

Agenda Item	6
Report No	PC/10/26

The Highland Council

Committee: Pensions Committee

Date: 18 June 2026

Report Title: Pension Fund Internal Audit Annual Report 2025/26

Report By: Strategic Lead (Audit & Risk)

1. Purpose/Executive Summary

1.1 The attached report includes an assessment of the Pension Fund's framework of governance, risk management and control, and the associated opinion which provides information for the Fund's Annual Governance Statement.

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 (Audit & Risk).

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. Annual Report 2025/26

5.1 The Global Internal Audit Standards (GIAS) came into effect from on 01/01/25. This was subsequently amended by the CIPFA Application Note on Global Internal Audit Standards in the UK Public Sector which are applicable from 01/04/25. Therefore, this is the first annual report under the GIAS in the UK Public Sector which requires the Chief Audit Executive to:

“... prepare an overall conclusion at least annually in support of wider governance reporting, mindful of any specific sector obligations or processes. This overall conclusion must encompass governance, risk management and control.”

“... report annually on the results of the quality assurance including progress against action plans to address instances of non-conformance.”

These requirements have been met by the report provided at **Appendix 1** with section 2 of the report also used to inform the Fund's Annual Governance Statement.

Designation: Strategic Lead (Audi & Risk)

Date: 18 May 2026

Author: Donna Sutherland

Background Papers:

Appendices: Appendix 1 – Pension Fund Internal Audit Annual Report 2025/26

Appendix 1



Highland Council Pension Fund
Internal Audit Annual Report 2025/26

1. INTRODUCTION

- 1.1 The purpose of this report is to provide an annual Internal Audit opinion for the period 1st April 2025 to 31st March 2026, and a report that can be used by the Pension Fund to inform its Annual Governance Statement (see section 2).
- 1.2 This report has also been produced to meet the requirements of the Global Internal Audit GIAS (the GIAS) which came into effect from 1st January 2025 and apply to all internal audit service providers. CIPFA subsequently issued "The Application Note: Global Internal Audit GIAS in the UK Public Sector" which changed this date to 1st April 2025. Therefore, this is the first annual report produced under the GIAS.

2. ANNUAL GOVERNANCE STATEMENT

2.1 Internal Control

Internal control is defined as *"the whole system of checks and controls, financial or otherwise, established by management in order to provide reasonable assurance"* regarding the achievement of one or more of the following objectives:

- The reliability and integrity of information.
- Compliance with policies, plans, procedures, laws, regulations and contracts.
- The safeguarding of assets.
- The economical and efficient use of resources.
- The accomplishment of established objectives and goals for operations or plans.

Any system of control can only provide reasonable, and not absolute assurance that control weaknesses or irregularities do not exist, or that there is no risk of material errors, losses, fraud or breaches of laws and regulations. Accordingly, the Board should seek continual improvement in the effectiveness of its systems of internal control.

It is the responsibility of senior management to establish an appropriate and sound system of internal control, and to monitor the continuing effectiveness of that system.

2.2 Internal Audit

The GIAS define internal auditing as *"an independent, objective assurance and advisory service governance, risk management and control processes"*. It also states that:

Internal auditing enhances the organisation's:

- Successful achievement of its objectives.
- Governance, risk management, and control processes.
- Decision-making and oversight.
- Reputation and credibility with its stakeholders.
- Ability to serve the public interest.

Internal auditing is most effective when:

- It is performed by competent professionals in conformance with the GIAS, which are set in the public interest.
- The internal audit function is independently positioned with direct accountability to the board.
- Internal auditors are free from undue influence and committed to making objective assessments.

The work undertaken by Internal Audit is documented in an audit report and issued to management. Any areas of concern together with the management agreed actions and target dates for implementation are summarised in an Action Plan within the report. It is the responsibility of management to ensure that implementation of these actions takes place as agreed. The Internal Audit Section will undertake periodic follow-up reviews to ensure that the management agreed actions have been satisfactorily implemented and the results of this will be reported to the Pensions Committee.

The Internal Audit Section operates in accordance with the GIAS in the UK Public Sector (the GIAS). Details of the assessment of conformance with the GIAS and the results of the Quality Assurance and Improvement Programme is included within the Highland Council's Internal Audit Annual Report 2025/26. This report was considered by the Council's Audit Committee on 27/05/26.

2.3 Internal Audit work

In accordance with the GIAS requirements, a risk based tactical audit plan is produced each year and submitted for approval to the Pensions Committee. The 2025/26 Internal Audit plan was agreed by the Pensions Committee on 12/02/25. This comprised of the following:

- Review of the systems of internal control to inform the Fund's Annual Governance Statement and the Internal Audit Annual Report 2024/25. This was completed and considered by the Committee on 04/09/25.
- Pension Fund – review of new software system and payment arrangements. This report was considered by the Committee on 16/03/26. It had the opinion of "Substantial Assurance" and concluded that there were good controls in place to ensure that pensioner payees were set up, paid, amended and cancelled correctly. The report contained 3 audit recommendations comprising of 1 medium and 2 low grades. The first recommendation identified that the existing controls to mitigate against fraud could be further strengthened. A number of different actions to address this recommendation were agreed and are now complete. The low grade recommendations related to procedural matters, the first being the need for a documented procedure covering the bank to ledger reconciliation process and more detailed written procedures setting out practice which could then be shared across the Pensions Team. These actions are complete with the exception of one action (see 2.4 (3) below).

2.4 Action Tracking

As part of the audit process, all audit recommendations are action tracked to ensure that the associated management actions were implemented as agreed.

Monthly tracking is undertaken whereby individual actions are then tracked once their due date has passed. The action tracking process also allows for revision of the agreed action target dates. Again, these are tracked once the revised target date has passed. There are presently three audits where there are actions outstanding as detailed in the table below.

Audit Name	Report Date	Medium		Low		Open actions Total
		No. Recs	Open actions	No. Recs	Open actions	
Pensions Fund Investments	08/09/21	0	0	1	1	1
Pension Fund Contributions	06/02/23	2	1	1	0	1
Pension Fund Payroll Payments	27/02/26	1	0	2	1	1
Total		3	1	4	2	3

Note: More than one action may have been agreed in response to a recommendation.

(1) Pension Fund Investments (1 Low priority Action)

The Investment Advisor tender was completed with new advisor in post from November 2025. It took 8 months for this process to be completed, and this was procuring using LGPS framework.

The Custodian tender remains outstanding, the LGPS framework for custodian contract is to be used and work is underway with procurement to move this forward. The Procurement Approval Group approved this submission on 06/05/26. In view of how long it takes to run a procurement exercise, a revised date of December 2026 is considered appropriate. (Original target date 31/12/22, revised target date 31/12/26).

(2) Pension Fund Contributions (1 Medium priority action)

The backlog of leavers/ retirements/ deaths and re-employment/ aggregation cases should be addressed, and a full year-end reconciliation carried out as soon as possible.

The next couple of years are shaping up to be busiest ever experienced with increased statutory requirements and it is key that the team address the backlogs that have increased since the Career Average Revalued Earnings scheme commenced on 01/04/15. The Service Plan 2023/24 included a proposal for a team specifically focused on addressing backlogs. During 2025/26 the performance of processing leavers/ retirements/ deaths had improved but there continues to be high volumes of aggregation cases. The 2026/27 budget approved by the Pensions Committee includes additional staff resource to support reducing outstanding cases, with a focus on aggregations. 5 pension technicians are now in post; it will take a period of 6-12 months for these staff to be fully trained and to see the impact on workloads. (Original action date 31/10/24, Revised action date 31/03/27).

(3) Pension Fund Payroll Payments (1 Low priority action)

There should be a detailed procedure for reconciling the bank to ledger including explanations of all sections of the spreadsheet. The procedure should ensure that by year end all transactions have been reconciled or a decision made to write off and journal appropriately. Procedure note will be included in the spreadsheet use to complete the bank to ledger reconciliation. The note will document that by year end decision will be taken on write offs for current financial year where appropriate. (Original action date 30/04/26, Revised action date 31/07/26).

2.5 Assurances from Fund Managers and Global Custodian

The Fund Managers and the Global Custodian normally each provide an annual assurance report (AAF 01/20/ ISAE 3402 or Sarbanes-Oxley based reporting for US-based organisations) which sets out the control procedures in place during the year, and includes an assessment, by an independent auditor, of the effectiveness of the systems of internal controls in operation throughout the period examined. Where the report did not cover the full financial year, a bridging letter was required to provide assurance that controls remained unchanged. Reports and bridging letters for 14 of the 15 Fund Managers, and the Global Custodian were provided.

One Fund Manager had not yet provided a report for the period 01/04/25 to 31/03/26 as this is not due until June 2026. The Fund Manager confirmed that they do not provide bridging letters in relation to the Report on Internal Controls. Instead, the Fund Manager provided a statement '*We confirm that since 31 March 2025 the controls in operation continue to be designed effectively in order to meet the control objectives as outlined in the report for the year to 31 March 2025. In addition, since that date, we are not aware of any significant weaknesses identified within our internal control environment which would result in a qualified opinion within the report for the year to 31 March 2026*'.

Review of the assurance reports provided showed that:

- 12 AAF 01/20/ISAE 3402 reports were received covering 11 Fund Managers and the Global Custodian. These provided an unqualified opinion of reasonable assurance.
- 2 Fund Managers (US-based organisations) provided alternative assurance in the form of Sarbanes-Oxley reporting. These organisations were subject to different legislative requirements and provided assurance through Form 10-K and 10-Q reporting. While this provides assurance in respect of the internal controls over financial reporting, it is not directly equivalent to ISAE 3402 assurance, particularly in relation to service organisation control reporting and sub-service arrangements. Both reports provided unqualified opinions.

In considering these assurances it was noted that:

- None of the reports fully aligned with the Pension Fund financial year (01/04/25 to 31/03/26). As a result, reliance was placed on bridging letters and confirmations to provide assurance for the remaining periods. These

confirmations are not independently audited and therefore may reduce the level of assurance available.

- Fund Managers and the Global Custodian outsourced some of their services/ systems to third parties (sub-service organisations). The normal approach is for the auditors to use the “carve out” method by excluding the sub-service’s control procedures from the scope of their work. Consequently, the controls operated by third-party providers were not subject to independent audit testing, and their control environments were not fully evaluated.
- Reports identified that certain control objectives could only be achieved where complementary controls operated by the Complimentary User Entity are suitably designed and operating effectively. These controls were not evaluated by the service auditors, and therefore reliance is placed on the effectiveness of the User Entity’s own internal controls.

2.6 Governance arrangements

The Highland Council, as administering authority of the Pension Fund, has approved and adopted a Local Code of Corporate Governance, which is consistent with the principles and reflects the requirements of the CIPFA/ SOLACE Guidance Note for Scottish Authorities – Delivering Good Governance in Local Government (2016).

The authority's financial and management arrangements also conform with the governance requirements of the CIPFA Statement on the role of the Chief Financial Officer in local government.

The Pension Fund has a separate Governance Policy Statement which is one of a number of key documents it must hold and is reviewed annually. The Governance Policy Statement 2025/26 was approved by the Pensions Committee on 04/09/25.

The Pension Regulator introduced a new General Code of Practice (GCoP) which came into effect in March 2024. The GCoP includes a number of different chapters and assessment of compliance against these was undertaken by the Pension Fund Manager. The outcome of this assessment and the associated action plan was reported to the Pensions Committee on 12/02/25.

2.7 Risk Management

CIPFA guidance on “*Managing risk in the Local Government Pension Scheme*” was updated in December 2018. This sets out the role of the Pensions Committee as follows:

- Determining the risk policy and reconciling this with the wider organisational risk policy;
- Setting the risk management strategy in line with the risk policy;
- Overseeing the risk management process including development of a risk register and ongoing, regular monitoring of the risks identified.

Within the Governance Policy Statement reference is made to the Fund’s Risk Management arrangements whereby identified risks and their countermeasures are contained within the Funding Strategy Statement (FSS).

These documents should be reviewed and updated on a regular basis. The latest FSS was approved by the Pensions Committee on 22/02/24 before it came into effect on 01/04/24.

The Risk Management Policy and Strategy was updated previously and approved by the Pensions Committee on 12/02/25.

The Pension Fund has its own risk register, and the format is based upon the CIPFA guidance which is recognised as best practice. This includes identifying the:

- key objectives of the Fund
- risks that could prevent these being achieved
- controls in place to mitigate these risks.

The gross risk and residual risk (remainder after the mitigating controls) are ranked as Red/ Amber/ Green. Red and Amber gross risks are recorded on the risk register together with any mitigating controls/ actions to address these.

Risk management updates were provided to the Pensions Committee meetings of 04/09/25 and 16/03/26. These reported that all 13 risks were being actively managed with their residual risk categorised as Green.

2.8 Committee Training

The Pension Fund recognises the importance of training of the Committee and Board members. An essential part of good governance is to ensure that members have the necessary skills and knowledge in order to effectively perform their role. There are also legal and regulatory requirements which must be complied with.

In order to address these requirements, a training policy is in place supported by inductions and an annual training programme. The policy and programme for 2025/26 was agreed by the Pensions Committee on 04/09/25.

2.9 Audit Opinion

On the basis of the work undertaken during the year, it was considered that the key systems operate in a sound manner and that there had been no fundamental breakdown in control resulting in material discrepancy. However, as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Pension Fund's framework of governance, risk management and control for the year to 31st March 2026.