AGENDA ITEM 3 (a)
DRAFT

FALKIRK COUNCIL

MINUTE of MEETING of the PENSIONS COMMITTEE held in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 13 SEPTEMBER 2012 at 9.30 A.M.

PRESENT: Depute Provost Patrick: Councillors Blackwood, Carleschi, Coleman, C Martin and Paterson; Councillor C Campbell (Employers Representative); G Eals (Trade Unions Representative) and A Redpath (Pensioners Representative).

CONVENER: Depute Provost Patrick

ATTENDING: Chief Finance Officer; Pensions Manager and Senior Committee Services Officer.

ALSO IN ATTENDANCE: Bruce Miller, Lothian Pension Fund

PE1. APOLOGIES

None intimated.

PE2. DECLARATIONS OF INTEREST

None declared.

PE3. MINUTE

There was submitted (circulated) and **NOTED** Minute of Meeting of the Pensions Panel held on 30 August 2012.

PE4. PENSIONS PANEL ADMINISTRATION

There was submitted Report (circulated) dated 6 September 2012 by the Chief Governance Officer (a) advising of the 15 Members appointed to serve on the Pensions Panel, and (b) informing that Councillor Callum Campbell, Grant Eals and Alastair Redpath were nominated as the co-opted Members of the Pensions Panel to sit on the Pensions Committee.

NOTED.

The Convener welcomed all the new Members of the Committee to the meeting.

PE5. PENSIONS PANEL CONSTITUTION

There was submitted Report (circulated) dated 5 September 2012 by the Chief Governance Officer submitting the draft constitution of the Pensions Panel for approval.

AGREED the draft constitution of the Pensions Panel.

PE6. FALKIRK COUNCIL PENSION FUND – TRAINING ARRANGEMENTS

There was submitted Report (circulated) dated 5 September 2012 by the Chief Finance Officer outlining the training arrangements that will be made available to assist the Members of both the Pensions Panel and the Pensions Committee attain the level of skill and knowledge that is commensurate with their role.

NOTED.

PE7. LOCAL GOVERNMENT PENSION SCHEME REFORM IN ENGLAND AND WALES

There was submitted Report (circulated) dated 4 September by the Chief Finance Officer presenting an update about proposed reform of the Local Government Pension Scheme (LGPS) in England and Wales and the possible impact some of it may have in Scotland.

NOTED.

PE8. PENSION FUND – GENERAL GOVERNANCE MATTERS

There was submitted Report (circulated) dated 4 September 2012 by the Chief Finance Officer presenting an update on various matters associated with the business of Falkirk Council Pension Fund.

Areas covered by the Report included the following:-

- Auto Enrolment
- Police and Fire Reform
- Infrastructure Investment
- Administration Update
- Local Authority Pension Fund Forum (LAPFF)
- Corporate Governance Update
- Annual Pension and Investment Conference 2013

NOTED the contents of the Report.

AGREED that:-

(1) the Convener and another Member to be determined, attend the LAPFF Conference in Bournemouth, between 28 – 30 November 2012, and

(2) the Senior Committee Services Officer liaise with Members of the Committee seeking interest from those who wish to attend the CIPFA (Scotland) Pensions Seminar in Edinburgh on 24 October 2012.

PE9. FALKIRK COUNCIL PENSION FUND - UNAUDITED ANNUAL REPORT AND ACCOUNTS 2011/12

There was submitted Report (circulated) dated 4 September 2012 by the Chief Finance Officer (a) referring to Regulation 31A of the Local Government Pension Scheme (Administration)(Scotland) Regulations 2008, which requires administering authorities to publish a pension fund annual report, recognising that pension fund accounts are separate from other accounts of the administering authority, and (b) attaching as an appendix for inspection, a copy of the Fund's Unaudited Annual Report and Accounts for 2011/12.

NOTED the publication of the Unaudited Falkirk Council Pension Fund Annual Report and Accounts 2011/12.

AGREED that the Chief Finance Officer submit a report to the next meeting of the Committee relating to the Fund's investment of short term cash deposits and the possible deployment of money market funds.

PE10. EXCLUSION OF PUBLIC

RESOLVED in terms of Section 50A (4) of the Local Government (Scotland) Act 1973, to exclude from the meeting the press and public for the following items of business on the ground that they would involve the likely disclosure of exempt information as defined in Paragraph 9 of Part 1 of Schedule 7A of the said Act.

PE11. FALKIRK COUNCIL PENSION FUND – UPDATED STATEMENT OF INVESTMENT PRINCIPLES

There was submitted Report (circulated) dated 4 September by the Chief Finance Officer referring to recent amendments made to the Statement of Investment Principles, a copy of which was attached as an appendix to the Report.

NOTED that the Statement of Investment Principles, has been updated to reflect changes in investment policy.

AGREED to approve the revised Statement and publish it on the Council's website, with fund employers, union contacts and Fund managers being notified of this.

P12. FUND MANAGER REVIEW AND PERFORMANCE MEASUREMENT

There was submitted Report (circulated) dated 4 September 2012 by the Chief Finance Officer reviewing the overall performance of the fund and of the undernoted fund managers:-

- Aberdeen Asset Management
- Baillie Gifford Bonds
- Baillie Gifford Diversified Growth
- Legal and General
- Newton Investment Management
- Schroder Investment Management

NOTED the:-

(1) Managers' performance for period ending 30 June 2012; and

(2) Action taken by Managers during the quarter to 30 June 2012 in accordance with the investment policies.

AGREED that the Chief Finance Officer:-

(1) investigate the possibility of Schroder UK Equity Mandate being extended to include a small constrained overseas dimension, and

(2) submit a report to the next meeting of the Committee examining the area of Property Exposure.

PE13. PRIVATE EQUITY AND CREDIT MARKETS UPDATE

There was submitted Report (circulated) dated 4 September 2012 by the Chief Finance Officer (a) advising that the Fund's strategic allocation to private equity is set at 5% of total funds assets and is managed by SL Capital Partners and Wilshire Associates; (b) informing that a further 5% is allocated to the infrastructure mandate and managed by Credit Suisse; (c) updating on the progress and events arising from each Managers Investment Programme for the quarter ending 30 June 2012, and (d) detailing the progress of the Fund's Investment in the M & G UK Companies Financing Fund.

NOTED the progress of the Private Equity, Infrastructure and Credit Markets Programmes as at 30 June 2012.

AGREED that a report be submitted to the next meeting of the Committee, addressing the question of investment in Infrastructure.

PE14. PRESENTATION BY NEWTON INVESTMENT MANAGERS

The Convener introduced Robert Hay and David Moylett from Newton Investments.

Their presentation covered the following areas:-

- Equity Markets Review
- Performance and Attribution
- Global Outlook
- Portfolio Positioning

The Convener thanked Messrs Hay and Moylett for their presentation

NOTED the performance of Newton Investment Managers.

PE15. PRESENTATION BY SCHRODER INVESTMENT MANAGERS

The Chair introduced Claire Watson and Kevin Murphy from Schroder Investments.

The presentation covered the following areas:-

- Performance Summary
- Schroders approach to investment
- UK Equity Performance Record
- Recent Market Environment
- Portfolio Positioning
- UK and European Property Market
- Industrial Property Investment

The Chair thanked Ms Watson and Mr Murphy for their presentation.

NOTED the performance of Schroder Investment Managers.

AGENDA ITEM 3 (b)

FALKIRK COUNCIL

**MINUTE OF MEETING OF THE PENSIONS PANEL
THURSDAY 22 NOVEMBER 2012
MUNICIPAL BUILDINGS, FALKIRK**

ATTENDING:

Officers – Falkirk Council
B Smail, Chief Finance Officer
A McGirr, Pensions Manager
D Kelly, Senior Committee Services Officer

Organisations
Councillor C Campbell, Stirling Council - Chair
A Douglas, Unison
M Keggan, Unison
G Laidlaw, Scottish Autism
S Mackay, Clackmannanshire Council
Councillor C R Martin, Falkirk Council
J McAuley, Falkirk Council
E Morrison, SCRA
W Watson, Stirling Council

Attending:
B Miller, Investment Manager, Lothian Pensions Fund
L Selman – Hymans Robertson
A Craik – Audit Scotland

1. APOLOGIES

Apologies were received form Councillor A Drummond, G Eals, J Ford, I McLean, A Redpath and A Stewart.

2. DECLARATIONS OF INTEREST

There were no declarations made.

3. MINUTES

(a) The Minute of Meeting of the Pensions Panel held on 30 August 2012 was submitted and **APPROVED**, and

(b) The Minute of Meeting of the Pensions Committee held on 13 September 2012 was submitted and **NOTED**

4. **FALKIRK COUNCIL PENSION FUND AUDITED ANNUAL REPORT AND ACCOUNTS 2011/12**

There was submitted Report (circulated) dated 1 November 2012 by the Chief Finance Officer (a) advising that administering authorities of local government pension funds are required to publish a pension fund annual report and pension fund accounts that are separate from the other accounts of the administering authority, and (b) presenting as appendices to the Report copies of both the Falkirk Council Pension Fund Annual Report and Accounts 2011/12 and the Annual Report on the 2011/12 Audit as prepared by Audit Scotland.

NOTED:-

(1) the completion of the 2011/12 Accounts process, and

(2) the presentation by Audit Scotland of the Annual Report on the 2011/12 Pension Fund Audit.

5. **PUBLIC SECTOR PENSIONS REFORM**

There was submitted Report (circulated) dated 5 November 2012 by the Chief Finance Officer presenting an update on the latest proposals for public sector pensions reform.

NOTED.

6. **PENSION FUND – GENERAL GOVERNANCE MATTERS**

There was submitted Report (circulated) dated 1 November 2012 by the Chief Finance Officer presenting an update on the undernoted matters associated with the business of Falkirk Council Pension Fund.

Areas covered by the Report:-

- Auto Enrolment
- LGPS Regulations Made
- LGPS Regulations in Draft Form
- Consumer Price Index
- National Fraud Initiative
- Local Authority Pension Fund Forum

NOTED.

7. **FUNDING AND INVESTMENT STRATEGY UPDATE**

There was submitted Report (circulated) dated 9 November 2012 by the Chief Finance Officer presenting the latest funding position of the Falkirk Council Pension Fund.

Ms Linda Selman of Hymans Robertson gave a presentation on the Funds Funding and Investment Strategy.

NOTED the content of the Report and the details presented by Ms Selman.

8. PENSION FUND CASH MANAGEMENT

With reference to the Meeting of the Pensions Panel held on 30 August 2012 when discussion took place on the investment of short term cash with the Clydesdale Bank and Northern Trust, there was submitted Report (circulated) dated 7 November 2012 by the Chief Finance Officer addressing the issue and providing details of the Pension Fund's current approach to Cash Management.

NOTED the Fund's practices in relation to the management of cash.

AGREED that a Cash Management Strategy be prepared for the Fund.

9. EXCLUSION OF PUBLIC

RESOLVED in terms of Section 50A(4) of the Local Government (Scotland) Act 1973, to exclude from the meeting the press and public for the following items of business on the ground that they would involve the likely disclosure of exempt information as defined in Paragraph 9 of Part 1 of Schedule 7A of the said Act.

10. SCHRODERS UK EQUITY MANDATE – OVERSEAS ELEMENT

With reference to the meeting of the Pensions Panel held on 30 August 2012 when discussions took place on extending the mandate of Schroders Investment Management to include an overseas dimension, there was submitted Report (circulated) dated 6 November 2012 by the Chief Finance Officer presenting the arguments for and against extending the mandate.

NOTED.

AGREED that the mandate should continue to be limited to UK Equities only.

11. SCHRODERS PROPERTY MANDATE – UNDER-PERFORMANCE

There was submitted Report (circulated) dated 8 November 2012 by the Chief Finance Officer (a) referring to the Pension Fund's Property Mandate which is managed by Schroder Investment Management; (b) advising that the Mandate has been performing below benchmark for some period of time, and (c) outlining options which could assist in improving performance.

NOTED.

AGREED to invite Schroders to the next meeting of the Pensions Panel to discuss the Property Mandate performance in detail.

12. GROUP ACTION – ROYAL BANK OF SCOTLAND

There was submitted Report (circulated) dated 8 November 2012 by the Chief Finance Officer (a) referring to the participation in 2008 by the Falkirk Council Pension Fund in a Rights Issue made to shareholders by the Royal Bank of Scotland (RBS); (b) outlining the allegations that the financial information supporting the Rights Issue misled investors to the bank's true financial position; (c) detailing the position of the Fund in respect of the civil action being co-ordinated against RBS, and (d) presenting an update on the current status of the action.

NOTED.

AGREED that the final decision on participation should be delegated to the Chief Finance Officer, in consultation with the Conveners of the Panel and the Committee.

13. PENSION FUND – INFRASTRUCTURE INVESTMENT

With reference to the meeting of the Pensions Committee held on 13 September 2012, there was submitted Report (circulated) dated 12 November 2012 by the Chief Finance Officer presenting information about current developments involving local authority pension funds, local investment and infrastructure, and how, in particular, these developments might be utilised to benefit the local economy.

NOTED.

AGREED to continue consideration of the matter, requesting further information from Advisers.

14. PERFORMANCE AND MANAGEMENT REVIEW

There was submitted Report (circulated) dated 12 November 2012 by the Chief Finance Officer reviewing the overall performance of the fund and of the undernoted fund managers:-

- Aberdeen Asset Management
- Baillie Gifford Bonds
- Baillie Gifford Diversified Growth
- Legal and General
- Newton Investment Management
- Schroder Investment Management

NOTED the performance and actions taken by the Managers, in accordance with the investment policies, for the period ending 30 September 2012.

15. PRIVATE EQUITY AND ALTERNATIVES UPDATE

There was submitted report (circulated) dated 8 November 2012 by the Chief Finance Officer, updating on the progress and events arising from the Investments Programme of SL Capital, Wilshire Associates, Credit Suisse and M&G for the quarter ending 30 September 2012.

NOTED the progress of the Private Equity and Alternatives Programmes as at 30 September 2012.

16. FUND MANAGER REVIEW

Presentation by Baillie Gifford

Laurence Linklater and Anne-Marie Gillon from Baillie Gifford gave a presentation covering the following areas:-

- Portfolio position as at 30 September 2012
- Asset Allocation
- Fund Value and Distribution
- Changes occurred during past 6 months
- Fund Performance
- Investment Views
- Positioning of Physical Bonds and Cash
- Corporate Bond Holdings

The Chair thanked Mr Linklater and Ms Gillon for their informative presentation.

AGENDA ITEM 4 (a)

FALKIRK COUNCIL

Subject:	**FALKIRK COUNCIL PENSION FUND - AUDITED ANNUAL REPORT AND ACCOUNTS 2011/12**
Meeting:	**PENSIONS COMMITTEE**
Date:	**6 December 2012**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 Administering authorities of local government pension funds are required to publish a pension fund annual report and pension fund accounts that are separate from the other accounts of the administering authority. This requirement began in financial year 2010/11. At the same time, the Scottish Government introduced the requirement for the pension fund annual report and accounts to be subject to a separate audit.

1.2 The purpose of this report is to update the Committee about the production and audit of the Fund Annual Report and Accounts for 2011/12.

2. ACCOUNTS SUBMISSION AND AUDIT PROCESS

2.1 The unaudited Annual Report and Accounts were submitted for audit ahead of the deadline of 30 June 2012.

2.2 The audit of the Annual Report and Accounts has been undertaken by the Fund's external auditors, Audit Scotland.

2.3 Under International Standard on Auditing 260 (ISA 260), auditors are required to communicate matters relating to the audit of the financial statements to those charged with governance. The notification is to be made in sufficient time to enable appropriate action to be taken if necessary. In relation to the 2011/12 audit, the ISA 260 document – "Communication of Audit Matters to those charged with Governance" – was e-mailed to the Pensions Panel and Pensions Committee on 18th September, 2012 with no adverse comments in reply.

2.4 The audited Annual Report and Accounts were authorised for issue on 24th September, 2012 ahead of the deadline of 30th September, 2012. A copy of the audited annual report and accounts is attached at Appendix 1.

2.5 The Committee should note that auditors are required to produce an annual report on matters of significance arising arisen out of the audit process. The Annual Report on the 2011/12 Audit is attached at Appendix 2 and the findings will be presented by Audit Scotland as part of this agenda item.

3. **2011/12 AUDIT**

Matters Arising

Several presentational and monetary changes were made during the audit process, resulting in the net assets being adjusted from £1.255 billion to £1.252 billion. In addition, four action points have been proposed by audit:

- the annual validation of contributions should be accelerated
- the Fund should set budgets for controllable items of expenditure
- the implications of a changing fund membership profile should be kept under review
- the implications of the pensions reform agenda should be kept under review

The action points are accepted in full, although it should be recognised that in relation to the annual validation of contributions the completion of the exercise depends on timeous submission of data from employers.

Audit Opinion

The audit opinion on the financial statements is free from qualification. The auditors are also satisfied that the Annual Report contains the appropriate content and is consistent with the audited accounts.

Internal Audit Activity

In addition to the formal audit of the Annual Report and Accounts, pension fund transactions have been reviewed as part of internal audit's 2012/13 audit plan.

4. CONCLUSION

4.1 The Pension Fund Annual Report and Accounts for 2011/12 have been completed within the statutory timescale and an unqualified opinion given by Audit Scotland in relation to the financial statements.

4.2 An action plan will be formulated in response to the points raised by the auditors.

5. RECOMMENDATION

5.1 The Committee is invited to note:

(i) the completion of the 2011/12 Accounts process, and

(ii) the presentation by Audit Scotland of the Annual Report on the 2011/12 Pension Fund Audit

Chief Finance Officer
Date: 1st November 2012
Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

APPENDIX 1

FALKIRK COUNCIL PENSION FUND

Annual Report and Accounts

2011/12

Falkirk Council

CONTENTS

FOREWORD BY THE CHIEF FINANCE OFFICER

As prescribed by Regulations, this is the second Pension Fund annual report and accounts, audited in their own right, separate and removed from Falkirk Council's annual financial statements. This provides the reader with a wide range of information about the Fund including details on the governance and performance of both Administration and Investment aspects, as well as the more traditional financial statements. These financial statements include the Pension Fund Account which details the Income and Expenditure of the Fund during the year, and the Net Asset Statement which breaks down the type and value of assets held at year end. Both these sections are further supplemented by the Notes to the Accounts.

The Fund's Net Asset Statement at year end 31 March 2012 shows that the Fund had £1.25bn of assets under its management compared with £1.19bn at 31 March 2011. The improved asset value is mainly the result of the returns on fund investments over the year of 3.9%, and increased employers and employee contributions.

Pension Funds by their very nature have long-term time horizons. The Falkirk Council Pension Fund as part of the Local Government Pension Scheme with its underpinning statutory framework is well placed to recognise this. In consequence, a Funding Strategy Statement (revised during 2011/12) allows employers to recover a deficit position over 20 years and a stability mechanism allows employers to budget for their contributions over the medium term. This is particularly important given the financial pressures prevalent across the public sector.

Financial year 2011/12 proved to be both very dynamic and challenging. The triennial Valuation was completed as at 31 March 2011. This resulted in a welcome improvement in the Funding Level to 86% reflecting the net impact of a range of variables, including investment performance, the bond yield used to value liabilities, assumptions on life expectancy and the switch from RPI to CPI as the measure of inflation. It should be remembered that the valuation is a snapshot in time, particularly when assessed against the backcloth of volatile financial markets.

The Fund extended its diversity with the appointment of two new asset mandates. Credit Suisse were allocated an Infrastructure mandate and Baillie Gifford supplemented their bond mandate with their Diversified Growth Fund. The Council decided to establish a Community Trust for its leisure and related services and this new entity was admitted to the Fund in its own right, albeit with guarantee backing from the Council.

During the year, the two most senior staff dealing with investments retired. After evaluating options, it was decided that entering into a Service Level Agreement with the Lothian Fund offered the best way forward. This was supplemented by an integration of the investment and administration sections under one Pensions Manager. It is believed that this is the best configuration to meet the challenges ahead.

And there are indeed many challenges on the horizon. Reform of the Local Government Pension Scheme in England and Wales is now taking shape, based on a career average rather than final salary, but clarification is awaited of the way forward in Scotland. Auto Enrolment will commence for some of the Fund employers from April 2013. There is also the formation of the national Police & Fire Authorities from April 2013. New governance arrangements designed to improve engagement and communications with stakeholders are in place to be introduced during 2012/13. And, of course, the public sector faces a regime of austerity over the medium and quite possibly longer term, the gravity of which will be materially determined by the volatility of financial markets and the prospects for world-wide economic growth.

Bryan Smail, CPFA MBA
Chief Finance Officer
29 June 2012

STATEMENT OF RESPONSIBILITIES FOR THE STATEMENT OF ACCOUNTS

THE ADMINISTERING AUTHORITY'S RESPONSIBILITIES

The Authority is required to:-

- Make arrangements for the proper administration of the financial affairs of the Pension Fund in its charge and to ensure that one of its officers has the responsibility for the administration of those affairs. In this Authority, that officer is the Chief Finance Officer.

- Manage its affairs to secure economic, efficient and effective use of its resources and safeguard its assets.

- Approve the Statement of Accounts.

THE CHIEF FINANCE OFFICER'S RESPONSIBILITIES

The Chief Finance Officer is responsible for the Statement of Accounts which have been properly prepared in accordance with the Local Government (Scotland) Act 1973, and the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the Code) and the 2007 Pensions Statement of Recommended Practice (the 2007 Pensions SORP).

In preparing this Statement of Accounts, the Chief Finance Officer has:-

- selected suitable accounting policies and then applied them consistently;
- made judgements that were reasonable and prudent; and
- complied with the accounting code of practice.

The Chief Finance Officer has also:-

- kept proper accounting records which were up to date; and
- taken reasonable steps to prevent and detect fraud and other irregularities.

STATEMENT OF ACCOUNTS

The Statement of Accounts presents a true and fair view of the financial position of the Pension Funds as at 31 March 2012 and their income and expenditure for the year ended 31 March 2012.

Bryan Smail, CPFA MBA
Chief Finance Officer
29 June 2012

FUND AND GOVERNANCE OVERVIEW

Fund Overview

Under the terms of the Local Government Pension Scheme, Falkirk Council is designated as an "Administering Authority" and is required to operate and maintain a pension fund - the Falkirk Council Pension Fund ("the Fund").

The Fund is used to pay pensions, lump sum benefits and other entitlements to scheme members and their dependants. Contributions to the Fund are made by employee members and by participating employers. The Fund also receives income from the assets it holds, which include equities, property and bonds.

Fund employers include Clackmannanshire, Falkirk and Stirling Councils, Central Scotland Police, Central Scotland Fire and Rescue Service, Central Scotland Valuation Board, the Scottish Environment Protection Agency (SEPA), the Scottish Children's Reporter Administration (SCRA), Forth Valley College, Falkirk Community Trust Ltd and a number of non-profit making charitable bodies in Central Scotland.

Scheme membership is made up of active members, deferred members and pensioner members. To be able to join the scheme, you must be employed by a participating employer and not be eligible to join one of the other public sector pension schemes.

An actuarial valuation of the Fund every three years acts as an independent financial health check to determine how much money has to be paid into the Fund to keep it in a position to pay benefits both now and in the future. The last valuation was held in March 2011 and showed that the Fund was 86% funded, meaning that it had 86% of monies needed to pay all the future benefits of scheme members. Two important aspects highlighted by the actuary were the risks posed to the Fund from future improvements in mortality rates and the challenges to the Fund from a maturing membership.

Whilst the impact of an ageing workforce on future cashflows should not be under-estimated, it is important to note that the time horizon of the Fund is long term. Consistent with this, there is a Funding Strategy Statement which allows employers with strong financial covenants to recover their deficit position over 20 years. A stability mechanism within the strategy also helps employers budget for their contributions in the short term.

Investment Management of the Fund is undertaken by external fund managers and overseen by the Council's Investments Section.

Administration of the Fund is undertaken in-house by the Pensions Section.

Governance Overview

Falkirk Council has delegated all its pension scheme business to its Investment Committee.

During 2011/12, the Committee met quarterly and comprised six Elected Members from Falkirk Council:

- Councillor John Patrick (Convener)
- Depute Provost Allyson Black
- Councillor Jim Blackwood
- Councillor Thomas Coleman
- Councillor Angus MacDonald [replaced by Councillor Lynda Kenna with effect from 22/06/11]
- Councillor Alistair McNeill

The Committee's key responsibilities were to:-

- establish and review investment strategy;
- ensure the suitability and adequate diversification of investments;
- set strategic asset allocation benchmarks and individual manager benchmarks and targets;
- review on a regular basis the investment managers' performance; and
- select and appoint investment managers and custodians as required.

(Councillors Patrick, Black, Blackwood and McNeill were all active members of the Scheme during 2011/12).

Communications

Communications with stakeholder groups was achieved by way of a Pensions Forum held in September 2011 and a Pensions and Investment Conference held in March 2012. These events were open to representatives from each of the employing bodies and trade unions. The issues discussed included actuarial matters, benefits and regulatory changes, investment performance and investment manager/adviser presentations.

Statement of Investment Principles

The Fund has published a Statement of Investment Principles governing its decisions about Fund investments. A copy of the document is available from the Chief Finance Officer, Falkirk Council, Municipal Buildings, West Bridge Street, Falkirk FK1 5RS or at www.falkirk.gov.uk/pensions.

Funding Strategy Statement

The Council's approach to funding scheme liabilities is set out in the Funding Strategy Statement. A copy of the document is available from the Chief Finance Officer, Falkirk Council, Municipal Buildings, West Bridge Street, Falkirk FK1 5RS or at www.falkirk.gov.uk/pensions.

Governance Compliance Statement

Following the publication in April 2011 of statutory guidance relating to the governance of local authority pension funds, the Fund undertook a wide ranging consultation with stakeholders to determine the nature of a revised governance structure. A revised governance framework, taking account of the results of the consultation, was approved by Falkirk Council on 14 March 2012 and will result in future pension fund business being conducted by a Pensions Committee, with the support of an advisory Pensions Panel. The Panel will consist of Trade Union, Employer and Pensioner representatives with three members of the Panel being co-opted to sit on the Committee where they will have full access to papers and voting rights.

The new governance arrangements will enable the Fund to be compliant with best practice guidelines from 2012/13 onwards.

In accordance with the requirements of the Pension Regulations, the Governance Compliance Statement in operation during 2011/12 is reproduced in the following section. Details of the new governance arrangements have also been provided.

GOVERNANCE COMPLIANCE STATEMENT

Regulation 27 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 (SSI 2008/228) requires Administering Authorities to prepare and publish a written statement setting out the terms of their current governance arrangements. The undernoted Statement sets out the compliance arrangements in place during 2011/12 and the arrangements which have been approved for 2012/13.

Principle A – Structure

	Requirement	Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	The management of the administration of benefits and strategic management of fund assets clearly rests with the main committee established by the appointing Council	Partial Compliance	Falkirk Council, as Administering Authority of the Falkirk Council Pension Fund, has established an Investment Committee to which it has delegated the function of "The management and investment of the Superannuation Fund".	Falkirk Council, as Administering Authority of the Falkirk Council Pension Fund, has established a Pensions Committee to which it has delegated the administration of benefits and strategic management of fund assets.
(b)	That representatives of participating LGPS employers, admitted bodies and scheme members (including pensioner and deferred members) are members of either the main or secondary committee established to underpin the work of the main committee	Partial Compliance	The Investment Committee comprises six Elected Members from the Administering Authority. The Investment Committee has established an Investment Forum comprising representatives from Fund employers and Trades Union representatives.	The Pensions Committee includes three members co-opted from the Pensions Panel representing the interests of members, pensioners and employers.
(c)	That where a secondary committee or panel has been established, the structure ensures effective communication across both levels	Partial Compliance	The Investment Forum is convened twice per year, with a meeting held in September of each year followed by an annual Pensions & Investment Conference held in March. The Investment Forum provides a means of communicating pension fund business to and from a number of stakeholder groups.	The main channel of communication between the Pensions Committee and the Pensions Panel lies with the three Committee members who are also Panel members. Communication is also assisted by synchronising Panel meetings with the corresponding Committee meeting.

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(d)	That where a secondary committee or panel has been established, at least one seat on the main committee is allocated for a member from the secondary committee or panel.	Not Compliant	See (b)	Three places on the Pensions Committee are reserved for members of the Pensions Panel.

Principle A – Structure

<u>Reason for non-compliance</u>

Revised arrangements have been put in place to ensure that from 2012/13 adequate stakeholder representation exists for scheme members, employers and pensioners.

Principle B – Representation

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That all key stakeholders are afforded the opportunity to be represented within the main or secondary committee structure. These include:			
	(i) Employing authorities (including e.g. admission bodies);	Partial Compliance	The Investment Committee comprises six Elected Members from the administering authority. All Fund employers are invited to meetings of the Investment Forum.	Representatives of major fund employers, including one admission body, sit on the Pensions Panel. A nominee from the Panel's employer representatives sits on the Pensions Committee.
	(ii) Scheme members (including deferred and pensioner scheme members);	Partial Compliance	Trades Union representatives are invited to meetings of the Investment Forum	Non-pensioners are represented by the Trade Union Panel members and by the Union representative who sits on the Pensions Committee. Pensioners are represented by the pensioner members who sit on the Panel and the member who sits on the Committee.
	(iii) Where appropriate, independent professional observers; and	Not Compliant	None	There are no independent professional observers of Committee or Panel business. It is considered that: • the diversity of representation; (employers, pensioner and Unions) • the training arrangements; • the annual audit process; and • access to existing professional advisors provide robust and adequate scrutiny of pension fund business.

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
	(iv) Expert advisors (on an ad-hoc basis).	Full Compliance	Support for the Investment Committee and Investment Forum is provided by the undernoted advisors: • actuary and investments, Hymans Robertson • corporate governance, Pensions and Investment Research Consultants Ltd (PIRC) • investment managers and custodian, as required.	Support for the Pensions Committee and Pensions Panel is provided by the undernoted advisors: • actuary and investments, Hymans Robertson • corporate governance, PIRC Ltd • investment managers and custodian, as required.
(b)	That where lay members sit on a main or secondary committee, they are treated equally in terms of access to papers and meetings, training and are given full opportunity to contribute to the decision making process, with or without voting rights.	Not Compliant	None	Panel members who are co-opted onto the Pensions Committee have equality of access to papers, meetings and training and have full opportunity to contribute to the decision making process, including the right to vote.

Principle B – Representation

<u>Reason for non-compliance</u>

Areas of partial or non-compliance have been addressed as part of the overall review of governance arrangements referred to under Principle A.

Principle C – Selection and role of lay members

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That committee or panel members are made fully aware of the status, role and function they are required to perform on either a main or secondary committee	Full Compliance	Elected Members of the Investment Committee are subject to the code of conduct of Falkirk Council. Induction training is delivered to Committee and Forum members.	Members of the Pensions Committee will be subject to the Falkirk Council Councillors' Code of Conduct. Members of the Pensions Panel will be appointed on the understanding that they will be subject to the Falkirk Council Councillors' Code of Conduct. Induction training will be delivered to Committee and Panel members.
(b)	That at the start of any meeting, committee members are invited to declare any financial or pecuniary interest related to specific matters on the agenda.	Full Compliance	Declaration of interests is a standard procedure at the start of all Committee meetings. Declarations are noted in the minutes.	Declaration of interests is a standard procedure at the start of all Committee and Panel meetings. Declarations are noted in the minutes.

Principle D – Voting

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	The policy of individual Administering Authorities on voting rights is clear and transparent, including the justification for not extending voting rights to each body or group represented on main LGPS committees.	Partial Compliance	All members of the Investment Committee have voting rights on the basis that they have executive responsibility for pension fund decision making.	All members of the Pensions Committee including co-opted members will have voting rights on the basis that they have executive responsibility for pension fund decision making.

Principle D – Voting

Reason for non-compliance

The question of extended voting rights has been addressed as part of the overall review of governance arrangements referred to under Principle A.

<u>Principle E – Training/Facility Time/Expenses</u>

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That in relation to the way in which statutory and related decisions are taken by the Administering Authority, there is a clear policy on training, facility time and reimbursement of expenses in respect of members involved in the decision-making process.	Partial Compliance	Training is delivered in large part by addressing specific items at Investment Committee but complemented by visits to Fund Managers and attendance at industry seminar/conferences. Expenses incurred by Members of the Investment Committee are met either by the Fund or the Falkirk Council scheme for payment of Members' expenses.	The administering authority's approach to training is set out in its training policy for the Pensions Committee and Pensions Panel members. Training is delivered in large part by addressing specific items at Committee and Panel meetings and complemented by visits to Fund Managers, bespoke training events and attendance at industry seminars and conferences. Expenses incurred by Committee and Panel members are met either by the Fund or the Falkirk Council scheme for payment of Members expenses.
(b)	That where such a policy exists, it applies equally to all members of committees, sub-committees, advisory panels or any other form of secondary forum.	Not Compliant	None	The Training Policy for the Pensions Committee and Pensions Panel applies uniformly to all members.
(c)	That the Administering Authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken.	Not Compliant	None	The Training Policy for the Pensions Committee and Pensions Panel includes the requirement for members to undergo training needs analysis and the development of commensurate training plans. A register of training undertaken will be maintained.

Principle E – Training/Facility Time/Expenses

<u>Reason for non-compliance</u>

Various aspects of training have been addressed as part of the overall review of governance arrangements referred to under Principle A.

Principle F – Meetings (Frequency/Quorum)

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That an Administering Authority's main committee or committees meet at least quarterly.	Full Compliance	The Investment Committee has a regular quarterly meeting covering investment and pensions administration matters. Additional meetings are called as required.	The Pensions Committee hold quarterly meetings. Additional meetings are called as required.
(b)	That an Administering Authority's secondary committee or panel meet at least twice a year and is synchronised with the dates when the main committee sits.	Partial Compliance	The Investment Forum is held in September of each year followed by an annual Pensions & Investment Conference held in March.	The Pensions Panel hold quarterly meetings and meets roughly two weeks in advance of the Pension Committee. Additional meetings are called as required.
(c)	That an Administering Authority that does not include lay members in their formal governance arrangements, must provide a forum outside of those arrangements by which the interests of key stakeholders can be represented.	Partial Compliance	The Investment Forum provides access for the majority of the stakeholder groups.	The Council does include lay members on its Pensions Committee. However, in order to ensure that the interests of wider fund stakeholders can be represented, the Fund holds a Pensions & Investment Conference each year.

Principle F – Meetings (Frequency/Quorum)

Reason for non-compliance

The question of synchronising meetings and increasing access rights to all stakeholder groups has been addressed as part of the overall review of governance arrangements referred to under Principle A.

Principle G – Access

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That subject to any rules in the Council's constitution, all members of main and secondary committees or panels have equal access to committee papers, documents and advice that falls to be considered at meetings of the main committee.	Not Compliant	None	Members of Pensions Committee and Pensions Panel have equal access to any committee papers, documents and advice that falls to be considered at meetings of the Pensions Committee.

Principle G – Access

Reason for non-compliance

The provision of Committee papers to stakeholder groups has been addressed as part of the overall review of governance arrangements referred to under Principle A.

Principle H – Scope

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That Administering Authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements.	Full Compliance	The Investment Committee agenda includes reports pertaining to both pensions and investments matters such as regulatory changes, actuarial valuation and funding level updates, admission agreements, investment strategy and Fund/Investment Manager performance.	The Pensions Committee and Panel agendas include reports pertaining to both administration and investment matters such as regulatory changes, actuarial valuation and funding level updates, admission agreements, investment strategy and Fund/ Investment Manager performance.

Principle I – Publicity

Requirement		Level of Compliance in 2011/12	Arrangements in Place 2011/12	Arrangements in Place 2012/13
(a)	That Administering Authorities have published details of their governance arrangements in such a way that stakeholders with an interest in the way in which the scheme is governed, can express an interest in wanting to be part of those arrangements.	Partial Compliance	Consultation into new governance arrangements progressed during 2011/12.	Employers, Unions and Pensioners have been consulted regarding the governance arrangements and invited to participate. Full details of the Governance arrangements are published on the Fund's website.

Principle I – Publicity

Reason for non-compliance

The Governance Policy Statement, following approval by the Investment Committee and Falkirk Council, has been circulated to all scheme employers and may be viewed on the Falkirk Council web-site at www.falkirk.gov.uk/pensions

Other aspects of stakeholder participation in the pension fund have been addressed as part of the overall review of governance arrangements referred to under Principle A.

REVIEW OF THE YEAR – ADMINISTRATION

Introduction
This section provides an overview of the arrangements made during 2011/12 for the administration of the Falkirk Council Pension Fund.

Staffing
Administration of the Fund is undertaken in house by the Pensions Section. The section consists of 10 employees (9.8 full time equivalent staff) and is headed by the Pensions Manager, who reports to the Depute Chief Finance Officer.

The composition of the Pensions Section is as follows:

Role	Nos.	Average Years of Service	Pensions Qualification
Pensions Manager	1	29 years	Yes
Pensions Project Officer	1	41 years	Yes
Pensions Officers	2	26 years	Yes (1 post)
Pensions Support Assistant	1	21 years	No
Pensions Assistants	4.8	10 years	No
Total	9.8		

The appointment during 2011/12 of a new management team within Finance saw renewed impetus being given to the retention of Investor in People (IIP) accreditation and to the introduction of the Achievement and Personal Development System (APDS) to better measure and manage staff needs and aspirations.

Main Activities
The principle activities of the Section are to:

- maintain records of scheme membership;
- calculate and pay retirement and death benefits;
- provide information and guidance to scheme stakeholders;
- ensure the Council meets its statutory obligations in relation to scheme administration;
- produce an Annual Report and Accounts for publication;
- contribute to the development of public sector pensions policy; and
- support the governance arrangements of the Pension Fund.

Section Goals and Values
The Pensions Section contributes towards the Council's goals and values through discharging the Council's pensions administration obligation. The Section recognises the need to provide a quality service and fully embraces the mission statement of Finance Services to:

- meet targets;
- invest in people;
- adopt new and more efficient methods of service delivery;
- be responsive to our customers;
- monitor and report performance; and
- achieve the goals we have set ourselves

The key objectives of the Pensions Section are:

- to provide an efficient and cost effective service
- to provide a good quality service that meets members' needs
- to ensure good governance of the Fund and compliance with statutory requirements
- to support the corporate activities of Falkirk Council and constituent Fund employers

Systems
Member data is maintained using the computerised in-house Pensions Administration System. The system contains records of members' service and contributions and is used to generate benefit calculations and annual statements. Active member records are supported by correspondence files in paper format. Archive records of all leaver members since 1986 are held as electronic images.

The system used to deliver the Fund's payroll requirement (including the payment of monthly pensions) is Resourcelink, licensed from NorthgateArinso.

The system used to deliver the Fund's accounting system requirements is Integra, licensed from Capita IB Solutions.

All systems are supported by the Council's ICT Division and by software suppliers.

Risk Management
The activities of the Pensions Section are not immune from risk. Risk may range from a failure of information systems to the physical damage of business premises. Whilst it is not possible to completely eliminate the risk of disruption to the day to day administration of the Fund, the nature of risk has been evaluated and strategies put in place to minimise its adverse effects. These strategies are set out in the following documents:

- the Operational Risk Management Action Plan
- the Finance Business Continuity Plan
- the Pensions Contingency Plan
- Staff and Employer Online Administration Manual

2011/12 Activity Review

General
The Section successfully completed all its statutory functions in the required timescale and to a high degree of accuracy. A recurring theme of 2011/12 has been the demands from stakeholders for information about the UK Government's pension reform agenda and how it impacts on the Local Government Pension Scheme in Scotland.

Public Sector Pension Reform
Whilst an outline framework for new career average schemes has been tentatively agreed in England and Wales, no decisions about the future of public sector schemes in Scotland has been taken by the Scottish Government, save for the implementation of higher employee contribution rates from April, 2012 in respect of Police, Fire and Teachers' Schemes.

Joint Working
The Pathfinder initiative into the delivery of the LGPS service in Scotland reached the conclusion that there was no business case for the merger of funds from either an investment or administration perspective. The consultant's final report did however make several suggested improvements for the manner in which Funds operate (e.g joint procurement). These are likely to be addressed as the public sector reform agenda moves forward.

Pension Fund Actuarial Valuation at 31/3/2011
The valuation of the pension fund as at 31/3/2011 was completed in accordance with the statutory timescale. Employers have been advised of the valuation results and have been given notice of the contribution rates that are payable for the three years from 2012/13. In order to improve engagement with employers in the valuation process, the actuary provided each employer with details of their own funding position and gave each employer the opportunity to have a one to one meeting.

The opportunity was also taken to update the Funding Strategy Statement to reflect the results of the valuation.

More information regarding the results of the valuation can be found in Note 16 of the financial statements and on Page 41 of this report in the Section "Actuarial Statement for 2011/12".

Pension Fund Governance Arrangements
The Pensions Section, in conjunction with the staff of the Chief Governance Officer, was heavily involved in the governance consultation exercise held with stakeholders during 2011/12. Consultees included Trade Unions, Fund Employers, Fund Pensioners, Investment Committee members and Elected members of Clackmannanshire and Stirling Councils who had been nominated by their respective Councils to attend the Investment Forum.

More information about the new governance arrangements can be found on Page 6 of this report in the Section "Governance Compliance Statement".

Transfer Values
The Treasury's 2010 review on the appropriate discount rate to use in relation to unfunded public sector pension schemes led to yet another change in the method of calculating cash equivalent transfer values and the underlying actuarial factors. This is the third change in as many years, the most recent previous change being due to the switch in indexation from RPI to CPI.

The amount of work involved in updating factors, re-specifying and testing systems, dealing with stockpiled cases and managing the expectations of members was considerable but has largely been concluded.

Other Key Initiatives
- Completion of unqualified audit of Pension Fund Annual Report and Accounts for 2010/11 – this being the first occasion on which the Fund was required to produce accounts separate to that of the Council
- Successful introduction of separate pension fund bank account
- Provision of pensions information to employers about Senior Managers and Councillors in compliance with the revised terms of the Local Authority Accounts (Scotland) Regulations 1985
- Completion of admission agreement for Falkirk Community Trust Ltd
- Meetings with Scottish Government over impact on pensions of Police and Fire Reform
- Pension records updated to reflect active members strike action in November, 2011
- Compliance with new Lifetime and Annual Allowance tax thresholds

Communications
Stakeholder communication during 2011/12 was undertaken through

- A Pensions Forum and an Annual Conference
- Global E-mail concerning pension reform prior to strike action
- Benefit Statements for active members
- Newsletters for active members
- Messaging facility on monthly pension advice slip
- "What's New" section at www.falkirk.gov.uk/pensions
- FRS17/IAS19 Briefing Session for employers

Performance

Performance information is supplied to CIPFA and the Scottish Government as part of an annual review of performance across all Councils. A range of service standards have also been developed by the Pensions Section and are monitored on a regular basis.

Key performance standards for the Section for the past 3 years are set out in the table below:-

	2009/10	2010/11	2011/12
Payment deadlines met	100%	100%	100%
Annual Member Admin. Cost	£17.02	£16.12	£16.45
Staff / Member ratio	1 to 3,042	1 to 2,893	1 to 2,932
Number of complaints	2	4	1
Lump Sums paid within 7 days	91%	92%	99%
Queries responded to in 14 days	67%	71%	72%

To ensure the Pensions Section staff remain abreast of current scheme developments, the Fund subscribes to an administration advisory service hosted by the Local Government Employers' Organisation.

Business Outlook

The landscape for 2012/13 is likely to be dominated by the ongoing issue of public sector pension scheme reform. Falling asset values and low bond yields married to extreme volatility in financial markets are likely to produce negative media headlines and in the current climate of austerity, it is inevitable that the affordability of the Scheme will again come under the spotlight.

Whilst the proposed implementation date for the Hutton reforms in England and Wales is April, 2014, we are aware that COSLA have been seeking urgent discussions with the Scottish Government to ascertain their policy intentions. Further government initiatives, including workplace pensions reform (i.e. auto enrolment) and the creation of single Police and Fire Services are also likely to impact on operational processes during 2012/13.

Whilst auto-enrolment is fundamentally the responsibility of individual employers, we intend to play a positive role in terms of co-ordinating training and ensuring that employer practices properly blend with the scheme's own entry requirements. An employer's auto-enrolment training event has been scheduled for 21st September, 2012.

Training is also likely to be a common theme with the newly formed Pensions Panel and Pensions Committee. Various initiatives and codes of practice demand that pensions decisions are taken only by persons suitably qualified to do so and the formation of the new governance structure is an opportunity to put a training regime in place that meets this aspiration. Initial training days have been scheduled for 16 August and 24 October 2012.

Pressures on local government finance and the need to drive down costs are likely to result in the Pensions Section revisiting its strategy of issuing pensioners with a monthly pension advice slip. Whilst this remains a visible and tangible link to all our pensioners, the substantial cost of around £25,000 per year cannot be ignored.

During 2012/13, as a result of staff retirements and a re-structuring, the investment team is being subsumed within an enlarged Pensions Section and will come under the responsibility of the Pensions Manager. A Pensions Accountant has been recruited to assist with the Fund's financial reporting obligations.

With such a variety of pension themes being played out from government reform to governance reform, communications will continue to be vital to the partnerships which the Pensions Section has cultivated with stakeholders over the years. To provide even greater clarity, the Section will be embarking on delivering a new web portal for members which will focus exclusively on the Local Government Pension Scheme.

MEMBERSHIP UPDATE

Membership numbers are most commonly affected by persons joining or leaving the Scheme as part of normal staff turnover. From time to time, however, there can be more significant membership movements resulting from factors such as economic circumstances or changes in scheme rules.

The balance of membership between contributors and pensioners is an important indictor of the maturity of the Fund and is a major factor in determining investment strategy.

Factors affecting recent membership numbers are as follows:

i) the challenging financial environment of the past three years has led to more employees than normal being granted early retirement (and not being replaced) thus reducing the number of active members but increasing pensioner member numbers;

ii) recruitment freezes and vacancy management strategies have led to a deceleration in the rate of enrolling new members and it remains to be seen whether the Government's Auto Enrolment initiative (which will first impact on the Falkirk Fund in April 2013) will halt the decline in active membership numbers;

iii) in July 2011, around 400 active members with Falkirk Council were transferred to Falkirk Community Trust Ltd, thus increasing Admission Body numbers and reducing Scheduled Body numbers; and

iv) the number of deferred members continues to grow reflecting the fact that some employers have been offering severance packages to younger members who do not qualify for pension release, but instead are entitled to deferred benefits.

Number of Scheme Members

	Membership 31/03/10	Membership 31/03/11	Membership 31/03/12
All Fund Employers			
Actives	13,305	12,939	12,668
Deferreds	4,551	4,869	5,085
Pensioners	7,090	7,600	8,119
	24,946	25,408	25,872
Scheduled Bodies			
Actives	12,338	11,948	11,286
Deferreds	4,094	4,358	4,518
Pensioners	6,820	7,301	7,779
	23,252	23,607	23,583
Admission Bodies			
Actives	967	991	1,382
Deferreds	457	511	567
Pensioners	270	299	340
	1,694	1,801	2,289

In general terms, total Fund membership (i.e. active, deferred and pensioner members) has reached something of a plateau in recent years. This is apparent from Figure A below where the steady membership increases of the late 1990s have reached a levelling out point.

This is further analysed in Figure B which demonstrates the emerging trend of reduced active members and increased pensioners and deferred members. Such a trend signifies a maturing of the Fund, and, if maintained, will have implications for the Fund's cash flows, the contribution rates paid by employers, and ultimately the investment strategy.

Figure A - Fund Membership from 1996 – 2012 in aggregate

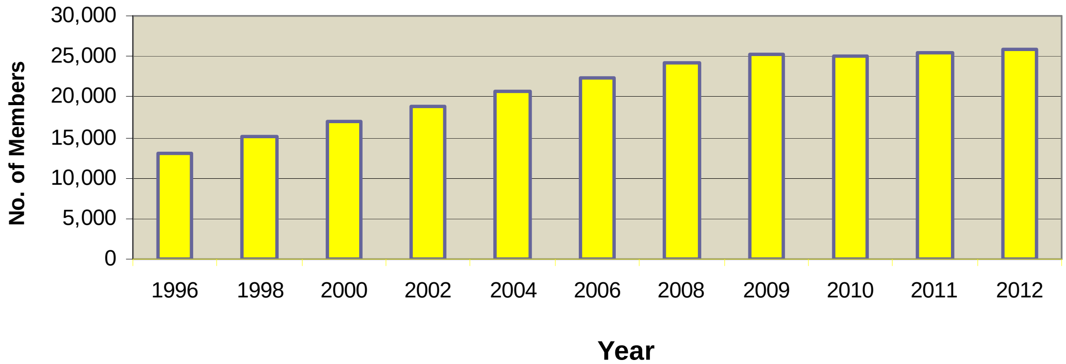
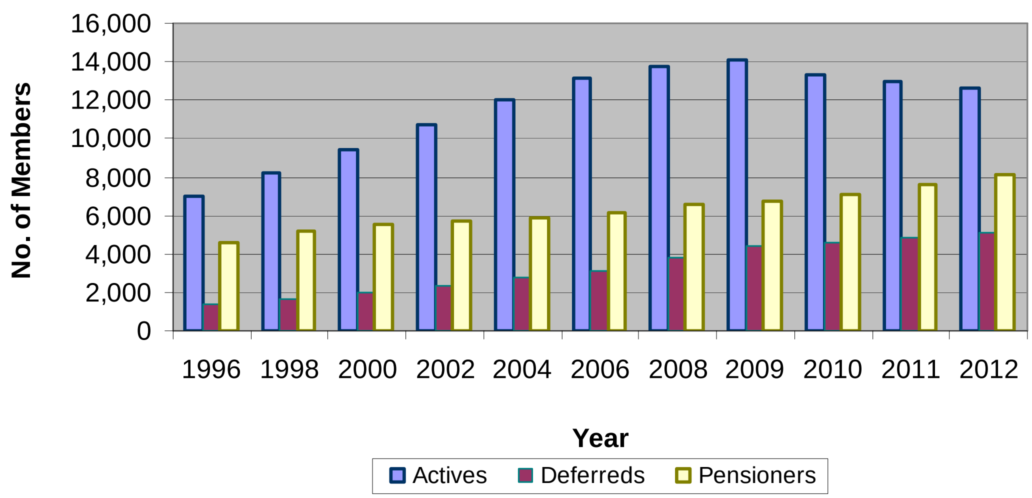


Figure B - Fund Membership from 1996 – 2012 by category



REVIEW OF THE YEAR – INVESTMENTS

Statement by Baillie Gifford & Co, Fund Managers

Economic and Market Background – 12 Months to 31 March 2012

During much of the 12 month period to 31 March, the overriding sentiment among investors was uncertainty, as a solution to problems in the Eurozone remained elusive and concerns persisted over the possibility of further weakness in the global economy. Meanwhile, confidence among consumers remained muted. This was reflected in poor retail sales and further weakness in house prices, especially in the UK, where several retailers closed for business.

However, during the early part of 2012, the European Central Bank made its latest attempt to stabilise the situation in the single currency area, and improving economic data began to emerge from the United States. Both of these factors had a generally positive impact on investment markets. Elsewhere, the outlook for China remained positive overall and spending by wealthy consumers in parts of Asia and the Middle East was buoyant.

Given the mixed backdrop, it is unsurprising that stock markets around the world enjoyed mixed fortunes. The UK ended the period around 1% higher, and the US posted a rise of 7%, but Emerging Markets lost 9% in sterling terms, Europe’s woes were reflected in a decline of 11%, and Developed Asia (including Japan) ended the period 2% lower.

UK Government bond markets benefited from their perceived status as a safe haven in times of extreme turbulence and were up 14% over the period, while overseas government bonds advanced 5% in local currency terms. Corporate bond returns were more diverse but, taken as a whole, finished the period substantially higher, with UK corporate bonds performing particularly well to post a rise of 9%,

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Calton Square,
1 Greenside Row,
Edinburgh EH1 3AN

Investment Strategy

In 2010/11 the Investment committee approved a revised Investment Strategy in which the Fund would decrease its allocation in traditional investments such as Equities and Bonds and increase its holding in Alternative Assets. Investments falling within the Alternative Asset class include Diversified Growth, Credit Markets, Infrastructure and Private Equity.

The revised allocation targets a 10% decrease in equities and 5% in bonds. This would fund the purchase of a Diversified Growth fund and the commitment to Infrastructure investments.

During 2011/12 the reallocation process commenced with the successful tender for new Infrastructure and Diversified Growth mandates.

Credit Suisse were appointed to the Infrastructure mandate with an $80m commitment being made by the Fund. The initial investment was funded from the reduction in the Baillie Gifford Bonds mandate.

Baillie Gifford was awarded the mandate for the Diversified Growth fund with the transition successfully completed in March 2012. The new account was funded by reductions in the Baillie Gifford Bonds, Schroder UK Equity and Newton Global Equity mandates and currently accounts for 9% of the Fund.

Asset Class	**Strategic Allocation %**	**Allocation as at 31/03/12 %**
Equities	60	64
Bonds	10	10
Property	10	8
Alternatives	20	17
• *Private Equity*	*5*	*7*
• *Infrastructure*	*5*	*1*
• *Diversified Growth*	*10*	*9*
Cash	-	1

As the revised investment strategy has just been actioned, the Fund has no immediate plans to further review its strategy. However, in conjunction with its investment advisors, the Fund is constantly monitoring global market conditions and will respond to potential opportunities/threats as they occur.

Corporate Governance

As a responsible investor, the Fund seeks to promote corporate social responsibility, good practice and improved company performance amongst all companies in which it invests. To this end, the Fund monitors investee companies to ensure they meet standards of acceptable practice in relation to their key stakeholders. During the year, the monitoring role was achieved by engaging with companies through:

- the Fund's Investment Managers (see note 9 to the financial statements, p34)
- Pensions and Investment Research Consultants (PIRC) who provide advice and research services on all matters pertaining to shareholder voting responsibilities
- membership of the Local Authority Pension Fund Forum (LAPFF) comprising 53 local government pension funds to promote and maximise their investment interests

Since August 2010, the Fund has engaged with PIRC to cast votes at company meetings covered by its Global Corporate Governance Research. The service applies to the Fund's direct equity holdings (circa 125) which ensures consistency of voting intentions across the multi-manager portfolios. Previously the Fund allowed its equity managers to cast their own votes at company meetings. This position was reviewed as it had the potential for inconsistent voting across managers. During 2011/12, voting was undertaken at 150 company meetings at which 1,550 votes were cast in favour of resolutions, 352 opposed and 187 cases of abstentions.

Engagement should also be considered within the context of the UK Stewardship Code. The Code comprises of seven principles which seek to improve the quality of engagement between institutional investors and investee companies. Consistent with Code requirements, asset managers must produce a statement of their commitment or explain their alternative approach to company engagement. It is pleasing to note that each of the Fund's investment managers has expressed their commitment to the Code.

Investment Performance

Short Term (1 year)
The Fund earned a return of 3.9% over the financial year against a benchmark return of 2.6%. Main contributions to the outperformance came from the UK and Global Equities mandates.

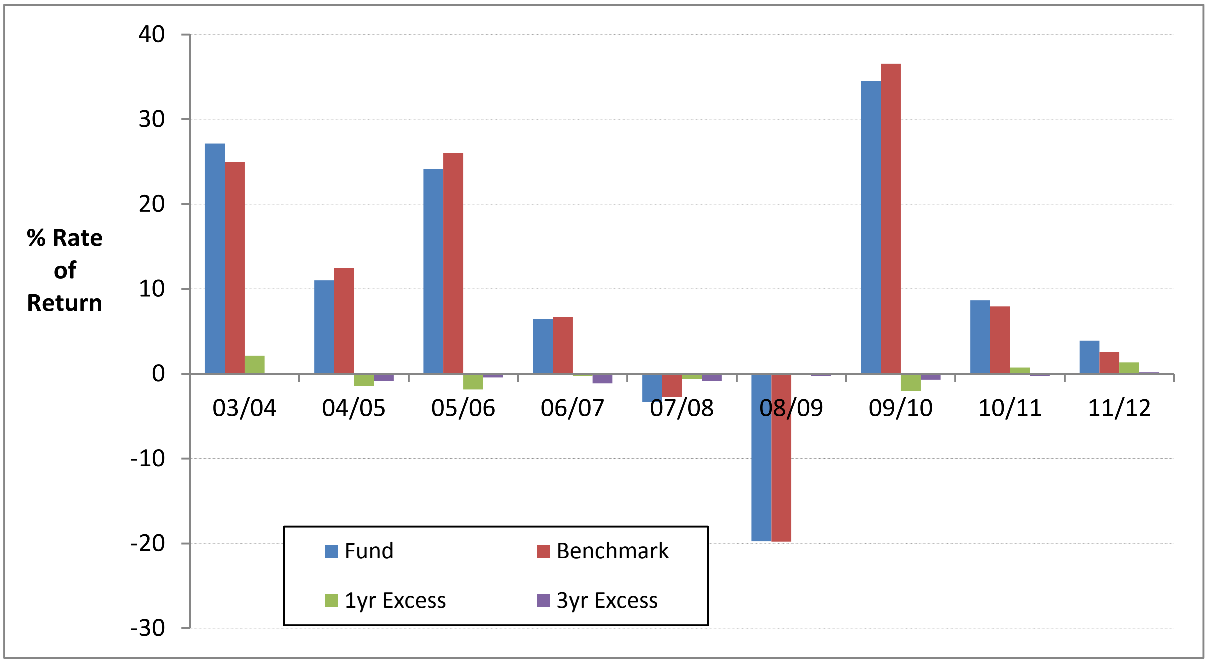
Medium Term (3 years)
The Fund's return of 15% has outperformed its benchmark return by 0.2%. The Fund benefited, in particular, from strong performance by its Bonds and UK Equities managers.

Longer Term (10 years)
The Fund's longer term performance of 5.5% slightly lags its benchmark return by 0.4% p.a. over the period. However, it remains comfortably ahead of price and wage inflation to which the pension fund liabilities are linked.

Annualised returns to 31 March 2012

	1 Year %	**3 Years %**	**10 Years %**
Falkirk Council Pension Fund	3.9	15.0	5.5
Benchmark	2.6	14.8	5.9
Retail Prices Index	3.6	4.5	3.3
National Average Earnings	0.2	2.6	3.2

Rolling 3 Years Performance
Annual periods ending 31st March including 1 year and rolling 3 years % excess returns



	Mar-04 %	Mar-05 %	Mar-06 %	Mar-07 %	Mar-08 %	Mar-09 %	Mar-10 %	Mar-11 %	Mar-12 %
Fund	27.13	11.02	24.18	6.46	-3.36	-19.75	34.53	8.65	3.91
Benchmark	24.99	12.47	26.03	6.7	-2.76	-19.77	36.57	7.92	2.55
1yr Excess	2.14	-1.45	-1.85	-0.23	-0.6	0.02	-2.04	0.73	1.36
3yr Excess	-	-0.84	-0.44	-1.14	-0.84	-0.25	-0.71	-0.28	0.19

STATEMENT OF ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable International Financial Reporting Standards (IFRS) as stipulated in the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

The following accounting statements summarise the transactions of the Fund for the financial year 2011/12 and their year-end position as at the 31st March 2012. As allowed under International Accounting Standard (IAS) 19, the actuarial present value of promised retirement benefit has been disclosed as a note to the accounts.

Basis

The Fund's financial statements are generally prepared on an accruals basis. However, the net assets statement does not include liabilities to pay pensions and benefits after the end of the fund year. Receipts and payments in respect of the transfer of benefits from and to other schemes are treated on a cash basis.

During the year 2011/12 there has been a review of accounting policy with regards to the treatment of employers' strain on fund contributions which has led to the restatement of previous year figures. To ensure compliance with the 2011/12 Code these payments are now recognised on an accrual basis whereas in previous years they had been accounted for on a cash basis.

(i) **Valuation of Investments**

Quoted investments are valued at closing prices. These prices may be the last trade prices or bid prices depending on the convention of the stock exchange or other market on which they are quoted. Overseas investments and cash are stated in sterling using exchange rates ruling at the financial year end.

The direct property portfolio was valued at 31 March 2011 by DM Hall LLP, Chartered Surveyors in accordance with the requirements of the RICS Valuation Standards 6th edition. This valuation is completed every 3 years, with the next one due 31 March 2014.

Unquoted holdings in private equity and infrastructure funds have been included at the fund managers' valuation adjusted for cash movements since the last valuation date.

(ii) **Investment Income**

Investment income is taken into account where dividends have been declared at the end of the financial year. The amount of irrecoverable withholding tax is disclosed as a separate line on the face of the Fund Account. Interest is included in the accounts on an accruals basis.

(iii) **Investment Management Fees**

Investment management fees are recognised on an accruals basis at a fee agreed in their respective mandates. Many of these fees are based on the market value of their particular holdings in the fund which can lead to fluctuations in the fee paid. The Fund does not contain any mandates with performance related fees.

Critical Judgement in Applying Accounting Policies

In applying these accounting policies, the Fund has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the statement of accounts are:

(i) **Change in Treatment of Employers' Strain on Fund Contributions**

To ensure compliance with the 2011/12 Code, the Fund has been required to change its treatment of employers' strain on fund contributions from being recognised on a cash basis to an accrual basis. This impacts on all strain payments made by employers in instalments.

Due to the complex nature and volume of these payments, the Fund has had to make assumptions based on the best available information when restating previous year balances. Under Section 3.3.2.3 of the Code of Practice on Local Authority Accounting, it is recognised that in some cases it may be impracticable for an entity to change an accounting policy retrospectively even after making every reasonable effort to do so.

Despite this allowance the Chief Finance Officer is comfortable with the assumptions made and the reasonableness of its end results.

(ii) **Unquoted Investments**

It should be recognised that determining the fair value of private equity and infrastructure investments is highly subjective. Inherently their valuations are based on forward-looking estimates and judgements are made on a variety of factors. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS.

At 31 March 2012 the Fund had a value of £97.2m (2011 £66m) in unquoted private equity and infrastructure investments.

(iii) **Actuarial present value of promised retirement benefits**

Each Fund is required to disclose the estimated actuarial present value of promised retirement benefits as at the end of the financial year. These estimates are prepared by the Fund's Actuary. These values are calculated in line with IAS19 assumptions and comply with the requirements of IAS26. However, the results are subject to significant variances based on changes to the underlying assumptions.

Assumptions Made About the Future and Other Major Sources of Estimation Uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council, private equity and infrastructure managers, the Fund Actuary and other financial information providers about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The table below highlights the approximate impact that small changes in the assumptions used by the Fund Actuary, would have on the liability of the Fund.

Change in assumptions at year ended 31 March 2012	Approximate % increase to liabilities	Approximate monetary amount (£m)
0.5% decrease in Real Discount Rate	9%	152
1 year increase in member life expectancy	3%	51
0.5% increase in the Salary Increase Rate	3%	51
0.5% increase in the Pension Increase Rate	7%	118

PENSION FUND ACCOUNT

This statement shows the revenue account of the Pension Fund and separates those transactions which are related to dealings with members as opposed to those transactions which are a consequence of investment.

Restated 2010/11 £'000	CONTRIBUTIONS AND BENEFITS	2011/12 £'000	Note
	Contributions receivable:		
55,562	From Employers	57,934	3/4
17,197	From Employees	16,538	3
3,899	Transfers from Other Schemes	2,455	
	Benefits Payable:		
(32,107)	Pensions	(36,326)	3
(19,504)	Lump Sums	(15,727)	3
	Payments to and on account of leavers:		
(224)	Refunds of contributions	(191)	
(3,697)	Transfers Out	(2,825)	
(408)	Administrative and Other Expenses	(444)	5
20,718	**Net Additions from dealing with Members**	21,414	
	RETURNS ON INVESTMENTS		
19,769	Investment Income	21,830	6
(328)	Taxation (Irrecoverable withholding tax)	(258)	
	Change in Market Value of Investments:		
75,648	Profit and Loss on disposal	24,424	
(1,283)	Unrealised	2,162	
(3,453)	Investment Management Expenses	(3,754)	7
90,353	**Net Return on Investments**	44,404	
111,071	**Net Increase/(Decrease) in the Fund during the year**	65,818	
1,075,100	**Opening Net Assets as at 1 April 2011**	1,186,171	
1,186,171	**Closing Net Assets as at 31 March 2012**	1,251,989	

PENSION FUND NET ASSETS STATEMENT

This statement discloses the size and type of the net assets of the scheme at the end of the financial year.

Restated 31 March 2010 £'000	Restated 31 March 2011 £'000		31 March 2012 £'000	Note
		INVESTMENT ASSETS		8/9
		Listed Investments		
191,331	225,585	U.K. Equities – Quoted	219,502	
3,896	4,678	U.K. Managed Funds – Unit Trusts	4,718	
73,700	74,951	U.K. Managed Funds – Property	85,736	
186,732	339,476	Overseas Equities	278,730	
10,837	10,531	Overseas Managed Funds – Property	9,183	
		Unlisted Investments		
24,555	40,322	UK Managed Funds	51,189	
530,242	409,491	UK Managed Funds – Unitised Insurance	492,447	
21,520	25,690	Overseas Managed Funds	46,010	
2,550	2,300	UK Property	2,300	
		Cash Deposits		
6,608	26,846	Other Investment Balances	30,671	
8,351	7,823	Cash Deposits	8,836	
		Other Financial Assets		
1,838	3,037	Dividends & Other Income Due	2,931	
59	-	Derivatives – Forward Foreign Exchange	344	10
1,062,219	1,170,730	**Total Financial Assets**	1,232,597	
		Financial Liabilities		
-	(6)	Derivatives – Forward Foreign Exchange	(93)	10
1,062,219	1,170,724	**NET FINANCIAL ASSETS**	1,232,504	
		NON-CURRENT ASSETS		
1,698	742	Long Term Debtors	2,030	19
		CURRENT ASSETS		
9,103	7,299	Cash Balances	12,559	20
4,023	10,045	Debtors	6,624	21
		CURRENT LIABILITIES		
(1,943)	(2,639)	Creditors	(1,728)	22
1,075,100	1,186,171	**NET ASSETS OF THE FUND**	1,251,989	

The fund's financial statements do not take account of liabilities to pay pensions and other benefits after the period end. The actuarial present value of promised retirement benefits is disclosed in Note 18.

The unaudited accounts were issued on 29 June 2012 and the audited accounts were authorised for issue by Bryan Smail, Chief Finance Officer on 24 September 2012. The Statement of Accounts presents a true and fair view of the financial position of the Pension Fund as at 31 March 2012 and their income and expenditure for the year ended 31 March 2012.

Bryan Smail

Bryan Smail, CPFA MBA
Chief Finance Officer

NOTES TO THE ACCOUNTS

1. Fund Operations and Membership

Falkirk Council is required to maintain a pension fund under the terms of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008. It is therefore deemed an Administering Authority for pension purposes.

The pension scheme to which the Fund relates is the Local Government Pension Scheme (LGPS). The LGPS, established under the Superannuation Act 1972, is a public sector scheme which provides defined benefits on a final salary basis. The scheme is contracted out of the State Second Pension and is fully registered with HM Revenue and Customs as a UK pension scheme.

The scheme rules are made by the Scottish Ministers through the office of the Scottish Public Pensions Agency and are mainly set out in the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 and the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008.

Administration of the Fund is undertaken in-house. The investments of the Fund are overseen by a small in-house team and managed by external Fund Managers within the overall policy direction of the Council's Investment Committee.

Contributions to the Fund are made by active members and their employers. The Fund is then used to pay pension and lump sum benefits to members and their dependants. A list of employers who participate in the Fund is included in this report (p47).

2. Restatement of Previous Year Balances

The Pension Fund Accounts for 2011/12 have required a change in accounting practice in respect to the treatment of employers' strain on fund contributions to ensure compliance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

Under the Code, the Fund should account for the income due on strain payments in full in the year in which the liability on the employer occurs, thereby meeting the revenue recognition criteria set down in paragraph 2.7.2.10. This has no effect on previous treatment where the employers paid their strain on fund contributions in one off lump sums, but has significant impact on those electing to pay by instalments. Previous treatment of instalment payments was done on a cash basis meaning that strain income was only recognised when cash was received.

This accounting treatment has been revised to comply with the Code. The entire strain revenue is recognised as it occurs with a corresponding debtor set up for the remaining payments. This change in practice has had the following effect on previous years balances.

Restatement	Statements Restated £'000	Adjustments Made £'000	Restated Figures £'000
Opening 1 April 2010 Net Asset Statement			
Long Term Debtor	-	1,698	1,698
Debtors	3,991	32	4,023
Net Assets	1,073,370	1,730	1,075,100
31 March 2011 Net Asset Statement			
Long Term Debtor	-	742	742
Debtors	5,801	4,244	10,045
Net Assets	1,181,185	4,986	1,186,171
2010/11 Fund Account			
Contributions received from employers	52,306	3,256	55,562

3. Contributions Receivable and Benefits Payable

Breakdown for 2011/12

	CONTRIBUTIONS RECEIVABLE		BENEFITS PAYABLE	
	Members £'000	Employers £'000	Pensions £'000	Lump Sum* £'000
Administering Authority	5,514	19,006	12,337	6,341
Other Scheduled Bodies	9,437	33,869	22,563	8,604
Admission Bodies	1,587	5,059	1,426	782
Totals	16,538	57,934	36,326	15,727

* Includes "Death Benefits" of £1.1m

Breakdown for 2010/11

	CONTRIBUTIONS RECEIVABLE		BENEFITS PAYABLE	
	Employees £'000	Employers £'000	Pensions £'000	Lump Sum* £'000
Administering Authority	5,875	18,438	11,261	5,050
Other Scheduled Bodies	9,969	33,219	19,635	13,836
Admission Bodies	1,353	3,905	1,211	618
Totals	17,197	55,562	32,107	19,504

* Includes "Death Benefits" of £0.99m

4. Employers' Contributions

Total 2010/11 £'000		Administering Authority £'000	Other Scheduled Bodies £'000	Admission Bodies £'000	Total £'000
46,979	Normal Contributions	15,596	28,330	4,231	48,157
1,166	Deficit Contributions	1,146	2,081	550	3,777
48,145		16,742	30,411	4,781	51,934
7,417	Strain on Fund Contributions	2,264	3,458	278	6,000
-	Augmentation Contributions	-	-	-	-
55,562	TOTAL	19,006	33,869	5,059	57,934

Normal contributions in the above table are sums paid by employers to fund the cost of ongoing benefit accrual (commonly referred to as "future service costs"). Deficit contributions are the sums paid by employers in order to return the Fund to an improved funding position (commonly referred to as "past service deficit"). The table shows an estimation of the split between normal and deficit contributions based on average contributions paid by employers in 2011/12. The level of normal and deficit contributions was set as a result of the Fund Valuation at 31st March, 2008. Contributions for 2012/13 will be determined according to the Fund Valuation as at 31st March, 2011.

The table also shows the pension strain contributions made by employers in order to fund the early release of scheme benefits.

5. Administrative and Other Expenses

2010/11 £'000		2011/12 £'000
368	Administration Costs	352
9	Actuarial Fees	63
25	External Audit	23
6	Fees and Subscriptions	6
408	TOTAL	444

6. Investment Income

2010/11 £'000		2011/12 £'000
8,077	UK Equities	9,956
108	UK Managed Funds – Others	142
2,984	UK Managed Funds – Property	2,690
7,800	Overseas Equities	8,990
323	Overseas Managed Funds – Property	123
-	UK Managed Funds – Unlisted	144
78	Overseas Managed Funds – Unlisted	(483)
208	UK Property	192
191	Cash & Other Income	76
19,769	TOTAL	21,830

7. Investment Management Expenses

2010/11 £'000		2011/12 £'000
3,205	External Investment Management Services	3,459
112	Custodian	139
106	Internal Administration	96
8	Performance Monitoring	9
22	Actuarial Fees – Investment Consultancy	51
3,453	TOTAL	3,754

8. Investments

	Market Value 01/04/11 £'000	Purchases at Cost £'000	Sale Proceeds £'000	Change in Market Value £'000	Market Value 31/03/12 £'000
Investment Assets					
UK Equities	225,585	42,672	(49,175)	420	219,502
UK Managed Funds – Unit Trusts	4,678	-	-	40	4,718
UK Managed Funds – Property	74,951	18,121	(10,057)	2,721	85,736
Overseas Equities	339,476	110,049	(165,260)	(5,535)	278,730
Overseas Managed Funds – Property	10,531	-	-	(1,348)	9,183
UK Managed Funds – Unlisted	40,322	12,212	(3,408)	2,063	51,189
UK Managed Funds – Unitised Insurance	409,491	120,461	(60,308)	22,803	492,447
Overseas Managed Funds – Unlisted	25,690	20,148	(2,249)	2,421	46,010
UK Property	2,300	-	-	-	2,300
Derivatives – Forward Foreign Exchange	(6)	1,152	(1,960)	1,065	251
	1,133,018	324,815	(292,417)	24,650	1,190,066
Other Investment Balances	29,883	51,221	(46,416)	(1,086)	33,602
Cash Deposits	7,823	-	-	3,022	8,836
NET INVESTMENT ASSETS	**1,170,724**	**376,036**	**(338,833)**	**26,586**	**1,232,504**

Investment Assets	Market Value 01/04/10 £'000	Purchases at Cost £'000	Sale Proceeds £'000	Change in Market Value £'000	Market Value 31/03/11 £'000
UK Equities	191,331	34,095	(13,193)	13,352	225,585
UK Managed Funds – Unit Trusts	3,896	-	-	782	4,678
UK Managed Funds – Property	73,700	6,891	(6,858)	1,218	74,951
Overseas Equities	186,732	199,236	(131,395)	84,903	339,476
Overseas Managed Funds – Property	10,837	-	-	(306)	10,531
UK Managed Funds – Unlisted	24,555	12,436	(1,615)	4,946	40,322
UK Managed Funds – Unitised Insurance	530,242	36,691	(121,227)	(36,215)	409,491
Overseas Managed Funds – Unlisted	21,520	3,969	(913)	1,114	25,690
UK Property	2,550	-	-	(250)	2,300
Derivatives – Forward Foreign Exchange	59	832	(521)	(376)	(6)
	1,045,422	294,150	(275,722)	69,168	1,133,018
Other Investment Balances	8,446	1,946	(2,004)	21,495	29,883
Cash Deposits	8,351	-	-	(528)	7,823
NET INVESTMENT ASSETS	**1,062,219**	**296,096**	**(277,726)**	**90,135**	**1,170,724**

Transaction costs are included in the cost of purchases and sale proceeds. Transaction costs include costs charged directly to the scheme such as fees, commissions and stamp duty. Transaction costs incurred during 2011/12 amounted to £573,156. In addition to the transaction costs disclosed above, indirect costs are incurred through the bid-offer spread on investments within pooled investment vehicles. The amount of indirect costs is not separately provided to the scheme.

The Fund holds the following investments in pooled funds, which are in excess of 5% of the value of the Fund.

2010/11		Investment Manager	Pooled Funds	2011/12	
£'000	%			£'000	%
-	-	Baillie Gifford Life Ltd.	Diversified Growth	114,422	9.1
91,792	7.8	LGIM Ltd *	UK Equity Index	93,176	7.4
90,051	7.6	LGIM Ltd *	North America Equity Index	90,813	7.2
69,524	5.9	Baillie Gifford Life Ltd	Sterling Aggregate Bond	72,416	5.8

* LGIM Ltd – Legal & General Investment Management Ltd

9. Funds Under External Management

MARKET VALUE 2010/11 £ million	(%)		MARKET VALUE 2011/12 £ million	(%)
166.5	14.3	Aberdeen Asset Management	176.9	14.4
153.0	13.0	Baillie Gifford Life Ltd.	234.0	19.0
256.5	22.0	Legal and General Investment Management Ltd.	258.6	21.1
239.8	20.5	Newton Investment Management Ltd.	175.9	14.3
184.3	15.8	Schroder Investment Management Ltd.	181.1	14.7
96.4	8.2	Schroder Investment Management Ltd. (Property)	99.0	8.0
38.3	3.3	SL Capital Partners LLP	44.7	3.6
28.7	2.5	Wilshire Private Markets Group	31.9	2.6
4.9	0.4	M&G UK Companies	10.3	0.8
-	-	Credit Suisse Securities	17.8	1.5
1,168.4	100.0		1,230.2	100.0

10. Derivatives

Derivatives – Forward Foreign Exchange
Summary of Contracts held at 31 March 2012

Contract	Settlement Date	Value of Currency Bought £'000	Asset £'000	Liability £'000	Net £'000
Various Currency Forwards	Within 1 month	16,909	253	-	253
Various Currency Forwards	Within 2 months	15,043	91	-	91
Various Currency Forwards	Within 3 months	9,311	-	(93)	(93)

Derivatives – Forward Foreign Exchange
Summary of Contracts held at 31 March 2011

Contract	Settlement Date	Value of Currency Bought £'000	Asset £'000	Liability £'000	Net £'000
Various Currency Forwards	Within 1 month	595	-	(6)	(6)

Three foreign currencies are involved with all contracts traded on an over-the-counter basis. These contracts are used by Fund Managers to reduce the extent to which the Fund is exposed to currency movements.

11. Securities Lending

The Fund did not participate in any stock lending programme managed by its global custodian, Northern Trust.

12. Classification of Financial Instruments

Accounting policies describe how different asset classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised. The following table analyses the fair value amounts of financial assets and liabilities by category and net assets statement heading. No financial assets were reclassified during the accounting period.

All financial instruments are marked to market (at fair value) in the Fund's accounting records hence there is no difference between the carrying value and fair value.

31 March 2011				31 March 2012		
Designated as fair value through net asset statement £'000	**Loans and receivables £'000**	**Financial liabilities at amortised cost £'000**		**Designated as fair value through net asset statement £'000**	**Loans and receivables £'000**	**Financial liabilities at amortised cost £'000**
			Financial assets			
			Investment assets			
565,062	-	-	Equities	498,232	-	-
480,181	-	-	Pooled investments	594,364	-	-
85,481	-	-	Property	94,919	-	-
-	-	-	Derivative contracts	344	-	-
-	-	-	Margin balances	-	-	-
-	7,823	-	Cash	-	8,836	-
-	29,883	-	Other investment balances	-	33,602	-
1,130,724	37,706	-		1,187,859	42,438	-
			Other assets			
-	7,299	-	Cash Balances	-	12,559	-
-	10,787	-	Debtors	-	8,654	-
-	18,086	-		-	21,213	-
1,130,724	55,792	-	**Assets total**	1,187,859	63,651	-
			Financial liabilities			
			Investment liabilities			
(6)	-	-	Derivative contracts	(93)	-	-
			Other liabilities			
-	-	(2,639)	Creditors	-	-	(1,728)
(6)	-	(2,639)	**Liabilities total**	(93)	-	(1,728)
1,130,718	55,792	(2,639)		1,187,766	63,651	(1,728)

2011		2012
1,183,871	**Total net financial instruments**	1,249,689
2,300	Amounts not classified as financial instruments	2,300
1,186,171	**Total net assets**	1,251,989

13. Net Gains and Losses on Financial Instruments

	2011 £'000	2012 £'000
Designated as fair value through net asset statement	69,418	24,650
Loans and receivables	20,967	1,936
Financial liabilities at amortised cost	-	-
Net gains and losses on financial instruments	90,385	26,586
Gains and losses on directly held freehold property	(250)	-
Change in market value of investments per fund account	90,135	26,586

14. Valuation of Financial Instruments Carried at Fair Value

The valuation of financial instruments has been classified into three levels, according to the quality and reliability of information used to determine fair values.

Level 1
Financial instruments at Level 1 are those where the fair values are derived from unadjusted quoted prices in active markets for identical assets or liabilities. Products classified as level 1 comprise quoted equities and unit trusts. Listed investments are shown at bid prices. The bid value of the investment is based on the bid market quotation of the relevant stock exchange.

Level 2
Financial instruments at Level 2 are those where quoted market prices are not available; for example, where an instrument is traded in a market that is not considered to be active, or where valuation techniques are used to determine fair value and where these techniques use inputs that are based significantly on observable market data.

Level 3
Financial instruments at Level 3 are those where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data. Such instruments would include unquoted equity investments, which are valued using various valuation techniques that require significant judgement in determining appropriate assumptions.

The values of the investments in private equity are based on valuations provided by the general partners to the private equity funds in which the Fund has invested. These valuations are prepared in accordance with the International Private Equity and Venture Capital Valuation Guidelines or similar guidelines provided by the British Venture Capital Association, which follow the valuation principles of IFRS. Valuations are usually undertaken annually at the end of December. Cash flow adjustments are used to roll forward the valuations to 31 March as appropriate.

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

	Quoted market price Level 1 £'000	Using observable inputs Level 2 £'000	With significant unobservble inputs Level 3 £'000	Total at 31 March 2012 £'000
Financial Assets				
Designated as fair value through net asset statement	876,198	214,462	97,199	1,187,859
Loans and receivables	63,651	-	-	63,651
Total Financial Assets	939,849	214,462	97,199	1,251,510
Financial Liabilities				
Designated as fair value through net asset statement	(93)	-	-	(93)
Financial liabilities at amortised cost	(1,728)	-	-	(1,728)
Total Financial Liabilities	(1,821)	-	-	(1,821)
Net Financial Assets	938,028	214,462	97,199	1,249,689

	Quoted market price Level 1 £'000	Using observable inputs Level 2 £'000	With significant unobservble inputs Level 3 £'000	Total at 31 March 2011 £'000
Financial Assets				
Designated as fair value through net asset statement	824,637	239,775	66,312	1,130,724
Loans and receivables	55,792	-	-	55,792
Total Financial Assets	880,429	239,775	66,312	1,186,516
Financial Liabilities				
Designated as fair value through net asset statement	(6)	-	-	(6)
Financial liabilities at amortised cost	(2,639)	-	-	(2,639)
Total Financial Liabilities	(2,645)	-	-	(2,645)
Net Financial Assets	877,784	239,775	66,312	1,183,871

15. Nature and Extent of Risks Arising from Financial Instruments

Risk and Risk Management

The Fund's primary long-term risk is that the Fund's assets will fall short of its liabilities (i.e. promised benefits payable to members). Therefore the aim of investment risk management is to minimise the risk of an overall reduction in the value of the fund and to maximise the opportunity for gains across the whole fund portfolio. The Fund achieves this through asset diversification to reduce market risk (as quantified below) and credit risk to an acceptable level. In addition the Fund manages its liquidity risk to ensure there is sufficient liquidity to meet the Fund's forecast cashflows. Responsibility for the fund's risk management strategy rests with the Pensions Committee. Risk management policies are reviewed on a consistent basis to reflect changes in activity and in market condition.

Types of Investment Risk

Fluctuations in overall price can arise from a variety of sources including market risk, foreign exchange risk, interest rate risk and credit risk. Each of these vary in importance and will not by themselves account for the overall pricing risk faced. To some extent they may offset each other. The Fund's analysis combines these factors when looking at the total market price risk.

(i) **Market Risk**

Market risk is the risk of loss from fluctuations in equity and other asset prices, interest and foreign exchange rates and credit spreads. The Fund is exposed to market risk from its investment activities, particularly through its equity holdings. The level of risk exposure depends on market conditions, expectations of future price and yield movements and the asset mix.

The objective of the Fund's risk management strategy is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on risk.

In general, excessive volatility in market risk is managed through the diversification of the portfolio in terms of geographical and industry sectors and individual securities. To mitigate market risk, the Council and its investment advisors undertake appropriate monitoring of market conditions and benchmark analysis.

The Fund manages these risks in two ways:

- The exposure of the Fund to market risk is monitored by maintaining asset class exposures such that risk remains within tolerable levels.
- Specific risk exposure is limited by applying maximum exposures to individual investments.

(ii) **Interest Rate Risk**

The Fund invests in financial assets for the primary purpose of obtaining a return on investments. These investments are subject to interest rate risks, which represent the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Fund's interest rate risk is recognised by the Council and its investment advisors. The Fund monitors the interest rate risk faced and will adjust its strategy in accordance with its Statement of Investment Principles. The fund's direct exposure to interest rate movement as at the 31 March 2012 is estimated to be around £260m.

(iii) **Currency Risk**

Currency risk represents the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the Fund (£UK). The Fund holds both monetary and non-monetary assets denominated in currencies other than £UK.

The Fund's currency rate risk is recognised by the Council and its investment advisors. For the internally managed private equity and infrastructure funds it is the Fund's policy to convert all non GBP cash deposits to Sterling at the end of the month to reduce the currency risk faced. It is left to the external managers discretion if they wish to hedge their currency position within their respective mandate. The fund's currency exposure as at the 31 March 2012 is estimated to be around £511m.

(iv) **Credit Risk**

Credit risk represents the risk that the counterparty to a transaction or a financial instrument will fail to discharge an obligation and cause the Fund to incur a financial loss. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the Fund's assets and liabilities (as outlined in Market Risk above).

In essence, the Fund's entire investment portfolio is exposed to some sort of credit risk. However the selection of high quality counterparties, brokers and financial institutions minimises credit risk that may occur through the failure to settle a transaction in a timely manner. The Fund has had no experience of default or uncollected deposits over the past five financial years.

Cash deposits are the major area of credit exposure where risk is not reflected in market price. At 31 March 2012 cash was 3.4% of total assets.

	Moody's Credit Rating	Balances at 31 March 2011 £'000	Balances at 31 March 2012 £'000
Held for Investment Purposes			
Northern Trust Global Investment Limited – Liquidity Funds	Aaa	8,014	9,761
Northern Trust Company – Cash Deposits	Aa3	26,293	23,072
Total Investment Cash		34,307	32,833
Held for Other Purposes			
Clydesdale Bank	A2	-	10,284
Total Cash		34,307	43,117

All of the Fund's cash deposits fall within the Council's minimum requirements of credit rating detailed in the Treasury Management Strategy. The credit rating used in this report is Moody's Long Term Outlook.

(v) **Liquidity Risk**

Liquidity risk reflects the risk that the Fund will not be able to meet its financial obligations as they fall due. The Council therefore ensures that the Pension Fund has adequate cash and liquid resources to meet its commitments. The Fund currently does not have access to an overdraft facility for short term cash needs. As part of the ongoing monitoring of the Fund's banking arrangements this position may be reviewed and amended accordingly.

A majority of the Fund's investment assets (estimated to be over 85%) could be converted into cash within three months in normal market conditions.

(vi) **Refinancing Risk**

Refinancing risk is the risk that the Council will be bound to replenish a significant proportion of its Pension Fund financial instruments at a time of unfavourable interest rates. The Council is not bound by any obligation to replenish its investments. As such, the Council does not have any financial instruments that have a refinancing risk as part of its Pension Fund management and investment strategies.

Sensitivity Analysis

By analysing past movement of asset prices it is possible to gain an indication of the likely volatility of an asset class. As market risk does not remain constant it is important that any analysis is completed over a sufficient long term period. In consultation with Goldman Sachs and Lothian Pension Fund it was determined that 10 years of data would be a suitable indicator of likely movements for the Fund.

This risk analysis incorporates volatility from market, interest rate, foreign exchange, credit, and all other sources of risk, and, more importantly, makes allowance for how these risks may offset each other.

The Goldman Sachs analysis predicts that the following annual movements in price are possible

Asset Type	Potential price movement (+ or -)
World Listed Equity	17.2%
Emerging Market Equity	30.5%
UK Gilts	4.6%
Emerging Market Debt	10.8%
UK Property	13.6%
Private Equity	32.9%
Hedge Fund	9.9%
Commodities	22.4%
Credit	7.2%
Infrastructure	16.1%

These price movements use standard deviation to determine what shifts are reasonably possible during the year. In short, for every two out of three years the movement would be expected to be lower while the remaining years percentage would be expected to be higher.

Had the market price of the fund investments increased/decreased in line with the standard deviation for each asset class above, the net assets available to pay benefits would have been as follows:

Asset Type	Value at 31 March 2012 £'000	% of fund %	% change +/- %	Value on increase £'000	Value on decrease £'000
World Listed Equity	714,041	57.9	17.2	836,857	591,226
Emerging Market Equity	61,619	5.0	30.5	80,413	42,825
UK Gilts	137,534	11.2	4.6	143,860	131,207
Emerging Market Debt	12,694	1.0	10.8	14,064	11,323
Property	100,686	8.2	13.6	114,379	86,992
Private Equity	104,629	8.5	32.9	139,052	70,206
Hedge Fund	21,074	1.7	9.9	23,160	18,987
Commodities	3,697	0.3	22.4	4,525	2,869
Corporate Credit	66,548	5.4	7.2	71,339	61,757
Infrastructure	9,982	0.8	16.1	11,589	8,375
Total [1]	**1,232,504**	**100.0**	**16.8**	**1,439,238**	**1,025,767**
Total [2]			**14.5**	**1,411,710**	**1,053,298**

It is important that we recognise the extent to which asset classes can move in correlation. 100% asset class correlation will move entirely in lock-step, while with 0% correlation they move independently. With negative correlation, they move in opposite directions. To the extent that correlation is less than 100%, the fund will benefit from diversification across asset classes and have a lower total volatility. Total [1] above does not take into account of how assets are correlated. The effect of correlation is shown in Total [2] and demonstrates the benefit of diversification reducing the volatility faced by 2.3%.

It should be noted that the above asset allocation for the fund differs to that stated earlier in the financial statements. This is the result of Goldman Sachs, in order to improve the accuracy of the risk assessment, breaking down the holdings of each Fund Manager and allocated investments to the asset type appropriate for the risk faced. Whilst the Fund has reported the asset allocation strictly by each Manager's mandate, Goldman Sachs have analysed the constituent elements of each mandate.

16. Actuarial Valuation as at 31 March 2011

The most recent actuarial valuation, carried out under Regulation 32 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, was undertaken as at 31 March 2011. This disclosed that the Fund's assets were sufficient to meet 86% of its liabilities.

In determining the employer contribution rates, the actuary took into account the funding policy as set out in the Funding Strategy Statement. The policy of the Administering Authority is to pursue a funding level of 100% and to generally allow employers (notably the scheduled bodies) to recover from their deficit position over a period of 20 years.

Full details of the methods and assumptions used in the 2011 valuation are set out in the actuary's valuation report dated 30 March 2012.

Copies of the Valuation report and the Funding Strategy Statement can be found at www.falkirk.gov.uk/pensions.

17. Actuarial Statement as at 31 March 2012

The Actuary has provided a statement describing the funding arrangements of the Fund during 2011/12. This can be found in a separate section later in this report (p45).

18. Actuarial Present Value of Promised Retirement Benefits

The actuarial value of promised retirement benefits at the accounting date, based on a roll forward of the 31 March 2011 valuation and assumptions consistent with IAS19 (International Accounting Standard), has been estimated by the Fund Actuary as £1,684m (£1,490m at 31 March 2011). This figure is used by the Pension Fund for statutory accounting purposes and complies with the requirements of IAS26. The assumptions underlying the figure match those adopted for the Administering Authority's FRS17/IAS19 reports at each year end. The figure is only prepared for the purposes of IAS26 and has no validity in other circumstances. In particular, it is not relevant for calculations undertaken for funding purposes and setting contributions payable to the Fund.

The key assumptions relied upon by the actuary in deriving the actuarial present value of promised retirement benefits are as follows:

Financial Assumptions	**31 March 2011 % p.a.**	**31 March 2012 %p.a.**
Inflation/pensions increase rate	2.8	2.5
Salary increase rate	5.1 **	4.8 *
Discount rate	5.5	4.8

* Salary increases are 1% p.a. nominal for 3 years to 31 March 2015 reverting to long term rate thereafter.

** Salary increases are 1% p.a. nominal for the period to 31 March 2013 reverting to the long term rate thereafter.

Longevity Assumptions
The life expectancy assumption is based on Fund specific statistical analysis with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies, in years, at age 65 are summarised below:

	31 March 2011 % p.a.	31 March 2012 %p.a.
Current pensioners	23.0	25.8
Future pensioners (assumed to be currently 45)	24.9	27.7

Commutation Assumptions
An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

19. Long Term Debtors

	31 March 2011 £'000	31 March 2012 £'000
Strain on Fund Contributions (Due in over 1 year)	742	2,030

Analysis of Long Term Debtors	31 March 2011 £'000	31 March 2012 £'000
Central government bodies	-	-
Other local authorities	684	1,992
NHS bodies	-	-
Public corporations and trading funds	-	-
Other entities and individuals	58	38
	742	2,030

20. Cash Balances

	31 March 2011 £'000	31 March 2012 £'000
Bank Account	-	10,284
Balance held by Falkirk Council	7,299	2,275
	7,299	12,559

As stipulated by The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 (SSI 2010 No. 233), all Local Authority Pension Funds are required to operate their own bank account from the 1 April 2011. From the 1 April 2011 all payments made to the Fund are paid directly into the Fund's separate bank account. Previously the Fund maintained a cash balance through the Council's loans fund.

Due to the Fund using Falkirk Council's financial management system, there was a working balance at year end which has been subsequently reversed in 2012/13.

21. Debtors

	31 March 2011 £'000	31 March 2012 £'000
Contributions due – employers	2,839	4,053
Contributions due – members	1,032	1,371
Strain on Fund Contribution (Due within 1 year)	4,244	789
Benefits Paid in Advance	1,012	198
Sundry Debtors	918	213
	10,045	6,624

Analysis of Debtors	31 March 2011 £'000	31 March 2012 £'000
Central government bodies	904	990
Other local authorities	7,692	4,852
NHS bodies	-	-
Public corporations and trading funds	-	-
Other entities and individuals	1,449	782
	10,045	6,624

22. Creditors

	31 March 2011 £'000	31 March 2012 £'000
Benefits Payable	(205)	(360)
Miscellaneous Creditors and Accrued Expenses	(2,434)	(1,368)
	(2,639)	(1,728)

Analysis of Creditors	31 March 2011 £'000	31 March 2012 £'000
Central government bodies	(102)	(177)
Other local authorities	(80)	(192)
NHS bodies	-	-
Public corporations and trading funds	(869)	(935)
Other entities and individuals	(1,588)	(424)
	(2,639)	(1,728)

23. Additional Voluntary Contributions

The Fund is required to offer an Additional Voluntary Contributions (AVC) facility to its Scheme Members. The arrangement operates on a money purchase basis with members' contributions being invested by Standard Life who are the Council's chosen AVC provider.

The AVC contributions are sent directly to Standard Life by employers and as a result, they do not form part of the contribution income of the Fund.

The net asset value of the AVC policy at 5 April 2012 was £2.41 million (£2.60 million at 5 April 2011). Contributions made by members during the year to 5 April 2012 were £0.22 million. Expenditure from the policy during the same period (including the purchase of member annuities) amounted to £0.50 million. These amounts are not included in the Pension Fund Accounts in accordance with regulation 4 of the Local Government Pension Scheme (Management and Investment of Funds)(Scotland) Regulations 2010 (SSI 2010 No. 233).

24. Related Party Transactions

Falkirk Council Pension Fund is administered by Falkirk Council. Consequently there is a strong relationship between the Council and the Pension Fund.

The Council incurred costs of £472k (2010/11: £519k) in relation to the administration of the Fund and was subsequently reimbursed by the Fund for these expenses. The Council is also the single largest employer of members of the Pension Fund and contributed £16.7m to the fund in 2011/12 (2010/11: £17.4m). All monies owing to and due from the fund were paid in year.

Transactions between the Council and the Fund are monitored by the Creditors section within Corporate Finance with the aim of any balances being settled as soon as reasonably practicable.

25. Contractual Commitments

As at 31 March 2012, the Fund had contractual commitments of £198m within its private equity and credit markets portfolio of which £93m remained outstanding at 31 March 2012.

26. Contingent Assets/Liabilities

The Fund has no material contingent assets or liabilities at the period end and there were no material non-adjusting events occurring subsequent to the period end.

27. Events After the Net Asset Statement Date

Since 31 March 2012, there has been a decline in the global stock markets which would impact the market value of the fund's investments were they to be valued as at the date these accounts were authorised. This change is deemed to be a non-adjusting post balance sheet event.

The unaudited Statement of Accounts were issued by the Chief Finance Officer on 29 June 2012 and the audited Statement of Accounts were authorised for issue on 24 September 2012. Events taking place after this date are not reflected in the financial statements or notes. There have been no material events since the date of the Net Asset Statement which have required the figures in the financial statements and notes to be adjusted.

ACTUARIAL STATEMENT FOR 2011/12

This statement has been prepared in accordance with Regulation 31A(1)(d) of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008, and Chapter 6 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the UK 2011/12.

Description of Funding Policy

The funding policy is set out in the Falkirk Council Funding Strategy Statement ("FSS"), dated December 2011. In summary, the key funding principles are as follows:

- To ensure the long term solvency of the Fund;
- To ensure that sufficient funds are available to meet all benefits as they fall due for payment;
- To enable employer contribution rates to be kept as nearly constant as possible and at a reasonable cost to the participating employers and to the taxpayers;
- To manage employers' liabilities effectively;
- To use reasonable measures to reduce the risk to scheme employers, and ultimately the taxpayers, from an employer defaulting on its pension obligations;
- To maximise the income from investments within reasonable risk parameters; and
- To address the different characteristics of the various employers to the extent that this is practical and cost effective.

The FSS sets out how the Administering Authority seeks to balance the conflicting aims of securing the solvency of the Fund and keeping employer contributions stable. The funding objective is to pursue a funding level of 100% (i.e. fund assets are 100% of the liabilities). Where an employer is in a deficit position, the funding strategy is generally to allow the deficit to be recovered over a period of 20 years. However, for employers whose covenant was considered by the Administering Authority to be sufficiently strong, contributions have been stabilised below the theoretical rate required to return their portion of the Fund to full funding over 20 years if the valuation assumptions are borne out. Asset-liability modelling has been carried out which demonstrate that if these contribution rates are paid and future contribution changes are constrained as set out in the FSS, there is still a better than 50% chance that the Fund will return to full funding over 20 years.

Funding Position as at the last formal funding valuation

The most recent actuarial valuation carried out under Regulation 32 of the Local Government Pension Scheme (Scotland) (Administration) Regulations 2008 was as at 31 March 2011. This valuation revealed that the Fund's assets, which at 31 March 2011 were valued at £1,199 million, were sufficient to meet 86% of the liabilities (i.e. the present value of promised retirement benefits) accrued up to that date. The resulting deficit at the 2011 valuation was £194 million.

Individual employers' contributions for the period 1 April 2012 to 31 March 2015 were set in accordance with the Fund's funding policy as set out in its FSS.

Principal Actuarial Assumptions and Method used to value the liabilities

Full details of the methods and assumptions used are described in my valuation report dated 30 March 2012.

(i) **Method**

The liabilities were assessed using an accrued benefits method which takes into account pensionable membership up to the valuation date, and makes an allowance for expected future salary growth to retirement or expected earlier date of leaving pensionable membership.

(ii) **Assumptions**

A market-related approach was taken to valuing the liabilities, for consistency with the valuation of the Fund assets at their market value.

The key financial assumptions adopted for the 2011 valuation were as follows:

Financial assumptions	31 March 2011	
	% p.a. Nominal	% p.a. Real
Discount rate	5.9%	3.1%
Pay increases *	5.1%	2.3%
Price inflation/Pension increases	2.8%	-

* plus an allowance for promotional pay increases. Short term pay growth was assumed to be 1% p.a. for 2011/12 and 2012/13, reverting to 5.1% p.a. thereafter.

The key demographic assumption was the allowance made for longevity. As described in the 2011 valuation report, life expectancy is based on the SAPS year of birth tables with improvements from 2008 in line with the Medium Cohort and a 1% p.a. underpin. Based on these assumptions, the average future life expectancies at age 65 are as follows (future pensioners are assumed to be aged 45 at 31 March 2011):

	Males	Females
Current Pensioners	23.0 years	25.8 years
Future Pensioners	24.9 years	27.7 years

Copies of the 2011 valuation report and Funding Strategy Statement are available on request from Falkirk Council, administering authority to the Fund.

Experience over the period since April 2011

The Administering Authority monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update was produced as at 31 January 2012. It showed that the funding level (excluding the effect of any membership movements) has worsened since the 2011 valuation due to falling real bond yields and lower asset returns than expected.

The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Catherine McFadyen
Fellow of the Institute and Faculty of Actuaries
For and on behalf of Hymans Robertson LLP
27 September 2012

SCHEDULED AND ADMISSION BODIES AS AT 31 MARCH 2012

Scheduled Bodies

Central Scotland Joint Fire and Rescue Service
Central Scotland Joint Valuation Board
Central Scotland Joint Police Board
Clackmannanshire Council
Falkirk Council
Forth Valley College
Scottish Children's Reporter Administration (SCRA)
Scottish Environment Protection Agency (SEPA)
Scottish Police Services Authority (Ex-Central Scotland Police)
Stirling Council
Visit Scotland (Ex-Argyll, The Isles, Stirling, Loch Lomond and Trossachs Tourist Board)

Admission Bodies

Active Stirling
Alsorts
Amey (Clackmannanshire Schools Project)
Association of Scottish Colleges
Ballikinrain School
Central Scotland Council for Racial Equality
Central Carers Association
Ceteris
Community Training and Development Unit
Cowane's Hospital
Dollar Academy Trust
Falkirk Community Trust Ltd
Forth and Oban Ltd (Falkirk Schools Project)
Forth and Oban Ltd (Stirling Schools Project)
Forth Valley GIS Ltd
McLaren Community Leisure Centre
Open Secret
Playplus
Raploch URC
Scottish Autism
Seamab School
Smith Art Gallery
Snowdon School Ltd
Stirling District Tourism Ltd
Stirling Enterprise Park Limited
Stirling University
Strathcarron Hospice
Valad Management (UK) Ltd
Water Industry Commission for Scotland
Waterwatch Scotland

Independent auditor's report to the members of Falkirk Council as administering body for Falkirk Council Pension Fund and the Accounts Commission for Scotland

I certify that I have audited the financial statements of Falkirk Council Pension Fund for the year ended 31 March 2012 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the fund account, the net assets statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the 2011/12 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Responsible Financial Officer and auditor

As explained more fully in the Statement of Responsibilities, the Chief Finance Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves 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. This includes an assessment of: whether the accounting policies are appropriate to the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the statement of accounts to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on financial statements

In my opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2011/12 Code of the state of the affairs of the group and of the body as at 31 March 2012 and of the income and expenditure of the group and the body for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2011/12 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In my opinion the information given in the Explanatory Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which I am required to report by exception

I am required to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit; or
- the Governance Compliance Statement does not comply with guidance from the Scottish Ministers.

I have nothing to report in respect of these matters.

Fiona Mitchell-Knight

Fiona Mitchell-Knight FCA
Assistant Director (Audit Services)
Audit Scotland
7th Floor
Plaza Tower
EAST KILBRIDE
G74 1LW

24 September 2012

ADDITIONAL INFORMATION

Key Documents Online

You can find further information on what we do and how we do it, on our website www.falkirk.gov.uk/pensions. The following documents are on the website:

- Actuarial Valuation Reports
- Funding Strategy Statement
- Annual Report and Accounts
- Governance Policy Statement
- Statement of Investment Principles

Fund Key Contracts

Actuaries:	Hymans Robertson LLP
Bankers:	Clydesdale Bank
Investment Custodians:	The Northern Trust Company
Investment Managers:	Details can be found in the notes to the accounts
Additional Voluntary Contributions (AVC) Managers:	Standard Life
Solicitors:	Falkirk Council - Legal Services

Contact Details

If you would like further information about Falkirk Council Pension Fund, please contact us.

Address:	Falkirk Council Pension Fund
Telephone:	01324 506316
Fax	01324 506334
E-Mail	pensions@falkirk.gov.uk or investments@falkirk.gov.uk
Web	www.falkirk.gov.uk/pensions

Independent Auditor

The Auditor appointed for this purpose by the Accounts Commission for Scotland is:

Audit Scotland
7th Floor
Plaza Tower
East Kilbride
G74 1LW

Falkirk Council Pension Fund

Annual report on the 2011/12 audit

AUDIT SCOTLAND

Prepared for Members of Falkirk Council as administering body for Falkirk Council Pension fund and the Controller of Audit

October 2012

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

Contents

Key messages

2011/12 audit findings

During 2011/12 we looked at the key strategic and financial risks faced by Falkirk Council Pension Fund. We audited the financial statements and looked at aspects of governance, use of resources and performance. This report sets out our main findings, summarising key outcomes from the 2011/12 audit and the outlook for the period ahead.

We have given an unqualified opinion that the financial statements of Falkirk Council Pension fund for 2011/12 give a true and fair view of the state of affairs of the fund as at 31 March 2012 and of the income and expenditure for the year then ended.

The overall position at 31 March 2012 is that the fund has net assets of £1,252 million. The actuarial value of promised retirement benefits at the accounting date has been estimated by the actuary as £1,684 million, giving a net liability of £432 million as at 31 March 2012 (£309 million as at 31 March 2012.).

The most recent triennial valuation was reported in January 2012 and set employer contributions for 1 March 2012 to 31 March 2015. The report highlighted that the fund's assets valued at 31 March 2011 (£1,199 million) were sufficient to meet 86% of its liabilities accrued up to that date, resulting in a funding shortfall of £194 million. This represents an improved position from the previous triennial valuation that reported a funding position of 79% (a funding shortfall of £255 million).

Revised governance structures were approved on 14 March 2012 which have resulted in all pension fund business now being conducted through a Pensions Committee, supported by an advisory Pensions Panel. The new governance arrangements will be considered during the planning stages of the 2012/13 audit.

The transition to the new allocation of investment assets was successfully implemented by 31 March 2012 and a revised Statement of Investment Principles was presented to the Pensions Committee on 13 September 2012 reflecting the new allocations.

Outlook

These are challenging times for pension fund management.

With the global economic outlook and increased levels of volatility on the financial markets there are particular problems for investment management and strategy. With investment performance key to the funding position of the LGPS this may impact on employer contributions in the medium term.

It is against this backdrop, and at a time of continued austerity in the public sector, that the new Public Service Pensions Bill has been published. The bill signals more changes ahead for the LGPS, with some changes aimed at reducing costs, and others at setting a common legislative framework and improving governance arrangements.

Proposed changes to the LGPS will impact on administrative workloads going forward as will any further severance activity by employers. Additionally auto enrolment begins for some employers in 2012/13 and this will also affect information requirements and administration arrangements.

The co-operation and assistance given to us by officers is gratefully acknowledged.

Introduction

1. This report is the summary of our findings arising from the 2011/12 audit of Falkirk Council Pension Fund. The nature and scope of the audit were outlined in the Audit Plan presented to the Investment Committee on 1 March 2012, and follow the requirements of the Code of Audit Practice prepared by Audit Scotland in May 2011. The purpose of the annual audit report is to summarise the auditor's opinions (i.e. on the financial statements) and conclusions, and to report any significant issues arising. The report is divided into sections which reflect our public sector audit model.

2. Appendix A provides details of our reports issued during 2011/12. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of the administering authority's arrangements for the management of the fund.

3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that the fund understands its risks and has arrangements in place to manage these risks. The fund should ensure that those charged with governance are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is addressed to those charged with governance and the Controller of Audit, and should form a key part of discussions with the pension committee, either prior to, or as soon as possible after, the formal completion of the audit of the financial statements. Reports should be available to the Scottish Parliament, other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.

5. This report will be published on our website after consideration by the fund. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

6. The management of the fund is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. The auditor is responsible for auditing and expressing an opinion on the financial statements. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

8. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland and give an opinion on:
   - whether they give a true and fair view of the financial transactions of the fund during the year ended 31 March 2012 and of the amount and disposition at that date of its assets and liabilities
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements

9. Auditors review and report on, as appropriate, other information published with the financial statements, including the foreword by the Chief Finance Officer and the governance compliance statement. This section summarises the results of our audit on the financial statements.

Audit opinion

10. We have given an unqualified opinion that the financial statements of Falkirk Council Pension Fund for 2011/12 give a true and fair view of the state of the affairs of the fund as at 31 March 2012 and of the income and expenditure for the year then ended.

Legality

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

Governance Compliance Statement

12. During 2011/12 internal audit reviewed and validated the information set out in the governance compliance statement to confirm whether the reported status was accurate and appropriate. Internal audit provided substantial assurance, concluding that the statement has been prepared in line with the relevant Scottish Public Pensions Agency guidance. However, some recommendations were made in relation to the documentation of pension fund risks and the inclusion of details relating to the roles and responsibilities of stakeholders. These areas for improvement will be kept under review as part of our 2012/13 audit.

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

Annual Report

14. The Scottish Government Guidance requires that the annual report for the pension fund incorporates the following:

- the annual accounts
- a report about the management and financial performance of the funds during the year, a report explaining the authority's investment policy and reviewing the performance during the year of the investments of each fund, and a report of the arrangements made during the year for the administration of the funds
- a statement by the actuary of the level of funding disclosed by their valuation
- the governance compliance statement, funding strategy statement, and statement of investment principles (or details of where these statements may be obtained)
- the extent to which levels of performance set out in the pension administration strategy have been achieved
- any other material which the authority considers appropriate.

15. We are satisfied that the report incorporates the above sections and that the other sections are consistent with the audited accounts.

Accounting issues

16. Local authority bodies in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the Code). Further guidance was issued for 2011/12, requiring more detailed disclosure in the accounts. We are satisfied that the financial statements have been prepared in accordance with the 2011/12 Code.

Accounts submission

17. The fund's unaudited financial statements and annual report were submitted to the controller of audit by the deadline of 30 June 2012. All necessary working papers were also available by this date. This enabled us to conclude the audit and certify the financial statements by 30 September 2012. This was a faster closing than 2010/11 when transitional arrangements were in place in recognition of it being the first year of separate pension accounts. The annual report, incorporating the financial statements, is now available for presentation to members and for publication.

Presentational and monetary adjustments to the unaudited accounts

18. As reported to members of the Pensions Committee in line with International Standard on Auditing 260 *'communication to those charged with governance'*, there were a number of adjustments identified and corrected during the audit to ensure that the disclosures in the financial statements comply with guidance. The net effect of these adjustments was a decrease in the net assets of the fund of £3.396 million in 2011/12.

Contributions receivable

19. Monthly totals for employee and employer contributions are recorded in the pensions system and processed to the financial ledger on a monthly basis. Reasonableness checks are carried out on contributions at the time of receipt. However, the detailed checking of contributions is not carried out until the year end when detailed data returns have been received from employers. Officers are currently in the process of uploading the year end returns to the pension system which will update each individual record with the relevant amounts. There is a risk, however, that if changes to membership contributions (e.g. starters, leavers and changes) are not timeously notified by employers, individual contributions may not be correctly recorded.

Refer Action Plan no 1

20. A high level year end check was undertaken comparing the monthly amounts recorded in the pensions system against the amounts recorded in the financial ledger. Assurance is therefore taken from the monthly checks performed on the remittance advices, and the high level analysis done at year end.

Prior year adjustments

21. During the year there was a change of accounting policy with regards to the treatment of employers' strain on fund contributions. To ensure compliance with the Code these payments are now recognised on an accrual basis whereas previously they were accounted for on a cash basis.

22. As a result, the entire strain revenue is recognised as it occurs with a corresponding debtor set up for the remaining payments. This change in accounting policy has led to the restatement of previous year figures within the financial statements.

Financial position

23. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

24. Auditors consider whether audited bodies have established adequate arrangements and examine:

- financial performance in the period under audit
- compliance with any statutory financial requirements and financial targets
- ability to meet known or contingent, statutory and other financial obligations
- responses to developments which may have an impact on the financial position
- financial plans for future periods.

25. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

Budgetary control

26. The pension fund does not set a budget for its activities or report on progress throughout the year. This is mainly due to the fact that, for most of its activities it does not have control over the value of the transactions at any one time.

27. The fund accepted last year that it would be beneficial for a budget to be set for the specific areas where it does exercise some control (administration costs, investment manager expenses and other overheads). However, there has been some slippage on implementing this recommendation, primarily due to the timescales in appointing a pension fund accountant. The fund intend on taking this forward in the coming months.

Refer Action Plan no 2

Financial position

28. The overall position at 31 March 2012 is that the fund has net assets of £1,252 million. The financial statements do not take account of the obligations to pay pensions and other benefits which fall due after the end of the year. The actuarial position of the scheme, which does take account of such obligations, is disclosed in the Notes to the Accounts.

29. The actuarial value of promised retirement benefits at the accounting date has been estimated by the Fund Actuary as £1,684 million (2010/11 £1,490 million), giving a net liability of £432 million as at 31 March 2012 (£309 million as at 31 March 2011.). The liability is an estimate of the present value of the future liabilities of the fund, based on the fund actuary's assumptions regarding the future discount rate, longevity of members and rate of inflation. This figure is

used by the pension fund for statutory accounting purposes and is not relevant for calculations undertaken for funding purposes and setting contributions payable to the fund.

Funding position

30. The most recent triennial valuation (as at 31 March 2011) was published in January 2012 and reported a funding level of 86% (a funding shortfall of £194 million) and calculated that a theoretical employer contribution rate of 20.5% would be required to extinguish the shortfall over a 20 year period. This compares to a 79% funding level (a funding shortfall of £255 million) and a 23.8% theoretical employer contribution rate from the previous valuation.

31. Falkirk Council, as the administering authority, monitors the funding position on a regular basis as part of its risk management programme. The most recent funding update, as at 31 January 2012 showed that the funding level (excluding the effect of any membership movements) has worsened since the 2011 valuation due to falling real bond yields and lower asset returns. The next actuarial valuation will be carried out as at 31 March 2014. The Funding Strategy Statement will also be reviewed at that time.

Outlook

32. Looking ahead it is clear that the outlook for public spending remains very challenging as significant budget reductions are required in future years. Spending constraints are set to continue and pressures on the fund will increase as scheduled and admitted bodies seek to deliver efficiencies through reductions in staffing levels.

33. An analysis of fund membership shows that there is an emerging trend of a reduced number of active members and increasing numbers of pensioners and deferred members. If this continues it will have an adverse impact on the pension fund in terms of cash flows, employers' contribution rates and, potentially, the investment strategy. The impact of reduced membership levels will need to be kept under review if the fund is to remain sustainable into the future.

Refer Action Plan no 3

Governance and accountability

34. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.

35. Through its chief executive or accountable/proper officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

36. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption

37. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

38. Falkirk Council Pension Fund's governance arrangements run alongside the governance arrangements of the administering authority, Falkirk Council. Until recently the Investment Committee was the delegated body for dealing with pension fund issues including, reviewing investment and fund manager performance, reviewing the investment strategy, appointing investment managers and receiving funding updates. However, following the publication of statutory guidance in relation to the governance of local authority pension funds, the fund undertook a wide ranging consultation with stakeholders to determine the nature of a revised governance structure.

39. The revised structure was approved by Falkirk Council on 14 March 2012 which has resulted in all pension fund business now being conducted by a Pensions Committee, with the support of an advisory Pensions Panel.

40. The new Pensions Panel had its first meeting on 30 August 2012 where the chair and other members representing trade unions, employers and pensioners were appointed. Three members were also appointed as co-opted members to the Pensions Committee. The first meeting of the new Pensions Committee took place on 13 September 2012.

41. A training policy was approved by the Investment Committee on 1 March 2012. The policy has been introduced to help identify the level of knowledge and skills required by members and outline the training arrangements for committee and panel members. On joining the committee or panel, members must undergo a training programme to understand the details of roles and responsibilities to allow them to participate in decision making and the scrutiny of complex pension issues. This introductory event was held on 16 August 2012.

42. Committee members will now be expected to attend three training sessions per year, including internal training events, seminars, conferences or complete online training. Panel members will be expected to attend two of these sessions. A record of attendance will be maintained and published in the pension fund annual report and accounts.

43. Pension funds are now required to produce a governance compliance statement which sets out the compliance levels with the areas specified in the guidance issued by the Scottish Government, including membership of the pension committee, frequency of meetings and individual training.

44. The governance compliance statement contained within the annual report and accounts reflects largely a 'partial compliance' status for the arrangements in place during 2011/12. It is expected that the new governance arrangements will enable the fund to be compliant with the guidance from 2012/13 onwards. We will review the new governance arrangements during the planning stages of our 2012/13 audit.

Internal control

45. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work is also informed by an assessment of risk and the activities of internal audit.

46. The fund's financial systems run alongside those of the administering authority and its financial ledger and payroll system are used to process transactions. There are specific systems and lines of responsibility for pension administration and for investment transactions.

47. As part of our work we took assurance from key controls within the fund's systems. The results of our review were reported in our letter of 15 June 2012. No significant control weaknesses were identified during this work.

48. Internal audit reviewed the governance compliance statement during 2011/12. Reliance was placed on this work to inform our wider governance and performance audit work under our Code of Audit Practice. The findings are summarised at paragraph 12 above. The pension fund transactional systems have been reviewed as part of internal audit's 2012/13 audit plan and these findings will be reported to the Pensions Panel and the Pensions Committee at the next cycle of meetings.

Prevention and detection of fraud and irregularities

49. The pension fund complies with the relevant fraud and irregularity policies of Falkirk Council and these have been reviewed as part of the council wide audit. No issues have been identified by us for inclusion in this report.

NFI in Scotland

50. Audit Scotland has coordinated another major counter-fraud exercise working together with a range of Scottish public bodies, external auditors and the Audit Commission to identify fraud and error. These exercises, known as the National Fraud Initiative in Scotland (NFI), are undertaken every two years as part of the statutory audits of the participating bodies. The latest exercise started in October 2010 and was reported in May 2012. The next round of NFI is due to commence in June 2012, and will look to expand the range of data sets and bodies.

51. The NFI works by using data matching to compare a range of information held on bodies' systems to identify potential inconsistencies or circumstances that could indicate fraud or error which are called 'matches'. Where matches are identified these are made available to bodies to investigate via a secure web application. Bodies investigate these and record appropriate outcomes based on their investigations.

52. As part of our local audit work we monitor the council's approach to participation in NFI both in terms of the submission of the required datasets and strategies for investigating the subsequent data matches. With regard to pensions there were 4 matching reports that identify people who are in receipt of pension but also appear on DWP and registrars records as being deceased or who appear on another payroll system. One member of the Pensions team is responsible for investigating these cases in conjunction with the Internal Audit Manager who co-ordinates the council wide exercise.

Standards of conduct and arrangements for the prevention/ detection of bribery and corruption

53. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. No issues have been identified by us for inclusion in this report.

Outlook

54. There are a number of on-going developments that may have a significant impact on the form and operation of local government pension schemes:

- following the acceptance by government of a principles document submitted by the Local Government Association, UNISON and GMB on how to take forward the reform of the Local Government Pension Scheme in England and Wales, a project has been set up to reach agreement on the elements of the new scheme together with the management and governance of the scheme going forward. The full extent of the recommendations made in the Hutton report and how they impact upon pension schemes in Scotland remains uncertain.

- further government initiatives, including workplace pension reforms, the HMRC Real Time Interface and the creation of single Police and Fire Services, are also likely to have an impact on operational processes during 2012/13.

55. It is important, in light of these on-going developments that the training needs of Pensions Committee and Panel and relevant officers should be kept under review to ensure that they are appropriately briefed on these developments and their potential impact as and when they crystallise.

Action Plan no 4

Best Value, use of resources and performance

56. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value.

57. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

58. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:

- a performance audit which may result in the publication of a national report
- an examination of the implications of a particular topic or performance audit for an audited body at local level
- a review of a body's response to national recommendations.

59. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.

60. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.

61. This section includes a commentary on the Best Value and performance management arrangements within the fund. We also note any headline performance measures used by members and comment on any relevant national reports.

Management arrangements

Best Value

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

Investment Performance

63. The main mechanism for measuring investment performance is through an analysis of the returns achieved by each of the fund's external fund managers. The manager's performance, in terms of achieving benchmarks, is subject to independent verification by the fund's custodian and is regularly reported to the investment committee, now the pensions committee.

64. The transition to the new allocation of investments arising from the revised investment strategy was successfully implemented by 31 March 2012 with Credit Suisse appointed to the infrastructure mandate and Baillie Gifford appointed to the Diversified Growth Fund. The revised allocation targeted a 10% decrease in equities and 5% in bonds to fund the purchase of the Diversified Growth fund and the commitment to Infrastructure investments. The fund recognised that the Statement of Investment Principles (SIPs) was required to be updated to reflect these changes and a draft document was presented to the pensions committee on 13 September 2012 and approved.

Administration performance

65. The fund reports administration information to the CIPFA Pensions Benchmarking Club and the Scottish Government on an annual basis. A range of service standards have also been developed by the Pensions Section and these are monitored on a regular basis. Following the recommendation made in last year's audit report, administration indicators are now reported more regularly to members. Performance information as 30 June 2012 was reported to the pensions panel on 30 August 2012 and the pensions committee on 13 September 2012.

66. The administration information reports a general improvement during 2011/12. All payment deadlines have been met, there has been an improvement in the percentage of lump sums paid within 7 days and the fund has received only 1 complaint. The annual administration cost per member has seen a slight increase over the financial year. However, it is worth noting that the fund expect the per member admin cost to continue to be amongst the lowest of all Scottish Funds.

Overview of performance in 2011/12

The Pension Fund's performance measurement outcomes

67. The fund holds investment assets of £1,233 million as at 31 March 2012, an increase of approximately 5% from £1,171 million in the previous year. The most recent investment information shows that the fund earned a 3.9 % return on its investments over the financial year against a benchmark return of 2.6%. The three year return shows a similar position where the fund’s return of 15% outperformed its benchmark return by 0.2%. However, the fund’s performance over the longer term (10 years) of 5.5% slightly lags its benchmark return by 0.4% p.a. over the period.

National performance reports

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

Exhibit 1: A selection of National performance reports 2011/12

• An overview of local government in Scotland - challenges and change in 2012	• The National Fraud Initiative in Scotland
• Learning the lessons of public body mergers	• How council's work: using cost information to improve performance

Source: www.audit-scotland.gov.uk

69. We suggest that officers review national performance reports as they become available and consider any findings which may impact on the pension fund.

Outlook

70. The current volatility in the stock market and the uncertainty around the sustainability of the Eurozone makes it important for pension funds to have a wide range of investment vehicles including hedging against currency fluctuations. Funds will have to remain vigilant and keep assessing their exposure to risk. Continuing to work, and communicating effectively with employers, the investment adviser and the actuary will be even more critical going forward.

Appendix A: audit reports

External audit reports and audit opinions issued for 2011/12

Title of report or opinion	Date of issue	Date presented to Pensions Committee
Annual Audit Plan	28 February 2012	01 March 2012
Internal controls management letter	15 June 2012	Planned for 6 December 2012
Report on financial statements to those charged with governance	14 September 2012	6 December 2012
Audit opinion on the 2011/12 financial statements	24 September 2012	6 December 2012
Report to Members on the 2011/12 audit	24 October 2012	6 December 2012

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	19	**Employee / Employer Contributions** Officers are currently in the process of reconciling the year end data returns to employee and employer contributions received throughout the year. Given that this process is completed after the accounts submission date, it provides little assurance over the contributions recorded in the financial statements. **Risk:** contributions may be misstated within the financial statements.	The fund will write to employers to require their year end data to be submitted timeously. Additionally, assurance will be sought from employers' auditors that contributions have been correctly calculated and deducted. These points will be developed further in a Pensions Administration Strategy.	Pensions Manager	31/01/2013
2	27	**Budgetary Control** The fund has yet to implement budgetary control processes for the elements of costs which it has the ability to control (administration costs, investment manager expenses and other overheads). **Risk:** costs may not be contained where they are not regularly monitored and assessed against predetermined budgets.	Budgets will be established in the specific areas mentioned.	Pensions Accountant	31/12/2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3	33	**Financial Challenges** There is an emerging trend towards a decline in the number of active members and increases in the numbers of pensioners and deferred members. The implications of this need to be managed by the pension fund to ensure its future financial sustainability. **Risk:** if this continues it will have an adverse impact on the pension fund in terms of cash flows, employers' contribution rates and, potentially, the investment strategy.	The demographic profile of the fund and the implications for Funding and Investment Strategies will be considered through periodic funding reviews, the triennial valuation and on-going dialogue with the fund's professional advisers. Key developments will be brought to the attention of the Panel and the Committee.	Pensions Manager	On-going
4	55	**Pension Reform** There are a number of on-going developments that may have a significant impact on the form and operation of local government pension schemes. **Risk:** if members are not kept up to date with the progress and impact of these changes, their ability to make decisions on behalf of the fund will be reduced.	Committee and Panel members will continue to be updated about matters affecting the operation of the Pension Fund (e.g. the pensions reform agenda)	Pensions Manager	On-going

AGENDA ITEM 5

FALKIRK COUNCIL

Subject: PUBLIC SECTOR PENSIONS REFORM
Meeting: PENSIONS COMMITTEE
Date: 6 December 2012
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

1.1 This report provides the Committee with an update on the latest proposals for public sector pensions reform.

2. LGPS REFORM IN ENGLAND AND WALES

2.1 An update on reform proposals for the Local Government Pension Scheme (LGPS) in England and Wales was given to the Panel at its meeting of 30th August, 2012. The main proposals, which are scheduled to take effect from April, 2014, include

- career average benefits
- accrual rate of 1/49th with increases linked to CPI
- scheme retirement age to be linked to state pension age

2.2 These changes will not affect any pensioners or deferred pensioners whose entitlement to benefit is established before April, 2014.

3. PUBLIC SERVICE PENSIONS BILL

3.1 The England and Wales LGPS reform proposals have been designed to fit with the terms of the Public Service Pensions Bill which was published in Westminster on 13th September.

3.2 The aim of the Bill is to establish a common framework for public service pensions to ensure that the schemes are sustainable and that costs are more evenly distributed between employers, public sector workers and taxpayers. In essence, the Bill is the UK Government's vehicle to implement the recommendations that emerged from Lord Hutton's 2011 report on public sector pensions.

3.3 The Bill focuses on two particular areas – scheme design and scheme governance.

Scheme Design

- No new final salary accrual beyond April, 2015
- Final salary link to be maintained for past membership
- Protection for members who are within 10 years of retirement

- Scheme normal pension age to be in line with new State Pension Ages
- Substantial control over scheme costs given to HM Treasury

Scheme Governance

- The current enabling legislation (i.e. the Superannuation Act 1972) is replaced
- Pensions Regulator to have a monitoring role over all public sectors schemes
- All public sector schemes to have pensions boards
- All board members to be suitably trained
- Funded schemes to have actuarial valuations independently scrutinised

4. LGPS REFORM IN SCOTLAND

4.1 The publication of the Public Service Pensions Bill with its UK wide application has given renewed impetus to the LGPS reform process in Scotland.

4.2 At a national level, meetings between COSLA and the Scottish Government about pensions reform have begun taking place. COSLA Leaders also agreed to establish a Sounding Board within COSLA to give the process political oversight. The inclusion of two local authority pension fund conveners on the Sounding Board will provide some input from a Fund perspective.

4.3 The Scottish Local Government Pensions Advisory Group (SLOGPAG) comprising representatives from Unions, Employers and the Scottish Government has been identified as the appropriate vehicle to take forward discussions.

4.4 Key issues identified by COSLA are:

- the delivery challenges posed by the Pensions Bill deadline of 2015
- whether there is any scope to push back the 2015 deadline
- what flexibility the Scottish Government has in terms of scheme design
- the cost of the new governance arrangements set out in the Bill

5. CONCLUSION

5.1 The reform process for the Local Government Pension Scheme in England and Wales continues to move forward consistent with the provisions being introduced by the Public Service Pensions Bill.

5.2 Discussions are now underway as to how the reforms should be implemented in Scotland. The implementation date is likely to be April, 2015 rather than the April, 2014 targeted in England and Wales.

5.3 The Scottish Government, COSLA and Unions must now produce a timetable which recognises key milestones and ensures that there is an adequate division of time and resources between consultation and implementation.

6. RECOMMENDATION

6.1 The Committee is asked to note the latest developments relating to Public Sector Pensions Reform and invited to comment.

Chief Finance Officer

Date: 5 November 2012

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL

AGENDA ITEM 6

FALKIRK COUNCIL

Subject:	**PENSION FUND – GENERAL GOVERNANCE MATTERS**
Meeting:	**PENSIONS COMMITTEE**
Date:	**6 December 2012**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Pensions Committee on various matters associated with the business of Falkirk Council Pension Fund.

2. AUTO ENROLMENT

2.1 The Government's Workplace Pensions Initiative – Auto-enrolment – came into effect on 1st October, 2012. The legislation requires Fund employers to enrol certain categories of employee into the pension scheme automatically.

2.2 Auto enrolment is being introduced on a phased basis with larger employers being the first to be subject to the new rules. Falkirk Council, with a staging date of 1st April, 2013, will be the first employer in the Fund to have to apply the new rules.

2.3 A training day for fund employers with staging dates in 2013 was hosted by the Fund on 21st September, 2012. Those employers should now be formulating action plans and, in particular, deciding whether to implement auto enrolment in full from the staging date or, as is permitted by legislation, postpone certain aspects of it until, at the latest, 2017.

2.4 Full implementation of auto enrolment means that, in addition to new recruits being automatically enrolled into the pension scheme, employees who have previously elected not to join the scheme will also be enrolled on the staging date. Under transitional arrangements, employers may delay enrolling previous non- joiners until 2017, but still have to enrol persons recruited after the staging date.

2.5 Employers may wish to invoke the transitional arrangements in order to avoid the additional employer pension contribution costs that will arise from a large influx of new members. Employers need to bear in mind, however, that in the longer term, an inflow of new members could help to maintain a healthy balance between the numbers of fund contributors and pensioners, and thus have a beneficial effect on employer contributions.

2.6 A report outlining Falkirk Council's own auto enrolment responsibilities was considered at the recent Joint Consultative Committee meeting and will be shared with Fund employers in due course. It is however a matter for each employer to determine their own policy and strategy in meeting their obligations under the auto enrolment legislation.

3. LGPS REGULATIONS MADE

3.1 The Local Government Pension Scheme (Administration) (Scotland) Amendment Regulations 2012 have been made with effect from 12th October, 2012.

3.2 As a result, the Scottish Police Authority and the Scottish Fire and Rescue Service become "scheduled bodies", thus enabling staff to participate in the Local Government Pension Scheme.

3.3 The impact of the regulations on the Falkirk Fund is that:

i) employees of Central Scotland Police and Central Scotland Fire and Rescue Service who are transferred to the new entities will remain members of the Falkirk Fund

ii) employees of the new bodies, who, if they had been employed prior to 1/4/2013, would have been employed by Central Scotland Police and Central Scotland Fire, will be enrolled into the Falkirk Fund.

4. LGPS REGULATIONS IN DRAFT FORM

4.1 The Draft Local Government Pension Scheme (Miscellaneous Amendments)(Scotland) Regulations 2012 have been issued for consultation.

4.2 The regulations make a number of technical changes to the scheme rules addressing issues such as auto enrolment, the annual allowance tax charge and admission agreements.

4.3 The regulations also give Funds scope to amend an employer's contribution rate if the Fund becomes aware that the employer is going to cease participation in the Fund.

5. CONSUMER PRICE INDEX

5.1 The Consumer Price Index (CPI) for September indicated that UK inflation was 2.2%. The September inflation rate is traditionally the figure used by the UK Government to increase public sector pensions (and various State benefits) from the following April.

5.2 Until 2010, Government used the Retail Price Index (RPI) as the basis for determining pension increases. Generally, RPI is higher than CPI due to the way the indices are calculated and due to RPI including housing costs (e.g. the September, 2012 RPI was 2.6%).

5.3 The Office of National Statistics is consulting about the way RPI is calculated. It is possible that a change in the method of calculation may be recommended which will reduce the gap that normally exists between RPI and CPI.

5.4 As index linked bonds are based on the rate of RPI, any reduction in the rate could lead to a fall in value of these securities. Because of the possibility of bond holders being detrimentally affected, the change may require the approval of the Chancellor of the Exchequer.

6. NATIONAL FRAUD INITIATIVE

6.1 The National Fraud Initiative is a data matching exercise conducted every two years by the Audit Commission to detect fraud and irregularities in various areas of public finance.

6.2 The Pensions Section has recently submitted pensioner and deferred pensioner data to the Commission. The main aim will be to identify pensioners who have died but for whom payments are still being claimed. The exercise also helps identify deferred pensioners who may have died without the Council being notified.

6.3 The results will be notified to Panel and Committee in due course.

7. LOCAL AUTHORITY PENSION FUND FORUM (LAPFF)

7.1 The LAPFF is a lobbying group made up of 55 local authority pension funds. It exists to promote good corporate practices within the companies in which funds invest.

7.2 The Annual LAPFF Conference is taking place in Bournemouth from 28th to 30th November, 2012. Councillors Patrick and Blackwood have agreed to attend on behalf of the Fund.

7.3 In the light of the "shareholder spring", this year's conference will focus on how investors can add their weight to reform. Topics on the agenda include tackling top pay and restoring standards in the banking sector.

7.4 In terms of recent engagement with companies, LAPFF have:

- met with directors at Barclays, Lloyds, HSBC and Standard Chartered to discuss 'true and fair view' accounting, as well as recent fines and reputational risk in the banking sector;
- signed an open letter to Rupert Murdoch asking the News Corp board to appoint an independent Chair at its successor companies;
- written to the Chair of Lonmin to express deep concern regarding violence at the company's South African platinum mine and to encourage the board to implement best practice principles in its relationships with police and security forces;
- discussed sustainability and supply chain management with Kingfisher, the parent of B&Q; and
- sent letters to various companies in the FTSE 350 encouraging them to improve boardroom gender balance as set out by the Davies Review.

7.5 The next formal meeting of the LAPFF which will set the business agenda for 2013 will be held in London in early January. The Panel and Committee may wish to consider whether they would like a delegate to attend this meeting.

9. RECOMMENDATION

9.1 The Committee is asked to note the contents of this report and invited to comment as appropriate.

Chief Finance Officer

Date: 1st November 2012

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL

AGENDA ITEM 7 (a)

FALKIRK COUNCIL

Subject: FUNDING AND INVESTMENT STRATEGY UPDATE
Meeting: PENSIONS COMMITTEE
Date: 6 December 2012
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

1.1 This purpose of this report is to advise the Committee of the latest funding position of the Falkirk Council Pension Fund.

1.2 The report also serves as an introduction to the presentation being given by Linda Selman of Hymans Robertson on the Fund's Funding and Investment Strategy.

2. BACKGROUND

2.1 The Pension Fund is valued every three years by an independent actuary. This is to ensure that the solvency of the Fund is maintained through employers paying an appropriate contribution. The last valuation took place on 31st March, 2011 and the next valuation is scheduled for 31st March, 2014.

2.2 The key results of the 2011 valuation, summarised at a whole Fund level, are set out below:

Future Service Rate	16.2%
Past Service Deficit Adjustment	4.3%
Total Employer Contribution	**20.5%**
Fund Assets	£1.199m
Fund Liabilities	£1,392m
Funding Deficit	-£193m
Funding Level	**86%**

2.3 In addition to three yearly valuations, the funding position is reviewed periodically between valuations. This is in accordance with the Funding Strategy Statement and helps demonstrate good stewardship of the Fund.

3. THE MONITORING PROCESS

3.1 The revised funding position is calculated by the Actuary, taking into account the results of the last valuation and subsequent cash flows and investment returns.

3.2 The funding reports are based on the pension fund position as a whole. Individual employers can, on request, commission reports about their own organisation.

4. FUNDING UPDATE

4.1 The funding policy is to achieve a funding level of 100%. If the Fund is in deficit, as at present, the policy is to implement increased employer contributions on a phased basis and to allow deficits to be repaired over a period of up to 20 years.

4.2 The latest funding position compared to the 2011 valuation is as follows:

	As at 31/03/2011	As at 30/09/2012	Amount of Change
Fund Assets	£1.199m	£1,322m	+£123m
Fund Liabilities	£1,392m	£1,702m	+£310m
Funding Deficit	-£193m	-£380m	-£187m
Funding Level	**86%**	**77%**	**-9%**

4.3 The funding update shows that as at 30th September, 2012 the funding level has fallen to 77%. This is partly due to asset underperformance (6.7% actual against 8.9% targeted) but primarily due to the fall in gilt yields which has pushed up the value of the scheme liabilities. Gilt yields, in turn, have been driven down by the successive rounds of quantitative easing undertaken by the Bank of England and the attraction of Government Bonds as a safe haven to foreign investors.

4.4 A copy of the funding report is attached at Appendix 1 to this report.

4.5 A presentation combining these funding issues with the on-going investment strategy is being delivered by Linda Selman, the Fund's investment adviser with Hymans Robertson.

5. RECOMMENDATION

5.1 The Committee is invited to comment on the update of the Fund's funding position and the presentation from Linda Selman.

Chief Finance Officer

Date: 9th November, 2012

LIST OF BACKGROUND PAPERS

NIL

HYMANS ROBERTSON

Navigator

Version 2.37

Funding projection as at 30 September 2012
Falkirk Council Pension Fund

Prepared by:
Catherine McFadyen

for and on behalf of Hymans Robertson LLP

9 November 2012

Important note
Accuracy of funding projections
The projections presented in this report reflect, on an approximate basis, movements in market conditions from time to time. Where market movements, in particular market yields and future inflation expectations, have diverged materially (i.e. by over 1% per annum) from the opening figures or where investment market conditions are particularly volatile, the results presented in this report might diverge from the underlying position by more than would normally be the case.

The only way to accurately assess the position is to undertake a full actuarial valuation.

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PUBLIC SECTOR

Actuarial funding update

Contents:

Executive summary

Purpose

I have been instructed to undertake regular funding updates for the Falkirk Council Pension Fund ("the Fund"). The starting point for this update is the formal valuation of the Fund carried out as at 31 March 2011. This funding update is produced for Falkirk Council as Administering Authority to the Fund.

Method

The update has been prepared on an approximate basis, using a roll forward approach. The roll forward allows for actual Fund returns up to 30 September 2012.

Results

At the formal valuation as at 31 March 2011, the funding level (i.e. the ratio of assets to liabilities) assessed on the ongoing funding basis was 86.1%.

The funding level at 30 September 2012, on the ongoing funding basis, is estimated to be 77.6%.

The funding level has fallen significantly since the valuation date as a result of adverse investment market experience.

The Fund assets have performed less well than anticipated returning 6.7% in the period from 1 April 2011 to 30 September 2012. The formal valuation assumed that the Fund assets would return 8.9% in an 18 month period. Please note that these figures relate to **investment return only**, the total increase in the asset value from 31 March 2011 to 30 September 2012 is 10.3% which is a result of both investment income **and** positive net cashflows in to the Fund.

The value placed on the liabilities has risen as a result of falling gilt yields. Gilt yields fell from 4.4% at the valuation date to 2.9% as at 30 September 2012. This fall was offset by a fall in our measure of CPI inflation from 2.8% to 1.9% meaning that the real gilt yield has fallen by 0.6% (from 1.6% to 1.0%). This has increased the value placed on the liabilities by around 13%.

I look forward to discussing this funding update with the Administering Authority

Catherine McFadyen FFA

Estimated projection of funding position as at 30 September 2012

Summary of funding position:

The projection of the funding level since the latest formal actuarial valuation as at 31 March 2011 is shown below.

Date	31 Mar 2011 £m	31 Jan 2012 £m	30 Sep 2012 £m
Liabilities - Ongoing Basis			
Assets	**1,199**	**1,235**	**1,322**
Liabilities	**1,392**	**1,742**	**1,702**
Surplus/(deficit)	**(194)**	**(507)**	**(381)**
Funding level	**86.1%**	**70.9%**	**77.6%**

Key assumptions and financial indicators:

Date Discount rate	31 Mar 2011 p.a.	31 Jan 2012 p.a.	30 Sep 2012 p.a.
- Pre-ret.			
Nominal	5.9%	4.5%	4.5%
Real	2.3%	1.4%	1.8%
- Post-ret.			
Nominal	5.9%	4.5%	4.5%
Real	2.3%	1.4%	1.8%
Sal. Escalation**	5.1%	4.6%	4.2%
(A): FIGs	4.4%	2.9%	2.9%
(B): ILGs	0.7%	-0.2%	0.2%
(C): Inflation	3.6%	3.1%	2.7%
(D): AA corp.	5.5%	4.6%	4.0%
(E): AA spread	1.2%	1.7%	1.1%
(F): AOA	1.6%	1.6%	1.6%
FTSE All Share	3,067.7	2,932.9	2,998.9
FTSE 100	5,908.8	5,681.6	5,742.1

(A) : Annualised UK govt. fixed interest gilt yield (over 15 years)

(B) : Annualised UK govt. index-linked gilt yield (over 15 years, 3% inflation)

*(C) : Implied RPI inflation derived from (A) - (B) **

(D) : Annualised iBoxx AA rated corporate bonds (over 15 years)

(E) : Credit risk spreads derived from (D) - (A)

(F) : Asset outperformance assumption pre-retirement assumed to be constant throughout the projection period and expressed relative to fixed interest gilt yields

** pension increases based on CPI inflation derived from (C) - 0.8%*

*** salary increases are 1% p.a. until 31 March 2013 before reverting to the long-term rate shown*

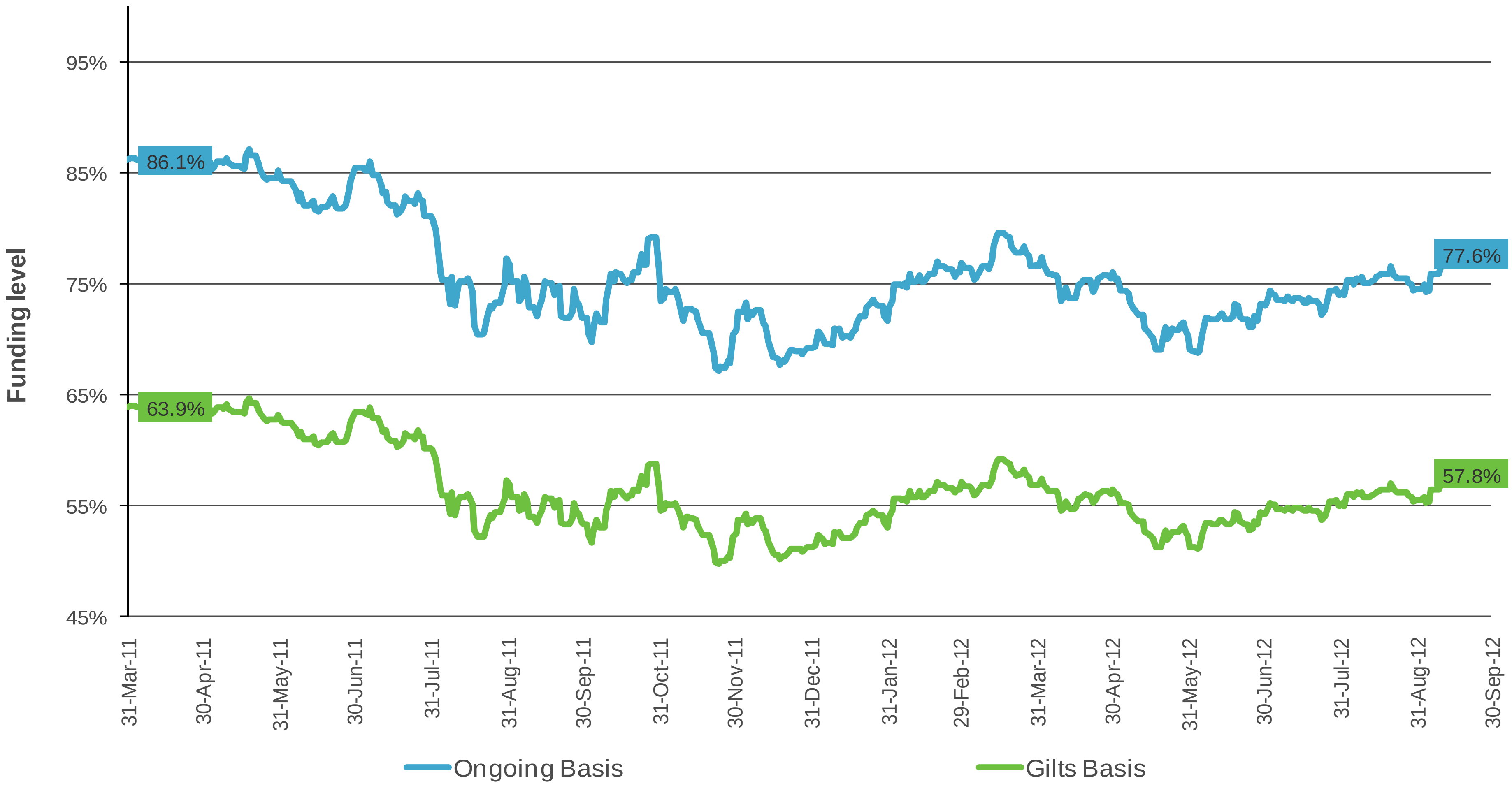
Estimated financial position on alternative bases

Date	31 Mar 2011 £m	31 Jan 2012 £m	30 Sep 2012 £m
Liabilities - Gilts Basis			
Assets	**1,199**	**1,235**	**1,322**
Liabilities	**1,877**	**2,349**	**2,286**
Surplus/(deficit)	**(678)**	**(1,114)**	**(964)**
Funding level	**63.9%**	**52.6%**	**57.8%**

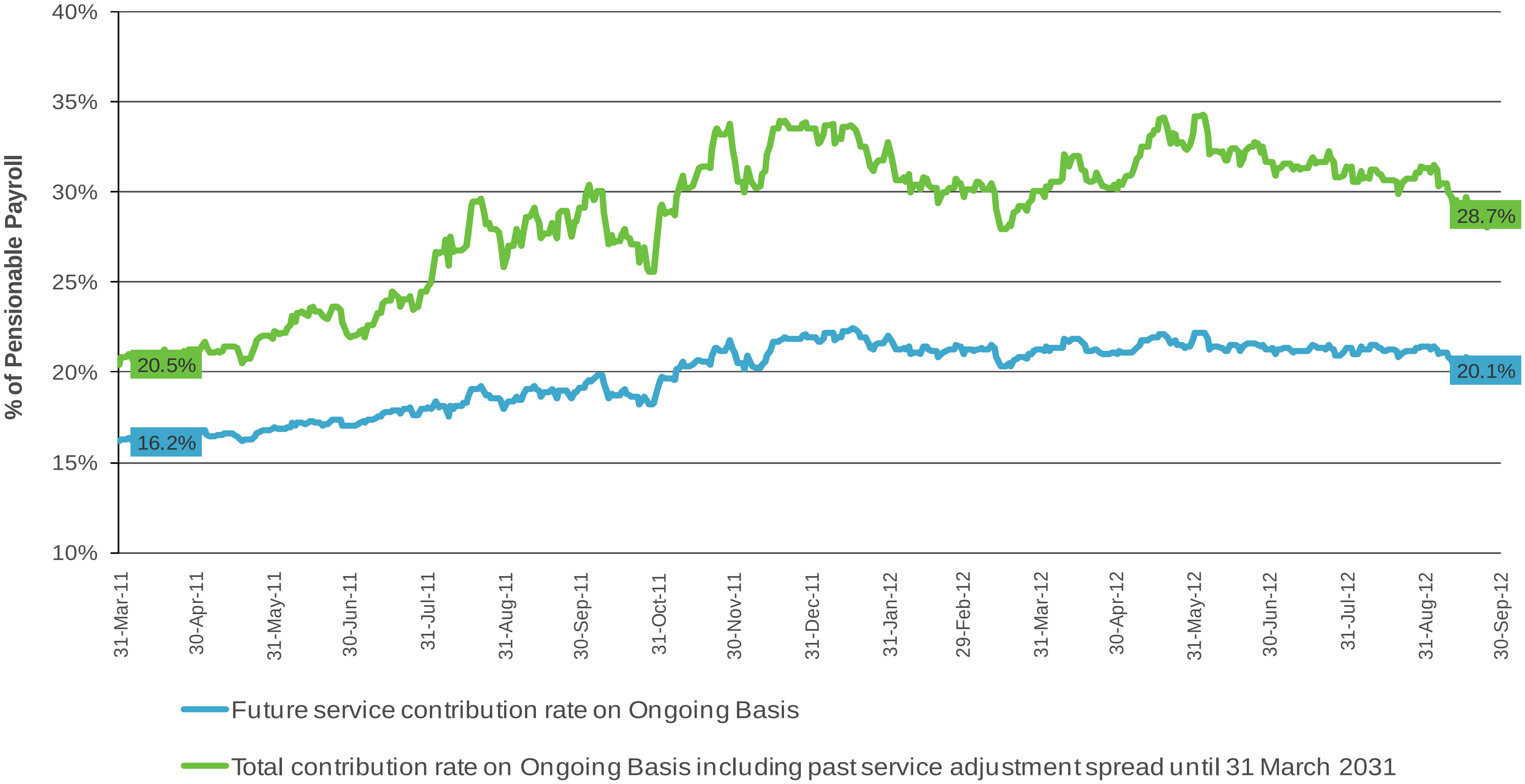
Key assumptions:

Discount rate	p.a.	p.a.	p.a.
- Pre-ret.			
Nominal	4.3%	2.9%	2.9%
Real	0.7%	-0.2%	0.2%
- Post-ret.			
Nominal	4.3%	2.9%	2.9%
Real	0.7%	-0.2%	0.2%
Sal. escalation	5.1%	4.6%	4.2%

Estimated projection of funding level from 31 March 2011 to 30 September 2012



Estimated progression of employer's contribution rate from 31 March 2011 to 30 September 2012



Attribution analysis

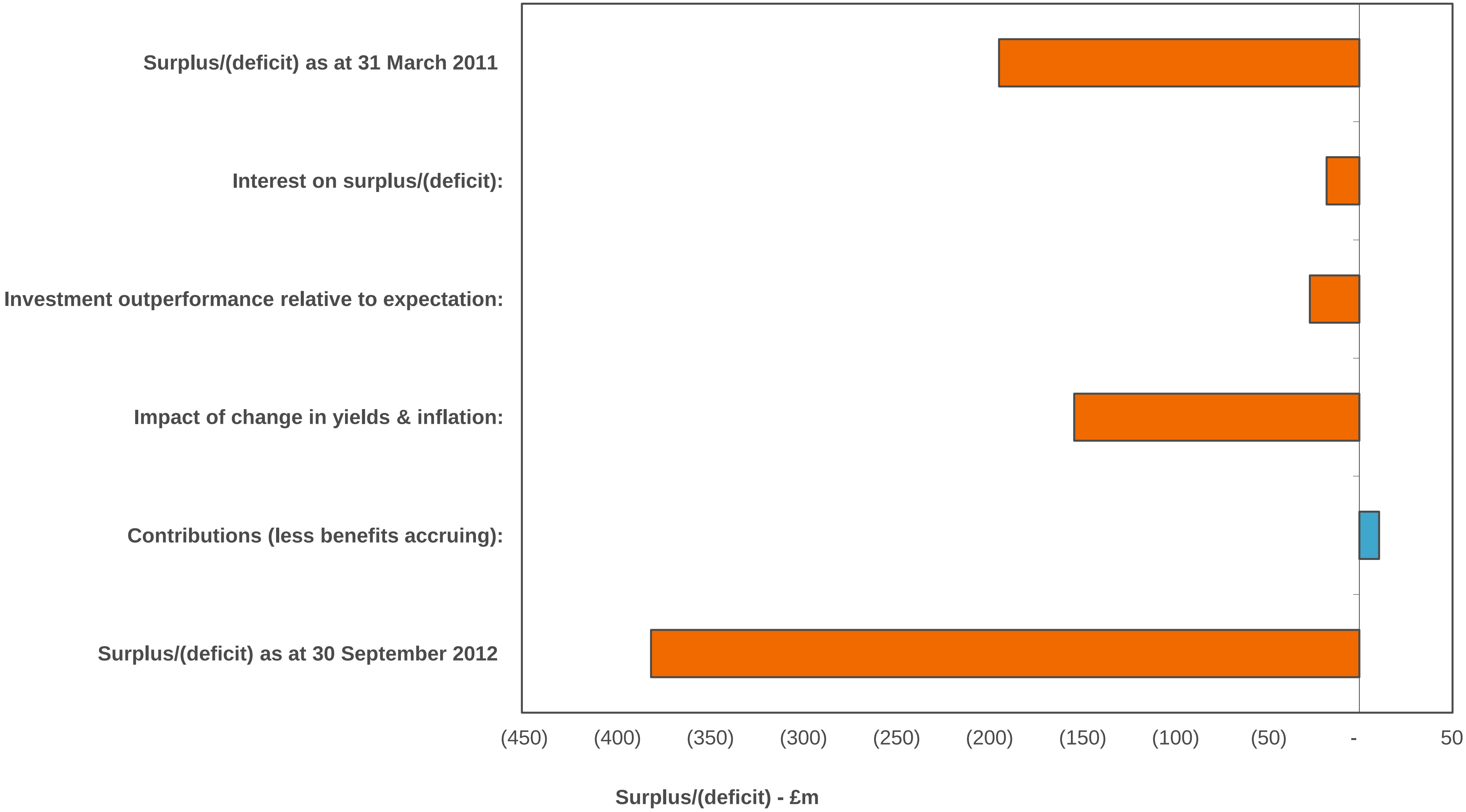
	£m	
Asset value as at 31 March 2011		**1,199**
Contributions paid in:	**93**	
Benefit payments:	**(53)**	
Investment returns:	**82**	
Asset value as at 30 September 2012		**1,322**

	£m	
Liability value as at 31 March 2011		**1,392**
Cost of benefits accruing:	**83**	
Interest on liabilities:	**127**	
Impact of change in yields & inflation:	**153**	
Benefit payments:	**(53)**	
Liability value as at 30 September 2012		**1,702**

	£m	
Surplus/(deficit) as at 31 March 2011		**(194)**
Interest on surplus/(deficit):	**(18)**	
Investment outperformance relative to expectation:	**(27)**	
Impact of change in yields & inflation:	**(153)**	
Contributions (less benefits accruing):	**11**	
Surplus/(deficit) as at 30 September 2012		**(381)**

Please note that figures in this schedule and the chart on the next page are estimates only.

Attribution analysis



Sensitivity matrix

Fixed Interest Gilt, semi-annual yield (% p.a.)	4,950	5,200	5,450	5,742	5,950	6,200	6,450
3.35	75% (395.4)	78% (350.8)	80% (306.1)	84% (253.9)	86% (216.8)	89% (172.2)	92% (127.5)
3.20	73% (436.2)	76% (391.6)	78% (346.9)	82% (294.8)	84% (257.6)	87% (213.0)	90% (168.3)
3.05	71% (478.4)	74% (433.7)	76% (389.1)	80% (336.9)	82% (299.8)	85% (255.2)	87% (210.5)
2.90	69% (522.0)	72% (477.4)	75% (432.7)	78% (380.5)	80% (343.4)	82% (298.8)	85% (254.1)
2.75	68% (567.1)	70% (522.4)	73% (477.8)	76% (425.6)	78% (388.5)	80% (343.8)	83% (299.2)
2.60	66% (613.7)	68% (569.0)	71% (524.4)	74% (472.2)	76% (435.1)	78% (390.5)	81% (345.8)
2.45	64% (661.9)	67% (617.2)	69% (572.6)	72% (520.4)	74% (483.3)	76% (438.6)	79% (394.0)

Equity – FTSE 100 price index (proxy)

30 September 2012 Projection

78%
(380.5)

All amounts are in £m

The starting point for this sensitivity matrix is the projected results as at 30 September 2012 on the Ongoing Basis.

The funding position is sensitive to changes in equities and bond yields and the funding graph reflects this based on historic market conditions.

The above table shows the impact of future changes in the bond yields (which affect the liabilities) and equities (using the FTSE100 Index as a proxy for equity markets generally both in the UK and overseas). The calculations assume that these changes occur immediately. In practice any changes will occur over time and the actual funding level will therefore also be affected by further benefit accrual, contributions and differences between expected and actual investment returns. Crucially, the calculations assume that all other factors and assumptions remain unchanged. In particular, the impact of the change in bond yields assumes that the implied inflation assumption remains unchanged. However, the liabilities are more sensitive to changes in real bond yields (i.e. net of assumed future inflation) rather than the nominal bond yield.

Appendix 1: Reliances and limitations

Reliances and limitations

In projecting forward the valuation results, a number of assumptions are made with regard to actual experience. As such, the accuracy of the projection declines over time. We would expect our projectionof the funding level to be within +/-2% of the underlying position for each year of projection. However, greater differences are possible, particularly if there have been volatile financial market movements or significant membership changes (especially if the scheme is small and individual member movements affect the funding position of the scheme). It is not possible to fully assess the accuracy of these projections without carrying out a full actuarial valuation.

The projection allows for:

(1) movements in the value of the assets as measured by manager performance and index returns;
(2) movements in liabilities as a result of changes in bond yields and hence inflation and discount rate assumptions;
(3) estimated cash-flows (contributions and benefit payments); and
(4) expected accrual of benefits for employee members from their service accrued since the latest valuation date (estimated based on the salary roll as at the latest valuation).

The projection does not allow for:

(1) changes in the mix of assets held since the last valuation;
(2) variations in liabilities arising from salary rises, deferred pension revaluation or pension increases differing from those assumed in the valuation;
(3) changes in the salary roll of employee members;
(4) variations between actual and expected demographic experience (e.g. on withdrawals or mortality); and
(5) changes in the asset outperformance assumption.

This actuarial funding update report is provided solely for the purposes of illustrating the projected funding position(s). It should not be used for any other purpose. It should not be released or otherwise disclosed to any third party except with our prior written consent, in which case it should be released in its entirety. Hymans Robertson LLP accept no liability to any third party unless we have expressly accepted such liability in writing.

Investment indices and yields used

The analysis set out in this report is prepared from and based upon external market data sources that we believe to be reliable but the accuracy of which cannot be guaranteed. The assets of the scheme are projected using benchmark indices which to the best of our understanding are indices that will closely replicate the performance of the scheme's assets. The performance of the scheme's assets will, at times, be different from our projections and the difference may be material to our projections. Where the investment data is available, we have allowed for investment manager under/out-performance.

Compliance with professional standards

The method and assumptions used to project the updated funding position are consistent with those used in the latest formal actuarial valuation, although the financial assumptions have been updated to reflect changes in financial conditions since the valuation. As such, the advice in this report is consistent with that contained in the latest formal valuation report.

This report also complies with the Technical Actuarial Standards on reporting (TAS R), Data (TAS D), Modelling (TAS M) and Pensions (TAS P). It forms an aggregate report when combined with the report on the latest formal funding valuation of the scheme.

Appendix 2: Benchmark indices and basis yields

Benchmark Indices
- FTSE 100
- FTSE 250
- FTSE Small Cap
- FTSE All Share
- FTSE All World Series North America (£)
- FTSE All World Series Japan (£)
- FTSE All World Series Developed Europe (£)
- FTSE All World Series Developed Asia Pacific (£)
- FTSE All World Series All World Developed Ex UK (£)
- FTSE All World Series All World Ex UK (£)
- FTSE All World Series All Emerging (£)
- UK Government Fixed Interest Gilts (Over 15 Years)
- UK Government Index-Linked Gilts (Over 5 Years)
- UK Government Index-Linked Gilts (Over 15 Years)
- iBoxx A rated UK Corporate Bonds (Over 15 Years)
- iBoxx AA rated UK Corporate Bonds (Over 15 Years)
- iBoxx AAA rated UK Corporate Bonds (Over 15 Years)
- iBoxx All Investment Grades rated UK Corporate Bonds (Over 15 Years)
- IPD Property
- Cash Indices LIBOR 1 Month

All indices used to project asset values are total return indices. However, any figures quoted in this report are from price indices as these are more widely recognised.

Some of the above indices have been used to track movements in the value of the assets. The indices are a standard list and not necessarily the same indices that the managers have been asked to track or beat. Some asset classes are not easily tracked by these benchmarks and therefore other approximations have had to be used in this projection leading to greater differences than the +/-2% per year from the true underlying position stated in Appendix 1.

Some of the following yields are used in the projection of the liabilities.

Basis Yields
- iBoxx AA rated UK Corporate Bond Over 15 Year Yield
- FTSE Actuaries Index-Linked Gilts (3% Inflation) Yield (Over 15 Years)
- FTSE Actuaries UK Government Fixed Interest Gilts Yield (Over 15 Years)

AGENDA ITEM 8

FALKIRK COUNCIL

Subject: PENSION FUND CASH MANAGEMENT
Meeting: PENSIONS COMMITTEE
Date: 6 December 2012
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

1.1 The question of the Fund's use of money market funds and its investment of short term cash with the Clydesdale Bank was raised at the last Pensions Committee meeting.

1.2 This report addresses those issues and provides the Committee with details of the Pension Fund's current approach to Cash Management.

2. REGULATORY CONTEXT

2.1 The Pension Scheme regulations require that an administering authority:

- invests any fund monies that are not immediately needed to meet benefit obligations;
- holds any fund monies in a separate account; and
- ensures that the separate account is maintained by an authorised deposit-taker

3. OPERATIONAL CONTEXT

3.1 The Pension Fund has net inflows from its dealings with members, so that generally in any month, the income from employee and employer contributions exceeds the pensions and lump sums being paid out.

3.2 Surplus cash is invested with either the Fund's banker, Clydesdale Bank, or forwarded to the Fund's custodian, Northern Trust, prior to being allocated to one or more of the Fund's investment managers.

3.3 A detailed review of the cash position is undertaken on a monthly basis around the 20th of each month. By that time, pensions have been paid out – this happens on the 15th of each month - and all contributions for the month received from fund employers.

3.4 The table below shows the contribution inflows and benefit outflows for the period April to September, 2012:

	April	May	June	July	August	September
Contributions **Benefits**	£5.6m -£5.1m	£5.9m -£4.6m	£6.1m -£5.1m	£6.6m -£5.5m	£5.6m -£6.3m	£6.2m -£4.3m
Surplus	£0.5m	£1.3m	£1.0m	£1.1m	-£0.7m	£1.9m

3.5 Approximately £5 million is retained each month in an interest bearing account with the Clydesdale Bank to act as a "float" to meet immediate scheme benefit commitments, such as the £3.5m needed for monthly pension payments. The £5 million cushion also recognises the fact that some benefit obligations can arise unexpectedly (e.g. ill health retirements, death grants or pensioners electing to take extra cash in lieu of pension).

3.6 Under current treasury arrangements, the absolute maximum sum that may be held with the Clydesdale, or any single institution, is £8 million.

3.7 Any other surplus funds are invested with Northern Trust and are initially held in their Global Cash account, before being swept on a nightly basis into one of their money market funds – the Sterling Fund.

3.8 Not all monies held with Northern Trust in the Sterling Fund can be allocated to investment managers immediately. A "float" is again necessary to ensure that there are sufficient funds to meet the regular flow of private equity drawdowns (including capital calls from Credit Suisse and M&G).

3.9 In view of the current frequency of drawdowns – around £10 million since April, 2012 - the Fund's practice is to maintain a cash balance with Northern Trust of at least £5 million.

4. CURRENT RATES OF RETURN

4.1 The rate of interest being paid by Clydesdale Bank is 0.50% p.a.

4.2 The rate of interest being paid by Northern Trust's Sterling Fund is 0.46%, however the fund fee of 0.20% effectively reduces the rate to 0.26%

4.3 The Clydesdale Bank has a long term investment grade A2 credit rating from Moody's.

4.4 The Northern Trust Sterling Fund has a AAA credit rating from Standard and Poor's.

4.5 Both counterparties have acceptable credit ratings in terms of the Council's treasury management guidelines.

4.6 There is an option of lending the funds to certain designated counterparties (e.g. local authorities), however this will only be done where a competitive interest rate is offered.

4.7 Whilst there are money market funds providing higher yields, the interest rate differential is not sufficient at this time to justify the additional operational overhead that would be incurred. For example, the RBS GBP Global Treasury Fund offers a net yield of around 0.4% for short term deposits. If £2m of the monies normally deposited with Northern Trust were instead invested in the RBS Fund, the additional interest over a year would equate to around £2,500. It should be noted, however, that it is unlikely additional monies could be held in this fashion continuously for a year.

4.8 Whilst the aim is for the Fund is to achieve an optimum return on its cash deposits, this has to be balanced against the need to invest cash securely and in a manner conducive with day to day transactional activities.

5. TREASURY MANAGEMENT STRATEGY

5.1 At present, the Fund uses the same criteria for investing cash as is set out in the Council's Treasury Management Strategy. This includes setting limits on the level of funds that may be held with a single institution and the level of counterparty credit worthiness that is acceptable.

5.2 As part of its own treasury arrangements, the Council monitors the money markets and will alert the Fund where investment opportunities present themselves.

5.3 In view of the need to demonstrate "clear water" between the financial transactions of the Fund and those of the Council, it is suggested that a separate Cash Management Strategy be constructed for the Fund and brought to the next Panel and Committee for approval. It is noted that a number of local authority funds are following this approach and that there is an outstanding audit recommendation for treasury/cash management arrangements for the Fund to be formalised more precisely.

6. CONCLUSION

6.1 The Fund needs to hold short term cash deposits to undertake its daily business. Funds are invested with either the Clydesdale Bank or with Northern Trust. Depending on the interest rates on offer, funds may be loaned to other entities subject to their credit worthiness.

6.2 The rates of return received from the Clydesdale Bank and Northern Trust are consistent with the need to hold cash as a secure and liquid asset.

7. RECOMMENDATION

7.1 The Committee is asked:

(i) to note the Fund's practices in relation to the management of cash, and

(ii) to agree to a Cash Management Strategy being prepared for the Fund.

Chief Finance Officer

Date: 7 November 2012

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL