

FALKIRK COUNCIL

Subject: FALKIRK COUNCIL PENSION FUND - ANNUAL ACCOUNTS 2013/14
Meeting: PENSIONS COMMITTEE
Date: 25 SEPTEMBER 2014
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

- 1.1 The purpose of this report is to ask the Pensions Committee to review the Audited Accounts and Annual Report of the Fund for 2013/14 and to ask the Pensions Committee to give its approval.

2. AUDIT PROCESS

- 2.1 The Pension Fund Annual Report and Accounts 2013/14 have now been audited and copies are attached. The auditor's certificate is free from qualification.
- 2.2 Matters arising have been highlighted by Audit Scotland in their ISA 260 document and have been reported to Committee in the preceding report.
- 2.3 A copy of the audited accounts and annual report will be posted on the Pension Fund website and will be brought to the attention of all Fund employers.

3. RECOMMENDATION

- 3.1 Members of the Pensions Committee are asked to review the Audited Falkirk Council Pension Fund Annual Report and Accounts 2013/14.
- 3.2 The Pensions Committee is asked to approve the Audited Falkirk Council Pension Fund Annual Report and Accounts 2013/14

Chief Finance Officer

Date: 12 September 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

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FOREWORD BY THE CHIEF FINANCE OFFICER

As prescribed by Regulations, the Pension Fund annual report and accounts are audited in their own right, separate and removed from Falkirk Council's annual financial statements. These provide the reader with a wide range of information about the Fund including details on the governance and performance of 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 provides comment on the value of assets held at year end. Both these sections are further supplemented by the Notes to the Accounts.

The Pension Fund Account at year end 31 March 2014 shows that contributions in 2013/14 have risen to £76m from £69m in 2012/13. This rise is the result of a combination of factors, including Auto-enrolment and increased strain costs arising from employer efficiency programmes. The Fund Account also shows that the market value of investments, including profits from trading, has risen by £123m during the year, reflecting a continuing improvement in financial markets.

The Fund's Net Asset Statement at year end 31 March 2014 shows that the Fund had £1.58bn of assets under its management compared with £1.46bn at 31 March 2013. The improved asset value is mainly the result of the returns on fund investments of 6.9% against a benchmark target over the year of 6%. This out performance is particularly welcome given the fact that the low yield on government bonds continues to require a high value to be placed on Fund liabilities.

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 allows employers with strong covenants 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.

The Pensions Committee took a decision in March to invest £30m in social/affordable housing. This is an innovative mandate and follows extensive background research and market soundings. The mandate was awarded to Hearthstone in associate with Castle Rock Edinvar.

Looking forward, there are a variety of significant challenges on the immediate horizon. The LGPS is being updated, most notably to a career average basis, in April 2015 to meet the requirements of the Public Service Pensions Act 2013. A Heads of Agreement on scheme design between COSLA, Unions and Scottish Government has been reached but similar agreement on governance arrangements remains the subject of discussion. This will require a review of the Fund's existing governance arrangements to reflect the introduction of the required Scheme Manager and Pension Board.

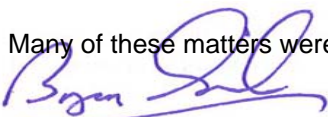
Work is also underway with the Fund employers and actuary in preparation for the 2014 triennial actuarial valuation. This will set employer contribution rates for the next 3 years and will occur within the framework of the Funding Strategy Statement mentioned above. One benefit arising from the inevitable rise in interest rates is that it will reduce the measurement of the Fund's liabilities.

The complexity of the new Scheme allied with other recent amendments to the LGPS which will involve multiple calculations of employee benefits requires investment in a new pensions system which will be fit for purpose going forward. This will of itself be a challenging project.

The Pension Act 2014 provides for contracting out to be abolished from April 2016. This will impact on both employees and employers and is particularly unwelcome given the financial pressures both are facing.

It is noteworthy that the debate in England and Wales on Fund numbers and structure has now moved on to consider questions of the relative merits of passive versus active management and the benefits of models which aggregate Fund investment. It is inevitable that this debate will impact on Scotland.

Many of these matters were covered in the Fund's annual Pensions and Investment Conference in March.



Bryan Smail, CPFA MBA
Chief Finance Officer
30 June 2014

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 Falkirk Council Pension Fund 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 the Fund's affairs to secure economic, efficient and effective use of its resources and safeguard its assets; and
- 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 2013/14 (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 Falkirk Council Pension Fund as at 31 March 2014 and its income and expenditure for the year ended 31 March 2014.



Bryan Smail, CPFA MBA
Chief Finance Officer
30 June 2014

Fund Overview

Under the statutory provisions 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 its investments, which include equities, property and bonds.

Fund employers include Clackmannanshire, Falkirk and Stirling Councils, Scottish Police Authority, Scottish Fire and Rescue Service, Central Scotland Joint 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.

An actuarial valuation of the Fund is undertaken every three years and acts as an independent financial health check to determine how much money needs to be paid to the Fund so that it can continue to pay benefits both now and in the future. The last valuation was produced on 31 March 2011 and showed that the Fund was 86% funded, meaning that it had 86% of monies needed to pay the benefits of scheme members based on the rights they had accumulated to that date. 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 cash-flows should not be under-estimated, it is important to note that the time horizon of the Fund is long term. Consistent with this, the funding strategy is to allow employers with strong financial covenants to recover any deficit position over a period of up to 20 years. A stability mechanism within the strategy also helps employers budget for their contributions in the short term and helps smooth out volatility from what could be significant changes in the employer contribution rate.

The Fund operates under the auspices of the Local Government Pension Scheme. Scheme membership is made up of active, deferred and pensioner members. To be able to join the scheme, a person must be employed by a participating employer and not be eligible to join one of the other public sector pension schemes.

Investment Management of the Fund is undertaken by external fund managers and overseen by the Council's Pensions Section. Administration of the Fund is undertaken in-house by the Pensions Section.

Governance Overview

Prior to the Local Government Elections of May, 2012, all Pension Fund business of Falkirk Council was delegated to its Investment Committee.

Following the publication in 2011 of statutory guidance relating to governance matters, the Authority undertook a wide ranging consultation which culminated in new governance arrangements being approved by Falkirk Council on 14 March 2012.

The new approach to governance means that pension fund business is delegated to a Pensions Committee with the support of an advisory Pensions Panel.

i) Pensions Committee

The Pensions Committee consists of nine members – six elected members from Falkirk Council and three members drawn from the Panel. The Committee meets on a quarterly basis with meetings being held mainly in public session. Members of the Committee are as follows:

| | | |
|------------------------------------|---|--|
| Councillor John Patrick (Convener) | - | Elected Member (Falkirk Council) |
| Councillor Jim Blackwood | - | Elected Member (Falkirk Council) |
| Councillor Thomas Coleman | - | Elected Member (Falkirk Council) |
| Councillor Steve Carleschi | - | Elected Member (Falkirk Council) |
| Councillor Craig Martin | - | Elected Member (Falkirk Council) |
| Councillor Dr CR Martin | - | Elected Member (Falkirk Council) |
| Councillor Callum Campbell | - | Employer Representative (Stirling Council) |
| Mr Alastair Redpath | - | Pensioner Representative |
| Miss Mary Keggan | - | Union Representative |

The Committee's key responsibilities are:-

- to oversee the administration of the Fund
- to manage the investments of the Fund
- to establish and review investment strategy
- to ensure the suitability and adequate diversification of investments
- to take proper advice in relation to investment matters
- to set the strategic asset allocation and individual manager benchmarks and targets
- to review the performance of investment managers on a regular basis
- to select and appoint investment managers and custodians as required
- to formulate and monitor a funding policy for the Fund
- to ensure the Fund is subject to actuarial valuations as required
- to approve the Annual Report and Accounts

(Councillors Patrick, Blackwood and Carleschi and Miss Keggan were active members of the Scheme during 2013/14. Mr Redpath is a pensioner member of the Scheme).

The Committee is supported at its meetings by officers and professional advisers. External Auditors were also in attendance at several of the 2013/14 meetings.

ii) Pensions Panel

The Panel comprises 15 members and includes Trade Union, Employer and Pensioner representatives. One member from each of these representative groups has been co-opted to sit on the Pensions Committee where they have full access to papers and voting rights. The Panel meets on a quarterly basis approximately two weeks prior to the corresponding Committee meeting. Members of the Panel are as follows:

| | | |
|---------------------------------------|---|--|
| Councillor Callum Campbell (Convener) | - | Employer Representative (Stirling Council) |
| Mr Willie Watson | - | Employer Representative (Stirling Council) |
| Mr Gordon Laidlaw | - | Employer Representative (Scottish Autism) |
| Mr Ed Morrison | - | Employer Representative (SCRA) |
| Mrs Jennifer Welsh | - | Employer Representative (SEPA) |
| Mrs Alison Stewart | - | Employer Representative (Forth Valley College) |
| Mrs Susan Mackay | - | Employer Representative (Clackmannanshire Council) |
| Councillor Archie Drummond | - | Employer Representative (Clackmannanshire Council) |
| Mrs Jackie McAuley | - | Employer Representative (Falkirk Council) |
| Vacant | - | Employer Representative (Falkirk Council) |
| Mr Alastair Redpath | - | Pensioner Representative |
| Mr Ian McLean | - | Pensioner Representative |
| Miss Mary Keggan | - | Union Representative |
| Mr Sandy Harrower | - | Union Representative |
| Mr Andy Douglas | - | Union Representative |

The Panel's main responsibility is to provide advice and guidance to the Pensions Committee on all matters relating to the business of the Falkirk Council Pension Fund. The Panel is also supported by officers and professional advisers.

Full details of the governance arrangements are set out in the Governance Compliance Statement which has been reproduced in Pages 7 to 11 of this report.

iii) Member Training

The Fund's training policy recognises that those persons involved in the governance of the Fund should have the necessary level of skills and knowledge to allow them to carry out their duties. Accordingly, various seminars, conferences and in house training events are made available for Committee and Panel members to attend. During 2013/14, these included:

02/10/2013 – Baillie Gifford – Local Authority Investment Seminar
12/10/2013 – Local Government Pension and Investment Forum
15/11/2013 – In house Training Event – on Assets, Equities and Bonds
12/12/2013 – COSLA - Reform of LGPS in Scotland

The Fund also hosted sessions on i) Accounting for Pensions and ii) Tax for High Earners. In Spring 2014 the Fund held its own annual Pensions and Investment Conference.

A training needs survey was carried out in December, 2013, the results of which are being taken into account in shaping future training arrangements.

iv) Attendance at meetings

Under the Governance arrangements, members of the Pensions Committee are required to attend at least three out of four Committee meetings annually. An analysis of attendance during 2013/14 showed that members were achieving the desired standard.

The Fund's governance policy, including the Governance Compliance Statement and Governance Training Statement, are set out in the Governance Framework documents.

Communications

Communication with stakeholder groups was achieved through emails, publication of committee minutes, newsletters, payslip messaging and the new pension fund website. The range of topics covered 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.

Funding Strategy Statement

The Fund's approach to dealing with the funding of its liabilities is set out in the Funding Strategy Statement.

More Information

Copies of the Statement of Investment Principles, the Funding Strategy Statement and the Governance Framework document are available from the Chief Finance Officer, Falkirk Council, Municipal Buildings, West Bridge Street, Falkirk FK1 5RS or at www.falkirkpensionfund.org.

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 2013/14 and meets the standards set out by the Scottish Public Pensions Agency in their paper of April 2011, entitled Governance Compliance Statement.

Principle A – Structure

| Requirement | | Level of Compliance | Arrangements in Place |
|-------------|---|---------------------|---|
| (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. | Full Compliance | 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. | Full Compliance | 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. | Full Compliance | <p>The main channel of communication between the Pensions Committee and the Pensions Panel lies with the three Committee members who are also Panel members.</p> <p>Communication is also assisted by synchronising Panel meetings with a corresponding Committee meeting and through the sharing of minutes.</p> |
| (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. | Full Compliance | Three places on the Pensions Committee are reserved for members of the Pensions Panel. |

Principle B – Representation

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|---|----------------------------|---|
| (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); | Full Compliance | 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); | Full Compliance | 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 | <p>There are no formal independent professional observers of Committee or Panel business.</p> <p>It is considered that:</p> <ul style="list-style-type: none"> the diversity of representation; (employers, pensioner and Unions) the annual audit process; and the attendance of professional advisors at most Panel and Committee meetings <p>provide robust and adequate scrutiny of pension fund business.</p> |
| | (iv) Expert advisors (on an ad-hoc basis). | Full Compliance | <p>Support for the Pensions Committee and Pensions Panel is provided by the undernoted advisors:</p> <ul style="list-style-type: none"> 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. | Full Compliance | 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 C – Selection and role of lay members

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|---|----------------------------|--|
| (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 | <p>Members of the Pensions Committee are subject to the Falkirk Council Councillors' Code of Conduct.</p> <p>Members of the Pensions Panel have been appointed on the understanding that they are subject to the Falkirk Council Councillors' Code of Conduct.</p> <p>Induction and ongoing training continues to be delivered to Committee and Panel members.</p> |
| (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 | <p>Declaration of interests is a standard procedure at the start of all Committee and Panel meetings. Declarations are noted in the minutes.</p> |

Principle D – Training/Facility Time/Expenses

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|--|----------------------------|--|
| (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. | Full Compliance | <p>The administering authority's approach to training is set out in its training policy for the Pensions Committee and Pensions Panel members.</p> <p>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.</p> <p>Expenses incurred by Committee and Panel members are met either by the Fund or the Falkirk Council scheme for payment of Members expenses.</p> |
| (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. | Full Compliance | <p>The Training Policy for the Pensions Committee and Pensions Panel applies uniformly to all members.</p> |
| (c) | That the Administering Authority considers the adoption of annual training plans for committee members and maintains a log of all such training undertaken. | Full Compliance | <p>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.</p> |

Principle E – Voting

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|--|----------------------------|--|
| (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. | Full Compliance | All members of the Pensions Committee including co-opted members have voting rights on the basis that they have executive responsibility for pension fund decision making. |

Principle F – Meetings (Frequency/Quorum)

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|--|----------------------------|--|
| (a) | That an Administering Authority's main committee or committees meet at least quarterly. | Full Compliance | 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. | Full Compliance | 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. | Full Compliance | 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 G – Access

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|--|----------------------------|---|
| (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. | Full Compliance | Members of the 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 H – Scope

| Requirement | | Level of Compliance | Arrangements in Place |
|--------------------|---|----------------------------|--|
| (a) | That Administering Authorities have taken steps to bring wider scheme issues within the scope of their governance arrangements. | Full Compliance | 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 | Arrangements in Place |
|--------------------|--|----------------------------|--|
| (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. | Full Compliance | 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. |

Certification

It is my opinion that the governance arrangements set out above provide reasonable and objective assurance that any significant risks impacting on the achievement of the principal objectives of the Pension Fund will be identified and actions taken to avoid or mitigate their impact.



Bryan Smail, CPFA MBA
Chief Finance Officer

Introduction

This part of the Annual Report provides a review of the Fund's administration, governance and investment activities during 2013/14 and a look forward at key themes expected to be of influence during 2014/15.

Business Context**Staffing**

The Pensions Section of Falkirk Council provides an in-house pensions administration and investment service to enable the Council to fulfil its statutory obligations within the terms of Local Government Pension Scheme. This is augmented through the Fund's service level agreement with the Lothian Pension Fund for the purpose of providing investment support, particularly in the areas of monitoring and reporting upon manager performance.

The Pensions Section consists of 11.5 full time equivalent staff and is headed by the Pensions Manager, who in the main reports directly to the Chief Finance Officer.

The composition of the Section is as follows:

| Role | Nos. | Average Years of Service | Pensions Qualification |
|--------------------------|-------------|---------------------------------|-------------------------------|
| Pensions Manager | 1 | 31 years | Yes |
| Pensions Project Officer | 1 | 43 years | Yes |
| Fund Accountant | 1 | 7 years | Yes |
| Pensions Officers | 2 | 28 years | Yes (1 post) |
| Pensions Support Officer | 1 | 23 years | No |
| Accountancy Assistant | 0.5 | 10 years | No |
| Trainee Pensions Officer | 1 | 0 years | No |
| Pensions Assistants | 4 | 13 years | No |
| Total | 11.5 | | |

Ethos

The Pensions Section contributes towards Falkirk Council's goals and values by discharging the Council's obligations as an administering authority. The Section recognises the need to provide an effective service and embraces the following mission statement:

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

The key objectives of the Pensions Section are:

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

Functions

The principle activities of the Pensions Section are:

- to oversee the implementation of the Fund's investment strategy
- to oversee the implementation of the Fund's funding strategy
- to undertake the administration obligations of the Fund, including the payment of benefits
- to provide information, guidance and communications material to Fund stakeholders
- to undertake the accounting obligations of the Fund
- to support the Pensions Committee and Pensions Panel in its activities
- to contribute to the development of public sector pensions policy

The work of the Section can be characterised broadly as being either Administration, Investment, Accounting, Governance or Communications related. The bulk of activity and staff time is however focused on administration related matters.

Systems

All Pensions Section staff have access to up to date computer hardware and operating systems. In addition to normal desktop software, the range of services provided by the Section requires it to have access to the following systems:

| System | Database | Purpose |
|---|-----------|------------------------------|
| In House Pensions Administration System | Ingres | Pensions Administration |
| Resourcelink | Oracle | Pensioner Payroll |
| Integra | Oracle | Financial Information System |
| Passport (Northern Trust) | Web Based | Custodian Information |
| Clydesdale Bank | Web Based | Fund Banking Information |

Within the Pensions Administration System, archive records of all Fund leavers since 1986 are held in electronic format.

The majority of investment managers, who manage assets for the Fund, have developed web based applications to enable clients to obtain up to date valuations and reports. Consolidated investment valuations are maintained by the Fund's Custodian Northern Trust, who also safeguard the Fund's assets and keep a record of transactions undertaken by managers.

Risk Management

Pension fund management is not immune from risk, whether this be a physical failure of hardware or a breakdown in systems of control. Whilst it is not possible to eliminate risk completely from day to day operational activity, the nature of risk has been evaluated and strategies put in place to minimise its adverse effects. These are set out in the following documents:

- the Operational Risk Management Action Plan
- the Finance Business Continuity Plan
- the Pensions Contingency Plan
- the Pension Fund Risk Register
- the Fund's Statement of Investment Principles

An analysis of investment risk is set out in note 23 (on page 44 of the Annual Report and Accounts).

Risk is a regular item of discussion at the quarterly Pensions Committee Panel meetings. The risk register can be viewed at www.falkirkpensionfund.org.

Service Standards

The key performance standards of the Pensions Section are:

- to maintain pension administration costs to less than £25 pa per scheme member
- to meet all deadlines for accounts, payments, statistical returns and remittances
- to respond to enquiries within 14 days

Performance information is supplied to both CIPFA and the Scottish Executive as part of an annual review of performance across all Councils. In addition, a range of detailed service standards have been developed by the Pensions Section.

Annual Review of 2013/14 Activities

As with 2012/13, 2013/14 was dominated by the pensions reform agenda and in particular by the well-publicised trio of state initiatives – the Public Service Pensions Act 2013, and Workplace Pensions (i.e. auto enrolment) and State Pension Reform.

Public Service Pensions Act 2013

The Public Service Pensions Act 2013, which contained many of the recommendations from the Hutton Review, received Royal Assent in May 2013. This requires that from April, 2015 public sector schemes, including the Local Government Pension Scheme, have to conform to a prescribed set of standards, such as:

- Having a Career Average structure
- Aligning scheme retirement age with State Pension Age
- Protecting the accrued rights of existing members on a final salary basis
- Providing additional protection for older members
- Having a mechanism to cap future costs for employers
- Instituting a national Scheme Advisory Board and local Pension Boards
- Giving greater powers given to Treasury and the Pensions Regulator

The process for reforming the Local Government Pension Scheme (LGPS) is being taking forward in Scotland by the Scottish Local Government Pension Advisory Group (SLOGPAG). The group consists of representatives from COSLA, Scottish Government and Trade Unions. A *Heads of Agreement on Scheme Design* was published in January, 2014. This confirmed that the accrual rate for LGPS 2015 would operate on a 1/49ths basis with revaluation at the rate of the Consumer Price Index. A *Heads of Agreement on Governance* is awaited and is expected to set out the basis on which local pension boards and the national Scheme Advisory Board are to function.

During the year the Pensions Section has contributed to various consultations pertaining to scheme reform.

Workplace Pensions Reform

Better known as Auto-Enrolment (AE), this initiative became law on 1st October, 2012, but did not affect any Falkirk Council Pension Fund employers until 2013/14. In essence, with effect from their auto enrolment start date (i.e. staging date), employers have to enrol certain categories of non scheme members into their auto enrolment nominated pensions vehicle. For local authorities the AE pensions vehicle is the Local Government Pension Scheme (Scotland) or, for teachers, the Scottish Teachers Superannuation Scheme.

The AE rules are complex and onerous in terms of the obligations placed on Payroll and HR administrators. The Pensions Section hosted 2 full day training events in 2012/13 to help prepare fund employers for the workload ahead.

Different employers within the Fund have taken differing approaches to auto enrolment with some postponing the enrolment of non joiners until 2017 and others embracing the enrolment concept in full.

The onset of auto-enrolment has generated a substantial increase in scheme membership (see Page 18). Going forward consideration will have to be given as to whether an additional resource is needed to support the increased throughput of records.

State Pension Reform

The Pensions Act 2014 confirmed that the UK Government is going ahead with its policy to replace the basic and additional State Pensions with a single-tier pension of £144 p.w. The change is scheduled to take place in April, 2016.

A key element of the reform is the ending of the National Insurance Contracting-Out rebate which is currently enjoyed by members and their employers. The cost to Falkirk Council as an employer has been estimated as £4m p.a. with the cost to Scottish local government generally being put at £125m.

Other Activities

Other key initiatives successfully completed during 2013/14 were as follows:

- pensioner payroll year end including pensions increase and P60 distribution
- FRS 17 and IAS 19 exercise
- audited Pension Fund Annual Report and Accounts for 2012/13
- active and deferred member benefit statements and newsletter
- risk register
- cash management strategy
- hosting of annual conference and other Panel and Committee training events
- annual allowance tax assessments
- processing of 2,000 protection certificates
- various requests from employers for cessation information
- participation in Club Vita
- decision made to invest in social and affordable housing
- commitments made to Wilshire Private Equity Fund IX and M&G UK Companies Financing Funds

Performance Indicators

| | Target | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|--------------------------------------|---------------------------|---------|---------|---------|---------|
| Annual Member Admin. Cost | Under £25 per member | £16.12 | £16.45 | £14.50 | £15.77 |
| Staff / Member ratio | Between 1:2500 and 1:3200 | 1:2893 | 1:2932 | 1:2972 | 1:3237 |
| No of Complaints | 0 | 4 | 1 | 1 | 3 |
| * Answer ad hoc enquiries in 14 days | 90% | 71% | 72% | 73% | 73% |
| Lump Sums payments | Pay within 7 days | 92% | 99% | 99% | 99% |

*The enquiries completion rate in 2013/14 was affected by the resignation of a Pensions Assistant in September, 2013. This post has now been replaced with a Trainee Pensions Officer but appointment to that post was not made until April, 2014.

Business Outlook

Triennial Valuation

2014/15 promises to be an especially challenging year for local authority pension funds in Scotland. The early part of the year is likely to be dominated by preparations being made for the actuarial valuation of 31 March 2014. The valuation will set the employer contribution rates for the three years starting from 1st April 2015 and will be eagerly awaited by employers given the current level of financial settlements. Results are expected in late autumn.

The results of the valuation will also be the catalyst for a review of investment strategy through an asset / liability modelling exercise and could potentially trigger the movement of assets between asset classes. The outcome of the asset review may also be influenced by the Department of Communities and Local Government (DCLG) call for (i) funds to collaborate more widely through collective investment arrangements (ii) for fund of fund structures to be phased out and (iii) for a greater proportion of assets to be managed passively.

During 2013/14, the Fund participated in Club Vita, an analytical longevity review service provided through the Fund's actuarial advisers, Hymans Robertson. It is hoped that by participating in Club Vita, the actuary will be able to formulate more accurate longevity assumptions as part of the valuation process.

The Reform Agenda

The latter part of 2014/15 will inevitably focus on the next incarnation of the Local Government Pension Scheme, namely the Career Average Revalued Earnings (CARE) arrangement being introduced from 1st April, 2015. Various statutory instruments are expected to be laid in the first half of 2014/15 to flesh out the precise terms of the new arrangements and to enable administrators and software developers to formulate their preparations for CARE.

Although the CARE arrangement begins on 1st April, 2015, the rights of existing members are to be protected on a final salary basis, meaning that most members in the Fund will have a benefit that is a mixture of Final Salary and Career Average. The complexities of this arrangement mean that the existing in-house Pensions Administration System is no longer fit for purpose. A new system will therefore be procured in 2014/15 and a project plan put in place to migrate data to the new system.

Arrangements are in hand to provide the Pensions staff and Fund employers with training on the new CARE Scheme. Additionally, a Communications strategy has been agreed nationally by all Scottish Funds with the aim of publicising the new Scheme to members before April next year.

The impact of the Public Service Pensions Act 2013 is not confined to administrative matters, but also extends to governance matters by requiring Funds to establish Pension Boards to help support Pensions Committees in complying with scheme rules and any codes of practice from the Pensions Regulator.

Miscellaneous

In order to promote/improve the take up of AVCs within the Fund, Prudential have been appointed to act as joint AVC Providers with Standard Life. This option should be available by late summer 2014.

The Scottish Public Pensions Agency (SPPA) is assuming responsibility for the pensions administration of officers in the Police Pension Schemes and the Firefighters Pension Schemes. The Pensions Section currently administers the rights of active, deferred and pensioner members of the former Central Scotland Police and Central Scotland Fire and Rescue Service. The migration of data to SPPA is expected to take place in late 2014/15 with a view to SPPA assuming responsibility by April 2015.

The provision of monthly payslips for pensioners costs around £25,000 per annum. Other costs arise from the despatch of newsletters and benefit statements by post. It is intended during the next 18 months to investigate the alternatives to paper payslips, although this timeframe may be affected by the facilities available within the newly procured Pensions Administration System.

The action of Clackmannanshire and Stirling Councils to implement an across the board pay cut has generated around 4,000 Protection Certificates. This will create an administrative overhead for both the Pensions section and feeder Payroll sections.

Following the Fund's £30m investment in Social and Affordable Housing, attention will be focused on the speed with which capital can be deployed by the Fund Manager Hearthstone and new housing units delivered.

The Fund's service level agreement with City of Edinburgh Council is scheduled to be reviewed during 2014/15 at which time options for joint investment in infrastructure projects will be considered.

The Government's decision to reduce the Annual Allowance tax threshold to £40,000 and lifetime allowance to £1.25m from 1st April, 2014 means that the tax rules will assume even greater significance to higher earners with more members than ever before being affected.

Conclusion

2013/14 has seen the continuation of a number of important activities both from an investment and administrative perspective. 2014/15 promises to be equally challenging with no let up in the pace of reform or goals to be met.

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, staff transfers, changes in scheme rules or Government initiatives.

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

Factors affecting recent membership numbers are as follows:

- i) 2013/14 has seen a substantial increase in the number of active members. This is the result of certain employers (e.g. Falkirk Council, Clackmannanshire Council, SEPA, Scottish Autism, Forth Valley College) implementing full auto enrolment including the enrolment of non scheme joiners and new employees. It should be borne in mind that a significant number of the new members will be part time and thus the overall effect on the scheme's maturity may not be as great as the increase in member numbers would suggest;
- ii) the challenging financial environment of the past few years continues to result in a steady flow of employees being granted early retirement thus creating a downward pressure on active membership but increasing pensioner member 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 and pensioner members continues to grow reflecting early retirement initiatives and workforce fluidity amongst Fund employers.

Number of Scheme Members

| | Membership 31/03/12 | Membership 31/03/13 | Membership 31/03/14 |
|---|--------------------------------|--------------------------------|--------------------------------|
| All Fund Employers | | | |
| Actives | 12,668 | 12,880 | 14,690 |
| Deferreds | 5,085 | 5,204 | 5,320 |
| Pensioners | 8,119 | 8,372 | 8,693 |
| | <u>25,872</u> | <u>26,456</u> | <u>28,703</u> |
| Maturity Level (% of Deferred + Pensioner members to Total) | 51.04% | 51.32% | 48.82% |
| Scheduled Bodies | | | |
| Actives | 11,286 | 11,450 | 13,086 |
| Deferreds | 4,518 | 4,599 | 4,685 |
| Pensioners | 7,779 | 7,996 | 8,284 |
| | <u>23,583</u> | <u>24,045</u> | <u>26,055</u> |
| Admission Bodies | | | |
| Actives | 1,382 | 1,430 | 1,604 |
| Deferreds | 567 | 605 | 635 |
| Pensioners | 340 | 376 | 409 |
| | <u>2,289</u> | <u>2,411</u> | <u>2,648</u> |

Figure A below shows that whilst total Fund membership (i.e. active, deferred and pensioner members) has been steady over the past few years, there has been a substantial rise in 2013/14.

Figure A - Fund Membership from 1996 – 2014 in aggregate

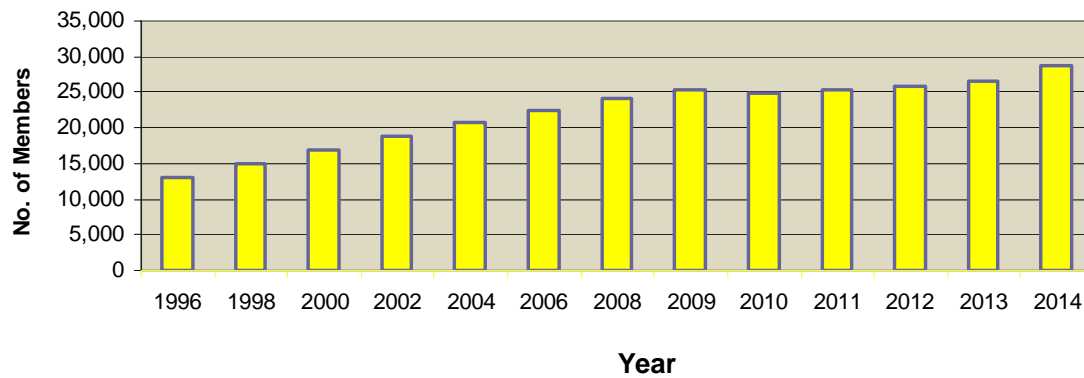
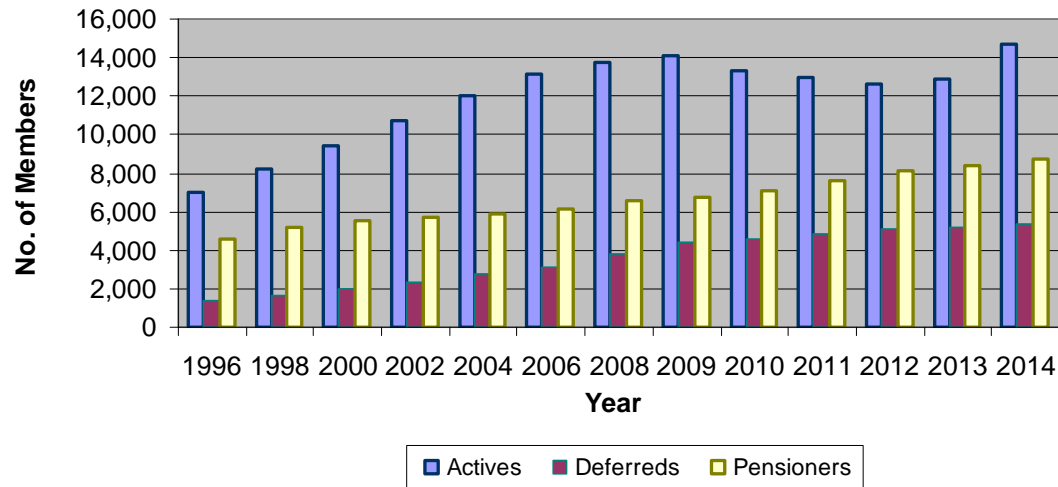


Figure B shows the growth in Membership split between active, deferred and pensioner members.

Figure B - Fund Membership from 1996 – 2014 by category



Statement by Schroders Investment Management Ltd, Fund Managers

The fragile economic recovery of 2013 paused in the first quarter. A number of factors helped stall the global economy and markets at the start of 2014.

US economic data improved over the course of 2013, prompting the Federal Reserve (Fed) to say in May that it might 'taper' its \$85 billion a month quantitative easing programme. However, it took until December to confirm the start. This and severe weather held back the economy in the first quarter.

China's previous rapid growth faltered in 2013 and continued to disappoint in the first quarter. Both manufacturing data and exports fell in the opening months of 2014. The radical policies of Prime Minister Shinzo Abe helped Japan's economic indicators to start moving in the right direction in 2013. However, growth was subsequently revised down, while the trade deficit continued to widen. Fears about April's rise in the consumption tax weighed on investors.

The struggles of many emerging markets beyond China continued. Several countries seen as vulnerable to a squeeze on money flows as a result of Fed tapering saw their currencies hit at the start of the year. Rising tensions over Ukraine was a major factor holding back markets in March.

In the eurozone, a fitful recovery finally began in the second quarter of 2013, helped by the European Central Bank cutting its interest rates in May to 0.5% and in November to 0.25%. Economic growth started to broaden out in 2014, albeit at a subdued rate. Elsewhere in Europe, the UK economy surprised many by its strength, while inflation remained subdued, although there were worries in some quarters that a new housing bubble is being inflated.

Lacklustre returns in the first quarter pared last year's strong returns from developed market equities, but still left the MSCI World Index up 19.6% in dollar terms over the 12 months to March. Continued signs of growth in the eurozone helped the MSCI EMU Index advance 34.1% in dollar terms. Japan's TOPIX Index was up 22.6% in dollars, despite a weak first quarter. The S&P 500 was only slightly behind, with a 22.4% rise which again breached all-time highs.

Fixed income markets changed tack over the 12 months. Bonds generally underperformed equities in 2013 as investors anticipated the Fed's tapering and started to favour riskier assets. Yields on Treasuries and UK gilts rose above 3% by the year end. However, defying many predictions, fixed income broadly outperformed equities in the first quarter. Treasury yields fell sharply in January, prompted by emerging market volatility and weak US economic data, while emerging market debt subsequently recovered the losses suffered in January.

Schroder Investment Management Limited,
31 Gresham Street,
London EC2V 7QA

Investment Strategy

Following the Fund actuarial valuation on 31 March 2011, the Investment Committee agreed to implement a revised Investment Strategy in which the Fund was to decrease its allocation to traditional investments such as Equities and Bonds and increase its holding in Alternative Assets. In this context, Alternative Assets include Diversified Growth Funds, Credit Markets, Infrastructure and Private Equity.

The revised allocation targeted a 10% decrease in equities and 5% decrease in bonds. This restructuring enabled the Fund to appoint Baillie Gifford to manage a Diversified Growth mandate and Credit Suisse to manage an Infrastructure mandate, with both appointments taking place in 2011/12.

Throughout 2013/14 the Fund has continued to build upon this strategy, making additional commitments to the Private Equity and Credit Markets and seeking to reduce equity exposure as rebalancing opportunities arose. Given the strong performance of UK Equities during the year and an announcement from Baillie Gifford that it was closing its Diversified Growth fund to further investments, the opportunity was taken to reinvest £40m of equities in the Baillie Gifford Fund as part of a general rebalancing exercise.

The Fund also continued to progress its programme of Infrastructure investments, providing a further \$13m in funding during the year to Grosvenor Capital Management – Grosvenor having taken ownership of the Customised Infrastructure Strategies Fund from Credit Suisse. The investments made to this Fund during the year has left it close to its commitment level.

A comparison of the strategic allocation of Fund Assets with the actual allocation at 31 March 2014 is set out below:

| Asset Class | Strategic Allocation % | Allocation as at 31/03/14 % |
|-----------------------------|-------------------------------|------------------------------------|
| Equities | 60 | 63 |
| Bonds | 10 | 9 |
| Property | 10 | 7 |
| Alternatives | 20 | 19 |
| • <i>Private Equity</i> | 5 | 5 |
| • <i>Infrastructure</i> | 5 | 2 |
| • <i>Diversified Growth</i> | 10 | 12 |
| Cash | - | 2 |

The Fund is holding a 2% allocation to cash in anticipation of making imminent investments in Social and Affordable Housing and in UK Infrastructure. These investments will help to address the current underweight positions of Property and Infrastructure respectively, with the first capital outlays on course for 2014/15.

The Fund has also initiated work to further analyse its cash position. Initial forecasts suggest that the Fund will be cash positive by around £20m p.a. for each of the next few years (i.e. pension contributions will outstrip pension benefits by that margin). The Fund plans to build on this analysis, incorporating the results of the 2014 valuation and the implementation of the CARE scheme, to produce longer term forecasts, including an estimate of when the Fund will become cash neutral or negative.

As mentioned above, 2014 will see the Fund undertake its triennial valuation. This will be accompanied by a re-assessment of the investment strategy to be undertaken with the assistance of the Fund's investment adviser. In the meantime the Fund will continue to monitor global market conditions and respond to potential opportunities/threats as they occur.

Investment Monitoring

Regulation 10 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) 2010 (SSI 2010/233) requires the periodic monitoring and review of investment managers performance. In 2012 the Fund entered into a shared service agreement with City of Edinburgh Council (Lothian Pension Fund) to assist with this activity.

As part of the monitoring process, Officers from the Lothian and Falkirk Funds have regular meetings with external managers to discuss their individual performance, process and strategy. Details of each Managers' performance and comment on their activities is provided to the Pensions Panel and Committee at the quarterly meetings. This helps to ensure that appropriate oversight and control is exercised by the Fund.

Investment Performance

The Fund's total returns over the short, medium and long term are set out below.

Short Term (1 year)

The Fund earned a return of 6.9% surpassing its benchmark by 0.9%. Strong performances in developed markets, particularly the UK, were negated slightly by exposure to emerging markets.

Medium Term (3 years)

The Fund's return of 8.8% has outperformed its benchmark return by 2.2%. Over this period, the Fund benefited from a strong performance by its Bond and UK Equity managers.

Longer Term (10 years)

The Fund's longer term performance of 7.9% has slightly outperformed the benchmark return by 0.2% p.a. This remains just ahead of price and wage inflation to which the pension fund liabilities are linked.

Returns showing the rolling 3 yearly performance of the Fund for the past decade are shown overleaf in the graph on page 23.

Annualised returns to 31 March 2014

| | 1 Year | 3 Years | 10 Years |
|------------------------------|--------|---------|----------|
| | % | % | % |
| Falkirk Council Pension Fund | 6.9 | 8.8 | 7.9 |
| Benchmark | 6.0 | 6.6 | 7.7 |
| Retail Prices Index | 2.5 | 3.1 | 3.3 |
| Consumer Price Index | 1.7 | 2.6 | 2.7 |
| National Average Earnings | 3.0 | 1.3 | 2.8 |

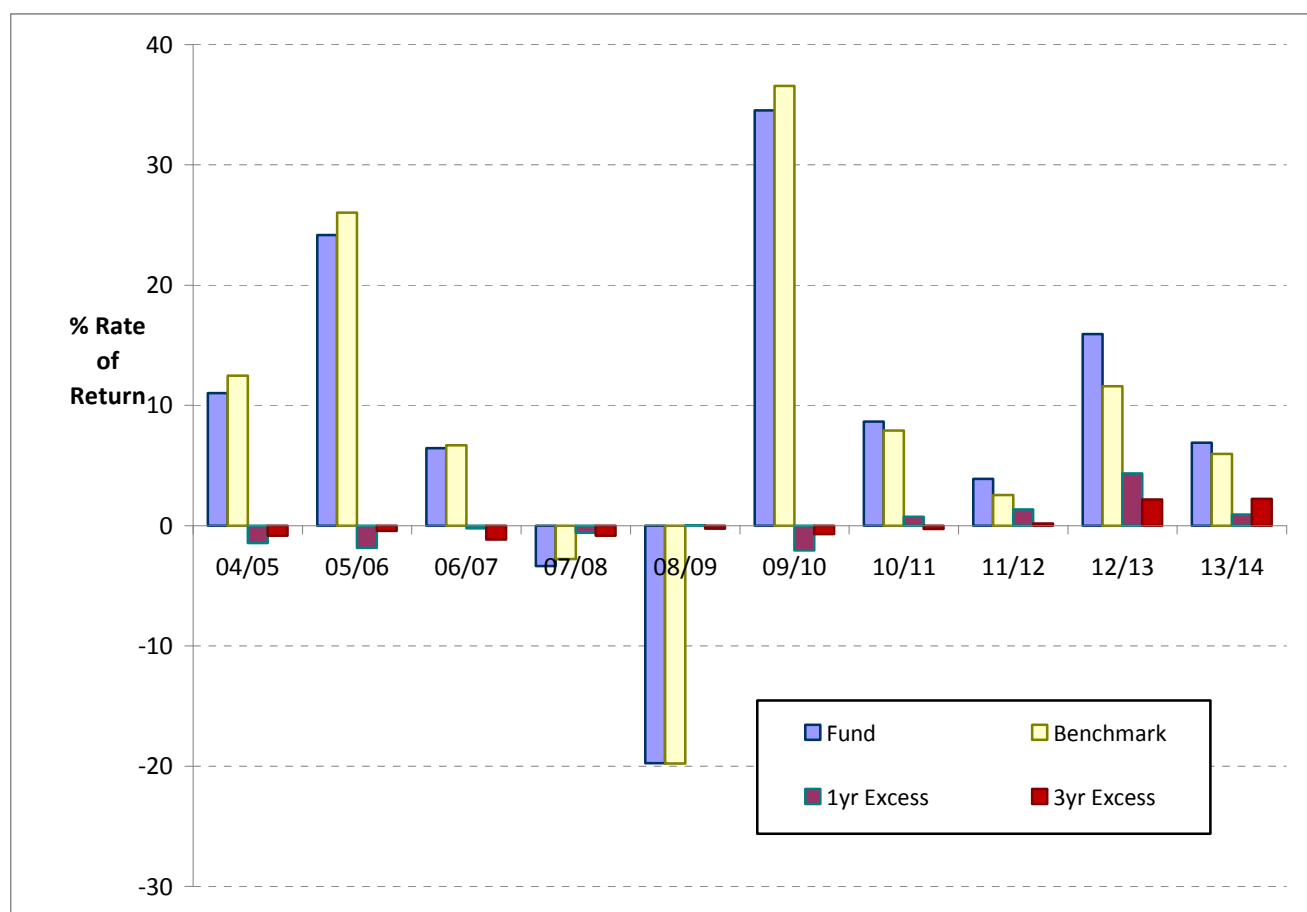
Manager Returns

Individually, the Fund's investment managers had the following performance against benchmark over the financial year:

| Investment Manager | Mandate | 1 Year | Benchmark |
|--|--------------------------------|--------|-----------|
| | | % | % |
| Aberdeen Asset Management | Global Equities | 1.58 | 6.72 |
| Baillie Gifford Life Ltd | Bonds | (0.61) | (0.85) |
| Baillie Gifford Life Ltd | Diversified Growth | 1.63 | 0.5 |
| Legal & General Investment Management Ltd. | Passive Equities | 8.11 | 7.92 |
| Newton Investment Management Ltd. | Global Equities | 6.79 | 6.75 |
| Schroder Investment Management Ltd. | UK Equities | 17.91 | 8.81 |
| Schroder Investment Management Ltd. | Property | 10.26 | 11.87 |
| Alternatives | Private Equity/ Infrastructure | 2.09 | 0.35 |

Rolling 3 Years Performance

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



| | Mar-05 % | Mar-06 % | Mar-07 % | Mar-08 % | Mar-09 % | Mar-10 % | Mar-11 % | Mar-12 % | Mar-13 % | Mar-14 % |
|------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Fund | 11.02 | 24.18 | 6.46 | -3.36 | -19.75 | 34.53 | 8.65 | 3.91 | 15.94 | 6.89 |
| Benchmark | 12.47 | 26.03 | 6.7 | -2.76 | -19.77 | 36.57 | 7.92 | 2.55 | 11.59 | 5.96 |
| 1yr Excess | -1.45 | -1.85 | -0.23 | -0.6 | 0.03 | -2.04 | 0.73 | 1.36 | 4.35 | 0.93 |
| 3yr Excess | -0.84 | -0.44 | -1.14 | -0.84 | -0.25 | -0.71 | -0.28 | 0.19 | 2.16 | 2.23 |

Investment Holdings

The Fund's current 10 largest individual stock holdings are listed below -

| Stock | Market Value as at 31st March 2014 (£) |
|--------------------------------------|--|
| VODAFONE GROUP ORD USD0.2095238 | 19,726,120.81 |
| ASTRAZENECA ORD USD0.25 | 15,531,984.72 |
| GLAXOSMITHKLINE ORD GBP0.25 | 15,484,884.80 |
| ROYAL DUTCH SHELL 'B'ORD EUR0.07 | 15,086,769.38 |
| ROCHE HLDGS AG GENUSSSCHEINE NPV | 14,324,114.22 |
| BRITISH AMERICAN TOBACCO ORD GBP0.25 | 13,131,195.65 |
| BP ORD USD0.25 | 12,820,147.20 |
| NOVARTIS AG CHF0.50 (REGD) | 12,242,653.19 |
| NESTLE SA CHF0.10(REGD) | 9,945,939.27 |
| UNITED TECHNOLOGIES CORP COM | 9,493,352.32 |

As a responsible investor, the Fund seeks to promote corporate responsibility and good practice 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 18 to the financial statements, page 40);
- the Fund's Pensions and Investment Research Consultants (PIRC) who provide advice and research services on all matters pertaining to corporate governance and shareholder voting responsibilities; and
- the Fund's membership of the Local Authority Pension Fund Forum (LAPFF) comprising 58 local government pension funds which exists to promote and maximise investment interests of Funds.

The Fund could potentially allow managers to exercise votes on its behalf at company meetings, however in order to ensure a consistent approach to voting, it has for the past few years engaged PIRC to undertake this service through its Proxy Voting facility.

During 2013/14, PIRC voted at 135 company meetings with 1371 votes being cast in favour of resolutions, 362 being opposed and 155 being cases of abstentions. Areas where negative votes were cast related predominantly to companies remuneration policies though PIRC also took an active role in challenging policies on gender balance on boards, conflicts of interest, and auditor independence.

PIRC generally attend one Panel and one Committee meeting each year in order to brief members about the latest developments in corporate governance. An update on corporate governance matters is given to members at the quarterly Panel and Committee meetings.

The Fund's corporate governance responsibilities 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. Under the seven principles, companies are required to:

1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

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.

PENSION FUND ACCOUNT

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

| 2012/13 £'000 | CONTRIBUTIONS AND BENEFITS | 2013/14 £'000 | Note |
|------------------|---|------------------|------|
| | Dealings with members, employers and others directly involved in the fund | | |
| 69,130 | Contributions | 76,433 | 8 |
| 4,383 | Transfers from Other Pension Funds | 3,316 | 9 |
| 73,513 | | 79,749 | |
| (52,729) | Benefits | (56,485) | 10 |
| (4,058) | Payments to and on account of leavers | (4,655) | 11 |
| (375) | Administrative and Other Expenses | (430) | 12 |
| (57,162) | | (61,570) | |
| 16,351 | Net Additions from dealing with Members | 18,179 | |
| | RETURNS ON INVESTMENTS | | |
| 21,607 | Investment Income | 26,484 | 13 |
| (229) | Taxes on Income | (268) | 14 |
| 179,033 | Profit and losses on disposal of investments and changes in market value of investments | 75,301 | 16 |
| (5,676) | Investment Management Expenses | (6,090) | 15 |
| 194,735 | Net Return on Investments | 95,427 | |
| 211,086 | Net Increase/(Decrease) in the net assets available for benefits during the year | 113,606 | |
| 1,251,989 | Opening Net Assets as at 1 April 2013 | 1,463,075 | |
| 1,463,075 | Closing Net Assets as at 31 March 2014 | 1,576,681 | |

PENSION FUND NET ASSETS STATEMENT

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

| 2012/13 £'000 | | 2013/14 £'000 | Note |
|------------------|--|------------------|------|
| 1,445,385 | INVESTMENT ASSETS | 1,575,496 | 16 |
| (341) | INVESTMENT LIABILITIES | (7,601) | 16 |
| 1,445,044 | | 1,567,895 | |
| | NON-CURRENT ASSETS | | |
| 1,611 | Long Term Debtors | 816 | 26 |
| | CURRENT ASSETS | | |
| 12,419 | Cash Balances | 4,228 | 27 |
| 6,878 | Debtors | 6,735 | 28 |
| | CURRENT LIABILITIES | | |
| (2,877) | Creditors | (2,993) | 29 |
| 1,463,075 | NET ASSETS OF THE FUND AVAILABLE TO FUND BENEFITS AT THE PERIOD END | 1,576,681 | |

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 25.

The unaudited accounts were issued on 30 June 2014 and the audited accounts were authorised for issue by Bryan Smail, Chief Finance Officer on xx September 2014. The Statement of Accounts presents a true and fair view of the financial position of the Pension Fund as at 31 March 2014 and their income and expenditure for the year ended 31 March 2014.



Bryan Smail, CPFA MBA
Chief Finance Officer

1. Fund and Scheme Overview**Introduction**

As part of its statutory obligations, Falkirk Council is required to operate the terms of the Local Government Pension Scheme (LGPS), including the maintenance and administration of a pension fund.

The LGPS is a public sector statutory scheme which provides defined benefits on a final salary basis. The Scheme was established under the Superannuation Act 1972. It is also contracted-out of the State Second Pension and is 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 primarily set out in the following statutory instruments:

- the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008;
- the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008; and
- the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2010.

Administration of the Fund is undertaken by an in-house team who oversee the benefits of contributors, deferred members and pensioners on behalf of Clackmannanshire, Falkirk and Stirling Councils, as well as for around 35 other employers. Teachers, Police and Firefighters do not come within the scope of the LGPS as they have their own national pension arrangements. A full list of employers who participate in the Falkirk Council Pension Fund is included in this report on Page 55.

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 Pensions Committee and advisory Pensions Panel. Support on investment matters is also provided through a service level agreement with the City of Edinburgh Council.

Membership

Membership of the LGPS is voluntary and, although employees may have been enrolled in the scheme automatically (either as a result of auto enrolment legislation or the Scheme's own contractual enrolment provisions), employees are free to choose whether to remain in the scheme or, having opted out, join it at a later date.

Organisations participating in the Scheme fall into two categories, namely:

Scheduled Bodies - organisations such as local authorities that are statutorily required to offer the Scheme to their employees; and

Admission Bodies - mainly charitable, non-profit making bodies that have reached an agreement with an Administering Authority to participate in the Scheme.

Around 40 employing bodies participate in the Falkirk Council Pension Fund. Full details of membership numbers are contained on Page 18 of the Annual Report.

Funding

Benefits are funded by contributions and returns on investments. Contributions are made by active members of the fund in accordance with the LGPS (Benefits, Membership and Contributions) (Scotland) Regulations 2008. The rate of employee contribution varies depending on a member's full time equivalent pensionable pay with designated pay bands attracting rates of between 5.5% and 12%.

Employee Contributions are matched by employer contributions which are based on the results of the three yearly actuarial funding valuation. The last such valuation was at 31st March, 2011. For the majority of fund employers in 2013/14, contribution rates were in the range 17% – 22% of pensionable pay. Full details of employer contribution rates can be found in the Valuation Report at www.falkirkpensionfund.org.

Benefits

Benefits under the LGPS are based on final pensionable pay and length of pensionable service, and are summarised below:

| | Service pre 1 April 2009 | Service post 31 March 2009 |
|----------|---|---|
| Pension | Each year worked is worth 1/80 th x final pensionable salary | Each year worked is worth 1/60 th x final pensionable salary |
| Lump Sum | Automatic lump sum of 3 x annual pension In addition, part of the pension may be exchanged for a lump sum. The conversion rate is £12 of lump sum for each £1 surrendered. The lump sum cannot be greater than 25% of the capital value of the pre 2009 and post 2009 pension rights. | No automatic lump sum Part of the pension may be exchanged for a lump sum. The conversion rate is £12 of lump sum for each £1 surrendered. |

Additionally, the Scheme provides a range of inflation proofed benefits including early payment of pension and lump sum on ill health or redundancy grounds, as well as death and survivor benefits.

The measure of inflation currently used by the Scheme in determining annual increases is the Consumer Price Index. Prior to April, 2010, the measure used was the Retail Price Index.

More information about scheme benefits can be found in the Member's Handbook which is accessible at www.falkirkpensionfund.org.

LGPS 2015

The Public Service Pensions Act 2013 requires that certain changes are made to public sector pension schemes by 1st April, 2015. The main changes affecting the LGPS are as follows:

- Scheme will operate on Career Average Re-valued Earnings (CARE) basis;
- Normal Retirement Age will be aligned with each member's own State Pension Age;
- Membership rights up to 31st March, 2015 will be protected on Final Salary basis;
- Transitional protection will exist for those closest to retirement; and
- The Scheme will have a national Advisory Board and local Pension Boards.

New regulations setting out details of LGPS 2015 were laid in June, 2014. Transitional and Governance regulations are expected to follow later in 2014.

2. Prior Year Adjustment

During the year, the Fund has changed its accounting policy in two areas such that a restatement of the 2012/13 results is required.

The first policy change relates to the treatment of balances due to brokers at year end. Previously a net figure was used and recognised within Other Investment balances. The new treatment recognises balances to/from brokers and this has impacted on both the Fund's assets and liabilities.

| | 2012/13 Restated Balance | Adjustment |
|------------------------|---|-------------------|
| | £'000 | £'000 |
| Investment Assets | 1,445,385 | 283 |
| Investment Liabilities | (341) | (283) |

The second policy change relates to the treatment of direct management expenses arising from the Fund's Alternative investments. Previously due to the complex nature of Private Equity and Infrastructure investments, management fees were rolled up within the investment and so would flow through as a loss on investment. The accounting treatment has been revised to recognise direct expenses relating to the management of these funds and include them within Investment Management Expenses. This has increased the Fund's Profit and loss on disposal as well as its Investment Management Expenses.

| | 2012/13 Restated Balance | Adjustment |
|---|---|-------------------|
| | £'000 | £'000 |
| Profit and losses on disposal of investments and changes in market value of investments | 179,033 | 1,558 |
| Investment management expenses | (5,676) | (1,558) |

3. Basis of Preparation

The Statement of Accounts summarises the Fund's transactions for the 2013/14 financial year and its financial position as at the year end of 31 March 2014. The accounts also report on the net assets available to pay pension benefits.

The accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts do not take account of obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis is disclosed at Note 25 of these accounts.

Amendments to accounting standard IAS 32 came into effect in January 2014 and changes to IFRS 13 come into effect in July 2014. Neither will have any effect on the Fund as it is already in compliance with the requirements.

4. Summary of Significant Accounting Policies

Fund account - revenue recognition

a) Contribution income

Normal contributions, both from the members and from employers, are accounted for on an accruals basis. Employer contributions are made at the percentage rate recommended by the Fund Actuary in the payroll period to which they relate. Employee contributions are made in accordance with the rates specified in the Scheme rules.

Employers' augmentation contributions and pension strain contributions are accounted for in the period in which the liability arises.

Any amount due in year but unpaid will be classed as a current financial asset. Amounts not due to be paid until future years are classed as long-term financial assets.

b) Transfers to and from other schemes

Transfer values represent the amounts received and paid during the year for members who have either joined or left the fund and are calculated in accordance with guidance from the Government Actuary. Individual transfers in/out are accounted for when received/paid, which is normally when the member liability is accepted or discharged.

Transfers in from members wishing to use the proceeds of their additional voluntary contributions to purchase scheme benefits are accounted for on a receipts basis and are included in Transfers In.

c) Investment income

i) Interest income

Interest income is recognised in the fund account as it accrues, using the effective interest rate of the financial instrument as at the date of acquisition or origination. Income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of the instrument and its amount at maturity calculated on an effective interest rate basis.

ii) Dividend income

Dividend income is recognised on the date the shares are quoted ex-dividend. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iii) Distributions from pooled funds

Distributions from pooled funds are recognised at the date of issue. Any amount not received by the end of the reporting period is disclosed in the net assets statement as a current financial asset.

iv) Property related income

Property-related income consists primarily of rental income.

Rental income from operating leases on properties owned by the fund is recognised on a straight-line basis over the term of the lease. Any lease incentives granted are recognised as an integral part of the total rental income, over the term of the lease.

Contingent rents based on the future amount of a factor that changes other than with the passage of time, such as turnover rents, are only recognised when contractually due.

v) Movement in the net market value of investments

Changes in the net market value of investments (including investment properties) are recognised as income and comprise all realised and unrealised profits/losses during the year.

Fund account - expense items

d) Benefits payable

Pensions and lump sum benefits payable include all amounts known to be due as at the end of the financial year. Any amounts due but unpaid are disclosed in the net assets statement as current liabilities.

e) Taxation

The Fund is a registered public service scheme under section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as a fund expense as it arises.

f) Administrative expenses

All administration expenses are accounted for on an accruals basis. Costs directly related to Fund activities are being charged to the Fund during the financial year. Costs which relate to both Fund and Non-Fund activities are apportioned between the Fund and the sponsors of the other pension arrangements administered by the Pensions Section. Any apportionment is carried out on the basis of share of aggregate membership numbers.

g) Investment management expenses

All investment management expenses are accounted for on an accruals basis.

Fees of the external investment managers and custodian are agreed in the respective mandates governing their appointments. Broadly, these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments change.

The cost of obtaining external investment advice and the fee in respect of the shared service agreement with City of Edinburgh Council (Lothian Pension Fund) is included in investment management charges.

The costs of the in-house investment administration team are charged to the Fund. The basis of allocation is as per the administration expenses described above.

Net assets statement

h) Financial assets

Financial assets are included in the net assets statement on a fair value basis as at the reporting date. A financial asset is recognised in the net assets statement on the date the fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes in the fair value of asset are recognised by the fund.

The values of investments as shown in the net assets statement have been determined as follows:

i) Market quoted investments

The value of an investment for which there is a readily available market price is determined by the bid market price ruling on the final day of the accounting period.

ii) Unquoted investments

The fair value of investments for which market quotations are not readily available is determined as follows:

- valuations of delisted securities are based on the last sale price prior to delisting, or where subject to liquidation, the amount the Council expects to receive on wind-up, less estimated realisation costs
- securities subject to takeover offer – the value of the consideration offered under the offer, less estimated realisation costs
- directly held investments include investments in limited partnerships, shares in unlisted companies, trusts and bonds. Other unquoted securities typically include pooled investments in property, infrastructure, debt securities and private equity. The valuation of these pools or directly held securities is undertaken by the investment manager or responsible entity and advised as a unit or security price. The valuation standards followed in these valuations adhere to industry guidelines or to standards set by the constituent documents of the pool or the management agreement.
- investments in unquoted property and infrastructure pooled funds are valued at the net asset value or a single price advised by the fund manager
- the values of the investments in unlisted private equity and infrastructure are based on valuations provided by the general partners to the 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. The 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.

iii) Pooled investment vehicles

Pooled investment vehicles are valued at closing bid price if both bid and offer prices are published; or if single priced, at the closing single price. In the case of pooled investment vehicles that are accumulation funds, change in market value also includes income which is reinvested in the fund, net of applicable withholding tax.

iv) **Freehold and leasehold properties**

The Fund's direct property holding was valued at 31 March 2014 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 due 31 March 2017. The valuer's opinion of market value and existing use value was primarily derived using comparable recent market transactions on arms-length terms at the time of the valuation.

i) **Foreign currency transactions and balances**

Dividends, interest and purchases and sales of investments in foreign currencies have been accounted for at the spot market rates at the date of transaction. End-of-year spot market exchange rates are used to value a) cash balances held in foreign currency bank accounts, b) market values of overseas investments and c) purchases and sales outstanding at the end of the reporting period.

j) **Derivatives**

Derivative contract assets are fair valued at bid prices. Derivative contract liabilities are fair valued at offer prices. Changes in the fair value of derivative contracts are reflected within the change in market value in the net assets statements.

The value of futures contracts is determined using exchange prices at the reporting date. Amounts due from or owed to the broker are the amounts outstanding in respect of the initial margin and variation margin.

The future value of forward currency contracts is based on market forward exchange rates at the year-end date and determined as the gain or loss that would arise if the outstanding contract were matched at the year-end with an equal and opposite contract.

k) **Cash and cash equivalents**

Cash comprises cash in hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to minimal risk of changes in value.

l) **Financial liabilities**

The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the net assets statement on the date the Fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised.

m) **Actuarial present value of promised retirement benefits**

The actuarial present value of promised retirement benefits of the Fund is assessed on an annual basis by the Fund Actuary in accordance with the requirements of IAS 19 and relevant actuarial standards. As permitted under IAS 26, the Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the net assets statements.

n) **Additional voluntary contributions**

The Fund provides an additional voluntary contributions (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. The Fund has appointed Standard Life as its AVC provider. AVCs are paid to Standard Life by employers and are specifically for providing additional benefits for individual contributors. Each AVC contributor receives an annual statement showing the amount held in their account and the movements in the year. (n.b. Prudential have been appointed as joint AVC providers with Standard Life from June 2014).

In accordance with regulation 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, AVCs are not included in the pension fund financial statements. Details of contributions paid and the total value of funds invested are disclosed in Note 30 on page 51.

5. Critical Judgement in Applying Accounting Policies

In applying its 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) Unquoted Investments

It should be recognised that determining the fair value of private equity and infrastructure investments is highly subjective. Inherently, valuations are based on forward-looking estimates and judgements 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 2014 the Fund had a value of £117.1m (2013 £113.8m) invested in unquoted private equity and infrastructure funds.

(ii) 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. 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.

6. Assumptions made about the future and other major sources of estimation uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions about the future or circumstances that are otherwise uncertain. The assumptions are made by the Council, by private equity and infrastructure managers, by the Fund Actuary and by other financial information providers. 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.

(i) Unquoted Investments

The Fund's asset allocation to Private Equity and Infrastructure exposes it to investments that are not publicly listed. Valuations for these assets will contain an element of estimation in their production.

There is a risk that these investments may be under or overstated in the accounts.

(ii) Actuarial present value of promised retirement benefits

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which salaries are projected to increase, changes in inflation, retirement ages, mortality rates and expected returns on pension fund assets. The Fund's actuary provides expert advice on the assumptions used to produce the estimated valuation presented in the Notes to the Accounts.

The table below highlights the approximate impact that a small change in the assumptions used would have on the liability of the Fund.

| Change in assumptions at year ended 31 March 2014 | Approximate % increase to liabilities | Approximate monetary amount (£m) |
|---|---------------------------------------|----------------------------------|
| 0.5% decrease in Real Discount Rate | 10% | 228 |
| 1 year increase in member life expectancy | 3% | 68 |
| 0.5% increase in the Salary Increase Rate | 3% | 68 |
| 0.5% increase in the Pension Increase Rate | 7% | 160 |

7. Events after the Balance Sheet Date

The unaudited Statement of Accounts were issued by the Chief Finance Officer on 30 June 2014 and the audited Statement of Accounts were authorised for issue on xx September 2014. 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.

8. Contribution Receivable

By Category

| 2012/13 £'000 | | 2013/14 £'000 |
|------------------|--|------------------|
| 50,063 | Employers – Normal/deficit Contributions | 54,432 |
| 2,481 | Employers – Strain Contributions | 4,552 |
| 16,586 | Members | 17,449 |
| 69,130 | TOTAL | 76,433 |

By Authority

| 2012/13 | | | 2013/14 | |
|------------------|--------------------|-------------------------|------------------|--------------------|
| Members £'000 | Employers £'000 | | Members £'000 | Employers £'000 |
| 5,442 | 17,650 | Administering Authority | 5,978 | 19,690 |
| 9,447 | 29,270 | Other Scheduled Bodies | 9,721 | 33,195 |
| 1,697 | 5,624 | Admission Bodies | 1,750 | 6,099 |
| 16,586 | 52,544 | TOTAL | 17,449 | 58,984 |

9. Transfers from Other Pension Funds

All transfers during the year related to individual transfer payments and not to bulk transfer payments.

10. Benefits Payable**By Category**

| 2012/13 £'000 | | 2013/14 £'000 |
|--------------------------|--|--------------------------|
| (39,651) | Pensions | (42,038) |
| (10,915) | Commutation and lump sum retirement benefits | (12,919) |
| (2,163) | Lump sum death benefits | (1,528) |
| (52,729) | TOTAL | (56,485) |

By Authority

| 2012/13 | | 2013/14 | |
|---------------------------|----------------------------|---------------------------|----------------------------|
| Pensions £'000 | Lump Sum* £'000 | Pensions £'000 | Lump Sum* £'000 |
| (13,555) | (4,655) | (15,452) | (4,343) |
| (24,263) | (7,324) | (23,272) | (9,359) |
| (1,833) | (1,099) | (3,314) | (745) |
| (39,651) | (13,078) | (42,038) | (14,447) |
| | TOTAL | | |

* Lump Sum includes Death Benefits

11. Payments to and on account of leavers

| 2012/13 £'000 | | 2013/14 £'000 |
|--------------------------|------------------------------------|--------------------------|
| (137) | Refunds to members leaving service | (151) |
| (3,921) | Individual transfers | (4,504) |
| (4,058) | TOTAL | (4,655) |

12. Administration Expenses

| 2012/13 £'000 | | 2013/14 £'000 |
|--------------------------|------------------------|--------------------------|
| (319) | Administration Costs | (351) |
| (23) | Actuarial Fees | (55) |
| (22) | External Audit | (22) |
| (11) | Fees and Subscriptions | (2) |
| (375) | TOTAL | (430) |

13. Investment Income

| 2012/13 £'000 | | 2013/14 £'000 |
|------------------|-----------------------------------|------------------|
| 9,764 | UK Equities | 11,293 |
| 125 | UK Pooled Equities | 180 |
| 3,037 | UK Managed Funds – Property | 3,357 |
| 7,841 | Overseas Equities | 8,206 |
| 187 | Overseas Managed Funds – Property | 372 |
| - | UK Private Equity | 1,551 |
| 351 | Overseas Private Equity | 1,215 |
| - | Overseas Infrastructure | 21 |
| 206 | UK Property | 183 |
| 96 | Cash & Other Income | 106 |
| 21,607 | TOTAL | 26,484 |

14. Taxes on Income

All tax withheld on income for the Fund relates to equity investments.

15. Investment Management Expenses

| 2012/13 £'000 | | 2013/14 £'000 |
|------------------|---|------------------|
| (5,433) | External Investment Management Services | (5,757) |
| (98) | Custodian | (97) |
| (98) | Internal Administration | (99) |
| (11) | Performance Monitoring | (14) |
| (36) | Actuarial Fees – Investment Consultancy | (123) |
| (5,676) | TOTAL | (6,090) |

These expenses cover all investment fees directly chargeable to the Fund. The Fund is exposed to a dual layer of fees in some of its more complex investments. These indirect fees are estimated to be £3.1m (£3.0m 2012/13) and are not included in the above figures.

16. Investments

| Market Value 31/03/13 £'000 | | Market Value 31/03/14 £'000 |
|-----------------------------------|--|-----------------------------------|
| INVESTMENT ASSETS | | |
| | Listed Investments | |
| 599,593 | Equities | 613,587 |
| 578,486 | Pooled Investments | 665,055 |
| 92,734 | Managed Property Funds | 109,735 |
| 113,762 | Private Equity/Infrastructure | 117,095 |
| 2,300 | Property (West Mains) | 2,300 |
| 243 | Derivatives – Forward Foreign Exchange | - |
| - | - Futures Contract | 33 |
| | Cash Deposits | |
| 8,376 | Other Balances | 16,164 |
| 46,536 | Deposits | 41,576 |
| | Other Investment Balances | |
| 3,296 | Debtors – Investment Income Due | 2,962 |
| 59 | – Due from Broker | 6,989 |
| 1,445,385 | Total Investment Assets | 1,575,496 |
| | INVESTMENT LIABILITIES | |
| (58) | Derivatives – Forward Foreign Exchange | (44) |
| (283) | Creditor – Due to Broker | (7,557) |
| (341) | Total Investment Liabilities | (7,601) |
| 1,445,044 | NET INVESTMENT ASSETS | 1,567,895 |

16b. Analysis of Investments (excluding derivative contracts)

| 31/03/13 £'000 | | 31/03/14 £'000 |
|-------------------|------------------------------|-------------------|
| | <u>Equities</u> | |
| 262,331 | UK | 270,001 |
| 337,262 | Overseas | 343,586 |
| 599,593 | | 613,587 |
| | <u>Pooled Funds</u> | |
| 120,886 | Equities – UK | 131,425 |
| 193,999 | - Overseas | 209,037 |
| 136,088 | Bonds - UK | 124,154 |
| - | - Overseas | 10,943 |
| 127,513 | Diversified Growth | 189,496 |
| 578,486 | | 665,055 |
| | <u>Property</u> | |
| 83,821 | Managed Fund – UK | 102,554 |
| 8,913 | - Overseas | 7,181 |
| 2,300 | Direct UK (West Mains) | 2,300 |
| 95,034 | | 112,035 |
| | <u>Private Equity</u> | |
| 55,458 | UK | 56,558 |
| 29,970 | Overseas | 26,729 |
| 85,428 | | 83,287 |
| | <u>Infrastructure</u> | |
| 28,334 | Overseas | 33,808 |
| 1,386,875 | | 1,507,772 |

| INVESTMENT ASSETS | Market Value 01/04/13 £'000 | Purchases at Cost £'000 | Sale Proceeds £'000 | Change in Market Value £'000 | Market Value 31/03/14 £'000 |
|-------------------------------|--|--|------------------------------------|---|--|
| Equities | 599,593 | 173,147 | (200,699) | 41,546 | 613,587 |
| Pooled Investments | 578,486 | 67,816 | (15,737) | 34,490 | 665,055 |
| Managed Property Funds | 92,734 | 13,367 | (1,984) | 5,618 | 109,735 |
| Private Equity/Infrastructure | 113,762 | 20,144 | (18,266) | 1,455 | 117,095 |
| Property (West Mains) | 2,300 | - | - | - | 2,300 |
| Derivatives | | | | | |
| - Exchange Traded Futures | - | 639 | - | (606) | 33 |
| - Forward Foreign Exchange | 185 | 429 | (299) | (359) | (44) |
| | 1,387,060 | 275,542 | (236,985) | 82,144 | 1,507,761 |
| Other Balances | 8,376 | 65,825 | (56,532) | (1,505) | 16,164 |
| Deposits | 46,536 | - | - | (5,338) | 41,576 |
| Broker Balance | (224) | - | - | - | (568) |
| Investment Income Due | 3,296 | - | - | - | 2,962 |
| NET INVESTMENT ASSETS | 1,445,044 | 341,367 | (293,517) | 75,301 | 1,567,895 |

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 2013/14 amounted to £629,981 (2012/13 £504,609). 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.

| INVESTMENT ASSETS | Market Value 01/04/12 £'000 | Purchases at Cost £'000 | Sale Proceeds £'000 | Change in Market Value £'000 | Market Value 31/03/13 £'000 |
|-------------------------------|--|--|------------------------------------|---|--|
| Equities | 498,232 | 122,263 | (102,472) | 81,570 | 599,593 |
| Pooled Investments | 497,165 | 5,057 | (141) | 76,405 | 578,486 |
| Managed Property Funds | 94,919 | 6,225 | (6,331) | (2,079) | 92,734 |
| Private Equity/Infrastructure | 97,199 | 25,326 | (13,875) | 5,112 | 113,762 |
| Property (West Mains) | 2,300 | - | - | - | 2,300 |
| Derivatives | | | | | |
| - Forward Foreign Exchange | 251 | 710 | (1,702) | 926 | 185 |
| | 1,190,066 | 159,581 | (124,521) | 161,934 | 1,387,060 |
| Other Balances | 7,385 | 47,727 | (47,605) | 869 | 8,376 |
| Deposits | 32,833 | - | - | 16,230 | 46,536 |
| Broker Balance | (711) | - | - | - | (224) |
| Investment Income Due | 2,931 | - | - | - | 3,296 |
| NET INVESTMENT ASSETS | 1,232,504 | 207,308 | (172,126) | 179,033 | 1,445,044 |

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

31 March 2013

| £'000 | % | |
|--------------|----------|--|
| 127,512 | 8.8 | Baillie Gifford Diversified Growth |
| 108,895 | 7.6 | L&G – UK Equity Index |
| 105,915 | 7.3 | L&G – North American Equity Index |
| 82,381 | 5.7 | Baillie Gifford Sterling Aggregate Bonds |

31 March 2014

| £'000 | % |
|--------------|----------|
| 189,496 | 12.1 |
| 118,426 | 7.6 |
| 112,624 | 7.3 |
| 82,263 | 5.3 |

Regulation 14 of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) 2010 (SSI 2010/233) places limits on the investments LGPS Funds can make. For example, restrictions are placed on the percentage of unlisted securities that the Fund can hold and the percentage that can be invested in one stock (i.e. 10% is the maximum). Although the Fund does hold a stock over 10% of the Fund value, this is allowed under regulation due to it being a unitised trust.

17. Securities Lending

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

18. Funds Under Management

| MARKET VALUE | | | MARKET VALUE | | |
|----------------------|------------|--|----------------------|------------|--|
| 31 March 2013 | | | 31 March 2014 | | |
| £ million | (%) | | £ million | (%) | |
| 208.6 | 14.5 | Aberdeen Asset Management | 212.0 | 13.5 | |
| 136.1 | 9.4 | Baillie Gifford Life Ltd. | 135.1 | 8.6 | |
| 127.5 | 8.8 | Baillie Gifford Life Ltd – Diversified Growth | 189.5 | 12.1 | |
| 302.8 | 21.1 | Legal and General Investment Management Ltd. | 327.5 | 20.9 | |
| 213.0 | 14.8 | Newton Investment Management Ltd. | 227.5 | 14.5 | |
| 226.3 | 15.7 | Schroder Investment Management Ltd. | 223.8 | 14.3 | |
| 100.2 | 6.9 | Schroder Investment Management Ltd. (Property) | 110.5 | 7.1 | |
| 43.6 | 3.0 | SL Capital Partners LLP | 43.1 | 2.8 | |
| 30.0 | 2.1 | Wilshire Private Markets Group | 26.7 | 1.7 | |
| 12.0 | 0.8 | M&G UK Companies | 13.4 | 0.9 | |
| 28.3 | 1.9 | Credit Suisse Securities | 33.8 | 2.2 | |
| 14.4 | 1.0 | In House Cash | 22.7 | 1.4 | |
| 1,442.8 | 100.0 | TOTAL | 1,565.6 | 100.0 | |

19. Derivatives

The Fund's approach to derivatives is to allow individual managers to decide to participate in derivative contracts subject to any limits set out in their investment management agreements. At present, only Newton chooses to do so, with derivatives making up 0.005% of their portfolio's value.

(a) Derivatives – Exchange Traded Futures Contracts

Summary of Contracts held at 31 March 2014

| Contract | Settlement Date | Value of Currency Bought £'000 | Market Value £'000 |
|-----------------|-----------------|-----------------------------------|-----------------------|
| Overseas Equity | Within 1 Month | 110 | 33 |

(b) Derivatives – Forward Foreign Exchange

Summary of Contracts held at 31 March 2014

| Contract | Settlement Date | Value of Currency Bought £'000 | Asset £'000 | Liability £'000 | Net £'000 |
|---------------------------|-----------------|-----------------------------------|----------------|--------------------|--------------|
| Various Currency Forwards | Within 1 month | 4,826 | - | (44) | (44) |

Summary of Contracts held at 31 March 2013

| Contract | Settlement Date | Value of Currency Bought £'000 | Asset £'000 | Liability £'000 | Net £'000 |
|---------------------------|-----------------|-----------------------------------|----------------|--------------------|--------------|
| Various Currency Forwards | Within 1 month | 12,832 | 101 | (58) | 43 |
| Various Currency Forwards | Within 2 months | 5,546 | 142 | - | 142 |

The above contracts are used as hedges reducing the extent to which Newton's portfolio is exposed to currency movement. Three foreign currencies are involved in this hedge and contracts are traded on an over-the-counter basis.

20. 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 2013 £'000 | | 31 March 2014 £'000 |
|------------------------|--|------------------------|
| 161,934 | Designated as fair value through net asset statement | 82,144 |
| 17,099 | Loans and receivables | (6,843) |
| - | Financial liabilities at amortised cost | - |
| 179,033 | Net gains and losses on financial instruments | 75,301 |
| - | Gains and losses on directly held freehold property | - |
| 179,033 | Change in market value of investments per fund account | 75,301 |

22. 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.

As at 31 March 2014

| | Quoted market price Level 1 £'000 | Using observable inputs Level 2 £'000 | With significant unobservable inputs Level 3 £'000 | Total at 31 March 2014 £'000 |
|---|---|---|---|------------------------------------|
| FINANCIAL ASSETS | | | | |
| Designated as fair value through net asset statement | 1,143,578 | 244,835 | 117,092 | 1,505,505 |
| Loans and receivables | 79,470 | - | - | 79,470 |
| Total Financial Assets | 1,223,048 | 244,835 | 117,092 | 1,584,975 |
| FINANCIAL LIABILITIES | | | | |
| Designated as fair value through net asset statement | (7,601) | - | - | (7,601) |
| Financial liabilities at amortised cost | (2,993) | - | - | (2,993) |
| Total Financial Liabilities | (10,594) | - | - | (10,594) |
| NET FINANCIAL ASSETS | 1,212,454 | 244,835 | 117,092 | 1,574,381 |

As at 31 March 2013

| | Quoted market price Level 1 £'000 | Using observable inputs Level 2 £'000 | With significant unobservable inputs Level 3 £'000 | Total at 31 March 2013 £'000 |
|---|---|---|---|------------------------------------|
| FINANCIAL ASSETS | | | | |
| Designated as fair value through net asset statement | 1,042,234 | 228,825 | 113,759 | 1,384,818 |
| Loans and receivables | 79,175 | - | - | 79,175 |
| Total Financial Assets | 1,121,409 | 228,825 | 113,759 | 1,463,993 |
| FINANCIAL LIABILITIES | | | | |
| Designated as fair value through net asset statement | (341) | - | - | (341) |
| Financial liabilities at amortised cost | (2,877) | - | - | (2,877) |
| Total Financial Liabilities | (3,218) | - | - | (3,218) |
| NET FINANCIAL ASSETS | 1,118,191 | 228,825 | 113,759 | 1,460,775 |

23. **Nature and Extent of Risks Arising from Financial Instruments**

Risk and Risk Management

The Fund's primary long-term risk is that its 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 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 future 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 as it relates to investments is to identify, manage and control market risk exposure within acceptable parameters, whilst optimising the return on assets. Investment risk is considered further in the Fund's Statement of Investment Principles.

In general, excessive volatility in market risk is managed by engaging a range of Fund Managers with differing approaches and philosophies and also 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's approach to managing risk can be described in two fundamental ways:

- by maintaining asset class exposures such that risk remains within tolerable levels; and
- 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 2014 is estimated to be around £340m.

(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. In respect of cash deposits managed internally under the terms of the Cash Management Strategy, it is the Fund's policy to convert all non GBP monies to Sterling at the end of a month to reduce the currency risk faced. In respect of cash held with external Fund Managers, it is left to their discretion as to whether they wish to hedge their currency position or not.

The Fund's currency exposure as at the 31 March 2014 is estimated to be around £792m.

(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.

The main area where risk is not reflected in a market price is cash deposits which at 31 March 2014 accounted for 2.9% of fund assets.

| Balances at 31 March 2013 £'000 | | Moody's Credit Rating | Balances at 31 March 2014 £'000 |
|---------------------------------------|--|--------------------------|---------------------------------------|
| | Held for Investment Purposes | | |
| 17,326 | Northern Trust Global Investment Limited – Liquidity Funds | Aaa-mf | 12,400 |
| - | Ignis Asset Management Sterling Liquidity Fund | AAAmf (Fitch) | 4,953 |
| 29,210 | Northern Trust Company – Cash Deposits | A1 | 14,223 |
| - | Santander UK PLC | A2 | 5,000 |
| - | Bank of Scotland PLC | A1 | 5,000 |
| 46,536 | Total Investment Cash | | 41,576 |
| | Held for Other Purposes | | |
| 8,189 | Clydesdale Bank | Baa2 | 3,927 |
| 54,725 | Total Cash | | 45,503 |

As part of its approach to managing credit risk, the Fund formalised its Treasury operations during 2013/14 through the implementation of a Cash Management Strategy. This details:

- the counterparties with whom the Fund may have dealings;
- the credit ratings that are deemed acceptable; and
- specific limits and conditions attaching to certain types of deposit.

The credit rating used above is Moody's Long Term Outlook.

Despite its credit rating, the Fund (along with Falkirk Council) continues to use the Clydesdale Bank for its day to day transactional banking operations. Balances, are however, closely monitored and minimised to a level of around £3m.

(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 in its capacity as Administering Authority 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 Fund will be bound to replenish a significant proportion of its Pension Fund financial instruments at a time of unfavourable interest rates. The Fund is not bound by any obligation to replenish its investments. In any event, the Fund does not have any financial instruments that have a refinancing risk as part of its Pension Fund management and investment strategies.

Sensitivity Analysis

The Fund's valuation is sensitive to fluctuations in its Asset prices. The level of these fluctuations is known as "volatility" and will differ between asset classes. By analysing historical data, it is possible to gain an indication of the likely volatility of certain asset classes. In consultation with KPMG and Lothian Pension Fund, the following analysis predicts the likely annual volatility of the Fund's assets.

| Asset Type | Potential price movement (+ or -) |
|------------------------------|--|
| Equities – Developed Markets | 20.0% |
| Equities – Emerging Markets | 30.0% |
| Private Equity | 30.0% |
| Commodities | 30.0% |
| Property – Balanced | 13.0% |
| Property – Infrastructure | 8.0% |
| Diversified Credit | 10.0% |
| Fixed Interest Gilts | 10.5% |
| Index-Linked Gilts | 8.5% |
| Cash | 1.5% |

Volatility is measured as the standard deviation of annual returns. Broadly speaking, in two years out of three, the asset's change in value (which could be a gain or a loss) is expected to be lower than the volatility figure, but in one year out of three, the change in value is expected to be higher than the volatility figure.

Asset classes don't always move in line with each other. The extent to which assets move together is known as their "correlation". A lower correlation means that there is less risk of assets losing value at the same time. The overall Fund benefits from "diversification" because it invests in numerous different asset classes, which don't all move in line with each other. Consequently, the aggregate risk at the Fund level is less than the total risk from all the individual assets in which the Fund invests. The following table shows the risks at the asset class level and the overall Fund level.

Position as at 31 March 2014

| Asset Type | Value at 31 March 2014 £'m | Asset Weight | Volatility | Potential Change =/ £'m | Value on increase £'m | Value on decrease £'m |
|---|---|-------------------------|-------------------|--|--|--------------------------------------|
| Equities - Developed Markets | 951.3 | 60.7% | 20.0% | 190.3 | 1,141.6 | 761.0 |
| Equities - Emerging Markets | 31.1 | 2.0% | 30.0% | 9.3 | 40.4 | 21.8 |
| Private Equity | 75.2 | 4.8% | 30.0% | 22.6 | 97.8 | 52.6 |
| Commodities | 13.1 | 0.8% | 30.0% | 3.9 | 17.0 | 9.2 |
| Property | 116.0 | 7.4% | 13.0% | 15.1 | 131.1 | 100.9 |
| Infrastructure | 41.4 | 2.6% | 8.0% | 3.3 | 44.7 | 38.1 |
| Diversified Credit | 162.7 | 10.4% | 10.0% | 16.3 | 179.0 | 146.4 |
| Fixed Interest Gilts | 63.5 | 4% | 10.5% | 6.7 | 70.2 | 56.8 |
| Index-Linked Gilts | 32.6 | 2.1% | 8.5% | 2.8 | 35.4 | 29.8 |
| Cash | 81.0 | 5.2% | 1.5% | 1.2 | 82.2 | n/a |
| Total Assets (without correlations) | 1,567.9 | 100.0% | 17.3% | 271.5 | 1,839.4 | 1,296.4 |
| Total Assets (including correlations) | 1,567.9 | | 14.9% | 233.0 | 1,800.9 | 1,334.9 |
| Assets Relative to Liabilities (including correlation) | 1,567.9 | | 14.1% | 221.1 | n/a | n/a |

The "Potential change" column shows the monetary effect of the expected volatility relative to each asset class. The actual annual change in value is expected to be lower than this in two years out of three, but higher in one year out of three. It can also be seen that the risk to the overall Fund assets is lower than the total of the risks to the individual assets.

However, because the purpose of a pension scheme is to make payments to scheme beneficiaries, the true risk of a pension scheme is not measured in absolute terms, but relative to its liabilities. This risk is shown in the bottom row of the above table. The risk is lower than the absolute asset risk, due to the impact of correlation with the discount rate used to value the liabilities.

It should be noted that the asset allocation used for this analysis will differ to that shown in the financial statements earlier. This is due to the Fund reporting its asset allocation in the financial statements according to each Manager's mandate, whilst for this section the most appropriate means is to analyse the mandate according to the underlying elements.

The corresponding/

The corresponding details as at 31 March 2013 are set out in the table below.

Position as at 31 March 2013

| Asset Type | Value at 31 March 2013 £'m | Asset Weight | Volatility | Potential Change =/ £'m | Value on increase £'m | Value on decrease £'m |
|--|---|-------------------------|-------------------|--|--|--------------------------------------|
| Equities - Developed Markets | 884.8 | 61.2% | 20.0% | 177.0 | 1,061.8 | 707.8 |
| Equities - Emerging Markets | 53.0 | 3.7% | 30.0% | 15.9 | 68.9 | 37.1 |
| Private Equity | 78.9 | 5.5% | 30.0% | 23.7 | 102.6 | 55.2 |
| Commodities | 6.2 | 0.4% | 30.0% | 1.9 | 8.1 | 4.3 |
| Property | 95.8 | 6.6% | 13.0% | 12.5 | 108.3 | 83.3 |
| Infrastructure | 33.2 | 2.3% | 8.0% | 2.7 | 35.9 | 30.5 |
| Diversified Credit | 135.7 | 9.4% | 10.0% | 13.6 | 149.3 | 122.1 |
| Fixed Interest Gilts | 54.2 | 3.7% | 9.0% | 4.9 | 59.1 | 49.3 |
| Index-Linked Gilts | 32.9 | 2.3% | 7.0% | 2.3 | 35.2 | 30.6 |
| Cash | 70.3 | 4.9% | 1.6% | 1.1 | 71.4 | n/a |
| Total Assets (without correlations) | 1,445.0 | 100% | 17.7% | 255.6 | 1,700.6 | 1,189.4 |
| Total Assets (including correlations) | 1,445.0 | | 15.3% | 221.1 | 1,666.1 | 1,223.9 |

24. 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.falkirkpensionfund.org

The Actuary has provided a statement describing the funding arrangements of the Fund during 2013/14. This can be found in a separate section later in this report (page 53).

25. 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 £2,281m (£2,011m at 31 March 2013). 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 2013 % p.a. | 31 March 2014 %p.a. |
|------------------------------------|----------------------------|---------------------------|
| Discount rate | 4.5 | 4.3 |
| Pay increase * | 5.1 | 5.1 |
| Price inflation/Pensions increases | 2.8 | 2.8 |

* Pay increases are 1% p.a. nominal until 31 March 2015 reverting to long term rate thereafter.

Longevity Assumptions

The life expectancy assumption is based on standard SAPS tables with improvements in line with the Medium Cohort and a 1% p.a. underpin from 2008. Based on these assumptions, the average future life expectancies at age 65 are summarised below:

| | Males | Females |
|--|------------|------------|
| Current pensioners | 23.0 years | 25.8 years |
| Future pensioners (assumed to be currently 45) | 24.9 years | 27.7 years |

Commutation Assumptions

An allowance is made for future retirees 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.

26. Non Current Assets**Long Term Debtors**

| 31 March 2013 £'000 | | 31 March 2014 £'000 |
|---|---|------------------------|
| 1,611 | Strain on Fund Contributions (Due in over 1 year) | 816 |
| <u>Analysis of Long Term Debtors</u> | | |
| 31 March 2013 £'000 | | 31 March 2014 £'000 |
| - | Central government bodies | - |
| 1,401 | Other local authorities | 702 |
| - | NHS bodies | - |
| - | Public corporations and trading funds | - |
| 210 | Other entities and individuals | 114 |
| 1,611 | TOTAL | 816 |

27. Cash Balances

| 31 March 2013 £'000 | | 31 March 2014 £'000 |
|------------------------|---------------------------------|------------------------|
| 8,189 | Bank Account | 3,927 |
| 4,230 | Balance held by Falkirk Council | 301 |
| 12,419 | TOTAL | 4,228 |

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 have been required to operate their own bank account from 1 April 2011. From 1 April 2011 all payments made to the Fund are paid directly into the Fund's separate bank account.

Due to the Fund using Falkirk Council's financial management systems to effect transactions, there is a small working balance at year end, mainly due to timing issues.

28. Debtors**By Category**

| 31 March 2013 £'000 | | 31 March 2014 £'000 |
|------------------------|---|------------------------|
| 4,187 | Contributions due – employers | 3,917 |
| 1,387 | Contributions due – members | 1,228 |
| 1,150 | Strain on Fund Contribution (Due within 1 year) | 1,508 |
| 17 | Benefits Paid in Advance | 12 |
| 137 | Sundry Debtors | 70 |
| 6,878 | TOTAL | 6,735 |

Analysis of Debtors

| 31 March 2013 £'000 | | 31 March 2014 £'000 |
|------------------------|---------------------------------------|------------------------|
| 974 | Central government bodies | 430 |
| 4,976 | Other local authorities | 5,486 |
| - | NHS bodies | 2 |
| - | Public corporations and trading funds | 4 |
| 928 | Other entities and individuals | 813 |
| 6,878 | TOTAL | 6,735 |

29. Creditors

| 31 March 2013 £'000 | | 31 March 2014 £'000 |
|------------------------|--|------------------------|
| (1,737) | Benefits Payable | (1,740) |
| (1,140) | Miscellaneous Creditors and Accrued Expenses | (1,253) |
| (2,877) | TOTAL | (2,993) |

Analysis of Creditors

| 31 March 2013 £'000 | | 31 March 2014 £'000 |
|------------------------|---------------------------------------|------------------------|
| (28) | Central government bodies | (15) |
| (8) | Other local authorities | (14) |
| - | NHS bodies | - |
| (1,049) | Public corporations and trading funds | (1,126) |
| (1,792) | Other entities and individuals | (1,838) |
| (2,877) | TOTAL | (2,993) |

30. 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. (n.b. Prudential have been appointed joint AVC providers with Standard Life from June, 2014).

The AVC contributions are sent directly to the AVC provider 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 with Standard Life at 5 April 2014 was £2.48 million (£2.54 million at 5 April 2013). Contributions made by members during the year to 5 April 2014 were £0.27 million. Expenditure from the policy during the same period (including the purchase of member annuities) amounted to £0.55 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).

31. Related Party Transactions

Falkirk Council

Falkirk Council Pension Fund is administered by Falkirk Council. Consequently, there is a strong relationship between the Council, in its capacity as an employing body, and the Pension Fund.

The Council incurred costs of £505k (2012/13: £473k) 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 £19.7m to the fund in 2013/14 (2012/13: £17.7m). 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. The balance at 31 March 2014 was £301k (£4.2m 2013).

Key Management Personnel

The following senior officers at Falkirk Council held key positions in the financial management of the Fund during the year:-

| Accrued CETV 31 March 2013 (£'000) | Role | Salary (£'000) | Service | Accrued CETV 31 March 2014 (£'000) |
|--|-----------------------|-------------------|----------|--|
| 716 | Chief Finance Officer | 86 | 29 years | 767 |
| 348 | Pensions Manager | 49 | 31 years | 368 |

“CETV” means Cash Equivalent Transfer Value.

32. Contractual Commitments

Outstanding capital commitments (investments) at 31 March 2014 totalled £63m (31 March 2013 : £66m).

These commitments relate to outstanding call payments due to unquoted limited partnership funds held in the private equity and infrastructure segments of the portfolio. The amounts “called” by these funds are irregular in both size and timing over the life of the investment.

33. 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.

ACTUARIAL STATEMENT FOR 2013/14

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 2013/14.

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.

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.

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 2013

Over the last year we expect that the funding level (excluding the effect of any membership movements) has improved due to stronger than expected investment performance over the period and a rise in gilt yields.

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

Julie West

Fellow of the Institute and Faculty of Actuaries

For and on behalf of Hymans Robertson LLP

15 September 2014

Scheduled Bodies

Central Scotland Joint Valuation Board
Clackmannanshire Council
Falkirk Council
Forth Valley College
Scottish Children's Reporter Administration (SCRA)
Scottish Environment Protection Agency (SEPA)
Scottish Fire and Rescue Service (ex Central Scotland Fire & Rescue Service)
Scottish Police 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
Cowane's Hospital
Dollar Academy Trust
Falkirk Community Trust Ltd
Forth and Oban Ltd (Falkirk Schools Project)
Forth and Oban Ltd (Stirling Schools Project)
McLaren Community Leisure Centre
Open Secret
Plus
Scottish Autism
Seamab School
Smith Art Gallery
Snowdon School Ltd
Stirling District Tourism Ltd
Stirling Enterprise Park Limited (STEP)
Stirling University *
Strathcarron Hospice
Thinkwhere Ltd. (formerly Forth Valley GIS Ltd)
Valad Management (UK) Ltd *
Water Industry Commission for Scotland
Waterwatch Scotland *

* Closed to new members

Independent auditor's report to the members of Falkirk Council as administering body for Falkirk Council 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 2014 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 2013/14 (the 2013/14 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 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 fund'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 annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. 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 2013/14 Code of the financial transactions of the fund during the year ended 31 March 2014, and of the amount and disposition at that date of its assets and liabilities
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2013/14 Code
- 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 matter

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
- the financial statements are not in agreement with the accounting records
- I have not received all the information and explanations I require for my audit
- 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 FCA
Assistant Director (Audit Services)
Audit Scotland
4th Floor, South Suite
Athenaeum building
8 Nelson Mandela Place
Glasgow
G2 1BT

25 September 2014

ADDITIONAL INFORMATION

Key Documents Online

You can find further information on what we do and how we do it on our website www.falkirkpensionfund.org. The following documents are on the website:

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

Fund Key Contacts

| | |
|---|---|
| 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, Prudential |
| Solicitors: | Falkirk Council - Legal Services McLay, Murray and Spens |

Contact Details

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

| | |
|-------------------|--|
| Address: | Pensions Section PO Box 14882 Falkirk Council Municipal Buildings, West Bridge Street Falkirk, FK1 5ZF |
| Telephone: | 01324 506338 (Accounting & Investment) |
| Telephone: | 01324 506316 (Administration) |
| Fax | 01324 506303 |
| E-Mail | pensions@falkirk.gov.uk or investments@falkirk.gov.uk |
| Web | www.falkirkpensionfund.org |

Independent Auditor

The Auditor appointed by the Accounts Commission for Scotland for the purpose of auditing the annual report and accounts is:

Audit Scotland
4th Floor, South Suite
The Athenaeum Building
8 Nelson Mandela Place
Glasgow
G2 1BT