



*cutting through complexity*

# Scottish Borders Council Pension Fund

Annual audit report to Scottish Borders Council as  
administering authority for Scottish Borders Council  
Pension Fund and the Controller of Audit

For the year ended 31 March 2016

13 September 2016

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### About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Scottish Borders Council ("the Council") and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the introduction and responsibilities section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

### Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Hugh Harvie who is the engagement leader for our services to Scottish Borders Council Pension Fund, telephone 0131 527 6682, email: [hugh.harvie@kpmg.co.uk](mailto:hugh.harvie@kpmg.co.uk) who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to [alex.sanderson@kpmg.co.uk](mailto:alex.sanderson@kpmg.co.uk). We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

# **Executive summary**

## Audit conclusions

- ■ We propose to issue an unqualified audit opinion on the financial statements of the Scottish Borders Council Pension Fund, following receipt of the management representation letter. Page 11

## Financial position

- ■ The latest triennial valuation (as at 31 March 2014) shows the funding level at 101% which corresponds to a surplus of £2.9m. The next triennial valuation will be carried out for the Fund as at 31 March 2017.
- ■ The number of pensioners have increased during the year to 3,157 resulting in an increase in pension benefits during the year of £1.2m which has contributed to the net withdrawal position of £2.1m from dealing with members. Page 6-9
- ■ Challenging market conditions have resulted in a small decrease in net assets of £2.6m during the year to £542.6m as at 31 March 2016. Investment returns have been particularly affected with the market value of investments decreasing £3.6m during the year which compares to an increase of £58.5m in the prior year. Despite difficult market conditions, the fund has continued to exceed the return benchmarks over both 1 and 3 year periods.
- ■ The challenging economic environment is expected to continue for the foreseeable future particularly following the Brexit vote on 23 June 2016 which has provoked a greater sense of uncertainty in the financial markets.

## Financial statements and related reports

- ■ We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in the audit strategy and plan document. We concur with management's accounting treatment and judgements. Page 11-16
- ■ One adjusted and one unadjusted difference were identified as part of our audit work. The adjusted audit difference relates to omitted investment income totaling £310,000 which has been correctly reflected in the financial statements. The unadjusted audit difference relates to the valuation of investment assets and amounts to £132,000 which is immaterial in the context of the financial statements. We have no matters to highlight in respect of independence and changes to management representations.

## Wider scope

- ■ We considered the four audit dimensions and focused on governance and transparency given its significance to the Pension Fund. Page 18-20
- ■ We concluded positively on the governance arrangements in place. A strong internal control environment was found to be in operation, transparency was evident with all board minutes being published, and effective scrutiny of decisions was apparent led by the Pension Board.

# Executive summary

## Scope and responsibilities

### Purpose of this report

The Accounts Commission has appointed KPMG LLP as auditor of Scottish Borders Council under part VII of the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at the Pension Fund and the Controller of Audit. The scope and nature of our audit were set out in our audit strategy document which was presented to the Pension Fund at the outset of our audit.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

### Accountable officer responsibilities

The Code sets out the Pension Fund's responsibilities in respect of:

- preparation of financial statements that show a true and fair view;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

### Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code. Appendix three sets out how we have met each of the responsibilities set out in the Code.

### Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems.

Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This annual audit report to members and our presentation to the audit and risk committee, together with previous reports to the Pension Fund Committee throughout the year, discharges the requirements of ISA 260.

# Financial position

## Overview

The key component in assessing the financial position of the Pension Fund is the triennial valuation in which the Fund's actuary undertakes every three years (in line with the Local Government Pension Scheme Regulations 2014) for the purposes of setting employer contribution rates for the forthcoming triennial period.

As part of this section, the most recent actuarial valuation has been analysed and our conclusions highlighted in respect of our IAS 26 assumptions review. The financial performance during the year has been assessed from a review of the fund account, and the financial position at the year end appraised with reference to the net assets statement.

## Triennial valuation

The actuarial valuation assesses the health of the Fund and provides a check that the funding strategy and assumptions used are appropriate. The 2014 Actuarial Valuation was undertaken for the Fund as at 31 March 2014 and was completed during the financial year 2014 - 15 by the Fund's actuaries, Barnett Waddingham.

The funding level at 31 March 2014 was 101%, which was above the valuation as at 31 March 2011 and corresponded to a surplus of £2.9m (the smoothed asset value totalled £490.5m and the scheme liabilities were valued at £487.6m).

The value of the scheme liabilities is an estimate of the assets required to pay pensions over the coming years. The smoothed asset value is the contributions received from employers and members as well as investment returns.

The next detailed actuarial valuation will be carried out for the Fund as at 31 March 2017.

## IAS 26 assumptions review

The Fund's actuary also undertakes a valuation of pension fund liabilities (actuarial present value of promised retirement benefits) at the accounting date as required by International Accounting Standard (IAS) 26, and calculated in line with IAS 19 assumptions.

Our team of in-house actuaries reviewed assumptions used in the valuation. It is understood from the Barnett Waddingham correspondence that:

- the assumptions considered in this report are based on market conditions at 31 March 2016; and
- the average duration of the liabilities is 19 years for the year ended 31 March 2016.

Please see a summary table on the following page of the assumptions applied together with a comparison to KPMG's guidance rates.

Overall the assumptions proposed by the employer can be considered to be reasonably balanced.

Assumptions	Scottish Borders Council	KPMG Central	Assessment
Discount rate	3.70%	3.48%	Acceptable
RPI inflation	3.30%	3.23%	Acceptable
CPI inflation/Pension Increases	2.40% RPI less 0.90%	2.23% RPI less 1.0%	Acceptable
Salary growth	4.20% CPI plus 1.80%	Typically 0%- 1.5% above RPI	Acceptable – This assumption is one for the employer to take a view on, based on expectations of future pay growth. The proposed assumption is acceptable under IAS 19 as it is in line with the Directors' best estimate view on future remuneration.
Life Expectancy at age 65	Male age 65: 22.8 Male age 45: 25.0 Female age 65: 23.7 Female age 45: 26.0	Male age 65: 22.2 Male age 45: 23.9 Female age 65: 24.2 Female age 45: 26.1	Acceptable

### Financial position

Current membership of the Fund is 10,259 of which 4,594 are actively contributing and 3,157 are in receipt of pension benefits. There has been a slight increase in relation to active contributing membership and a continuing rise in the number of pensioners. Total contributions have increased by £0.4m and benefits payable have increased by £1.2m during the year. This has led to the current year net withdrawal position of £2.0m (2014-15: £1m) from dealing with members.

Net return on investments decreased significantly to £2.7m in 2015-16 (2014-15: £62.9m) primarily due to much more challenging market conditions during the year which have resulted in a decrease of £2.6m in the market value of investments which compares to an increase of £58.5m in the prior year. Investment returns are monitored by the Pension Fund Committee throughout the year, and from 1 April 2015, the detailed review of individual investment manager performance has been delegated by the Pension Fund Committee to the Investment and Performance Sub-Committee. Recent historic performance of the fund has been stable against the backdrop of volatile investment markets.

Given the challenging market conditions, there has been a net decrease of £2.5m in the fund during the year ended 2015-16 which compares to a net increase of £59m in the prior year.



# Financial position (continued)

Fund account		
£m	2016	2015
<b>Contributions and benefits</b>		
Contributions receivable	18.6	18.2
Transfers in	0.4	0.7
	<b>19.0</b>	<b>18.9</b>
Benefits payable	(20.3)	(19.1)
Payment on account of leavers	(0.7)	(0.8)
	<b>(21.0)</b>	<b>(19.9)</b>
Net withdrawals from dealing with members	(1.9)	(1.0)
<b>Management expenses</b>	<b>(3.3)</b>	<b>(2.9)</b>
<b>Return on investments</b>		
Investment income	6.4	4.6
Change in market value of investments	(3.5)	58.4
Taxes on income	(0.1)	(0.2)
<b>Net returns on investments</b>	<b>2.7</b>	<b>62.9</b>
Net increase/(decrease) in the fund	(2.6)	59.0
<b>Opening Net Assets of the Scheme</b>	<b>545.1</b>	<b>486.1</b>
<b>Closing Net Assets of the Scheme</b>	<b>542.6</b>	<b>545.1</b>

Net assets statement		
£m	2016	2015
Equities	203.9	216.5
<b>Managed funds:</b>		
Property	32.5	28.7
Global equities	82.9	76.2
UK equities	62.4	65.3
Bonds	18.6	18.4
Diversified fixed income	39.9	39.9
Alternatives	92.5	93.8
Open ended investment contracts	1.7	1.7
Derivatives – forward foreign exchange	1.4	(2.5)
Cash deposits	5.7	6.5
Other investment balances	0.9	0.7
<b>Current assets and liabilities</b>		
Cash balances	1.4	1.1
Contributions due from employers	0.2	0.1
Current assets	0.4	0.1
Current liabilities	(2.1)	(1.4)
<b>Total net assets</b>	<b>542.6</b>	<b>545.1</b>

The above allocation of investment assets is in line with the mandates provided to the investment managers and is also consistent with the Statement of Investment Principles.

Return on investment	1 Year rolling return		
	Fund	Bench <sup>1</sup>	LA <sup>2</sup>
	%	%	%
Total fund	(0.1)	(0.4)	0.2
including Currency Hedging			
Global equities	2.9	(0.4)	(1.6)
including UK			
UK equities	(3.7)	(3.9)	(3.8)
Pooled bonds	(0.4)	0.5	0.2
UK government bonds	3.3	3.2	2.9
UK corporate bonds	(0.4)	0.4	(0.9)
Property	10.3	10.6	10.5
Alternatives	(1.6)	4.6	8.7
Cash	0.4	0.3	2.2

Key:

1 Bench: Benchmark Return which reflects the overall performance of the individual markets available to the manager within the mandate given to them.

2 LA: Local Authority Weighted Average Return based on WM Company's League Tables for period to 31 March 2016.

The fund return over 1 year was (0.1%) p.a. compared to a benchmark of (0.4%). This positive performance against the benchmark was supported by a strong performance from Morgan Stanley in the global equities market. This market produced a 2.9% 1 year return against a benchmark of (0.4%). This positive performance helped to offset under performance by Harris Associates in global equities, M&G in bonds and LGT in alternative portfolios. Please refer to the above table for further details on the return on investment produced by each assets class against their benchmarks.

The performance of the fund in all of the asset classes with the exception of UK corporate bonds and the alternative portfolios exceeded the 3 year benchmark return.

### Financial plans 2016-17

Management does not budget financial performance of the Pension Fund due to the nature of income and expenditure.

### Conclusion

The Pension Fund has maintained a strong financial position during 2015-16 despite very challenging market conditions. There has been a small decrease in net assets of £2.6m to £542.62m as at 31 March 2016. The fund's return over 1 and 3 year periods exceeded the benchmarks showing the fund is continuing to perform well in a difficult economic environment.

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# **Financial statements and related reports**

#### Audit opinion

Our audit work is complete subject to receipt of a management representation letter and an update of subsequent events. Following approval of the annual accounts by the Pension Fund Committee we intend to issue an unqualified opinion on the truth and fairness of the state of the Pension Fund's affairs as at 31 March 2016, and of the Pension Fund's net decrease for the year then ended. There are no matters identified on which we are required to report by exception.

#### Financial reporting framework, legislation and other reporting requirements

The Pension Fund is required to prepare its financial statements in accordance with International Financial Reporting Standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2015-16 ("the Code"). In addition, consideration has been given to the Local Government Pension Scheme Fund Accounts 2015/16 – example accounts and disclosure checklist published by the Chartered Institute of Public Finance Accountants (CIPFA). Our audit confirmed that the financial statements have been prepared in accordance with the Code and relevant legislation.

#### Statutory reports

We have not identified any circumstances to notify the Controller of Audit that indicate a statutory report may be required.

#### Other communications

We did not encounter any significant difficulties during the audit. There were no other significant matters arising from the audit that were discussed, or subject to correspondence with management that have not been included within this report. There are no other matters arising from the audit, that, in our professional judgement, are significant to the oversight of the financial reporting process.

#### Audit misstatements

There was one audit adjustment made to the draft annual accounts which impacted on the net assets and investment income for the year. There was also one judgemental unadjusted audit differences in relation to the valuation of investments. This misstatement is less than our materiality threshold hence it does not require to be adjusted in order for us to issue an unqualified audit opinion. Further details of these audit misstatements are provided in appendix one.

#### Written representations

There are no changes to the standard representations required for our audit from last year.

#### Materiality

We summarised our approach to materiality in our audit strategy. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that our planning materiality for 2015-16 of £470,000 remains appropriate. We report all misstatements greater than £24,000.

#### Forming our opinions and conclusions

In gathering the evidence for the above opinion(s) and conclusion(s) we have:

- performed controls testing and substantive procedures to ensure that key risks to the annual accounts have been covered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the annual accounts through discussions with senior management to gain a better understanding of the work performed in relation to prevention and detection of fraud.

#### Financial statements preparation

High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 11 July 2016. This included the management commentary and governance statement.

#### Significant risks and other focus areas in relation to the audit of the financial statements

We summarise below the risks of material misstatement as reported within the audit strategy. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the audit and risk committee may better understand the process by which we arrived at our audit opinion.

Significant risks:

- management override of controls fraud risk.

Other focus areas:

- fraud risk from income recognition;
- valuation of investments.

We have no changes to the risk or our approach to addressing the assumed ISA risk of fraud in management override of controls and risks of fraudulent revenue recognition. We do not have findings to bring to your attention in relation to these matters. No control overrides were identified.

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
<p><b>Fraud risk from management override of controls</b></p> <p>Professional standards require us to communicate the fraud risk arising as a result of management override of controls as a significant risk; as management are typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p>	<p>Our audit methodology incorporated management override of controls as a default significant risk. We did not identify any specific additional risks of management override as part of the audit of the fund.</p> <p>In line with our methodology, we carried out appropriate controls testing and substantive procedures, including testing over journal entries, accounting estimates and significant transactions that are outside the organisation's normal course of business, or are otherwise unusual.</p>	<p>We found no instances of management override of controls from our audit testing and witnessed evidence of a strong control environment in operation.</p>

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
<p><b>Fraud risk from income recognition</b></p> <p>Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. Given that income only comprises of contributions received and investment income, we do not regard the risk of fraud from the recognition of this revenue as significant given the income figures are taken directly from payroll and investment reports respectively.</p>	<p>In relation to contribution income, we performed detailed controls testing over the contribution return reconciliations, and over starters and leavers. We also performed various substantive analytical procedures together with detailed cut-off testing to ensure contribution income has been recognised in the correct accounting period.</p> <p>In relation to investment income, detailed substantive procedures were carried out with a sample of income transactions being vouched to fund manager reports. The movements in the values of the investment assets were verified by obtaining third party confirmation of 100% of the investments held at the year end.</p>	<p>We found no instances of fraud arising from our income controls testing and substantive work.</p> <p>We did however identify that investment income was understated at the year end. The finding was presented to management and they processed the appropriate adjustment, see appendix one for further details.</p>
<p><b>Valuation of investment assets</b></p> <p>Valuation of investment can be one of the more volatile elements of the financial statement and in the case of the pension fund is a material balance. Due to the inherent risk, we give additional focus to the accounting of the valuation of investments.</p>	<p>To gain assurance over the valuation of the year end investments, we obtained third party confirmations over 100% of the year end valuation of investments from the fund managers directly and compared it to the valuation on draft financial statements.</p> <p>We tested all the investments and performed pricing audit procedures over listed investments of the Fund. The year end bid values were assessed using our internal research tools to determine the reasonableness of the year end fund manager's valuation.</p>	<p>We found differences between the direct confirmations from the fund managers and reported values on the draft financial statements. The differences were presented to management as a proposed audit adjustment as set out in appendix one. Given the amount is immaterial to the financial statements, management opted not to adjust for this misstatement.</p>

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
<b>Management Commentary</b>	<p>The financial statements form part of the annual report for the year ended 31 March 2016. We reviewed the content of the management commentary against the disclosure requirements and are content with the proposed reports. The overall quality of the management commentary was good with clear presentation throughout. We provided management with some relatively minor suggestions relating to how the reports could be enhanced and where additional information disclosures should be made.</p>	<p>We are satisfied that the information contained within the management commentary is consistent with the financial statements.</p>
<b>Annual governance statement</b>	<p>The statement for 2015-16 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the Pension Fund's governance framework, operated internal controls, and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework.</p>	<p>We consider the governance framework and annual governance statement to be appropriate for the Pension Fund and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.</p>



#### Qualitative aspects

ISA 260 requires us to report to those charged with governance our views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

We consider the accounting policies adopted by the Pension Fund to be appropriate, and there have been no changes to adopted accounting policies in the year. There are no significant accounting practices which depart from what is acceptable under IFRS or the Code.

Financial statement disclosures were considered against requirements of the Code, relevant legislation and IFRS. No departures from these requirements were identified.

#### Future accounting and audit developments

ISA (UK & Ireland) 700 and 720 have been revised for accounting periods beginning on or after 17 June 2016. These revise the requirements for the structure and content of the independent auditor's report. Audit Scotland is considering whether to early adopt the standards for 2016-17.

**Wider scope**

## Introduction

The Code frames the wider scope of our audit in terms of four audit dimensions; financial management, financial sustainability, governance and transparency and value for money. At the centre of these dimensions is Best Value.

It remains the responsibility of the audited body to ensure that they have proper arrangements in place across each of these audit dimensions. These arrangements should be appropriate to the nature of the audited body and the services and functions that it has been created to deliver. We review and come to a conclusion on these proper arrangements.

During our work on the audit dimensions we have considered the work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code.

## Audit work and conclusions

Given the nature of the Pension Fund, the audit dimensions of financial sustainability, financial management and value for money are all captured within governance and transparency as this audit dimension is central to every aspect of the Pension Fund.

The audit dimensions are achieved through the governance procedures in place. Effective financial management and sustainability is directed by the Pension Fund Committee through committee meetings using guidance provided by the Pension Fund's investment consultant and actuary. Value for money is delivered through the mandates provided to the investment managers and is also reviewed as part of the regular committee meetings.

We will summarise the work we have undertaken in the year to obtain assurances over the arrangements in place and our conclusions on the effectiveness and appropriateness of these arrangements.

Where we have found arrangements to not be effective or are absent we have provided further narrative and recommendations for improvement. Where we have found the arrangements to be generally effective and operating as expected we have identified this in the conclusions we have formed.



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

In considering governance and transparency we performed the following work:

### *Reviewing the organisational structure, reporting lines and level of scrutiny within the Pension Fund.*

The Pension Fund demonstrates effective scrutiny, challenge and transparency on decision making through various levels of committee meetings. Decisions are transparent as actions are documented within detailed board minutes which are available on the Scottish Borders Council website.

The Pension Fund Committee has overall responsibility for ensuring sound governance arrangements are in place but has been supported by the Pension Board and the Investment and Performance sub-committee from 1 April 2015. This Pension Board and the sub-committee were set up in response to the new governance regulations published by the Scottish Government in February 2015. The Pension Board offers increased scrutiny over the Pension Fund Committee's decisions and the Investment and Performance sub-committee has provided additional assistance in monitoring investment performance. We are satisfied that the Pension Fund's new arrangements are in compliance with the new governance regulations published by the Scottish Government.

### *Reviewing the annual governance statement*

Our observations and conclusions on the annual governance statement are provided on page 15.

### *Reviewing and testing the internal control environment.*

Management is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the financial statements. The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work. KPMG's identification of weaknesses, where applicable, does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

As part of our work, we undertook a review of the latest internal control reports issued by the Fund's investment managers. The exceptions reported by the independent auditors of the investment managers were reviewed and we planned our audit approach taking into account the assurance gained through these reports.

The exceptions reported recognised the internal control deficiencies had no direct impact on the Pension Fund audit, giving comfort over the evidence provided by the investment managers. Additional testing was performed to corroborate the information received from the investment managers with the custodian reports that were independently received by us.

#### *Conclusion*

Our testing confirms that controls relating to financial systems and procedures are designed appropriately and operate effectively.

We consider the governance framework to be appropriate to the Pension Fund and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

The Pension Fund Committee is effectively scrutinised by the Pension Board and all key decisions are transparent due to them being documented in detailed board minutes which are publicly available.

From reviewing the governance arrangements in place, it is clear that the Pension Fund is in compliance with the new governance regulations published by the Scottish Government.

# Appendices

#### Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There was one audit adjustment required to the draft annual accounts which impacted on the net assets and investment income for the year. There was also one unadjusted audit differences in relation to the valuation of investments. This misstatement is less than our materiality threshold hence it does not require to be adjusted in order for us to issue an unqualified audit opinion

CAPTION	NATURE OF ADJUSTMENT	BALANCE SHEET		INCOME AND EXPENDITURE	
		£000 DR	£000 CR	£000 DR	£000 CR
<b>Investment income – Adjusted</b>	Investment income from some of the year end fund manager reports was omitted in error. The total amount omitted totalled £310,000. Both investment assets and investment income were therefore understated at the year end. Management correctly adjusted for this and the financial statements have been correctly updated.	310			310
<b>Investment assets – Unadjusted</b>	Differences were identified between the direct investment valuation confirmations from the fund managers and the reported values in the draft financial statements with the net difference amounting to £132,000. The total value per the investment confirmations was higher than the amount recognised in the accounts hence the proposed audit adjustment is to increase investment assets. Management have opted not to adjust for this difference given it is immaterial to the financial statements.	132			132

To Pension Fund Committee members

#### Assessment of our objectivity and independence as auditor of the Scottish Borders Council Pension Fund

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

#### General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity

#### Independence and objectivity considerations relating to the provision of non-audit services

##### *Summary of fees*

We have considered the fees charged by us to the Pension Fund for professional services provided by us during the reporting period.

Total fees charged by us for the year ended 31 March 2016 amounted to £28,950, £23,000 of which relates to audit fees and £5,950 to specialist tax services. The audit fee in the prior year was also £23,000 and there were no non-audit services provided.



### Independence and objectivity considerations relating to other matters

KPMG has been appointed as the Pension Fund's investment consultant from 1 April 2016. KPMG's period of appointment as external auditor ceases following the 2015-16 financial year hence there are no conflicts of interest.

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Pension Fund Committee.

### Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

This report is intended solely for the information of the Pension Fund Committee and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

**KPMG LLP**

# Appendix three

## Appointed auditors responsibilities

Area	Appointed auditors responsibilities	How we've met our responsibilities
Corporate governance	Review and come to a conclusion on the effectiveness and appropriateness of arrangements to ensure the proper conduct of the bodies affairs including legality of activities and transactions, Conclude on whether the monitoring arrangements operate and are operating in line with recommended best practice.	Page 20 sets out our conclusion on these arrangements.
Financial statements and related reports	Provide an opinion on audited bodies' financial statements on whether financial statements give a true and fair view of the financial position of audited bodies and their expenditure and income Provide an opinion on whether financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements	Page 11 summarises the opinions we expect to provide.
Financial statements and related reports	Review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns.	Page 15 reports on the other information contained in the financial statements, covering the annual governance statement and management commentary.
Financial statements and related reports	Notify the Controller of Audit when circumstances indicate that a statutory report may be required.	Page 11 sets out any notifications we have made to the Controller of Audit.
Financial statements and related reports	Review and conclude on the effectiveness and appropriateness of arrangements and systems of internal control, including risk management, internal audit, financial, operational and compliance controls.	Page 20 sets out our conclusion on these arrangements.

# Appendix three

## Appointed auditors responsibilities (continued)

Area	Appointed auditors responsibilities	How we've met our responsibilities
Standards of conduct – prevention and detection of fraud and error	Review and conclude on the effectiveness and appropriateness of arrangements for the prevention and detection of fraud and irregularities, bribery and corruption and arrangements to ensure the bodies affairs are managed in accordance with proper standards of conduct. Review National Fraud Initiative participation and conclude on the effectiveness of bodies engagement.	These arrangement are reviewed and concluded on as part of the Scottish Borders Council external audit. Please refer to the Scottish Borders Council audit report for further details.
Financial position	Review and conclude on the effectiveness and appropriateness of arrangements to ensure that the bodies financial position is soundly based.	Pages 6 to 9 set out our conclusion on these arrangements.
Financial position	Review performance against targets.	Pages 6 to 9 summarise our review of how the body has performed against it's financial targets.
Financial position	Review and conclude on financial position including reserves balances and strategies and longer term financial sustainability.	Page 6 to 9 sets out our conclusion on the bodies financial position including reserves balances.



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