VALSTYBĖS KONTROLĖ
PUBLIC AUDIT

PUBLIC AUDIT REPORT

RESULTS OF THE FINANCIAL AUDIT OF THE SET OF ACCOUNTS OF THE PENSION ANNUITIES FUND FOR 2023

15 May 2024

No FAE-5

The National Audit Office—the supreme audit institution—supervises the lawfulness and efficiency of the management and use of public assets and the execution of the public budget. By providing audit observations and recommendations, the National Audit Office promotes a positive and effective impact of public audit on the public financial management and control system and on results-oriented and public-oriented public management. For more information on the activities of the National Audit Office and the results of public audit, please visit www.valstybeskontrole.lt.

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The public audit report was submitted to the Seimas of the Republic of Lithuania, the Ministry of Social Security and Labour of the Republic of Lithuania, the Board of the State Social Insurance Fund under the Ministry of Social Security and Labour.

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INTRODUCTION

Objective and scope of the audit

We have carried out a financial audit of the set of accounts of the Pension Annuities Fund for 2023 in accordance with the Law on the Accumulation of Pensions and the Law on the National Audit Office[1]. The audit was conducted in accordance with the International Standards of Supreme Audit Institutions, which include International Standards on Auditing. The audit report presents only the matters identified in the audit and the independent opinion on the Fund's annual accounts is expressed in the auditor's report. The scope of the audit and the methods applied are described in more detail in the Annex "Audit scope and methods" (pages 8-9).

Purpose of the Pension Annuities Fund

As of 1 July 2020, the Pension Annuities Fund, a resource fund, started operating after the Board of the State Social Insurance Fund (the "SSIF") became the centralised payer of pension annuities. The resources of this Fund consist of lump-sum contributions from participants, income from the investment of the fund's assets, borrowed money and other legally obtained money. The resources of the Pension Annuities Fund may only be used 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 adopted by the payer of pension annuities.

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 assets of the Pension Annuities Fund are managed in a transparent, sustainable manner[2]. The fulfilment of this objective by the payer of pension annuities is overseen by the Pension Annuity Board acting in a collegial manner[3].

The Pension Annuities Fund is accounted for and reported on by the Board of the SSIF separately from its own accounting as a budgetary institution. Pursuant to the Law on the Accumulation of Pensions[4], the budget of the Pension Annuities Fund is approved by the Law of the Republic of Lithuania on the Approval of the Budget Indicators of the Pension Annuities Fund for the respective year.

The set of annual accounts of the Pension Annuities Fund is prepared and submitted to the National Audit Office by the 1st of April of the following year at the latest, and to the Government by the 5th of May, which, after approving the set of accounts, submits it to the Seimas by the 15th of May at the latest. The National Audit Office submits to the Seimas the public auditor's report and the public audit report on the audited set of annual accounts[5] by the 15th of May at the latest. The Fund's set of annual accounts, together

[1] Law on the Accumulation of Pensions, Article 35(10)(4), and Law on the National Audit Office, Article 8(2)(4).

[2] Ibid., Article 35(1)(1).

[3] Ibid., Article 35(2)(1) and (2).

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

[5] Annex to the Law on Public Sector Accountability.

with the National Audit Office's auditor's report on those accounts, are published on the pension annuity payer's website by the 1st of June of the following reporting year[6].

[6] Law on the Accumulation of Pensions, Article 35(11)(1).

AUDIT RESULTS

1. THE SET OF ANNUAL ACCOUNTS IS ACCURATE IN ALL MATERIAL RESPECTS

1. The Pension Annuities Fund's set of annual accounts is prepared in accordance with the Law on Public Sector Accountability and the Public Sector Accounting and Financial Reporting Standards[7]. We have not identified any material misstatements in the Fund's set of accounts for 2023, which are accurate in all material respects.

2. In 2023, the first distribution[8] of investment gains (EUR 433.8 thousand)[9] was made to pension annuity beneficiaries, which, when divided among the beneficiaries, resulted in an average increase of 2%[10] in the annuity payable to the beneficiaries. Our testing of the calculation of the gains and the distribution of the gains to the beneficiaries did not reveal any discrepancies.

2. PENDING AMENDMENTS TO THE LAW ON THE ACCUMULATION OF PENSIONS MAY HAVE A NEGATIVE IMPACT ON THE SUSTAINABILITY OF THE FUND'S ACTIVITIES

3. The payer of pension annuities invests the Fund's assets in order to ensure maximum benefit for annuitants, in accordance with the approved asset investment strategy and investment policy[11], and distributes the gains to the annuitants. The Fund's investment volumes are substantially influenced by the new flows of annuitants and the ability to forecast them.

4. At the end of 2023, the Fund had 2,806 pension annuitants[12], of whom 877 purchased an annuity in the reference year: this represented around 87% of the planned number of new

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

[8] Order No V-260 "On the Distribution of the Gains of the Pension Annuities Fund" of 27 June 2023 of the Director of the Board of the SSIF.

[9] Investment gains earned in the previous year and distributed in 2023 amounted to EUR 474.4 thousand: EUR 433.8 thousand from the growth portfolio and EUR 40.6 thousand of other investment gains.

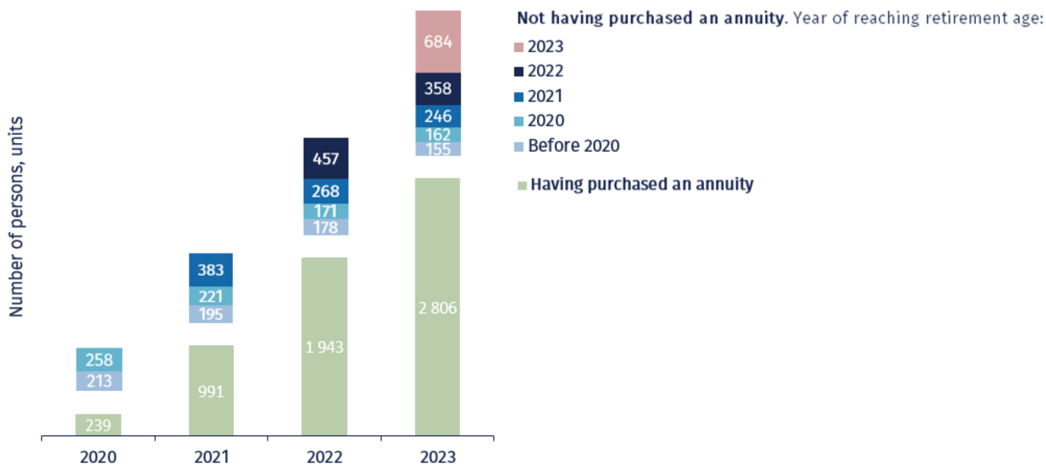
[10] The report on pension annuities payment activities in 2023, approved by Order No V-110 of the Director of the Board of the SSIF of 27 March 2024, states that "Pension annuities have been increased for those beneficiaries who purchased a pension annuity by the end of 2022 and were alive on 1 July 2023. The percentage of pension annuity increase also depended on individual factors such as the lump sum contribution of the annuitant with which the pension annuity was purchased, the type of pension annuity, the age of the annuitant, the length of the period for which the annuitant has been receiving the pension annuity, etc. The maximum amount by which the pension annuity was increased was EUR 12.36 (an increase of about 3.7%). The lowest increase was EUR 0.03, but in this case the pension annuity was purchased at the end of December 2022, so the annuity had a payout period of only a few days."

[11] Order V-427 "Investment Policy and Strategy of the Pension Annuities Fund" of the Director of the Board of the SSIF of 1 September 2020 (wording of Order No V-281 of 25 July 2022).

[12] Data from the report on payment activities of pension annuities for 2023, approved by Order No V-110 of the Director of the Board of the SSIF of 27 March 2024.

participants[13]. Some of the persons (1,605) who became entitled to a pension annuity[14] took the opportunity to postpone their decision to purchase it by remaining members of the pension fund and continuing to accumulate assets with pension fund companies. Due to fluctuations in the financial markets, the value of a participant's assets in the pension fund is constantly changing and the timing of the purchase of a pension annuity will determine both the amount of their annuity (the value of a unit of assets held by a pension fund participant is calculated on the basis of the data of the date of the application for the pension benefit (annuity) contract) and the share of the future gains to be distributed to them.

Fig. 1. Persons who had purchased an annuity and postponed the purchase



Source: National Audit Office based on data provided by the Board of the SSIF and data from the pension annuity payment activity reports from 2020 to the end of 2023.

5. The 2023 Pension Annuities Fund's set of accounts indicates that the pending amendments to the Law on the Accumulation of Pensions (related to the ruling of the Constitutional Court[15], according to which the law must provide for the right to terminate old-age pension accumulation on the initiative of the participant for important reasons) increase the risk of an increase in the need for additional loans in the future, due to the reduction of the Fund's revenue and, consequently, of the deductions for the Fund's management and administration (as at 31 December 2023, the Fund's debt obligations to the Ministry of Finance comprised EUR 344.1 thousand[16] and the Fund's investment policy and strategy may need to be revised.

[13] Data from the 2023 set of accounts of the Pension Annuities Fund (Note 11).

[14] Participants in Tier II pension funds are only entitled to a pension benefit when they reach retirement age (unless the participant has an early pension). Once a participant has become eligible and has elected to receive the assets accumulated in the pension fund in their name, depending on the size of the accumulated assets, the following pension benefits may be payable: a lump sum, a periodic payment or a pension annuity. For pension assets below EUR 10,000 (EUR 10,807 from 2023), the purchase of a pension annuity is not compulsory, but, if the amount accumulated is equal to or higher than the amount indicated, the accumulated pension assets are paid only after the purchase of a pension annuity from the payer of pension annuities.

[15] Resolution No KT21-N3/2024 of the Constitutional Court "On Compliance of Article 4(8), Article 5, and Article 29 of the Law of the Republic of Lithuania on the Accumulation of Pensions (as amended on 28 June 2018) with the Constitution of the Republic of Lithuania".

[16] The interest-free loans granted by the Ministry of Finance have been used to cover management and administration costs from 2020 to 2023. They mature between 2026 and 2030.

6. According to the draft amendment[17], there are currently more than 1.4 million persons of working age participating in the pension scheme, of whom around 0.8 million are active participants, i.e. contributing to the pension scheme. It is projected that, should the grounds for withdrawal from the pension scheme arise, some of the participants (around 20%) will leave it and around 0.6 million will continue to participate actively. The projected number of withdrawals and the reduced accuracy of the Fund's long-term cash flow projections (due to the lack of an exhaustive list of reasons for withdrawal) would have a significant impact on the sustainability of the Pension Annuities Fund:

   - ✓ An increase in the Fund's borrowing needs (the total amount of loans would rise from EUR 0.6 million to EUR 2.5 million);
   - ✓ Postponed final loan repayment deadlines (to 2035 instead of 2028);
   - ✓ The Fund's investment strategy would have to be reviewed.

   A change in the Fund's investment policy and strategy would likely lead to a situation where the Fund's asset liability coverage requirement would not be met[18] (105% coverage at the end of 2023 [19]) and a need for a subsidy from the public budget would arise. The reduced accuracy of long-term cash flow projections would also affect decisions on the increase in pension annuities (as a share of distributed gains), which would fall from the target of 2% annually to 0-1% annually.

Auditor General — Mindaugas Macijauskas

[17] Draft law amending Articles 3, 4, 6, 8, 13, 28, 29, 30, 33, 35^{1}, 35^{2}, 35^{7} and 35^{8} and 35^{8} of Law No IX-1691 on the Accumulation of Pensions and amending the Annex to the Law.

[18] The payer of pension annuities is obliged to ensure that the Fund's assets are not less than the amount of the technical provisions made (Article 35(7)(1) of the Law on the Accumulation of Pensions).

[19] Annex to the explanatory notes No P3 "Technical Provisions of the Pension Annuities Fund by Type of Pension Annuity as at 31 December 2023".

ANNEXES

Public Audit Report
"Results of the Financial Audit of the Set of Accounts of the Pension Annuities Fund for 2023"
Annex

Audit scope and methods

The audited set of accounts of the Pension Annuities Fund for 2023 included:

- ✓ The statement of financial position, the statement of performance, the statement of changes in net assets, the statement of cash flows and explanatory notes prepared on the basis of data as at 31 December 2023.

Subsidiary, controlled and/or consolidated bodies:

- ✓ The Fund has no subsidiaries, controlled or consolidated bodies.

Materiality applied to the audit:

- ✓ A material misstatement, or a combination of misstatements, exceeding 2% of assets (which amounted to EUR 796.1 thousand) for the statements of financial position and changes in net assets and 2% of income (which amounted to EUR 260.6 thousand) for the statements of performance and cash flows is considered a material item in the 2023 set of accounts of the Fund. Smaller misstatements that are relevant to the user of the information because of the nature, the circumstances or the context in which they occurred are also considered to be qualitatively material. The absence of, or failure to comply with, key internal controls is also considered to be qualitatively material.

Limitations on the scope of the audit:

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

The audit was completed:

- ✓ In accordance with the International Standards of Supreme Audit Institutions[20], which include International Standards on Auditing (ISA)[21];
- ✓ To obtain reasonable assurance that the accounts are free from material misstatement. Full assurance is not possible due to the inherent limitations of audit

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[20] ISSAI 2000-2899 "Financial Audit Standards", available online: https://www.valstybeskontrole.lt/LT/post/15649/ (accessed on 15 April 2024).

[21] International Standards on Auditing and Assurance issued by the International Auditing and Assurance Standards Board of the International Federation of Accountants (translated into the Lithuanian language by the Lithuanian Chamber of Auditors (before 28 February 2017) and the Authority of Audit, Accounting, Property Valuation and Insolvency Management under the Ministry of Finance of the Republic of Lithuania (after 1 March 2017), available online: https://avnt.lrv.lt/lt/teisine-informacija/teises-aktai/auditas (accessed on 15 April 2024).

and internal control and the fact that we have not checked all (100%) of the economic operations, economic events, and transactions.

Audit scope and methods
The opening and closing balances of assets and, respectively, of financing amounts, liabilities and net assets at the beginning and end of 2023:
- At the beginning of 2023, the assets amounted to EUR 25,228.6 thousand, and to EUR 39,805.2 thousand at the end of 2023; - At the beginning and at the end of 2023, the financing amounts comprised EUR 0.0 thousand; - At the beginning of 2023, liabilities amounted to EUR 26,190.1 thousand, and to EUR 38,339.2 thousand at the end of 2023; - At the beginning of 2023, net assets amounted to EUR (-)961.5 thousand, and at the end of 2023 they amounted to EUR 1,466.0 thousand.
Income received and costs incurred in 2023:
The Fund received EUR 13,028.8 thousand in income from pension annuity contributions and incurred operating costs of EUR 14,197.6 thousand, of which: EUR 12,047.3 thousand – represented the change in the value of technical provisions; EUR 1,730.8 thousand was the cost of pension annuity benefits; EUR 419.5 thousand were management and administration costs. – –
Revenue received and expenses incurred in 2023:
The Fund received EUR 12,907.4 thousand in pension annuity contribution revenue and incurred EUR 2,186.5 thousand in operating expenses, of which: EUR 1,717.7 thousand were the expenses of annuity payments; – – EUR 424.4 thousand were management and administrative expenses; EUR 44.5 thousand were other expenses. –
Areas assessed and procedures carried out regarding the data of the 2023 set of accounts
The examination of the audited entity's operational, accounting and internal control systems has identified areas where there is a risk of material misstatement:
– No areas where there is a risk of material misstatement have been identified.
Areas where the effectiveness of internal control procedures was assessed (testing of controls was carried out):
– Testing of internal control procedures was carried out in the area of financial assets (also includes related financial and investment activities and cash). For the 2022 audit, testing of internal control procedures was carried out in the areas of pension annuity benefit costs/expenses (also includes the related liability and cash area) and income/revenue: the results of the testing were used.
Areas where key audit procedures (detailed tests and/or analytical procedures) were performed:
– In the areas of fixed and current assets, small- and large-scale detailed tests and main analytical procedures were performed to obtain completeness, certainty, existence, assessment, and disclosure statements. Investments were assessed for compliance with legislation. In the areas of income and revenue, large-scale detailed tests and main analytical procedures were performed to obtain completeness, certainty, existence, assessment, and disclosure statements. – Main analytical audit procedures were performed in the areas of fixed and current liabilities (technical provisions) and operating costs (changes in the value of technical provisions, pension annuity benefits, management and administration) to obtain completeness, certainty, existence, assessment, and disclosure statements. In the area of expenses, main analytical procedures and small- and large-scale detailed tests were performed. Small-scale detailed tests were performed to assess the accuracy of the calculation of the amount of pension annuities, and main analytical procedures were performed to assess the accuracy of the calculation, allocation and distribution of investment profit and profit from other sources to annuitants. – In the area of financial and investment activity costs, small-scale detailed tests and main analytical procedures were performed to obtain completeness, certainty, existence, assessment, and disclosure statements. – Compilation of annual accounts – analytical procedures were performed to obtain assessment and disclosure statements.
Overall assessment of the set of accounts:
The following was assessed: – The appropriateness of the accounting policies used and the reasonableness of the accounting estimates and related management disclosures. The Bank of Lithuania is the supervisory authority that performs the function of supervising the activities of the payer of pension annuities, which includes approving the

Audit scope and methods
methodology for calculating the technical provisions; therefore, our assessment covers the calculation of the amount of technical provisions in accordance with the methodology, but does not include an assessment of the appropriateness of the methodology itself; – The overall presentation, structure and content of the accounts, including disclosures, and whether the accounts present the underlying transactions and events in a manner that complies with the requirements of the Public Sector Accounting and Financial Reporting Standards and the Law on the Accumulation of Pensions.