



Committee and Date

Pension Committee

13 September 2012

10 am

Item

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Public

INTERNAL AUDIT OUTTURN REPORT FOR SHROPSHIRE COUNTY PENSION FUND 2011/12

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1. Summary

This annual report provides members with details of the work undertaken by Internal Audit for the year ended 31 March 2012. It reports on progress against the 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).

Final performance has been good with 100% of the plan being delivered.

All assurances given were categorised as Good. A total of 32 recommendations have been made in the six audit reports related to the year. Three Significant recommendations have been made which all relate to the Axis IT system.

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 Fund's internal control environment for 2011/12.

2. Recommendations

The Committee are asked to consider and endorse, with appropriate comment;

- a) Performance against the Audit Plan for the year ended 31 March 2012.
- b) The Audit Service Manager's positive year end opinion on the Fund's internal control environment for 2011/12 on the basis of the work undertaken and management responses received.

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 risk register. The Plan is delivered in an effective manner; where Internal Audit independently and objectively examines, evaluates and reports on the adequacy of the 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 create 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.
- 3.3 There are no direct environmental, equalities or climate change consequences of this proposal.

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.

5. Background

- 5.1 This report is the culmination of the work of the Internal Audit team during 2011/12 and seeks to:
- Provide an opinion on the adequacy of the governance arrangements;
 - Inform the review of an effective Internal Audit by providing performance data against the plan.
- 5.2 The requirement for Internal Audit derives from local government legislation, including section 151 of the Local Government Act 1972 which requires the Pension Fund to make arrangements for the proper administration of its financial affairs. Proper administration includes Internal Audit. More specific requirements are detailed in the Accounts and Audit Regulations 2011, in 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 The CIPFA Code of Practice for Internal Auditors in Local Government defines the scope of the annual report on internal audit activity. The annual report should include an assessment as to the extent to which compliance with the Code has been achieved. This annual report provides information to support that assessment and that an effective Internal Audit is established for the Pensions Fund, in accordance with the requirements of the 2011 Accounts and Audit Regulations. A report on Internal Audit's compliance with the full Code of Practice is reported to the Shropshire Council Audit Committee and can be accessed on the Council website.
- 5.4 Internal Audit operates a strategic risk based plan. The plan is reviewed 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. The plan does not contain any contingency provision; any unforeseen work demands that may arise, i.e. special investigations, would be delivered in addition to the planned work in agreement with the Fund Administrator.

Annual Internal Audit Opinion from Internal Audit Work undertaken during 2011/12

- 5.5 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 enabling Pensions Committee to deliver their annual assurance statement to stakeholders.
- 5.6 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 undertaken on the fundamental systems. Whilst identifying a number of areas where minor improvement can be made, no significant material weaknesses that could result in a material misstatement in the Pension Fund's accounts were identified.
 - From other planned audit work undertaken during the year, there have been no major financial weaknesses or issues identified; the Pension Fund's systems, internal control environment and risk management procedures are sound and working effectively.
- 5.7 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.

5.8 **On the basis of the work undertaken and management responses received; the Pension Fund’s fundamental 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 Pension Fund’s internal control environment for 2011/12.**

Key Assurances provided during 2011/12

5.9 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.

5.10 Audit work is risk assessed on a scale of one to four which is established as part of the Audit Needs Assessment. In 2011/12 we issued six final audit reports which are listed at Appendix A. All of these resulted in a ‘Good’ level of assurance.

5.11 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.

5.12 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.

5.13 A total of 32 recommendations have been made in the six audit reports issued in the year; these are broken down by audit area in the table below.

Audit opinion and recommendations made on 2011/12 audits

System	Level of Assurance Given	Number of Recommendations made				Total
		BP	RA	S	F	
Corporate Governance	Good	0	1	0	0	1
Pension Fund Monitoring	Good	0	4	0	0	4
*Investment Managers Internal Control Reports	Good	0	2	0	0	2
*Majedie and SFI Internal Controls	Good	0	1	0	0	1
Pensions Administration	Good	8	9	0	0	17
Axis IT	Good	0	4	3	0	7
Totals		8	21	3	0	32
Percentage		34%	66%	0	0	100%

* Note that these two audits are performed early in 2011/12, when up to date information is available.

5.14 Good assurance was given to all audit areas examined in the year. In each case positive responses have been received by management and will be followed up next year to determine whether satisfactory action has been taken.

5.15 The team has achieved 100% of the plan which is in line with its target, although some work on Pensions Administration was completed in April 2012.

5.16 It is management's responsibility to ensure accepted audit recommendations are implemented within an agreed timescale. No recommendations have been rejected in the year by management.

5.17 Of the 32 recommendations made three are rated as significant and 21 are rated as requires attention. The remaining best practice recommendations are designed to add value to the high level of controls in place. This is a reflection of the experience and diligence of the staff in the team, as there are so few significant recommendations and no fundamental recommendations from the audits performed.

Quality Assurance/Customer Feedback Survey

- 5.18 A customer feedback survey form is sent out with the all audits completed. These provide key feedback on the quality of audit service in relation to a number of areas, including:
- Pre auditing arrangements;
 - Post audit briefings;
 - Audit scope;
 - Accuracy, clarity and timeliness of the report production;
 - Practicality of recommendations;
 - Professionalism of approach and
 - Communication skills.
- 5.19 The surveys are a key part of ensuring the work meets our client expectations and that the quality of audit work is maintained. Only two survey forms were returned; the results have been analysed over the last year and are identified in the table below. Overall the results are pleasing, showing services delivered consistently at a high level.

Customer Feedback Survey Forms - percentage of excellent and good responses

Item Being Scored	2011/12
Pre-audit arrangements	100%
Post-audit briefing	100%
Audit coverage/scope of the audit	100%
Timeliness of production of report	100%
Accuracy and clarity of report	100%
Practicality of recommendations	100%
Professionalism of approach	100%
Communication skills	100%
Timeliness, competence, manner	100%
Number of forms returned	4

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.

Cabinet Member (Portfolio Holder)

N/A

Local Member - N/A

Appendices

Appendix A - Summary of Findings from Pension Fund Audit Reports 2011/12

Summary of Findings from Pension Fund Audit Reports 2011/12

1 Pension Fund Investment Managers Monitoring - This area is reviewed on an annual basis. The audit concentrated on key controls in the following areas:

- Previous recommendations have been implemented.
- Investment of the 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'. Whilst limited progress had been made in respect of the three previous recommendations, this has not affected the assurance level. The four minor exceptions noted are in respect of updating procedure notes, ensuring that fees deducted directly from the fund value are appropriately checked and authorised, reconciling fees deducted to ensure that they are in line with managers agreements and the prompt roll over of previous years balances. Recommendations have been made to address these weaknesses.

Assurance Level: Good

2 Pensions Administration – This area is also reviewed on an annual basis. The 2011/12 audit concentrated on the following objectives:

- Recommendations made in the previous Pensions Administration Audit, the Audit Commission Audit and the Employee Contribution Audit have been implemented.
- Fund Administrators have sufficient resources and skills to effectively process transactions.
- 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.
- Pension payments made on the payroll are processed accurately, in a timely manner and are authorised appropriately.
- 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 and 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 recovered accurately and promptly.
- Pension accounts are reconciled on a regular and timely basis.
- Personal data is processed in a secure and controlled manner in line with internal policy and legislation.
- Management information is accurate and reliable.

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

Eight previous recommendations were followed up together with three previous recommendations from the audit of participating bodies' employee contributions controls. The audit resulted in a total of 17 recommendations, five of which were reiterated from last year. Of these, eight are best practice recommendations, which are not aligned to any risk. The remaining nine minor weaknesses identified relate to the need to verify dates of birth for some pensions in payment; including version control details on procedure notes; the development of a procedure note to define tolerance levels for differences in year-end contribution reconciliations; the prompt completion of employer contribution year-end reconciliations; procedure notes relating to strike action need to be updated. In addition it was identified that outstanding responses from employees relating to strike action should be pursued; the incorrect treatment of transfer out values for female members with no post-1988 service; the authorisation structure for high value payments needs to be formalised and the contributions spreadsheet was a little out of date.

Assurance Level: Good

3 **AXIS (Pensions System)** – This area is also reviewed on a regular basis. Members will recall that this audit was postponed from 2010/11 due to other priorities that arose during the year. The 2011/12 audit concentrated on the following objectives:

- The system complies with all external legislation and policies.
- The application is secure.
- Users have received the required training.
- Parameter data is correct, updated in a timely manner and access is restricted.
- Data is accurately input and the authenticity of the data is verified.
- Data is processed in a timely manner and validated.
- Output is secure, accurate and reaches the intended recipient in a timely manner.
- There are continuity processes in place to ensure system availability.
- Management/Audit trails are in place
- Changes to the system are managed effectively.
- Recording and documentation is retained for key changes made to the

system.

- Clear procedures are in place for the authorisation of changes.
- System changes are applied by appropriately qualified staff.
- Interfaces with the system are secure, efficient and effective.

The audit identified three weaknesses which are deemed to be significant. These highlighted that users of the AXIS application should not have access to their own record; the restricting of administration level access rights to the Exchequer Systems team and the need to investigate errors on the back up logs.

Assurance Level: Good

4 Corporate Governance – This is the first audit of Corporate Governance of the Pension Fund. The audit concentrated on the following objectives:

- Fund objectives are defined, agreed and supported by appropriate performance and risk management processes, to include consideration of fraud risk.
- An appropriate investment strategy is in place and has been adopted.
- Operational investment processes support the investment strategy to ensure maximisation of investment returns.
- Performance of external advisors and service providers is managed to maximise their contribution to the values of the fund without placing excessive reliance upon them.
- Fund assets are sufficient to meet its obligations and liabilities, avoiding an adverse impact on the council tax payer / service provision.
- Accurate accounting records are maintained and appropriate statutory reports including unqualified statutory accounts are produced.
- Relevant statutory regulations including updates to LGPS are adhered to.
- There is a system in place to communicate adequately with all relevant stakeholders.
- Those charged with the governance of the fund and the scheme are able to fulfil their responsibilities effectively.

It was extremely pleasing to report that review of these areas gave rise to only one minor recommendation relating to consideration of the inclusion in the risk register of the risks and opportunities in moving to the Shared Service function and the potential impact that this may have upon the ability of the team to continue to provide the Pensions Administration service.

Assurance Level: Good

5 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, SOC1 and SSAE16 reports, which are subject to External Audit review. The review is performed after the financial year end, when the most up to date reports are available, in order to give the Pensions Committee reliance upon the most recent information available. 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 these reports. There have been a few exceptions identified in the reports 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. Two minor recommendations have been made following this review of control reports which are aimed at improving the process next year.

Assurance Level: Good

- 6 **Review of Investment Managers Internal Control Self Assessments –** There are two fund managers who do not produce AAF 01/06, SOC1 or SSAE16 control reports. Treasury Management 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. As with the other investment managers, this audit review was also completed in June 2012. Overall the audit has provided some assurance over the internal control environment of the two 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 independently assessed reports. It is commendable that only one minor recommendation has arisen from review of these practices.

Assurance Level: Good