Scottish Borders Council Pension Fund

2023/24 Annual Audit Report

Prepared for Scottish Borders Pension Fund Committee and the Controller of Audit

September 2024

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Key messages

2023/24 annual report and accounts

1 Our audit opinions on the annual report and accounts of Scottish Borders Council Pension Fund (the Pension Fund) are unmodified.

2 The annual accounts of the Pension Fund give a true and fair view of the state of affairs of the Fund as at 31 March 2024 and have been properly prepared in accordance with the financial reporting framework.

Financial management

3 The Pension Fund's investments increased in value by £71 million in year to £937 million. This reflected market movements impacting fund performance with a return on investments of 9.1%, which was below the benchmark of 12.1%. Fund performance has improved in year reflecting increased optimism in market conditions.

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

Financial sustainability

5 The 2023 triennial valuation has resulted in a funding level of 134%, a significant increase from the 2002 funding level of 110%. The employers' contribution rate for the Scottish Borders Council Pool will reduce to 17.0% for the period 2024/25 – 2026/27.

6 Cash flows in relation to members continue to be negative with more paid in benefits that received in contributions. Surplus cash is generated through investment income to give overall positive cash flows.

7 The investment strategy is under review following the triennial valuation and this will drive the composition of the portfolio of investments going forward.

8 We currently have no concerns over the arrangements for financial sustainability.

Vision, leadership and governance

9 The Pension Fund has effective and appropriate governance arrangements for delivery of its plans.

10 Members training requirements were met in year and a skills assessment completed.

11 The Pension Fund continues to be a signatory to the Stewardship Code.

Use of resources to improve outcomes

12 Like other Scottish Local Government Pension funds, the Pension Fund reported increases in pension fund assets in 2023/24. However, the Pension Fund did not achieve benchmark return targets.

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

Introduction

1. This report summarises the findings from the 2023/24 annual audit of the Scottish Borders Council Pension Fund (the Pension Fund). The scope of the audit was set out in an Annual Audit Plan presented to the 4 March 2024 meeting of the Pension Fund Committee. This Annual Audit Report comprises:

- significant matters arising from an audit of the Pension Fund's annual report and accounts
- conclusions on the following wider scope areas that frame public audit as set out in the *Code of Audit Practice 2021:*
    - Financial Management
    - Financial Sustainability
    - Vision, Leadership, and Governance
    - Use of Resources to Improve Outcomes
- conclusions on the administering authority's arrangements related to the pension fund for meeting its Best Value duties.

2. This report is addressed to the Pension Fund Committee and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Audit appointment from 2023/24

3. John Boyd has been appointed by the Accounts Commission as auditor of the Fund for the period from 2022/23 until 2026/27.

4. We would like to thank Pension Fund Committee members, senior officers, and other staff of the administering authority, particularly those in finance and HR, for their cooperation and assistance over this year's audit and we look forward to working together constructively over the remainder of the five-year appointment.

Responsibilities and reporting

5. The administering authority (Scottish Borders Council) of the Pension Fund has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts for the pension fund that are in accordance with proper accounting practices. The administering authority is also responsible for compliance with legislation and putting

arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

6. The responsibilities of the independent auditor are established by the Local Government (Scotland) Act 1973 the Code of Audit Practice, and supplementary guidance and International Standards on Auditing in the UK.

7. Weaknesses or risks identified are only those which have come to my attention during my team's normal audit work and may not be all that exist. Communicating these does not absolve management of the administering authority from its responsibility to address the issues raised and to maintain adequate systems of control.

8. This report contains an agreed action plan at Appendix 1. It sets out specific recommendations, the responsible officers, and dates for implementation.

Auditor Independence

9. 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 2023/24 audit fee of £26,370 as set out in my 2023/24 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

10. The annual audit adds value to the Pension Fund by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, arrangements to ensure the best use of resources and financial sustainability.
- sharing intelligence and good practice identified.

1. Audit of 2023/24 annual accounts

Public bodies are required to prepare annual accounts comprising financial statements and other related reports. These are principal means of accounting for the stewardship public funds.

Main judgements

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

The annual accounts of the Scottish Borders Council Pension Fund (the Pension Fund) give a true and fair view of the state of affairs of the Fund as at 31 March 2024 and have been properly prepared in accordance with the financial reporting framework.

Audit opinions on the annual report are unmodified

11. The Pension Fund Committee approved the annual report and accounts for the Fund for the year ended 31 March 2024 on 23 September 2024, and the annual accounts were approved by the Council on 26 September 2024.

12. As reported in the independent auditor's report, in my opinion as the appointed auditor, the financial statements:

- give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the management commentary and annual governance statement and governance compliance statement were consistent with the financial statements and properly prepared in accordance with the applicable requirements.

Overall materiality was assessed on receipt of the unaudited annual report and accounts as £14 million

13. Broadly, the concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and hence impact their opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature. It is ultimately a matter of the auditor's professional judgement.

14. The initial assessment of materiality was carried out during the risk assessment and planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual accounts and is summarised in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Amount
Overall materiality	£14 million
Performance materiality	£9.8 million
Reporting threshold	£0.7 million

15. The overall materiality threshold for the audit of the annual report and accounts of the Pension Fund was set with reference to gross investment assets, which was judged as the figure most relevant to the users of the financial statements.

16. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 70% of overall materiality, reflecting our accumulated knowledge of the Pension Fund.

17. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

Audit work responded to the risks of material misstatement we identified for the annual report and accounts

18. We obtained audit assurances over the identified significant risks of material misstatement in the annual report and accounts. Exhibit 2 sets out the significant risks of material misstatement to the financial statements identified in the 2023/24 Annual Audit Plan. It also summarises the further audit procedures 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 annual accounts

Audit risk	Assurance procedure	Results and conclusions
1. Risk of material misstatement due to fraud	• Assess the design and implementation of controls over journal entry processing.	No issues were identified regarding the design and

Audit risk	Assurance procedure	Results and conclusions
caused by management override of controls As stated in ISA (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• 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. • Test journals at the year-end and post-closing entries and focus on significant risk areas. • Consider the need to test journal entries and other adjustments throughout the year. • Evaluate significant transactions outside the normal course of business. • Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements. • We will assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.	implementation of journal entry processing. Testing of in year, year end and post-closing journal entries were focused on risk areas and no issues were identified. No issues were identified relating to unusual activity relating to journal processing. No significant transactions outside the course of normal business were identified. No issues were identified in controls and disclosures for related parties. No changes were made to methodology or assumptions used to prepare accounting estimates in year. **Conclusion**: no evidence of material misstatement through fraud or misstatement from management override of controls.
2. Estimation applied to level 3 investments The Pension Fund has a significant portfolio of level 3 investments (£344.4 million as at 31 March 2023) where valuations involve the application of a variety of estimates in determining appropriate valuations. This subjectivity gives rise to a significant risk of material misstatement in the financial statements.	• Critically assess the Pension Fund's arrangements for arriving at the valuation of level 3 investments, including the use of experts in undertaking the valuation. • Confirmation of year end valuations to valuation reports and/or other supporting documentation, including third party confirmation. • Review the relevant investment managers' controls reports for	Level 3 investments were agreed to custodian and independently sourced fund manager reports. Analytical procedures allowed us to gain assurance that the valuation of level 3 investments is appropriate. A review of investment managers controls' reports was completed, and no exceptions noted. Reviewed the results of questionnaires used by the Pension Fund to assess investment manager's arrangement but noted that

Audit risk	Assurance procedure	Results and conclusions
	qualifications or exceptions that may affect the audit risk. • Review the arrangements in place at the Pension Fund to assess investment managers' governance arrangements. • Review the disclosures included in the accounts to ensure these are adequate in directing the user of the accounts to areas with significant judgement and estimation uncertainty.	there was no evidence of following up issues identified in this assessment, see paragraph 35. Reviewed the accounts disclosures and minor points were identified relating to notes in the accounts. **Conclusion**: Satisfied that there were no material misstatements in the valuation of level 3 investment. We have raised a recommendation around enhancing control environment over level 3 investments.

19. In addition, we identified an "areas of audit focus" in the 2023/24 Annual Audit Plan where we considered there to be a risk of material misstatement to the financial statements. This area of specific audit focus was:

- the disclosure of the actuarial valuation of the Pension Fund liabilities. This involves a complex actuarial estimate. The Pension Fund engage an independent actuary to support the estimation. The valuation is based on a range of financial and demographic estimations about the future, based on a well-established methodology. The subjectivity around these estimates gives rise to a presentational risk of material misstatement.

20. We kept this area under review throughout the audit. We are satisfied that the actuarial valuation of defined benefit pension scheme obligations has been appropriately disclosed in the accounts in accordance with IAS (Internation Accounting Standard) 26: Accounting and Reporting by Retirement Benefit Plans. We have considered the reasonableness of the assumptions applied by the actuary in arriving at the valuation. Based on the findings of the audit procedures performed, there are no matters which we need to bring to your attention.

Significant findings and key audit matters

21. Under ISA (UK) 260, we communicate significant findings from the audit to the administering authority, including our view about the qualitative aspects of the fund's accounting practices.

22. The Code of Audit Practice also requires me to highlight key audit matters within the annual audit report which are defined in ISA (UK) 701 as those matters judged to be of most significance.

23. We have no significant findings to report from the audit.

There were two non-material misstatements identified within the financial statements totalling £6.67 million which were not adjusted. This was less than our performance materiality and we did not require to change our audit approach

24. **Timing differences with the valuation of Level 3 investment assets** - When preparing accounts, the custodian provides information from fund managers on the valuation of level 3 investment assets. For a number of fund managers, the latest available data was dated for December 2023. We obtain statements from fund managers and the 31 March 2024 position information. Timing misstatements of £4.51 million (both positive and negative) were identified from this work and confirmed with the custodian. The impact of this on the annual accounts would have been a net increase in investment assets of £1.85 million in the Net Asset Statement. As in previous years, this has not been adjusted for in the accounts. We are satisfied these are not material to the understanding of investment assets in the accounts.

25. **Write down of Level 3 investment asset after the reporting period (adjusting event)** – After year end, an investment asset included within one fund manager mandate had the value written down to £0. The Pension Fund's investment consultants, ISIO has confirmed the value of this was £2.46 million at 31 March 2024. There were conditions known at year end which identified there were specific issues with this investment. Under IAS (International Accounting Standard) 10 this would be classed as an adjusting event because it provides evidence of conditions that existed at the end of the reporting period. This would decrease investment assets by £2.46 million in the Net Asset Statement. The Pension Fund has considered the value compared to the fund overall and determined that they did not want to adjust for this.

26. We are satisfied this is not material to the understanding of investment assets in the accounts.

27. **Level 1 assets misclassification** - The Pension Fund has 2 investments with M&G totalling £130.90 million. These were classified as Level 1 investments. Audit work identified that these are unit trusts and confirmed with the fund managers that these should be classified as Level 2 investments. These have been reclassified in the accounts from Level 1 to Level 2 and the prior year has been restated at the note level. There is no impact for the Net Asset Statement in either year. Given the nature of the other Level 1 and Level

2 investments assets and from work done to confirm these with fund managers and/or testing, we are satisfied other investment assets are correctly classified.

28. **Cash holdings** - From audit work, we identified that cash balances from disinvestments and distributions totalling £30.09 million were included within fund manager mandates. This should have been classified as internally managed cash. This has been adjusted in the annual accounts at a note level and there is no impact for the Net Asset Statement.

29. Whilst £12 million had been identified for investment in April 2024, there was an additional £18.09 million which could have been invested in line with the Pension Fund's investment strategy. We note all cash was held by the custodian in an interest bearing account. In total at year end, the Pension Fund had £58.84 million of cash available for investment.

Recommendation 1

The Pension Fund should regularly review fund mandates for distributions and disinvestments and instruct the custodian to 'sweep' any cash into the internally managed cash account, so that any excess holdings can be identified and invested in a timely manner in accordance with the Pension Fund's investment strategy.

30. We also noted that there were some minor amendments required through the narrative sections of the annual report and accounts. This has led to additional information in the management commentary relating to significant post year end investments and further information in the governance section to fully comply with requirements. We are satisfied these changes have been addressed.

31. We considered the size, nature and circumstances of uncorrected misstatements, individually and in aggregate, and concluded that these were not material. The impact of the uncorrected misstatements is included in Appendix 2.

The unaudited annual report and accounts were received in line with the agreed audit timetable. We recognised there were improvements in working papers from the previous year but identified some areas for further development.

32. The unaudited annual accounts were received in line with our agreed audit timetable on 28 June 2024.

33. We noted that there was a significant improvement in the working papers provided for the audit compared to 2022/23, following the appointment of the Pensions Investments and Accounting Manager in February 2024. We also received additional back up in a more timely manner, which helped us progress our audit work.

34. We noted that there are now improved and more timely reconciliations to support the year end accounts including between custodian and ledger. It was agreed with management that areas for further improvement included carrying out more regular reconciliation of information from the custodian and ledger, cash holdings and management fees.

Recommendation 2

Working papers and management information can be improved by having regular reconciliation of information from the custodian and ledger and for management fee information.

35. An annual due diligence review of investment managers is carried out, where the Pension Fund issues governance questionnaires to fund managers requesting specific information such as internal controls reports. Whilst we noted that due diligence questionnaires were now subject to review by management, any discrepancies or issues identified as part of the review were not followed up with the fund managers. The questionnaire should also be revised to ensure that the Pension Fund gets more comprehensive information from the fund managers. The Pension Fund will be able to provide assurance to members regarding governance arrangements.

Recommendation 3

Whilst a review of due diligence questionnaire was carried out, discrepancies and issues were not followed up with fund managers. The questionnaire can be revised to ensure more comprehensive information is received from fund managers which will better support the work of the Pension Fund.

Good progress was made on prior year recommendations

36. The Pension Fund has made good progress in implementing the agreed prior year audit recommendations. Actions not fully implemented have been superseded by new recommendations and this is set out in Appendix 1.

2. Financial management

Financial management means having sound budgetary processes, and the ability to understand the financial environment and whether internal controls are operating effectively.

Conclusions

The Pension Fund's investments increased in value by £71 million in year to £937 million. This reflected market movements impacting fund performance with a return on investments of 9.1%, which was below the benchmark of 12.1%. Fund performance has improved in year reflecting increased optimism in market conditions.

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

There was an increase in the value of investment assets of £71 million reflecting increased optimism in financial markets

37. The Pension Fund has seen a 9.1% increase in the value of investment assets to £937 million which is a significant improvement compared to 2022/23 where investments fell by 4.8%. The in year increase was still below the benchmark of 12.1% for 2023/24.

38. Investments assets have seen stronger positive growth over the last two quarters of 2023/24, following two quarters where there was little movement in the value of investments. The performance improvement was mainly in the Pension Fund's global equity mandates with improvements seen in technology related stock. Property and infrastructure assets have tended to have poorer performance in year, and this relates to the uncertainty over the future path for interest rates.

39. There continues to be a challenging global backdrop, with world events having an impact on financial markets and investments. Although indicators have suggested a strengthening economic position in the USA, and interest rates in the UK are slowly decreasing, a change in political party in the UK post year end, and presidential elections in the USA later in 2024 may also impact on financial markets going forward.

40. The Pension Fund's performance in 2023/24 is summarised in Exhibit 3.

Exhibit 3
Assets, funding level and investment performance

Increase in net assets	Funding level	Investment performance
£938.3 million Closing net assets as at 31 March 2024 (+8.3%)	**134%** Net assets vs promised retirement benefits 31 March 2024 (based on the 2023 triennial valuation)	**3.3%** Average annual return on investments over 3 years (against a benchmark of 8.3%)
£866.2 million Opening net assets at 1 April 2023	**110%** Opening net assets as a proportion of promised retirement benefits (based on the 2020 triennial valuation)	**9.1%** Return on investments 2023/24 (against a benchmark of 12.1%)

Source: 2023/24 Scottish Borders Council Pension Fund unaudited annual report and accounts

41. The promised retirement benefits at 31 March 2024 have been estimated at £793 million (31 March 2023: £731 million), showing a £62 million (8.5%) increase. This estimate uses assumptions in line with Internal Accounting Standards (IAS) 19 requirements for the purposes of the Pension Fund's financial statements. It is not directly comparable to the liability measured on a funding basis. With the fair value of fund assets (investment assets) £937 million, this means a net asset position of £144 million.

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

42. The Director of Finance 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.

43. 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. The administration budget performance and cash flows are also reported. We noted that the actual expenditure costs relating to investment management were £0.62 million (10.3%) greater than budgeted. This directly related to fees for the two new fund managers in year.

44. From attendance at Pension Fund Committee meetings, we observed and concluded that reports presented to members are subject to appropriate review and scrutiny. We have concluded that the Pension Fund has appropriate and

effective financial management arrangements in place, including comprehensive reporting of investment performance.

The Pension Fund has appropriate financial control arrangements in place

45. From a review of the design and implementation of systems of internal control (including those relating to IT) relevant to our audit approach, we did not identify any internal control weaknesses which could affect the Pension Fund's ability to record, process, summarise, and report financial and other relevant data and result in a material misstatement in the financial statements. Minor housekeeping points, regarding evidencing review of bank reconciliations and journals have been discussed with management and actions have been implemented post year end in relation to this.

Internal audit's opinion is that there are generally sound systems of governance, risk management and internal control operating within the Pension Fund during 2023/24

46. The Pension Fund's internal audit function is carried out by Scottish Borders Council's internal audit function. Internal audit completed its planned work in year and issued its opinion for 2023/24 to the June 2024 Pension Fund Committee meeting. The Chief Officer Audit & Risk's opinion was that there were generally sound systems of governance, risk management and internal control operating within the Fund during 2023/24.

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

47. In the public sector there are specific fraud risks, including those relating to pension claimants and other claims made by individuals and organisations. Public sector bodies are responsible for implementing effective systems of internal control, including internal audit, which safeguard public assets and prevent and detect fraud, error and irregularities, bribery, and corruption. We note that the Pension Fund uses services such as the Department of Work and Pensions' Tell Us Once service which will help support identification of errors regarding pension overpayments.

48. The Pension Fund follows the policies and procedures of the administering authority and has adequate arrangements in place to prevent and detect fraud or other irregularities.

3. Financial sustainability

Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Conclusions

The 2023 triennial valuation has resulted in a funding level of 134%, a significant increase from the 2002 funding level of 110%. The employers' contribution rate for the Scottish Borders Council Pool will reduce to 17.0% for the period 2024/25 – 2026/27.

Cash flows in relation to members continue to be negative with more paid in benefits that received in contributions. Surplus cash is generated through investment income to give overall positive cash flows.

The investment strategy is under review following the triennial valuation and this will drive the composition of the portfolio of investments going forward.

We currently have no concerns over the arrangements for financial sustainability.

The 2023 triennial valuation has resulted in a funding level of 134%.

49. There is a statutory requirement for local government pension funds to undertake a full actuarial valuation of assets and liabilities every three years. This is referred to as a triennial valuation.

50. The most recent triennial funding valuation took place across Local Government Pension Scheme funds in 2023/24 based on data as at 31 March 2023. The main purpose of the valuation is to review the financial position of each fund and to set appropriate contribution rates for each employer for the upcoming three-year period as part of the fund's overall funding strategy.

51. The results of the 2023 full triennial valuation of the Pension Fund showed a funding level of 134%, a significant increase from the 2020 funding level of 110% This meant that overall, the Pension Fund had a surplus of assets over liabilities and that the fund assets were higher than projected liabilities.

52. The result of this increased in surplus has been that the employers' contribution rate for the Council Pool would reduce to 17.0% for the period

2024/25 to 2026/27. This will be kept under review annually. This is a reduction in 1.5 percentage points from 2023/24 and included in Exhibit 4.

Exhibit 4
Scottish Borders Council pool rate – employer contributions

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
Scottish Borders Council pool rate	18.0%	18.0%	18.5%	17.0%	17.0%	17.0%

The Funding Strategy Statement has been revised following the completion of the triennial valuation and the investment strategy review is ongoing.

53. The Funding Strategy Statement is a summary of the Pension Fund's approach to funding liabilities and sets out the context for communication on funding, employer contribution rates and funding risks. It is required to ensure sufficient resources are available to provide for members' pensions and lump sum benefits. The statement requires to be reviewed annually and has been fully revised following the results of the triennial valuation.

54. The updated key messages from the statement are included within the Pension Fund's 2023/24 Annual Accounts. This review was undertaken by Hymans Robertson LLP, actuary to the Pension Fund, during 2023/24 and the findings reported to the Pension Fund Committee in March 2024.

55. The investment strategy is set for the long-term but is regularly monitored and formally reviewed every three years to ensure that it remains appropriate to the profile of the Pension Fund's liabilities. It identifies benchmarks for each type of asset classification e.g. equity, debt. This revision of the investment strategy following the triennial valuation is ongoing.

56. The investment strategy reflects key factors including:

- The fund is a maturing fund, so a focus will remain on capital growth of investments, with sufficient cash flow to meet current needs.
- Reflecting the recommendations from the Independent Governance Review reported in December 2022, actions will be taken to commence reviewing the governance arrangements which will consider reducing the number of fund mandates.
- An increased consideration of ESG (environmental, social and governance) factors to improve the credentials of the Pension Fund as there are increasing regulations due in this area.

57. The Statement of Investment Principles was revised in March 2024 and includes a move towards a greater focus on income producing assets. The main

focus of the Pension Fund however is to continues to seek capital growth to meet future liabilities.

58. During 2023/24 the Pension Fund agreed to invest in two new fund managers: Nuveen and Quinbrook. These are classed as ‘impact’ allocations, and both are in the renewables and natural capital field. The onboarding of both took place in year and £10 million investment was committed and almost all drawn down by each fund in year. Post year end £20 million was invested in CBRE, another new fund manager. It had previously been agreed to invest in the UK affordable housing fund, but the capital draw down was after year end and therefore not include in the 2023/24 financial statements. This is the first investment in residential property, with other property mandates relating to commercial property.

59. We have concluded that medium-term financial planning arrangements are appropriate.

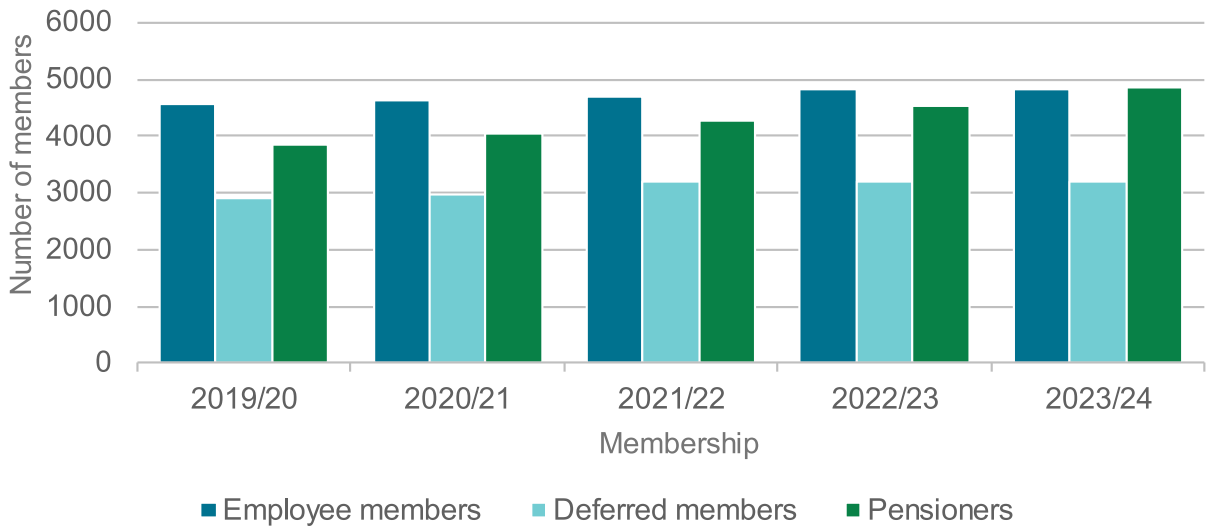
Pension Fund membership levels continue to increase but the ratio of active members to pensioners continues to reduce

60. The Pension Fund is a multi-employer fund with Scottish Borders Council and seven other admitted and scheduled bodies making contributions at present. There are 17 employer organisations in total, with nine small organisations having only deferred pensioners or pensioners.

61. Although overall membership increased by 318 in year (2022/23: +383), this was a reduction of 6 active (contributing) members (2022/23: +139), an increase of 316 pensioners (2022/23 +251), with an increase of 12 deferred members (2022/23: -7). The current membership profile is shown in Exhibit 5.

62. The Pension 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 Pension Fund maintains the capacity to meet the current and future pension entitlements of its members.

Exhibit 5
Scottish Borders Council Pension Fund membership



Source: Scottish Borders Council Pension Fund 2023/24 audited financial statements

63. Active membership of the fund fell by 6 members, the first fall in active members since 2018/19. Total membership increased by 318, an increase of 2.5%.

64. In 2023/24 the number of pensioners receiving a pension from the Pension Fund increased by 316 to 4,848 and the number of pensioner members continues to increase steadily each year. The number of active members dipped below the number of pensioners in year for the first time. This ratio has reduced over the last number over the past five years. In 2019/20 pensioners were 84.3% of active members with this increasing so that pensioners are now marginally over 100% of active members in 2023/24.

Cash flows in relation to members continue to be negative with more paid in benefits that received in contributions. Surplus cash is generated through investment income to give overall positive cash flows.

65. Cash flows from dealings with members continue to be negative as has been the case over the last number of years, with more paid out in benefits than that received from contributions. It is expected this negative cash flow in relation to members will continue going forward. Over the long term, the cash flow position will impact on the investment strategy as income from investments rather than contributions will be needed to pay pensions as detailed in Exhibit 6 and Exhibit 7.

Exhibit 6
Contributions and benefits paid in 2023/24

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
Employer contributions	17.051	0.723	2.540	20.314
Employee contributions	5.393	0.234	0.791	6.418
Total contributions	22.444	0.957	3.331	26.732
Pension benefits paid				32.654

Source: Scottish Borders Council Pension Fund 2023/24 unaudited annual accounts and supporting papers

66. The Fund is a maturing fund, with the continued growth in pensioner numbers within the Fund's membership making future funding pension payments increasingly challenging. The Statement of Investment Principles for both 2023 (approved in March 2023) and 2024 (approved in March 2024) has reflected this in the investment strategy with a move towards a greater focus on income generating assets to address the negative cashflows. The main focus of the fund however is to continue to seek capital growth to meet future liabilities.

Exhibit 7
Cash flows from 2021/22 to 2023/24

	2021/22 £m	2022/23 £m	2023/24 £m
Contributions	22.593	24.318	26.732
Transfers in	3.346	0.742	3.480
Benefits paid	(25.390)	(28.281)	(32.654)
Transfers out/leavers	(681)	(1.882)	(1.332)
Management expenses	(6.395)	(5.997)	(7.577)
Investment income	17.600	16.284	22.505
Total	**11.073**	**5.184**	**11.154**

Source: Scottish Borders Council Pension Fund 2021/22 to 2023/24 unaudited annual accounts

67. The Pension Fund recognises a failure to manage the liquidity required for the Pension Fund's cash flow as an amber risk on the risk register. It notes that the risk factors include the changing demographics. It has a number of mitigations in place to deal with this risk and the risk after mitigation is classed as green. The funding position suggests that this is not currently an issue, but this is an area that should be monitored.

We currently have no concerns about the financial sustainability of the Pension Fund or the viability of the funding strategy

68. Given the triennial valuation showed that the Pension Fund was 134 per cent funded at 31 March 2023 and the healthy net asset position at 31 March 2024, we currently have no concerns about the financial sustainability of the Pension Fund or the viability of the funding strategy.

4. Vision, leadership and governance

Public sector bodies must have a clear vision and strategy and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

Conclusions

The Pension Fund has effective and appropriate governance arrangements for delivery of its plans.

Members training requirements were met in year and a skills assessment completed.

The Pension Fund continues to be a signatory to the Stewardship Code.

Governance arrangements are appropriate and operate effectively

69. 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 – currently one employer vacancy), 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.

70. The Pension Fund's governance arrangements have been set out in the Annual Governance Statement in the annual report and accounts. We note that during 2024 a number of revisions to plans and policies have been undertaken. We have reviewed these arrangements and concluded that they are appropriate.

71. A new Governance and Business Plan 2024/25-2026/27 has been introduced which in addition to core activities, also includes actions from Stewardship Code submissions and the independent review (reported December 2022). This plan details actions and expected timescales to meet

Pension Fund objectives. This was approved on by the Pension Fund Committee on 2 September 2024.

72. In year, the Pensions Investment and Accounting Manager position has been filled, after being vacant for approximately 18 months and this will support the delivery of the new plans. The Pensions Investment and Accounting Manager will support the Council's Director of Finance (Section 95 officer for the Pension Fund) in delivering outcomes.

There are effective arrangements for ensuring compliance with the new General Code of Practice from the Pensions Regulator

73. The Public Sector Pensions Act 2013 provided for extended regulatory oversight by the Pensions Regulator. The Pensions Regulator issued a new General Code of Practice on 28 March 2024 which sets out the expectations of conduct and practice that funds should meet to comply with their duties in pensions legislation.

74. The Pension Fund obtained a compliance checker from Hymans Robertson LLP to identify areas from the new General Code of Practice where the Pension Fund currently did not fully comply with the new requirements. The Business and Governance Plan 2024/25 – 2026/27 identifies that this will be reviewed, and appropriate action will be taken to address any areas of non-compliance. We note that reporting of the compliance checker work will be in December 2024. Given the timing of this work, it is too early to comment on progress, and we will keep this in view during our work in 2024/25.

A revised risk register was introduced in year

75. A revised risk register was introduced in March 2024, following work being carried out throughout 2023/24. The impact of this has been to reduce and amalgamate risks so that there are 17 key risks instead of over 50. These have been grouped into five key themes covering: funding, investments, administration, governance and national policy/regulations.

76. The revised risk register contains all expected detail including details of the risk, owner, timeframe, risk score, mitigating factors/controls in place and a mitigated risk score. Now, at each quarterly Pension Fund Committee, a key theme from the risk register is discussed at each meeting, providing increased visibility of risks with the committee members.

A training skills assessment was completed in year and member training requirements were met in year

77. In 2023/24, all members of the Pension Fund Board and Committee met the training requirements for the role, which is a minimum of two training sessions per year. This was primarily addressed through an extended training day in May 2023 which consisted of a number of sessions to meet the requirements. Additional training opportunities were identified throughout the year.

78. The training policy for 2024/25 was approved by the Committee on 2 September 2024. A skills needs assessment was also carried out which has

identified key areas to take forward in 2024/25 including the new General Code of Practice.

The Pension Fund continued to be a signatory to the Stewardship Code during 2023/24

79. During 2023 the Pension Fund was accepted as a signatory to the UK Stewardship Code. The UK Stewardship Code 2020 sets high stewardship standards for those investing money on behalf of UK savers and pensioners, and those that support them. Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

80. The Code applies to asset owners (the Pension Fund), asset managers and service providers. Organisations listed are required to report every year to the FRC (Financial Reporting Council) on their application of the Code. Reports are assessed by the FRC and organisations that meet the reporting expectations are accepted as signatories. The application to the Code identified a number of future actions which will be expected to be addressed as part of annual reporting to the FRC. The Pension Fund continues to be a signatory with the second submission approved in February 2024.

Performance reporting and other information in the accounts provide details of the Pension Fund over the year

81. The Management Commentary included in the annual 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. All areas were covered in the report directly, or via links to other areas of the accounts. It complied with the requirements in place and provided sufficient detail for understanding the Pension Fund's performance. There was some duplication in the reporting in other information, particularly investments. Going forward there is scope to look to enhance these disclosures.

The Pension Fund does not yet have to comply with the Taskforce for Climate Related Financial Disclosures (TCFD). The Pension Fund Committee has an ambition to report in line with TCFD ahead of regulatory guidance, given its importance to the Pension Fund.

82. The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 and the Occupational Pension Schemes (Climate Change Governance and Reporting) (Miscellaneous Provisions and Amendments) Regulations 2021 introduced new requirements for certain trustees. From 1 October 2022, the rules will apply to trustees of pension schemes with net relevant assets of £1 billion or more. Climate reporting rules require relevant trustees to measure, as far as they are able, and report on their investment portfolios' Paris alignment. These disclosures are commonly

referred to as the Taskforce for Climate Related Financial Disclosures (TCFD). The Pension Fund has publicly signed up as a supporter of the TCFD.

83. The Pension Fund does not yet meet the relevant threshold for reporting but continues to keep this in view with preparatory work ongoing. In addition, the timing for Scottish Local Government Pension Scheme members to comply when they meet this threshold is not yet confirmed. The Pension Fund has commissioned its investment consultants, ISIO, to help with this work and reports on this are currently generally discussed in the private session of the Pension Fund Committee. Given this is preparatory work, we are satisfied this is appropriate. The Pension Fund Committee has an ambition to report in line with TCFD ahead of confirmed regulatory guidance given its importance to the Pension Fund. It plans to continue to evolve this reporting going forward once guidance is confirmed.

84. Whilst the Pension Fund has a fiduciary duty to work in the best interest of scheme beneficiaries (pensioners), the Pension Fund has considered its approach to environmental, social and governance (ESG) issues, and reported in the annual accounts that it believes that a positive ESG issues can positively affects the financial performance of investments. The Pension Fund has two new investments in 2023/24 relating to natural capital and renewables, totalling £20 million, see paragraph 58.

5. Use of resources to improve outcomes

Public sector bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities.

Conclusions

Like other Scottish Local Government Pension funds, the Pension Fund reported increases in pension fund assets in 2023/24. However, the Pension Fund did not achieve benchmark return targets.

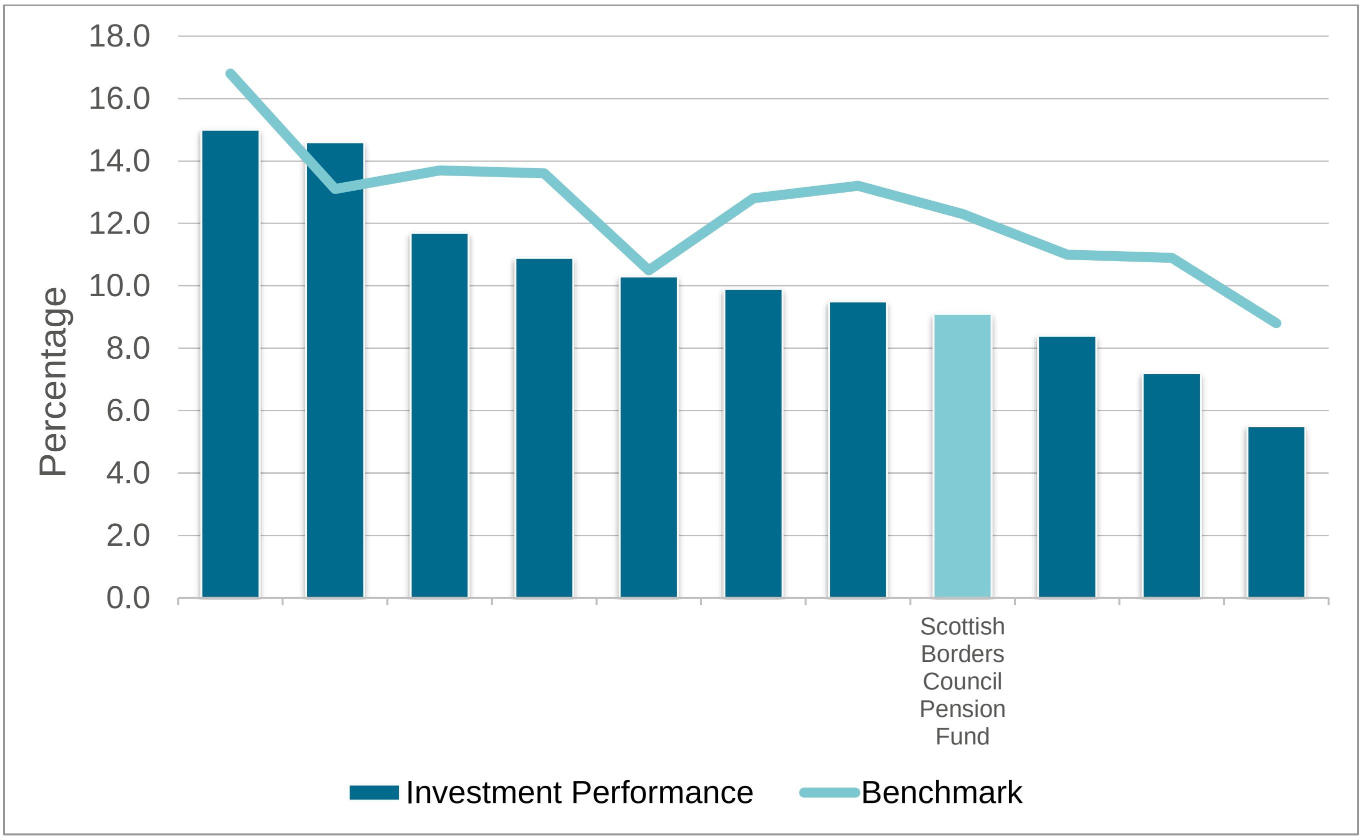
The Pension Fund has an appropriate best value framework in place which includes effective arrangements for monitoring investment performance and scrutinising investment management.

2023/24 was a less challenging year for Scottish Local Government Pension Schemes than previous years. All eleven funds reported increases in pension fund assets during the year, although only one fund reported an above benchmark return.

85. 2023/24 was a less challenging year for Scottish Local Government Pension Schemes than previous years. As shown in Exhibit 8, all eleven funds reported positive movements in net assets during the year, although only one fund reported an above benchmark return, with investment performance ranging from 5.5 per cent to 15 per cent (compared to returns ranging from -6 per cent to 1 per cent in 2022/23). The Fund's net return of 9.1 per cent (against a benchmark return of 12.3 per cent) placing below the middle of this range.

Exhibit 8

Scottish LGPS pension funds 2023/24 – Net return on investment and benchmark return



Source: 2023/24 Scottish LGPS

Investment performance has improved in year, but remains below the benchmark set for the year.

86. The Pension Fund has appointed 13 external investment managers with 19 associated funds, and in addition has a further portfolio of investments in collaboration with Lothian Pension Fund. Individual investment manager performance is reviewed regularly by the Pension Fund Committee via quarterly reports. In addition, the Investment and Performance Sub-Committee regularly meets with representatives from the various investment fund managers on a cyclical basis to support scrutiny of performance.

87. Financial markets have shown more resilience in 2023/24 and there is more optimism, particularly with evidence of a strengthening US market. Returns against global equities were positive towards the end of the financial year, boosted by technology shares performance. Infrastructure assets and property mandates have struggled in year due to uncertainties over interest rates. Twelve funds have delivered an absolute positive return in year, but only five of these have delivered a relative positive return (against benchmark).

88. The Independent Governance Review by Clare Scott (December 2022) identified the complexity of the Pension Fund investment arrangements and recommended reducing the number of mandates/fund managers. The Pension Fund wants to maintain a diversified portfolio and the 2024 investment strategy identifies a move towards having fewer managers. This should support reducing

the administrative burden going forward and we will continue to watch this going forward, noting that this can be a lengthy process.

The main focus of the Pension Fund is to seek and capital growth to meet future liabilities, whilst there is an increased focus is income producing assets

89. The Statement of Investment Principles for 2024, approved in March 2024, restates the funding objective to build up the required assets in a way that produces employer contributions, which are as stable as possible. The Pension Fund has made a move towards a greater focus on income producing assets. The main focus of the Pension Fund continues to seek capital growth to meet future liabilities. As noted above the investment strategy for the next three year will be issued in September 2024.

The Pension Fund's administration function has performed well against targets

90. The revised Pension Administration Strategy was approved in March 2024. This details the service standards against which administration performance is measured. Outcomes for the year are reported to the Penson Fund Committee and included within the annual accounts.

91. The service standards across performance measures were generally met in year. All annual benefits statements were issued before the deadline of 31 August. The McCloud Remedy underpin information was not included in the 2024 Annual Benefit Statements issued to members. The Pension Fund reported this to the Pension Regulator.

92. Employer performance measures including new starts notification, change notification and retirement information were all within the target working days all were in excess of the 90% threshold. Standards for estimates of transfers in and out were below the 20 working days targets and were 80% and 74% respectively. In March 2024, we noted that there has been an agreement to increase the pension administration staffing by one full time equivalent on a permanent basis. This will help with the increasing number of scheme members and the increasing requirements for the role.

93. We noted that one employer was late with contribution payments three times in the year. The Pension Fund administration team are working with this employer to ensure payments going forward are on a more timely basis.

94. We concluded that the Pension Fund Committee receives timely updates on administration performance and also changes and improvements in administrative related matters.

A pensions dashboard will be required in the future to support the public in accessing pension information in one place

95. Following the introduction of automatic enrolment, and a subsequent increase in the number of people saving for retirement it has meant it may be difficult for people to keep track of their pensions. The UK Government is

introducing pensions dashboards to improve the way people can see and interact with their pensions, through the Pensions Dashboards Regulations 2022. Pensions dashboards will be an electronic communications service intended to be used by individuals to access information about their pensions online, securely, and all in one place.

96. As a pension provider, the Pension Fund is will be legally required to have a pension dashboard. It was originally expected to take place during 2023/24 but the Department for Work and Pensions (DWP) announced a delay to pensions dashboard implementation, with it expected that Local Government Pension Schemes will be expected to have a dashboard in place by 31 October 2025.

97. To be prepared, the Pension Fund's data quality is regularly tested and working methods updated to ensure data is consistently of high quality. Future development of systems will include the procurement of a member tracing service and a pensions dashboard compatible Internet Service Provider (ISP). The Pension Fund has signed up for the data cleansing and enrichment service provided by Heywood Technologies to further improve the quality of the data ahead of the dashboard implementation date and to continue to improve data quality. The dashboard is expected to be implemented by October 2025.

98. iConnect is a cloud based system that manages the flow of employee information from payroll system to the fund's pension administration system. The software enables employers to provide employee information in a secure method. The monthly data uploads inform the Pension Fund of any changes to members details, new joiners and leaver forms, removing the burden of cumbersome employer year end reporting. We note that this is an area for development in the Business and Governance Plan with planned implementation for larger employers during 2025.

Recommendation 4

The service auditor and disaster recovery testing reports should be obtained from Heywood Technologies to support the assessment of the pension administration control environment. Going forward it should be ensured that these reports cover the new dashboard and iConnect.

The administering authority has appropriate arrangements in place for securing Best Value at the Pension Fund.

99. The administering authority, Scottish Borders Council, has responsibility for the ensuring that its business, including that of the Pension Fund, is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively. The Council also has a statutory duty to make arrangements to secure Best Value, which are subject to audit.

The outcome of audit work on the administering authority's Best Value arrangements is reported in the Council annual audit report. There are no findings directly applicable to the Pension Fund.

Appendix 1: Action plan 2023/24

2023/24 recommendations

Issue/risk	Recommendation	Agreed management action/timing
1. Cash holdings Cash holdings relating to distributions and disinvestment were held within fund manager mandates. **Risk** – cash available for investment is not utilised in line with the investment strategy and best value is not achieved.	The Pension Fund should regularly review fund mandates for distributions and disinvestments and instruct the custodian to 'sweep' any cash into the internally managed cash account, so that any excess holdings can be identified and invested in line with the Pension Fund's investment strategy. Paragraph 28.	**Accepted** Monthly review of custody accounts cash balances for each Investment Manager to sweep cash to internally managed cash account. Advise ISIO cash balance available for reinvestment. **Responsible officer** Jill Murray **Agreed date** September 2025
2. Reconciliations Regular reconciliations mean that management information and subsequently working papers provide clearer information and explanations for any variances. **Risk** – reasons for any variances from expectation may be difficult to identify and errors may not be identified on a timely basis.	Working papers and management information can be improved by having regular reconciliation of information from the custodian and ledger and for management fee information. Paragraph 34.	**Accepted** Quarterly review and reconciliation of NT (custodian) income and expenses to BW (ledger) income and expenses. **Responsible officer** Jill Murray **Agreed date** September 2025
3. Due diligence questionnaire Whilst due diligence questionnaires were received from all fund managers, where information was not shared or there were issues identified, there was no follow up.	Whilst a review of due diligence questionnaire was carried out, discrepancies and issues were not followed up with fund managers. The questionnaire can be revised to ensure more comprehensive information is received from fund managers	**Accepted** Review and update of current due diligence questionnaires to capture required elements addressed during audit, follow up any issues identified on review of completed questionnaires.

Issue/risk	Recommendation	Agreed management action/timing
Risk – without the scrutiny as part of a follow up process, investments held by managers may be exposed to unnecessary risks.	which will better support the work of the Pension Fund. Paragraph 35.	**Responsible officer** Jill Murray **Agreed date** March 2025
4. Systems service auditor report The pension administration platforms will include the new dashboard and iConnect and therefore service auditor reports should be obtained to support the risk assessment both new and current systems. **Risk** – without review of these documents there may be unidentified control environment risks.	The service auditor and disaster recovery testing reports from Heywood Technologies should be obtained and reviewed on an annual basis to support the assessment of the pension administration control environment. Going forward it should be ensured that these reports cover the new dashboard and iConnect. Paragraph 98.	**Accepted** Pensions Administration Team will work alongside Heywood Technologies to request the provision of the additional information to support this request. Consideration will also be given to a LGPS Scotland wide request for this information through the SPLG meeting forum with all Funds in Scotland using Heywood software. **Responsible officer** Ian Angus **Agreed date** 31 March 2025 and annual thereafter

Follow-up of prior year recommendations from previous annual audit reports

Issue/risk	Recommendation and Agreed actions	Progress
1. 2022/23 AAR Working papers/reconciliations Management should ensure that working papers accurately reflect the records held by the Fund. Risk – without accurate working papers there is an increased risk of errors in the accounts.	Management should review working papers to ensure they are reconciled with the accounts. In addition, a wider reconciliation between the ledger, the custodian and investment/fund managers records held by the Fund should be reconciled. **Agreed action:**	**Partially implemented and superseded by 2023/24 recommendation 2.** There has been a significant improvement in the working papers and reconciliations are now carried out, but there is scope for some further improvements.

Issue/risk	Recommendation and Agreed actions	Progress
	Officers are committed to working with Audit Scotland on lessons learned from this year's audit, to ensure that working papers meet audit requirements. **Responsible officer** Suzy Douglas & Ian Angus **Agreed date** 31st March 2024	It has been agreed with management that more regular in year reconciliations of custodian records and management expenses will be carried out.
2. 2022/23 AAR Due diligence governance questionnaires Each year all investment managers are written to requesting they complete a due diligence questionnaire. This is to support oversight of investment managers. In year, one did not respond and there was no evidence on an overall review by the Fund. **Risk** – without this scrutiny and review, investments held by managers may be exposed to unnecessary risks.	Due diligence questionnaires shared with investment managers should be subject to review to ensure that management are aware of any issues arising which could impact the investments held by the Fund. **Agreed action:** Officers will undertake a review of due diligence reports from investment managers to ensure proper consideration of any issues arising. **Responsible officer** Suzy Douglas **Agreed date** 31st March 2024	**Partially implemented and superseded by recommendation 3.** Whilst a review has been carried out the responses to due diligence questionnaires, there has been no follow up of any issues identified.
3. Member training Given the Fund complexities, all members of the Board and Committee are expected tom undergo regular training. Not all members attended training during 2022/23 nor completed the toolkit which is expected to be completed	All members of the Pension Fund Committee should ensure that the required pension toolkit training and other annual essential training requirements are completed to assist in discharging their fiduciary duties. **Agreed action:**	**Implemented** No issues identified in 2023/24.

Issue/risk	Recommendation and Agreed actions	Progress
within 6 months of joining the committee. Risk – without training, members may not be able to fully discharge their fiduciary duties.	A comprehensive Committee and Board training session was delivered on 17th May 2023 which covered the structure and governance of the fund along with specific updates from the Council's actuary, investments and pensions administration. There will be a focus during the remainder of 2023/24 to ensure all members have completed required training. **Responsible officer** Suzy Douglas **Agreed date** 31st March 2024	
4. Recommendations from independent reviews There have been independent reviews and normal Fund business which has resulted in a number of actions to be taken forward. Risk – without a consolidated tracker with action owners and timescales, there is a risk that matters may not be progressed effectively.	Recommendations/actions from the independent review and from the Stewardship Code application and other Fund business should be consolidated in a tracker, and progress towards meeting them, including expected timescale and action owners, should be reported periodically to the Pension Fund Committee. **Agreed action:** An update has been provided to the Pension Fund Committee & Board meeting of the 22nd September 2023 confirming that an action plan will be developed ahead of the Committee meeting on the 12th December 2023. This action plan will pull together all improvement actions from the independent review and	**Implemented** We noted the updates provided in year. We also noted that the Business and Governance Plan 2024/25 – 2026/27 includes an Action Plan which includes the objectives of the Fund, and the plan encompasses recommendations from independent reviews.

Issue/risk	Recommendation and Agreed actions	Progress
	Stewardship code application. **Responsible officer** Suzy Douglas & Ian Angus **Agreed date** 31st December 2023	
5. 2021/22 AAR Investment management expenses 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. Risk - The transparency of costs related to investment management expenses is not properly reflected in the accounts	As part of the accounts preparation process, management should ensure that investment managers provide information to the fund on a timely basis. **Agreed action:** **In progress** – delays in information were also noted in 2022/23. **Management response:** Officers will work with investment managers ahead of the 31st March 2024 to put all reasonable measures in place to ensure information is provided in a timely way. **Responsible officer** Suzy Douglas **Revised date** 31st March 2024	**Implemented** No issues identified in 2023/24 relating to late information.

Appendix 2. Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £0.7 million.

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.

Narrative	Account areas	Fund Account		Net Assets Statement	
Accounting Misstatements		**Dr £m**	**Cr £m**	**Dr £m**	**Cr £m**
1. Investment assets late information	Investment assets			1.84	
	Net fund assets				1.84
2. Level 3 asset write down	Investment assets				2.46
	Net fund assets			2.46	

Scottish Borders Council Pension Fund

2023/24 Annual Audit Report

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