

# Highland Council Pension Fund

## Review of internal controls 2012/13



Prepared for members of The Highland Council as administering body for the Highland Council Pension Fund

June 2013

**AGENDA ITEM 9**  
**REPORT No PC/11/13**

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## Introduction

1. The Local Government Pension Scheme (LGPS) is a common scheme throughout Scotland, administered by 11 individual pension funds which manage net assets of around £24 billion on behalf of scheme members. Whilst the individual pension funds are administered by local authorities, they adhere to the nationally determined regulations of the LGPS.
2. The Highland Council administers the Highland Council Pension Fund (the Fund) on behalf of its own employees, and 36 other admitted and scheduled bodies. It has approximately 26,000 members and as at 31 March 2012 had net assets of £1.033 billion. The Fund also administers the pension schemes for Northern Police Officers and Highlands and Islands Fire Fighters.
3. The Highland Council's Director of Finance is responsible for the administration of the Fund's financial affairs including the maintenance of a sound system of internal control. A sound system of internal control will assist in managing risk, and help in the attainment of organisational policies, aims and objectives.
4. This report contains findings from the reviews carried out as part of the audit of the Fund's 2012/13 financial statements. The risks outlined are only those that came to our attention during the course of our reviews and are not necessarily, therefore, all of the risks which may exist within the Fund's main financial systems.
5. It remains the responsibility of management to determine the extent of the internal control system appropriate to the Fund. We would stress, however, that an effective system of internal control is an essential part of the efficient management of any organisation.

## Audit Objectives

6. In carrying out our audit of the annual financial statements, we seek to gain assurances that the Highland Council Pension Fund:
  - has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements and the effective management of its assets and interests
  - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
  - complies with established policies, procedures, laws and regulations.
7. We gain this assurance from work performed in the audit year. Wherever possible, we seek to rely on Internal Audit's work where their scope and coverage is adequate for our purposes. For 2012/13, we plan to place reliance on Internal Audit's work to support the Head of Internal Audit and Risk Management's opinion on the Fund's system of internal control, including reviews of the AXIS pension administration system (computer audit), the pension contributions system, and internal controls reports received from the global custodian and investment fund managers. As this work is not scheduled for completion until the end of July, we plan to review Internal Audit's work in these areas as part of our audit of the financial statements.

## **Audit Scope**

8. We reviewed the following internal control systems in order to assess the extent to which we could gain assurances for the audit of the 2012/13 financial statements:
  - Pension Investments
  - Pensions Administration (excluding contributions)
9. Our review involved identification and assessment of the risks inherent in these systems, based on the likelihood of them occurring and the impact they could have. We also assessed the adequacy of the procedures and key controls in place to address the identified risks and the extent to which these reduce each risk to an acceptable level. In addition, we reviewed progress made in implementing the agreed actions included in the action plan appended to the Review of Internal Controls 2011/12 report.
10. The Fund also uses the main financial systems (payroll, accounts payable, accounts receivable, treasury management, cash & cash equivalents and general ledger) of its administering authority, The Highland Council. Our review of the controls in operation within these systems was conducted as part of our audit of The Highland Council, the results of which will be reported in a separate report.

## **Audit Findings**

### **2012/13 audit**

11. Our 2012/13 audit work confirmed that the Highland Council Pension Fund has a satisfactory level of internal control in place within the pension investments and pension administration systems to enable us to take our planned assurances for the audit of the 2012/13 financial statements.

### **Follow up of Review of Internal Controls 2011/12 report**

12. Our review of progress made in implementing the agreed actions included in the action plan appended to the Review of Internal Controls 2011/12 report concluded that three of the six planned actions had been fully implemented, and that the remainder had been partially implemented. Our detailed findings, together with revised implementation dates, are set out in the Appendix.

## **Acknowledgement**

13. The contents of this report were discussed with relevant officers to confirm factual accuracy. The assistance and co-operation we received during the course of our audit is gratefully acknowledged.

# Appendix

## Follow up of the Review of Internal Controls 2011/12 report

No	Issue and Risk	Planned Action / Responsible Officer / Target Date	Update & Status
1	<p>The Fund has not tendered for custodian services since Northern Trust was appointed in 2002. Regular tendering for custodian services enables the Fund to demonstrate that it is achieving best value from its appointed custodian.</p> <p><b>Risk: the Fund cannot demonstrate that it is achieving best value from its appointed custodian.</b></p>	<p>The contract can be ended on the provision of 30 days notice. The custodian is effectively monitored on the same timeline as the Fund's Investment Managers as it is their reports that are considered by the Investment Sub Committee. To date, there have been no issues with accuracy or timeliness. Dialogue with the custodian is regular and issue of fees is constant. A recent reduction in fees has been agreed.</p> <p>The Treasury and Investment Section will be tendering Treasury advice services, the Investment Advisory Service and Banking Service in the next financial year. It is intended to look at open ended contracts when these exercises are complete and establish a timetable for retendering open ended contracts by 31 March 2013.</p> <p><b>Responsible Officer</b> Head of Accounting and Budgeting</p> <p><b>Target Date</b> - March 2013</p>	<p>A new Pension Fund investment advisor has been appointed with effect from 1 April 2013. The new advisor has a revised remit, and during the course of 2013 will be asked to undertake a performance review of the Global Custodian, with the outcome of that review being used to inform future strategy for Custodian services. That review will be completed by 31 March 2014.</p> <p><b>Action Partially Completed</b></p> <p><b>Revised Target Date</b> 31 March 2014</p>

No	Issue and Risk	Planned Action / Responsible Officer / Target Date	Update & Status
2	<p>There is no evidence that the annual internal controls reports provided by fund managers and the custodian are reviewed by pensions' staff and Internal Audit each year prior to the Head of Internal Audit and Risk Management preparing his annual opinion on the effectiveness of the Fund's system of internal financial control.</p> <p><b>Risk: there is insufficient evidence available to support the opinion on the effectiveness of the system of internal financial control included within the financial statements.</b></p>	<p>This (2011/12) is the first year that internal control reports have been required from Fund Managers and will form part of the year end process going forward. These reports were reviewed by Internal Audit for 2011/12 and were considered by the Head of Internal Audit and Risk Management when forming his opinion on the effectiveness of the Fund's system of internal financial control. They are referred to in his report.</p> <p><b>Responsible Officer</b>  Head of Accounting and Budgeting &amp; Head of Internal Audit and Risk Management</p> <p><b>Target Date</b> - June 2012</p>	<p>Internal control reports from the fund managers and the global custodian were obtained and reviewed in order to confirm that the appropriate assurances were provided by the independent accountants on the effectiveness of the systems of internal controls in operation throughout the period to 31 March 2012.</p> <p><b>Action Completed</b></p>
3	<p>The admission agreement for one of the new employing bodies admitted to the scheme during 2011/12 was not signed by all relevant parties before the employer was admitted to the scheme, and another could not be found.</p> <p><b>Risk: the rights and obligations of employing bodies cannot be enforced if the admission agreement is not signed and retained.</b></p>	<p>A minor amendment was required to one admission agreement which delayed the formal sign off.</p> <p>In the case of the missing agreement, this involved one employee where, as part of the agreement, all pension costs and liabilities remained with the Council.</p> <p>A checklist will be prepared to ensure that all steps in the Admission Agreement process are complete prior to allowing new employers into the scheme.</p> <p><b>Responsible Officer</b>  Head of Exchequer and Revenues</p> <p><b>Target Date</b> - September 2012</p>	<p>Checklist now in place.</p> <p><b>Action Completed</b></p>

No	Issue and Risk	Planned Action / Responsible Officer / Target Date	Update & Status
4	<p>The establishment of the Pensions Committee to oversee the administration of the Fund provides a good opportunity to review existing governance arrangements to ensure that they are applicable to the needs of a local government pension scheme. The following areas are highlighted for consideration as part of any review:</p> <ul style="list-style-type: none"> <li>• <b>Risk register</b> – although the risk management process outlined in the Funding Strategy Statement is fairly comprehensive, a separate risk register is not maintained for the Fund.</li> </ul>	<p>Agreed the establishment of the Pensions Committee allows governance procedures to reflect the distinct nature of the Pension Fund.</p> <p>Devise a risk register</p> <p><b>Responsible Officer</b> Head of Accounting and Budgeting &amp; Head of Internal Audit and Risk Management</p> <p><b>Target Date</b> - March 2013</p>	<p>The Pension Committee agreed an updated Funding Strategy Statement (FSS) including a statement on key risks and controls relating to the Fund in February 2013. A commitment was also given at that meeting to incorporate any changes arising from CIPFA's updated guidance on 'Managing risk in the LGPS' into the next review of the FSS. It is intended to develop a Fund specific risk register as part of the next review of the FSS.</p> <p><b>Action Partially Completed</b></p> <p><b>Revised Target Date</b> 31 March 2014</p>



No	Issue and Risk	Planned Action / Responsible Officer / Target Date	Update & Status
	<ul style="list-style-type: none"> <li><b>Policies and procedures</b> – policies on the prevention and detection of fraud, and procedures for whistleblowing have yet to be tailored and adopted for the Fund.</li> </ul> <p><b>Risk: the Fund's governance arrangements are not applicable to the needs of a local government pension scheme.</b></p>	<p>Devise policies on the prevention and detection of fraud, and procedures for whistleblowing.</p> <p><b>Responsible Officer</b> Head of Accounting and Budgeting &amp; Head of Internal Audit and Risk Management</p> <p><b>Target Date</b> - March 2013</p>	<p>An updated Governance Policy Statement (GPS) for the Fund was submitted to the Pensions Committee in May 2013. The GPS adopts (and provides links to) the Highland Council's policies on whistleblowing and anti-fraud/anti-corruption policies for the Fund which, after review by officers, were considered suitable for adoption by the Fund without amendment.</p> <p><b>Action Completed</b></p>
	<ul style="list-style-type: none"> <li><b>Duties of pension trustees</b> - the preparation of a tailored Code of Conduct, or handbook for members of the Pensions Committee and Investment Sub-Committee would ensure they were clear about their duties, roles and responsibilities.</li> </ul>	<p>Prepare a code of conduct for members of the Pensions Committee.</p> <p><b>Responsible Officer</b> Head of Accounting and Budgeting</p> <p><b>Target Date</b> - March 2013</p>	<p>The GPS incorporates a section on duties of Pension Fund members, and explains their "quasi trustee" role.</p> <p><b>Action Completed</b></p>

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5	<p>The Resources Committee (now Pensions Committee) does not consider an annual programme of audit work or audit reports, including a year end statement of assurance on the effectiveness of the system of internal control.</p> <p><b>Risk: assurances over the adequacy and effectiveness of the system of internal controls are not available to underpin effective governance and support the governance compliance statement.</b></p>	<p>Given the new requirements for separate reporting on Pension Fund activity an annual programme of work relating to this and a year-end assurance statement will be provided to the Resources Committee.</p> <p><b>Responsible Officer</b> Head of Internal Audit and Risk Management</p> <p><b>Target Date</b> - April 2012</p> <p><i>Update as at June 2012</i> - there was no Pensions Committee meeting in April 2012 so Internal Audit plan to submit their annual programme of work and year end statement to the next available meeting. Work is currently ongoing to support the opinion on the adequacy and effectiveness of the governance arrangements and the systems of internal financial control.</p> <p><b>Revised target date</b> August/September 2012</p>	<p>A report assessing the adequacy, reliability and effectiveness of the Pension Fund's system of internal financial control for the year ended 31 March 2012 was submitted to the Pension Committee meeting on 13 September 2012. Internal Audit's work plan for 2013/14 was submitted to the Pensions Committee in May 2013.</p> <p><b>Action Completed</b></p>

No	Issue and Risk	Planned Action / Responsible Officer / Target Date	Update & Status
6	<p>The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010 sets out in schedule I, part 1, the limits on investments of a certain type that the pension fund is allowed to hold. At present, these limits are monitored by Fund Managers on a portfolio basis but there is no overall monitoring of the limits as they apply to the total Fund.</p> <p><b>Risk: the Fund does not comply with the investments limits in the Regulations.</b></p>	<p>Discussions are on-going with the Pension Fund's global custodian regarding the provision of investment monitoring services for individual fund managers and for the overall Pension Fund.</p> <p><b>Responsible Officer:</b> Head of Accounting and Budgeting</p> <p><b>Target Date -</b> September 2011</p> <p><i>Update as at June 2012 -</i> a meeting with a representative from the custodian has taken place and the options offered are currently being considered by management.</p> <p><b>Revised target date</b> March 2013</p>	<p>Work is ongoing, after initial discussion with the custodian, to identify and implement monitoring arrangements.</p> <p>Consideration is being given to an in-house solution or alternatives which will require custodian or Investment Adviser support. Work was not progressed by 31 March due to other prioritised tasks e.g. transition to Pyrford and bank accounts reconciliation.</p> <p><b>Revised target date</b> September 2013</p>