

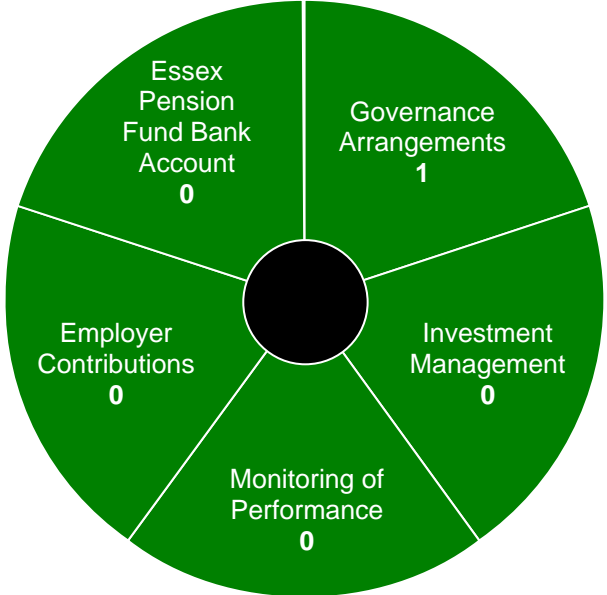











Final Internal Audit Report 2011/12 – Pension Investment (KFS10)

1. Executive Summary

<p>Department: Finance</p> <p>Audit Sponsor: Martin Quinn, Head of Investments</p> <p>Distribution List: Peter Lewis, Interim Assistant Director Financial Strategy; Martin Quinn, Head of Investments; Kevin McDonald, Group Manager Investments; Margaret Lee, Director for Finance; Councillor Rodney Bass, Chair of Pensions Board; Louise Wishart, Audit Commission.</p> <p>Date of last review: January 2011</p> <p>Date Issued: January 2012</p>	<p>Overall Opinion</p> <p>FULL ASSURANCE </p> <p>Direction of Travel</p> <p>Control environment has not changed since our prior 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>0 Moderate</p> <p>1 Best Practice</p>	<p>Number of Recommendations</p> <p>1 Made</p> <p>0 Rejected</p> <p>N/A Critical Rejected</p> <p>N/A Major Rejected</p>
<p>Scope of the Review and Limitations:</p>	<p>The review focussed on the control framework in relation to employer contributions, compliance with best practice, management of investments and performance monitoring. There has been no formal transfer of funds between fund managers in the financial year 2011/12 and were not reviewed as part of this audit.</p>			
<p>Critical and Major Findings and Recommendations</p> <p>No issues were raised on completion of this review.</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: Lauren Whitehart		Issues raised and officers responsible for implementation:						
Fieldwork Completed: 3 January 2012		Name	Critical	Major	Moderate	Best Practice	Total	Agreed
Draft Report Issued: 12 January 2012		Kevin McDonald – Group Manager Investments	0	0	0	1	1	1
Management Comments Expected: 26 January 2012								
Management Comments Received: 17 January 2012		Releasing Internal Audit Reports: 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.						
Final Report: 26 January 2012		Risk Management: 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	
Registered Risks Reviewed								
PF0007 PF0010 PF0012	Governance Arrangements: Lack of knowledge of and failure to apply pension regulations leading to ultra vires acts and a failure to comply with regard to: <ul style="list-style-type: none">preparing, publishing and maintaining the Statement of Investment Principles, Statement of Compliance, Funding Strategy and Annual Report;obtaining actuarial valuations and certificates; andproviding copies of these documents to stakeholders resulting in potential loss of reputation, qualification of accounts and legal reprimand. Lack of knowledge of and a failure to operate best practice resulting in governance arrangements not matching up to recommended best practice leading to loss of reputation and employer and employee confidence.					Yes		
PF0011 PF0014 PF0010 PF0013	Investment Management: Poor strategic planning and response to incidents, changes in markets, rules and regulations leading to failure of the funding strategy resulting in a forecasted inability to pay benefits and a consequent need to raise employer contributions and thus contributions from Council Tax. 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 value and loss of reputation. Fund assets are 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 resulting in potential loss of income and capital and providing poor value of money for the Pension Fund and Council Tax payer.					Yes		
PF0009 PF0008	Monitoring of Performance: 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		

PF0009	Employer Contributions: Employer contributions not amended in line with actuarial recommendations resulting in potential forecasted shortfall in the Pension Fund leading to increased reliance on Council Tax and damage to reputation.	Yes	
PF0010	Employer contributions not accurately accounted for allowing erroneous entries to appear in the accounts resulting in misrepresentation of the fund value, potential qualification of accounts and loss of reputation.		
PF0010	Essex Pension Fund Bank Account: Lack of reconciliation of the Essex Pension Fund bank account resulting in erroneous entries remaining undetected (e.g. pension income/expenditure posted to ECC, incorrect amounts posted). Failure to subsequently correct miscoded transactions may result in loss for the Pension Fund and / or Essex County Council.	Yes	

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 work days 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 work days 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 work days 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. Advice and Best Practice

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Responses and Agreed Actions
Operating Effectiveness - ISC Declarations of Interest					
1.	<p>The mechanism used by the Investment Steering Committee to declare interests changed from April 2011, with this no longer being minuted as an agenda item.</p> <p>It was confirmed by enquiry with the Group Manager, Investments that Members are required to declare interests as and when they arise, alongside the annual completion of a related party disclosure.</p>	<p>Governance Arrangements</p> <p>Failure to ensure references to declarations of interest are documented may result in potential legal challenge and financial loss to ECC.</p>	<p>In order to maintain transparency, references made by the Chairman of the Investment Steering Committee of the need to declare interests within Investment activities should be formally minuted.</p>	<p>●</p> <p>Advice and Best Practice</p>	<p>Agreed: Yes</p> <p>Action to be taken: Declaration of Interest item to be reinstated in agenda and minutes of future ISC meetings.</p> <p>Additional Resources Required for Implementation: No</p> <p>Responsible Officer: Kevin McDonald (Group Manager Investments)</p> <p>Target Date: 29 February 2012</p>

4. Controls Assessment Schedule

Governance Arrangements Risks:

Lack of knowledge of and failure to apply pension regulations leading to ultra vires acts and a failure to comply with regard to:

- preparing, publishing and maintaining the Statement of Investment Principles, Statement of Compliance, Funding strategy and Annual Report;
- obtaining actuarial valuations and certificates; and
- providing copies of these documents to stakeholders

resulting in potential loss of reputation, qualification of accounts and legal reprimand.

Lack of knowledge of and a failure to operate best practice resulting in governance arrangements not matching up to recommended best practice leading to loss of reputation and employer and employee confidence.

Control	Control In Place?	Action Plan Ref.
As per the Local Government Pension Scheme Regulations 2008 each Administering authority must obtain an actuarial valuation of the assets and liabilities of each of its pension funds as at 31 st March 2010 and in every third year afterwards.	Yes	
Best practice guidance has been considered and where ever possible adhered to	Yes	
Mechanisms are in place to allow Admitted Bodies to the scheme to contribute to decisions without being excessively influenced by the Administering Authority.	Yes	
Key Staff members within the Pensions Investment team are aware of the best practice guidance and its location.	Yes	
The relationship between the Fund, the Administering Authority and other employers in the scheme is established and communicated.	Yes	
Any formal reports / documentation are made available to all key stakeholders of the pension funds	Yes	
Those charged with the governance of the Fund and the Scheme are able to fulfil their responsibilities effectively.	Yes	
The preparation and issuance of key documentation as per the Local Government Pension Scheme (Administration) Regulations 2008 has been adhered to.	Yes	

Investment Management Risks:

Poor strategic planning and response to incidents, changes in markets, rules and regulations leading to failure of the funding strategy resulting in a forecasted inability to pay benefits and a consequent need to raise employer contributions and thus contributions from Council Tax.

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 value and loss of reputation.

Fund assets are 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 resulting in potential loss of income and capital and providing poor value of money for the Pension Fund and Council Tax payer.

Control	Control In Place?	Action Plan Ref.
Fund assets are subject to regular assessment through actuarial valuation.	Yes	
Complete and authorised contract agreements with fund managers are operative prior to initiating investment activity. Checks are completed to ensure Fund Managers adhere to contractual agreements, ethical standards, best practice and statutory regulations.	Yes	
Pension Obligations are calculated, reviewed and reported on a periodic basis.	Yes	
Calculations of timing differences between custodian and fund manager are undertaken	Yes	
A documented investment / funding strategy is in place and is reviewed on a periodic basis	Yes	
Investment guidelines and restrictions are established to regulate how funds may be invested	Yes	
Appropriate external advisors are engaged to ensure management investment decisions optimise the value of the fund.	Yes	
Reconciliations are undertaken regularly and independently checked by another member of staff.	Yes	
The journal updating IFS has supporting evidence, is accurate and is fully authorised.	Yes	
The strategy has considered the pension funds own liabilities and risk profile in determining issues such as asset mix. An effective communication framework is in place ensuring that any significant changes in the market or statutory regulations is identified and reported promptly to ensure appropriate responsive action is taken.	Yes	
Records retained by the Council, Custodians and Fund Managers are reconciled on a periodic basis	Yes	
A reconciliation between book cost and cash is undertaken with supporting information	Yes	
SAS70 / AAF 01/60 forms are obtained from fund managers and examined on annual basis.	Yes	
Transaction errors are rectified promptly.	Yes	

Monitoring of Performance 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.
Any breach of investment guidelines or contract is identified and action is taken to address the breach.	Yes	
Checks are completed to confirm the completeness and accuracy of Fund Manager fees.	Yes	
An effective performance framework is in place with monitoring against benchmarks taking place.	Yes	
Administration / Fund manager costs are reviewed on a periodic basis to ensure value for money is achieved.	Yes	
Contracts are regularly reviewed in light of changing market conditions and actual performance	Yes	

Employer Contributions Risks:

Employer contributions not amended in line with actuarial recommendations resulting in potential forecasted shortfall in the Pension Fund leading to increased reliance on Council Tax and damage to reputation.

Employer contributions not accurately accounted for 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.
Checks are completed to ensure all employer contributions are received, complete, accurate and accounted for correctly.	Yes	
Employers are informed of actuarial recommendations and changes and verification of contributions received.	Yes	
On an annual basis an M99 reconciliation is completed.	Yes	
Employee contribution rates should be between 5.5% and 7.5%	Yes	
Effective frame work is in place for managing the receipt of contributions from respective employers	Yes	

Essex Pension Fund Bank Account Risks:

Lack of reconciliation of the Essex Pension Fund bank account resulting in erroneous entries remaining undetected (eg pension income/expenditure posted to ECC, incorrect amounts posted).

Failure to subsequently correct miscoded transactions may result in loss for the Pension Fund and / or Essex County Council.

Control	Control In Place?	Action Plan Ref.
The Essex Pension Fund Bank account is subject to reconciliation on a regular basis.	Yes	
Miscodings are promptly identified and amended to the correct cost centre.	Yes	