

Falkirk Council Pension Fund

**Annual Audit Report to Members
and the Pensions Committee
and Board - year ended 31 March
2019**

27 September 2019

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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 with 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 Diane McGiffen, 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.

Executive Summary

Financial statements: Audit Opinion

We have concluded our audit of the Pension Fund's financial statements for the year ended 31 March 2019. We identified one audit difference of £4.5 million related to the valuation of investments at 31 March 2019, and one difference of £3 million in the disclosures around unfunded commitments, which management chose not to adjust on the basis of materiality. We have no further unadjusted differences to report.

We concluded that the other information subject to audit, including the Management Commentary and Annual Governance Statement, were appropriate.

Presentation and disclosures

The draft financial statements and supporting working papers were generally of good quality. We worked with the Pension Fund Manager to draw upon good practice to make improvements to the Management Commentary and other minor disclosure amendments, which have been reflected in the updated financial statements.

Wider Scope: Financial Management

The Pension Fund has established core financial management arrangements, and we are satisfied that these are adequate for the current management of its financial activities.

No significant matters for improvement in financial management arrangements have been noted through internal audit activity in the year or through our own observations through the course of our procedures.

Financial Sustainability

The Pension Fund continues to review its investment strategy and arrangements to ensure it is meeting its target for full funding over a rolling 20 year period.

It is expected that the Fund's investment strategy going forward will continue to increase focus on its joint investment arrangements with Lothian Pension Fund.

Governance and Transparency

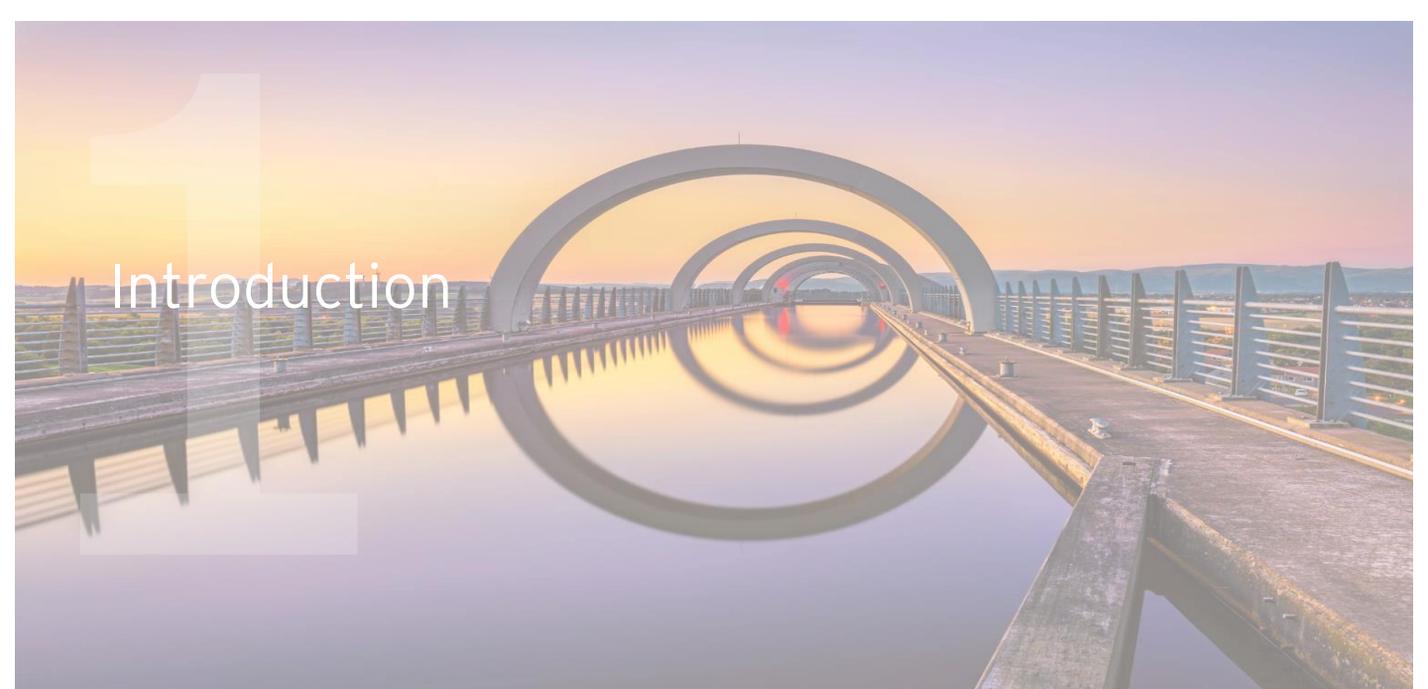
We have no significant matters to report in respect of the Fund's governance and transparency arrangements during the year.

Management has made good progress in implementing recommendations from internal and external audit in the year. No significant findings were noted from internal audit activity in the year.

Value for money

We have no significant matters to report in respect of the management's arrangements for securing value for money for the Fund.

Management's fund performance and investment and administration costs remain comparable with the majority of Scottish Pension Funds. Arrangements are in place to scrutinise the performance of Fund managers.



Introduction

Purpose of this report

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as the external auditor of the 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 Financial Reporting Council; 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 members of the Pension Fund and the Controller of Audit, and presented to both Pension Fund’s management and those charged with governance. After consideration by the Pension Fund, this report is provided to Audit Scotland and published on their 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.

A key objective of our audit reporting is to add value by supporting the improvement of the use of public money. We aim to achieve this through sharing our insights from our audit work, our observations around where the Pension Fund employs best practice and, if applicable, where practices can be improved. We use these insights to form our audit recommendations to support the Pension Fund in improving its practices around financial management and control, as well as around key aspects of the wider scope dimensions of audit. In particular, for the 2018/19 audit, we have considered the effectiveness of management’s implementation of recommendations raised from our previous audit work. These are highlighted throughout the report together with our judgements and conclusions regarding current arrangements.

Our independence

We confirm that we have undertaken client and engagement continuance procedures, which include our assessment of our continuing independence to act as your external auditor.

Scope and Responsibilities

The Code sets out the responsibilities of both the Pension Fund and the auditor (summarised in Appendix A). We outlined these in our Annual Audit Plan, which was presented to the Audit Committee on 21 March 2019.

Our Annual Audit Plan set out an overview of our audit scope and approach for the audit of the 2018/19 financial statements. We can confirm that we carried out our audit in accordance with the plan. As part of our yearend audit procedures we updated our materiality levels to reflect the most recent financial information for the Fund, these are outlined below. In accordance with the plan, we have set our reporting threshold to communicate the details of errors identified at £250,000.

Overall Materiality	Tolerable Error	Nominal amount
£49.8 million	£24.9 million	£250,000
2% of the Pension's Fund net assets	Materiality at an individual account level	Level that we will report to committee

As outlined in our Annual Audit Plan, based on considerations around the expectations of financial statement users and qualitative materiality, we apply lower materiality levels to the audit of key management personnel disclosures and Related Party Transactions.

Financial statement audit

We are responsible for conducting an audit of the Pension Fund's financial statements. We provide an opinion as to:

- ▶ Whether they give a true and fair view of the financial position of the Pension Fund as at 31 March 2019 and its expenditure and income for the year then ended; and
- ▶ Whether they have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2018/19 Code of Practice on Local Authority Accounting in the United Kingdom.

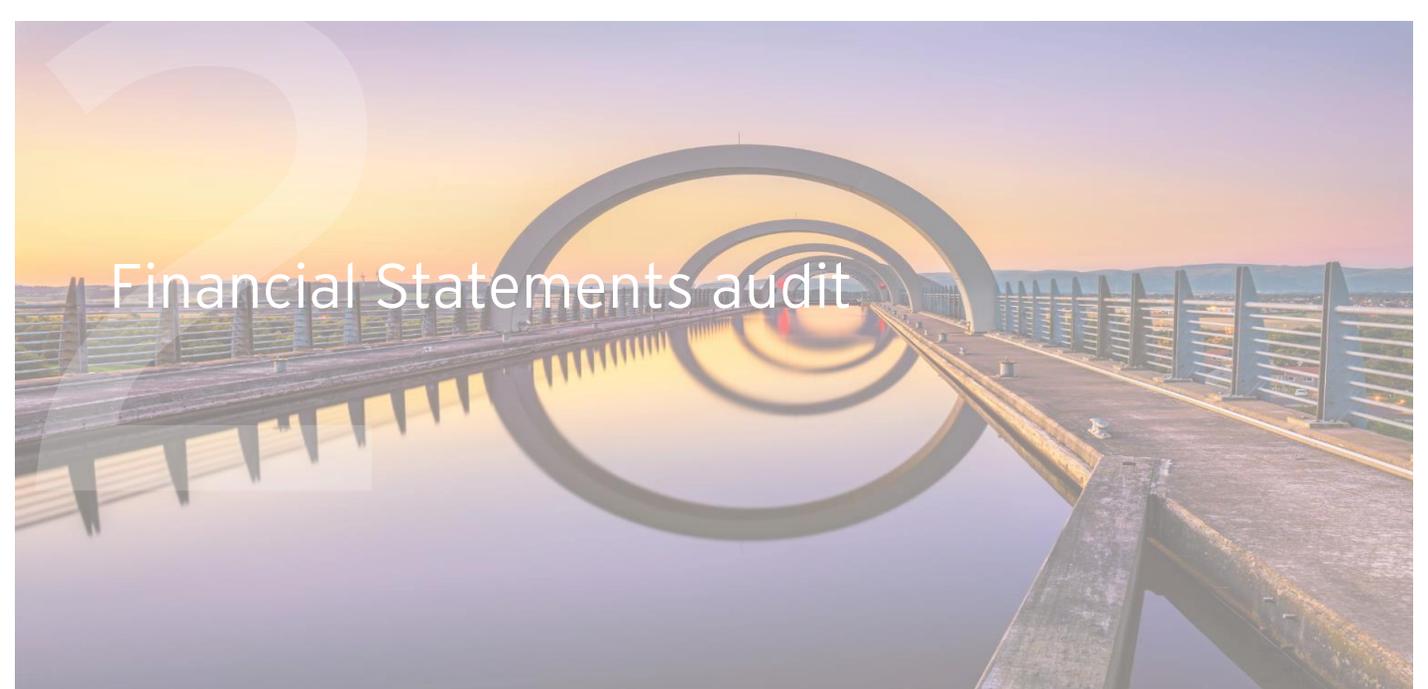
We also review and report on the consistency of the other information prepared and published along with the financial statements. Our findings are summarised in Section 2 of this report.

Wider Scope audit

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the four dimensions of wider scope public audit:

- ▶ Financial sustainability;
- ▶ Financial management;
- ▶ Governance and transparency; and
- ▶ Value for money.

Our findings against each dimension are summarised in Section 3 of this report.



Financial Statements audit

Introduction

The Pension Fund Annual Accounts enables the Fund to demonstrate accountability for its resources and its performance in the use of those resources during the year.

This section of our report summarises the audit work undertaken to support our audit opinion, including our conclusions in response to the significant and other risks identified in our Annual Audit Plan.

The Plan highlighted one area that we identified as a fraud risk, which is a presumed risk for all entities in line with auditing standards, related to the risk of fraud through management override of controls to misstate the year end valuation of Fund investments. We recognise the valuation of complex investments held by the Fund at year end as a significant audit risk in itself.

Compliance with Regulations

The Local Authority Accounts (Scotland) Regulations 2014 set out the statutory requirements on the Pension Fund to prepare financial statements, ensure their availability for public inspection and consideration by the Pensions Committee and Board.

The Pension`s Fund unaudited financial statements were considered by the Pensions Committee and Board on 27th June 2019, prior to their submission to us for audit, and in advance of the deadline of 30 June. The inspection notice was published on 17th June 2019, in accordance with Regulations.

Financial statement audit outcomes

The unaudited financial statements were prepared to a good standard. We identified one unadjusted audit difference in relation to the valuation of private equity and other complex investments at the balance sheet date.

We read the management commentary and compared the content against the information in the financial statements and against the statutory requirements. We concluded that the management commentary met the requirements placed on the Pension Fund.

We reviewed the Annual Governance Statement within the financial statements against the required guidance. We were satisfied that it met the requirements and was consistent with both the governance framework and key findings from relevant audit activity.

Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations (2014).

We made a number of recommendations in respect of presentational changes to the unaudited accounts, to ensure compliance with accounting standards and good practice. All changes have been made in the updated financial statements with one exception, in relation to the disclosure of unfunded commitments at yearend in note 25 to the financial statements (where a difference is noted of £3 million between the financial statements disclosures and supporting fund manager statements).

In respect of our core audit work we identified one audit difference above our reporting threshold, of £4.5 million in relation to the valuation of investments. Management has chosen not to adjust on the basis of materiality. We concur with this assessment and have outlined our work in this area in more detail on page 10 of this report.

Our overall audit opinion is summarised on the following page.

Our audit opinion

Element of opinion	Basis of our opinion	Conclusions
<p>Financial statements</p> <ul style="list-style-type: none"> ▶ Truth and fairness of the state of affairs of the Pension Fund at 31 March 2019 and the amount and disposition at that date of its assets and liabilities ▶ Preparation of the financial statements in accordance with the relevant financial reporting framework 	<p>We report on the outcomes of our audit procedures to respond to our assessed risk of misstatements, including significant risks within this section of our report.</p> <p>We are satisfied that accounting policies are appropriate and estimates are reasonable.</p> <p>We have considered the financial statements against Code requirements, and additional guidance issued by CIPFA and Audit Scotland.</p>	<p>We propose to issue an unqualified audit opinion on the 2018/19 financial statements for Falkirk Council Pension Fund.</p>
<p>Going concern</p> <ul style="list-style-type: none"> ▶ We are required to conclude and report on the appropriateness of the use of the going concern basis of accounting 	<p>We conduct core financial statements audit work, including management's assessment of the appropriateness of the going concern basis.</p> <p>Wider scope procedures including the forecasts are considered as part of our work on financial sustainability.</p>	<p>We have no matters to report.</p>
<p>Other information</p> <ul style="list-style-type: none"> ▶ We are required to consider whether the other information in the financial statements is materially inconsistent with other knowledge obtained during the audit 	<p>We conduct a range of substantive procedures on the financial statements. Our conclusion draws upon:</p> <ul style="list-style-type: none"> ▶ Review of committee and board minutes and papers, regular discussions with management, our understanding of the Pension Fund and the wider sector. 	<p>We are satisfied that the Annual Report meets the core requirements set out in the Code of Practice on Local Authority Accounting.</p>
<p>Matters prescribed by the Accounts Commission</p> <ul style="list-style-type: none"> ▶ The information given in the Management Commentary/ Governance Compliance Statement/ Annual Governance statement are consistent with the financial statements and have been properly prepared. 	<p>Our procedures include:</p> <ul style="list-style-type: none"> ▶ Agreeing the format of the reports to regulations and agreeing the disclosures to underlying accounting records and supporting schedules ▶ Reviewing the content of narrative disclosures to information known to us. 	<p>We intend to issue an unqualified opinion.</p>
<p>Matters on which we are required to report by exception</p>	<p>We are required to report on whether:</p> <ul style="list-style-type: none"> ▶ adequate accounting records have been kept, ▶ financial statements are not in agreement with the accounting records, or ▶ we have not received the information we require. 	<p>We intend to issue an unqualified opinion.</p>

Significant and fraud audit risks

Management Override of Investment Assets Valuations

Our Annual Audit Plan recognises that under ISA (UK) 240, management is considered to be in a unique position to perpetrate fraud in financial reporting because of its ability to manipulate accounting records directly or indirectly by overriding controls that otherwise appear to be operating effectively. We respond to this risk on every engagement.

We have determined that the way management could be most likely to override controls is by manipulating the value of the year-end investment asset balances posted in totality to the accounts at year-end. Our procedures around this aspect of the risk are outlined on the following page.

Our procedures to address the risk around management override included:

- ▶ We considered the risk of fraud, enquired with management about their assessment of the risks of fraud and the controls to address those risks. We also updated and developed our understanding of the oversight of those charged with governance over management's processes over fraud. We have not identified any material weaknesses in controls or evidence of material management override.
- ▶ We tested 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 identified risk criteria for the journals and tested any relevant journals considered to be at higher risk of misstatement to understand the basis for the transaction and agree to third party supporting evidence. We did not identify any exceptions as a result of our testing.
- ▶ We have obtained third party confirmations of the Fund's externally held investment balances at the Pension Fund's year end 31 March 2019 from both custodians and investment managers. We have investigated any differences in valuation between these sources and agreed the final balance for investments in the accounts.
- ▶ We did not identify any significant unusual transactions outside the normal course of business.
- ▶ We agreed with management's assessment that there are no material accounting estimates included in the financial statements that have a direct impact on the Fund's financial position, beyond the estimates used by third parties to value assets in which the Pension Fund has investments. We consider the accounting policies adopted by the Fund to be appropriate. There are no significant accounting practices which materially depart from what is acceptable under IFRS or the Code.
- ▶ We have considered the actuarial assumptions disclosed. As these are obtained from a third party there is minimal scope for management to manipulate these.

We did not identify any instances of evidence of management override of controls.

As outlined in our audit plan there is a significant audit risk around the valuation of complex investments. We completed our audit procedures around these balances held by the Fund in line with those outlined in our plan.

Valuation of complex investments - Significant risk

As of 31 March 2018, the Fund held investments of £2.3 billion, of which around 52% (£1.2 billion) were classified as Level 2 and Level 3 investments, meaning there are not publicly quoted prices in place for these types of investments in an active market. We have therefore assigned a significant risk to the valuation of Private Equity and Infrastructure funds, Managed Property Funds and Pooled Investments. Around 50% of the pooled investments are in listed equities, our audit focus around this risk is focused on the remaining harder to value assets included in pooled investments.

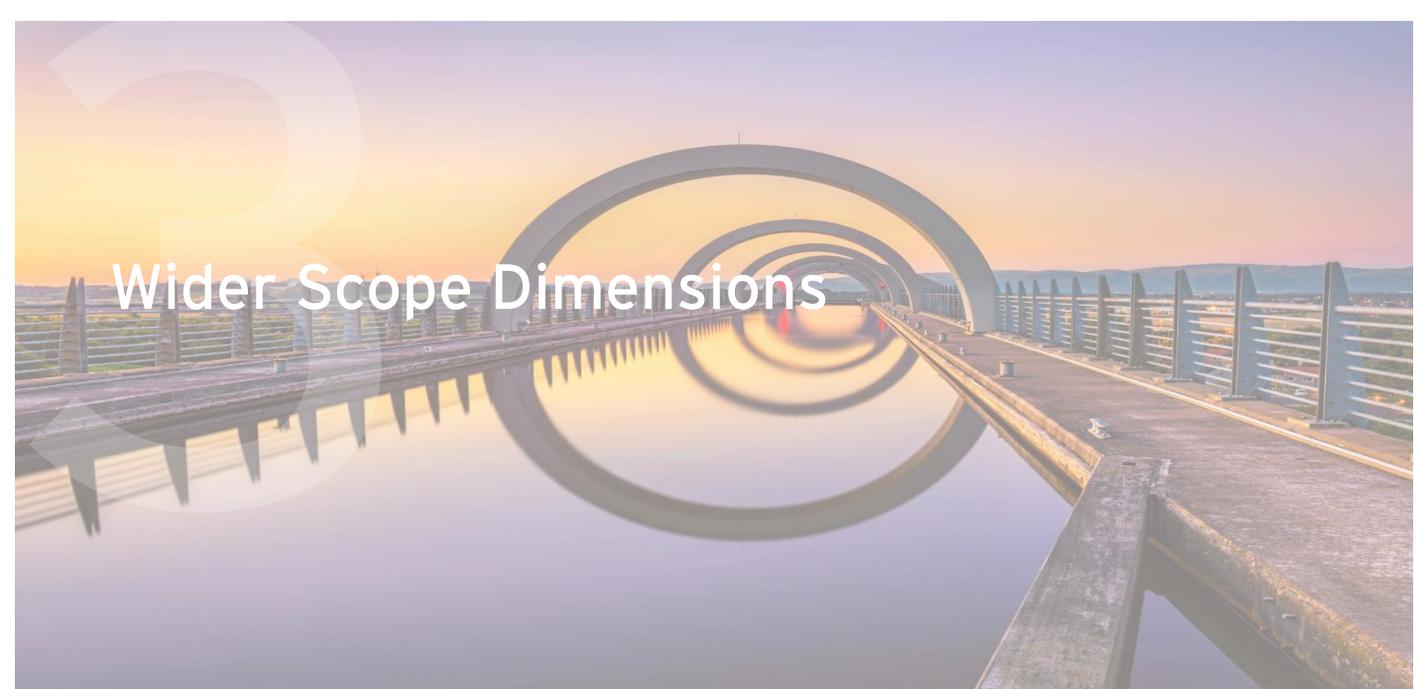
Our procedures to address this risk included:

- ▶ Where fund managers complete controls' reports, we obtained for all material investments and reviewed for qualifications or exceptions that may affect the audit risk and scope. Where necessary, we have obtained bridging letters for the period between report dates and financial statements date where they differ. No issues that could affect the risk or scope of the audit were identified.
- ▶ We have reviewed the basis of valuation for unquoted investments to be satisfied that it is in line with the accounting policy and CIPFA requirements.
- ▶ For managed property funds and pooled investments we tested all material balances to lower testing threshold of (10% of the tolerable error) and agreed all balances samples to third party fund managers' reports.
- ▶ For private equity and infrastructure we have obtained the most up to date financial statements for each investment, and the capital statement the Financial Statements' date. We have considered the audit opinions for the fund to identify possible issues with the valuation and recalculated the Fund's share of the investment based on its percentage ownership.

We identified one audit difference - a £4.5 million understatement of investments, which management has chosen not to adjust.

We identified a number of differences between the Pension Fund recorded balances and the confirmations we received from fund managers. We confirmed this occurred where valuation gains to 31 March 2019 were not reported to the Pension Fund before the unaudited accounts are prepared, but are available by the time of the audit of the financial statements.

The total differences identified were £4.5 million for private equity and infrastructure (2017/18: £8.6 million). Management has chosen not to adjust the accounts for the differences, noting the financial statements are prepared with the best information available at the time of preparation in line with required statutory guidelines.



Wider Scope Dimensions

Introduction

Under Audit Scotland's Code of Audit Practice (May 2016), we are required to reach conclusions in relation to the effectiveness and appropriateness of the Pension Fund's arrangements for each of the four wider scope audit dimensions.

We apply our professional judgement to risk assess and focus our work on each of the dimensions. In doing so, we draw upon conclusions expressed by other bodies including the Pension Fund's internal auditors, along with national reports and guidance from regulators and Audit Scotland. For each of the dimensions, we conclude on our assessment on the adequacy of the Pension Fund's arrangements throughout the year and at the yearend, as well as the overall pace of improvement where issues have been identified in the past.

The Wider Scope Dimensions

Financial Management:

- ▶ considers the effectiveness of financial management arrangements, including whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Financial Sustainability:

- ▶ considers the medium and longer term outlook to determine if planning is effective to support service delivery. This will focus on the arrangements to develop viable and sustainable financial plans.

Governance and Transparency:

- ▶ is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

Value for Money

- ▶ considers whether value for money can be demonstrated in the use of resources. This includes the extent to which there is an alignment between spend, outputs and outcomes delivered and that there is a clear focus on improvement.

Financial Management

The Pension Fund has established core financial management arrangements, and we are satisfied that these are adequate for the current management of its financial activities.

No significant matters for improvement in financial management arrangements have been noted through internal audit activity in the year or through our own observations through the course of our procedures.

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.

Fund financial management arrangements

We give consideration to the financial management arrangements in place at the fund through our financial statement audit procedures. No significant matters were noted through the course of our work in respect of financial management. In particular we considered management's arrangements for preparation of the financial statements at yearend, and its approach to monitoring, and following up where applicable, the timing of contribution payments from employers both throughout the year.

Internal audit scrutiny of financial management arrangements

We have also considered the results of the Pension Fund's Internal Audit findings for the year in relation to financial management. The Internal auditor issued a report in the year in relation to the operational controls associated with the calculation of new member contributions, for paying or receiving transfer values, for refunding contributions, and for making payments to retiring members or in respect of deceased Fund members. In all matters the internal auditor noted the processes were, in general, working effectively. One low risk recommendation was made in respect of ensuring that written procedural instructions are prepared in relation to the preparation of monthly contributions received from Fund employers.

Processes and controls around submission of employer returns

In our 2017/18 annual audit report we made a recommendation in respect of the timeliness and quality of employer returns submitted to the Fund at the financial yearend, and have followed up on the actions undertaken in the year to address this. In 2018/19 we have noted that management reported a breach in relation to 2017/18 returns, and raised the matter with employers at regular meetings and engaged with the Pensions Regulator on specific areas of concern as they deem material.

In particular, a training event was held with employers in November 2018 in conjunction with the Pensions regulator which included a focus on the employers' responsibilities with respect to providing accurate and timely data. We have concluded that in 2018/19 there has been improvement in the process since last year. However, management has noted this will require a level of ongoing scrutiny to ensure the quality and timeliness of submissions continues to improve going forward, as the pressures on employers' own financial management resources are likely to continue in the current public sector funding environment.

Following our recommendation in the 17/18 audit, we have witnessed improvements in the process for employer returns in the year. This will continue to be an area of focus going forward.

Financial Sustainability

The Pension Fund continues to review its investment strategy and arrangements to ensure it is meeting its target for full funding over a 20 year period.

It is expected that the Fund's investment strategy going forward will continue to increase focus on its joint investment arrangements with Lothian Pension Fund.

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.

2017/18 saw the Fund conclude its triennial Funding Valuation of 31 March 2017. The results saw improvements in the funding level of the Fund from 85% at the 2014 valuation to 92% now. Following the valuation, it became evident that the affordability of revised contribution rates for smaller bodies was challenging. Management has secured arrangements for larger bodies to formally take on a number of smaller bodies' share of assets and liabilities.

Fund investment strategy

A review of the Fund's investment strategy has taken place over the course of 2018/19 with the Fund's collaborative partners, Lothian Pension Fund and Fife Pension Fund. The review, supported by Hymans Robertson, has resulted in limited change with the Fund's current allocation of capital to various asset classes determined to be consistent with its funding aims of positioning employer contributions at an affordable level, to achieve the aim of being fully funded over a rolling 20 year period from the Fund valuation date. The review aims to define high level strategy in terms common to each of the three funds in order to facilitate greater collaboration and efficiency in the implementation of the strategy.

As outlined in the Fund's statement of investment principles and in line with prior years, the future projected strategic allocation of investments shows a significant divestment from the current allocation, however the current allocation is within the permitted limits. Meeting the objective allocation as it is outlined will continue to increase the significance of the role of the Fund's new Joint Investment Strategy Panel as new investments are sought.

In recent years, the Fund has extended its collaborative relationship with Lothian Pension Fund and Fife Pension Fund, with the Joint Investment Strategy Panel providing a platform to further the engagement with the Funds. The model allows the Pensions Committee and Board to focus on developing investment strategy - the main determinant of return - with the implementation being delegated to the Chief Finance Officer.

Governance and Transparency

We have no significant matters to report in respect of the Fund's governance and transparency arrangements during the year.

Management has made good progress in implementing recommendations from internal and external audit in the year. No significant findings were noted from internal audit activity in the year.

We have reviewed the adequacy of governance arrangements in place at the Pension Fund. In particular, we consider and report on whether these are appropriate and operating effectively and if there is effective scrutiny, challenge and transparency on decision-making.

Pension Fund governance arrangements

The key governance functions of the Fund are achieved through the Pensions Committee and Pensions Board who meet four times per year. Management ensures those charged with governance receive sufficient information on a routine basis to promote a reasonable level of scrutiny and challenge of the performance of the Fund. The Fund's Training Policy was updated and approved by the Pensions Committee and Board in December 2018 and outlines the Fund's approach to ensuring that those charged with the governance have the necessary knowledge and skills required to support them in their roles. In line with the policy, Management advise members of upcoming training events through the general governance update presented at each Committee meeting and attendance is monitored and reported. Management ensures transparency of Fund governance arrangements through timely publication of key meeting minutes and papers, and public access to governance meetings is limited only where it qualifies as exempt information under Schedule 7A of the Local Government (Scotland) Act 1973.

Policies and procedures

Management have indicated that they are developing a policy register to record when key policies and procedures are to be reviewed to ensure they are relevant and up to date. Management considers all key policies and procedures on an ongoing basis to ensure they remain relevant and up to date. Where matters driving change are identified policies are updated and subject to scrutiny through the relevant Committee or Board. Through the course of our audit work we have not identified any policies and procedures that are out of date or not subject to the appropriate review and approval. In 2017/18 we raised a recommendation around the Fund's business continuity and conflict of interest documentation and arrangements. We have confirmed through our review this year these actions have been addressed by management.

Management has made good progress in respect of implementation of internal and external audit recommendations through the year.

Internal audit activity in the year

Internal audit activity appears appropriate and proportionate to the risks affecting the Fund, and arrangements are in place for management and members to monitor and act on key risks. There were no specific recommendations raised in relation to governance during 2018/19. The Annual Governance Statement noted that 2 low risk internal audit recommendations remained outstanding:

- ▶ Ensuring written procedural instructions are prepared on the monthly contributions received from Fund employers; and
- ▶ Establishing an Access Control Policy for the Pensions Administration system.

We have also confirmed through the year that all previously outstanding external audit recommendations have been addressed in the year.

Fund Governance Statement

We have reviewed the annual governance statement prepared for the Fund for 2018/19 and agree that it is consistent with our findings from our audit procedures.

Governance around Fund investments

Responsible investing has been an area of increased attention within LGPS in recent years. The Fund's Statement of Investment Principles highlights that the Fund's fiduciary duty means that the pursuit of financial return is its paramount concern. However, non-financial considerations may be taken into account where it does not involve any risk of financial detriment. Recognising the concerns of its stakeholders, the Fund has sought to engage with members on the topic through inclusion of a detailed section on their approach to responsible investment.

Future Fund structures

A consultation on the review of the current structure of the Local Government Pension Schemes in Scotland was launched in summer 2018 by the Scheme Advisory Board with consultees asked to consider four structural options:

- ▶ The Status Quo of 11 funds
- ▶ Increased collaboration between the Funds
- ▶ Pooling of assets
- ▶ Fund merger (e.g. one Fund or several Funds)

A working group was established by the Fund consisting of Committee and Board members to evaluate management's proposed response before sharing and seeking approval from the Pensions Committee and Board in December 2018. The Fund submitted a response in support of a three Fund structure as it believed that this would support improved decision making, result in fee savings from scale investing and lead to better management of key person/system risks.

The Scheme Advisory Board ('SAB') met in April 2019 to consider the consultation responses and it was determined that there was not an appetite for pooling and SAB now intends to commission more work to assess further the feasibility of moving to a merged structure.

The future of LGPS structure in Scotland remains an area of ongoing consideration going forward.

Preparations for EU Withdrawal

We noted within our Annual Audit Plan that Audit Scotland had highlighted preparations for EU withdrawal as a risk across public sector bodies. We drew on good practice guidance from Audit Scotland to assess the Fund's readiness for Brexit as at the planned departure date of 29 March 2019, and its subsequent readiness following the planned postponement to 31 October.

The Fund has recognised the uncertainties existing around the anticipated withdrawal from the EU and has added "Brexit" as a risk in its risk register. The most material anticipated impact on the Fund is likely to be on the value of its assets as a consequence of the potential adverse economic impact in the UK and an undermining of consumer and business confidence.

The consequences of Brexit have been considered throughout the year at the quarterly meetings of the Joint Investment Strategy Panel with the focus being on whether any tactical investment change is warranted. The Panel has noted ongoing pressure on UK equities but is content that as a long term investor no immediate action is required. The Panel also noted that a disruptive Brexit may challenge the UK economy and lead to a further devaluation of sterling against major currencies. Given that many of the Fund's assets are overseas assets denominated in foreign currency, a collapse in sterling would boost Fund valuations. In that circumstance, the judgement would be whether from a tactical perspective overseas assets should be sold to lock in gains.

In general terms, management consider the risks around Brexit to be part of the wider climate of uncertainty and geo political risk in which the Fund operates. Management will continue to monitor developments closely in advance of and following the UK's withdrawal. The Pension Committee and Board will continue to be kept informed of the latest deliberations and risks. The Fund notes the significant uncertainty around the current situation and is committed to ensuring it reacts rapidly to address matters as they develop in advance of and subsequent to 31 October.

In our view the Fund has undertaken an approach to assessing the impact of anticipated EU withdrawal (both at 29 March and in anticipation of the revised withdrawal date) which is reasonable in line with the nature of the Fund's activities.

Value for Money

We have no significant matters to report in respect of the management's arrangements for securing value for money for the Fund.

Management's fund performance and investment and administration costs remain comparable with the majority of Scottish Pension Funds. Arrangements are in place to scrutinise the performance of Fund managers.

Value for money 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 consider this through a review of the Pensions Committee and Pensions Board activity in the year, as well as the wider arrangements in place across the Pension Fund to make best use of its resources.

Fund performance in 2018/19

The Fund's achieved a return of 8.5% in 2018/19, against benchmark return of 6.8% above benchmark. This was the joint second highest compared with other Scottish local government pension schemes (returns achieved between 9.5% and 4% per the published LGPS unaudited annual report and accounts 2018-19). Fund investment performance against benchmark was also strong with the Fund exceeding benchmark by 1.7% across 1 year, and by 1.3% across 3 year and 5 year investment returns. However, analysis against the LGPS Scottish average investment return (using 2017/18 data) shows that the Fund is below average against the 1 year, 3 year and 5 year investment returns.

The total unit costs per member (which encompass investment management, administration and oversight and governance costs) over the last 4 years have been on a downward trajectory since 2014/15, however in 2018/19 has increased significantly (£30 increase compared to 2017/18). With respect of administration costs, these have been reflecting increases in staffing levels to support service delivery. These remain within the Scottish average of £20-£30 per member.

Investment management expenses have also returned to 2014-15 levels after three years of reductions. In general, these fees are based on the market value of investments, and therefore can increase or decrease as the value of these investments change.

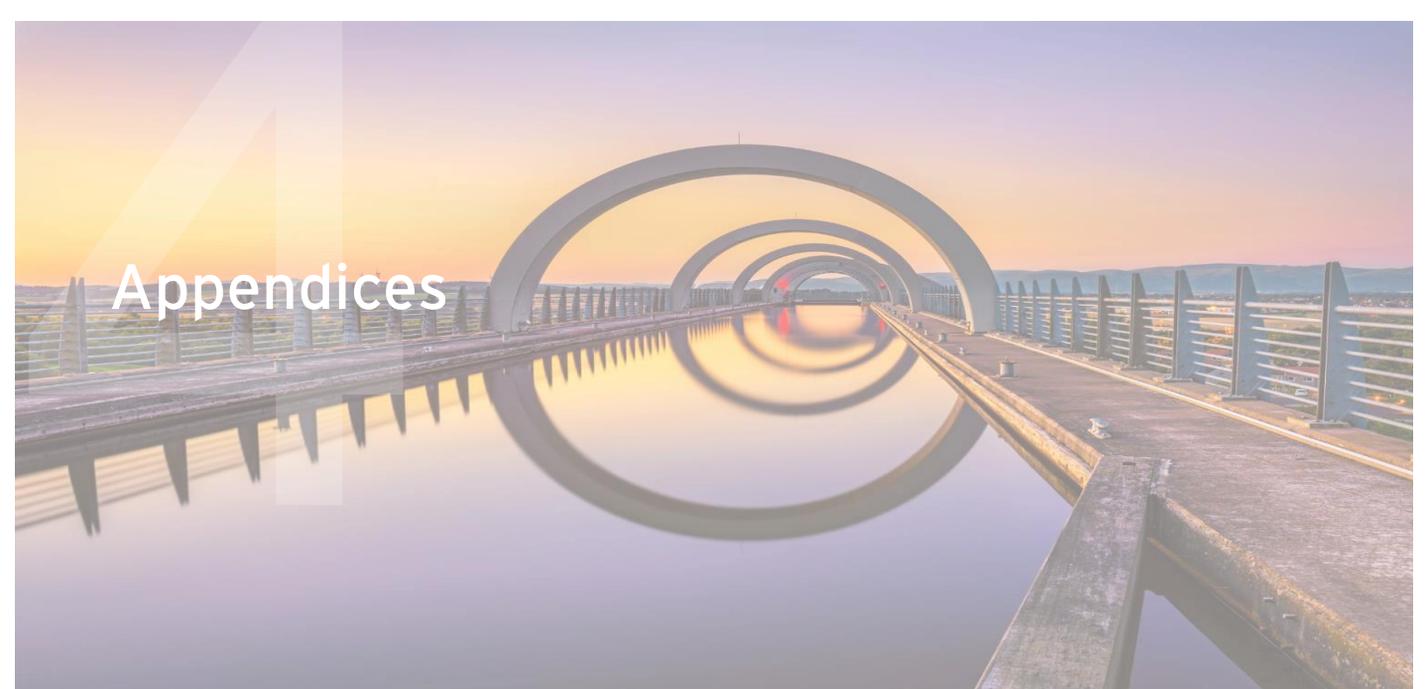
Scrutiny of fund manager performance

We have considered fund manager performance through review of minutes and attendance at the Pension Committee and Board. We have also reviewed the Fund's statement of investment principles which has been subject to review in March 2019 in conjunction with Fife Pension Fund and Lothian Pension Fund. The revised SIP, similar to the investment strategy, seeks to set out a common set of investment principles that supports all three funds in achieving their investment targets and provides a basis to expand collaboration activity. We have concluded that there is appropriate level of scrutiny of fund manager performance which supports the Fund in complying with their investment principles.

Exhibit 1: Falkirk Council Pension Fund Investment Performance

Year	2016/17	2017/18	2018/19	Average
Fund return	20.0%	3.1%	8.5%	10.5%
Benchmark return	18.4%	2.5%	6.8%	9.3%
LGPS Scotland average return	21.4%	5.4%	-	-
Administration costs per member	£18.11	£22.32	£22.41	£21.0
Investment management expenses	£9,791k	£10,053k	£11,290k	£7,118k
Total Fund unit costs per member	£340	£337	£367	£348

Source: Falkirk Council Pension Fund 2018/19 Unaudited Financial Statements; Falkirk Council Pension Fund 2017/18 Audited Financial Statements; Falkirk Council Pensions Fund 2016/17 Audited Financial Statements.



Appendices

A - Code of Audit Practice: responsibilities

B - Independence and audit quality

C - Required communications with the Pensions Committee

D - Timing and deliverables of the audit

Appendix A: Code of Audit Practice Responsibilities

Audited Body's Responsibilities

Corporate Governance

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 audit committees or equivalent) in monitoring these arrangements.

Financial Statements and related reports

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- ▶ 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.
- ▶ maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures.
- ▶ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority.
- ▶ maintaining proper accounting records.
- ▶ preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report 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.
- ▶ 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.

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.

Standards of conduct / prevention and detection of fraud and error

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.

Financial position

Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- ▶ such financial monitoring and reporting arrangements as may be specified
- ▶ compliance with any statutory financial requirements and achievement of financial targets
- ▶ balances and reserves, including strategies about levels and their future use
- ▶ how they plan to deal with uncertainty in the medium and longer term
- ▶ the impact of planned future policies and foreseeable developments on their financial position.

Best Value

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. Specified audited bodies also have to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

Appendix B: Independence and audit quality

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.

Matters that we are required to communicate

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY), its directors and senior management and affiliates, and you, including all services provided by us and our network to you, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 April 2018 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan, dated 21 March 2019.

We complied with the Financial Reporting Council's 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 management and members of the Pension Fund consider the facts known collectively 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 on 26 September 2019.

Audit Fees

	2018/19	2017/18
Component of fee:		
Total agreed auditor remuneration	£21,000	£17,360
Audit Scotland fixed charges:		
Pooled costs	£2,040	£1,540
Audit support costs	£1,320	£1,110
Total fee	£24,360	£20,000

Matters that we are required to communicate

International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

The EY 2018 UK Transparency Report, volumes one and two, can be accessed on our website at <https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018>. This material is published to provide a timely and relevant source of information about EY in general, and our audit business in particular.

The disclosures are extensive. For example, they explain our outlook and how we are structured and governed, including the role of our Independent Non-Executives and how we apply the requirements of the UK's Audit Firm Governance Code. We refer to the quality of our audits and our commitment to recruiting, developing and diversifying our people and talent pool. We also explain how we manage our risks and remain innovative and technologically advanced in what we do and how we do it.

Maintaining high audit quality across all of our engagements is of paramount importance to us. Our transformational Audit Quality Programme continues and is a part of the global EY Sustainable Audit Quality Programme (SAQ).

Our Audit Quality Board (AQB) continues to oversee all matters relating to audit quality and sets the agenda for the Audit Quality programme. The AQB meets monthly and also holds an annual strategy session. The AQB reports to the EY UK Board. The AQB receives regular updates on regulatory matters, results of internal and external reviews, results of root cause analysis, resourcing, the SAQ programme and pursuit approvals, as well as a comprehensive dashboard on quality measures.

Our Audit Quality Support Team (AQST), which started within the SAQ programme, reviews 40 to 50 audits each audit cycle providing challenge and guidance to the engagement teams. These are in-depth reviews carried out by experienced auditors independent of the audit team. AQST reviews enhance the quality of both the audit under review and other audits on which team members apply the lessons learned. The AQST has now become a business-as-usual function.

Audit Quality Framework / Annual Audit Quality Report

Audit Scotland's Appointments and Assurance Team are responsible for applying the new Audit Quality Framework across all financial audits and performance and Best Value audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission.

We support Audit Scotland in their commitment to reporting on audit quality through responding to requests for information and providing the results of internal quality reviews undertaken in respect of relevant public sector audits in Scotland.

The most recent audit quality report which covers our work at the Pension Fund since appointment can be found at: https://www.audit-scotland.gov.uk/uploads/docs/report/2018/as_audit_quality_1718.pdf

Appendix C: Required Communications

Required communication	Our reporting to you
<p>Terms of engagement / Our responsibilities</p> <p>Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.</p> <p>Our responsibilities are as set out in our engagement letter.</p>	<p>Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice</p>
<p>Planning and audit approach</p> <p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p>	<p>Annual Audit Plan</p>
<p>Significant findings from the audit</p> <ul style="list-style-type: none"> ▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Significant difficulties, if any, encountered during the audit ▶ Significant matters, if any, arising from the audit that were discussed with management ▶ Written representations that we are seeking ▶ Expected modifications to the audit report ▶ Other matters if any, significant to the oversight of the financial reporting process 	<p>Annual Audit Plan</p> <p>We request written representation from you in respect of key matters arising during the course of our audit, and in accordance with auditing standards. A copy of this letter is provided for your consideration and signature at the time of approval of the financial statements</p>
<p>Going concern</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"> ▶ Whether the events or conditions constitute a material uncertainty ▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▶ The adequacy of related disclosures in the financial statements 	<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 opinion.</p>
<p>Misstatements</p> <ul style="list-style-type: none"> ▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▶ The effect of uncorrected misstatements related to prior periods ▶ A request that any uncorrected misstatement be corrected ▶ Corrected misstatements that are significant ▶ Material misstatements corrected by management 	<p>This Annual Audit Report</p>
<p>Fraud</p> <ul style="list-style-type: none"> ▶ Enquiries of the Pensions Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▶ A discussion of any other matters related to fraud 	<p>This Annual Audit Report</p>

Required communication

Our reporting to you

Consideration of laws and regulations

- ▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off
- ▶ Enquiry of the Pensions Committee and Board into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Pensions Committee may be aware of

Annual Audit Report (to be issued on completion of audit work) or as occurring if material.

We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.

Related parties

Significant matters arising during the audit in connection with the entity's related parties including, when applicable:

- ▶ Non-disclosure by management
- ▶ Inappropriate authorisation and approval of transactions
- ▶ Disagreement over disclosures
- ▶ Non-compliance with laws and regulations
- ▶ Difficulty in identifying the party that ultimately controls the entity

No significant matters have been identified.

Independence

Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence

Communication of 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 about the general policies and process within the firm to maintain objectivity and independence

Annual Audit Plan

This Annual Audit Report - Appendix B

Internal controls

Significant deficiencies in internal controls identified during the audit

This Annual Audit Report - no significant deficiencies reported

Subsequent events

Where appropriate, asking the Pensions Committee whether any subsequent events have occurred that might affect the financial statements.

We have asked management and those charged with governance. We have no matters to report.

Material inconsistencies

Material inconsistencies or misstatements of fact identified in other information which management has refused to revise

This Annual Audit Report

Appendix E: Timing and deliverables of the audit

We deliver our audit in accordance with the timeline set by the Pension Fund, in accordance with guidance from Audit Scotland. Below is a timetable showing the key stages of the audit and the deliverables through the 2018/19 audit cycle.

	Audit Activity	Deliverable	Timing
JAN			
FEB	<ul style="list-style-type: none"> ➤ Audit planning and setting scope and strategy for the 2018/19 audit 	Annual Audit Plan	21 March 2019
MAR			
APR			
MAY	<ul style="list-style-type: none"> ➤ Ongoing assessment around wider scope dimensions and support of Audit Scotland requested information 	n/a - as appropriate	n/a
JUN			
JUL	<ul style="list-style-type: none"> ➤ Year-end substantive audit fieldwork on unaudited financial statements 	Audit clearance meeting	July / August 2019
AUG			
SEP	<ul style="list-style-type: none"> ➤ Conclude on results of audit procedures ➤ Issue opinion on the IJB's financial statements 	Certify Annual Financial Statements Issue Annual Audit Report	27 September 2019

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Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

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