

Internal Audit Report

Pension Fund Investments

Final

Assignment Lead: Olu Abiwon, Auditor

Assignment Manager: Danny Simpson, Principal Auditor

Prepared for: East Sussex County Council

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Internal Audit Report – Pension Fund Investments

Report Distribution List

Draft Report

Susan Greenwood, Head of Pensions

Russell Wood, Head of Investment

Final Report

Susan Greenwood, Head of Pensions

Russell Wood, Head of Investment

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Ian Gutsell, Chief Finance Officer

Pension Committee Members

Pension Board Members

This audit report is written for the officers named in the distribution list. If you would like to share it with anyone else, please consult the Chief Internal Auditor.

Chief Internal Auditor: Russell Banks, ☎ 07824 362739, ✉ Russell.Banks@eastsussex.gov.uk

Audit Manager: Nigel Chilcott, ☎ 07557 541803, ✉ nigel.chilcott@eastsussex.gov.uk

Anti-Fraud Hotline: ☎ 01273 481995, ✉ fraudhotline@eastsussex.gov.uk

1. Introduction

- 1.1. The East Sussex Pension Fund (the Fund) is part of the national Local Government Pension Scheme and provides retirement benefits for employees of East Sussex County Council (ESCC), as well as employees from 149 other employers.
- 1.2. As the designated 'administering authority' under the LGPS Regulations, ESCC is legally responsible for managing and administering the Fund on behalf of all participating employers, members, and their dependents. While ESCC holds this responsibility, it has delegated the day-to-day management of the fund to the East Sussex Pension Committee. The Pension Board also assists in ensuring compliance with regulations.
- 1.3. Pension funds have long-term liabilities to pay pensioners so the Fund's investment strategy must find a delicate balance between necessary risk taking for growing the Fund with the secure, sound investment needed to pay benefits. The Council, via the East Sussex Pension Committee, is responsible for setting the Fund's overall investment strategy and reviewing investment performance to ensure the Fund meets its return targets.
- 1.4. Valued at £5.1bn as of 30 June 2025, the Fund's investment portfolio is diversified across asset classes, including equities, Government bonds, property, and infrastructure. The Fund delegates investment decisions (the actual buying and selling of assets) to external investment fund managers. These managers are held to specific performance targets and benchmarks.
- 1.5. This review is part of the agreed ESPF's 2025/26 Internal Audit Strategy for Pensions.
- 1.6. This report has been issued on an exception basis, whereby only weaknesses in the control environment have been highlighted in the detailed findings section of the report.

2. Scope

- 2.1. The purpose of the audit was to provide assurance that controls are in place to meet the following objectives:
 - The Fund's investments perform sufficiently well to meet the Fund's liabilities.
 - Investment returns are received in full and in a timely manner.
 - Accounting of the Pension Fund is accurate.

3. Audit Opinion

- 3.1 **Substantial assurance** is provided in respect of Pension Fund Investments 2025/26. This opinion means controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.

Appendix A provides a summary of the opinions and what they mean and sets out management responsibilities.

4. Basis of Opinion

- 4.1. We have provided Substantial Assurance over the controls operating within the area under review because:
- 4.2. Adequate processes are in place to safeguard the Fund's assets and prevent excessive risk taking. Funds are invested in only type of asset classes permitted and within the maximum investment limits set by the Pension Committee. Independent and external assurances are obtained that confirms that the Fund Managers appointed by the Council are complying with investment restrictions and that any investment errors or exceptions are identified and resolved.
- 4.3. The Fund's custodian, Northern Trust, ensures that all investment returns are received timeously and in full.
- 4.4. Regular reconciliations take place to provide assurance that transactions are accurately reflected in the general ledger and within a reasonable timeframe.
- 4.5. However, there are minor areas where controls could be strengthened further.
- 4.6. Investment in private credit assets is currently below the lower limit of the Pension Committee's tolerance level and is not in line with the target percentage as set out in the Investment Strategy. More of the Fund's asset could be invested into private credit assets to maintain a better diversified portfolio and avoid missing appropriate investment opportunities.
- 4.7. There is inconsistency with how performance benchmarks set by the Pension Committee are being used to assess the performance of fund managers outside of LGPS pooled arrangements, which may distort or misrepresent fund managers' performance. A formal management actions is not proposed on this issue on the basis that under government regulations, all LGPS pension funds must transfer their assets into pooled investment arrangements by 31 March 2026.

5. Action Summary

- 5.1. The table below summarises the actions that have been agreed together with the risk rating in the context of the area under review:

Risk	Definition	No	Ref
High	This is a major control weakness requiring attention.	0	
Medium	Existing procedures have a negative impact on internal control or the efficient use of resources.	0	
Low	This represents good practice; implementation is not fundamental to internal control.	1	1
Total number of agreed actions		1	

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- 5.2. Full details of the audit findings and agreed actions are contained in the detailed findings section below.
- 5.3. As part of our quarterly progress reports to Audit Committee we seek written confirmation from the service that all high priority actions due for implementation are complete. The progress of all (low, medium and high priority) agreed actions will be re-assessed by Internal Audit at the next audit review. Periodically we may also carry out random sample checks of all priority actions.

6. Acknowledgement

- 6.1. We should like to thank all staff that provided assistance during the course of the audit.

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Detailed Findings

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
1	<p>Asset Allocation</p> <p>To ensure diversification and manage concentration risk, the Pension Committee has set allocation targets for the Fund to invest across a range of asset classes. This approach helps to reduce the impact of underperformance in any single asset class and supports portfolio stability.</p> <p>If an asset allocation falls outside its tolerance range, rebalancing should occur. The Pension Committee's investment strategy is to invest around 5% of the Fund into private credit assets, with a tolerance range of 3% to 7% to allow for market volatility without triggering frequent and costly rebalancing transactions. However, only 0.5% of the Fund is currently invested in private credit assets. All other asset class allocations were found to be within the Committee's tolerance levels.</p>	Underweight allocation to any asset class may result in missed investment opportunities for enhanced returns and portfolio diversification benefits.	Low	<p>Private Credit has been identified by the Pension Committee as an area that the Fund needed to allocate commitments. The Committee wanted to do this through their existing Asset Pool rather than outside it, so the Fund worked with the ACCESS pool to create an investment option. In June 2025, the Fund committed 3% of its assets to private credit, but not the full amount because the Committee wanted to spread investments across different years for better diversification. It will take about three years for managers to fully invest this amount.</p> <p>Due to the "Fit for the Future" consultation and the need to move to a new Asset Pool, the Fund is now working with the new pool to commit the remaining 2%, which is expected to happen in June 2026.</p>
Responsible Officer:		Russell Wood, Head of Investment	Target Implementation Date:	June 2026

Appendix A

Audit Opinions and Definitions

Opinion	Definition
Substantial Assurance	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Reasonable Assurance	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Partial Assurance	There are weaknesses in the system of control and/or the level of non-compliance is such as to put the achievement of the system or service objectives at risk.
Minimal Assurance	Controls are generally weak or non-existent, leaving the system open to the risk of significant error or fraud. There is a high risk to the ability of the system/service to meet its objectives.

Management Responsibilities

The matters raised in this report are only those which came to our attention during our internal audit work and are not necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required.

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

This report, and our work, should not be taken as a substitute for management's responsibilities for the application of sound business practices. We emphasise that it is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal Audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.