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Scottish Borders Council Pension Fund

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

Audit: Year ended 31 March 2014

30 September 2014

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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 ("Council") and is made available to Audit Scotland and the Accounts Commission (together "the beneficiaries"), and 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. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the beneficiaries alone.

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

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the 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 (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a beneficiary's publication scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

This report is presented in connection with our audit of Scottish Borders Council Pension Fund for the year ended 31 March 2014.

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 for the year ended 31 March 2014.

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

<p>Context</p>	<p>The year ended 31 March 2014 is the fifth year for which local authorities responsible for administering a pension fund forming part of the Local Government Pension Scheme have been required to publish an annual report and financial statements for the pension fund separate from the authority's own financial statements.</p> <p>In addition to Scottish Borders Council ("the Council") itself, there are two other scheduled bodies and 12 admitted bodies participating in the Scottish Borders Pension Council Fund ("the Pension Fund"); the Council accounts for 8,732 out of a total membership of 9,311 (93.7%) in the Pension Fund.</p> <p>A triennial valuation of the Pension 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%. The triennial valuation as at 31 March 2014 is currently underway.</p>
<p>Financial statements</p>	<p>The 2013 -14 financial statements have been prepared in accordance with the Code of practice on Local Authority Accounting in the United Kingdom 2013-14 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. The accounting policies for the pension fund remain appropriate.</p> <p>Draft financial statements were provided on 30 June 2014, in line with the statutory and agreed timetable. These were complete and to a high standard. Supporting evidence was available for the commencement of our audit.</p> <p>Overall, we consider arrangements in the control environment associated with the compilation of the financial statements to be appropriate for the Pension Fund.</p> <p>We have issued an unqualified audit opinion on the 2013-14 financial statements. There were no significant accounting or audit matters.</p>
<p>Governance</p>	<p>Management has reported full compliance in the governance statement. This is the second time full compliance has been reported following the progress made to improve governance processes during the year.</p>
<p>Use of resources</p>	<p>Management monitors the performance of investments and this is reported regularly to the Pension Fund Committee. Costs are also benchmarked against other Scottish local authority pension funds. The three year rolling return on assets to 31 March 2014 was 8.9%, compared to a benchmark of 8.6%.</p>

Purpose of this report

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit of the Scottish Borders Council Pension Fund for the year ended 31 March 2014. It is addressed to both those charged with governance at the Pension Fund and the Controller of Audit.

The scope and nature of our audit were set out in our audit strategy document which was presented to the Pension Fund at the outset of our audit for 2013-14.

Responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out the Pension Fund's and the Chief Financial Officer's responsibilities in respect of:

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

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

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

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

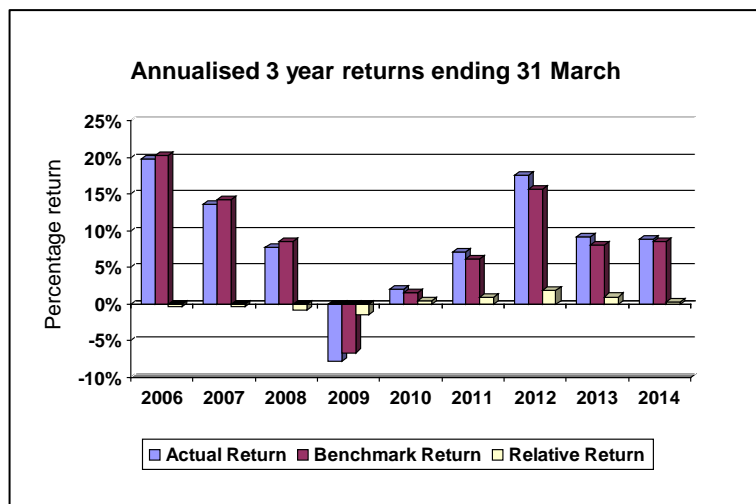
This annual audit report to members of the Pension Fund, together with previous reports to the Pension Fund during our audit planning work, discharges the requirements of ISA 260.

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

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 committee on a quarterly basis.

The overall return of the fund over three years to 31 March 2014 was 8.9%, 0.3% higher than the benchmark return. The historic investment performance of the fund is detailed in the table below. The net assets of the fund increased by £40 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 Pension Fund's investment policies, no changes were made to the fund managers or the passive currency hedge managers engaged during the year. There is a continual review of the performance of fund managers to monitor performance which may lead to further changes in 2014 -15.



The latest finalised triennial valuation was undertaken for the Pension Fund as at 31 March 2011. This reflected a slight decrease in the long term funding position from 96.5% to 95.7% when compared to the 2008 valuation. The fund actuary estimates a period of 12 years for the Pension 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 2011) showed that the funding level of 95.7% was the eighth out of 16 Scottish local government pension funds. The Council recognises 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.

There are a number of developments on the horizon for pension funds, such as auto-enrolment. A comprehensive training policy is in place which is reported regularly to members. This allows members to ensure that they give ongoing consideration to the training or advice they may require to carry out their responsibilities for the pension fund going forward.

A £40 million increase in the asset valuation at the year end (£483.6 million compared to £444.4 million at the previous year end) included £35 million of realised investment market gains. These realised gains were predominantly as a result of the portfolio re-balancing in May 2013 following an investment strategy review and involved 11% divestment of equities and re-investment into alternative assets. Investment income has fallen to £5.3 million in the year from £6.1 million in the prior year, a 16% decrease. This was due in the main to this re-balancing activity mid-year.

Over-arching and supporting corporate governance arrangements were not subject to significant change and continue to provide a sound framework for organisational decision-making.

<p>Governance compliance statement</p> <p>Corporate governance and internal control arrangements</p> <p>Standards of conduct and prevention and detection of corruption</p>	<p>The governance compliance statement included within the 2013-14 annual report shows an improvement in compliance compared to previous years. Action has been taken in year to address areas of partial compliance and non-compliance. Enhancements to governance arrangements during the year included the drafting and approval of a separate risk register for the Pension Fund which has been subject of a further detailed review in June 2013 by the Pension Fund committee. The committee has also approved an updated pension administration strategy and training policy. We have reviewed the governance compliance statement and confirm it is consistent with our understanding of the Pension Fund.</p> <p>A governance statement for the pension fund was approved in June 2014 and this details the operation of the committee which meets quarterly.</p> <p>Management of the pension fund is undertaken by Council staff who are therefore subject to Council policies on standards of conduct, fraud and corruption.</p> <p>As part of the audit, we undertook a review of the latest internal control reports issued by the Pension Fund's investment managers. The exceptions reported by the independent auditors of the investment managers were reviewed and we devised our audit approach based on the assurance gained through these reports. Exceptions reported were recognised as mainly internal control deficiencies bearing no impact on the Pension Fund audit and giving comfort over the evidence provided by the investment managers. Independent reviews of each of the reports as at the date of the audit work were also performed for extra comfort over the evidence. In order to introduce an element of unpredictability during the audit and gain comfort over the completeness of the reports, additional testing was performed where the information received from the investment managers was corroborated to the custodian reports that were independently received by us.</p> <p>Our testing of the design and operation of Council financial controls over significant risk points relevant to the Pension Funds confirms that controls are designed appropriately and operating effectively.</p>
<p>Management representation letter</p>	<p>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. The representation letter contains standard matters and there are no issues in this regard that we wish to bring to your attention.</p>



Financial statements and accounting

Audit conclusions

We have issued an unqualified audit opinion on the financial statements.

International Standards on Auditing require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk and that management override of controls is a significant risk.

We have satisfactorily carried out audit work to address these risks.

Audit conclusions

Following approval of the financial statements by the Council's Chief Financial Officer, we have issued an unqualified opinion on the truth and fairness of the state of the Fund affairs as at 31 March 2014, and of its expenditure and income for the year then ended. The financial statements have been properly prepared in accordance with the 2013-14 Code of Practice, and prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- reviewed assumptions and judgements made by management and considered these for appropriateness; and
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements.

Significant risks

Revenue recognition

International Standard on Auditing (UK and Ireland) 240 requires us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. As the Fund income is primarily received from investments, contributions and transfers in, we did not regard the risk of fraud from this revenue recognition to be significant. We have however undertaken tests over revenue recognition for the purposes of our audit and have concluded appropriately on the amounts recognised in respect of 2013-14.

Management override of controls

To address this risk, we have performed testing of journal entries during the year and at the year end, undertaken a review of unusual transactions in the year, made enquiries with employees outside the finance department, incorporated audit tests of an unpredictable nature and undertaken testing of controls, including 'higher level' controls and reviewed management's accounting estimates for bias.

Our work did not identify any matters that required adjustment in the financial statements or which require to be brought to your attention.

There have been no substantive changes to the financial reporting framework as set out in the Code of Practice.

Accounting policies have been applied consistently.

<p>Financial reporting framework</p>	<ul style="list-style-type: none"> ■ The Fund prepares its financial statements in accordance with the Code of Practice which is based upon International Financial Reporting Standards (“IFRS”). ■ There have been no significant changes in financial reporting requirements, and consequently there are no substantive changes to the Fund accounting policies. We are satisfied that the accounting policies adopted remain appropriate. ■ No newly effective accounting standards are considered likely to have a material impact on the Fund financial statements in the coming year.
<p>Financial statements preparation</p>	<ul style="list-style-type: none"> ■ The unaudited financial statements were authorised for issue by the Chief Financial Officer on 26 June 2014, and passed to us for audit in line with the statutory timetable. ■ In accordance with regulations, the unaudited financial statements were made available for public inspection for the statutory period. No objections were received. ■ Good quality supporting documentation was made available in electronic format to support the unaudited financial statements.
<p>Going concern</p>	<ul style="list-style-type: none"> ■ The Fund’s net asset statement as at 31 March 2014 shows a net asset position of £486.064 million, the majority of which relates to managed funds of £483.610 million. There are no concerns over the Fund’s ability to continue as a going concern.
<p>Other matters</p>	<ul style="list-style-type: none"> ■ Mandatory communications required by International Standards on Auditing are given in Appendix one. ■ There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content.



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Appendices

Mandatory communications regarding audit adjustments, auditor independence and representation letter content are given here.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	<p>There were no audit adjustments required to the draft financial statements which impacted on the net assets or the net expenditure for the year.</p> <p>A small number of numerical and presentational adjustments were required to some of the financial statements notes.</p>	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	<p>We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you.</p> <p>There are no unadjusted audit differences.</p>	-
Confirmation of Independence Letter issued by KPMG to the Pension Fund	<p>We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff.</p>	Appendix two
Schedule of Fees Fees charged by KPMG for audit and non-audit services	<p>Audit fees for 2013-14 were agreed with management in accordance with the range specified by Audit Scotland. There were no non-audit services.</p>	-
Draft management representation letter Proposed draft of letter to be issued by the Pension Fund to KPMG prior to audit sign-off	<p>There are no significant changes to the standard representation required for our audit from last year.</p>	Appendix three

Auditing Standards require us to consider and confirm formally our independence and related matters in our dealings with the Pension Fund.

We have appropriate procedures and safeguards in place to enable us to make formal confirmation in our letter included opposite.

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

We have considered the fees paid to us by the Fund for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards.

As a result we have underlying safeguards in place to maintain independence through:

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

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 members of the Fund.

Confirmation of audit independence

We confirm that as of 8 September 2014, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

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

Yours faithfully

KPMG LLP



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