



















Final Internal Audit Report 2009/10 – Pensions Investments (KFS9)



1. Executive Summary

<p>Department: Finance</p> <p>Audit Sponsor: Martin Quinn, Head of Investments.</p> <p>Distribution List: Martin Quinn, Head of Investments; Kevin McDonald, Group Manager Investments; Margaret Lee, Chief Financial Officer; Councillor Rodney Bass, Chair of Pensions Board; Louise Wishart, Audit Commission.</p> <p>Date of last review: 2008/09</p>	<p>Overall Opinion</p> <p>SUBSTANTIAL ASSURANCE </p> <p>Direction of Travel</p> <p>The control environment has improved since the previous audit. </p>	<p>Number of Control Design issues identified</p> <p>0 Critical</p> <p>0 Major</p> <p>0 Moderate</p> <p>0 Best Practice</p>	<p>Number of Control Operating in Practice issues identified</p> <p>0 Critical</p> <p>0 Major</p> <p>2 Moderate</p> <p>0 Best Practice</p>	<p>Number of Recommendations</p> <p>2 Made</p> <p>0 Rejected</p> <p>n/a Critical Rejected</p> <p>n/a Major Rejected</p>
<p>Scope of the Review:</p> <p>Limitations:</p>	<p>The review focussed on the investments made by the fund in relation to compliance with best practice, management of investments, monitoring of performance, transitions and employer contributions.</p>			
<p>Critical and Major Findings and Recommendations:</p> <p>There were no new major or critical findings within this review.</p> <p>This review has not identified any new control issues. The two moderate recommendations made relate to the two issues which were identified in 2008/9 which are still outstanding. All other recommendations made in the 2008/9 Internal Audit report have now been addressed.</p>	<p>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:</p>  <ul style="list-style-type: none">  Critical priority Control Design or Control Operating in Practice issues identified  Major priority Control Design or Control Operating in Practice issues identified  Moderate priority Control Design or Control Operating in Practice issues identified  No / Minor Control Design or Control Operating in Practice Issues identified 			



Auditor: Matt Pinnock		Issues raised and officers responsible for implementation:						
Fieldwork Completed: 17th February 2010 Draft Report Issued: 1 March 2010 Management Comments Expected: 22 March 2010 Management Comments Received: 30 March 2010 Final Report: 8 April 2010		Name	Critical	Major	Moderate	Best Practice	Total	Agreed
		Samantha Andrews	0	0	1	0	1	1
		Judith Dignum	0	0	1	0	1	1
		Risk Register Updates: The Audit Sponsor is responsible for updating all findings relating to registered risks and for ensuring that unregistered risks have been incorporated within the Council's risk register. There are no new risks needing to be added to the Council's risk register.						
Registered Risks Reviewed								
Risk Ref	Risk					Risk already identified	Risk managed	
CRG0001/CRG0004/ CRG0006	Governance Arrangements and Best Practice <ul style="list-style-type: none">Lack of knowledge of and failure to apply pension regulations and best practice leading to ultra vires acts and a failure to comply with preparation and publishing of accounts, reports, strategies, statements and actuarial valuations resulting in potential loss of reputation, employer/employee confidence, qualification of accounts and legal reprimand.					Yes		
CRG0005	Investment Management <ul style="list-style-type: none">Poor strategic planning and response to changes leading to failure of the funding strategy resulting in a forecasted inability to pay benefits and a consequent need to raise employer contributions.Poor security of data leading to potential loss of records resulting in non compliance with regulations and additional staff costs to correct.Lack of reconciliations between Council records and fund manager records allowing discrepancies between the two remaining undetected and potential errors in the accounts resulting in qualification of accounts, misrepresentation of fund values and loss of reputation.Fund assets not accurately accounted for resulting in potential errors in the accounts and fund valuation leading to inaccurate actuarial conclusions and potential funding shortfall causing increased employer contributions from Council Tax.Lack of restrictions/guidelines on investments allowing fund managers to make imprudent investments resulting in potential loss of income and capital and providing poor value for money for the Pension Fund and Council tax payer.					Yes		
CRG0008						Yes		
CRG0004						Yes		
CRG0007						Yes		
CRG0003/CRG0007	Monitoring of Performance <ul style="list-style-type: none">Poor contract drafting and/or management allowing poor performance in the supply of services to the pension fund to occur without redress resulting in loss of reputation, reduced investment income, potential legal proceedings and increased employer contributions and funding from Council Tax.Poor management of administration costs resulting in poor value for money and reduced value of the pension fund potentially resulting in increased employer contributions to ensure the fund is forecasted to meet future commitments.					Yes		
CRG0002						Yes		
CRG0003	Transitions between Investment Managers <ul style="list-style-type: none">Lack of authorisation procedures resulting in transitions being made without authorisation/ resulting in potential fraudulent or erroneous transfers remaining undetected.Transitions are not accurately recorded allowing erroneous entries to appear in the accounts resulting in misrepresentation of the fund value, potential qualification of accounts and loss of reputation.					Yes		
CRG0003						Yes		
CRG0007	Contributions <ul style="list-style-type: none">Employer contributions not amended in line with actuarial recommendations resulting in potential shortfall in the fund leading to damage to reputation.Employer contributions not accurately accounted for allowing erroneous misrepresentation of the fund value, qualification of accounts and loss of reputation.					Yes		
CRG0004						Yes		
Unregistered Risks Identified & Audited – none.								


2. Basis of our opinion and assurance statement

Risk rating	Assessment rationale
 Critical	<p>Major financial loss – Large increase on project budget/cost: (Greater of £1.0M of the total Budget or more than 15 to 30% 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 & 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 & service performance. Mass strike actions etc.</p>
 Major	<p>High financial loss – Significant increase on project budget/cost: (Greater of £0.5M of the total Budget or more than 6 to 15% 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 workdays lost. Major impact on morale & performance of more than 100 staff.</p>
 Moderate	<p>Medium financial loss – Small increase on project budget/cost: (Greater of £0.3M of the total Budget or more than 3 to 6% 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 workdays lost. Some impact on morale & performance of up to 100 staff.</p>
 Best Practice	<p>Minimal financial loss – Minimal effect on project budget/cost: (< 3% Negligible effect on total Budget or <1% 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 workdays lost or minimal medical treatment. No impact on staff morale.</p>
Level of assurance	Description
Full	Full assurance – 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	Substantial assurance – 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	Limited assurance – 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	No assurance – 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. Recommendations and Action Plan

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Response and Agreed Actions
Operating effectiveness - Timeliness of Reconciliations					
1.	<p>Inspection of the reconciliations determined they were not being completed in a timely manner. For example, the reconciliation for April 2009 for Legal and General was not completed until December 2009. Factors contributing to the delay were the workload around closure of the 2008/09 accounts and delays in receiving the required paperwork from the fund managers and custodian. It is imperative that reconciliations are carried out as soon as possible.</p>	<p>Governance and Financial</p> <p>Delays in performing reconciliations may allow discrepancies to remain undetected and may hamper subsequent investigation.</p>	<p>Reconciliations should be conducted in a timely manner to allow any issues to be raised as soon as possible.</p>	<p>● Moderate</p>	<p>Agreed: yes. Please note that there were particular issues around the specific example quoted where, following earlier reconciliations in line with the timetabled programme, the manager concerned was required to issue and then reissue reports which then needed further reconciliation.</p> <p>Action to be taken: None other than to continue with current practice to ensure timely reconciliation.</p> <p>Additional Resources Required for implementation: no.</p> <p>Responsible Officer: Samantha Andrews.</p> <p>Target Date: Ongoing.</p>

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Response and Agreed Actions
Operating effectiveness - Representatives of Police and Fire Authorities within the Pension Fund Board					
2.	<p>The previous audit identified issues surrounding the membership of the Pension Board; this issue remains outstanding since a review of the membership will not take place until 2011.</p> <p>The findings from the report in 2008/9 are set out below :</p> <p>'Not all key stakeholders are represented within the main or secondary pension fund committee structure.</p> <p>Recent DCLG guidance stated that all key stakeholders of local government pension funds should be afforded the opportunity to be represented within the main or secondary Pension fund committee structure. This includes scheduled and admitted bodies to the scheme, scheme members and expert advisors.</p> <p>Our review of the membership of the new Pension Fund Board identified that representation has only been accorded to certain scheduled bodies and to scheme members. Although it is recognised that the scheduled bodies represented are key stakeholders, town & parish councils, admitted bodies (transferee and community of interest) and a number of scheduled bodies, including the education sector, have not been accorded any representation. The membership also excludes any expert advisors</p>	<p>Governance</p> <p>Failure to adhere to recommended best practice may lead to loss of reputation and employer confidence.</p>	<p>When the membership of the Pension Fund Board is reviewed in 2011 all key stakeholders should be afforded the opportunity to be represented in line with principles set out in the CLG guidance.</p>	<p> Moderate</p>	<p>Agreed: Yes</p> <p>Comment:The Guidance issued in regard to Committee Membership and Representation is not that the Board should have representatives from all the main categories of employing bodies but that all key stakeholders should be afforded the opportunity to be represented. In fact the guidance recognises that the number of stakeholders affected by the local management of the pension scheme and governance of pension funds is vast and that it would be impractical to expect individual committee structures to encompass every group or sector that has an interest in the decisions that fall to be made under the scheme's regulations. The Council considered all stakeholders in deciding upon the number of Board members and the bodies asked to nominate representatives in order to ensure that all key stakeholders were represented. The representation is to be reviewed in 2011 after a suitable period of operation of the new governance arrangements.</p> <p>Action to be taken: None other than the planned review in 2011.</p> <p>Additional Resources Required for implementation: no</p> <p>Responsible Officer: Judith Dignum (Governance Officer).</p> <p>Target Date: 31 March 2011.</p>

4. Controls Assessment Schedule

Governance Arrangements Risks:

- Lack of knowledge of and failure to apply pension regulations and best practice leading to ultra vires acts and a failure to comply with preparation and publishing of accounts, reports, strategies, statements and actuarial valuations resulting in potential loss of reputation, employer/employee confidence, qualification of accounts and legal reprimand.

Control	Control in Place?	Action Plan Ref.
Investment staff are trained and have access to latest guidance, statements of recommended practice and legislation.	Yes	
Pension Board and Investment Steering Committee have appropriate and sufficient membership to facilitate proper governance of the fund.	Partially	2

Investment Management Risks:

- Poor strategic planning and response to changes leading to failure of the funding strategy resulting in a forecasted inability to pay benefits and a consequent need to raise employer contributions.
- Poor security of data leading to potential loss of records resulting in non compliance with regulations and additional staff costs to correct.
- Lack of reconciliations between Council records and fund manager records allowing discrepancies between the two remaining undetected and potential errors in the accounts resulting in qualification of accounts, misrepresentation of fund values and loss of reputation.
- Fund assets not accurately accounted for resulting in potential errors in the accounts and fund valuation leading to inaccurate actuarial conclusions and potential funding shortfall causing increased employer contributions from Council Tax.
- Lack of restrictions/guidelines on investments allowing fund managers to make imprudent investments resulting in potential loss of income and capital and providing poor value for money for the Pension Fund and Council tax payer.

Control	Control in Place?	Action Plan Ref.
Well defined and agreed strategy in place and available to all staff and stakeholders.	Yes	
Data held securely within office and electronically.	Yes	
Monthly reconciliations of fund managers' portfolios and Council records completed in a timely manner and checked by another member of staff.	Partially	1
Council records updated based on verified data and checked by another member of staff.	Yes	
Contracts between Council and fund managers providing parameters for investment.	Yes	

Performance Management Risks:

- Poor contract drafting and/or management allowing poor performance in the supply of services to the pension fund to occur without redress resulting in loss of reputation, reduced investment income,

potential legal proceedings and increased employer contributions and funding from Council Tax.

- Poor management of administration costs resulting in poor value for money and reduced value of the pension fund potentially resulting in increased employer contributions to ensure the fund is forecasted to meet future commitments.

Control	Control in Place?	Action Plan Ref.
Well drafted contracts in place defining performance targets, administration costs and penalties/methods of redress.	Yes	

Transition Risks:

- Lack of authorisation procedures resulting in transitions being made without authorisation/ resulting in potential fraudulent or erroneous transfers remaining undetected.
- Transitions are not accurately recorded allowing erroneous entries to appear in the accounts resulting in misrepresentation of the fund value, potential qualification of accounts and loss of reputation.

Control	Control in Place?	Action Plan Ref.
Authorisation process in place to prevent unauthorised transitions.	Yes	
Reconciliation of transitioned accounts before, during and after to ensure completeness.	Yes	

Contributions Risks:

- Employer contributions not amended in line with actuarial recommendations resulting in potential shortfall in the fund leading to damage to reputation.
- Employer contributions not accurately accounted for allowing erroneous misrepresentation of the fund value, qualification of accounts and loss of reputation.

Control	Control in Place?	Action Plan Ref.
Employers informed of actuarial recommendations and changes and verification of contributions received.	Yes	
Reconciliation of contributions to ensure accurately accounted for and received.	Yes	