

CIPFA Pensions Network

Local Authority Pension Fund Annual Reports – A review of Annual Reports 2012/13

A practical guide to improving the quality and compliance of Annual Reports

February 2014

Introduction

Currently pension fund administering authorities are gearing up to implement the 2014 scheme which is a massive change to the local government pension scheme (LGPS). Added to this are increased public and political scrutiny of the scheme and the introduction of new regulation from The Pensions Regulator.

In the face of all this change it is all too easy to lose sight of what a pension is about, which is basically that this is the pay of members deferred by them to help build up a pension for their old age. In effect pension funds are acting in trust for their members and therefore have a financial stewardship duty to all their members to demonstrate how they have discharged that obligation. The primary route for local authority pension funds to report back to their membership is via the annual report.

This paper highlights areas of good practice for funds in producing and publishing pension fund annual reports.

Statutory Requirements

The content of and publication requirements for local authority pension fund annual reports are statutorily prescribed by Regulation 34 of the LGPS (Administration) Regulations 2009¹ in England and Wales and Regulation 31A of the LGPS (Administration)(Scotland) Regulations 2008, as amended.

Both jurisdictions use the same key phrases which are:

An administering authority **must** prepare....the pension fund annual report which **contains**:....
....must **publish** on or before 1 December....
....must **have regard** to guidance

These mean that:

- local authority pension fund administering authorities have no discretion about preparing an annual report and that it must contain all the content prescribed by the Regulations. This means a comprehensive document with all the various reports required by the Regulations not cross references elsewhere for this information;
- the annual report should be accessible on the authority's website. I would suggest that it should be easily accessible from the website as this is a key document; and
- "have regard to" means that authorities need a good reason for not following guidance issued. Whilst the CIPFA publication *Preparing the annual report – guidance for Local Government Pension Scheme funds*² (published August 2012) does not yet have statutory force, it is best professional practice for CIPFA professionals and should be followed.

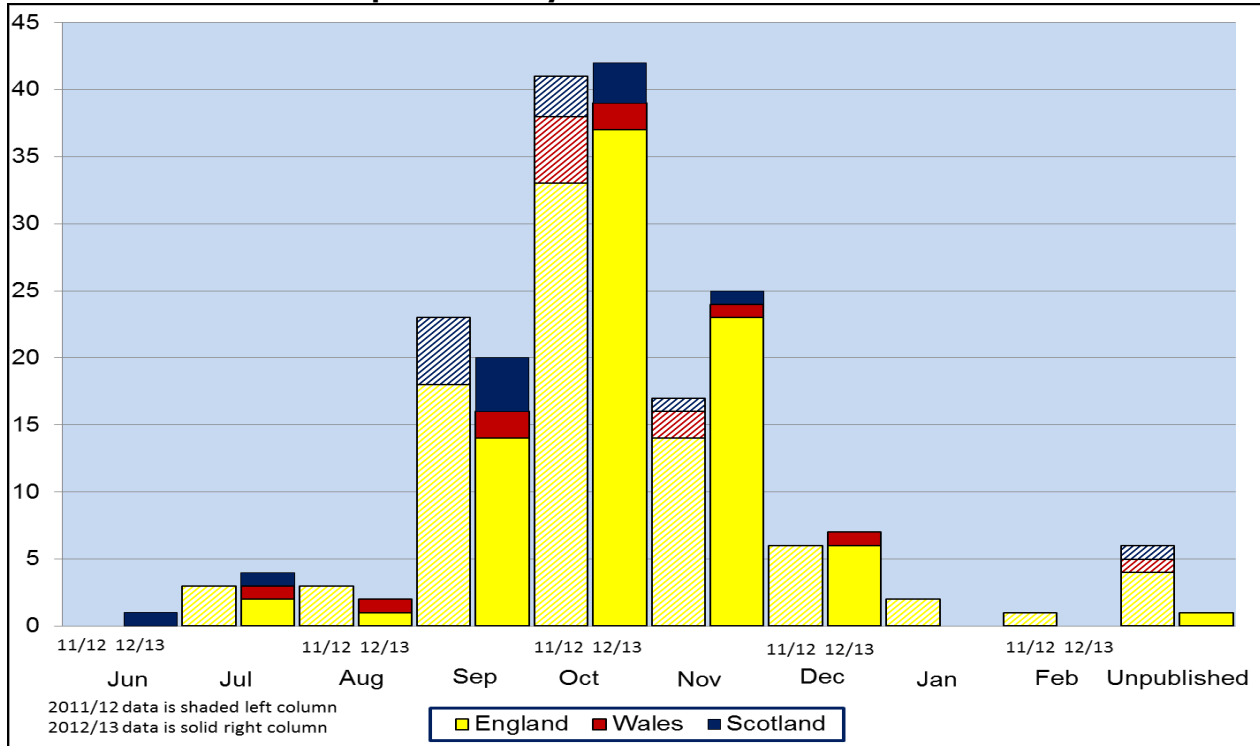
¹ See <http://timeline.lge.gov.uk/maninvst/20130410/ManInvest2009.htm>

² See <http://www.cipfa.org/policy-and-guidance/publications/p/preparing-the-annual-report-guidance-for-local-government-pension-scheme-funds>

Publication

Overall the number of funds meeting the 1 December publication deadline improved by 7% from 85% in 2011/12 to 92% in 2012/13 financial year (see Exhibit 1 below). All Scottish funds published before the deadline. As in 2011/12, the peak period for publication is the end of September- beginning of October which links with the statutory deadline for publishing the audited annual accounts. However for most English funds the publication date was later, slipping by one month from September to October.

Exhibit 1: 92% of funds published by 1 December



Source: WTAS analysis of 2011/12 and 2012/13 published annual reports

However authorities could do more to improve the speed of publication. For example:

- authorities could streamline internal procedures for authorising the report for publication to minimise the current 3 week delay between the audit opinion and publication of the annual report.
- authorities could project plan the preparation and publication of the annual report to aim to publish much earlier. Only 7% of funds published before the end of August and three quarters published after 1 October i.e. more than six months after the year-end.

Publication good practice:

- ✓ Create a project plan for preparing and publishing the annual report
- ✓ Identify what information you want, from whom and when –this is the timeline for the project plan and helps identify pinch points in the process
- ✓ Use the CIPFA Guidance to identify the sections needed for the report – don't just copy from previous years' reports
- ✓ Populate the annual report with those sections which you already have prepared before the year-end, which will most likely include:

- The governance compliance statement
- The funding strategy statement
- The statement of investment principles
- The communications policy

✓ Arrange for Member approval – although not required, this is good practice

Accessibility

Generally, pension fund annual reports were easier to find in 2012/13 than 2011/12 taking on average only two pages to locate – half that in 2011/12. However, only 28% could be accessed directly from the website home page.

This contrasts with publication of annual reports by FTSE 100 companies where the annual report is seen as a key document for communicating with all stakeholders and consequently is prominently displayed on the homepage.

The pension fund annual report is a key document demonstrating the authority's stewardship of the funds under its management, so this should be easily accessible. At the risk of stating the obvious, most people are unlikely to read what they cannot find.

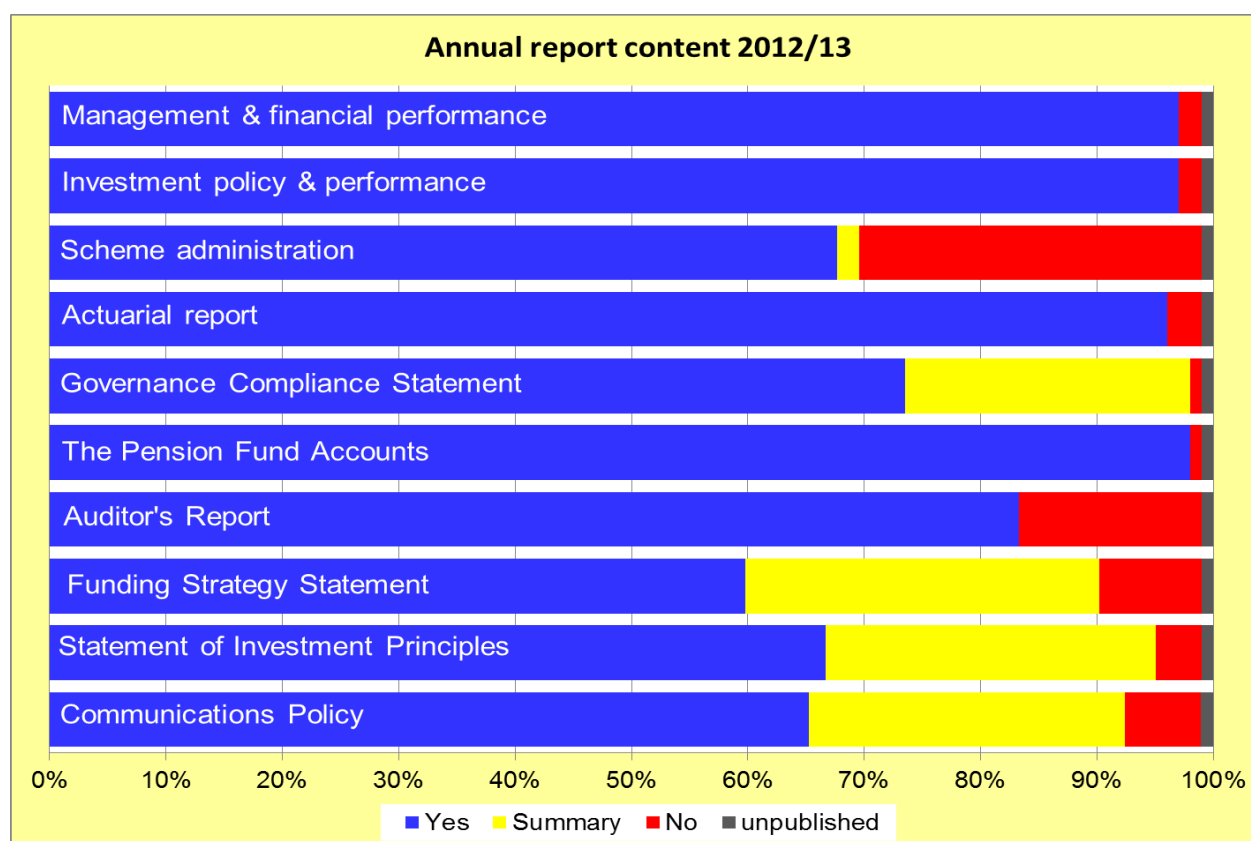
Accessibility good practice:

- ✓ File Annual Reports in a logical part of the website, preferably via a link direct from the home page. Failing that under **Reports and Documents** rather than **Investments** or **Investor Relations**;
- ✓ File annual reports in date order, beginning with the most recent;
- ✓ Remove superseded versions, such as unaudited drafts;
- ✓ Document names and references should be standardised, and relate clearly to what the document is. If someone is searching for a pension fund annual report, then that is what they will search for;
- ✓ Annual reports should be distinguished from newsletter and other publications;
- ✓ Check that the annual report is actually searchable on your website
- ✓ Keep the website up to date. For example, a website saying that it was last updated 11 March 2013, yet only has the 2008/09 annual report is clearly not up to date

Content

Overall there has been an improvement in annual reports including the sections prescribed in the Regulations and amplified in the CIPFA Guidance. However around one-third of pension funds are either not including elements or including only a summary and cross-referring to the fund website for the full document (see Exhibit 2 below)

Exhibit 2: Two-thirds of fund annual reports include all the prescribed content



Source: WTAS analysis of 2011/12 and 2012/13 published annual reports

Much of the content of the annual report is a “given” in terms of layout or content, namely: the actuarial report, governance compliance statement, pension fund accounts, auditors report, funding strategy statement and the statement of investment principles.

However the first three areas of the annual report show the widest variation in content and presentation between annual reports, and the most variable level of compliance with the CIPFA Guidance:

- The management and financial performance report
- The investment policy and performance report
- The scheme administration report.

Auditors reports

Although not required by regulation, auditing standards require that published information containing the audited accounts should include a copy of the auditor’s report. If this is unavailable then the annual report should state that the accounts included are unaudited.

Management and financial performance report

The management and financial performance section of the annual report covers the four areas:

1. scheme management and advisors
2. risk management
3. financial performance; and

4. administration management performance

Management and financial performance reports tended to fall down in two key areas – risk management and the three year summaries of financial performance.

Risk management

The CIPFA Guidance states that the report should contain:

- how risk management is integrated within the governance structure
- how risks are identified, managed and reviewed
- a summary of the key risks and what actions are being taken to mitigate those risks
- the approach taken to managing third party risk such as late payment of contributions and how assurance is sought over third party operations
- how investment risk is managed i.e. appropriate advice sought and action taken to review performance against the investment strategy on a regular basis

Most reports contained a description of corporate risk management processes, but either failed to contain a summary of the key risks arising during the year and the actions taken to mitigate them, or (at the other extreme) included long lists of overly detailed information in no discernable order.

Worcestershire Pension Fund publish a very clear summary of their top five key risks and the actions taken to mitigate those risks. The disclosure uses a simple tabular approach coupled with a visual traffic light system – see Exhibit 3 below.

Exhibit 3: Worcestershire Pension Fund uses a clear traffic light system and a simple table format

<u>Risk Management</u>							
The Pension Fund is subject to many different risks in areas such as; governance, investments, funding, administration and communications. In order to manage these risks a Pension Fund Risk Register is maintained and reviewed on a quarterly basis. Risks identified have been reduced to an acceptable level through planned actions. The register is managed by the Director of Resources and risks have been identified and assigned to 'Risk Owners'.							
The key risks identified within the Pension Fund risk register are as follows;							
Objectives area at risk	Objective at risk	Description of risk or not achieving the objectives	Risk Category	Risk Type	Gross Risk Score	Actions Taken	Residual Risk Score
Investments	To maximise the returns from investments with reasonable risk parameters.	If investment return is below that assumed by the actuary in funding the plan this could lead to an increasing deficit and additional contribution requirements. The larger the level of mismatch between assets and liabilities the bigger the risk.	Directorate Threat	Financial	12	Diversified portfolio, annual strategy review, asset liability study, option to extend recovery periods to smooth contribution increases.	9
Investments	To maximise the returns from investments with reasonable risk parameters.	If investment strategy is inconsistent with funding plan then it can lead to employers paying the incorrect contribution	Directorate Threat	Financial / Reputational	12	Triennial reviews linked with funding strategy and investment strategy. Asset	2

Source: Worcestershire Pension Fund annual report 2012/13

East Riding Pension Fund's report on third party risk (see Exhibit 4):

- makes a clear link to the Fund's Statement of Investment Principles
- sets out what controls are in place; and
- draws a conclusion

Exhibit 4: Reporting third party risk

Third party risks

The Statement of Investment Principles requires an annual written statement from the Investment Managers that they have adhered to the principles set out in the statement. Statements are received from the Director of Corporate Resources and Schroder Investment Management.

In addition, assurance to access the internal controls and procedures at Schroder Investment Management and State Street Global Services is also sought.

- **Schroder Investment Management prepares an Audit and Assurance Faculty Report which covers the control objectives and procedures relating to its investment activities. The report is audited by Pricewaterhousecoopers in accordance with International Standard on Assurance Engagement (ISAE) 3402 and 3000 and the Institute of Chartered Accountants in England and Wales Technical Release AAF/01/06.**
- **State Street's control procedures audited by Ernst Young was performed in accordance with the Statement on Standards for Attestation Engagements No 16 (SSAE 16) issued by the American Institute of Certified Public Accountants (AICPA) and the International Standard on Assurance Engagement (ISAE) 3402 issued by the International Accounting and Assurance Standards Board.**

Both of these audits concluded that the control procedures are suitably designed and operated as described during the period under review.

Source: East Riding Pension Fund annual report 2012/13

Financial performance

The purpose of the financial performance report is to summarise the financial performance and position of the pension fund as reported in the pension fund accounts, explain trends in the major cash-flows and how these link to the investment strategy and performance, and how the fund is controlling its own expenses in managing the pension fund. Barely a fifth of all pension funds included any report on financial performance.

East Riding Pension Fund provides a very clear financial performance report covering all areas set out in the CIPFA Guidance:

- ✓ a simple year on year variance analysis of the Fund Account and Net Assets Statement with simple explanation of the changes;
- ✓ an analysis of the timeliness of receipt of contributions and whether the option to levy interest was exercised;
- ✓ budget v outturn report on all operational expenses (both administration and investment management) together with an explanation of variances;
- ✓ forecast of the main fund cash-flows and asset values for the current year plus outturn v forecast for the previous two years; and
- ✓ five year analysis of pension overpayments, recoveries and write-offs.

Administration management performance

There appears to be some confusion amongst practitioners between the administrative management performance section of the annual report, and the scheme administration report. The first focusses on the performance of administration services while the second covers who does what rather than performance.

Whilst 65% of annual reports included some data on administration performance often these lack meaningful comparatives or adequate commentary to explain graphs and charts.

The Wandsworth Pension Fund report on administration performance provides both performance data and meaningful commentary over the following areas:

- Industry standard PIs for dealing with members
- Customer satisfaction levels
- Complaints received
- Staff indicators
- Five year analysis of membership data and trends
- Age-sex profile of membership

Investment policy and performance

The purpose of the investment policy and performance section of the annual report is to demonstrate how different categories of investments have performed over time and how the fund's statement of investment principles has been applied in practice.

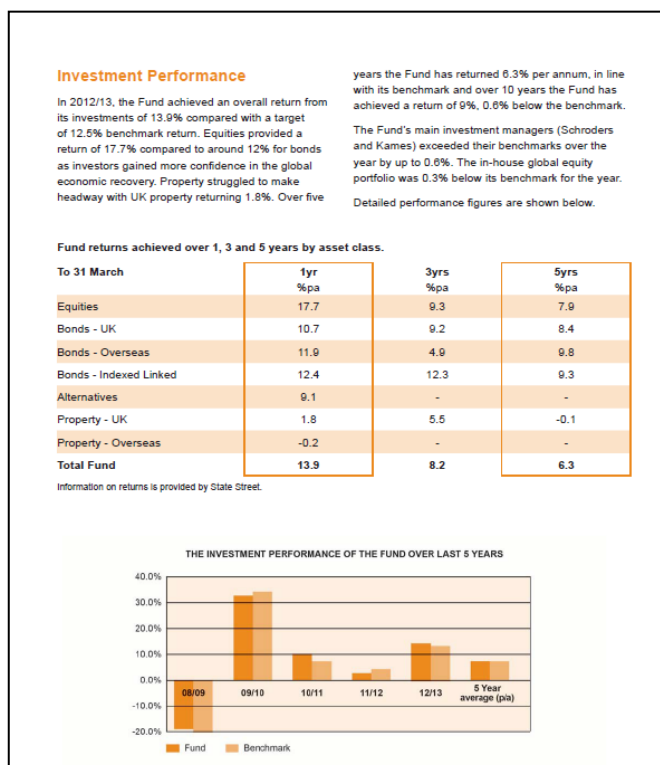
The CIPFA Guidance states that the investment policy and performance report should contain:

- a comparison of the planned with the outturn asset allocation with an explanation of any variances
- investment performance by asset class and fund manager compared against benchmarks for 1, 3 and 10 years
- the fund's responsible investment policies and how these have been discharged
- the fund's approach to the UK Stewardship Code and extent of compliance with the Myners Principles
- arrangements for administration and custody of investments i.e. who does what and how the fund obtains assurances over these functions
- how the fund is implementing its funding strategy statement.

Too many annual reports included lengthy and unnecessary commentaries on the global equities market, government policy, recession and recovery, which say nothing about what the pension fund itself did to respond to these outside influences.

Funds which provided clear investment performance reports include: East Riding, Merton, North Yorkshire, Staffordshire and Nottinghamshire.

Exhibit 5: Reporting investment performance – less is worth more



Nottinghamshire Pension Fund's report on investment performance:

- ✓ focusses on how the fund itself has performed against its plans
- ✓ uses simple, short, clear messages and selective use of graphs and tables
- ✓ is only three pages long

Source: Nottinghamshire Pension Fund annual report 2012/13

Investment performance reporting good practice:

- ✓ Use simple and clear messages to make key points
- ✓ Use graphs to explain performance and variances
- ✓ Consider the readership - most fund members are not reading the annual report to obtain general economic information, but to find out how investments made on their behalf have been made and whether or not these decisions were successful

Scheme administration report

The scheme administration report should be a review of the administrative arrangements for the fund. In other words it should focus on who does what not performance.

The CIPFA Guidance states that the report should contain:

- A description of the key areas of technology used by the fund, such as websites and self-service options
- Member administration (including data quality) and details of any outsourced functions
- Pensioner administration
- assurance arrangements e.g. controls assurance reports or internal audit over these functions
- an outline of the fund's internal dispute resolution procedure with an analysis of activity

The annual reports for East Riding, Wandsworth and Nottinghamshire provide good examples of what the CIPFA Guidance is expecting.

Summary reporting

In the private sector it is common practice for listed public companies to produce a summary annual report in addition to their statutory company annual reports produced under the Companies Acts. This recognises that the statutory reports are lengthy documents which the majority of shareholders are probably not interested in. Although not a statutory requirement a small number of pension fund authorities (15 in 2012/13) also publish summary pension fund annual reports.

Good examples of summary pension fund reports are the Bedfordshire and Devon summary reports which are both two sides of A4 only, and the Strathclyde summary report included in the Pensioner Newsletter for 2012/13.

Summary report good practice:

- ✓ Simple naming of the document which says what it is e.g. summary annual report
- ✓ No more than 4 pages – anything longer is not really a summary
- ✓ Accessed from the same page as the full annual report
- ✓ Summary financial information
- ✓ Short clear messages e.g. investment return was x%
- ✓ Clear use of graphics
- ✓ Where to go for more information

Conclusions

Overall the assessment would be that good progress is being made and there are several examples of good practice identified, but still some areas of non-compliance to be addressed. Council workers, most of whom are literally trusting local authority pension funds with their life savings, deserve to have this information clearly and consistently set out, and easily available. Moreover, as 2013/14 would appear to be the calm before the storm of future operational and financial reporting changes, now might be as good a time as any to ensure all current requirements are being met.

Peter Worth is Managing Director of Worth Technical Accounting Solutions, a company established in 2012 to provide bespoke accounting services to public sector. He is a CIPFA associate and member of the CIPFA Pensions Advisory Network.



Neil Sellstrom
Pensions Advisor
CIPFA Networks
3 Robert Street
London
WC2N 6RL
01287 619679 \ 07775 021371
neil.sellstrom@cipfa.org
cipfa.org



Certificate No.