Audit of 2017/18 annual accounts (local authorities) - module 10 local government pension scheme accounts

Technical guidance note 2017/10(LA)

AUDIT SCOTLAND

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Contents

1 Introduction

Purpose of module

1. This module provides guidance on applying technical guidance note 2017/10(LA) to the audit of the annual accounts of pension funds forming part of the local government pension scheme (LGPS)

2. It also provides supplementary information on, and guidance on the risks of misstatement in, the following areas
   - Presentation of financial statements.
   - Contributions and other payments to the fund.
   - Investments.
   - Benefits.
   - Management expenses.
   - The actuarial present value of promised retirement benefits.
   - Governance compliance statement and other reports in the wider annual report.
   - Summary financial statements.

Contact point for this module

3. The contact point in Audit Scotland's Professional Support for this module is Tim Bridle, Manager - Local Government (Technical) - Tbridle@audit-scotland.gov.uk.

LGPS overview

4. The LGPS is a defined benefit scheme established under the *Superannuation Act 1972*. The current scheme (the 2015 LGPS) was established by The Local Government Pension Scheme (Scotland) Regulations 2014 and subsequent 2015 amendment regulations (the LGPS regulations). The 2015 LGPS came into existence and replaced the 2009 LGPS on 1 April 2015. However, The Local Government Pension Scheme (Transitional Provisions and Savings)(Scotland) Regulations 2014 protect the benefits accrued by members of the 2009 LGPS.

5. The LGPS in Scotland comprises eleven separately administered pension funds. The scheme managers responsible for the local administration of each fund are referred to as administering authorities.

6. Membership of the pension funds comprises employees, elected members, and pensioners of the administering authorities and other participating employers.

2 Application of other modules to LGPS

Purpose of section

7. This section of module 10 provides guidance on applying the other modules of technical guidance note 2017/10(LA) to the audit of LGPS annual accounts.

Summary of other modules' application

8. The following tables summarise the application of the other modules to the LGPS, and either provide supplementary guidance in some areas or indicate the section of this module in which it is provided.

Overview module

9. The following table summarises the application of the overview module which largely applies in full, other than in respect of the required financial statements, though there are additional considerations:

Section	Applicability	Supplementary guidance
Section 1 Introduction	Applies	Administering authorities are required to comply with the requirements of Regulation 55 of the LGPS regulations in respect of the pension fund annual report. Statutory guidance issued with finance circular 5/2015 clarifies that the annual accounts within the pension fund annual report are considered to be an additional abstract of accounts required by section 96(3) of the *Local Government (Scotland) Act 1973*. The purpose of the annual accounts is to report to all pension fund participants as a group in contrast with the cost of retirement benefits to an individual employer which is reported in each local authority's own annual accounts. It is expected that an administering authority will publish one document that satisfies the requirements of both the LGPS regulations and the accounts regulations. That document is referred to in this module as the annual report and accounts.

Section	Applicability	Supplementary guidance
Section 2 Accounts regulations	Applies	As the annual accounts are considered to be an abstract of accounts, Regulation 8(2) of The Local Authority Accounts (Scotland) Regulations 2014 applies.
Section 3 Proper accounting practices	Applies	Statutory guidance requires the financial statements to be prepared in accordance with proper accounting practices set out in the *Code of practice on local authority accounting in the UK* (the accounting code). There is supplementary guidance on the content of LGPS annual accounts later in this section.
Section 4 Auditing standards	Applies	The Financial Reporting Council's practice note 15 provides guidance on the application of ISAs to occupational pension schemes.
Section 5 Presentation of financial statements	Not applicable	Guidance on the presentation of the financial statements is provided at section 3 of this module.
Section 6 Accounting policies, estimates and prior year errors	Applies	No further guidance is required.

Modules 1 to 6

10. The following table covers the application of modules 1 to 6 of the technical guidance note:

Module	Applicability	Supplementary guidance and action
Module 1 Property, plant and equipment	Not applicable	LGPS pension funds do not generally hold property, plant and equipment.
Module 2 Provisions, creditors and accruals	Applies	The main principles apply though many of the specific provisions referred to will not be applicable.

Module	Applicability	Supplementary guidance and action
Module 3 Financial instruments	Applies	Supplementary guidance on investments is provided at section 5 of this module. An additional consideration for borrowing is Regulation 5 of *The Local Government Pension Scheme (Management and Investment of Funds (Scotland) Regulations 2010* (the investment regulations) which sets out the circumstances in which an administering authority may borrow for the purposes of the pension fund. **Auditors should** assess whether the administering authority has borrowed only • by way of temporary loan or overdraft to pay benefits due under the scheme; or meet investment commitments arising from changes to the balance between different types of investment • if it reasonably believes that the sum borrowed, and any interest, can be repaid out of its pension fund within 90 days from the date of borrowing.
Module 4 Retirement benefits	Not applicable	Equivalent guidance from an LGPS perspective is provided in sections 4 (contributions), 6 (benefits) and 8 (actuarial present value of promised retirement benefits) of this module.
Module 5 Reserves	Not applicable	No further guidance is required.
Module 6 Group financial statements	Applies	Although there is the possibility of group financial statements being required, this is very rare in practice.

Module 7

11. Most of the sections in module 7 of the technical guidance note do not apply to the LGPS. The following table lists those that do apply along with some supplementary guidance:

Section	Supplementary guidance and action
Section 6 Fair value measurement	This applies to investments as the accounting code adapts IFRS 13 to remove pension fund investments from its scope exclusions. There is supplementary guidance at section 5 of this module.
Section 7 Investment property	Supplementary guidance on investments properties is provided at section 5 of this module.

Section	Supplementary guidance and action
Section 10 Cash and cash equivalents	As an additional consideration, **auditors should** confirm that, in accordance with Regulation 6 of the investment regulations, pension fund money is kept in a separate bank account held by the administering authority for that purpose.
Section 14 Events after the reporting period	No further guidance is required.
Section 15 New accounting standards, key assumptions and related parties	Section 3.9.4 of the accounting code sets out the disclosure requirements for related parties. Although paragraph 3.9.4.3 of the accounting code states that the disclosure requirements for key management personnel are satisfied by the disclosures for officer remuneration, this is based on the assumption that there are such disclosures in the same financial statements. The inclusion of a remuneration report in the authority's own financial statements does not satisfy the disclosure requirements for key management personnel in the pension fund financial statements. **Auditors should** assess whether the disclosures required for key management personnel have been met for 2017/18.

Module 8

12. The following table lists the sections is module 8 which apply to the LGPS along with some supplementary guidance:

Section	Applicability	Supplementary guidance and action
Section 2 Remuneration reports	Not applicable	A statement should be disclosed that a remuneration report is not required because no relevant persons have received remuneration.
Section 3 Management commentary	Applies	The LGPS regulations also require a report about the management and financial performance of the fund. Guidance is provided in section 9 of this module.
Section 4 Annual governance statement	Applies	The LGPS regulations also require a governance compliance statement. Guidance is provided in section 9 of this module.
Section 5 Statement of responsibilities	Applies	No further guidance is required.

Section	Applicability	Supplementary guidance and action
Statement 6 Other information	Applies	Supplementary guidance is provided in section 9 of this module.

Content of LGPS pension fund annual report and accounts

13. The requirements of the accounts regulations and the LGPS regulations in respect of the contents of the annual report and accounts, along with where guidance is provided in this technical guidance note, are summarised in the following table:

Accounts regulations (annual accounts)	LGPS regulations (annual report)	Guidance in this TGN
Financial statements	Financial statements	Sections 3 to 8
Management commentary	Report about the management and financial performance of the fund	Module 8 Section 3
Annual governance statement	Governance compliance statement	Module 8 Section 4 Section 9 of this module
Statement that no remuneration report is required		No further guidance required
Statement of responsibilities		Module 8 Section 5
	Other specified reports	Section 9 of this module

14. **Auditors should** check that in accordance with the accounts regulations, the annual accounts include

- the financial statements required by proper accounting practices
- a statement that a remuneration report is not required
- a management commentary
- an annual governance statement (or a combined governance statement that includes the governance compliance statement
- a statement of responsibilities.

15. Where a required element of the annual accounts is missing, **auditors should**

- consider whether its exclusion is appropriate
- request that the authority includes the missing element where its inclusion is required
- where an authority declines to include the required element, consider the impact on the affected opinion in the independent auditor's report.

3 Presentation of financial statements

Purpose of section

16. This section of module 10 replaces section 5 of the overview module. It provides information on, and guidance on the risks of misstatement in, the presentation of the LGPS financial statements.

17. Guidance on risks in respect of recognition and measurement of financial statement areas is provided in the relevant section of this module.

Summary of proper accounting practices

18. Regulation 8(2) of the accounts regulations requires the annual accounts to include the financial statements required by proper accounting practices as set out in the accounting code.

19. The accounting code (at section 6.5) requires local authorities to account for pension funds in accordance with *IAS 26 Retirement benefit plans.* IAS 26 does not comprehensively specify the requirements for preparing financial statements for pension funds, which means that other relevant provisions apply to the extent that they are not superseded by specific IAS 26 requirements.

20. Section 6.5 of the accounting code follows the same approach and does not by itself specify all the requirements for preparing pension fund financial statements. Other relevant provisions of the code apply to the extent they are not superseded by section 6.5.

21. In addition, IAS 26 is an old standard, and paragraphs 6.5.2.1 to 6.5.2.10 of the accounting code contain a number of adaptations (referred to throughout this module) to bring it up to date.

Sources of guidance on proper accounting practices

22. LASAAC has issued guidance on the financial statements in Scottish local government pension scheme - using the financial statements.

23. CIPFA has produced *Example accounts and disclosure checklist*.

Risks of misstatement

24. The following paragraphs highlight potential risks of misstatement in respect of the presentation of financial statements, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

A complete set of financial statements is not properly presented

25. Paragraph 6.5.3.6 of the accounting code requires the financial statements of a pension fund to comprise
    - a fund account
    - a net assets statement
    - notes to the financial statements.

26. **Auditors should** assess whether the authority has
    - presented a complete set of financial statements for 2017/18
    - clearly identified the financial statements and distinguished them from the other information, statements and reports in the annual accounts
    - clearly identified each financial statement and the notes
    - presented both the financial statements with equal prominence
    - disclosed a description of the purpose of each statement on its face. Although the accounting code allows the description to be in the management commentary, guidance from the Scottish Government states that it should be on the face of each statement
    - offset assets and liabilities or income and expenses only where required or permitted by the accounting code.

27. When checking that the accounting code's disclosure requirements have been met**, auditors should**
    - request that the authority completes CIPFA's disclosure checklist that accompanies the example accounts.
    - investigate the reasons for any non-compliance that is highlighted.

28. Where the authority declines to do so, **auditors should** establish the alternative means by which the authority satisfies itself regarding the completeness of disclosures, and assess whether the arrangements are adequate.

Fund account is not properly presented

29. The fund account should show the transactions during 2017/18 that have changed the value of net assets available for benefits.

30. The following table sets out the items that paragraph 6.5.3.6 of the accounting code requires to be included in the fund account, along with an explanation and/or information on where guidance is provided in this technical guidance note:

Item	Explanation
Contributions	See section 4
Transfers in from other pension funds	
Benefits	See section 6
Payments to and on account of leavers	
Net (additions)/withdrawals from dealings with members	A sub-total showing the net of the above items
Management expenses	See section 7
Net additions/withdrawals including fund management expenses	A sub-total
Investment income	See section 5
Taxes on income	
Profit and losses on disposal of investments and changes in the market value of investments	
Net return on investments	Sub-total of above three items
Net (increase)/decrease in the net assets available for benefits during the year	Total of all above items

31. **Auditors should** assess whether the 2017/18 fund account is presented in accordance with paragraph 6.5.3.6 of the accounting code.

32. The code allows the option to disclose the actuarial present value of promised retirement benefits (explained at section 8) in the net assets statement. This is not common in practice but, if this option is chosen, auditors should check that the following are also present in the fund account

- the change in actuarial present value of promised retirement benefits during 2017/18
- the surplus/(deficit) on the pension fund for 2017/18.

Net assets statement is not properly presented

33. The net assets statement should show the assets available for benefits, and the associated liabilities, at 31 March 2018. The following table sets out the items that paragraph 6.5.3.6 of the accounting code requires to be included in the net assets statement, along with an explanation and information on where guidance is provided in this technical guidance note:

Item	Explanation
Investment assets	See section 5
Investment liabilities	
Total net investments	Sub-total
Borrowings	See section 2
Current assets	Includes contributions due at 31 March 2018, and cash balances not included in investments
Current liabilities	Includes benefits unpaid at 31 March 2018
Net assets of the fund available to fund benefits at the end of the reporting period	Total of all above items

34. **Auditors should** assess whether the net assets statement has been presented in accordance with paragraph 6.5.3.6 of the accounting code.

35. The net asset statement may also present the actuarial present value of promised retirement benefits where the authority chooses that option.

Presentation of financial statements is not consistent with previous years

36. Paragraph 3.4.2.33 of the accounting code requires local authorities to retain the presentation and classification of items in the financial statements used in previous years unless another presentation or classification is required by the code or is more appropriate.

37. **Auditors should**
    - identify any cases where the authority has changed the presentation or classification of items in 2017/18
    - assess whether the new presentation or classification is more appropriate
    - assess whether the authority has accurately reclassified the 2016/17 comparative amounts for changes in the presentation, and any changes of classification, of items in 2017/18
    - confirm that the nature of, and reasons for the reclassification, as well as the amount of each item reclassified, has been disclosed. Auditors should assess whether the disclosures are complete, concise, clear, relevant and free from misstatement.

38. Where 2016/17 comparative amounts have not been reclassified on the grounds that it is impracticable, **auditors should** assess whether the authority has made every reasonable effort to reclassify the amounts. Where auditors are satisfied that reclassification is impracticable, they should
    - confirm that the authority has disclosed the
      - reason for not reclassifying the amounts

  - the nature of the adjustments that would have been made if the amounts had been reclassified.
- assess whether the disclosures are complete, clear, concise and free from misstatement.

39. Where auditors do not consider it impracticable to reclassify the items, they should request the authority to do so. Where the authority declines, and the misstatement is material, **auditors should** consider the impact on their opinion on the financial statements.

Information in the notes is not properly disclosed

40. The information to be disclosed in notes to the financial statements is set out in the accounting code at paragraph 6.5.5.1.

41. Specific guidance is provided in the relevant module of this technical guidance note. As an overall responsibility, **auditors should**
    - assess whether the notes have been presented in a systematic manner as required by paragraph 3.4.2.83 of the accounting code
    - confirm that each item in the financial statements has been cross-referenced to any related information in the notes.

42. The notes in CIPFA's illustrative accounts are an example of a systematic order. Also, the accounting code provides examples of systematic ordering at paragraph 3.4.2.84. These include
    - giving prominence to the areas that the authority considers to be most relevant to an understanding of its financial performance and financial position
    - grouping together information about items measured similarly such as assets measured at current value
    - following the order of the line items in the fund account and net assets statement.

4 Contributions to the fund

Purpose of section

43. This section of module 10 provides information on, and guidance on the risks of misstatement in, contributions and other payments to the pension fund.

Definition

44. Contributions are payments from employers and employees to the pension fund which are invested to help meet the long-term cost of the benefits payable.

Summary of proper accounting practices

45. Paragraph 6.5.3.6 of the accounting code requires

- a line for contributions and a line for transfers from other pension funds to be presented in the fund account
- an analysis between employer and employee contributions to be either presented on the face of the fund account or disclosed in the notes.

Risks of misstatement

46. The following paragraphs highlight potential risks of misstatement in respect of contributions and other payments into the fund, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Employee contributions are not properly calculated

47. There are two types of employee member as explained in the following table:

Type of member	Regulation	Explanation
Active	3	Currently employed by the administering authority or other participating bodies and is making contributions from pensionable pay to the pension fund
Deferred	6	Previously an active member but has chosen to leave their accumulated contributions in the fund to benefit from a pension in the future

Contributions from active members are payments made into the pension fund which increase assets and liabilities. The LGPS regulations require employee contributions to be calculated by applying specified rates to pensionable pay as explained in the following table:

Feature	Explanation
Normal contribution rates	• Employee contributions are paid on a tiered basis over five earnings bands set out at regulation 9(2)(b) of the LGPS regulations, with the contribution rate being determined by the amount of earnings falling into each band. • The earnings for each band in the regulations are expressed as at 1 April 2014 and are increased each year by any increase to benefits under the relevant pensions increase order. The *Pensions Increase (Review) Order 2017* sets out the increase from 1 April 2017. • The contribution rates range from 5.55% to 12%.
Other contribution rates	• Regulation 10 allows members to elect to pay a reduced rate of 50% of that which would otherwise be payable. • Regulation 16 allows an active member to pay additional pension contributions up to £6,500 (this limit is expressed as at 1 April 2015 and is increased by subsequent pension increase orders).
Pensionable pay	• Pensionable pay is defined at regulation 20 as all an employee's salary, wages, and other pensionable emoluments. • In some circumstances (e.g. reduced pay on sick leave), an assumed pensionable pay requires to be calculated in accordance with regulation 21. • Under Regulation 93, a member may be protected from a permanent reduction in pay for 10 years.

48. **Auditors should** assess whether

- contributions during 2017/18 are at the correct rate
- the rate is applied to correct pensionable pay
- contributions are in respect of all members, and only members.

49. Under the LGPS regulations, responsibility for calculating the contributions lies with the employing authority rather than the administering authority. Testing should therefore be straight-forward for the 11 employing authorities that are also administering authorities, as auditors will have access to the necessary information.

50. For the other 21 employing authorities, testing of employee contributions will have been carried out as part of the audit of retirement benefits set out at module 4. **Auditors** of those employing authorities **should** provide assurance to the pension fund auditor as to whether, based on their testing of payroll, there are

- matters arising that could impact on the employing authority's ability to properly account to the pension fund for contributions
- audit findings expected to be material to the employer
- issues to be reported to those charged with governance.

51. Where auditors of employing authorities are not in a position to give sufficient assurance for 2017/18 to the satisfaction of the pension fund auditor, further testing of contributions will be required. It is considered most efficient if the testing is carried out by the auditor of the employing authorities. In the event this is not possible, arrangements should be made for the auditor of the pension fund to visit the employing authority to undertake the testing directly.

52. **Auditors** of pension funds **should** contact the auditors of the other employing authorities, and any other scheme employers they consider necessary, to agree arrangements for satisfactory assurances to be provided.

Employer contributions are not properly calculated

53. Employer members of the LGPS are summarised in the following table:

Employers	Explanation
Administering authorities	An employing authority which administers the particular pension fund
Scheduled bodies	Bodies with a statutory obligation to join, e.g. other councils in the area, non-uniformed staff in the police and fire services, and colleges
Admitted bodies	Bodies who meet certain conditions set out at part 2 of schedule 2 to the LGPS regulations, e.g. a body which provides a public service (they may have their own admission fund separate to the main fund)

54. The rates for employer contributions are calculated to ensure that the existing assets and future contributions will be sufficient to meet future benefit payments from the fund. Regulation 60 of the LGPS regulations requires administering authorities to obtain a triennial valuation by actuaries of the assets and liabilities of each pension fund as at 31 March. Some key features of the valuation are summarised in the following table:

Feature	Explanation
Assessment of labilities	Liabilities are assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes financial assumptions for discount rates, pay increases, pension increases, as well as longevity assumptions.
Notifying actuaries of future events	Authorities need to make sure that actuaries are made aware of future events that could affect the calculation of the liability, e.g. • significant redundancy schemes • workforce growth or reduction schemes • significant service restructuring or pay re-grading • planned pay awards.
Expected rate of return for investments	Actuaries apply a discount rate that reflects the expected rate of return for investments (which is different to the estimate disclosed for the purposes of the financial statements explained at section 8).
Actuarial report	The actuaries provide a report to the administering authority in respect of the valuation and a rates and adjustments certificate specifying the primary rate of employers' contribution, and any adjustments for a particular body (i.e. secondary rate), for each of the three years beginning on 1 April in the year following that in which the valuation date falls. The most recent actuarial valuation was as at 31 March 2017 which set contribution rates for the three years from 1 April 2018.

55. There are two categories of employer contributions as explained in the following table:

Type of contribution	Explanation
Normal contributions	These are set in respect of scheme membership expected to be completed after the date of the actuarial valuation, i.e. 'future service'. The contribution rate required to meet the expected cost of future service benefits is derived from an assessment of the cost of future service benefits, less expected employee contributions.
Deficit recovery contributions	Some contributions are in respect of scheme membership completed before the valuation date. This is where funds have a deficit at the actuarial valuation, and employers are required to make a contribution towards restoring the funding position in excess of the amount required to fund the ongoing accrual of benefits (i.e. deficit funding). The deficit recovery period varies depending on the individual circumstances of each employer.

56. **Auditors should** assess whether the employers' contributions for 2017/18 have been

- calculated using the correct primary percentage. This is the primary rate of the employer's contribution specified in the rates and adjustments certificate expressed as a percentage of the pay of its employees who are active members
- calculated using the correct pensionable pay
- increased or reduced by any secondary rate adjustments specified for that employer for that year in the rates and adjustments certificate.

57. As with employee contributions, **auditors** of pension funds **should** contact the auditors of the other employing authorities, and any other scheme employers they consider necessary, to agree arrangements for satisfactory assurances to be provided.

Further employer payments are not properly calculated

58. Further payments are made by scheme employers to the fund under regulation 66 where benefits are paid out to a member early. The payments are to compensate for what is referred to as 'strain on the fund costs' caused by the earlier payment. Payments require to be made to the fund for the early payment of retirement benefits on ill-health grounds under regulation 34. An administering authority may require further payments for benefits becoming immediately payable for

- early retirement under regulation 29(5), including the cost of waiving any reduction under regulation 29(8)
- flexible retirement under regulation 29(6), including the cost of waiving any reduction under regulation 29(8)
- redundancy under regulation 29(7).

59. **Auditors should** confirm that these further payments in 2017/18 have been properly calculated. As with employer and employee contributions, auditors of pension funds should contact the auditors of the other employing authorities, and any other scheme employers they consider necessary, to agree arrangements for satisfactory assurances to be provided

Contributions and further payments are not properly accounted for

60. The accounting code requires contributions to be recognised as income in the fund account when

- it is probable that the economic benefits or service potential associated with the transaction will flow to the pension fund
- the amount of the contributions can be measured reliably.

61. **Auditors should** assess whether

- normal contributions during 2017/18, both from employers and employees, have been recognised on an accruals basis in the period to which they relate

- deficit recovery contributions and pension strain contributions have been recognised in the period in which the liability arises
- a debtor has been recognised at 31 March 2018 where the recognition criteria has been met but contributions or further payments have not been received
- a creditor has been recognised at 31 March 2018 if contributions have been received but the recognition criteria has not been met (i.e. receipt in advance).

62. Admitted bodies are required to assess their risk of dissolving due to insolvency. Where necessary, the body is required to enter into an indemnity or bond agreement. **Auditors should** check that
    - indemnities or bonds are in place at 31 March 2018 with appropriate admitted bodies
    - an impairment loss has been recognised at 31 March 2018, where appropriate, for potential non-payment where a dissolved admitted body is not covered by adequate indemnities or bonds.

Information on contributions is not properly disclosed

63. **Auditors should** confirm that the authority has complied in 2017/18 with the accounting code's disclosure requirements for contributions set out at
    - paragraph 6.5.3.6 which requires contributions analysed between employer and employee to be disclosed in the notes if not presented on the face of the fund account
    - paragraph 6.5.5.1 o) and r) which require disclosure in the notes of
        - the funding policy, i.e. the basis on which the contribution rate has been set for both the administering authorities and scheduled bodies
        - contributions receivable analysed between the administering authority, scheduled bodies, and admitted bodies.

64. **Auditors should** assess whether the disclosures are complete, clear, concise, and free from misstatement.

Transfers payments from other pension funds are not properly recognised

65. **Auditors should** check that, in accordance with paragraph 6.5.3.6 of the accounting code, a line has been presented in the 2017/18 fund account for transfers from other pension funds under regulation 98 of the LGPS regulations.

66. **Auditors should** assess whether the transfers during 2017/18 are complete and free from misstatement.

Additional voluntary contributions are not properly treated

67. Regulation 17 of the LGPS regulations permits active members to enter into arrangements to pay additional voluntary contributions (AVCs). The arrangements are established between

the administering authority and an external insurance company. The AVC payments are invested in the insurance company rather than the pension fund.

68. IAS 26 does not refer to AVCs but paragraph 6.5.5.1 v) of the accounting code requires information on them to be disclosed. **Auditors should**

- confirm that
  - any AVC payments during 2017/18 have been excluded from the fund account
  - the amount of AVCs paid by members during 2017/18 and the value at 31 March 2018 of separately invested AVCs have been disclosed.
- assess whether the disclosures are complete, clear, concise and free from misstatement.

Payments for added years are not properly treated

69. Employing authorities make payments to retired members when they have decided to augment their benefits by adding years to their length of qualifying service (generally referred to as 'added years') under The Local Government (Discretionary Payments and Injury Benefits) (Scotland) Regulations 1998. Administering authorities often manage the payments as agents of the employing authorities. As this is an agency arrangement, the payments (both to the fund from the employing authority and from the fund to pensioners) should not be recognised in the fund account as either contributions or benefits paid.

70. **Auditors should**

- confirm that
  - 'added years' payments during 2017/18 have been accounted for on agency basis
  - information regarding the payments of 'added years' has been disclosed as an agency arrangement in accordance with paragraph 3.4.4.1 3 of the accounting code.
- assess whether the disclosures are complete, clear, concise and free from misstatement.

5 Investments

Purpose of section

71. This section provides information on, and guidance on the risks of misstatement in, investments. It supplements sections 4 and 5 of module 3.

Summary of proper accounting practices

72. The accounting code (paragraph 6.5.1.2) requires authorities to account for investments in accordance with *IAS 39 Financial instruments: Recognition and measurement*, *IAS 32 Financial instruments: presentation*, and *IFRS 7 Financial instruments: disclosure*. Pension fund investments should be included in the category of fair value through profit and loss.

73. The disclosure requirements of IFRS 13 apply to pension fund investments.

74. For the avoidance of doubt, IFRS 9 does not apply until 2018/19.

Sources of guidance on proper accounting practices

75. CIPFA has issued *Guide to the application of the 2008 investment governance group principles to the management of LGPS funds*.

Risks of misstatement

76. The following paragraphs highlight potential risks of misstatement in respect of investments, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Investments are not complete

77. **Auditors should** assess whether the administering authority has identified all the pension fund investments. The Local Government Pension Scheme (Management and Investment of Funds (Scotland) Regulations 2010 (the investment regulations) provide for the use and investment of pension fund money. The investing powers of pension funds are wider than those available to local authorities generally, and include

- securities
- equities
- investment property
- cash deposits
- derivative contracts
- pooled investments (a means of seeking economies of scale and risk diversification through a variety of investors 'pooling' their investments).

78. Key requirements of the investment regulations are summarised in the following table:

Regulation	Requirement
3	The term 'investments' has its normal meaning but it also includes contracts • entered into in the course of dealing in financial futures or traded options • of insurance and stock lending arrangements.
11	An administering authority is required to formulate a policy for the investment of fund money. A report which explains the authority's investment policy and reviews the performance of the investments requires to be included in the pension fund annual report.
12	An administering authority is required to prepare, maintain and publish a written statement of investment principles. The statement is required to be included in the pension fund annual reports and cover the authority's policy on • the types of investment to be held and the balance between them • the risk and expected return on investments • the realisation of investments • socially responsible investment • the exercise of voting rights attached to investments.
Part 1 of Schedule 1	This part limits the proportion of fund money which can be invested in specified investments to the percentage shown in a table in that schedule.

79. Authorities are also expected to adopt good practice in respect of fund money. This includes adherence to the *Myners principles*, which sets out the following six principles relating to pension fund investment decision-making

- effective decision making
- clear objectives
- risk and liabilities
- performance assessment
- responsible ownership
- transparency and reporting.

Investments are not properly measured

80. Investments should be carried at fair value using the valuation techniques set out in IFRS 13. They therefore need to be regularly re-measured by administering authorities.

81. Paragraph 6.5.3.3 of the accounting code clarifies that marketable securities should be valued at market value, measured by the current bid price in accordance with IAS 39. These requirements supersede the provisions of IAS 26 which provide an option to carry securities with a fixed redemption value based on the redemption value assuming a constant rate to maturity.

82. Pension funds use derivative contracts (explained at section 5 of module 3) more than local authorities. Derivatives are contracts that specify conditions for future payments, which are often related to specific dates, indexes, or exchange rates. Derivatives can be used for risk management (e.g. hedging) to limit the exposure of the fund to future events (e.g. to mitigate unexpected changes in foreign exchange rates). Forms of derivative contract used by pension funds include

- futures/forwards - an agreement to buy or sell an asset at a future date at an agreed price
- forward foreign currency - an agreement to buy or sell foreign currency at a future date at an agreed exchange rate
- options - an agreement which allows the option to buy or sell an asset at a future date at an agreed price.

83. **Auditors should**

- confirm that fair value has been established by using any published price quotations in an active market or, in the absence of that information, a suitable valuation technique in accordance with IFRS 13
- confirm that there has not been any deduction for transaction costs that would be incurred on disposal
- assess whether the calculation of fair value is free from misstatement.

84. Some equity instruments do not have a quoted price in an active market for an identical instrument, and fair value cannot be otherwise reliably estimated. When the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, paragraph 7.3.2.8 of the accounting code allows the instrument to be measured subsequent to initial recognition at cost. If an authority wishes to use this approach in 2017/18, **auditors should** assess whether the authority has made a reasonable effort to identify a reliable basis of valuation.

Investment income has not been properly calculated

85. Interest income credited to the fund account should be determined by applying the effective interest rate to the carrying amount. The effective interest rate is the rate that exactly discounts estimated future cash receipts over the expected life of the instrument to the initial net carrying amount.

86. Dividends on equity investments should be credited when they become receivable. Rental income from investment property during the year should be recognised gross in the fund account.

87. **Auditors should**

- confirm that interest, dividend and gross rental income receivable during 2017/18 has been credited to the fund account
- assess whether the amount credited is complete and free from misstatement.

Taxes on income are not recognised

88. Pension funds are exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. However, income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax should be accounted for as a fund expense as it arises.

89. **Auditors should**

- confirm that irrecoverable withholding tax during 2017/18 has been charged to the fund account
- assess whether the amount charged is complete and free from misstatement.

Movements in fair value of investments are not properly calculated

90. Movements in the net market value of investments (including investment properties) may arise from gains or losses arising from

- changes in fair value
- impairment losses
- disposal.

91. The gain or loss arising from a change in the fair value of an investment should be recognised in the fund account. The gain or loss is the difference between fair value and the amortised cost (calculated using the effective interest rate), with the calculation based on the ‘clean’ price of the instrument, i.e. excluding accrued interest.

92. The administering authority should have made an assessment at 31 March 2018 as to whether there is objective evidence of impairment. Where an impairment has been identified, the loss should be recognised in the fund account.

93. When an investment is disposed of, the gain or loss should be recognised in the fund account.

94. **Auditors should**

- confirm that
  - gains and losses arising from changes in fair value during 2017/18 have been recognised in the fund account
  - the gain or loss is the difference between fair value and amortised cost based on the 'clean' price
  - impairment losses during 2017/18 have been recognised in the fund account

  – gains and losses arising from disposal during 2017/18 have been recognised in the fund account
- assess whether the amount charged/credited is complete and free from misstatement.

Investments are not properly presented

95. IAS 26 does not specify how the assets of a pension fund are to be presented, other than requiring them to be suitably classified. However, the accounting code has adopted the format for a net assets statement from the pensions SORP. **Auditors should** assess whether
- investments at 31 March 2018 have been analysed in accordance with paragraph 6.5.3.6 of the accounting code either on the face of the net assets statement or in the notes
- investment income receivable during 2017/18 has been analysed in accordance with paragraph 6.5.3.6 of the accounting code either on the face of the fund account or in the notes.

Information on investments is not properly disclosed

96. The disclosure requirements for pension fund investments are set out at paragraph 6.5.5.1a), c) to m) and t). This includes, as examples, the following
- Assets at 31 March 2018 suitably classified (if not presented on the face of the net assets statement).
- The basis of valuation for each significant class of asset.
- Where investments are held for which an estimate of fair value is not possible, disclosure of the reason why fair value is not used.
- A reconciliation between the opening and closing value of investments analysed into meaningful categories.
- A breakdown of derivative contracts by their main types, a summary of the key terms and notional amount of the derivative contracts held at 31 March 2018, and explanation of the objectives and policies for holding derivatives and the strategies for achieving those objectives that have been followed during the period.

97. In addition, the following disclosure requirements also apply
- paragraphs 7.4.2.2 to 7.4.3.10 of the accounting code in respect of financial assets
- section 2.10.4 of the accounting code in respect of fair value measurement.

98. CIPFA's example accounts provide helpful illustrations of the required disclosures.

99. **Auditors should**
- confirm that the authority has complied in 2017/18 with the disclosure requirements in the accounting code for pension fund investments, financial assets and fair value measurement
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

6 Benefits

Purpose of section

100. This section of module 10 provides information on, and guidance on the risks of misstatement in, benefits paid from the fund to pensioners and other members.

Definition and explanation

101. Benefits include retirement pension, lump sums and death grants payable to members.

Summary of proper accounting practices

102. The accounting code at paragraph 6.5.3.6 requires

- a line for benefits to be presented in the fund account
- an analysis of benefits to be either presented on the face of the fund account or disclosed in the notes.

Risks of misstatement

103. The following paragraphs highlight potential risks of misstatement in respect of benefits, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

All members are not identified

104. There are three categories of member who should be receiving benefits under the regulations. They are summarised in the following table:

Regulation	Category of member	Explanation
7	Pensioner member	Receives retirement benefits from the fund as a former contributor
8(1)	Pension credit member	Receives retirement benefits under a pension sharing arrangement in accordance with the *Welfare Reform and Pensions Act 1999*
8(2)	Survivor member	Receives retirement benefits as a dependent of a former contributor who is deceased

105. **Auditors should** assess whether all members receiving benefits during 2017/18 fall into one of the above categories.

Retirement pensions are not properly calculated

106. Under regulation 29(1), a member with a qualifying service of at least two years who attains normal pension age (and is not an employee in local government service at that time) is entitled to immediate payment of a retirement pension without reduction. Retirement pensions are generally based on the member's length of qualifying service and their pensionable pay.

107. Some key issues around the calculation of retirement pension are summarised in the following table:

Issue	Explanation
Normal pension age	Prior to 1 April 2015, normal pension age was 65. From 1 April 2015, it has been aligned with the state pension age as specified in Schedule 4 to the *Pensions Act 1995* (or if higher, age 65). A member may elect to defer payment until they are 75 and receive an actuarial enhancement.
Pensionable pay	Prior to 1 April 2015, pensionable pay was based on the member's final salary • Any pension built up before April 2009 is calculated at an accrual rate of 1/80th of pensionable pay for each year of service. • Any pension built up from 1 April 2009 to 31 March 2015 is calculated at a 1/60th accrual rate. From 1 April 2015, this is based on a career average revalued earnings basis rather than final salary (regulation 23(4) of the 2015 LGPS regulations). The amount of earned pension for a scheme year is 1/49th of the member's pensionable pay received in that year (or 1/98th where contributions were temporarily reduced).
Voluntary early or flexible retirement	A member who is at least 55 may elect to receive immediate payment of • their retirement pension (subject to the consent of the employing authority where the member is less than 60) • all or part of their retirement pension where the member reduces their working hours or grade (referred to as flexible retirement). In both cases above, the amount of pension is normally subject to an actuarial reduction to recognise the early payment. However, under regulation 29(8), the employing authority may agree to waiver all or some of the reduction. There is also some transitional protection under The Local Government Pension Scheme (Transitional Provisions and Savings)(Scotland) Regulations 2014.

Issue	Explanation
Redundancy	Regulation 29(7) covers the cases where an active member has attained the age of 55 or over and • is dismissed from employment by reason of redundancy or business efficiency; or • their employment is terminated by mutual consent on grounds of business efficiency. The member is entitled to immediate payment of retirement pension.
Ill health	Under regulation 34, an active member is entitled to early payment of a retirement pension if • their employment was terminated by a scheme employer on the grounds of ill-health before the age of 65 • they are permanently incapable of discharging efficiently the duties of the employment they were engaged in; and • they have qualifying service for at least two years.
Additional pension	Regulation 30 permits scheme employers to award an additional pension of up to £5,000 to • an active member • a member who was dismissed by reason of redundancy, or business efficiency, or whose employment was terminated by mutual consent on grounds of business efficiency. The decision requires to be made within 6 months of the date the member's employment ended.
Pension increases	Retirement pensions are increased each year by the relevant pensions increase order. *The Pensions (Increase) Order 2017* sets out the increase for 2017/18.

108. **Auditors should** assess whether retirement pensions included in the 2017/18 fund account are complete and free from misstatement. This includes assessing whether

- the appropriate accrual rate has been applied
- the correct pensionable pay has been used
- actuarial reductions have been applied where appropriate
- the conditions of regulations 29 and 34 have been complied with
- the correct increase has been applied
- any additional pension under regulation 30 has been properly calculated
- retirement pensions include all amounts known to be due as at 31 March 2018.

Lump sums are properly calculated

109. Under regulation 32 of the LGPS regulations a member may, before the benefit crystallises, commute all or part of the retirement pension payable at a rate of £12 for every £1 of annual pension commuted, subject to a maximum of 25% of the capital value of the member's accrued rights (calculated in accordance with actuarial guidance from the Scottish Ministers).

110. For pension built up before April 2009 under the 2009 LGPS, there was an automatic lump sum of three times the annual pension.

111. **Auditors should** assess whether lump sum payments included in the 2017/18 fund account are complete and free from misstatement. This includes considering whether

- on pensions built up since 1 April 2009
  - the retirement pension payable has been commuted at a rate of £12 for every £1 of annual pension commuted
  - the total amount of the commuted sum does not exceed 25% of the capital value of the member's accrued rights
  - the capital value has been calculated in accordance with guidance issued by the Scottish Ministers.
- for pension built up before April 2009, the lump sum equates to three times the annual pension.

Death grants are not properly calculated

112. The LGPS provides for death grants to be paid to members who die before the age of 75. The calculation of the grant depends on the category of member as summarised in the following table:

Category of member	Regulation	Calculation
Active members	38	Highest of • three times the member's annual assumed pensionable pay as at the date of the member's death • death grant payable for deferred members • death grant payable for pension members
Deferred members	41	Five times the amount the member would have been entitled to receive as annual pension
Pension credit members	41	Three times the amount the member would have been entitled to receive as annual pension

Category of member	Regulation	Calculation
Pension members	44	Ten times the annual amount the member would have been entitled to receive as retirement pension at the date of death if there had been no commutation under regulation 32. The amount should be reduced by • the amounts of any such commuted lump sum; and • any retirement pension paid to the member.

116. **Auditors should** assess whether lump sum payments included in the 2017/18 fund account are complete and free from misstatement. This includes assessing whether

- the relevant members died before the age of 75
- the grant was calculated as set out in the above table depending on the category of member
- the liability for death grant has been recognised when the obligating event occurs (i.e. the date of death) rather than when the payment is made.

Information on benefits has not been properly disclosed

117. The accounting code's disclosure requirements for benefits are set out at

- paragraph 6.5.3.6 which requires an analysis between the following benefits (if not presented on the face of the fund account)
  - retirement pensions
  - commutations of lump sum benefits
  - purchased annuities
  - lump sum death benefits.
- paragraph 6.5.5.1 r) which requires disclosure of the total benefits payable analysed between the administering authority, scheduled bodies, and admitted bodies.

118. **Auditors should**

- confirm that the authority has complied with the disclosure requirements of the accounting code in 2017/18
- assess whether the disclosures are complete and free from misstatement.

Transfer payments to other pension funds are not properly recognised

119. Auditors should check that, in accordance with paragraph 6.5.3.6 of the accounting code, a line has been presented in the fund account for payments to or on account of leavers under regulation 94 (individuals) or regulation 96 (bulk transfers).

120. Individual transfers out are accounted for when paid, which is normally when the member liability is discharged. Bulk transfers are accounted for on an accruals basis in accordance with the terms of the transfer agreement.

121. **Auditors should** assess whether the transfers during 2017/18 are complete and free from misstatement. In accordance with regulation 97, **auditors should** check that the amount of the bulk transfer has been determined by an actuary to be equal to the value of the liabilities which have accrued in respect of those members.

7 Management expenses

Purpose of section

122. This section provides information on, and guidance on the risks of misstatement in, management expenses.

Changes in 2017/18

123. Paragraph 6.5.5.1 of the accounting code has been amended to require pension funds to disclose information on transaction costs.

Summary of proper accounting practices

124. Paragraph 6.5.3.6 of the accounting code requires a line for management expenses to be presented on the face of the fund account presented after the sub-total for dealings with members.

Sources of guidance on proper accounting practices

125. CIPFA has issued guidance called *Accounting for local government pension schemes management expenses* which sets out a framework for the consistent reporting of management expenses. A footnote in the accounting code recommends that local authorities pay due regard to that guidance.

Risks of misstatement

126. The following paragraphs highlight potential risks of misstatement in respect of management expenses, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Management expenses do not include all types or relevant cost

127. The CIPFA guidance recommends that management expenses should comprise the three categories of expenditure summarised in the following table:

Administration expenses	Oversight and governance expenses	Investment management expenses
Expenses related to • members and pensioners, including all activities the authority must perform to administer entitlements and provide members with scheme and benefit entitlement information • interaction with scheme employers, e.g. data collection and verification, contributions collection and reconciliation • associated projects	Expenses associated with • the selection, appointment, performance management and monitoring of external fund managers • investment advisory services • the operation and support of the pensions committee • internal or external reporting • legal services in connection with investment management • internal and external audit	Expenses incurred in relation to the management of pension fund assets and financial instruments entered into in relation to the management of fund assets

128. **Auditors should** confirm that

- administration expenses for 2017/18 are in accordance with the CIPFA guidance and do not include any expenses
  - incurred by the administering authority in its role as a scheme employer
  - associated with the administration of any other scheme with which the administering authority is associated.
- oversight and governance costs during 2017/18 are accordance with the above table
- investment management expenses are included.

Investment management expenses are not complete

129. Under regulation 8, an administering authority may appoint investment managers to manage and invest fund money on its behalf. Investment managers are required to report quarterly to the authority on the action they have taken. The CIPFA guidance recommends that investment management expenses should comprise the four types of expenses summarised in the following table:

Types of investment management expenses	Explanation
Transaction costs	Costs associated with the acquisition, issue or disposal of fund assets and associated financial instruments usually a flat rate fee charged quarterly or half-yearly
Management fees	Fees calculated and charged periodically depending on contract terms and usually linked to fund value
Performance fees	Fees which become payable to a manager when a minimum level of performance is achieved
Custody fees	Fees charged by a custodian

130. The CIPFA guidance states that investment management expenses include

- expenses that are directly invoiced by investment fund managers; and
- any fees that are payable to fund managers which are deducted from fund assets.

131. The following table sets out some complex issues in respect of identifying all investment management expenses:

Issue	Explanation and action
Capitalisation of some transaction costs	**Auditors should** confirm that transaction costs on investment property have been excluded from the fund account as the accounting code requires them to be capitalised. Transaction costs on financial instruments during 2017/18 should be reported gross in the fund account as they are not capitalised under the accounting code (in contrast with the pension SORP).
Transaction costs and management fees netted off against income	It is common practice for fund managers to net off transaction costs and management fees against investment income, and therefore likely that not all costs/fees are routinely reported back to the pension fund. **Auditors should** check that the pension fund has requested that the fund managers provide the necessary information. If it is not provided, **auditors should** assess whether a reasonable estimation technique has been used for 2017/18, with any limitations disclosed in the notes.

Issue	Explanation and action
Management fees deducted from pooled funds at source	In the case of pooled funds, management fees may be deducted from the pool at source, effectively through the redemption of units in the fund. The value of the pooled fund is then reported at the end of the reporting period net of the units redeemed. **Auditors should** assess whether the authority has included a reasonable estimate for these fees for 2017/18. Paragraph 49 of the CIPFA guidance advises that the value of the fees can usually be measured by • applying the year end unit offer price to the units redeemed: or • contacting the fund manager directly.
'Fund of funds' structure	Certain types of investment (such as private equity and hedge funds) are commonly accessed through a 'fund of funds' structure, with costs being incurred at each tier in the investment structure. **Auditors should** assess whether the authority has included a reasonable estimate for these fees for 2017/18. The previous edition of the CIPFA guidance required all costs at each tier to be reported by the pension fund. The guidance was revised in 2016 to clarify that reported costs should be limited to those where the pension fund has both • a contractual liability to pay; and • control.

Management expenses are not properly presented and disclosed

132. **Auditors should**

- confirm that management expenses has been presented in a separate line in the 2017/18 fund account
- assess whether the amount is free from misstatement.

133. Paragraph 6.5.5.1 of the 2017/18 accounting code has been amended to require the total amount of transaction costs of all major asset classes to be disclosed in the notes, including an explanation to enable users to understand the nature of the transaction costs and how they arise for different types of investment. This includes capitalised transaction costs for investment property. **Auditors should**

- confirm that the authority has complied with paragraph 6.5.5.1 for 2017/18
- assess whether the disclosure is complete, clear, concise and free from misstatement.

134. The CIPFA guidance recommends that authorities should disclose in the notes an analysis of management expenses across the following three cost categories

- Investment management costs
- Administration expenses

- Oversight and governance costs.

135. It also recommends that an analysis of investment management expenses be disclosed across
    - transaction costs
    - management fees
    - performance fees
    - custody fees.

136. The CIPFA guidance is not mandatory, but the accounting code recommends that due regard is paid to it. The Accounts Commission has expressed a desire for the guidance to be followed in the interest of achieving consistency.

137. **Auditors should** therefore strongly encourage their authorities to follow this guidance. While not following the guidance would not necessarily result in a misstatement (and hence not be a qualification issue), auditors should report any failure to follow the guidance in the annual audit report.

8 Actuarial present value of promised retirement benefits

Purpose of section

138. This section of module 10 provides information on, and guidance on risks of misstatement in, the actuarial present value of promised retirement benefits.

Summary of proper accounting practices

139. IAS 26 and paragraph 6.5.2.7 of the accounting code require the actuarial present value of promised retirement benefits to be disclosed.

Risks of misstatement

140. The following paragraphs highlight potential risks of misstatement in respect of the actuarial present value of promised retirement benefits, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Actuarial present value of promised retirement benefits is not properly calculated

141. The actuarial present value of promised retirement benefits is the IAS 26 terminology for what *IAS 19 Employee benefits* refers to as the ‘defined benefit obligation’. It is therefore equivalent to the liability that employing authorities are required to show in their own financial statements in respect of their future liability to pay pensions earned at 31 March.

142. **Auditors should** confirm that it has been calculated on an IAS 19 basis rather based on the triennial valuations.

143. **Auditors should** therefore refer to module 4, but the following table summarises some key differences between the IAS 19 liability and the liability used for calculating contributions:

Issue	Disclosure in financial statements	Triennial valuations
Discount rate	The discount rate is determined by reference to market yields at 31 March on high quality corporate bonds (i.e. returns on relatively 'secure' investments).	Actuaries may apply a discount rate that reflects the expected rate of return of investments for the fund (i.e. anticipated 'market rate of return'). Normally anticipated market rates will be higher than those for high quality corporate bonds, which means that the estimate of promised retirement benefits used for the setting of employer contribution rates will often be lower than the estimate disclosed in the financial statements.
Assumptions	While the actuary may make suggestions about reasonable assumptions, the administering authority's proper officer should have used assumptions that are reasonable and appropriate for its circumstances.	The actuary will normally determine the assumptions used.
Salary levels	IAS 26 permits the IAS 19 valuation to be based on either current salary levels or projected salary levels. The accounting code does not allow the former option, and auditors should confirm that projected salary levels approach has been used.	

Actuarial present value of promised retirement benefits is not properly presented or disclosed

144. IAS 26 gives various options for the presentation or disclosure of the actuarial present value of promised retirement benefits, and paragraph 6.5.2.8 of the accounting code explains how these are to be applied and this is summarised in the following table:

Presentation option	Explanation
Net assets statement	This is only permitted if the actuarial present value of promised retirement benefits is estimated as at 31 March 2018. This does not require a full actuarial valuation at that date, and the same actuarial techniques for rolling forward the last full triennial actuarial revaluation used to estimate individual employers' IAS 19 pension liabilities between triennial revaluations (as explained in module 4) may be used. Under this option, the fund account requires to disclose the resulting surplus or deficit. This is the accounting code's preferred approach, but is not commonly used.
Notes	If this option is used, the actuarial valuation does not have to be at 31 March 2018, but the latest IAS 19 valuation should be used (with the date of the valuation disclosed). This is the approach that pension funds usually adopt though they generally obtain IAS 19 valuations every year.
Reference to actuarial report	This option requires reference to the information in the accompanying actuarial report to be disclosed.

145. **Auditors should** assess whether the disclosure of the actuarial present value of promised retirement benefits at 31 March is free from misstatement.

Information on the actuarial present value of promised retirement benefits is not properly disclosed

146. The disclosure requirements regarding information on the actuarial present value of promised retirement benefits is set out at paragraphs 6.5.5.1 p) and q) of the accounting code. They require disclosure of

- an explanation of the relationship between the actuarial present value of promised retirement benefits and the net assets available for benefits, and the policy for the funding of promised benefits
- a description of significant actuarial assumptions and the method used to calculate the actuarial present value of promised retirement benefits.

147. **Auditors should**

- confirm that the authority has complied with the disclosure requirements of the accounting code in 2017/18
- assess whether the disclosures are complete, clear, concise, and free from misstatement.

9 Non-financial statements

Purpose of section

148. This section provides guidance on auditors' responsibilities for, and the risks of misstatement in, the following non-financial statements included in the annual report and accounts

- Governance compliance statement.
- Other required statements.

Governance compliance statement

Summary of reporting requirements

149. The governance compliance statement provides details regarding the delegation of the pension fund function, and sets out the extent to which the governance arrangements for the pension fund comply with guidance from the Scottish Ministers.

150. In addition to the requirement for an annual governance statement in the annual accounts (explained at section 4 of module 8), an additional consideration for the pension fund is that regulation 53 of LGPS regulations requires the inclusion of a governance compliance statement in the annual report.

151. Finance circular 6/2015 recommends that an administering authority includes either

- a single governance statement with two sections, with the first being the annual governance statement, and the second the governance compliance statement; or
- two separate statements, with the annual governance statement followed immediately by the governance compliance statement.

152. The remainder of this section covers the governance compliance statement regardless of the option chosen. Auditors should refer to section 4 of module 8 in respect of the annual governance statement.

Summary of auditors' responsibilities

153. The Accounts Commission requires auditors to express an opinion in the independent auditor's report on whether the

- information given in the governance compliance statement is consistent with the financial statements
- the governance compliance statement has been prepared in accordance with regulation 53.

154. The governance compliance statement is included in the definition of 'other information' and 'statutory other information' under ISA (UK) 720 (explained in section 3 of module 8).

155. For the avoidance of doubt, auditors' responsibilities are not designed to provide positive assurance on governance arrangements. There is no requirement to form an opinion on the effectiveness of the governance procedures, and auditors are not required to assess whether

- all risks and controls have been addressed by the authority
- all risks are satisfactorily addressed by internal controls
- the actions described in the statement will remedy any underlying weakness associated with an internal control issue.

156. The test procedures that auditors should undertake are set out throughout this section and are summarised in Appendix 1 to this section.

157. The model independent auditor's report for 2017/18 will be provided in a separate technical guidance note and will include wording for the opinion on the governance compliance statement.

Risks of misstatement

158. The following paragraphs highlight potential risks of misstatement in the governance compliance statement, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Governance compliance statement is inconsistent with the financial statements

159. Auditors should perform procedures necessary to identify any material inconsistencies between information in the governance compliance statement and the financial statements.

Test procedure 1 - inconsistencies with financial statements

Auditors should

- **select amounts or other items in the governance compliance statement and compare them with the corresponding amounts or other items in the financial statements**
- **request that any misstatements be corrected**
- **discuss any uncorrected material misstatement in the governance compliance statement with Audit Scotland**
- **report in the independent auditor's report**

160. The governance compliance statement may include amounts or other items that are intended to be the same as, to summarise, or to provide greater detail about, the amounts or other items in the financial statements. In order to evaluate their consistency, auditors should select amounts or other items in the governance compliance statement and compare them with the corresponding amounts or other items in the financial statements.

161. When checking the consistency of the selected items, auditors should

- for information that is intended to be the same as information in the financial statements, compare the information to the financial statements
- obtain a reconciliation between an amount within the governance compliance statement and the financial statements and
  - compare items in the reconciliation to the financial statements and the governance compliance statement; and
  - check whether the calculations within the reconciliation are arithmetically accurate.
- for information intended to convey the same meaning as disclosures in the financial statements, compare the words used and consider the significance of differences in wording used and whether such differences imply different meanings.

162. If auditors identify a material inconsistency between information in the governance compliance statement and the financial statements, auditors should
- conclude whether there is a misstatement in the governance compliance statement
- conclude whether there is a misstatement in the financial statements
- request the authority to correct any misstatement identified.

163. Further guidance on cases where a material misstatement in the governance compliance statement is not corrected will be provided in the technical guidance note on independent auditor's reports, but in summary auditors should
- discuss the matter with Audit Scotland's Professional Support
- describe the material misstatement in the independent auditors report
- qualify their opinion on the governance compliance statement in respect of inconsistency with the financial statements.

Governance compliance statement is not in accordance with regulation 53

164. Auditors should perform procedures necessary to conclude as to whether the governance compliance statement has been prepared in accordance with regulation 53 of the LGPS regulations.

Test procedure 2 - non-compliance with regulation 53

Auditors should • **use the checklist at Appendix 2 to assess whether information required by regulation 53 has been omitted from the governance compliance statement** • **request that any misstatements be corrected** • **discuss any uncorrected material misstatement in the governance compliance statement with Audit Scotland** • **report in the independent auditor's report**

165. Regulation 53 of the LGPS regulations requires the governance compliance statement to provide detail regarding the delegation of the pension fund function, and set out the extent to which the governance arrangements for the pension fund comply with guidance from the Scottish Ministers.

166. Under section 56 of the 1973 Act, an administering authority can delegate its pension investment functions to committees, sub-committees or officers. Under section 57, it is for the appointing authority to decide on the number of committee members and their terms of office. Although there is no one single model in operation, most pension funds are managed by a formal committee representing the political balance of the administering authority.

167. The pensions committee arranges for the supervision and administration of the investments and the appointment of fund managers, and has regard to pension scheme administration matters. CIPFA's Pensions finance knowledge and skills framework addresses the training and development of pension committee members in governance matters.

168. Regulation 51(4) requires each administering authority to establish a pension board. Provisions relating to the establishment of pension boards are included in The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. CIPFA's Local pension boards - a technical knowledge and skills framework addresses the training and development of pension board members. The board is required to assist the authority comply with

- the LGPS regulations
- any other legislation relating to the governance and administration of the scheme
- requirements imposed by the Pension Regulator.

169. From 1 April 2015, the Pensions Regulator took on an extended regulatory role under the *Public Service Pensions Act 2013* in respect of governance matters for public service pension schemes including the LGPS. Code of practice 14 Governance and administration of public service pension schemes from the Pensions Regulator sets out the legal requirements for public service pension schemes.

170. Auditors should assess whether any information required by regulation 53 to be included in the governance compliance statement has been omitted. This includes situations where

required information has been presented separately without appropriate cross-reference. In order to assess whether required information has been omitted, auditors should check whether the governance compliance statement includes the items summarised at appendix 2 to this section.

171. A required item is the extent to which the delegation complies with guidance from the Scottish Ministers, and the reasons for any non-compliance. The guidance includes a combination of descriptive text explaining the rationale of each compliance principle, and also a description of the relevant statutory provisions. The guidance sets out nine principles (e.g. structure; representation; selection and role of lay members; voting, etc) against which administering authorities should measure their governance arrangements. Most authorities use a tabular format in practice that lists each principle, indicates whether there is full compliance, and provides commentary for each.

Governance compliance statement is inconsistent with auditor's knowledge

172. Auditors should perform procedures necessary to identify any material inconsistencies between information in the governance compliance statement and the auditor's knowledge obtained in the audit.

Test procedure 3 - inconsistency with auditor's knowledge

Auditors should

- **consider whether there is a material inconsistency between the governance compliance statement and the knowledge they have obtained in performing the audit**
- **request that any misstatements be corrected**
- **discuss any uncorrected material misstatement in the governance compliance statement with Audit Scotland**
- **report in the independent auditor's report**

173. The governance compliance statement may be consistent with the financial statements and be prepared in accordance with regulation 53, but may still be inconsistent with the auditor’s knowledge acquired in the course of performing the audit. ISA (UK) 720 requires auditors to consider whether there is a material inconsistency between the governance compliance statement and the auditor's knowledge obtained in the audit. The auditor’s knowledge obtained in the audit includes the auditor’s understanding of the local authority and its environment.

174. In considering whether there is a material inconsistency between the governance compliance statement and the auditor’s knowledge obtained in the audit, auditors may focus on those matters that are of sufficient importance that a misstatement in relation to that matter could be material.

175. If auditors identify an inconsistency between information in the governance compliance statement and their knowledge, auditors should

- conclude whether there is a misstatement in the governance compliance statement
- consider whether their understanding of the local authority and its environment needs to be updated
- request the local authority to correct any misstatement identified.

176. Further guidance on cases where a material misstatement in the governance compliance statement is not corrected will be provided in the technical guidance note on independent auditor's reports, but in summary auditors should

- discuss the matter with Audit Scotland's Professional Support
- describe the material misstatement in the independent auditor's report.

Information in the governance compliance statement is misleading

Test procedure 4 - misleading information

Auditors should

- **consider whether any information in the governance compliance statement is misleading**
- **request that any misstatements be corrected**
- **discuss any uncorrected material misstatement in the governance compliance statement with Audit Scotland**
- **report in the independent auditor's report**

177. A misstatement in the governance compliance statement can also exist when the information is misleading. This includes situations where it omits or obscures information necessary for a proper understanding of a matter disclosed in the governance compliance statement.

178. When reading the governance compliance statement, auditors should remain alert for instances where the information is misleading.

179. If auditors identify any information in the governance compliance statement that is misleading, auditors should

- conclude whether there is a misstatement in the governance compliance statement
- request the local authority to correct any misstatement identified.

180. Further guidance on cases where a material misstatement in the governance compliance statement is not corrected will be provided in the technical guidance note on independent auditor's reports, but in summary auditors should

- discuss the matter with Audit Scotland's Professional Support
- describe the material misstatement in the independent auditors report.

Governance statements are not properly signed

181. **Auditors should** check that the annual governance statement or combined governance statement in the audited accounts has been signed by the Chief Executive and the convenor of the pension committee. Although the accounts regulations refer to the Leader of the Council being the signatory, Finance circular 6/2015 considers that the convenor should be nominated to sign the relevant statements instead of the Leader of the Council.

182. Although there is no explicit requirement for a separate governance compliance statement to be signed, it is good practice to do so.

Other required reports in annual report

Summary of reporting requirements

183. In addition to the governance compliance statement, Regulation 55 of the LGPS regulations require the annual report to contain

- a report on the management and financial performance of the pension fund
- a report explaining the authority’s investment policy and reviewing the performance during the year of the investments of each fund
- a report of the arrangements made during the year for the administration of the funds
- a statement by the actuary of the level of funding disclosed by their most recent valuation
- the funding strategy statement and statement of investment principles
- the extent to which levels of performance set out in the pension administration strategy have been achieved.

Summary of auditors' responsibilities

184. The statements required by regulation 55 are included in the definition of 'other information' under ISA (UK) 720 (explained in section 3 of module 8) as they are in the same document as annual accounts. Any material misstatements in the reports should be reported in the independent auditor's report, but auditors are not required to express any opinions in respect of these required statements.

185. The requirement for a management commentary in regulation 8(2) of the accounts regulations applies to LGPS annual accounts. Auditors should therefore refer to section 2 of module 9. Finance circular 6/2015 considers that the convenor of the pension committee should be nominated to sign the management commentary in place of the Leader of the Council.

186. An additional consideration for the LGPS is that regulation 53 of the LGPS regulations requires a report on the management and financial performance of the pension fund. Where the pension fund includes a separate report on the management and financial performance, the information is not covered by the opinions on the management commentary, but it should be read under ISA (UK) 720.

187. The Scottish Government recommend in finance circular 6/2015 that one report is prepared which satisfies both the accounts regulations and the LGPS regulations. Where a pension fund adopts this approach, auditors are not required to extend their opinion to cover compliance with the LGPS regulations.

Risks of misstatement

188. The following paragraphs highlight potential risks of misstatement in the other required reports, and set out actions for auditors to undertake to assess whether the authority has followed the required treatment.

Required reports are inconsistent with auditor's knowledge or misleading

189. ISA (UK) 720 requires auditors to consider whether there is a material inconsistency between the required statements and the auditor's knowledge obtained in the audit, and to remain alert for instances where the information is misleading.

190. If auditors identify an inconsistency or misleading information, they should

- conclude whether there is a misstatement in the required statements
- consider whether their understanding of the local authority and its environment needs to be updated
- request the local authority to correct any misstatement identified.

191. Where a material misstatement in the required statements is not corrected, auditors should

- discuss the matter with Audit Scotland's Professional Support
- describe the material misstatement in the independent auditors report.

10 Summary financial statements

Purpose of section

193. This section of module 10 provides information and guidance on auditors' responsibilities in respect of summary financial statements.

Administering authority's responsibilities

194. Regulation 54 of the LGPS regulations requires an administering authority to send a summary of the revenue account and balance sheet of the fund, and any report by the auditor, to each body whose employees are active members immediately after completion of the audit. It is assumed that this may entail the preparation of a summarised fund account and net asset statement.

Summary of auditors' responsibilities

195. **Auditors should** establish how the administering authority is intending to comply with regulation 54. Where a summarised fund account and net asset statement is prepared, auditors are required to examine the summarised accounts and express an opinion on the consistency with the full financial statements. A separate technical guidance note will provide a model auditor's report to be used for this purpose.

Audit procedures on summarised accounts

196. **Auditors should** check that there are no inconsistencies with the full financial statements by assessing whether

- the authority's processes and controls for the preparation of the summarised financial statements are adequate
- information has been accurately extracted from the full financial statements
- the use of headings in the summarised financial statements are compatible with the full statements from which they are derived
- information has been summarised in a manner which is consistent with the full statements
- all necessary information has been included.

197. Once the above checks have been completed, **auditors should**

- bring to the authority's attention any identified inconsistency between the summarised financial statements and the full statements so that it can be eliminated
- if the inconsistency is not eliminated, include a description of the inconsistency in their report on the summarised financial statements

- set out any modification to any opinion in the report on the full financial statements, or any emphasis of matter or other matter paragraph, in the report on the summarised financial statements
- sign the report on the summarised financial statements and pass it to the authority.

Appendix 1

Auditor action checklist - governance compliance statement

Test procedures	Yes/No/N/A	Initials/date	W/P ref
1 Have you • selected amounts or other items in the governance compliance statement and compared them with the corresponding amounts or other items in the financial statements? • concluded whether an inconsistency with the financial statements means there is a misstatement in the governance compliance statement? • requested that any misstatement be corrected?			
2 Have you • used the checklist at Appendix 2 to assess whether information required by regulation 53 has been omitted from the governance compliance statement? • requested that any misstatements be corrected?			
3 Have you • considered whether there is a material inconsistency between the governance compliance statement and the knowledge you have obtained in performing the audit? • requested that any misstatements be corrected?			
4 Have you • considered whether any information in the governance compliance statement is misleading? • requested that any misstatements be corrected?			
5 Have you discussed any uncorrected material misstatement in the governance compliance statement with Professional Support?			

Appendix 2

Checklist - required content of governance compliance statement

Required item	Yes/No/N/A
1 A statement as to whether the authority delegates its functions.	
2 The terms, structure and operational procedures of the delegation.	
3 The frequency of any committee or sub-committee meetings.	
4 Whether such a committee or sub-committee includes representatives of employing authorities or members and, if so, whether those representatives have voting rights.	
5 The extent to which the delegation complies with guidance from the Scottish Ministers, and the reasons for any non-compliance.	
6 Details of the terms, structure and operational procedures relating to the pension board.	