



Falkirk Council Pension Fund

Annual Audit Report to
Members and the
Controller of Audit

September 2015

The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies. (www.audit-scotland.gov.uk/about/ac)

Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. (www.audit-scotland.gov.uk)

The Accounts Commission has appointed Fiona Mitchell Knight as the external auditor of Falkirk Council Pension Fund for the period 2011/12 to 2015/16.

This report has been prepared for the use of Falkirk Council Pension Fund and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

Key contacts

Fiona Mitchell Knight, Assistant Director
fmitchell-knight@audit-scotland.gov.uk

Jim Rundell, Senior Audit Manager
jrundell@audit-scotland.gov.uk

Louise Dodds, Auditor
ldodds@audit-scotland.gov.uk

Audit Scotland
4th floor (South Suite)
8 Nelson Mandela Place
Glasgow
G2 1BT



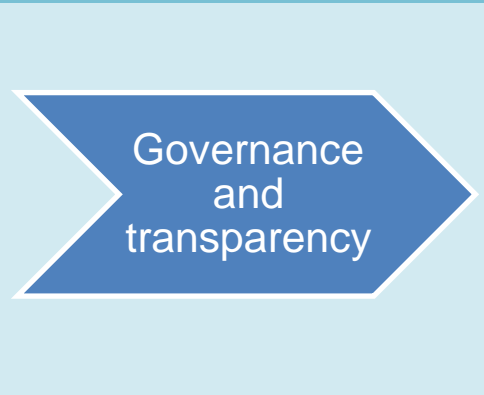
Telephone: 0131 625 1500


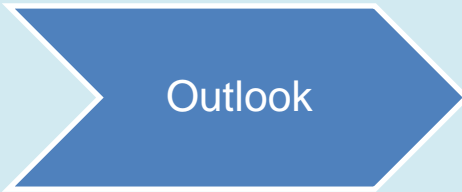
Website: www.audit-scotland.gov.uk

Contents

Key messages.....	4	Best Value	23
Introduction.....	6	Appendix I – Significant audit risks	27
Audit of the 2014/15 financial statements	7	Appendix II - Summary of local audit reports 2014/15	30
Financial management and sustainability.....	12	Appendix III – Action plan.....	31
Governance and transparency.....	17		

Key messages

 <p>Audit of financial statements</p>	<ul style="list-style-type: none">• The independent auditor's report on the 2014/15 financial statements of Falkirk Council Pension Fund is unqualified.• No adjustments were required to the Fund's financial statements.
 <p>Financial management and sustainability</p>	<ul style="list-style-type: none">• The 2014 triennial valuation reported that the Fund's assets were sufficient to meet 84.8% of its liabilities. A more recent interim valuation by the Fund's actuary estimated that the funding deficit had declined to 79.3%.• Fund net assets at 31 March 2015 were £1,799.8 million, an increase of £223.2 million (or 14.2%) over the year, reflecting the favourable market conditions for investors during the year.• The Fund has prepared an administration budget for the first time.
 <p>Governance and transparency</p>	<ul style="list-style-type: none">• Overall, the Fund had effective governance arrangements in place during the year.• New governance arrangements were implemented from 1 April 2015 to comply with the Public Service Pensions Act 2013. This included the establishment of a local Pensions Board.• The Fund actively participates in the National Fraud Initiative.• A timescale has yet to be agreed for the recruitment and appointment of a permanent accountant.• Aspects of governance could be improved. For example, the Internal Audit Manager should provide the Pensions Committee with an annual assurance report that includes an opinion on the systems of internal control.

 Performance	<ul style="list-style-type: none">• The Fund has good performance management arrangements.• The Fund achieved a 13.4% return on investments in 2014/15 compared to a benchmark target of 12.1%. Also, it outperformed benchmark targets over the medium and longer term.• All fund managers posted positive absolute returns on investment performance in 2014/15 reflecting a strong year for equities and bonds although the performance of Aberdeen Asset Management continues to remain under close scrutiny.• Administration performance has deteriorated due to pressures on staff resources.
 Outlook	<ul style="list-style-type: none">• From the start of 2015/16, the Fund will provide benefits on a “career average” basis. This change will increase the complexity and workload of Fund administration.• The pensioners’ payroll system is due to transfer from the council’s Resourcelink system to a module on Altair. This will require good project management.• The global investment outlook continues to be marred by political and economic challenges.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of Falkirk Council Pension Fund (the 'Fund'). The report is divided into sections which reflect our public sector audit model.
2. The management of the Fund is responsible for:
 - preparing financial statements which give a true and fair view
 - implementing appropriate internal control systems
 - putting in place proper arrangements for the conduct of its affairs
 - ensuring that the financial position is soundly based.
3. Our responsibility, as the external auditor of Falkirk Council Pension Fund, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.
5. **Appendix III** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Falkirk Council Pension Fund understands its risks and has arrangements in place to manage these risks. The Pensions Committee and senior management should ensure that they are satisfied with proposed actions and have a mechanism in place to assess progress and monitor outcomes.
6. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
7. We are grateful for the cooperation and assistance we received from officers during the course of the audit.

Audit of the 2014/15 financial statements

<p>Audit opinion</p>	<ul style="list-style-type: none"> • We have completed our audit and issued an unqualified independent auditor’s report.
<p>Going concern</p>	<ul style="list-style-type: none"> • The financial statements of Falkirk Council Pension Fund have been prepared on a going concern basis. We are not aware of any events or conditions that cast doubt on the Fund’s ability to continue as a going concern.
<p>Other information</p>	<ul style="list-style-type: none"> • We review and report on other information published with the financial statements, including the management commentary, governance compliance statement and annual governance statement. We have nothing to report in respect of these statements.

Submission of financial statements for audit

8. We received the unaudited financial statements on 19 June 2015, in accordance with the agreed timetable. The working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit to deadline.

Overview of the scope of the audit of the financial statements

9. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Pensions Committee on 12 March 2015.
10. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.
11. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks

identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

12. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

13. 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 decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).
14. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
15. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of Falkirk Council Pension Fund we set our planning materiality for 2014/15 at £7.643 million or 10% of contributions (based on the audited 2013/14 accounts). We also report all misstatements greater than £100,000. Performance materiality was calculated at £3.822million, to reduce to an acceptable level the probability of

uncorrected and undetected audit differences exceeding our planning materiality level.

16. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our original calculations remained appropriate.

Evaluation of misstatements

17. A number of presentational adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements.

Significant findings from the audit

18. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:
 - the auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures
 - significant difficulties encountered during the audit
 - significant matters arising from the audit that were discussed, or subject to correspondence with management
 - written representation requested by the auditor

- other matters which in the auditor's professional judgement, are significant to the oversight of the financial reporting process.

19. There has been a significant improvement in the disclosure of investment management expenses which now include direct expenses from private equity and infrastructure investments.
20. The table overleaf contains a summary of the significant findings that, in our view, require to be communicated to you in accordance with ISA 260.

Issue	Resolution
<p>Annual Governance Statement (AGS):</p> <p>The Annual Governance Statement contained a number of factual inaccuracies and potentially misleading information on the scope of internal audit work. External audit requested that a number of changes be made to the content of the AGS particularly in relation to internal audit.</p>	<p>The Annual Governance Statement was revised to take account of points raised by external audit.</p>
<p>Year end reconciliation of employer / employee contributions:</p> <p>The monthly returns of employee and employer contributions received from admitted bodies are recorded on a controls spread sheet by pensions staff. These are then posted to the ledger after checking to bank statements to confirm receipt. Reasonableness checks are also carried out on the contributions at the time of receipt. In previous years, a reconciliation was also carried out at the year-end between contributions recorded in the ledger and the detailed annual returns received from employers.</p> <p>The year end reconciliation was incomplete at the time of our audit with annual returns still outstanding from 11 out of 37 admitted bodies. For those bodies where returns had been received the differences on reconciliation were immaterial relative to total contributions. Where returns were still outstanding the total value of contributions from those bodies was approximately £831,000 out of total contributions received of approximately £75,000,000 (1.1%). This is not material to the accounts.</p>	<p>The monthly checks performed on the remittance advices provide assurance that the figures in the ledger are reliable and materially correct. The ledger figures were used in compiling the Annual Report and Accounts.</p>

Recent developments

Public Services Pensions Act 2013

21. In terms of the 2013 Act, a number of significant changes to the Local Government Pension Scheme (LGPS) (Scotland) apply from 1 April 2015 including those illustrated below:

Benefits from 1 April 2015 will build up on a career average basis at the rate of 1/49th of annual pensionable earnings

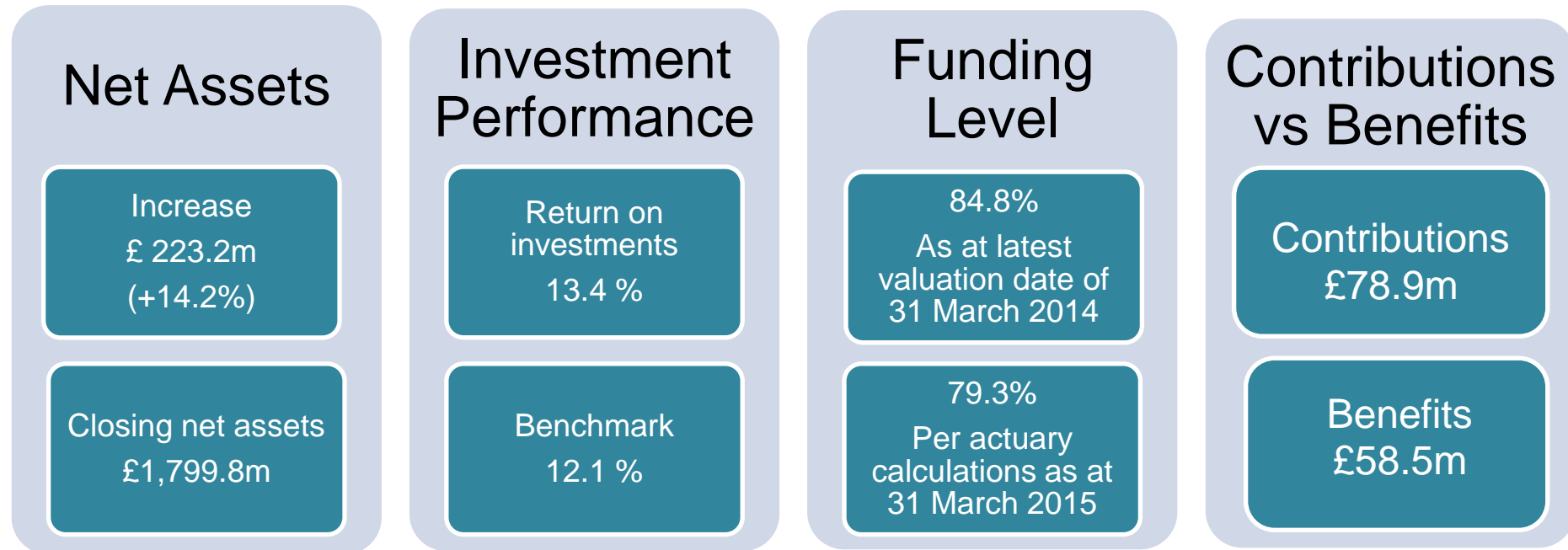
Normal Pension Age will be aligned with each member's own State Pension Age

The LGPS will have a National Advisory Board and local Pension Boards

Revised governance arrangements

22. The 2013 Act is supported by a number of new sets of regulations including the Local Government Pension Scheme (Governance) (Scotland) Regulations 2015. These set out the new governance arrangements from 1 April 2015.
23. At a national level the new arrangements include the establishment of a Scheme Advisory Board. Its role is to:
- provide advice to Scottish Ministers on proposed changes to the LGPS (Scotland)
 - provide advice to Scheme Managers or Scheme Pension Boards on the effective and efficient administration of the Scheme and any funds within the Scheme.
24. The Act also extends the powers of the Pensions Regulator to cover standards of governance and administration in the LGPS (Scotland).
25. Another key feature of the new governance arrangements is the requirement for a local Pensions Board to be established to assist the Scheme Manager (i.e. Falkirk Council) in securing compliance with the scheme rules and with the Pension Regulator's Codes of Practice. In the Governance and Transparency section of this report we comment on progress made in implementing these new arrangements.

Financial management and sustainability



Financial management

26. In this section we comment on the Fund's financial outcomes and assess its financial management arrangements.
27. Pension fund finances are independently assessed every three years by the Fund's actuary. Employer contribution rates are determined by the actuary and used by the council as administering body to set an annual budget for the Fund's expenditure and income. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

Financial outcomes

28. The Fund reported an increase in net assets of £223.2 million (14.2%) to approximately £1.8 billion. The increase is due mainly to £27.1million from investment income and £188.7 million from increases in the value of investments as a result of favourable conditions in the equities market. The Fund has also benefited from investment in growth generating assets.
29. The Fund's Actuary, Hymans Robertson, have estimated that the Fund's liabilities have risen from £1.8 billion at 31 March 2014 to £2.2 billion at 31 March 2015. This is a result of falling gilt yields which in turn leads to a lower discount rate and higher values being placed on the Fund's liabilities.
30. It is important to note that the £2.2 billion does not appear in the financial statements as they do not take account of the Fund's obligations to pay pensions after 31 March 2015.

Financial management arrangements

31. As auditors, we consider whether pension funds have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
 - the proper officer has sufficient status within the council to be able to deliver good financial management
 - financial regulations are comprehensive, current and promoted within the council
 - reports monitoring performance against budgets are accurate and provided regularly to budget holders
 - monitoring reports do not just contain financial data but are linked to information about performance
 - members provide a good level of challenge and question budget holders on significant variances.
32. We assessed the role and status of the proper officer against the Chartered Institute of Public Finance and Accountancy's *Statement on the role of the Chief Finance Officer in Local Government*. We concluded that, in relation to the Fund, the council as administering body generally complied with the aforementioned statement. However, we have raised some concerns about whether the Pensions Section is sufficiently resourced to be fit for purpose (refer to paragraphs 88 to 90).
33. The Fund relies on the council's standing orders and financial regulations. The former were updated in May 2015 and take account of the new governance arrangements resulting from

the Public Services Pensions Act 2013. Financial regulations while comprehensive are due to be updated sometime later this year.

- 34. An administration budget was prepared for the first time in the current financial year while the budget for 2015/16 was reported to the Pensions Committee in March 2015. Also, the Fund's Annual Report and Accounts includes details of actual income and expenditure against approved budget with explanations for significant variances.
- 35. The Fund has good performance arrangements with regular monitoring and review of investment managers performance.

Conclusion on financial management

- 36. Overall, subject to comments on staff resourcing, we concluded that financial management arrangements are effective.

Financial sustainability

- 37. The Fund gives its members a guarantee that in exchange for contributions during their employment, the Fund will pay a pension until the end of each member's life. Financial sustainability means that the Fund maintains the capacity to meet the current and future needs of its members despite changes in investment performance and life expectancy.
- 38. In assessing financial sustainability we look at various aspects of activity, including the funding position, membership levels and long-term recovery measures where there is a deficit.

Funding position

- 39. One of the key objectives of the Administering Authority as set out in the Fund's Funding Strategy Statement is to hold sufficient assets to meet the assessed cost of members' past service benefits. A funding level of 100% would be needed for this objective to be met at the valuation date.
- 40. The most recent triennial valuation of the Fund was completed during 2014. This valuation showed that the Fund's assets as at 31 March 2014 amounted to £1,577 million. These were sufficient to meet 84.8% of its liabilities at that date. The funding shortfall was £283 million as illustrated below.

Table 1: Funding valuations 2008 to 2014

Fund Details	March 2008 £ million	March 2011 £million	March 2014 £million
Assets	947	1,199	1,577
Liabilities	(1,202)	(1,392)	(1,860)
Net Liability	(255)	(193)	(283)
Funding Level	78.7%	86.1%	84.8%

Source: Falkirk Council Pension Fund Annual Reports and Accounts

- 41. The current funding position represents a slightly weaker position than that reported in March 2011 when the funding position was 86.1% although still a stronger position than the 78.7% funding level reported in March 2008.

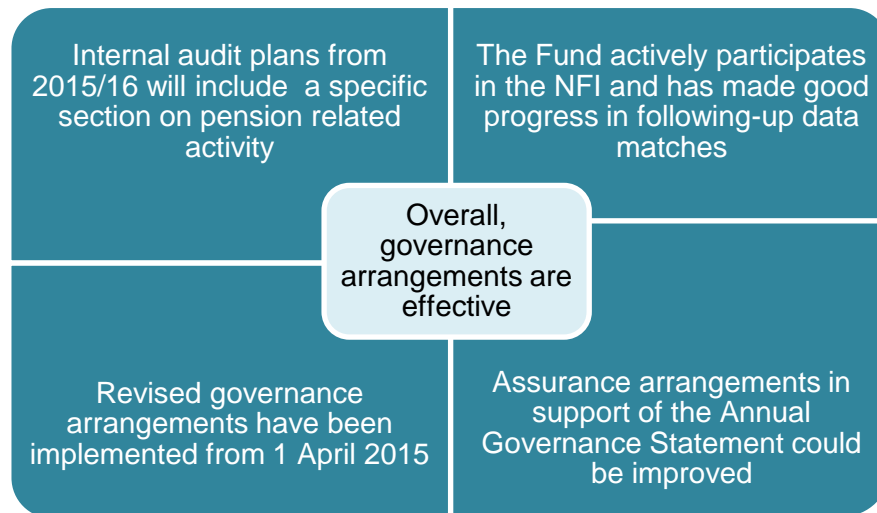
42. Hymans Robertson also review the funding position annually and by their calculations the estimated funding position at 31 March 2015 was 79.3%. This is based on assets of £1,820 million and liabilities of £2,297 million which results in a net liability of £477 million. This weaker position is due primarily to the fall in gilt yields from 5.1% (March 2014) to 3.8% (March 2015) and reflects market uncertainty in the short term.
43. In reducing the funding deficit the factor most likely to have a beneficial effect is a rise in interest rates. This will drive up bond yields and reduce overall liabilities. Interest rates are not expected to increase until late next year.
44. Following the 2014 valuation, the Actuary has specified that the majority of Fund employers pay deficit contributions as a fixed sum rather than as a percentage of pay. This will provide greater certainty for the Fund over the level of deficit contributions that it receives.
45. Fund membership has remained fairly stable over the year. Also, there has been an increase in active members with numbers rising from 12,939 in 2010/11 to 14,589 in 2014/15; a 12.7% increase. Furthermore, there was surplus of contribution income over the cost of pensions with contributions of £78.9 million exceeding benefits of £58.5 million by £20.4 million in 2014/15. This surplus contributes towards the Fund's requirement to provide current and future needs of members.
46. It is important that the Fund closely monitors membership and contribution levels so that it can continue to pay benefits from its regular contribution inflow.
47. The Fund's Investment Strategy is under review. The aim of the strategy will be to return the Fund to a positive funding position in the longer term.
48. An investment sub-group has been formed to oversee the construction of a gradual de-risking plan to enable the Fund to allocate more assets to fixed income as the funding level improves and thereby reduce the exposure to investment risk.
49. The sub-group will also review the portfolio of assets required for the Fund to achieve its objectives. Thereafter, a decision will be made to appoint portfolio managers.
50. Overall, we concluded that, despite the current deficit, the Fund is financially sustainable because of increasing contribution levels and the long-term view of investments.

Outlook

51. It is clear that the outlook for public spending remains very challenging and the need for spending constraints and budget reductions will continue. Any further staff reduction schemes introduced by employers will place pressures on the Fund from increased administration workloads and reductions in member contribution levels.

52. The Public Service Pensions Act 2013 is designed to ensure the continued sustainability of the LGPS. In particular, the introduction of the 'employer cost cap' which will shift some of the risk of future rises in scheme costs onto members.
53. The Scottish LGPS Advisory Board was formed with effect from 1 April 2015 under section 7 of the Public Service Pensions Act 2013. It is expected to operate at a national level and will have members drawn from employers, trade unions, professional advisors and bodies such as the Pensions Regulator and the National Association of Pension Funds.
54. The UK Government's pension initiatives include auto enrolment, freedom of choice and the abolition of contracting out. This means that the pace of pension reform will remain challenging.

Governance and transparency



55. Falkirk Council is the administering body for the Fund. Members and management of the council are responsible for establishing governance arrangements for the Fund. This to ensure that the Fund's business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements.
56. As part of our planning work on the council audit we reviewed various aspects of governance that also apply to the Fund including standing orders, financial regulations, Codes of Conduct

for officers and members and anti-fraud and corruption arrangements.

57. Overall, we concluded that these arrangements are effective and support governance arrangements. We also concluded that the Fund conducts its business in an open and transparent manner.

Governance structures

58. The main governance structures in place during 2014/15 were as follows:
- **Pensions Committee.** This committee comprised six councillors from Falkirk Council and three co-opted members drawn from the Union, Employer and Pensioner groupings. This Committee had delegated authority to maintain and administer all aspects of Fund business including governance, formulating investment policy, managing assets, accounting and funding matters.
 - **Pension Panel.** This consisted of 15 members representing the interests of scheme members, employers and pensioners. Its role was to support the Pensions Committee in scrutinising the activities of the Fund.
59. As previously mentioned at paragraphs 22 to 25 new governance arrangements came into force on 1 April 2015. These were discussed and agreed by the Pensions Committee in December 2014 and were ratified by Falkirk Council in the same month.

- 60. The main change has been the dissolution of the Pensions Panel and its replacement by a local Pensions Board in compliance with the Public Service Pensions Act 2013. The Board's role is to assist the Scheme Manager (i.e. Falkirk Council) in ensuring compliance with the rules relating to scheme governance and administration.
- 61. These changes were included in the Governance Policy and Compliance Statement reported to the first joint meeting of the Pensions Committee and Pension Board on 26 June 2015. The Committee and Board plan to meet concurrently to ensure that business is focused.
- 62. Based on our observations and through attendance at the Pensions Panel and Pensions Committee during the year we concluded that the governance arrangements were operating effectively. Also, good progress has been made in implementing revised governance arrangements to comply with the requirements of the Public Service Pensions Act 2013.

Transparency

- 63. Transparency means that scheme members have access to understandable, relevant and timely information about how the Fund is taking decisions and how it is using its resources. Members should also be able to hold the Fund to account for the decisions it makes.
- 64. The meetings of the Pensions Committee are open to the public. Committee agenda, papers and reports are published on Falkirk Council's website (save the occasional exempt paper) which is

easy to access and navigate around. The Committee papers and reports provide comprehensive information on all aspects of the Fund's activities including investment performance and the performance of individual companies used by the Fund to manage its portfolio investments.

- 65. The Fund also has its own dedicated website where members can access a range of information including new pensions regulations, the Annual Report and Accounts and the role of the Pensions Committee.
- 66. Scheme members also receive an annual statement that provides details of benefits accrued, information on topical pension issues and a review of the Fund's progress. Due to current staffing issues there has been a delay in issuing statements to deferred members. Annual statements have been issued to active members.
- 67. Overall we concluded that the Fund is open and transparent in the way it conducts its business. Also, scheme members and the public are able to attend regular meetings of the Pensions Committee.

Internal control

- 68. As auditors we concentrate on the significant systems and the key controls within them to provide us with assurance on the accuracy and reliability of figures generated by those systems. For those systems provided by the council (e.g. trade payables, trade receivables and ledger) we carried out a mixture of testing and reliance on the work of internal audit.

69. For pension specific systems (e.g. pensions administration and investments) we carried out a high level review of controls because testing in previous years had not identified any significant control weaknesses. A recent internal audit report issued on 15 July 2015 also concluded that substantial assurance can be placed on governance arrangements and on key controls within pension related systems (e.g. pensioner payroll).
70. Based on the work carried out we concluded that systems were operating effectively and no significant issues were identified that require to be brought to the attention of members.

Internal audit

71. Internal audit provides members and management of the council with independent assurance on risk management, internal control and corporate governance processes. The Fund's internal audit service is provided by Falkirk Council's internal audit function.
72. We are required by international auditing standards to make an assessment of the internal audit function and the extent to which we can formally rely on their work. We concluded that the internal audit function operated in accordance with the Public Service Internal Audit Standards and had sound documentation standards and procedures in place. Consequently, we were able to take assurance on aspects of internal audit work where systems (e.g. trade receivables) are shared with the council.
73. In our 2013/14 Annual Audit Report and 2014/15 Annual Audit Plan we highlighted that the 2014/15 internal audit plan for the council did not include any pension specific work. Management subsequently addressed this by including a pension section within the council's 2015/16 internal audit plan. While this plan was submitted to the council's Audit Committee in April 2015 it was not presented to the Pensions Committee for consideration.
- Recommendation 1**
74. In future, the Internal Audit Manager (or his representative) plans to attend the Pensions Committee, as required, to present audit findings and answer questions raised by members.
75. The Pension Fund section of the council's internal audit plan for 2015/16 outlines the work to be undertaken, namely:
- a review of the arrangements for the governance and management of the Fund; and
 - transactional testing, although an outline of the scope of internal audit work was not detailed in the audit plan.
76. This work was undertaken early in 2015/16 and reported to management on 15 July 2015. The transactional testing covered transfer values, contributions and pension payments with samples drawn from the 2014/15 financial year.

Annual Governance Statement

77. The Local Authority Accounts (Scotland) Regulations 2014 introduced a new requirement from 2014/15 for local authorities, or appropriate committee, to undertake a review at least once in each financial year of the effectiveness of its system of internal control and consider findings before approving an Annual Governance Statement.
78. In the case of the Falkirk Council Pension Fund, the Pensions Committee has delegated responsibility for governance issues. At its meeting on the 26 June 2015 the Committee approved the Annual Governance Statement but without full consideration of the system of internal control. In particular, the Committee did not receive an Annual Assurance Report from internal audit in which the Audit Manager is required to provide an opinion on the adequacy and effectiveness of the system of internal control.
79. Also, in terms of the 2014 Accounts Regulations the Pensions Committee must from time to time assess the efficiency and effectiveness of the internal audit function in accordance with recognised standards and practices.

Recommendation 2

Arrangements for the prevention & detection of fraud & corruption and maintaining standards of conduct

80. The Fund has adopted the policies used by Falkirk Council for preventing and detecting fraud. Also, the Fund is governed by the Council's Code of Conduct for Members and Officers. Additionally, all members are expected to apply the Standards Commission for Scotland's Councillors' Code of Conduct. We reviewed these arrangements as part of our planning process for the council and concluded that they were adequate.

National Fraud Initiative

81. The Fund also participates in the National Fraud Initiative. This is a biennial counter fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different systems, to identify data matches that might suggest the existence of fraud or error.
82. The Fund has made good progress to date in investigating data matches with 242 out of 415 (58%) matches investigated by July 2015. This level of review exceeds the minimum requirements. All high risk matches have been reviewed and the remaining cases are categorised as low risk or areas where investigation is not required. No frauds or potential frauds have been identified to date. The Internal Audit Manager also maintains oversight of the NFI process to monitor progress in investigating matches.
83. Overall we concluded that pensions staff are proactive in reviewing and investigating NFI matches.

Data migration to Altair system

84. During the course of 2014/15, Pension Fund records migrated from the in-house Pensions Administration System (PAS) to an externally hosted system (i.e. Altair). As part of our audit we carried out sample testing of records both before and after the migration process for completeness and accuracy.
85. Our audit work did not identify any significant risks affecting the overall completeness and accuracy of membership data. Furthermore, during the migration process there was discussion between management and the system provider (Heywood). This was evident prior to, during and post implementation of the migration process.
86. Pensions administration staff also carried out their own testing of the system. However, a clear audit trail was not always maintained which detailed the extent of testing, or findings, resulting from this work. There are plans to transfer the pensioners payroll to a new system in the near future. It is important that when the transfer takes place a clear audit trail of checks is put in place to assess the effectiveness of the process.
87. Overall, the migration from the old to the new pension administration system was successful and our testing of the migration process did not identify any significant issues that require to be brought to the attention of members.

Staff resources

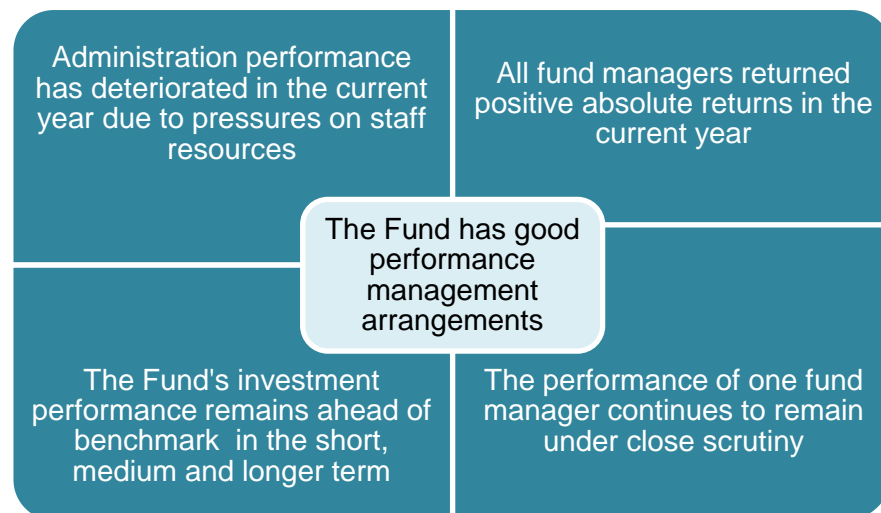
88. The pensions section has been carrying a vacancy for a pension fund accountant post since September 2014. An accountant was seconded from corporate finance in April 2015 to provide accounting support and help in the preparation of the financial statements.
89. Since then the secondee has secured a promoted post within corporate finance and it is not clear how long they will be able to continue to provide support to the Fund. Also, there is no clear timeframe for appointing a permanent fund accountant. At the same time the Pensions Manager is on planned long term leave. The pension fund accountant would normally be expected to cover some of his responsibilities.
90. There are other staffing issues which could also have an adverse impact on the work of the pensions section. The section is under considerable pressure to maintain current levels of service. This is exacerbated by the long term absence of a one member of staff and the recent retirement of a very experienced member of staff. This has resulted in a backlog of processing and is reflected in a deterioration of performance against administration targets as summarised in paragraphs 105 to 110. Also this has meant that individual records on the Altair system have not been fully updated. The pressures on staff will only increase with the introduction of career average pensions.

Recommendation 3

Outlook

91. The introduction of career average pensions from 1 April 2015 will increase administrative workloads but could also generate more enquiries from Fund members seeking clarification of their benefits on an on-going basis.
92. The pensioners' payroll system is due to transfer from the council's Resourcelink system to a module on Altair. This was originally scheduled for autumn 2015 but has now been deferred until a later date. This will require a lot of careful planning and testing.

Best Value



93. The Fund has a duty to ensure Best Value in the provision of services and to report performance publicly so that fund members, employers and other stakeholders know the quality of service being delivered and what they can expect in the future.
94. The Fund is covered by the overall Best Value arrangements of the council as the administering authority. A recent Best Value audit reported in August did not identify any specific actions for the Fund to address. The council is preparing an action plan in response to the findings from the audit. The council's auditors will monitor and report on progress.

Performance management

95. The Pensions Committee meets on a quarterly basis to review performance. The Committee is helped in its work by professional advisers. It is normal practice for two investment managers to present at the quarterly meetings of the Committee. This gives members and their advisers the opportunity to hold managers to account for their activities and performance. From our attendance at Committee we can confirm that members actively scrutinise performance.
96. The Pension Fund Manager and Chief Finance Officer regularly meet with investment managers to discuss performance and investment strategy. In addition, the Fund has a Resourcing Agreement with Lothian Pension Fund and this provides additional support in monitoring investment managers performance.
97. Overall, we concluded that the Fund has good performance management arrangements in place.

Investment performance

98. In recent years there has been considerable volatility in the financial markets which has affected investment return particularly in the wake of the global financial crisis of 2008/09 and more recently within the Eurozone due to the threat of 'Grexit'.
99. The Fund's performance has remained positive over the short, medium and longer term as illustrated in the table overleaf.

Table 2: Investment performance

	2014/15 % per annum	3 years % per annum	5 years % per annum
Fund return	13.4	12.0	9.7
Benchmark return	12.1	9.8	7.9
Excess	1.3	2.2	1.8

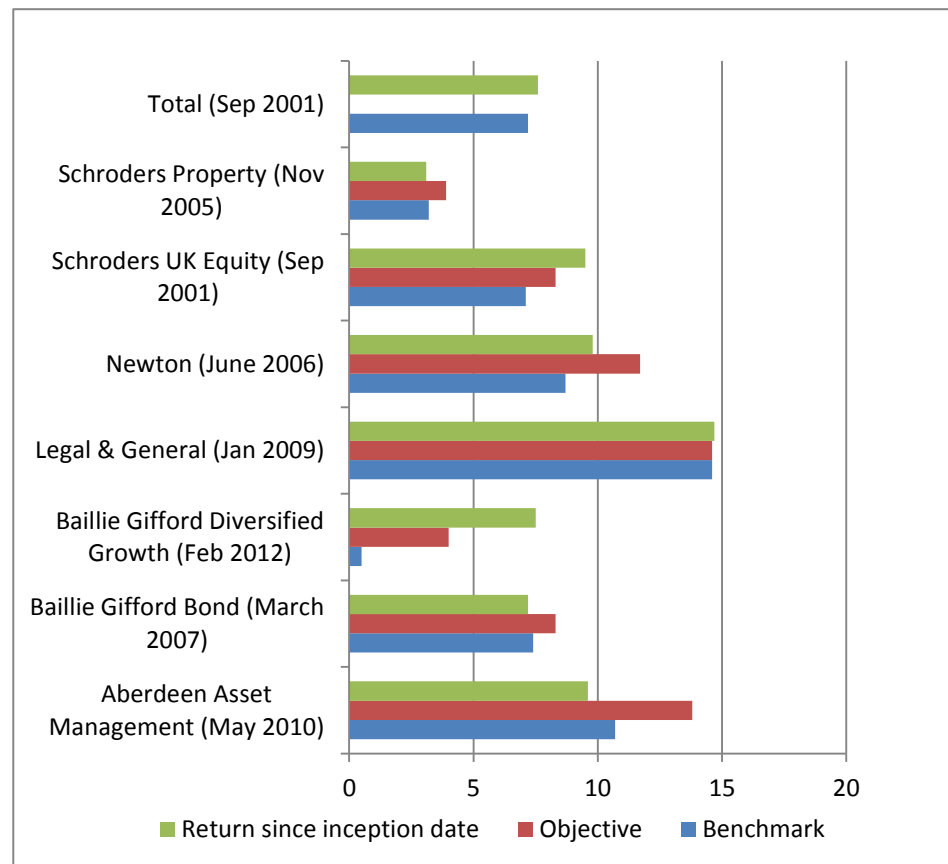
Source: Falkirk Council Pension Fund Annual Report & Accounts 2014/15

Fund manager performance

- 100. All fund managers returned positive absolute returns in 2014/15 helped by the strong performance from equities and bonds. However, performance against benchmark has been more varied.
- 101. Most investment managers achieved their benchmark performance in 2014/15. Three fund managers failed to achieve their benchmark although in two cases only marginally. However, one manager (Aberdeen Asset Management) disclosed a significant level of underperformance as was the case last year.
- 102. A recent presentation from Aberdeen Asset Management to the joint meeting of the Pensions Board and Pensions Committee failed to adequately address all members' concerns. We have been advised that this manager continues to be placed 'on watch' to ensure better performance in future.

- 103. Fund managers performance varies against different performance standards with only two fund managers exceeding their specified objectives as illustrated below.

Graph 1: Fund managers performance



Source: Falkirk Council Pension Fund - Pensions Committee June 2015

104. The Fund takes a long-term view of its investments and it expects fund managers to achieve their prescribed targets over longer periods of time. The Pensions Manager liaises closely with fund managers to monitor performance. Any significant risks or concerns about fund managers not achieving their objectives would be reported to the Pensions Committee.

Administration performance

105. The Pensions Manager has developed a range of service standards to monitor administration performance. These are monitored on a regular basis and are reported to the Pensions Committee annually. Work is in progress to ensure that similar performance reports can be generated on the new pension administration system (Altair).
106. The main indicators used to monitor and review administration performance are summarised in the following table covering the last three years.

Table 3: Administration performance 2012/13 to 2014/15

Standard	Target	2012/13	2013/14	2014/15
Annual admin. cost per member	Under £25 per member	£14.50	£15.77	£23.51
Staff / member ratio	1:2500 to 1:3200	1:2972	1:3237	1:3307
No. of complaints received	Zero	1	3	4
Answer ad hoc queries in 14 days	70%	73%	73%	65%

Source: Falkirk Council Pension Fund Annual Report & Accounts 2014/15

107. The increase in administration costs per member is primarily due to the implementation of the Altair system. It was introduced to help cope with the administrative demands of the career average pension scheme from 1 April 2015. Further costs will be incurred in 2015/16 as additional modules of Altair are implemented.
108. Performance in responding to ad hoc queries within the 14 days has deteriorated against the 14 day performance standard as outlined in table 3 above. This is due primarily to above average workflow in year and staff being involved in other tasks e.g. preparation for the implementation of Altair. The situation has been exacerbated by staff absences as a result of maternity leave and long term sickness absence. This has caused an additional

burden on remaining pensions staff and is reflected in the staff / member ratio in table 3 above.

109. A representative from Heywood (provider of Altair) will be providing support to staff to aid IT processing throughout 2015. This should help to improve administration performance.
110. Additional resources are to be made available to improve performance. In the meantime, pensions administration staff are focussing on core business to minimise the impact on service delivery although some backlogs are inevitable.

National performance audit reports

111. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15 there were no reports issued which were directly related to pension funds.
112. A number of local government reports were issued during the year and some of the topics covered may be of general interest to members i.e.
- Scotland's public finances – a follow-up :progress in meeting the challenges (June 2014)
 - Update on developing financial reporting (March 2015)
 - An overview of local government in Scotland (March 2015).
113. These and other performance audit reports are readily accessible on Audit Scotland's website (www.audit-scotland.gov.uk).

Outlook

114. There is considerable pressure on public bodies to make savings with many reducing their workforce through voluntary severance and as a consequence a large number of member and employer retirement estimates can be expected. There is a risk that these pressures may prompt some employers to leave the scheme.
115. Low interest rates combined with a relaxed monetary policy have resulted in high equity valuations and low yields on fixed interest securities. Against this background, investment managers are going to find it difficult to achieve positive returns in 2015/16.
116. Continued turmoil in the Middle East and Ukraine together with persistent weaknesses in the Eurozone and Chinese economies creates uncertainty in the financial markets. Also, the UK government's commitment to hold a referendum on continued membership of the European Union is adding to this uncertainty and there is the risk that these factors could have a negative impact on asset valuations.

Appendix I – Significant audit risks

The table below sets out the financial statement audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

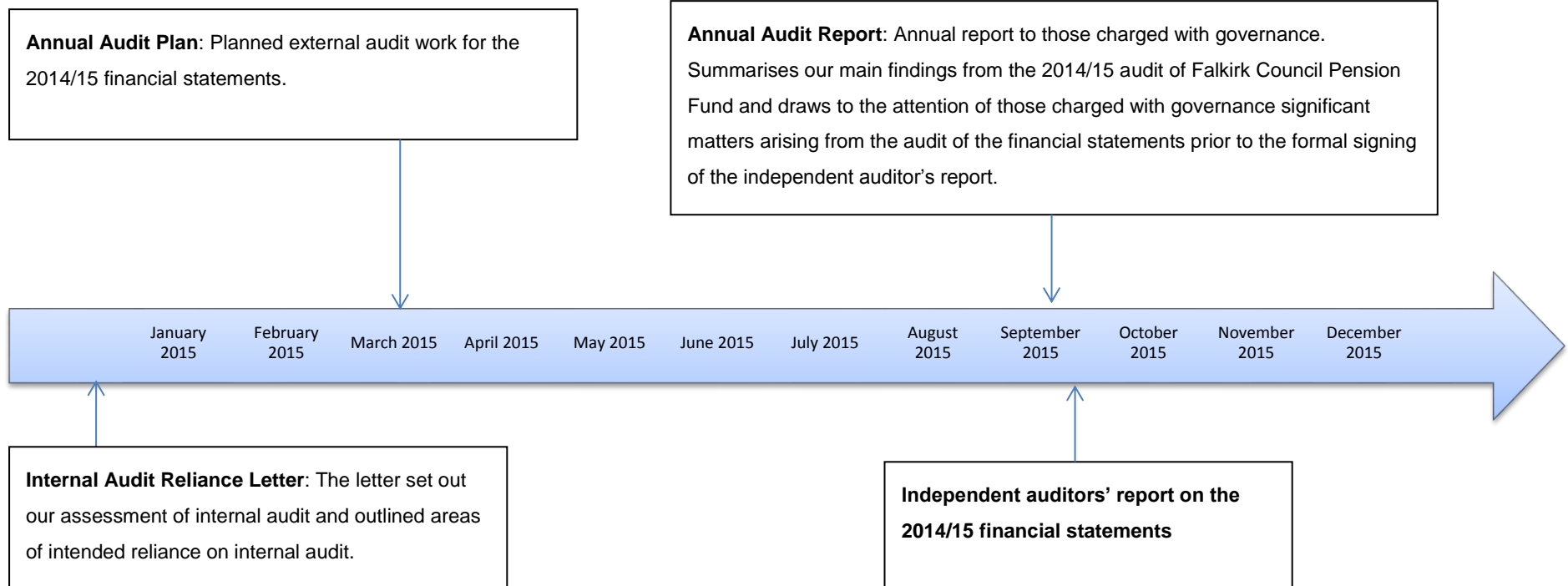
Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement in the financial statements		
<p>Accountancy staff</p> <p>At the time of submitting our Annual Audit Plan to the Pensions Committee there was no pension fund accountant in post. There was a risk of the financial statements being submitted to external audit late and there was also an increased risk of errors within the accounts due to a lack of specialist accounting knowledge and support.</p>	<ul style="list-style-type: none"> • Update provided to the external audit team on filling the accountant post • The financial statements and working papers were provided to external audit by 30 June 2015. 	<p>An accountant was seconded to the pensions section in April 2015. The Pension Fund Annual Report and Accounts were prepared on time for audit and there were no significant issues arising from the audit.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Annual Governance Statement (AGS)</p> <p>From 2014/15 Pension Funds are required to include an Annual Governance Statement in their accounts. This is in addition to the Governance Compliance Statement (GCS) already required under pension administration regulations. The 2014 Accounts Regulations also require the Fund to undertake an annual review of systems of control and report this in the AGS or combined AGS and GCS. Internal audit’s plan for 2014/15 did not include any specific work on the Fund. This could affect the level of assurance given on the review of internal controls while there is also the risk of AGS disclosures being incomplete.</p>	<ul style="list-style-type: none"> • The Fund prepared an Annual Governance Statement. • Regular reporting of financial information including accounts and investment performance to the Pensions Committee. • Previous years’ work carried out by external audit including remedial actions taken in response to recommendations. • Internal audit testing of pensions’ transactions relating to 2014/15 is scheduled for 2015/16. • Participation in the National Fraud Initiative. • The Pensions Section is subject to the council’s wider framework of control including Financial Regulations, Codes of Conduct and Schemes of Delegation. 	<p>We carried out the assurance procedures as planned and we asked for amendments to the AGS included in the unaudited accounts. A revised AGS was received and we concluded that this reflected the Fund’s governance arrangements and was consistent with our knowledge of its control environment.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>Investment Management Expenses</p> <p>Accurate presentation and disclosure of investment management costs has been a contentious issue for pension funds. There is a risk that these will not be presented correctly in the financial statements and members may not be able to gauge whether best value is being achieved.</p>	<ul style="list-style-type: none"> • The Fund followed, as far as practical, Cipfa’s newly published guidance which sets out a framework for the consistent disclosure of expenses. • Consulted with other pension funds and practitioners, as appropriate, on disclosures. 	<p>We carried out the assurance procedure as planned and concluded that the accounting and disclosure of management expenses was more transparent and in line with extant guidance issued by the Chartered Institute of Public Finance & Accountancy (Cipfa).</p>
<p>Management override of controls</p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> • Quarterly performance reports from Fund Managers. • Reports from the Pension Fund Custodian. • Scrutiny of accounts and performance by the Pensions Committee. 	<p>We carried out the assurance procedures as planned and did not identify any instances of management override of controls.</p>

Appendix II – Summary of local audit reports 2014/15

Summary of Falkirk Council Pension Fund local audit reports 2014/15



Appendix III – Action plan

Action plan

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
1 19 / 73	<p>Issue</p> <p>Internal audit plans, while submitted to the council's Audit Committee, are not presented to the Pensions Committee for consideration.</p> <p>Risk</p> <p>The internal audit plan may not cover all the areas required by members in carrying out their annual review of the Fund's governance and internal control environment.</p> <p>Recommendation</p> <p>Internal audit plans should be presented to the Pensions Committee for consideration.</p>	<p>From 2016/17, Internal Audit Plans will be presented to the Pensions Committee for consideration.</p>	<p>Internal Audit Manager</p>	<p>March 2016</p>

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
<p>2 20 / 79</p>	<p>Issue The Pensions Committee did not receive an Annual Assurance Report from Internal Audit when conducting their review of the governance and internal control framework of the Pension Fund</p> <p>Risk The Pensions Committee may not have all the information available to them to undertake their annual review of systems of internal control as required by the 2014 Accounts Regulations.</p> <p>Recommendation The Pensions Committee should receive an Annual Assurance Report from the Internal Audit Manager on the work carried out by internal audit on the systems of control.</p>	<p>A summary of Internal Audit’s findings on Pensions Governance and Transactional Testing work is to be included in a report to the 24 September meeting of the Pensions Committee.</p> <p>From 2015/16, the Internal Audit Manager will present an Annual Assurance Report to the Pensions Committee.</p>	<p>Internal Audit Manager</p> <p>Internal Audit Manager</p>	<p>September 2015</p> <p>April 2016</p>

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
<p>3 21 / 90</p>	<p>Issue</p> <p>At present the Pensions Section is not sufficiently resourced to be fit for purpose. In particular, there is no clear timeframe for appointing a permanent pension fund accountant.</p> <p>Risk</p> <p>The council is unable to fulfil its responsibilities as Fund Administrator.</p> <p>Recommendation</p> <p>The council needs to ensure that sufficient and appropriate resources are in place to administer the Pension Fund effectively. Priority should be given to appointing a permanent Pension Fund Accountant.</p>	<p>The Section has faced a “perfect storm” of staff absences due to long term sickness, maternity leave and departures allied with concurrent diverse and significant developments relating to Pensions.</p> <p>Interim arrangements were put in place to deal with the accountant vacancy and a permanent recruitment will take place aligned with the return to work of the Pensions Manager.</p> <p>The developing relationship with Lothian provides additional support and resilience.</p> <p>The staffing position will be kept under review.</p>	<p>Chief Finance Officer</p>	<p>December 2015</p>