



Chief Officer Audit & Risk (Chief Audit Executive for the SBC Pension Fund)
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**Internal Audit Annual Assurance Report 2023/24 for the
Scottish Borders Council Pension Fund**

to

**SBC Director of Finance, Pension Accounting & Investment Manager,
Director of People Performance & Change, and HR Shared Services Manager**



29 May 2024

1 Introduction

The Public Sector Internal Audit Standards (PSIAS) (2017) requires that:

“The chief audit executive [SBC’s Chief Officer Audit & Risk] must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.

The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation’s framework of governance, risk management and control.

The annual report must incorporate:

- the opinion;
- a summary of the work that supports the opinion; and
- a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme.”

2 Audit Opinion on the Governance, Risk Management and Internal Control

The Chief Officer Audit & Risk’s (Chief Audit Executive for the SBC Pension Fund) opinion is that there are generally sound systems of governance, risk management and internal control operating within the Scottish Borders Council Pension Fund during 2023/24.

The SBC Pension Fund generally operates under good public sector practice governance arrangements under the SBC Scheme of Administration, the SBC Pension Fund Governance Policy and Compliance Statement as well as through the joint meetings of the Committee and Board that support scrutiny and transparency of decisions made.

Robust risk management arrangements are in place. The Pension Fund Risk Register has been significantly modified and consolidated resulting in a clearer focus on the most significant risks. The new Risk Management Policy and Strategy for the SBC Pension Fund will ensure there is a relevant risk management framework in place aligned to the SBC Pension Fund’s objectives, governance and administration.

Robust business planning arrangements are in place to demonstrate clarity of required developments and improvements. A 3-year Business Plan is approved, with progress on actions being subject to monitoring by the Pension Fund Committee and Pension Board.

Sound investment practices are in place which follow approved investment principles, an appropriate investment strategy, and effective governance over investment decisions. The Fund has underperformed against expectations in some investments over the 3-year period ending 31 March 2024 driven by the Fund's equity mandates (both Global and UK) and property mandate. Notwithstanding, the 2023 Actuarial Valuation reported a funded position of 134% (increased from the 2020 funded position of 110%).

3 Scope of the Internal Audit Annual Plan 2023/24

The Internal Audit work that has been performed during the year is in accordance with that set out in the approved Internal Audit Annual Plan 2023/24 for the SBC Pension Fund. The level of Actual Audit Days 26 was slightly more than the Plan Days 20 in total for the SBC Pension Fund. The range and breadth of Internal Audit work, which is listed below, is sufficient to inform the Internal Audit overall assurance opinion and conclusions on the adequacy of the SBC Pension Fund's overall control environment. There has been no impairment to the independence or objectivity of the Internal Audit function during the year.

Internal Control, Governance and Risk Management

- Assess the Pension Fund's corporate governance arrangements in place to deliver its objectives set out in its Business Plan. Use the Governance Policy and Compliance Statement as an integrated toolkit to test key elements to determine whether these are operating as described. Assess compliance with the Stewardship Code, including progress with implementation of agreed improvements.
- Specific review of the Pension Fund's risk management arrangements including the planned refocus of the risk register to reflect current objectives.

Business plan improvements and developments

- Assess whether the Business Plan is aligned to Pension Fund priorities and objectives, and specifically review progress with the key tasks and actions that are due to be completed during 2023/24.

Investment practices

- Check a sample of Investment transactions to test key controls including segregation of duties, documentation, and compliance with the Pension Fund's Responsible Investment Policy and procedures.
- Assess progress with implementation of actions in response to the Investment Oversight recommendations within The Pensions Regulator Single Code Review report.

Recommendations Follow Up Review

- Follow-up progress by Management with implementation of Audit Actions and areas of improvement by the agreed date recommended in 2022/23 audit assurance work and check on the adequacy of new internal controls.

Advice and Consultancy

- As a 'critical friend' to Management, provide advice and internal challenge on projects involving major change and systems implementation.

Attendance at Boards / Committees

- Prepare for and attend Committee / Board meetings and other relevant forums to observe planning, approval, monitoring and review activity of business and performance.

Audit Planning for 2024/25

- Review strategic risks and audit universe, develop and consult on proposed coverage within the Internal Audit Annual Plan 2024/25 for the SBC Pension Fund.

Internal Control and Governance

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making.

The Pension Fund Committee is the main decision-making body for the Fund and is comprised of seven Scottish Borders Council Councillors: One member of the Executive, three other Members of the Administration, two members of the Opposition, and one other Elected Member.

The Pension Board assists the Committee in securing compliance with the regulations, other legislation and requirements of the Pensions Regulator. The Pension Board consists of four employer representatives and four employee Union representatives.

The Investment & Performance Sub-Committee develops investment strategy and monitors investment performance. Consists of the Pension Fund Committee Members, one employer and one employee representative from the Pension Board.

The joint meetings of the Pension Fund Committee and Pension Board were held on 22 June, 8 August (Special), 22 September, and 12 December 2023, and 17 January (Special) and 4 March 2024. Internal Audit's observation of the joint meetings and review of the Minutes of meetings continues to indicate that strong leadership is in place, members are working together in a constructive way, and the Minutes support the scrutiny being undertaken and transparency of the decisions made. In response to a suggestion by Internal Audit the previous year, the Minutes of the joint meetings since 12 December 2023 clearly distinguish for those Present the membership of the Pension Fund Committee and the representatives of the Pension Board to ensure clarity of roles. The Investment & Performance Sub-Committee meetings were held on 26 June, 25 August and 30 October 2023, and 18 March 2024. Internal Audit suggests that meetings are synchronised to ensure that relevant information is reported on a timely basis to the Pension Fund Committee.

Adherence to the current Training Policy, approved in June 2019, is a recognised area for improvement by Management following the lapse in setting an annual Training Plan for 2023/24. Nevertheless, some Member Training has taken place during the year 2023/24. Minor modifications will be required to the Pension Fund's Annual Governance Compliance Statement 2023/24 to reflect the training practices in operation during the year.

The Independent Adviser submitted a report 'Review of Governance of the Scottish Borders Council Pension Fund' with recommendations to the joint meeting of the Pension Fund Committee and the Pension Board on 13 December 2022. These recommendations have been amalgamated with actions necessary to ensure compliance with the Stewardship Code in a combined action plan. Not all recommendations made by the Independent Adviser will be implemented. All actions to be taken forward in the combined action plan will be completed by the end of the 2025/26 financial year.

Conclusion

The SBC Pension Fund generally operates under good public sector practice governance arrangements under the SBC Scheme of Administration, the SBC Pension Fund Governance Policy and Compliance Statement as well as through the joint meetings of the Committee and Board that support scrutiny and transparency of decisions made.

Risk Management

Risk management is a process of identifying potential risks to the achievement of objectives in advance, analysing them and taking precautionary steps in order to mitigate those risks, thus managing the effect of uncertainty on objectives. Compliance with the principles of good governance requires the Joint Pension Fund Committee and Pension Board to adopt a coherent approach to the management of risks that it faces in the achievement of its strategic objectives.

A Risk Management Policy and refreshed Risk Management Strategy were approved by the Pension Fund Committee in March 2024.

The Risk Management Policy Statement defines risk and risk management, outlines the vision, and states the roles and responsibilities in managing the risks of the SBC Pension Fund. The Senior Officers (SBC) supporting the Pension Fund have the primary responsibility to systematically identify, analyse, evaluate, control, record and monitor risks of the SBC Pension Fund. The Committee and Board, while the statutory roles and functions are separate, need to be assured that risks to the achievement the SBC Pension Fund's primary aim and underpinning objectives are being adequately managed, and be content that risk-based information is sufficient to support sound decision-making

The 3-year Risk Management Strategy 2024-2026 outlines the approach that will be adopted to systematically identify, analyse, evaluate, control, record and monitor risks of the SBC Pension Fund, in support of the Risk Management Policy Statement. It will enable the SBC Pension Fund to continue to refine its approach to managing risks, with a focus on aligning Risk Management to the business planning and performance management process.

The Risk Management Strategy is based upon the professional standards in the Management of Risk (MoR) Guide and CIPFA guidance "Managing Risk in the Local Government Pension Scheme". The strategy is underpinned by:

- A clear and widely understood structure to secure implementation
- A commitment to achievement
- Appropriate training arrangements
- Regular monitoring and reporting arrangements

Now approved by the Pension Fund Committee the Risk Management Policy and Strategy will ensure there is a relevant risk management framework in place for the SBC Pension Fund aligned to its objectives, governance and administration.

During the year the Risk Register has been significantly modified and consolidated resulting in a clearer focus on the most significant risks.

Internal Audit have made no recommendations in respect of risk management arrangements in this report.

Conclusion

Robust risk management arrangements are in place. The Pension Fund Risk Register has been significantly modified and consolidated resulting in a clearer focus on the most significant risks. The new Risk Management Policy and Strategy for the SBC Pension Fund will ensure there is a relevant risk management framework in place aligned to the SBC Pension Fund's objectives, governance and administration.

Business plan improvements and developments

It is essential that the Business Plan is aligned to Pension Fund priorities and objectives, and that key tasks and actions identified within the plan are undertaken.

The 2023/24 – 2025/26 Business Plan for the SBC Pension Fund was approved by at the joint meeting of the Pension Fund Committee and Pension Board on 22 June 2023. Included within the Business Plan were key objectives and actions with target dates. Having a Business Plan for the Pension Fund is a good way of demonstrating compliance with the “Myners Principle” relating to effective decision making.

The Action Plan is split into three objectives which support the Strategic Aims of the Fund:

- Set levels of employer contribution that will build up a fund of assets that will be sufficient to meet all future benefit payments from the Fund; and build up the required assets in such a way that produces levels of employer contribution that are as stable as possible.
- Deliver a High Quality Pension Service to Members.
- Ensure that Scottish Borders Pension Fund is managed effectively, transparently and in compliance with legal requirements.

A Business Plan Performance Update, outlining progress on the Business Plan actions at mid-year, was presented to the joint meeting of the Pension Fund Committee and Pension Board on 12 December 2023. The Business Plan reflects both the Fund’s Statement of Investment Principles (SIP), and the Committee’s Environmental, Social and Governance (ESG) beliefs and its approach on how ESG factors should be integrated in investment decision-making. The implementation of the ESG responsible investment principles is ongoing as some Fund Managers require time to adjust to the Fund’s Policy requirements.

Internal Audit have made no recommendations in respect of business planning arrangements in this report.

Conclusion

Robust business planning arrangements are in place to demonstrate clarity of required developments and improvements. A 3-year Business Plan is approved, with progress on actions being subject to monitoring by the Pension Fund Committee and Pension Board.

Investment practices

Robust Investment practice is concerned with setting guiding principles, developing an appropriate strategy, and ensuring effective governance over investment decisions.

The primary objective of the Fund which frames key considerations when agreeing the Statement of Investment Principles and Investment Strategy is to provide for members' pension and lump sum benefits on their retirement or for their dependants' benefits on death before or after retirement, on a defined benefits basis. The adoption of an Investment Strategy and structure is significant in supporting the Funding Strategy. The Investment Strategy incorporates an appropriate balance between risk and return to build up the required assets in a way that produces stable employer contributions to the Fund.

Statement of Investment Principles

It is a requirement of the Local Government Pension Scheme (LGPS) Regulations that the Pension Fund maintains a Statement of Investment Principles (SIP), which is reviewed on a regular basis the latest revision approved on 9 March 2023 by the Pension Fund Committee and Pension Fund Board. The Pension Fund Committee is responsible for making decisions in relation to the SIP and approving any decisions in relation to any changes to fund managers, investment advisers and custodian. The Pension Fund Investment and Performance Sub-Committee ('Sub-Committee') keep the SIP under observation and makes recommendations to the Pension Fund Committee as necessary.

The Statement of Investment Principles sets out the strategic framework to deliver the Fund's objectives and includes the policy on the types of investment to be held, the balance between different types of investment, risk considerations, the expected return on investments, realising of investments, social, environmental, or ethical considerations in investments, exercising the rights (including voting rights) attaching to investments and stock lending.

Investment Strategy

The Pension Fund Committee and Pension Board has developed and approved an Investment Strategy which forms part of the SIP with the assistance of external Investment Consultant. The Investment Strategy is presented as a strategic asset allocation which sets benchmark percentage allocations across the various asset classes. Asset liability modelling techniques were used in its development.

A full review of the Investment Strategy will be carried out following the results of the Actuarial Valuation as of 31 March 2023, that was presented at the joint meeting of the Pension Fund Committee and Pension Board on 12 December 2023.

The Pension Fund Committee will, as far as is practicable and as an aid to long term stability, seek to maintain a positive ratio of assets to liabilities at each Actuarial Valuation.

Investment and divestment decisions

The Pension Fund Committee is responsible for making decisions in relation to the SIP and approving any decisions in relation to any changes to Fund Managers, Investment Advisers and Custodian. The external Investment Consultant who supports the Pension Fund Committee and Pension Fund Board in their decision-making process.

Internal Audit have been assured that Investment Mandates are in place for all investments.

Transactions that take place are made through the Custodian Bank.

Monitoring Performance of the Fund

Each quarter, the external Investment Consultant reports on the Fund's quarterly performance by individual investment manager and mandate to the joint meeting of the Pension Fund Committee and Pension Board.

The Investment and Performance Sub-Committee also met each investment manager during the year giving the Pension Fund Committee an opportunity to gain a deeper understanding of the investments, their decision-making processes, and their performance.

Report of the Independent Adviser (December 2022)

The Independent Advisor made several observations and recommendations in respect of the Fund's Investment, as follows:

- For a relatively small fund, the investment arrangements are very complex. Consolidating of the large number of investment managers/mandates to a smaller number of asset classes could aid Committee's understanding of the key issues; and
- Benchmarking of administration and investment should be undertaken on a regular basis, including cost and performance, with results reported to Committee.

Financial overview

The Fund has had negative cash flow for a few years as there are less actively contributing members compared to members receiving pensions. It also has deferred members who are presently neither contributing to nor receiving benefits from the Fund. The Fund is categorised as a maturing fund, and this is reflected in the Investment Strategy with a move towards a greater focus on income-producing assets. The main focus of the Fund is to continue to seek capital growth to meet future liabilities.

The strategic asset allocation also diversifies the risk exposure in its use of managers. The Fund currently has 11 firms of Investment Managers with 17 funds (this excludes the Investment Managers used through the collaboration with the Lothian Pension Fund).

The Fund has underperformed against expectations in some investments over the 3-year period ending 31 March 2024, driven by the Fund's equity mandates (both Global and UK) and property mandate. Notwithstanding, the 2023 Actuarial Valuation reported a funded position of 134% (increased from the 2020 funded position of 110%).

Responsible investment

The Trustees have an overriding duty to maximise investment returns for the benefit of the Fund members but also have a responsibility to ensure the Fund is undertaking its investment activities in a socially responsible way. This means the fund must be aware of its Environmental, Social and Governance (ESG) responsibilities.

The Fund approved a revised Statement of Responsible Investment Policy (the 'Policy') on 17 March 2022 setting out the approach to responsible investment and arrangements to monitoring investment manager performance against the key principles set out in the policy on an annual basis.

The approved Policy also approved 6 key responsible investment objectives. These are. SDG 13 - Climate Change, SDG 7 - Affordable & Clean Energy, SDG 1 - No Poverty, SDG 2 - Zero Hunger, SDG 3 - Good Health & Well-being and SDG 10 - Reduce Inequalities. Data is not robust, reliable and comparable data universally available from all investment managers in respect of some objectives.

The Fund engages with investment managers to ensure they are meeting these key principles and that they are incorporating ESG considerations into their investment decisions.

The Fund's investment external Investment Consultant undertook an ESG Impact Assessment 2022 and advised that the majority of the Fund's current investment mandates meet criteria or at a minimum partially meet their criteria on an overall basis, but noted that while at an overall level all mandates satisfy requirements, there are individual areas within various mandates which could potentially be improved, with some changes being likely to be more challenging to make than others.

Reporting requirements from the Task Force on Climate Related Financial Disclosures (TCFD) and the Paris Aligned Investment Initiative have not been considered in this report.

Internal Audit have made no recommendations in respect of investment practices in this report.

Conclusion

Sound investment practices are in place which follow approved investment principles, an appropriate investment strategy, and effective governance over investment decisions. The Fund has underperformed against expectations in some investments over the 3-year period ending 31 March 2024 driven by the Fund's equity mandates (both Global and UK) and property mandate. Notwithstanding, the 2023 Actuarial Valuation reported a funded position of 134% (increased from the 2020 funded position of 110%).

5 *Follow up of Internal Audit Recommendations*

There were no formal recommendations made in the Internal Audit Annual Assurance Report 2022/23 for the SBC Pension Fund.

6 **Public Sector Internal Audit Standards (PSIAS)**

The 2020/21 External Quality Assessment (required every 5 years) and 2023/24 Annual Self-Assessment of practices against the professional standards PSIAS (2017) have both indicated that Scottish Borders Council's Internal Audit function conforms with the requirements within the 13 Assessment Areas of the Definition of Internal Auditing, the Code of Ethics, the Attribute Standards, and the Performance Standards. This includes the production of this report to communicate the results of its Internal Audit work during the year for the SBC Pension Fund.