



Committee and Date

Pensions Committee

15 September 2011

10am

Item

12

Public

INTERNAL AUDIT WORK FOR SHROPSHIRE COUNTY PENSION FUND 2010/11

Responsible Officer Ceri Pilawski

e-mail: ceri.pilawski@shropshire.gov.uk

Telephone:

01743 252027

1. Summary

This annual report provides members with details of the work undertaken by Internal Audit for the year ended 31 March 2011. It reports on progress against the Pension Funds annual audit plan. It also provides the Head of Audit's (Audit Service Manager's) opinion on the internal controls, as required by the CIPFA Code of Practice for Internal Audit in Local Government, which in turn contributes to the review of the effectiveness of the systems of internal control as required by the Accounts and Audit Regulations 2011 4(2).

On the basis of the work undertaken and management responses received; the Pension Fund's financial systems, internal control environment and risk management procedures are sound and working effectively and the Audit Service Manager is able to deliver a positive year end opinion on the Council's internal control environment for 2010/11.

2. Recommendation

The Pensions Committee are asked to note, with or without comment, this report.

REPORT

3. Risk Assessment and Opportunities Appraisal

- 3.1 The delivery of a risk based Internal Audit Plan is an essential part of ensuring probity and soundness of the Pension Fund's financial and risk management systems and procedures and is closely aligned to the Pension Fund's strategic and operational risk registers. The Plan is delivered in an effective manner; where Internal Audit independently and objectively examines, evaluates and reports on the adequacy of its customers control environments as a contribution to the proper, economic, efficient and effective use of resources. It provides assurances on the Internal Control systems, by identifying areas for improvement or potential weaknesses and engaging with management to address these in respect of current systems and during

system design. Failure to maintain robust internal controls creates an environment where poor performance, fraud, irregularity and inefficiency can go undetected leading to financial loss and reputational damage.

- 3.2 The recommendations contained in this report are compatible with the provisions of the Human Rights Act 1998 and the Accounts and Audit Regulations 2011.

4. Financial Implications

- 4.1 The Internal Audit plan is delivered within approved budgets; the work of Internal Audit contributes to improving the efficiency, effectiveness and economic management of the Pension Fund and its associated budgets.

5. Background

- 5.1 This report is the culmination of the work of the Internal Audit team during 2010/11 and seeks to provide an opinion on the adequacy of the governance arrangements and inform the annual review of the effectiveness of the Pension Funds system of internal control by commenting on the nature and extent of significant risks.
- 5.2 The Accounts and Audit Regulations 2011 identify that “a relevant body must undertake an adequate and effective internal audit of its accounting records and systems of internal control in accordance with the proper practices in relation to internal control”.
- 5.3 Internal Audit operates a strategic risk based plan for the Pension Fund. The plan is re-visited each year to ensure that suitable audit time and resources are devoted to reviewing the more significant areas of risk, this results in a comprehensive range of audits undertaken in the year, to support the overall opinion on the control environment.

Annual Internal Audit Opinion from Internal Audit Work undertaken during 2010/11

- 5.4 Shropshire Council provides Internal Audit services for the Shropshire County Pension Fund, as an external client. It is the responsibility of Shropshire County Pension Fund to develop and maintain the internal control framework. In undertaking its work, Internal Audit has a responsibility under the CIPFA Code of Practice 2006 to form an opinion on the Pension Fund’s overall control system. This opinion plays a key part in informing the Pension Fund’s Annual Governance Statement.
- 5.5 The results of individual audits, when combined, form the basis for the overall opinion on the adequacy of the Pension Fund’s internal control systems. No system of internal control can provide absolute assurance against material misstatement or loss, nor can Internal Audit give that absolute assurance. The work of Internal Audit is intended only to provide reasonable assurance on controls on the basis of the work undertaken. In assessing the level of

assurance to be given, I have taken into account the work performed in 2010/11.

5.6 These assurances are provided on the basis that management carry out the actions they have agreed in respect of the recommendations made to address any weakness identified and improvements suggested.

5.7 **On the basis of the work undertaken and management responses received; the Pension Fund’s financial systems, internal control environment and risk management procedures are sound and working effectively and the Audit Service Manager is able to deliver a positive year end opinion on the Council’s internal control environment for 2010/11.**

Key Assurances provided during 2010/11

5.8 Audit assurance opinions are awarded on completion of audit reviews reflecting the efficiency and effectiveness of the controls in place, opinions are graded as follows:

Good	Evaluation and testing of the controls that are in place confirmed that, in the areas examined, there is a sound system of control in place which is designed to address relevant risks, with controls being consistently applied.
Reasonable	Evaluation and testing of the controls that are in place confirmed that, in the areas examined, there is generally a sound system of control but there is evidence of non compliance with some of the controls.
Limited	Evaluation and testing of the controls that are in place performed in the areas examined identified that, whilst there is basically a sound system of control, there are weaknesses in the system that leaves some risks not addressed and there is evidence of non-compliance with some key control.
Unsatisfactory	Evaluation and testing of the controls that are in place identified that the system of control is weak and there is evidence of non compliance with the controls that do exist. This exposes the Council to high risks that should have been managed.

5.9 Audit work is risk assessed on a scale of one to four which is established as part of the Audit Needs Assessment. In 2010/11 we issued five final audit reports which are listed at **Appendix A**. Four of these resulted in a ‘Good’ level of assurance, with the audit of Investment Managers Internal Controls (Majedie & SFI) being given a ‘Reasonable’ level of assurance.

5.10 Audit recommendations are also an indicator of the effectiveness of the Pension Fund’s internal control environment and are rated according to their priority:

Best Practice (BP)	Proposed improvement, rather than addressing a risk.
Requires Attention (RA)	Addressing a minor control weakness or housekeeping issue.
Significant (S)	Addressing a significant control weakness where the system may be working but errors may go undetected.
Fundamental (F)	Immediate action required to address major control weakness that, if not addressed, could lead to material loss.

5.11 A summary of the level of assurance for each fundamental review area together with the number of recommendations made is shown in the table below.

Audit opinion and recommendations made on Pension Fund audits 2010/11

System	Level of Assurance Given	Number of Recommendations made			
		BP	RA	S	F
Pension Fund Investment Managers	Good	0	3	0	0
Pensions Administration	Good	2	6	0	0
Review of Investment Managers Internal Control Reports	Good	0	3	2	0
Review of Investment Managers Internal Controls (Majedie & SFI)	Reasonable	0	0	2	0
Participating Bodies Employee Contributions Controls	Good	1	2	0	0

5.12 It is management's responsibility to ensure accepted audit recommendations are implemented within an agreed timescale. As part of annual audits recommendations are revisited as a matter of course.

Compliance with CIPFA Code of Internal Audit Practice

5.13 The Audit Commission in 2010 reviewed Internal Audit against the Code and was satisfied that it complies 99%. The 1% non-compliance relates to some minor non audit works that, in the Audit Commission's view did not distract from the main business. Internal Audit has completed a self assessment in the current year against the same Code and reported this to Shropshire Council's Audit Committee who continues to be satisfied with its compliance.

List of Background Papers (This MUST be completed for all reports, but does not include items containing exempt or confidential information)

Pension Fund Internal Audit Plan

Code of Practice for Internal Auditors in Local Government 2006 –published

December 2006.

Accounts and Audit Regulations 2011.

Various internal documents supporting the review of the CIPFA Code of Practice checklist.

Audit Management system.

Cabinet Member (Portfolio Holder)

Keith Barrow, Leader of the Council and Brian Williams, Chairman of Audit Committee

Local Member: All

Appendices

Appendix A Summary of Findings from Pension Fund Audit Reports 2010/11

Summary of Findings from Pension Fund Audit Reports 2010/11

- 1 ***Pension Fund Investment Managers*** – This area is reviewed on an annual basis. The audit concentrated on key controls in the following areas:
- The extent to which recommendations made in the 2009/10 audit had been implemented.
 - That investment of the pension fund complies with statute, regulations and any restrictions specified.
 - Appropriate control is exercised over fund managers.
 - Transactions undertaken by Fund Managers are independently recorded and verified.
 - Appropriate accounting entries are made and fund balances are reflected in the accounting system.
 - Relevant management information is provided to strategic management.
 - Information is secure and satisfactorily controlled.
 - Personal data is processed in a secure and controlled manner in line with internal policy and legislation

The audit concluded that there is a sound system of control and the overall level of assurance was assessed as 'good'. It is pleasing to note that the previous recommendation had been implemented. Three minor exceptions were noted in respect of updating procedure notes, checking for compliance in a timely manner where breaches in investment restrictions are identified and the signing of reconciliations of fees deduced to evidence check. Recommendations have been made to address these weaknesses.

Assurance Level: Good

- 2 ***Pensions Administration*** – This area is also reviewed on an annual basis, with a 'full' audit being undertaken every 3-4 years, and interim audits concentrating on key controls. The last 'full' audit was performed in 2007/08 and a full audit is scheduled for 2011/12. The 2010/11 audit concentrated on the following objectives:

- Recommendations made in the 2009/10 Pensions Administration Audit have been implemented;
- Contributions including, employees and employers, are recorded accurately and promptly;
- New starters are identified and recorded accurately;
- Benefits paid are calculated correctly and paid to eligible persons. Changes are appropriately authorised and processed correctly;
- Persons leaving the pension scheme have their deferred pension recorded accurately; any payments made from the scheme to leavers (other than normal pensions) are accurate or appropriately authorised;
- Transfers in and out of the scheme are calculated correctly, actioned promptly and authorised appropriately;
- Administrative costs are dealt with satisfactorily and other costs are recovered accurately and promptly;
- Pensions accounts are balanced in the payroll system;

- Personal data is processed in a secure and controlled manner in line with internal policy and legislation.

Evaluation and testing of the controls that are in place confirmed that, in the areas examined, there is generally a sound system of control. It is pleasing to report, once again, that operations are consistently performed to a high standard.

There were four previous recommendations to follow up from the previous year, all of which were assessed as satisfactorily implemented. The audit resulted in eight recommendations, two of which are best practice recommendations, which are not aligned to any risk. The remaining six minor weaknesses identified relate to consideration of the need to maintain a spreadsheet of contribution rates; having sight of additional identification documents to establish maiden names in a few isolated cases; running reports in relation to the verification of dates of birth; confirming date of death notifications to death certificates; minor changes to the Children's Entitlement to Pension form; and ensuring that option forms are signed by the member before a refund is made.

Additional Testing on Transfers in and Transfers out of the scheme was performed at the end of the year to assist the External Auditors in providing assurance on the satisfactory treatment of transfers into and out of the fund over the whole of the financial year.

Assurance Level: Good

- 3 **AXIS (Pensions System)** – A Computer Audit of the Pensions System is performed on a regular basis, with a 'full' audit being undertaken every 3-4 years, and interim audits concentrating on key controls. The audit scheduled for 2010/11 was postponed due to other priorities that arose during the year.

In postponing this audit from the plan, an assessment was performed of the risk of doing so. This took into account the stability of the system; that there have been no changes in key staff; that there were no previous recommendations and that associated systems audits within this area had found no significant issues.

This audit is in the plan for 2011/12.

- 4 **Review of Investment Managers Internal Control Reports** – This annual review provides assurance on the security and management of our funds, based upon the information provided in 'AAF 01/06' and 'SAS70' reports, which are subject to External Audit review. Reports are reviewed in the first instance by Treasury staff, who seek explanations of any areas where there appear to be weaknesses or concerns in the reports. Following the receipt of these responses, the reports are subject to a second review by Internal Audit.

Overall the audit has provided assurance over the internal control environment of the majority of our Investment Managers. There is a robust system in place for the review of weaknesses identified in SAS and AAF reports. There have been a few exceptions identified which are deemed to be low risk, and where they have not been followed up in the control report, they are being followed up with the respective managers to ensure the issues have been fully addressed

and where necessary improvements made. Six recommendations have been made following this review of control reports, three of which are reiterated from the previous audit. Once satisfactorily implemented, these will provide further assurance in respect of the control environments in operation for Investment Managers. The findings from this audit work will help contribute to the Pension Fund Statement on the adequacy of controls in place for 2010/11.

Assurance Level: Good

- 5 **Review of Investment Managers Internal Controls** – There are two Fund Managers who do not produce SAS70 or AAF 01/06 control reports. Internal Audit invited these Managers, Majedie and Strategic Fixed Income LLC (SFI), to complete a specifically designed questionnaire, the results of which were detailed in a separate report.

Overall the audit has provided some assurance over the internal control environment of the two selected Investment Managers. However, it must be remembered that this review is based upon information provided by the Managers, which has not been subject to any independent review, and not tested by us. The very fact that these reports are not independently assessed presents a higher risk than with managers who complete SAS 70 and AAF (01/06) reports. Last year, two recommendations were made to ensure that a process is put in place to review, challenge and monitor the reports that are available. It is disappointing to report that these recommendations are both reiterated in this report.

Assurance Level: Reasonable

- 6 **Participating Bodies Employee Contributions Controls** – In order to provide assurance to the Fund Administrator and the Pensions Board on the adequacy of contribution levels, a sample of participating bodies (who run independent payroll systems) was approached to request access to their records. All three responded positively, and the Group Auditor and Pensions Team Leader visited the Wrekin Housing Trust, Bridgnorth Town Council and Shrewsbury College in March 2011.

The following checks were made on a sample of employees who are members of the scheme, at each authority:- the pensionable pay was confirmed; the employee contribution rate was identified and confirmed as correct to the employer's records; and the monthly contribution was manually calculated for each employee in the sample and was confirmed to the most recent payslip.

Where written policies were available, a copy was obtained from the employer.

The exercise has been beneficial in providing assurance to the Fund Administrators that assurance can be gained that SCPF is doing as much as is practically possible to ensure that participating bodies are complying with legislation. The bandings make it difficult to do reasonableness checks without this type of exercise.

It has also highlighted that a reminder to apply rates correctly to bandings may be beneficial, and that it is good practice to require that participating bodies provide copies of their policies to enable pension's staff to check for

compliance and to help explain any significant shortfalls in employee contributions, as shown up in the Actuarial Valuations.

Assurance Level: Good