

# Scottish Borders Council Pension Fund

2018/19 Annual Audit Report



 AUDIT SCOTLAND

To Scottish Borders Council as administering authority for Scottish Borders Council Pension Fund and the Controller of Audit

September 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## 2018/19 annual report and accounts

- 1 Scottish Borders Council Pension Fund's (the fund) financial statements give a true and fair view and were properly prepared.
- 2 The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared.

## Financial management

- 3 The fund has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.
- 4 The fund grew by 7.6% during 2018/19, slightly below its benchmark of 7.7%. The fund has a rolling three-year performance of 11.3%, which is above the benchmark of 10%. The fund is continuing to make progress with its asset strategy, reducing exposure to equity investment from 58% to 48% of the total fund.

## Financial sustainability

- 5 The 2017 Triennial valuation shows a funding level of 114%, the highest in Scotland, an increase from 101% in 2014. This allows the main pool of employing bodies to maintain their employer contribution rate at 18%.
- 6 The continued increase in pensioner membership will make funding future pension payments increasingly challenging. Cash flow projections show that the fund will continue to rely on investment income to pay pensions. Management are taking measures to increase income from investments to ease cashflow pressures.

## Governance and transparency

- 7 There are effective governance arrangements in place that support scrutiny of decisions made by management and the Pension Fund Committee.
- 8 Papers and minutes of meetings of the Pension Fund Committee are available on the Scottish Borders Council website. There is also a dedicated website for the fund, making available a wide range of important information relevant to members of the fund.

## Value for money

- 9 The investment performance is subject to regular review and scrutiny by the Fund's Investment Sub-Committee, which reports to the Pension Fund Committee.
- 10 There are satisfactory arrangements in place for monitoring investment performance and scrutinising investment management.

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# Introduction

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1. This report is a summary of our findings arising from the 2018/19 audit of Scottish Borders Council Pension Fund (the Fund).

2. The scope of our audit was set out in our Annual Audit Plan presented to the 11 March 2019 meeting of the Pension Fund Committee. This report comprises our:

- audit of the Fund's annual accounts
- consideration of the wider dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1 Audit dimensions



Source: Code of Audit Practice 2016

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3. The main elements of our audit work in 2018/19 have been our:

- audit of the Fund's 2018/19 annual accounts including the issue of an independent auditor's report setting out our opinions
- review of the Fund's main financial systems
- consideration of the four audit dimensions of public audit.

## Added Value

4. We add value to the Fund through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that have been accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

**5.** In so doing, we aim to help the Fund promote improved standards of governance, better management and decision making and more effective use of resources.

## Responsibilities and reporting

**6.** Scottish Borders Council (the 'Council') is the administering authority for the Scottish Borders Council Pension Fund. The Council delegates this responsibility to the Pension Fund Committee (the 'Committee'). The Pension Fund Board (the 'Board') is responsible for establishing arrangements to ensuring the proper conduct of the affairs of the Fund in accordance with the law and the requirements of the Pensions Regulator.

**7.** The Committee and Board are responsible for establishing effective governance arrangements and ensuring that financial management is effective. In the case of Scottish Borders Pension Fund, the arrangement is for the Council's Audit and Scrutiny Committee to review the effectiveness of internal control arrangements and to recommend the annual report and accounts for approval by the Council.

**8.** Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973, the [Code of Audit Practice 2016](#), and supplementary guidance, and International Standards on Auditing in the UK.

**9.** As public sector auditors we give independent opinions on the annual accounts. Additionally, we also conclude on:

- the effectiveness of the Fund's performance management arrangements,
- suitability and effectiveness of corporate governance arrangements, and financial position and,
- arrangements for securing financial sustainability.

**10.** In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).

**11.** This report raises matters from the audit of the annual accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**12.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.

**13.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2018/19 audit fee of £20,580 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**14.** This report is addressed to both the members of the Scottish Borders Council as administering authority for the Scottish Borders Pension Fund and the Controller of Audit and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**15.** We would like to thank all management and staff for their cooperation and assistance during the audit.

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# Part 1

## Audit of 2018/19 annual accounts

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### Main judgements

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**Scottish Borders Council Pension Fund's financial statements give a true and fair view and were properly prepared.**

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**The management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared.**

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The annual accounts are the principal means by which the pension fund demonstrates effective stewardship and use of resources to its external stakeholders.

### Audit opinions on the annual accounts

**16.** The annual accounts for the year ended 31 March 2019 were approved by the Council on 26 September 2019. We reported, within our independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- the management commentary, annual governance statement and governance compliance statement were all consistent with the financial statements and properly prepared in accordance with the guidance.

**17.** We have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

### Submission of annual accounts for audit

**18.** We received the unaudited annual accounts on 28 June 2019, in line with the audit timetable set out in our 2018/19 Annual Audit Plan.

**19.** The working papers provided with the unaudited accounts by the Human Resources Shared Services (HRSS) team and the finance team were of an adequate standard and finance staff provided good support to the audit team. This helped ensure the final accounts audit process ran smoothly.

### Risks of material misstatement

**20.** [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual accounts and any wider audit dimension risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance over the outcome of these risks.

**21.** We have no issues to report from our work on the risks of material misstatement highlighted in our 2018/19 Annual Audit Plan.

**22.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves



considering both the amount and nature of the misstatement. It is affected by our perception of the financial information needs of users of the financial statements.

**23.** Our initial assessment of materiality was carried out during the planning phase of the audit and was based on the September 2018 Investment Performance Information, see [Exhibit 2](#). With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

**24.** On receipt of the unaudited 2018/19 annual accounts we revised our planning materiality calculations. The revised amounts did not change overall materiality as shown in [Exhibit 2](#).

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## Exhibit 2

### Materiality values

Materiality level	Planning Amounts
Overall materiality	£7.30 million
Performance materiality	£4.38 million
Reporting threshold	£220,000
Specific materiality for certain classes of transactions	£2.28 million
Specific performance materiality for certain classes of transactions	£1.4 million

Source: Audit Scotland

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## Significant findings from the audit in accordance with ISA 260

**25.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures.

**26.** The significant findings are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

### Qualitative aspects of the audit

**27.** We identified 2 significant findings in relation to the qualitative aspects of accounting practices and these are highlighted in [Exhibit 3](#). These are further highlighted in [Appendix 1](#) with recommendations.



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## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Key reconciliations are not being performed</b></p> <p>On selecting a sample of debtors and creditors balances for further testing, we found that several balance sheet codes (e.g. pension suspense accounts) are not being reviewed or reconciled.</p>	<p>The balances were caused by the financial coding structure in the new financial system implemented from April 2017. Management carried out additional work and provided further supporting evidence to reconcile the balances at the year end.</p>

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Issue	Resolution
<p>Without reconciliations or reviews being carried out, there is a risk of uncorrected errors not being identified on a timely basis.</p>	 Recommendation 1 (refer <a href="#">appendix 1</a> , action plan)
<p><b>2. Reconciliation of pensions paid figure</b></p> <p>There is no monetary reconciliation performed to show the total pensions paid figure agrees with the ledger. Therefore, the total pensions paid figure cannot be tied back to the ledger.</p> <p>The HRSS manager advised that there has never been a reconciliation performed between pensions paid figure and the financial ledger.</p> <p>A monthly report run for differences in payments from one month to the next is available but unfortunately due to work pressures and staff shortages this has not been completed for this financial year. This would be an effective control over the pensions paid figure on a month by month basis.</p>	<p>We carried out analytical and substantive procedures to gain assurance that the total pension paid figure is not materially misstated.</p>  Recommendation 2 (refer <a href="#">appendix 1</a> , action plan)

Source: Audit Scotland

## How we evaluate misstatements

**28.** There were no material adjustments to the unaudited financial statements arising from our audit.

**29.** It is our responsibility to request that all errors above the reporting threshold are corrected. The final decision on this lies with those charged with governance considering advice from senior officers and materiality.

**30.** One adjustment was made to the unaudited accounts arising from our audit which exceeded our reporting threshold. The Pension Fund's main bank account balance of £2.6m was included under investment assets in the unaudited accounts. This has been amended in the audited accounts to classify the balance under current assets. There was no impact on the closing net assets figure for the fund.

## Amendments to the accounts arising from legal and other judgements

**31.** In December 2018 the Court of Appeal upheld a claim from firefighters and judges that changes to their pension schemes were discriminatory based on age. The UK Government sought leave to appeal the decision (commonly known as the McCloud Ruling) to the Supreme Court however this was denied at the end of June 2019, after the unaudited accounts were prepared. This ruling will impact on other public sector pension schemes, including LGPS, which have seen similar changes in their pension schemes.

**32.** Following the decision, the Fund requested a revised IAS 26 report from the Fund actuary in order to quantify the increase in estimated liabilities as a result of the ruling. This revised report estimated the actuarial present value of promised retirement benefits as £941million for Scottish Borders Council Pension Fund an increase of £6 million. This revised assessment does not impact on the primary

financial statements of the Fund, however the relevant disclosure notes in the audited accounts were updated to include the revised values of promised retirement benefits.

## Objections

The Local Authority Accounts (Scotland) Regulations 2014 require local government bodies to publish a public notice on their website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The notice for the Fund was published on the website of the administering authority (Scottish Borders Council) and complies with the regulations. No objections were received to the Fund accounts.

## Follow up of prior year recommendations

**33.** There has been good progress in implementing our prior year audit recommendations. Out of 7 recommendations, 5 have been actioned. There has been an improvement in the working papers provided to us from management. For actions not yet implemented, revised responses and timescales have been agreed with management and are set out in [Appendix 1](#).

# Part 2

## Financial management



### Main judgements

The fund has appropriate and effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.

Systems of internal control operated appropriately and effectively in 2018/19.

Scottish Borders Council Pension Fund achieved a return of 7.6%, slightly below the benchmark of 7.7%, however the rolling three-year performance of 11.3% is above the benchmark of 10%.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.





### Financial performance in 2018/19

34. Pension fund finances are independently assessed every three years by an actuary. This assessment determines the employer contribution rates and deficit funding payments for the upcoming three-year period and takes account of the strength of employer covenants and the fund's investment strategy.

35. The Fund's performance in 2018/19 is summarised in [Exhibit 4](#).

### Exhibit 4

#### Assets, liabilities, funding level and investment performance

Increase in net assets	Increase in estimated liabilities	Funding level	Investment performance
 <p><b>£48 million</b> (+6.5%)</p>	 <p><b>£91 million</b> (+9.7%)</p>	 <p><b>114%</b> 2017 Funding valuation</p>	 <p><b>7.6%</b> Return on investments 2018/19</p>
<p><b>£733 million</b> Closing net assets</p>	<p><b>£935 million</b> Closing liabilities</p>	<p><b>101%</b> 2014 Funding Valuation</p>	<p><b>9.1%</b> Return on investments over 5 years</p>

Source: 2018/19 Scottish Borders Pension Fund unaudited annual report and accounts

- 36.** The net assets of the Fund increased to £733 million at 31 March 2019 from £685 million at 31 March 2018. This increase of £48 million (6.5%) reflected the volatile and variable market conditions faced by investors over the year.
- 37.** During 2018/19 contributions to the Fund amounted to some £19.4 million. This was less than the benefits paid out which totalled £22.8 million. This is the sixth year of benefits paid exceeding contributions into the Fund, signalling a maturing of the Fund.
- 38.** At the same time the Fund's Actuary, Hymans Robertson, estimated that pension liabilities had risen from £845 million at 31 March 2018 to £941 million at 31 March 2019 (£96 million increase). The liabilities have been estimated by rolling forward cash flows and investment returns from the 2017 triennial valuation.
- 39.** Although the Fund continues to perform well, management are aware that a number of challenges face the Fund and the wider environment in which it operates. A number of issues may increase pressures on the future funding position, including economic growth and the impact of EU withdrawal. Pension specific issues such as the scheme cost cap mechanism, guaranteed minimum pension (GMP) equalisation and the McCloud ruling on age discrimination within pension schemes are also likely to impact on the funding position in the coming years.
- 40.** The Fund has considered these challenges and continues to monitor risks through the risk register. The funding strategy statement and investment strategy are reviewed and revised following actuarial valuations to ensure that the Fund is well placed to continue to pay its liabilities.

## Financial management arrangements

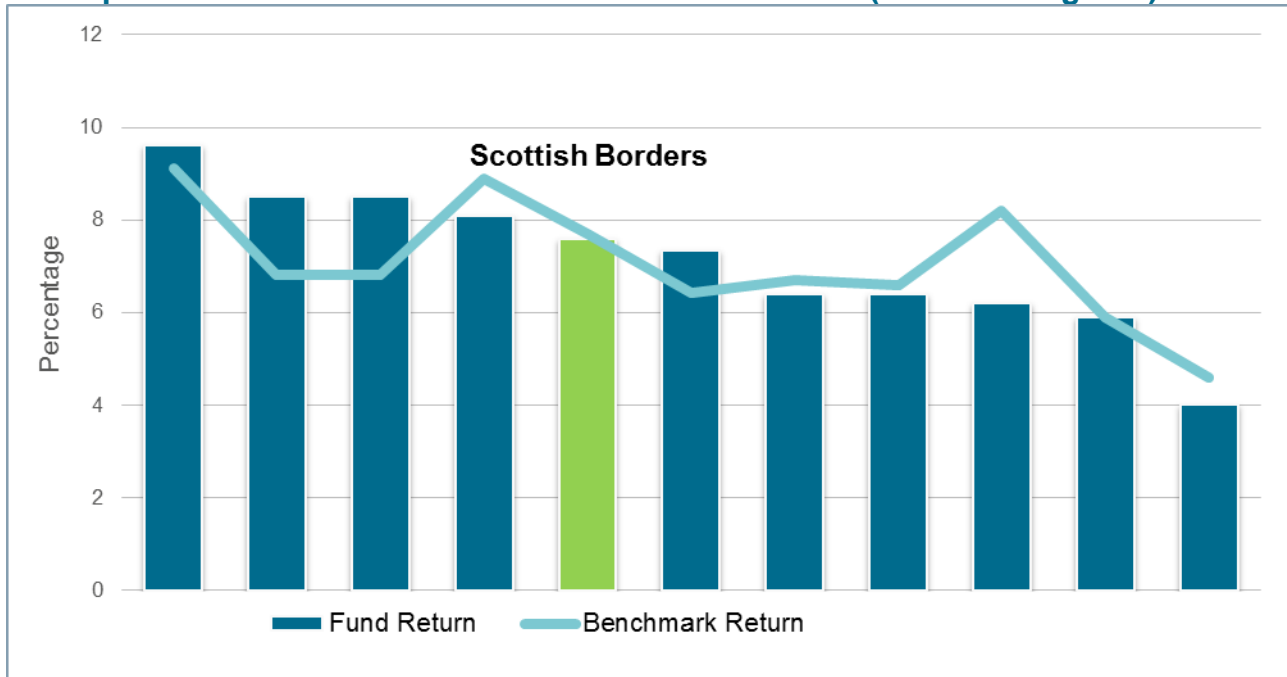
- 41.** The Chief Financial Officer for Scottish Borders Council is the proper officer responsible for Scottish Borders Council Pension Fund. The financial regulations of Scottish Borders Council, as administering authority, apply to the Fund. We consider these to be comprehensive and promote good financial management.
- 42.** Investment performance reports are submitted to the Pension Fund Committee on a quarterly basis, with administration performance reports submitted annually. Reports are comprehensive and well presented with enough narrative to describe issues to Councillors and other committee members. Through our attendance at the Pensions Committee we have observed adequate level of review and scrutiny by members. The Council has delivered training to members of the committee during the year including training on Financial markets and Investment Products, the role of the Fund Custodian, the general Pension Fund Regulatory Environment and the LGPS regulatory environment. It is important that Committee members undertake all given training to ensure knowledge and skills are kept current. In addition and in line with the Training Policy, 100% of the Pensions Committee and 75% of the Board, have completed the Pension Regulators Trustee Toolkit for defined benefit schemes.
- 43.** We have concluded that the financial management arrangements in place at Scottish Borders Council Pension Fund are sufficient to ensure the ongoing success of the Fund.

## Investment performance in 2018/19

- 44.** Financial year 2018/19 has been a relatively positive year for investment performance for most LGPS pension funds across Scotland as illustrated in [Exhibit 5](#).

## Exhibit 5

### LGPS pension funds – Net return on investment 2018/19 (unaudited figures)



Source: 2018/19 LGPS pension fund unaudited financial statements

**45.** Most funds failed to achieve their benchmarks in 2018/19. Scottish Borders Council Pension Fund achieved a return of 7.6% on its investments. This is slightly below the fund benchmark of 7.7% for 2018/19. The fund has rolling three-year performance of 11.3% which is above the benchmark of 10%.

**46.** We conclude that the Fund's overall performance is good. It has just marginally underperformed this year by 0.1%. Rolling 5-year performance for the fund is 9.1% against a benchmark of 8.2%. Management are continuing to diversify away from equity assets into income generating inflation-linked assets that are more resilient to the volatility of the equities markets, as well as provide cash to pay pensions.

## Systems of internal control

**47.** As part of our audit we identify and inspect the key internal controls in those accounting. Our objective is to gain assurance that Scottish Borders Council Pension Fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements. The Pension Fund uses some of the administering authority's key financial systems, in particular the general ledger, payroll and accounts payable systems.

**48.** Our findings were included in our management report which was presented to the Council's Audit and Scrutiny Committee on 25 June 2019. We concluded that the key controls were operating satisfactory.

## Internal audit

**49.** Internal Audit provides the Fund with independent assurance on the fund's overall risk management, internal control and corporate governance processes. We reviewed the fund's internal audit arrangements in accordance International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could rely on the work of internal audit.

**50.** To minimise duplication of effort we use the work of Internal Audit wherever possible. In 2018/19 we used Internal Audit's work on the controls in place over Business World. We also considered internal audit report findings on Governance as part of our wider dimension work.

### **Standards of conduct for prevention and detection of fraud and error**

**51.** Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

**52.** We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the administering body's Scottish Borders Council's arrangements for the prevention and detection of fraud and corruption. The council has a range of established procedures for preventing and detecting fraud and irregularity including a whistleblowing policy, anti-fraud strategy and codes of conduct for members and officers.

**53.** We concluded that appropriate arrangements were in place for preventing and detecting fraud and corruption in 2018/19. We are not aware of any specific issues we require to bring to your attention.

# Part 3

## Financial sustainability



### Main judgement

The 2017 Triennial valuation shows a funding level of 114%, the highest in Scotland. This allows the main pool of employing bodies to maintain their employer contribution rate at 18%.

Management are taking steps to reduce exposure to volatile equity investments and diversify into income generating inflation-linked assets by revising their investment strategy.

The continued increase in pensioners in the Fund's membership will make funding pension payments increasingly challenging. Cash flow projections show that the fund will continue to rely on investment income to pay pensions.

Financial sustainability looks forward to the medium and longer term to consider whether the Fund maintains the capacity to meet the current and future needs of its members.

### Funding position and financial planning

**54.** The March 2017 triennial valuation reports that the fund assets were enough to meet 114% of its liabilities. The primary employer contribution rate was increased to 20.6%, however, on the actuary's advice, the Fund has utilised the over-funding to set the secondary rate at a level to maintain employer contributions at 18% for the next three years. Management reviewed and updated the Funding Strategy Statement which was approved in September 2018.

**55.** The fund reported net withdrawals of £3.6million in 2018/19. Management actively monitor its cash-flow position and report the position to every meeting of the Pension Fund Committee.

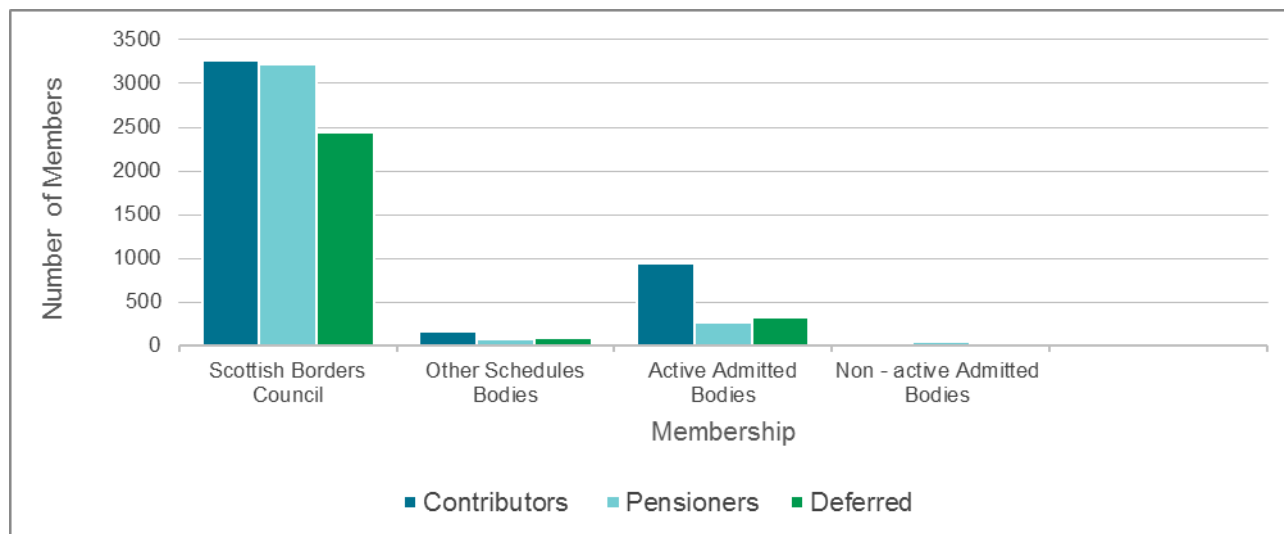
**56.** Management has considered the negative cash flow reality of the Fund and revised the Investment Strategy. This has resulted in a move away from growth generating assets such as equities to income generating and inflation-linked assets providing cash flows to the Fund to pay pensions.

### Membership levels

**57.** The pension fund is a multi-employer fund with 1 Local Authority (Scottish Borders Council), and 17 other employers. The current membership profile is shown at [Exhibit 6](#). The proportion of pensioners relative to active contributing members further increased in 2018/19.



## Exhibit 6 Scottish Borders Council Pension Fund membership



Source: Scottish Borders Council Pension Fund 2018/19 audited financial statements

**58.** Membership of the fund increased from 10,667 to 10,961 members at 31 March 2019; an increase in members of 2.6%.

**59.** The Fund gives its members a guarantee that in exchange for contributions during their employment, the Fund will pay a pension until the end of each member's life. In addition to this, the fund must also meet any survivor benefits which have been awarded on death of members. It is important that the fund maintains the capacity to meet the current and future needs of its members.

### Contributions

**60.** Following the latest triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for 2018/19 onwards. The approximate split of all contributions received in year is set out at [Exhibit 7](#).

## Exhibit 7 Contributions in 2018/19

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
<b>Total contributions</b>	14.1	0.7	4.5	19.4

Source: Scottish Borders Council Pension Fund 2018/19 unaudited financial statements

### EU Withdrawal

**61.** There remains significant uncertainty surrounding the terms of the UK's withdrawal from the European Union (EU). EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce – the extent to which potential changes to migration are likely to affect the availability of the people and skills needed to deliver services.
- Funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports.
- Regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.

**62.** Management continue to prepare for the UK's withdrawal from the European Union. The external fund managers, who are responsible for managing investments, have appropriate arrangements in place to ensure regulatory requirements will continue to be met following Brexit.

**63.** Management recognise the difficulty of planning for Brexit amid considerable uncertainty. In terms of the market implications for investment performance, the Fund is taking a diversified, balanced approach to mitigate against the risk. For example, reducing equity investment and increasing investment in infrastructure, which is not as tied to global events. Additionally, the Fund is diversified geographically with investment in overseas equities and other investments, reducing dependency on UK and EU investments.

**64.** The Pension Regulator and Pensions and Lifetime Savings Association (PSLA) have issued briefing notes highlighting the key areas Pension Funds should consider when preparing for Brexit. The fund has considered these areas and undertaken actions to complete the areas highlighted.

**65.** Management should continue to monitor the wider impact of EU withdrawal on the Fund and its wider environment.

# Part 4

## Governance and transparency



### Main judgements

**There are effective governance arrangements in place that support scrutiny of decisions made by the Pension Fund Committee.**

**Committee papers and minutes of meetings of the Pension Fund Committee are available on the Scottish Borders Council's website. There is also a dedicated website for the fund, making available a wide range of important information relevant to members of the fund.**

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.

### Governance arrangements

**66.** Scottish Borders Council is the administering body for Scottish Borders Council Pension Fund. The Council has delegated responsibility for governance to the Pension Fund Committee. This committee, supported by the Board (made up of four scheme employer representatives and four trade union representatives), is responsible for establishing arrangements that ensure the proper conduct of the affairs of the Fund. It is also responsible for ensuring that decisions are made within the terms of the Local Government Pension Scheme.

**67.** Members are provided with adequate training so that they are clear about their roles and responsibilities and are kept up to date on current issues so that they can scrutinise papers effectively. The Training Policy for the Fund sets out targets for members of the Pension Fund Board and Committee to attend at least two training events each year. Only 72% of members of the Pension Fund Committee met the training target and 87% of the Board met the training target.



### Recommendation 5

**Pensions Committee and Pension Board members should ensure that they keep their pensions knowledge up to date and take advantage of the training and development opportunities offered.**

### Action Plan Appendix 1, Recommendation 5

**68.** The Committee and Board are responsible for establishing effective governance arrangements and ensuring that financial management is effective. In the case of Scottish Borders Pension Fund, the arrangement is for the Council's Audit and Scrutiny Committee to review the effectiveness of internal control arrangements and to recommend the annual report and accounts for approval by the Council.

**69.** We saw evidence of good quality information being made available to the committee by management and advisers, enabling challenge and scrutiny to be undertaken by members.

**70.** The Fund is supported by good governance arrangements including effective controls over the Council's systems upon which the Fund depends for financial reporting.

## Openness and transparency

**71.** Openness and transparency mean that the public members of the pension fund have access to understandable, relevant and timely information about how the fund is taking decisions and how it is using resources.

**72.** The Pension Fund Committee and Board meetings are held in public with commercially sensitive information dealt with in private sessions. Minutes of the public meetings are available on the Scottish Borders Council website.

**73.** Management procured a stand-alone website for the Fund which went live during 2017/18. This makes available a wide array of important information to members.

**74.** Overall, we concluded that the Fund conducts its business in an open and transparent manner

## Pensions Regulator Public Service Code

**75.** There were no breaches of the Code that required to be reported to the Pensions Regulator in 2018/19.

## Review of the future structure of Local Government Pension Scheme in Scotland

**76.** The Scottish Scheme Advisory Board is undertaking a review of the future structure of the Local Government Pension Scheme in Scotland. Four options have been identified by the Board:

- Retain the current structure of eleven funds
- Promote cooperation in investment and administration between the eleven funds
- Pool investments between the funds
- Merge the funds into one or more funds.

**77.** Stakeholder views were sought through a consultation process and the Fund submitted a response in December 2018. In their response to the consultation the Pension Fund Committee and Pension Fund Board strongly favoured collaboration given risks and uncertainty associated with other options. Following the consultation process, a draft report incorporating stakeholder views was considered at the Scheme Advisory Board meeting on 24 April 2019. The outcome of this and any ministerial consideration, is awaited.

# Part 5

## Value for money



### Main judgements

The investment performance is subject to regular review and scrutiny by the Fund's Investment and Performance Sub-Committee.

There are satisfactory arrangements in place for monitoring investment performance and scrutinising investment decisions.

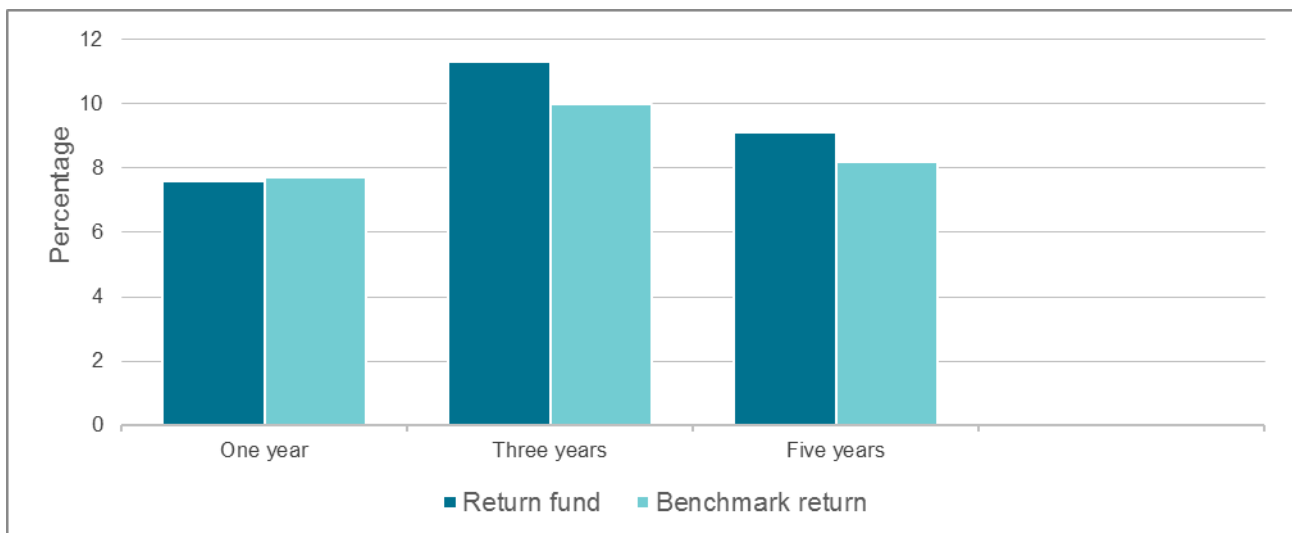
Value for money is concerned with using resources effectively and continually improving services.

### Investment performance

**78.** The Pension Fund Investment and Performance Sub-Committee meets twice a year. A review of fund managers' performance is a standing item on the committee's agenda. At each meeting, committee members receive a report outlining overall fund performance including an analysis of risks and returns.

**79.** [Exhibit 8](#) shows the fund's performance against benchmark over one, three and five years.

### Exhibit 8 Fund investment performance



Source: KPMG 2019 Quarter 1 Investment Performance Report

**80.** Over the medium to longer term the Fund has outperformed its benchmark over three and five years.

**81.** As shown earlier in [Exhibit 5](#) net investment performance compared favourably with other LGPS Funds in Scotland.

**82.** Under the career average pension scheme (CARE), accrued benefits are indexed at Consumer Price Index (CPI). Benefits earned under the previous final salary schemes will continue to increase in line with earnings.

**83.** The Fund appoints several external fund managers. Individual investment manager performance is reported on a quarterly basis to the Pension Fund Committee by the investment consultant, KPMG. In addition, all investment managers are subject to review at least annually by the Investment and Performance Sub-Committee, and again by management to discuss operational issues. Fund managers are required to complete annual compliance checklists which are reviewed by management for instances of non-compliance with laws and professional standards

**84.** The investment strategy of the Fund is included in the Statement of Investment Principles which was updated in September 2018. The Fund has adopted a risk/return asset framework as the basis for modelling and agreeing the investment strategy. The Fund is made up of 48% equities, a 10% decrease from 2017/18. The Fund continues to invest in other assets classes such as long-lease property, private credit and infrastructure, by partnering with Lothian Pension Fund.

**85.** Investment return and risk are inextricably linked, and it is not possible for us to comment on the relative performance of the Fund's investments given the risk exposure of the asset allocation and investments made. Although asset allocation is largely in line with the Fund's investment strategy, the Fund is overweight in equities (48% at 31 March 2019 against a target of 40%). The Fund is underweight in Long Lease Property by 2%, underweight in Alternatives by 4% and overweight in Bonds by 6%. Management are working with the Investment Consultant to identify appropriate opportunities to invest in line with the agreed strategy.

## Management expenses

**86.** There are three main categories of management expense, with the largest being investment management costs. Other expenses are the cost of the administration services provided by the Council and oversight and governance costs.

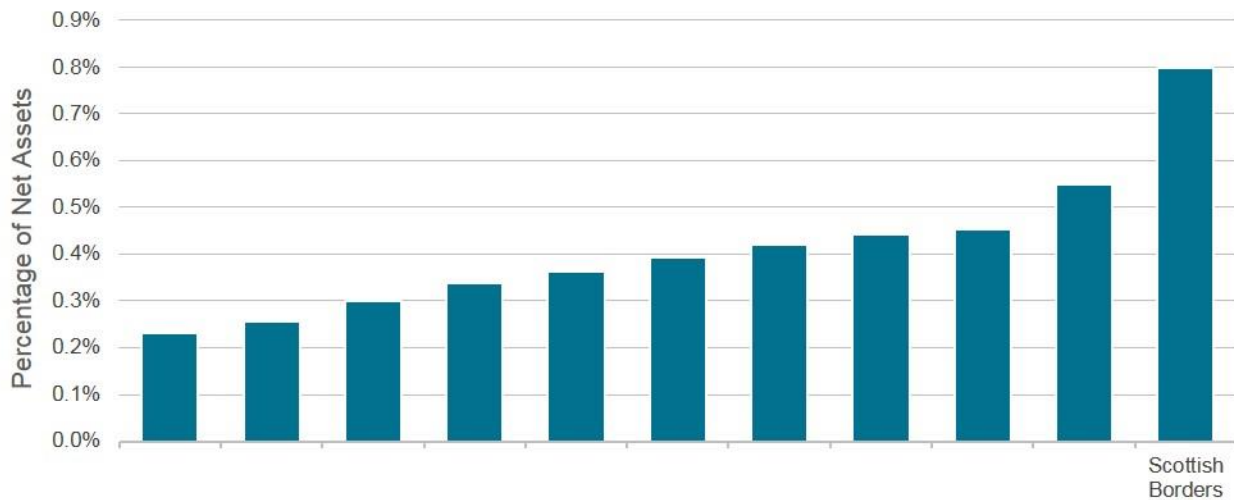
**87.** CIPFA published revised guidance on local government pension scheme management expenses (LGPS). This guidance sets out a framework for the reporting of investment management costs and was applied from 2016/17. The new guidance recommends that only expenses that can be directly controlled by the fund should be included.

**88.** External investment manager fees are agreed in the respective mandates governing their appointments. These are usually based on the market value of the investments under their management and therefore increase or reduce as the value of these investments' changes.

**89.** Investment management expenses have decreased from £8.2m in 2017/18 to £5.8m in 2018/19. The large decrease is mainly driven by a decrease in transaction costs. For 2018/19, transactions costs are £1 million, a decrease of £3 million compared to last year. This is due to one off transaction costs taking place in 2017/18.

**90.** Exhibit 10 shows figures for total management expenses relative to net assets across the Scottish Local Government Pension Funds, with investment management expenses for the Scottish Borders Council Pension Fund highlighted. The Fund had the highest percentage in Scotland; however, variances in investment strategies and administrative structures (e.g. in-house staff vs. outsourced services) will impact on the amount of external investment management expertise purchased.

## Exhibit 9 Investment Management Expenses



Source: 2018/19 LGPS pension fund unaudited financial statements

**91.** We have concluded that the fund has satisfactory arrangements in place for monitoring investment performance and scrutinising investment management expenses. However, CIPFA guidance on management expenses has enabled greater transparency in investment management fee information including the development of benchmarking information. Management should make use of the additional information now available on the cost of investment management services to make informed decisions on value for money, as well as the performance of managers.

### Administrative expenses

**92.** The workload of the pension administration section continues to grow primarily due to the introduction of the career average pension scheme (CARE) from 1 April 2015. Other factors impacting on the administration workload include auto enrolment, freedom of choice and implementation of Business World, the new accounting and payroll system of Scottish Borders Council.

**93.** The Fund's administration strategy sets out a range of service standards against which administration performance is monitored. These are measured on a regular basis and are reported to the Pension Fund Committee and Board.

### National performance audit reports

**94.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2018/19, we published reports which might be of direct interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

# Appendix 1

## Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Key reconciliations are not being performed</b></p> <p>On selecting a sample of debtors and creditors for further testing, we found that several balance sheet codes (e.g. pension suspense accounts) are not being reviewed or reconciled.</p> <p><b>Risk</b></p> <p>There is a risk of uncorrected errors not being identified on a timely basis.</p>	<p>Management should perform monthly reconciliations across payroll to ensure all balances are investigated and adjusted when necessary.</p> <p><a href="#">Exhibit 3</a></p>	<p>Agreed. Steps to reconciliations have already been taken reintroduce monthly.</p> <p><b>Responsible officer</b></p> <p>HR Shared Services manager</p> <p><b>Agreed date</b></p> <p>September 2019</p>
2	<p><b>Reconciliation of pensions paid figure</b></p> <p>There is no monetary reconciliation performed to show the total pensions paid figure agrees with the ledger. Therefore, the total pensions paid figure cannot be tied back to the ledger.</p> <p>The HRSS manager advised that there has never been a reconciliation performed between pensions paid figure and the financial ledger.</p> <p>A monthly report run for differences in payments from one month to the next is available but unfortunately due to work pressures and staff shortages this has not been completed for this financial year. This would be an effective control over the pensions paid figure on a month by month basis.</p>	<p>The pensions paid figure should be reconciled month on month and variances to the ledger investigated. Management should perform monthly reconciliations between the pensions paid figure and the ledger.</p> <p><a href="#">Exhibit 3</a></p>	<p>Agreed. Steps to introduce such monthly reconciliations have already been taken by management.</p> <p><b>Responsible officer</b></p> <p>HR Shared Services manager</p> <p><b>Agreed date</b></p> <p>December 2019</p>





No.	Issue/risk	Recommendation	Agreed management action/timing
	<p><b>Risk</b></p> <p>The figures in the financial ledger could be under or overstated.</p>		
3	<p><b>Financial &amp; HR Capacity</b></p> <p>We found that staff capacity is still showing signs of pressure. There is dependency on key staff in Finance and in Human Resources Shared Services (HRSS).</p> <p>Strain on staff resources in HRSS has meant key reconciliations and working papers were not available or prepared to a level suitable for audit from HRSS.</p>	<p>Resource requirement of the Pension Fund should be assessed within both departments and addressed to ensure administration of the Fund is efficient and effective.</p> <p><a href="#">Exhibit 3</a></p>	<p>Agreed. A review of capacity will be undertaken.</p> <p><b>Responsible officers</b></p> <p>Service Director HR and Chief Financial Officer</p> <p><b>Agreed date</b></p> <p>31 December 2019</p>
4	<p><b>Evidence of review of exception reporting</b></p> <p>Controls over the pension payroll such as the investigation of exception reporting were in place. However, there was no evidence of management review of the control.</p> <p><b>Risk</b></p> <p>There is a risk that without evidence of review, the quality key control processes deteriorate to a point where the control is no longer effective.</p>	<p>Procedures should be put in place to ensure controls are adequately reviewed and monitored by management to ensure their efficacy is maintained.</p>	<p>Agreed. Controls will be reviewed signed and dated by management on a quarterly basis.</p> <p><b>Responsible officer</b></p> <p>HR Shared Services manager.</p> <p><b>Agreed date</b></p> <p>31 December 2019</p>
5	<p><b>Training and development</b></p> <p>Pensions Committee and Pension Board members are expected to attend at least two training sessions per year. During 2018/19 28% of Committee members and 13% Board members did not attend two or more training sessions.</p> <p><b>Risk</b></p> <p>Members do not have or maintain the expertise required to monitor and scrutinise Pension Fund performance effectively.</p>	<p>Pensions Committee and Pension Board members should ensure that they keep their pensions knowledge up to date and take advantage of the training and development opportunities offered.</p> <p><a href="#">Paragraph 67</a></p>	<p>Agreed. Memembers of the Pension Fund Committee and Board are required to complete the Pensions Regulator's Trustee Toolkit training for DB schemes. Committee and Board members are encouraged to attend the various training events run by the Fund during the year. Members will be written to remind them of the requirement to keep their knowledge and skills of pensions related matters current.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
			<b>Responsible officer</b> Pensions and Investments Manager  <b>Agreed date</b> 30 September 2019

## Follow up of prior year recommendations

6	<p><b>Quality of Accounts Working Papers</b></p> <p>Due to the complexity of Custodian accounting information, the working papers required the Custodian data to be analysed across the ledger's coding structure to ensure the ledger recorded the correct information. This resulted in complex journals. Working papers were not referenced or linked to the Custodian data.</p> <p><b>Risk</b></p> <p>Without high quality working papers, journals into the ledger may be incorrect, resulting in misstated financial statements.</p>	<p>Officers should prepare working papers directly within the Custodian spreadsheet that allows for linking of data. Where external sources of information are required, this should be clearly referenced.</p>	<p>We confirmed that workings papers provided to us by the finance team for the audit were of good quality. The finance team has greatly improved the process of creation working papers. The working papers were linked directly to the custodian when applicable.</p> <p><b>Action Complete.</b></p>
7	<p><b>Investment Valuations</b></p> <p>The Custodian did not use Fund Manager valuations as at 31 March 2018 for some assets. The valuations used were the best available at the time the Custodian accounting information was prepared.</p> <p><b>Risk</b></p> <p>Without adequate review of investment movements by management, the values reported in the accounts may be materially misstated.</p>	<p>Management should ensure that investment asset values reported are as accurate as possible and that any potential differences due to timing of information are adequately considered.</p>	<p>After discussion with management, we conclude that this issue will always occur due to timing differences.</p> <p>The working papers provided confirmed adjustments were required to the final valuations. These adjustments had been made by management, with reference to the relevant fund manager report. This should be continued going forward to ensure the values reported in the accounts are based on the most up to date information available.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing Action Complete.
8	<p><b>Validation of overseas pensioners</b></p> <p>Validation of pensioners is considered a key control that should be in place to ensure that pensioners in receipt of pensions are still eligible to receive payment.</p> <p>We identified that, whilst letters and statements are issued to overseas pensioners, there is no process to evidence their existence.</p> <p><b>Risk</b></p> <p>There is a risk that without adequate controls being in place to validate the existence of pensioners, pensions are paid to deceased pensioners</p>	<p>A process should be developed to ensure the existence of overseas pensioners can be validated.</p>	<p>We confirmed a process has now been developed to ensure the existence of overseas pensioners. Life certificates have been sent to overseas pensioners and all have been received back. This is a process which will now happen on a yearly basis.</p> <p><b>Action Complete.</b></p>
9	<p><b>Completeness of 'Tell Us Once' processing</b></p> <p>One of the key processes in place to ensure deceased pensioners payments are stopped timeously is using the Council's 'Tell Us Once' service, whereby the next of kin inform the Council to ensure Council Tax and other payments are stopped.</p> <p>We found that no complete record is kept of these notifications to evidence that all</p>	<p>All notifications into the Council should be kept and recorded to ensure that all pension payments are stopped timeously when required.</p>	<p>We confirmed that all notifications are kept and recorded.</p> <p><b>Action Complete.</b></p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>notifications had been actioned timeously.</p> <p><b>Risk</b></p> <p>There is a risk that not all 'Tell Us Once' notifications are actioned resulting in overpayment of pensions.</p>		
10	<p><b>Evidence of review of exception reporting</b></p> <p>Controls over the pension payroll such as the investigation of exception reporting were in place. However, there was no evidence of management review of the control.</p> <p><b>Risk</b></p> <p>There is a risk that without evidence of review, the quality key control processes deteriorate to a point where the control is no longer effective.</p>	<p>Procedures should be put in place to ensure controls are adequately reviewed and monitored by management to ensure their efficacy is maintained.</p>	<p><b>See Action Plan Point 4 above</b></p>
11	<p><b>Pension Administration System Standing Data</b></p> <p>We identified errors in the contribution rate standing data in the pension administration system. No contributing members were affected by this error on this occasion, however it is important that all standing data is subject to timely review.</p> <p><b>Risk</b></p> <p>There is an inherent risk of error when inputting standing data into key systems.</p>	<p>Sufficient review of standing data input into systems should be carried out to ensure errors are identified and rectified.</p>	<p>We confirmed that reviews are now carried out. When data is entered, this is further reviewed by another member of staff before it is changed in the system.</p> <p><b>Action Complete.</b></p>
12	<p><b>Financial &amp; HR Capacity</b></p> <p>We found that staff capacity was showing signs of pressure. There is dependency on key staff in Finance and in HR. Staff absence has meant key reconciliations and working papers were not available or prepared to a level suitable for audit.</p>	<p>Resource requirement of the Pension Fund should be assessed and addressed to ensure administration of the Fund is efficient and effective</p>	<p><b>See Action Plan Point 3 above</b></p>



# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing on prepayments and accruals.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>From controls and substantive testing carried out in year, there was no evidence of management override of controls.</p>
<p><b>2 Risk of fraud over expenditure</b></p> <p>ISA 240 presumes a risk of fraud over income. This has been rebutted because of the low risk of fraud over contributions and investment income receivable to the Fund as a result of effective controls and the straight forward nature of contributions processing.</p> <p>This risk is expanded to include the risk of fraud over expenditure in the public sector by the Code of Audit Practice and the Financial Reporting Council's Practice Note 10 (revised).</p> <p>The Fund makes a high volume of payments, including high value payments, which can constitute a risk of misstatement of expenditure.</p>	<p>Evaluation of the effectiveness of systems for expenditure recognition and recording</p> <p>Review of custodian arrangements and completion of 'review of work by service auditors' in accordance with ISA 402 for the custodian.</p> <p>Analytical procedures on expenditure streams.</p> <p>Substantive testing of expenditure.</p>	<p>Our work did not identify any issues.</p>

Audit risk	Assurance procedure	Results and conclusions
<p><b>3 Estimation, judgements and Classification</b></p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments and the actuarial valuation. Investments include pooled funds, where valuations involve the application of judgement in determining appropriate amounts.</p> <p>The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>This subjectivity entails a risk of misstatement in the financial statements. Additionally, a new actuary, Hymans Robertson, has been appointed during 2018/19, increasing the risk that assumptions are not appropriate for the Fund's circumstances.</p>	<p>Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments.</p> <p>Confirmation of valuations to valuation reports and/ or other supporting documentation.</p> <p>Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary.</p> <p>Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2018/19.</p>	<p>From our 'review of the work of an expert' and our substantive testing we did not identify any issues in relation to this risk.</p>

#### Risks identified from the auditor's wider responsibility under the Code of Audit Practice

<p><b>4 Governance and transparency</b></p> <p>Narrative in the disclosures of the accounts need to keep up with Scheme requirements to ensure transparency of arrangements. Examples include: reporting the Career Average Revalued Earnings (CARE) scheme as the extant scheme, and reporting which members are included as a result of Transfer of Undertakings Protection of Employment (TUPE) transfers.</p>	<p>Review the governance disclosures in the annual report and accounts.</p> <p>Assess whether the Fund can demonstrate that the governance arrangements in place are appropriate and operating effectively.</p> <p>Determine whether there is effective scrutiny, challenge and transparency on the decision making and on the financial and performance reporting</p> <p>Review the consistency of the annual governance statement and the governance compliance statement with the disclosures made in the financial statements.</p>	<p>Our work did not identify any issues.</p>
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# Appendix 3

## Summary of national performance reports 2018/19

		 <b>2018/19 Reports</b>	
Local government in Scotland: Challenges and performance 2018		<b>Apr</b>	
Councils' use of arm's-length organisations		<b>May</b>	 Scottish Fire and Rescue Service: an update
Scotland's colleges 2018		<b>Jun</b>	
		<b>Jul</b>	 The National Fraud Initiative in Scotland 2016/17
Forth Replacement Crossing		<b>Aug</b>	 Major project and procurement lessons
Children and young people's mental health		<b>Sept</b>	 Superfast broadband for Scotland: further progress update
NHS in Scotland 2018		<b>Oct</b>	
Health and social care integration: update on progress		<b>Nov</b>	 Local government in Scotland: Financial overview 2017/18
		Dec	
		Jan	
		Feb	
		<b>Mar</b>	 Local government in Scotland: Challenges and performance 2019

### Reports of relevant interest

[Local government in Scotland: Challenges and performance 2018](#) – April 2018

[Councils' use of arm's-length organisations](#) – May 2018

[Local government in Scotland: Financial overview 2017/18](#) – November 2018

[Local government in Scotland: Challenges and performance 2019](#) – March 2019



# Scottish Borders Council Pension Fund

## 2018/19 Annual Audit Report

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)