



Final Internal Audit Report 2017/18 – Pensions Investments (KF4)

1. Executive Summary





<p>Function: Corporate and Customer Services</p> <p>Audit Sponsor: Kevin McDonald, Director for Essex Pension Fund</p> <p>Distribution List: Kevin McDonald; Margaret Lee, Executive Director for Corporate and Customer Services; Jody Evans, Head of Essex Pension Fund; Sam Andrews, Investment Manager; Sara Maxey Employer Relationship Manager; Cllr. Louise McKinlay, Cabinet Member for Resources; Dan Cooke, Ernst & Young (External Audit)</p> <p>Final Report Issued: 01 May 2018</p> <p>Date of last review: June 2017</p>	<p>Overall Opinion</p> <p>GOOD ASSURANCE </p> <hr/> <p>Direction of Travel</p> <p>The control environment has improved since 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 Low</p>	<p>Number of Control Operating in Practice Issues Identified</p> <p>0 Critical</p> <p>0 Major</p> <p>1 Moderate</p> <p>2 Low</p>	<p>Number of Recommendations</p> <p>3 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 audit examined the extent to which the risks relating to potential non-compliance with governance arrangements, investment and funding management, performance reporting, receipt of member contributions and financial oversight were being addressed, controlled and managed.</p> <p>A separate Pensions Administration audit has been carried out under assignment reference KF5 which assessed the controls to manage risks associated with processing fund starters, amendments and leavers, making payments and associated reconciliations, system access and security, business continuity, and management information on the administering of the fund.</p>			
<p>Executive summary comments</p> <p>There are no critical or major recommendations in this report.</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> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: red; margin-right: 5px;"></div> <p>Critical priority Control Design or Control Operating in Practice issues identified</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: orange; margin-right: 5px;"></div> <p>Major priority Control Design or Control Operating in Practice issues identified</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: yellow; margin-right: 5px;"></div> <p>Moderate priority Control Design or Control Operating in Practice issues identified</p> </div> <div style="display: flex; align-items: center;"> <div style="width: 20px; height: 20px; background-color: green; margin-right: 5px;"></div> <p>No / Minor Control Design or Control Operating in Practice Issues identified</p> </div>			



Auditors: Tione Bowazi Audit Manager: Greg Mortimer Head of Assurance: Paula Clowes Fieldwork Completed: 26 March 2018 Draft Report Issued: 19 April 2018 Management Comments Expected: 03 May 2018 Management Comments Received: 30 April 2018 Final Report: 01 May 2018		Issues raised and officers responsible for implementation:							
			Name	Critical	Major	Moderate	Low	Total	Agreed
			Jody Evans, Head of Essex Pension Fund	0	0	1	1	2	2
			Sam Andrews, Investment Manager	0	0	0	1	1	1
		Releasing Internal Audit Reports: All distributed draft and final reports remain the property of the respective Director and the Executive Director for Corporate Services. 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. 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									
N/A	N/A						N/A	N/A	
Unregistered Risks Identified & Audited									
N/A	Governance Board structures and memberships and roles and responsibilities are not in line with statutory and regulatory requirements causing less effective funding and investment decisions leading to an increasing deficit and otherwise avoidable increases in contributions and cause subsequent damage to the fund's and ECC's reputation. Incomplete or out of date declarations of interest of board members and key officers could cause a potential perception of compromised decision making or a lack of transparency which could damage the fund's and ECC's reputation. Insufficient knowledge and training of those governing and managing the fund could cause less effective funding and investment decisions leading to an increasing deficit and otherwise avoidable increases in contributions. Subsequent damage to the fund's and ECC's reputation.						N/A	●	
N/A	Investment and Funding The fund does not have up to date, approved, and aligned strategic documents setting out future funding and investment requirements leading to an increasing deficit requiring increases in contributions that could have been avoided. Subsequent damage to the fund's and ECC's reputation. The fund does not access independent expert advice to influence its investment and funding strategies leading to an increasing deficit requiring increases in contributions that could have been avoided and subsequent damage to the fund's and ECC's reputation. Allowable investment types / classes and any limits on such are not defined and the fund's investments are placed in unacceptable vehicles or at an unacceptable level of risk of loss or ultra vires therefore subsequent damage to the fund's and ECC's reputation. Significant amounts of employees leave the fund and or employers cease to exist without sufficient means to fulfil their future liabilities an increasing deficit requiring increases in contributions from remaining employers and employees.						N/A	●	
N/A	Performance reporting The performance of the fund's investments is not insightfully monitored and reported to allow any timely remedial action required. This can lead to An increasing deficit requiring increases in contributions that could have been avoided and subsequent damage to the fund's and ECC's reputation.						N/A	●	

	Other measures of the effectiveness, efficiency and economy of the fund's administration and management of risk are not insightfully monitored and reported to allow any timely remedial action required therefore the fund's administrative overhead does not represent value for money and subsequent reputational damage to ECC as administering authority.		
N/A	Receipt of Contributions from Member Bodies Contributions from member bodies are not completely or accurately received or are not received in a timely manner causing negative cash flow issues for the fund and/or reduced sums available to invest.	N/A	●
N/A	Financial Oversight The fund managers' and custodians' records do not reconcile leading to unidentified and uncorrected errors could lead to a qualified external audit opinion on the fund's financial statements and subsequent damage to the fund's and ECC's reputation. The fund's financial system and its bank account(s) do not reconcile leading to unidentified and uncorrected errors could lead to a qualified external audit opinion on the fund's financial statements causing subsequent damage to the fund's and ECC's reputation <i>Please note the audit testing of the bank reconciliation is undertaken as part of the Oracle Integrated Assurance audit (KF1) but due to its importance to the Pensions Investments control environment it will also influence this report's opinion.</i>	N/A	●

2. Basis of our opinion and assurance statement

Risk rating	Assessment rationale
 Critical	<p>Critical and urgent in that failure to address the risk could lead to one or more of the following occurring:</p> <ul style="list-style-type: none"> ▪ Significant financial loss (through fraud, error, poor value for money) ▪ Serious safeguarding breach ▪ Life threatening or multiple serious injuries ▪ Catastrophic loss of service ▪ Failure of major projects ▪ Critical Information loss leading to Information Commissioner's Office (ICO) referral ▪ Reputational damage – Intense political and media scrutiny i.e. front-page headlines, television coverage. ▪ Possible criminal, or high profile, civil action against the Council, Members or officers. ▪ Intervention by external agencies <p>Remedial action must be taken immediately</p>
 Major	<p>Major in that failure to address the issue or progress the work would lead to one or more of the following occurring:</p> <ul style="list-style-type: none"> ▪ High financial loss (through fraud, error, poor value for money) ▪ Safeguarding breach ▪ Serious injuries or stressful experience requiring medical treatment, many work days lost. ▪ Significant disruption to service (Key outcomes missed, some services compromised. Management action required to overcome medium term difficulties) ▪ Major Information loss leading to internal investigation ▪ Reputational damage – Unfavourable external media coverage. Noticeable impact on public opinion. ▪ Scrutiny required by external agencies <p>Remedial action must be taken urgently</p>
 Moderate	<p>Moderate in that failure to address the issue or progress the work would lead to one or more of the following occurring:</p> <ul style="list-style-type: none"> ▪ Medium financial loss (through fraud, error or poor value for money) ▪ Significant short-term disruption of non-core activities ▪ Scrutiny required by internal committees. ▪ Injuries or stress level requiring some medical treatment, potentially some work days lost ▪ Reputational damage – Probable limited unfavourable media coverage. <p>Prompt specific action should be taken</p>
 Low	<p>Low in that failure to address the issue or progress the work would lead to one or more of the following occurring:</p> <ul style="list-style-type: none"> ▪ Low financial loss (through error or poor value for money) ▪ Minor errors in systems/operations or processes requiring action or minor delay without impact on overall service delivery schedule. Handled within normal day to day routines. ▪ Reputational damage – Internal review, unlikely to have a wider impact. <p>Remedial action is required</p>
Assurance Level	Description
Good	Good 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 of Low risk rating. Any Moderate recommendations would need to be mitigated by significant strengths elsewhere.
Adequate	Adequate 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 or reputational damage. 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 Responses and Agreed Actions
Control Design – CMIS records					
1.	<p>During 2017/18 ECC's Democratic Services staff were responsible for publishing the Essex Pension Fund (EPF) agendas and minutes and maintaining the membership details on the CMIS system.</p> <p>Responsibility for creating and publishing all Essex Pension Fund agendas and minutes will transfer from Democratic Services to EPF staff in 2018/19.</p> <p>A review of CMIS noted a number of errors and omissions and late actions during the year. This included:</p> <ul style="list-style-type: none"> • a delay in publishing the Pension Advisory Board minutes for the meeting held in January 2018 • incorrect membership details were published for the Essex Pension Advisory Board including: <ul style="list-style-type: none"> ○ four names who were no longer members of the Board were showing as members ○ three current members of the Board were not included 	<p>Governance:</p> <p>Relevant information relating to the governance and business of the fund is not publically available in a timely manner and correct.</p>	<p>As Essex Pension Fund will be taking over publication of agendas and minutes of the Pension Boards from Democratic Services, a timetable should be produced for the publishing of agendas and minutes and updating membership details to ensure information is made publically available in required timescales and is correct.</p>	<p>●</p> <p>Moderate</p>	<p>Agreed: Yes</p> <p>Action to be taken: EPF are currently restructuring, a new role will be in place WEF 01 07 2018 and a timetable will be produced.</p> <p>Additional Resources Required for Implementation: new resource in place WEF July 2018</p> <p>Responsible Officer:</p> <p>Jody Evans, Head of Essex Pension Fund and Compliance Team -Essex Pension Fund</p> <p>Target Date: 31/7/2018</p>

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Responses and Agreed Actions
	<p>on the membership details.</p> <p>Audit Note:</p> <p>ECC's Democratic Services were contacted and the errors have been confirmed as corrected on 23 March 2018.</p>				
Control Design – Training records					
2.	<p>A training log is maintained by EPF recording all relevant training and events attended by members of the Pension Boards during the year.</p> <p>The log for the financial year ending 31 March 2018 was reviewed and it was noted the substitute members for the boards were not included on the training log.</p> <p>Therefore it could not be verified that the substitutes have been attending the necessary training to assist in decision making at board meetings.</p>	<p>Governance:</p> <p>Insufficient knowledge and training of those governing and managing the fund to make the correct decisions.</p>	<p>The substitute members should be included on the training log to ensure that their training needs can be assessed and met.</p>	<p>●</p> <p>Low</p>	<p>Agreed: Yes</p> <p>Action to be taken: The new Compliance team will cover in July 2018.</p> <p>Additional Resources Required for Implementation: Yes</p> <p>Responsible Officer:</p> <p>Jody Evans, Head of Essex Pension Fund and Compliance Team – Essex Pension Fund</p> <p>Target Date: 31/7/2018</p>
Operating Effectiveness – Reconciliations					
3.	<p>The team prepare various reconciliations between the Fund's General Ledger and Custodian / Investment Fund managers' records and also its control accounts.</p> <p>The General Ledger records are</p>	<p>Financial Oversight:</p> <p>Discrepancies, fraud or error may not be identified and could lead to an external</p>	<p>The preparer of the reconciliations should take a screenshot of the General Ledger balance being reconciled and include it in the reconciliation pack to ensure there is prime evidence of the</p>	<p>●</p> <p>Low</p>	<p>Agreed: Yes</p> <p>Action to be taken: Confirmed in Place</p> <p>Additional Resources Required for</p>

	Matters Arising	Potential Risk Implications	Recommendations	Priority	Management Responses and Agreed Actions
	downloaded into Excel but there is no prime evidence within the reconciliation documents themselves to confirm the balance on the General Ledger and therefore confirm this agrees to the balance on the Custodian and Investment Fund record.	audit qualification on the Fund's financial statements.	General Ledger balance.		<p>Implementation: No</p> <p>Responsible Officer: Sam Andrews – Investment Manager</p> <p>Target Date: 30/4/2018</p>

4. Controls Assessment Schedule

Governance Arrangements risks:

Board structures and memberships and roles and responsibilities are not in line with statutory and regulatory requirements causing less effective funding and investment decisions leading to an increasing deficit and otherwise avoidable increases in contributions and therefore subsequent damage to the fund's and ECC's reputation

Incomplete or out of date declarations of interest of board members and key officers could cause a potential perception of compromised decision making or a lack of transparency which could damage the fund's and ECC's reputation.

Insufficient knowledge and training of those governing and managing the fund could cause less effective funding and investment decisions leading to an increasing deficit and otherwise avoidable increases in contributions therefore subsequent damage to the fund's and ECC's reputation.

Control	Control In Place?	Action Plan Ref.
The pension fund is supported by a formally constituted governance structure of the Pensions Strategy Board (PSB), Pensions Advisory Board (PAB) and the Investment Steering Committee (ISC). The governance structure is in line with relevant legislation and regulation.	Yes	
The governance boards and committee have documented and recently approved terms of reference clearly setting out roles, responsibilities and delegated responsibilities and powers. Including emergency decision making powers if and when decisions outside the usual governance / meeting timetable needs to be made	Yes Yes	
The pension fund has a governance policy which is regularly reviewed and approved.	Yes	
Updates on the activities of the PAB and ISC are reported to PSB to ensure it has oversight of their activity and operation.	Yes	
Board and committee meeting minutes and papers are produced and promptly made publicly available.	Partially	1
The fund has annual and three-year Business plans. Progress in delivering the plans is regularly reported to the PSB.	Yes	
The work of the pension fund is supported by external investment consultants and an independent advisor on governance and administration matters.	Yes	
The PSB and PAB has assessed its effectiveness of operation, identifying areas for further improvement where needed	Yes	
Board and committee member training needs are identified based on the CIPFA Knowledge and Skills Framework Training delivered is logged and reported through the regular performance scorecard report highlighting any gaps in training	Partially	2
Pension staff's training requirements identified and performance managed through the Essex Supporting Success process.	Yes	

Control	Control In Place?	Action Plan Ref.
Declarations of interests are made at each meeting.	Yes	
Standing Declarations of interest have been completed and kept up to date.	Yes	

Investment and Funding risks:

The fund does not have up to date, approved, and aligned strategic documents setting out future funding and investment requirements leading to an increasing deficit requiring increases in contributions that could have been avoided therefore subsequent damage to the fund's and ECC's reputation.

The fund does not access independent expert advice to influence its investment and funding strategies leading to an increasing deficit requiring increases in contributions that could have been avoided therefore subsequent damage to the fund's and ECC's reputation.

Allowable investment types / classes and any limits on such are not defined and the fund's investments are placed in unacceptable vehicles or at an unacceptable level of risk of loss or ultra vires therefore subsequent damage to the fund's and ECC's reputation.

Significant amounts of employees leave the fund and or employers cease to exist without sufficient means to fulfil their future liabilities an increasing deficit requiring increases in contributions from remaining employers and employees.

Control	Control In Place?	Action Plan Ref.
An Investment Strategy Statement (ISS) has been developed in the required timescale as required by regulations to replace the Statement of Investment Principles.	Yes	
The ISS references to and is consistent with the objectives and approach articulated in the Funding Strategy Statement.	Yes	
The ISS has been produced taking advice from the fund's Institutional Consultant and its independent Investment Adviser.	Yes	
An Actuarial Valuation report has been received from the fund actuary. The results of the valuation results were consulted on with employers.	Yes in 2017	
A Funding Strategy Statement (FFS) has been produced and agreed as required by regulation which sets out how the fund's liabilities will be met in future based on the latest valuation of the fund. The FSS was consulted on with employers. The FSS references to and is consistent with the objectives and approach articulated in the ISS	Yes	
The ISS define the asset classes and types of investment in which investment managers are allowed to invest, the allocation to investment each manager and any restrictions on investments.	Yes	
There is a regular programme of reviews and studies of assets and liabilities by the Independent Investment Advisor to inform the work of the ISC. Reports are presented to the ISC	Yes	
The fund receives expert advice on market outlook etc. from Independent Investment Advisor. Officers and advisors discuss any key issues and the	Yes	

Control	Control In Place?	Action Plan Ref.
outcomes of the meetings are presented to the ISC.		
Investment management-related (and funding-related) risks, and how they are to be managed, are captured in the fund's risk register. The risk register is regularly reported to the PSB.	Yes	
A cash flow statement is produced and managed to maintain sufficient liquidity to ensure the fund can meet its liabilities as they become due. <i>The cash flow statement is developed as maintained by Essex County Council Financial Services staff who provide Treasury Management services for short-term in-house cash through a service level agreement. The 2017/18 audit of Treasury Management did not identify any issues with the management of the cash flow statement.</i>	Yes	
There is an agreed Treasury Management Policy and Strategy for the fund setting out the approach to managing short-term in-house cash, cash held and managed by the custodian and the realising of investment income.	Yes	
There is a scheme of delegation in place and investment decisions have been made in accordance with delegated authority.	Yes	
There is a process in place to monitor funds due from maturing investments to ensure they are received on time.	Yes	

Monitoring and reporting of Performance risks

The performance of the fund's investments is not insightfully monitored and reported to allow any timely remedial action required.

Other measures of the effectiveness, efficiency and economy of the fund's administration and management of risk are not insightfully monitored and reported to allow any timely remedial action required.

Control	Control In Place?	Action Plan Ref.
A comprehensive, balanced performance scorecard is regularly reported to the PSB setting out the fund's performance in regard to governance, investments, funding, administration, and communications.	Yes	
A risk register is regularly reported to the PSB setting out the risks to effective governance, investment risk, funding risk, administration risk, and communications risk and how these risks will be managed. The risk register regularly assesses and reports whether such risks are being effectively managed.	Yes	
Benchmarking of the comparative cost of administering the fund and returns are regularly measured and reported as part of the performance scorecard.	Yes	
An annual report on the operation and outcome of the fund's activity is published	Yes	
The ISC review the performance of each investment fund manager quarterly against set targets on returns. Remedial action is taken action required.	Yes	

Control	Control In Place?	Action Plan Ref.
Officers and advisors discuss any key issues and the outcomes of the meetings are presented to the ISC.	Yes	

Receipt of Contributions from Member Bodies risks

Contributions from member bodies are not completely or accurately received or are not received in a timely manner causing negative cash flow issues for the fund and/or reduced sums available to invest.

Control	Control In Place?	Action Plan Ref.
There is a communication policy in place to manage the relationship with members and employers.	Yes	
Year-end data from employers is validated prior to upload to the pensions system to ensure accuracy and completeness of data There is a scheme of penalty charges for late and inaccurate data.	Yes	
There is ongoing tracking of monthly contributions received from member bodies to identify late and or incorrect amounts received.	Yes	
Outstanding contributions are chased up with the relevant member body.	Yes	
There is an annual reconciliation of contributions due and received to ensure there is an accurate picture of over or underpayments.	Yes	

Financial Oversight

The fund managers' and custodians' records do not reconcile leading to unidentified and uncorrected errors could lead to a qualified external audit opinion on the fund's financial statements and subsequent damage to the fund's and ECC's reputation.

The fund's financial system and its bank account(s) do not reconcile leading to unidentified and uncorrected errors could lead to a qualified external audit opinion on the fund's financial statements and subsequent damage to the fund's and ECC's reputation

Please note as the bank reconciliation is completed by the ECC Cashiers team, the audit testing of the bank reconciliation is undertaken as part of the Oracle Integrated Assurance audit (KF1). Due to its importance to the Pensions Investments control environment it also influences this report's opinion.

Please note that the controls and any issues arising relate to the overall processes to all bank account reconciliations completed by ECC. The issues below are not specific to the pension fund-related reconciliation. The reconciliations section of the TCS audit did not confirm any loss or error related to the pension fund bank account.

Control	Control In Place?	Action Plan Ref.
A process is in place to ensure that reconciliations of Investment Manager records and Custodian records (of bond and equity mandates) are completed monthly and in a timely manner.	Yes	

Control	Control In Place?	Action Plan Ref.
The reconciliations are independently reviewed and signed off.		
There is a six monthly reconciliation of the Custodian records to the EPF General Ledger to ensure assets are correctly accounted for as well as income and expenditure items.	Partially	3
Bank reconciliations are completed promptly and regularly so that fraudulent transactions or errors are identified and managed in a timely way <i>(Note this is an ECC completed process)</i>	Partially	Separate recommendation also raised in TCS (Reconciliations) report
There is oversight of whether bank reconciliations have been completed to ensure required action is completed accurately and on a timely basis <i>(Note this is an ECC completed process)</i>	Partially	Separate recommendation also raised in TCS (Reconciliations) report
There is effective communication between finance teams and cashiers to ensure outstanding items are resolved promptly and that errors and fraudulent transactions are identified in a timely way.	Yes	