

# North East Scotland Pension Fund

2020/21 Annual Audit Report – DRAFT



Prepared for the Aberdeen City Council Pensions Committee and the Controller of Audit  
September 2021

# Contents

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Contents	2
Key messages	3
Introduction	5
1. Audit of 2020/21 annual accounts	8
2. Financial management	11
3. Financial sustainability	16
4. Governance and transparency	21
5. Best Value	24
Appendix 1	28
Appendix 2	30
Appendix 3	33

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# Key messages

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## 2020/21 annual accounts

- 1 The financial statements of North East Scotland Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2021 and have been properly prepared in accordance with the financial reporting framework.
- 2 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.

## Financial management

- 3 The Fund has had a strong investment performance in 2020/21 and recovered from the significant impact of the Covid pandemic on investment values last year.
- 4 The Fund has appropriate and effective financial management arrangements.
- 5 Systems of internal control operated appropriately and effectively in 2020/21, with two areas for improvement: reconciliations and authorisation limits.
- 6 Standards of conduct and arrangements for prevention and detection of fraud and error were appropriate.

## Financial sustainability

- 7 The triennial funding valuation as at March 2020 assessed both funds as fully funded. The investment strategy has been reviewed and updated accordingly.
- 8 The insurance buy-in contract for the Transport Fund reduces risk for the Fund and increases certainty around the funding of the liabilities insured.
- 9 The Fund has appropriate and effective financial planning arrangements in place.

## Governance and transparency

- 10 The governance arrangements introduced in response to the pandemic are appropriate and operated effectively.
- 11 The Pension Fund demonstrates a commitment to openness and transparency.

- 12** There are effective arrangements for complying with the Pensions Regulator Public Service Code but member attendance at pensions training is not meeting the minimum expected level.
- 13** The Fund is actively considering Environmental, Social and Corporate Governance matters.

## **Best Value**

- 14** The pension administration function's performance against targets has been affected by added pressures from the Covid-19 pandemic, but performance in priority areas remained high.
- 15** Fund investment performance in 2020/21 has exceeded all agreed benchmarks as markets recover from the significantly reduced annual returns last year.
- 16** The Fund has effective arrangements in place for monitoring investment performance and scrutinising investment management expenses.

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# Introduction

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**1.** This report is a summary of our findings arising from the 2020/21 audit of North East Scotland Pension Fund (NESPF or “the Fund”). The Fund consists of two funds, the North East Scotland Pension Fund (the main fund) and the Aberdeen City Council Transport Fund (the transport fund). Both funds are part of the Local Government Pension Scheme (LGPS). Hereafter we will refer to “the Fund” in the singular.

**2.** The scope of our audit was set out in our Annual Audit Plan presented to the March 2021 meeting of the Pensions Committee. This report comprises:

- an audit of the Fund’s annual accounts
- consideration of the wider dimensions of financial management, financial sustainability, governance and transparency, and value for money, that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#)

**3.** The main elements of our audit work in 2020/21 have been:

- an audit of the Fund’s 2020/21 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 financial management, financial sustainability, governance and transparency and value for money.

## Added Value

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

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 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.

## Responsibilities and reporting

**5.** Aberdeen City Council is the administering authority for the North East Scotland Pension Fund. The council delegates this responsibility to the Pensions Committee. The committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The Pensions Committee is required to review the effectiveness of internal control arrangements and approve the annual accounts.

**6.** Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973, the [Code of Audit Practice 2016](#), and supplementary guidance, and International Standards on Auditing in the UK.

**7.** 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
- arrangements for securing financial sustainability.

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

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

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

## Auditor Independence

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

**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 2020/21 audit fee of £43,000, as set out in our Annual Audit Plan, remains unchanged.

**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 the management and staff who have been involved in our work for their cooperation and assistance during the audit.

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# 1. Audit of 2020/21 annual accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

The financial statements of North East Scotland Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2021 and have been properly prepared in accordance with the financial reporting framework.

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

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## Our audit opinions on the annual accounts are unmodified

**15.** The annual accounts for the year ended 31 March 2021 were approved by the Aberdeen City Council Pensions Committee on 17 September 2021. We reported within the independent auditor's report that:

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

## Submission of annual accounts for audit

**16.** The unaudited annual report and accounts were received in line with our agreed audit timetable on 29 June 2021. The working papers provided with the unaudited accounts were of a good standard and finance staff provided excellent support to the audit team during the audit. This helped ensure that the audit of the annual accounts process ran smoothly. The annual accounts were signed off in September 2021, in line with the agreed timetable.

## There were no objections raised to the annual accounts

**17.** 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 North



East Scotland Pension Fund was published on the website of the administering authority (Aberdeen City Council) and complies with the regulations. No objections were received to the North East Scotland Pension Fund accounts.

## Overall materiality is £57.5 million

**18.** We apply the concept of materiality in both planning and performing the audit and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report. We identify a benchmark on which to base overall materiality, such as gross expenditure, and apply what we judge to be the most appropriate percentage level for calculating materiality values.

**19.** The determination of materiality is based on professional judgement and is informed by our understanding of the entity and what users are likely to be most concerned about in the financial statements. In assessing performance materiality, we have considered factors such as our findings from previous audits, any changes in business processes and the entity's control environment including fraud risks.

**20.** Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual accounts and is summarised in [Exhibit 1](#).

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### Exhibit 1 Materiality values

Materiality level	Main Fund	Transport Fund
Overall materiality (1% of gross assets)	£57.5 million	£3 million
Performance materiality (65% of overall materiality)	£37 million	£2 million
Reporting threshold	£250 thousand	£75 thousand
Specific materiality (Benefits payable)	£17 million	£1.1 million
Specific performance materiality (Benefits payable)	£11 million	£0.7 million

Source: Audit Scotland

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

**21.** [Appendix 2](#) provides our assessment of the risks of material misstatement in the annual accounts and any wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the team were directed. The appendix identifies

the work we undertook to address these risks and our conclusions from this work.

## We have one significant finding to report on the annual accounts

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

**23.** The significant findings from our audit of the financial statements are summarised in [Exhibit 2](#). Some minor presentation and disclosure adjustments were also made in the audited accounts.

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### Exhibit 2

#### Significant findings from the audit of the financial statements

Issue	Resolution
<p><b>1. Private equity level 3 valuations as at 31 March 2021</b></p> <p>The draft accounts were prepared using the latest available valuations of private equity level 3 investments (as at 31 December 2020). The valuations of private equity level 3 investments as at 31 March 2021 were subsequently received by the pension fund in August 2021. These valuations showed a material increase in the value of these assets and management proposed to adjust the accounts so the most recent available information would be reflected in the audited accounts.</p>	<p>Management adjusted the accounts for the 31 March 2021 valuations, increasing Net Assets as at 31 March 2021 by £66 million. We have reviewed this adjustment and are satisfied that it reflects the most recent available valuations.</p>

Source: Audit Scotland

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## We have no unadjusted misstatements above our reporting threshold to report

**24.** It is our responsibility to request that all misstatements above the reporting threshold are corrected. We have no unadjusted misstatements above our reporting threshold to report from the 2020/21 audit.

## 2. Financial management

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

### Main judgements

The Fund has had a strong investment performance in 2020/21 and recovered from the significant impact of the Covid pandemic on investment values last year.

The Fund has appropriate and effective financial management arrangements.

Systems of internal control operated appropriately and effectively in 2020/21, with two areas for improvement: reconciliations and authorisation limits.

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

### The Fund has had a strong investment performance in 2020/21 and recovered from the significant impact of the Covid-19 pandemic on investment values last year

**25.** When considering the investment performance of the Fund during 2020/21, it is important to recognise the impact at the start of the financial year of Covid-19 on financial markets and investments. Asset values reduced significantly at the end of 2019/20, from a height of £4.8 billion to £4.4 billion at year end, as the global impact of the pandemic significantly increased market volatility. Asset values have recovered during 2020/21 and the Main Fund's net assets increased from £4,367 million as at 31 March 2020 to £5,777 million (£1,410 million increase) as at 31 March 2021. The Main Fund's performance in 2020/21 is summarised in [Exhibit 3](#).

**26.** The Fund's actuary, Mercer Limited, estimated that pension liabilities had increased by 14% from £5,252 million as at 31 March 2020 to £6,003 million at 31 March 2021 (£751 million increase) for the Main Fund.

**27.** During 2020/21 the £168 million benefits payable by the Main Fund exceeded the £143 million contributions receivable by the Fund. Benefits payable in 2020/21 were 8.6% higher than in 2019/20. Pensioner numbers rose by 536, a 2.4% increase. Other factors in addition to increasing pensioner numbers, affected the rise in benefits payable, including individual members' entitlement. This is the second year that the Main Fund has reported negative cash flows and this position is expected to continue as the scheme matures.

**28.** The Fund operates in a challenging environment and a number of issues may increase pressures on the future funding position, including (lack of) 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 are also likely to impact on the funding position in the coming years.

**29.** The Fund actively considers 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.

**30.** 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.

### Exhibit 3

#### Main Fund assets, liabilities and investment performance

Increase/ (decrease) in net assets	Increase/(decrease) in estimated liabilities	Investment performance
<b>£5,777 million</b>	<b>£6,003 million</b>	<b>32.2%</b>
Closing net assets as at 31 March 2021	Closing liabilities as at 31 March 2021	Return on investments 2020/21
<b>+£1,410 million</b> +32.2%	<b>+£751 million</b> +14.3%	
<b>£4,367 million</b>	<b>£5,252 million</b>	<b>13.5%</b>
Opening assets as at 1 April 2020	Opening liabilities as at 1 April 2020	Average annual return on investments over 5 years

Source: 2020/21 North East Scotland Pension Fund audited annual report and accounts

**31.** The Transport Fund's net assets have decreased from £308.8 million as at 31 March 2020 to £304.6 million as at 31 March 2021 (£4.2 million decrease). The impact of the Covid-19 pandemic on investment asset values last year was masked by the assets of Strathclyde Pension Fund No.3 Fund merging with those of the Aberdeen City Council Transport Fund during 2019/20. This merger increased the net assets significantly last year. During 2020/21 over £200 million of the Transport Fund's investment assets have been replaced by the Insurance Buy-In Contract. This is an insurance policy with Rothesay Life PLC that matches against some of the Transport Fund liabilities and reduces the risk exposure of the Fund (see paragraphs 52-53). The Transport Fund's performance in 2020/21 is summarised in [Exhibit 4](#).

**32.** The estimated Transport Fund liabilities increased by £21 million (10%), from £217 million as at 31 March 2020 to £238 million as at 31 March 2021.

**33.** The Transport Fund's benefits payable (£11.1 million) and contributions receivable (£11.0 million) were broadly similar this year. The Fund paid out only £8,000 more in benefits in 2020/21 than it received in contributions. Membership numbers were quite stable year on year, with a 1.6% overall reduction and pensioner numbers reducing by 1. The Fund is a closed fund (i.e. not open to new active members) so an overall reduction in pensioner numbers is expected over time. There was a large increase in pensioner numbers last year because of the merger with Strathclyde Pension Fund No.3 Fund. As reported last year, there was not a corresponding increase in contributions receivable through the merger: the 2017 triennial funding valuation for Strathclyde Pension Fund No.3 Fund set the employer's contribution rate at nil, because the Fund was over 100% funded. The 2020 triennial funding valuation for the Transport Fund has set the new employer contribution rate for both First Aberdeen Limited and First Glasgow Limited at nil from 2021/22 to 2023/24.

#### Exhibit 4 Transport Fund assets and liabilities

Increase/ (decrease) in net assets	Increase/(decrease) in estimated liabilities
<b>£304.6 million</b>	<b>£238 million</b>
Closing net assets as at 31 March 2021	Closing liabilities as at 31 March 2021
<b>(-£4.2 million)</b> (-1.4%)	<b>+£21 million</b> +9.7%
<b>£308.8 million</b>	<b>£217 million</b>
Opening assets as at 1 April 2020	Opening liabilities as at 1 April 2020

Source: 2020/21 North East Scotland Pension Fund audited annual report and accounts

#### Financial management arrangements were appropriate and effective

**34.** The Chief Officer - Finance for Aberdeen City Council is the Proper Officer responsible for North East Scotland Pension Fund. The financial regulations of Aberdeen City Council, as administering authority, apply to the Fund. We consider these to be comprehensive and current, and to promote good financial management.

**35.** Investment and administration performance reports are submitted to the Pensions Committee on a quarterly basis. Reports are comprehensive, covering reviews of the equity and bond markets, overall performance of the funds and reviews of the performance of each investment manager. Overall, the Fund has appropriate and effective financial management arrangements in place.

## Systems of internal control operated effectively, with two areas for improvement: reconciliations and authorisation limits

**36.** 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 North East Scotland Pension Fund has systems for recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**37.** The Pension Fund uses some of the administering authority's key financial systems, in particular the general ledger, payroll and accounts payable systems.

**38.** We take assurance from audit reporting by KPMG, the external auditor of Aberdeen City Council, that the internal controls over these financial systems were operating effectively during 2020/21. The 2020/21 annual audit report for Aberdeen City Council reported controls testing in the following areas, with satisfactory results: journal entries; budget monitoring; bank reconciliations; procurement (contract awards); and controls over the provision of pension fund membership information to the actuary. Progress is reported against the outstanding prior year recommendations to improve IT controls. KPMG will follow up implementation of these recommendations in their 2021/22 audit. KPMG have given an unmodified opinion on Aberdeen City Council's 2020/21 accounts.

**39.** Internal audit's annual opinion for Aberdeen City Council confirmed that "reasonable assurance can be placed upon the adequacy and effectiveness of the Council's framework of governance, risk management and control in the year to 31 March 2021."

**40.** We have taken assurance over the administering authority's financial systems from these sources.

**41.** We also gain assurance from internal audit's work on the North East Scotland Pension Fund, and from our own audit testing of pension fund key controls. Internal audit's annual report on their work in relation to North East Scotland Pension Fund was reported to the Pensions Committee in June 2021. The internal auditor's 2020/21 opinion for North East Scotland Pension Fund confirmed that "reasonable assurance can be placed upon the adequacy and effectiveness of the NESPF's framework of governance, risk management and control in the year to 31 March 2021".

**42.** Our audit testing of the fund's own pension administration system identified two control weaknesses that require improvement action. Audit testing of transfers out of the fund identified a transfer where the amount authorised was above the officer's delegated authorisation limit. Discussion with officers confirmed that they had not realised that their authorisation limit for transfers was lower than the authorisation limit for other areas of work. To check if this misunderstanding had led to more transfers out being authorised inappropriately, we reviewed the authorisation of an additional sample of transfers out. Authorisation of two transfers in this additional sample exceeded the delegated authorisation limit. We have reviewed the substance of the

transfers and concluded that in each case the amount was correct and was supported by documentation.

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## Recommendation 1

The Pension Fund should ensure that officers are familiar with their delegated authorisation limits and remain within those limits, escalating authorisation to more senior officers if required.

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**43.** Monthly reconciliations of the Altair pensions system to the ledger should be undertaken for each fund. However, reconciliations for the former Strathclyde No.3 Fund were not prepared on a timely basis during the year. One reconciliation was carried out at the year end. Lack of timely reconciliation can make it more difficult to investigate and clear issues if several months have passed since the issue occurred. We have reviewed the March 2021 reconciliation (which forms part of our standard planned year end audit work) and agreed it to supporting documentation: no issues were identified.

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## Recommendation 2

The Pension Fund should ensure that reconciliations are prepared on a timely basis for all accounts.

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

**44.** North East Scotland Pension Fund is 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.

**45.** We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the administering body's (Aberdeen City Council) arrangements for the prevention and detection of fraud and corruption. These include Code of Conduct for members and officers, Whistleblowing Policy and the Fraud, Bribery and Corruption Policy.

**46.** The risk profile of public bodies during 2020/21 has been significantly affected by the Covid-19 pandemic, including the move to working from home. This is likely to have increased the risk of fraud and error as control environments and internal controls have had to change to allow for services to operate effectively and respond to issues in a timely manner. We have reviewed the arrangements put in place by North East Scotland Pension Fund to address any heightened risks and concluded that there are appropriate arrangements for the prevention and detection of fraud, error and irregularities.

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## 3. Financial sustainability

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

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### Main judgements

The triennial funding valuation as at March 2020 assessed both funds as fully funded. The investment strategy has been reviewed and updated accordingly.

The insurance buy-in contract for the Transport Fund reduces risk for the Fund and increases certainty around the funding of the liabilities insured.

The Fund has appropriate and effective financial planning arrangements in place.

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### The triennial valuation as at March 2020 assessed both funds as fully funded

**47.** A full triennial valuation of the North East Scotland Pension Fund was carried out at 31 March 2020 and reported to the Pensions Committee in March 2021. One of the main purposes of the triennial valuation is to inform the setting of pension contribution rates for the forthcoming 3 years and to inform a review of funding and investment strategies to ensure the continued payment of members' pension benefits as they fall due.

**48.** The March 2020 triennial funding valuation reported that the Main Fund assets were sufficient to meet 103% of its liabilities. This is a slight drop from 107% in the 2017 valuation, but it still means that, overall, the investment assets were higher than the projected liabilities. This, alongside some deficit recovery contributions being made, enabled the fund to reduce the employer's contribution rate for one council and maintain the employer's contribution rate at 19.3% for the other two councils for the period 2021-2024. The rates for the other bodies range from 11.9% to 65.8%.

**49.** The Transport Fund was assessed as 114% funded, meaning that the Fund's assets were higher than its projected liabilities. This is an improved funding position from the 2017 funding valuation when the Transport Fund was assessed as 94% funded. The triennial funding valuation takes account of last year's completed merger with the former Strathclyde No.3 Fund. The former Strathclyde No.3 Fund was assessed as 114% funded in its 2017 funding valuation. The administering authority and the employers, First Aberdeen Limited and First Glasgow Limited, have agreed to set the new employer contribution rate at nil for the period 2021-2024.



## Financial planning arrangements are appropriate and effective

**50.** There is considerable volatility in pension funding and the results of the triennial valuation are in effect a snapshot of the Fund at 31 March 2020. Following each triennial valuation, the Fund reviews and revises its funding strategy. The funding strategy is a summary of the Fund's approach to funding liabilities. The investment strategy outlines the types of investment to be held and the balances between the different types of investment.

**51.** The Investment Strategy Review 2021 was reported to the Pensions Committee in March 2021. The updated Funding Strategy Statement was also reported alongside the triennial valuation results. The Fund is 103% funded and has the long term objective of maintaining its funding level at 100%. To achieve this, it is seeking to lock in recent gains and rebalance its investments closer to the benchmarks set for different asset types: growth assets 55%; income/protection assets 45%. The Fund therefore needs to reduce its growth asset allocation and increase its income/protection allocation. This can be done by reducing global equities and increasing bonds/credit and infrastructure assets. This move will take time and progress will be reported to the Pensions Committee.

**52.** The Transport Fund has a different risk profile and investment strategy as a maturing closed fund. De-risking is a key objective to ensure the Fund can cover its liabilities. At the request of First Group (the employer for members of the Transport Fund) the Fund completed a buy-in arrangement with an insurance company, Rothesay Life PLC, to cover the combined future liabilities of Transport Fund members. A buy-in is an insurance policy purchased by a pension fund, which is matched against some or all of the liabilities held. The Transport Fund insurance buy-in contract reduces longevity risk for the pension fund (transferring it to the insurer) and provides greater certainty over funding of the estimated liabilities (because pension payments are funded by the insurer). It is the first arrangement of its kind in the Local Government Pension Scheme in Scotland.

**53.** In November 2020 the Fund used £232 million of Transport Fund investment assets to purchase a bulk annuity policy with Rothesay Life PLC. This policy covers the liabilities of 1,371 members who were pensioners at the agreement date of 19 November 2020. The Fund continues to administer the pensions of these members, but Rothesay Life PLC reimburses the Fund for the pension payments. The value of the buy-in contract is assessed annually by the Fund's actuary and is included as a long term asset in the Net Assets Statement (£206.4 million as at 31 March 2021). The actuarial revaluation is reflected in the Fund Account. We reviewed the accounting treatment of the insurance buy-in contract and concluded it was appropriate. Additional disclosure to explain this arrangement has been included in the audited accounts.

**54.** Other Transport Fund members are not covered by the insurance buy-in contract and these pension liabilities will be funded by income from the remaining investment assets as set out in the Funding Strategy Statement and Investment Strategy.

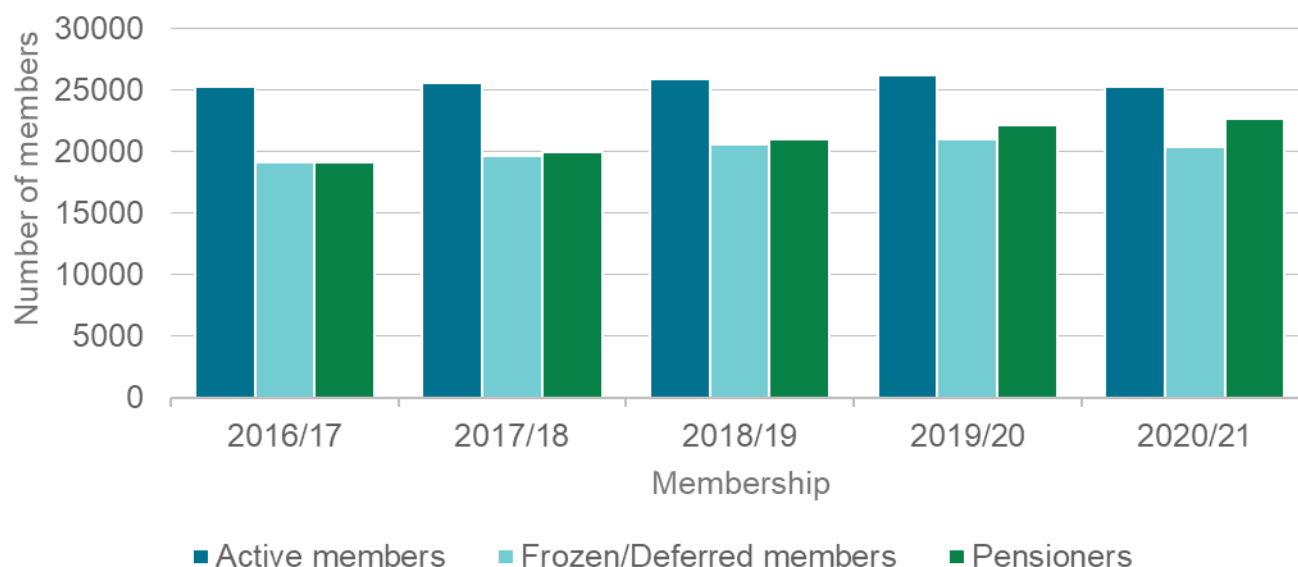
55. We have concluded that the Fund has an appropriate framework in place through which it demonstrates effective financial planning.

### Fund membership remained stable but the ratio of active members to pensioners is reducing

56. The Main Fund is a multi-employer fund with 3 local authorities, and 45 other employers. The current Main Fund membership profile is shown at [Exhibit 5](#).

57. 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.

#### Exhibit 5 Main Fund membership



Source: North East Scotland Pension Fund 2020/21 audited financial statements

58. Membership of the Main Fund remained stable year on year, reducing by 42 members to 69,375 members in total at 31 March 2021. The number of pensioner members continues to increase. In 2020/21, the number of pensioners receiving a pension from the Main Fund increased by over 500. The number of active members continues to outweigh the number of pensioners but the ratio of active members to pensioners has reduced in the past 5 years. 2020/21 cash flows from dealing with members were negative for the second year running, with more paid out in benefits that was received from contributions. Over the long term, the cash flow position will impact on the investment strategy as income from investments rather than contributions will be needed to pay pensions.

**59.** Future membership numbers are difficult to predict with any certainty as they are dependent on several factors including employer budgets, recruitment decisions, and promotion of the pension scheme. In addition, increased pension flexibilities mean that pensions can be drawn from the age of 55 to 75, which adds to the uncertainty.

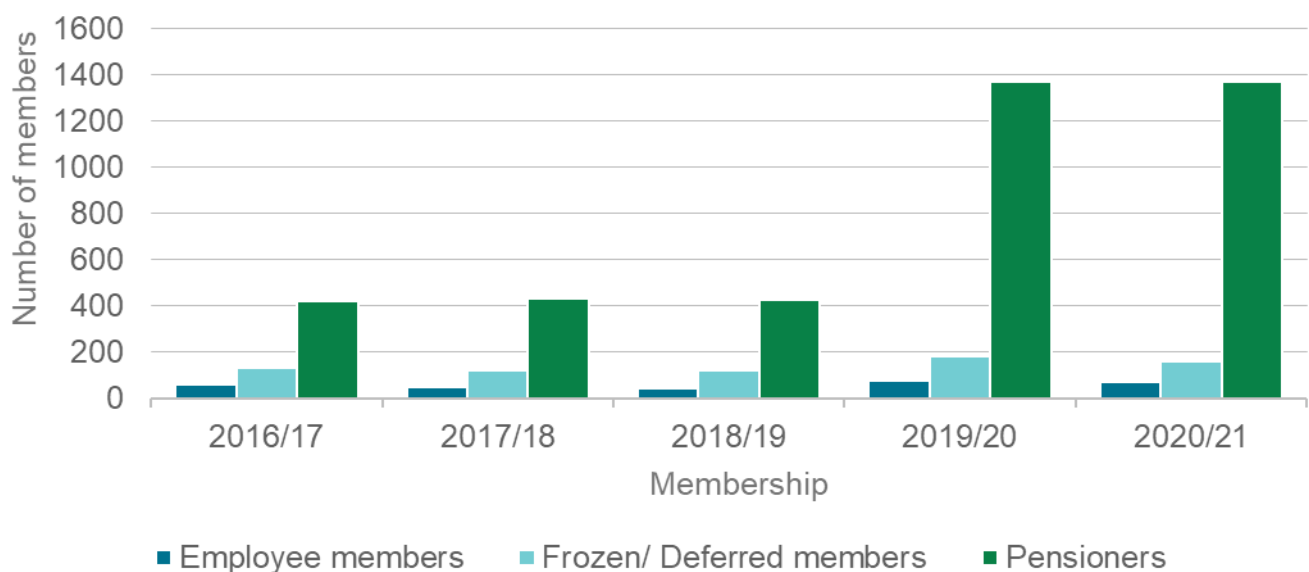
**60.** With most employers still open to new membership and with continuing support from auto enrolment, the recent trend of growth in membership seems likely to continue for the foreseeable future.

**61.** There was one bulk transfer out of the Fund in 2020/21, as Visit Scotland received Ministerial approval to consolidate all its LGPS memberships into one LGPS fund, Lothian Pension Fund. 77 members were transferred from North East of Scotland Pension Fund to Lothian Pension Fund.

**62.** The Transport Fund membership profile is shown at [Exhibit 6](#).

## Exhibit 6

### Transport Fund membership



Source: North East Scotland Pension Fund 2020/21 audited financial statements

**63.** The Transport Fund is a closed fund: membership increased significantly in 2019/20 due to the merger of Strathclyde Pension Fund No.3 Fund with the Aberdeen City Council Transport Fund. As noted above, the insurance buy-in contract reduces the financial risk for the Transport Fund.

## Future rates of employer contributions have remained stable or fallen for the largest employers but there is greater variation in rates across the smaller employers.

64. Following the triennial valuation in 2020, the actuary agreed employer contribution rates with individual employers from 1 April 2021. As noted above, the employer rate has reduced from 19.3% to 17.9% for one local authority and remained at 19.3% for the other two local authorities. The rates for the other bodies range from 11.9% to 65.8%. These rates previously ranged from 11% to 33.8%. 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 7](#).

### Exhibit 7 Contributions in 2020/21

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Transferee Bodies £m	Total £m
Employer contributions	27.634	63.609	6.592	4.117	101.952
Employee contributions	8.707	19.923	2.144	1.273	32.047
Strain Contributions	1.489	0.567	0.001	0	2.057
Deficit Recovery Contributions	2.391	3.582	0.090	0	6.063
Total	40.221	87.681	8.827	5.390	142.119

Source: North East Scotland Pension Fund 2020/21 audited financial statements and supporting working papers

65. The continued growth in pensioner numbers within the Main 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.

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# 4. Governance and transparency

The effectiveness of scrutiny and oversight and the transparent reporting of information

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## Main Judgements

The governance arrangements introduced in response to the pandemic are appropriate and operated effectively.

The Pension Fund demonstrates a commitment to openness and transparency.

There are effective arrangements for complying with the Pensions Regulator Public Service Code but member attendance at pensions training is not meeting the minimum expected level.

The Fund is actively considering Environmental, Social and Corporate Governance matters.

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## Governance arrangements operating throughout the Covid-19 pandemic have been appropriate and operated effectively

**66.** North East Scotland Pension Fund temporarily amended its governance arrangements in response to the pandemic. The impact of Covid-19 from March 2020 has been set out in the Annual Governance Statement in the Fund's annual report and accounts. We also reported in last year's [annual audit report](#) on the revised governance arrangements.

**67.** The Fund's property assets are valued by Savills (UK) Limited, a firm appointed on the Fund's behalf by one of the fund managers, Aberdeen Asset Managers Limited (now called Abrdn). This contract came to an end on 31 December 2020. Abrdn reported that its tender exercise for property valuation services was delayed by the Covid-19 pandemic. The contract with Savills has been extended for a year.

**68.** We have concluded that overall, North East Scotland Pension Fund has appropriate governance arrangements in place which support effective scrutiny, challenge and decision-making.

## There are effective arrangements for complying with the Pensions Regulator Public Service Code but member

## attendance at pensions training is not meeting the minimum expected level

**69.** The Public Sector Pensions Act 2013 provided for extended regulatory oversight by the Pensions Regulator. The Pensions Regulator issued a code on the governance and administration of public service pension schemes in January 2015 which funds are expected to comply with.

**70.** The Fund conducts a compliance review against the code on a six-monthly basis and reports annually to the Pensions Committee and Pension Board. The latest report assessing the Fund's compliance with the Pensions Regulator's code was submitted to the Pensions Committee and Pension Board in March 2021. This provided assurance that the Fund is largely in compliance with the regulations. There were no breaches of the code that required to be reported to the Pensions Regulator in 2020/21.

**71.** The Pensions Regulator places a legal requirement on Pension Board members to maintain an appropriate level of knowledge and understanding of scheme rules, documents recording scheme administration policies and pensions law. Pensions Committee and Pension Board members are expected to attend at least two training sessions per year. Three Pension Board members and three Pensions Committee members did not attend at least two training sessions during 2020/21: two Board and two Committee members attended no training during the year. Training sessions were offered online during 2020/21 to enable access to training while working remotely.

**72.** Members have varying levels of experience in their roles and their training needs will vary accordingly. Individual training needs are assessed in conjunction with pension fund officers and members can request targeted training.

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### Recommendation 3

The Pension Fund should work with Pension Board and Pensions Committee members to ensure that individuals' training needs are being met and members are supported in their monitoring and scrutiny role. Members should review their training needs to ensure they keep their pensions knowledge up to date. Specific training should be requested if required.

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### Performance reporting was of a good standard

**73.** Management Commentaries included in the annual accounts should provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

**74.** The Fund's 2020/21 management commentary is of good quality and is written with the stakeholder in mind. It presents some complex areas in an

understandable style which increases transparency in reporting the financial performance and financial position.

## **The Pension Fund demonstrates a commitment to openness and transparency**

**75.** Openness and transparency in how a body operates and makes decisions is key to supporting understanding and scrutiny. Transparency means that the public has access to understandable, relevant and timely information about how the body is taking decisions and using resources.

**76.** The Pension Fund demonstrates a commitment to openness and transparency. A range of information for members, employers and the public is available on the North East Scotland Pension Fund website. Aberdeen City Council publishes the Pensions Committee agenda papers and minutes on its website, with appropriate exemptions for private papers. Meetings are now a hybrid of in-person attendance and remote attendance using Microsoft Teams. As public attendance at committee meetings has not been possible during lockdown restrictions, draft minutes are published to ensure timely information is available. Members of the public can now make arrangements with the council to attend hybrid meetings in person.

**77.** Pensions Committee meetings are the vehicle for member scrutiny of pension fund decision making and use of resources. As noted above, the Pension Fund should support members through training and development to feel confident in their monitoring and scrutiny role. We have observed limited public scrutiny at Pensions Committee meetings, particularly in relation the accounts and audit reports. We acknowledge this may be because Fund performance has been very positive, and reports to the Pensions Committee contain sufficient detail and explanation. In addition, a recent members' training session focused on the 2020/21 annual report and accounts, to support members in their scrutiny of role.

## **Good practice point: The Fund is actively considering Environmental, Social and Corporate Governance matters**

**78.** The Fund actively engages with the companies it invests in regarding Environmental, Social and Governance (ESG) matters. The Statement of Investment Principles sets out the Fund's approach to responsible investment. The Fund's membership of the Local Authority Pension Fund Forum (LAPFF) and being a signatory to Principles for Responsible Investment offer an opportunity to engage on a wider scale on key issues: examples include working with companies to secure commitment to achieving a carbon neutral position, reducing the use of plastics and withdrawing from fossil fuel mining. The Fund is also a member of the Carbon Disclosure Project and a signatory to Climate Action 100+. As a signatory the Fund supports Climate Action 100+ in its engagement with the boards and senior management of companies around the world to implement a strong governance framework, take actions to reduce greenhouse gas emissions and provide enhanced corporate disclosures.

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# 5. Best Value

Using resources effectively and continually improving services

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## Main judgements

The pension administration function's performance against targets has been affected by added pressures from the Covid-19 pandemic, but performance in priority areas remained high.

Fund investment performance in 2020/21 has exceeded all agreed benchmarks as markets recover from the significantly reduced annual returns last year.

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

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## The pension administration function's performance against targets has been affected by added pressures from the Covid-19 pandemic, but performance in priority areas remained high

**79.** The Pensions Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance. The focus of measuring the performance of pensions administration includes both member experience and statutory compliance.

**80.** The Fund's business plan sets out a range of service standards against which administration performance is monitored. The administration function's performance against its targets for pensions processing have been affected by the pressures of the Covid-19 pandemic, alongside an increasing workload. Most staff are working from home which makes many processes slower. However, performance in several priority areas has remained high, including issuing annual benefit statements on time 99.66% and notifications of retirement estimates within target timescales 94%. The Fund has moved its transfer out quotations online and has worked with its software supplier to automate deferred benefit processes, which should both improve performance going forward.

**81.** Administrative expenses for the Main Fund increased in 2020/21 to £2.9 million from £2.2 million in 2019/20, including governance and oversight costs. The unit cost per member has increased by 32.6% in the past 5 years. Fund membership has increased by 9.1% over the same period. The workload of the pension administration section continues to grow, including the completion of the insurance buy-in contract for the Transport Fund during 2020/21. Other factors, such as the introduction of the career average pension scheme (CARE)



from 1 April 2015 and auto enrolment, also increase the administration workload.

**82.** Given the increasing workload pressures, the Fund undertook an administration review with the actuary during 2020, covering process (common admin tasks); management information; people (job roles, documentation, communication etc.) and capacity analysis (tasks created and completed). Areas of strength identified included data quality, use of I-Connect as an efficient and effective tool for obtaining member data and transferring it onto the pensions admin system, and accurate and efficient system calculation automation. Recommendations for improvement included implementing bulk processing, reducing manual processes following automated updates, reviewing how information is uploaded to the system and creating a formal process for staff to suggest change. The Fund has committed to implementing improvements over the 12-18 months.

### **Fund investment performance in 2020/21 has exceeded all agreed benchmarks as markets recover from the significantly reduced annual returns last year**

**83.** The Fund appoints several external investment managers. Individual investment manager performance is reviewed regularly by the Pensions Committee and the Fund's investments team also carries out annual diligence reviews for each appointed fund manager.

**84.** Financial markets have largely recovered from last year's exceptional volatility, when returns against most asset classes, especially equities, reduced significantly due to the impact of the Covid-19 pandemic. 2020/21 investment performance has exceeded the agreed benchmarks.

**85.** [Exhibit 8](#) shows that over the year, the Fund generated a return of 32.2% against a benchmark of 23.7%. Equity portfolios were the most significant contributor to this increase. Over the medium to longer term, the Fund has outperformed its three-, five- and since-inception benchmarks.

## Exhibit 8

### Fund investment performance



Source: North East Scotland Pension Fund 2020/21 audited financial statements

**86.** Investment return and risk are inextricably linked, and it is not possible for us to give an opinion on the relative performance of the Fund's investments given the risk exposure of the asset allocation and investments made.

**87.** As noted in paragraph 51, the Fund's most recent investment strategy has updated the benchmark for growth assets (from 57.5% to 55%) and income/protection assets (from 42.5% to 45%). The Fund continues to rebalance its investments towards these benchmarks. This means reducing growth assets (equities were 68.8% against the benchmark of 55%) and increasing income/protection assets such as bonds and infrastructure assets. The Pensions Committee is regularly updated with details of how closely aligned the Fund's investments are with its investment strategy.

**88.** We concluded that the Fund has adequate arrangements in place for monitoring investment performance.

### The Fund adequately scrutinises investment management expenses

**89.** 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 Aberdeen City Council and oversight and governance costs.

**90.** 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.

**91.** Investment management expenses for the Main Fund have increased from £18.0 million in 2019/20 to £23.8 million in 2020/21 (excluding administration, governance and oversight expenses: see paragraph 81). The main reason for this increase in expenses relates to the 29% increase in investment assets' value. Investment management expenses for the Transport Fund have increased from £0.181 million to £0.447 million.

**92.** The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses. The Fund continues to work with Fund Managers to increase transparency in reporting of investment management expenses.

### **National performance audit reports**

**93.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2020/21, we published reports which may be of interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

**94.** The Pensions Committee considered the LGPS supplement to the Local Government in Scotland: Financial Overview 2019/20 at its March 2021 meeting.

### **Good practice points**

**95.** The administration review conducted with the actuary has identified ways to increase efficiency and improve service provision at a time when the administrative function is experiencing increasing workload pressures and performance is affected by staff working from home during the Covid-19 pandemic.

# Appendix 1

## Action plan 2020/21

### 2020/21 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>1. Authorisation limits</b></p> <p>Audit testing identified three transfers out of the Pension Fund which exceeded the delegated authorisation limit of the officer who authorised it.</p> <p>Risk – Transfers out of the Pension Fund are not properly authorised.</p>	<p>The Pension Fund should ensure that officers are familiar with their delegated authorisation limits and remain within those limits, escalating authorisation to more senior officers if required.</p> <p><a href="#">Paragraph 42</a></p>	<p>In 2020/21, workflow tasks adapted to incorporate a prompt re limit. However, going forward, there will be a review of limits, systems and processes.</p> <p>Accounting Manager &amp; Benefit Administration Manager</p> <p>March 2022</p>
<p><b>2. Reconciliations</b></p> <p>The Altair ledger reconciliation for the former Strathclyde No.3 Fund should have been completed monthly. This wasn't done and wasn't noticed until year end when the annual accounts were being prepared. One reconciliation (March 2021) was then prepared for the whole year.</p> <p>Risk – Lack of timely reconciliation can make it more difficult to investigate and clear issues if several months have passed since the issue occurred.</p>	<p>The Pension Fund should ensure that reconciliations are prepared on a timely basis for all accounts.</p> <p><a href="#">Paragraph 43</a></p>	<p>The year end reconciliation identified no issues. Management are reviewing the frequency of reconciliations and considering combining the two Transport Fund reconciliations into one. The review to include any improvements to the process where required.</p> <p>Accounting Manager</p> <p>March 2022</p>
<p><b>3. Member training and engagement</b></p> <p>Pensions Committee and Pension Board members are expected to attend at least two training sessions per year. There is also a legal</p>	<p>The Pension Fund should work with Pension Board and Pensions Committee members to ensure that individuals' training needs are being met and members are supported in their monitoring</p>	<p>Additional training on the Annual Report &amp; Accounts was held 26 August 2021, led by the Chief Officer – Finance and the Pensions Manager.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>requirement for Pension Board members to maintain an appropriate level of knowledge and understanding of scheme rules, documents recording scheme administration policies and pensions law.</p> <p>Three Pension Board members and three Pensions Committee members did not attend at least two training sessions during 2020/21: two Board and two committee members attended no training during the year.</p> <p>Risk – There is a continuing risk of ineffective scrutiny, challenge and transparency on the decision making and on the financial and performance reporting.</p>	<p>and scrutiny role. Members should review their training needs to ensure they keep their pensions knowledge up to date. Specific training should be requested if required.</p> <p><a href="#">Paragraph 72</a></p>	<p>Officers will continue to support elected members through provision of training and clear, comprehensive reports, to exercise effective public scrutiny.</p> <p>Chief Officer – Finance &amp; Pensions Manager</p> <p>Ongoing</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
<p><b>1. Management override of controls</b></p> <p>International Standard on Auditing (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>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p><b>Results:</b> We undertook detailed testing of journal entries, accruals, and prepayments. We also reviewed accounting estimates and transactions for appropriateness.</p> <p><b>Conclusion:</b> We did not identify any incidents of management override of controls.</p>
<p><b>2. Estimation, judgements and classification</b></p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments and in the actuarial valuation. North East Scotland Pension Fund investments include investments such as property, unquoted equity and pooled funds, where valuations involve the application of judgement in determining appropriate amounts.</p> <p>The actuarial valuation depends on a number of</p>	<p>Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments.</p> <p>Confirmation of 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 2020/21.</p>	<p><b>Results:</b> We carried out 'reliance on a management expert' work on the custodian, the valuer and the actuary. This included review of the PwC report on actuarial assumptions. We concluded that we could place reliance on the custodian, the valuer and the actuary.</p> <p>We reviewed the valuation reports and confirmed these to the asset valuations in the accounts with no issues identified.</p> <p>The draft accounts were amended to reflect the Private Equity level 3 investment valuations for 31</p>

Audit risk	Assurance procedure	Results and conclusions
<p>assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>The Transport Fund insurance buy-in contract will be subject to an annual actuarial valuation.</p> <p>This subjectivity entails a risk of misstatement in the financial statements.</p>		<p>March 2021 which became available in August 2021. We confirmed all valuations to fund manager reports.</p> <p><b>Conclusion:</b> We did not identify any significant issues with the estimations and judgements used in the annual report and accounts.</p>
<p><b>3. Transport Fund Insurance Buy-In Contract</b></p> <p>In 2020/21 the Pension Fund entered into an insurance buy-in contract to cover the cost of paying pensioners within the Transport Fund. This is a new arrangement and we will carry out additional audit procedures to ensure that it is accounted for correctly.</p>	<p>Review of accounting disclosures and management commentary.</p> <p>Confirmation of valuations to supporting documentation.</p>	<p><b>Results:</b> We reviewed the accounting disclosures and management commentary for appropriateness. We confirmed the valuation to supporting documentation.</p> <p><b>Conclusion:</b> We did not identify any significant issues with the accounting treatment of the insurance buy-in contract or the valuation used in the annual report and accounts.</p>

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

Audit risk	Assurance procedure	Results and conclusions
<p><b>4. Public scrutiny by those charged with governance</b></p> <p>We noted that scrutiny of the annual accounts and audit reports can be limited in comparison to other Pensions Committee reports and would encourage members to strengthen their scrutiny of the annual report and accounts as the Fund's primary vehicle to</p>	<p>Review of member training arrangements: training needs assessments, sessions arranged by officers, and sessions attended.</p> <p>Attendance at Pensions Committee meeting to observe the presentation of annual report and accounts and the scrutiny thereon.</p>	<p><b>Results:</b> We have observed limited public scrutiny, as evidence by member comments and questions, at Pensions Committee meetings. We acknowledge that the Pension Fund's reported financial position has been positive, and members may feel assured by this, with less need to ask</p>

Audit risk	Assurance procedure	Results and conclusions
<p>demonstrate stewardship of public funds.</p> <p>There is a risk of ineffective scrutiny, challenge and transparency on the decision making and on the financial and performance reporting.</p>		<p>questions of officers or auditors.</p> <p>Not all Pensions Committee or Pension Board members participated in the expected two training sessions during the past year. Online training has been offered to all members during 2020/21. It is a legal requirement that Pension Board members maintain an appropriate level of knowledge and understanding of scheme rules, documents recording scheme administration policies and pensions law.</p> <p><b>Conclusion:</b> There is a continuing risk of ineffective scrutiny, challenge and transparency on the decision making and on the financial and performance reporting.</p> <p><a href="#">See Appendix 1.</a></p>

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# Appendix 3

## Summary of national performance reports 2020/21

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### April

[Affordable housing](#)

### June

[Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway](#)

[Local government in Scotland Overview 2020](#)

### July

[The National Fraud Initiative in Scotland 2018/19](#)

### January

[Digital progress in local government](#)

[Local government in Scotland: Financial overview 2019/20](#)

### February

[NHS in Scotland 2020](#)

### March

[Improving outcomes for young people through school education](#)

# North East Scotland Pension Fund

## 2020/21 Annual Audit Report – DRAFT

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