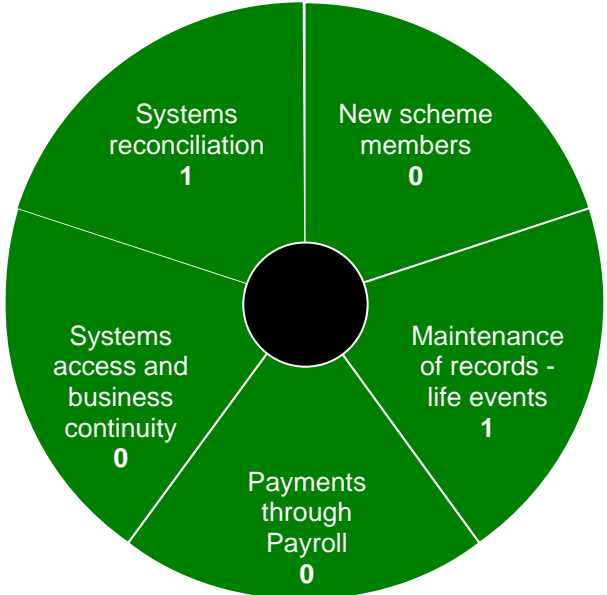


# Internal Audit Report 2011/12 – Pensions Service Administration (KFS11)

## 1. Executive Summary

|  |   |   |   |  |
|--|---|---|---|--|
| <p><b>Department:</b> Finance</p> <p><b>Audit Sponsor:</b> Peter Lewis, Interim Assistant Director - Financial Strategy</p> <p><b>Distribution List:</b> Peter Lewis, Interim Assistant Director Financial Strategy; Jody Evans, Pensions Services Manager; Daniel Chessell, Team Manager, Joel Ellner, Team Manager; Martin Quinn, Head of Investments; Pensions; Cllr Rodney Bass, Chairman of Essex Pension Fund Board; Louise Wishart, Audit Commission.</p> <p><b>Final report issued:</b> March 2012</p> <p><b>Date of last review:</b> February 2011</p>  | <p><b>Overall Opinion</b></p> <p><b>FULL ASSURANCE</b></p> <p><b>Direction of Travel</b></p> <p>Control environment has improved since our prior audit</p>  | <p><b>Number of Control Design Issues Identified</b></p> <p>0 Critical</p> <p>0 Major</p> <p>0 Moderate</p> <p>0 Best Practice</p>  | <p><b>Number of Control Operating in Practice Issues Identified</b></p> <p>0 Critical</p> <p>0 Major</p> <p>0 Moderate</p> <p>2 Best Practice</p> | <p><b>Number of Recommendations</b></p> <p>2 Made</p> <p>0 Rejected</p> <p>N/A Critical Rejected</p> <p>N/A Major Rejected</p> |
| <p><b>Scope of the Review and Limitations:</b></p>   | <p>This audit reviewed maintenance of pension member scheme records; payroll and lump sum payments; systems access; business continuity and system reconciliations. The Pension Fund banking arrangements and bank reconciliation were out of scope of this audit as they have been incorporated within the Pensions Investment audit (KFS10). Following recommendations made by Hymans Robertson and the subsequent action plan currently under consideration by the Essex Pension Fund Board, review of the Management Information has also been excluded from this review.</p> |   |   |  |
| <p><b>Critical and Major Findings and Recommendations</b></p> <p>There are no critical or major recommendations. The recommendations from the 2010/11 audit review have been implemented.</p> <p><b>ADDENDUM:</b></p> <p>It was advised by the Pensions Services Manager that following the introduction of e-payroll for schools and Essex Business Group in October / November 2011, Pensions Administration are not being notified of leavers, redundancies, death in service and retirements in a timely way to allow Pensions to communicate with members about their choices. This increases the risk that payments may be late, incurring interest payments (currently 1% above bank base rate) and key performance indicators not being met. The failure of ECC to meet its statutory requirements under the Local Government Pension Scheme regulations could result in fines from the Pension regulator.</p> <p>A temporary work around is currently in place to minimise the risks whilst a permanent solution is being sought through discussions with ECC Payroll staff. The issue has been added to the Corporate Risk Register.</p> |   | <p><b>Each risk area for this review is shown as a segment of the wheel. The key to the colours on the wheel is as follows:</b></p> <ul style="list-style-type: none"> <li>Critical priority Control Design or Control Operating in Practice issues identified</li> <li>Major priority Control Design or Control Operating in Practice issues identified</li> <li>Moderate priority Control Design or Control Operating in Practice issues identified</li> <li>No / Minor Control Design or Control Operating in Practice Issues identified</li> </ul>  |   |  |



|  |  |  |          |       |          |                         |       |              |
|--|--|--|----------|-------|----------|-------------------------|-------|--------------|
| <b>Auditors:</b> Sarah Collins and Craig Clawson   |  | <b>Issues raised and officers responsible for implementation:</b>  |          |       |          |                         |       |              |
| <b>Fieldwork Completed:</b> 23 February 2012       |  | Name   | Critical | Major | Moderate | Best Practice           | Total | Agreed       |
| <b>Draft Report Issued:</b> 28 February 2012       |  | Joel Ellner – Team Manager   | 0        | 0     | 0        | 1                       | 1     | 1            |
| <b>Management Comments Expected:</b> 20 March 2012 |  | Jody Evans – Pensions Services Manager   | 0        | 0     | 0        | 1                       | 1     | 1            |
| <b>Management Comments Received:</b> 5 March 2012  |  | <b>Releasing Internal Audit Reports:</b> All distributed draft and final reports remain the property of the respective Director and the Executive Director for Finance. Approval for distributing this report should be sought from the relevant Director. Care must be taken to protect the control issues identified in this report. |          |       |          |                         |       |              |
| <b>Final Report:</b> March 2012                    |  | <b>Risk Management:</b> The management of the following risks has been reviewed in this audit. Where appropriate, the Audit Sponsor is responsible for adding new risks identified to the relevant risk register.  |          |       |          |                         |       |              |
| Risk Ref   | Risk   |  |          |       |          | Risk Already Identified |       | Risk Managed |
| <b>Registered Risks Reviewed</b>                   |  |  |          |       |          |                         |       |              |
| PF0001   | <b>Systems access and business continuity:</b> Loss of connectivity causing an inability to deliver a service for Pensions administration and Pensioner payroll which may lead to claims being made against the Pension Fund and loss of reputation.   |  |          |       |          | Yes                     |       | ●            |
| PF0002   | <b>Systems reconciliation:</b> System errors will not be identified leading to errors or omissions in the transfer of data between the Axis modules.   |  |          |       |          | Yes                     |       | ●            |
| <b>Unregistered Risks Identified &amp; Audited</b> |  |  |          |       |          |                         |       |              |
| N/A  | <b>New scheme members:</b> New scheme members (including transfers in) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Pension Fund regulations. Supporting documentation for members is not retained resulting in failure to demonstrate members have met the requirements of the scheme.   |  |          |       |          | N/A                     |       | ●            |
| N/A  | <b>Maintenance of records - life events:</b> Scheme members’ records (including transfers out, retirement, death, deferred membership and changes to working hours, salary and contributions) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Pension Fund regulations and potential for incorrect pension calculations.   |  |          |       |          | N/A                     |       | ●            |
| N/A  | <b>Payments through Payroll:</b> New members to the payroll system are not authorised, processed and recorded completely and accurately and in accordance with scheme rules resulting in incorrect and/or illegitimate payments being made to pensioners or dependants and individuals who are no longer eligible. Notifications of deaths are not received and actioned promptly resulting in overpayments of pensions and the potential for fraudulent payments. The recovery of pension overpayments is not managed resulting in financial loss to the Pension Fund. Amendments to payroll data are not authorised, processed and recorded completely and accurately; and checked for accuracy resulting in over/underpayments. Management information and checks on the payroll process are inadequate resulting in errors and fraudulent payments going undetected. Lump sum payments are not authorised and processed correctly resulting in incorrect or potentially fraudulent payments. |  |          |       |          | N/A                     |       | ●            |
| N/A  | <b>Systems access and business continuity:</b> Access to AXIS and payroll systems and data is not controlled and restricted to relevant staff, leading to systems and data being amended and/or fraudulently manipulated by unauthorised people. Pension Fund data is not held securely resulting in loss or theft of data.  |  |          |       |          | N/A                     |       | ●            |
| N/A  | <b>Systems reconciliation:</b> Reconciliations between the Pension Fund payroll system and the general ledger are not performed regularly resulting in errors going undetected and inaccurate financial reporting. Reconciliations of payroll, payment file and BACS are not carried out resulting in erroneous and/or fraudulent payments being made. Returned monies are not properly recorded, managed and reconciled resulting in failure to account for such monies and detect any errors.  |  |          |       |          | N/A                     |       | ●            |
| N/A  | <b>Management information:</b> Following the results of the Hymans Robertson review in November 2010 and the recommendations presented to the Pensions Board in June 2011 an action plan is currently been drawn up to address the identified recommendations. This action plan is to be presented to the Pensions Board early next year and as a result no testing will be completed in this area at this time.   |  |          |       |          | N/A                     |       | N/A          |

## 2. Basis of our opinion and assurance statement

| Risk rating  | Assessment rationale   |
|--|--|
| <br>Critical      | <p>Major financial loss – Large increase on project budget/cost: (Greater of <b>£1.0M</b> of the total Budget or more than <b>15 to 30%</b> of the departmental budget). Statutory intervention triggered. Impacts the whole Council. Cessation of core activities. Strategies not consistent with government's agenda, trends show service is degraded.</p> <p>Failure of major projects – elected Members &amp; Corporate Leadership Team are required to intervene. Intense political and media scrutiny i.e. front-page headlines, TV. Possible criminal, or high profile, civil action against the Council, Members or officers.</p> <p>Life threatening or multiple serious injuries or prolonged work place stress. Severe impact on morale &amp; service performance. Mass strike actions etc.</p> |
| <br>Major         | <p>High financial loss – Significant increase on project budget/cost: (Greater of <b>£0.5M</b> of the total Budget or more than <b>6 to 15%</b> of the departmental budget). Service budgets exceeded. Significant disruption of core activities. Key targets missed, some services compromised. Management action required to overcome medium term difficulties.</p> <p>Scrutiny required by external agencies, Audit Commission etc. Unfavourable external media coverage. Noticeable impact on public opinion.</p> <p>Serious injuries or stressful experience requiring medical treatment, many work days lost. Major impact on morale &amp; performance of more than 100 staff.</p>   |
| <br>Moderate      | <p>Medium financial loss – Small increase on project budget/cost: (Greater of <b>£0.3M</b> of the total Budget or more than <b>3 to 6%</b> of the departmental budget). Handled within the team. Significant short-term disruption of non-core activities. Standing Orders occasionally not complied with, or services do not fully meet needs. Service action will be required.</p> <p>Scrutiny required by internal committees or Internal Audit to prevent escalation. Probable limited unfavourable media coverage.</p> <p>Injuries or stress level requiring some medical treatment, potentially some work days lost. Some impact on morale &amp; performance of up to 100 staff.</p>   |
| <br>Best Practice | <p>Minimal financial loss – Minimal effect on project budget/cost: (&lt; <b>3%</b> Negligible effect on total Budget or &lt;<b>1%</b> of departmental budget)</p> <p>Minor errors in systems/operations or processes requiring action or minor delay without impact on overall schedule. Handled within normal day to day routines.</p> <p>Internal review, unlikely to have impact on the corporate image.</p> <p>Minor injuries or stress with no work days lost or minimal medical treatment. No impact on staff morale.</p>  |
| Level of assurance   | Description  |
| Full   | <b>Full assurance</b> – there is a sound system of internal control designed to achieve the objectives of the system/process and manage the risks to achieving those objectives. Recommendations will normally only be Advice and Best Practice.   |
| Substantial  | <b>Substantial assurance</b> – whilst there is basically a sound system of control, there are some areas of weakness, which may put the system/process objectives at risk. There are Moderate recommendations indicating weaknesses but these do not undermine the system's overall integrity. Any Critical recommendation will prevent this assessment, and any Major recommendations relating to part of the system would need to be mitigated by significant strengths elsewhere.   |
| Limited  | <b>Limited assurance</b> – there are significant weaknesses in key areas in the systems of control, which put the system/process objectives at risk. There are Major recommendations or a number of moderate recommendations indicating significant failings. Any Critical recommendations relating to part of the system would need to be mitigated by significant strengths elsewhere.   |
| No   | <b>No assurance</b> – internal controls are generally weak leaving the system / process open to significant error or abuse. There are Critical recommendations indicating major failings.  |

**Auditors' Responsibilities** 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. We shall endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, Internal Audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected. Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist, unless we are requested to carry out a special investigation for such activities in a particular area.

### 3. Advice and Best Practice

|   | Matters Arising  | Potential Risk Implications   | Recommendations   | Priority                      | Management Responses and Agreed Actions   |
|---|--|---|---|-------------------------------|---|
| Operating Effectiveness – Procedure Notes and Process Mapping |  |   |   |                               |   |
| 1.  | It was identified during audit testing that there is no evidence of formal review of the procedure notes and process maps during 2011/12.  | <b>Governance</b><br>Failure to formally review procedures at least annually may lead to inconsistencies in practice which may result in key tasks not being correctly completed. Out of date; or inaccurate process maps may result in staff following incorrect or cumbersome processes which may result in inefficiencies in completing tasks. | It is recommended that all procedure notes and process maps relating to the Pensions Administration are formally reviewed (at least annually) to ensure compliance with any changes either in legislation or process. Evidence of the date of review should be noted on the procedure notes and process maps.   | ●<br>Advice and Best Practice | <b>Agreed:</b> Yes.<br><br><b>Action to be taken:</b><br>A spreadsheet will be created to record all procedures and process maps with annual review dates by 31 May 2012.<br><br>All procedures and processes will be reviewed annually and this will be recorded in the spreadsheet week beginning 1 June 2012.<br><br><b>Additional Resources Required for Implementation:</b> No.<br><br><b>Responsible Officer:</b> Joel Ellner - Team Manager and Helen Pennock Administration Assistant Officer.<br><br><b>Target Date:</b> 31 May 2012.    |
| Operating Effectiveness - Payroll Calculation report          |  |   |   |                               |   |
| 2.  | Following discussions with the Assistant Team Manager Pensioner Payroll (ATM) it was established that one of the monthly reports produced is the "Payroll Calculation Report"; this report details all payments to be made to Pensioners in the month of less than £5 or more than £1,500. The report has approximately 50 lines per page and is usually 60+ pages long, each line on the report is currently manually checked to ensure the payment is correct, this is a very time consuming activity and has not resulted in any errors being found in the last financial year.<br>The ATM queried the appropriateness of | <b>Governance</b><br>Unnecessary processes may cause a drain on resources which may result in inefficiencies in processing tasks in a timely and organised manner.  | It is recommended, that consideration is given to retaining the 100% check for payments less than £5 and more than £1,500, (though this upper limit could be increased to bring it more in line with the average level of payments), and supplementing this with scenario testing.<br>All payment scenarios would need to be identified; an example of each scenario should be calculated manually with the sample being rotated periodically. The results of each of the scenario calculations | ●<br>Advice and Best Practice | <b>Agreed:</b> Yes.<br><br><b>Action to be taken:</b><br>We will maintain the current parameters of £5 lower limit and £1,500 upper limit. The whole report has to be produced as part of the payroll processing, however we will not check every entry on the report. Instead we will then check any errors i.e. negative elements and zero net payments, but will operate scenario testing for the warnings. We will take an example of each scenario, rotating the sample to different members each month and check the details, recording the |

|  | Matters Arising   | Potential Risk Implications | Recommendations  | Priority | Management Responses and Agreed Actions   |
|--|---|-----------------------------|--|----------|---|
|  | <p>the limit with the Auditor with the possibility of increasing the amount from £1,500 to £2,500 which would result in a smaller report and therefore reduce the amount of time spent manually checking the report. Further discussions established that the purpose of the manual calculation checks is to ensure that the Payroll system is correctly calculating pension payments and to check the validity of any high pension payments. Scenario testing was discussed as an alternative to the current checking process. From review of the report it would appear that there would be approximately seven different scenarios required for testing each month, which would significantly reduce the length of time it would take to check the payments.</p> |                             | <p>should be recorded and signed off each month. Should any discrepancies be identified then the scenario testing would need to be extended and more detailed checking would be required to establish why the errors had occurred and any issues resolved as a matter of priority.</p> |          | <p>outcome. Should any discrepancies be identified we will then extend the scenario testing to a wider sample.</p> <p>We propose that we complete the current financial year with the process that we currently have in place and commence this new procedure from 1 April 2012 (period 1).</p> <p><b>Additional Resources Required for Implementation:</b> No.</p> <p><b>Responsible Officer:</b> Jody Evans – Pensions Services Manager and Holly Aldham - Assistant Team Manager - Pensioner Payroll</p> <p><b>Target Date:</b> 30 April 2012.</p> |

## 5. Controls Assessment Schedule

### New Scheme Members Risks:

New scheme members (including transfers in) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Pension Fund regulations. Supporting documentation for members is not retained resulting in failure to demonstrate members have met the requirements of the scheme.

| Control   | Control In Place? | Action Plan Ref. |
|---|-------------------|------------------|
| Genus forms have been entered accurately. PN10 have been received and agreed as accurate. Notification letters sent to member.  | Yes               |                  |
| All documentation relating to manually added scheme members is recorded and notifications sent to scheme members in a timely manner.  | Yes               |                  |
| Defined process is in place to authorise and admit new starters and these are complied with. New scheme members are entered onto AXIS accurately and receive a notification of membership in a timely manner.                     | Yes               |                  |
| Documentation received and completed for individuals transferring in is recorded on the system and retained. All quotations, calculations, notifications to scheme members and payments are checked by management before payment. | Yes               |                  |

### Maintenance of Records - life events Risks:

Scheme members' records (including transfers out, retirement, death, deferred membership and changes to working hours, salary and contributions) are not authorised, processed and recorded completely and accurately; and in accordance with scheme rules resulting in failure to comply with the Pension Fund regulations and potential for incorrect pension calculations.

| Control   | Control In Place? | Action Plan Ref. |
|---|-------------------|------------------|
| Documentation is received and retained on notification of death in accordance with regulations and all related documentation is retained.   | Yes               |                  |
| Deferred pensions are independently checked and authorised before they are brought into payment. Documentation is retained.   | Yes               |                  |
| All records are supported by appropriate documentation. Input and output checks are undertaken and review of records is completed by a manager. Documents are retained in accordance with agreed policy.                  | Yes               |                  |
| Procedure notes describing all key processes are followed by staff.   | Yes, partially    | 1                |
| Overpayments identified are recovered in accordance with set policy.  | Yes               |                  |
| Defined process for including members (retirees) to the payroll system is in place to ensure they are appropriately authorised, processed and recorded completely and accurately and in accordance with the scheme rules. | Yes               |                  |
| Transfers out have been calculated in accordance with scheme rules, approved by a manager and all documentation retained.   | Yes               |                  |

## Payments through Payroll Risks:

New members to the payroll system are not authorised, processed and recorded completely and accurately and in accordance with scheme rules resulting in incorrect and/or illegitimate payments being made to pensioners or dependants and individuals who are no longer eligible.

Notifications of deaths are not received and actioned promptly resulting in overpayments of pensions and the potential for fraudulent payments.

The recovery of pension overpayments is not managed resulting in financial loss to the Pension Fund.

Amendments to payroll data are not authorised, processed and recorded completely and accurately; and checked for accuracy resulting in over/underpayments.

Management information and checks on the payroll process are inadequate resulting in errors and fraudulent payments going undetected.

Lump sum payments are not authorised and processed correctly resulting in incorrect or potentially fraudulent payments.

| Control   | Control In Place? | Action Plan Ref. |
|---|-------------------|------------------|
| Amendment reports are produced and checked before the BACS file is sent for payment.  | Yes               |                  |
| Amendments to payroll data are in writing and promptly recorded and authorised by management.   | Yes               |                  |
| BACS file reports are reconciled with movements' summary and the report is checked for errors.  | Yes               |                  |
| All new members to the payroll system are authorised by management.   | Yes               |                  |
| Payments are independently checked, properly authorised, supported by appropriate documentation and calculations are correctly applied. | Yes               |                  |
| Basic checks are performed on dates, control totals, new payees and deletions before payroll is authorised.                             | Yes               |                  |
| Procedure notes and guidelines around payroll processes are in place and readily available to staff.                                    | Yes               |                  |

## Systems Access and Business Continuity Risks:

Loss of connectivity causing an inability to deliver a service for Pensions administration and Pensioner payroll which may lead to claims being made against the Pension Fund and loss of reputation.

Access to AXIS and payroll systems and data is not controlled and restricted to relevant staff, leading to systems and data being amended and/or fraudulently manipulated by unauthorised people.

Pension Fund data is not held securely resulting in loss or theft of data.

| Control   | Control In Place? | Action Plan Ref. |
|---|-------------------|------------------|
| Access rights and restrictions are in line with business need and ensure segregation of duties. Controls over passwords, regular password changes, account lockout after failed attempts are in place and administered. | Yes               |                  |
| Regular backup of core data is taken and tests are done of recovery.  | Yes               |                  |
| Regularly tested business continuity / disaster recovery plans are in place if critical systems are unavailable and tested regularly.   | Yes               |                  |

## Systems Reconciliation Risks:

System errors will not be identified leading to errors or omissions in the transfer of data between the Axis modules.  
Reconciliations between the Pension Fund payroll system and the general ledger are not performed regularly resulting in errors going undetected and inaccurate financial reporting.  
Reconciliations of payroll, payment file and BACS are not carried out resulting in erroneous and/or fraudulent payments being made.  
Returned monies are not properly recorded, managed and reconciled resulting in failure to account for such monies and detect any errors.

| Control  | Control In Place? | Action Plan Ref. |
|--|-------------------|------------------|
| Reconciliations between the Pension Fund payroll system and the General Ledger are performed monthly and signed off by management.                     | Yes               |                  |
| Reconciliation between the AXIS modules is carried out to ensure that all data transferred between modules is complete and there are no system errors. | Yes               |                  |
| Pension control account are reconciled monthly and evidenced as reviewed by a senior official.   | Yes               |                  |
| Procedure notes describing key processes are followed by staff in performing reconciliation.   | Yes, partially    | 2                |