NATIONAL AUDIT
OFFICE OF LITHUANIA
• BRINGING BENEFITS •

PUBLIC AUDIT REPORT

ASSESSMENT OF THE REGULARITY OF THE 2020 SET OF STATEMENTS OF THE PENSION ANNUITIES FUND AND THE LEGALITY OF THE MANAGEMENT, USE, AND DISPOSAL OF ITS FUNDS AND PROPERTY

28 May 2021

No. FAE-3

The main function of the National Audit Office of Lithuania is to supervise the lawfulness and effectiveness of the management and the use of public finances and other property and the execution of the State budget. By providing audit observations and recommendations, the National Audit Office aims to improve the efficiency of the public sector and the benefits it brings to society, and to set an example for the public sector as a whole by setting the highest standards of quality in its work.

The audit was carried out by Vita Andrulytė.

Public Audit Report has been submitted to the Seimas of the Republic of Lithuania, the Government of the Republic of Lithuania, the State Social Insurance Fund Board under the Ministry of Social Security and Labour, and the Ministry of Social Security and Labour.

CONTENTS

INTRODUCTION

Objective and Scope of the Audit

In accordance with the Law on the Accumulation of Pensions and the Law on National Audit Office[1], we have carried out the audit of the regularity of the 2020 set of statements of the Pension Annuities Fund and the legality of the management, use, and disposal of its funds and property.

The audit has been performed in accordance with the Public Auditing Requirements, International Auditing Standards, and International Standards of Supreme Audit Institutions. The audit report includes only the matters performed and identified during the audit, and independent opinion on the set of statements is presented in the auditor's report. The scope and methods of the audit are described in greater detail in Annex "Audit Scope and Methods".

Purpose of the Pension Annuities Fund

In 2004, a pension accumulation system was launched in Lithuania[2], allowing to accumulate a portion of the state social insurance contributions in pension funds. Since then, the amount of the cumulative pension contribution[3] has changed several times, and, in 2013, new conditions[4] came into force for new participants in the second pillar of the pension system: in addition to the participant's share of the social security contributions, a share of the participant's own funds and the State budget started to be paid to the participant's private pension account. Since its inception in 2004, the pension accumulation system has been voluntary with the accumulated funds paid out to the pension participant by the pension accumulation companies under agreed conditions, and this model remained in place until 1 January 2019. From 2019,[5] employees under 40 are automatically enrolled in the pension accumulation system (with the option to opt-out). The second pillar pension fund now is funded from only two sources (the participant and the State budget). From 1 July 2020, the funds accumulated in the second pillar pension fund, if they exceed EUR 10 thousand, regardless of the moment when the person became a participant of pension accumulation, are paid only by the payer of pension annuities – the State Social Insurance Fund Board under the Ministry of Social Security and Labour (hereinafter – SSIF Board under MSSL).

For the payment of pension annuities, a new entity of the public sector – the Pension Annuity Fund – was established. The resources (funds) of this Fund consist of lump-sum contributions (funds accumulated by participants), income from the investment of the

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[1] Law on the Accumulation of Pensions, Article 35(10)(4) and Law on National Audit Office, Article 9(1)(2).

[2] Law on the Accumulation of Pensions, 04/07/2003 No. IX-1691.

[3] The pension contribution rate was 2.5% in 2004, 3.5% in 2005, 4.5% in 2006, and 5.5% in 2007 and 2008; since 01/01/2009 and 30/06/2009 – 3%; since 01/07/2009 and 31/12/2011 – 2%; in 2012 – 1.5%, in 2013 – 2.5% of the participants income on which national social security contributions are calculated. Law on Reform of the Pension System, Article 4

[4] Law on the Accumulation of Pensions (version in force since 24/11/2012 till 01/01/2019).

[5] Ibid. (version in force since 01/01/2019).

Fund's resources, borrowed funds, and other legally received funds. The resources of the Pension Annuities Fund may be used only for the payment of pension annuity benefits, for the management and administration costs of the Fund, for investment activities, and for making other payments as provided for in the legislation approved by the payer of pension annuities.

The payer of the pension annuities offers three products (types) of pension annuities: a standard pension annuity, a standard pension annuity with a guaranteed payment period, and a deferred pension annuity[6].

The objective of the payer of pension annuities is to ensure that pension annuities are paid to beneficiaries for life, for their maximum benefit, and that the Pension Annuities Fund is managed in a transparent and sustainable manner. The Pension Annuities Board[7], acting in a collegial capacity, oversees how the payer of pension annuities meets this objective.

Pursuant to the Law on the Accumulation of Pension[8], the budget of the Pension Annuities Fund is approved by the Law on the Approval of the Budget Indicators of the Pension Annuities Fund for the respective year. The budget figures (estimates) of the Fund for 2020 were not approved by the Seimas and the payer of pension annuities acted in accordance with the budget of the Pension Annuities Fund approved by itself[9].

The Pension Annuity Fund is accounted for and reported on by the SSIF Board under the MSSL separately from its own accounting as a budgetary institution. The Fund's set of annual statements is drawn up in accordance with the Law on Public Sector Accountability and provisions of public sector accounting and financial reporting standards. The requirements for the accounting and reporting of the Pension Annuities Fund and the recognition and measurement of the Fund's property, liabilities, income, and expenses are set out in the 29th public sector accounting and financial reporting standard "Accounting and Reporting by the Pension Annuities Fund". In accordance with this procedure, a single set of annual statements is drawn up in which the cash flow statement compares the cash flow information with the Fund's budget execution information, showing the amounts disbursed and the amounts planned to be disbursed (authorised) for each line of the statement.

The set of annual statements of the Pension Annuities Fund with the Auditor's Report of the National Audit Office on that set of statements are published on the website of the payer of pension annuities no later than on June 1 of the following accounting year[10].

[6] Law on the Accumulation of Pensions, Article 29(2)

[7] Ibid., Article 35

[8] Ibid., Article 35(10)(1).

[9] Law amending the Law on the Accumulation of Pensions No IX-1691, Article 8(17)

[10] Law on the Accumulation of Pensions, Article 35(11)

AUDIT RESULTS

1. THE SET OF ANNUAL STATEMENTS OF THE PENSION ANNUITIES FUND IS CORRECT IN ALL MATERIAL RESPECTS

1. The Pension Annuities Fund is a new public sector entity – a fund of resources – that started its activities on 1 July 2020. The composition of the set of Fund's annual statements and the requirements for the information contained therein are determined by the Minister for Finance[11]. Our audit procedures have disclosed no material misstatements in the Fund's 2020 set of statements, which are correct in all material respects. According to the set of statements, in 2020, the Fund collected EUR 3,654.62 thousand of income from pension annuities contributions and incurred EUR 3,525.39 thousand of expenses due to the change in the value of technical provisions, EUR 107.98 thousand for management and administration costs, and EUR 45.58 thousand for pension annuities benefits costs.

2. START OF THE FUND'S ACTIVITIES: POSITIVE FINANCIAL AND INVESTMENT PERFORMANCE, DEDUCTIONS NOT YET SUFFICIENT TO COVER THE FUND'S MANAGEMENT AND ADMINISTRATION COSTS

2. To provide the funds needed to manage liquidity and longevity risk as well as to earn a target investment return on each pension annuity, the funds of the Pension Annuities Fund are invested. The result of financial and investment activities for the first half of the year was positive at EUR 126.62 thousand. It is a change in the fair value of a financial asset and is not converted into cash. In subsequent periods, it is planned[12] to convert some of the profits into cash and distribute them to the beneficiaries of pension annuities. When this will happen and how the profit will be distributed is to be determined by the payer of pension annuities – the amount of the target return and the description of the procedure for the distribution of the profit are planned to be elaborated and approved by the SSIF Board under the MSSL in 2021.

3. During the six months of performance, 239 persons purchased a pension annuity, 2.4 times more than planned (99). The management and administration costs of the Pension Annuities Fund are covered by deductions from lump-sum contributions (the participant's accumulated funds) or, if deductions are insufficient, by borrowed funds. In 2020, this deduction amounted to 2.5% (EUR 91.37 thousand) and did not cover costs (EUR 107.98 thousand). Pursuant to the Law on the Accumulation of Pensions[13], the SSIF Board under

[11] Law on Public Sector Accountability (version in force from 01/01/2022), Article 9(5).

[12] Law on the Accumulation of Pensions, Article 35(1)(2)(10).

[13] Law on the Accumulation of Pensions, Article 35(1)(2)(15).

the MSSL, as the payer of the pension annuities, applied to the Ministry of Finance for a State on-lending loan of EUR 136.1 thousand to cover the Fund's performance management and administration costs. An interest-free loan of this amount was granted for a period of 10 years, of which EUR 30 thousand was disbursed to the Fund by the Ministry of Finance in 2020.

4. As the Fund's actual receipts (and, therefore, deductions) exceeded the planned ones by more than 3 times (planned EUR 926.3 thousand, received EUR 3,214.77 thousand), the need for borrowed funds was also lower. In 2020, the Ministry of Finance, representing the Government in borrowing on behalf of the State, borrowed at average profitability[14] of 0.81% for the 10-year period, which means that it will incur debt management costs of around EUR 240 annually on the EUR 30 thousand borrowed and re-lent to the Fund, which are covered by the State budget (EUR 36 in 2020).

Auditor General Mindaugas Macijauskas

[14]The weighted average 10-year profitability on government securities in 2020 was 0.33%, while the 10-year profitability on foreign government securities in 2020 was 0.83%.

ANNEX

Public audit reports
“Assessment of the Regularity of the 2020 Set of Statements of the Pension Annuities Fund and the Legality of the Management, Use, and Disposal of its Funds and Property”
Annex

Scope and Methods of the Audit

The objective of the Audit:

- to assess the data of the 2020 set of statements of the Pension Annuities Fund and to provide an independent opinion;
- to assess the legality of the management, use, and disposal of its funds and property in 2020 in selected areas.

The audited statements of 2020:

- statement of financial position, performance statement, statement of changes in net assets, cash flow statement, and explanatory note, prepared according to the data of 31 December 2020.

We note that the scope of the audit was not limited.

The Fund has no subsidiaries, controlled or consolidated bodies.

The Audit was performed:

- in accordance with the Public Auditing Requirements [15], International Auditing Standards (IAS)[16], and International Standards of Supreme Audit Institutions[17];
- to obtain reasonable assurance that there are no material misstatements in the provided statements and the management, use, and disposal of Fund’s funds and property in selected areas is lawful. Absolute assurance is not possible due to the inherent limitations of audit and internal control and the fact that we have not tested all (100%) of the economic transactions, economic events, and concluded contracts.

Scope and Methods of the Audit
Balances of property and correspondingly of funding amounts, liabilities, and net assets at the beginning and end of 2020:

[15] Auditor General Decree No. V-26 of 21 February 2002 “On the Adoption of the Public Auditing Requirements”.

[16] https://avnt.lrv.lt/lt/teisine-informacija/teises-aktai/auditasInternational standards for auditing, published by the International Auditing and Assurance Standards Board of the International Federation of Accountants and translated by The Lithuanian Court of Auditors (until 28/02/2017) and The Authority of Audit, Accounting, Property Valuation and Insolvency Management under the Ministry of Finance of the Republic of Lithuania (from 01/03/2017), internet access: https://avnt.lrv.lt/lt/teisine-informacija/teises-aktai/auditas (accessed on 05/05/2021)

[17] Financial Auditing Standards ISSAI 2000-2899, The Compliance Audit Standard ISSAI 4000, internet access: https://www.valstybeskontrole.lt/LT/post/15649/ (accessed on 05/05/2021).

Scope and Methods of the Audit

The Pension Annuities Fund has started its activities on 1 July 2020 and during this period its balances of property, funding amounts, liabilities, and net assets constituted EUR 0; at the end of 2020, property and correspondingly funding amounts, liabilities, and net assets constituted EUR 3,682.85 thousand.

Income and costs of 2020:

The Fund has received EUR 3,654.62 thousand of income from pension annuities contributions and incurred EUR 3,678.95 thousand of costs of the main activities, including:

- EUR 3,525.39 thousand due to the change in the value of technical provisions;
- EUR 45.58 thousand due to the pension annuities benefits costs;
- EUR 107.98 thousand due to the management and administration costs.

Revenue obtained and expenditure incurred in 2020:

The Fund received EUR 3,214.77 thousand of revenue (funds received from pension accumulation companies) and incurred EUR 134.20 thousand of expenditure, including:

- EUR 44.51 thousand due to the annuities benefits expenditure;
- EUR 84.11 thousand due to the management and administration services expenditure;
- EUR 5.58 thousand due to other expenditures.

The assessed areas and performed procedures regarding the data of the 2020 set of statements

Having carried out the audit of the audited entity activities, accounting, and internal control systems, areas in which material risk of distortion exists have been established:

- The key areas of audit have been established: financial fixed assets, received pension annuities contributions, long-term debentures, technical provisions of pension annuities, income from pension annuities contributions, costs of the main activity (due to the change in the value of technical provisions, pension annuities benefits, management and administration services), cash, the result of financial and investment activities. Areas with material risk of distortion have not been identified.

Areas where the effectiveness of control procedures has been established (performed control testing):

- The area of pension annuities benefits.

Areas where substantive audit procedures (detailed tests and analytical procedures) were performed:

- In the area of financial fixed assets, medium-scale detailed tests were carried out, while, in the areas of current assets and revenue, large scale detailed tests were performed to obtain affirmations of completeness, authenticity, existence, assessment, and disclosure.
- In the areas of liabilities and change in the value of technical provisions (costs), large scale detailed tests were performed to obtain affirmations of completeness, authenticity, existence, assessment, and disclosure.
- In the area of pension annuities benefits costs, large scale detailed tests were performed to obtain affirmations of completeness, authenticity, existence, assessment, and disclosure.
- In the area of Fund's activities management and administration costs, medium-scale detailed tests were performed to obtain affirmations of completeness, authenticity, existence, assessment, and disclosure.
- In the area of annual statements, large scale assessment was performed to obtain affirmations of completeness, authenticity, existence, assessment, and disclosure.

The overall assessment of the set of statements:

Assessed:

- the suitability of the used accounting methods and the validity of the accounting assessments and related management disclosures;
- the overall presentation, structure, and content of the statements, including disclosures and the fact if justifying transactions and events are presented in these statements according to the Standards of Public Sector Accounting and Financial Reporting;

The assessed areas and procedures carried out in these areas regarding the legality of the management, use, and disposal of the Pension Annuities Fund's funds and property in 2020

Having carried out the audit of the audited entity activities and internal control systems, areas in which material risk of non-compliance exists have been established:

- The key areas of audit have been established: investment, borrowing, management and administration expenses, and pension annuities expenses. The material risk of non-compliance has not been identified.

Areas where the effectiveness of control procedures has been established (performed control testing):

- The area of pension annuities benefits.

Areas where substantive audit procedures (tests of details and analytical procedures) were performed:

In the area of investment, it was assessed if the investments were made in accordance with legislation. In the area of expenses, it was assessed how legal provisions were followed regarding the payment of annuities benefits and the covering of Fund's administration expenses.

Scope and Methods of the Audit
Legislation assessed for compliance:
Legislation: • Law on the Accumulation of Pensions, Sections V, V-1, and VI. Orders of the Director of the Board of the State Social Insurance Fund: • 03/06/2020 No. V-232 “Methodology for the Estimation of Pension Annuities Amount according to all Types of Pension Annuities”. • 03/06/2020 No. V-235 “Description of the Allocation and Payment Procedure of Pension Annuities”. • 10/06/2020 No. V-257 “Methodology for the Estimation of Technical Provisions of Pension Annuities”. • 24/07/2020 No. V-367 (recast, 30/12/2020 No. V-706) “Description of the Estimation and Compensation Procedure of the Pension Annuities Fund Management and Administration Costs”. • 01/09/2020 No. V-425 (recast, 04/12/2020, V-661) “Description of Asset Investment Procedures of the Pension Annuities Fund”. • 01/09/2020 No. V-427 (recast, 04/12/2020, V-662) “Pension Annuities Fund’s Investment Policy and Strategy”. • 26/06/2020 No. V-313 “On the Adoption of the Pension Annuities Fund’s Budget for 2020” Other legislations: • Resolution No. 03-70 of 28 May 2020 of the Board of the Bank of Lithuania “On the Approval of the Description of the Estimation Requirements of the Pension Annuities Fund’s Technical Provisions”.

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