

Item: 8

Monitoring and Audit Committee: 25 September 2025.

Internal Audit – Pension Investments.

Report by Chief Internal Auditor.

1. Overview

- 1.1. The internal audit plan 2024/25 included a review of Pension Investments, this audit has been completed and the internal audit report is attached as Appendix 1 to this report.
- 1.2. The Orkney Islands Council Pension Scheme is the smallest Local Government Pension Scheme (LGPS) in both Scotland and the UK. The fund is built up from contributions from both employees and employing bodies, together with interest and dividends from investments, out of which pensions and other benefits are paid.
- 1.3. The objective of this audit was to provide assurance that the Council has effective and robust procedures in place for the management of pension fund investments.
- 1.4. The audit provides Substantial assurance that procedures and controls relating to Pension Investments are well controlled and managed.
- 1.5. The internal audit report, attached as Appendix 1 to this report, includes one low priority recommendation regarding the Pension Fund Training Policy.

2. Recommendations

- 2.1. It is recommended that members of the Committee:
 - i. Scrutinise the findings contained in the internal audit report, attached as Appendix 1 to this report, relating to the procedures and controls around Pension Investments, in order to obtain assurance that action has been taken or agreed where necessary.

For Further Information please contact:

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Implications of Report

1. **Financial:** None directly related to the recommendations in this report.
2. **Legal:** None directly related to the recommendations in this report.
3. **Corporate Governance:** In terms of the Scheme of Administration, consideration of Internal Audit findings and recommendations and to review actions taken on recommendations made, is a referred function of the Monitoring and Audit Committee.
4. **Human Resources:** None directly related to the recommendations in this report.
5. **Equalities:** An Equality Impact Assessment is not required in respect of Internal Audit reporting.
6. **Island Communities Impact:** An Island Communities Impact Assessment is not required in respect of Internal Audit reporting.
7. **Links to Council Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Council Plan strategic priorities:
 - ☐ Growing our Economy.
 - ☐ Strengthening our Communities.
 - ☐ Developing our Infrastructure.
 - ☐ Transforming our Council.
8. **Links to Local Outcomes Improvement Plan:** The proposals in this report support and contribute to improved outcomes for communities as outlined in the following Local Outcomes Improvement Plan priorities:
 - ☐ Cost of Living.
 - ☐ Sustainable Development.
 - ☐ Local Equality.
 - ☐ Improving Population Health.
9. **Environmental and Climate Risk:** None directly related to the recommendations in this report.
10. **Risk:** Internal Audit evaluates the effectiveness and contributes to the improvement of the risk management processes.
11. **Procurement:** None directly related to the recommendations in this report.
12. **Health and Safety:** None directly related to the recommendations in this report.
13. **Property and Assets:** None directly related to the recommendations in this report.
14. **Information Technology:** None directly related to the recommendations in this report.
15. **Cost of Living:** None directly related to the recommendations in this report.

List of Background Papers

Internal Audit Plan 2024/25.

Appendix

Appendix 1: Internal Audit Report – Pension Investments.



Internal Audit

Audit Report

Pension Investments

Draft issue date: 1 July 2025

Final issue date: 14 July 2025

Distribution list:	Director of Enterprise and Resources Head of Finance Service Manager Corporate Finance Service Manager Pension and Payroll Team Manager Corporate Finance
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Audit Opinion

Based on our findings in this review we have given the following audit opinion.

Substantial

The framework of governance, risk management and control were found to be comprehensive and effective.

A key to our audit opinions and level of recommendations is shown at the end of this report.

Executive Summary

This review was carried out to provide assurance that the Council has effective and robust procedures in place for the management of pension fund investments.

Our audit placed reliance on the external pension fund audit where we considered it appropriate to do so to avoid duplication.

Some areas of good practice were identified during this audit including:

- Effective governance in place due to Sub-committee and policies.
- Training is regularly provided and monitored.
- Good attitude toward risk management with the risk register being regularly reviewed.
- Investment performance is monitored.
- Reconciliations are completed periodically.

The report includes 1 recommendation which has arisen from the audit. The number and priority of the recommendations are set out in the table below. The priority headings assist management in assessing the significance of the issues raised.

Responsible officers will be required to update progress on the agreed actions via the Ideagen Risk Management system.

Total	High	Medium	Low
1	0	0	1

The assistance provided by officers contacted during this audit is gratefully acknowledged.

Introduction

Orkney Islands Council Pension Fund has contributions from both employees and employers along with interest and dividends from investments to build the pension fund.

Pension funds can be invested in different areas including equities, bonds, infrastructure and private loans. Different products will have varying levels of risk and costs.

Orkney Islands Council Pension Fund was valued at over £530m on 31 March 2024.

This review was conducted in conformance with the Global Internal Audit Standards in the UK Public Sector.

Audit Scope

The scope of this audit included a review of the following:

- That funds are invested in accordance with statutory requirements and approved policy.
- Acquisitions and disposals are properly controlled and recorded.
- All income earned is received and properly recorded.
- Investment performance is reviewed.
- Training provided to trustees.

Audit Findings

1.0 Policy

- 1.1 The Statement of Investment Principles (SIP) is a formal document that outlines the policies governing the investment decisions of the pension fund.
- 1.2 For example the SIP includes the fund objective, types of investments held and risks.
- 1.3 The management of the pension fund and the SIP were reviewed for compliance and found to align with the requirements set out in The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, this includes investments being appropriately diversified.
- 1.4 The SIP has been reviewed regularly since it was initially created in 2003 with the most recent version being approved by the Pension Fund Sub-committee in November 2022.
- 1.5 In the financial year (FY) 2022/23 Pension Fund external audit, a recommendation was made to implement a climate strategy.
- 1.6 A Responsible Investment policy which covers climate strategy was approved by the Pension Fund Sub-committee in February 2024.
- 1.7 The current training policy was approved by the Pension Fund Sub-committee in April 2015.
- 1.8 We recommend that the training policy is reviewed periodically to ensure it is up to date.

Recommendation 1

2.0 Procedure

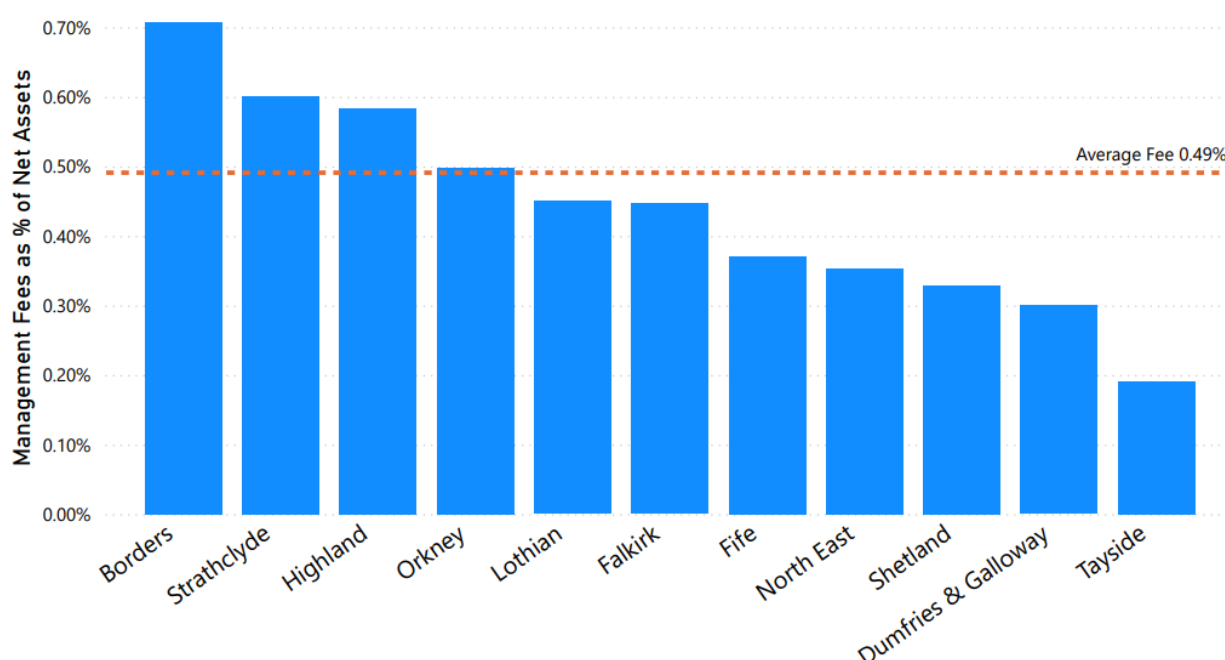
- 2.1 The Pension Fund Sub-committee and the Pension Board meet regularly, generally at least once per quarter.
- 2.2 Investments can be a complex area, training is important to ensure members of the Sub-Committee and the Board have sufficient knowledge to aid in discussion and decision making.
- 2.3 Training is regularly provided to Sub-committee and Board members on a range of topics relating to pensions investments. Members are required to attend at least 1 training session per year. Training attendance is monitored and recorded.
- 2.4 In the previous Pensions Investment internal audit (carried out in FY 2019/20) there was 1 recommendation that the pension fund risk register is reviewed regularly.
- 2.5 Since the previous internal audit the risk register has been reviewed annually, with the most recent review occurring in February 2025.
- 2.6 Hymans Robertson act as the fund's actuaries and perform a triennial valuation.
- 2.7 The Pension Fund's advisors, also Hymans Robertson, provide a strategy review annually. The review provides different options, analysis and recommendations in regard to fund allocation. Changes in fund allocation must be agreed by the Pension Fund Sub-committee.

- 2.8 When funds are allocated to a new investment product or fund it may also have a new investment manager. Ensuring the manager is suitable to act as a steward for the funds is important.
- 2.9 New managers can be interviewed by officers and members of the Pension Fund Sub-committee and the Board to ensure the manager is appropriate. Hymans Robertson can assist with sourcing managers and in interviews. Using financial advisors for assistance is suitable.
- 2.10 Regular reconciliations act as a strong control to help with accurate financial records and reduce the chance of fraud. Reconciliations are conducted quarterly for the different investments.
- 2.11 Internal control reports are assessments that evaluate the effectiveness of an organisation's systems for managing risk, ensuring accurate financial reporting, and safeguarding assets.
- 2.12 The Council does not conduct a review of internal control reports for banks or investment funds, these reports are reviewed as part of the external audit process for the pension fund.

3.0 Investments

- 3.1 Hymans Robertson also provide a quarterly performance monitoring report for the pension fund. The report looks at manager performance and fund performance against benchmarks. Underperforming areas can be flagged for discussion and reviewed.
- 3.2 Management fees from Local Government Pension Schemes across Scotland were compared by taking management fees divided by net assets. Data was compiled from pension scheme annual reports for FY 2023/24. The chart in Figure 1 shows the results.

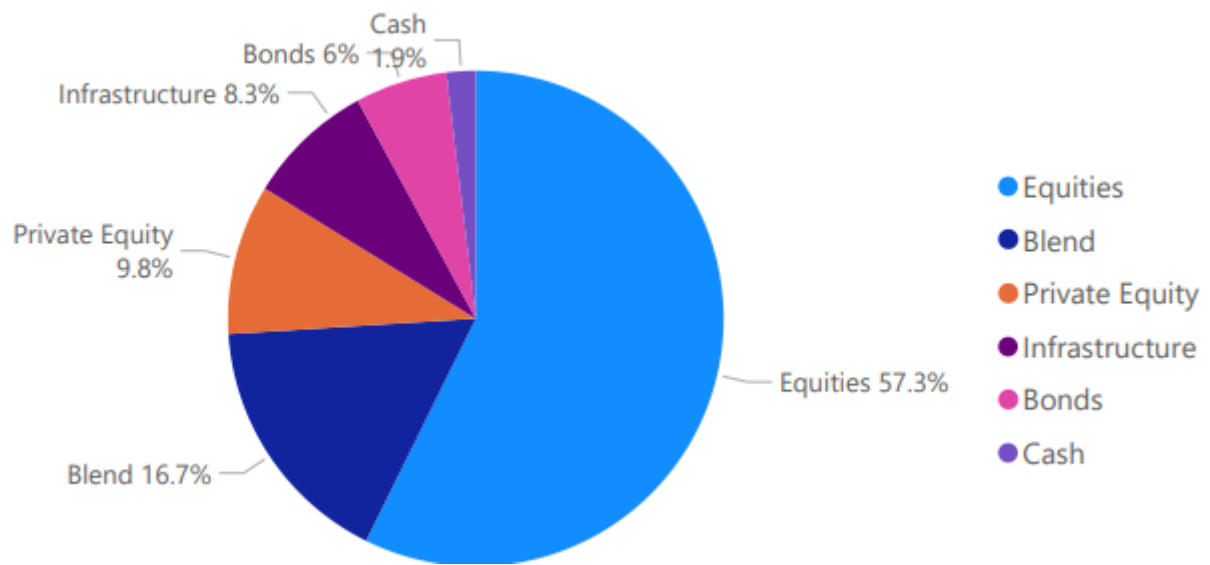
Figure 1 – Investment Management Fees FY 2023/24



Source: Annual Accounts & Report 2023/24 for each respective pension fund.

- 3.3 Orkney ranked 4th for management fees with 0.50% of net assets, slightly higher than the average of 0.49%.
- 3.4 Note that fees vary depending on the types of assets or products held within funds. Bonds, equities and private debt will all likely have different fees associated with each product.
- 3.5 A breakdown of the pension fund allocation is shown in Figure 2 below.

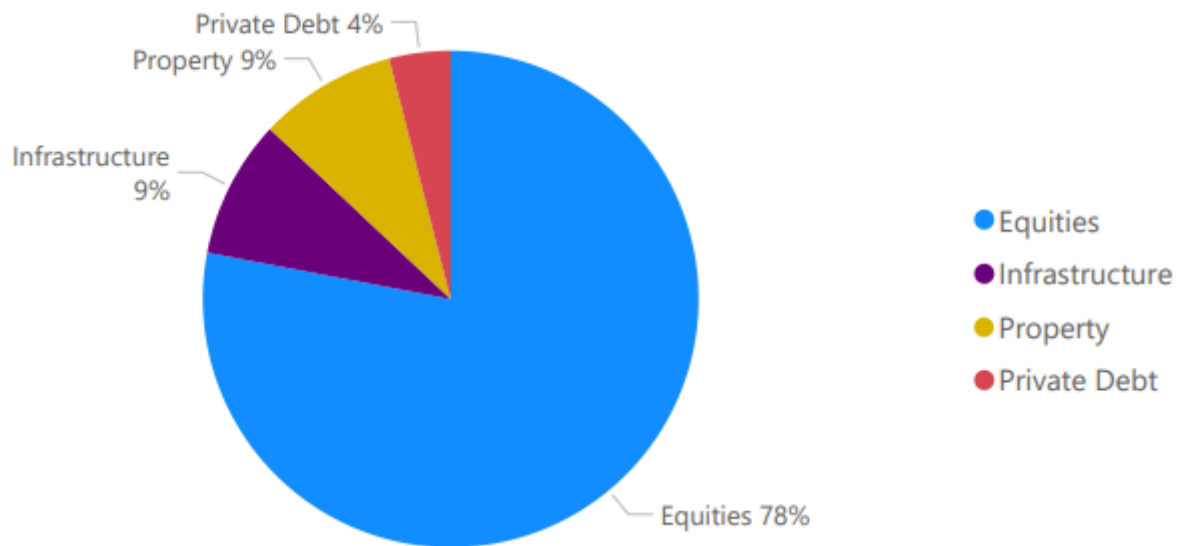
Figure 2 – Orkney Islands Council Pension Fund Allocation at 31/3/24.



Source: Orkney Islands Council Pension Fund Annual Report 2023/24

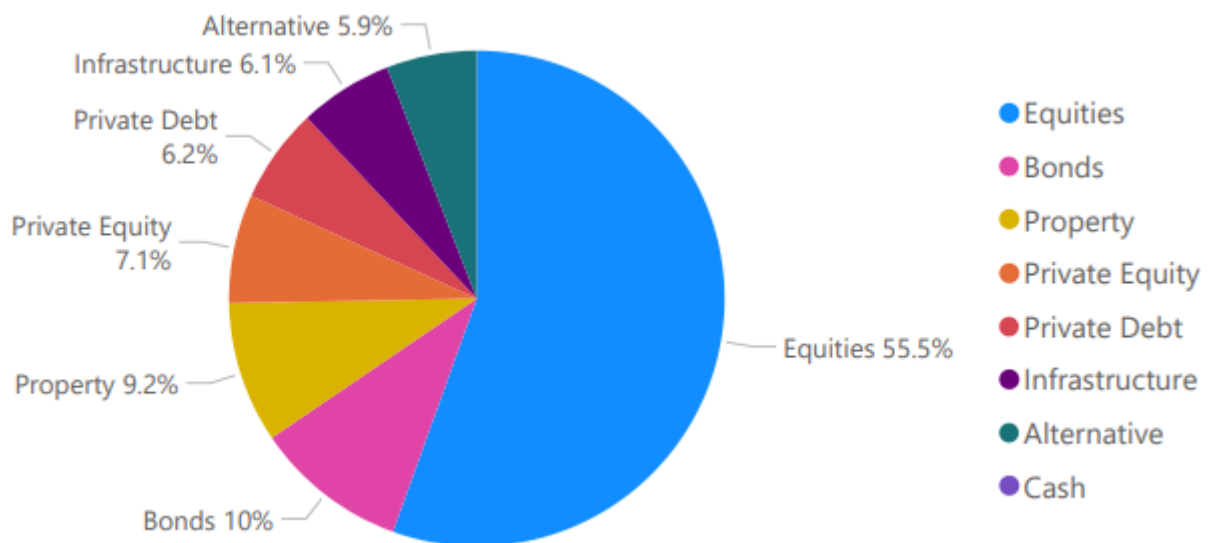
- 3.6 For comparison see charts of Shetland and Highland council pension funds allocations below.

Figure 3 – Shetland Islands Council Pension Fund Allocation at 31/3/24.



Source: Shetland Islands Council Pension Fund Annual Report 2023/24.

Figure 4 – Highland Council Pension Fund Allocation at 31/3/24.



Source: Highland Council Pension Fund Annual Report 2023/24.

4.0 Environmental, Social & Governance

- 4.1 Members of the Pension Fund Sub-committee have a fiduciary duty to act in the best interests of the scheme and its beneficiaries.
- 4.2 Environmental, Social & Governance (ESG) factors can affect the value of investments and should be considered in analysis.
 - 4.2.1 Environmental factors include resource scarcity, waste management, pollution, carbon emissions and energy efficiency.

- 4.2.2 Social factors include health & safety, workforce diversity, working conditions and data protection.
- 4.2.3 Governance factors include board structure, business ethics, shareholder rights and executive compensation.
- 4.3 The Council's ESG statement and Responsible Investment Policy is broadly in line with other Scottish pension funds. The Sub-committee believes climate change poses a risk and should be considered in investment managers decisions. They also support achieving Net Zero by 2050. Other Scottish pension funds share these beliefs with many being signatories on Climate Action 100+.
- 4.4 The United Nation's Principles for Responsible Investment (UN PRI) lay out 6 principles related to responsible investing; the Sub-committee requires fund managers to be signatories of the UN PRI. Some, but not all other pension funds, including Lothian and Tayside, are also signatories of the UN PRI.
- 4.5 Note that ESG and Responsible Investment are different from Ethical Investment. Ethical Investment aligns investment with personal beliefs and may avoid certain industries.
- 4.6 Prohibiting investment in specific industries due to personal beliefs can conflict with the fiduciary duty of members.
- 4.7 There are currently no restrictions on industries to invest into.
- 4.8 Owning shares in an organisation can enable voting at an organisation's shareholder meetings.
- 4.9 Exercise of voting rights are delegated to investment managers. Voting decisions are included in quarterly reports. Hymans Robertson monitor investment manager Responsible Investment performance as part of their quarterly report.

Action Plan

Recommendation	Priority	Management Comments	Responsible Officer	Agreed Completion Date
1 We recommend the training policy is reviewed periodically to ensure it is up to date	Low	The training policy established in 2015 will be reviewed and updated if required.	Team Manager – Corporate Finance	31 December 2025

Key to Opinion and Priorities

Audit Opinion

Opinion	Definition
Substantial	The framework of governance, risk management and control were found to be comprehensive and effective.
Adequate	Some improvements are required to enhance the effectiveness of the framework of governance, risk management and control.
Limited	There are significant weaknesses in the framework of governance, risk management and control such that it could be or become inadequate and ineffective.
Unsatisfactory	There are fundamental weaknesses in the framework of governance, risk management and control such that it is inadequate and ineffective or is likely to fail.

Recommendations

Priority	Definition	Action Required
High	Significant weakness in governance, risk management and control that if unresolved exposes the organisation to an unacceptable level of residual risk.	Remedial action must be taken urgently and within an agreed timescale.
Medium	Weakness in governance, risk management and control that if unresolved exposes the organisation to a significant level of residual risk.	Remedial action should be taken at the earliest opportunity and within an agreed timescale.
Low	Scope for improvement in governance, risk management and control.	Remedial action should be prioritised and undertaken within an agreed timescale.