

**FALKIRK COUNCIL**

**Subject: PENSION FUND ANNUAL AUDIT REPORT – 2013/14**  
**Meeting: JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE**  
**Date: 11 DECEMBER 2014**  
**Author: CHIEF FINANCE OFFICER**

**1. INTRODUCTION**

- 1.1 This report presents the Panel and Committee with details of the Audit Scotland Pension Fund report for 2013/14.

**2. BACKGROUND**

- 2.1 The audited Annual Report and Accounts were approved at the meeting of the Pensions Committee on 25 September 2014.
- 2.2 The Annual Report and Accounts have been posted on the Pension Fund website and brought to the attention of all fund employers. A copy of the Audit Report will be posted after this meeting. Publication of Annual Account and Audit Report ensures compliance with Regulation 30 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008.

**3. AUDIT SCOTLAND REPORT**

- 3.1 The Audit Scotland report provides a summary of the Fund's current standing as well as detailed comment on matters such as the Fund's financial position, governance and performance.
- 3.2 The most significant observations are as follows:
- the audit opinion for the 2013/14 Annual Report and Accounts was unqualified
  - the funding level at 31 March 2014 was 84%
  - falling bond yields have resulted in increased liabilities
  - investment returns have outperformed benchmark targets over short, medium and long term
  - the Fund has sound governance arrangements
  - significant challenges lie ahead arising from the ongoing pensions reform agenda
- 3.3 The report highlights several areas where management action should be considered.
- Investment Management Expenses;
  - Budgetary Control
  - New Pensions Administration System
  - New Career Average Scheme and Governance Arrangements
  - Internal Audit activity

3.4 A number of these points were already part of the Pension Section's work plan for 2014/15 and will continue to be taken forward in preparing the next set of accounts.

3.5 The full Audit Scotland report is attached as an appendix to this report.

#### **4. CONCLUSION**

4.1 A report on the pension fund audit for 2012/13 has been completed by the Fund's external auditors, Audit Scotland.

4.2 A number of recommendations have been made and an action plan instituted to address the various issues.

4.3 Completion of Audit Scotland's report successfully concludes the audit process in respect of the 2013/14 accounts.

#### **5. RECOMMENDATION**

5.1 The Panel and Committee are asked to note Audit Scotland's Annual Report on the 2013/14 pension fund audit.

**Chief Finance Officer**

**Date: 18 November 2014**

**Contact Officer: Alastair McGirr**

#### **LIST OF BACKGROUND PAPERS**

NIL



## **Falkirk Council Pension Fund**

### **Annual report on the 2013/14 audit**

Prepared for the members of Falkirk Council as  
administering body for Falkirk Council Pension  
Fund and the Controller of Audit

October 2014

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## Key messages

### Financial statements

- We have given an unqualified opinion on the financial statements of Falkirk Council Pension Fund for 2013/14.

### Financial position

- Fund net assets are £1,577 million at 31 March 2014.
- The actuarial value of retirement benefits is £2,281 million.
- The net liability of £704 million has increased from £548 million last year due to falling bond yields.
- The funding level at 31 March 2014 was 84% ( 86% in 2011).

### Governance & accountability

- The Falkirk Council Pensions Fund has sound governance arrangements that include a Pensions Committee supported by an advisory Pensions Panel.
- Internal audit plans for 2014/15 do not include any provision for work on the Pension Fund and its systems.

### Best Value, use of resources & performance

- Despite the funding gap increasing, investment returns have outperformed benchmark targets over the short, medium and longer term.
- The rolling three year performance is also ahead of target.

### Outlook

- The uncertainty in the global financial markets and the consequent effect on the stock market means that pension funds will require to remain vigilant and keep assessing their exposure to risk.
- New governance arrangements come into force on 1 April 2015 as a result of the Public Services Pensions Act 2013.
- Changes are needed for administering a career average scheme and auto enrollment for staff.

### Financial Statements

1. We have given an unqualified audit opinion that the financial statements of Falkirk Council Pension Fund ('the Fund') for 2013/14 give a true and fair view of the state of affairs of the Fund as at 31 March 2014 and of the income and expenditure for the year then ended.

### Financial position

2. The Fund had net assets of £1,577 million as at 31 March 2014. The actuarial value of promised retirement benefits at the accounting date has been estimated by the actuary, on an IAS 19 basis, as £2,281 million, giving a net liability of £704 million as at 31 March 2014 (£548 million as at 31 March 2013).

### Funding position

3. The most recent triennial valuation was reported in January 2012. The report highlighted that the Fund's assets valued at 31 March 2011 (£1,199 million) were sufficient to meet 86% of its liabilities accrued up to that date, resulting in a funding shortfall of £194 million. This represents an improved position from the previous triennial valuation in 2008 that reported a funding position of 79% (a funding shortfall of £255 million).
4. However, the interim funding position at 31 March 2014, as advised by the Fund's actuary, shows a slightly weaker

position with assets falling to 84% of liabilities. A recent review by Club Vita indicates that longevity assumptions used in the 2011 actuarial valuation over-estimated the life expectancy of the Fund's pensioners. Applying Club Vita's assumptions on longevity could result in the Funding position improving by around 6% and the deficit would reduce by £130 million.

5. The triennial valuation at 31 March 2014 which will set the employer contribution rates for the next three years starting from 1 April 2015 will incorporate the results of Club Vita. This and other measures such as annual funding reviews and cash flow modelling are designed to improve the management and oversight of the Fund in the longer term.
6. In addition, the Public Service Pensions Act 2013 will introduce changes to ensure the continued survival of the Local Government Pension Scheme. Notably the 'employer cost cap' will shift some of the risk of future rises in scheme costs onto members.
7. In recent times active membership of the Fund declined due to the recession which saw restrictions on recruitment and accelerated severance programmes. This has now been halted through the auto-enrolment initiative which has seen membership increase by approximately 2,000 in the last two years. The impact is being kept under review.

### Governance and accountability

8. The Falkirk Council Pensions Fund has sound governance arrangements that include a Pensions Committee supported by an advisory Pensions Panel with representatives from fund employers, pensioners and trade unions.
9. We also concluded that the Pension Fund has adequate internal controls (including internal audit) and satisfactory arrangements for the prevention and detection of fraud and corruption.

### Best Value and performance

10. Over the long term, the overall level of investment return achieved by the Fund is expected to exceed the rate of return assumed by the actuary in valuing the Fund. Investment returns of Falkirk Council Pension Fund have outperformed benchmark targets over the short, medium and longer term. The current rolling three year performance is also ahead of benchmark.

### Outlook

11. Global financial markets in 2013/14 had to face a combination of political tensions in Ukraine and the Middle East, as well as the prospects of monetary policy tightening in the US and a loss of economic momentum. Particularly in China where policy makers are grappling with high levels of credit. With investment

performance key to the Funding position of the LGPS, this may impact on employer contributions in the medium term.

12. The Fund will need to review its governance arrangements to comply with the Public Services Pensions Act 2013 which requires funds to establish a Pensions Board and take cognisance of relevant Codes of Practice for the Pensions Regulator. Challenges also arise from administering the staged implementation of auto-enrolment and the move to pensions based on average pay. The Fund is acquiring a new Pensions Administration system to help address these challenges.

# Introduction

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13. This report is a summary of our findings arising from the 2013/14 audit of the Falkirk Council Pension Fund. The purpose of the annual audit report is to summarise the auditor's opinions and conclusions, and to report any significant issues arising from the audit. The report is divided into sections which reflect our public sector audit model.
14. Our responsibility, as the external auditor of Falkirk Council Pension Fund, is to undertake our audit in accordance with International Standards on Auditing (UK and Ireland) and the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.
15. The management of Falkirk Council Pension Fund is responsible for:
  - preparing financial statements which give a true and fair view
  - implementing appropriate internal control systems
  - putting in place proper arrangements for the conduct of its affairs
  - ensuring that the financial position is soundly based.
16. This report is addressed to the members of Falkirk Council and the Controller of Audit and should form the basis of discussions with the Pensions Committee as soon as possible after it has been issued. Reports should be made available to stakeholders and the public, as audit is an essential element of accountability and the process of public reporting.
17. This report will be published on our website after it has been considered by the Pensions Committee. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits. The overview report is published and presented to the Local Government and Regeneration Committee of the Scottish Parliament.
18. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. Local reports and relevant national reports are summarised at Appendix I. We do not repeat all of the findings in this report, but focus on the financial statements and any significant findings from our wider review of Falkirk Council Pension Fund.
19. The concept of audit risk is of key importance to the audit process. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements. We set out in our annual audit plan the related sources of assurance and the audit work we proposed to undertake to secure appropriate levels of assurance. Appendix II sets out the significant audit risks identified at the planning stage and how we addressed



## Introduction

each risk in arriving at our opinion on the financial statements.

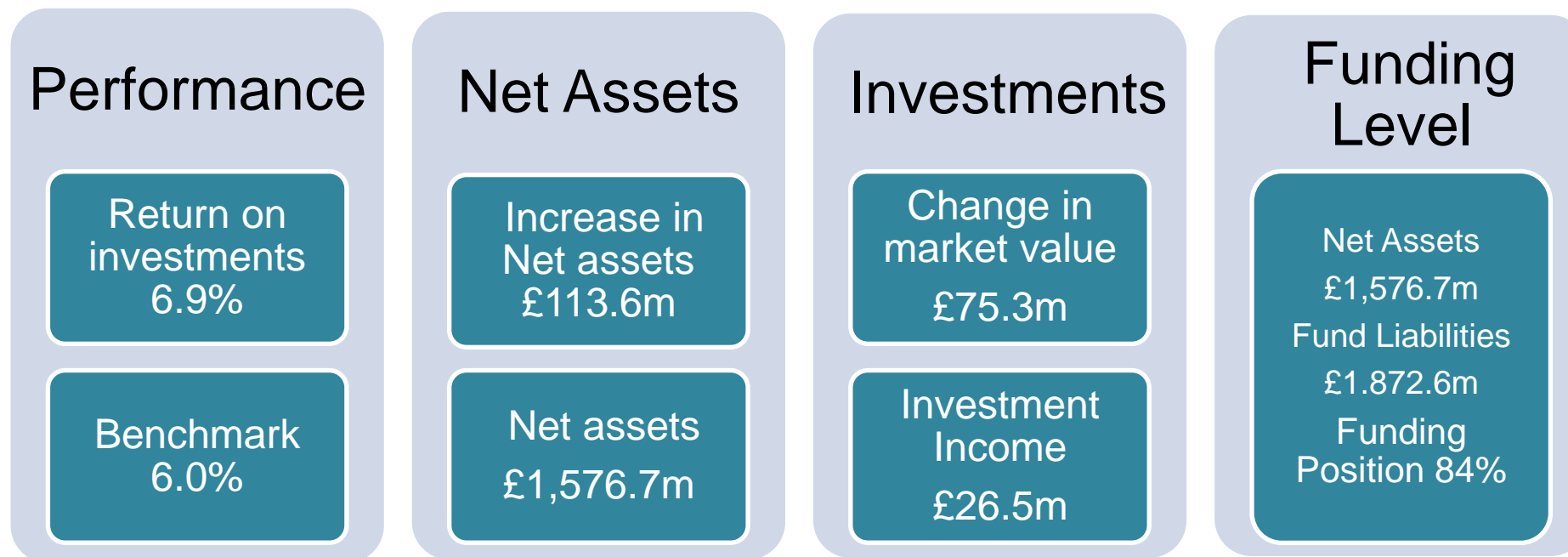
20. Appendix III is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed 'management action/response'.
21. We recognise that not all risks can be eliminated or even minimised. What is important is that Falkirk Council Pension Fund understands its risks and has arrangements in place to manage these risks. The council and the Proper Officer should ensure that they are satisfied with proposed management action and have a mechanism in place to assess progress and monitor outcomes.

22. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures. Our comments should consequently not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

## Acknowledgement

23. The co-operation and assistance given to us by officers during the conduct of our audit is gratefully acknowledged.

## Financial statements



### Audit opinion

24. We gave an unqualified opinion that the financial statements of Falkirk Council Pension Fund for 2013/14 give a true and fair view of the state of the affairs of the Fund as at 31 March 2014 and of the income and expenditure for the year then ended.

### Other information published with the financial statements

25. Auditors review and report on other information published with the financial statements, including the explanatory foreword and the annual governance compliance statement. We have nothing to report in respect of these statements.

### Legality

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

### Accounting issues arising

#### *Presentational and monetary adjustments*

27. A number of presentational adjustments were identified during the course of the audit. These were discussed and agreed with management who agreed to amend the unaudited financial statements.
28. Additionally, there was one monetary error identified during the course of the audit. This related to the duplication of a lump sum payment offset by other payments not included in the accounts. If the error had been adjusted it would have resulted in the net assets of the Fund increasing by £30,000. However, the error was immaterial to the financial statements and we concurred with management that the accounts should not be amended.
29. Local authority bodies in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and the Service Reporting Code of Practice 2013/14 supported by International Financial Reporting Standards (IFRS). We concluded that the financial statements have been prepared in accordance with extant guidance.

### Report to those charged with governance

30. We presented our report to those charged with governance (ISA 260) to the Pensions Committee on 25 September 2014. The primary purpose of that report is to communicate the significant findings arising from our audit prior to finalisation of the independent auditor's report. The main points are set out in the following paragraphs.
31. **Investment management expenses:** Investment management expenses recorded in the Pension Fund Account are incomplete. They exclude indirect investment manager fees that arise from the 'fund of funds structures'. These fees are accounted for within 'Profit and losses on disposal of investments and changes in market value of investments'. However, the calculation of the fees is a complex area, particularly in regard to pooled investment funds, and it is not possible to separately identify these fees. This matter does not relate solely to Falkirk Council Pension Fund but also applies to other pension funds in Scotland.

32. The Pension Fund has sought to address this issue by attaching an estimate of these expenses to note 15 to the accounts.

### Recommendation no.1

33. **Bank account:** Under the terms of the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 pension funds are required to maintain a separate bank account. Falkirk Council Pension Fund operates a separate bank account although certain transactions are processed through the main council bank accounts and then monies are transferred in or out of the pension fund bank account. This does not fulfil the requirement in our opinion.
34. As a result of transactions being passed through the council's bank account it is difficult to determine at any given point the status of the account i.e. is the balance due to the council or to the pension fund. If the balance is due to the pension fund then the council is liable to pay interest to the Fund at no less than a commercial rate.
35. **Employer/employee contributions:** The data return submitted by one large employer was received late and was inaccurate. A return by another employer indicated the amount remitted by the employer was £36,000 in excess of the amount included in the pension fund accounts.

36. **Cash balances:** The cash balances in the Net Asset Statement include £301,000 described as balances held by Falkirk Council. This amount is a balancing figure after accounting for all transactions relating to the council, and management have advised that all except £3,000 of this amount can be attributed to the pension fund.

37. Of the remaining balance, management has confirmed that it is likely to be fully attributable to the pension fund but this has yet to be fully verified. Based on management assurances and work completed to verify the balance to date we have not treated this as an unadjusted error.

## Outlook

38. The financial statements of the Fund are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). The main new standards to be adopted in 2014/15 include:
- IFRS 13 Fair value measurement
  - IAS 32 Financial Instruments: Presentation
  - Annual improvements to IFRSs 2009-2011 cycle
39. The revised Local Authority Accounts (Scotland) Regulations 2014 apply to financial years 2014/15 onwards.

40. The regulations set out in more detail what is required in respect of financial management and internal control, and in respect of the annual accounts themselves. The significant changes include:
- the requirement for the unaudited accounts to be considered by the Pensions Committee. This can take place following submission to the auditor and up to 31 August if necessary. In addition the audited accounts must be considered and approved for signature by the Pensions Committee by 30 September with publication on the Council's website by 31 October
  - the Pensions Committee will be required to carry out an annual review of the Fund's system of internal control, together with the requirement to approve an annual governance statement or equivalent
  - the Pensions Committee will be required to consider the efficiency and effectiveness of internal audit.
41. The draft programme of meetings for 2015 has a Pensions Committee meeting scheduled for 4 June 2015 to approve the unaudited accounts. This is very tight as the 2013-14 unaudited accounts were not available until the end of June 2014. The next available meeting in 2015 would not be until 25 September 2015. In terms of the accounts regulations the absolute deadline for approval of the unaudited accounts would be 31 August 2015. Given these dates there is a risk that the unaudited accounts may not be available for consideration by

the Pensions Committee within the prescribed timescale.

42. We have raised our concerns about the planned meetings of the Pensions Committee in 2015 with the Democratic Services Manager who co-ordinates and compiles the Committee meetings timetable.

### **Recommendation no.2**

43. Moreover, the Pensions Accountant recently resigned to take up a position with another pension fund. The Pensions Accountant plays a key role in preparing the unaudited accounts. This represents a significant loss of financial accounting knowledge and expertise. Management recognise this risk and are planning to address it through a combination of recruitment and some sharing of resources with another Fund.

### **Recommendation no.3**

## Financial position

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

### Financial results

#### *Budgetary control*

47. The pension fund prepared an annual budget for its administration costs in 2013/14, although the budget is not

disclosed in the financial statements and performance against budget is not routinely reported to the Pensions Committee.

#### **Recommendation no.4**

#### *Financial position*

48. The overall position at 31 March 2014 is that the Fund has net assets of £1,577 million. The financial statements do not take account of the obligations to pay pensions and other benefits which fall due after the end of the year. The actuarial position of the scheme, which does take account of such obligations, is disclosed in Note 25 to the accounts. When taking into account these obligations (£2,281 million) the overall funding position of the Fund, on an IAS 19 basis, is 69% which equates to a deficit of £704.3 million.

#### **Funding position**

49. The most recent triennial valuation was reported in January 2012. The report highlighted that the Fund's assets valued at 31 March 2011 were sufficient to meet 86% of its liabilities accrued up to that date, resulting in a funding shortfall of £193 million. This represents an improved position from the previous triennial valuation (as at March 2008) which reported a funding position of 79% (a funding shortfall of £255 million).

50. Since this time, the Funding position has seen some fluctuation in its position. This is monitored on a regular basis as part of the administering authorities risk management programme. The interim funding position as at 31 March 2014 is 84%. The movement in valuations is summarised in table 1 below, updated with fund values as determined by the Actuary for the year ending March 2013/14:

**Table 1: Movement in valuations 2008 to 2014**

Fund Details	2008	2011	2014
	£ million	£million	£million
<b>Assets</b>	947	1,199	1,577
<b>Liabilities</b>	(1,203)	(1,392)	(1,872)
<b>Net Liability</b>	(255)	(193)	(295)
<b>Funding Level</b>	79%	86%	84%

*Source: previous reports and advice from the Fund's actuary*

51. At a local level, the sustainability of the Fund is managed in a number of ways including annual funding reviews, cash flow modelling and the re-assessment of employer contribution rates at the triennial valuation. Also, any employers seeking to exit the Fund must secure their liabilities.
52. Furthermore, the Public Service Pensions Act 2013 is designed

to ensure the continued sustainability of the Local Government Pension Scheme. In particular, the *employer cost cap* measures about to be introduced will shift some of the risk of future rises in scheme costs onto members.

53. Recent turmoil in the Middle East and Ukraine as well as the general slowdown in global economic recovery has been impacting on financial markets and the funding position may be affected by falling asset values in the short term. This is closely monitored by the Fund and the Pensions Committee to ensure there is no lasting impact.
54. The actuarial value of promised retirement benefits at the accounting date has been estimated by the Fund Actuary as £2,281 million (2012/13 £2,011million), giving a net liability of £704 million as at 31 March 2014 (£548 million as at 31 March 2013). The increase in the net liability is mainly due to a fall in real bond yields. The liability is an estimate of the present value of future liabilities of the Fund, based on the Fund actuary's assumptions regarding the future discount rate, longevity of members and rate of inflation.
55. Actuarial assumptions include retirement rates, numbers and age of members within their valuations, and although the position is challenging the Fund reviews its position on a regular basis. Work is currently underway with the Fund employers and actuary in preparation for the 2014 triennial actuarial valuation.

56. The Fund has joined Club Vita, an organisation which advises funds on managing longevity risk. A report from Club Vita submitted to the Pensions Committee on 25 September 2014 indicated that the longevity assumptions used in the 2011 triennial valuation over estimated the life expectancy of the Fund's pensioners.
57. Applying the longevity assumptions from Club Vita could result in a reduction in the Fund's liabilities by £130 million and improve the Funding position by around 6%. This information will be considered when the actuary comes to set the contributions rates for the three years starting from April 2015.

## Outlook

58. Looking ahead it is clear that the outlook for public spending remains very challenging as significant budget reductions are required in future years. Spending constraints are set to continue and pressures on the Fund will increase as scheduled and admitted bodies seek to deliver efficiencies through reductions in staffing levels.
59. In recent years there has been a decline in active members due to the recession which saw restrictions on recruitment and accelerated severance programmes. This has now been halted through the auto-enrolment initiative which came in on a staged basis mid-way through 2012/13 as illustrated below:

**Table 2: Fund membership 2010 to 2014**

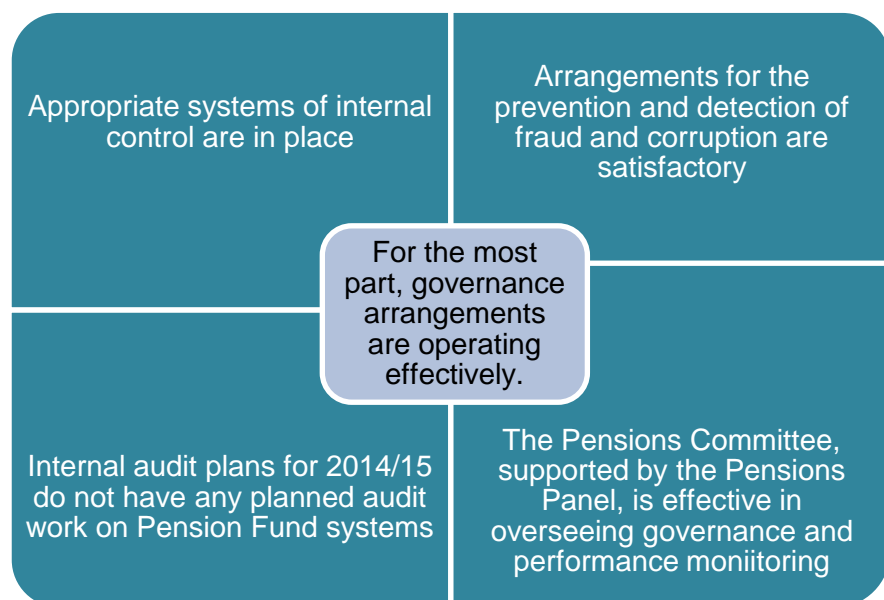
Scheme members	Scheme membership				
	31/3/10	31/3/11	31/3/12	31/3/13	31/3/14
<b>Active members</b>	13,305	12,939	12,668	12,880	14,690
<b>Deferred</b>	4,551	4,869	5,085	5,204	5,320
<b>Pensioners</b>	7,090	7,600	8,119	8,372	8,693
<b>Total</b>	24,946	25,408	25,872	26,456	28,703

*Source: Annual report and accounts 2012/13 and 2013/14*

60. The increase in membership is estimated to have resulted in annual employee contributions rising from £16 million to £17 million. The modest rise reflects the fact that many of those auto enrolled were part-time members. This is an area for management to monitor closely to ensure that the increase in number of active members is sustained.
61. The volatility in the global financial markets and the effect on the stock market makes it important for pension funds to have a wide range of investment vehicles including hedging against currency fluctuations. Pension funds will have to remain vigilant and keep assessing their exposure to risk.



# Governance and accountability



62. Members of the council and the Proper Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Falkirk Council Pension Fund and for monitoring the adequacy and effectiveness of these arrangements.

## Corporate governance

63. The corporate governance framework within Falkirk Council Pension Fund is centred on the Pensions Committee which is supported by the Pensions Panel.
64. Based on our observations and audit work our overall conclusion is that the governance arrangements within Falkirk Council Pension Fund are operating effectively.

## Governance processes and committees

65. Falkirk Council acts as the Administering Authority for the Pension Fund. It is responsible for managing and administering the scheme for scheduled and admitted bodies.
66. The council has delegated the administration, management and investment of the Pension Fund to the Pensions Committee. The committee comprises six councillors from Falkirk Council and three co-opted members. Co-opted members are nominated by the Pensions Panel to represent the interests of scheme members, employers and pensioners. The responsibilities of the Pensions Committee are set out in Falkirk Council's scheme of delegation.
67. The Pensions Panel exists to enhance participation in the

development and scrutiny of matters relating to the Pension Fund. The panel consists of 15 members representing the interests of three groups within the Fund - scheme members, employers and pensioners.

- 68. The Pension Fund will require to review its governance arrangements as a result of the Public Services Pensions Act 2013. The Act requires at a national level the establishment of a Scheme Advisory Board to provide advice and guidance with regard to the management and administration of the LGPS.
- 69. At a local level, the Act requires the establishment of a Pensions Board to support the Scheme Manager (i.e. Administering Authority). The Pensions Board must contain an equal number of employer and member representatives.
- 70. A Heads of Agreement on governance matters has been concluded between COSLA and the trade unions. However, the statutory regulations underpinning the new governance requirements will not be available until early 2015. To enable the new governance arrangements to be in place by the specified date of 1 April 2015 consultation on the new arrangements will have to be undertaken in advance of the final regulations being known. There is a risk that the Fund will not have appropriate arrangements in place by 1 April 2015.

### Recommendation no.5

## Governance Compliance Statement

- 71. Pension administration regulations require an administering authority to prepare and publish a governance compliance statement to measure their pension fund's governance arrangements against the standards set out in the guidance issued by the Scottish Ministers. Having reviewed the governance compliance statement we are satisfied that it complies with the guidance issued by the Scottish Ministers.
- 72. Of the nine principles for compliance only one area has been classified as not compliant and this has mitigating arrangements in place. The governance structures have been seen to be working well with no issues with regard to openness, reporting or scrutiny. From attendance at meetings, our review of papers and minutes the information reported in the Governance Compliance Statement appears to be accurate and appropriate.
- 73. The Code of Practice on local authority accounting in the United Kingdom 2014/15 has been amended to require the inclusion of a separate statement on system of internal financial control (SSIFC) or additional disclosures, reports or statements as necessary in order to meet the requirements of that statement. Internal audit will play an important role in giving assurances in relation to the SSIFC or equivalent.

## Internal control

74. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. The extent of this work is also informed by an assessment of risk and the activities of internal audit.
75. As part of our work we took assurance from key controls within the Fund's systems. We relied on our systems work carried out in 2012/13 supplemented by a high level review of controls using walk through tests to confirm that controls were operating as documented. In addition, substantive checking of transactions was carried out at the year end. No significant control weaknesses were identified during this work.

## Internal audit

76. Internal audit is an important element of the Fund's governance structure. The internal audit service is provided by the council's internal audit section. We reviewed internal audit in terms of ISA 610 and concluded that they operated in accordance with the Public Service Internal Audit Standards and had sound documentation standards and reporting procedures in place.
77. Internal audit carried out comprehensive testing of pension payments, collection of contributions and transfers in 2012-13 which confirmed that there were no significant internal control

issues. In terms of ISA 330 (*Auditors responses to assessed risks*) we are able to place reliance on audit evidence from a previous audit year.

78. We noted that Internal Audit's plans for 2014/15 do not include any work on pension systems. We can place some reliance on prior years' work but going forward internal audit's plans should include specific work on Pension Fund systems in order to provide the Pensions Committee the necessary assurances on the adequacy of the control environment.

### Recommendation no.6

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

79. The Falkirk Pension Fund complies with the relevant fraud and irregularity policies of Falkirk Council and these have been reviewed as part of the council wide audit. We concluded that these arrangements were satisfactory.
80. Falkirk Council Pension Fund participates in the National Fraud Initiative (NFI). The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

## Governance and accountability

- 81. As part of our local audit work we monitor the Fund's approach to participation in NFI both in terms of the submission of the required datasets and strategies for investigating the subsequent data matches. No potential fraud has been identified in the current year although two cases are still under investigation.
- 82. Pension fund staff are proactive in reviewing data matches and ensuring that potential frauds are investigated.

## Outlook

- 83. There are a number of challenges for the Fund including the move to pensions on a career average basis and revised governance arrangements as such as the requirement to establish a Pensions Board as described at paragraph 64.
- 84. Auto enrolment is now being implemented across employers who are members of Falkirk Council Pension Fund. This will inevitably have an impact on administrative workloads, but early preparation and changes to work flow have been put in place to minimise the impact of change.
- 85. The Fund must also be well prepared for the introduction of career average pensions. There will be a requirement to maintain pension records for each individual that will bring together a range of entitlements arising from benefits built up under different pension regimes. This will not only increase administrative workload initially, but will also undoubtedly

generate many more queries and enquiries from fund members seeking clarification on their benefits on an ongoing basis.

### Recommendation no.7

- 86. A new Pensions Administration System is being implemented during 2014/15 to meet these challenges. The Fund is currently implementing a new Pensions Administration Service (Altair) which is due to be completed by February 2015. The cost of the new system is currently estimated at £1.5 million for a contract lasting four years. It is anticipated that administration costs will rise from £16 per member to £22 per member as a result of the implementation of the new system once start up costs have been absorbed.
- 87. The implementation of the new system will involve migration of data from the old system. In these situations there is always the risk that data could be corrupted during the transfer.

### Refer to action plan point no.8

# Best value, performance and use of resources

## Best Value

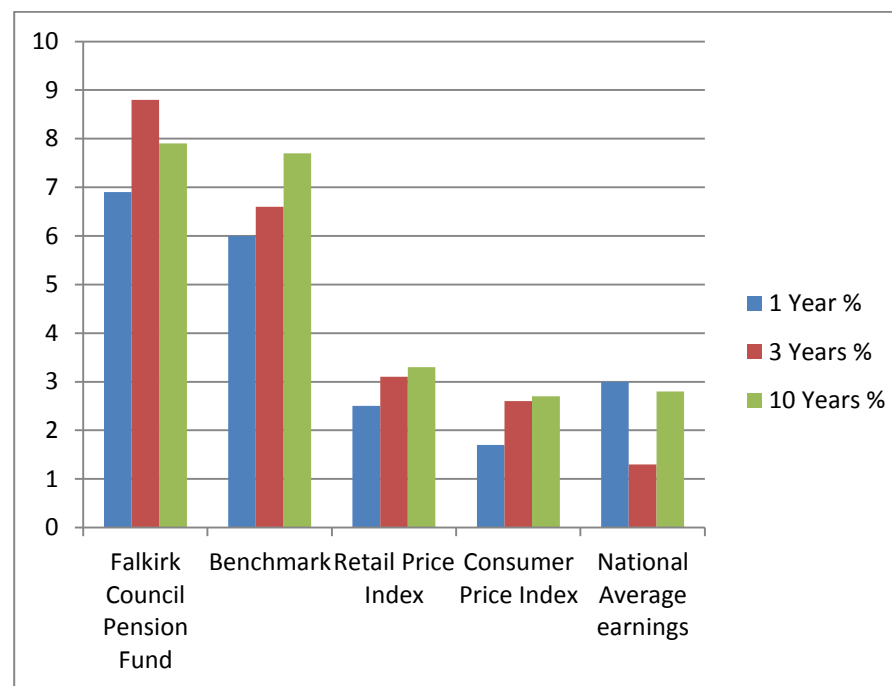
88. The pension fund has not been subject to a Best Value review, however, it is covered by the overall Best Value arrangements of the administering authority.

## Performance

### Investment performance

89. The main mechanism for measuring investment performance is through an analysis of the returns achieved by each of the Fund's external fund managers. The manager's performance, in terms of achieving benchmarks, is subject to independent verification by the Fund's custodian and is regularly reported to the pensions committee.
90. Over the long term, the overall level of investment return achieved by the Fund is expected to exceed the rate of return assumed by the actuary in valuing the Fund. Investment returns of Falkirk Council Pension Fund have outperformed benchmark targets over the short, medium and longer term. The current rolling three year performance is also ahead of benchmark as illustrated in table 2.

**Table 2: Investment Performance**



Source: Falkirk Council Pension Fund Annual Report & Accounts 2013/14

91. The table shows that over a period of one, three and ten years the pension fund has outperformed National Average Earnings, the Consumer Price index, the Retail Price Index and Benchmark performance.

## Fund manager performance

92. Each Active Investment Manager has a defined performance benchmark and objective against which performance will be measured.

**Table 3: Fund managers' performance 2013-14**

Fund Manager	Mandate	Performance Benchmark	Actual Performance
Aberdeen Asset Mgt	Global Equities	6.72	1.58
Baillie Gifford	Bonds	(0.85)	(0.61)
Baillie Gifford	Diversified Growth	0.5	1.63
Legal & General	Passive Equities	7.92	8.11
Newton	Global Equities	6.75	6.79
Schroder	UK Equities	8.81	17.91
Schroder	Property	11.87	10.26
Alternatives	Private Equity/Infrastructure	0.35	2.09

*Source: Falkirk Council Pension Fund Annual Report & Accounts 2013 - 14*

93. Investment fund managers mostly exceeded their performance benchmark for 2013-14 although two did not achieve their benchmark with one of these disclosing a significant underperformance. We have been advised that this manager has been placed 'on watch' to ensure better performance is achieved in future.

## Administration performance

94. The Fund reports administration information to the CIPFA Pensions Benchmarking Club and the Scottish Government on an annual basis. A range of service standards have also been developed by the Pensions Section and these are monitored on a regular basis by the Pensions Manager. Administration indicators are now reported more regularly to members.
95. Three complaints were received in year, one of which was not responded to within three days. Targets were not met for responding to estimate requests and ad-hoc enquiries.
96. These two areas will face increasing pressure as pension details become more complicated after the effects of both auto enrolment and the change from pensions based on final salary to average pay. Individuals will now have multiple entitlements which could add confusion on the part of the individual and an increased workload for the pensions' administration staff in bringing this information together.

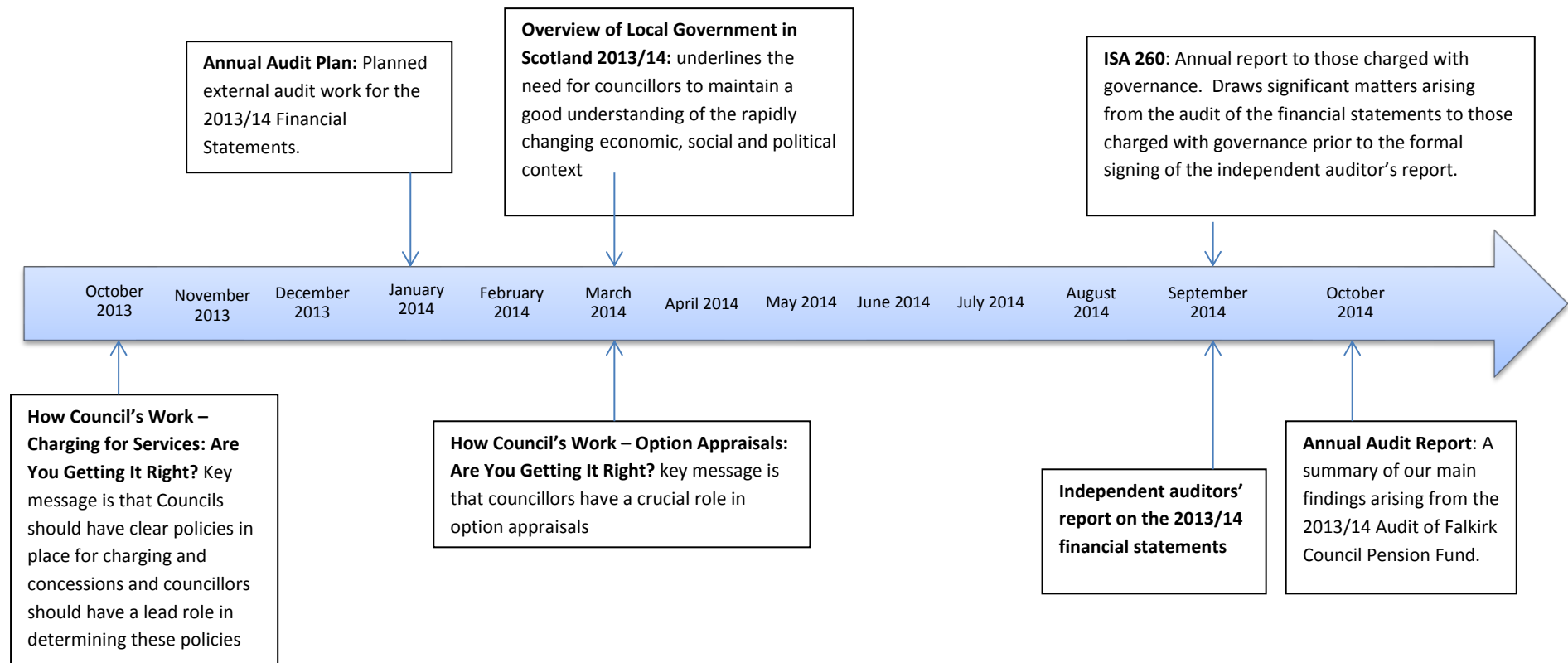
## National performance reports

97. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are included in Appendix 1 along with locally produced audit reports.

## Use of resources

98. In response to comments made in our 2012-13 Annual Audit report management agreed to develop a timetable for tendering and re-tendering of services during 2013 to 2015 including the re-tendering for Custodian Services and Lost Member Tracing. These are now underway.

## Appendix I – Summary of Falkirk Council Pension Fund local audit and National reports 2013/14





## Appendix II – Significant audit risks

The table below sets out the key audit risks identified at the planning stage and it details the assurances that we have received on completing our audit work in these areas.

Audit Risk	Assurance
<p><b>Investment manager expenses</b></p> <p>Investment management expenses recorded in the Pension Fund Account exclude investment manager fees arising from ‘fund of fund structures’.</p> <p><b>Risk:</b> <i>members cannot gauge whether best value is being obtained.</i></p>	<p>Management have made progress in identifying separately investment manager fees arising from ‘fund of fund structures’. This resulted in an estimate of these expenses in the notes to the accounts.</p> <p>The Fund plans to implement the best practice recommended by CIPFA which is being currently developed and should be available for 2014-15.</p>
<p><b>Working paper requirements</b></p> <p>A trial balance should be produced as part of a year-end working paper package. This enables all balances within the Fund to be easily reconciled to the financial statements, and ensures all transactions have been included within the accounts.</p> <p><b>Risk:</b> <i>account balances cannot be fully reconciled to the financial statements.</i></p>	<p>A good year-end working papers package was prepared in support of the unaudited 2013-14 accounts.</p> <p>A trial balance was produced for all accounts, excluding investments that enabled fund balances to be readily reconciled to the financial statements. Investment balances were agreed to the custodian reports.</p>

## Appendix II – Significant audit risks

Audit Risk	Assurance
<p><b>Pension reform</b></p> <p>The Fund faces a number of challenges in order to comply with requirements of the CARE scheme to be introduced by 1 April 2015, and the demands of auto enrolment. It is intended that a new administration system will be introduced, in order that the Fund can meet these administrative requirements.</p> <p><i><b>Risk:</b> appropriate systems are not in place to meet increasingly complex administrative and workload demands.</i></p>	<p>A new pension administration system based on Altair is being developed by Heywood and is due for implementation by February 2015.</p> <p>Training events are being scheduled for the pensions' team and employers to ensure they are familiar with the operation of the new system.</p>

## Appendix II – Significant audit risks

Audit Risk	Assurance
<p><b>Governance requirements</b></p> <p>The Public Service Pensions Act 2013 states that a fund should either have a separate Committee and Pension Board, or a combined arrangement. Currently there is a separate Pensions Committee and Pensions Panel in place. However, these arrangements do not meet the requirements of the Act. If a separate Pensions Board is maintained then it will require equal numbers of employer and member representatives.</p> <p><b>Risk:</b> <i>appropriate governance arrangements are not in place by 1 April 2015.</i></p>	<p>A report was submitted the Pensions Committee on 25 September which outlined the proposals to go out for consultation with stakeholders as follows:</p> <ul style="list-style-type: none"> <li>• How many employer and trade union representatives should sit on the new Pensions Board?</li> <li>• How will employer and union representatives be selected?</li> <li>• What will the term of appointment be for Board members?</li> <li>• How will the Board Chair be appointed (if there are equal member numbers)?</li> <li>• Should substitute Board members be permitted?</li> <li>• Should non-Falkirk Council elected members continue to sit on the Pensions Committee? If so is the current configuration of one employer, one union and one pensioner representative appropriate?</li> <li>• Should an independent specialist be formally invited to sit on the Committee (such persons can only have observer status on the Board)?</li> </ul> <p>Per current plans the consultation is due to end by 30 November 2014 to allow responses to be considered by Committee. The statutory regulations underpinning the new governance rules will not be available until early 2015 and consequently the consultation process will have to be undertaken in advance of the final regulations.</p>

## Appendix II – Significant audit risks

Audit Risk	Assurance
<p><b>Training</b></p> <p>In a period of change it is important that members receive on-going training on the impact of pension reforms to ensure their knowledge and understanding is up to date.</p> <p><b>Risk:</b> <i>members will not be able to perform their scrutiny function effectively without appropriate training.</i></p>	<p>A programme of training events will be made available to the Pensions Panel and Pensions Committee. Amongst other issues, this will cover the new version of the scheme being introduced from 2015.</p> <p>There will also be training put in place for any members of the Pension Board, once membership is confirmed and taking into account members skill sets.</p>

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
1/32	<p><b>Investment managers' expenses</b></p> <p>Investment management expenses recorded in the Pension Fund Account exclude indirect investment manager fees that arise from the 'fund of funds structures'.</p> <p><b>Risk</b></p> <p>Management may not be able to determine whether they are securing best value for the services they receive in the absence of incomplete information on fund managers' fees.</p> <p><b>Recommendation</b></p> <p>Implement best practice, in relation to the disclosure of fund managers' expenses, as recommended by CIPFA.</p>	<p>The Fund will monitor guidance issued by CIPFA in relation to indirect fees and will continue to engage with relevant Managers to provide sufficient information.</p>	<p>Pensions Manager (Alastair McGirr)</p>	<p>April 2015</p>

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
2/42	<p><b>Accounts regulations 2014</b></p> <p>The timescale for the Pensions Committee (or its successor) approving the 2014/15 unaudited accounts is very tight.</p> <p><b>Risk</b></p> <p>The unaudited pension fund accounts may not be available for approval by the Pensions Committee within the timescale prescribed in the 2014 Accounts Regulations.</p> <p><b>Recommendation</b></p> <p>Review the scheduled meetings of the Pension Committee in 2014-15 to ensure there is sufficient time to comply with the timescale for submitting the unaudited accounts in terms of the 2014 accounts regulations.</p>	<p>Arrangements have been made to re-schedule the June Pensions Committee to 26 June 2015 to ensure sufficient time is available to submit the unaudited accounts in terms of the 2014 Accounts Regulations.</p>	<p>Pensions Manager (Alastair McGirr)</p>	<p>Immediate</p>

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
3/43	<p><b>Pension fund accountant</b></p> <p>The pension fund accountant has resigned his position to take up another post with another Pension Fund.</p> <p><b>Risk</b></p> <p>Loss of accounting knowledge and expertise that could adversely impact on the production of the 2014/15 annual report and accounts.</p> <p><b>Recommendation</b></p> <p>Ensure that sufficient accounting support is put in place to allow the 2014/15 unaudited accounts to be prepared on time for auditing.</p>	<p>The critical importance of the accounting process is recognised and as a consequence, the Fund would intend to address the loss of its Accountant through a combination of either like for like recruitment or some sharing of resources with the Lothian Pension Fund.</p>	<p>Pensions Manager (Alastair McGirr)</p>	<p>31 Dec 2014</p>

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
4/47	<p><b>Budgetary control</b></p> <p>The Fund does not disclose its budget for administration costs in the financial statements and performance against budget is not routinely reported to the Pensions Committee.</p> <p><b>Risk</b></p> <p>Performance against budget is not monitored effectively.</p> <p><b>Recommendation</b></p> <p>The budget for administration costs should be disclosed in the financial statements and members should receive regular budget monitoring reports.</p>	<p>The per member administration cost of the Falkirk Council Fund is the lowest amongst Scottish funds. However, the point is accepted and steps will be taken to report the administration budget to the Pensions Committee.</p>	<p>Pensions Manager (Alastair McGirr)</p>	<p>31 Mar 2015</p>



## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
5/70	<p><b>Public Services Pensions Act 2013</b></p> <p>New governance arrangements, in terms of the 2013 Act, come into force on 1 April 2015 although the statutory regulations underpinning these new arrangements will not be available until early 2015. Consultations with existing Pension Panel and Pension Committee members will also have to be carried out in advance of the final regulations being known.</p> <p><b>Risk</b></p> <p>The pension fund may not have appropriate governance arrangements in place by 1 April 2015.</p> <p><b>Recommendation</b></p> <p>Robust plans should be put in place to ensure that new governance arrangements are implemented by 1 April 2015.</p>	<p>A timetable setting out the key milestones in establishing the new governance arrangements has been reported to the August / September round of the Pensions Panel and Committee.</p> <p>A consultation exercise is being undertaken with stakeholders and responses will be considered further at a joint meeting of the Panel and Committee on 11 December 2014.</p> <p>Subject to the receipt of final Governance legislation, this will enable the revised governance framework to be established prior to the deadline of 1 April, 2015.</p>	Pensions Manager (Alastair McGirr)	31 Mar 2015

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
6/78	<p><b>Internal audit</b></p> <p>Internal audit's plans for 2014/15 do not include any provision for work on the pension fund.</p> <p><b>Risk</b></p> <p>Internal audit may not be available to give management or the Pensions Committee assurance on the adequacy of controls in place within pensions' systems.</p> <p><b>Recommendation</b></p> <p>Internal audit plans should include work specific to the Pensions Fund and its systems and controls.</p>	<p>Although internal audit work on Fund matters is limited during 2014/15 (NFI activity being the exception), significant work on systems and controls has been undertaken in previous years and can still be used to provide some assurance.</p> <p>The changing pensions landscape in terms of governance, systems and scheme changes make it appropriate that pension fund activity is more heavily scrutinised. This will be reflected in the internal audit work plan for 2015/16 as already discussed with the Internal Audit Manager.</p>	Gordon O'Connor (Internal Audit Manager)	31 Jan 2015

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
7/85	<p><b>Career average pensions</b></p> <p>With the introduction of career average pensions there will be a requirement to maintain pension records for each individual that will bring together a range of entitlements arising from benefits built up under different pension regimes. This will not only increase administrative workload initially, but will also undoubtedly generate many more queries and enquiries from fund members seeking clarification on their benefits on an ongoing basis.</p> <p><b>Risk</b></p> <p>The Fund will have insufficient staff to deal with the increased workload leading to delays in providing information to members.</p> <p><b>Recommendation</b></p> <p>The pensions section should review whether it has sufficient resources to deal with the expected increase in enquiries from members of the pension fund.</p>	<p>It is accepted that the transition from Final Salary to Final Salary / Career Average will place significant demands on the Pensions administration team.</p> <p>In the longer-term, it is expected that efficiencies will be wrung out of the new Pensions Administration System. However, in the short term it may be necessary to increase the staffing resource to deal with demand.</p>	Pensions Manager (Alastair McGirr)	31 Jan 2015

## Appendix III – Action plan

Action plan point/para	Issue, risk and recommendation	Management action/response	Responsible officer	Target date
8/87	<p><b>New pension administration system</b></p> <p>A new pension administration system (Altair) is being implemented with work due to be completed by February 2015. This will involve the migration of data from the old to the new system.</p> <p><b>Risk</b></p> <p>There is a risk that some data may be corrupted during the migration process.</p> <p><b>Recommendation</b></p> <p>Controls should be put in place to ensure that data transferred from the old pension administration system to the new one is complete, accurate and reliable.</p>	<p>Although the timescale for migration is extremely tight, significant preparatory work has been undertaken as a result of the project to migrate Police and Fire Pension Scheme records to SPPA.</p> <p>Heywood (suppliers of Altair) are experienced in migrating data and their processes include significant validation checkpoints to ensure that all data is comprehensively uploaded and mapped by the time the system goes live.</p> <p>Pensions staff continue will continue to have access to the existing Pensions administration system in the event that membership queries arise.</p>	Pensions Project Officer (David Cunningham)	28 Feb 2015