








Final Internal Audit Report 2013/14 – Pension Investment (KFS 108)

1. Executive Summary

<p>Department: Corporate Services Audit Sponsor: Kevin McDonald, Director for Essex Pension Fund Distribution List: Margaret Lee, Executive Director for Corporate Services and Corporate Operations; Kevin McDonald, Director for Essex Pension Fund; Jody Evans, Head of Essex Pension Fund Cllr Rodney Bass, Chairman Essex Pension Fund Board Christine Connolly External Audit</p> <p>Final Report Issued: 13 March 2014 Date of last review: April 2013</p>	<p>Overall Opinion</p> <p>FULL ASSURANCE </p>	<p>Number of Control Design Issues Identified</p> <p>0 Critical 0 Major 0 Moderate 1 Best Practice</p>	<p>Number of Control Operating in Practice Issues Identified</p> <p>0 Critical 0 Major 0 Moderate 0 Best Practice</p>	<p>Number of Recommendations</p> <p>0 Made N/A Rejected N/A Critical Rejected N/A Major Rejected</p>
	<p>Direction of Travel</p> <p>Control environment has not changed since our prior audit </p>			


<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. The Essex Pension Fund's assets were transferred to a new Custodian, Northern Trust, in October 2012. Whilst this occurred in 2012-13, no review of this was undertaken in the audit of 2012-13 therefore, confirmation of the transfer was determined in this review to provide assurance of the completeness and accuracy of transfer. However, all other testing samples were taken from 2014.</p>
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<p>Critical and Major Findings and Recommendations There are no Major and Critical Recommendations</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
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Auditor: Nicola Meadows Fieldwork Completed: 31 January 2014 Draft Report Issued: 25th February 2014 Management Comments Expected: 18 March 2014 Management Comments Received: 10 March 2014 Final Report: 13 March 2014	Issues raised and officers responsible for implementation:						
	Name	Critical	Major	Moderate	Best Practice	Total	Agreed
	Advice and best practice recommendations	0	0	0	1	1	N/A
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.							
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 resulting in potential loss of reputation, qualification of accounts and legal reprimand. <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 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.</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 of 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> <p>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.</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 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	
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Unregistered Risks Identified & Audited

n/a	None	n/a	n/a
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2. Basis of our opinion and assurance statement

Risk rating	Assessment rationale
 Critical	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. 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. Life threatening or multiple serious injuries or prolonged work place stress. Severe impact on morale & service performance. Mass strike actions etc.
 Major	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. Scrutiny required by external agencies, Audit Commission etc. Unfavourable external media coverage. Noticeable impact on public opinion. Serious injuries or stressful experience requiring medical treatment, many work days lost. Major impact on morale & performance of more than 100 staff.
 Moderate	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. Scrutiny required by internal committees or Internal Audit to prevent escalation. Probable limited unfavourable media coverage. Injuries or stress level requiring some medical treatment, potentially some work days lost. Some impact on morale & performance of up to 100 staff.
 Best Practice	Minimal financial loss – Minimal effect on project budget/cost: (< 3% Negligible effect on total Budget or < 1% of departmental budget) Minor errors in systems/operations or processes requiring action or minor delay without impact on overall schedule. Handled within normal day to day routines. Internal review, unlikely to have impact on the corporate image. Minor injuries or stress with no work days lost or minimal medical treatment. No impact on staff morale.
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
Control Design - Lack of reconciliation of apportioned deficit amounts					
1.	<p>The Town and Parish Council deficit liability is apportioned across all Councils on a per capita basis. In apportioning the total to individual parish Councils a transposition error was identified for one Parish Council. This apportionment had not been reconciled resulting in the in year notification to that particular council being understated.</p> <p>This error would have been identified as part of the year end reconciliation process.</p>	<p>The amount collected from individual Town and parish Councils may be incorrect, resulting in over/under payment of the deficit amount.</p>	<p>The apportionment of deficit collection rates across Town and Parish Councils should be reconciled to ensure no errors have occurred before collection schedules are prepared and communicated with the individual Councils.</p> <p>Audit Note The Director for the Essex Pension Fund has advised that for future years, all data is being updated and checked as a result of the 2013 Actuarial Valuation</p>	<p>● Advice and Best Practice</p>	<p>Response not required for advice and best practice recommendations.</p>

5. 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.
<p>Best practice guidelines are available, and are adhered to wherever possible.</p> <p>Key staff members within the Pension Investment team are aware of best practice guidelines available.</p> <p>Those charged with the governance of the Fund and the Scheme are able to fulfil their responsibilities effectively.</p>	Yes	
<p>The Fund's Governance Policy is published, and governance arrangements are subject to review.</p> <p>Required documentation (in accordance with the Local Government Pension Scheme (Administration) Regulations 2008) has been prepared, published and issued.</p> <p>Formal reports and documentation is available for all key stakeholders.</p> <p>Actuarial valuations have been completed and received.</p>	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 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.

Control	Control In Place?	Action Plan Ref.
Records retained by Essex County Council, appointed Custodians and Fund Managers are reconciled on a periodic basis.	Yes	

Control	Control In Place?	Action Plan Ref.
<p>A reconciliation between book cost and cash is undertaken, with supporting information. Calculations of timing differences between Custodian and Fund Manager are undertaken.</p> <p>The journal updating IFS has supporting evidence, is accurate and is fully authorised.</p>		
<p>Appropriate independent external advisors are engaged, to provide formal advice with a view to mitigating risks and optimising the value of the fund.</p> <p>Strategic plans are in place, to reflect the Fund's investment objectives. The strategy considers the Pension Fund's own liabilities and risk profile.</p> <p>Significant changes in the market are identified promptly and effectively communicated.</p>	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.
<p>An effective contract management framework is in place, with monitoring against benchmarks undertaken.</p> <p>Contracts are regularly reviewed in light of changing market conditions and actual performance.</p> <p>Any breach of investment guidance or contract is identified, and addressed.</p>	Yes	
<p>Administration / Fund Manager costs are reviewed on a periodic basis to ensure that value for money is achieved.</p>	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.
<p>Checks are completed to ensure that all employer contributions are received, are complete, accurate, and accounted for correctly.</p> <p>Contributions are amended in line with actuarial recommendations.</p>	Yes	
<p>Contribution rates are accurately applied. A process is in place to verify contributions received. Contributions are amended in line with actuarial recommendations.</p> <p>On an annual basis, an M99 reconciliation is completed.</p>	Yes	

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.
The Essex Pension Fund Bank account is subject to reconciliation on a regular basis. Miscodings are promptly identified and amended to the correct cost centre.	Yes	