

# Strathclyde Pension Fund

2018/19 Annual Audit Report



 AUDIT SCOTLAND

To Members of the Strathclyde Pension Fund Committee and the Controller of Audit

4 September 2019

## Who we are

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

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



## About us

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

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

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

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# Key messages

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## 2018/19 annual report and accounts

- 1 Strathclyde Pension Fund's financial statements give a true and fair view of the financial transactions of the funds during the year ended 31 March 2019 and of the amount and disposition at that date of their assets and liabilities.
- 2 The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared.

## Financial management

- 3 The Fund has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.
- 4 Strathclyde Pension Fund No.1 achieved a return of 5.9% which was in line with the benchmark return set for the year.
- 5 Systems of internal control operated appropriately and effectively in 2018/19.

## Financial sustainability

- 6 The funding level of Fund No.1 has increased to 108.7%, based on estimates from the Fund's actuary. The Fund demonstrates effective financial planning.
- 7 The Fund is revising its investment structure to increase investment income returns and address the predicted deficit cash flow position over the coming years.

## Governance and transparency

- 8 The Fund has effective governance arrangements in place that support scrutiny of decisions made by the Pension Fund Committee.
- 9 Decisions are transparent with Pension Fund Committee meetings held in public, and committee papers and minutes available on the Fund's website via link to Glasgow City Council's website.

## Value for money

- 10 The Fund's investment performance is subject to regular review and scrutiny by the Pension Fund Committee. The investment strategy is forward looking, considers the unpredictability of future economic conditions and continues to diversify in order to be more resilient to future challenges.
- 11 The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management.

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# Introduction

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1. This report is a summary of our findings arising from the 2018/19 audit of Strathclyde Pension Fund (the Fund).

2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2019 meeting of the Strathclyde Pension Fund 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](#).

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## Exhibit 1 Audit dimensions



Source: Code of Audit Practice 2016

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3. The main elements of our audit work in 2018/19 have been:

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

## Added Value

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

- engaging with officers to identify good practice in LGPS financial reporting and inform the development of the Fund's annual report and accounts template for 2018/19
- working in partnership with the CIPFA Pensions Network to deliver events in Scotland, aimed at identifying upcoming pensions developments. These events are attended by practitioners from across Scotland, including from the Fund
- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that have been accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) 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. In so doing, we aim to help the Fund promote improved standards of governance, better management and decision making and more effective use of resources.

## Responsibilities and reporting

6. Glasgow City Council is the administering authority for Strathclyde Pension Fund. The council delegates this responsibility to the Pension Fund Committee. The committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The Pension Fund Committee is required to review the effectiveness of internal control arrangements and approve the annual accounts.

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. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).

**10.** This report raises matters from the audit of the annual accounts and consideration of the wider audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**11.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.

**12.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2018/19 audit fee of £55,870 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**13.** This report is addressed to both the members of the Pension Fund Committee and the Controller of Audit and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**14.** We would like to thank all management and staff for their cooperation and assistance during the audit.

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# Part 1

## Audit of 2018/19 annual accounts

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### Main judgements

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**Strathclyde Pension Fund's financial statements give a true and fair view of the financial transactions of the funds during the year ended 31 March 2019 and of the amount and disposition at that date of their assets and liabilities.**

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

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

### Audit opinions on the annual accounts

**15.** The annual accounts for the year ended 31 March 2019 were approved by the Strathclyde Pension Fund Committee on 4 September 2019. We reported, within the independent auditor's report that:

- the financial statements give a true and fair view of the financial transactions of the funds during the year ended 31 March 2019 and of the amount and disposition at that date of their assets and liabilities, and that they were properly prepared in accordance with the guidance
- 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.

**16.** We have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

### Submission of annual accounts for audit

**17.** We received the unaudited annual accounts on 13 June 2019, in line with the agreed timetable set out in our 2018/19 Annual Audit Plan.

**18.** 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

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

**20.** We have no issues to report from our work on the risks of material misstatement highlighted in our 2018/19 Annual Audit Plan.

**21.** 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. It is affected by our perception of the financial information needs of users of the financial statements.

**22.** Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#). With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

**23.** On receipt of the unaudited annual accounts we reviewed our planning materiality calculations and concluded that they remained appropriate [Exhibit 2](#).

## Exhibit 2 Materiality values

Materiality level	Fund No.1	Fund No.3
Overall materiality	£200 million	£2 million
Performance materiality	£150 million	£1.5 million
Reporting threshold	£250,000	£20,000
Specific materiality	£5.8 million	£78,000
Specific performance materiality	£4.3 million	£58,000

Source: Strathclyde Pension Fund Annual Audit Plan 2018/19

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

**24.** 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 covering accounting policies, accounting estimates and financial statements disclosures.

### Qualitative aspects of the audit

**25.** We have no significant findings to report around the qualitative aspects of the 2018/19 accounting practices.

### Evaluation of misstatements

**26.** Two adjustments were made to the unaudited annual report and accounts arising from our audit. Both of these adjustments exceeded our reporting threshold for Fund No.3.

**27.** Investment income for Fund No.3 amounting to approximately £200,000 was incorrectly included in the "change in market value of investments" line in the Fund Account for Fund No.3. This was corrected and resulted in the "change in market value of investments" on the Fund Account decreasing by £200,000 with a corresponding increase in investment income. There was no impact on closing net assets figure for Fund No.3.

**28.** Approximately £30,000 of investment management fees relating to Fund No.3 were incorrectly accrued within Fund No.1. Although the value of the misstatement is below our clearly trivial reporting threshold for Fund No.1, it exceeds our reporting threshold for Fund No.3. Correcting this misstatement resulted in the

current assets for Fund No.1 decreasing by £30,000 and current liabilities increasing by £30,000. There was no effect on net assets for Fund No.1. For Fund No.3 there was a £30,000 movement between the invoice creditor and the inter-company creditor. There was no effect on net assets for Fund No.3.

**29.** 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 adjusted for the items detailed above.

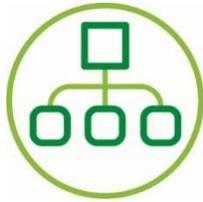
### **Amendments to the accounts arising from legal and other judgements**

**30.** In December 2018 the Court of Appeal upheld a claim from firefighters and judges that changes to their pension schemes were discriminatory based on age. The UK Government sought leave to appeal the decision (commonly known as the McCloud Ruling) to the Supreme Court however this was denied at the end of June 2019, after the unaudited accounts were prepared. This ruling will impact on other public sector pension schemes, including LGPS, which have seen similar changes in their pension schemes.

**31.** Following the decision, the Fund requested a revised IAS26 report from the Fund actuary in order to quantify the increase in estimated liabilities as a result of the ruling. This revised report estimated the actuarial present value of promised retirement benefits as £25.949 billion for Fund No.1, an increase of £266 million, and £161 million for Fund No.3, an increase of £1 million. These revised assessments do not impact on the primary financial statements of the Funds, however the relevant disclosure notes in the audited accounts were updated to include the revised values of promised retirement benefits.

# Part 2

## Financial management



### Main judgements

The Fund has appropriate and effective arrangements in place for financial management.

Strathclyde Pension Fund No.1 achieved a return of 5.9% which was in line with the benchmark return.

Systems of internal control operated appropriately and effectively in 2018/19

Financial management is about financial capability, sound monitoring arrangements and whether the control environment and internal controls are operating effectively.

### Financial performance in 2018/19

32. 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.

33. The Fund's performance in 2018/19 is summarised in [Exhibit 3](#).

### Exhibit 3

#### Assets, funding level and investment performance

Increase in net assets (Fund No.1)	Funding level (Fund No.1)	Investment performance (Fund No.1)
 <p><b>£21.936 billion</b></p> <p>Closing net assets as at 31 March 2019 (+5.43%)</p>	 <p><b>108.7%</b></p> <p>31 March 2019 Interim valuation (based on roll forward approximation from 2017 valuation)</p>	 <p><b>11.3%</b></p> <p>Average annual return on investments over 5 years</p>
<p><b>£20.806 billion</b></p> <p>Opening assets at 1 April 2018</p>	<p><b>105.6%</b></p> <p>2018 Interim valuation</p>	<p><b>5.9%</b></p> <p>Return on investments 2018/19</p>

Source: 2018/19 Strathclyde Pension Fund unaudited annual report and financial statements

**34.** The promised retirement benefits at 31 March 2019 have been projected by the actuary using a roll forward approximation from the latest formal funding valuation as at 31 March 2017. These have been estimated at £25.949 billion (2018/19 – £22.787 billion), showing a 13.9% increase. This estimate uses assumptions in line with Internal Accounting Standards (IAS) 19 requirements, for the purposes of the Fund's financial statements. It is not directly comparable to the liability measures on a funding basis.

**35.** The information contained in [Exhibit 3](#) demonstrates that Fund No.1 has performed well in 2018/19, both in terms of investment returns and also in terms of funding level. The interim funding valuation result of 108.7% shows improvement from the previous valuation and reflects a strong funding position at 31 March 2019.

**36.** Although the Fund continues to perform well, management are aware that a number of challenges face the Fund and the wider environment in which it operates. A number of issues may increase pressures on the future funding position, including economic growth and the impact of EU withdrawal. Pension specific issues such as the scheme cost cap mechanism, guaranteed minimum pension (GMP) equalisation and the McCloud ruling on age discrimination within pension schemes are also likely to impact on the funding position in the coming years.

**37.** The Fund has considered these challenges and continues to monitor risks through the corporate risk register. The funding strategy statement and investment strategy are reviewed and revised following actuarial valuations to ensure that the Fund is well placed to continue to pay its liabilities.

**38.** The Fund is also committed to ensuring it has appropriate resources in place to support ongoing pension administration activities, along with strategies and plans that take account of future challenges.

**39.** The Fund presented its 2019/20 business plan to the Strathclyde Pension Fund Committee in March 2019. The plan identifies a number of key priorities for the year ahead. This includes reviewing the administration strategy and data improvement plan. The Fund has also recognised the potential resource implication of the increased administration resources that will be required to process the effects on pensions of employer equal pay settlements.

## Financial management arrangements

**40.** The Executive Director of Finance for Glasgow City Council is the proper officer responsible for Strathclyde Pension Fund. The financial regulations of Glasgow City Council, as administering authority, apply to the Fund. We consider these to be comprehensive, and current, and promote good financial management.

**41.** Investment and administration performance reports are submitted to the Pension Fund Committee throughout the year. Reports are comprehensive and include fund performance trends, investment manager performance against benchmarks and movements in asset allocations. The committee also consider papers requesting approval for proposed investments. A quarterly report is also provided by the Investment Advisory Panel. Reports presented to the committee are subject to appropriate review and scrutiny by members.

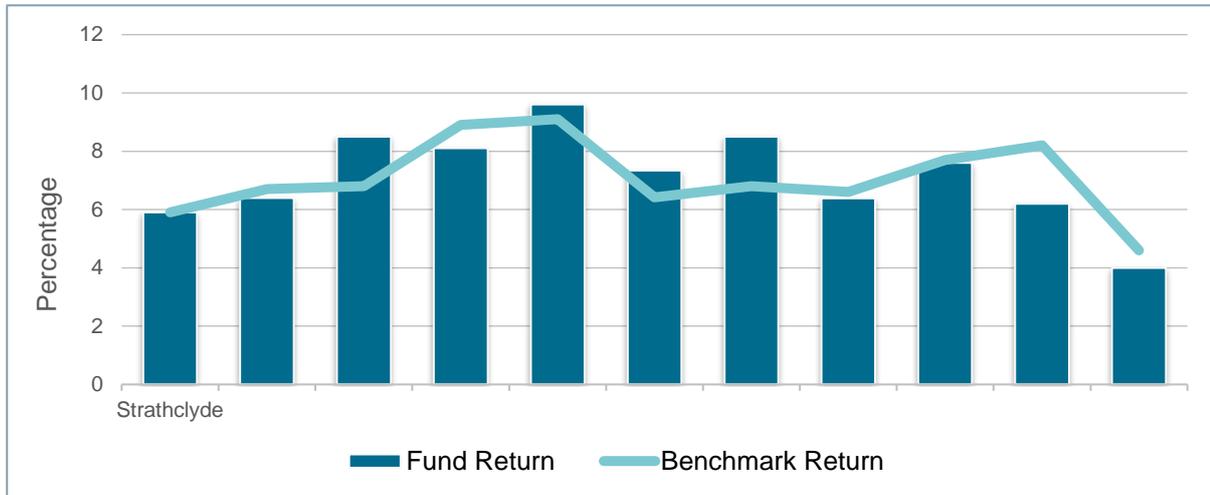
**42.** Overall, the Fund has effective financial management arrangements in place. This includes comprehensive reporting of investment performance.

## Investment performance in 2018/19

**43.** Financial year 2018/19 has been a positive year for investment performance for most LGPS pension funds across Scotland as illustrated in [Exhibit 4](#).

## Exhibit 4

### LGPS pension funds 2018/19– Net return on investment and benchmark return (unaudited figures)



Source: 2018/19 LGPS pension fund unaudited financial statements

**44.** Investment performance across the Local Government Pension Scheme funds was at a broadly similar level with 2017/18. Strathclyde Pension Fund No.1 achieved a return of 5.9% on its investments, in line with the fund benchmark of 5.9% for 2018/19. The return was also consistent with the prior year return of 6.0%.

**45.** From [Exhibit 4](#) it can be seen that all of the funds recorded a return on their investment which was within 2% the agreed benchmark. In addition to Strathclyde performing in line with the benchmark return, 4 funds outperformed the agreed benchmark return and 6 funds reported investment returns below their agreed benchmark return.

## Systems of internal control

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

**47.** The Fund uses a number of the financial systems of Glasgow City Council, such as the financial ledger system, however it also uses its own systems for pensions administration. Our findings were included in a management letter presented to the Strathclyde Pension Fund Committee on 11 June 2019.

**48.** We used the work of internal audit for their review of the pension payroll process. This review was reported to the Strathclyde Pension Fund Committee on 6 March 2019. The report concluded that reasonable assurance could be placed on the control environment, however it identified a number of control weaknesses and areas for improvement which we considered to present a risk of material misstatement.

**49.** Consequently, we undertook additional audit procedures to gain assurance in relation to the impact of the identified control weaknesses. Our work did not identify any matters that resulted in a material misstatement in the 2018/19 financial statements of the Fund.

## Internal audit

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

**51.** The internal audit function is carried out by Glasgow City Council. We conducted a review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS).

**52.** To avoid duplication of effort we use the work of internal audit wherever possible. In addition to our consideration of internal audit's work on payroll, we considered their report findings on the following areas as part of our wider dimension work:

- Gifts and Hospitality
- Reputation Management
- General Data Protection Regulations compliance
- Payroll
- Investment – Direct Investment Portfolio.

## National Fraud Initiative

**53.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

**54.** In October 2018 Glasgow City Council provided data for the 2018/19 National Fraud Initiative (NFI), which included pensions data supplied by the Strathclyde Pension Fund Office. This data was matched with other national data including Department of Work and Pensions records of deceased persons, as well as data from other local authorities and the health service.

**55.** At the most recent data run date of August 2019, 3,035 matches have been identified. To date, the Fund has processed and closed 1,322 matches. Work is ongoing to investigate the remaining matches. The matching exercise is an important control which provides assurance that the Fund's records are consistent with a host of other public bodies. The Fund investigates all matches as part of their pension administration processes.

**56.** The Fund is proactive in participating in the NFI exercise and investigates matches in a timely manner.

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

**57.** Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

**58.** We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the administering authority, Glasgow City Council's arrangements for the prevention and detection of fraud and corruption. These include codes of conduct for members and officers, whistleblowing policy and an anti-fraud strategy and response plan.

**59.** We concluded that appropriate arrangements were in place for preventing and detecting fraud and corruption in 2018/19. We are not aware of any specific issues we require to bring to your attention.

# Part 3

## Financial sustainability



### Main judgement

**The funding level of Fund No.1 has increased to 108.7%, based on estimates from the Fund's actuary. The Fund demonstrates effective financial planning.**

**The Fund is revising its investment structure to increase investment income returns and address the predicted deficit cash flow position over the coming years.**

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.

### Funding position and financial planning

**60.** The March 2017 triennial valuation for Fund No. 1 (issued in December 2017) reported that fund assets were sufficient to meet 105% of its liabilities. The interim valuation by the Fund's actuary estimated that the funding level had increased to 108.7% as at 31 March 2019. This interim valuation uses the same base data as the triennial funding valuation, rolled forward to take account of changes in membership and updated assumptions.

**61.** Following each triennial valuation, the Fund reviews and revises the funding strategy statement. The next full review is due to be completed by 31 March 2021.

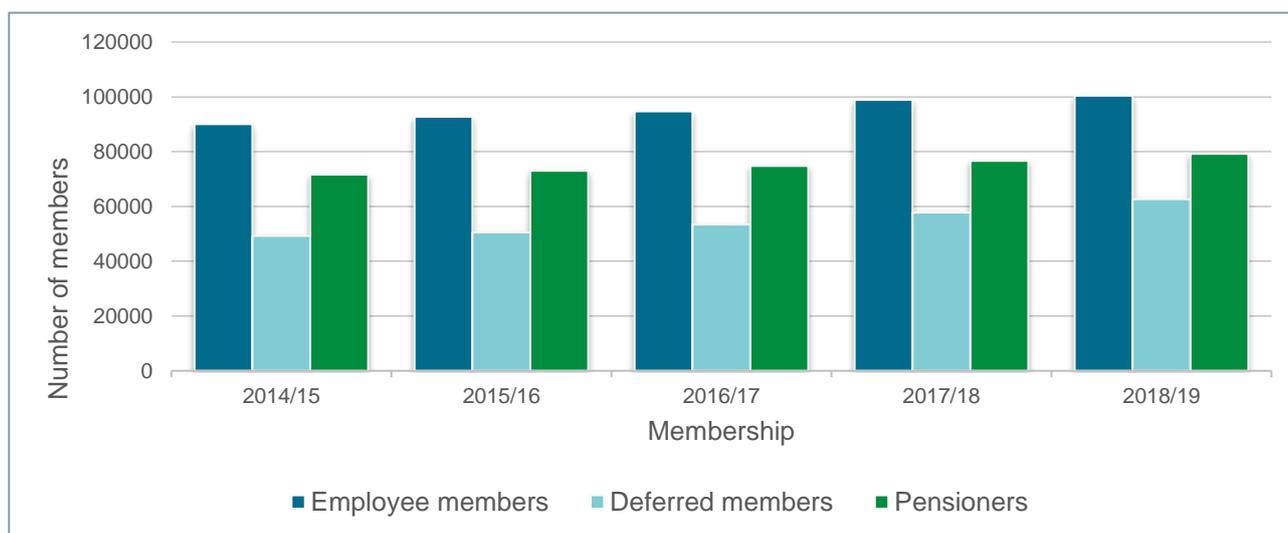
**62.** The funding strategy statement is a summary of the Fund's approach to funding liabilities. The investment strategy is set for the long-term but is monitored continually and reviewed every 3 years using asset-liability modelling to ensure that it remains appropriate to the profile of the Fund's liabilities. The investment strategy is outlined in the Fund's statement of investment principles.

**63.** We concluded that the Fund has an appropriate framework in place through which it demonstrates effective financial planning.

### Membership levels

**64.** The pension fund is a multi-employer fund with 12 local authorities, and around 160 other employers. The current membership profile is shown at [Exhibit 5](#). The number of active members continues to outweigh the number of pensioners.

## Exhibit 5 Strathclyde Pension Fund (Fund No.1) membership



Source: Strathclyde Pension Fund 2018/19 unaudited financial statements

**65.** Membership of the fund increased by 8,962 to 242,274 members at 31 March 2019; an increase in membership of 3.8%. The impact of auto-enrolment continues to contribute to the increase in employee members.

**66.** The Fund gives its members a guarantee that in exchange for contributions during their employment, it will pay a pension until the end of each member's life. It is important that the fund maintains the capacity to meet the current and future pension entitlements of its members.

**67.** In 2018/19 the number of pensioners receiving a pension increased by over 2,500. The number of pensioner members continues to increase steadily each year and is a key contributor to the ongoing deficit in dealings with members.

**68.** Future membership numbers are difficult to predict with any certainty as they are dependent on a number of factors including employer budgets, recruitment decisions, and promotion of the pension scheme.

**69.** With most employers still open to new membership and with continuing support from auto enrolment, the recent trend of growth in membership seems likely to continue for the foreseeable future.

### Contributions and benefits paid

**70.** Following the latest triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for 2018/19 onwards. For the majority of employers, the current funding surplus is being used to subsidise and stabilise contribution rates. For a small number of employers, these rates include an element of deficit recovery contributions to support employers financial planning. The approximate split of all contributions received in year is set out at [Exhibit 6](#).

## Exhibit 6

### Contributions and benefits paid in 2018/19 (Fund No.1)

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
Employer contributions including strain costs	64.198	273.941	99.413	437.552
Employee contributions	20.376	80.932	29.811	131.119
Transfers in/out				9.455
<b>Total income</b>				578.126
Benefits paid	84.890	419.875	85.604	590.369
Transfers out				39.869
<b>Total expenditure</b>				630.238

Source: Strathclyde Pension Fund 2018/19 unaudited financial statements

**71.** As in previous years the Fund reported a deficit from dealings with members. For 2018/19 this amounted to of £52.112 million. This means that pension payments exceeded member contributions.

**72.** As part of its 2018/19 Business Plan, the Fund reviewed its contributions/benefits cash flow model and used the revised 10-year cash flow projections to inform the 2019/20 Business Plan. The Fund is projecting increasing negative cash flows for the next ten years, with the estimated gap between contributions and payments rising to £154 million by 2028/29.

**73.** The continued growth in pensioner numbers within the Fund's membership makes funding pension payments increasingly challenging. The Fund has considered this as part of its investment strategy and is further diversifying its investment structure to increase investment in income generating assets.

## EU Withdrawal

**74.** The Fund continues to prepare for the UK's withdrawal from the European Union. The Fund's external fund managers, who are responsible for managing investments, have appropriate arrangements in place to ensure regulatory requirements will continue to be met following Brexit.

**75.** The majority of the Fund's investments are outside of the UK and denominated in currencies other than sterling. While this limits the risk arising from any devaluation of sterling, the fluctuation of exchange rates combined with the volatility of returns from overseas investment still presents a risk to the value of the Fund's investments. To mitigate this, the Fund operates a currency hedging programme to hedge around one third of its overseas listed equity.

**76.** The Fund should continue to monitor the wider impact of EU withdrawal on the Fund and its wider environment.

# Part 4

## Governance and transparency



### Main judgements

**The Fund has effective governance arrangements in place that support scrutiny of decisions made by the Pension Fund Committee.**

**Decisions are transparent with Pension Fund Committee meetings held in public, and committee papers and minutes available on the Fund's website via link to Glasgow City Council's website.**

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

### Governance arrangements

**77.** Glasgow City Council is the administering authority for Strathclyde Pension Fund. The council has delegated responsibility for governance to the Executive Director of Finance. The Pension Fund Committee is the main decision-making body of the Fund. It is supported by the Pension Board and is responsible for establishing arrangements that ensure the proper conduct of the affairs of the Fund. It is also responsible for ensuring that decisions are made within the terms of the Local Government Pension Scheme.

**78.** The responsibilities of the Executive Director of Finance, the Pension Fund Committee and the Pension Board are set out in the Statement of Investment Principles.

**79.** The main functions of the fund are management of investments and administration of scheme benefits. These functions are carried out in accordance with the Local Government Pension Scheme (Scotland) regulations which are statutory instruments made under the Superannuation Act 1972 and Public Service Pensions Act 2013.

**80.** From our work we concluded that effective arrangements were in place for governance, decision making and scrutiny during the financial year. A training policy and practice statement for the Fund together with a training plan for 2018/19 was presented to the Strathclyde Pension Fund Committee. This has been completed in year and a new plan has been put in place for 2019/20. We concluded that effective arrangements are in place for member training and development.

**81.** In addition to the Pension Fund Committee and Pension Board, an Investment Advisory Panel (IAP) is also in place which comprises of investment officers from the fund and representatives from Hymans Robertson as the fund's actuary and investment consultant. The panel also includes three independent expert advisors. The IAP supports the Pension Fund Committee and is responsible for developing investment strategy and monitoring investment performance.

**82.** Overall, we concluded that the Fund has adequate governance arrangements in place which support good governance and accountability.

## Openness and transparency

**83.** Openness and transparency means that the public, in particular, members of the pension fund have access to understandable, relevant and timely information about how the fund is taking decisions and how it is using resources.

**84.** There is evidence from several sources which demonstrate the Fund's commitment to transparency:

- the Pension Fund Committee meetings are held in public and are streamed live online via Glasgow City Council's website
- papers and meetings for the Pension Fund Committee are publicly available on the fund's website via a link to Glasgow City Council website
- Key documentation including funding strategy statements and actuarial valuations for both Fund No. 1 and Fund No. 3 are available on the pension fund's website.

**85.** The Fund held an annual general meeting on 14 June 2019 and over 100 stakeholders attended. Senior officers presented an overview of the Fund's business and performance for 2018/19.

**86.** We concluded that the Fund demonstrates a commitment to openness and transparency and conducts its business in an open and transparent manner.

## Pensions Regulator Public Service Code

**87.** The Fund maintains a log of any breaches of the regulations. In 2018/19, the Fund reported one breach of law to the Pensions Regulator (TPR) as they considered this breach to be of potential material significance. This related to a failure to issue deferred benefit entitlement and options notifications to members within the two-month timescale.

**88.** In July 2019, TPR confirmed in writing to the Fund that it did not plan to take any action against the Fund in relation to this issue, however it would monitor progress on remedial action. The Fund has put plans in place and dedicated people resources in order to remedy the issue by the end of December 2019. We will consider progress in this area as part of our 2019/20 audit.

## Review of the future structure of Local Government Pension Scheme in Scotland

**89.** The Scottish Scheme Advisory Board is undertaking a review of the future structure of the Local Government Pension Scheme in Scotland. Four options have been identified by the board:

- Retain the current structure of eleven funds
- Promote cooperation in investment and administration between the eleven funds
- Pool investments between the funds
- Merge the funds into one or more funds.

**90.** Stakeholder views were sought through a consultation process and the Fund submitted a response in December 2018. Following the consultation process, a draft report incorporating stakeholder views was considered at the Scheme Advisory Board meeting on 24 April 2019. The outcome of consideration by the Board and any ministerial consideration, is awaited.

## Merger of Fund No.3

**91.** Fund No.3 has been a closed fund to new employers since it was established in 1993 and had an estimated funding level of 114% at the 2017 triennial valuation. The Fund is now very mature and the sole employer, First Glasgow, is expected to exit the Fund when active membership ceases.

**92.** A report on future options for Fund No.3 was considered at the Strathclyde Pension Fund Committee in December 2018. The committee approved plans to wind up Fund No.3 through its merger into a similar LGPS arrangement managed for First Bus by North East Scotland Pension Fund. The planned merger will take place during 2019/20. The Fund have identified the merger as a priority on their 2019/20 business plan.



### Recommendation 1 – Merger of Fund No.3

**The Fund should ensure that adequate plans are in place to ensure the merger of Fund No.3 is carried out effectively. This includes ensuring that appropriate arrangements are in place for transfer of information and financial reporting.**

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# Part 5

## Value for money



### Main judgements

The Fund's investment performance is subject to regular review and scrutiny by the Pension Fund Committee. The investment strategy is forward looking, considers the unpredictability of future economic conditions and continues to diversify in order to be more resilient to future challenges.

The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management.

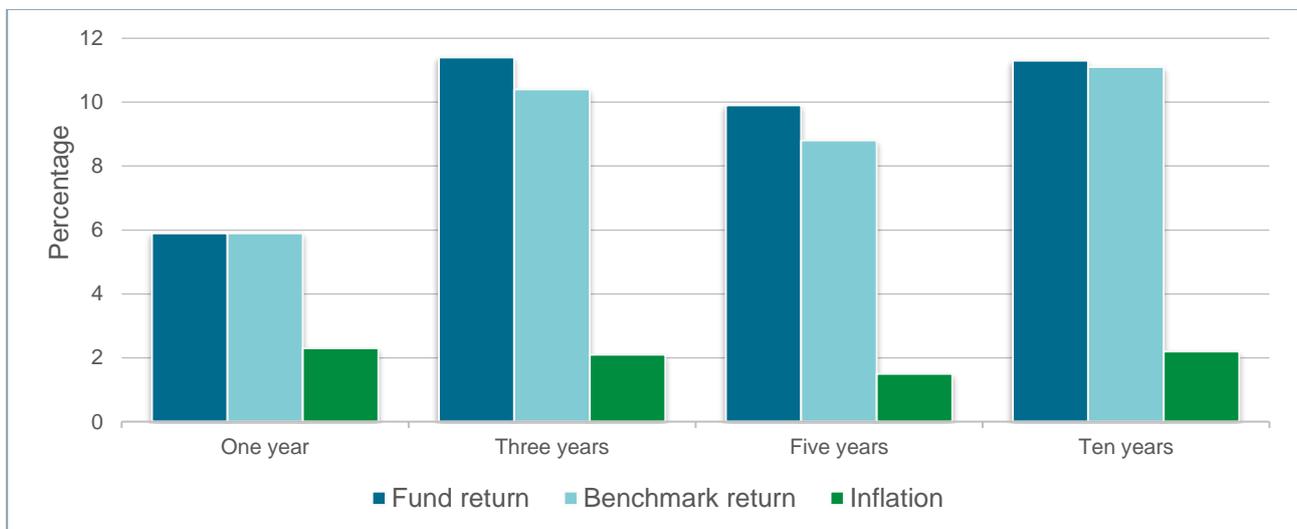
Value for money is concerned with using resources effectively and continually improving services.

### Investment performance

**93.** The Strathclyde Pension Fund Committee meets on a quarterly basis. Investment reports outlining investment performance are presented to the committee throughout the year.

**94.** [Exhibit 7](#) shows that over the year, the Fund generated a return of 5.9% against a benchmark of 5.9%. Equity portfolios were the most significant contributor to this increase. Over the medium to longer term, the Fund has outperformed its three, five- and ten-years benchmarks.

### Exhibit 7 Fund investment performance



Source: Strathclyde Pension Fund 2018/19 unaudited financial statements

**95.** The Fund appoints several external investment managers. Individual investment manager performance is reported on a regular basis to the Pension Fund Committee. In addition, all investment managers are subject to review at

least annually by the Investment Advisory Panel (IAP). Investment managers are required to complete annual compliance checklists. The Fund's investments team also carry out annual diligence reviews for each appointed fund manager.

**96.** The investment strategy of the Fund is included in the Statement of Investment Principles which was last updated in March 2019. The Fund has adopted a risk/return asset framework as the basis for modelling and agreeing the investment strategy.

**97.** Since the 2014 actuarial valuation, the Fund has progressively reduced its equity exposure and diversified its asset base through a range of approved structured investment strategies, in line with its Statement of Investment Principles.

**98.** The investment strategy focuses on increasing the diversification of the portfolio, including increasing allocations in income generating assets and assets which offer a greater level of protection from inflation. The strategy also takes the unpredictability of future economic conditions into consideration and continues to diversify in order to be more resilient to future challenges.

**99.** A further review of strategy is planned to be carried out alongside the 2020 actuarial valuation.

**100.** A review of the Fund's internally managed Direct Investments Portfolio (DIP) was carried out in year. The Strathclyde Pension Fund Committee approved a number of changes including increases in overall capacity and the target size of investments. Additional investment in DIP will enable the Fund to further diversify its assets base in line with the overall investment strategy.

**101.** 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. Although asset allocation is largely in line with the Fund's investment strategy, the Fund retains overweight positions in equity and cash, as the implementation of the current investment strategy continues. As a result, the Fund remains underweight in both short-term enhanced yield and long-term enhanced yield investments.

**102.** It is important that the Fund does not diverge too far from the long-term investment strategy and structure agreed by the Strathclyde Pension Fund Committee. The Investment Advisory Panel continues to monitor asset allocation and the re-balancing strategy and provides a quarterly report to the Strathclyde Pension Fund Committee.

## Management expenses

**103.** 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 oversight and governance costs.

**104.** External investment manager fees are agreed in the respective mandates governing their appointments. The fees are relative to the risk and complexity involved in managing a particular asset and strategy.

**105.** Investment management expenses have increased from £108.8 million in 2017/18 to £120.3 million in 2018/19. The main reason for this increase in expenses relates to the 5.43% increase in asset value.

**106.** The Fund has encouraged all of its listed equity investment managers to sign up to the Code of transparency and has engaged with managers of other assets classes to do so as and when cost templates become available.

**107.** The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

## National performance audit reports

**108.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2018/19, we published reports which might be of direct interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

# Appendix 1

## Action plan 2018/19

No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Transfer of Fund No.3 to North East Scotland Pension Fund in 2019/20</b></p> <p>The No.3 Fund will merge with LGPS arrangements managed by North East Scotland Pension Fund in 2019/20.</p> <p><b>Risk</b></p> <p>A lack of planning could lead to information not be transferred correctly and financial reporting may not be complete.</p>	<p>The Fund should ensure that adequate planning is in place to ensure that the merger of the Fund is carried out effectively. This includes ensuring that appropriate arrangements are put in place for transfer of information and financial reporting.</p>	<p>A detailed project plan has been agreed and is reviewed regularly by all parties involved in the merger process. Member data was transferred securely in August 2019. Financial reporting will be addressed at the conclusion of the process.</p> <p><b>Director of Strathclyde Pension Fund</b></p> <p><b>March 2020</b></p>
<b>Follow up of prior year recommendations</b>			
2	<p><b>Annual Report presentation</b></p> <p>Our audit identified a number of presentational and disclosure issues which were discussed with management, including potential changes to the document structure to improve the flow of the financial statement's sections within the annual report. In addition, the web links included throughout the report are only to the home page of the pension fund rather than to specific areas on funding, investment, etc.</p> <p><b>Risk</b></p> <p>Information in the annual report is challenging to follow and does not assist stakeholders in understanding the accounts.</p>	<p>The Fund should review the structure and presentation of the annual report and accounts, to further enhance the flow of the document and incorporate good practice into the existing reporting template.</p>	<p>Management reviewed the presentation of the annual report and accounts for 2018/19. A new template for the was developed for the report and the positioning and lay out of disclosures were reviewed. Significant progress has been made in improving the structure, flow and presentation of the information in the annual report and accounts.</p> <p><b>This issue is now closed</b></p>
3	<p><b>Funding Position</b></p> <p>The fund has reported a deficit in dealings with members and</p>	<p>The fund should continue to closely monitor the implementation of the funding and investment strategies and the impact of the fund's cash</p>	<p>The contributions/benefits cash flow model was reviewed. Revised cash flow projections for the</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>although active membership has increased, the continued increase in pensioners in the fund's membership will make funding pension payments increasingly challenging. The fund's cash flow projections in the Annual Business Plan 2018/19 show that the fund will use investment income to pay pensions over the next ten years.</p> <p><b>Risk</b></p> <p>There is a risk that the fund will have to increasingly rely on investment income to make up the shortfall between contributions income and pension payments.</p>	<p>flow position, given the negative cash flows forecast for the next ten years.</p>	<p>next 10 years were included in the 2019/20 Business Plan.</p> <p>Projections estimate that the negative cash flows will continue for the forward-looking ten-year period and the deficit is estimated to grow to £154m by 2028/29.</p> <p><b>Issue is now closed</b></p>

# Appendix 2

## Significant audit risks identified during planning

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

Audit risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Assessment of the estimation methodology applied by the Fund and the reasonableness of accounting estimates within the financial statements.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>From controls and substantive testing carried out in year, there was no evidence of management override of controls.</p>
<p><b>2 Risk of fraud over income and expenditure</b></p> <p>Under ISA 240 (UK) there is a presumed risk that income may be misstated due to the improper recognition of income.</p> <p>The Financial Reporting Council's <a href="#">Practice Note 10 (revised)</a> expands this to include the risk that material misstatements occur by the <a href="#">manipulation of expenditure recognition</a>.</p>	<p>We have rebutted the risks of fraud over income and expenditure, therefore no specific procedures are required as part of our planned audit work.</p>	<p>Our work did not identify any issues.</p>
<p><b>3 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of investments and the actuarial valuation.</p> <p>Investments include level 3 investments such as unquoted equity, where valuations involve the application of considerable judgement in determining appropriate amounts.</p>	<p>Completion of a 'review of the work of an expert' in accordance with ISA 500, for the work of third parties undertaking valuations of significant unquoted investments. This will consider the competence, expertise and objectivity of any experts used.</p> <p>Assessment of fund manager valuation techniques, including consistency of approach.</p>	<p>From our 'review of the work of an expert' and our substantive testing we did not identify any issues in relation to this risk.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>This subjectivity entails a risk of misstatement in the financial statements.</p>	<p>Confirmation of year end valuations to valuation reports and/ or other supporting documentation.</p> <p>Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary.</p> <p>Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2018/19.</p>	

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# Appendix 3

## Summary of national performance reports 2018/19

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

### Reports of relevant interest

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

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

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

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

# Strathclyde Pension Fund

## 2018/19 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](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)