NFI process, but the Fund is now recovering £1,810 of pension overpayments.

77. The administering authority is proactive in investigating matches on behalf of the Fund and there are no issues of concerns at the current time which we would require to highlight in this report.

Standards of conduct for prevention and detection of fraud and error

78. We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the administering authority's 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.

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

Cyber security

80. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017 which requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate. The Fund's IT services are provided by Dundee City Council. Our review of this area is ongoing and will be reported in Dundee City Council's Annual Audit Report which will be issued on 26 September 2018.

General Data Protection Regulation

81. The new General Data Protection Regulation (GDPR) came into force on 25 May 2018. This replaced the UK Data Protection Act 1998 (DPA). As a Regulation, all EU member states must implement it in the same way. GDPR sets out further requirements than the DPA and has introduced new and significantly changed data protection concepts.

82. GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to comply with new GDPR data handling arrangements could result in the Fund incurring significant fines.

83. The Executive Director of Corporate Services submitted a report to the Pension Sub-committee in December 2017, setting out the impact of the implementation of the GDPR on the Fund. The report highlighted that providers of third party administration and other services such as professional advisors and scheme actuaries are directly responsible for aspects of compliance with the GDPR and will have joint data controller responsibilities.

84. The report identified the steps being taken by the Fund to understand and document what data is held by the Fund and how it is used and become familiar with data subjects' rights under the GDPR and when they will apply.

85. Further steps taken include analysis and review of communication channels and content and review of contractual arrangements with service providers (in their roles as data processors and joint data controllers).

86. We have concluded that the Fund made good progress with planning for the GDPR requirements prior to the implementation of the Regulations from 25 May

2018. We will review the continued implementation of the Regulations as part of our 2018/19 audit.

Part 5

Value for money

Main judgements

Adequate arrangements are in place for monitoring investment performance. The Fund's investment performance is subject to regular review and scrutiny by the Pension Sub-committee.

The Fund generated a return of 5.6% against its benchmark of 3.9%.

Six of the eight fund managers exceeded their one year benchmark returns in 2017/18 and also their 3,5 and 10 year benchmarks.

Investment performance

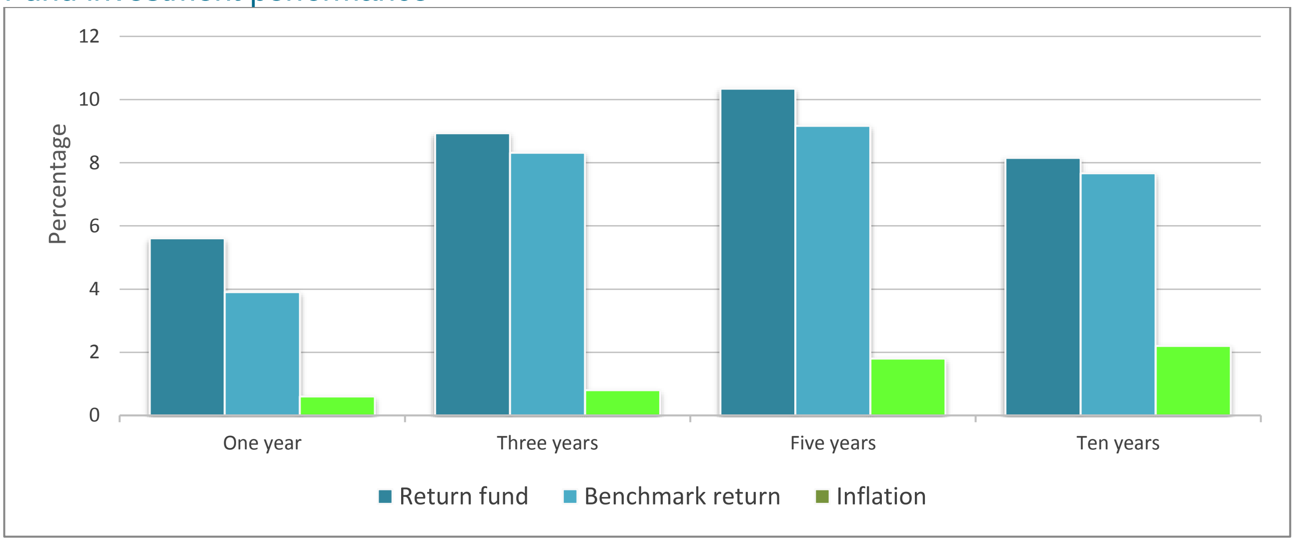
Value for money is concerned with using resources effectively and continually improving services.

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

88. Exhibit 9 shows that over the year, the Fund generated a return of 5.6% against a benchmark of 3.9%. Equity portfolios were the most significant contributor to this increase. Over the medium to longer term the Fund has outperformed its benchmark over three, five and ten years.

Exhibit 9

Fund investment performance



Source: Tayside Pension Fund 2017/18 audited financial statements

89. Under the career average pension scheme (CARE), accrued benefits are indexed at Consumer Price Index (CPI). Benefits earned under the old final salary scheme will continue to increase in line with earnings. As can be seen from Exhibit 9, investment returns have outperformed inflation over the longer term, going some way to meeting increases in the historic liabilities.

90. The fund uses eight fund managers. Individual investment manager performance is reported on a quarterly basis to the Pension Sub-Committee. The Fund's external investment advisor attends the meetings in an advisory capacity, when required. The external investment advisor also provides an annual report to the Pension Sub-Committee each March covering the managers' and fund performance for the previous full calendar year.

91. Most fund managers exceeded their one year benchmark returns in 2017/18, with only Goldman Sachs and GSAM (Broad Street Real Estate Credit Partners III) failing to achieve benchmark. Goldman Sachs also fell below its longer term benchmark returns (3, 5 and 10 years). The Goldman Sachs benchmark is based on market value and, as the investments are not held for sale, the spot valuation is less relevant. The GSAM fund is in its initial stages, having committed to only 5 investments and no returns were expected in 2017/18. The Pension Sub-committee will continue to monitor the performance of Goldman Sachs and the GSAM fund going forward.

92. Quarterly meetings are held with all the fund managers and fund managers attend the Pension Sub- Committee meetings on a rotational basis to make presentations.

93. Investment return and risk are inextricably linked and it is not possible for us to comment on the relative performance of the fund's investments given the risk exposure of the asset allocation and investments made. However, the asset allocation is largely in line with the Fund's investment strategy. The investment objective of the fund is to maximise the overall return whilst maintaining a prudent and balanced investment exposure.

Management expenses

94. 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 governance fees e.g. fees for actuarial services.

95. CIPFA published revised guidance on LGPS management expenses. This guidance sets out a framework for the reporting of investment management costs and was applied from 2016/17. The new guidance recommends that only expenses that can be directly controlled by the fund should be included.

96. 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 bench-marking information and in the context of returns achieved, to ensure that value for money is being secured.

97. Investment management costs have increased from £8.516 million in 2016/17 to £9.248 million in 2017/18, an increase of £0.732 million (8.6%). Investment management fees are generally based on the market value of the investments under their management and therefore increase or reduce as the value of these investments changes (we have already noted at paragraph 21 that the CIPFA guidance has not been fully complied with as investment transaction costs of £1.7 million has been excluded from the sum reported). The increase in the reported Investment management expenses in 2017/18 is due, in the main, to the good performance of investments over the year.

98. We have concluded that the Fund has adequate arrangements in place for monitoring investment performance. CIPFA guidance on management expenses has enabled greater transparency in investment management fee information including the development of benchmarking information. Management should make use of the additional information now available on the cost of investment management services to make informed decisions on value for money, as well as the performance of managers.

Administrative performance

99. The workload of the pension administration section continues to grow primarily due to the introduction of the career average pension scheme (CARE) from 1 April 2015. Other factors impacting on the administration workload include auto enrolment, requests generated from freedom of choice, continuing work arising from the Guaranteed Minimum Payment reconciliation and increased voluntary retirement workload.

100. We reported last year on the potential outsourcing of some of the section's workload. Two service providers were appointed in June 2017, one to carry out the Guaranteed Minimum Pension reconciliation which is due to be submitted to HMRC by December 2018 and one to process the legacy backlog of specific cases. Two temporary staff were also recruited for a period of six months from April/May 2017.

101. Work on the Guaranteed Minimum Pension reconciliation is ongoing with the outsourced service provider scheduled to complete the work prior to the HMRC due date. The outsourcing of the work on the legacy backlog has been extended and is expected to be complete by September 2018.

102. A report on administration performance is reported to the Pension Sub-committee but this has continued to focus on the volume of key tasks undertaken and does not provide details of performance against target performance levels or comparatives with prior years.

103. A report on a pension administration strategy update was presented to the Pension Sub-committee on 5 March 2018, which included administration performance measures and targets. The report noted that baseline information would not be available for these measures until full implementation of the Pensionweb system on 1 April 2018 and from then full measurement and monitoring of the measures would commence and be reported on a quarterly basis. Information from the first quarter of 2018/19 is currently being collated and is scheduled to be reported to the August 2018 meeting of the Pension Sub-committee.

104. We have concluded that improvements have been made to the system for administration performance reporting but it will be the second quarter of 2018/19 before reporting is carried out in line with the pension administration strategy update.

National performance audit reports

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

106. The Pension Sub-Committee considers Audit Scotland reports that are relevant to its remit to identify any issues that might be of interest and relevance.

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	**Governance arrangements** Internal audit plans and reports on the Fund continue to be scrutinised by the council's Scrutiny Committee and do not fall within the responsibilities of the Pension Sub-committee. The internal audit arrangements do not fully meet our recommendation made in 2016/17. **Risk** Members of the Pension Sub-committee do not have the opportunity to consider significant areas of governance and compliance relating to the Fund.	The Pension Sub-committee should receive internal audit plans and reports for scrutiny. This should include an Annual Internal Audit report with the internal auditor's opinion on the adequacy of the control environment for the Fund. Paragraph 59	Action: All future Pension Fund internal audit plans and reports will be submitted to the Pension Sub-committee. The SLA with internal audit will be reviewed to consider how an annual internal audit report can be provided. Responsible officer: Senior Manager – Financial Services Target date: September 2018

Follow up of prior year recommendations (PY)

PY1	**Governance arrangements** The current processes for considering and approving the Annual Report and Accounts is contrary to the approved arrangements. In addition, audit arrangements for the Fund are not included within the remit of the Pension Sub-committee. **Risk:** Members of the Pension Sub-committee do not have the opportunity to consider significant areas of governance	The governance processes should be reviewed to ensure that the approved arrangements for the Annual Report and Accounts are adhered to. Consideration should also be given to including audit arrangements within the remit of the Pension Sub-Committee.	The Annual Report and Accounts is now approved by the Pension Sub-Committee. External audit plans and reports are also considered by the Pension Sub-committee but internal audit arrangements remain outwith the Sub-committee's consideration. Action partly complete and action taken forward to point 1 above.

No.	Issue/risk	Recommendation	Agreed management action/timing
	and compliance relating to the Fund.		
PY2	**Administration Performance** Administration performance reporting could be improved to include details of performance against target performance levels or comparatives with prior years. There is also no reference to benchmarking performance data (benchmark administration costs data is available from the Chartered Institute of Public Finance and Accountancy (CIPFA)). **Risk:** Management is unable to demonstrate the specific pressures on administration services and the impact of those pressures on providing the service.	The Fund should consider changes to reporting its administration performance to incorporate performance against targets and regular reporting of benchmarking performance data to members.	Administration performance measures and targets have been identified. Performance against these measures and targets is scheduled to be reported for the first time in August 2018. Action partly complete - scheduled to be complete in September 2018.

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		
1 Risk of management override of controls As stated in International Standard on Auditing (ISA) 240 *The auditor's responsibilities relating to fraud in an audit of financial statements*, management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk.	Detailed testing of journal entries. Review of accounting estimates. Focused testing of accruals and prepayments. Evaluation of significant transactions that are outside the normal course of business.	Carried out detailed testing of journal entries. Reviewed accounting estimates for bias. Tested year end accruals and prepayments. **Conclusion:** Our work did not identify any material errors that required adjustment to the financial statements.
2 Risk of fraud over income and expenditure ISA 240 requires auditors to presume a risk of fraud where income streams are significant. The Fund receives a material amount of income from a variety of sources including pension contributions and investment income. Additionally, the Code of Audit Practice requires consideration of the risk of fraud over expenditure. The Fund incurs	Analytical procedures on income and expenditure transactions Evaluation of the effectiveness of systems of internal control Substantive testing of transactions focusing on the areas of greatest risk Review the content of service auditor reports.	Evaluated the effectiveness of systems of internal control and tested the internal controls. Analytical review of income streams and expenditure carried out. Reviewed the content of service auditor reports. **Conclusion:** We did not identify any instances of income and expenditure being materially misstated.

	Audit risk	Assurance procedure	Results and conclusions
	significant expenditure on pension payments.		
3	**Estimation and judgements** There are two main areas within the financial statements which require the exercise of estimation and judgement: • the measurement and valuation of investments • the actuarial present value of promised retirement benefits. Valuation of investments can be one of the more volatile elements of financial statements. There is a significant degree of subjectivity in the measurement and valuation of investments. This includes level 3 investments, such as unquoted equity, where valuations use techniques that require significant judgement in determining appropriate assumptions. The actuarial present value of the promised pension benefits (calculated in line with International Accounting Standard (IAS) 19 *Employee Benefits* assumptions) depends on a number of assumptions about the future, all of which are based on actuarial judgements. The subjectivity represents an increased risk of misstatement in the financial statements.	Review of the work of an expert (professional valuer and actuary) in accordance with ISA500 Evaluation of the significant assumptions and judgements made in the valuation of unquoted assets and liabilities Test valuations to valuation reports and/or other supporting documentation Test amounts reported for the present value of the promised pension benefits.	Reviewed the work of the actuary. Agreed valuations of investments to valuation reports provided by the global custodian. **Conclusion:** Our work did not identify any material errors that required adjustment to the financial statements.
4	**Repatriation of the Transport Fund** The Pension Sub-Committee approved a proposal to repatriate the assets and liabilities of the single employer Tayside Transport Fund back to the main fund in 2017/18. The aim of the proposal was to improve efficiencies. The repatriation took place in June 2017 and this will need to be properly accounted for and reported in the 2017/18 financial statements. This is a one-off transfer and therefore there is an increased	Review of the accounting treatment and disclosures within the financial statements.	Reviewed the accounting treatment and disclosures within the financial statements. **Conclusion:** Our work did not identify any material errors that required adjustment to the financial statements.

Audit risk	Assurance procedure	Results and conclusions
risk of misstatement in the financial statements.		
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
5 Pension administration performance The workload of the pension administration section continues to grow and continues to stretch the existing resources available. Two service providers were appointed in June 2017, one to carry out the Guaranteed Minimum Pension reconciliation which is due to be submitted to HMRC by December 2018 and one to process the legacy backlog of specific cases. Two temporary staff were recruited for a period of six months from April/May 2017 to alleviate the backlog of cases. There is a risk that the workload will continue to stretch the resources available.	Review of pension administration performance through administration performance indicators Monitor the impact of the outsourced work	Reviewed pension administration performance indicator reporting to identify whether we could assess administration performance. Monitored impact of outsourced work. **Conclusion:** administration performance indicators are not yet reported so we are unable to conclude on administration performance. Outsourced work on the Guaranteed Minimum Pension reconciliation is ongoing.
6 Pension administration performance reporting In our 2016/17 Annual Audit Report we recommended improvements to pension administration performance reporting to incorporate performance against targets and regular reporting of benchmarking performance data to members. Without regular reporting of performance management may be unable to demonstrate the specific pressures on administration services and the impact of those pressures on providing the service.	Review and assess the revised pension administration performance reporting arrangements.	Reviewed and assessed the pension administration performance reporting arrangements in place. **Conclusion:** administration performance indicators are scheduled to be reported to the Pension Sub-committee in August 2018.

Appendix 3

Summary of national performance reports 2017/18

2017/18 Reports

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

Tayside Pension Fund

Proposed 2017/18 Annual Audit Report

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk