

Scottish Borders Council Pension Fund

2019/20 Annual Audit Report



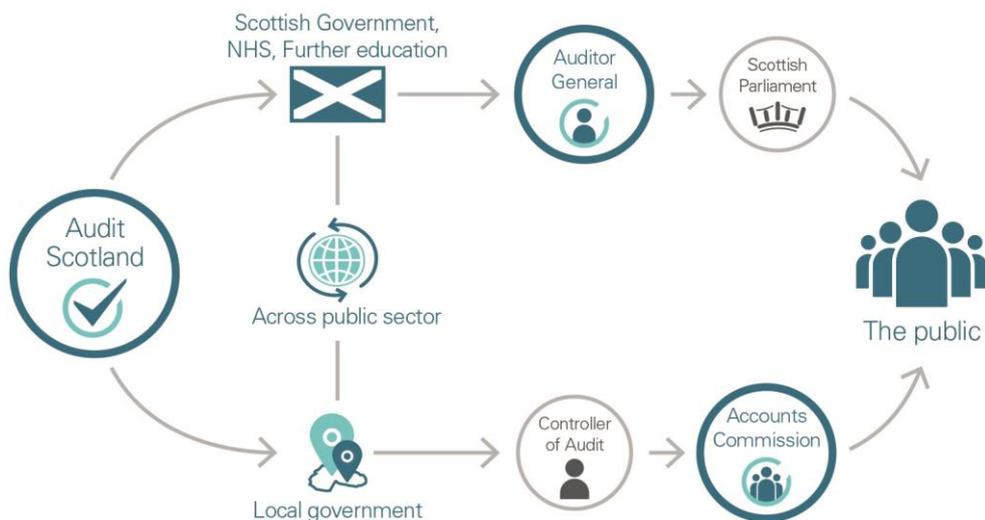
 AUDIT SCOTLAND

Prepared for Scottish Borders Council as administering authority for Scottish Borders Council Pension Fund and the
Controller of Audit
September 2020

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

2019/20 annual accounts

- 1 Scottish Borders Council Pension Fund's (the Fund) financial statements give a true and fair view and were properly prepared.
- 2 An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property investment valuations. The audit opinion is not modified in respect of this.

Financial management

- 3 There are effective arrangements in place for financial management.
- 4 The Fund had a negative performance of 1.7% during 2019/20, against a benchmark of negative 1.9%. On a rolling three year basis, performance is 3.8% which is above the benchmark of 3%. The Fund is continuing to make progress with its asset strategy, reducing exposure to equity investment from 48% to 44% of the total fund.

Financial sustainability

- 5 There are appropriate and effective financial planning arrangements in place.
- 6 The 2017 triennial valuation showed a funding level of 114%, the highest in Scotland, and an increase from 101% in 2014. This allowed the main pool of employing bodies to maintain their employer contribution rate at 18%. Work on the next triennial valuation as at 31 March 2020 is currently underway with an anticipated completion date of March 2021.

Governance and transparency

- 7 There are effective governance arrangements in place.
- 8 Papers and minutes of meetings are available on the Council's website. There is also a dedicated website for the Fund, making available a wide range of important information relevant to members
- 9 On 26 March 2020 Scottish Borders Council held a virtual meeting to agree temporary decision-making arrangements to minimise social contact. All routine Council and Committee meetings were cancelled and additional powers were delegated to the Chief Executive. From May 2020, Council Committee meetings restarted and meetings were held on a virtual basis. The Pension Fund Committee and Pension Board held their first virtual meeting on the 22nd June 2020. We consider these changes to be appropriate.
- 10 The Fund demonstrates commitment to Environmental, Social and Corporate Governance (ESG) issues through the approval of the Statement of Responsible Investment Policy, by actively engaging with investment managers to ensure they are incorporating ESG considerations into their investment decisions and by becoming a signatory to Climate Action 100+.

Value for money

- 11** There are good arrangements in place for monitoring investment performance and scrutinising investment management expenses.
- 12** Investment performance is subject to regular review and scrutiny by the Fund's Investment Sub-Committee.

Introduction

1. This report is a summary of our findings arising from the 2019/20 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 February 2020 meeting of the Audit and Scrutiny Committee. This report comprises:

- an audit of the Fund's annual report and 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](#).

Exhibit 1 Audit dimensions



Source: Code of Audit Practice 2016

3. The main elements of our audit work in 2019/20 have been:

- an audit of the Fund's 2019/20 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- a review of the Fund's main financial systems
- consideration of the four audit dimensions.

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

- 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. Taking this together, 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 ensure 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 Council 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. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

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.

12. Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.

Auditor Independence

13. Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

14. 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 2019/20 audit fee of £21,040 as set out in our Annual Audit Plan remains unchanged.

15. This report is addressed to both the members of the Scottish Borders Council as administering authority for the Scottish Borders Council Pension Fund and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

16. We would like to thank management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2019/20 annual accounts



Main judgements

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

An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property investment valuations. The audit opinion is not modified in respect of this.

The annual accounts are the principal means of accounting for the stewardship of resources and performance

Our audit opinion on the annual accounts is unmodified

17. The annual accounts for the year ended 31 March 2020 were approved by Scottish Borders Council on 5 November 2020. We reported, within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- 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.

18. All working papers were provided electronically and the audit team were able to complete the audit remotely. The working papers provided with the unaudited financial statements from the finance team were of a good standard and finance staff provided support to the audit team which helped ensure the audit process ran smoothly.

19. The working papers provided by the Human Resources Shared Services (HRSS) team were of an adequate standard and HRSS staff provided reasonable support to the audit team, however we did experience some instances where there was a slow turnaround in receiving documents from this team.

Objections

20. 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 Scottish Borders Council Pension Fund was published on the website of the administering authority (Scottish Borders Council) and complies with the regulations. No objections were received to the Scottish Borders Council Pension Fund accounts.

Submission of annual accounts for audit

The Scottish Government has advised that it considers the provisions made in Schedule 6 of the Coronavirus (Scotland) Act 2020 to be sufficient to allow each

local authority to determine its own revised timetable for the Annual Accounts. The unaudited Annual Report and Accounts were received in line with our agreed audit timetable on 29 June 2020.

Consideration of materiality

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

22. Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#). With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

23. In addition to planning materiality we set lower, specific materiality levels for certain classes of transaction, account balances or disclosures where lesser amounts could influence the decisions of the users of the accounts.

24. We recognise that transactions with members and payments to pensioners are areas of importance to the users of the accounts and we set specific materiality levels as shown in [Exhibit 2](#).

25. On receipt of the unaudited annual report and accounts we reviewed our materiality and revised the figures as set out in Exhibit 2 below. The method used to calculate materiality is consistent with the planned approach.

Exhibit 2 Materiality values

| Materiality level | Planning Amounts (based on 2018/19 accounts) | Revised Amounts (based on 2019/20 accounts) |
|----------------------------------------------------------------------|----------------------------------------------|---------------------------------------------|
| Overall materiality | £7.33 million | £7.13 million |
| Performance materiality | £4.40 million | £4.28 million |
| Reporting threshold | £220,000 | £214,000 |
| Specific materiality for certain classes of transactions | £2.28 million | £2.36 million |
| Specific performance materiality for certain classes of transactions | £1.37 million | £1.42 million |

Source: Audit Scotland

Appendix 2 identifies the main risks of material misstatement and our audit work to address these

26. [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and 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 in relation to these risks.

Significant findings from the audit in accordance with ISA 260

27. 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. The significant findings from our audit are summarised in [Exhibit 3](#)

Exhibit 3

Significant findings from the audit of financial statements

| Issue | Resolution |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>1. Material uncertainty in the valuation of property investments</p> <p>Property investments for Blackrock and UBS portfolio valuations both include a "material valuation uncertainty clause". The investment valuations affected amount to £98m, which is 13.7% of total investment asset value. Covid-19 meant the property sector were faced with an unprecedented set of circumstances on which to base a judgement.</p> <p>As at the valuation date, fund managers considered that less weight could be given to previous market evidence for comparison purposes to inform opinions of value. Consequently, less certainty and a higher degree of caution should be attached to the valuations than would normally be the case.</p> | <p>Scottish Borders Council Pension Fund updated their accounting policies in the Annual Report and Accounts to disclose this material valuation uncertainty.</p> <p>We have included an 'Emphasis of Matter' paragraph in our independent auditor's report to highlight this matter. Emphasis of Matter paragraphs are added to auditors' reports where the auditor considers it necessary to draw users' attention to matters which are fundamental to the understanding of the accounts. The audit opinion is not modified in respect of this matter.</p> <p>No further action required.</p> |

Identified misstatements of £0.94 million were not adjusted in the accounts. These were less than our performance materiality

28. We identified misstatements totalling £0.94 million, which would have decreased investment asset values by £0.94 million. These consist of late valuations received for Level 3 assets. The valuations for these assets are included in the accounts with a lagged valuation date of 31 December 2019. The valuations were not available when the unaudited accounts were issued. The final valuations were received during our audit. After discussions with management, we concluded that adjustments for these final valuations were not required as the total adjustment required of £0.94 million is below our performance materiality level. We have concluded that the misstatements identified arose from issues that have been isolated and identified in their entirety, and do not indicate any systemic error.

Follow up of prior year recommendations

29. Management has made adequate progress in implementing our prior year audit recommendations. 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

There are effective arrangements in place for financial management.

The Fund had a negative performance of 1.7% during 2019/20, against a benchmark of negative 1.9%. On a rolling three year basis, performance is 3.8% which is above the benchmark of 3%. The Fund is continuing to make progress with its asset strategy, reducing exposure to equity investment from 48% to 44% of the total fund.

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

Financial Performance in 2019/20

30. 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.

31. The Fund's performance in 2019/20 is summarised in [Exhibit 4](#)

Exhibit 4

Assets, funding level and investment performance

Decrease in net assets



£713 million

Closing net assets as at
31 March 2020

(-2.72%)

£733 million

Opening assets at 1 April 2019

Funding level



114%

2017 Funding Valuation

101%

2014 Funding Valuation

Investment performance



6.3%

Average annual return on
investments over 5 years

-1.7%

Return on investments 2019/20

32. The promised retirement benefits at 31 March 2020 have been projected by the actuary using a roll forward approximation from the latest formal funding valuation as at 31 March 2017. These have been estimated at £887 million (2018/19 – £941 million), showing a 5.7% decrease. This estimate uses assumptions in line with Internal Accounting Standards (IAS) 19 requirements, for the purposes of the Fund's financial statements. It is not directly comparable to the liability measures on a funding basis.

33. The information contained in [Exhibit 3](#) demonstrates that the Fund has performed relatively well in 2019/20. The Fund has seen a negative performance of 1.7%, against a benchmark of negative 1.9%. The rebalancing of the asset portfolio has meant that the Fund has not been subjected to the full effect of market volatility due to Covid-19.

34. 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 pressure 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.

35. The Fund has considered these challenges and continues to monitor risks through the corporate 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 meet its liabilities.

36. The 2019/20 – 2021/22 business plan identifies a number of key priorities for the years ahead.

Financial management arrangements

37. The Executive Director Finance and Regulatory 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, current, and promote good financial management.

38. 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, Investment Concepts and Terminology, the role of the Fund Custodian, LGPS Benefits Structure and Regulatory Environment. It is important that Committee members undertake all given training to ensure knowledge and skills are kept current.

39. Overall, the Fund has appropriate and effective financial management arrangements in place. This includes comprehensive reporting of investment performance.

Systems of internal control

40. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. 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 the administering authority's key financial systems, in particular the general ledger, payroll and accounts payable systems. Whilst we concluded that overall

systems of internal control are operating effectively we did identify issues relating to the validation of pensioners. These are detailed in [Appendix 1](#) setting out specific recommendations, responsible officers and dates for implementation.

Standards of conduct and arrangements for prevention and detection of fraud and error

41. Scottish Borders Council Pension Fund is 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.

42. We assessed the Fund's arrangements for the prevention and detection of fraud. The Fund relies on the 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

43. We have concluded that appropriate arrangements are in place for the prevention and detection of fraud, error and irregularities, bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

Part 3

Financial sustainability



Main judgement

There are appropriate and effective financial planning arrangements in place.

The 2017 triennial valuation showed a funding level of 114%, the highest in Scotland, and an increase from 101% in 2014. This allowed the main pool of employing bodies to maintain their employer contribution rate at 18%. Work on the next triennial valuation as at 31 March 2020 is currently underway with an anticipated completion date of March 2021.

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.

Financial planning arrangements

44. The March 2017 triennial valuation for the Fund (issued in December 2017) reported that fund assets were sufficient 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%.

45. The March 2020 triennial valuation for the Fund is currently underway with a completion date anticipated of March 2021. This will be the first triennial valuation completed by the newly appointed actuary of the Fund, Hymans Robertson, who replaced Barnett Waddingham as the Fund's actuary in 2019.

46. Following each triennial valuation, the Fund reviews and revises the funding strategy statement. The next full review is due to be completed by 31 March 2021.

47. The funding strategy statement is a summary of the Fund's approach to funding liabilities. The investment strategy is set for the long-term but is monitored continually and reviewed every 3 years using asset-liability modelling to ensure that it remains appropriate to the profile of the Fund's liabilities. The investment strategy is outlined in the Fund's statement of investment principles.

48. We concluded that the Fund has an appropriate framework in place through which it demonstrates effective financial planning.

Membership levels

49. The Fund is a multi-employer fund with one Local Authority, and 16 other employers. The current membership profile is shown at [Exhibit 5](#). The number of active members continues to outweigh the number of pensioners.

Exhibit 5 Scottish Borders Council Pension Fund membership



Source: Scottish Borders Council Pension Fund 2019/20 unaudited financial statements

50. Membership increased from 10,961 to 11,338 members at 31 March 2020; a total increase in membership of 3.4%. After decreasing in recent years, employee members grew over the last year by 4.5%. These contributing employee members assist with the cash flow of the fund. Deferred non-contributing members increased by 1% and pensioners increased by 4%.

51. The Fund gives its members a guarantee that in exchange for contributions during their employment, it 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 pension entitlements of its members.

52. In 2019/20 the number of pensioners receiving a pension increased from 3,707 to 3,856, an increase of 4.0%. The number of pensioner members continues to increase steadily each year, as can be seen from the exhibit above, and is a key contributor to the ongoing deficit.

53. Future membership numbers are difficult to predict with any certainty as they are dependent on a number of factors including employer budgets, recruitment decisions, and promotion of the pension scheme.

54. With most employers still open to new membership and with continuing support from auto enrolment, the recent trend of growth in membership seems likely to continue for the foreseeable future.

Contributions

55. Following the latest triennial valuation in 2017, the Actuary agreed employer contribution rates with individual employers for 2018/19 onwards. For the majority of employers, the current funding surplus is being used to subsidise and stabilise contribution rates. The approximate split of all contributions received in year is set out at [Exhibit 6](#).

Exhibit 6

Contributions in 2019/20

| | Administering authority £m | Other scheduled bodies £m | Admitted bodies £m | Total £m |
|---------------------|----------------------------------|------------------------------------|--------------------------|-------------|
| Total Contributions | 15.5 | 0.9 | 3.4 | 19.8 |

Source: Scottish Borders Council Pension Fund 2019/20 unaudited financial statements

56. The Fund reported a deficit of £5.3m in 2019/20. This means that pension payments out exceeded member contributions in, and investment income was used to ensure pensions were paid.

57. The continued growth in pensioner numbers makes funding pension payments increasingly challenging. The Fund has considered this as part of its investment strategy and is further diversifying its investment structure to increase investment in income generating assets.

58. As mentioned earlier in the report, the 2020 triennial valuation is currently underway with results anticipated in March 2021. The outcome of this valuation may lead to future revisions to the investment strategy and asset allocation based on the advice of the newly appointed actuary, Hymans Robertson. The outcome of this valuation and revisions to investment strategy may also result in changes to contribution rates going forward.

Part 4

Governance and transparency



Main judgements

There are effective governance arrangements in place.

Papers and minutes of meetings are available on the Council's website. There is also a dedicated website for the Fund, making available a wide range of important information relevant to members.

On 26 March 2020 Scottish Borders Council held a virtual meeting to agree temporary decision-making arrangements to minimise social contact. All routine Council and Committee meetings were cancelled and additional powers were delegated to the Chief Executive. From May 2020, Council Committee meetings restarted and meetings were held on a virtual basis. The Pension Fund Committee and Pension Board held their first virtual meeting on the 22nd June 2020. We consider these changes to be appropriate.

The Fund demonstrates commitment to Environmental, Social and Corporate Governance (ESG) issues through the approval of the Statement of Responsible Investment Policy, by actively engaging with investment managers to ensure they are incorporating ESG considerations into their investment decisions and by becoming a signatory to Climate Action 100+.

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

59. 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.

60. There has been a change to the Scheme of Administration with regards to the delegation of decision making for the annual report and accounts sign off. From 2019/20 the Pension Fund Committee will review the annual report and accounts and recommend the accounts approval to the Council. The annual report and accounts will also be submitted to the Audit and Scrutiny Committee for noting. We consider this to demonstrate good governance arrangements. Pension Fund committee members receive pension fund specific training, which equips them to effectively scrutinise the annual report and accounts.

The Covid-19 pandemic has affected governance and working arrangements

61. The impact of Covid-19 has been set out in the Annual Governance Statement in the annual report and accounts. We note that the following changes were made in response to the outbreak.

62. On 26 March 2020 Scottish Borders Council held a virtual meeting to agree temporary decision making arrangements to minimise social contact during the pandemic. It was agreed all formal Council and Committee meetings be cancelled unless required for statutory reasons and additional powers delegated to the Chief Executive in consultation with Officers and Members. From May 2020, Council Committee meetings restarted and meetings were held on a virtual basis. The Pension Fund Committee and Pension Board held their first virtual meeting on the 22nd June 2020.

63. Business continuity plans were implemented with staff mainly working at home with full access to systems and files. During the pandemic services have been maintained and payments made in a timely manner.

64. The arrangements detailed above are appropriate and adequate and support good governance and accountability.

Openness and transparency

65. Openness and transparency means that the public, in particular, 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.

66. 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.

67. Overall, we conclude that the Fund conducts its business in an open and transparent manner.

Appropriate arrangements are in place to comply with the Pensions Regulator Public Service Code

68. There were no breaches of the Code that required to be reported to the Pensions Regulator in 2019/20.

The Fund is actively considering the future structure of Local Government Pension Scheme in Scotland

69. 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.

70. Stakeholder views were sought through a consultation process and the Fund submitted a response in December 2018. Following the consultation process, a draft report incorporating stakeholder views was considered at the Scottish Scheme Advisory Board meeting on 24 April 2019. The outcome of this meeting is still awaited.

The Fund is actively considering Environmental, Social and Corporate Governance factors

71. The Fund believes that a positive approach to Environmental, Social and Corporate Governance issues can have a positive impact on the financial performance of investments.

72. The Fund approved a Statement of Responsible Investment Policy on the 30 November 2018 which details the Fund's approach to responsible investment and arrangements to monitor manager performance against the principles in this policy. The overwhelming majority of fund managers engaged with Scottish Borders Council Pension Fund (99.8%) are signatories to the United Nations Principles for Responsible Investment. The Fund became a signatory to Climate Action 100+ in March 2020. As a signatory the Fund supports Climate Action 100+ in its engagement with the boards and senior management of companies around the world to implement a strong governance framework, take actions to reduce greenhouse gas emissions and provide enhanced corporate disclosures.

Part 5

Value for money



Main judgements

There are good arrangements in place for monitoring investment performance and scrutinising investment management expenses.

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

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

Investment performance

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

74. [Exhibit 7](#) shows the Fund's performance against benchmark over one, three and five years.

Exhibit 7 Fund investment performance



Source: Scottish Borders Council Pension Fund 2019/20 unaudited financial statements

75. Over the medium to longer term the Fund has outperformed its benchmark over three and five years. Benchmarks are set by the Pension Fund in consultation with their investment consultant, Isio.

76. 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, Isio. 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

77. The investment strategy of the Fund is included in the Statement of Investment Principles which was last 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 44% equities, a 4% decrease from 2018/19. The Fund continues to invest in other assets classes such as long-lease property, private credit and infrastructure, by partnering with Lothian Pension Fund.

78. The investment strategy focuses on increasing the diversification of the portfolio, including increasing allocations in income generating assets and assets which offer a greater level of protection from inflation. The strategy also takes the unpredictability of future economic conditions into consideration and continues to diversify in order to be more resilient to future challenges.

79. 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 retains overweight positions in equity as the implementation of the current investment strategy continues. Management are working with the Investment Consultant to identify appropriate opportunities to invest, in line with the agreed strategy.

80. The Covid-19 outbreak dominated markets over Q1 2020, with the social and economic impacts of the virus resulted in heightened volatility and negative performance across the majority of asset classes. The rebalancing and diversification work of the fund, which has been ongoing for the past 5 years, has meant the full effect of the market crash has not been felt by the Fund.

Management Expenses

81. 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.

82. External investment manager fees are agreed in the respective mandates governing their appointments. The fees are relative to the risk and complexity involved in managing a particular asset and strategy.

83. Investment management expenses have decreased from £5.8 million in 2018/19 to £5.3 million in 2019/20. The main reason for this decrease in expenses relates to the 2.4% decrease in asset value.

84. The Fund has encouraged all of its listed equity investment managers to sign up to the Code of transparency and has engaged with managers of other asset classes to do the same.

85. The Fund has adequate arrangements in place for monitoring investment performance and scrutinising investment management expenses.

National performance audit reports

86. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2019/20, we published reports which may be of interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

Appendix 1

Action plan 2019/20

| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1 | <p>Pensioner validation using ATMOS reports</p> <p>As part of our review of pension payment controls, we requested a sample of ATMOS match reports for testing. These reports are used by management to identify deceased pensioners so that pension payments are stopped in a timely manner, minimising overpayments.</p> <p>The ATMOS match reports we received for testing were five months old. Therefore, there is no evidence that the matches have been investigated by management in a timely manner.</p> <p>Risk</p> <p>There is a risk that, without prompt investigation by management, pensions are being overpaid.</p> | <p>ATMOS reports should be reviewed and any matches investigated in a timely manner to prevent any overpayments to deceased pensioners.</p> <p>Paragraph 40</p> | <p>Action being taken to address this, including the training of further members of the Pensions Administration Team to remove Single Point of Failure</p> <p>Responsible officer</p> <p>Ian Angus, HR Shared Services Manager</p> <p>Agreed date</p> <p>31 October 2020</p> |
| 2 | <p>Validation of overseas pensioners</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, the process to ensure their existence, has not been carried out during 2019/20.</p> <p>Risk</p> | <p>The existing process in place should be reviewed to ensure it is still appropriate. The process should be actioned on a frequent basis to ensure existence of overseas pensioners.</p> <p>Paragraph 40</p> | <p>Overseas Pensioners have been written to and asked to provide confirmation by 30 September 2020, any failures to respond will result in pension payment being suspended for the October payroll</p> <p>Responsible officer</p> <p>Ian Angus, HR Shared Services Manager</p> <p>Agreed date</p> <p>31 October 2020</p> |



No. **Issue/risk**

Recommendation

Agreed management action/timing

There is a risk that without adequate controls being in place to validate the existence of pensioners, pensions are paid to deceased pensioners

Follow up of prior year recommendations

3 **Key reconciliations are not being performed**

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.

Risk

There is a risk of uncorrected errors not being identified on a timely basis.

Management should perform monthly reconciliations across payroll to ensure all balances are investigated and adjusted when necessary.

Outstanding

Work continues on the remaining balance sheet codes and monthly reviews will be implemented

Responsible officer

Ian Angus, HR Shared Services Manager

Agreed date

31 October 2020

4 **Reconciliation of pensions paid figure**

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.

The HRSS manager advised that there has never been a reconciliation performed between pensions paid figure and the financial ledger.

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.

Risk

The figures in the financial ledger could be under or overstated.

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.

UPDATE 2019/20

Whilst there is an automated nature to the transfer of the figures between the payroll system and ledger data, there is a residual risk that manual intervention to the financial ledger codes may impact ledger data. The inclusion of this control will strengthen the control environment.

Outstanding

Report used to undertake the verification of the month on month payments has been updated to include the ledger information, this will be reconciled to the ledger entries on a monthly basis to ensure there are no additional entries processed

Responsible officer

Ian Angus, HR Shared Services Manager

Agreed date

31 October 2020



| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 5 | <p>Financial & HR Capacity</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>In progress</p> <p>Through discussions with management, we noted a new staff member has been appointed within the finance team which will reduce the key dependency on one member of staff in this department.</p> <p>Within the HRSS team, we were advised that whilst there are no staff capacity issues in terms of staff numbers, there has been various staff changes/unexpected absences which have caused some challenges.</p> <p>With ongoing challenges and uncertainty anticipated for the fund including work required on the outcome of the GMP reconciliation and the McCloud judgement, the outcomes of these will be monitored and resources will be reviewed for these additional challenges.</p> <p>Management are continuing to monitor this.</p> <p>Revised Management Action</p> <p>Impact of additional challenges through legislative changes will be monitored to ensure there is appropriate staffing levels to deal with this and business as usual. Additionally, we are in the process of implementing Members Self Service which help reduce the number of routine enquiries from scheme members where they will be able to obtain quotes directly via the self service functionality and removes the need to issue Annual</p> |



| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-----|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | | | <p>Benefit Statement in paper format.</p> <p>Responsible officer</p> <p>Ian Angus, HR Shared Services Manager</p> <p>Agreed date</p> <p>31 March 2021</p> |
| 6 | <p>Evidence of review of exception reporting</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>Risk</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>Complete</p> <p>We confirmed that processes are now in place to detail management review of the controls in place.</p> |
| 7 | <p>Training and development</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>Risk</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>Complete</p> <p>We confirmed that for 2019/20 all members of the Pensions Committee and Pensions Board met their training requirements. This will be monitored each year.</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 |
|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Risks of material misstatement in the financial statements | | Results and conclusions |
| <p>1 Risk of material misstatement caused by management override of controls</p> <p>Auditing Standards require that audits are planned to consider the risk of material misstatement due to fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls that result in fraudulent 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>Conclusion: Satisfactory</p> |
| <p>2 Risk of material misstatement caused by fraud in expenditure</p> <p>The Code of Audit Practice and the Financial Reporting Council's Practice Note 10 (revised) expand the ISA 240 risk of fraud over income (see paragraph 5 below). As most public sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</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> <p>Conclusion: Satisfactory</p> |
| Risks identified from the auditor's wider responsibility under the Code of Audit Practice | | |
| <p>3 Estimations, Judgements and Classifications</p> <p>There is a significant degree of subjectivity in the measurement and valuation of investments and the actuarial valuation. Investments include level 3</p> | <p>Completion of 'review of the work of an expert' in accordance with ISA 500, for the actuary.</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> <p>An 'Emphasis of Matter' paragraph is included in the</p> |

| Audit risk | Assurance procedure | Results and conclusions |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>investments such as unquoted equities, where valuations involve the application of considerable 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. This subjectivity entails a risk of misstatement in the financial statements.</p> | <p>Confirmation of valuations to valuation reports and/ or other supporting documentation.</p> | <p>independent auditor's report to draw attention to the impact of Covid-19 on property investment valuations. The audit opinion is not modified in respect of this matter.</p> <p>Conclusion: Satisfactory</p> |

Appendix 3

Summary of national performance reports 2019/2020



| | | | |
|----------------------------------------------------------|-------------------------------------------------------------------------------------|-------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | | Apr | |
| Social security: Implementing the devolved powers |  | May | |
| Scotland's colleges 2019 |  | Jun |  Enabling digital government |
| | | Jul | |
| NHS workforce planning - part 2 |  | Aug | |
| Finances of Scottish universities |  | Sept | |
| NHS in Scotland 2019 |  | Oct | |
| | | Nov | |
| Local government in Scotland: Financial overview 2018/19 |  | Dec | |
| Scotland's City Region and Growth Deals |  | Jan |  Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models |
| | | Feb | |
| | | Mar |  Early learning and childcare: follow-up |

Scottish Borders Council Pension Fund

2019/20 Annual Audit Report

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