

**The Highland Council**

**Pensions Committee – 22<sup>nd</sup> August 2013**

Agenda Item	<b>4</b>
Report No	<b>PC/10/13</b>

**Statement on Internal Control 2012/13**

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

Summary

The attached report, Statement on Internal Control 2012/13 contains an assessment of the adequacy, reliability and effectiveness of the Fund's system of internal financial control and provides information for the annual Statement of Accounts.

**1. Introduction**

- 1.1 In order to comply with the requirements of the CIPFA/ LASAAC Code of Practice on Local Authority Accounting, a Statement on Internal Control must be produced. Section 2 of the attached report gives details relating to the Statement on Internal Control and the sources of information which inform the Statement.
- 1.2 On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However, as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Pension Fund's internal control systems for the year to 31<sup>st</sup> March 2013.

**2. Implications**

- 2.1 There are no Resource, Legal, Equalities, Climate Change and Risk implications arising from this report.

Recommendation

Members are invited to note the content of the attached report and the audit opinion provided, and to raise any relevant points with the Head of Internal Audit & Risk Management.

Designation: Head of Internal Audit & Risk Management

Date: 5<sup>th</sup> August 2013

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Background Papers



**Highland Council Pension Fund**  
**Statement on Internal Control 2012/13**

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## **1. INTRODUCTION**

- 1.1 The purpose of this report is to provide an assessment of the adequacy, reliability and effectiveness of the internal control systems within the Pension Fund. This complies with the requirements of the CIPFA/ LASAAC Code of Practice for Local Authority Accounting in the United Kingdom which recommends that Scottish Authorities voluntarily conduct an annual review of the effectiveness of its system of internal control and include a statement reporting on the review with any Statement of Accounts. In respect of the Highland Council Pension Fund a Statement on Internal Control is produced.

## **2. STATEMENT ON INTERNAL CONTROL**

### **2.1 Responsibilities for Internal Control**

It is the responsibility of senior management to establish an appropriate and sound system of internal control, and to monitor the continuing effectiveness of that system.

The Head of Internal Audit and Risk Management, Highland Council, provides an annual overall assessment of the robustness of the system of internal control.

### **2.2 Internal Control**

Internal control is defined as *"the whole system of checks and controls, financial or otherwise, established by management in order to provide reasonable assurance"* regarding the achievement of one or more of the following objectives:

- The reliability and integrity of information.
- Compliance with policies, plans, procedures, laws, regulations and contracts.
- The safeguarding of assets.
- The economical and efficient use of resources.
- The accomplishment of established objectives and goals for operations or plans.

Any system of control can only provide reasonable, and not absolute assurance that control weaknesses or irregularities do not exist, or that there is no risk of material errors, losses, fraud or breaches of laws and regulations. Accordingly the Fund should seek continual improvement in the effectiveness of its systems of internal control.

### **2.3 Internal Audit**

Internal Audit is an independent appraisal function established for the review of the internal control system as a service to the Highland Council and by extension, to the Pension Fund. It objectively examines, evaluates and reports upon the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources. Any areas of concern together with the management agreed actions and target dates for implementation are summarised in an Action Plan within the report. It is the responsibility of management to ensure that implementation of these actions takes place as agreed. The Internal Audit Section will undertake periodic follow-up reviews to ensure that the management agreed actions have been satisfactorily implemented.

The Internal Audit Section operates in accordance with the requirements of the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006. As required by the Code, a risk based tactical audit plan for the Highland Council is produced each year, and submitted for information to the Audit and Scrutiny Committee. Within this plan, provision is made for the auditing of key systems relevant to the Pension Fund and details of the annual planned audit activities are provided to the Pensions Committee.

## **2.4 Evaluation of Control Environment**

Evaluation of the control environment is informed by a number of different sources:

- The audit work undertaken by the Internal Audit Section during the year to 31st March 2013. This includes work undertaken directly for the Pension Fund and indirectly where the Highland Council's financial systems are used. For this year, this consisted of:
  - (i) a high level review of the adequacy and effectiveness of the Pension Fund's system of internal control,
  - (ii) targeted testing of key controls to confirm that the Council's main financial systems are operating as intended, and this included a sample of transactions relating to the Pension Fund,
  - (iii) assurance provided by individual audits of the Council's main financial systems.
- An applications audit of the Pensions computer system.
- A systems-based audit of Pension Fund Contributions.
- Knowledge and audit appraisal of the governance, risk management and performance monitoring arrangements.
- The assessment of risk completed during preparation of the annual tactical plan.
- Any findings reported by the External Auditor and any other inspection agencies.

## **2.5 Information Security**

The Council's information systems are used to administer the Pension Fund, and these are provided by Fujitsu Services as part of a five year contract which commenced on 01/04/10. With regard to this service, assurance has been obtained in various areas. In particular, Fujitsu have provided an ISO 27001 (information security management) certificate which covers the period 05/05/12 – 04/12/15 and this covers their Data Centre in Stevenage and back up site in London. A visit was also made to the Stevenage Data Centre by Computer Audit staff on 21/05/13 and no areas of concern were identified.

With regard to the system used for administering Pension Fund contributions (AXISe) the software supplier also has an ISO 27001 certificate which covers the period 20/12/11 – 19/12/14.

A Customer Authorisation Notice (CAN) from the Public Services Network is in place, allowing use of this Network to 30/09/13. The Council's Computer Audit staff were involved in witnessing aspects of the testing towards achieving the CAN.

With regard to information management, an Information Management Strategy and Information Management Policy are both in place. Although the supporting Information Management Framework and Information Security Framework have not been implemented, the Council has recognised this and has a plan in place to complete these.

## **2.6 Governance, Risk Management and Performance Monitoring**

Local Government Pension Schemes are required to measure compliance of their governance arrangements against compliance standards and this is included within the Pension Fund's Annual Report.

The Pension Fund also has a Governance Policy Statement which is one of a number of key documents it must hold and this was recently updated in May 2013. Within the Statement reference is made to the Fund's Risk Management arrangements whereby identified risks and their countermeasures are contained within the Funding Strategy Statement (FSS). New CIPFA guidance on "*Managing risk in the LGPS*" was issued in November 2012 and it is intended that any changes required will be incorporated into the next review of the FSS. This will

also include the development of a Fund specific risk register. At present, strategic risks are addressed through the Council's risk management arrangements.

The performance of Pension Fund investments are reported on a quarterly basis to the Pensions Committee's Investment Sub Committee. In addition, a periodic report upon the efficiency and accuracy of pension contributions and administration is provided to the Pensions Committee. The most recent report was provided on 23/05/13 and this included details of a performance across a range of indicators for the period 01/07/12 – 31/03/13.

## **2.7 Review of Internal Controls and Main Financial Systems**

As stated at 2.4 above, a high level review of the Fund's system of internal control was undertaken and this did not identify any areas of concern.

Administration of the Pension Fund is undertaken by Highland Council staff using the Council's financial systems, although the Fund has its own bank account. During the financial year 2012/13 an audit was undertaken of the Debtors system. In addition, the other main financial systems; Creditors, Payroll, General Ledger, Income and Budgetary Control have been subject to a review of the key controls including:

- Financial procedures and guidance issued to staff;
- Segregation of duties;
- User access levels and appropriateness;
- System backups.

A sample of transactions across all organisations which use the Council's financial systems was also selected for detailed testing to verify that the controls were operating as expected. This was verified from the testing of the Council's transactions and no control issues were identified.

In their "Report to those charged with governance on the 2011/12 audit" Audit Scotland identified that Pension Fund income and expenditure could be banked into or paid through the Council's bank account. In response, it was agreed that processes would be revised to ensure that Pension Fund transactions are recorded in the correct bank accounts in future years.

This has been actioned with work undertaken to address the 2011/12 legacy issues and to improve the process for 2012/13 transactions. However, due to the set-up of the Council's financial system, users can inadvertently select the wrong bank account details and so individual transaction errors can still occur. This risk can be mitigated by the regular monitoring of transactions, reconciliation between the ledger and bank account, and addressing any anomalies identified. Whilst this mitigating action is in place, it is recognised that there were a number of adjustments required for the 2012/13 Accounts and it would be of benefit to ensure that this is undertaken on a monthly basis in order to ensure that adjustments are actioned timeously.

It should be noted that the bank account issue does not affect the overall audit opinion.

## **2.8 Internal Audits**

The Tactical Plan for 2013/14 was provided to the Pensions Committee on 23/05/13 and the planned activities consist of an audit of Pension Fund Contributions and work to support the Statement on Internal Control for 2012/13.

The Pension Fund Contributions audit examined transactions for the year 2012/13 and reviewed two main areas:

- Ensuring that there are appropriate controls in place for admission to the Fund and that contributions are received promptly and are properly accounted for.

This involved checking that the contributions were paid into the Pension Fund's Bank Account.

- Review of transfers in/ from the Fund to ensure that these were calculated correctly and received/ paid promptly.

In addition, a computer audit of the Pensions' system from the previous year is nearing completion, and this will ensure that:

- Physical and logical access controls comply with best practice.
- Application controls in terms of input, processing, output, audit trail, backup, restore and business continuity are satisfactory.
- Contractual license, security and support arrangements are in place.

Some minor issues have been identified which will be addressed in separate audit reports, which will be provided to the Pensions Committee, but these do not affect the audit opinion.

## **2.9 Assurances from Fund Managers and Global Custodian**

The 6 Fund Managers and the Global Custodian each provide an annual assurance report (AAF 01/06/ISAE 3402) which sets out the control procedures in place during the year, and includes an assessment, by an independent accountant, of the effectiveness of the systems of internal controls in operation throughout the period examined.

These reports were obtained and reviewed, and it was confirmed that the appropriate assurances were provided by the independent accountants.

## **2.10 Action Tracking**

As part of the audit process, the recommendations are action tracked to ensure that the management agreed actions have been satisfactorily implemented. The results of the action tracking process in respect of Pension Fund matters are reported periodically to the Pensions Committee.

## **2.11 Audit Opinion**

On the basis of the work undertaken during the year, it is considered that the key systems operate in a sound manner and that there has been no fundamental breakdown in control resulting in material discrepancy. However as no system of control can provide absolute assurance against material loss, nor can Internal Audit give that assurance, it is the audit opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the Pension Fund's internal control systems for the year to 31<sup>st</sup> March 2013.