

**DEVON PENSION FUND**  
**ANNUAL INTERNAL AUDIT REPORT 2014/15**  
**and**  
**PROPOSED INTERNAL AUDIT PLANS 2015/16**

**Section 1 - ANNUAL INTERNAL AUDIT REPORT 2014/15**

**1 INTRODUCTION**

1.1 The following report sets out the background to audit service provision, review work undertaken in 2014/15, and provides an opinion on the overall adequacy and effectiveness of the Authority's internal control environment.

1.3 This supports the organisation in complying with the Accounts and Audit Regulations 2011 which requires all Authorities to carry out a review at least once in a year of the effectiveness of its system of internal control, and to incorporate the results of that review into their Annual Governance Statement (AGS). The AGS must then be published with the Annual Statement of Accounts.

**2 BACKGROUND**

**2.1 Service Provision**

2.1.1 The Internal Audit (IA) Service for the Devon Pension Fund (the Fund) is delivered by the Devon Audit Partnership. This is a shared service arrangement between Devon County Council, Torbay Council and Plymouth City Council constituted under section 20 of the Local Government Act 2000.

**2.2 Regulatory Role**

2.2.1 There are two principal pieces of legislation that impact upon internal audit in local authorities:

- **Section 6 of the Accounts and Audit Regulations (England) Regulations 2011** which states that ".....a relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control ....."
- ".....a larger relevant body must, at least once in each year, conduct a review of the effectiveness of its internal audit ....."
- **Section 151 of the Local Government Act 1972**, which requires every local authority to make arrangements for the proper administration of its financial affairs.

2.2.2 There are also professional guidelines which govern the scope, standards and conduct of Internal Audit, including the Public Sector Internal Audit Standards (PSIAS).



2.2.3 In addition, Internal Audit is governed by policies, procedures, rules and regulations established by the Authority. These include standing orders, schemes of delegation, financial regulations, conditions of service, anti-fraud and corruption strategies, fraud prevention procedures and codes of conduct, amongst others.

### 3 OBJECTIVES AND SCOPE

3.1 This report presents a summary of the audit work undertaken; includes an opinion on the adequacy and effectiveness of the Fund's internal control environment. The report outlines the level of assurance that we are able to provide, based on the internal audit work completed during the year.

3.2. The Head of Devon Audit Partnership is required to provide the Authority with an assurance on the system of internal control of the Fund. It should be noted, however, that this assurance can never be absolute. The most that the internal audit service can do is to provide reasonable assurance, based on risk-based reviews and sample testing, that there are no major weaknesses in the system of control. In assessing the level of assurance to be given the following have been taken into account:

- all audits completed during 2014/15
- any significant recommendations not accepted by management and the consequent risks
- internal audit's performance
- any limitations that may have been placed on the scope of internal audit.

### 4 INTERNAL AUDIT COVERAGE 2014/15

4.1 Financial management arrangements within the Authority are well established and staff have many years of experience giving them a good understanding and knowledge of the financial controls and requirements of regulations and policies. The individual assurance opinions issued in respect of our assignment work were as follows:

Key – PF = Pension fund PP = Peninsula Pensions

Areas Covered		PF or PP	Level of Assurance
1	Treasury Management	DCC & PF	Good standard
2	Performance of Fund managers and External Investment Advisor- Administrative processes and procedures	PF	High Standard
3	Review of contingency arrangements / Transition management arrangements - in the event of the collapse of a fund manager, or negligence or wilful default	PF	Good Standard
4	Custodian services - these exist and performance is regularly monitored	PF	Good Standard

Cnt'd

Areas Covered		PF or PP	Level of Assurance
5	Admission and departure of employers to the fund. Administrative processes and procedures. Impact on Fund liabilities. Admitted Bodies Status.	PF & PP	To be finalised in Quarter 1
6	Accounting regulations	PF	High Standard
7	Pension Fund systems may not be secure and appropriately maintained	PF	N/A*
8	Concentration of knowledge in a small number of officers- risks of departures and ill health	PF	Good Standard
9	Strain Payments	PP	High Standard
10	Organisational Review	PP	N/A*
11	Refunds – with reference to new regulations	PP	Good Standard

\*Pension Fund Security: There was no output for this audit as during the initial testing stages it was identified that there was considerable overlap with other audit work as there was only the one bespoke system for the Custodian Services (which was audited at the end of the financial year) and the other systems used are DCC's general ones and we were able to rely upon work undertaken during the DCC Material Systems audits.

\*Organisational Review – this was a piece of consultancy audit work designed to support the progress of the new processes and procedures rather than assurance work designed to provide an opinion.

4.2 Our reviews provided sufficient evidence that the Devon Pension Fund and Peninsular Pensions have suitable governance arrangements in place to mitigate exposure to identified risks. Good working practices are in place to meet statutory requirements. The Investment and Pension Fund Committee are kept well informed, concerning the Fund's value and the allocation of assets, and are updated regarding the LGPS Governance scheme.

4.3 We identified some areas where controls could be improved and actions were agreed with management, however the activities were, in some places, limited due to the funding /resource constraints. This was particularly noticeable for the refunds audit. Executive summaries from our work are shown in Appendix A

## 5 INTERNAL AUDIT OPINION

5.1 In carrying out systems and other reviews, Internal Audit assesses whether key, and other, controls are operating satisfactorily within the area under review, and an opinion on the adequacy of controls is provided to management as part of the audit report.

5.2 Our final audit reports also include an action plan which identifies responsible officers, and target dates, to address control issues identified during a review. Implementation of action plans are reviewed during subsequent audits or as part of a specific follow-up process.



devon **audit** partnership

5.3 Management have been provided with details of Internal Audit's opinion on each audit review carried out in 2014/15 to assist them with compilation of their individual annual governance assurance statements. No significant weaknesses were identified in these reviews, however if any significant weaknesses had been identified in specific areas, these would have been considered by the Authority in preparing its Annual Governance Statement which is included with its published Statement of Accounts for 2014/15.

5.4 Overall, and based on work performed during 2014/15, Internal Audit is able to provide reasonable assurance on the adequacy and effectiveness of the Fund's internal control environment.

## **Section 2 - INTERNAL AUDIT PLANS 2015/16**

### **1 INTRODUCTION**

1.1 Under the Local Government Act 1972, the Chief Financial Officer has a statutory duty to make arrangements for the proper administration of the Authority's financial affairs. Assurance that this is the case is given through the reporting of Internal Audit. Audits will be carried out under the terms of Accountancy and Audit Regulations 2011.

1.2 As the Internal Auditors for the Pension Fund it is our responsibility to ensure that all financial systems are operating effectively and in line with the Authority's financial regulations. and for Peninsula Pensions it is our responsibility to ensure that we provide an independent, objective assurance service, designed to add value and improve the organisations operations. We help the Pension Fund accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. We achieve this through the two audit plans: one for the Devon Pension Fund and one for Peninsular Pensions

### **2 THE AIM OF THE PLANS**

2.1 The audit plans are reviewed and agreed on an annual basis, incorporating the key risks identified through the Fund's risk register and areas identified by Internal Audit in consultation with management. However recent good practice also recognises that it is advisable for plans to remain flexible, to enable them to be amended according to prevailing risks and changes to the control environment in the organisation, so whilst the annual plan should be approved at an appropriate level, it should also be capable of being flexed as necessary. The plan also incorporates the requirements of the external auditors in reviewing finance systems. The plan is also shared with the external auditors.

2.2 The main objectives of the plan are to provide assurance to the Chief Financial Officer and the external auditors that all financial systems are: -

- Secure
- Effective
- Efficient
- Accurate
- Complete
- Compliant

2.3 In order to confirm this risk-based reviews; system reviews and compliance testing are completed at the Fund's administrative office and at Peninsular Pensions offices.

### **3 THE PLANS**

3.1 The audit plans for the financial year 2015/16 allows for up to 40 days of internal audit support for the Pension Fund and 45 days of internal audit support for Peninsular Pensions.

3.2 These include the financial audit reviews required as part of the Internal Audit service's responsibilities in reporting to the Chief Financial Officer, but also satisfy external auditors of the security and effectiveness of the financial systems. but also satisfy external auditors of the effectiveness of the control, risk and governance arrangements established by management.

3.3 We liaise with the Fund's external auditors to discuss the testing planned to ensure they can place reliance on the work of internal audit. The remainder of the planned days incorporates reviews of specific systems as identified through an audit risk assessment process, the Authority's risk register and discussion with management.

3.4 Any significant findings from the previous year's audit plan will be reviewed to ensure that agreed recommendations have been implemented and are effective.

3.5 As part of the audit plan we will also provide assistance and advice, and be a central contact point for senior management.

#### 4 TIMETABLE

4.1 The audits will be completed at specified times of the year through consultation and prior agreement with senior management. This will also take into account the timetable of external audit where applicable.

4.2 All findings will be reviewed with senior management at the end of each audit programme and prior to the issue of any draft reports.

4.3 A copy of all final reports will be forwarded to your External Auditors for their information.

#### 5 2015/16 PLANS

5.1 The following table sets out the planned internal audit work for 2015/16. Other issues and systems are sometimes identified during the course of the audits and if found will be discussed with senior management. These issues may be incorporated into future audit plans dependent upon priority and risk assessment.

#### Devon Pension Fund Plan 2015/16

<b>Audit risk areas</b>	<b>Days</b>
1. Governance arrangements appropriate to the new legislation to be introduced in April 2015	15
2. The Investment and Pension Fund Committee are unable to fulfil their responsibilities effectively resulting in: <ul style="list-style-type: none"> <li>• Non-compliance with legislation or best practice</li> <li>• Inability to determine policy, make effective decisions and / or deliver service</li> <li>• Risk to reputation</li> </ul>	10
3. Treasury management (reconciliation of loans / deposits and returns)	2
4. Accounting regulations	5
5. Communication - insufficient communication and engagement with the Pension Fund Stakeholders	5
6. Planning	3
<b>Total days</b>	<b>40</b>



devon **audit** partnership

5.2 The cost of these days will be £10,200 (plus VAT). Additional support will be provided as and when required. Our standard daily rate for this work will be £255, although specialist support may be at a different rate.

### Peninsular Pension Plan 2015/16

<b>Audit risk areas</b>	<b>Days</b>
1. Member self service	10
2. Retirements	15
3. New style pensions – career averages	5
4. New code of conduct from Pension Regulator	10
5. Audit planning	5
<b>Total days</b>	<b>45</b>

5.3 The cost of these days will be £11,475 (plus VAT). Additional support will be provided as and when required. Our standard daily rate for this work will be £255, although specialist support may be at a different rate

Robert Hutchins  
Head of Devon Audit Partnership  
May 2015

## Executive Summaries for audits completed in 2014/15

**PF: Treasury Management:** The control environment relating to the Pension Fund Treasury Management (TM) function is generally robust. There are comprehensive procedures in place, including an approved TM Strategy, and relevant officers are knowledgeable and experienced. Investments placed are appropriate, with the transfer of monies being independently checked and authorised. With the exception of Pension Fund investments, TM activity is regularly reconciled to the main accounting system; and it is pleasing to note that only a small number of recommendations have been made in this year's report.

Sample testing of Pension Fund investments placed did not identify any issues

**PF: Performance of Fund Managers:** The Devon Pension Fund has adopted reasonable processes to manage the performance of both the Fund Managers and the External Independent Advisor. These were found to be comparable to how other local authorities manage their pension funds.

We were unable to find evidence of a formal tender exercise having been undertaken prior to the Independent Advisor being appointed in 2010. Despite this, we did not have concerns with the credentials of the current Advisor, and the appointment had been subject to a formal review and approval from the Investment and Pensions Committee.

There are currently no performance measures within the contract in place to monitor the performance of one Advisor. The Fund should consider a periodic review of all third parties to ensure that quality of service is being provided.

**PF: Contingency Arrangements:** The loss of funds in the event of the collapse of a Fund Manager will affect the valuation of the Devon Pension Fund. However a number of controls are in place to mitigate the effects of this event. There is guidance provided by CIPFA that the Investment Team are expected to follow and the audit found that here are measures in place to meet these requirements.

The tendering process is utilised when considering new Fund Managers and their performance is also fully reported to and scrutinised by the Investment and Pension Fund Committee. These elements were examined within the audit of the Performance of Fund Managers and the External Advisor carried out in June 2014 which resulted in the audit opinion of "High Standard" being given.

We confirm that there is a separation of duties between the Investment Management and Custody of Investments.

See below regarding the audit of the new Custodian arrangements in place after 1st September 2014.

Further to the annual report and accounts for 2012/13 all Fund Managers used by the Fund were checked to the Financial Services Register and found to be approved by the regulatory authorities. Evidence was also provided that the Fund is meeting the guidelines covered within the "Principles for Investment Decision Making in the Local Government Pension Scheme in the United Kingdom."



Transition Management could not be tested in this audit as the contracted provider JP Morgan withdrew this service in 2013. At the time of the audit it was confirmed with the Investment Team that the service would be covered on an ad-hoc basis with established contacts within the financial services field in the intervening time. This is because a more formal contract to provide Transition Management was in the process of being drawn up with the new Custodian, Northern Trust. Recommendations and papers were being written by the Investment Team for approval by the Investment and Pension Fund Committee at their meeting on 12th September 2014.

**PF: Custodian Services:** At the time of this audit a new Custodian Contract with Northern Trust had just commenced following a successful tender through the National Framework that was overseen by Devon Procurement Services.

Northern Trust are a fully authorised and regulated financial institution for this service, where all the assets of the Devon Pension Fund are held and administered under a Service Level Agreement with Key Performance Indicators. We were unable to examine any reviews of performance of the Custodian as the contract had only just started but on discussion with the Investment Team, there have been substantial communications already to ensure the performance meets the needs of the Devon Pension Fund. It was also established that Devon Procurement Service will annually monitor the contract with the Investment Team as part of their own monitoring, to ensure the Custodian is meeting expectations.

The responsibility for reviewing and reporting the performance of the Custodian is held by the County Treasurer for Devon County Council. We were unable to confirm at the time that a regular report was made to Committee for scrutiny. It was established that reporting would be made on an exceptional basis by the Investment Team. However in order to improve governance after the annual report by the Custodian to the Investment Team, it was recommended that this be incorporated into the quarterly report for subsequent Committee meetings.

**PF: Accounting Regulations:** The Investment team is responsible for managing the Fund's investments and actuarial valuations. The Fund was valued at approximately £3bn as at 31 March 2014. In common with many other local government pension schemes, we understand that the fund is at present approximately 83% funded.

Significant changes have been made in recent years in respect of accounting and disclosure standards relating to Pension Funds. The relevant standards are Financial Reporting Standard 17 (FRS17), International Accounting Standard 19 (IAS 19) and the recent amendment, and the forthcoming impact of FRS 102, the new financial accounting standard.

Our review has indicated that there were adequate controls are to ensure that all the relevant statutory and regulatory accounting and financial reporting standards are in place, and that regular updates and guidance are received in respect of any forthcoming new guidance and legislation.

Whilst a new pension Custodian has recently been appointed following the successful completion of a full external tendering process, this is not expected to impact in any way on the present internal control and statutory reporting processes.

We made three recommendations to further enhance arrangements. These related to; 1) keeping up to date with new and amended accounting and disclosure standards; 2) the

frequency of internal and external pension fund reconciliations and; 3) the independent oversight of these reconciliations; these recommendations have been agreed by management.

**PF: Concentration of knowledge in a small number of officers:** At present, the risk of a breakdown in internal processes and service delivery has been scored as high. The Fund team has acknowledged that there are a number of controls which need to be put in place in order to reduce this level of risk. This includes the introduction of a revised procedure manual to encompass all investment and treasury management tasks. The Investment Manager confirmed that the manual will be revised and fully up to date by the end of March 2015.

**PP: Strain Payments:** Following a walkthrough of processes and procedures and sample testing, we found that there were reasonable processes in place to manage the correct calculation and recovery of strain payments.

Our testing included a sample of 10 strain payments. In one of this sample we identified that an incorrect payment amount had been stated on the original invoice sent to the employer and an incorrect cost for the strain payment on the original estimate provided. We would consider the incident to be isolated and mainly due to human error. Overall we would consider that there were good controls in place to check the accuracy of strain costs, and to mitigate the risks of incorrect or non-payment of a strain cost. The errors identified were corrected.

**PP: Refunds:** There are adequate processes and procedures in place with regard to the processing of refunds of employees' contributions. Comprehensive process notes have been produced for staff to follow and training has been provided. However, there is currently a back log of refunds that require processing. The increase in refunds is due partly to the changes in the legislation but also there was a period earlier in the year when refunds were not prioritised owing to the fact that other issues had a higher priority.

It is understood that the issue of outstanding refunds was discussed with the County Treasurer, Devon County Council (DCC) and Peninsula Pensions Senior Management Team.

Numbers regarding outstanding refunds as at 6th November 2014 were:

- 2965 Frozen refunds where the member has not made contact (1493 of these are DCC)
- 385 Frozen refunds outstanding for calculation
- 125 Actual refunds awaiting to be calculated and paid.

It is clear that, at least temporarily, additional resources need to be allocated to the processing of refunds in order to clear the back log.

From our sample of testing employees' pension contribution refunds were found to be calculated and paid accurately with adequate controls in place and records retained.

PP Response – It should be noted that the figure of 2965 reflects the number of scheme members who have entitlement to either a refund or transfer from the Devon & Somerset Funds, their records have been updated by Peninsula Pensions, they are not outstanding work within the team.



devon **audit** partnership

The LGPS Regulations changed 1/4/14 increasing the number of scheme members entitled to refunds which has impacted on the team resources.

We have invested in additional staff and following their training have been able to address this backlog with positive results, reducing the numbers by approximately 50% in both cases but also reducing the time it takes for monies to reach scheme members. At the beginning of 2014/15 we were completing approximately 30 refunds per month which has now increased to 50-60 per month.