

Falkirk Council Pension Fund

Annual report on the 2010/11 audit



Prepared for the members of Falkirk Council and the Controller of Audit
November 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Key messages

2010/11

2010/11 is the first year in which Scottish Government regulations require local government pension funds to prepare an annual report separate from the administering authority's own statutory accounts. The report is required to include separate pension fund financial statements which require a separate audit certificate.

During 2010/11 we looked at the key strategic and financial risks faced by Falkirk Council Pension Fund (the fund). We audited the financial statements and looked at aspects of governance, use of resources and performance. This report sets out our main findings, summarising key outcomes from the 2010/11 audit and the outlook for the period ahead.

We have given an unqualified opinion that the financial statements of Falkirk Council Pension Fund for 2010/11 give a true and fair view of the state of the affairs of the board as at 31 March 2011 and of the income and expenditure for the year then ended.

Our review of the fund's governance arrangements identified a number of areas where further development is required to allow the fund to meet best practice. This has been recognised in the Governance Compliance Statement contained within the fund's financial statements and a wide ranging internal review of the governance arrangements is underway.

Outlook

Looking ahead, it is clear that the outlook for public spending for the period 2012/13 to 2014/15 remains very challenging, while volatility on the financial markets continue to affect the value of fund assets.

The triennial funding valuation was carried out by the scheme actuary as at March 2011 and the results of this will shortly be published. It establishes the extent to which, on future assumptions, the scheme assets currently meet the liabilities. At this stage it is uncertain what the impact on the funding level will be, however attaining a fully funded scheme in the future will put additional financial pressure on employers at an already difficult time.

Officers have advised us that the recent Scottish Spending Review has not passed on the member contribution increases imposed in England and in other public sector pension schemes in Scotland such as police, fire and health. However the shortfall in funding will have to be found from other means, if not by increased members' contributions.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of Falkirk Council Pension Fund (the fund). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. Appendix A provides details of our reports issued during 2010/11. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of the administering authority's arrangements for the management of the fund.
3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that those charged with governance understand the risks and have arrangements in place to manage these risks. The fund should ensure that those charged with governance are satisfied with the proposed management action and have a mechanism in place to assess progress.
4. This report is addressed to those charged with governance and the controller of audit. It should be made available to the public and other stakeholders. Audit is an essential element of accountability and the process of public reporting. This report will be published on our website after consideration by those charged with governance.
5. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

6. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
7. Auditors are required to audit financial statements and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.
8. Auditors review and report on, as appropriate, other information published with the financial statements, including the foreword by the Chief Finance Officer and the governance compliance statement. This section summarises the results of our audit of the financial statements.

Audit opinion

9. We have given an unqualified opinion that the financial statements of Falkirk Council Pension Fund for 2010/11 give a true and fair view of the state of the affairs of the fund as at 31 March 2011 and of the income and expenditure for the year then ended.

Legality

10. Through our planned audit work we consider the legality of the pension fund's financial transactions. In addition the Chief Finance Officer has confirmed that, to the best of his knowledge and belief, the financial transactions of the pension fund were in accordance with relevant legislation and regulations. There are no legality issues arising from our audit which require to be brought to the attention of those charged with governance.

Governance Compliance Statement

11. We are satisfied that this statement covers the areas and levels of compliance required by the Scottish Government's guidance.

Annual Report

12. The Scottish Government Guidance requires that the annual report for the pension fund incorporates the following:
 - the annual accounts;
 - a report about the management and financial performance of the funds during the year, a report explaining the authority's investment policy and reviewing the performance during the year of the investments of each fund, and a report of the arrangements made during the year for the administration of the funds;

- a statement by the actuary of the level of funding disclosed by their valuation;
 - the governance compliance statement, funding strategy statement, and statement of investment principles (or details of where these statements may be obtained);
 - the extent to which levels of performance set out in the pension administration strategy have been achieved;
 - any other material which the authority considers appropriate.
13. We are satisfied that the report incorporates the above sections and that the other sections are consistent with the audited accounts.

Accounting issues

14. Local authority bodies in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the 2010/11 Code), including for the first time in 2010/11 the application of International Financial Reporting Standards (IFRS). We were satisfied that the fund prepared the accounts in accordance with the 2010/11 Code.

Accounts submission

15. The fund's unaudited financial statements and annual report were submitted to the controller of audit by the deadline of 30 June 2011. A comprehensive working papers package was also available by this date. The other sections of the Annual Report were available from 25 July 2011. This enabled us to conclude the audit and certify the financial statements by the transitional submission date of 30 November 2011 (from 2011/12, submission of the audited financial statements will be required by 30 September). The annual report, incorporating the financial statements, is now available for presentation to members and for publication (**O/S**).

Presentational and monetary adjustments to the unaudited accounts

16. As reported to members of the Investment Committee in line with International Standard on Auditing 260 '*communication of audit matters to those charged with governance*', there were a number of audit adjustments required to the financial statements as a result of our audit findings and these have been corrected in the financial statements as appropriate.

Prior year adjustments

17. The 2010/11 financial statements have been prepared in accordance with the 2010 Code which is based on International Financial Reporting Standards (IFRS) instead of the previous practice of preparing financial statements under UK Generally Accepted Accounting Practice (GAAP). This transition did not require a prior year adjustment to the 2009/10 audited financial statements of Falkirk Council Pension Fund as there were no material changes resulting from IFRS which affected the preparation of its accounts.

Outlook

Audit appointment for 2011/12

18. Audit appointments are made by the Accounts Commission, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment. The procurement process for the next five years was completed in May 2011. From next year (2011/12) Audit Scotland will again be the appointed auditor for the Falkirk Council Pension Fund, but a different audit team will be in place. We look forward to continuing the good working relationships that exist.

Financial position

19. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
20. Auditors consider whether audited bodies have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
21. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

Budgetary control

22. The pension fund does not set a budget for its activities or report on progress through the year. This has been mainly due to the fact that, for most of its activities (receiving contributions, paying pensions, investing activities), it does not have control over the value of the transactions at any one time. There are however some elements (administration costs, investment manager expenses and other overheads) where it does have some control and it would be helpful to set a budget for such areas of expenditure.

Refer Action Plan no. 1

Financial position

23. The overall position at 31 March 2011 set out in the net assets statement is that the fund has assets of £1,181 million. The financial statements do not take account of the obligations to pay pensions and other benefits which fall due after the end of the year. The actuarial position of the scheme, which does take account of such obligations, is disclosed in the Notes to the Accounts.
24. The actuarial value of promised retirement benefits at the accounting date has been estimated by the Fund Actuary as £1.490m. This gives an estimated net liability of £309 million as at 31 March 2011. The liability is an estimate of the present value of the future liabilities of the fund, based on the fund actuary's assumptions regarding the future discount rate, longevity of members and rate of inflation. This figure is used by the pension fund for statutory accounting purposes and is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

25. The value of the pension fund liability at 31 March 2011 has reduced from the previous year. The main reason for this is due to the change in the basis of indexing the value of pension payments from retail price index to consumer price index and its effect of reducing future liabilities. In effect this means that future pension increases are now linked to the consumer price index, which is expected to rise at a lower rate than the previous retail price index, giving lower payments to pensioners and hence less future liabilities for the pension fund.

Outlook

2011/12 budget

26. At the last full actuarial valuation of the pension fund as at 31 March 2008 the actuary reported that the pension fund had a funding level of 79% (a funding shortfall of £255 million) and calculated that a theoretical employer contribution of 23.8% of pay would be required to extinguish this shortfall over a 20 year period. Due to financial constraints, the actuary and the council agreed a 'stabilisation strategy' for employers with a strong covenant, resulting in lower contribution rates for Clackmannanshire, Falkirk and Stirling Councils and Police, Fire and Valuation Joint Boards of 18%, 18.5% and 19% for the years 2009/10 to 2011/12.
27. The triennial review by the scheme actuary as at 31 March 2011 will be important in determining future levels of employer contributions. The final report from the actuary will not be available until early 2012.

Financial forecasts beyond 2011/12

28. Looking ahead, it is clear that the outlook for public spending for the period 2012/13 to 2014/15 remains very challenging. The high level figures for Scotland that were announced in the UK Comprehensive Spending Review indicate that significant budget reductions will be required in these years. This will impact on contributions received and benefits payable where scheduled and admitted bodies reduce staffing levels.

Governance and accountability

29. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
30. Through its board, chief executive and/or accountable/proper officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
31. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
 - corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
32. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

33. Falkirk Council Pension Fund's governance arrangements run alongside the governance structures of the administering authority, Falkirk Council. The current arrangements are that the Investment Committee deals with all pension fund issues.
34. The Investment Committee met quarterly in 2010/11 to consider reports on various issues affecting the Pension Fund including the performance of individual fund managers, reviews of investment strategies, funding level updates and governance arrangements.
35. As a new requirement from 2010/11, pension funds have to produce a governance compliance statement which sets out the areas that it does and does not comply with guidance issued by the Scottish Government on committee governance arrangements. The guidance covers membership of the pension committee, frequency of meetings, training of members and several other areas.
36. The governance compliance statement contained within the Annual Report and Accounts reflects a largely 'partial compliant' status for the Pension Fund's governance arrangements. There is much to do before the arrangements comply with good practice, however a review has been carried out by the Chief Finance Officer resulting in a number of improvement measures based on guidance issued by the Scottish Pensions Agency in April 2011.

37. Areas where improvements have been approved by the Investment Committee include revised terms of reference and delegated powers for the Investment Committee (to be re-named the Pensions Committee), establishment of a Pensions Panel, representation of stakeholder groups, voting rights and access to training and papers.

Refer Action Plan no. 2

Internal control

38. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit. We note that there is currently no programme of internal audit work specifically targeted at the Pension Fund and there has been no internal audit activity in this area for 2010/11. We have therefore been unable to place any reliance on internal audit work during 2010/11.

Refer Action Plan no. 3

39. The pension fund's financial systems run alongside those of the administering authority and its financial ledger and payroll system are used to process transactions. There are specific systems and lines of responsibility for pension administration and for investment transactions. Our review of these financial systems did not identify significant issues.

Outlook

40. As noted at paragraph 36 above, Members have approved revised governance arrangements for Falkirk Council Pension Fund. As a result, the Investment Committee will be reconstituted as a Pensions Committee with increased terms of reference to cover all aspects of the management of the fund. This Committee may wish to reflect on the new requirements for a separate Annual Report and Accounts and a separate audit opinion and consider the processes required to discharge its responsibilities as "those charged with governance". We will continue to monitor developments in this area.

Use of resources and performance

41. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value.
42. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.
43. As part of their statutory responsibilities, the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
 - a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
44. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments
45. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.
46. This section includes a commentary on the Best Value and performance management arrangements within the pension fund. We also note any headline performance measures used by members and comment on any relevant national reports.

Management arrangements

Best Value

47. The pension fund has not been subject to a Best Value review, however it is covered by the overall Best Value arrangements of the administering authority.

Investment Performance

48. The main way the pension fund measures performance is through an analysis of returns achieved on as managed by several specialist fund managers. Performance against benchmark targets is subject to independent verification by the Fund's custodian, Northern Trust, and is regularly reported to the Investment Committee.

Administration Performance

49. Falkirk Council Pension Fund supplies administration performance information to CIPFA and the Scottish Government annually. Service standards have also been developed and are monitored by Fund officers. Although key performance indicators are reported in the Annual Report and Accounts, including the percentage of payment deadlines met, unit administration costs per scheme member, lump sums paid within 7 days and queries responded to in 14 days, there is no regular reporting of administration performance to members.

Refer Action Plan no. 4

Overview of performance in 2010/11

The Pension Fund's performance measurement outcomes

50. In 2010/11 the pension fund investments performed 0.8% above the benchmark, at 8.7%, largely due to the out-performance of Bonds and Global Equities mandates. The three year return of 5.5% showed an underperformance against the three year benchmark of 5.7% as a result of a sharp decline in equity and property investments in 2008/09.
51. As outlined above, performance data for the administration of the scheme is reported in the Annual Report and Accounts. This information demonstrates a general improvement in pension administration. All payment deadlines have been met in the last three years and there has been an improvement in the unit administration costs per scheme member. Improvements have also been made in the percentage of lump sums paid within 7 days (92%; prior year 91%) and the percentage of queries responded to in 14 days (71%; prior year 67%).

Outlook

52. The Pension Fund sets its investment performance targets based on advice from the investment advisor about market performance and standard industry benchmarks. The current volatility in the stock market makes it important for pension funds to have a wide range of investment vehicles.

National performance reports

53. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of interest are detailed in Exhibit 1:

Exhibit 1: A selection of national performance reports 2010/11

- | | |
|---|--|
| <ul style="list-style-type: none">• The cost of public sector pensions in Scotland• Scotland's public finances: responding to the challenges | <ul style="list-style-type: none">• An overview of local government in Scotland 2010 |
|---|--|

Source: www.audit-scotland.gov.uk

54. Members may wish national performance reports to be considered as they become available and for any findings which impact on the pension fund to be reported to them to assist them in discharging their duties as those charged with governance for the Pension Fund.

Appendix A: audit reports

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Committee
Annual audit plan	24 March 2011	21 March 2011 *
Review of the governance arrangements	9 November 2011	24 November 2011 **
Report on financial statements to those charged with governance	16 November 2011	24 November 2011 **
Audit opinion on the 2010/11 financial statements	30 November 2011	TBD

* *Audit Committee*

** *Investments Committee*

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	22	<p>No budgetary control processes are in place for the elements of costs (administration costs, investment manager expenses and other overheads) which the Pension Fund has the ability to control.</p> <p>Risk</p> <p>Costs may not be contained where they are not regularly monitored and assessed against predetermined budgets.</p>	Propose that the Pensions Committee should receive an annual budget and monitoring reports in respect of pension fund administration and investment management investment costs	Pensions Manager	February, 2012
2	37	<p>The council has recognised that a number of improvements are required to the Fund's governance arrangements before they can fully comply with best practice. Revised arrangements have been approved.</p> <p>Risk</p> <p>Governance arrangements do not comply with best practice.</p>	A review of governance arrangements consistent with the statutory guidance issued by SPPA is currently underway with the implementation of the arrangements expected to take place after the May, 2012 local authority elections	Chief Finance Officer / Pensions Manager	June, 2012
3	38	<p>There is currently no internal audit programme presented to Members for Falkirk Council Pension Fund. No internal audit</p>	<p>Comments noted.</p> <p>All Internal Audit business in respect of the Pension Fund will be reported to the</p>	Pensions Manager / Internal Audit Manager	June, 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<p>work was carried out in this area in 2010/11.</p> <p>Risk</p> <p>Members do not receive independent assurance over the internal control and governance arrangements which support the governance compliance statement.</p>	Pensions Committee		
4	49	<p>Administration performance information is not regularly reported to Members. There may also be some scope to consider whether the current level of information provided is sufficient to allow Members to monitor administrative performance effectively and identify any need for corrective action e.g. there is currently no user survey carried out to assess users' satisfaction with the administration services provided.</p> <p>Risk</p> <p>Members do not have the opportunity to identify performance issues in the pension administration function.</p>	<p>Position noted.</p> <p>A review of key administration indicators will be undertaken and reported to the Pensions Committee at least twice per year.</p>	Pensions Manager	June, 2012