

# Falkirk Council Pension Fund

Year ended 31 March 2017

Annual Audit Report

Pensions Committee and Board – 21 September 2017



**EY**

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## About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Accounts Commission has appointed us as external auditor of Falkirk Council Pension Fund (the Pension Fund) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Local Government (Scotland) Act 1973 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

This report is for the benefit of the Pension Fund and is made available to the Accounts Commission, the Controller of Audit and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

## Complaints

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

## Purpose of this report

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as the external auditor of Falkirk Council Pension Fund (the Pension Fund) for the five year period 2016/17 to 2020/21. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; Auditing Standards and guidance issued by the Auditing Practices Board; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Report is designed to summarise our key findings and conclusions from our audit work. It is addressed to both the members of the Pensions Committee and Board and the Controller of Audit, and presented to both management and those charged with governance, identified as being the Pension Fund's Pensions Committee and Board. It will be published on Audit Scotland's website.

We draw your attention to the fact that our audit was not designed to identify all matters that may be relevant to the Pension Fund. Our views on internal control and governance arrangements have been based solely on the audit procedures performed in respect of the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

## Scope and responsibilities

The Code sets out the responsibilities of both the Pension Fund and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the Pensions Committee and Board on 16 March 2017. We summarise the responsibilities of the Pension Fund in Appendix A.

Our Annual Audit Plan also provided you with an overview of how we intended to carry out our responsibilities as your auditor. We carried out our audit in accordance with this plan.

We planned our procedures using a materiality of £18.3 million. We reassessed this using the actual year-end figures, to confirm that the materiality remained appropriate for the audit. We subsequently adjusted materiality to £22.2 million to reflect the increase in pension fund assets at yearend. The threshold for reporting audit differences is £250,000 in line with Audit Scotland guidance.

## Status of the audit and audit opinion

We have completed our audit of the Falkirk Pension Fund's financial statements for the year ended 31 March 2017. We have issued an unqualified audit opinion on those financial statements.

## Acknowledgement

We would like to thank all members of the Pension Fund's management and staff involved in the audit for their co-operation and assistance during our work.

## Accounting and audit matters – our reporting on the Pension Fund’s financial statements

### Preparation of financial statements

- ▶ The unaudited financial statements were prepared to an acceptable standard. We have identified one audit difference which has not been adjusted by management. This is in relation to the valuation of private equity investments at the balance sheet date. We have also identified that the sensitivity analysis disclosures did not fully meet the exact requirements of the Code and have brought this to your attention for information purposes.

### Significant and Fraud risks

- ▶ Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Pension Fund’s financial position based on manipulation of revenue or expenditure transactions.

### Other matters and reporting requirements

- ▶ Our testing on opening balances was completed satisfactorily. We have no matters to bring to your attention in respect of our work on the qualitative aspects of the financial statements.
- ▶ We have concluded that the Pension Fund has complied with the requirements of the Local Authority Accounts (Scotland) Regulations 2014. In respect of our ‘Opinions on other prescribed matters’, which includes the management commentary and the annual governance statement, we have concluded that our opinion is unqualified. We have not identified any other matters on which we are required to report by exception.

## Wider scope audit dimensions – our judgements and conclusions on the Pension Fund’s arrangements

### Financial sustainability

- ▶ Ensuring the long term sustainability of the Pension Fund is of key strategic importance. This includes ensuring contributions, investment income and ability to liquidate investments are sufficient to cover benefits over the short term and the fund as a whole can meet its estimated liabilities as they crystallise over the longer term.
- ▶ We have no significant matters to report in respect of financial sustainability for the Fund. The next 12 months is expected to result in significant developments in respect of the future sustainability of the fund, as the new statement of investment principles is implemented and the actuarial valuation of the fund as at 31 March 2017 is finalised, along with the funding and investment impact going forward for the fund and members.

### Governance and transparency

- ▶ The Pensions Committee and Chief Finance Officer have delegated authority for establishing robust governance arrangements in respect of the Pension Fund. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations.
- ▶ We have no significant matters to report in respect of the Fund’s governance and transparency arrangements during the year. We have noted through discussions with management that arrangements around the Fund’s conflicts’ policy and register of interests for members’ and management arrangements are under review following internal audit recommendations. We have made one recommendation around management’s consideration of business continuity arrangements.

### Financial management

- ▶ With significant financial challenges facing public sector bodies, it is essential the Pension Fund has robust financial management arrangements to ensure that it can continue to deliver on its responsibilities.
- ▶ We have concluded that on the whole arrangements around financial management appear appropriate. We have noted one recommendation in respect of employer contribution reconciliations and one recommendation in respect of private equity and infrastructure investment valuations at year end.

### Value for Money

- ▶ This dimension is focused on how the Pension Fund effectively utilises its resources and the arrangements in place to ensure the Fund performance is as robust as possible over the short, medium and longer term.
- ▶ We have no significant matters to report in respect of the management’s arrangements for securing value for money for the Fund. We have considered arrangements for reviewing fund manager performance and for tendering for key services in relation to investment management and custodian services.

## Appendices

We have confirmed our independence to act as auditor of the Pension Fund. Auditor remuneration of £19,720 was agreed with management. No non-audit services were provided.

We have made four recommendations for action by management. All have been accepted by management.

# **1. Financial statements and accounting**

# 1. Financial statements and accounting



The Pension Fund's Annual Accounts enables the Fund to demonstrate accountability for its resources and its performance in the use of those resources during the year. They are prepared in accordance with proper accounting practice, which is represented by the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom.

## Audit opinion

In respect of the financial statements, we report on the truth and fairness of the financial transactions of the Fund during the Fund year and of the amount and disposition of the assets and liabilities at the year end in accordance with applicable law and the 2016/17 Code of Practice.

The detailed form and content of our audit report, plus the requirements underpinning the report, are contained in the Audit Scotland guidance at [http://www.audit-scotland.gov.uk/uploads/docs/um/tgn\\_2017\\_5\\_local\\_authorities.pdf](http://www.audit-scotland.gov.uk/uploads/docs/um/tgn_2017_5_local_authorities.pdf) (Appendix 1).

We have issued an unqualified opinion following the satisfactory completion of our work.

We have not identified any circumstances to notify the Controller of Audit that a statutory report may be required under the Local Government (Scotland) Act 1973.

## Financial statements preparation

As part of your oversight of the Pension Fund's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared predominantly by the finance team to support the audit.

Overall we considered the quality of the financial statements and the supporting working papers provided by management to be of a high quality and robust in supporting the information in the financial statements. Through our review of the financial statements we suggested a number of presentational and disclosure requirements which have been accepted and updated by management. In particular we have identified one instance where we do not consider management's disclosures to meet the requirements of the Code of Practice, in respect of sensitivity analysis. Management has provided a rationale for its disclosures and we accept it is not a material departure from the requirements of the Code that would impact our audit opinion. We have included a recommendation in the action plan to consider this point going forward.

## Materiality

We planned our procedures using a materiality of £18.3 million. We reassessed this using the actual year-end figures and determined it was appropriate to increase materiality to £22.2 million based on the significant increase in the Fund's assets at year-end. Our threshold for reporting audit differences remained at £250,000 in line with Audit Scotland requirements.

## Audit differences

We identified an unadjusted audit difference in the draft financial statements which management has chosen not to adjust. We have included more information on the nature of the adjustment on page 6 of this report. Management has provided a rationale for not adjusting the identified difference and this is included in the Letter of Representation. The aggregated impact of the unadjusted audit difference is an understatement of net assets of approximately £6.2 million. On the grounds of our overall audit materiality we can accept the audit difference in giving our opinion.

We have not identified any further unadjusted audit differences through the course of our work. We have issued an unqualified audit opinion on the financial statements.

## Overall Conclusion

- ▶ We have issued an unqualified opinion on the Fund's financial statements.
- ▶ We have updated our audit materiality from our audit plan communicated to the Pension Committee to reflect the increased value of the Fund's assets at the year-end.
- ▶ The unaudited financial statements were prepared to an acceptable standard. We identified one unadjusted audit difference and one instance where disclosures did not meet the strict definition of that required by the Code.

Our Audit Plan identified key areas of focus for our audit of the Pension Fund's financial statements, including significant risks. This report sets out our updated consideration of the risks to the Fund's financial statements, the results of our audit procedures plus any relevant observations, including our views on areas which might be conservative, and where there may be potential risk and/or exposure.

### Fraud risk – risk of fraud in revenue recognition

#### What is the risk?

As identified in ISA 240 (UK and Ireland), management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identified this risk as a significant risk in our audit plan but have subsequently updated our consideration to fraud risk. This adjustment to the audit classification did not impact our audit procedures at the year end audit.

#### Results of audit procedures

##### 1. Test the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements

We obtained all journals posted by management to record the transactions of the Pension Fund, which are hosted on the Falkirk Council financial ledger. We subsequently tested any material manual journals to understand the basis for the transaction and agree to third party supporting evidence.

##### 2. Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates

There are no material accounting estimates included in the financial statements that have a direct impact on the Fund's financial position. We have considered the actuarial assumptions disclosed in this report on page 7, however as these are obtained from a third party there is minimal scope for management to manipulate these.

##### 3. Evaluate the business rationale for any significant unusual transactions

We did not identify any significant unusual transactions.

#### Changes to the Code of Practice in 2016/17

There were a number of changes to the Accounting Code of Practice in 2016/17 which impact on the preparation of the Pension Fund's financial statements. These include:

- ▶ Changes to the disclosure of management expenses in line with the recent CIPFA guidance and rents from properties which should be shown gross. Consequently, the Fund changed its accounting policy in relation to the treatment of indirect fees deducted from investment capital, with a restatement of 2015/16 made as in the prior year, indirect fees deducted from capital were included in the reported management fees. Following revised guidance from CIPFA (i.e. "Accounting for Local Government Pension Scheme Management Expenses") issued in June 2016, the Fund now only recognises in the accounts expenses directly invoiced by investment managers and fees payable to fund managers that are deducted from fund assets. As a result of the restatement, reported 2015/16 management fees have been reduced by £1.9m. The Fund's Profit and Loss on disposal of investment and changes in market values of investments have also been reduced by £1.9m.
- ▶ Changes in the basis of classifying investment assets and liabilities into fair value hierarchies to follow the recommendations contained in *Practical Guidance on Investment Disclosures* issued by PRAG in June 2016.
- ▶ Remuneration of key management personnel disclosures in the related party transactions note.

We have reviewed the accounts against the changes required above and confirmed all adjustments and changes to disclosures were made appropriately, with no audit differences identified.

#### Risk of fraud in revenue recognition – what we concluded

- ▶ Our testing has not identified any material misstatements relating to management override.
- ▶ Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Fund's financial position.

Our Audit Plan identified other aspects of our work which arise either in accordance with International Standards on Auditing (UK & Ireland) or in accordance with the Code. These are set out below.

### Higher inherent risk – valuation of complex investments

#### What is the risk?

The Fund's investments include complex unquoted pooled investment vehicles, including infrastructure and property funds, and private equity funds. The prices for these investments are not publically available. The nature of investments means that any error in valuation made by the investment manager could result in a significant valuation difference. Current market volatility means valuations can quickly become outdated, especially when there is a significant time period between the latest available audited information and the fund year end. Such variations could have a significant or material impact on the financial statements.

In our Audit Plan previously submitted to the Pension Committee we identified this as a 'significant risk' area. On review of the year end balance relating to complex investments against total assets and against our updated materiality we have re-classified the risk as being a 'higher inherent risk'. The main rationale for this classification is that while there are higher risks of valuing these assets, the breadth of investment fund managers managing the entire portfolio makes it less likely for one error in judgement to cause a material misstatement.

#### Results of audit procedures

##### 1. Obtain third party confirmations of the investments at the Pension Fund's year end

We obtained third party confirmations of the private equity and infrastructure investment balances at year end 31 March 2017 from the investment fund managers for all material balances. Our testing covered £185.0 million of the £186.6 million year end balance.

We identified a number of differences between the balances in the accounts and the confirmations we received from fund managers, amounting to an understatement of valuation in the accounts. On investigation we confirmed this related to updates to 31 March fund balances where such information had not been available at the time management prepared the financial statements.

We have subsequently raised an audit difference of £6.2 million. Management has chosen not to adjust the difference, noting the financial statements are prepared with the best information available to the timetable required by statutory guidelines. Management has also highlighted that this approach is common across the sector in Scotland. While we appreciate the adjustment is not material to the financial statements for this year it is possible that it might in the future given the Fund's strategic investment plan to increase the level of private equity and infrastructure investments. We have therefore raised an action in the action plan for the year end valuation approach for private equity and infrastructure to be reviewed and considered to ensure that it takes account of the increased risk of material misstatement in the future.

*Action plan point 1*

##### 2. Where available, review relevant controls' reports for qualifications or exceptions that may affect the audit risk and scope.

Where they were available, we obtained controls' reports for fund managers holding material investments. No issues that could affect the risk or scope of the audit were identified.

##### 3. Review the basis of valuation for unquoted investments to be satisfied that it is in line with the accounting policy and CIPFA requirements.

We have reviewed the valuation basis for all unquoted investments and it is in line with the accounting policy and CIPFA requirements in all material respects.

##### 4. Perform tests of valuation such as reviewing transactions around the year end, performing 'look through' testing or obtaining latest available audited accounts and auditing any subsequent cash movements between the date of the audited accounts and the Fund's year end.

We performed these tests for the material balances and identified the understatement of £6.2 million.

### Valuation of complex investments – what we concluded

- ▶ We identified one material audit adjustment which management has chosen not to adjust. The impact of this would be to increase the pension fund's net assets by £6.2 million in 2016/17. A recommendation has been raised in the action plan in respect of this adjustment and management's valuation of private equity and infrastructure going forward.

## Other audit matters

### Opening balances and first year audit procedures

International Standard on Auditing (UK and Ireland) 510: *Initial audit engagements – opening balances* requires auditors to obtain sufficient, appropriate audit evidence that opening balances do not contain misstatements that materially affect the financial statements. The standard also requires auditors to verify that appropriate accounting policies are reflected in the opening balances and that they have been consistently applied in the current period's financial statements. Our procedures performed as part of our first year audit included:

- ▶ Review the work of the predecessor auditor where appropriate, to identify any issues that may impact upon the opening balances.

We held handover discussions the previous auditor and reviewed their 2015/16 audit results report to identify any additional, specific risks to the financial statements we were not previously aware of. We did identify two recommendations in the audit report from 2015/16 which we considered for follow up as part of our work in 2016/17, in respect of the timely completion of year end data returns.

We have followed up on the finding and recommendation during 2016/17 and noted through discussions with management and review of the year end returns and reconciliations provided that issues remain with the timeliness and quality of information from scheme employers.

*Action point 2*

- ▶ Substantively test opening balances to ensure they agree to the prior year audited accounts and closing trial balance.  
The nature of the Pension Fund financial statements is such that the vast majority of material opening balances relate to investments held at the balance sheet date. We have agreed these balances to third party supporting evidence with no material differences.

### Qualitative aspects of the financial statements

We have reviewed the significant accounting policies, which are disclosed in the annual accounts, and we consider these to be appropriate to the pension fund.

During the audit we identified the requirement for a reclassification adjustment to reclassify the Baillie Gifford Bond Fund previously presented within the Bonds category to Pooled Investment vehicles which reflects the proper asset type (CY: £175 million, PY: £156 million).

We have also considered the disclosures made in the financial statements against the requirements of the CIPFA Code of Practice and disclosure checklist. We noted one area, in respect of the disclosure of sensitivity analysis, where the disclosures do not meet the strict requirements of the Code. We have discussed with management who have confirmed they have sought to address the disclosure requirements in relation to sensitivity analysis by considering risk on an aggregated basis. It is recognised that this approach does not provide the extent or detail of disclosures recommended in the Code, however management feels to obtain this information would be disproportionately expensive to the Fund. Management considers that these risk metrics are an appropriate and proportionate basis on which to measure and assess the range of investment risks faced by the Fund.

We have included a recommendation that this be reviewed for the future financial statements disclosures, however we concur with management's view that the current disclosures do not materially impair the financial statements to users.

*Action point 3*

## Other audit matters – what we concluded

- ▶ Our testing on opening balances was completed satisfactorily.
- ▶ We identified the need for a reclassification of Baillie Gifford Bond to Pooled Investment Vehicles which has been agreed and adjusted in the accounts
- ▶ We have raised one matter in respect of our work on the qualitative aspects of the financial statements.

## 2. Financial statements and accounting



The Local Authority Accounts (Scotland) Regulations 2014 set out the statements which should be included in the Annual Report and Accounts in addition to the financial statements. These items are covered by our independent auditor's report as *Other prescribed matters*, in accordance with the Audit Scotland requirements under the Code.

### Other reporting requirements

#### The Local Authority Accounts (Scotland) Regulations 2014 (the Regulations)

Regulations 8 to 10 set out the statutory requirements on the Pension Fund in respect to the Annual Accounts, availability for public inspection and the consideration and signing by the Pension Committee.

As required, we received the unaudited Annual Accounts by the 30 June deadline. The Pensions Committee and Board considered the unaudited Annual Accounts on 24 August 2017, in advance of the 31 August deadline. No statutory objections were received on the unaudited financial statements.

#### Management Commentary

The requirement for the Pension Fund to include a management commentary is included in Regulation 8(2)(a). Audit Scotland requires us to read the information in the management commentary and express an opinion on whether the:

- ▶ information given in the management commentary is consistent with the financial statements and whether it has been prepared in accordance with the statutory guidance.

Guidance on the content of the management commentary was issued by the Scottish Government within Local Government Finance Circular 5/2015, while Part 2 of the Circular provides statutory guidance on the specific requirements. In undertaking our work we considered whether the management commentary provided a fair and balanced review of the Pension Fund's business; a description of the principal risks and uncertainties; financial and non-financial key performance indicators; a description of the Pension Fund's strategy and business model and the main trends and factors likely to affect future developments; performance and position of the Fund's business and explanation of the amounts in the financial statements.

The management commentary was generally of good standard. We suggested amendments to aid the clarity of presentation and also to report more specifically on the financial performance in the year. Management took on board these comments and made changes to the audited financial statements.

#### Annual Governance Statement (AGS)

Audit Scotland requires us to read the information in the annual governance statement and express an opinion on whether the:

- ▶ information given in the annual governance statements is consistent with the financial statements and whether the statement has been prepared in accordance with *Delivering good governance in local government: framework 2016*.

We set out the work undertaken in respect of the Pension Fund's annual governance statement as part of the Wider Scope – Governance & Transparency section of this Report. As a result of this, we required changes to the draft AGS to be made by management.

### Other reporting requirements – what we concluded

- ▶ We have concluded that the Pension Fund has complied with the requirements of the Regulations.
- ▶ In respect of our 'Opinions on other prescribed matters', which includes the management commentary, and the annual governance statement, we have concluded that our opinion is unqualified.
- ▶ We have not identified any other matters on which we are required to report by exception

## **2. Wider scope audit**

# 3. Wider scope audit



In accordance with the Code, conclusions and judgements formed in respect of the four audit dimensions - financial management; financial sustainability; governance and transparency; value for money - which frame the wider scope of public sector audit contribute to the overall assessment and assurance on Best Value.

## Wider scope audit risks

The Code requires us to undertake work in respect of each of the four dimensions on an annual basis. The Code also sets out an expectation that 'significant' risks identified through our planning process that relate to the wider scope dimensions will be communicated with you. In undertaking our risk assessment in respect of the wider scope audit areas, we distinguish between the definition of 'significant risks' which apply to the audit of the financial statements, by referring to 'Wider Scope Audit Focus Areas'.

In our Annual Audit Plan we did not identify any wider scope audit focus areas, and no new areas were identified during our year end audit work. We have outlined our considerations in respect of the wider scope dimensions below, focusing on key areas of audit focus in the year and areas where we have identified actions for improvement.

## Financial management

With the significant financial challenges facing public sector bodies, it is essential that the Pension Fund has robust financial management arrangements to ensure that it can continue to deliver on its responsibilities.

Given the nature of this wider scope dimension significant consideration is given through our audit of the Fund's draft financial statements through the procedures we undertake as part of this process. Through the course of our financial statement audit work we have identified two recommendations for management that relate to the wider financial management of the Fund. These are in respect of:

- ▶ The process for valuation of private equity and infrastructure investments at year end – see action point 1.
- ▶ The robustness of employer contribution reconciliation information provided at year end – see action point 2.

No other significant matters were noted through the course of our work in this respect. We noted two areas of audit emphasis around financial management in the year where we have concluded management's arrangements were appropriate:

- ▶ Management correctly identified, adjusted and disclosed all management expenses to the appropriate gross level following revised CIPFA guidance issued for the 16/17 accounts, including correct restatement of prior year comparatives.
- ▶ Management has demonstrated a robust approach to monitoring, and following up where applicable, the timing of contribution payments from employers both throughout the year and at the year end.

## Financial sustainability

Ensuring the long term sustainability of the Fund is of key strategic importance. This includes ensuring contributions, investment income and ability to liquidate investments are sufficient to cover benefits over the short term and the fund as a whole can meet its estimated liabilities as they crystallise over the longer term.

We have no significant matters to report in respect of financial sustainability for the Fund, while noting there are significant future developments expected in the upcoming 12 months and beyond in this area:

- ▶ The future projected strategic allocation of investments by asset class shows further significant divestment from the current allocation focused on equities, with the largest increases being pooled investment vehicles such as bonds and property. This will continue to increase the significance of the role of the Fund's new Joint Investment Strategy Panel as new investments are sought.
- ▶ The Fund's next full actuarial valuation of the fund is due at 31 March 2017, and will form the revised basis for the assessment of the Fund's future obligations in respect of retirement benefits to members and its current funding status. Management notes the full results are anticipated around the year end with discussions with employers to take place around future funding arrangements going forward before 31 March 2018.

## Governance and transparency

The Pensions Committee and Chief Finance Officer have delegated authority for establishing robust governance arrangements in respect of the Pension Fund. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations.

We have no significant matters to report in respect of the Fund's governance and transparency arrangements during the year. Management has confirmed that arrangements around the Fund's conflicts' policy and register of interests for members' and management arrangements are under review following internal audit work performed in the year. Specifically it is recommended the Fund should have its own arrangements for identifying possible conflicts and recording all interests of members and management, beyond that of the Councils. To avoid duplication we have not raised a similar recommendation however we concur with internal audit's view and will follow up on the implementation of these arrangements as part of our 2017/18 audit considerations.

During the year management implemented a new pension payroll system. We considered the transfer of data from the old system to the new system and the transactions posted through the new system as part of our financial statement audit procedures. We have also considered management's arrangements around business continuity in respect of key systems. We note the Fund relies on the Council's arrangements for efficiency's purpose, however we note that this should be considered and supplemented where appropriate for the specific arrangements in place at the Fund.

*Action point 4*

We have no other matters to report by exception in respect of governance and transparency. As part of our work we also considered the following areas of focus:

- ▶ Management ensures those charged with governance receive sufficient information on a routine basis to evaluate the performance of investment fund managers.
- ▶ Internal audit activity appears appropriate and proportionate, and arrangements are in place for management and members to monitor and act on key risks through the Fund's risk register.

## Value for money

This dimension is focused on how the Pension Fund effectively utilises its resources and the arrangements in place to ensure the Fund performance is as robust as possible over the short, medium and longer term.

We have no significant matters to report in respect of the management's arrangements for securing value for money for the Fund. We have considered arrangements for reviewing fund manager performance and for tendering for key services in relation to investment management and custodian services. We note that the Fund's joint investment strategy panel is relatively new to the overall governance arrangements and as such arrangements should continue to be reviewed going forward through 2017/18.

## Wider scope audit requirements – what we concluded

- ▶ We have no significant matters to report in respect of our wider scope audit considerations.
- ▶ We have noted a number of recommendations in respect of financial management arrangements going forward through the course of our financial statement audit.
- ▶ We have noted one recommendation in respect of considering future business continuity arrangements for the Fund, and we will follow up on an internal audit recommendation conflict and register of interest arrangements.

# Appendices

- A. Pension Fund responsibilities**
- B. Required communications with the Audit Committee**
- C. Auditor independence**
- D. Management representations**
- E. Action plan**

# A. The Pension Fund's responsibilities



The Code of Audit Practice (the Code) summarises the responsibilities on all audited bodies falling within the public sector audit framework. We summarise these on this page.

## Responsibilities of audited bodies

<b>Corporate governance</b>	<p>Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Pensions Committee and Boards or equivalent) in monitoring these arrangements.</p>
<b>Financial statements and related reports</b>	<p>Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:</p> <ul style="list-style-type: none"> <li>▶ preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation</li> <li>▶ maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures</li> <li>▶ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority</li> <li>▶ maintaining proper accounting records</li> <li>▶ preparing and publishing, along with their financial statements, an annual governance statement, and management commentary (or equivalent) that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.</li> </ul> <p>Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework.</p> <p>Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.</p>
<b>Standards of conduct / prevention and detection of fraud and error</b>	<p>Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.</p>
<b>Financial position</b>	<p>Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>▶ such financial monitoring and reporting arrangements as may be specified</li> <li>▶ compliance with any statutory financial requirements and achievement of financial targets</li> <li>▶ balances and reserves, including strategies about levels and their future use</li> <li>▶ how they plan to deal with uncertainty in the medium and longer term</li> <li>▶ the impact of planned future policies and foreseeable developments on their financial position.</li> </ul>
<b>Best Value</b>	<p>Local authority bodies have a statutory duty, under the Local Government (Scotland) Act 1973 and associated statutory guidance, to make arrangements to secure best value through the continuous improvement in the performance of their functions.</p> <p>Specified audited bodies also have to prepare and publish performance information in accordance with directions issued by the Accounts Commission.</p>

## B. Required communications



There are certain additional communications that we must provide to the Pensions Committee and Board in accordance with ISA 260 and other auditing standards, which are set out below.

Required communication - what is reported?	Our reporting to you
<p><b>Terms of engagement</b></p> <p>Confirmation by the Pensions Committee and Board of acceptance of terms of engagement as written in the engagement letter signed by both parties.</p>	<p>Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice</p>
<p><b>Planning and audit approach</b></p> <p>Communication of the planned scope and timing of the audit, including any limitations.</p>	<p>Annual Audit Plan – 16 March 2017</p>
<p><b>Significant findings from the audit</b></p> <ul style="list-style-type: none"> <li>▶ Our view of the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Any significant difficulties encountered during the audit</li> <li>▶ Any significant matters arising from the audit that were discussed with management</li> <li>▶ Written representations we have requested</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Any other matters significant to overseeing the financial reporting process</li> <li>▶ Findings and issues around the opening balance on initial audits</li> </ul>	<p>This Annual Audit Report – 21 September 2017</p>
<p><b>Going concern</b></p> <p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	<p>No conditions or events were identified, either individually or together to raise any doubt about the Pension Fund's ability to continue for the 12 months from the date of our report.</p>
<p><b>Misstatements</b></p> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ Significant corrected misstatements, in writing</li> </ul>	<p>This Annual Audit Report – 21 September 2017</p>
<p><b>Fraud</b></p> <ul style="list-style-type: none"> <li>▶ Asking the Pensions Committee and Board whether they have knowledge of any actual, suspected or alleged fraud affecting the Pension Fund</li> <li>▶ Unless all those charged with governance are involved in managing the entity, any fraud identified or information obtained indicating that a fraud may exist involving: <ul style="list-style-type: none"> <li>(a) management;</li> <li>(b) employees with significant roles in internal control; or</li> <li>(c) others where the fraud results in a material misstatement in the financial statements.</li> </ul> </li> <li>▶ A discussion of any other matters related to fraud, relevant to Pensions Committee and Board responsibility.</li> </ul>	<p>This Annual Audit Report – 21 September 2017</p>

Required communication - What is reported?	Our reporting to you
<p><b>Related parties</b></p> <p>Significant matters arising during the audit in connection with the Pension Fund's related parties including, where applicable:</p> <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and/or regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	<p>We have no matters to report.</p>
<p><b>Significant deficiencies in internal controls identified during the audit</b></p> <ul style="list-style-type: none"> <li>▶ Significant deficiencies in internal controls identified during the audit.</li> </ul>	<p>This Annual Audit Report – 21 September 2017.</p> <p>No significant deficiencies were identified in the course of our audit which required immediate communication to the Pensions Committee.</p>
<p><b>Subsequent events</b></p> <ul style="list-style-type: none"> <li>▶ Where appropriate, asking the Pensions Committee and Board whether any subsequent events have occurred that might affect the financial statements.</li> </ul>	<p>We have asked management and those charged with governance. We have no matters to report. We will inquire again on signing the audit opinion.</p>
<p><b>Other information</b></p> <ul style="list-style-type: none"> <li>▶ Where material inconsistencies are identified in other information included in the document containing the financial statements, but management refuses to make the revision.</li> </ul>	<p>We have no matters to report.</p>
<p><b>External confirmations</b></p> <ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ We were unable to obtain relevant and reliable audit evidence from other procedures.</li> </ul>	<p>We have received all requested confirmations.</p>
<p><b>Consideration of laws and / or regulations</b></p> <ul style="list-style-type: none"> <li>▶ Audit findings of non-compliance where it is material and believed to be intentional. This communication is subject to compliance with legislation on "tipping off"</li> <li>▶ Asking the Pensions Committee and Board about possible instances of non-compliance with laws and/or regulations that may have a material effect on the financial statements, and known to the Pensions Committee and Board.</li> </ul>	<p>We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.</p>
<p><b>Independence</b></p> <ul style="list-style-type: none"> <li>▶ Communication of all significant facts and matters that have a bearing on EY's objectivity and independence.</li> </ul>	<p>This Annual Audit Report – 21 September 2017, Appendix C</p>

Professional ethical standards, and the Terms of our Appointment, require us to communicate all significant facts and matters that have a bearing on EY's objectivity and independence as auditor of the Pension Fund.

## What we are required to communicate

Communicating key elements of the audit engagement partner's consideration of independence and objectivity such as:

- ▶ The principal threats
- ▶ Safeguards adopted and their effectiveness
- ▶ An overall assessment of threats and safeguards
- ▶ Information on the firm's general policies and processes for maintaining objectivity and independence
- ▶ Communications whenever significant judgments are made about threats to objectivity or independence and the appropriateness of safeguards.

## Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan dated 16 March 2017.

We complied with the APB Ethical Standards and the requirements of Audit Scotland's Terms of Appointment. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your Pensions Committee and Board consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the Pensions Committee and Board on 21 September 2017.

## Summary of fees

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2017.	Agreed fee per Annual Audit Plan	£19,720
	Auditor remuneration	£17,190
We confirm that we have not undertaken non-audit work outside the Code requirements.	Fixed costs *	£2,530
	Non-audit fees	-
Our audit fee was not agreed with management at the time of our Audit Plan. Fees now agreed are shown in the table opposite.	<b>Total audit fees</b>	<b>£19,720</b>

\* Fixed costs comprise £1,500 pooled costs and £1,030 contribution to Audit Scotland's costs.

ISA (UK and Ireland) 580.10 requires the auditor to obtain written representation that management, including those charged with governance, has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant, their fair presentation.

## **Ernst & Young LLP**

5 George Square  
Glasgow G2 1DY  
[Date]

This letter of representations is provided in connection with your audit of the financial statements of Falkirk Council Pension Fund (“the Fund”) for the year ended 31 March 2017. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the financial statements give a true and fair view of the financial transactions of the Fund during the ended 31 March 2017, and of the amount and disposition of the Fund’s assets and liabilities as at 31 March 2017, in accordance with CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.

We understand that the purpose of your audit of the Fund’s financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing (UK and Ireland), which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

### **A. Financial Statements and Financial Records**

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with The Local Authority Accounts (Scotland) Regulations 2014 and CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.
2. We confirm the Fund is a registered pension scheme. We are not aware of any reason why the tax status of the Fund would change.
3. We acknowledge, as members of management of the Fund, our responsibility for the fair presentation of the financial statements. We believe the financial statements referred to above give a true and fair view of the financial position and financial performance of the Fund in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, and are free of material misstatements, including omissions. We have approved the financial statements.

4. The significant accounting policies adopted in the preparation of the financial statements are appropriately described in the financial statements.
5. As members of management of the Fund, we believe that the Fund has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, that are free from material misstatement, whether due to fraud or error.
6. We believe the effect of the unadjusted audit difference, relating to the under-valuation of the Fund’s investment assets of approximately £6.2 million, accumulated by you during the current audit and pertaining to the latest period presented is immaterial, both individually and in the aggregate, to the financial statements taken as a whole. We have not corrected this difference on grounds of materiality.
7. Management has sought to address the disclosure requirements in relation to sensitivity analysis by considering risk on an aggregated basis. It is recognised that this approach does not provide the extent or detail of disclosures recommended in the Code, however management feels to obtain this information would be disproportionately expensive to the Fund. Management considers that these risk metrics are an appropriate and proportionate basis on which to measure and assess the range of investment risks faced by the Fund.

## B. Fraud

1. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
2. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
3. We have no knowledge of any fraud or suspected fraud involving management or other employees who have a significant role in the Pension Fund's internal controls over financial reporting. In addition, we have no knowledge of any fraud or suspected fraud involving other employees in which the fraud could have a material effect on the financial statements. We have no knowledge of any allegations of financial improprieties, including fraud or suspected fraud, (regardless of the source or form and including without limitation, any allegations by "whistleblowers") which could result in a misstatement of the financial statements or otherwise affect the financial reporting of the Pension Fund.
2. All material transactions have been recorded in the accounting records and are reflected in the financial statements.
3. We have made available to you all minutes of the meetings of the Pension Committee and Board (or summaries of actions of recent meetings for which minutes have not yet been prepared) held through the year to the most recent meeting on the following date: 21st September 2017.
4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Pension Fund's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the period ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the financial statements.

## C. Compliance with Laws and Regulations

1. We have disclosed to you all identified or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements.
2. We have not made any reports to The Pensions Regulator, nor are we aware of any such reports having been made by any of our advisors.
3. There have been no other communications with The Pensions Regulator or other regulatory bodies during the Fund year or subsequently concerning matters of non-compliance with any legal duty. We have drawn to your attention all correspondence and notes of meetings with regulators.
5. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.
6. We have disclosed to you, and the Pension Fund has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.
7. No transactions have been made which are not in the interests of the Fund members or the pension fund during the fund year or subsequently

## D. Information Provided and Completeness of Information and Transactions

1. We have provided you with:
  - Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - Additional information that you have requested from us for the purpose of the audit; and
  - Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.
1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the financial statements.
2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent.

## F. Subsequent Events

1. There have been no events subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto. We confirm we are not aware of any significant permanent diminution in value of any of the Fund's assets

## G. Other information

1. We acknowledge our responsibility for the preparation of the other information. The other information comprises the information other than the financial statements and auditor reports. We confirm that the content contained within the other information is consistent with the financial statements.
2. In particular, we confirm the disclosures within the Management Commentary reflects our understanding of the financial and non-financial performance of the Pension Fund over the reporting year, is consistent with the financial statements and has been prepared in accordance with relevant guidance.
3. We also confirm the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared reflects the Pension Fund's governance framework, is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).

## I. Derivative Financial Instruments

1. We confirm the Fund's statement of investment principles has been duly reviewed to ensure that such investments comply with any limitations imposed by its provisions.
2. The financial statements disclose all transactions in derivative financial instruments that have been entered into during the period, those still held by the Fund at the year end and the terms and conditions relating thereto.
3. Management has duly considered and deemed as appropriate the assumptions and methodologies used in the valuation of 'over the counter' derivative financial instruments which the Fund is holding, and these have been communicated to you.

## J. Actuarial Valuation

1. The latest report of the actuary, Hyman Robertson as at 31 March 2014 been provided to you. To the best of our knowledge and belief we confirm that the information supplied by us to the actuary was true and that no

significant information was omitted which may have a bearing on his report.

## K. Private Equity and infrastructure Investments

We are satisfied that the valuation of the private equity and infrastructure investments appropriately reflects fair value.

*Yours faithfully,*

\_\_\_\_\_  
Chief Finance Officer

\_\_\_\_\_  
Chair of the Pension Committee

This action plan summarises specific recommendations included elsewhere within this Annual Audit Report.

## Classification of recommendations

**Grade 1:** Important weaknesses and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.

**Grade 2:** Weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.

**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and risk	Our recommendation	Management's response
1	<p>We have raised an audit difference of £6.2 million in relation to the valuation of private equity investments at year end. This has occurred where management has prepared the financial statements based on information available at the time but new information was subsequently available at the time of the audit.</p> <p>While we accept management's decision not to adjust the difference this year, it is possible that this difference increases in the future given the Fund's strategic investment plan to increase the level of private equity and infrastructure investments in its Fund.</p>	<p>We recommend the year end valuation approach for private equity and infrastructure be reviewed by management.</p> <p>Specific focus should be given to updating year end valuations based on subsequently available information to take into account the increased risk of material misstatement in future years.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>Management will give consideration to updating valuations from unlisted assets should subsequent information be made available by managers post year-end. Management notes that its current approach has been in place for a number of years and has been acceptable to former auditors. It proposes therefore to take soundings from colleagues at other Funds and from authoritative bodies (e.g. CIPFA) before committing to the recommendation.</p>
2	<p>We have noted through discussions with management and review of the year end returns and reconciliations provided by employers that issues remain with the timeliness and quality of information from scheme employers.</p>	<p>Management should ensure those charged with governance are aware of the issues identified in year and agree an action plan with relevant employers to make improvements going forward in 2017/18.</p> <p style="text-align: right;"><i>Grade 2</i></p>	<p>An update on the posting of member contributions and earnings will be provided to the Committee and Board at the meeting of 21 September 2017. Employers were reminded about the importance of providing timeous, complete and accurate data and at an employer briefing session last November and by email dated 27 March 2017. Management has scheduled meetings with two of the employers whose data has given rise to a number of queries.</p>

## Classification of recommendations

**Grade 1:** Important weaknesses and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.

**Grade 2:** Weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.

**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and risk	Our recommendation	Management's response
3	We have considered management's disclosures included in the financial statements in respect of sensitivity analysis and note the disclosures do not meet the strict definitions of the code. While we note management's consideration of the most proportionate disclosure approach this should be subject to ongoing review.	Management should review the arrangements for obtaining sensitivity analysis for financial statement disclosure going forward to ensure the requirements of the code are met to the extent that is reasonably possible.  <i>Grade 3</i>	Management confirm that due consideration will be given to changing the reported Sensitivity Analysis so that it accords with the disclosure as defined in the Code. Management note that the existing level of disclosure was deemed reasonable and proportionate by Audit Scotland during their recent tenure as Fund auditors and would therefore wish to weigh up the practicalities and costs of obtaining more detailed risk metrics before committing to the recommendation.
4	We have noted the Fund's business continuity arrangements are based on the Council's arrangements. There is a risk that bespoke arrangements required are not considered.	Management should consider the current business continuity arrangements as they stand and any supplementary arrangements required specific to the fund.  <i>Grade 2</i>	Management accept the point that has been made regarding the need for continuity arrangements to be more tailored towards Fund business. A review of the Fund's continuity arrangements will be undertaken during the remainder of 2017/18 with details recorded in a separate Fund Business Contingency document.

**EY | Assurance | Tax | Transactions | Advisory**

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