

# Scottish Borders Council Pension Fund

2016/17 Annual Audit Report



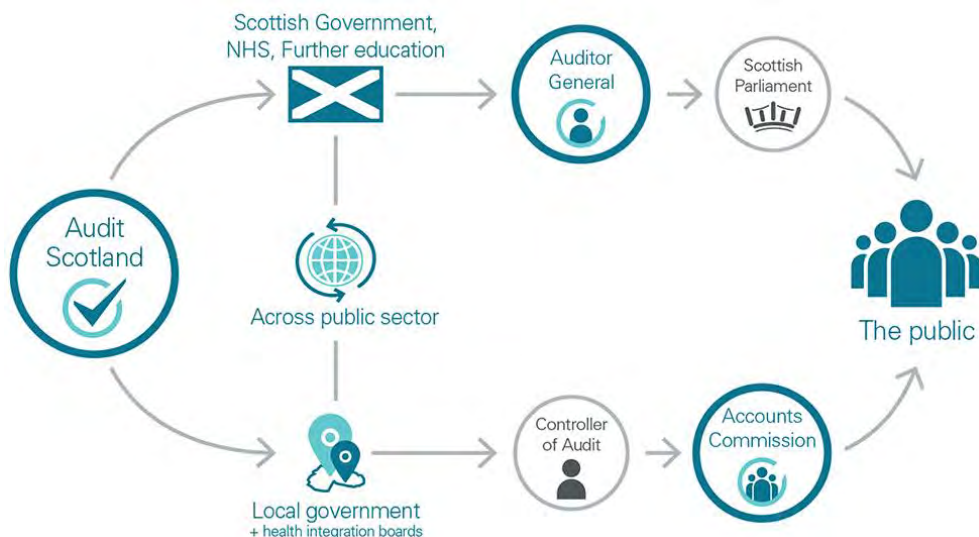
 AUDIT SCOTLAND

To Scottish Borders Council as administering authority for Scottish Borders Council Pension Fund and the  
Controller of Audit  
25 September 2017

## 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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## 2016/17 annual report and financial statements

- 1 We have issued unqualified opinions on the financial statements, management commentary, annual governance statement and governance compliance statement.

## Financial management

- 2 The Fund has effective arrangements in place for financial management. This includes comprehensive reporting of investment performance.

## Financial sustainability

- 3 The continued increase in pensioners in the Fund's membership will make future funding of pension payments increasingly challenging. Cash flow projections show that the Fund will continue to rely on investment income to pay pensions for the foreseeable future. Therefore management has revised the Investment Strategy. This has resulted in a move away from growth generating assets such as equities to income generating assets. This has enabled the more immediate needs of the Fund to be met.

## Governance and transparency

- 4 The Fund has effective governance arrangements in place that support scrutiny of decisions made by the Pension Fund Committee.
- 5 Decisions are transparent with committee papers and minutes of meetings of the Pension Fund Committee available on the Scottish Borders Council website.

## Value for money

- 6 The Fund's performance is subject to regular review and scrutiny by the Pension Fund Committee. The Fund reviews the value for money that it receives from its investment managers on an on-going basis. Adequate arrangements are in place through monitoring of investment performance and participation in fee and performance benchmarking surveys.
- 7 Individual investment manager performance is reported on a quarterly basis to the Pension Fund Committee. In addition all investment managers are subject to review by the Investment & Performance Sub-Committee. This is consistent with good practice.

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# Introduction

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1. This report is a summary of our findings arising from the 2016/17 audit of Scottish Borders Pension Fund ('the Fund' or 'the Pension Fund').

2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2017 meeting of the Scottish Borders Council Audit and Risk Committee. This report comprises:

- an audit of the annual report and financial statements
- consideration of the wider dimensions 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 2016/17 have been:

- an interim audit of the Fund's main financial systems and governance arrangements
- an audit of the Fund's 2016/17 annual report and financial statements including the issue of an independent auditor's report setting out our opinions.

4. Scottish Borders Council ('the Council') is the administering authority for the Pension Fund. The Council is responsible for establishing effective governance and financial arrangements. The Council delegates this responsibility to the Pension Fund Committee. Additionally, the Pension Fund Committee is required to

review the effectiveness of internal control arrangements and approve the annual report and financial statements.

**5.** Our responsibilities as independent auditor are established by the Local Government (Scotland) Act 1973, the [Code of Audit Practice \(2016\)](#), and supporting guidance, and are guided by the auditing profession's ethical guidance.

**6.** As public sector auditors we provide independent opinions on the annual report and financial statements. We also review and report on the arrangements within the Fund to manage its performance and use of resources such as money and assets. In doing this, we aim to support improvement and accountability.

**7.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice \(2016\)](#),

**8.** This report raises matters from the audit of the annual report and financial statements, risks or control weaknesses. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.

**9.** Our annual audit report contains an action plan at [Appendix 1 \(page 21\)](#). It sets out specific recommendations, responsible officers and dates for implementation.

**10.** As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

**11.** This report is addressed to both the members of the Scottish Borders Council as administering authority of the 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).

**12.** We would like to thank all management and staff who have been involved in our work for their co-operation and assistance during the audit.

# Part 1

## Audit of 2016/17 annual report and financial statements



### Main judgements

**Our audit opinions are all unqualified. These cover the financial statements, the management commentary, the annual governance statement and governance compliance statement.**

#### Unqualified audit opinions

**13.** The annual report and financial statements for the year ended 31 March 2017 were reviewed by the Scottish Borders Council Audit & Scrutiny Committee on 25 September 2017 and approved by the Council on 28 September 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements;
- unqualified audit opinions on the management commentary, annual governance statement and governance compliance statement.

**14.** Additionally, we have nothing to report in respect of those matters which we are required to report by exception.

#### Submission of annual accounts for audit

**15.** We received the unaudited annual report and financial statements on 22 June 2017, in line with our agreed audit timetable.

**16.** Finance staff provided good support to the audit team which helped ensure the final accounts audit process ran smoothly. We feel that the introduction of Business World, a new accounting system, will provide an opportunity to improve procedures in preparing the financial statements and associated working papers.

#### Risks of material misstatement

**17.** [Appendix 2 \(page 22\)](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. Also, included within the appendix are wider dimension risks, how we addressed these and our conclusions thereon.

#### Materiality

**18.** Materiality defines the maximum error that we are prepared to accept and still conclude that that our audit objective has been achieved. The assessment of what

The annual report and financial statements are the principal means of accounting for the stewardship of resources and the performance in the use of those resources.

is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

**19.** Our initial assessment of materiality for the annual report and financial statements was undertaken during the planning phase of the audit, based on the value of Benefits paid and Transfers out at 31 March 2016. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

**20.** On receipt of the 2016/17 unaudited annual report and financial statements and prior to completion of audit testing we reviewed our original materiality calculations and concluded that our original calculations remained appropriate. Materiality used throughout the audit is detailed in [Exhibit 2](#).

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## Exhibit 2

### Materiality values

Materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 10% of Benefits paid & Transfers Out for the year ended 31 March 2016, this has remained unchanged.	£2.15 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 60% of overall materiality.	£1.29 million
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 4% of overall materiality.	£85,000

### Evaluation of misstatements

**21.** There were no material adjustments to the unaudited financial statements arising from our audit. The only misstatement identified related to an overstated debtor and creditor with the Council of £168k. This was adjusted by finance officers.

### Significant findings

**22.** International Standard on Auditing 260 requires us to communicate to you significant findings from the audit. These are summarised below in [Exhibit 3](#) on page 9. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.



## Exhibit 3

### Significant findings from the audit of financial statements

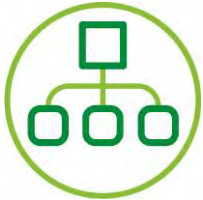
Issue	Resolution
<p><b>1. Adjusted Error</b></p> <p>Debtors and Creditors due from/to Scottish Borders Council were overstated by £168k. This error is due to the respective creditor not being netted off against the debtor in the accounts.</p>	<p>This error has been adjusted by netting the balances off. This may have been avoided by timely and complete working papers.</p>
<p><b>2. Completeness of Disclosures</b></p> <p>We identified a number of fair value disclosures relating to investment balances that were incomplete.</p>	<p>The disclosures have been added as appropriate to the final version of the annual report and financial statements.</p> <p>The CIPFA Disclosure Checklist should be used to ensure completeness of disclosures, as suggested in <a href="#">Action Plan in Appendix 1, point 3</a></p>

### Other Findings

**23.** Our audit identified a number of presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited financial statements.

# Part 2

## Financial management



### Main judgements

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





### Financial performance in 2016/17

24. 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.

25. The Fund's performance in 2016/17 is summarised in [Exhibit 4](#)

### Exhibit 4

Assets, liabilities, funding level and investment performance

Increase in net assets per custodian	Increase in estimated actuarial liabilities	Funding level	Investment performance
			
<b>£112 million</b> (+20.1%)	<b>£210 million</b> (+30.1%)	<b>101%</b> 2014 Triennial funding valuation	<b>21.5%</b> Return on investments 2016/17
<b>£654 million</b> Closing net assets	<b>£907 million</b> Closing liabilities	<b>101%</b> 2017 Triennial funding valuation due December 2017	<b>10.9%</b> Return on investments over 3 years

**26.** The net assets of the Fund increased to £654 million at 31 March 2017 from £542 million at 31 March 2016. This significant increase of £112 million (20%) reflects the investment policy in place at the Pension Fund as well as the rise in the overall investment market over 2016/17 as illustrated in [Exhibit 6](#) on Page 12.

**27.** During 2016/17, benefits paid out totalled £20 million. This was in excess of contributions paid into the Fund which totalled £18.4 million. 2016/17 is the fourth year that benefits have exceeded contributions, requiring the Fund to rely on income from investments to make up the difference.

**28.** At the March 2014 Triennial Funding Valuation the Fund was assessed by the actuary, Barnett Waddingham, to be 101% funded, meaning the investment assets were larger than the liabilities.

**29.** In addition to the Triennial Funding Valuation, 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. This uses the same base data as the Triennial Funding Valuation rolled forward to the current financial year, taking account of changes in membership numbers and updating assumptions to the current year. This valuation is not carried out on the same basis as that used for setting employer contribution rates and the Fund does not take account of liabilities to pay pensions and other benefits in the future.

**30.** The actuarial present value of promised retirement benefits estimates the Fund's liabilities rising from £697 million at 31 March 2016 to £907 million at 31 March 2017 (£210 million increase).

**31.** It should be recognised that not all funds have liabilities assessed on the same prudential scales. The use of differing actuarial firms and assumptions creates difficulties in direct comparisons. It should be noted that this valuation is an accounting estimate.

**32.** The 2017 triennial valuation due at the end of 2017 will provide a more accurate funding position.

**33.** Fund Officers are beginning to use Cashflow Modelling to understand the maturing position of the Fund allowing them to tailor the investment strategy to meet demands as they arise.

## Financial management arrangements

**34.** The Chief Financial Officer for Scottish Borders Council is responsible for the preparation of the annual report and financial statements of the Scottish Borders Council Pension Fund. The financial regulations of Scottish Borders Council, as administering authority, apply to the Pension Fund. We consider these to be comprehensive, and current, and promote good financial management.

**35.** Investment and administration performance reports are submitted to the Pension Fund Committee on a quarterly basis. Reports are comprehensive, detailing the performance of investments and providing insights into the state of the economy and potential impacts on the Fund's investments. Also, through our attendance at the Pension Fund Committee we have observed a good level of review and scrutiny by members.

**36.** Based on evidence reviewed to date, being the financial regulations of the Council, investment updates to Committee and investment decisions made, our view is that the financial management arrangements in place at Scottish Borders Council Pension Fund are sufficient to ensure the ongoing success of the Fund.

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

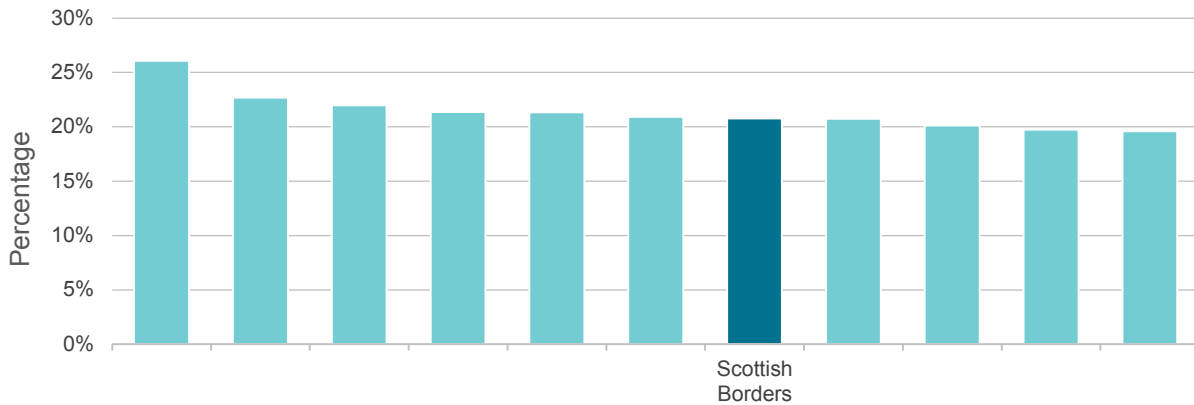
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## Financial outcomes

37. 2016/17 has been a strong year for investment performance for most Local Government Pension Scheme (LGPS) pension funds across Scotland as illustrated in [Exhibit 5](#).

### Exhibit 5

LGPS pension funds – Net return on investment 2016/17 (unaudited figures)



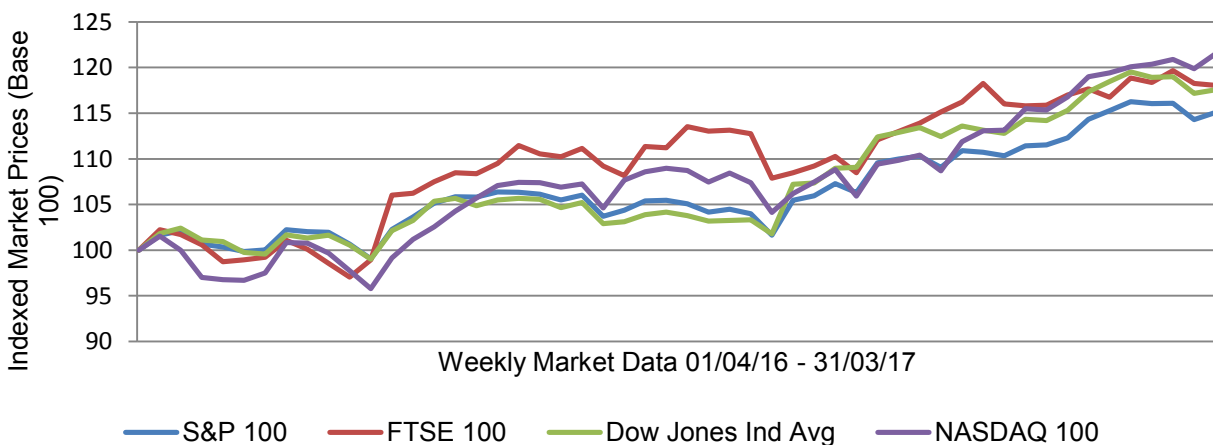
Source: 2016/17 LGPS pension fund unaudited financial statements

38. Most funds achieved their benchmarks in 2016/17 and Scottish Borders Council Pension Fund achieved a return of 21.8% on its investments. This is above the Fund benchmark of 20.9% for 2016/17. The three year Fund return is 10.9%, compared to the benchmark of 10%.

39. The Fund’s investment performance has been positive in 2016/17 as a result of strong but volatile investment markets as [Exhibit 6](#) demonstrates. The average increase in value of the selected indices was 18%.

### Exhibit 6

Indexed market prices 16/17



Source: Investing.com

## Internal controls

**40.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. The primary systems for the Fund are maintained and controlled by the administering authority, Scottish Borders Council. 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.

**41.** Our findings were included in an interim audit report presented to the Audit & Scrutiny Committee on 28 June 2017. We concluded that the majority of controls were operating effectively with the exception of bank reconciliations. These had not been prepared for a number of months year due to staffing pressures arising from staff absence and implementing a new accounting system. Refer to [Action Plan in Appendix 1, Point 1](#).

## Fraud prevention and detection

**42.** We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the administering body's (Scottish Borders Council) arrangements for the prevention and detection of fraud and corruption. These include a Code of Conduct for members and officers, a whistleblowing policy and an anti-fraud strategy.

**43.** We concluded through planning work and controls testing that appropriate arrangements were in place for preventing and detecting fraud and corruption in 2016/17.

# Part 3

## Financial sustainability



### Main judgement

**The continued increase in pensioners in the Fund's membership will make funding future pension payments increasingly reliant on returns from invested assets.**

### Funding position

- 44.** The March 2014 triennial valuation reported that the Fund assets were sufficient to meet 101% of its liabilities. The March 2017 triennial valuation is due for publication around December 2017.
- 45.** The Fund has started to analyse its cashflows to help inform investment and disinvestment decisions to ensure cashflow needs are met.
- 46.** Contribution rates will be considered by the Actuary at the next triennial funding valuation date of 31 March 2017, scheduled for publication around December 2017. Following this, officers will review and update the Funding Strategy Statement.
- 47.** We have concluded that despite forecast cash flows being negative in the medium to long term, management has taken this into account and revised the Investment Strategy. This has resulted in a move away from growth generating assets such as equities to income generating assets. The actuary determines that investment assets should deliver 5.5% per annum to ensure the Fund is fully funded for the current contribution rates set.
- 48.** The upcoming Triennial Valuation will determine whether contributions require to be adjusted to ensure the ongoing viability of the Fund.

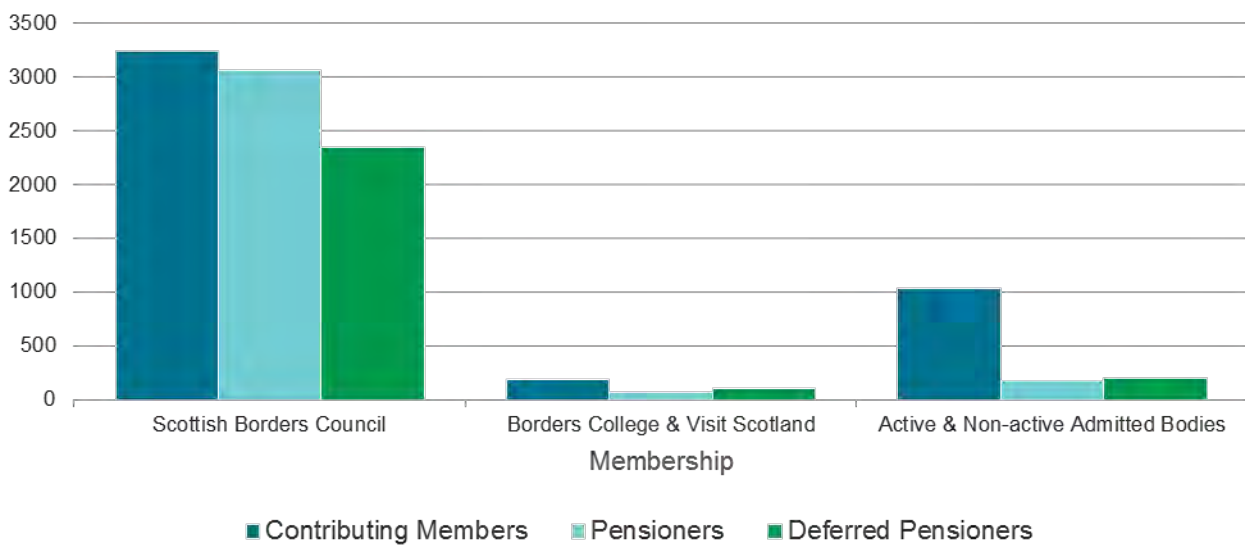
Financial sustainability looks forward to the medium and longer term to consider whether the Fund maintains the capacity to meet the current and future needs of its members.

### Membership levels

- 49.** The Pension Fund is a multi-employer fund, including the Council and 11 other employers. The current membership profile is shown at [Exhibit 7](#). There are still more active members than pensioners.

## Exhibit 7

### Scottish Borders Council Pension Fund membership



Source: Scottish Borders Council Pension Fund 2016/17 financial statements

**50.** Total membership of the Fund increased by 173 to 10,432 members at 31 March 2017, however active members decreased from 4,594 as at 31 March 2016 to 4,466 (128, or 2.8%).

**51.** 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. It is important that the fund maintains the capacity to meet the current and future needs of its members through attracting new, contributing members and ensuring investment assets match the liability of pensions due in the future.

## Contributions

**52.** Following the last triennial valuation in 2014, the Actuary agreed employer contribution rates with individual employers for the period 2015 to 2018.

**53.** The Fund reported net withdrawals of £2.2 million in 2016/17. This means that pension payments exceeded member contributions and investment income was used to ensure pensions were paid. The Fund's cash flow projections show that the Fund will continue to rely on investment income to pay pensions. The continued increase in pensioners in the Fund's membership will make funding pension payments increasingly challenging.

# Part 4

## Governance and transparency



### Main judgements

**The fund has effective governance arrangements in place that support scrutiny of decisions made by the Pension Fund Committee.**

#### Governance arrangements

**54.** Scottish Borders Council is the administering body of the Pension Fund. The Council has delegated responsibility for governance to the Pension Fund Committee. This committee, supported by the Pension 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 Pension Fund. It is also responsible for ensuring that decisions are made within the terms of the LGPS.

**55.** We found effective scrutiny and challenge of policy and investment decisions, good quality information being made available to committee members by officers and evidence that committee and board members receive appropriate and sufficient training in order to carry out their roles.

#### Other aspects of governance

**56.** We reviewed various other aspects of governance that apply to the Fund including standing orders and arrangements for reporting breaches of regulation to the Pensions Regulator.

**57.** Overall, we concluded that there are open and transparent arrangements in place.

#### Pensions Regulator Public Service Code

**58.** Scottish Borders Council Pension Fund members were consulted as part of a national review of LGPS governance commissioned by the Scottish Public Pensions Authority (SPPA). The final report has not yet been received by Scottish Borders Council Pension Fund. However we have been advised that no material issues were identified. Additionally no breaches by the Fund were reported to the Regulator in 2016/17. We are aware that a breach will be reported in 2017/18 as a result of the Pension Fund not meeting the deadline for issuing benefit statements.

#### Internal audit

**59.** Internal audit provides the Fund with independent assurance on the Administering Authority's overall risk management, internal control and corporate governance processes.

**60.** The internal audit function is carried out by Scottish Borders Council Internal Audit Service. We carried out a review of the adequacy of the internal audit

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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.

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function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

**61.** We noted that the Fund's annual governance statement refers to the work performed by internal audit during the year. However the 2016/17 internal audit annual report makes no specific reference to the assurances provided for the Pension Fund. Refer to [Action Plan in Appendix 1, Point 2](#).

## Transparency

**62.** Transparency means that the public, in particular members, have access to understandable, relevant and timely information about how the Fund is taking decisions and how it is using resources.

**63.** There is evidence from a number of sources which demonstrate the Fund's commitment to transparency. For example, the Fund's annual report and financial statements are available on the Scottish Borders Council website, as well as the Funding Strategy and Statement of Investment Principles. This information provides stakeholders with sufficient information to scrutinise the effectiveness and management of the Pension Fund.

**64.** Meetings of the Pension Fund Committee and Pensions Board are held in public with the minutes made publicly available on the Council's website. Appropriate sections of the meetings are held in private, largely being discussion around investment strategy.

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

# Part 5

## Value for money



### Main judgements

The Fund's performance is subject to regular review and scrutiny by the Pension Fund Committee with appropriate input from their Independent Investment Consultant.

The Fund reviews the value for money that it receives from its investments on an ongoing basis. Adequate arrangements are in place through monitoring of investment performance and participation in fee and performance benchmarking surveys.

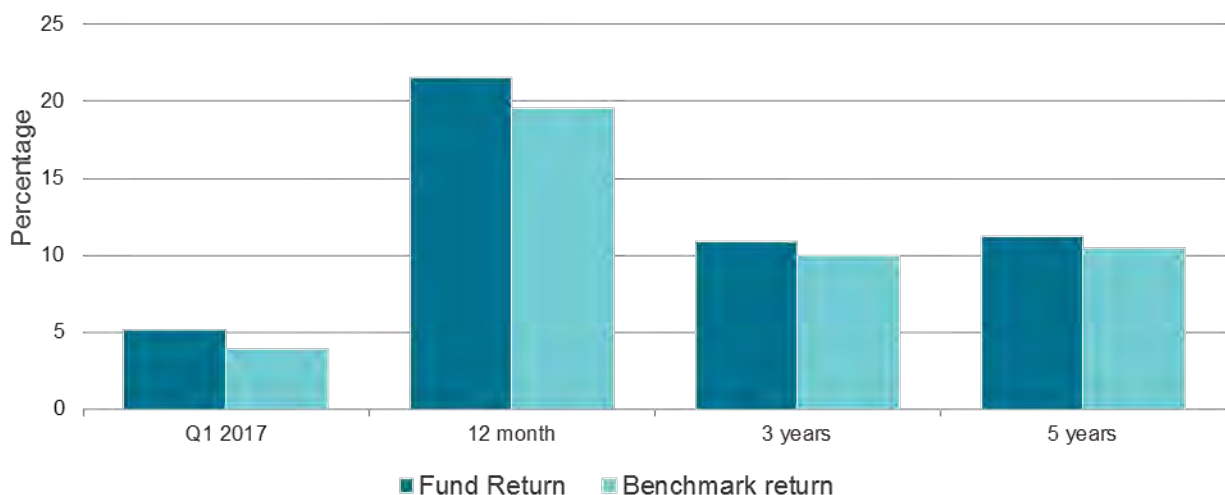
### Investment performance

66. The Pension Fund Performance and Investment Sub-Committee meets bi-annually. Presentations by, and 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 as prepared by the Independent Investment Consultant, KPMG.

67. [Exhibit 8](#) shows that the Fund outperformed its benchmark in 2016/17 and for the 5 year period to 31 March 2017. As shown earlier in [Exhibit 5](#) net investment performance was comparable to other LGPS Funds in Scotland.

### Exhibit 8

#### Fund investment performance



**68.** Fund manager and investment performance is reported to the quarterly Pension Fund Committee meetings. With advice from the Independent Investment Consultant, the Committee are ultimately responsible for the investment strategy and the cost of implementing that strategy.

**69.** 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. However, what we can say is that the asset allocation is largely in line with the Fund's investment strategy. The introduction of a new Independent Investment Consultant has seen a change to the investment mix in the strategy, largely reducing investments in equities and moving towards lending and longer-term investments in order to improve certainty and reduce the risk of exposure to inflation in Fund liabilities.

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

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## Management expenses

**70.** 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 the governance fees for actuarial and audit services.

**71.** CIPFA published revised guidance on local government pension scheme management expenses. This guidance sets out a framework for the reporting of investment management costs and was applied from 2016/17.

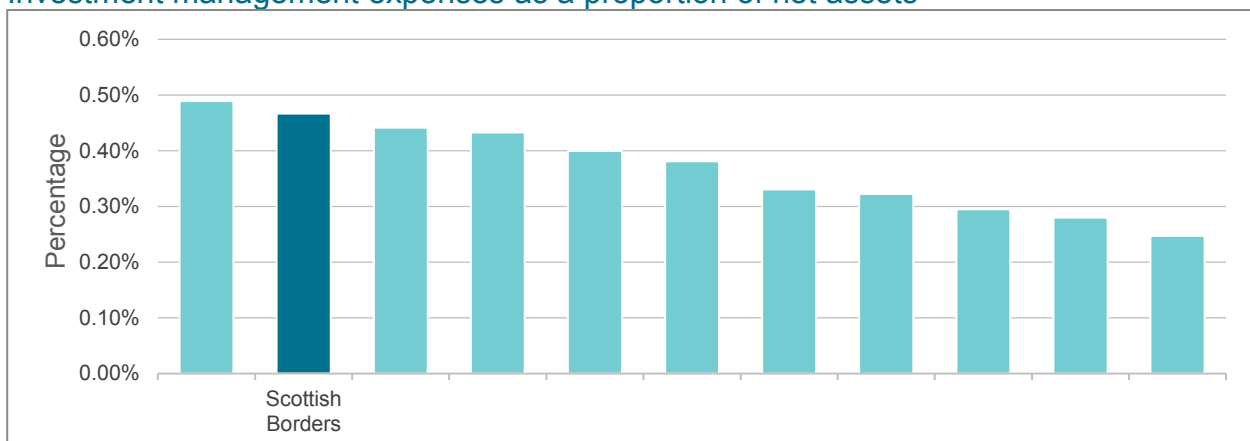
**72.** External investment manager fees are agreed in the respective mandates governing their appointments. Generally these are based on the market value of the investments under their management and therefore increase or reduce as the value of these investments changes throughout the year.

**73.** Investment management expenses have increased from £2.75 million in 2015/16 to £3.1 million in 2016/17.

**74.** Exhibit 9 shows figures for investment management expenses relative to net assets across the Scottish Pension Funds, with investment management expenses for Scottish Borders Council Pension Fund highlighted. The Fund had the second highest percentage in Scotland; and is the third smallest pension fund. 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 procured. Also, a comparison of investment management expenses may not reflect the risk profile or returns of the individual funds.

## Exhibit 9

### Investment management expenses as a proportion of net assets



Source: 2016/17 unaudited local government pension fund financial statements

**75.** We concluded that the Fund has adequate arrangements in place for monitoring investment performance. However focus should be given to reducing investment management expenses where possible to ensure value for money.

### **Administrative expenses**

**76.** 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, the issuing of benefits statements and the Guaranteed Minimum Payment reconciliation. Pension Fund officers have identified opportunities to outsource resource intensive tasks such as the Guaranteed Minimum Payment reconciliation through the use of a procurement framework.

**77.** The Fund's business plan 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 Pensions Fund Committee quarterly.

**78.** Employers are required to submit year end contribution returns to the Fund by May for the preceding 31 March year end. This is an important control over the accuracy of pension contributions received and recorded in the pensions systems and is of increased importance following the introduction of CARE as the member benefit statement requires actual salary data from all employers. All year end contribution returns relating to 2016/17 have been received.

### **National performance audit reports**

**79.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, we published a number of reports which are of direct interest to the Fund. These are outlined in [Appendix 3 \(page 24\)](#) accompanying this report.

# Appendix 1

## Action plan 2016/17

### 2016/17 recommendations for improvement



#### Issue/risk



#### Recommendation



#### Agreed management action/timing

#### 1. Financial & HR Capacity

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.

Resource requirement of the Pension Fund should be assessed and addressed to ensure administration of the Fund is efficient and effective.

An assessment of pension fund resources will be undertaken following the audit to ensure the council retains sufficient capacity and expertise to continue to support the pension effectively. This in house expertise will be augmented by the cost effective use of external resources to provide specialist services where required.

Chief Financial Officer and Service Director Human Resources

31 December 2017

#### 2. Governance

Our review of the Annual Governance Statement of the Fund found that Internal Audit perform an assessment of Governance and Controls in place over the Pension Fund. However, the Internal Audit Annual Report makes no specific reference to the assurance provided for the Pension Fund.

The Internal Audit Annual Report should include a specific reference to Scottish Borders Council Pension Fund, as their work over the systems and controls in place at Scottish Borders Council covers the same systems for the Pension Fund, and the Pension Fund Governance statement refers to Internal Audit assurance over their controls and systems.

The SBC Internal Audit Annual Report is the internal audit assurance report for the Council. A separate Internal Audit assurance report will be prepared for and presented to the Pension Fund from 2017/18.

Chief Officer Audit and Risk

31 March 2018

#### 3. Financial Statement Disclosures

Our review of the unaudited annual report and financial statements identified disclosures that were incomplete. These include disclosures relating to debtors, creditors and investment fair values. Including these will improve transparency and understanding of the financial statements.

CIPFA disclosure checklist and example accounts guidance should be used to ensure disclosures are complete.

Noted, a review of the disclosures recommended by the CIPFA checklist will be undertaken and these will be included in the 2017/18 pension fund accounts where they are considered to add value and enhance transparency.

Chief Financial Officer

31 March 2018

# 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 report and financial statements and those relating to 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 in order to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<p>Substantive procedures over reviewing journals, estimates and accrued income provided assurance that there was no occurrence of management override of key controls.</p>
<p><b>2 Risk of fraud over expenditure</b></p> <p>Practice Note 10 (Audit of financial statements of public sector bodies in the UK) and the Code of Audit Practice expands the ISA 240 requirements to aspects of expenditure such as pension payments and investments.</p>	<p>Regular budget monitoring and reporting</p> <p>Robust internal controls in financial systems to mitigate risk of error or manipulation</p>	<p>Audit procedures over income, spend and investment assets were performed. No instances of fraud were identified.</p>
<p><b>3 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement of investment assets for a pension fund by investment managers. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Actuarial valuation to provide pension figures for the financial statements. Officer review of actuary information to ensure data and assumptions used are reasonable.</p>	<p>An assessment was made over the competence and capability of Actuary and Custodian to provide sound estimates and valuations.</p> <p>No issues identified.</p>
<p><b>4 Disclosure Requirements</b></p> <p>New disclosure requirements require the application of International Financial Reporting Standard (IFRS) 13 for pension fund investment</p>	<p>Officers preparing the accounts keep their knowledge of the Code up to date.</p>	<p>Review of the financial statements against the Disclosure Checklist and example accounts guidance from CIPFA provided assurance or identified issues over disclosures</p>

Audit risk	Assurance procedure	Results and conclusions
<p>assets, as well as changes to the way management expenses are disclosed per the 2016/17 Code of Practice in local authority accounting in the United Kingdom ("the Code") . These changes introduce the risk that the financial statements are not prepared in accordance with financial reporting standards.</p>		<p>made. Refer to <a href="#">Action Plan in Appendix 1, Point 3.</a></p>
<p><b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b></p>		
<p><b>5 Financial sustainability</b></p> <p>There is a risk to financial sustainability as a result of the pension fund maturing and the number of pension benefits paid out being greater than the contributions paid in.</p> <p>Additionally, should scheduled or admitted bodies to the fund cease whilst their share of assets are in deficit, the remaining bodies have to make up the shortfall.</p>	<p>Management review and revise the funding strategy every 3 years based on actuary's triennial valuation.</p> <p>Funds are managed to ensure that deficits are minimised.</p>	<p>Our review of minutes of committee meetings, discussions with officers and review of investment consultant reports concluded that the negative cashflow position is being managed effectively.</p> <p>Due to low numbers of 'exiting employers', being smaller bodies with no active members, the Fund has historically subsumed any liability. We will continue to monitor this throughout our audit appointment.</p>
<p><b>6 Change in Custodian</b></p> <p>During the year there was a change in Custodian. This introduces the risk that investment assets are not properly managed and secured.</p>	<p>Custodian procured to ensure experienced and secure management of investment assets.</p>	<p>An assessment was made over the competence and capability of the custodian, Northern Trust, as well as the procurement arrangements.</p> <p>No issues identified.</p>
<p><b>7 Budgetary control</b></p> <p>The Fund does not prepare an annual budget; there is a risk of lack of transparency and scrutiny available over the costs that can be controlled by the pension fund such as administration and investment costs.</p>	<p>Budget setting will be assessed to determine the value of scrutiny.</p>	<p>A budget for management expenses has been prepared for 2017/18. This will provide Members with useful information to scrutinise the cost and efficiency of the Fund.</p>

# Appendix 3

## Summary of national performance reports 2016/17



Apr			
May		Common Agricultural Policy Futures programme: an update	
Jun		South Ayrshire Council: Best Value audit report	 The National Fraud Initiative in Scotland
Jul		Audit of higher education in Scottish universities	 Supporting Scotland's economic growth
Aug		Maintaining Scotland's roads: a follow-up report	 Superfast broadband for Scotland: a progress update
			 Scotland's colleges 2016
Sept		Social work in Scotland	 Scotland's new financial powers
Oct		Angus Council: Best Value audit report	 NHS in Scotland 2016
Nov		How councils work – Roles and working relationships in councils	 Local government in Scotland: Financial overview 2015/16
Dec		Falkirk Council: Best Value audit report	 East Dunbartonshire Council: Best Value audit report
Jan			
Feb		Scotland's NHS workforce	
Mar		Local government in Scotland: Performance and challenges 2017	 i6: a review
			 Managing new financial powers: an update

### Pension fund relevant reports

[Local Government in Scotland Financial Overview 2015/16 – LGPS Supplement](#) – November 2016.



# Scottish Borders Council Pension Fund

## 2016/17 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)