

# Scottish Borders Council Pension Fund 2021/22 Annual Audit Report



 AUDIT SCOTLAND

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

October 2022

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# Key messages

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## 2021/22 annual report and accounts

- 1 Our audit opinions on the annual report and accounts are unmodified.
- 2 The financial statements of Scottish Borders Council Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2022 and have been properly prepared in accordance with the financial reporting framework.

## Financial management

- 3 The Fund pays out more than it collects annually from fund members, with investment returns making up the difference. The value of the Fund increased by 5.9% to £911 million during 2021/22, but investment performance was below the benchmark return set for the year.
- 4 The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.

## Financial sustainability

- 5 Recent triennial valuations provide assurance over the financial sustainability of the fund and the viability of its funding strategy.
- 6 The Fund reviewed its investment strategy following the March 2020 triennial valuation and will continue to diversify the investment structure to support income generation.

## Governance and transparency

- 7 Governance arrangements have been appropriate and operated effectively.
- 8 There is effective scrutiny, challenge and informed decision-making by committee.
- 9 The Fund actively considers Environmental, Social and Governance matters as part of its Investment Strategy.

## Best Value

- 10 The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising management expenses.

- 11** Scottish Borders Council Pension Fund was awarded Local Government Pension Scheme (LGPS) Fund of the Year (assets under £2.5bn) at the LAPF Investments Awards.
- 12** 2021/22 was a challenging year for Scottish Local Government Pension Schemes. Ten of the eleven funds still reported positive movements in net assets during the year, but only three of those funds, not including Scottish Borders, reported above benchmark returns.

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# Introduction

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1. This report is a summary of our findings arising from the 2021/22 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 March 2022 meeting of the Pension Fund Committee and to the March 2022 Audit and Scrutiny Committee. This report comprises:
  - an audit of the Fund's annual report and accounts
  - consideration of the wider dimensions of financial management, financial sustainability, governance and transparency, and value for money, that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).
3. The main elements of our audit work in 2021/22 have been:
  - an audit of the Fund's 2021/22 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 of financial management, financial sustainability, governance and transparency and value for money.

## 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.

## Responsibilities and reporting

5. Scottish Borders Council is the administering authority for the Scottish Borders Council Pension Fund. The council delegates this responsibility to the Pension Fund Committee. The committee is responsible for establishing effective governance arrangements and ensuring that financial management is

effective. The Pension Fund Committee also recommends the annual report and accounts for approval by the Council. The Council's Audit and Scrutiny Committee is responsible for reviewing the effectiveness of internal control arrangements.

**6.** 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.

**7.** 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
- arrangements for securing financial sustainability.

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

**9.** 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.

**10.** 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

**11.** 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.

**12.** 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 2021/22 audit fee of £22,110 as set out in our Annual Audit Plan remains unchanged.

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

## Audit appointment from 2022/23

**14.** The Accounts Commission is responsible for the appointment of external auditors to local government bodies. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants. The current appointment round was due to end in 2020/21 but this was extended for a year so that 2021/22 is the last year of the current appointment round.

**15.** The procurement process for the new round of audit appointments covering 2022/23 to 2026/27 was completed in May 2022 and Audit Scotland has again been appointed as the external auditor for Scottish Borders Council Pension Fund. Although Audit Scotland remain the board's external auditors, to maintain the independence and objectivity of the audit team, the engagement lead and other staff working on the audit will be changed for the 2022/23 audit. The outgoing audit team will work with officers and the new audit team to ensure a smooth transition.

**16.** A new [Code of Audit Practice](#) applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the Code issued in May 2016.

**17.** We would like to thank Committee members and other staff, particularly those in finance and the pensions administration team for their co-operation and assistance over the last six years.

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# 1. Audit of 2021/22 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

Our audit opinions on the annual report and accounts are unmodified.

The financial statements of Scottish Borders Council Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2022 and have been properly prepared in accordance with the financial reporting framework.

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## Our audit opinions on the annual report and accounts are unmodified

**18.** The annual report and accounts for the year ended 31 March 2022 were approved by the Scottish Borders Council on 24<sup>th</sup> November 2022. 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.

## The Covid-19 pandemic had no impact on audit evidence

**19.** The completeness and accuracy of accounting records and the extent of information and explanations that we required for our audit were not affected by the Covid-19 outbreak.

**20.** The working papers provided with the unaudited accounts were of a good standard and finance staff provided support to the audit team during the audit. This helped ensure that the audit of the annual accounts process ran smoothly.

## The annual report and accounts were submitted in line with our agreed audit timetable

**21.** Submission dates for the audited annual report and accounts for 2020/21 and 2021/22 were deferred in line with the later dates for producing the annual accounts because of the impact of Covid-19. Audit Scotland has set target



dates for 2021/22 which transition to more regular timescales. For 2021/22, the deadline for the audited annual report and accounts is 31 October 2022. We will present our Annual Audit Report to the Pension Fund Committee in October 2022, but due to diary commitments, the accounts will now be signed off in November 2022.

**22.** The unaudited annual report and accounts were received in line with our agreed audit timetable on 30 June 2022.

## **There were no objections raised to the annual report and accounts**

**23.** 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.

## **Overall materiality is £9.1 million**

**24.** We apply the concept of materiality in both planning and performing the audit and in evaluating the effect of identified misstatement on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the independent auditor's report. We identify a benchmark on which to base overall materiality, such as gross assets, and apply what we judge to be the most appropriate percentage level for calculating materiality values.

**25.** The determination of materiality is based on professional judgement and is informed by our understanding of the entity and what users are likely to be most concerned about in the financial statements. In assessing performance materiality, we have considered factors such as our findings from previous audits, any changes in business processes and the entity's control environment including fraud risks.

**26.** Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. This was reviewed on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

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### **Exhibit 1**

#### **Materiality values**

<b>Materiality level</b>	<b>Amount</b>
Overall materiality	£9.1 million
Performance materiality	£5.9 million

Materiality level	Amount
Reporting threshold	£250 thousand
Specific materiality (applied to benefits expenditure and contributions income in the fund account)	£2.5 million
Specific performance materiality	£1.5 million

Source: Audit Scotland

## We have no significant findings to report on the annual report and accounts

**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. We have no issues to report from the audit.

## We have obtained audit assurances over the significant financial statements' risks identified in our 2021/22 Annual Audit Plan

**28.** We have obtained audit assurances over the identified significant risks of material misstatement to the financial statements. [Exhibit 2](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

### Exhibit 2

#### Significant risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p><b>1. Risk of material misstatement due to fraud caused by the management override of controls</b></p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be</p>	<ul style="list-style-type: none"> <li>Assess the design and implementation of controls over journal entry processing.</li> <li>Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</li> </ul>	<p>No issues identified.</p> <p>No issues identified.</p>

Audit risk	Assurance procedure	Results and conclusions
operating effectively.	<ul style="list-style-type: none"> <li>• Test journals at the year-end and post-closing entries and focus on significant risk areas.</li> <li>• Consider the need to test journal entries and other adjustments during the period.</li> <li>• Evaluate significant transactions outside the normal course of business.</li> <li>• Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements.</li> <li>• Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</li> <li>• Focussed testing of accounting accruals and prepayments.</li> </ul>	<p>No unusual or inappropriate transactions were identified as part of our detailed journal testing.</p> <p>No unusual or inappropriate transactions were identified as part of our detailed journal testing.</p> <p>Substantive testing of transactions throughout the year were concluded as satisfactory.</p> <p>No issues identified.</p> <p>No changes to methods identified.</p> <p>Focussed testing on accruals and prepayments did not identify any instances of management override of controls.</p> <p><b>Conclusion:</b> We have not identified any indication of management override in the year leading to material misstatement or significant concern.</p>
<p><b>2. Estimations applied to level 3 investments</b></p> <p>The pension fund has a significant portfolio of level 3 investments, for example unquoted equities, where valuations involve the application of a variety of estimates in determining appropriate valuations. This</p>	<ul style="list-style-type: none"> <li>• Confirmation of year end valuations to valuation reports and/or other supporting documentation.</li> <li>• We will review user entity controls in relation to the use of service organisations.</li> <li>• Review the relevant investment manager</li> </ul>	<p>No significant issues identified.</p> <p>No issues identified.</p>

Audit risk	Assurance procedure	Results and conclusions
subjectivity gives rise to a significant risk of material misstatement in the financial statements.	<p>controls' reports for qualifications or exceptions that may affect the audit risk.</p> <ul style="list-style-type: none"> <li>Review the arrangements in place at the Fund to assess investment managers' governance arrangements.</li> <li>Review the disclosures included in the accounts to ensure these are adequate in directing the user of the accounts to acknowledge the areas of major sources of estimation and uncertainty with regards to level 3 assets.</li> </ul>	<p>No issues identified.</p> <p><a href="#">See Appendix 1 Recommendation 4</a></p> <p>No issues identified.</p> <p><b>Conclusion:</b> From our review of investment manager reports, review of disclosures and our review of the user entity controls in relation to the use of a service organisation, we did not identify any significant issues in relation to this risk.</p>

## Other areas of audit focus

**29.** We identified in our 2021/22 Annual Audit Plan areas where we considered there to be other risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks. The areas of specific audit focus were:

- Estimations applied to the actuarial valuation: The actuarial valuation depends on a range of financial and demographic estimations about the future. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements.
- Valuation of level 1 and level 2 assets: Investments held by the Pension Fund are subject to market price fluctuations and a degree of estimation. The Pension Fund holds material level 1 (where valuation derived directly from unadjusted quoted active market price) and level 2 (where the instrument is traded in a market not considered to be active or where the fair value is determined using valuation techniques based on market prices). Due to the material amounts and in particular, the degree of subjectivity and complexity in the valuation of level 2, this gives rise to a risk of material misstatement in the financial statements.

**30.** We kept these areas under review throughout our audit and based on the findings of the audit procedures performed, there are no matters which we need to bring to your attention.

## Other matters arising from the audit of the financial statements

**31. Pension Recalculation:** In our 2020/21 audit, we reported an error with a pension lump sum payment. Management agreed to recalculate the member's options and to re-engage with the member. During our 2021/22 audit we identified a further error and alerted management. This is detailed in [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation.

**32. Pension Overpayment:** The aforementioned error has resulted in an overpayment. As it was an error made by officers who are employed by the council (with salary costs recharged to the pension fund), and not the individual, it was agreed no recovery of overpayment would be sought. The cost has been borne by the pension fund and not the council. Whilst a scheme of delegation is in place for the council there is a need to consider an appropriate scheme of delegation for decisions that impact on the pension fund. This should include information on what circumstances would give rise to not seek recovery of overpayment, and what entity should bear the cost of that overpayment. This is detailed in [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation.

**33. Investment Management Expenses:** We identified that £0.128m was omitted from the investment management expenses. This was a timing error caused by information not completely available at the time of the preparation of the accounts. We reviewed each of the cost transparency initiative templates, completed by fund managers, provided after the year end and this total reflects the total of costs omitted. We recommend a new process is put in place for the collection and recording of investment management fees to ensure these are complete. This is detailed in [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation.

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## Recommendation 2

As part of the accounts preparation process, management should ensure that investment managers provide information to the fund on a timely basis.

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## Identified misstatements of £2.9 million were not adjusted in the accounts. These were less than our performance materiality and we did not need to further revise our audit approach

**34.** Total misstatements identified had a net value of £1.5million. Misstatements identified related to:

- **Level 3 late valuations** Misstatements identified were £2.2million, which if adjusted, would have increased investment asset values by £2.2 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 2021. The valuations were not available when the unaudited accounts were issued. The final valuations were received during our audit.

- **Investment management expenses** Misstatements identified were £0.12m. Investment managers had not provided complete information at the time of the accounts preparation. If these had been adjusted, there would be no overall impact as both management expenses and change to market value would be adjusted.
- **Baillie Gifford Global Investments** Information included in the custodian values on comparison with the fund manager values differed by £0.625m. The fund had used the custodian values for accounts preparation purposes. The differences are mainly timing related, with the majority driven by the fund manager cutting a share price of a suspended trading investment company. If these had been adjusted, this would have decreased investment asset values by £0.625m.

**35.** After discussions with management, we concluded that adjustments for these were not required as the total net adjustment required to investment assets of £1.5 million is below our performance materiality level.

**36.** 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. Items not adjusted are detailed in [Appendix 2](#).

### **Progress was made on prior year recommendations**

**37.** The Fund has made 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](#).

## 2. Financial management

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

### Main judgements

The Fund pays out more than it collects annually from fund members, with investment returns making up the difference. The value of the Fund increased by 5.9% to £911 million during 2021/22, but investment performance was below the benchmark return set for the year.

The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance.

### The annual performance of the Fund was significantly impacted by Covid-19 and other world events

38. When considering the investment performance of the Fund during 2021/22, it is important to recognise the impact of Covid-19 and other world events on financial markets and investments. The global impact of the pandemic and the conflict in Ukraine has significantly increased market volatility. The Fund's performance by the conclusion of 2021/22 is summarised in [Exhibit 3](#).

### Exhibit 3

#### Assets, funding level and investment performance

Increase in net assets	Funding level	Investment performance
<b>£911 million</b>	<b>110%</b>	<b>7.3%</b>
Closing net assets as at 31 March 2022 (+5.9%)	2020 Funding Valuation	Average annual return on investments over 5 years
<b>£860 million</b>	<b>114%</b>	<b>5.9%</b>
Opening net assets at 1 April 2021	2017 Funding Valuation	Return on investments 2021/22

Source: 2021/22 Scottish Borders Council Pension Fund unaudited annual report and accounts

**39.** Despite the volatile market conditions, the Fund has seen a positive performance of 5.9%, against a benchmark of 10.6% for 2021/22. The net assets of the Fund increased from £860 million at 31 March 2021 to £911 million at 31 March 2022. During 1<sup>st</sup> April 2021 to 31<sup>st</sup> December 2021, investment assets continued to grow, with a peak of £938m as at 31<sup>st</sup> December 2021. In the last quarter of 2021/22, there was significant market volatility for most major asset classes. This was attributed to concerns over rising inflation, monetary policy and the Russia-Ukraine war.

**40.** Hymans Robertson estimated the pension liabilities decreased by 2.8% to £1,057 million at 31 March 2022 (2020/21 – £1,088 million). This estimate uses assumptions in line with International Accounting Standard (IAS) 26 requirements, for the purposes of the Fund's financial statements.

### **The Fund has appropriate and effective financial management arrangements in place which includes comprehensive reporting of investment performance**

**41.** The Acting Chief Financial Officer for Scottish Borders Council is the Proper Officer responsible for Scottish Borders Council Pension Fund. The financial regulations of Scottish Borders Council, as administering authority, apply to the Fund. We consider these to be current, comprehensive and support good financial management.

**42.** The Pension Fund Committee receives administration and performance reports at its quarterly meetings. These reports are comprehensive and include fund performance trends, investment manager performance against benchmarks and movements in asset allocations. From attendance at Committee we observed and concluded that reports presented to members are subject to appropriate review and scrutiny.

**43.** Overall, we have concluded that the Fund has appropriate and effective financial management arrangements in place, including comprehensive reporting of investment performance.

### **Financial systems of internal control operated effectively**

**44.** 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 the Fund has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**45.** Our work in 2021/22 covered the key controls over the systems used for pension administration activity and the pension fund's investments. The Fund also uses the financial systems of the administering authority, Scottish Borders Council. The main council systems used by the Fund are the general ledger system and the payroll system. Our review of the controls in operation within these systems was conducted as part of our audit of Scottish Borders Council.

**46.** Our review of the systems used by the Fund and the administering authority did not identify any significant control weaknesses which could affect the Fund's



ability to report financial and other relevant data in the financial statements, and we concluded that systems of internal control for the Fund operated effectively during 2021/22.

**47.** Whilst we concluded that overall systems of internal control are operating effectively, we noted that some general documentation and administrative control procedures had not been completed. This was initially raised in our 2020/21 AAR. We understand some control procedures were historically completed in paper format, which have not been updated to reflect the move to home working. This is detailed in [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation.

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### **Prior year recommendation 6**

Management should review administrative procedures in place and update these to reflect the move to home working. Management should also ensure that officers are familiar with their responsibilities for the completion of supporting paperwork to evidence processes have been completed and reviewed in a timely manner.

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### **Standards of conduct and arrangements for prevention and detection of fraud and error were appropriate**

**48.** 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 by putting proper arrangements in place.

**49.** The risk profile of public bodies during 2021/22 has been significantly affected by the Covid-19 pandemic. This is likely to have increased the risk of fraud and error as control environments and internal controls have had to change to allow for services to operate effectively and respond to issues in a timely manner.

**50.** The Fund relies on the Council's arrangements for the prevention and detection of fraud and corruption. We have reviewed the arrangements put in place by the Council to address any heightened risks and concluded that there are appropriate arrangements for the prevention and detection of fraud, error and irregularities.

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## 3. Financial sustainability

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

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### Main judgements

Recent triennial valuations provide assurance over the financial sustainability of the fund and the viability of its funding strategy.

The investment strategy was reviewed following the March 2020 triennial valuation and will continue to diversify the investment structure to support income generation.

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### Recent triennial valuations provide assurance over the financial sustainability of the fund and the viability of its funding strategy

**51.** The results of the 2020 full triennial valuation of the Scottish Borders Council Pension Fund showed a funding level of 110%. This is a slight drop from 114% in the 2017 valuation, but it still means that, overall, the investment assets were higher than the projected liabilities.

### Medium term financial planning arrangements are appropriate and effective

**52.** There is considerable volatility in pension funding and the results of the triennial valuation are in effect a snapshot of the Fund at 31 March 2020. Following each triennial valuation, the Fund reviews and revises its funding strategy. The funding strategy is a summary of the Fund's approach to funding liabilities. The investment strategy outlines the types of investment to be held and the amount held in the different types of investment

**53.** The last review was carried out in 2021 after the results of the 2020 triennial valuation. The revised investment strategy reflects the Fund's decision to focus on income generation to build capacity to fund annual benefits as cash flows from dealings with members continue to be negative. 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. This has been a proactive response from the Fund to move to more income bearing assets to pay annual pensions as the fund matures.

**54.** The Fund has begun implementing the key changes agreed as part of the review. This includes the restructuring of the Fund's equity portfolio, the

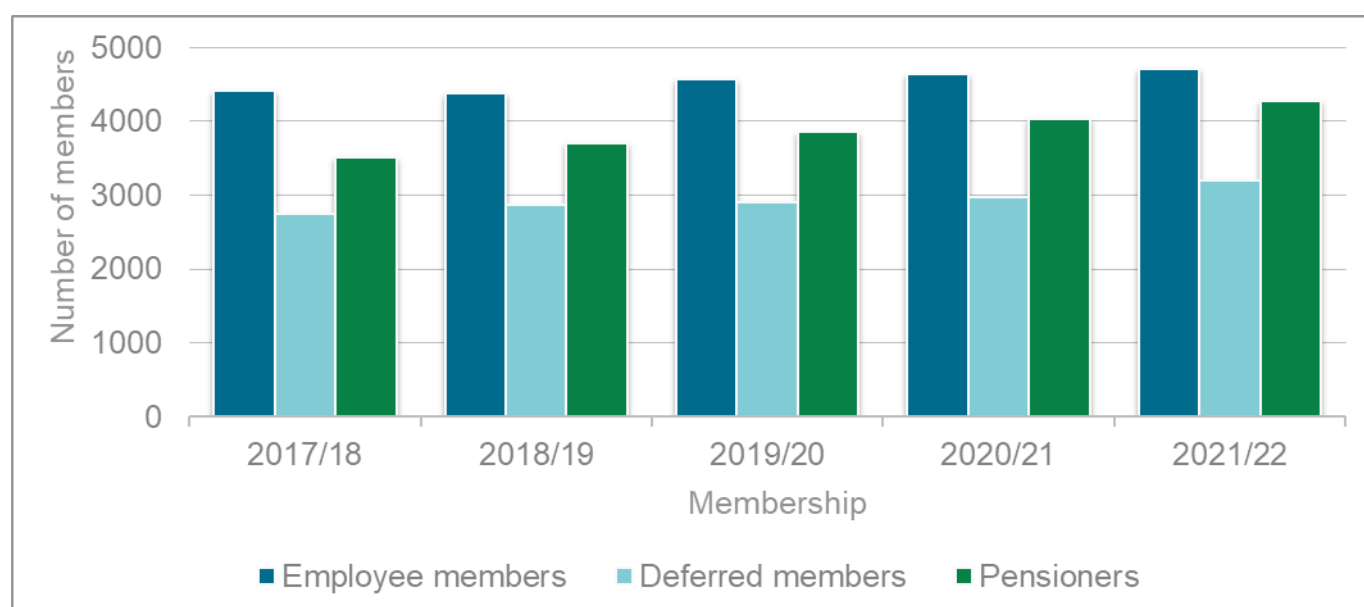
implementation of a new pooled infrastructure equity mandate and the restructuring of the property portfolio.

### Fund membership levels continue to increase but the ratio of active members to pensioners is reducing

**55.** The Fund is a multi-employer fund with one Local Authority, and 16 other employers. The current membership profile is shown at [Exhibit 4](#).

**56.** 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 members' life. It is important that the fund maintains the capacity to meet the current and future pension entitlements of its members.

#### Exhibit 4 Scottish Borders Council Pension Fund membership



Source: Scottish Borders Council Pension Fund 2021/22 unaudited financial statements

**57.** Membership of the fund increased by 514 to 12,178 members at 31 March 2022; an increase in membership of 4.4%. The impact of auto-enrolment continues to contribute to the increase in employee members.

**58.** In 2021/22 the number of pensioners receiving a pension from Scottish Borders Council Pension Fund increased by over 240 and the number of pensioner members continues to increase steadily each year. The number of active members continues to outweigh the number of pensioners but the ratio of active members to pensioners has reduced over the past five years.

**59.** Cash flows from dealings with members continue to be negative with more paid out in benefits than that received from contributions. The cash flow position

impacts the investment strategy as income from investments rather than contributions is needed to pay pensions. The fund has been maturing since 2013/14. 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. This has been a proactive response from the Fund to move to more income bearing assets to pay annual pensions as the fund matures.

### Future rates of employer contributions

**60.** Following the triennial valuation in 2020, the actuary agreed employer contribution rates with individual employers from 1 April 2021. For the majority of employers, the current funding surplus is being used to subsidise and stabilise contribution rates. For one employer, their rate includes an element of deficit recovery contributions to support the employer's financial planning. The approximate split of all contributions received in year is set out at [Exhibit 5](#).

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#### Exhibit 5 Contributions in 2021/22

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
<b>Employer contributions</b>	13.94	0.74	2.35	17.03
<b>Employee contributions</b>	4.60	0.25	0.65	5.5

Source: Scottish Borders Council Fund 2021/22 audited financial statements and supporting working papers

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# 4. Governance and transparency

The effectiveness of scrutiny and oversight and the transparent reporting of information

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## Main judgements

Governance arrangements are appropriate and operate effectively.

There is effective scrutiny, challenge and informed decision making by committee.

The Fund actively considers Environmental, Social and Governance matters as part of its Investment Strategy.

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## Governance arrangements are appropriate and operate effectively

**61.** 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.

**62.** Following the local government elections in May 2022 a new Pension Fund Committee was appointed. This included 5 councillors who served on the Committee during 2021/22 and 2 councillors who were newly appointed to the committee.

**63.** Due to the specialised nature of the Fund, it is vital that members have appropriate knowledge and understanding to provide appropriate challenge and scrutiny. The Fund prepares an annual training programme which covers training, including The Pensions Regulator Trustee Toolkit training, and other essential training that will assist members in discharging their fiduciary duty.

**64.** Members are required to carry out appropriate levels of training to ensure they can perform their required duties. There is no formal induction in place for new members to the Fund. Per the training policy, new members are required to complete the Pension Regulator Toolkit within six months of joining. Members are required to attend at least two meetings per year, not all members

completed this requirement for 2021/22. This is detailed in [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation.

**65.** Scottish Borders Council Pension Fund amended its governance arrangements in response to the pandemic. The impact of Covid-19 from March 2020 has been set out in the Annual Governance Statement in the Fund's annual report and accounts.

**66.** We have concluded that overall, Scottish Borders Council Pension Fund has appropriate governance arrangements in place which support effective scrutiny, challenge and decision-making.

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### Recommendation 3

Management should work with the Pension Board and Pension Committee to ensure members are aware of their attendance requirements.

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### There are effective arrangements for complying with the Pensions Regulator Public Service Code

**67.** The Public Sector Pensions Act 2013 provided for extended regulatory oversight by the Pensions Regulator. The Pensions Regulator issued a code on the governance and administration of public service pension schemes in January 2015 which funds are expected to comply with.

**68.** There were no breaches of the Code that required to be reported to the Pensions Regulator in 2021/22.

### Performance reporting was of a good standard

**69.** The Management Commentary included in the annual report and accounts should provide information on a body, its main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

**70.** The Fund's 2021/22 management commentary is of good quality and is written with the stakeholder in mind. It presents some complex areas in an understandable style which increases transparency in reporting the financial performance and financial position.

### The Fund actively considers Environmental, Social and Governance matters as part of its Investment Strategy.

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

**72.** The Fund approved a revised Statement of Responsible Investment Policy on 17 March 2022 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. The Fund actively engages with fund managers to ensure they are incorporating ESG opportunities to increase investment in sustainable funds. This is demonstrated by the £94m investment with LGIM in their Global ESG Passive Equity fund and the transition of £114m from the Baillie Gifford Global Equity Fund to their Global Paris Aligned Fund.

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# 5. Best Value

Using resources effectively and continually improving services

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## Main judgements

The Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising management expenses.

Scottish Borders Council Pension Fund was awarded Local Government Pension Scheme (LGPS) Fund of the Year (assets under £2.5bn) at the LAPF Investments Awards.

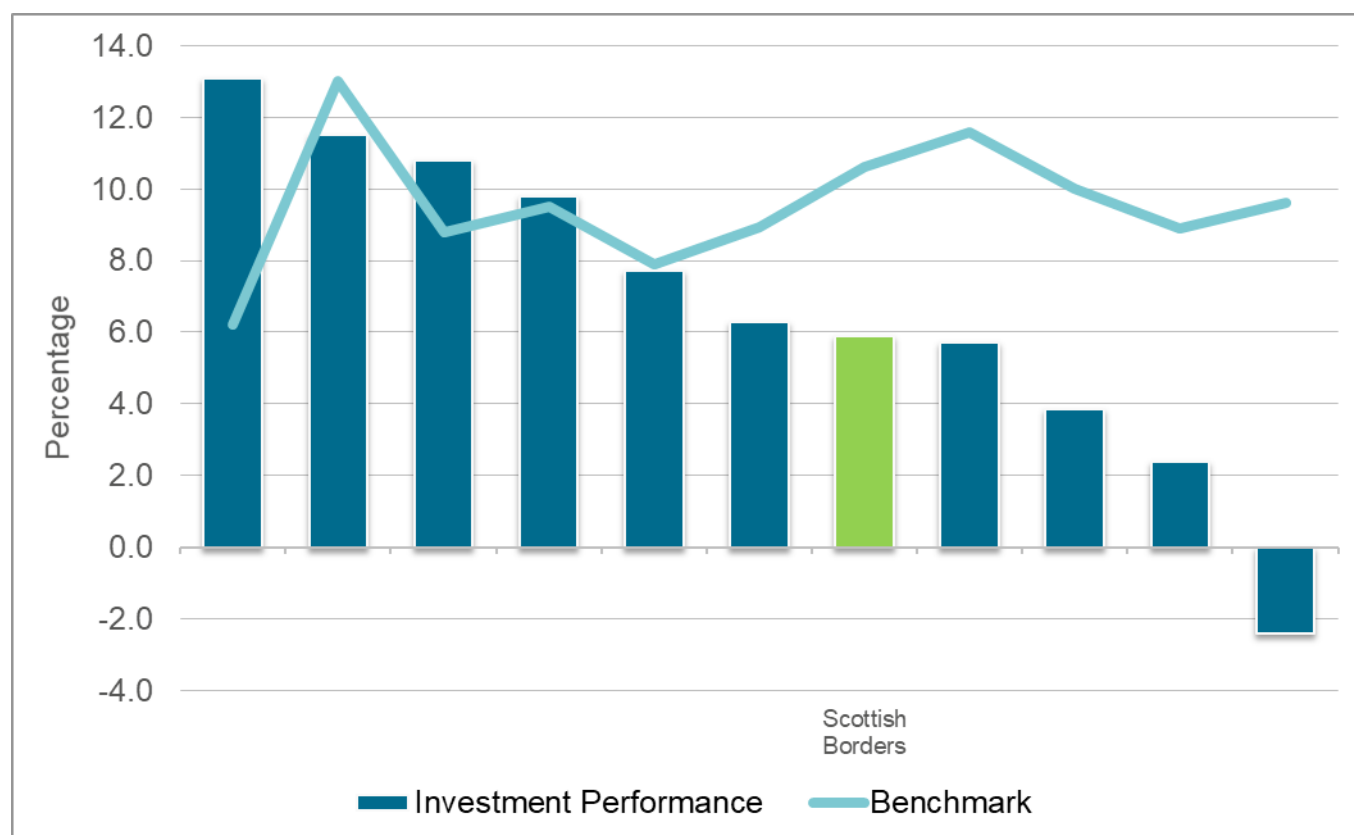
2021/22 was a challenging year for Scottish Local Government Pension Schemes. Ten of the eleven funds still reported positive movements in net assets during the year, but only three of those funds, not including Scottish Borders, reported above benchmark returns.

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**2021/22 was a challenging year for Scottish Local Government Pension Schemes. Ten of the eleven funds still reported positive movements in net assets during the year, but only three funds reported above benchmark returns.**

**73.** As shown in [Exhibit 6](#), 2021/22 was a challenging year for Scottish Local Government Pension Schemes due to the impact of Covid-19 and other world events on financial markets and investments. Ten of the eleven funds still reported positive movements in net assets during the year, but only three funds reported above benchmark returns, with investment performance ranging from -2% to 13%. Scottish Borders Council Pension Fund's increase of 5.9% placed it near the bottom of this range and reflected the greater impact of the wider market conditions on the value of equity markets over the last 12 months.



**Exhibit 6****LGPS pension funds 2021/22 – Net return on investment and benchmark return**

Source: 2021/22 LGPS pension fund unaudited financial statements

## The pension administration function has performed well against targets

**74.** The Scottish Borders Council Pension Fund Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance. The focus of measuring the performance of pensions administration includes both member experience and statutory compliance.

**75.** The Fund's business plan sets out a range of service standards against which administration performance is monitored. The Pensions Team were able to comply with the legislative requirement to issue annual benefit statements. This was achieved with some staff attending their normal workplace, whilst the majority worked from home. During 2021/22 the Pensions Administration Team focussed all efforts on ensuring the statutory elements of the service, as highlighted by the Pensions Regulator, continued to be provided, with all payments to pensioners being issued on time.

**76.** The administration function's performance against its targets for Service Standards have been affected by the pressures of the pandemic, alongside an increasing workload. However, performance in several priority areas has remained high, including issuing 100% of annual benefit statements on time.

**77.** During 2021/22, the Fund implemented Members Self Service. This has helped reduce the number of routine enquiries from scheme members as they are able to obtain information directly via the self-service functionality. Key administration tasks reported for 2021/22 included 1,367 pension estimates. With the implementation of Members Self Service, over 12,500 benefit calculations were run. This should help improve performance going forward.

### **The continuing impact of Covid-19 and the conflict in Ukraine on global markets reduced expected annual returns**

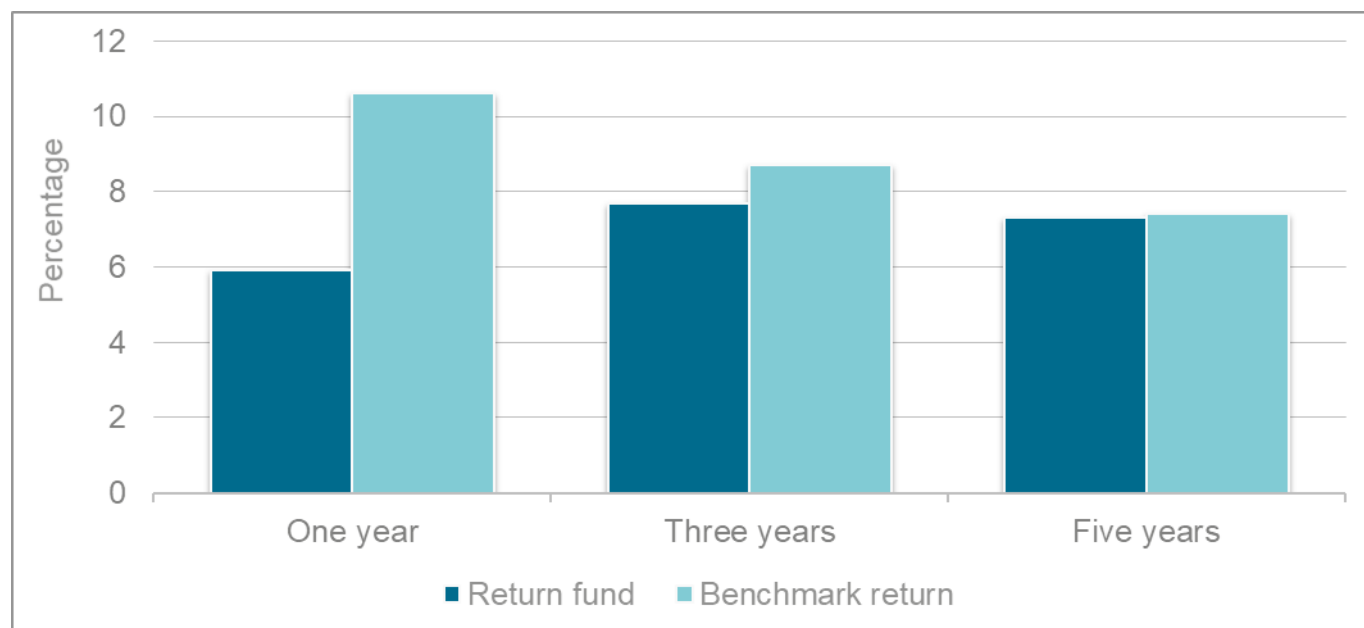
**78.** The Fund appoints several external investment managers. Individual investment manager performance is reviewed regularly by the Pension Fund Investment and Performance Sub-Committee Committee and the Fund's investments team also carries out annual diligence reviews for each appointed fund manager.

**79.** Financial markets have been exceptionally volatile in recent years due to the ongoing Covid-19 pandemic and more recently as result of the conflict in Ukraine. Returns against most asset classes, especially equities, reduced significantly. Throughout 2021/22, investment returns continued to increase each quarter, with a peak value of £938m as at Dec 2021. Performance of the Fund's assets was mixed in quarter 4. This was due to the challenging and volatile market conditions including concerns over rising inflation, tapering monetary policy, and the Russia-Ukraine war. Investment assets dropped by £29m in quarter 4.

**80.** [Exhibit 7](#) shows that over the year, the Fund generated a return of 5.9% against a benchmark of 10.6%. Over the medium to longer term, the Fund has underperformed against its three-, five- and ten-years benchmarks.

## Exhibit 7

### Fund investment performance



Source: Scottish Borders Council Pension Fund 2021/22 unaudited financial statements

## Investment 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.** Investment management expenses have increased from £5.3 million in 2020/21 to £5.6 million in 2021/22. The main reason for the increase in expenses relates to the 5.9% increase in asset value.

**83.** The Fund has encouraged all its listed equity investment managers to sign up to the Code of Transparency and has engaged with managers of other assets classes to do so as and when cost templates become available.

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

## National performance audit reports

**85.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2021/22, we published reports which may be of interest to the Fund. These are outlined in [Appendix 3](#) accompanying this report.

# Appendix 1

## Action plan 2021/22

### 2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>1. Pension Overpayment</b></p> <p>Through our audit work we identified one case where the council made an error in the calculation of a benefit. As it was an error made by the council, and not the individual, no recovery of overpayment was sought. The cost has been borne by the pension fund and not the council.</p> <p><b>Risk</b></p> <p>That governance arrangements are not sufficient to support decision making for pension fund matters.</p>	<p>Whilst a scheme of delegation is in place for the council there is a need to consider an appropriate scheme of delegation for decisions that impact on the pension fund. This should include guidance on what circumstances would give rise to not seek recovery of overpayment, and what entity should bear the cost of that overpayment.</p> <p><a href="#">Paragraph 31</a></p>	<p>Formal overpayment policy for the Pension Fund drafted and will be presented to Pension Fund Committee and Board for approval.</p> <p><b>Responsible officer</b></p> <p>HR Shared Services Manager</p> <p><b>Agreed date</b></p> <p>31 December 2022</p>
<p><b>2. Investment management expenses</b></p> <p>Around £0.128m of investment management expenses were not notified by the investment manager in time for closedown of the accounts and were not therefore included within the accounts.</p> <p><b>Risk</b></p> <p>The transparency of costs related to investment management expenses is not properly reflected in the accounts.</p>	<p>As part of the accounts preparation process, management should ensure that investment managers provide information to the fund on a timely basis.</p> <p><a href="#">Paragraph 32</a></p>	<p>Management will ensure that there is a specific focus during the accounts preparation process on ensuring that information is provided by investment managers on a timely basis.</p> <p><b>Responsible officer</b></p> <p>Acting Chief Financial Officer</p> <p><b>Agreed date</b></p> <p>31<sup>st</sup> March 2023</p>

Issue/risk	Recommendation	Agreed management action/timing
<p><b>3. Member attendance</b></p> <p>Pension Committee and Pension Board members are required to attend at least two meetings of the Pension Fund Committee and Board per year. For 2021/22 a member of the committee and a member of the pension board only attended one meeting.</p> <p><b>Risk</b></p> <p>Members are not present to monitor and scrutinise Pension Fund performance effectively.</p>	<p>Management should work with the Pension Board and Pension Committee to ensure members are aware of their attendance requirements.</p> <p><a href="#">Paragraph 65</a></p>	<p>Management will ensure that members are aware of their attendance requirements for the Pension Board and Pension Committee through Elected Member training and induction processes.</p> <p><b>Responsible officer</b></p> <p>Acting Chief Financial Officer</p> <p><b>Agreed date</b></p> <p>31<sup>st</sup> December 2022</p>
<p><b>4. Annual due diligence review of investment managers</b></p> <p>Annually, the fund issues governance questionnaires to fund managers requesting specific information such as internal controls reports. These should be reviewed to check for any concerns which may impact the fund. For 2021/22 whilst the questionnaires were issued, it was evident these had not been subject to review by management.</p> <p><b>Risk</b></p> <p>That investments held by managers are exposed to unnecessary risks.</p>	<p>Management should ensure that governance questionnaires and supporting information received by each fund manager are reviewed to ensure they are aware of any issues arising which could impact the investments they hold.</p>	<p>Agreed, management will ensure governance questionnaires are reviewed in line with the recommendation.</p> <p><b>Responsible officer</b></p> <p>Acting Chief Financial Officer</p> <p><b>Agreed date</b></p> <p>31<sup>st</sup> March 2023</p>

## Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>5. Pension Recalculation</b></p> <p>Audit testing identified one error included within a member's lump sum pension calculation. The options presented to the member were not based on accurate information. This is considered to be an isolated error. Management relied on a model used by other LGPS Funds to calculate the pension due; this model had not however been updated to reflect the specific circumstances of the member. This error was also missed on independent review of the pension calculation.</p> <p><b>Risk</b></p> <p>There is a risk that calculations are not accurate, and members are not presented with the correct pension options.</p>	<p>For unusual or exceptional pension benefits, management should ensure that there are additional quality assurance arrangements in place for the review of calculations.</p> <p><b><u>Update for 2021/22</u></b></p> <p>We reviewed the recalculated options presented to the member. We identified a further error within the calculation and alerted management. Additional audit testing was not required as we could readily conclude that this was an isolated case.</p>	<p><b>In Progress</b></p> <p>Continue to review unusual or exceptional benefits with management reviewing in line with relevant legislation/regulations.</p> <p><b>Responsible officer</b> HR Shared Services Manager</p> <p><b>Revised date</b> 31 October 2022 and ongoing thereafter</p>
<p><b>6. Administrative Procedures</b></p> <p>Audit testing identified administrative procedures in paper format have not been updated nor completed with the move to home working. This includes the completion of checklists for specific tasks such as procedures following retirement of an employee and leavers checklists. We also identified there is no documented checks on pension calculation figures.</p>	<p>Management should review administrative procedures in place and update these to reflect the move to home working. Management should also ensure that officers are familiar with their responsibilities for the completion of supporting paperwork to evidence processes have been completed and reviewed in a timely manner.</p> <p><b><u>Update for 2021/22</u></b></p> <p>Whilst we noted</p>	<p><b>In Progress</b></p> <p><b>Revised action</b></p> <p>Reminder to be issued to all members of the Pensions Team to ensure all checklists/calculations are fully signed off.</p> <p><b>Responsible officer HR</b> Shared Services Manager</p>

Issue/risk	Recommendation	Agreed management action/timing
<p><b>Risk</b></p> <p>There is a risk all required tasks are not completed and errors not identified in a timely manner.</p>	<p>improvements in some areas, such as documented checks on calculation figures, we found not all areas had been actioned/replaced with the move to home working. For example, documented checklists of completion of specific tasks.</p>	<p><b>Revised date</b></p> <p>31 October 2022</p>
<p><b>7. Pensioner validation using ATMOS reports</b></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><b>Risk</b></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><b><u>Update for 2020/21</u></b></p> <p>This was not actioned for the financial year 2020/21.</p>	<p><b>Complete</b></p> <p>During 2021/22, the fund signed up to the National NI Database. This is a data sharing project with other LGPS pension funds in England, Wales and Scotland. This is used alongside the Tell Us Once notification system. Each month, the team uploads all member data to the NI Database. On a weekly basis, a member of the HRSS team logs in to the Tell Us Once notification system and checks for any matches. This allows HRSS to stop any pensions promptly and take action thereafter. This is an improved process introduced during 2021/22 which negates the requirement to review ATMOS reports. We reviewed this new process as part of our controls work and no issues were identified.</p>
<p><b>8. Validation of overseas pensioners</b></p> <p>Validation of pensioners is considered a key control that should be in place to ensure that pensioners in receipt of pensions are still eligible to receive payment. We identified that, whilst letters and statements are</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><b><u>Update for 2020/21</u></b></p> <p>This was last completed by Scottish Borders Council</p>	<p><b>Complete</b></p> <p>This was completed for 2021/22. Management should continue to ensure this process is carried out periodically.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>issued to overseas pensioners, the process to ensure their existence, has not been carried out during 2019/20.</p> <p><b>Risk</b></p> <p>There is a risk that without adequate controls being in place to validate the existence of pensioners, pensions are paid to deceased pensioners</p>	<p>Pension Fund in September 2020. This process should be completed annually.</p>	
<p><b>9. Reconciliation of pensions paid figure</b></p> <p>There is no monetary reconciliation performed to show the total pensions paid figure agrees with the ledger. Therefore, the total pensions paid figure cannot be tied back to the ledger.</p> <p>The HRSS manager advised that there has never been a reconciliation performed between pensions paid figure and the financial ledger.</p> <p>A monthly report run for differences in payments from one month to the next is available but unfortunately due to work pressures and staff shortages this has not been completed for this financial year. This would be an effective control over the pensions paid figure on a month-by-month basis.</p> <p><b>Risk</b></p> <p>The figures in the financial ledger could be under or overstated.</p>	<p>The pensions paid figure should be reconciled month on month and variances to the ledger investigated. Management should perform monthly reconciliations between the pensions paid figure and the ledger.</p> <p><b><u>Update 2019/20</u></b></p> <p>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.</p> <p><b><u>Update for 2020/21</u></b></p> <p>Reconciliations were provided for periods 6-12 for the 2020/21 period. As this had not been actioned for the full period, a complete reconciliation was not available for audit purposes.</p>	<p><b>Complete</b></p> <p>We were provided with a complete reconciliation detailing the gross payments to pensioners tied back to the general ledger postings.</p>



# Appendix 2

## Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting thresholds and request they be corrected.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in [Exhibit 1](#). We are satisfied that these errors do not have a material impact on the financial statements.

Account areas	Pension Fund Account		Pension Fund Net Assets Statement	
	Dr £000	Cr £000	Dr £000	Cr £000
1. Management expenses	0.12m			
2. Change in market value		(0.12m)		
3. Investment assets			2.2m	
4. Change in market value		(2.2m)		
5. Investment assets				(0.625m)
6. Change in market value		0.625m		
<b>Net impact</b>		(1.575m)	1.575m	

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# Appendix 3

Summary of national performance reports 2021/22 and briefing papers

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## May

[Local government in Scotland Overview 2021](#)

## June

[Covid 19: Personal protective equipment](#)

## July

[Community justice: Sustainable alternatives to custody](#)

## September

[Covid 19: Vaccination programme](#)

## January

[Planning for skills](#)

[Social care briefing](#)

## February

[NHS in Scotland 2021](#)

## March

[Local government in Scotland: Financial Overview 20/21](#)

[Drug and alcohol: An update](#)

[Scotland's economy: Supporting businesses through the Covid 19 pandemic](#)

# Scottish Borders Council Pension Fund 2021/22 Annual Audit Report

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