

Agenda Item	9b
Report No	PC/17/21

HIGHLAND COUNCIL

Committee: Pensions Committee and Pensions Board

Date: 22nd September 2021

Report Title: **Highland Council Pension Fund Internal Report – Audit of Investments**

Report By: Corporate Audit Manager

1. Purpose/Executive Summary

- 1.1 Details are provided of the audit review of Pension Fund Investments and a copy of the report is attached.

2. Implications

- 2.1 There are no Resource, Risk Legal, Community (Equality, Poverty and Rural), Climate Change/ Carbon Clever or Gaelic implications arising from this report.

3. Recommendations

- 3.1 The Committee/ Board is asked to consider the content of the report, the audit opinion provided, and to raise any relevant points with the Corporate Audit Manager.

4. Internal Audit Reports

- 4.1 Each Internal Audit report contains an audit opinion based upon the work performed in respect of the subject under review. There are five audit opinions which can be provided:
- (i) **Full Assurance:** There is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.
 - (ii) **Substantial Assurance:** While there is a generally a sound system, there are minor areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
 - (iii) **Reasonable Assurance:** Whilst the system is broadly reliable, areas of weakness have been identified which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk
 - (iv) **Limited Assurance:** Weaknesses in the system of controls are such as to put the system objectives at risk, and/ or the level of non-compliance puts the system objectives at risk.
 - (v) **No Assurance:** Control is generally weak, leaving the system open to significant error or abuse, and/ or significant non-compliance with basic controls leaves the system open to error or abuse.
- 3.2 The report has the audit opinion of Full Assurance and concluded that the key controls for Pension Fund investments are operating effectively.

Designation: Corporate Audit Manager

Date: 8th September 2021

Author: Donna Sutherland

Background Papers:

Internal Audit Final Report

Resources and Finance

Pension Fund Investments

Description	Priority	No.
Major issues that managers need to address as a matter of urgency.	High	0
Important issues that managers should address and will benefit the Organisation if implemented.	Medium	0
Minor issues that are not critical but managers should address.	Low	1

Audit Opinion

The opinion is based upon, and limited to, the work performed in respect of the subject under review. Internal Audit cannot provide total assurance that control weaknesses or irregularities do not exist. It is the opinion that **Full Assurance** can be given in that there is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.

Distribution:

Executive Chief Officer, Resources and Finance
 Head of Corporate Finance and Commercialism, Resources and Finance
 Service Finance Manager (Corporate Budgeting, Treasury and Taxation), Resources and Finance
 Treasury Accountant, Resources and Finance
 External Audit

Report Ref: HRF05/001

Draft Date: 01/09/21

Final Date: 08/09/21

1. Introduction

- 1.1 The audit reviewed the key controls surrounding the Council's Pension Fund investment arrangements, including compliance with relevant legislation and guidance. A sample of transactions, in respect of the financial years 2020/21 and 21/22, was examined to ensure that the objectives could be achieved.
- 1.2 The market value of the Fund's net investment assets as at 31st March 2021 was £2,387.3m, compared to £1,885.2m at 31st March 2020 with a target asset allocation of:
- 21.5% - UK Equities
 - 34.5% - Global Equities
 - 12% - Fixed income
 - 10% - Property Funds
 - 5% - Private Equity
 - 5% - Alternative risk premia strategies
 - 7% - Property debt and private credit
 - 5% Infrastructure.
- 1.3 The Fund's assets are managed by 8 appointed Fund Managers (a further 2 are in the process of being set up and will be funded in by the end of 2021). A Global Custodian oversees the Fund Manager's activities ensuring that investments are safeguarded, and transactions executed and recorded efficiently and securely. The Custodian also provides consolidated accounting and performance reporting services to the Fund. An Investment Advisor provides specialist advice on investment strategy and performance and assists in selecting new Fund Managers.

2. Main Findings

- 2.1 *The Fund's investments are made in accordance with its statutory requirements and relevant policies.*

This objective was substantially achieved as there are adequate arrangements in place to ensure the Pension Fund complies with legislation. The Council's Scheme of Delegation delegates responsibility for the determination of investment policies to the Investment Sub-Committee and requires these comply with all relevant legislation and arrangements accord with best practice.

As required by Local Government Pension Scheme (LGPS) Regulations, the Council's Pension Fund policy is set out in the Funding Strategy Statement and the Statement of Investment Principles.

The Multi Asset Absolute Return (MAAR) Fund Manager was appointed in accordance with the Council's Contract Standing Orders (CSOs). However, a contract award notice was not published as required in accordance with CSOs and Procurement Regulations. Procurement exercises have taken place to appoint Multi Asset Credit and Infrastructure Fund Managers, the Investment Advisor helped assess and select these Managers in accordance with Local Government Pension Scheme (LGPS) Regulations. The other existing Fund Managers are historic appointments, appointed prior to current procurement practices. They are classified as investments as opposed to having a contract. There are investment management agreements in place and Fund Managers are held to account by regular performance review.

The contract for the Investment Advisor expired on 31/03/19 and the Custodian has not been tendered for in recent years. The Service explained that there are plans to tender for these services; but recent focus has been on the MAAR, Multi Asset Credit, Infrastructure Manager, and private credit appointments (see Action Plan Ref L1).

LGPS Investment Regulations prescribe limits on the amount the Fund can invest in certain legal structures. Each of the Fund Managers is made aware of these limits and the Investment Advisor provides quarterly reporting to the Investment Sub Committee, with the target asset allocation set to comply with these limits.

- 2.2 *All Fund investments, acquisitions and disposals are properly controlled and recorded.*

This objective was fully achieved. Each Fund Manager operates within their investment management agreement to buy and sell investments. There are occasions where monies require to be transferred out of the Pension Fund to facilitate a capital call notice from the private equity Fund Manager (the new Infrastructure Manager will require capital calls also).

For these transfers the Treasury Team prepare transaction documentation, then if funds are required an authorised signatory approves sending of funds via CHAPS (Clearing House Automated Payment System). However recent practice has been to use cash held by the other Fund Managers to cover capital calls (generally there is sufficient cash in the private equity portfolio code to cover capital calls due to receiving funds (distributions)). Instructions to transfer funds between the Managers are sent to the Custodian which must be approved by an authorised signatory. 2 capital call notices were examined; authorisation was appropriate and adequate supporting documents held. All other transfers for 20/21 and 21/22 to date had appropriate authorisation.

The Treasury Team undertake monthly reconciliations between the reports provided by the Custodian and the individual Fund Managers to ensure that the Custodian's records are complete and accurate. Once this has been verified, any financial changes are processed into the financial ledger. Reconciliations for March and June 2021 were selected for review. All reconciliations had been completed by an appropriate Officer and independently checked. Where a variance had been identified an adequate explanation had been provided.

2.3 *All Pension Fund income is received in full, on time and is accurately recorded.*

This objective was fully achieved. The Custodian is responsible for ensuring that all due income is received, and this is specified in section 2.3 of the Custody Agreement. A monthly report is received from the Custodian detailing all income for the period. The Treasury Accountant also carries out checks to ensure that the correct amount has been received where a distribution payment is due from the private equity Fund Manager.

2.4 *There are appropriate arrangements in place for the monitoring and appraisal for the performance of the Fund's investments.*

This objective was fully achieved. Performance benchmarks are set up when the Fund Manager is appointed and agreed by the Investment Sub-Committee. There is an Investment Management Agreement in place with each Fund Manager which

sets out the agreed performance benchmarks. On a quarterly basis a performance report, prepared by the Fund's appointed Investment Advisor, is presented to the Investment Sub-Committee. The reports analyse overall Fund and individual Fund Manager performance against benchmarks for the quarter, 1 year, 3 year and 5 year periods. Fund Managers also make formal presentations to the Investment Sub-Committee (ISC) on a rotational basis.

Consideration was given to the Pension Fund's position on Environmental, Social and Governance (ESG) matters which highlighted the progress made in this area as detailed below:

- The Statement of Investment Principles outlines the Fund's position on ESG matters
- Fund Managers provide details of ESG credentials in their presentations to the ISC
- Members of ISC and Pensions Committee have the right to raise concerns and voice opinions on investments
- The Advisor rates all Fund Managers on their ESG credentials and provides investment advice on prospective investments, they outlined the ESG credentials of prospective bidders for the Multi Asset Credit Manager
- The Fund has signed up to the Institutional Investors Group on Climate Change
- The Fund has transferred part of its portfolio to another portfolio aligned to the Paris Agreement on climate change
- 2 Responsible Investment workshops are being held for Pension Committee and Pension Board on the 10 September and 22 September to increase understanding of ESG matters with a view to developing a Responsible Investment Policy Statement.

3. Conclusion

The key controls for the Council's Pension Fund investments are operating effectively and ensure that investments comply with relevant legislation and guidance.

4. Action Plan

Ref	Priority	Finding	Recommendation	Management Response	Implementation	
					Responsible Officer	Target Date
L1	Low	The contract for the Investment Advisor expired on 31/03/19 and the Custodian has not been tendered for in recent years.	These 2 services should be reviewed and put to tender in line with CSOs and Procurement Regulations to ensure competitive prices and services are provided.	Agreed.	Finance Manager (Corporate Budgeting, Treasury and Taxation)	31/12/22