cutting through complexity

Tayside Pension Fund and Tayside Transport Pension Fund

Annual audit report to Dundee City Council as administering authority for Tayside Pension Fund and Tayside Transport Pension Fund and the Controller of Audit

Audit: year ended 31 March 2015

30 September 2015

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About this report

This report has been prepared in accordance with the responsibilities set out in Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Dundee City Council ("the Council") as administering authority for Tayside Pension Fund and Tayside Transport Pension Fund ("the Funds") and is made available to Audit Scotland and the Controller of Audit (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the circumstances set out in the executive summary: scope and responsibilities.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the *Code*"). This specifies a number of objectives for the audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance,* this report summarises our work in relation to the financial statements for the year ended 31 March 2015.

We wish to record our appreciation of the continued co-operation and assistance extended to us during the course of our work.

Area	Summary observations	Analysis
Strategic overview		
Key issues and update	The Triennial Funding Valuation as at March 2014 was undertaken during 2014-15 with the last exercise carried out in March 2011. The outcome of the 2014 Valuation was an actuarial value of assets of £2,396.5 million for Tayside Pension Fund ("Main Fund") and an actuarial value of assets of £52.2 million for Tayside Transport Pension Fund. This reflected a slight improvement in the long term funding position of both the Main Fund and Transport Fund from 98.2% and 96.6% to 99.8% and 99.9% respectively. The employers' contribution rate was decreased from 18% to 17% for the Main Fund and from a fixed value of £0.84 million to 33.8% for the Transport Fund. The next triennial valuation will be undertaken as at 31 March 2017.	Page 7
Financial position	For the Main Fund, the net withdrawals from dealings with members in 2014-15 was £1.4 million compared to a net deposit position of £3.7 million in 2013-14. This is primarily due to the number of pensioners having increased in contrast to the relatively stable position of the number of contributing members. For the Transport Fund, the net withdrawals from dealings with members has remained consistent with the prior year at £1.7 million. Investments showed positive returns owing to favourable market conditions evidenced during 2014-15 with the Main Funds' net return on investments being £381.5 million (2013-14: £197.1 million) and the Transport Fund's net return on investments being £7.6 million in 2014–15 (2013-14: £3.8 million). The closing investment assets for 2014-15 were Main Fund; £2,843.1 million (2013-14: £2,463.1 million) and Transport Fund; £60.8 million (2013-14: £56.1 million).	Page 8
Financial statements and accounting		
Audit conclusions	We have issued an unqualified audit opinion on the 2014-15 financial statements, following their approval by the Scrutiny Committee on 23 September 2015. The financial statements, management commentary and governance statement were received by the start of audit fieldwork and were supported by high quality working papers.	Page 13

Headlines (continued)

Area	Summary observations	Analysis
Financial statements and accounting (continued)		
Significant risks and audit focus areas	The areas of audit focus were agreed with the management as part of our planning procedures and audit work has been completed to satisfy the requirements of ISA 330. The areas highlighted below are the significant risks and specific audit focus areas identified within our audit strategy: ■ Fraud risk from management override of controls. ■ Fraud risk from income recognition. We performed procedures in response to assessed risks, including tests of key financial controls. In respect of each matter, we are content with management's judgements and accounting treatment.	Page14
Accounting policies	There have been no changes to accounting policies applied in 2014-15. No newly effective accounting standards are expected to have a material impact on the 2015-16 financial statements.	Page 15
Going concern	The annual accounts have been prepared on a going concern basis. Management consider it appropriate to adopt a going concern basis for the preparation of these financial statements.	Page 15
KPMG Benchmarking Analysis		
Benchmarking analysis	KPMG analysed how financial controls of the Funds compare to those of other pension schemes of a similar size and what we assess as best practice through our pension scheme benchmarking analysis. Our audit practice comprises over 700 pension schemes, including 72 with net assets of over £200 million, giving us a comprehensive database from which to develop authoritative comparative information. Our analysis plots your scheme against a 'benchmark' which is derived from KPMG audit clients of a similar size. We present the results in a 'web-o-gram' across four categories (trustee governance, scheme administration, investments and scheme accounting).	Page 17

Headlines (continued)

Area	Summary observations	Analysis
Governance and narrative reporting		
Governance	Dundee City Council is the administering authority for the Funds. The majority of this responsibility is delegated through the Council's Policy and Resource's Committee to the Pension Funds', Pension Sub-Committee. Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making. New governance arrangements were introduced by the Scottish Government in February 2015 requiring the set up and operation of local pension boards by April 2015 and gave additional responsibilities to the Pension sub-Committee.	Page 24
Internal controls	Testing of the design and operation of financial controls over significant risk was undertaken as part of our audit. We concluded that controls relating to financial systems and procedures are designed appropriately and operating effectively.	Page 26

Scope and responsibilities

Purpose of this report

The Accounts Commission has appointed KPMG LLP as auditor of Dundee City Council and therefore Tayside Pension Fund and Tayside Transport Pension Fund ("the Funds"), under part VII of the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at the Funds and the Controller of Audit. The scope and nature of our audit were set out in our audit strategy document which was presented to the Pension Fund Committee at the outset of our audit.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

Director of Corporate Service's responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out the Pension Funds' responsibilities in respect of:

- preparation of financial statements that show a true and fair view;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance.

Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, 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.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the audit and risk committee, together with previous reports to the Pension Committee throughout the year, discharges the requirements of ISA 260.

Strategic overview

Our perspective on key business issues and financial position

Key business issues

Key high level summary of:

- **The main matter affecting the pension fund in 2014-15 is the triennial valuation. The funding level as at the 31 March 2014 has increased since the last valuation as at 31 March 2011. As at 31 March 2014 funding level was at 99.8% for the Main Fund which corresponds to a deficit of £4.7 million and Transport Fund was at 99.9% which corresponds to a deficit of £0.1 million.**
- **Our team of in-house actuaries reviewed IAS 26 Assumptions proposed by the Fund. These are considered to be appropriate.**

Triennial valuation

In line with the Local Government Pension Scheme Regulations 2014, the Fund's actuary undertakes a funding valuation every three years for the purpose of setting employer contribution rates for the forthcoming triennial period. The Actuarial Valuation assesses the health of the fund and provides a check that the funding strategy and assumptions used are appropriate. The 2014 Actuarial Valuation was undertaken for the Fund as at 31 March 2014 and was completed during the financial year 2014-15 by the Fund's actuaries, Barnett Waddingham. It was undertaken in accordance with Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 as amended.

The funding level at 31 March 2014 was above the valuation as at 31 March 2011. As at 31 March 2014 funding level was at 99.8% for the Main Fund, which corresponds to a deficit of £4.7 million and 99.9% for the Transport Fund which corresponds to a deficit of £0.1 million.

The table below shows the results of the triennial valuation:

Past Service Funding Position – The Funds		
	Main Fund (£m)	**Transport Fund (£m)**
Value of the Scheme Liabilities	(2,401.2)	(54.2)
Smoothed Asset Value	2,396.5	54.1
(Deficit)	(4.7)	(0.1)
Funding Level	99.8%	99.9%

The value of the scheme liabilities is an estimate of the assets required to pay pensions over the coming years. The smoothed asset value is the contributions received from employers and members as well as investment returns. The next detailed actuarial valuation will be carried out for the Fund as at 31 March 2017.

The valuation also introduced and included a 5% volatility reserve set by the actuary within their assumptions in both funds to allow for adverse short term financial experience in the period to next valuation as a result of likely volatility in the market between the valuations.

The triennial valuation resulted in significant other experience re-measurements which increased the level of funding within the scheme. There were two main components of this which were the trueing up of membership data and lower than anticipated salary increases. Our actuaries liaised with the scheme actuaries in order to assess the reasonableness of the experience gain reported. Our view is that while the existence of such experience gains and losses is not unusual the size of the gain suggests greater accuracy is needed when performing future roll-forwards of data.

IAS 26 assumptions review

In addition to the Triennial Funding Valuation, the Fund's actuary also undertakes a valuation of the Funds' liabilities (actuarial present value of promised retirement benefits) at the accounting date as required by International Accounting Standard (IAS) 26, and calculated in line with IAS 19 assumptions.

Our team of in-house actuaries reviewed assumptions used in the valuation. It is understood from the Barnett Waddingham correspondence that:

- the assumptions considered in this report are based on market conditions at 31 March 2015; and
- the average duration of the liabilities is 19 years at the period ending 31 March 2015.

Overall we consider the assumptions proposed by the employer can be considered to be reasonably balanced.

Tayside Fund Main Account Financial position 2014-15

Management does not budget financial performance of the Funds due to the nature of income and expenditure.

For the Main Fund, the net withdrawals from dealings with members for 2014-15 was £1.4 million which has moved from a net deposits position in 2013-14 of £3.7million.

Investments showed strong positive returns owing to favourable market conditions evidenced during 2014-15 with the Main Fund's net return on investments of £381.5 million (2013-14 £197.1 million).

The net increase in the Main Fund during the year was £380.1 million (2013-14: £200.8 million).

Financial position

Current membership of the Main Fund is 42,176 of which 17,622 are actively contributing and 21,839 are in receipt of pension benefits. There has been a relatively static position in relation to active contributing membership and a continuing rise in the number of pensioners. The Main Fund has moved from a net deposit position from dealing with members in 2013-14 to a net withdrawal position from dealing with members in 2014-15. This movement was primarily influenced by an increase in total contributions by £1.4 million and an increase in benefits payable by £5.5 million during the year. The net impact of these and other smaller components is a net withdrawal position from dealing with members of £1.4m shown in the table opposite.

Net return on investment increased by £184.3 million, to £381.5 million in 2014-15 (2013-14: £197.1 million) primarily due to the positive change in market value of investments in line with the investment review performed by the Funds' investment consultants, Aon Hewitt. Investment returns are monitored by the pension sub-committee throughout the year and recent historic performance has been strong.

Management does not budget financial performance of the Funds due to the nature of income and expenditure.

Fund account		
£'000	**2015**	**2014**
Contributions and benefits		
Contributions receivable	91,412	89,984
Transfers in	3,324	3,762
	94,736	**93,746**
Benefits payable	(89,649)	(84,148)
Payment to and on account of leavers	(5,238)	(4,741)
Administration expenses	(1,232)	(1,192)
Net (withdrawals)/deposits from dealing with members	**(1,383)**	**3,665**
Return on investments		
Investment income	56,574	59,067
Change in market value of investments	336,802	146,447
Investment management expenses	(11,921)	(8,391)
Net returns on investments	**381,455**	**197,123**
Net increase in the fund	**380,072**	**200,788**
Opening net assets of the scheme	**2,463,063**	**2,262,275**
Closing net assets of the scheme	**2,843,135**	**2,463,063**

Tayside Fund Main Account Financial position 2014-15 (continued)

Investments returns are monitored throughout the year and the performance of investment managers is subject to regular review against benchmarks.

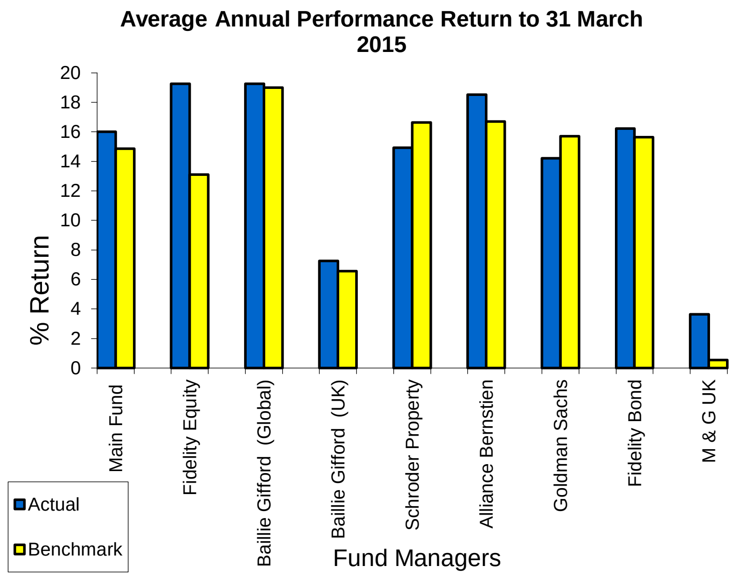
Total net assets increased by £380.2 million during the year ended 31 March 2015.

The main reason for the increase in the investment valuations is the strong performance of the assets and favourable market conditions.

Net Assets Statements as at 31 March 2015

The key financial indicator for the Funds is considered to be the performance of the Funds' investments. This is monitored through the year and reported to the pension sub-committee on a quarterly basis. With the exception of Schroders Property and Goldman Sachs all investment managers have outperformed the benchmark in respect of year ended 31 March 2015.

In the financial year to 31 March 2015 the Main Fund returned 16.01% which was 1.14% in excess of the overall benchmark set by the statement of investment principles across different asset classes and mandates for the year.



The net assets of the Main Fund increased by £380.1 million in the year, primarily as a result of investment income and gains on the market value of investments.

Net assets statement		
£'000	**2015**	**2014**
Listed investments		
UK Equities	656,278	593,619
UK Pooled Funds	64,398	57,927
UK Fixed Interest – Public Sector	47,461	39,579
UK Fixed Interest - Other	7,850	11,131
UK Index linked - Public sector	91,285	77,281
Overseas equities	654,486	564,960
Overseas Pooled funds	208,047	175,409
Overseas Open Ended Investment Companies	352,658	290,860
Overseas – Fixed Interest - Other	17,877	12,841
Derivatives (Futures)	286	418
Unlisted investments		
UK Open Ended Investment Companies	339,194	296,038
M&G Fund	11,782	14,529
Overseas Open Ended Investment Companies	68,140	62,821
Property Unit Trusts	304,428	232,546
Cash Balances held by fund Managers	16,093	25,209
Financial Debtors	19,691	11,598
Total investment assets	**2,860,054**	**2,466,766**
Financial liabilities	**(15,900)**	**(7,087)**
Cash and Bank	1,340	2,381
Contributions due form employers	7,903	5,614
Sundry Debtors	1,471	1,768
Sundry Creditors	(11,733)	(6,316)
Total net assets	**2,843,135**	**2,463,063**

Source: 2014-15 draft financial statements.

Tayside Transport Fund Account Financial Position 2014-15

For the Transport Fund, the net withdrawals from dealings with members in 2014-15 has remained in line with prior year at £1.7 million.

Investments showed strong positive returns owing to favourable market conditions evidenced during 2014-15, with net return on investments of £7.6 million in 2014-15 (2013-14: £3.8 million).

The net increase in fund during 2014-15 was £5.8 million (2013-14: £2.1 million).

Financial position

Current membership of the Fund is 565 of which 59 are actively contributing and 500 are in receipt of pension benefits. The balance of contributing members and the active pensioners has remained relatively in line with the previous year's dealings. The net withdrawal position remained in line with the prior year mainly as a result of a decrease in total contributions of £0.07 million and a decrease in benefits payable of £0.09 million during the year.

Net return on investment increased by £3.8 million, to £7.6 million in 2014-15 primarily due to the positive change in market value of investments. Investment returns are monitored throughout the year and recent historic performance has been favourable.

Fund account		
£'000	**2015**	**2014**
Contributions and benefits		
Contributions receivable	916	988
Benefits payable	(2,551)	(2,647)
Payment on account of leavers	(78)	-
Administration expenses	(36)	(30)
Net withdrawals from dealing with members	(1,699)	(1,749)
Return on investments		
Investment income	810	799
Change in market value of investments	6,981	3,191
Investment management expenses	(199)	(180)
Net returns on investments	7,592	3,810
Net increase in the fund	5,843	2,121
Opening net assets of the scheme	**56,291**	**54,170**
Closing net assets of the scheme	**62,134**	**56,291**

Source: 2014-15 draft financial statements.

Tayside Transport Fund Account Financial Position 2014-15 (continued)

Total net assets increased by £5.8 million during the year ended 31 March 2015.

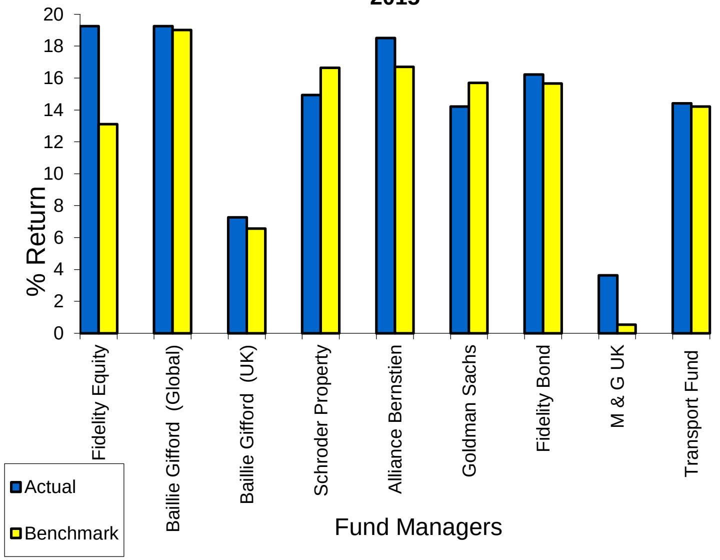
The main reason for the increase in the investment valuations is the strong performance of the assets and favourable market conditions.

Net Assets Statements as at 31 March 2015

The key financial indicator for the Transport Fund is considered to be the performance of the Funds' investments. This is monitored through the year and reported to the pension sub-committee on a quarterly basis. With the exception of Schroders Property and Goldman Sachs all investment managers have outperformed the benchmark in respect of year ended 31 March 2015.

In the financial year to 31 March 2015 the Transport Fund returned 14.22% which was in line the overall benchmark across different asset classes and mandates for the year.

Average Annual Performance Return to 31 March 2015



The net assets of the Transport Fund increased by £5.8 million in the year, primarily as a result of investment income and gains on the market value of investments.

Net assets statement		
£m	**2015**	**2014**
Listed investments		
UK Equities	14,811	14,230
UK Fixed Interest – Public Sector	3,608	3,550
UK Fixed Interest - Other	515	596
UK Index linked - Public sector	6,892	6,085
Overseas equities	15,827	14,397
Overseas – Fixed Interest - Other	1,490	1,036
Derivatives (Futures)	18	35
Unlisted investments		
UK Open Ended Investment Companies	12,092	11,137
Overseas Open Ended Investment Companies	105	92
Property Unit Trusts	4,510	3,986
Cash Balances held by fund Managers	700	836
Financial Debtors	1,014	101
Total Investment Assets		
Financial liabilities	**(753)**	**(25)**
Cash and Bank	1,355	311
Contributions due form employers	6	6
Sundry Debtors	1	-
Sundry Creditors	(58)	(58)
Total net assets	**62,134**	**56,291**

Source: 2014-15 draft financial statements.

Financial statements and accounting

Our perspective on the preparation of the financial statements and key accounting judgements made by management

Audit conclusions

We have issued an unqualified audit opinion.

The financial statements, including the governance statement, were made available on a timely basis and were accompanied by high quality working papers.

Audit conclusions

Our audit work is complete. Following approval of the financial statements by the Pension sub-committee we have issued an unqualified opinion on the truth and fairness of the state of the Funds' affairs as at 31 March 2015. There are no matters identified on which we are required to report by exception. There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content, as reported in appendix one.

In gathering the evidence for our opinion we have:

- performed controls testing and substantive procedures to ensure that key risks to the financial statements have been covered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the financial statements through discussions with senior management and internal audit to gain a better understanding of the work performed in relation to prevention and detection of fraud; and
- attended scrutiny committee to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Financial statements preparation

- High quality working papers and full draft financial statements were provided on the statutory deadline of 30 June 2015. This included the explanatory foreword, management commentary, remuneration report and governance statement. The latter had already been considered, along with supporting evidence, and approved by the Pension Fund committee. During the audit we identified an issue with the officers identified to sign the statements within the fund account which is detailed in appendix two.
- In advance of our audit fieldwork, we issued a ‘prepared by client’ request setting out a list of required analyses and supporting documentation. The standard of documentation was very good.
- The Local Authority Accounts (Scotland) Regulations 2014 came into force on 10 October 2014, replacing regulations which had applied since 1985. The regulations contain provisions for the unaudited annual financial statements as submitted to the auditor to be considered by the audit and risk committee no later than 31 August 2015, and the audited financial statements to be presented to the scrutiny committee for consideration and approval prior to auditor signature before 30 September 2015.

Significant risks and audit focus areas

The significant areas of risk identified in our audit strategy were in respect of:

- **management override of controls.**

and other focus areas of:

- **fraud risk from income recognition.**

We report on the audit focus area of valuation of investment assets.

We summarise below the risks of material misstatement as reported within the audit strategy document along with additional risks identified during the course of the audit. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the audit and risk committee may better understand the process by which we arrived at our audit opinion.

We have no changes to the risk or our approach to addressing the assumed ISA risks of fraud in management override of controls or revenue recognition fraud risk.

Focus areas	Our response	Audit findings
Valuation of investment assets The investment assets reported in the net assets statements, managed by the fund managers were valued at their market price as at 31 March 2015.	To gain assurance over the valuation of the year end investments for both Funds, we obtained third party confirmations over 100% the year end valuation of investments from the fund managers directly and compared it to the valuation on draft financial statements. We tested all the investments and performed pricing audit procedures over listed investments of the Funds. The year end bid values were assessed using our internal research tools to determine the reasonableness of the year end fund manager’s valuation.	No significant differences were noted on the pricing audit procedure to gain reasonable assurance over direct confirmations.

Accounting policies

There have been no substantive changes to the financial reporting framework as set out in the *Code of practice on Local Authority Accounting in the United Kingdom 2014-15*

There have been no significant changes to accounting policies in 2014-15.

Accounting framework and application of accounting policies

Area	Summary observations	Audit findings
Code of practice on Local Authority Accounting in the United Kingdom 2014-15 (“the Code”)	The 2014-15 financial statements have been prepared in accordance with the Code which is based upon International Financial Reporting Standards (“IFRS”). The 2014-15 Code has a number of amendments from the 2013-14 version. Management have reflected these changes to the reporting requirements in the financial statements, where appropriate. The amendments include: ■ adoption of the new group accounting standards IAS 26; ■ amendments in respect of the restated opening balance sheet; and ■ changes to the requirements for accounting for combinations of bodies and transfer of functions.	We considered whether the impact of adoption of the new accounting would have a material effect on the Funds’ financial statements. No material matters were noted.
Going concern	■ Management considers it appropriate to adopt a going concern basis for the preparation of these financial statements. The Net Assets statements show that at 31 March 2015 the Main Fund had net assets of £2,843.1 million and Transport Fund of £62.1 million.	Given the nature of the high level of funding, 99%+ for both the funds, we are satisfied that it is appropriate for the financial statements to be prepared on the basis adopted.
Management commentary	The financial statements form part of the annual report for the year ended 31 March 2015. We reviewed the content of the management commentary against the disclosure requirements and are content with the proposed reports. We provided management with some relatively minor suggestions relating to how the reports could be enhanced and where additional information disclosures should be made.	We are required to consider information related to the membership of the Funds included as part of the Management comments. We are satisfied that the information contained within the Management commentary is consistent with the financial statements.

KPMG Benchmarking Analysis

Our overall perspective on financial control reporting.

KPMG Benchmarking Analysis

Financial governance comparative analysis – trustee governance

KPMG analyses how financial controls of the Funds compare to those of other pension schemes of a similar size and what we assess as best practice through our pension scheme benchmarking analysis. Our audit practice comprises some 700 pension schemes, including 72 with net assets of over £200 million, giving us a comprehensive database from which to develop authoritative comparative information.

Our analysis plots the Funds against a 'benchmark' which is derived from KPMG audit clients of a pension schemes for corporate and public sector schemes with net assets greater than £1 billion. We present the results in a 'web-o-gram' across four categories (trustee governance, scheme administration, investments and scheme accounting).

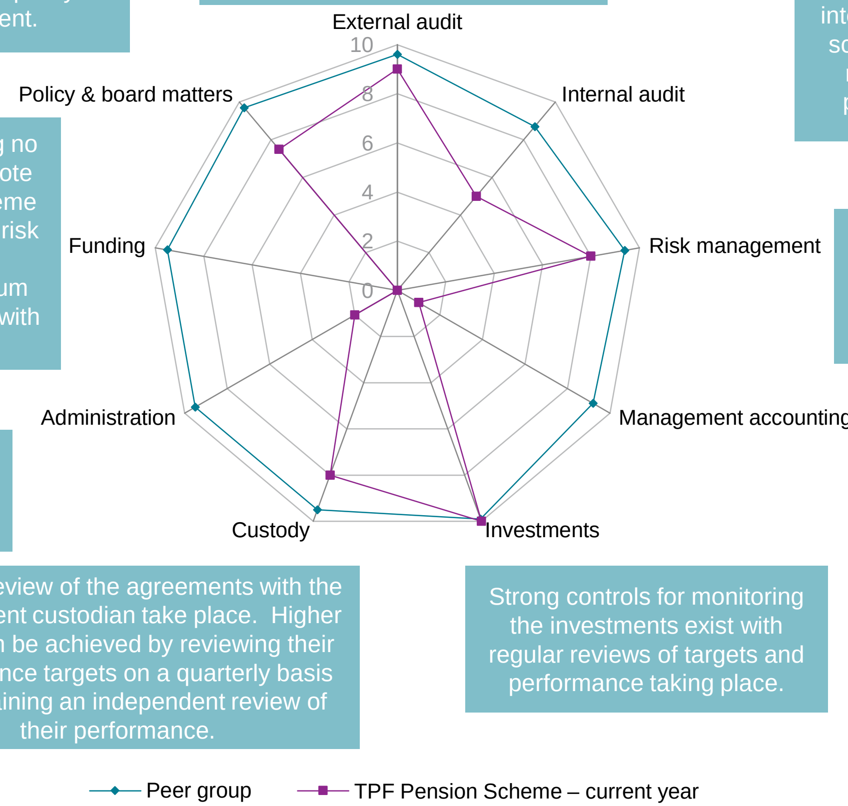
The Trustees have a formal policy for trustee training and monitoring advisors. Higher score can be achieved by establishing a formal policy for self assessment.

High score reflects formal meeting with the auditor at both planning and completion of scheme audit cycle. Written reports are produced at both stages. This also compensates for the infrequent internal audit reviews.

The moderate score is reflective of the infrequent internal audit reviews. Higher score achievable by regular reviews with the findings presented to the relevant committees.

Low score is as a result of there being no review of employer covenants. We note however all the employers in the scheme are government backed, thus funding risk is inherently low. We also note the existence of an annual employee forum together with regular communication with scheme employers.

Risk register reviewed quarterly which highlights action to be taken. Follow up is performed to assess the progress.



Higher score achievable by carrying out data quality audits in accordance with The Pension Regulator's guidance.

Regular review of the agreements with the independent custodian take place. Higher score can be achieved by reviewing their performance targets on a quarterly basis and obtaining an independent review of their performance.

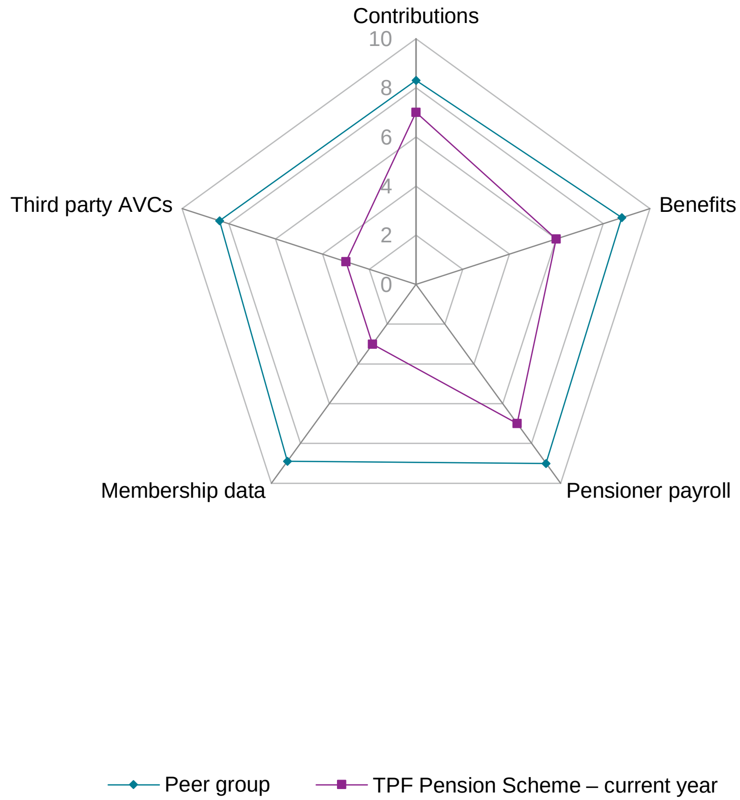
Strong controls for monitoring the investments exist with regular reviews of targets and performance taking place.

Low score is as a result of complete management accounts not being prepared on a monthly basis. We note that , management performs regular reviews of the contributions tracker and review the pension payroll for benefits payable. Investments are monitored on a monthly basis by performing reconciliations between the custodian and the investment manager's valuation.

Financial governance comparative analysis – dealings with members: Defined benefit

The scheme currently carries out a high level calculation of the employer and employee contributions. Higher score can be achieved by performing expected contribution calculation and comparing them with the actual contribution received from the employers and employees.

Higher score can be achieved by monitoring and checking the AVC accumulations regularly and reviewing the internal controls report of the AVC provider.



Benefit calculation controls have a high level of manual input. Higher score would be achieved by making the processes automated with periodic checks being carried out by internal audit/management.

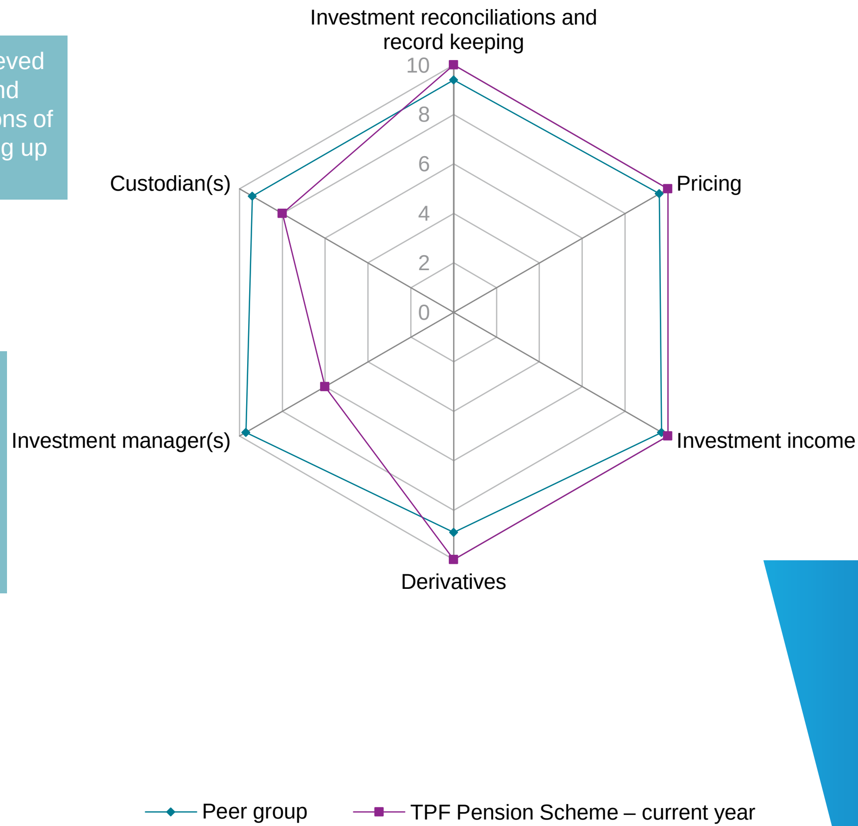
Compliance checks should be performed to ensure data quality is maintained in line with guidelines of The Pension Regulator. Higher score can be achieved by performing monthly checks on the membership details and reconciling them against the employer records of membership details.

Strong controls exist around pension payroll and administration. Higher score can be achieved by reconciling the pension payroll and administration and maintaining an audit trail for the pension increase checks performed.

Financial governance comparative analysis – investments: Segregated funds

Higher score can be achieved by actively reviewing and discussing issues/exceptions of the custodian and following up on them.

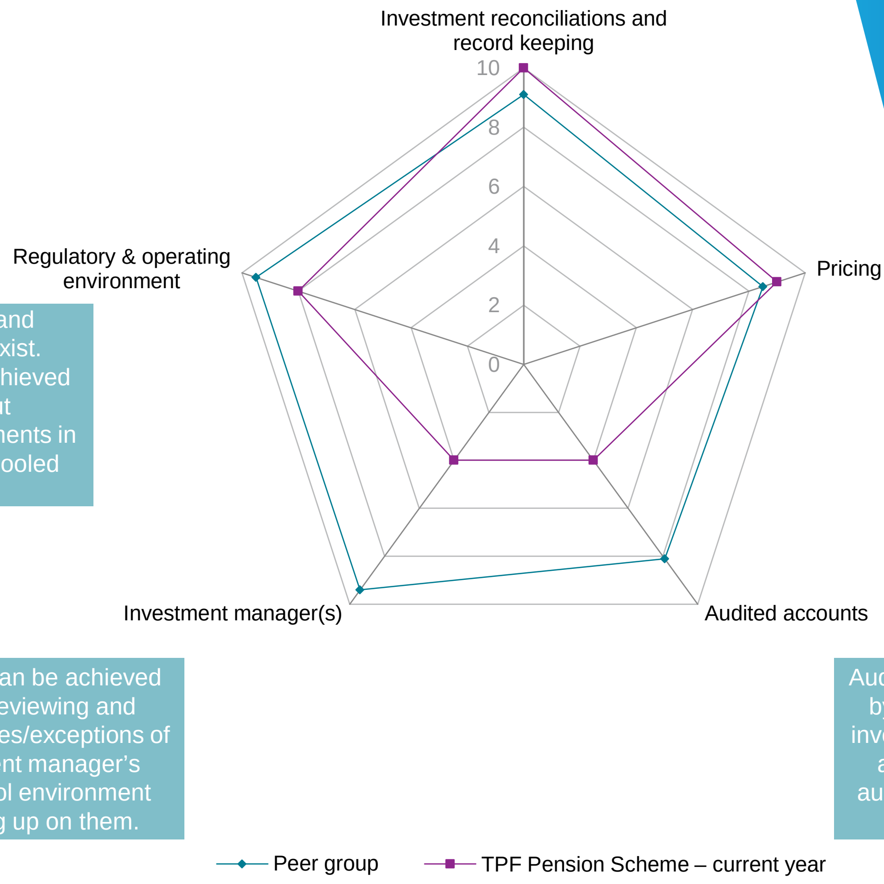
Higher score can be achieved by actively reviewing and discussing issues/exceptions noted in the investment manager's internal control environment and following up on them.



Perfect score in investment reconciliation, pricing, income and derivatives is reflective of the strong controls in place for the investment management with regular reconciliations of income and investments being performed between the investments and custodians. Pricing of investments is regularly monitored by the custodian with month end sign off being performed to manage any timing differences.

Financial governance comparative analysis – investments: Pooled investment vehicles

High score in investment reconciliation, pricing and income is reflective of the strong controls in place for investment management with regular reconciliations of income and investments being performed between the investments and custodians. Pricing of investments is regularly monitored by the custodian with month end sign off being performed to manage any timing differences.

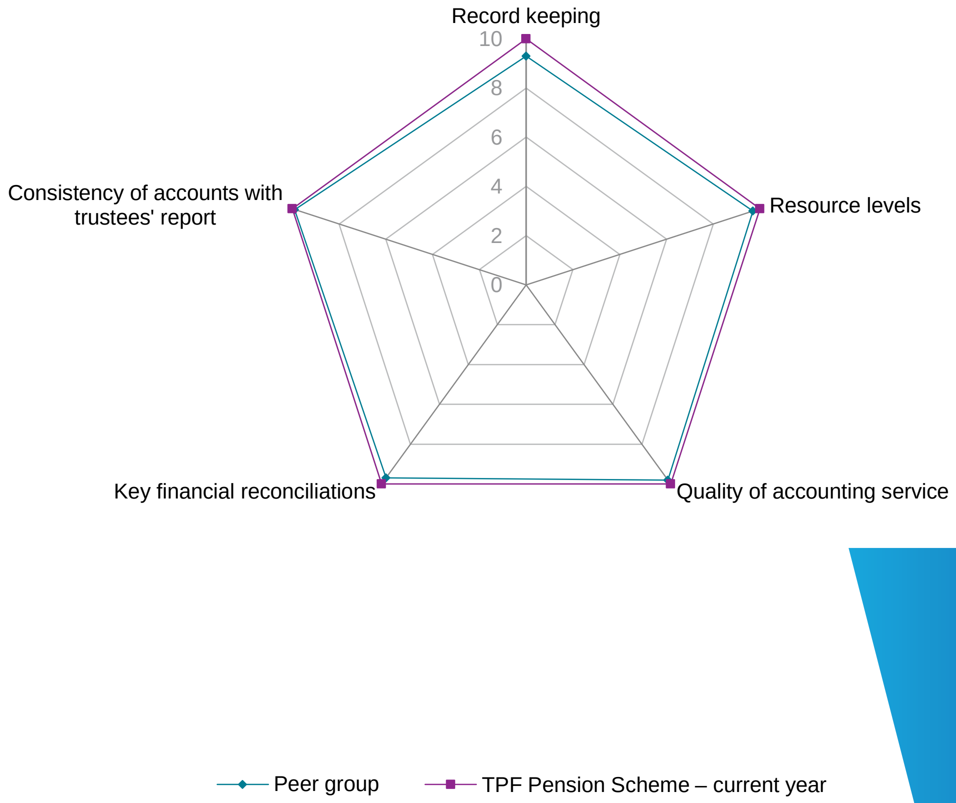


Strong compliance and regulatory controls exist. Higher score can be achieved by enquiring about compensating arrangements in case of the failure of pooled management.

Higher score can be achieved by actively reviewing and discussing issues/exceptions of the investment manager's internal control environment and following up on them.

Audited accounts are produced by all the funds the scheme invests in. Higher score can be achieved by reviewing the audited accounts on a regular basis.

Financial governance comparative analysis – scheme accounting



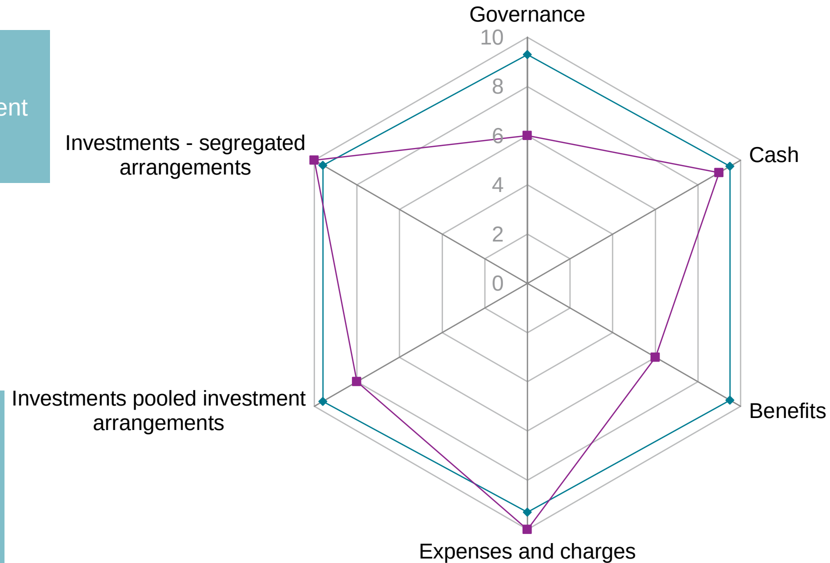
High score in scheme accounting parameters is reflective of the strong controls in place for keeping up-to-date information related to investments and pension administration.

Financial governance comparative analysis – fraud

Strong controls exist over the governance compliance. Higher score can be achieved by enquiring about fraud instances that may have occurred at the service organisations.

Strong controls over governance and management of investments.

Strong controls for cash payment process, higher score can be achieved by having two signatories for cheques approval process.



High score reflective of the strong arrangements in place with the investment managers. Higher score can be achieved by performing regular due diligence checks on the investment managers.

Higher score can be achieved by making approved changes only on production of original documentation or proof of identity of the members.

Strong controls exist over administrative expenses and investment management fees.

Peer group — TPF Pension Scheme – current year

Governance and narrative reporting

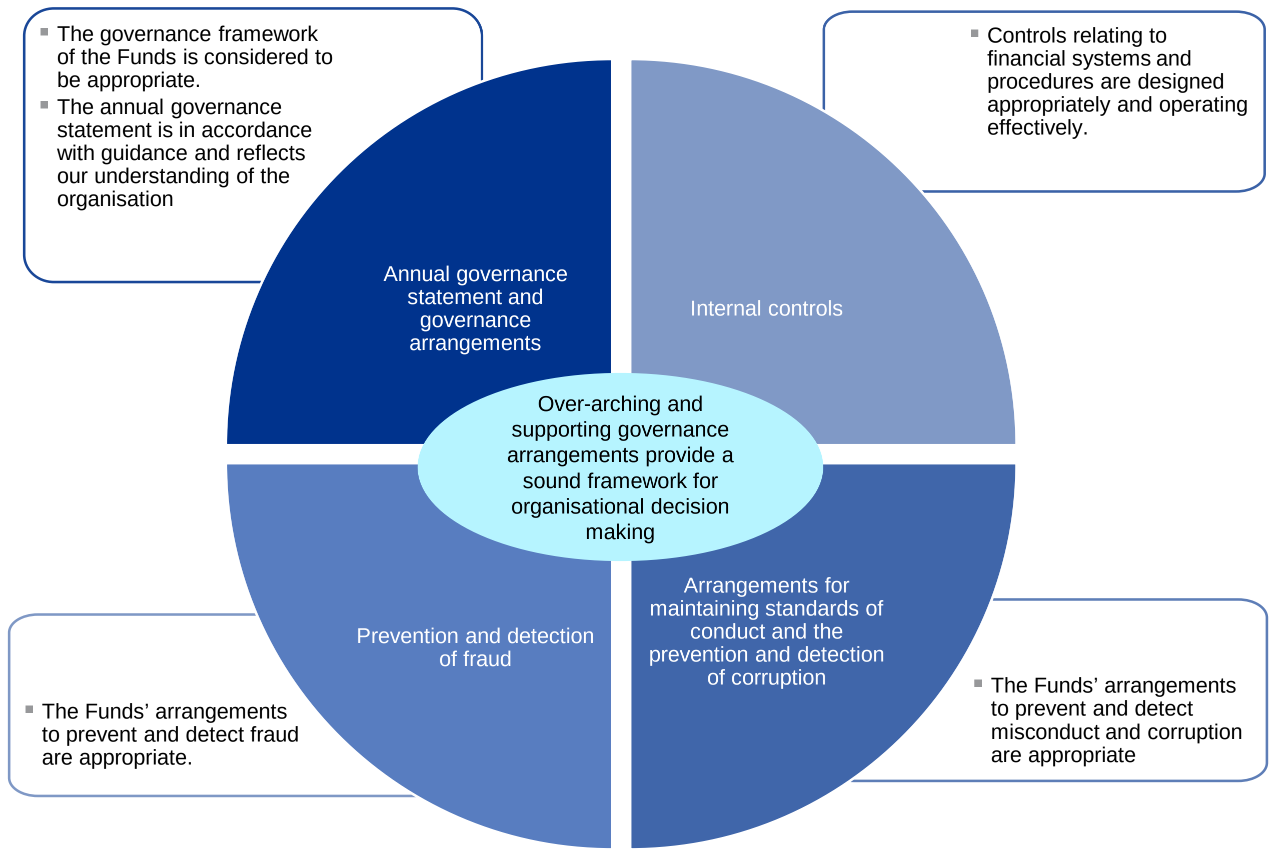
Our overall perspective on narrative reporting, including the management commentary, annual governance statement, governance compliance statement and risk management statement.

Controls findings from our audit.

Corporate governance arrangements

We considered the Fund's corporate governance arrangements against a number of key areas which we consider to make up an effective governance framework.

Our audit findings against each key area are provided opposite.



Corporate governance arrangements (continued)

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Annual governance statement

The Funds include an annual governance statement within their annual accounts. The following elements have been included.

The governance compliance statement for the Funds was approved by the pension sub-committee on 30 June 2015 and is consistent with our understanding of the governance arrangements. The statement should be subject to an annual review by the pension sub-committee and action taken to enhance any areas which only report partial or non-compliance where appropriate.

We provided management with some relatively minor suggestions relating to how the reports could be enhanced and where additional information disclosures should be made to meet the requirements of the Local authority Accounts (Scotland) regulations 2014. This has been noted in appendix two.

Governance arrangements

The Funds have a pension sub-committee to ensure sound governance arrangements. The Scottish Government published new governance regulations for the pension fund in February 2015 which required the set up and operation of local pension boards by 1 April 2015 and introduced a national scheme advisory board to advise Scottish ministers and individual pension schemes. The Policy and Resource Committee approved a constitution, nomination and selection process and terms of reference in anticipation of the creation of the local pension board and appointed members prior to the 1 April 2015 deadline. There is an agreed training plan to accommodate statutory requirements and the new Pension Board are currently undertaking relevant training.

The new governance arrangements extended to pension administration and, in response to this, the existing Pension Sub-Committee amended their terms of reference and remit to accommodate and became the Pension Sub-Committee and additional training is being provided in respect of additional responsibilities.

We have updated our understanding of the governance framework and documented this though our overall assessment of the Fund's risk and control environment. We consider the governance framework to be appropriate for the Fund and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Corporate governance arrangements (continued)

Our work concluded that that controls relating to financial systems and procedures are designed appropriately and operating effectively.

The Funds have procedures in place for the prevention and detection of fraud and corruption.

Internal controls

Management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the financial statements. Our testing of the design and operation of higher level controls designed for pension administration and investments management noted no exceptions.

The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work. KPMG's identification of weaknesses, where applicable, does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

As part of our work, we undertook a review of the latest internal control reports issued by the Pension Funds' investment managers. The exceptions reported by the independent auditors of the investment managers were reviewed and we planned our audit approach taking into account the assurance gained through these reports.

Exceptions reported recognised internal control deficiencies that had no direct impact on the Pension Fund audit, giving comfort over the evidence provided by the investment managers. Additional testing was performed to corroborate the information received from the investment managers with the custodian reports that were independently received by us.

Prevention and detection of fraud

No material fraud or other irregularities were identified during the year. The arrangements include policies and codes of conduct for staff and board members, supported by a fraud prevention policy and response plan.

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

The Funds have arrangements including policies and codes of conduct for staff and board members, supported by a whistleblowing policy. Board members are responsible for setting the 'tone at the top' and are responsible for abiding by the code of conduct and disclosing interests which may be of importance, material or otherwise to their work at the Funds.

Our testing confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.

We consider that the Fund has appropriate arrangements to prevent and detect fraud.

We consider that the Fund has appropriate arrangements to prevent and detect inappropriate conduct and corruption.

Appendices

Mandatory communications

There were no changes to the core financial statement and there are no unadjusted audit differences

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft financial statements which impacted on the net assets or net operating cost for the year. A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.	Appendix two
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial. There are no unadjusted audit differences.	-
Confirmation of Independence Letter issued to the Scrutiny Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Partner and audit staff.	Appendix three
Schedule of Fees Fees charged by KPMG for non-audit services	There were non-audit fees related to overseas tax reclaims for the year.	Appendix three
Draft management representation letter Proposed draft of letter to be issued by audit team to KPMG	There are no changes to the standard representations required for our audit from last year.	-
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the risk profile of the Funds and financial statements balances. Materiality was determined at £3.1 million (Main Fund) and £0.04 million (Transport Fund): This represented approximately 2% of total investment income, contribution receivable and transfers in, and is broadly consistent with the materiality identified in our audit strategy. We designed our audit procedures to detect errors at a lower level of precision, i.e. £2.3 million (Main Fund) and £0.03 million (Transport Fund). We report identified errors greater than £0.15 million (Main Fund) and £0.002 million (Transport Fund) to the Pension sub-committee.	

Audit disclosure amendments

Under auditing standards we are required to bring to the attention of the Fund trustees any misstatements, including omissions or other errors in presentation or disclosure (other than those that are clearly trifling) identified during the course of our normal audit work for which no adjustment has been made in the financial statements. If we have identified any material misstatements which have been corrected by management we should also bring these to your attention in order to assist you in fulfilling your governance responsibilities, which include reviewing the effectiveness of the system of internal control.

Area	Summary observations	Audit findings
Signing of statements in the accounts	We reviewed relevant local authority pension fund guidance and identified that the statements within the draft accounts were not being signed off by the appropriate officers.	We communicated the requirements to management who have updated the financial statements to ensure the statements are signed of in line with the relevant local authority pension fund guidance.
Additional disclosures or statement have been made in the governance statement in line with regulations.	We provided management with some minor suggestions relating to how the governance statement could be enhanced and where additional information disclosures should be made to meet the requirements of the Local authority Accounts (Scotland) regulations 2014.	Management have updated the governance statement to ensure it was in line with the regulations and included an acknowledgement of responsibility for ensuring there is a sound system of governance (incorporating the system of internal control and an indication of the level of assurance that the systems and processes that comprise the pension fund's governance arrangements can provide.

Auditor independence

Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with the Funds.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit taxation services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the Funds and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the board of directors.

Confirmation of audit independence

We confirm that as of 30 September 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

This letter is intended solely for the information of the audit committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

cutting through complexity