

The Highland Council

Pensions Committee – 23<sup>rd</sup> May 2013

Agenda Item	5
Report No	PC/07/13

**Internal Audit Review of Pension Fund Investments**

**Report by the Head of Internal Audit & Risk Management**

Summary

This report refers to an audit of Pension Fund Investments which was undertaken as part of the annual plan for 2012/13.

**1. Introduction**

1.1 Whilst only the Report Summary and the Action Plan is attached for consideration by Members, it should be noted that full copies of reports are available if requested.

Each Internal Audit report contains an audit opinion based upon the work performed in respect of the subject under review. There are four audit opinions which can be provided:

- (i) **Full Assurance:** There is a sound system of control designed to achieve the system objectives and the controls are being consistently applied.
- (ii) **Substantial Assurance:** While there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.
- (iii) **Limited Assurance:** Weaknesses in the system of controls are such as to put the system objectives at risk, and/ or the level of non-compliance puts the system objectives at risk.
- (iv) **No Assurance:** Control is generally weak, leaving the system open to significant error or abuse, and/ or significant non-compliance with basic controls leaves the system open to error or abuse.

**2. Final Report – Pension Fund Investments**

2.1 The attached report is one of **Substantial Assurance** and concludes that the management of the Pension Fund complies with statutory requirements and the Council's policy relating to Pension Fund investments. The issues identified from the audit are minor in nature and are addressed in the Action Plan appended to the Report Summary. These issues are due to be addressed by 31<sup>st</sup> October 2013.

Recommendation

Members are invited to consider the Final Report

Designation: Head of Internal Audit & Risk Management

Date: 28<sup>th</sup> April 2013

Author: Nigel Rose, Head of Internal Audit & Risk Management

Background Papers

## AUDIT REPORT SUMMARY

### Report Title

Finance Service: Pension Fund Investments

Report No.	Type of Audit	Issue Date	
HK27/003	Systems	Draft Report	28/09/12
		Final Report	20/12/12

### 1. Introduction

1.1 This audit was undertaken as part of the annual plan for 2012/13 and reviewed the Council's Pension Fund investment arrangements including compliance with relevant legislation and guidance. The market value of Fund investments as at 31<sup>st</sup> March 2012 was £1,024.m, compared to £981.7m at 31<sup>st</sup> March 2011.

### 2. Review Objectives

The objectives of the review were to ensure that:

- 2.1 The Pension Fund complies with statutory requirements and the Council's policy relating to Pension Fund Investments. The Fund has an appropriate management and reporting structure.
- 2.2 The Pension Fund is able to meet its financial obligation and its assets are safeguarded from loss.
- 2.3 The transfer of funds to the Pension Fund Managers is carried out efficiently and effectively.
- 2.4 Appropriate performance targets are set for the Fund, including the acceptable level of risk. The targets are monitored and appropriate remedial action taken where required.
- 2.5 The Pension Fund's activity is accurately recorded in the Financial Ledger.

### 3. Main Findings

The main findings of the review, referenced to the above review objectives, are as follows:

- 3.1 The objective was fully achieved. The Council's Pension Fund policy is set out in the Funding Strategy Statement (FSS) and Statement of Investment Principles (SIP). Specialist advice is provided by the Pension Fund Advisors. The Fund's FSS and SIP are currently being updated following the latest Triennial Actuarial review and this will also take into account the changes from the latest Local Government Pension Scheme (LGPS) Regulations 2010.
- 3.2 This objective was substantially achieved as the Council receives a Triennial valuation of Pension fund from the Pension Fund Actuaries. This reviews the future position of the Pension Fund and provides recommendations upon the funding levels required to meet the Fund's liabilities. Currently there are no formal processes in place to measure the performance of the Pension Fund Custodian who holds all of the Fund's assets. There are informal arrangements with quarterly performance monitoring and regular meetings with the Custodian. Although the fees were decreased in May 2012, the service has not been formally tendered since 2002. It should also be noted that in the event of poor performance, the contract could be ended on the provision of 30 days' notice.
- 3.3 This objective was fully achieved. Appropriate procedures are in place to ensure that Senior Managers are made aware of any balance surplus funds monthly, approval to transfer balance is obtained and respective interested parties are informed of the impending transfers, with associated paperwork held.

- 3.4 This objective was fully achieved. Reports upon the performance of Fund Managers against the benchmarks are prepared on a quarterly basis by the Custodian and these are reviewed by the Treasury Team. Regular reports upon performance are provided to the Investment Sub-Committee. The performance of Fund Managers must be considered over a reasonable timeframe but action has been taken to replace one Fund Manager who has consistently under-performed against their benchmarks.
- 3.5 This objective was substantially achieved. Pension Fund reconciliations are undertaken between the Global Custodian and the individual Fund Managers reports. Minor issues were noted regarding the reconciliations not dated when verified by the independent checking officer, and the monthly analysis of cash movement spreadsheet was not verified or dated by the independent officer. At the time of the audit, the checklist used by the Treasury team was to be updated to include a review and analysis box.

#### **4. Conclusion**

- 4.1 The majority of the audit objectives were achieved and the issues identified from the audit are minor in nature. The management of the Pension Fund has followed guidance by setting an appropriate reporting and management structure. There are 3 recommendations made as a result of this audit consisting of 1 medium and 2 low grades. These are due to be implemented by 31/10/13.

#### **5. Audit Opinion**

- 5.1 The opinion is based upon, and limited to, the work performed in respect of the subject under review. Internal Audit cannot provide total assurance that control weaknesses or irregularities do not exist. It is the opinion that **Substantial Assurance** can be given in that while there is a generally a sound system, there are areas of weakness which put some of the system objectives at risk, and/ or there is evidence that the level of non-compliance with some of the controls may put some of the system objectives at risk.

## AUDIT REPORT ACTION PLAN

### Report Title

### Report No.

**Finance Service: Pension Fund Investments**

**HK27/003**

The Action Plan contains **3** recommendations as follows:

#### Description

Major issues that managers need to address as a matter of urgency.

**Priority**      **Number**

High              0

Medium          1

Low               2

Important issues that managers should address and will benefit the Organisation if implemented.

Minor issues that are not critical but managers should address.

          3          

#### Total recommendations

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT ACTION	IMPLEMENTATION	
					AGREED	RESPONSIBLE OFFICER
3.2	Medium	There are no procedures in place to ensure the Custodian arrangements provide best value to the pension Fund.	Formal monitoring and review procedures should be established to ensure effective management of the Pension Fund, which should be in accordance with Council's requirements. The review should take into account achievement of best value and effectiveness of the investment practices employed.	To date, there have been no issues with accuracy or timeliness. Where there are any issues these will be formally recorded and regularly reviewed.  Dialogue with the custodian is regular and issue of fees is constant. A recent reduction in fees has been agreed. These meetings will be formally documented and arrangements made to hold these on at least an annual basis.	Head of Accounting and Budgeting	31/10/13
3.3.1	Low	There are minor issues whereby there was no evidence that all reconciliations had been reviewed by an independent officer. Where they had been independently reviewed, these had not been dated.  Also, the monthly analysis of cash movement spreadsheet was not reviewed by an independent officer.	All pension fund reconciliations should be prepared by one officer and then reviewed by an independent officer. The reconciliation should be signed and dated by the preparing and checking officers.	The monthly Pension Fund checklist has been updated to include a review and analysis box which will be signed by an independent officer.	Head of Accounting and Budgeting	31/03/13

## AUDIT REPORT ACTION PLAN

Report Title

Report No.

Finance Service: Pension Fund Investments

HK27/003

REPORT REF.	GRADE	FINDING	RECOMMENDATION	MANAGEMENT ACTION	IMPLEMENTATION		
					AGREED	RESPONSIBLE OFFICER	TARGET DATE
3.3.2	Low	The cash movement reconciliation figures for security receipts and deliveries were not included in the relevant monthly cash analysis which is used to enter data on the Ledger.	All Pension Fund movements, as detailed in the Custodian's report should be included within the Pension Fund reconciliation and reflected in the Financial Ledger.	The security receipts and deliveries highlighted were internal transactions within a Fund portfolio which did not affect the overall Fund portfolio value. These transactions were not included in the cash movement analysis as the net effect was nil and there was no reconciliation difference.  Where security receipts and deliveries affect more than one portfolio, these are always recorded in the ledger.  In future, the Treasury team will ensure that all transactions are included in the analysis and recorded on the ledger.		Head of Accounting and Budgeting	31/03/13