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Scottish Borders Council Pension Fund

Annual audit report

Audit: Year ended 31 March 2012

14 September 2012

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About this report

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

This report is for the benefit of Scottish Borders Council ("the Council") and is made available to Audit Scotland and the Accounts Commission (together "the beneficiaries"). It has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

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

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

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

We also draw your attention to the following:

- management of Scottish Borders Council are responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems;
- weaknesses or risks identified by us are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist; and
- communication by us of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve Scottish Borders Council management from its responsibility to address the issues raised and to maintain an adequate system of control.

Executive summary

The year ended 31 March 12 is the second year for local authorities responsible for administering a pension fund forming part of the Local Government pension Scheme have been required to publish an annual report for the pension fund separate from the authority's own financial statements.

In addition to Scottish Borders Council ("the Council"), there are three other scheduled bodies and 13 admitted bodies participating in the fund. Scottish Borders Council accounts for 8,394 out of a total membership of 9,005 (93%) in the fund.

A triennial valuation of the fund was carried out as at 31 March 2011. This resulted in a minor decrease in the long term funding position from 96.5% funded at March 2008 to 95.7% funded at 31 March 2011. The employers' contribution rate was maintained at 18%.

Draft financial statements were prepared and submitted in line with the agreed timetable. An error in the draft financial statements was identified and corrected by management prior to the audit commencing. There are no adjustments arising from our audit and we intend to issue unqualified opinions on the financial statements.

Proper governance of the pension fund is the responsibility of the pension fund sub-committee which is a sub-committee of the Council and meets quarterly. Local authority elections in May 2012 resulted in a change of administration at the Council and, accordingly, changes to the pension fund sub-committee membership.

In line with the prior year, management reports partial compliance in three areas and non-compliance in one area of the governance compliance statement. A number of recommendations were made in the 2010-11 following the external audit and management has made progress against these. A separate pension fund risk register was put in place during the year and is subject to cyclical updating and review. In line with Scottish Government guidance, a pension fund administration strategy was approved by the pension fund sub-committee in June 2012. A training policy statement and training policy was considered and approved in September 2012.

Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code"). This specifies a number of objectives for our audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance*, this report summarises our work in relation to the financial statements.

We wish to record our appreciation of the co-operation and assistance extended to us by Council staff during the course of our work.

Financial statements	
Draft financial statements were provided on 29 June 2012, in line with the agreed timetable. These were complete and to a high standard. Management subsequently identified one error in the draft financial statements which was amended in the financial statements prior to our audit work commencing. Supporting evidence was available for the commencement of our audit. Overall, we consider arrangements in the control environment associated with the compilation of the financial statements to be appropriate for the pension fund. We intend to issue unqualified audit opinions on the 2011-12 financial statements and the regularity of transactions reflected in those financial statements.	Page 5
Use of resources	
Management does not set annual budgets for the pension fund as much of the income and expenditure is outside the control of management. Management does, however, monitor the performance of investments and this is reported regularly to the pension fund sub committee. The three year rolling return on assets was 17.5% compared to a benchmark of 15.6%.	Page 5
Governance	
In line with the prior year, management reports three areas of partial compliance and one area of non-compliance in the governance compliance statement. Following audit recommendations in 2010-11, progress has been made in each of these areas which should allow full compliance to be reported in 2012-13.	Page 6

Accounting policies; technical accounting matters

The Code of Practice on Local Authority Accounting in the United Kingdom 2011-12 (“the Code”) did not include any major amendments for pension fund financial statements.

All accounting policies have been applied consistently.

Accounting policies	There have been no changes to accounting policies in 2011-12. The accounting policies for the pension fund remain appropriate.
Code of practice on Local Authority Accounting in the United Kingdom 2011-12 (“the Code”)	The 2011-12 financial statements have been prepared in accordance with the Code supported by International Financial Reporting Standards (“IFRS”). There were no changes to the Code impacting on the pension fund and accounting policies have been applied consistently year on year.
Accounting adjustment	One numerical adjustment was made to the financial statements, prior to commencing our on site audit work. This related to the accounting for a currency hedge. The cash arising from a realised hedge was being held by the pension fund custodian JP Morgan at the year end. As this account was a new account, the situation had not occurred before. It was identified by management’s reconciliation process and required a subsequent adjustment to the draft accounts. Correcting this balance increased the net assets of the pension fund by £1.7 million. There no adjustments arising from our audit procedures and there are no unadjusted audit differences to report.

Financial position

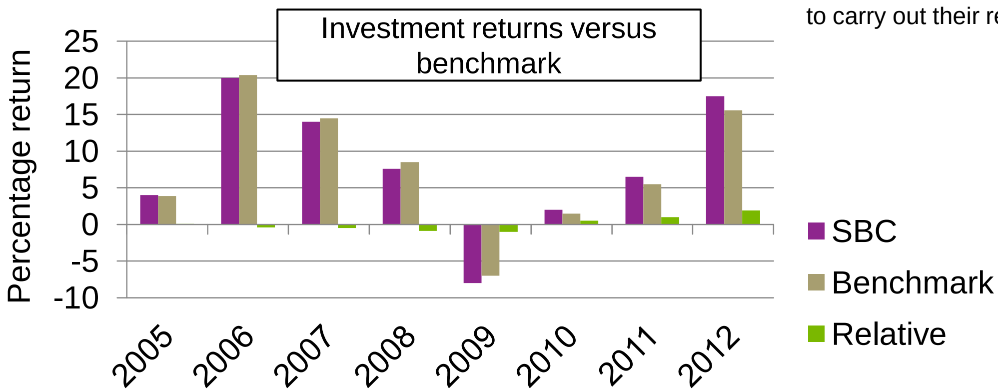
Management does not budget financial performance of the pension fund due to the nature of income and expenditure.

Investments returns are monitored throughout the year and recent historic performance has been positive.

The pension fund does not budget financial performance as the majority of income and expenditure is outwith the control of the pension fund such as contributions receivable and pensions payable. The key financial indicator for the pension fund is considered to be the performance of the fund's investments. This is monitored through the year and reported to the sub-committee on a quarterly basis.

The overall return of the fund over three years was 17.5%, 1.9% higher than the benchmark return and 3.0% higher than the local authority weighted average return. The historic investment performance of the fund is detailed in the table below. The net assets of the fund increased by £14 million in the year, primarily as a result of investment income and gains on the market value of investments.

Following an independent review of the fund's investment policies, two new fund managers were appointed post year end. In September 2012 the pension fund sub-committee agreed to undertake a high level investment review of the pension fund. The results of this are expected to be reported in March 2013.



A triennial valuation was performed for the fund as at 31 March 2011. This reflected a slight decrease in the long term funding position from 96.5% funded to 95.7% funded. The fund actuary estimates a period of 12 years for the fund to return to a nil deficit position.

An analysis of the funding position of the pension fund using the most recently available information (as at 31 March 2008) showed that the funding level of 96.5% was the second highest of all Scottish local government pension funds. It should be noted however, that the actuarial assumptions used to calculate scheme liabilities have a significant impact on funding levels. In our view, these are likely to vary between different funds.

Local authority elections in May 2012 resulted in a change of administration at the Council and, accordingly, changes to the pension fund sub-committee membership. Members place some reliance on the challenge and expertise brought by the fund's investment advisors, Aon Hewitt.

There are a number of developments on the horizon for pension funds, such as auto-enrollment. Members should ensure that they give ongoing consideration to any training or advice they may require to carry out their responsibilities for the pension fund going forward.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements were subject to significant change and continue to provide a sound framework for organisational decision-making.

Governance compliance statement **Corporate governance and internal control arrangements** **Standards of conduct and prevention and detection of corruption**	The governance compliance statement is in line with that published in the 2010-11 financial statements. Three areas of partial compliance are noted and one area of non-compliance, however, management has taken action to address most of these. Enhancements to governance arrangements during the year included the drafting and approval of a separate risk register for the fund; arrangements are in place to ensure this is subject to regular review by the sub-committee. Further enhancements have been made post year end, with the approval of a pension fund administration strategy and training policy. Both of these should also be subject to regular review by the sub-committee to ensure they remain appropriate. We have reviewed the governance compliance statement and can confirm it is consistent with our understanding of the pension fund. A governance statement for the pension fund was approved in March 2010 and this details the operation of the pensions sub-committee which is a sub-committee of the Council and meets quarterly. Management of the pension fund is undertaken by Council staff who are therefore subject to Council policies on standards of conduct, fraud and corruption. Our testing of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively.
Management representation letter	In accordance with International Standards on Auditing (UK & Ireland) management is required to provide us with representations on specific matters such your financial standing, application of accounting policies, and whether the transactions in the financial statements are legal and unaffected by fraud. In particular, we will be requesting confirmation that: ▪ all events subsequent to the date of the financial statements and for which IAS 10 *Events after the reporting date* requires adjustment or disclosure, have been adjusted or disclosed; and ▪ you acknowledge your responsibility for such internal control as you determine necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, you acknowledge your responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

Appendices

Auditor's Independence

We are required by ethical standards to formally confirm our independence you.

There are no specific matters which have impinged on our independence.

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

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

General procedures to safeguard independence and objectivity

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

- instilling professional values;
- communications;
- internal accountability;
- risk management;
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Council.

It was felt not necessary to put any safeguards in place.

Confirmation of audit independence

We confirm that as of 24 September 2012, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Lead and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

Audit Scotland code of audit practice – responsibilities of the Council

Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

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