Strathclyde Pension Fund

2021/22 Annual Audit Report – DRAFT



AUDIT SCOTLAND

Prepared for the Strathclyde Pension Fund Committee and the Controller of Audit
October 2022

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Key messages

2021/22 annual report and financial statements

1 The financial statements of Strathclyde Pension Fund (the Fund) give a true and fair view the financial transactions of the Fund during the year ended 31 March 2022 and of the amount and disposition at that date of its assets and liabilities.

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

Financial management

3 The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.

4 The value of the Fund increased by 7.6% to £28.4 billion during 2021/22, with investment performance slightly below the benchmark return set for the year.

5 The conflict in Ukraine has significantly increased market volatility, and along with the Covid pandemic and the impact of government measures in response to the cost-of-living crisis, there is a risk of further fluctuations in the Fund value in future years, as the long-term impact of these events becomes clearer.

Financial sustainability

6 The Fund's funding position is strong, although it faces significant uncertainty due to the current economic climate.

7 Negative cash flows are expected from member activity in future years; however, the current investment strategy provides sufficient income to pay pensions in the medium term.

8 We currently have no concerns about the financial stability of the Fund, however in the current economic climate, the Fund will need to maintain focus on the viability of the funding strategy.

Governance and transparency

9 The Fund has appropriate arrangements to support good governance and accountability. There is effective scrutiny, challenge and informed decision making by committee.

10 There are effective arrangements for complying with the Pensions Regulator Public Service Code.

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

12 We have concluded that the overall reporting of performance within the annual report and financial statements was of a good standard.

Best Value

13 The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management.

14 2021/22 was a challenging year for Scottish Local Government Pension Schemes generally. Most funds reported positive movements in net assets during the year, but only three funds reported above benchmark returns.

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

16 The pension administration function has performed well against most targets in 2021/22.

Introduction

1. This report is a summary of our findings arising from the 2021/22 audit of Strathclyde Pension Fund (the Fund).

2. The scope of our audit was set out in our Annual Audit Plan presented to the June 2022 meeting of the Strathclyde Pension Fund Committee. This report comprises:

- an audit of the Fund's annual report and financial statements
- our 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 2021/22 have been:

- an audit of the Fund's 2021/22 annual report and financial statements 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 aim to add value to the Fund and help promote improved standards of governance, better management and decision making and more effective of use of resources 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. Glasgow City Council is the administering authority for the Strathclyde Pension Fund. The council delegates this responsibility to the Strathclyde Pension Fund Committee. The committee is responsible for establishing effective governance arrangements and ensuring that financial management is effective. The Strathclyde Pension Fund 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 control.

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

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 2021/22 audit fee of £60,030 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

Audit appointment from 2022/23

13. The Accounts Commission is responsible for the appointment of external auditors to local government bodies including pension funds. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants. The current appointment round was due to end in 2020/21 but this was extended for a year so that 2021/22 is the last year of the current appointment round.

14. The procurement process for the new round of audit appointments was completed in May 2022. From financial year 2022/23, Ernst & Young LLP will be the appointed auditor for the Strathclyde Pensions Fund. We are working closely with the new auditors to ensure a well-managed transition.

15. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the Code issued in May 2016.

Acknowledgement

16. We would like to thank the Strathclyde Pension Fund Committee members, management and staff for their co-operation and assistance over the last six years.

1. Audit of 2021/22 annual report and financial statements

The annual report and financial statements are the principal means of accounting for the stewardship of resources and performance in use of those resources

Main judgements [Subject to completion of audit procedures]

The financial statements of Strathclyde Pension Fund give a true and fair view the financial transactions of the Fund during the year ended 31 March 2022 and of the amount and disposition at that date of its assets and liabilities.

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

Our audit opinions on the annual report and financial statements are unmodified

17. The annual report and financial statements for the year ended 31 March 2022 were approved by the Strathclyde Pension Fund Committee on 11 October 2022. We reported, within the independent auditor's report that:

- the financial statements give a true and fair view of the financial transactions of the Fund during the year ended 31 March 2022 and of the amount and disposition at that date of its assets and liabilities
- the management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared in accordance with relevant guidance.

The annual audit report and financial statements were submitted in line with our agreed audit timetable

18. We received the unaudited annual report and financial statements on 22 June 2022 and working papers were provided by 30 June 2022, in line with our agreed audit timetable. The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team during the audit.

19. Following the appointment of a new audit engagement lead in August 2022, the audit timetable was revised to take account of additional audit quality

requirements arising from the change of engagement lead. However, the accounts were still signed off prior to the 31 October deadline.

Public inspection requirements were not fully met, however there were no objections raised to the annual report and financial statements

20. Regulation 9 of the Local Authority Accounts (Scotland) Regulations 2014 requires local government bodies to give public notice on their websites by 17 June (at the latest) of the right to inspect its annual report and accounts. The accounts should be available for inspection from 1 July at the latest, for a period of 15 working days from the date specified in the notice.

21. As part of our audit, we confirmed the Fund's accounts were available for inspection from 1 July, in line with the regulations. However, the public inspection notice for the Fund's accounts did not appear on the administering authority's website until 20 June 2022, three days after the deadline set in the regulations. No objections were raised to the 2021/22 annual accounts.

Our audit approach and testing reflected the calculated materiality levels

22. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the perceptions and decisions of users of the annual accounts. The assessment of what is material is a matter of professional judgement. A misstatement or omission, which would not normally be regarded as material by value, may be important for other reasons (for example, an item contrary to law). In forming our opinion on the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

23. Our initial assessment of materiality for the annual report and financial statements was carried out during the planning phase of the audit. This was reviewed on receipt of the unaudited annual report and financial statements and our final materiality levels are summarised in Exhibit 1.

Exhibit 1
Materiality levels for the 2021/22 audit

Materiality	Amount
Overall materiality	£284 million
Performance materiality	£213 million
Reporting threshold	£250 thousand

Source: Audit Scotland

Lower specific materiality levels for the 2021/22 audit

24. In addition to overall materiality, we can set lower, specific materiality levels for certain classes of transaction, account balances or disclosures where lesser amounts could influence the decisions of the users of the financial statements. We recognise that transactions (for example, payments to pensioners and income from employers and members) are of importance to the users of the financial statements and we therefore set lower specific materiality levels for these account areas as shown in Exhibit 2.

Exhibit 2
Lower specific materiality levels for transactions in 2021/22

Materiality	Amount
Specific materiality (applied to benefits expenditure and contributions income in the fund account)	£7 million
Specific performance materiality	£5.5 million
Reporting threshold	£250 thousand

Source: Audit Scotland

We have obtained audit assurances over the significant financial statements' risks identified in our 2021/22 Annual Audit Plan

25. We have obtained audit assurances over the identified significant risks of material misstatement to the financial statements. Exhibit 3 sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3

Identified significant risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
Risk of material misstatement due to fraud caused by management override of controls	Detailed testing of journal entries, targeted on higher risk journals at year end that may be indicative of fraud.	**Satisfactory** While testing identified some misstatements (para 29.), the completion of the

Audit risk	Assurance procedure	Results and conclusions
As stated in International Standard on Auditing 240, management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise are operating effectively.	Assessment of the estimation methodology applied by the Fund and the reasonableness of accounting estimates within the financial statements. Focused testing of accruals and prepayments. Evaluation of significant transactions outside the normal course of business.	assurance procedures did not identify any evidence of management override of controls.

Source: Audit Scotland

Other areas of audit focus

26. We identified in our 2021/22 Annual Audit Plan areas where we considered there to be other risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks. The areas of specific audit focus were:

- **Estimations applied to level 3 investments:** The pension fund has a significant portfolio of level 3 investments, for example unquoted equities, where valuations involve the application of a variety of estimates in determining appropriate valuations. This subjectivity gives rise to a risk of material misstatement in the financial statements. Our audit procedures included consideration of the competence, expertise and objectivity of fund managers preparing the valuations; obtaining an understanding of management's involvement and oversight in the valuation process; assessment of fund manager techniques including consistency of approach; agreement of manager valuations to the custodian report and other supporting documentation.

- **Estimations applied to the actuarial valuation:** The actuarial valuation depends on a range of financial and demographic estimations about the future. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements. Our audit procedures included consideration of the competence, expertise, and objectivity of the actuary; obtaining an understanding of management's involvement and oversight in actuarial reporting; agreement of pension disclosures to actuary reports and supporting documentation; using an independent expert to challenge key assumptions applied.

27. We kept these areas under review throughout our audit and based on the findings of the audit procedures performed, there are no matters which we need to bring to your attention.

We have no significant findings to report on the annual report and accounts

28. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. We have no issues to report from the audit.

Misstatements of £1.990 million identified during the audit were adjusted in the accounts, these were less than our performance materiality and we did not need to further revise our audit approach

29. Two misstatements totalling £1.990 million were identified in the accounts presented for audit. These related to:

- An over-accrual of £1.335 million in respect of lumps sums and death grants payable
- £0.655 million pension payments and administrative expenditure misclassified in the fund account as a change in market value of investments.

30. We have concluded that the misstatements identified above arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality.

31. Management adjusted for these identified misstatements in the certified accounts. The impact of these adjustments was an increase of £1.335 million in the net assets of the Fund.

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 appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.

The value of the Fund increased by 7.6% to £28.4 billion during 2021/22, with investment performance slightly below the benchmark return set for the year.

The conflict in Ukraine has significantly increased market volatility, and along with the Covid pandemic and the impact of government measures in response to the cost-of-living crisis, there is a risk of further fluctuations in the Fund value in future years, as the long-term impact of these events becomes clearer.

The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance

32. The Executive Director of Finance for Glasgow City Council is the Proper Officer responsible for Strathclyde Pension Fund. The financial regulations of Glasgow City Council, as administering authority, apply to the Fund. We consider these to be current, comprehensive and support good financial management.

33. The Strathclyde Pension Fund Committee receives administration and performance reports at its quarterly meetings. These reports are comprehensive and include fund performance trends, investment manager performance against benchmarks and movements in asset allocations. The reports are informed by the work of the Investment Advisory Panel, whose remit includes monitoring investment performance. From attendance at Committee, we observed and concluded that reports presented to members are subject to appropriate review and scrutiny.

34. Overall, we have concluded that the Fund has appropriate and effective financial management arrangements in place, including comprehensive reporting of investment performance.

Areas of improvement were identified in the systems of internal control in operation during the year

35. The Fund uses the financial systems of the administering authority, Glasgow City Council. The main council systems used by the Fund are the general ledger system and the payroll system. Our review of the controls in operation within these systems has been conducted as part of our audit of Glasgow City Council. We have also considered and tested the specific pension fund systems of pensions administration and investments.

36. Our review of systems did not identify any significant control weaknesses which could affect the Fund's ability to report financial and other relevant data in financial systems. However, we did identify the following improvement areas which have been raised with management:

- **SAP/Altair reconciliations:** Detailed pension calculations are recorded in the Altair pension system and reflected through the SAP financial ledger. However, timing differences can arise between the information reflected in the two systems, with the volume of transactions making a detailed reconciliation resource intensive. We conducted additional audit procedures at financial year end and confirmed there was no material impact on the financial statements in 2021/22. Officers are developing a new reporting tool which would make use of current functionality in Altair, with a view to implementing improved arrangements during 2022/23.

- **Management assurances on the work of experts:** Fund assets include over £6 billion of level 3 investments, where valuations are based on the application of valuation techniques by fund managers rather than quoted market prices. Management needs to assure themselves that the approach used by the experts, including the assumptions and estimates used, are appropriate. While our audit confirmed that procedures were in place during the year to gain these assurances, there is scope to improve the formal documentation of the process and conclusions.

The value of the Fund increased by 7.6% to £28.4 billion during 2021/22, with investment performance slightly below the benchmark return set for the year

37. The Fund's performance in 2021/22 is summarised in Exhibit 4. The net assets of the Fund increased by over £2 billion, mainly attributable to an increase in the value of private equity and infrastructure (£1.306 billion), pooled investment vehicles (£0.437 billion) and property assets (£0.459 billion). These positive market values contributed to a positive annual fund investment return for the year of 7.7%, which was slightly below the benchmark return of 7.9%.

Exhibit 4
Assets, funding level and investment performance

Increase in net assets	Funding level	Investment performance
£28.366 billion Closing net assets as at 31 March 2022 (+7.63%)	**128%** As at 31 March 2022 (interim valuation based on roll forward approximation from 2020 triennial valuation)	**7.7%** Return on investments 2021/22
£26.354 billion Opening net assets as at 1 April 2021	**127%** As at 31 March 2021	**7.8%** Average annual return on investments over 5 years

Source: 2021/22 Strathclyde Pension Fund annual report and financial statements

The conflict in Ukraine has significantly increased market volatility, and along with the Covid pandemic and the impact of government measures in response to the cost-of-living crisis, there is a risk of further fluctuations in the Fund value in future years, as the long-term impact of these events becomes clearer

38. When considering the investment performance of the Fund during 2021/22, as set out in Exhibit 4, it is important to recognise the impact of Covid-19 and other world events on financial markets and investments. The global impact of the pandemic and the conflict in Ukraine has significantly increased market volatility. Alongside this, recent government measures to address the cost-of-living crisis and stimulate the UK economy have also resulted in currency and market uncertainty.

39. While the Fund's current financial position is still strong, the longer-term outlook remains uncertain. There is a risk that there will be further market volatility and fluctuations in the value of investments in future years as the long-term impact of the Covid-19 pandemic and recent UK and world events becomes clearer.

The Fund reported a surplus from dealings with members of £17 million for 2021/22

40. In recent years, the Fund has reported deficits in its dealings with members, with investment income used to cover the difference between member contributions and payments. This position reversed in 2021/22, with a reported surplus from dealing with members of £17 million for 2021/22 compared to a deficit of £19 million in 2020/21. However, this one-off change was a result of a bulk transfer in during the year, with an employer consolidating its membership in one LGPS fund.

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.

Main judgements

The Fund's funding position is strong, although it faces significant uncertainty due to the current economic climate.

Negative cash flows are expected from member activity in future years; however, the current investment strategy provides sufficient income to pay pensions in the medium term.

We currently have no concerns about the financial stability of the Fund or the viability of the funding strategy.

The Fund's funding position is strong, although it faces significant uncertainty due to the current economic climate

41. As reported in our 2020/21 Annual Audit report, the results of the 2020 full triennial valuation of the Strathclyde Pension Fund showed a funding position of 106%. This surplus position allowed the Fund to maintain the main employer group contribution rate at 19.3% for the period 2021-2024.

42. The actuary undertakes interim valuations in the intervening years, using the same base as the triennial funding valuation rolled forward to take account of changes in membership and updated assumptions. The interim valuation by the Fund's actuary estimated that the funding level had increased to over 120% as at 31 March 2022.

43. In their report, the actuary highlighted the war in Ukraine resulted in volatile markets at the start of 2022 but the overall impact on the accounting position at the year-end was limited. However, significant uncertainty remains in the medium term over the impact of the conflict on market returns. Current slow economic growth and inflation rate pressures also present risks to the overall position of the Fund.

44. The Fund also recognises risks associated with the macro-economic and demographic impacts of climate change and has assessed these through asset-liability climate scenario modelling. No immediate change was proposed to the Fund's investment strategy following a report in March 2021 on the first iteration of the modelling. However, some amendments were agreed including a £1.7

billion allocation to the RAFI Fundamental Climate Transition index (which targets reduction in carbon intensity) and a £250 million increase in the Fund's global infrastructure commitment, which has a one third allocation to renewable assets. The output from scenario modelling will be used in future by the Fund to assess an appropriate allowance for climate risk within funding assumption prudence and to inform future investment strategy considerations.

The Fund implemented actions to maintain its investment strategy and structure during the year

45. The Fund uses a 4-step risk/return asset framework as the basis for modelling its investment strategy. In March 2021, the Pension Fund Committee agreed to retain the existing step-2 strategic model, with the next full review scheduled for 2023.

46. Several changes were implemented during 2021/22, to ensure the investments strategy was maintained, including:

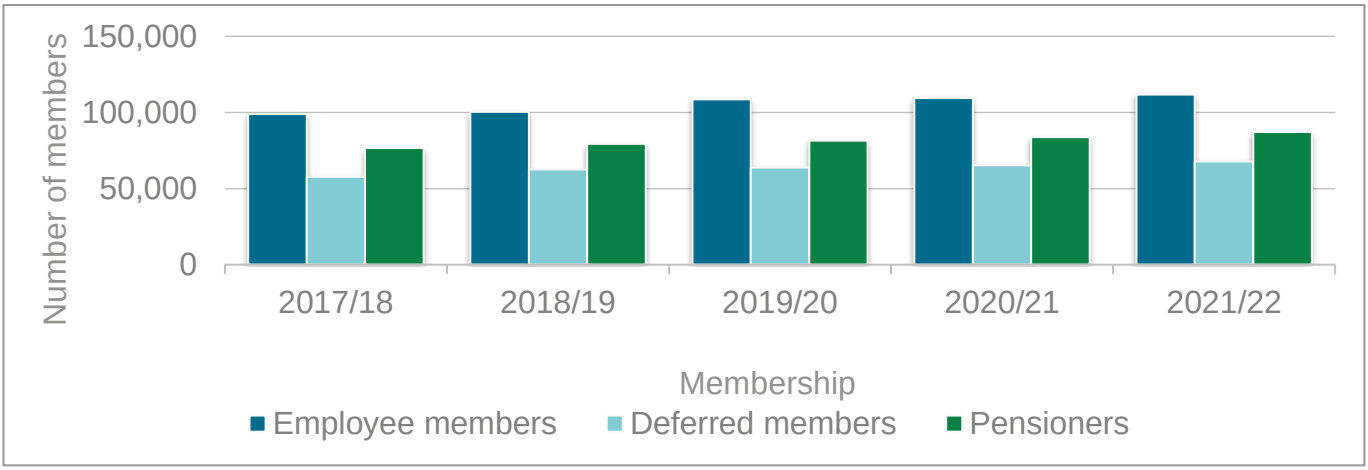
- The divestment of £200 million from listed equities, used to fund long term and short-term enhanced yield commitments and ensure asset allocations remain within target ranges
- A review of the Fund's rebalancing strategy and implementation of a relative value framework, to generate additional value and reduce risk of capital losses by varying allocations held in protection assets
- A review of the Direct Impact Portfolio, resulting in an increase in individual investment size parameters and an extension of the co-investment programme.

Fund membership levels continue to increase but the ratio of active members to pensioners is reducing

47. The Fund is a multi-employer fund with twelve local authorities and 147 other employers. The current membership profile is shown at Exhibit 5.

48. 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 members' life. It is important that the fund maintains the capacity to meet the current and future pension entitlements of its members.

Exhibit 5
Strathclyde Pension Fund membership



Source: Strathclyde Pension Fund annual report and financial statements 2017/18 to 2021/22

49. Overall membership of the fund increased by 8,222 to 266,600 members at 31 March 2022: an increase in membership of 3.2%. In 2021/22 the number of pensioners receiving a pension from the Fund increased by over 3,300. While the number of active members continues to outweigh the number of pensioners, the ratio of active members to pensioners has reduced from 1.33:1 to 1.28:1 over the last three years. This, combined with increasing life expectancy over this period, continues to place additional pressure on the Fund. However, this does not present any immediate risk to the financial sustainability of the Fund.

Negative cash flows are expected from member activity in future years; however, the current investment strategy provides sufficient income to pay pensions in the medium term

50. The continued growth in pensioner numbers within the Fund's membership has resulted in negative cash flows in prior years. Dealings with members in 2021/22 resulted in a surplus of £17 million, as noted at paragraph 40. However, this was a result of bulk transfer in during the year, and future cash flow projections remain negative.

51. The Fund considered member activity during the year as part of an analysis on current and future investment income. The Fund's most recent 10-year forecast identified that less than 20% of distributed income is currently required to pay pensions, although this may increase to over 40% over the period. This provides sufficient flexibility over the medium term to meet deficits from member activity.

We currently have no concerns about the financial stability of the Fund, however in the current economic climate, the Fund will need to maintain focus on the viability of the funding strategy

52. Given the actuary's interim valuation showed that the Fund is over 120% funded (paragraph 42.) and the healthy net asset position at 31 March 2022 (Exhibit_4), we currently have no concerns about the financial stability of the Fund. However, in the current economic climate the Fund will need to maintain focus on the viability of the funding strategy.

4. Governance and transparency

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

Main judgements

The Fund has appropriate arrangements to support good governance and accountability. There is effective scrutiny, challenge and informed decision making by committee.

There are effective arrangements for complying with the Pensions Regulator Public Service Code.

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

We have concluded that the overall reporting of performance within the annual report and financial statements was of a good standard.

The Fund has appropriate arrangements to support good governance and accountability. There is effective scrutiny, challenge and informed decision making by committee

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

54. The responsibilities of the Executive Director of Finance, the Strathclyde Pension Fund Committee and the Pension Board are set out in the Fund's Statement of Investment Principles which is reviewed regularly.

55. In addition to the Pension Fund Committee and Pension Board, an Investment Advisory Panel (IAP) is also in place which comprises investment officers from the Fund and representatives from Hymans Robertson as the Fund's actuary and investment consultant. The panel also includes three

independent expert advisors. The IAP supports the Strathclyde Pension Fund Committee and is responsible for developing investment strategy and monitoring investment performance.

56. During 2020, committee meetings commenced on a virtual platform, in response to the challenges of Covid-19, and these arrangements continued through 2021/22. Following review, the committee moved to a hybrid meeting environment in late 2022, with a mix of remote and in-person attendance.

57. We consider that governance arrangements are appropriate and support effective scrutiny, challenge and decision making.

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

58. 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.

59. The Fund monitors compliance with requirements and maintains a log of any breaches of the regulations, with material breaches reported to the Pensions Regulator. The Pension Fund Committee also receives updates on any compliance issues through regular administration update reports. Management confirmed that during 2021/22 there were no reportable breaches.

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

60. Strathclyde 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.

61. We have assessed the Fund's arrangements for the prevention and detection of fraud as part of the 2021/22 audit. The Fund relies on the arrangements of the administering authority, Glasgow City Council, for the prevention and detection of fraud and corruption. These include codes of conduct for members and officers, a whistleblowing policy and an anti-fraud strategy and response plan.

62. We concluded that the Fund has appropriate arrangements in place to prevent and detect fraud and corruption. We are not aware of any specific issues during 2021/22 that we require to bring to your attention.

Performance reporting was of a good standard

63. In addition to the consistency opinion on the management commentary covered in Part 1 of this report, we also considered the qualitative aspects of the management commentary included in the annual report and financial statements. The purpose of the management commentary is to provide information on the Fund, its main objectives and the principal risks faced. It

should provide a fair, balanced, and understandable analysis of the Fund's performance as well as helping stakeholders understand the financial statements.

64. We reviewed the management commentary in the Fund's annual report against sectoral guidance and concluded it satisfied these requirements.

65. As part of its climate change strategy, the Fund has committed to reporting on its approach to climate risk using a framework aligned to the recommendations of the Financial Stability Board's task force on climate related financial disclosures (TCFD). The framework covers 4 thematic areas: governance; strategy; risk management; and metrics and targets.

66. For the second year, the Fund's annual report includes a separate section on the climate change strategy, setting out its approach to climate risk against these four areas. Enhanced disclosures this year include a minimum standards framework for assessing energy companies within active equity portfolios, and baselined net-zero emissions information.

67. In April 2021, the Fund applied to be a signatory to the Financial Reporting Council's UK Stewardship Code. The Code comprises a set of 'apply and explain' principles for asset managers and asset owners, supported by reporting expectations which indicate the information that organisations should publicly report to become a signatory. In September 2021, the Fund was confirmed as one of 23 new asset owner signatories to the Code.

68. We have concluded that the overall reporting of performance within the annual report and financial statements was of a good standard.

5. Best Value

Using resources effectively and continually improving services

Main judgements

The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management.

2021/22 was a challenging year for Scottish Local Government Pension Schemes generally. Most funds reported positive movements in net assets during the year, but only three funds reported above benchmark returns.

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

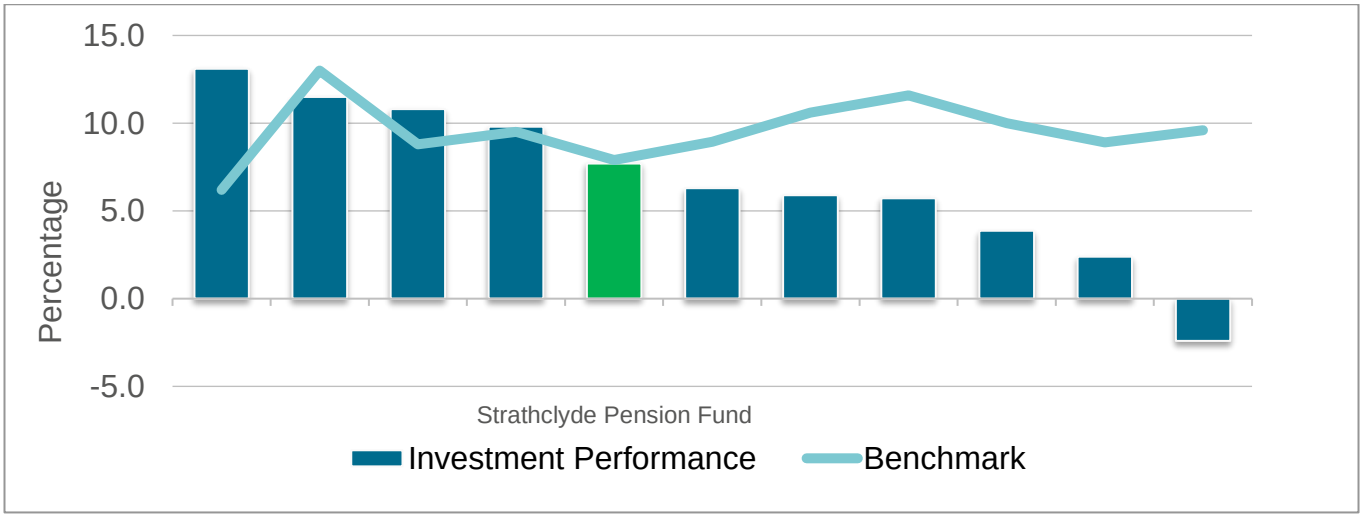
The pension administration function has performed well against most targets in 2021/22.

2021/22 was a challenging year for Scottish Local Government Pension Schemes generally. Most funds reported positive movements in net assets during the year, but only three funds reported above benchmark returns

69. 2021/22 was a challenging year for Scottish Local Government Pension Schemes due to the impact of Covid-19 and other world events on financial markets and investments. Ten of the eleven funds still reported positive movements in net assets during the year as shown in Exhibit 6. However, only three funds reported above benchmark returns, with investment performance ranging from -2 per cent to 13 per cent (compared to returns ranging from 16 per cent to 38 per cent in 2020/21). Strathclyde Pension Fund's return of 7.7 per cent placed it in the middle of this range.

Exhibit 6

LGPS pension funds 2021/22 – Net return on investment and benchmark return



Source: 2021/22 LGPS pension fund unaudited financial statements

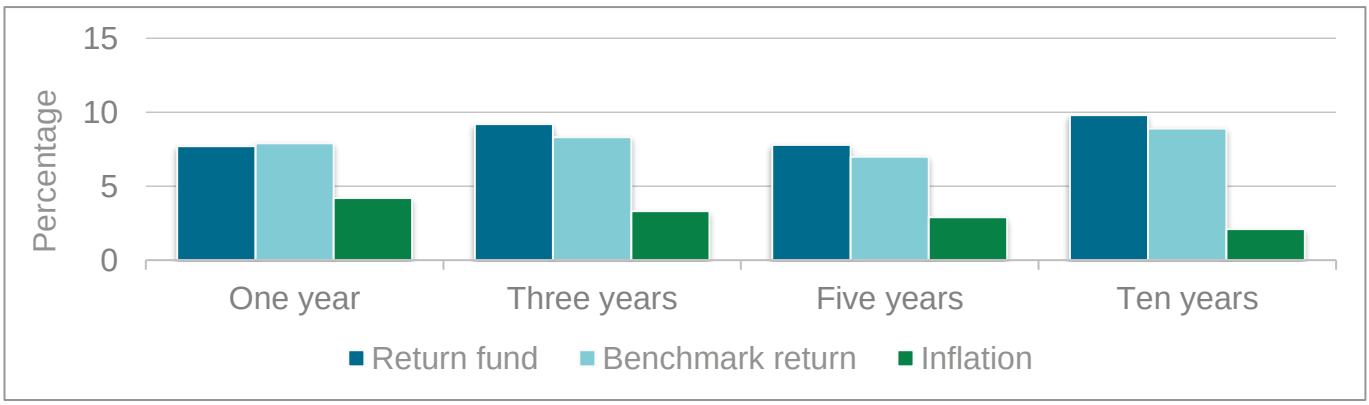
Covid-19 and the conflict in Ukraine on global markets had some impact on annual returns but investment performance continues to outperform medium- and longer-term benchmarks

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

71. Financial markets have been exceptionally volatile in recent years due to the ongoing Covid-19 pandemic and more recently as result of the conflict in Ukraine. However, long term enhanced yields performed strongly during the financial year along with equity portfolios, which account for a significant proportion of Funds assets. At the other extreme, credit assets lost almost 5% of their value during the year. The continued diversification of the Fund's assets mitigated this exposure to deliver overall satisfactory performance.

72. Exhibit 7 shows that over the year, the Fund generated a return of 7.7% against a benchmark of 7.9%. Equity portfolios were the most significant contributor to this increase. Over the medium to longer term, the Fund has outperformed its three-, five- and ten-years benchmarks.

Exhibit 7
Longer-term Fund investment performance



Source: Strathclyde Pension Fund 2021/22 unaudited financial statements

73. The fund uses the services of 19 different fund managers as part of their portfolio management. Strong performance was delivered on some individual portfolios but was generally mixed across managers and asset classes. Investment manager performance is subject to regular scrutiny by the Investment Advisory Panel.

The Fund has appropriate arrangements in place to scrutinise investment management expenses

74. 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 Glasgow City Council and oversight and governance costs.

75. Investment management expenses decreased from £204.330 million in 2020/21 to £167.839 million in 2021/22, mainly because of a reduction in performance related fees paid to the Fund's investment managers. The Investment Advisory Panel undertook a post year-end review of the 2021/22 management fees and costs alongside manager 1-year and 5-year performance data. Overall, the Panel was comfortable that the fees and costs incurred in 2021/22 were largely as expected for the size of the Fund and demonstrated some correlation between level of fees and performance.

76. Overall, we concluded that the Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

The pension administration function has performed well against most targets in 2021/22

77. The Strathclyde Pension Fund Committee receives reports on both fund administration and investment performance. The focus of measuring the

performance of pensions administration includes both member experience and statutory compliance.

78. In the previous financial year, turnaround performance for membership transactions was impacted by resourcing and operational challenges because of Covid-19. The easing of restrictions has resulted in significant improvements during 2021/22, with turnaround times near to or exceeding targets in most transaction areas. The main exception to this was deferred member transactions, where 84% of transactions were processed within 2 months against a target of 90%. However, this is a significant improvement on the 63% achieved in the prior year.

79. Overall, we have concluded that the administration function has performed well against most targets in 2021/22.

National performance audit reports

80. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2021/22, we published reports which may be of interest to the Fund. These are outlined in Appendix 1 accompanying this report.

Appendix 1

Summary of national performance reports 2021/22 and briefing papers

May

Local government in Scotland Overview 2021

June

Covid 19: Personal protective equipment

July

Community justice: Sustainable alternatives to custody

September

Covid 19: Vaccination programme

January

Planning for skills

Social care briefing

February

NHS in Scotland 2021

March

Local government in Scotland: Financial Overview 20/21

Drug and alcohol: An update

Scotland's economy: Supporting businesses through the Covid 19 pandemic

Strathclyde Pension Fund

2021/22 Annual Audit Report – DRAFT

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

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