

Agenda Item	4c
Report No	PC/7/19

HIGHLAND COUNCIL

Committee: Pensions Committee and Pensions Board

Date: 8th August 2019

Report Title: **Highland Council Pension Fund Internal Report – Pension Fund 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, Legal, Community (Equality, Poverty and Rural), Climate Change/ Carbon Clever or Gaelic implications arising from this report. The audit review also provides assurance that the key controls in place to manage the associated risks for pension fund investments are operating effectively and that the relevant legislation is complied with.

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 audit review of Pension Fund Investments has the audit opinion of Full Assurance and there is 1 low grade priority recommendation. This has been agreed by management and the appropriate action should be implemented by 30/09/19.

Designation: Corporate Audit Manager

Date: 30th July 2019

Author: Donna Sutherland

Background Papers:

Internal Audit Final Report

Corporate Resources Service

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:

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

Report Ref: HDA03/002.bf

Draft Date: 12/07/19

Final Date: 30/07/19

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 year 2018/19, 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 2019 was £1.999bn, compared to £1.884bn at 31st March 2018 with an asset allocation of:
- 66.9% - Equities
 - 15.5% - Fixed Income
 - 9.5% - Property Funds
 - 5.3% - Private Equity
 - 2.8% - Commercial Real Estate Debt.
- 1.3 The Fund's assets are managed by 7 appointed Fund Managers and a Global Custodian is contracted to oversee the Fund Manager's activities to ensure that investments are managed efficiently and securely. An Investment Advisor provides specialist advice on areas such as investment strategy and performance.

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 most recent Fund Managers were appointed in accordance with the Council's Contract Standing Orders and the Procurement Unit has been involved in the process.

Procurement exercises are taking place to appoint a Multi Asset Credit Fund and a Multi Asset Absolute Return Manager but these are not due to be completed until late 2019. 5 of the Fund Managers were not listed on the contract register as they were appointed several years ago. Procurement said they not aware of any grounds for these not to be listed on the Register (see section L1 of the Action Plan). The contract for the Investment Advisor was found to have expired on 31/03/19. The Service explained that a new advisor was to be appointed effective 01/09/19 but that the Service Finance Manager (Corporate Budgeting, Treasury and Taxation) had requested a direct award until the tender exercise is completed.

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 monitors them against these. An in-house retrospective check is also carried out.

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

This objective was fully achieved. Each Fund Manager operates within the investment management agreement to buy and sell stocks which accounts for the majority of transactions. However, there are occasions where monies require to be transferred out of the Pension Fund to facilitate a capital call notice from the Partners Group (the private equity Fund Manager).

For these transfers the Treasury Team prepare transaction documentation, then an authorised signatory approves sending of funds via CHAPS (Clearing House Automated Payment System). 2 capital call notices were examined; authorisation was appropriate and adequate supporting documents held.

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. 2 monthly reconciliations for 6 Fund Managers (and 1 quarterly for the other Fund

Manager) 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 Partners Group.

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 agreed by the Investment Sub-Committee and ratified by the Pension 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 put 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, which include investment performance, to the Investment Sub-Committee (ISC) on a rotational basis (each Fund Manager presents to Committee roughly once a year).

At the request of the Depute Chief Executive/Director of Corporate Resources consideration was given to what steps Officers have taken to ensure the Fund achieves Value for Money (VFM). Good evidence of steps taken to achieve VFM was provided:

- Fees for the Investment Adviser will be reviewed as part of the tendering process.
- Following negotiation, the Custodian fees have been reduced with effect from 1 April 2019.

- An agreement is in place for securities lending. This generates income which is greater than the Custodian fees.
- One Fund Manager now bills the Pension Fund based on total holding so there has been a fee saving.
- All Fund Managers will provide cost reports from December 2019 which will enable comparison across LGPS funds and provide a basis for challenging fees.
- Cash balances sitting with the Custodian are invested in money market funds daily to earn interest.
- Attendance at the annual Scottish LGPS training event is by video conferencing to avoid travel and accommodation costs.
- Officers attend meetings with colleagues from other LGPS Funds to share performance data and best practice.

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. The majority of audit objectives were achieved and the issues identified from the audit are minor in nature and do not affect the system of control.

4. Action Plan

Ref	Priority	Finding	Recommendation	Management Response	Implementation	
					Responsible Officer	Target Date
L1	Low	5 of the Fund Managers were not listed on the Contracts Register and Procurement were not aware of there being any grounds for these contracts not to be on the Contracts Register.	All Fund Managers receiving more than £10,000 per annum should be listed on the Contracts Register.	Information will be provided to Procurement on these 5 Fund Managers for the Contracts Register.	Accountant	30/09/19