


Final Internal Audit Report 2014/15 – Pension Investment (KFS19)

1. Executive Summary

<p>Function: Corporate Services</p> <p>Audit Sponsor: Margaret Lee, Executive Director for Corporate and Customer Services</p> <p>Distribution List: Margaret Lee, Executive Director for Corporate and Customer Services; Kevin McDonald, Director for Essex Pension Fund; Jody Evans, Head of Essex Pension Fund; Christine Connolly, Ernst & Young (External Audit). Cllr Rodney Bass, Chairman Essex Pension Fund Board.</p> <p>Final Report Issued: 16th April 2015 Date of last review: March 2014</p>	<p>Overall Opinion</p> <p>GOOD 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 Low</p>	<p>Number of Control Operating in Practice Issues Identified</p> <p>0 Critical</p> <p>0 Major</p> <p>0 Moderate</p> <p>0 Low</p>	<p>Number of Recommendations</p> <p>0 Made</p> <p>N/A Rejected</p> <p>N/A Critical Rejected</p> <p>N/A Major Rejected</p>
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<p>Scope of the Review and Limitations:</p>	<p>The audit examined the extent to which the risks regarding potential non-compliance with governance arrangements, investment management and performance monitoring, and receipt of employer contributions were being addressed, controlled and managed. There are no limitations of scope.</p>
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<p>Critical and Major Findings and Recommendations</p> <p>No recommendations were identified.</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>  <p> ■ 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 </p>
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Auditor: Jo Russell Fieldwork Completed: 24th March 2015 Draft Report Issued: 2 April 2015 Management Comments Expected: 23 April 2015 Management Comments Received: 14 April 2015 Final Report: 16 April 2015	Issues raised and officers responsible for implementation:						
	Name	Critical	Major	Moderate	Low	Total	Agreed
	n/a	0	0	0	0	0	
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
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Registered Risks Reviewed

	<p>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:</p> <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; and • providing copies of these documents to stakeholders <p>resulting in potential loss of reputation, qualification of accounts, and legal reprimand.</p> <p>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.</p>	Yes	
	<p>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.</p> <p>Poor security of data leading to potential loss of records, resulting in non-compliance with regulations and additional staff costs to correct.</p> <p>Lack of reconciliations between Council and Custodian records allowing discrepancies between the two to remain undetected and potential errors in the accounts, resulting in qualification of the accounts, misrepresentation of Fund value and loss of reputation.</p> <p>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.</p> <p>Lack of restrictions/guidelines on investments resulting in potential loss of income and capital and providing poor value for money for the Pension Fund.</p>	Yes	
	<p>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.</p>	Yes	
	<p>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.</p> <p>Employer contributions not accurately accounted for allowing erroneous entries to appear in the accounts resulting in misrepresentation of the Fund value, potential qualification of the accounts and loss of reputation.</p>	Yes	
	<p>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).</p> <p>Failure to subsequently correct miscoded transactions may result in loss for the Pension Fund and/or Essex County Council.</p>	Yes	

Unregistered Risks Identified & Audited
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	None		
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2. Basis of our opinion and assurance statement

Risk rating	Assessment rationale
 Critical	Critical and urgent in that failure to address the risk could lead to one or more of the following occurring: <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	Major in that failure to address the issue or progress the work would lead to one or more of the following occurring: <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	Moderate in that failure to address the issue or progress the work would lead to one or more of the following occurring: <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	Low in that failure to address the issue or progress the work would lead to one or more of the following occurring: <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.

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.
Best practice guidelines and available and are adhered to wherever possible. Key staff members within the Pension Investment team are aware of best practice guidelines available. Those charged with the governance of the Fund and the scheme are able to fulfil their responsibilities effectively.	Yes	
The Fund's Governance Policy is published, and governance arrangements are subject to review. Required documentation (in accordance with the Local Government Pension Scheme Regulations 2013) have been published and issued. Formal reports and documentation is available for all key stakeholders. Actuarial valuations have been completed and received.	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.

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 and Custodian records allowing discrepancies between the two to remain undetected and potential errors in the accounts, resulting in qualification of the 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 for money for the Pension Fund.

Control	Control In Place?	Action Plan Ref.
Records retained by Essex County Council, appointed Custodians and Fund Managers are reconciled on a periodic basis. A reconciliation between book cost and cash is undertaken, with supporting information. Calculations of timing differences between Custodian and Fund Manager are	Yes	

Control	Control In Place?	Action Plan Ref.
undertaken.		
The journal updating IFS has supporting evidence, is accurate and is fully authorised.		
Appropriate independent external advisors are engaged, to provide formal advice with a view to mitigating risks and optimising the value of the Fund.	Yes	
Strategic plans are in place, to reflect the Fund's investment objectives. The strategy considers the Pension Fund's own liabilities and risk profile.		
Significant changes to the market are identified promptly and effectively communicated.		

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.

Control	Control In Place?	Action Plan Ref.
An effective contract management framework is in place, with monitoring against benchmarks undertaken.	Yes	
Contracts are regularly reviewed in light of changing market conditions and actual performance.		
Any breach of investment guidance or contract is identified, and addressed.		
Administration / Fund Manager costs are reviewed on a periodic basis to ensure that value for money is achieved.	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 the accounts and loss of reputation.

Control	Control In Place?	Action Plan Ref.
Checks are completed to ensure that all employer contributions are received, are complete, accurate and accounted for correctly.	Yes	
Contributions are amended in line with actuarial valuations.		
Contribution rates are accurately applied. A process is in place to verify contributions received. Contributions are amended in line with actioned recommendations.	Yes	
On an annual basis, an M99 reconciliation is completed.		

Essex Pension Fund Bank Account Risks:

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.

Control	Control In Place?	Action Plan Ref.
<p>The Essex Pension Fund bank account is subject to reconciliation on a regular basis.</p> <p>Miscoding are promptly identified and amended to the correct cost centre.</p>	Yes	