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PENSION FUND COMMITTEE AND PENSION BOARD
THURSDAY, 7 MARCH 2019

A MEETING of the PENSION FUND COMMITTEE AND PENSION BOARD will be held at KPMG, SALTIRE COURT, 20 CASTLE TERRACE, EDINBURGH EH1 2EG on THURSDAY, 7 MARCH 2019 at 10.00 AM

J. J. WILKINSON,
Clerk to the Council,

1 March 2019

BUSINESS		
1.	**Apologies for Absence**	
2.	**Order of Business**	
3.	**Declarations of Interest**	
4.	**Minute** (Pages 3 - 30) Minute of Meeting held on 30 November 2018 to be noted and signed by the Chairman. (Copy attached).	2 mins
5.	**Pension Fund Investment and Performance Sub-Committee** To note the Minute of the Pension Fund Investment and Performance Sub-Committee held on 25 February 2019. (To follow)	2 mins
6.	**Risk Register Update** (Pages 31 - 38) Consider report by Chief Financial Officer. (Copy attached).	10 mins
7.	**Budget Monitoring & Setting** (Pages 39 - 44) Consider report by Chief Financial Officer. (Copy attached).	5 mins
8.	**Information Update** (Pages 45 - 50) Consider briefing paper by Chief Financial Officer. (Copy attached).	10 mins
9.	**Local Governmment in Scotland - Financial Overview 2017/18** (Pages 51 - 112) Consider report by the Accounts Commission which provides an outline of the overall financial health of local government. Supplements include 'Local Government Pension Scheme 2017/18'. (Copy attached).	10 mins

10.	**Any Other Items Previously Circulated**	
11.	**Any Other Items which the Chairman Decides are Urgent**	
12.	**Items Likely To Be Taken In Private** Before proceeding with the private business, the following motion should be approved:- “That und Section 50A(4) of the Local Government (Scotland) Act 1973 the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 8 of Part 1 of Schedule 7A to the aforementioned Act.”	
13.	**Minute** (Pages 113 - 116) Private Section of Minute of Meeting held on 30 November 2018 to be noted and signed by the Chairman. (Copy attached).	5 mins
14.	**Pension Fund Investment and Performance Sub-Committee** To note the private minute of the Pension Fund Investment and Performance Sub-Committee held on 25 February 2019. (To follow).	2 mins
15.	**Quarter Performance Update** (Pages 117 - 158) Consider report by KPMG. (Copy attached).	30 mins

NOTES

1. **Timings given above are only indicative and not intended to inhibit Members' discussions.**

2. **Members are reminded that, if they have a pecuniary or non-pecuniary interest in any item of business coming before the meeting, that interest should be declared prior to commencement of discussion on that item. Such declaration will be recorded in the Minute of the meeting.**

Membership of Committee:- Councillors D. Parker (Chairman), J. Brown, G. Edgar, C. Hamilton, D. Moffat, S. Mountford, S. Scott, S. Aitchison, Mr E Barclay, Mr M Drysdale, Ms T Dunthorne, Ms K M Hughes, Ms L Ross, Ms C Stewart and Ms H Robertson

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Please direct any enquiries to Judith Turnbull Tel No. 01835 826556
Email: Judith.Turnbull@scotborders.gov.uk

SCOTTISH BORDERS COUNCIL
PENSION FUND COMMITTEE AND PENSION BOARD

MINUTES of Meeting of the PENSION FUND COMMITTEE AND PENSION BOARD held in Council Chamber, Council Headquarters, Newtown St Boswells on Friday, 30 November 2018 at 10.00 am

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Present:-	Councillors D. Parker (Chairman), J. Brown, G. Edgar, C. Hamilton, S. Scott, S. Aitchison, Mr E Barclay, Mr M Drysdale, Ms L Ross and Ms C Stewart
Apologies:-	Councillors D Moffat, S Mountford, Ms K Hughes, Ms H Robertson.
In Attendance:-	Chief Financial Officer, Pension and Investment Manager, HRSS Team Leader, Mr D O'Hara, Investment Advisor (KPMG), Democratic Services Officer (J Turnbull).

1. **MINUTE**
There had been circulated copies of the Minute of the Meeting of 13 September 2018.

DECISION
NOTED for signature by the Chairman.

2. **PENSION FUND INVESTMENT AND PERFORMANCE SUB-COMMITTEE**
There had been circulated copies of the Minute of the Pension Fund Investment and Performance Sub-Committee dated 29 October 2018.

DECISION
NOTED the Minute.

3. **REVIEW OF ADDITIONAL VOLUNTARY CONTRIBUTION (AVC) PROVISION**
There had been circulated copies of a report by the Chief Financial Officer providing members with the outcome of the review undertaken on the Additional Voluntary Contribution (AVC) provision currently provided by the Fund. The report explained that the Pension Fund, under the Social Security Act 1986, was required to ensure that a person could, if desired, pay additional voluntary contributions to their pension. The Fund currently has arrangements in place with Standard Life for an AVC Scheme to allow individuals to increase their pensions. The number of employees currently active in this scheme however, was low. The Business Plan approved on 14 June 2018, had highlighted the need to undertake a full review of the current provision to ensure it met the requirements of the Fund and relevant legislation. A review was undertaken by KPMG on behalf of the Fund, with the findings contained in Appendix 1, to the report, circulated with the agenda. The review found Standard Life to be a relatively strong provider in the AVC market but highlighted a number of steps which could improve the current provision. The main areas of improvement were around communication and promotion of the scheme and also monitoring the performance of the products offered by Standard Life under the AVC scheme. To address these areas of improvement the report detailed actions which would be undertaken. These actions would also be included in the 2019/20 – 2022/23 Business Plan. The Pension and Investment Manager, Mrs Robb, advised that Scottish Borders Council was considering implementing a salary sacrifice scheme for AVCs, managed by AVC Wise; who would be invited to give a presentation to the Pension Fund Committee and Pension Board.

DECISION
NOTED

(a) **The outcome of the Review undertaken by KPMG contained in Appendix 1 to the report; and**

(b) **The actions detailed in paragraph 4.3 of the report circulated with the agenda.**

4. **RISK REGISTER UPDATE**

With reference to paragraph 4 of the Minute of 13 September 2018, there had been circulated copies of a report by the Chief Financial Officer which formed part of the risk review requirements. The report provided the Pension Fund Committee and Pension Board with an update on the progress of the actions taken by management to mitigate these risks, a review of any new risks and highlighted changes to any of the risks contained in the risk register. Identifying and managing risk was a corner stone of effective management and was required under the Council's Risk Management Policy and process guide and CIPFA's guidance "Delivering Governance in Local Government Framework 2007". It was further reflected and enhanced in the "Local Government Pension Scheme" published by CIPFA. A full risk review had been undertaken on 1 May 2018 and the revised risk register was approved by the joint Pension Fund Committee and Pension Board on 14 June 2018. Appendix 1 to the report, detailed the risks within the approved risk register, actions and progress of these actions to date

DECISION

(a) **NOTED**

(i) **The management actions progress as contained in Appendix 1, to the report; and**

(ii) **That no new quantifiable risks have been identified since the last review.**

(b) **AGREED to a key risk review being undertaking in March 2019 and reporting of progress on the risk management actions.**

5. **COMMUNICATION POLICY**

There had been circulated copies of a report by the Service Director Human Resources proposing the implementation of the Communication Policy for the Scottish Borders Council Pension Fund. The Pension Fund was required by the Local Government Pension Scheme (Scotland) Regulations 2018, to have an up-to-date Communication Policy, detailed at Appendix 1 to the report, circulated with the agenda. The Communication Policy sets out the vision to make pension issues understandable to all stakeholders and provided access to accurate up to date information in the most effective manner, making use of technologies whenever possible. In response to a question, Ms Green, HRSS Team Leader, advised that there was no additional financial implications associated with officers attendance at promotional events, the cost being absorbed within the HRSS Team.

DECISION

AGREED the Communication Policy as set out in Appendix 1 to the report.

6. **BUSINESS PLAN PERFORMANCE UPDATE**

With reference to paragraph 10 of the Minute of 14 June 2018, there had been circulated copies of a report providing members of the Pension Fund Committee and Pension Board with an update on delivery of the actions within the approved Business Plan. The 2018/19 – 2020/21 Business Plan for the Pension Fund was approved by the Pension Fund Committee and Pension Board on 14 June 2018. Included within the plan were key objectives and actions with target dates. As part of the risk register update approved by the joint meeting on 13 September 2018, it was agreed a mid-year progress report on the business plan actions would be presented to Members at the December 2018 meeting, with a further progress report and update at the June 2019 meeting. The report explained that there were 19 key tasks due for completion during 2018/19. Of these nine were fully completed, six were on track to be completed by the approved target date, two had missed their original target date but were presented elsewhere on the agenda and two had been superseded and were no longer required.

DECISION

(a) NOTED the progress of the 2018/19 actions within the business plan.

(b) AGREED that a further update be presented at the June 2019 meeting.

7. **BUDGET MONITORING TO 30 SEPTEMBER 2018**

With reference to paragraph 3 of the Minute of 13 September, there had been circulated copies of a report providing the Pension Fund Committee and Pension Board with an updated position of the Pension Fund budget to 30 September 2018, including projections to 31 March 2019. The Local Government Pension Scheme (Scotland) Regulation 2014 required Administering Authorities ensured strong governance arrangements and set out the standards they were to be measured against. To ensure the Fund met the standards a budget was approved on 14 June 2018 following the recommendations within the CIPFA accounting guidelines headings. The report was the second quarterly monitoring report of the approved budgets. The total expenditure to 30 September 2018 was £0.347m with a projected total expenditure of £6.389m. The projected expenditure was in line with budget.

DECISION

NOTED:

(a) the actual expenditure to 30 September 2018; and

(b) the projected expenditure.

8. **REVIEW OF THE STRUCTURE OF SCOTTISH LOCAL GOVERNMENT PENSION SCHEME - CONSULTATION RESPONSE**

8.1 With reference to paragraph 6 of the Minute of 13 September, there had been circulated copies of a report requesting approving of the consultation response from the Pension Fund Committee on the review of the structure of Scottish Local Government Pension Scheme. The report explained that following a request from Scottish Government the Scheme Advisory Board had launched a consultation process on the future structure of the Scottish Local Government Pension Scheme. The process had been launched in June 2018 and sought to establish the views of employee and employers' representatives on four options: (i) To retain the current structure with 11 funds; (ii) To promote cooperation in investing and administration between the 11 funds; (iii) To pool investments between the 11 funds; and, (iv) To merge the 11 funds into one or more funds. The Pension Fund Committee and Pension Board had received all information available to the Fund and at the joint meeting on 13 September had a full discussion of the options. A draft response was contained in Appendix 1, to the report which reflected the agreed position of the Committee and the Board. It had been agreed that a separate response would be submitted by the Pension Board and employers would also be encouraged to submit responses. It was noted that responses had to be submitted no later than 7 December 2018.

8.2 The Chief Financial Officer, Mr Robertson, discussed the response in detail, highlighting that the objective of the Fund was to build up assets in order to meet all future pension fund liabilities. The 2017 Triennial Valuation had determined a funding level of 114%, and over the past 10 years the fund had delivered a strong performance, with net assets increasing over that period by 133% to stand at £684m at the end of March 2018. The Fund was well diversified across a range of asset classes and is now positioned to better withstand future fluctuations in financial markets and any change could have a detrimental impact on performance and membership. Mr Robertson advised that one of the drivers for change was to encourage investment in infrastructure. However, through collaboration with Lothian Pension Fund, the fund already invested in infrastructure. Mr Robertson concluded that there was no reliable, empirical case to support change and further work was required to evaluate the benefits and risks associated with change before this could be supported as being in the best interests of the fund. Mr O'Hara added that he had reviewed the document, and considered it a clear response in terms of the views of Pension Fund members. However, it was agreed to delegate responsibility to the Chief Financial Officer, Pension Investment Manager and the Investment Advisor to finalise the response and submit on behalf of the Pension Fund Committee. In response to questions, Mr O'Hara advised that aggregating investments between funds could deliver economies of scale and a reduction in asset managers' fees. However, this would incur significant set up costs and Scottish funds were already benefitting from reduced fees following pooling in England and Wales. In response to a question regarding the fund being forced to merge, Mr Robertson advised that changes could be implemented through Ministerial direction.

DECISION
(a) AGREED:

(i) To delegate responsibility to the Chief Financial Officer, Pension Investment Manager and Investment Advisor – KPMG, to finalise the consultation response; and

(ii) That Appendix A attached to the Minute, be submitted as the response from Scottish Borders Council Pension Fund Committee.

(b) NOTED that a separate response would be submitted by the Pension Board.

9. **STATEMENT OF RESPONSIBLE INVESTMENT POLICY**
With reference to paragraph 9 of the Minute of 13 September 2018, there had been circulated copies of a report requesting approval of the Statement of Responsible Investment Policy for the Pension Fund. The Pension Fund as part of its fiduciary duties was required to ensure appropriate consideration was given to Environmental, Social and Governance (ESG) issues as part of its investment decisions, whilst acting in the best interest of the scheme beneficiaries. The Committee and Board, to ensure its fiduciary duties were met and in line with good practice, had agreed to the development of a separate Statement of Responsible Investment. A draft of this was presented to the Committee and Board in September and Appendix 1 to the report reflected the outcome of the discussion from the meeting. The Policy sets out the overarching principles the Fund required Managers to act within and how the Fund would monitor the adherence to this policy. It was noted that the draft Statement had been available on the Scottish Borders Council Pension Fund website for members of the fund to review and comment on.

DECISION
AGREED to the Statement of Responsible Investment as contained in Appendix 1, to the report.

10. **INFORMATION UPDATE**

10.1 With reference to paragraph 8 of the Minute of 13 September 2018, there had been circulated a briefing paper by the Pension and Investment Manager and HR Shared Services Team Leader providing members with an update on a number of areas which were being monitored and where work was progressing. Full reports on individual areas would be tabled as decisions and actions were required. In summary:

10.2 Guarantee Minimum Pension (GMP) Reconciliation
ITM Limited had indicated that due to the delay in receiving responses from HMRC, the project would now be concluded by the first quarter in 2019. 84% of discrepancies had been reconciled with 16% awaiting data from HMRC or further investigation by SBC/ITM.

10.3 Pension Regulator Scheme Return – Data Scoring
The Pension Regulator (TPR) had introduced a Scheme to ensure pension funds adhered to good practice on record keeping. The scheme had identified issues around postcodes being held in the incorrect field, and also around total contributions. A full report on the Scheme would be presented to the next meeting.

10.4 Scheme Advisory Board
The Scheme Advisory Board (SAB) had met on 4 October 2018, the minutes of which were circulated at the meeting.

10.5 Training Opportunities
The date for the Pension and Lifetime Savings Association (PLSA) conference was 6-8 March 2019. To assist attendance the joint meeting would be held in Edinburgh on the 7th March. Mrs Robb also advised that Baillie Gifford's next seminar would be 9-10 October 2019. The Fund would be allocated six places. Further details would be circulated when available.

DECISION
NOTED the information update.

11. **ITEMS LIKELY TO BE TAKEN IN PRIVATE**
AGREED under Section 50A(4) of the Local Government (Scotland) Act 1973 to exclude the public from the meeting during consideration of the business contained in the following items on the ground that they involved the likely disclosure of exempt information as defined in paragraphs 6 and 8 of the part 1 of Schedule 7A to the Act.

12. **MINUTE**
The Committee noted the Private Minute of the meeting of 13 September 2018.

13. **PENSION FUND INVESTMENT AND PERFORMANCE SUB-COMMITTEE**
The Committee noted and agreed the Private Minute of the Pension Fund Investment and Performance Sub Committee on 29 October 2018.

14. **QUARTER PERFORMANCE UPDATE TO 30 SEPTEMBER 2018**
The Committee noted a private report by KPMG.

15. **INFRASTRUCTURE INVESTMENT UPDATE**
The Committee noted the infrastructure investment position.

16. **PROCURMENT UPDATE - SENIOR & JUNIOR INFRASTRUCTURE DEBT**
The Committee noted and approved the Infrastructure Debt Procurement report.

17. **PROCUREMENT UPDATE - ACTUARY**
The Committee noted the outcome of the procurement process for Actuarial services.

The meeting concluded at 11.25 am

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Review of the Structure of the Scottish Local Government Pension Scheme
CONSULTATION RESPONSE FORM

Instructions
Responses in this form should be drafted in conjunction with the accompanying consultation report. To respond, please complete the **respondent details** and as many of the **consultation questions** your organisation wishes to complete and return the form via email to the Pensions Institute at consultation@pensions-intitute.org no later than **Friday, 7 December 2018**.

This consultation is being conducted in electronic form only, so **responses must be emailed**; hard copy posted or delivered responses cannot be received. Any queries about the consultation should be addressed to Matthew Roy, Fellow, Pensions Institute at matthew.roy@pensions-institute.org.

RESPONDENT DETAILS

Name of responding organisation(s) Please list the full name of each organisation participating in this response.	**Organisation type** Is your organisation an administering authority, employer, or employee group? Please record for each responding organisation.
Scottish Borders Council Pension Fund	**Pension Fund**
Authors Please list any people that wish to be recorded as authors of this response, including name, job title and organisation.	**Consent** Please confirm each author consents to their information being retained for analysing the consultation responses by writing 'confirm' by their name.
David Robertson, Chief Financial Officer Kirsty Robb Pensions and Investment Manager	confirm
Date Please date the response.	30/11/18

Covering information
If you wish to include covering information with your response, please include the text here. The text can wrap onto additional pages if needed.

Scottish Borders Council Pension Fund

The Scottish Borders Council Pension Fund (the Fund) as part of the Local Government Pension Scheme (LGPS) is administered by Scottish Borders Council (the Administering Authority. The fund has 18 scheme employers, 4,409 active members and issued 6,575 benefit statements during in the year to 31 March 2018. The fund had 10,667 members as at 31/3/18.

The LGPS scheme is governed by the Public Service Pensions Act 2013. The fund is administered by the Council in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Scotland) Regulations 2014 (as amended)
- The Local Government Pension Scheme (Transitional Provisions and Savings) (Scotland) Regulations 2014
- The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010
- The Local Government Pension Scheme (Governance) (Scotland) Regulations 2015

It is a contributory defined benefit pension scheme designed to provide pensions and other benefits for pensionable employees of Scottish Borders Council and a range of other scheduled and admitted bodies within the Scottish Borders area.

Objectives

The primary aim of the fund is to

- provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death before or after retirement, on a defined benefits basis.

The funding Objectives are to

- set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund.
- build up the required assets in such a way that ensure levels of employer contribution that are stable.

The latest Triennial Valuation was undertaken at 31 March 2017. The outcome of the 2017 Valuation was a funding level of 114%, an improvement in the position assessed at 2014 of 101%. The funding position equates to a surplus of over £80m demonstrating that the fund is meeting its primary objective.

On the advice of the actuary this surplus has been used over time to offset increases in the primary employer's contribution rate of 20.6%. As a result there was no change in the overall Fund common pool employer contribution rate which remained at 18% one of the lowest employer rates in the LGPS in Scotland.

At 31 March 2018 the fund had £684.6m of assets under management, an increase of £30.2m (5.6%) on the position as at 31 March 2017.

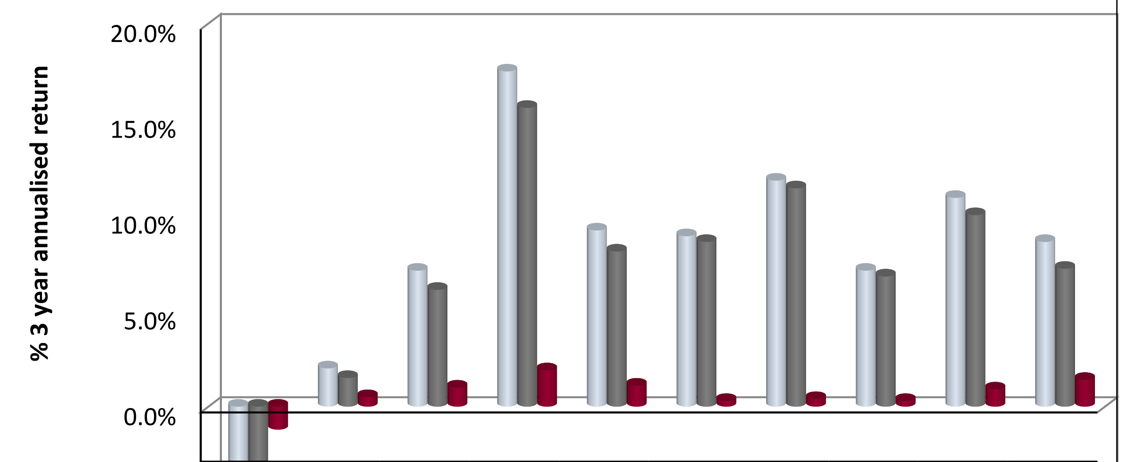
The fund has delivered strong performance of 8.6% for the rolling 3 year period to 31 March 2018.

Investment Performance

The Fund's performance against benchmark over the past 10 years is highlighted in the chart below. This chart demonstrates that the rolling 3 year annualised relative return (i.e. Fund's return achieved compared with the benchmark) since 2010 has been positive, and that over the 10 year period there has only been one year of negative returns overall for the Fund and that was immediately following the financial crisis in 2008.

On average the fund has returned relative out performance against bench mark of 0.66% per annum over the last 10 years.

3 Year Annualised Returns ending 31 March



	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Actual Return	(7.8)%	2.0%	7.1%	17.5%	9.2%	8.9%	11.8%	7.1%	10.9%	8.60%
Benchmark Return	(6.6)%	1.5%	6.1%	15.6%	8.1%	8.6%	11.4%	6.8%	10.0%	7.20%
Relative Return	(1.2)%	0.5%	1.0%	1.9%	1.1%	0.3%	0.4%	0.3%	0.90%	1.40%

The Fund achieved these favourable returns in 2017/18, with all Fund Managers producing a positive return. Global equities provided the highest out performance against benchmark. Relative out performance of 1.4% was achieved for the year against the benchmark of 7.2%.

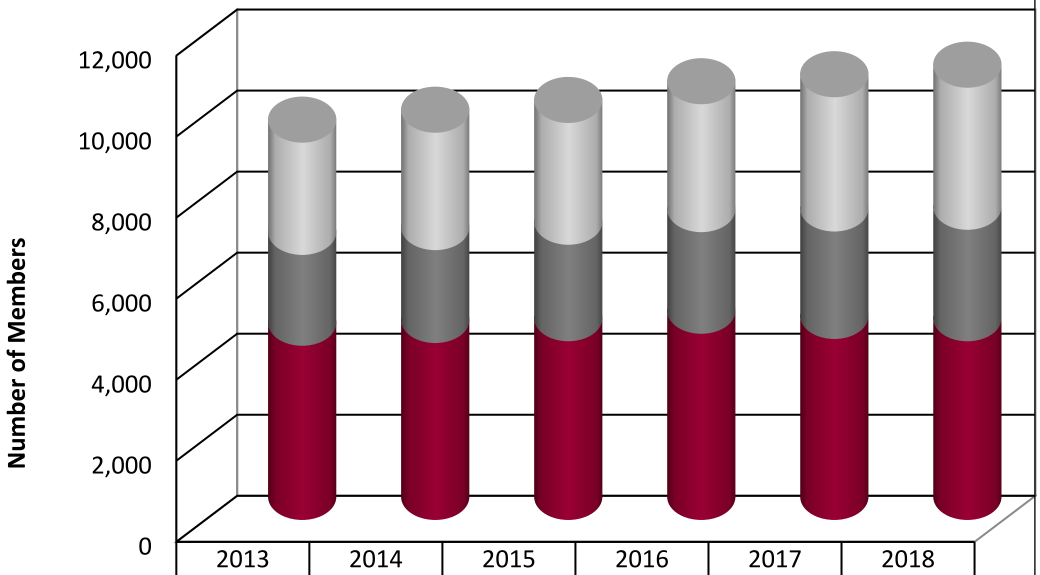
Over the last 10 years the net assets of the fund have increased by 133%.

Asset Diversification

The fund is well diversified across a range of assets classes including global and UK equities, bonds, alternatives, direct lending, private credit, property and infrastructure. This latter asset class is accessed in collaboration with Lothian Pension fund. The Fund is now well positioned to withstand future fluctuations in financial markets.

Overview of Fund Membership

Current membership of the Fund is 10,667 of which 4,409 are actively contributing and 3,507 are in receipt of pension benefits. The following chart summarises the trends in membership:



	2013	2014	2015	2016	2017	2018
Contributing	4,298	4,366	4,410	4,594	4,466	4,409
Deferred	6,540	6,658	6,791	7,102	7,118	7,160
Pensioners/Dependents	9,311	9,556	9,797	10,259	10,432	10,667

Since 2013 the total membership has increased by 1,356 members (a 15% increase overall). During this period the number of pensioners and their dependants has increased by 23%, and the number of active contributing members has increased by 3%. This presents a challenge to the Fund to ensure that it manages its future cash flows effectively as the fund matures. This was included as part of the considerations when undertaking the full investment review.

The strong asset position, along with the 2017 (114%) Triennial Valuation of funding level, demonstrates that the Fund is well placed to meet its future pension and other benefit liabilities.

Recent changes in the legislation around what pensioners are able to do with their pension benefit entitlements have increased individual freedoms to withdraw from pension funds, potentially triggering significant transfer movements. The Scottish Borders fund has not however seen any significant withdrawals as a result of this legislation and continues to monitor this position.

Governance and Decision Making

Following the significant changes required in the governance arrangements which came into force on 1 April 2015 the Scottish Borders Pension Fund Board was established. Joint meetings of the Pension Fund Committee and Pension Fund Board have been held regularly during 2017/18.

The remit of the Pension Fund Board is to assist the Council (as administering authority) in relation to:

a) securing compliance with the regulations and other legislation relating to the governance and administration of the Scheme and any statutory pension scheme that is connected with it;
b) securing compliance with requirements imposed in relation to the Scheme and any connected scheme by the Pensions Regulator; and
c) such other matters as the regulations may specify.

This body is made up of four scheme employer representatives and four trade union representatives.

The membership of the Pension Fund Committee comprises elected members from the administering authority, Scottish Borders Council.

Knowledge and Skills

The Funds Training Policy was updated and agreed on 22 June 2017. The Training Policy sets out a target for all members of the Pension Fund Committee and Pension Fund Board in relation to attendance at Committee meetings and training events. Compliance with the policy is monitored regularly.

The Policy requires members of the Pension Fund Board and Committee to attend at least two meetings per year and two training events. All Members of the Pension Fund Committee fully met the training and attendance targets set in the Training Policy. 75% of the Pension Fund Board met the attendance target and 75% met the training target. The Training policy also for 2017/18 required all members of the Committee and Board to undertake The Pension Regulator Trustee Toolkit within 6 months of becoming a member. The Fund is able to demonstrate full compliance with the relevant best practice standards and this is set out in the Governance Compliance Statement accessible at http://www.scottishborderscouncilpensionfund.org/media/4239/annual-report-2017-18-audited.pdf

A full copy of the Business Plan can be found at www.scotborders.gov.uk/pensions.

The Statement of Investment Principles (SIP) can be found here www.scotborders.gov.uk/pensions.

The full version of the actuary report and the current Funding Strategy is available via the Pension Funds website: http://scottishborderscouncilpensionfund.org/

The Fund's Pensions Administration Strategy was approved in September 2015. This sets out scheme employer and administering authority roles and responsibilities and defines the service performance standards. A comprehensive report on Pensions Administration performance for 2017/18 was presented to the joint meeting of the Pension Fund Committee and Pension Board on 14 June 2018 and a copy of the report is available via the Council's committee papers website http://scottishborders.moderngov.co.uk/.

Against this background the statutory Audit for 2017/18 of Scottish Borders Pension Fund under taken by Audit Scotland concluded positively on the management of the Fund.

The Scottish Borders Pension fund is by any objective measure well managed and governed effectively. The fund is fully compliant with the relevant legislation and has well established board and committee arrangements in place. The Scottish Borders Council pension fund is 114% funded and, has a growing membership. The fund is well diversified to protect against market shocks and has recently concentrated on income yielding assets in response to the increasing maturity profile of the membership.

The Borders employer contribution rates are amongst the lowest in Scotland and the Fund complies fully with CIPFA guidance on fee transparency. The fund is assisted by appropriately qualified and experienced officers, external advisers and fund managers. It has opted up to professional status under MiFID 2 and is well placed to meet the future challenges facing the LGPS.

The SBCPF recognises that if the LGPS in Scotland was being established afresh an 11 fund structure would probably not be the model chosen to administer the fund. Nevertheless, the long track record of strong performance of the Scottish Borders Pension fund, the lack of robust evidence of the benefits of change and potentially negative impact such change will have on to the stability, performance and funding position has led the Fund to conclude that making any change to the structure of the LGPS in Scotland is an unacceptably high risk strategy.

The evidence to support change is at best selective. Pension fund reforms being undertaken in England and Wales have proved expensive and have yet to demonstrate any positive impact on fund performance.

It may be that some marginal cost savings could be delivered by fewer, larger funds over the longer term. Evidence to support this view is however again at best limited and it should be noted that some of the largest UK pension funds have recently experienced funding and governance issues.

It should also be noted that smaller scale funds, unburdened by weighty governance structures can often move quickly to access attractive niche investment opportunities. For example the Borders recently accessed a long lease property mandate which now has a six month investment queue. While economies of scale may be possible the costs associated with transitioning to new investment mandates will offset such savings for years to come.

The Fund is already investing infrastructure in collaboration with Lothian Pension fund and plans to further develop this relationship in future.

SBCPF believes that everyone should have access to high quality benefits and that the continuing high levels of engagement in the fund demonstrate continued confidence in the stability of the scheme and in the benefits of local management. This view is assisted greatly by the involvement of local elected members, local trades unions representative and local employers in the decision making process through both the

Pension fund committee and the Board.

The Fund believes that there is no reliable empirical case for change and much more work would have to be done to evaluate the benefits and significant risks associated with change before this could be supported as being in the best interests of the fund membership.

In the absence of evidence to the contrary the SBCPF is of the view that such change is likely to have a detrimental impact on performance and pensioner confidence and for this reason believes the status quo should remain while proper evaluation of the evidence supporting any change is undertaken. If change is required the Scottish Borders Pension Fund would support a voluntary collaboration model, avoiding the need for pooling or expensive, time consuming and un-proven structural reform.

The Scheme Advisory Board is respectfully reminded that the primary fiduciary duty of the LGPS is to take decisions which are in the best interests of its members. Any changes to the structure of the LGPS in Scotland must place the interests of the scheme members at the forefront of decision making. There is no evidence that the measures being considered by this consultation will deliver against this objective.

The consultation questions follow.

CONSULTATION QUESTIONS

Question 1: Retain the current structure with 11 funds

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a) Cost of investing:

- ***How well informed do you feel about the investment costs in your fund? What information do you rely on to specify and measure these?***

The Scottish Borders Council Pension fund has undertaken a significant amount of work with its fund managers in recent years to ensure there is a full understanding of the investment costs of the fund that complies fully with the requirements of CIPFA's Guidance on Accounting for Local Governance Pension Schemes.

The Fund encourages its pension managers to sign up to the LGPS fee transparency code and fully disclose both internal and external management fees and transaction costs within its annual accounts.

- ***How well does the current system manage investment costs?***

The fund has good information with regard to fee levels allowing objective evaluation and comparison of the fees charged by individual managers.

The absolute level of cost while important is not however always the most important determining factor in retaining a fund manager. While fees levels are an important consideration the fund believes that paying additional fees to deliver out performance through active management of pension fund investments is an equally important consideration.

The fund believes that the overall value for money delivered by a manager is a more important consideration than fee levels.

The fund employs competitive tendering in the procurement of investment managers and in the procurement of other services including investment advisors, tax advice, custodian services and for actuarial services thereby ensuring best value is delivered. SBCPF uses the Norfolk Framework which is an excellent example of collaborative working across LGPS funds across the UK.

How would you improve the measurement and management of investment costs in the current system?

SBCPF already has a good understanding of the costs of investment including layered fees in our alternative mandates. All fund managers employed by the LGPS should be required to disclose their full fee structure in line with the fee transparency code.

The sharing of detailed information on fee rates per managers across all funds in England, Wales and Scotland would allow clear comparison of rates and aid funds in their discussion with Managers.

b) Governance:

How well informed do you feel about the governance of your fund? What

information do you rely on to measure this?

The SBCPF is audited on an annual basis by Audit Scotland. The 2017/18 audit of the pension fund concluded positively on the governance of the fund noting " the fund has effective governance arrangements in place that support the scrutiny of decisions made by the pension fund committee."

The recent advent of Pension Boards, with local employee membership, has added a further positive dimension to the governance of the pension fund.

The fund undertakes benchmarking of the outputs of the fund, including investment performance, funding level, expenses and contribution rates to assess its performance.

It publishes an annual Governance Statement under the 2014 regulations to demonstrate compliance with the governance standards required by Scottish Ministers. These standards are established via a number of best practice principles and the fund is able to objectively measure its compliance against these standards.

The fund also measures its compliance against the Myners principles which reflect best practice guidance issued by CIPFA covering the effectiveness of decision making, the setting of clear objectives for the fund, the understanding of risks and liabilities, performance assessment, responsible ownership, transparency and reporting.

SBCPF have a strong training policy which is monitored on an annual basis. All members of the Committee and Board are required to complete The Pension Regulator Trustee Toolkit within 6 months and must meet annual training requirements.

- ***How well is the current system governed?***

The 2016 KPMG review of the governance of the LGPS concluded positively with regards to the standard of governance in place across the LGPS in Scotland.

Pension Fund Boards, although only introduced in 2015, have added a further positive dimension ensuring scrutiny of pension fund committee decisions and the effective engagement of employee representatives in the management of pension funds.

Statutory external Audit of the LGPS funds is undertaken annually. These do not highlight any concerns with the current governance arrangements in place across funds.

All funds are required to comply with the requirement of MiFID 2

- ***How would you improve governance of the current system?***

The KPMG review of the system outlined no fundamental weaknesses in the LGPS governance model in Scotland.

All funds should be required to publish information regarding their investment strategy, actuarial report and funding assumptions as well as performance and key policy documents for example the statement of investment principles or their ESG policies.

Pension Fund committees should meet jointly with Pension Boards on a regular basis and committee meetings should be held in public wherever possible.

The minutes of meetings should be published.

SBCPF meets all these requirements.

The introduction of Boards and the Scheme Advisory Board has added an extra layer of governance and oversite and the Fund believes a strong proactive Scheme Advisory Board has the potential to ensure all funds are fully meeting the required standards of governance and oversight.

- ***How important is it to maintain a local connection with respect to oversight and strategy?***

The LGPS is a local service. The SBCPF believes that decisions that affect local people are best made locally by elected members and that these decisions should be as transparent and open as possible.

The costs of the LGPS are a significant component of the costs of employing staff and therefore are a significant element of council budgets which local councilors are responsible for.

The SCBPF believes it is important therefore that there is effective oversight and scrutiny of pension funds at local level. This is best achieved where there is close alignment between scheme members and their dependents and those charged with taking decisions. Such close alignment improves accountability. Decisions with regard to investments, ethical investment, environmental issues, risk management etc. should kept as local as possible so that elected representatives can be held responsible to their members and the local electorate for their decisions with regard to oversight and strategy, and ultimately, their stewardship of the pension fund. The local nature of decision making guarantees an effective voice for employee representatives on pension fund boards.

- **How would you determine if the benefits of a local connection in governance outweigh the benefits of scale?**

The Propensity to good governance in any organisation bears no relationship to scale. There is no evidence that larger size funds perform better, or that they have fundamentally lower costs. There is no evidence to suggest that the current model is not working effectively either in terms of governance standards or in terms of investment performance.

Operating risks:

- ***ow well informed do feel about the operating risks of your fund? What***

information do you rely on to specify and measure these?

The pension fund in the Borders holds regular meetings with their fund managers to assess and understand the risks associated with their investments.

The pension fund has a published risk policy.

The risk register is reviewed on a quarterly basis by the Pension Fund Committee.

The risk register is publically available here https://www.scottishborderscouncilpensionfund.org/media/4253/180614-full-risk-register.pdf

SBCPF has opted up to professional status under MiFID 2 which requires funds to have access to appropriate, professionally - qualified advice to ensure they can manage risks effectively.

- ***How well are operating risks managed in the current system?***

  The performance of the LGPS in Scotland and the content of external audit reports indicate these risks are being managed effectively. The SBCPF has appropriately qualified, experienced officers managing both the pension fund investment and pension fund administration processes. The fund has a strong risk based culture and has effective arrangements in place for managing those risks. The fund does not manage any money internally instead relying on the expertise of professional investment firms. The operation of the fund is supported by independent expert advisor KPMG, external Custodian Northern Trust and our actuary Barnett Waddingham.

- ***How would you improve the measurement and management of operating risks in the current system****?*

By requiring members to undertake mandatory training e.g. the Trustee toolkit to ensure they have a good understanding of operating risks.

By requiring each fund to publish a comprehensive risk register for the fund which is subject to regular review.

Infrastructure:

- ***How well informed do you feel about your fund's investments in infrastructure? What information do you rely on?***

The principal of investment in infrastructure is well established where this offers comparative advantage over other asset classes for example diversification benefits or index linked annual income. Scottish Borders Council Pension Fund is actively collaborating in a range of Infrastructure investments with Lothian Pension fund. This arrangement provides SBCPF with cost effective access to investment opportunities which are also being accessed by Falkirk, Fife and NILGOS. Recent investments include renewable energy, telecoms and transport infrastructure.

- ***How do you rate the current system's ability to invest in infrastructure?***

The principal objective of a pension fund is to build up a fund of assets sufficient to meet future pension fund liabilities not to fund public infrastructure projects.

There is an inherent tension between optimizing risk and return for pension funds and delivering public investment in infrastructure at the lowest possible cost to the taxpayer.

There are however excellent examples of the LGPS investing in infrastructure which is increasing featuring as part of the Asset Allocation Strategy of LGPS funds for example it is understood Strathclyde has now allocated over £330m in this asset class.

Scottish Borders has made an allocation of 5% of assets under management to infrastructure and is investing in this asset class in collaboration with Lothian Pension fund

- ***How would you increase investment in infrastructure in the current system?***

The attractiveness of this asset class can only be assessed in comparison to the risk and return profile of other assets. Having an appropriate vehicle to access infrastructure investment in a cost effective manner would assist.

The Scottish Futures trust has recently undertaken work in this area and published a paper with regard to housing infrastructure investment.

The structures to easy enable such large scale investment in infrastructure, which balances suitable returns within an optimized risk profile, with low cost project funding which can match PWLB costs, are not however yet suitably developed. Development of such a model would help to facilitate infrastructure investment.

The desire to see LGPS funds investing in infrastructure is a well-established political objective; however, it must be recognized that fund assets are separate from council funds and they exist to pay for liabilities. Any decision to invest in infrastructure need to be based on an objective assessment of risk and reward to the pension fund as well as the cost and benefit of such investment to local communities. One cannot be assessed and achieved without an understanding of the other and there needs to be an acceptance that meeting the policy objective of having pension funds invest in local infrastructure must result in the risk of lower investment returns or higher pension costs for Local Authorities.

Do you have any additional comments about this option?

This option represents the Status Quo for the LGPS in Scotland and any other options considered must deliver demonstrably better outcomes, based on robust empirical data, for them to be seriously considered.

The LGPS is an integral part of local government and of local decision making and is a considerable success story by any measure. Costs are low, governance is effective, member trust in the current system is high and most importantly funding levels are near or above 100% in all funds.

The LGPS faces significant challenges, but then so do the rest of the public services, and the reforms being consulted upon within this consultation are unlikely to solve these issues or lead to better outcomes. They could in fact prove highly costly and do significant damage!

Question 2: Promote cooperation in investing and administration between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***What impact do you think promoting agreements between funds would have on investment costs?***

  Promoting joint agreements relating to collaborative investments could have some positive impacts in terms of fees. This is particularly the case with regard to the cost of investing in alternative asset classes such as infrastructure.

- ***What would be the positive impacts?***

  Economies of scale may be delivered to some of the smaller funds through greater purchasing power.

  Collaboration and cooperation will give all funds the confidence to invest in a wider range of diversified assets and provide access to a wider breadth of expertise.

- ***What would be the negative impacts?***

Collaboration does not remove the requirement for individual funds to undertake due diligence regarding prospective investments. Each party to the collaborative investment agreement must undertake their own research and fully understand the risks and potential benefits of investing before committing.

Governance:

- ***What impact do you think promoting agreements between funds would have on governance?***

None. Collaboration does not remove the requirement for each fund to ensure its governance arrangements are operating effectively.

- ***What would be the positive impacts?***

Sharing of best practice and closer cooperation on co investment opportunities should have a positive impact. A wider range of individuals scrutinizing and challenging investment decision should lead to better outcomes

- ***What would be the negative impacts?***

The difficulty of coordinating investment decisions, often to tight market driven timescales could be a potential disadvantage. Collaboration does not remove any governance overhead from individual funds.

Operating risks:

- ***What impact do you think promoting agreements between funds would have on operating risks?***

  No material impacts if collaboration is undertaken on a voluntary basis with each fund retaining responsibility for its own investment decisions. Significant voluntary cooperation already exists between LGPS funds that share best practice and access a range of services through nationally agreed procurement frameworks.

- ***What would be the positive impacts?***

  There could be potential benefits through economies of scale.

Increase collaboration around Pension Administration could have a positive impact above that already in place. All administering authorities now operate on the same administration system which, whilst working with the provider, could lead to increased synergies around documentation and testing of system upgrades resulting from changes to regulations

What would be the negative impacts?

Formal legally binding agreements need to be documented leading to additional legal costs.

d) Infrastructure:

- ***What impact do you think promoting agreements between funds would have on funds' ability to invest in infrastructure?***

In practice this arrangement is already working effectively with respect to infrastructure.

- ***What would be the positive impacts?***

  Smaller funds would have access to a wider range of investment opportunities on a cost effective basis. A recent good example is the benefits that have been gained by Falkirk and Scottish Borders Council through collaboration with Lothian Pension Fund in a range of infrastructure based investments. Co investment provides the opportunity to share legal, technical due diligence costs.

- ***What would be the negative impacts?***

There is however the potential for disagreement and challenge arising from service failure or adverse investment returns. This could increase the risk of legal challenge and require formal dispute resolution procedures.

Risk that under a collaborative investment model inappropriate resilience is placed upon the work of others and the necessary diligence on behalf of individual funds does not take place with sufficient rigor. The effectiveness of any diligence process is reliant upon funds having a clear understanding of the key features and risks associated with investment products.

While not a negative impact, the complicated nature of these investment has required Lothian Pension Fund to set up an FCA registered company which manages the co investment process.

Do you have any additional comments about this option?

Closer collaboration could allow the retention of local expertise in the Finance and HR function providing depth and resilience across Scotland, particularly in smaller authorities, which would otherwise be lost. It should be recognized that expertise in pensions and investment, an understanding of financial markets and pension benefits provides significant advantages and support to the wider local authority. This would be lost under a formal restructuring proposal but could be retained under a collaboration model. This point is linked strongly to concerns over key person risk should restructuring occur allowing the retention of local experience to advise local councillors and board members appropriately.

Question 3: Pool investments between the 11 funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***What impact do you think pooling investments between funds would have on the cost of investing?***

Pooling of investments would require significant restructuring of LGPS investment mandates at significant cost. The study undertaken by Mercers does not support the view that larger fund always have lower costs and perform better based on their snapshot analysis of the LGPS 2015 accounts.

- ***What would be the positive impacts?***

There could be a positive impact on some of the smaller funds fee costs from investment pooling. The larger funds e.g. Strathclyde are unlikely to see much if any benefit due to their existing scale. Reducing costs is important but will only deliver benefit if it improves net investment returns.

- ***What would be the negative impacts?***

The drive to reduce costs may lead to a reduction in the number of fund managers willing and able to engage with the LPGS. One effect of pooling on passive investments in E&W is that fees have been reduced to the level where there are now fewer larger players left in the market. Gains made may however be eroded over time by the as the few remaining firms exert their dominant market position .

Pooling may provide fee costs benefits in the short term but these are also likely to be offset by transition and reorganization costs.

The drive to the bottom in terms of fees may lead to the risk that any short term fee gains made through market competition may not be sustainable in the longer term - which could see reversal of the current position and fees increasing.

The LGPS in Scotland is already able to access comparatively low investment fees when compared to England and Wales as set out in Mercers structure review paper. **If asset pooling were possible, under what circumstances should a fund consider joining an asset pool?**

Pooling should only be undertaken if it provides significant advantages to the fund. These advantages will differ depending on the circumstances of each fund. The performance of the SBPF make it difficult to envisaged what the additional benefits of pooling would be.

- ***Under which circumstances should the SLGPS consider directing funds to pool?***

SBPF is strongly opposed to any proposal that would force pooling on anything other than a voluntary basis The only circumstances where this should be considered is if there was sustained evidence of governance failures at a local level or evidence that funds were completely unable to meet their long term liabilities on an actuarial basis.

b) Governance:

- ***What impact do you think pooling investments between funds would have on governance?***

Pooling is likely to a require additional governance and administrative structures to be established.

- ***What would be the positive impacts?***

  There is as yet no evidence that pooling has had a positive impact in England and Wales.

- ***What would be the negative impacts?***

This option may require additional layers of governance, lessen local involvement in investment decisions and make decision making more remote.

c) Operating risks:

- ***What impact do you think pooling investments between funds would have on***

operating risks?

There is likely to be little impact on operating risks arising from pooling. Day to day investment would continue to be carried out by line managers.

- ***What would be the positive impacts?***

  SBCPF can not envisage any positive impact on operating risks from pooling.

- ***What would be the negative impacts?***

Pooling will in all likelihood lessen the number of fund managers in the LGPS concentrating investments with fewer firms, reducing diversification and arguably increasing risk.

d) Infrastructure:

- ***What impact do you think pooling investments between funds would have on funds' ability to invest in infrastructure?***

Decisions to invest in infrastructure are only taken where these provide additional benefit to a pension fund for example greater diversification. Pooling is unlikely to have any material impact on a pension funds appetite to invest in infrastructure. Strathclyde. Lothian, Fife, Falkirk and Scottish Borders already invest in infrastructure.

- ***What would be the positive impacts?***

None

- ***What would be the negative impacts?***

None

Do you have any additional comments about this option?

Yes. There are significant risks associated with this option and a lack of tangible data to support it.

Pooling will introduce an added layer of bureaucracy. Staff would be required to run the new pools at potentially significant cost if staffing arrangements and grades sit out with LGPS pay structures.

There is no evidence yet that the pooling arrangements in England and Wales have delivered any cost benefits or improvements in governance. The costs of pooling may be significant and will require substantial professional advice from pension fund managers, investment consultants and actuaries

Tangible evidence is scarce; however, anecdotal evidence of pooling so far seems to indicate that the process has been problematic with concerns over loss of local accountability and governance.

The drive to establish larger pools may perversely have the effect of increasing fee costs in the longer term as fewer remaining providers are able to exercise their market dominance to increase fees with little risk of losing business.

The timing of the financial transitions required to establish pools may be problematic if disinvestments are executed at a time when markets are volatile. This will introduce risk and unnecessary cost.

Increasing cost may perversely cause pools to invest in higher risk, higher yield assets to recover the ground lost through timing losses and to recover reorg/ transition costs.

Pooling would result in a dilution of local expertise and knowledge potentially increasing risk to the smaller councils where staff often performs a wider role with respect to the financial management of the authority.

Pooling may thereby reduce opportunities for elected members to access financial advice and reduce expertise at a local level.

Pooling will not promote collaboration and expertise across the wider funds' activities.

Pooling of investment will offer no advantages for pension fund administration.

It is concerning that the evidence base used for pooling in England and Wales is so selective, out of date and unrelated to UK LGPS fund performance.

Question 4: Merge the funds into one or more new funds

The text can wrap onto additional pages.

a) Cost of investing:

- ***What impact do you think mergers between funds would have on the cost of investing?***

Merger would require significant restructuring of LGPS investment mandates at significant cost. The study undertaken by Mercers does not support the view that larger fund always have lower costs and perform better based on their snapshot analysis of the LGPS 2015 accounts.

Both investment advisors and investment managers have noted that the effects of pooling in England and Wales are already providing benefits for the Scottish LGPS through lower fees while to date the costs of restructure have been avoided.

- ***What would be the positive impacts?***

Larger funds tend to be able to access cheaper fees due to scale. These may benefit the smaller funds who manage a minority of LGPS assets.

- ***What would be the negative impacts?***

  The consultation document notes significant cost savings as a potential advantage of this option. There is however as yet little UK and clearly no Scottish evidence to support this assertion The larger funds that already enjoy these benefits of scale are unlikely to see any benefits in terms of cost reduction as they already access the cheapest fees.

Proposal is untried and the risks of merger are not fully understood. This feels like a step in the dark for unquantified benefits

- ***If merging were possible, under what circumstances should a fund consider a merger?***

  Forced merger could require primary legislation.

- ***Under what circumstances should the SLGPS consider directing funds to merge?***

Significant evidence of governance failures or the inability to meet future liabilities following a deficit recovery period agreed with the fund actuary.

b) Governance:

- ***What impact do you think mergers between funds would have on governance****?*

It would have a significant impact on local governance for those councils who currently operate a fund.

A merged model with one governance structure would be cheaper to administer

- ***What would be the negative impacts?***

This would effectively remove a local service from local control. Recent examples of merger in other services at national level have proved to be controversial and problematic with a lack of clarity regarding the realisation of the original objectives.

c) Operating risks:

- ***What impact do you think mergers between funds would have on operating risks?***

It is not clear what effect this option would have on funding levels, which could potentially change for individual employers under a fully merged structure.

- ***What would be the positive impacts?***

  This option would eliminate key person risk for smaller pension funds.

- ***What would be the negative impacts?***

This option would however increase pressure on remaining council staff and as TUPE would be required reduce capacity at local level.

d) Infrastructure:

- ***What impact do you think mergers between funds would have on funds' ability to invest in infrastructure?***

It is unclear how merger would assist with the process of investment in infrastructure. If such investment is identified as being the correct course of action for funds as part of their strategy this should be pursued. A number of pension funds are already investing I infrastructure. Collaboration without restructure provides an equally valid route to access infrastructure at potentially much lower cost.

- ***What would be the positive impacts?***

A larger fund may have more appetite for alternative infrastructure investments.

- ***What would be the negative impacts?***

There is a danger that merger is seen as providing a solution to a political aspiration. Potential Investment in infrastructure should not be seen as a driver for this option.

See below

e) Do you have any additional comments about this option?

New governance arrangements would be required and this would incur additional costs during transition.

The move to formal restructure would lessen links to local decision making for example with regard to investment strategy and asset allocation, removing a key role for elected members in the governance of pension funds.

The effect on employer contributions is not known. It should be noted however that some of the smaller funds have the lowest contribution rates at present indicating a high degree of efficiency in terms of cost and investment returns. The funds in rural areas in SBCPF also have the some of the highest longevity for fund members.

The effect of any merger on Fund diversification is not known. There is a risk that investment in assets with higher risk profiles over many years may be required to compensate for the costs of merger.

Full Merger is likely to require expensive restructuring. There is no evidence that restructuring in England and Wales has, or will, deliver tangible benefits when compared to previous arrangements.

Any move to restructure the current LGPS must be based on sound empirical evidence and must deliver tangible improvement for both large and smaller funds when compared to the current structure.

The process of merger may unsettle the membership of the LGSP encouraging transfers out of the fund and discouraging new entrants.

Question 5: Preferred and additional options

The text can wrap onto additional pages.

a) Which option does your organisation prefer? Please explain your preference.

The Fund believes that there is no reliable empirical case for change and much more work would have to be done to evaluate the benefits and risks associated with change before options involving pooling or merger could be supported as being in the best interests of the fund membership.

In the absence of evidence to the contrary the SBCPF is of the view that such change is likely to have a detrimental impact on performance and pensioner confidence and for this reason believes option 1 should be considered. However SBCPF believes increased collaboration (option 2) could achieve a number of positive benefits whilst the options and results of the E&W changes undergo a proper evaluation of the evidence before any change is undertaken. This would avoid the need for pooling or expensive, time consuming and un-proven structural reform.

b) What other options should be considered for the future structure of the LGPS?

There are no other options SBCPF identify should be considered.

c) What would be the advantages and disadvantages of these other option for funds' investment costs, governance, operating risks and ability to invest in infrastructure?

N/A

d) Are there any other comments you would like to make?

No

The consultation questions end.

RISK REGISTER UPDATE

Report by Chief Financial Officer

JOINT MEETING OF PENSION FUND COMMITTEE AND PENSION BOARD

7 March 2019

1 PURPOSE AND SUMMARY

1.1 **This report forms part of the risk review requirements and provides the Members of the Pension Fund Committee and Pension Board with an update of the progress of the actions taken by management to mitigate these risks, a review of any new risks and highlights changes to any of the risks contained in the risk register.**

1.2 Identifying and managing risk is a corner stone of effective management and is required under the Council's Risk Management Policy and process guide and CIPFA's guidance "Delivering Governance in Local Government Framework 2007". It is further reflected and enhanced in the "Local Government Pension Scheme" published by CIPFA.

1.3 A full risk review was undertaken on 1 May 2018 and the revised risk register was approved by the Joint Pension Fund Committee and Pension Fund Board on 14 June 2018 with an update of the actions undertaken on 30 November 2018.

1.4 Appendix 1 details the risks within the approved risk register which have been identified management, actions and the progress of these actions to date.

2 RECOMMENDATIONS

2.1 **It is recommended that the Committee and Board:**

(a) Note the progress with the management actions contained in Appendix 1;

(b) Notes no new quantifiable risks have been identified since the last review; and

(c) Agrees to a full review being undertaken in June 2019.

3 BACKGROUND

3.1 Identifying and managing risk is a corner stone of effective management and is required under the CIPFA guidance "Delivering Governance in Local Government Framework 2007" and in the "Local Government Pension Scheme" published by CIPFA.

3.2 The Risk Register has been developed in line with the Council's approach to risk management as set out in the "Risk Management process guide" and assesses risks using a risk score based on likelihood and impact. It has been further refined to reflect best practice "Managing Risk in the Local Government Pension Scheme" also published by CIPFA.

3.3 The Pension Fund's Business Plan 2018/19 – 2020/21 was approved on 14 June 2018, setting out the aims and objectives of the Pension Fund. These aims and objectives are recognised in the formation and approval of the Pension Funds risk register.

3.4 The Council's revised Risk Management process guide uses the following risk scoring:

Level of risk	Risk score
RED	High –Risk Score Range 15-25
AMBER	Medium – Risk Score Range 6 – 12
GREEN	Low – Risk Score Range 1 - 5

3.5 To comply with the Council's revised policy of risk management and best practice, a Risk Management reporting cycle was developed around the performance and business plan reporting of the Pension Fund. As a result the following cycle of reporting was adopted:

Quarterly
- Quarterly Investment Performance Report;
- Key risks, escalation of any risks that are perceived to have changed adversely and any new risks need to be considered by the Committee;
- Update on progress of risk management action delivery.

Bi-Annually
- Mid-Year Progress report on Business Plan Actions;
- Key risks, escalation of any risks that are perceived to have changed adversely and any new risks need to be considered by the Committee;
- Update on progress of risk management action delivery.

Annually
- Annual Governance Meeting with Annual Report and Policy/Strategy Performance Reports;
- Annual reporting on progress with Business Plan and approval of updated Business Plan;
- Annual reporting on progress with Risk Management Actions and approval of fully reviewed Risk Register including consideration of any new risks.

4 RISK REGISTER UPDATE

4.1 A full risk workshop was undertaken on 1 May 2018 by Officers in order to ensure that the risk register's contents were still relevant and up-to-date. The outcome of the workshop was then considered and approved at the Committee/Board meeting on 14 June 2018**.** The first update on the actions was reported to Committee/Board on 13 September.

4.2 The progress of the individual management actions identified in the current risk register is detailed in Appendix 1.

4.3 The actions undertaken in the quarter do not result in recommendations to change the risk scores.

4.4 No new risks have been identified during the period.

5 IMPLICATIONS

5.1 **Financial**

There are no direct financial implications of this report.

5.2 **Risk and Mitigations**

The purpose of providing the update to the Committee and Board is to improve the risk management framework for the Pension Fund and demonstrate that the Members of the Pension Fund Committee and the Pension Board understand the risks faced and how it is proposed to manage, mitigate or tolerate these risks. The Additional Proposed Actions as contained in Appendix 1 are designed to directly enhance the management of risks.

5.3 **Equalities**

It is anticipated that there are no adverse impact due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

5.4 **Acting Sustainably**

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 **Carbon Management**

There are no direct carbon emissions impacts as a result of this report.

5.6 **Rural Proofing**

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 **Changes to Scheme of Administration or Scheme of Delegation**

No Changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report

6 CONSULTATION

6.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Service Director HR and the Clerk to the Council have been consulted and their comments have been included in the report.

Approved by

David Robertson **Signature ....**
Chief Financial Officer

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

Background Papers:
Previous Minute Reference: Pension Fund Committee and Pension Board 30 November 2018

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Pension & Investment Team can also give information on other language translations as well as providing additional copies.

Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166. email: t&cteam@scotborders.gov.uk

APPENDIX 1

Pension Fund - Full Risk Register

No.	Category	Risk	Risk Factor/Cause	Effect/Consequences	Proximity	Risk Owner	Controls: Current Controls	Controls: Control Assessment	Current Risk: Impact	Current Risk: Likelihood	Current Risk: Score	Progress: Actions as at 08/03/2018
1.1	Asset & Investment	Failure to achieve the target investment returns set out in the Statement of Investment Principles over the longer term may lead to significant increased employer contribution rates and costs of implementing changes to the investment strategy.	Inappropriate strategic asset allocation for Fund's requirements; Inappropriate investment approaches within asset class; Underperformance/ negative investment returns from investments under management; Significant and sustained market and economic events creating adverse movements in valuations; Investment Strategy inconsistent with Funding Strategy.	Significant rises in the employer contributions; Costs involved in implementing changes to investment strategy; Funding Deficit for Fund.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Continual monitoring of investment performance; Engagement with Investment Adviser to update investment strategies and periodic review of strategic asset allocation; Scrutiny of Investment Manager performance by Investment & Performance Sub-Committee; Actuary reports included element of prudence. TREAT Additional Actions Proposed: Enhance officer role in monitoring of investment returns to enable more timely action to be taken. Encourage more thorough challenge of Advisers and Fund Managers.	Effective	4	3	12	Training requirements being actioned as part of Training plan to ensure have required skills and knowledge to enable challenge. Meeting scheduled for 19th March to finalising performance monitoring and accounting reporting from Custodian.
1.4	Asset & Investment	Failure to take expert advice or risk of poor investment/actuarial advice may lead to the Fund's assets not being properly managed resulting in inappropriate investment decisions and poor returns and/or insufficient funding levels	Committee ignores advice provided by expert adviser; External adviser provides inappropriate/inaccurate/ insufficient advice to Committee/Officers.	Wrong or inappropriate decisions resulting in inadequate investment returns and/or insufficient funding levels potentially increasing employers contribution rates.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Robust procurement processes around the recruitment and appointment process; Investment Adviser in place and performance reviewed annually Benchmark performance against other LAs; Regular benchmarking and cross verification of advice with other LAs through Local Govt. Pension Scheme(Scotland) Investment & Governance Group; Other info sources and discussions with non-Fund investment managers/advisers to validate advice and performance of Fund; Pension Fund Board provides scrutiny role TREAT Ongoing training for elected members of the Pension Board and Committee	Effective	4	2	8	Training requirements being actioned as part of Training plan to ensure have required skills and knowledge to enable challenge.
1.9	Asset & Investment	Investment Strategy is inconsistent with Funding Strategy may lead to the fund not being managed properly through setting employer contribution rates incorrectly resulting in the future liabilities of the Fund not being able to be covered by its assets and requiring employers to increase contribution rates to address any funding gap.	Investment Strategy for Fund set without appropriate consideration of the requirements of the Funding Strategy	future liabilities of the Fund not being able to be covered by its assets; Employers increase contribution rates to address any funding gap.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Full actuarial valuation undertaken on Triennial basis. Funding Strategy Statement and Statement of Investment Principles updated and approved at the same time. As part of this assess requirement for Investment strategy to be reviewed and updated accordingly. TREAT Additional Actions Proposed: Undertake a full investment strategy review following 2017 valuation.	Effective	2	2	4	Revised investment strategy approved on 13 September 2018. Implementation being actioned.
2.2	Employer	Adoption of either an inappropriately slow or rapid pace of funding rates for different employers may result in improper management of the Fund and result in inappropriate employer contribution rates and a possible shortfall in assets to cover the employer's liabilities.	Failure by employer to notify the fund of significant changes of membership.	Improper management of the Fund; Inappropriate employer contribution rates and a possible shortfall in assets to cover the employer's liabilities.	Ongoing	Pension Fund Committee/ Chief Financial Officer	Full actuarial valuation undertaken on Triennial basis, 2017 valuation completed; Review Pooling arrangements at each Valuation and implement appropriate de-pooling e.g. SBHA & CGI to reflect employer situations; Annual declaration made by each Employer for forth coming changes Ensure full reporting of options are presented to the Committee and Board when employer circumstances change to ensure decision making fully informed. TREAT Undertake next valuation for 2020	Effective	2	2	4	Hymans Robertson appointed as Actuary, initial meeting held and information transferred from Barnett Waddingham

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APPENDIX 1

Pension Fund - Full Risk Register

No.	Category	Risk	Risk Factor/Cause	Effect/Consequences	Proximity	Risk Owner	Controls: Current Controls	Controls: Control Assessment	Current Risk: Impact	Current Risk: Likelihood	Current Risk: Score	Progress: Actions as at 08/03/2018
3.5	Resources & skills	Failure of Officers to maintain sufficient level of competence to discharge their duties could lead to failure to manage the Fund effectively as a result of their inability to provide appropriate decision making support and advice.	Changes in legislation; New investment types and vehicles; Lack of documented procedures.	Failure to manage the Fund effectively.	Ongoing	Chief Financial Officer/ Service Director of HR	Use of External Advisers provides additional resilience and resources; PRD process implemented to identified training and development requirements; Active participation in Scottish Investments and Governance Group (IGG) and Scottish Pensions Liaison Group; Produce notes completed Regular engagement with external Investment Managers to supplement knowledge. TREAT Additional Action Proposed: Improvement in quality of procedure notes for officers.	Partially Effective	2	3	6	Procedural notes being implemented for Business World processes. Wider process reviews are being processed by Admin.
4.3	Liquidity	Significant differences between Actuarial Assumptions in the Triennial Valuation Reports and reality may lead to setting Funding and Investment Strategies which may result in insufficient cashflow to fund current obligations or insufficient funding to cover future liabilities	CPI inflation; Mortality levels; Investment Returns.	Setting Funding and Investment Strategies; Insufficient cashflow to fund current obligations or insufficient funding to cover future liabilities; Increased employer contributions.	Ongoing	Chief Financial Officer	Full actuarial valuation undertaken on Triennial basis; Detailed dialogue with Actuary ahead of valuation to agree evidence based assumptions to be used; Regular information provided by Actuary on differences as they occur from assumptions. Any strain on fund incurred paid by employer at point of retirement; Regular monitoring of investment performance and where medium to long term trend in returns is identified then this will be reviewed. TREAT Additional Actions Proposed - undertake market testing of Actuarial services	Effective	2	3	6	Tender process completed and recommendation to appoint Hymans Robertson approved at Committee on 30 November. Appointment letter issued
4.6	Liquidity	Failure to manage the liquidity required for the Fund's cashflows may lead to assets being sold at unattractive times or investment opportunities missed due to unavailability of cash, resulting in an adverse impact on the valuation of the Fund's assets.	Higher than anticipated levels of retirement; Higher levels of lump sums commutation taken on retirement.	Requirement to divest investment assets at an unattractive time or missing investment opportunities which result in an adverse impact on the value of the Fund's assets	Ongoing	Capital & Investments Manager	Daily and weekly monitoring of Pension Fund's Cashflows; Estimated monthly cash shortfall identified TREAT Additional Actions Proposed: Improve quality of medium term cashflow forecasting for the Fund; Asset allocation review to review cash flow projections requirements;	Partially Effective	2	2	4	Dividends from Infrastructure, Private Credit and Long Lease property now being paid rather than reinvested. Currently reviewing position with UBS property and M&G to fully fund the cashflow gap.
5.4	Administrative	Failure to prevent fraud or misappropriation by scheme member, employee or scheme employer within the Fund may lead to loss of funds.	Lack of monitoring; Lack of segregation of duties.	Inability to provide a high quality pension service to members; Financial loss to the Fund; Impact on benefits paid to members.	Ongoing	HR Shared Services Manager	Robust segregation of duties and other internal controls to mitigate against this risk; Immediate action taken upon discovery of fraud; Internal & External Audit programme also picks up the monitoring of this risk. TREAT Additional actions proposed - to request from each External Employers audited accounts to provide assurance on their internal controls	Effective	2	2	4	Annual assurance review requests issued to all managers. Returns due to be completed by 31 March.

APPENDIX 1

Pension Fund - Full Risk Register

No.	Category	Risk	Risk Factor/Cause	Effect/Consequences	Proximity	Risk Owner	Controls: Current Controls	Controls: Control Assessment	Current Risk: Impact	Current Risk: Likelihood	Current Risk: Score	Progress: Actions as at 08/03/2018
6.2	Regulatory & Compliance	Changes in legislation and other regulatory frameworks may impact adversely on the Fund in terms of funding levels and governance structures	Central Govt. legislation changes.	Loss of independence in the management of the Fund; Impact on Fund value and benefits; Increased costs to the Fund, employer contributions; Potential loss of active scheme members.	Ongoing	Chief Financial Officer/ Service Director of HR	Participation in active CIPFA and Scottish Pension network allow changes and impacts to be identified quickly; Involvement with COSLA discussions on Pensions; Monitoring and highlighting actions and decisions from scheme advisory board; TREAT Additional Actions Proposed: Seek to input into any of the legislative change through active membership of COSLA;	Partially Effective	4	4	16	Responding to all consultations and participating in all national groups. Chief Financial Officer active member of Director of Finance group. Monitoring Scheme Advisory Board web site on monthly basis
6.5	Regulatory & Compliance	Changes in LGPS Structures	Review by Scheme Advisory Board on LGPS structures	Fund may cease to exist, assets may be pooled, Administration could pooled	Ongoing	Chief Financial Officer	Monitoring of political position via Scheme Advisory Board TREAT Additional actions proposed - Actively engage with Scheme Advisory Board and consultants undertaking review	Partially Effective	3	4	12	Consultation responses from Pension Fund Committee and Pension Fund Board submitted by 7th December 2018
7.3	Reputation	Failure to appoint relevant advisers and review their performance may lead to inappropriate management of the Fund resulting from poor advice to decision makers	Lack of capacity of Officers to monitor.	Failure to achieve Pension Fund objectives; Inappropriate management of the Fund resulting from poor advice to decision makers; Legal challenge	Ongoing	Chief Financial Officer/ Service Director of HR	Identify requirements of external advisers and appoint appropriately. Annual review undertaken with Investment Advisor and Custodian. TREAT Additional Actions proposed: Implement annual review of Advisers;	Effective	2	2	4	Annual review held with Custodian on 5th October and Investment Manager on 13 November
7.6	Reputation	Pension Fund does not fulfil its fiduciary duties with appropriate regard with its ESG responsibilities	Lack of skills & knowledge Lack of information from Managers Lack of clear policy	Failure to manage the Pension Fund properly; Financial loss; Reputation damage.	Ongoing	Chief Financial Officer	Training provided to Members and Officers on their roles and fiduciary responsibility; Monitoring on quarterly basis of Segregated Portfolios voting Policy contained with Statement of Investment Principles including support for UNPRI TREAT Additional Actions Proposed review of ESG policy and future monitoring arrangements	Partially Effective	2	2	4	Revised Policy approved at Committee on 30 November. Policy published on Web site and initial monitoring report to be present to Committee in June.

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PENSION FUND BUDGET MONITORING TO 31 DECEMBER 2018 AND BUDGET 2019/20

Report by Chief Financial Officer

JOINT PENSION FUND COMMITTEE AND PENSION FUND BOARD

7 March 2019

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1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to provide the Pension Fund Committee and Pension Fund Board with an update position of the Pension Fund budget to 31 December 2018 including proposed budget for 2019/20.**

1.2 The Local Government Pension Scheme (Scotland) Regulation 2014 requires Administering Authorities to ensure strong governance arrangements and sets out the standards they are to be measured against.

1.3 To ensure the Fund meets the standards a budget was approved on 14 June 2018 following the standard presentation recommended by the CIPFA accounting guidelines. This report is the third quarterly monitoring report of the approved budget.

1.4 The total expenditure to 31 December 2018 is £0.82m with a projected total expenditure of £6.409m against a budget of £6.401. The projected overspend is a result of the Data Quality check required per The Pension Regulator.

1.5 The budget of £6.402m is proposed for 2019/20 reflecting the revised asset allocation approved in September 2018 and allows for the implementation of Members Self Service portal.

2 RECOMMENDATIONS

2.1 It is recommended that the Pension Fund Committee:-

(a) Notes the actual expenditure to 31 December 2018 and

(b) Agrees the proposed budget for 2019/20.

3 BACKGROUND

3.1 The Local Government Pension Scheme (Scotland) Regulation 2014 require Administering Authorities to ensure strong governance arrangements and sets out the standards they are to be measured against. The Fund is required to report compliance with these standards within its Annual Report. To demonstrate full compliance requires the setting and monitoring of a budget for the Fund.

3.2 The 2018/19 budget was approved at the Joint Pension Fund Committee and Pension Fund Board meeting on 14 June 2018. The approved budget follows the Local Government Pension Scheme management costs guidance issued by CIPFA into the following 3 categories.

Category	**Costs included**
Investment Management	All expenses incurred in relation to management of pension fund assets. Including costs invoiced direct and fees deducted from fund assets. Custody and performance fees also included
Administration	Costs incurred in administration of the fund including staff, IT costs and associated overheads, benefits consultants.
Oversight and governance	Costs incurred in the selection & appointment of managers, audit fees, investment advisory services, tax advisory, accounting services, banking service and support to the pensions committee and board.

3.3 There has been growing pressure to improve the level of transparency of fees for investors. The Scheme Advisory Board for England and Wales has also been working on this area and has produced a Code of Transparency which the Scheme Advisory Board Scotland has recommended funds adopt the code. Scottish Borders Pension Fund has, for the last few years, been disclosing both fees paid direct and fees deducted at source. This code requires the Fund to also show any additional lower level transaction costs previously not shown as this data has not previously been available from investment managers.

3.4 In November 2018 the Cost Transparency Initiative (CTI) was launched and became the organisation taking forward the work of the previous working group. They have launched a pilot to test the templates with a number of Managers.

4 MONITORING TO 31 DECEMBER 2018

4.1 The table below shows the actual expenditure to 31 December 2018 and proposed budget for 2019/20.

	Actual Expend to 31 Dec 18 £000's	2018/19 Projected Expend £000's	2018/19 Budget £000's	2017/18 Variance £000's	2019/20 Proposed Budget £000's
Investment Management Fees	586	5,792	5,792	0	5,750
Administration	199	376	368	8	390
Oversight & Governance	35	241	241	0	262
Total	**820**	**6,409**	**6,401**	**8**	**6,402**

4.2 Investment Management fees are charged on a quarterly basis in arrears based on the value of assets held on a quarterly basis. The third quarter investment management fees are not therefore included in the expenditure to 31 December 2018 totals.

4.3 The proposed budget for 2019/20 reflects the revised strategic asset allocation approved at the Joint meeting on 13 September. The implementation of this will have an impact on investment fees as the funds are transferred. The impact on fees will be assessed and reviewed as part of the ongoing monitoring to Committee. The small reduction in the projected fees is based on a reduction in transaction fees as the fund reduces its exposure from active equities to more illiquid assets per the asset strategy.

4.4 Due to the increasing complexity of the fund and its investment a one off allowance has been included within the fees for a review of taxation positon of fund. This will ensure the fund is fully maximizing it's tax reclaims which have a direct impact upon the overall performance of the fund's investment returns.

4.5 The projected overspend of £8k for Administration represents the one off costs for the data quality check required by The Pension Regulator.

4.6 The proposed budget for Administration includes an allowance of £69k for the implementation and additional support costs of Member Self Services which has been identified in the Pension Fund Business Plan. A full Business case and project plan will be presented to the Committee in September 2019.

4.7 The proposed budget for Oversight and Governance reflects assumptions for pay awards and increased costs of performance monitoring due to the increased number of fund managers.

5 IMPLICATIONS

5.1 Financial

There are not costs attached to any of the recommendations contained in this report.

5.2 Risk and Mitigations

This report is part of the governance framework to manager the operation of the Pension Fund and reflects the compliance with the best practice recommendations. Risk are managed in line with the Corporate Risk Management framework, with risks and controls monitored and reported on a quarterly basis.

5.3 Equalities

It is anticipated that there are no adverse impact due to race, disability, gender, age, sexual orientation or religion/belief arising from the proposals in this report.

5.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 Carbon Management

There are no direct carbon emissions impacts as a result of this report.

5.6 Rural Proofing

It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 Changes to Scheme of Administration or Scheme of Delegation

There are not changes to the Scheme of Administration or the Scheme of Delegation required as a result of this report.

6 CONSULTATION

6.1 The Monitoring Officer, the Chief Legal Officer, the Chief Officer Audit and Risk, the Service Director HR and the Clerk to the Council have been consulted and their comments have been included in the report.

Approved by

David Robertson
Chief Financial Officer **Signature ....**

Author(s)

Name	Designation and Contact Number
Kirsty Robb	Pension & Investment Manager, 01835 825249

Background Papers:
Previous Minute Reference: Joint Pension Fund Committee and Pension Fund Board 30 November 2018

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Pension and Investment

Team can also give information on other language translations as well as providing additional copies.

Contact us at Contact us at: Pension & Investment Team, Council Headquarters, Newtown St Boswells, Melrose, TD6 OSA Tel: 01835 825249 Fax 01835 825166. email: treasuryteam@scotborders.gov.uk

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Scottish Borders COUNCIL

INFORMATION UPDATE

Briefing Paper by Chief Financial Officer

PENSION FUND COMMITTEE & PENSION BOARD

7 March 2019

1 PURPOSE AND SUMMARY

1.1 **This briefing paper is to provide members of the Committee and the Board with an update on a number of areas which are being monitored and areas where work is progressing. Full reports on the individual areas will be tabled as decisions and actions are required.**

2 GMP RECONCILATON

2.1 Stage 2 of the GMP Reconciliation is progressing by ITM Limited on behalf of Scottish Borders Council. This stage of the project is the reconciliation of discrepancies between HMRC and Scottish Borders Council pension records for Active or Deferred members and Pensioners.

2.2 Scottish Borders Council received the latest report from ITM on 22 February 2019 and these are summarised below:-

43%	Percentage of fund members have been reconciled
45%	Percentage of fund members who are out with the scope for reconciliation. Generally members who have no liability under the scheme having either pre 6 April 1978 service only or only post 5 April 2016 service.
12%	Percentage of fund members who are still unreconciled. These are awaiting data from HMRC or further investigation is required by gathering historic payroll details
100%	

2.3 As at 22 February 2019 a total of 50% of the discrepancies are showing on HRMC but not on SBC records. SBC are currently reviewing these members and the majority of them are showing as Teachers rather than LGPS members. More work is required to be carried out on these members and report back to ITM to have HMRC records amended.

Scottish Borders Council continue to receive monthly updates on the progress of the GMP Reconciliation exercise from ITM Limited. A meeting has been arranged for 6 March 2019 for a further update on the progress of the project.

3 PENSION REGULATOR SCHEME RETURN – DATA SCORING

3.1 A telephone conference was recently held between Aquila Heywood and Scottish Borders Council to discuss the results. SBC were informed that they were in the Top 5 of Aquila Heywood customers in the UK for the quality of their data.

3.2 Work has been carried out in the areas where the score was the poorest:-

Common Data – 51.7% - Postcode fields – the postcodes have now been populated in the postcode field and all template letters have been amended in accordance with Heywood to ensure that there are no blank fields between the last address line and the postcode field.

Scheme Specific Data – Total Contributions – a report has been processed to update the bulk contributions posting.

3.3 The formal rectification plan has not been finalised as work has been carried out rectifying the issues reported on the Data Scoring. It is hoped that the rectification plan can be ready for the June 2019 meeting.

4 ANNUAL EMPLOYERS MEETING

4.1 The Annual Employers Meeting has been arranged for 12 March 2019

5 SCHEME ADVISORY BOARD

5.1 The Scheme Advisory Board (SAB) met on 12th February 20198. The agenda contained the following items

- SAB work plan
- Structure Review consultation
- Annual report working group
- Draft Annual Report
- Equal Pay and Pensions
- Transparency Code
- Governance Review – Training & Communication
- SPPA update
- Financial report

5.2 Appendix 1 contains the SAB published summary of the meeting.

6 TRAINING OPPORTUNTIES

6.1 The next training event to be organised by the Scottish Officers group has been scheduled for 3rd September 2019 at COSLA. Agenda items are currently being developed.

6.2 Baillie Gifford will be holding their Local Authority Training & Seminar event of 9-10 October 2019 in Edinburgh. The fund will be limited to 6 places for the event. The agenda will be circulated nearer the time and names of interested parties taken.

Author(s)

Name	Designation and Contact Number
Kirsty Robb Anthea Green	Pension & Investment Manager, 01835 825249 HR Shared Services Team Leader, 01835 826722

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Trade Union Side Secretary
Simon Watson
UNISON
Grampian Resource Centre
7, Alford Place
Aberdeen AB10 1YD
Tel: 01224 620624
s.watson@unison.co.uk

Employers Side Secretaries
Jonathan Sharma / Kathy Cameron
COSLA
Verity House,
19, Haymarket Yards,
Edinburgh EH12 5BH
Tel 0131 474 9269
jonathan@cosla.gov.uk
kathy@cosla.gov.uk

February 2019

BULLETIN

Structures Consultation

The SAB received an update on the progress of the structures consultation. By the time it closed in December, there was a high response with a broad spread of views. Certain areas were identified where respondents held conflicting views of the underlying facts, and additional analysis is being undertaken to help clarify this and enable the board to determine a set of recommendations. A number of other areas of broad agreement by respondents were also noted. The final report will go to the next SAB for approval.

Transparency Code

The SAB has formally joined a new online system for collecting and analysing investment fees and costs charged by investment managers, due to launch in April 2019. Stage one is a process to collect and validate data, and giving users guidance on using the system. Stage two will analyse the data, and a final stage will automate the process. The SAB will contact boards with more information in the near future.

SLGPS scheme Cost Cap

Some “transitionary protections” for members of the Judges’ and Firefighters’ pensions schemes are discriminatory on grounds of age, according to the Court of Appeal. The UK Government has asked to appeal to the Supreme Court, but meanwhile has halted the valuations of all public sector pension schemes because the outcome may mean additional costs to the schemes. So the current analysis of whether the ”Cost Cap” for the SLGPS had been breached, which was expected in mid-2019, is now on hold.

Training

The SAB discussed how to ensure that Pension Board members, and SAB members, understood what training was necessary and also desirable for them to fulfill their roles. Most Boards have a training programme for members, but there is significant variation in what training members have actually had. The joint-secretaries will progress this and report back to the next meeting.

Pensions Developments

Recent developments related to pensions, including a new Single Guidance Finance Body for pensions and money; a critical Competition and Markets Authority report into investment consultancy; bad advice for those utilising “Pensions Freedoms”; climate friendly investments by the Merseyside Pension Fund; WASPI women winning the right to a Judicial Review and a consultation (in England) about enhanced rights for council workers to stay in the LGPS if they are outsourced.

Annual Report

The SAB agreed its annual, and an update format for next year.

Further details on our website www.lgpsab.scot.

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Local government in Scotland

Financial overview 2017/18

ACCOUNTS COMMISSION

Prepared by Audit Scotland
November 2018

The Accounts Commission

The Accounts Commission is the public spending watchdog for local government. We hold councils in Scotland to account and help them improve. We operate impartially and independently of councils and of the Scottish Government, and we meet and report in public.

We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

Our work includes:

- securing and acting upon the external audit of Scotland's councils and various joint boards and committees
- assessing the performance of councils in relation to Best Value and community planning
- carrying out national performance audits to help councils improve their services
- requiring councils to publish information to help the public assess their performance.

You can find out more about the work of the Accounts Commission on our website: www.audit-scotland.gov.uk/about-us/accounts-commission

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Links

PDF download

Web link

Information box

Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

These question mark icons appear throughout this report and represent questions for councillors.

Audit team

The core team consisted of: Carol Calder, Kathrine Sibbald, Ashleigh Madjitey, Ruth Azzam and David Docherty, with support from other colleagues and under the direction of Brian Howarth.

Key facts

£8.3 billion IJBs' spending in 2017/18

6.9 per cent Real terms reduction in Scottish Government revenue funding since 2013/14

£17.4 billion Council income 2017/18

£12.2 billion Council net spending on day-to-day services in 2017/18

£2.7 billion Council capital spending in 2017/18

£1.9 billion Councils' usable reserves (excluding Orkney and Shetland) at 31 March 2018

£6.6 billion Councils' share of the Local Government Pension Scheme deficit at 31 March 2018

£15.1 billion Councils' net debt (excluding Orkney and Shetland) at 31 March 2018

£2.4 billion Council budgets delegated to IJBs in 2017/18

Chair's introduction

Welcome to the Accounts Commission’s 2018 financial overview report for local government.

This report reflects a similar situation to last year as councils face an increasingly complex range of challenges and continuing pressure on finances. Challenges include increasing demand across many of the wide range of services councils deliver to local communities. Demand has to be met against tightening budgets in many service areas along with uncertainty stemming from external factors such as EU withdrawal.

One of the most significant issues for councils continues to be funding. In 2017/18, funding from the Scottish Government, councils’ main source of funding, again reduced in real terms. The reduction was largely offset by increases in council tax and councils’ fee income, with most councils applying the maximum three per cent increase to council tax. In total, the net effect of Scottish Government and council action was a reduction in funding of only 0.1 per cent in real terms although the impact on individual councils varied. In general, increased spending in education and social work was offset by reductions in other services. I would also note that the relationship of funding of individual councils to areas of deprivation remains unclear.

The forecast trend is for further reductions in funding from the Scottish Government in the medium term. Pressure therefore remains on councils to make further savings and find ways to meet service demand more efficiently and effectively. This will require difficult decisions and innovative thinking by councillors and senior management working together.

It is important that these decisions are taken in a planned and coordinated way. It is positive progress that almost all councils now have medium-term financial planning in place and some have made progress with long-term financial projections. I would encourage all councils to build on medium-term plans and develop suitable long-term financial planning. This supports consistency in financial decisions with corporate priorities and outcome aims, as well as supporting transformation initiatives. Councillors also need to be clear about the potential impact of planned savings or changes to fees and charges on the local community and economy as well as on achieving corporate objectives.

Last year, we highlighted the risk for some councils plans to use significant amounts of their reserves to manage funding gaps. I am pleased that this year, although overall reserves have continued to reduce, no council is using its reserves at a level that risks their financial sustainability in the next two to three years. We will continue to have an interest in how councils set their reserves policy and utilise reserves as funding pressures continue in the coming years.

The Commission recognises that one of the other most significant challenges for councils are financial issues associated with the Integration Joint Boards (IJBs). The majority of IJBs have underlying financial sustainability issues and without year-end support from the NHS and council partners, 20 out of the 30 IJBs would have reported deficits. In November 2018, we published a report on progress with *Health and social care integration*. This highlighted areas for improvement, including financial management and financial planning. The Commission will continue to keep a focus on IJBs and consider how best to monitor their progress in future.

Finally, we welcome that the audits of annual accounts from all 32 councils were signed off with no qualifications. This is testament to the hard work of council staff, especially those within the finance function, and of our auditors. We also note that again there has been some progress with the quality of reporting on financial matters. However, we encourage councils to continue to improve the transparency and clarity of financial information provided to councillors and the public.

I hope you find this overview useful and would welcome any feedback you may have.

Graham Sharp
Chair of Accounts Commission

Summary

Key messages

1 Councils depend on Scottish Government funding for a significant part of their income. Scottish Government revenue funding to councils reduced in 2017/18, in cash terms by 0.6 per cent (£0.06 billion) and in real terms, by 2.3 per cent (£0.22 billion). Council tax increases and increased fees and charges were used by councils to increase overall budgets by £0.3 billion (cash terms).

2 In 2017/18, councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves. Councils are under pressure to find different ways to fund and deliver services. In 2017/18, 24 councils increased council tax, whereas in 2018/19, all councils increased council tax.

3 Overall increases in spending in Education and Social Work were offset by reductions in other services.

4 Eighteen councils ended 2017/18 with lower levels of usable reserves than they had at the start of the year. Total usable reserves fell by £18 million, a relatively small amount.

5 Funding to the Integration Joint Boards (IJBs) increased in 2017/18 by three per cent in cash terms (1.4 per cent in real terms), including additional funding from the NHS. The majority of IJBs have underlying financial sustainability issues, with 20 incurring deficits or dependent on additional ('deficit') funding from their partners.

6 The financial outlook is for reductions in Scottish Government revenue funding to councils. This will mean continued and increasing financial pressures on council services, especially those that are not protected.

7 The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks.

councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves

About this report

1. This report provides a high-level independent analysis of the financial performance of councils during 2017/18 and their financial position at the end of that year. It also looks ahead and comments on the financial outlook for councils. It is one of two overview reports that the Accounts Commission publishes each year. The second report comments on the wider challenges and performance of councils. It will be published at the end of the financial year, in March 2019.

2. Our primary sources of information for the financial overview are councils' 2017/18 audited accounts, including management commentaries and the 2017/18 external annual audit reports for each council. We have supplemented this with data submitted by councils to the Scottish Government through local finance returns (LFRs) and Provisional Outturn and Budget Estimates (POBE). LFRs present spending information on a different basis from the spending information that councils record in their annual accounts. We do not audit data contained in the LFRs.

3. We refer to 'real-terms' changes in this report. This means we are showing financial information from past and future years at 2017/18 prices (and 2018/19 prices where 2018/19 comparisons are made), adjusted for inflation so that they are comparable. We also refer to figures in 'cash terms'. This means we are showing the actual cash or money paid or received.

4. Throughout the report, we identify examples of questions that councillors may wish to consider, to help with understanding their council's financial position and to scrutinise financial performance. The Accounts Commission encourages councillors to use an appropriate level of scepticism in scrutiny and ensure they receive sufficient information to answer their questions fully. The example questions are also available on our website in *Supplement 1: Scrutiny tool for councillors*.

5. Accompanying this report, and to facilitate insight and comparisons across the sector, we have provided additional financial information on our website. The information is based on councils' audited accounts. We hope this will be useful for senior council finance officers, their staff and other interested stakeholders. We will also publish a separate supplement on the Local Government Pensions Scheme (LGPS) in December 2018.

6. Orkney and Shetland have been excluded from some exhibits that show usable reserves and debt. This is because their values would make it difficult to see the relative positions of other councils. Most councils hold usable reserves of between seven and 36 per cent of their annual revenue, whereas Shetland's reserves were 260 per cent of its annual revenue and Orkney's 329 per cent of its annual revenue. These large reserves relate to oil, gas and harbour-related activities. Both Orkney and Shetland also have significant investments rather than borrowing, unlike other councils.

Part 1

Councils' budgets and spending in 2017/18

Key messages

1 Councils depend on Scottish Government funding for a significant part of their income. Scottish Government revenue funding to councils reduced by 2.3 per cent (£0.2 billion) in real terms in 2017/18, but council tax, grants to services and fees and charges increased, and overall budgets grew by £0.3 billion in cash terms.

2 Between 2013/14 and 2017/18, funding from the Scottish Government to local government decreased at a faster rate, 6.92 per cent, than the Scottish Government revenue budget at 1.65 per cent.

3 Distribution of funding from the Scottish Government is based mainly on population but could be more transparent to ensure clarity about how funding distribution reflects factors that drive demand and costs in councils.

4 In 2017/18, councils managed funding gaps of four per cent in their net expenditure budgets of £12 billion, mainly through savings and planned use of reserves. Their outturn at the year-end was better than budgeted.

5 Overall increases in spending in Education and Social Work were offset by reductions in other services

Council funding

The main source of councils' funding is the Scottish Government

7. Scottish councils get their annual funding and income from a range of sources (Exhibit 1, page 10). In 2017/18, these totalled £17.4 billion. The main source of funding is the Scottish Government, contributing 55 per cent. In 2017/18, the Scottish Government provided £9.65 billion (compared to £9.71 billion in 2016/17). Within this total, a relatively small element (two per cent, £211 million) is for specific policy areas, such as the Pupil Equity Fund, previously known as the Attainment Scotland Fund. This has increased from £91 million (one per cent) in 2016/17.

Scottish Government revenue funding to councils reduced by 2.3 per cent (£0.2 billion) in real terms in 2017/18

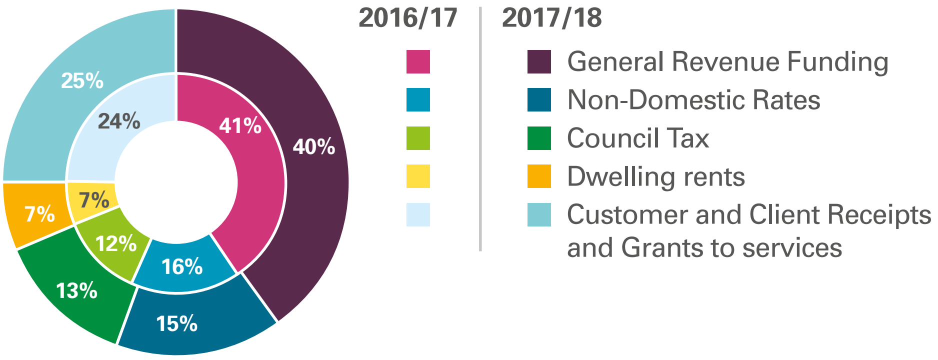
Although Scottish Government funding reduced, increases in council tax and charges increased the total amount available to councils to meet expenditure

8. Total income and funding of £17.4 billion is an increase from £17.1 billion in 2016/17. Reductions in Scottish Government funding of £57 million have been more than countered by increases in charges and grants to services, dwelling rents and council tax totalling £328 million. In total, this means that total income and funding is £271 million more in 2017/18 than 2016/17. Across Scotland in 2017/18, 13 per cent of income, £2.3 billion, was generated through council tax and 25 per cent, £4.3 billion, through fees, charges and grants credited to services.

Exhibit 1

Sources of council revenue income, 2017/18

Total funding and income to councils in 2017/18 was £17.4 billion.



Source: Finance Circulars and Audited Financial Statements

An element of Scottish Government 2017/18 funding was agreed late, limiting councils' ability to properly plan and agree their budgets

9. Provisional funding allocations for 2017/18 were issued to councils on 15 December 2016 and further increases were agreed and communicated to councils in a letter from the Finance Minister, on 2 February. The financial circular of 9 March 2017 confirmed these changes. The amount to be distributed to councils as revenue funding increased by £182 million (1.9 per cent). Councils agree their budgets at meetings during February and March. One council noted in its budget papers that 'In the last few days, (the Finance Minister) announced …change(s) on 2nd February, the day before the administration's budget proposals were due to be signed off'. Another council noted that a 'very late and material revision was made to the revenue grant settlement… present(ing) challenges in terms of configuring a balanced budget at short notice and ensuring value for money spending proposals'. Receiving significant changes at a late stage in the budgeting process limits the time available to councils to plan, discuss and agree budgets.

Scottish Government Revenue funding fell by 2.3 per cent in real terms in 2017/18

10. Exhibit 2 (page 11) shows that in 2017/18 the **total revenue funding** from the Scottish Government reduced by 0.6 per cent in cash and 2.3 per cent in real terms. Including additional funding of £34.5 million and health and social care funding via the NHS, Scottish Government funding was reduced by 0.8 per cent in real terms in 2017/18, compared to the previous year.

Total revenue funding:

This consists of general resource grants, specific revenue grants (together known as revenue grants), and Non-Domestic Rates income (NDR).

Total revenue funding does not include the additional £34.5 million added at Stage 1 of the Budget Bill to be paid in 2017/18 in respect of 2018/19. It also does not include health and social care funding paid to local government via the NHS.

Exhibit 2

Changes in Scottish Government funding in 2017/18

Scottish Government Revenue funding fell by 2.3 per cent in real terms in 2017/18.

	2016/17 £m	2017/18 £m	Cash %	Real %
Revenue Grant	6,939	6,985	0.7 ▲	-1.0 ▼
NDR	2,769	2,666	-3.7 ▼	-5.3 ▼
Total revenue funding	**9,708**	**9,651**	**-0.6 ▼**	**-2.3 ▼**
Further funding		35[1]		
Health & social care funding via NHS	250	357		
	9,958	**10,043**	**+0.9 ▲**	**-0.8 ▼**

Note: £34.5 million was added at Stage 1 of the Budget Bill to be paid in 2017/18 and 2018/19. Accounting standards meant that this was correctly treated as 2017/18 income by councils.

Source: Finance Circulars 1/2017 and 4/2018

11. In 2017/18, the Scottish Government paid an additional £107 million to NHS boards to assist with health and social care. This was used mostly to offset new living wage and sleepover costs of care workers in local government.

Local government funding has reduced at a faster rate than other areas of the Scottish public sector

12. In May 2018, the Scottish Parliament Information Centre (SPICe) reported that between 2013/14 and 2017/18, funding from the Scottish Government to local government decreased at a faster rate than the Scottish Government revenue budget; 7.1 per cent and 1.8 per cent respectively. Using a similar approach, but with up-to-date inflators, the reductions have been 6.92 per cent and 1.65 per cent (Exhibit 3, page 12). This demonstrates a significantly higher impact on total local government funding compared to the total Scottish Government revenue budget. In cash terms, the funding from the Scottish Government to local government has fallen by 1.18 per cent while the Scottish Government revenue budget has grown by 4.41 per cent.

Distribution of funding from the Scottish Government could be clearer about how it reflects factors that drive costs in councils

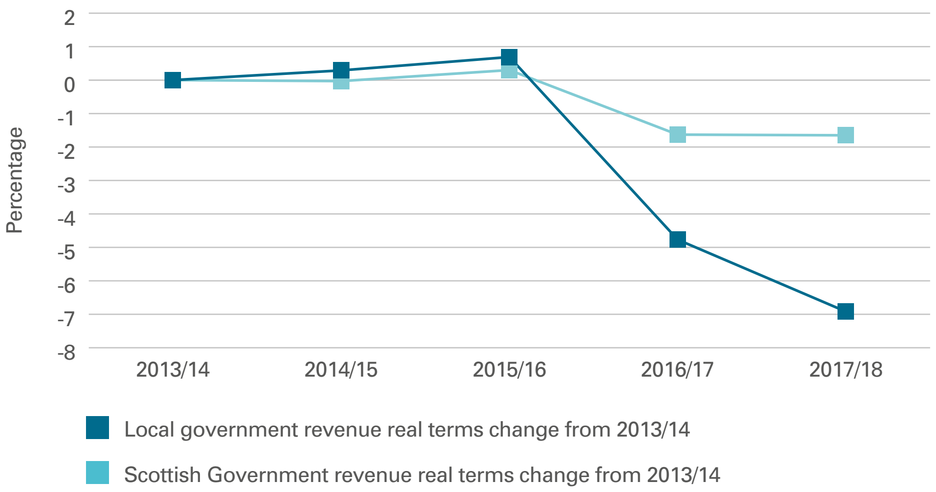
13. As we reported last year, the Scottish Government and COSLA's mechanism for distributing funding to councils is the main determinant of a councils' overall funding. Grant-aided Expenditure, or GAE, is a needs-based methodology, used to allocate the Scottish Government's pre-determined spending review totals among councils. It is made up of 89 indicators such as 'services for people with disabilities' and 'road maintenance'. These indicators are weighted to reflect factors that impact on the demand for and cost of delivering services, for example, 'the size of the 16 to 64 year-old population' and 'length of roads to maintain'.

14. The weighting factors determine the proportion of GAE funding that goes to each council. It is important to note that GAE is purely a methodology to redistribute spending review totals: councils are not obligated to spend the specific amounts on each area identified in the methodology.

Exhibit 3

Real terms change in revenue funding for Scottish Government and councils since 2013/14

Scottish Government revenue budget has fallen by 1.65 per cent between 2013/14 and 2017/18, while revenue funding to councils has fallen by 6.92 per cent over the same period.



Note: Local government funding shown is General Revenue Grant funding, other ring-fenced funding, and NDR.

Source: Audit Scotland; and SPICe

15. Since 2008/09, the total amount of GAE has remained at £7.9 billion and the weighting allocated to each GAE indicator has stayed the same. Each year the councils' relative proportion of funding has been recalculated using the 89 indicators, which means that the amount each council receives may change as its 'population', 'number of teachers', or value of other indicators change. However, the methodology used, and relative importance of each indicator used in arriving at the overall distribution of GAE has not changed in ten years.

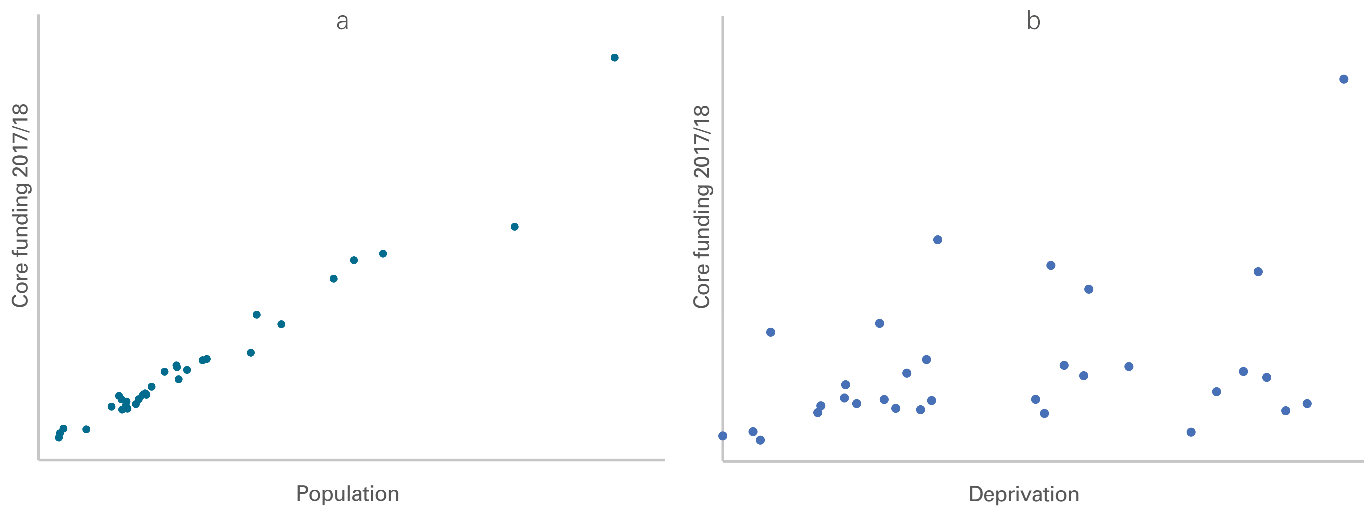
16. The majority of GAE is allocated according to population-based factors. Other factors are far less significant influences on total funding. For example, those which might be considered to link to deprivation, for example 'the number of current income deprived', are linked to a much smaller proportion of funding than population-based weighting factors.

17. This is demonstrated when we consider the relationship between how much funding a council receives and its population size and deprivation levels. The former is a very strong determinant of overall funding and the latter is only a moderate to weak factor (Exhibit 4, page 13). Given Scotland's demographic changes and the Scottish Government's commitment to tackling social and economic inequality, there is a risk that the GAE weightings no longer sufficiently represent need.

Exhibit 4

Scottish Government core funding compared to council population size and deprivation levels

The majority of core funding is allocated to councils according to population-based factors. A much smaller proportion of factors linked to deprivation influences funding levels.



Note: Deprivation has been calculated using the percentage of datazones in the council which are in the 30 per cent most deprived datazones in Scotland. Based on the Scottish index of multiple deprivation (SIMD).

Source: Scottish Government finance circulars; National Records for Scotland 2017 population estimates; and Scottish Index of Multiple Deprivation.

18. Scottish Government funding provided to councils on top of the GAE funding allocation, £3.7 billion in 2017/18, is either distributed using the same proportions as the GAE funding or through a separate methodology agreed by the Scottish Government and COSLA. The Scottish Government advises that in 2017/18, £0.2 billion was distributed using the GAE methodology and £3.5 billion through individual separate methodologies. The basis of the calculations for the separate methodologies are not publicly available and should be more transparent.

19. The £3.7 billion funding includes former ring-fenced grants, new policy commitments (since 2008/09), additional funding from the government spending reviews, special island needs allowance and loan charges. This funding, alongside the GAE, makes up the 'total estimated expenditure' which is then adjusted to take account of expected council tax and non-domestic rates income and specific ring-fenced grants such as the Pupil Equity Fund.

20. The Scottish Government and COSLA have two groups that consider the funding distribution allocations on a regular basis, the settlement and distribution group (SDG) which is supported by the data issues working group (DIWG). These groups work on understanding the strategic issues behind the distribution of funding and updating the data behind the indicators. Both groups include membership from Scottish Government, COSLA and several Directors of Finance. We recognise that a review of funding distribution is difficult in times of reducing budgets, as there will inevitably be some councils that end up with smaller allocations of funding, putting further strain on already tight budgets. But we continue to believe that it is important that the Scottish Government and COSLA assure themselves that the funding formula remains fit for purpose.

Council tax changes raised a further £189 million in 2017/18

21. Council tax is another important source of income for councils. In 2017/18, £2.3 billion, 13 per cent of council funding came from council tax, which is set by individual councils. Councils raised a further £189 million in 2017/18 through council tax, compared to 2016/17.

22. In 2017/18, the Scottish Government's council tax freeze was lifted but with a maximum increase of three per cent. Twenty-four councils chose to increase council tax, with twenty-one increasing rates by the maximum three per cent (Exhibit 5). This raised an estimated £49 million.

23. The national changes in 2017/18, also included increases to the council tax bands E to H and removal of second-home discounts. These changes raised the remaining £140 million and benefited councils with a relatively higher proportion of higher banded properties.

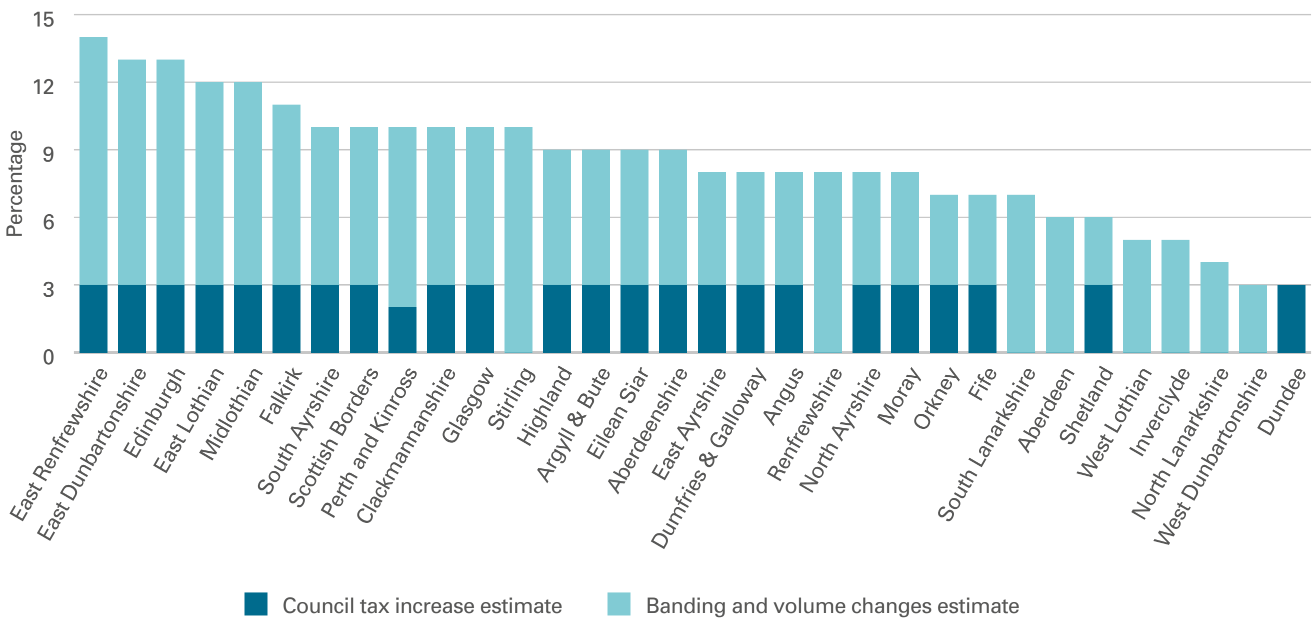
A significant element of income comes from fees, charges, house rent and grants taken directly to services

24. In 2017/18, 32 per cent (£5.4 billion) of councils' income was generated from fees, charges, rents and grants taken to services. The majority of this sum comes from two sources including house rents and grants from government and other bodies, such as the Department of Work and Pensions, which are credited to services. A smaller proportion of this money is raised from a wide range of charges for services including parking charges, music tuition in schools and fees for road closure consent. These are not easily distinguishable in the audited financial statements.

Exhibit 5

Increase in council tax income by council, 2017/18

Council tax changes raised a further £189 million in 2017/18.



Source: Audited financial statements 2017/18

There is significant variation between councils in charges for services

25. There is wide variation in what councils charge for and the level of charge made for services. In 2017/18 and 2018/19, there is variation in how councils are making increases to their income from fees and charges. Some councils are making incremental increases across the range of charges and fees they use. Some councils are making significant increases to groups of fees and charges, such as those related to commercial waste, harbour management or to burial and cremation. Some councils are introducing new fees and charges, these include, for example, charges for garden waste collection, use of residential centres, car parking charges, public toilets, and for pest control.

26. An analysis of a sample of 16 types of charges, from data provided by local audit teams in each council, indicates that from 2016/17 to 2018/19, 11 increased by more than the rate of inflation. Inflation over the two-year period has been calculated at 4.7 per cent. The service charges which showed the highest increases were:

- purchase of grave (lair), where of the 22 councils that had provided information on fees, the average increase was 20 per cent
- adult burial (interment), where 23 councils reported an average increase of 12 per cent
- junior swimming access, where 11 councils reported an average increase of 11 per cent.

Councils' budgets 2017/18

Councils identified some consistent pressures in setting their 2017/18 budgets

27. Councils' 2017/18 budget papers identified some common themes in the pressures that councils were identifying. These include:

- Staff costs – as the single most significant expenditure for councils, changes to staff-related costs can generate significant pressure on budgets. Specific pressures included:
  - Pay inflation was a consistent pressure across councils. The Highland Council identified pay and pensions pressures of £4.2 million (0.7 per cent of its budget).
  - The introduction of the living wage and sleepover arrangements: this affected adult care services particularly. Renfrewshire Council's budget identified this pressure as £2.0 million (0.5 per cent of its budget)
- Other costs – inflationary pressures. Renfrewshire Council identified the ending of commissioned contracts and the renegotiation of new national care home contracts in adult care services as a budget pressure of £1.2 million (0.3 per cent of its budget).
- Financing costs – when a council borrows or invests in assets it can incur additional financing costs that become a new annual budget pressure. The Highland Council budgeted for additional pressures of £4.3 million (0.7 per cent of its budget) (including additional loans charges and unitary charges).

?

Does your council have a charging policy?

Is it in line with corporate plans and objectives?

When was this last reviewed?

Do you receive sufficient information about the potential impact on the service and wider community when making decisions about changing fees and charges?

What information do you need to be able to explain increases in fees and charges to your constituents?

?

How do you engage with the budget-setting process and ensure you have the opportunity to influence the development and content of a strategic budget?

- Apprenticeship levy – this is a new levy on bodies of 0.5 per cent of pay bills above £3 million. The Highland Council identified this as a pressure of £1.2 million (0.2 per cent of its budget), East Ayrshire as £0.8 million (0.2 per cent of its budget) and Dundee City Council £1.0 million (0.3 per cent of its budget). Budgets tended not to assume receipt of funding or grants from the Scottish Government or Scottish Apprenticeship Advisory Board in respect of the levy.

- Demand costs – increasing demand for services was noted as a cost pressure. This was most distinct in adult care services. Renfrewshire Council identified this as £1.2 million (0.3 per cent of its budget). East Ayrshire Council agreed to fund demand pressures in adult social care of £2.0 million (0.6 per cent of its budget).

Budgeted net expenditure of £12.4 billion included 'funding gaps' of four per cent

28. Councils' 2017/18 budgets identified total final net expenditure budgets of £12.4 billion. This is after fees, charges and grants are credited to services as budgeted income. These total net expenditure budgets were not fully met by remaining income from core Scottish Government funding, including NDR, and council tax. The shortfall or 'funding gap' was £0.5 billion (four per cent).

Funding gaps were managed by planned savings and temporary use of reserves

29. Councils identified funding gaps of up to six per cent of total revenue, but still managed to present balanced budgets through:

- planned budget savings of £0.4 billion (three per cent of revenue funding). These included management and staff reductions and restructuring, service redesign and procurement

- planned use of £0.1 billion of unearmarked reserves.

Some councils reverted to a temporary planned use of reserves due to the uncertainty presented by the local government elections in May 2017

30. The local government elections in May 2017 had a bearing on some councils' approach to budget-setting. With outgoing administrations and the possibility of changed incoming administrations, officers did not feel able to agree transformational savings plans with outgoing administrations or have confidence that these could be sustained with new incoming administrations. This meant that reserves were used as a short-term contingency to manage funding gaps in 2017/18 until wider transformational plans could be agreed with new administrations. This demonstrates why medium and long-term financial planning is important.

Councils' outturn against their 2017/18 budget was more favourable than planned

31. 2017/18 net expenditure was £12.2 billion compared to the final budget of £12.4 billion. Common themes for this improved position were savings on staff costs and loan charges.

32. As we noted above the planned use of reserves was £105 million. The actual use of revenue reserves was much lower at £38 million and those that planned to use unearmarked General Fund reserves to balance the budget did not need to use reserves in line with their plan.

How does annual budget-setting link to medium and long-term financial planning in your council?

Does your council have a savings plan?

What are the options to close future funding gaps?

How well are you kept informed about progress in delivering those savings?

Overall increases in spending in education and social work were offset by reductions in other services

33. Scottish Government provisional outturn data identified expenditure grew by 1.1 per cent in cash terms, compared to 2016/17. In real terms it fell by 0.6 per cent. There were significant differences in expenditure between services:

- Education expenditure increased by 3.2 per cent (1.5 per cent in real terms). This reflects several national priorities including raising attainment.
- Social Work expenditure increased by 2.4 per cent (0.7 per cent in real terms). This included funding the living wage and demand pressures.
- Other 'non-protected' services fell by 2.6 per cent (4.3 per cent in real terms). This includes environmental services, culture and related services, planning and development services, and roads and transport.

Which service areas are under the most pressure to make savings?

What impact will savings have on the delivery of services and outcomes for service users, the wider community and the local economy?

What are the potential risks?

Part 2

Councils' financial position

Key messages

1 Eighteen councils drew on their usable reserves in 2017/18, overall by a relatively small amount.

2 Some councils have relatively higher levels of debt for their size.

3 Local policies vary on whether cash and investments are held to support reserves. This could increase the need for further future borrowing.

4 Capital expenditure in 2017/18 decreased by five per cent in real terms. Housing and education were the main areas of investment. Despite this the number of social houses provided by councils continues to fall.

5 Some councils have had significant increases in their debt positions.

6 There were delays with the valuation of pensions liabilities in councils across Scotland in 2017/18, but the net pension liability has reduced substantially in 2017/18.

7 Management commentaries in councils' accounts should do more to explain financial outturn against budget.

in 2017/18, councils drew on their usable reserves by £18 million, a relatively small element of usable reserves

Councils' financial position

In 2017/18, councils drew on their usable reserves by £18 million, a relatively small element of usable reserves

34. In last year's overview report we noted that more councils were drawing on their usable reserves. This trend continued in 2017/18, with 18 councils ending 2017/18 with lower levels of usable reserves than they had at the start of the year. In 2016/17, 20 councils were in this position.

35. Some councils added to their usable reserves including South Lanarkshire (increased by £15 million, 15 per cent), Stirling (increased by £6 million, 22 per cent) and Dundee (increased by £7 million, 35 per cent), due to significant in-year surpluses relative to the usable reserve balance. One council had a significant reduction in usable reserves: Aberdeen City reduced its usable reserve by £21 million (25 per cent), through a combination of a General Fund deficit and using part of its capital reserve.

?

What is the council's reserve policy?

What have reserves been used for in recent years?

Supporting services and bridging the funding gap or transforming services?

36. It is important that councillors are aware how usable reserves are being used each year, especially where the cumulative scale of this is potentially significant to financial sustainability. Northamptonshire County Council, in its 2017/18 financial statements, identifies that 'financial pressures ....have led to a position where the council has had to utilise almost all of its General Fund (£12 million) and earmarked reserves (£5.5 million) in order to deliver a balanced year-end outturn for 2017-18.' Our analysis based on 2018/19 budgets and levels of General Fund reserves indicates there are no short-term concerns in Scottish councils.

What are the different types of usable reserves your council holds?

Do you know what these can be spent on?

Is it clear that the reserves are needed for the purposes they are assigned?

Are the reserves sufficient for those purposes?

Could the reserves be better used for something else?

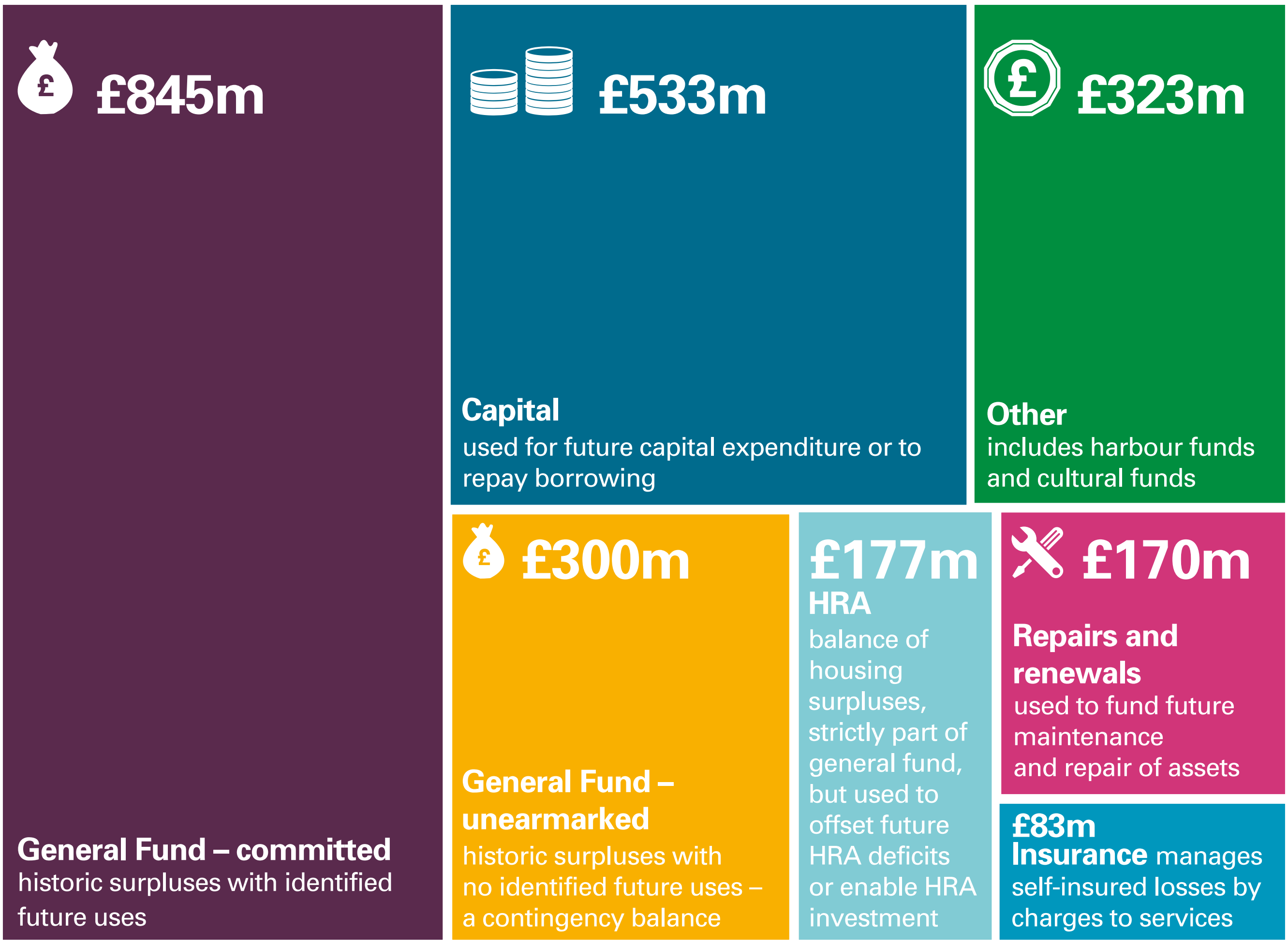
The overall total General Fund position is consistent with 2016/17 at £1.15 billion

37. Usable reserves held by councils totalled £2.4 billion. This includes General Fund balances and other statutory reserves. Within this total the General Fund balance remains relatively unchanged from 2016/17 at £1.15 billion. The nature and value of usable reserves are shown in Exhibit 6.

Exhibit 6

The relative size and nature of council's usable reserves

In 2017/18, usable reserves held by councils totalled £2.4 billion.



Source: Audited financial statements 2017/18

There is significant variation in the relative size and the nature of reserves held

38. Councils adopt different strategies for creating and managing their reserves, with some councils operating significant capital funds with associated investment plans. This provides a significant variation in the nature and extent of funds held (Exhibit 7). Councillors should scrutinise the nature, extent and timing of plans for using specific and committed funds to ensure that these remain valid, appropriate and reasonable.

Some councils have relatively higher debt than others

39. Councils' **net debt** varies by between 45 per cent of annual revenue in Shetland to 203 per cent in West Dunbartonshire (Exhibit 8, page 21). Higher levels of debt lead to higher annual costs of servicing this debt and councils need to ensure this is affordable. West Dunbartonshire has total debt of £535 million offset by cash assets of £22 million. This is a net external debt of £513 million compared to annual revenue of £253 million (from council tax, NDR, revenue support grant and dwelling rents).

Gross debt/net debt:

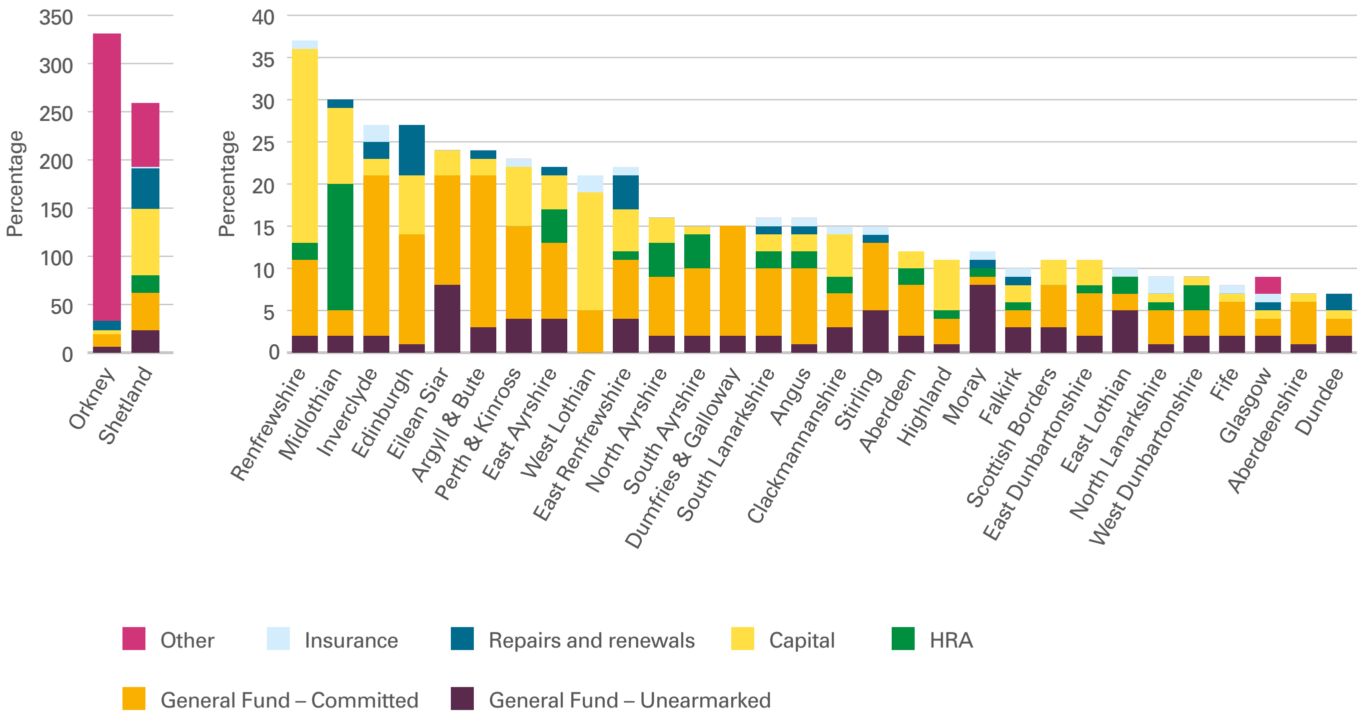
Gross debt is the total outstanding borrowing and the liabilities associated with PFI/PPP/NPDO and HuB schemes.[1] This includes both long and short-term balances.

Net debt is 'gross debt' less any cash or investments, which form part of the council's overall approach to treasury management.

Exhibit 7

Usable reserves as a percentage of council annual revenue

There is significant variation in the relative size and the nature of reserves held.

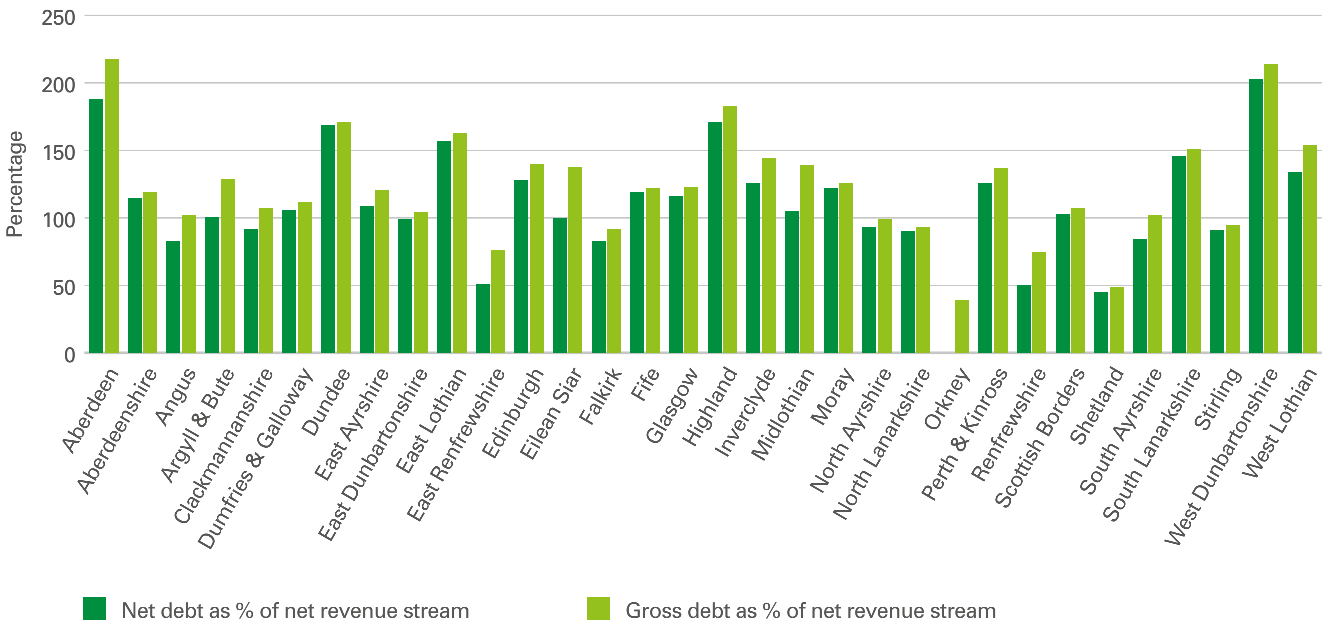


Source: Audited financial statements 2017/18 (Orkney and Shetland have reserves which are above 250 per cent of their annual revenue)

Exhibit 8

Council gross and net external debt compared to its annual revenue

Councils' net borrowing varies between 45 per cent of annual revenue in Shetland to 203 per cent in West Dunbartonshire.



Note: NRS is the net revenue stream, ie the net spending used for day-to-day delivery of council operations.

Source: Audited financial statements 2017/18 (Orkney is excluded as it has net investments)

Councils don't always have cash to support reserves and might need to borrow further

40. Thirteen councils have significant cash or investments that can be used to support the reserves position (Exhibit 9, page 22): spending reserves would reduce the cash or investments held. However, other councils have chosen in the past to use their cash or investments to fund capital spending rather than take on further borrowing. This means that some councils would need to borrow further over the longer term to provide the cash to spend on commitments identified in their reserves. This borrowing would increase their 'underlying' debt position from the position shown in Exhibit 9.

41. Councillors should be aware of the current borrowing position and the potential need for future borrowing when agreeing authorised borrowing limits as part of the prudential code.

Capital spending in real terms reduced by five per cent in 2017/18

42. In real terms, capital expenditure decreased by £138 million (five per cent) between 2016/17 and 2017/18 to £2,698 million. Exhibit 10 (page 22), illustrates the level of capital expenditure across the main services areas. The majority of investment is in schools' estate, new social housing and major refurbishment of social housing.

What is the council's current debt position?

Do you have clear information about the potential need for future borrowing when agreeing authorised borrowing limits?

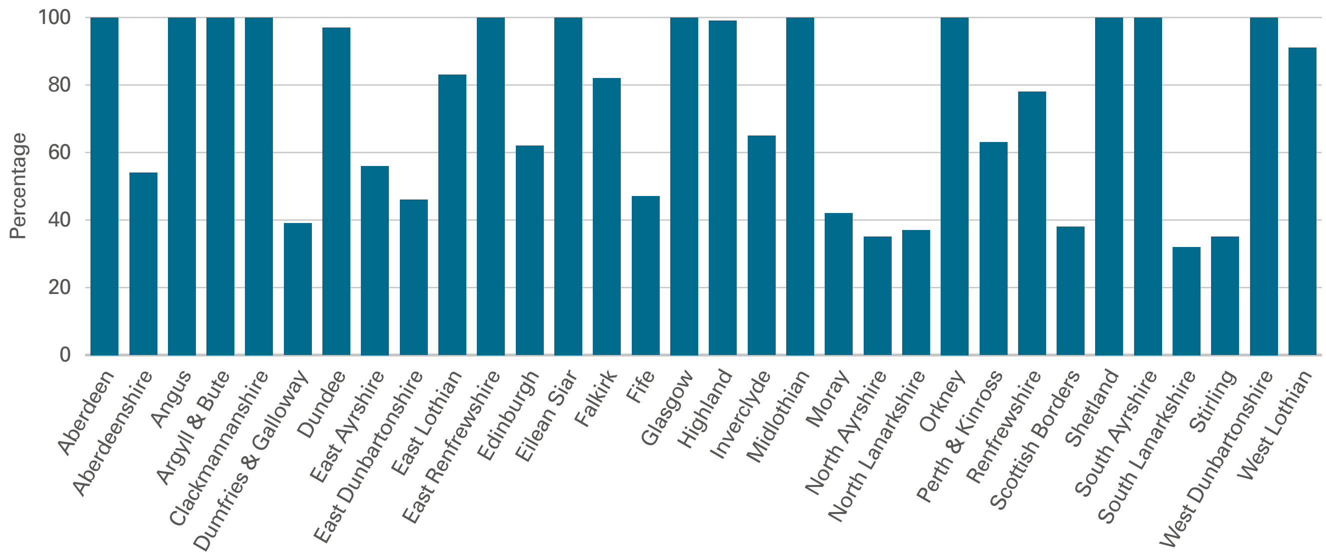
What share of the council's budget is taken up with interest payments and debt repayment?

What proportion of the council's debt is linked to inflation or at fixed rates? What does this mean for longer-term affordability?

Exhibit 9

Extent that usable reserves are represented by cash or investments

Thirteen councils have significant cash or investments that can be used to support the reserves position.

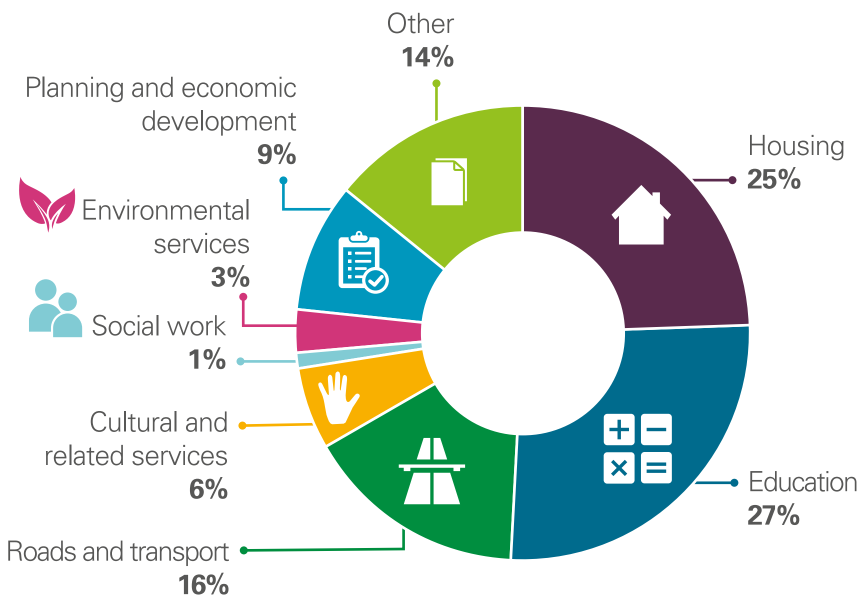


Source: Audited financial statements 2017/18 (100 per cent shown as max. amount, some councils exceed 100 per cent)

Exhibit 10

Capital expenditure by service area, 2017/18

The majority of investment is in schools' estate, new social housing and major refurbishment of social housing.



Source: Scottish Government POBE provisional outturn by service

Despite investment in social housing overall, numbers of council houses continue to fall

43. Across Scotland, social housing is provided by a mix of housing associations and by councils. In 24 areas, councils continue to be significant housing providers. The number of council houses in Scotland continued to fall slightly in 2017/18, down a further 334 houses (0.1 per cent of stock), although the rate of decrease has slowed. The right-to-buy council housing ended in Scotland on 31 July 2016, but applications submitted by that date are still being processed during 2017/18, with 1,640 sales in the first three quarters of 2017/18. Sales and other contributing factors, such as demolitions, continue to offset the number of new houses being completed by councils (with housing stock). This net movement varied between councils: 16 councils saw a decrease in house numbers and ten increased in 2017/18 (six councils no longer have housing stock following stock transfer).

Government grants and amounts from revenue continue to be the main sources of funding for capital expenditure

44. Sources of capital expenditure funding included (Exhibit 11, page 24):

- £1 billion of government grants (£138 million or 16 per cent higher than in 2016/17)
- £0.6 billion of internal charges to services (loans fund principal repayments) (£0.7 billion in 2016/17)
- £0.6 billion increase in the underlying need to borrow[2] (£0.7 billion in 2016/17) with £0.3 billion of this resulting in an increase in external borrowing.

Some councils had significant increases in their net debt position

45. Councils' net debt increased in 2017/18 by £0.6 billion to £15.1 billion. Twenty councils increased their net debt by a total of £0.8 billion, with another 11 councils reducing their net debt by £0.2 billion.

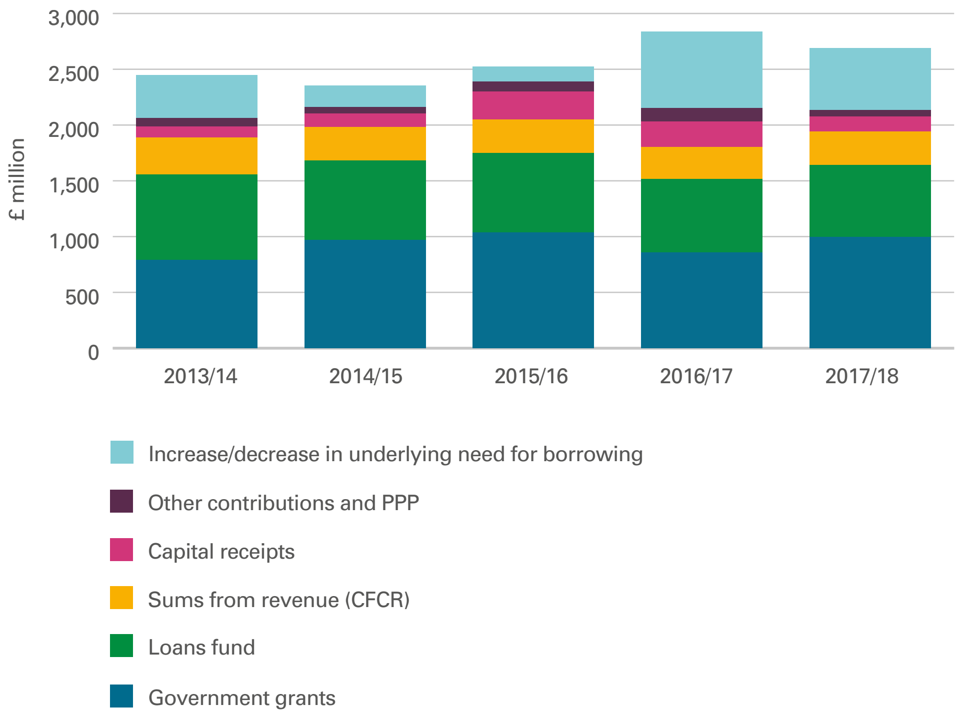
46. The councils with notable increases included:

- Argyll and Bute Council – a £58 million increase (31 per cent) due to increase in primary school finance leases and increased long-term borrowing.
- Aberdeen City Council – with the largest increase in net debt of £211 million (28 per cent) represented by a reduction in investments and an increase in finance leases, associated with Marischal Square and the ongoing capital investment and use of reserves to support delivery of the transition to its 'Target Operating Model'.
- Perth and Kinross Council – increased debt by £75 million (21 per cent) represented by an increase in long-term borrowing for capital expenditure.

Exhibit 11

Sources of funding for capital expenditure, 2013/14 to 2017/18 (real terms)

Government grants and amounts from revenue continue to be the main sources of funding for capital expenditure.



Source: Audited financial statements, sources of capital financing in real terms 2017/18 prices

Other key elements in the audited financial statements

There were delays with the valuation of pensions liabilities in councils across Scotland in 2017/18

47. Councils account for their share of the Local Government Pension Funds (LGPS) in accordance with International Accounting Standard 19 - Employee Benefits (IAS19). This relies on valuations of pension fund assets and liabilities by the scheme's actuary. Actuarial reports across Scotland used estimated data for the final part of the year. Asset returns estimated by the actuary for the final part of the year were significantly lower than actual returns, as a result of significant changes in markets. This resulted in pension fund assets reported in the council's balance sheet being understated in the unaudited accounts. This issue was corrected in the majority of audited accounts across Scotland.

48. In updating the IAS19 report, an actuary also identified an omission in the original calculation of liabilities in three councils resulting in an increase to the council's net pension liability.

49. This issue affected councils and a significant number of subsidiary bodies that are also members of the LGPS.

The net pension liability has reduced substantially in 2017/18 compared to 2016/17

50. In 2017/18, councils' total net pension liabilities in the Scottish Local Government Pension Scheme (LGPS) reduced by 43 per cent from £11.5 billion in 2016/17 to £6.6 billion in 2017/18. All councils reduced their liability, except for Aberdeen City Council. This significant improvement was due to:

- an increase in pension fund assets of £1.1 billion, an increase of four per cent
- a reduction in scheme liabilities of £3.8 billion due to reductions in life expectancy, lower than assumed salary increases and increases in the discount factor used to value future benefits, based on bond rates.

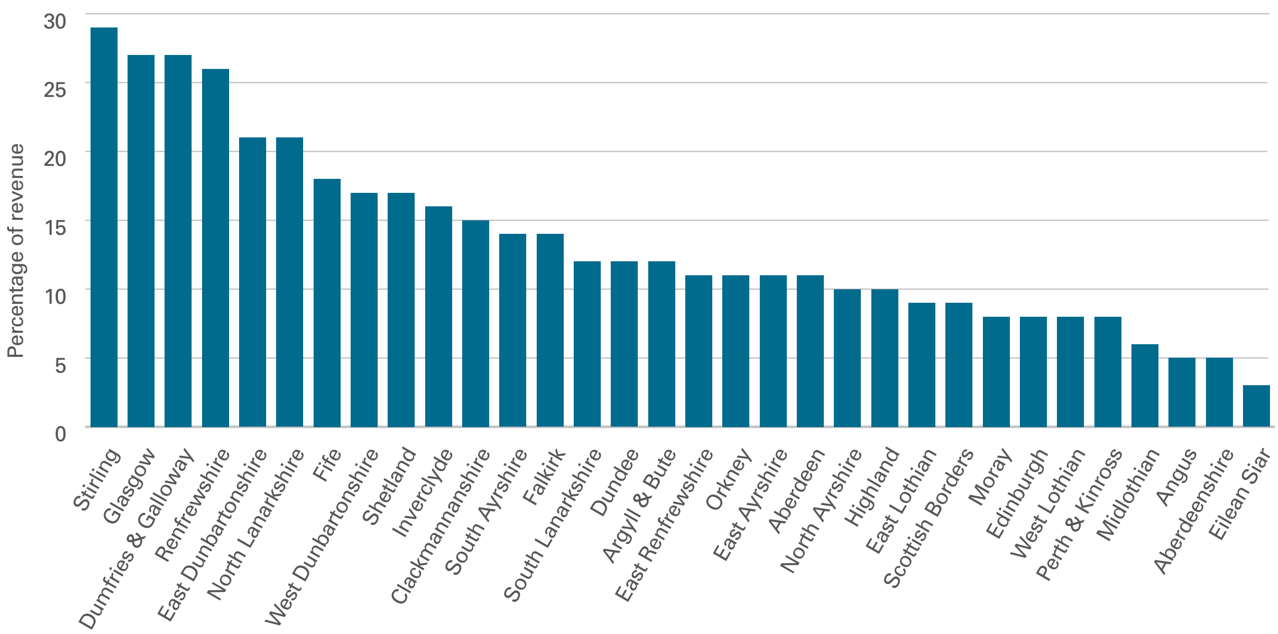
Unfunded LGPS liabilities vary significantly across councils

51. Unfunded liabilities are amounts that are not met by the Local Government Pension Schemes, but by individual employers. These can occur when an employer approves an early retirement, without actuarial reduction or with enhanced pension. Exhibit 12 shows that value of these unfunded benefits as a percentage of the annual revenues of each council. These ongoing commitments can represent annual payments of one to two per cent of revenue.

Exhibit 12

The total liability for LGPS unfunded liabilities as a percentage of annual council revenue

The amounts councils are committed to pay to pension funds for historic early retirements over the medium to long-term varies significantly.



Source: Audited financial statements 2017/18 and IAS19 valuation reports by actuaries

Glasgow City Council reports additional financial pressures that may arise from further equal pay claims

52. In our *Equal Pay in Scottish councils* report, we identified that all employers have a legal responsibility to ensure that women and men receive equal pay for equal work. In 1999, Scottish councils and trade unions reached the Single Status Agreement to harmonise local government pay and employment terms and conditions and eliminate pay inequality. Implementing the Single Status Agreement was a complex process that required all councils to undertake a large-scale job evaluation exercise. Councils underestimated the risks in this process and legal challenges continue to identify further issues.

53. Glasgow City Council has identified a new contingent liability[3] disclosure in 2017/18 for equal pay claims, which it is unable to estimate. This is based on a May 2017 ruling by the Court of Session on pay protection claims, affecting around 8,000 claimants and an August 2017 ruling on the council's Job Evaluation Scheme. This will take time to resolve and the potential scale is likely to be significant and impact on the council's financial planning.

Financial management, governance and transparency

Management commentaries could do more to explain council outturns in the accounts

54. Auditors' reviews of accounts are increasingly concerned with the transparency and clarity of the narrative contained within the management commentary that accompanies the financial statements. There are a few key aspects to an assessment of whether financial reporting is transparent in the narrative:

- Is the outturn against budget position for the year clearly shown with the reasons for significant variances obvious?
- Is the outturn reported in the narrative reconciled to the movement in General Fund contained in the financial statements and major differences explained?
- Some councils do not specifically report on progress against agreed savings in their accounts. Therefore, it is difficult to demonstrate if planned savings were achieved. Councils that did report this said they achieved 105 per cent of their planned savings.

55. We identified Comhairle Nan Eilean Siar's management commentary as an example of good practice. Financial performance in 2017/18 was clearly identified in the management commentary. This included the income, expenditure and surplus/deficit positions for significant elements of the council's budget that was consistent with overall movements on the General Fund.

56. There were improvements in this area in 2017/18. However, there are still circumstances where these basic expectations of transparency are not met and the financial outturn in the management commentary does not help the reader understand clearly how the council has performed against budget and how this is reconciled to the accounts.

Do budget monitoring reports clearly explain financial performance against plans and any changes to plans, including the reasons for change?

Does the management commentary clearly explain the council's financial performance and the changes to plans and reasons for those changes?

What additional training would you like to receive to develop your knowledge and skills for financial scrutiny?

Part 3

Integration Joint Boards' overview 2017/18

Key messages

1 Funding to the IJBs increased in 2017/18 by three per cent in cash terms. Most of this additional funding came from the NHS and includes additional Scottish Government funding to the NHS for IJBs of £107 million.

2 The majority of IJBs have underlying financial sustainability issues, with 11 out of 30 incurring deficits in 2017/18. A further eight would have incurred deficits without additional ('deficit') funding from their partners.

3 Reserve positions vary enormously between IJBs.

4 Medium-term financial planning is not used by most IJBs and further improvements to financial management should be introduced.

57. Funding to the IJBs increased in 2017/18 by three per cent in cash terms. Including additional Scottish Government funding to the NHS for IJBs of £107 million. IJBs were established as a result of the Public Bodies (Joint Working) (Scotland) Act 2014 (the Act). They are partnerships between NHS boards and councils and are responsible for the delivery of adult health and social care, and in some council areas, for other services, such as children's services. We reported on progress in November 2018 in our report, *Health and social care integration – update on progress*.

58. In 2017/18, IJBs were responsible for directing £8.3 billion of health and social care resources, money that was previously separately managed by councils and NHS boards. In total, 29 per cent or £2.4 billion of IJB funding was allocated from councils, and £5.9 billion or 71 per cent from the NHS (Exhibit 13, page 28).

59. The total resources available to IJBs has increased by three per cent, in cash terms, from £8.1 billion in 2016/17. The majority of this £240 million was allocated from the NHS:

- £107 million was provided by Scottish Government to the NHS to direct towards social care services delivered by councils.
- In some cases, NHS boards directed additional funding to address overspends in prescribing.

the majority of IJBs have underlying financial sustainability issues

?

What is the IJB's financial position? Is it financially sustainable?

What are the levels of reserve held by the IJB?

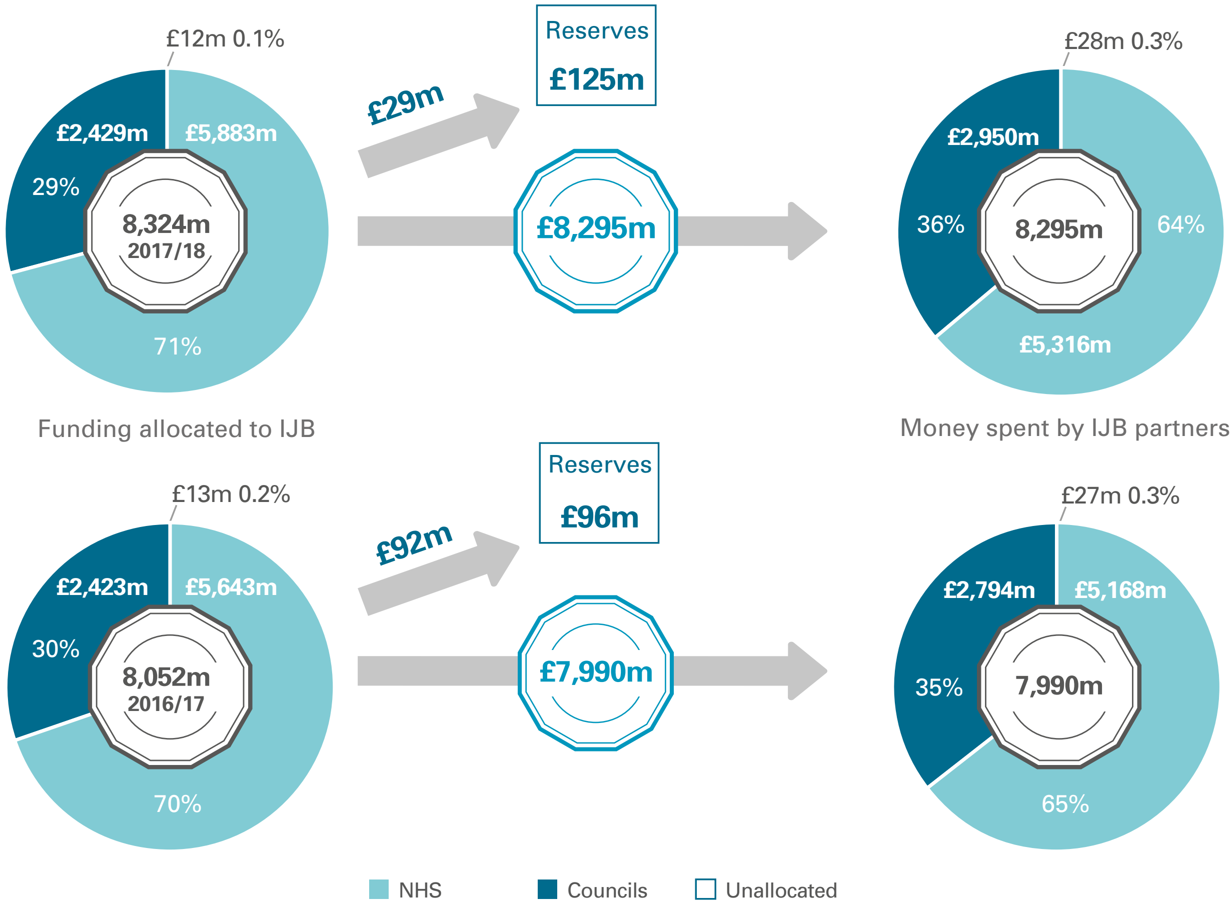
Are these in line with the IJB's reserve policy?

What does the IJB's financial position mean for the council and for the delivery of services?

Exhibit 13

Income and expenditure of Integration Joint Boards in 2016/17 and 2017/18

IJBs spent £8.3 billion on delivering health and social care services in 2017/18, 3.8 per cent (£305 million) more than in 2016/17. Of this 36 per cent was spent by councils and 64 per cent by the NHS.



Note: Some aspects of funding and expenditure is not attributed to either NHS or councils in a few audits. This represents about £15m and £12m of income in 2016/17 and 2017/18 respectively and around £28m of expenditure in both years.

Source: IJB audited accounts

60. IJBs spent £8.3 billion on delivering health and social care services in 2017/18, 3.8 per cent (£305 million) more than in 2016/17. Of this, 36 per cent was spent by councils and 64 per cent by the NHS.

61. The aim of the reform is to meet the challenges of Scotland's ageing population by shifting resources to community-based and preventative care at home, or in a homely setting. Therefore, it would be reasonable to expect the difference between what the NHS allocates to IJBs and what it receives for acute services to increase. In 2017/18, the difference was 6.6 percentage points compared to 5.1 percentage points in 2016/17, but this does not necessarily represent any operational shift in how services are provided.

The majority of IJBs have underlying financial sustainability issues and without year-end support from partners, 20 out of 30 would have reported deficits

62. Fourteen IJBs had a surplus in 2017/18 compared to 23 in 2016/17. Those with a surplus added a further £42 million to their reserves (£95 million in 2016/17). This does not properly identify the underlying position, as 19 IJBs had additional funding from their partners, which improved their outturn position by £51 million. Without additional funding, a further eight IJBs would have reported a loss in 2017/18, rather than the 11 that did. Eight of the IJBs drew on reserves from previous years to meet in-year deficits.

63. Auditors report that prescribing costs and adult social care costs appear to be the main reasons for overspends. Auditors noted that in NHS Greater Glasgow and Clyde a 'risk-share' agreement on prescribing pressures with the health board has ended in 2017/18 and this will present IJBs in that area with greater financial risk in 2018/19.

Reserve positions vary enormously

64. The total of reserves held by IJBs has grown from £96 million in 2016/17 to £125 million over 2017/18, and now represents 1.5 per cent of total income (compared to 1.2 per cent in 2016/17).

65. IJBs hold reserves for two main purposes that assist strategic financial management and risk management:

- to earmark, or build up, funds which are to be used for specific purposes in the future
- to provide a contingency fund to cushion the impact of unexpected events or emergencies.

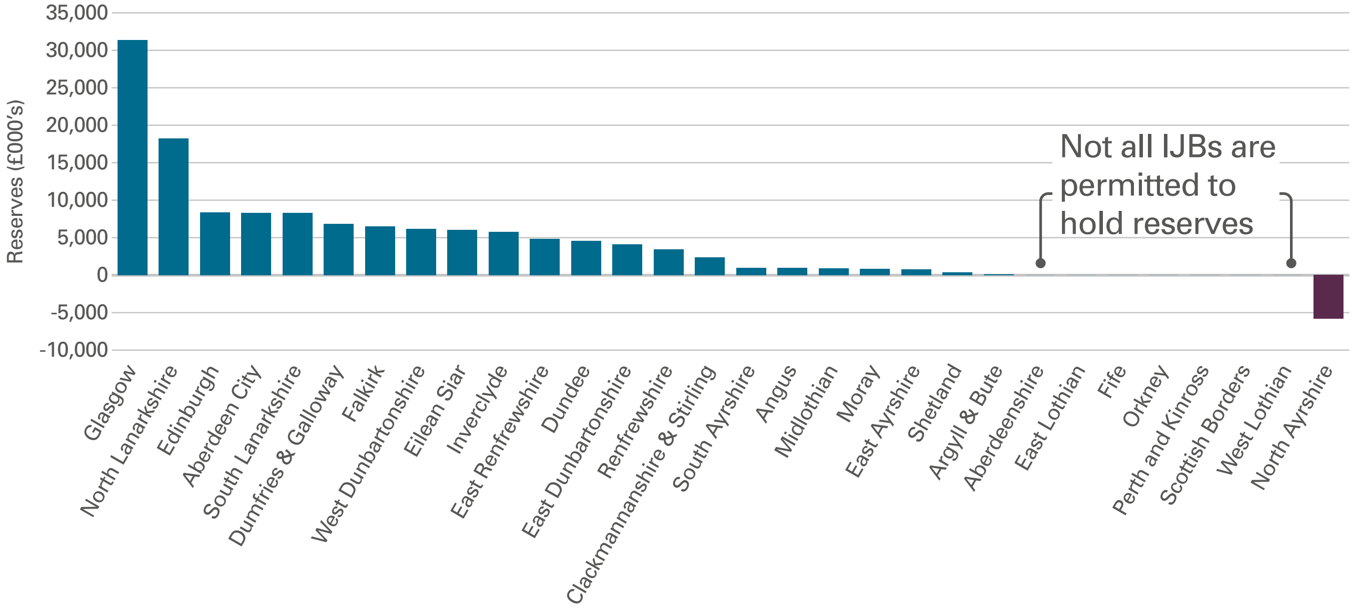
66. Forty per cent of the total reserves are held by two IJBs: £31 million in Glasgow and £18 million in North Lanarkshire. Comhairle nan Eilean Siar has the highest reserve relative to its income at ten per cent (Exhibit 14, page 30). North Ayrshire is unusual in having a negative reserve of £5.8 million.

67. The auditor for North Ayrshire IJB highlighted concerns that 'in the medium term, the IJB is faced with an extremely challenging financial position'. In line with many other IJBs, it has not achieved short-term financial balance, but it has not been deficit funded by its partners.

Funding gaps in 2018/19 are significant in IJBs and many do not have balanced budgets

68. Most auditors identified significant financial pressures in 2018/19 in their 2017/18 annual audit reports. The estimated funding gap for IJBs in 2018/19 was £248 million (three per cent of total income). Which is greater than identified in councils. Twelve of the IJBs still do not have balanced budgets for 2018/19 and a further four plan to incur deficits which will be met by accumulated reserves. We reported in November 2018, that these financial pressures make it difficult for IJBs to improve services.

Exhibit 14
Integration Joint Board reserves
Forty per cent of the total reserves are held by Glasgow and North Lanarkshire. North Ayrshire is unusual in having a negative reserve of £5.8 million.



Source: Audited financial statements 2017/18

IJB financial planning and financial management should be further improved

69. Only a third of IJBs have a medium-term financial plan, typically covering three years, and there is no evidence of longer term-financial planning.

70. Auditor's identified issues with financial management in the IJBs including:

- a lack of agreement or a late agreement of budgets
- poor financial monitoring due to delays and inaccuracies during the year
- instances where the projected outturns forecasts during the last quarter of 2017/18 were very different from those actually achieved.

71. As we reported in our *Health and social care report* these are fundamental issue which will limit the ability of Integration Authorities to improve the health and social care system.

Part 4

Councils' financial outlook

Key messages

1 In 2018/19, Scottish Government revenue funding to local government increased by 0.2 per cent after two years of real-terms reductions.

2 The Scottish Government published a five-year financial strategy in May 2018, but multi-year budgets are not yet being developed. The financial strategy identifies greater future uncertainty and likely further reductions of nine per cent in real terms over the next five years in 'other non-protected' council funding.

3 Many councils are in the early stages of delivering transformational change.

4 Medium-term financial planning has been adopted by almost all councils, but less than half have significant long-term plans over five years.

5 Councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent), with all 32 councils raising council tax rates by three per cent in 2018/19. There are no councils where the budgeted use of reserves is a critical issue over the next three years.

6 The impact of EU withdrawal is not yet clear, but councils need to identify the risks and develop contingency plans to manage these risks, as far as possible.

councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent)

Council future funding

Scottish Government revenue funding to local government increased by 0.2 per cent

72. The Local Government Settlement in 2018/19 increased by 1.7 per cent (cash terms) from 2017/18 to £9.8 billion. This was a real-terms increase of 0.2 per cent (Exhibit 15, page 32).

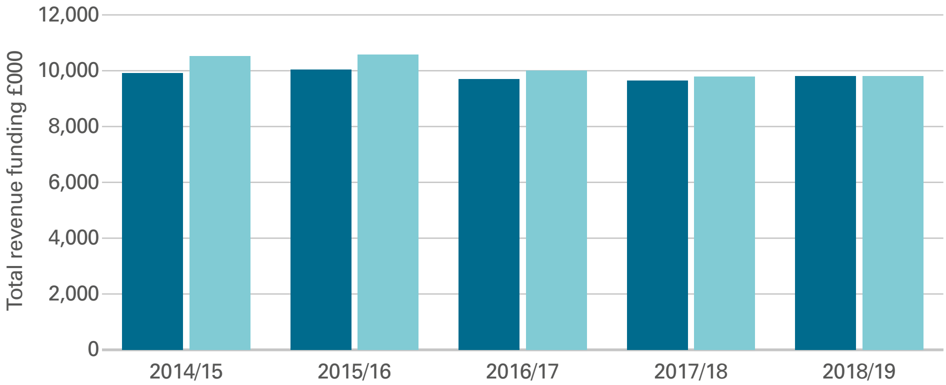
An increase in the 2018/19 settlement was late and the early payment of £35 million in 2017/18 reduced transparency in the funding available between the two years

73. On 31 January 2018, the Scottish Government announced an additional £160 million of general revenue grant funding for local authorities as part of the 2018/19 budget-setting process. Although welcomed by councils, this

Exhibit 15

Scottish Government funding to councils in real and cash terms

Scottish Government total revenue funding to councils increased in 2018/19 after two years of reduction.



	2014/15	2015/16	2016/17	2017/18	2018/19
SG total revenue funding – cash terms	9,920.6	10,039.4	9,707.9	9,650.7	9,814.4
SG funding revenue funding – real terms	10,525.8	10,580.5	10,005.5	9,793.3	9,814.4

Source: Audit Scotland; and Scottish Government financial circulars 2014/15 to 2018/19

announcement was late in the budget planning process (refer to paragraph 9, for comments on late funding allocations). Of the additional £160 million, £35 million was reallocated from projected 2017/18 underspends within the Scottish Government and was paid to councils on 28 March 2018. For accounting purposes, following consultation with auditors, this was treated as 2017/18 income by councils. By paying 2018/19 funding allocations to local authorities in the previous financial year, this reduced transparency in the effective funding for each year to councils and increased the reserves carried by councils at 31 March 2018.

The Scottish Government published a five-year financial strategy in May 2018

74. Funding settlements to councils continue to be provided on an annual basis. This makes it challenging for councils to plan and budget effectively for the medium term, given such a significant proportion of their income comes from Scottish Government funding. On 30 June 2017, the Budget Process Review Group[4] published its final report and this included a recommendation that the Scottish Government should develop a medium-term financial strategy. The Scottish Government's five-year financial strategy was published in May 2018.

Multi-year budgets are not yet being developed by the Scottish Government.

75. The five-year financial strategy identifies that 'in recent years the Scottish Government has delivered a series of annual budgets, an approach which will continue for the 2019-20 budget process', but also identifies 'an expectation that the next UK Spending Review (in 2019) will … provide the Scottish Government with the opportunity to develop a multi-year approach to the development of its budgets'.

76. The five-year financial strategy notes that 'as the Scottish Government moves away from being funded primarily through the block grant to a combination of devolved taxes and the block grant, the number of variables which will affect its longer-term funding outlook will increase'. Three key determinants are identified:

- changes in UK Government spending
- UK Government fiscal policy
- Scottish tax revenue relative to the rest of the UK.

77. The analysis suggests that, by 2022/23, the Scottish Budget could be around £37.6 billion, but scenario modelling indicates that the potential range for this could be between £35.5 billion and £39.7 billion, reflecting potential growth in the Scottish Budget between 2017/18 and 2022/23 of between £4.2 billion and £8.4 billion (in cash terms). The range of this variability amounts to around ±six per cent of the overall budget.

78. The key resource budget commitments of the Scottish Government's social contract are Health, Police, Early Learning and Childcare, Attainment, Higher Education and Social Security. The financial strategy identifies greater future uncertainty and likely further reductions of nine per cent in real terms over the next five years in 'other non-protected' funding.

79. Two of these areas directly increase future local government funding settlements: early learning and childcare and attainment. Early learning and childcare commitments by the Scottish Government include further (recurring) uplifts in funding to councils of £210 million in 2019/20, £201 million in 2020/21 and £59 million in 2021/22. The Scottish Government has assumed a commitment to allocate additional specific revenue grants of £180 million in each of the three years 2018/19 to 2020/21 through the Pupil Equity Fund. However, other expenditure areas (non-protected areas), which are managed by councils, are not identified as a 'key resource budget commitment'.

80. The SPICe briefing paper in June 2018, identified that 'The Scottish Government's Budget priority choices inevitably mean that other non-protected areas of spend must take up more of the slack from any future spending reductions. Under the range of scenarios provided by the Scottish Government, "other expenditure" will fall by between one and 16 per cent in real terms over the period to 2022/23, with the bulk of reductions occurring in 2019/20 and 2020/21… under the central scenario, other expenditure will fall in real terms by £1 billion (nine per cent). The largest element by far of "other expenditure" is the non-early learning and childcare part of Local Government.'

Financial pressures and planning

Councils continue to recognise significant financial challenges in the medium term

81. Most councils have identified financial challenges over the next few years including:

- decreasing revenue support grant and capital grant
- EU withdrawal and the risk of inflationary effects
- pay award pressures
- demand pressures, particularly the expected population growth in some council areas and the reduction in the relative proportion of working age to non-working age
- legislative changes which are not funded
- the economic performance of Scotland compared to the rest of the UK.

Many councils are in the early stages of delivering transformational change

82. Over half of councils began a new or refreshed transformation or change programme in the past year and one-third within the past three years. A few councils have yet to establish a programme. Because much of the transformation work is relatively recent it is too early to assess the effectiveness of the approaches taken.

83. The majority of work within transformational or change programmes is focused on service review and improvement work. Cross-organisational themes tend to focus on delivering, for example, staff and management restructures, office and property rationalisations, improvements in HR, payroll and finance systems. Some activity will have been more visible to the public such as digital approaches to customer services, increases in fees and charges, and redesign of waste management services. With funding expected to reduce further in the medium term, councils will need to consider more significant redesigns of how they operate and deliver services.

84. Transformation or change is challenging, and councils have highlighted a few common issues that have contributed to this including the effort and focus over recent years on establishing and progressing the health and social care arrangements with the NHS. Another factor is the long lead time and delays associated with ICT projects. With service and management redesign, the capacity of staff and management has been impacted. Over a third of councils have established training programmes to support transformation and change and over a third of councils have, or have recently agreed, to establish dedicated teams to support their programme.

85. The Accounts Commission recognises that with the financial pressures, councillors need to make difficult decisions. This requires effective political leadership and communications. It is essential that all councillors, not just the administration, work effectively with officers and other stakeholders to identify and deliver necessary savings. It is important that councils engage effectively with their communities about plans for savings and service redesign. We published a report *Roles and working relationships in councils – are you still getting it right?*, to support councillors in their role.

What is your council's financial position?

What particular challenges does the council face?

What new financial pressures are there for 2018/19 and 2019/20 and how much will these cost?

Does your council have a transformation plan?

Does it set out the aims and objectives and how and when these will be achieved?

Are projects within the transformation programme achieving their aims in terms of service quality, performance and cost?

How effectively are you engaged and informed about the council's transformation programme and kept informed about progress?

Are detailed options appraisals or business cases set out for changes to services planned within transformation activity?

Medium-term financial planning has been adopted by almost all councils, but less than half have significant long-term plans over five years

86. In previous reports we have emphasised the importance of medium and long-term planning to effective financial management. Councils have made good progress: 30 councils now have a medium-term financial plan. Councils' long-term financial planning is not as well developed. Sixteen councils do not yet demonstrate any long-term financial planning, some councils have elements of long-term financial plans evident such as long-term forecasting. Five councils have long-term financial plans that cover ten years or more. Only five of the plans that exceed five years appear to have considered the financial impact of population/demographic/demand changes over the longer term.

87. In the *Best Value Assurance Report on Fife Council* this year, we identified that the ten-year long-term financial model, based on demand forecasts, is an example of good practice among Scottish councils.

88. Around a third of councils use scenario planning within their medium or long-term financial planning. It is important that councils continue to consider potential funding scenarios and the implications for and options for services in the medium and longer term. Transformational change plans are likely to cover a number of years and should be consistent with financial planning. Financial plans should also consider the impact of demand changes over the longer term.

Does the transformation programme of work aim to make positive change to improve outcomes for communities?

Is it about seeking opportunities to do things differently to maintain or improve performance or is the focus only on make savings?

Councils' budgets 2018/19

Councils expect to manage smaller funding gaps in 2018/19 of £0.3 billion (two per cent)

89. Council's 2018/19 budgets identified total net expenditure budgets of £12.2 billion. These were not fully met by the remaining income from core Scottish Government and council tax. The shortfall or 'funding gap' was £0.3 billion (two per cent). The extent of funding gaps and savings plans is less in 2018/19 than 2017/18 and councils did not plan to use unearmarked reserves to support revenue budgets as they did in 2017/18.

90. All 32 councils raised council tax rates by three per cent in 2018/19, providing budgeted income of £2.5 billion.

91. In the 2018/19 budgets, all 32 councils increased council tax by the maximum three per cent, making the highest Band D rate, in Glasgow, at £1,286 and the lowest, in Eilean Siar, at £1,086.

Funding gaps are to be managed by planned savings, temporary use of reserves and additional fees and charges.

92. Councils presented balanced budgets with proposals to bridge the expected funding gap through:

- planned budget savings of £75 million (0.6 per cent of revenue funding)
- planned use of around £71 million of unearmarked reserves (0.9 per cent of net expenditure)
- increased fees and charges
- council tax increases.

Does your council have a long-term financial strategy (ten years or more) that reflects the anticipated changes in demographics and demands on services?

Do medium and long-term financial plans include a range of potential funding and financial scenarios?

Funding gaps vary between councils, there are no councils where the budgeted use of reserves would deplete them within three years

93. The number of councils budgeting to use unearmarked reserves in 2018/19 has reduced from 23 (in 2017/18) to 18. Last year we reported that three councils would run out of General Fund reserves within two to three years if they continued to use them at the levels planned in 2017/18. We are pleased to note that there are no councils in this position in 2018/19, with councils generally reducing their planned reliance on unearmarked General Fund reserves.

What is the likely use of unearmarked reserves for 2018/19?

How does the remaining unearmarked reserve compare to forecast funding gaps?

What are the plans for using different reserve funds in 2019/20 and beyond?

Are these plans appropriate and reasonable?

Withdrawal from the EU

94. The UK will leave the European Union (EU) on 29 March 2019. If the UK Government and EU agree the terms of the UK's withdrawal before this date, there will be a transition period to the end of 2020. Preparations for EU withdrawal across councils vary. Approaches commonly include monitoring and inclusion in risk registers as well as briefings and report to councillors. Some councils also reflect the risk in corporate and financial plans. Several councils have established working groups to focus on this issue.

95. If the UK Government and EU fail to agree arrangements for the UK's exit from the EU, there will be no transition period and organisations will need to respond immediately. There is an urgent need for all councils to identify the associated risks. It is critical they have contingency plans in place to allow them to manage these risks and respond rapidly in the event of the UK leaving the EU with no transition period.

96. The Scottish Government and COSLA are working with NHS boards, councils and other public bodies to draw together information on their workforces. This will be used to assess the potential impact of EU withdrawal on the delivery of services.

97. Audit Scotland produced a paper *Withdrawal from the European Union, Key audit issues for the Scottish public sector*, October 2018. We will consider further the implication of EU withdrawal for Scottish local government in our overview report *Local government in Scotland: Challenges and performance*, in March 2019. We have included questions from this key issues paper in *Supplement 1: Scrutiny tool for councillors* accompanying this report.

What planning and measures has your council undertaken in preparation for EU withdrawal?

What are the risks and potential impacts of EU withdrawal for the functions of your council and for the wider communities of your council area, in terms of workforce, regulation and funding?

Endnotes

1 PFI/PPP/NPD/HuB - PFI is an approach financing public infrastructure where the private partner finances, designs, builds, and operates the infrastructure asset. PPPs, on the other hand, may refer to a wider range of public-private collaboration, and include several business structures and partnership arrangements such as joint ventures, concessions, outsourcing, and PFI. PFI and PPP generally involve a long-term contractual agreement between the public and private sectors with financing and risk sharing by the private partner. Scotland's Non-Profit Distributing (NPD) model is a type of PPP agreement. It differs from the PFI model in that that private sector returns are capped and any excess profit goes back to the public sector. NPDs also promote enhanced governance and transparency through the appointment of a public interest director to the project company.

2 An increase in the underlying need to borrow could be funded by a council over the short/medium term from working capital including reduced cash and investments. It may not result in external borrowing in year. In fact, many councils chose not to borrow as they did not consider current borrowing rates to be favourable.

3 Contingent Liability – a possible obligation that arises from past events and will be confirmed only by the occurrence or nonoccurrence of one-or more uncertain future events not wholly within the control of the council.

4 The remit of the group was 'to carry out a fundamental review of the Scottish Parliament's budget process following the devolution of further powers in the Scotland Act 2012 and Scotland Act 2016'.

Local government in Scotland

Financial overview 2017/18

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk

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Local government financial overview 2017/18

Scrutiny tool for councillors

ACCOUNTS COMMISSION

This scrutiny tool captures some potential questions for councillors and relates to our report *Local government in Scotland: Financial overview 2017/18*. It is designed to provide councillors with examples of questions they may wish to consider to help them better understand their council's financial position and to scrutinise financial performance.

How well informed am I?		
Questions for councillors to consider	**What do I know?**	**Do I need to ask further questions?**
Financial planning and budget		
1. Does your council have a long-term financial strategy (ten years or more) that reflects the anticipated changes in demographics and demands on services?		
2. Do medium and long-term financial plans include a range of potential funding and financial scenarios?		
3. What is your council's financial position? What particular challenges does the council face?		
4. What new financial pressures are there for 2018/19 and 2019/20 and how much will these cost?		

Cont.

How well informed am I?		
Questions for councillors to consider	**What do I know?**	**Do I need to ask further questions?**
5. How do you engage with the budget setting process and ensure you have the opportunity to influence the development and content of a strategic budget?		
6. How does annual budget setting link to medium and long-term financial planning in your council?		
Savings and transformation plans		
7. Does your council have a savings plan? What are the options to close future funding gaps? How well are you kept informed about progress in delivering those savings?		
8. Which service areas are under the most pressure to make savings? What impact will savings have on the delivery of services and outcomes for service users, the wider community and the local economy? What are the potential risks?		
9. Does your council have a transformation plan? Does it clearly set out the aims and objectives and how and when these will be achieved?		
10. Does the transformation programme of work aim to make positive change to improve outcomes for communities? Is it about seeking opportunities to do things differently to maintain or improve performance or is the focus only on making savings?		
11. Are projects within the transformation programme achieving their aims in terms of service quality, performance and cost?		
12. How effectively are you engaged and informed about the council's transformation programme and kept informed about progress?		
13. Are detailed options appraisals or business cases set out for changes to services planned within transformation activity?		

Cont.

How well informed am I?		
Questions for councillors to consider	**What do I know?**	**Do I need to ask further questions?**
Reserves		
14. What is the council's reserves policy?		
15. What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services?		
16. What are the different types of usable reserves your council holds? Do you know what these can be spent on?		
17. What is the likely use of unearmarked reserves for 2018/19? How does the remaining unearmarked reserve compare to forecast funding gaps?		
18. What are the plans for using the different reserve funds in 2019/20 and beyond? Are these plans appropriate and reasonable?		
19. Is it clear that the reserves are needed for the purposes they are assigned? Are the reserves sufficient for those purposes? Could the reserves be better used for something else?		
Levels of debt and affordability		
20. What is the council's current debt position? Do you have clear information about the potential need for future borrowing when agreeing authorised borrowing limits?		
21. What share of the council's budget is taken up with interest payments and debt repayment?		
22. What proportion of the council's debt is linked to inflation or at fixed rates? What does this mean for longer-term affordability?		

Cont.

How well informed am I?	
Budget outturn reports and management commentaries	
23. Do budget monitoring reports clearly explain financial performance against plans and any changes to plans, including the reasons for change?	
24. Does the management commentary clearly explain the council's financial performance and the changes to plans and reasons for those changes?	
Financial scrutiny	
25. What additional training would you like to receive to develop your knowledge and skills for financial scrutiny?	
Charging for services	
26. Does your council have a charging policy? Is this in line with corporate plans and objectives? When was this last reviewed?	
27. Do you receive sufficient information about the potential impact on the service and the wider community when making decisions about changing fees and charges?	
28. What information do you need to be able to explain increases in fees and charges to your constituents?	
Integration joint board	
29. What is the IJB's financial position? Is it financially sustainable?	
30. What are the levels of reserves held by the IJB? Are these in line with the IJB's reserve policy?	
31. What does the IJB's financial position mean for the council and for the delivery of services?	

Cont.

How well informed am I?		
Questions for councillors to consider	**What do I know?**	**Do I need to ask further questions?**
EU withdrawal		
32. What planning and measures has your council undertaken in preparation for EU withdrawal?		
33. What are the risks and potential impacts of EU withdrawal for the function of your council and for the communities of your council area, In terms of workforce, regulation and funding?		

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: info@audit-scotland.gov.uk
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ACCOUNTS COMMISSION

Prepared by Audit Scotland
December 2018

The Accounts Commission

The Accounts Commission is the public spending watchdog for local government. We hold councils in Scotland to account and help them improve. We operate impartially and independently of councils and of the Scottish Government, and we meet and report in public.

We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

Our work includes:

- securing and acting upon the external audit of Scotland's councils and various joint boards and committees
- assessing the performance of councils in relation to Best Value and community planning
- carrying out national performance audits to help councils improve their services
- requiring councils to publish information to help the public assess their performance.

You can find out more about the work of the Accounts Commission on our website: www.audit-scotland.gov.uk/about-us/accounts-commission

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Summary

Key messages

1. **The triennial funding valuation at 31 March 2017 showed improved funding positions for most funds, with a number showing funding levels of more than 100 per cent.**
2. **Employer contribution rates have largely remained the same or gone up, reflecting lower expectations around investment returns going forward.**
3. **Membership of the Scottish Local Government Pension Scheme (SLGPS) continues to grow but total benefits and administration costs have exceeded contribution income in the last two years.**
4. **Investment returns were positive in 2017/18 although short-term performance was variable across funds.**
5. **Pension funds have been reviewing their investment strategies due to factors such as the maturity of the pension fund, the overall funding position and investment advisers' outlook on markets (particularly in connection with EU withdrawal).**
6. **Some pension funds have introduced Investment Panels. Lothian, Falkirk and Fife pension funds are collaborating on investment advice.**
7. **There have been many changes affecting the administration of schemes including new regulations, staffing pressures and new systems.**
8. **The Scottish Scheme Advisory Board is currently consulting on the future structure of the SLGPS.**

About this report

1. This supplement accompanies our Local government in Scotland: Financial overview 2017/18 and provides an overview of the Scottish Local Government Pension Scheme (SLGPS). We have drawn on the annual accounts of the pension funds administered by councils and on the reports of their appointed auditors. There are 11 main funds in Scotland, but also a number of other funds - often "Transport Funds" - administered by councils. Unless otherwise identified, our comments refer to the main 11 funds. The 11 main funds cover 32 local authorities and around 500 other employers.
2. This report identifies some of the major issues that pension funds had to deal with in 2017/18.

Funding

Triennial valuations

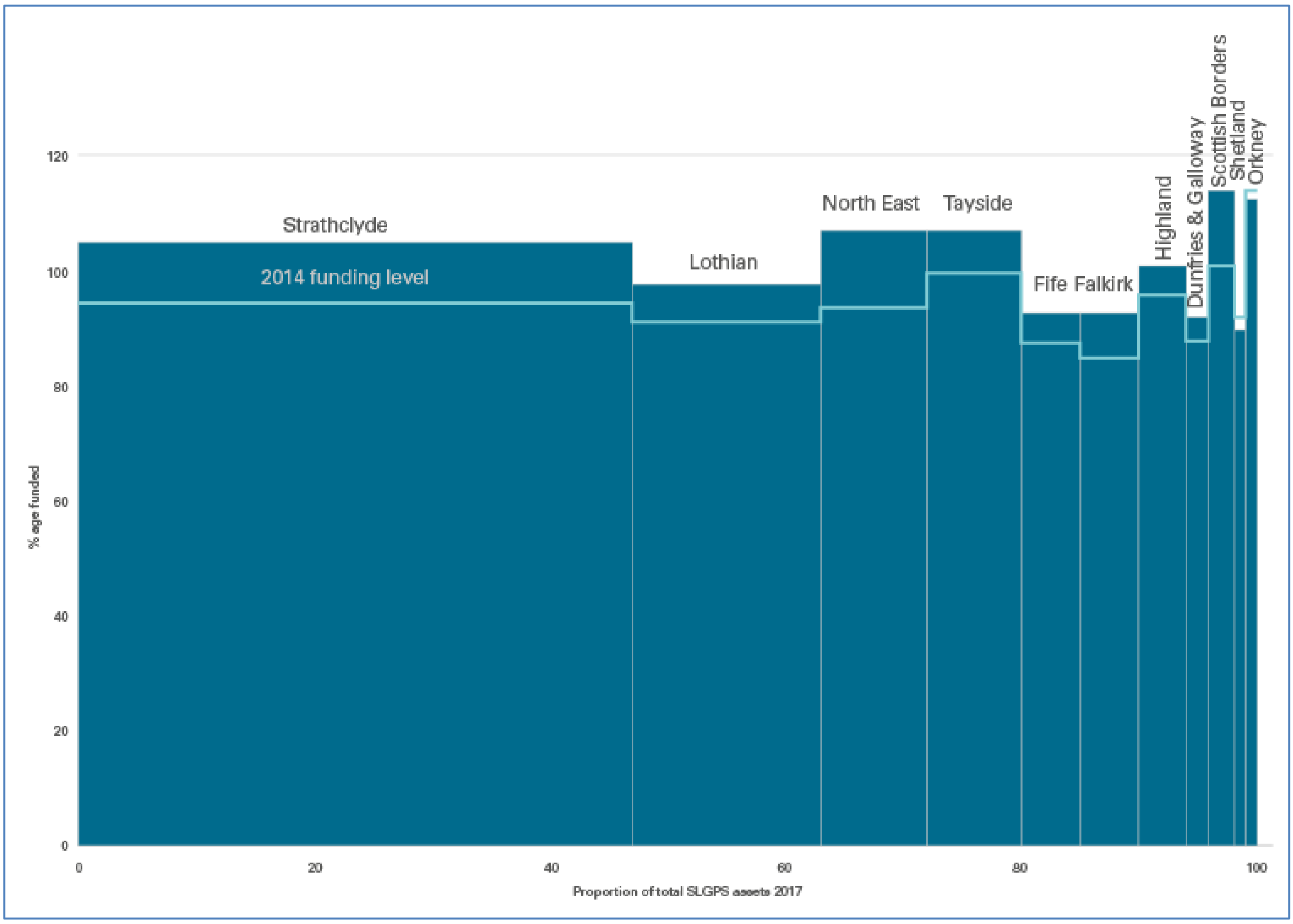
The triennial funding valuation at 31 March 2017 showed improved funding positions for most funds with a number showing funding levels more than 100 per cent.

3. The results of the triennial funding valuation, undertaken at 31 March 2017, were reported in 2017/18. In overall terms, SLGPS assets exceeded the liabilities to be met by the scheme. Assets of the main funds had increased to £42 billion while the estimated value of liabilities increased to around £41 billion. However, not all pension funds were fully funded as shown in Exhibit 1.

Exhibit 1

SLGPS funding levels 2014 and 2017

Strathclyde accounts for 47 per cent of SLGPS assets at 31 March 2017 and had a funding level of 105 per cent. In most cases funding levels improved with six funds in excess of 100 per cent.



Source: Pension fund annual reports and accounts

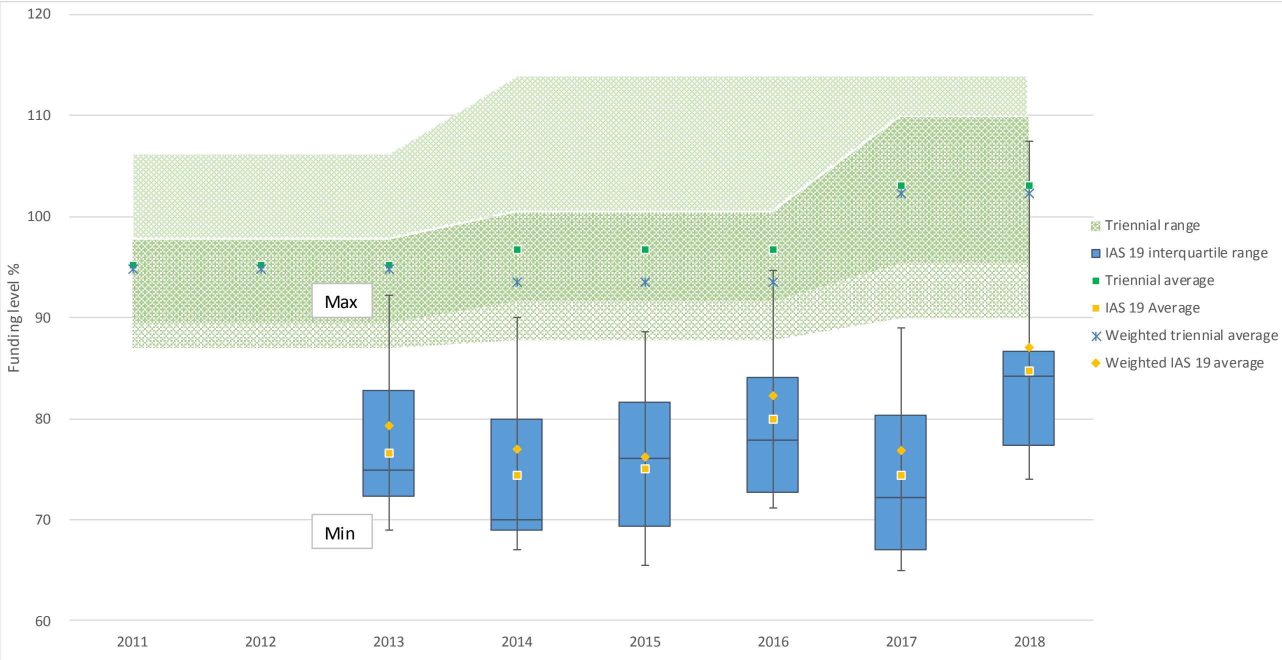
4. The 2017 funding positions represented an improvement on 2014 for all funds, except Orkney and Shetland. These improved funding positions arise because of increased asset values.

5. Triennial valuations at 31 March 2017 provide one basis for assessing the overall position of funds (funding basis). Actuaries prepare a valuation at 31 March each year, on an accounting basis (IAS19 basis). This approach uses a lower discount rate for long-term liabilities and this tends to produce a more cautious result, as can be seen in Exhibit 2.

Exhibit 2

Valuation history of SLGPS funds (triennial and IAS 19)

IAS19 annual valuations tend to be more cautious than the triennial funding valuations.



Source: Pension fund annual reports and accounts 2010/11 to 2017/18

Employer contributions have tended to stay the same following the triennial valuation

6. For most employers, contribution rates have remained the same even where pension funding levels exceed 100 per cent. This reflects lower expectations for investment returns going forward:

- at Strathclyde, North East Scotland, Tayside, Highland, Shetland, Scottish Borders, Fife, and Dumfries and Galloway pension funds contribution rates have remained stable
- rates in Lothian and Falkirk pension funds have increased
- Orkney rates have reduced.

Membership and cashflow

Membership of the SLGPS continues to grow but benefits and administration costs have exceeded contribution income in the last two years

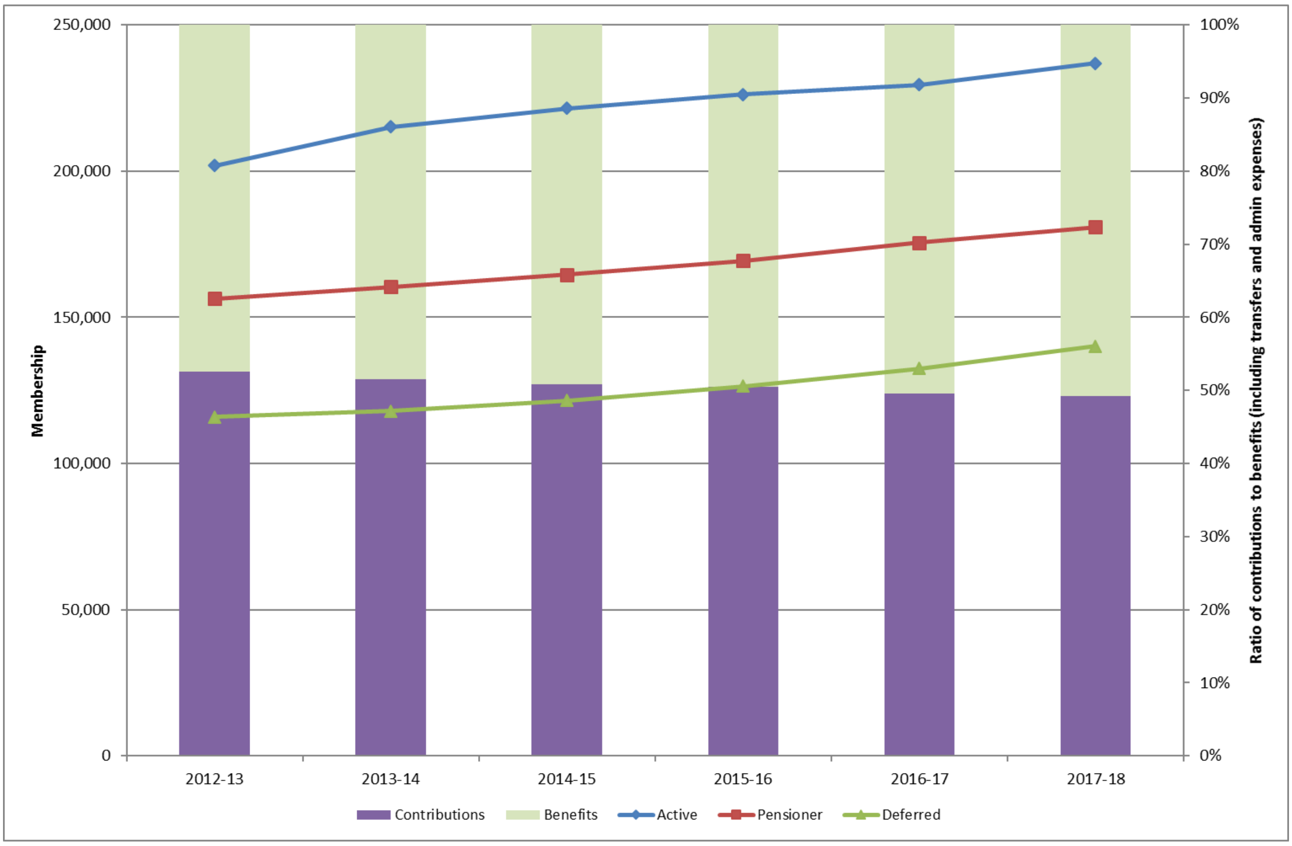
7. Exhibit 3 shows that the numbers of both active employee members and pensioner members of the SLGPS have been increasing in recent years. This is largely a result of auto enrolment and employer severance schemes. Active membership increased by 7,300 or three per cent in

2017/18 and pensioner numbers went up by 5,300, also an increase of three per cent. Across the SLGPS, total contribution income is now less than the benefits paid (negative cashflow from dealing with members). Five funds now have negative cashflows. As funds mature, an element of pension payments are being made from investment returns, rather than being met from ongoing contributions from active members. It's important that funds manage the cashflow implications of this.

Exhibit 3

SLGPS membership, contributions and benefits 2013 to 2018

Membership has been increasing. Costs are greater than contributions received.



Source: Pensions fund annual reports and accounts

8. The proportion of active members compared to pensioner members is higher than it was five years ago. Despite there being greater numbers of active members, this has not reversed the trend of negative cashflow from dealing with members. This is plausible as many of these new active members were added through auto enrolment and are lower paid employees with lower contributions relative to pensions in payment.

Investment performance and strategy

Investment returns

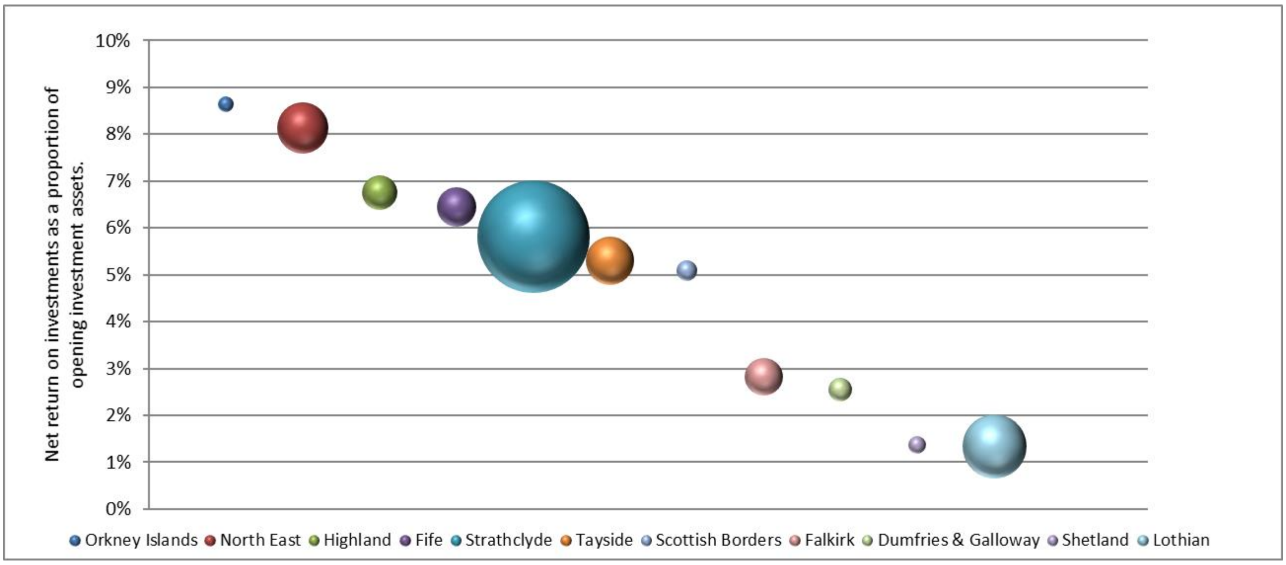
Annual investment returns were positive in 2017/18 although performance was variable

9. Investment returns remained positive in 2017/18 despite increased volatility and decline in the final quarter of the year. The weighted average return on investments was around five per cent, a significant decrease compared to 18 per cent in 2016/17. This reflects the general performance of markets between the two years. The performance and relative size of each pension fund is shown in Exhibit 4.

Exhibit 4

Annual investment returns and fund size 2017/18

The weighted average investment return for the SLPGS was just over 5 per cent in 2017/18.



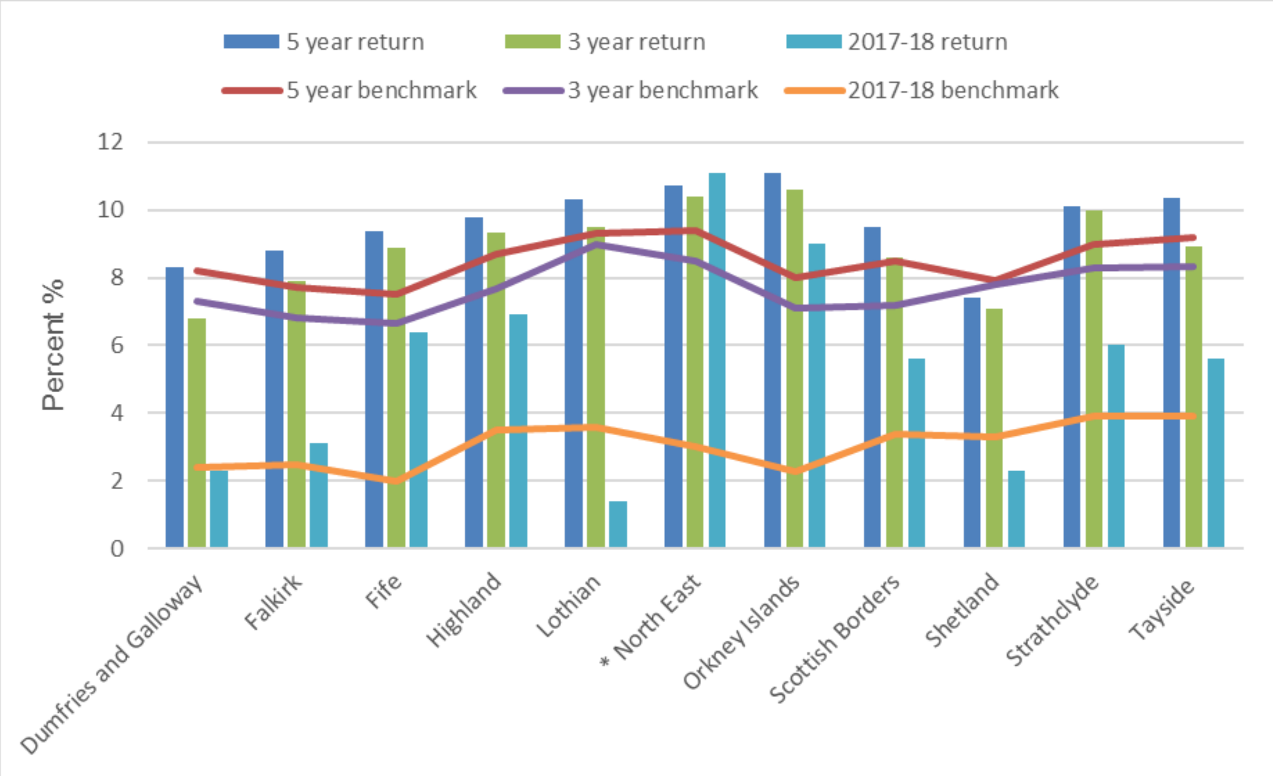
Source: Pension fund annual reports and accounts

10. Variability of investment performance between pension funds can reflect differences in the nature of assets which each fund holds, the way in which they are managed and the related risks. Another way of assessing the returns in each fund is to consider how the fund has compared against its benchmarks over 1 year, 3 years and 5 years. The benchmarks are set locally to reflect the nature of each investment mandate and the proportion of different mandates in the portfolio. Performance against each of the 11 funds benchmarks is shown in Exhibit 5.

Exhibit 5

Pensions fund performance against their benchmarks 2017/18

Investment returns for most funds were above benchmark over the 5 years to 31 March 2018.



** North East Scotland pension fund figures are on a gross basis*

Source: Pension fund annual reports and accounts

11. Exhibit 5 identifies, for example, that in Lothian pension fund the return on investments in 2017/18 was 1.4 per cent, which was behind the benchmark of 3.6 per cent, however, the performance over the five and ten-year period to 31 March 2018 exceeded the benchmark by an average of 1.1 percentage points.

Investment strategies

Investment strategies are set by each fund and indicate the nature and extent of investments the fund should hold

12. Investment strategies are set locally by each of the pension funds, although they have to comply with a common regulatory framework. Pension funds appoint independent professional advisors to help them with their investment strategies. Some funds use external firms for direct investment advice to pensions committees and boards. Some funds have investment panels that employ specialist advisers before recommendations are made to the pensions committee/boards. In 2017/18, Fife Pension Fund joined with Lothian and Falkirk in a collaborative arrangement for investment governance which includes a joint investment strategy panel advising all of these funds.

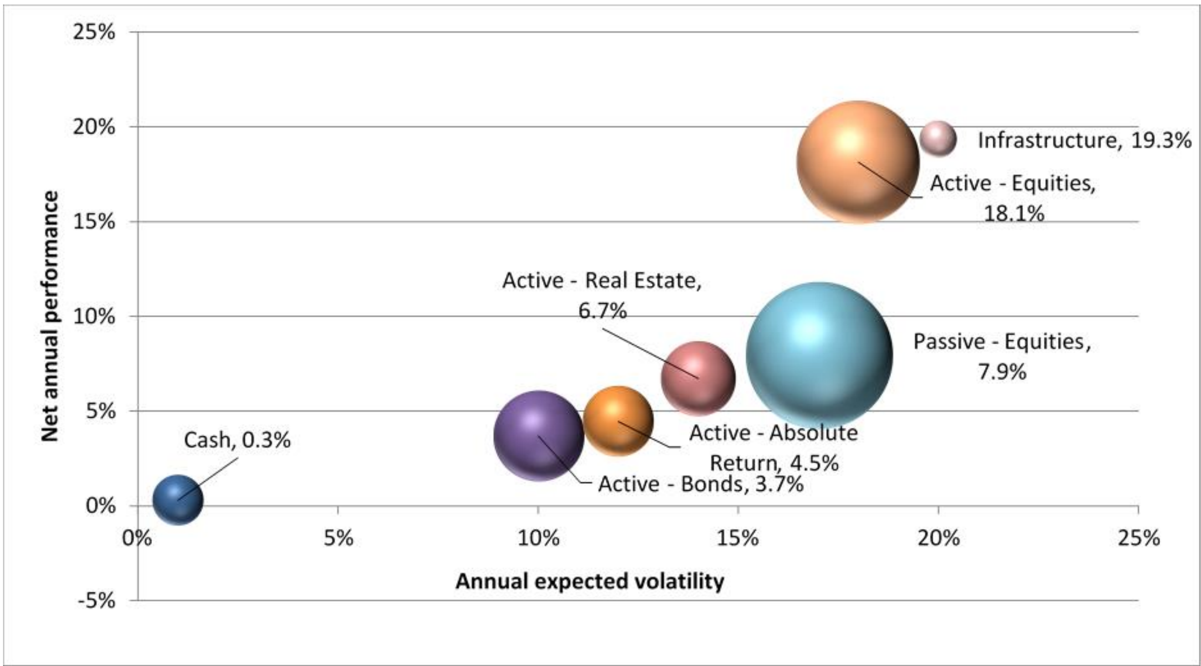
13. Investment strategies should take account of the current funding and cash-flow position of the fund and reflect the investment outlook to achieve the returns necessary to maintain employer contributions. Seeking higher returns typically exposes pension funds to higher risk.

14. Exhibit 6 demonstrates the different investments and their relative size and returns at Fife pension fund. The fund has 11 investment mandates, managed by nine fund managers. Cash balances form a relatively small working capital balance and achieve very low returns. Infrastructure investments earned high returns but are relatively modest in size. Equities - both active and passive mandates - form the majority of the invested assets. Passive equity investments earned much lower rates of return than active mandates, but they also have lower fees. Investments that earned the higher rates of return were also considered to be the most volatile (riskier).

Exhibit 6

Asset allocations, performance and volatility – Fife Pension Fund as at 31 March 2018

Passive equities were the largest category of investment delivering relatively high returns but with a relatively high exposure to market volatility.



Source: Fife pension fund annual audit report

Pension funds have been reviewing their investment strategies

15. Some funds identified that they have reviewed their investment strategies. This is due to factors such as the maturity of the pension fund, the overall funding position and investment advisers' outlook on markets (particularly in connection with EU withdrawal):

- One fund identified that "the primary consideration was the impact of the EU withdrawal on movement in investments and risk".

- At Scottish Borders Pension Fund, the auditor noted that the fund is ".. to diversify away from equity assets into income generating inflation-linked assets that are more resilient to the volatility of the equities markets. Increasing investment in infrastructure, which is not as tied to global events… management are aware of the currency fluctuation risk and are working with their investment consultant to determine ways to mitigate that risk".
- Strathclyde Pension Fund noted that it had begun "the implementation of a revised strategic target model… to hold less equity and move to more short-term and long-term enhanced yield assets… such as UK and overseas property. The fund has reduced equity holdings by £2 billion from 68.6 per cent of assets… to 56.7 per cent… to de-risk the investment portfolio at a time where there is some increasing uncertainty in global markets."

16. Funds are also reporting that the actual investment portfolio is not consistent with their investment strategies. Increases in the value of equities has meant that some funds are holding more of their total value in equities ('overweight in equities') compared to their investment strategies:
    - Fife Pension Fund auditor reported that 62 per cent of the fund’s investments are in equities, that the fund has not rebalanced its mandates since last year, remains overweight in equities (against a target of 55 per cent) and underweight in bonds.
    - The auditor of Falkirk Pension Fund identified that "the future projected strategic allocation of investments, outlined in the fund’s statement of investment principles, shows a significant divestment from the current allocation".

Investment costs

Investment costs are becoming more transparent

17. In recent years there has been increased interest in the investment costs incurred by the SLGPS, with a drive for more transparency from investment managers about the fees and charges they make. Ensuring that investment management expenses are reasonable can be one way for pension funds to increase returns without increasing risk.

18. However, full transparency is still to be achieved. The auditor at Tayside Pension Fund identifies that "the fund has incurred £1.7 million of investment transaction costs, which it has capitalised as part of the cost of the investments rather than including within investment management expenses."

19. Investment management expenses have increased in 2017/18. The main reason for this increase in expense is the growth in equity values, but there are other reasons:
    - Fife Pension Fund reported a high initial cost of the infrastructure mandate, which carries out private equity-type investments. It levied performance fees of £1.7 million and made two new investments with one-off fees of £1.6 million.
    - Scottish Borders Pension Fund auditor noted that "there has been significant... investment management expenses of… £8.2 million. This is largely because of one-off

transaction costs associated with investment in long-lease property, which is seen as a key part of the investment strategy. (Their adviser was)... confident this cost will be recouped through investment performance."

Governance

Committees and boards

Pension committees and pension boards oversee the funds

20. From 1 April 2015 all pension funds were required to introduce local pension boards in line with the Public Service Pensions Act 2013. This is the third year of operation of the Pensions Board. The Pensions Board usually meet concurrently with the Pensions Committee. The remit of the Pensions Board is to support the Pension Committee to comply with regulations and the requirements of the Pensions Regulator. In some councils, the responsibility for pension fund matters is split between committees.

21. Division of pension responsibilities to two committees may restrict the information available to some responsible for governance. In Fife, the oversight of pension fund governance and risk management remain in the remit of Fife Council's Standards and Audit Committee. Weaknesses in pension fund governance and management arrangements are reported to the Standards and Audit Committee, but not routinely to the Superannuation Fund and Pensions Sub-Committee or the Pensions Board. The two committees share the same convenor, so this helps to ensure that key issues are brought to the attention of both.

Some pension funds have introduced investment panels

22. To assist and advise the pension committee and board on investments strategy and performance, some pension funds have introduced advisory panels. This helps officers call on wider investment knowledge and expertise. It also introduces a governance process which sits between the investment advisor and the committee, reducing the burden on committees and on council officers to consider the detail of investment proposals/decisions. Strathclyde Pension Fund's Investment Advisory Panel (the IAP) comprises "investment officers from the fund, representatives from Hymans Robertson (as the fund's actuary and investment consultant). The panel also includes three independent expert advisors. The IAP supports the Pension Fund Committee and is responsible for developing investment strategy and monitoring investment performance."

23. At Lothian Pension Fund, the pensions committee has delegated responsibility for investment strategy to the executive director of resource who takes advice from an Investment Strategy Panel made up of the chief executive of the fund, chief investment officer and two external independent investment consultants.

Collaboration

Lothian, Falkirk and Fife pension funds are collaborating on investment advice

24. Lothian, Falkirk and Fife pension funds have set up a joint working arrangement which includes a joint Investment Strategy Panel. The role of this panel will be to advise the chief

financial officers of each administering authority on the implementation of investment strategy. Over the last year, Lothian collaborated with Falkirk on seven infrastructure investments.

25. The Scottish Borders Pension Fund also noted that it "continues to invest in other assets classes such as long-lease property, private credit and infrastructure, by partnering with Lothian Pension Fund."

Other issues

In 2017/18 Tayside undertook a repatriation exercise

26. As noted in the introduction to this report, apart from the main 11 funds, there are a few other funds managed by councils. These include Lothian Buses Pension Fund and Scottish Homes Pension Fund, for example. These funds are distinct from the main funds. They are often closed to new members and, as mature funds, have funding and investment strategies that are very different to the main funds.

27. At Tayside Pension Fund, following legal, actuarial and investment opinion and full employer consultation, the Pensions Sub-committee approved the repatriation of assets and liabilities of the Tayside Transport Fund back to the main fund. This was intended to provide the single employer, Xplore Dundee, with a guaranteed future contribution rate and to provide administrative efficiencies and value for money. The expectation is that repatriation would reduce custodial and actuarial fees, investment and management costs. The repatriation took place on 30 June 2018 and resulted in the transfer of £71 million of transport fund net asset values into the main fund which had a net asset valuation of £3.5 billion at that date.

Cessations can lead to additional financial pressures

28. Auditors have been reporting that a number of employers have indicated they want to leave, or have left, pension funds in 2017-18. These cessation events can lead to additional contributions from those employers and sometimes decisions on the recoverability of cessation debts. Cessation payments at Lothian Pension Fund were £1.4 million in 2017/18 and it has long-term debtors of £1.5 million associated with cessation.

29. At 31 March 2018, the North East Pension Fund recognised that there were three employers who had exited from the Fund where payment of the termination fee may not be recovered in full.

There were some reported issues with employer returns

30. Employers are required to submit year-end contribution returns and compliance returns usually by the May after each financial year-end. This is an important control over the accuracy of pension contributions received and recorded in the pensions systems and is of increased importance following the introduction of Career Average Revalued Earnings (CARE) schemes: as the member benefit statement requires actual salary data from all employers.

31. All year-end contribution returns relating to 2017/18 have been received by funds. One auditor identified issues with the lateness of contribution returns, with more auditors identifying issues with employer compliance returns.

Administration

Changes affecting funds

There have been many changes affecting the administration of schemes

32. SLGPS pension funds have faced significant administration challenges in recent years. We have identified the effect of auto-enrolment and the increase in membership at paragraph 7, but there have been other changes.

33. Revised Local Government Pension Scheme regulations came into effect on 1 June 2018. The changes to the regulations aim to consolidate amendments since April 2015 and include:

- LGPS members can elect to take early payment of their pension from age 55, with an actuarial reduction. They will not require consent from their employing body.
- There is increased flexibility for administering authorities when employers exit the pension scheme. Exit credit can be provided to exiting employers if appropriate.
- There are changes to additional voluntary contributions following the introduction of freedom and choice in pensions by the UK Government, which permits payment from age 55 as a lump sum.

34. New data regulations (GDPR) covering data protection came into force on 25 May 2018. Auditors reported that pension funds' preparations for this had been completed as planned.

35. In May 2017, several health boards across NHS Scotland were affected by the Wannacry global ransomware attack. In response to this, the Scottish Government launched 'A Cyber Resilience Strategy for Scotland: Public Sector Action Plan, 2017/18'. The action plan outlines various requirements that public bodies should take forward. It includes an action for public bodies to achieve a Cyber Essentials Plus certification by the end of October 2018. There is a need to consider whether the pensions' systems supplier meets Cyber Essentials standards. We recommend the fund encourages its suppliers to adopt the Cyber Essentials standard.

36. The auditor at Fife Pension Fund noted the loss of five experienced staff members from the administration team and issues with reconciliations and recording of non-routine transactions. Borders Council implemented a new financial system, Business World, in April 2017 and undertook a subsequent restructuring of the finance function. The auditor noted that "this has placed a significant burden on key team members at certain times."

Outlook

SLGPS structural review

The Scottish Scheme Advisory Board (SSAB) is currently consulting on the future structure of the SLGPS

37. In 2017 the SSAB reported to the Scottish Minister on options for the future structure of the SLGPS. The report referred to the potential economies of scale and cost savings available in relation to the administration and investment activity of pension funds, highlighting the likely impact of different options on local governance and oversight. The report included four options for consideration:

- retain the current structure with 11 funds
- promote cooperation in investing and administration between the 11 funds
- pool investments between 11 funds
- merge the 11 funds into one or more funds.

38. Early in 2018 the Scottish Minister requested that the SSAB consult more widely on these options and in June 2018 a consultation was launched, with a decision on the future course of action in 2019.

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