

Agenda Item	<b>8b</b>
Report No	<b>PC/15/24</b>

**Committee:** **Pensions Committee**

**Date:** **9 October 2024**

**Report Title:** **Internal Audit Report – Pension Fund Investments**

**Report By:** **Strategic Lead (Corporate Audit & Performance)**

**1. Purpose/Executive Summary**

- 1.1 An audit of Pension Fund Investments was undertaken and a copy of this report is attached.

**2. Recommendations**

- 2.1 The Committee is asked to note the content of the report, the audit opinion provided and to raise any relevant points with the Strategic Lead (Corporate Audit & Performance).

**3. Implications**

- 3.1 There are no Resource, Legal, Community (Equality, Poverty, Rural and Island), Climate Change / Carbon Clever, Risk, Health and Safety (risks arising from changes to plant, equipment, process, or people, or Gaelic implications).

**4. Impacts**

- 4.1 In Highland, all policies, strategies or service changes are subject to an integrated screening for impact for Equalities, Poverty and Human Rights, Children's Rights and Wellbeing, Climate Change, Islands and Mainland Rural Communities, and Data Protection. Where identified as required, a full impact assessment will be undertaken.
- 4.2 Considering impacts is a core part of the decision-making process and needs to inform the decision-making process. When taking any decision, Members must give due regard to the findings of any assessment.
- 4.3 This is an update report and therefore an impact assessment is not required.

## **5. Internal Annual Report**

- 5.1 The Internal Audit report has the opinion of Full Assurance and concluded that the key controls for the Council's Pension Fund investments were operating effectively and ensure that investments comply with relevant legislation and guidance. As a result, there were no recommendations made.

Designation: Strategic Lead (Corporate Audit & Performance)

Date: 25 September 2024

Author: Donna Sutherland

Background Papers:

Appendices: Appendix 1 – Internal Audit Report – Pension Fund Investments

## 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	0

### Distribution:

Assistant Chief Executive - Corporate  
Head of Corporate Finance, Resources and Finance  
Pension Fund Manager, Resources and Finance

### 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.

**Report Ref:** HRF05/002  
**Draft Date:** 14/05/24  
**Final Date:** 16/05/24

## 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, from the date of the previous audit in 2021/22 (HRF05/001), was examined to ensure that the audit objectives could be achieved.
- 1.2 The market value of the Fund's net investment assets as at 31st March 2024 was £2,643m, compared to £2,406m at 31st March 2023 with strategic asset allocation targets of:
- 56% - Equities
  - 12% - Fixed income
  - 10% - Property
  - 7% - Property debt and private credit
  - 5% - Private Equity
  - 5% - Infrastructure
  - 5% - Alternative risk premia strategies.
- 1.3 The Fund's assets are managed by 12 appointed Fund Managers and a Global Custodian oversees the Fund Manager's activities ensuring that investments are safeguarded, and transactions are 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 *Pension Fund investments are made in accordance with its statutory requirements and relevant policies.*

This objective was substantially achieved. The Council's Scheme of Delegation assigns responsibility for the determination and management of investment policies to the Pensions Committee and 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 was set out in the Funding Strategy Statement and the Statement of Investment Principles (SIP).

LGPS Investment Regulations prescribe limits on the amount the Fund can invest in certain legal structures. The Fund Manager's contracts set out portfolio limits and restrictions and each year they are required to submit an independently verified statement to confirm that they have complied with the SIP as part of the year end process. The investment advisor is also fully aware of legislative limits and restrictions and monitors Fund Managers against these on a quarterly basis and this is reported to the Investment Sub-committee (see 2.4).

Since the last audit was carried out, 3 new Fund Managers have been appointed. The procurement exercise was carried out in line with the National LGPS Framework and with the support of the Investment Advisor in all cases i.e., the Fund Managers had been selected from a shortlist provided by the Investment Advisor and the recommendation to appoint was approved by the Investment Sub Committee. All other Fund Managers had either been appointed in accordance with relevant procurement practices or were historic appointments.

The contract for the Investment Advisor expired on 31/03/19 and the Custodian has not been tendered for in recent years. This was identified as a finding in the previous audit in 2021/22, and a low priority recommendation made that these services should be reviewed and tendered in line with Contract Standing Orders and Procurement Regulations. The agreed target date for completion was 31/12/22 but due to a reduction in staffing resources, other work matters having to be prioritised, and the requirement to retain the services of the Investment Advisor until completion of the triennial valuation and subsequent investment strategy review, it hasn't yet been completed. Revised target dates of 31/10/23 and 31/03/24 were agreed as part of the action tracking process and a further extension to 31/05/25 has been requested.

2.2 *Pension 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. With regard to the alternative investments (private equity, property debt, private debt, and infrastructure), a commitment is made to the fund being invested in and capital calls are made by the Fund Manager to meet this commitment. The capital calls are funded using cash held by the Custodian within the Highland Council portfolio. A sample of 3 capital call transactions was examined out of 20 that had been completed in the 2023/24 financial year. In all instances, they had been appropriately authorised and adequate supporting documentation was held electronically.

The Treasury Team undertake reconciliations between the reports provided by the Custodian (monthly) and the individual Fund Managers (either monthly or quarterly) to ensure that the Custodian's records are complete and accurate. Monthly reconciliations are also carried out to confirm that the opening and closing balances of the investments (from Custodian reports) agree to the financial ledgers (cash and investment) for each Fund Manager. A sample of 12 monthly and quarterly reconciliations was examined from the 2023/24 financial year and all had been completed by an appropriate Officer, independently checked and variances were within accepted tolerance levels.

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. The Custodian provides a monthly report for each Fund Manager which includes an 'Income and Expense Summary' section detailing income received. This information was checked against the information received from Fund Managers, and the details of income received were recorded in the Fund's ledger by Treasury staff (see 2.2).

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

This objective was fully achieved. There is an Investment Management Agreement in place with each Fund Manager which sets out the agreed performance benchmarks. The Investment Advisor prepares a quarterly performance report, and this was 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.

2.5 *Requirements for Pension Fund investments have been properly defined, communicated, and are monitored in line with the Highland Council Pension Fund Responsible Investment Policy to ensure compliance and that any Environmental, Social and Governance (ESG) requirements where applicable are taken into account.*

This objective was fully achieved. Requirements relating to Pension Fund investments, including ESG factors (section 14 – Responsible Investing) were set out in the SIP. It was reviewed regularly, and any changes were approved by the Pensions Committee. The Responsible Investing (RI) Policy sets out the Fund's approach to responsible investing which was defined as "the integration and consideration of ESG issues into both initial asset investment processes and then ongoing asset ownership practices" and it was approved by the Pensions Committee.

As stated in 2.1, Fund Managers are required to submit annual statements confirming that they have complied with the investment principles set out in the SIP. The RI Policy was circulated to all Fund Managers in March 2022 and each Fund Manager is assigned an ESG rating by the Investment Advisor which is reviewed at Investment Sub Committee. Compliance with the SIP and RI Policy was also monitored through the reporting process set out in 2.4. A climate scenario assessment had been

carried out as part of the Triennial Actuarial Valuation which was presented to the Pensions Committee on 22/02/24.

There were no regulatory requirements relating to ESG investment practices and therefore, the approach taken by Highland Council as the Administering Authority for the Fund, is discretionary and in line with approved investment policies.

### **3. Conclusion**

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