

27 April 2017**Agenda Item: 7****REPORT OF SERVICE DIRECTOR – FINANCE, PROCUREMENT &
IMPROVEMENT****PENSION FUNDS AND THE ROLE OF AUDIT****Purpose of the Report**

1. To present information for Board members on the role of audit in the governance and control of the Nottinghamshire Pension Fund.

Information and Advice***Internal and External Audit***































2. The financial arrangements of the Nottinghamshire Pension Fund are subject to audit by both internal auditors and external auditors. Whilst both sets of auditors share some characteristics and there will be some degree of overlap in scope between the two, there are notable differences in the roles that each delivers.
3. The key distinction lies in the primary focus for internal and external auditors, as summarised below:
 - External auditors are primarily concerned with the annual financial statements and whether these present a true and fair view of the Pension Fund's financial position
 - Internal auditors are primarily concerned with the effectiveness of the arrangements for governance, internal control and risk management. The Public Sector Internal Audit Standards define internal auditing as, '*...an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*'
4. Both internal and external auditors are required to be independent of the activities they audit, and both are required to conduct their work, and report their findings, in accordance with the proper standards. There is also a duty on both to take account of each other's work, to minimise the risk of duplication and so ensure inefficiency in the overall audit regime. Typically, external audit will look to place reliance on the work of internal audit wherever possible.
5. The external auditor of the Nottinghamshire Pension Fund is appointed by Public Sector Audit Appointments Limited, a body approved for this purpose by the Secretary of State for Communities and Local Government. The current external auditor of the Pension Fund is

KPMG. The internal audit provider is Nottinghamshire County Council's Internal Audit Section, an in-house team of approximately 11 full-time equivalent staff.

Internal audit approach to planning and risk assessment




6. The work of the external auditor is somewhat rigid in terms of its scope and timing, being driven by the objective of delivering the annual opinion on the Pension Fund's financial statements. Members received the report of External Audit for 2015/16 at its meeting in September 2016, and this set out the scope, objectives and findings from the external audit activity last year. The remainder of this report focuses on the work of Internal Audit.
7. The input of Internal Audit is much more flexible, both in terms of its timing and scope. The starting point is for Internal Audit to carry out an annual Audit Needs Assessment to plan its work across the County Council on a rolling three-year basis. All areas of the Council's activity, including the Pension Fund, are risk assessed, using an established methodology. This is based around a weighted scoring approach, using the following risk factors:
 - Value and volume of transactions involved with the activity
 - The known level of internal control in place (from previous audits)
 - The value of cash and bank transactions
 - The relative complexity of the activity
 - Whether the activity is stable or subject to change
 - How sensitive the activity is for the Council among its key stakeholders
 - The number of sites where the activity is carried out
 - The number of years since the previous audit
8. This results in each area of activity being categorised as high/medium/low priority and, having matched this against the resources available to the Internal Audit team, a draft Annual Audit Plan is drawn up. Consultations are held with senior Council officers on the content of the draft plan, culminating in the presentation of the Annual Plan to the Council's Audit Committee in March each year.
9. The current Audit Needs Assessment includes an entry for pensions activity. The screen print below at **Table 1** is an extract from the Internal Audit Section's automated system showing the outcome of the assessment as 'high priority'. This is not to suggest that there is specific intelligence to hand that the control, governance and risk management arrangements for pensions are a cause for concern. The priority rating is a product of the weighted scoring factors described above and, given the high value and volume of transactions which are processed through the Pension Fund each year, it is expected that this will remain a high priority activity for Internal Audit coverage.
10. Currently, Internal Audit aims to cover all high priority areas at least twice in each rolling three-year period. Medium priority areas are covered once, and no coverage is scheduled for low priority activities. As will be seen below at paragraph 13, there has been some form of coverage by Internal Audit in each of the past three years.

Table 1 – Audit Needs Assessment for Pensions

Entity	Process Process Area2 Name	Process	Assessm	Score	Rating
 Customers & Human Resources	Customers & Human Resources	 Pensions		69.14	High
 Customers & Human Resources	 Pensions	 Value		100.00	Very High
 Customers & Human Resources	 Pensions	 Volume		80.00	High
 Customers & Human Resources	 Pensions	 Internal Control		60.00	Medium
 Customers & Human Resources	 Pensions	 Cash & Bank		40.00	Low
 Customers & Human Resources	 Pensions	 Complexity		100.00	Very High
 Customers & Human Resources	 Pensions	 Stability		80.00	High
 Customers & Human Resources	 Pensions	 Sensitivity		60.00	Medium
 Customers & Human Resources	 Pensions	 No. of Sites		20.00	Very Low
 Customers & Human Resources	 Pensions	 Time since last audit		80.00	High

Types of Internal Audit input

11. The nature of the work carried out by Internal Audit may vary, depending on more detailed assessments of how the internal audit resource can best be used from year to year. The main types of audit coverage are the following:
 - a) Assurance reviews – a structured, risk-based approach to evaluating the effectiveness of governance, control and risk management in an area of activity
 - b) Counter-fraud activity – targeted work to deter, detect or investigate suspected cases of fraudulent activity
 - c) Advice and consultancy input – ad hoc assignments and advisory input to assist management in addressing areas of current concern
 - d) Certification work – testing of formal returns and statements to certify their accuracy to external parties. This type of input is unlikely to be relevant to the Pension Fund.
12. The most common form of audit input is the assurance review. The Internal Audit team applies a risk-based approach to this work, in accordance with public sector audit standards. The key stages of this approach are set out in **Appendix 1**. All assurance reviews result in the issue of one of three standard audit opinions about the level of assurance that can be provided to management as a result of the audit:

	LIMITED ASSURANCE	Risk levels are high
	REASONABLE ASSURANCE	Risk levels are acceptable
	SUBSTANTIAL ASSURANCE	Risk levels are low

Audit reporting and follow-up in the overall governance framework

13. As indicated in Appendix 1, Internal Audit's final reports are circulated to the pertinent Councillors and senior officers at the Council. Reports relating to pension fund activity are distributed to:

Councillors

Leader of the Council
Leaders of the opposition parties
Audit Committee members

Officers

Corporate Director of Resources
s151 Finance Officer
Pensions service managers
External auditor

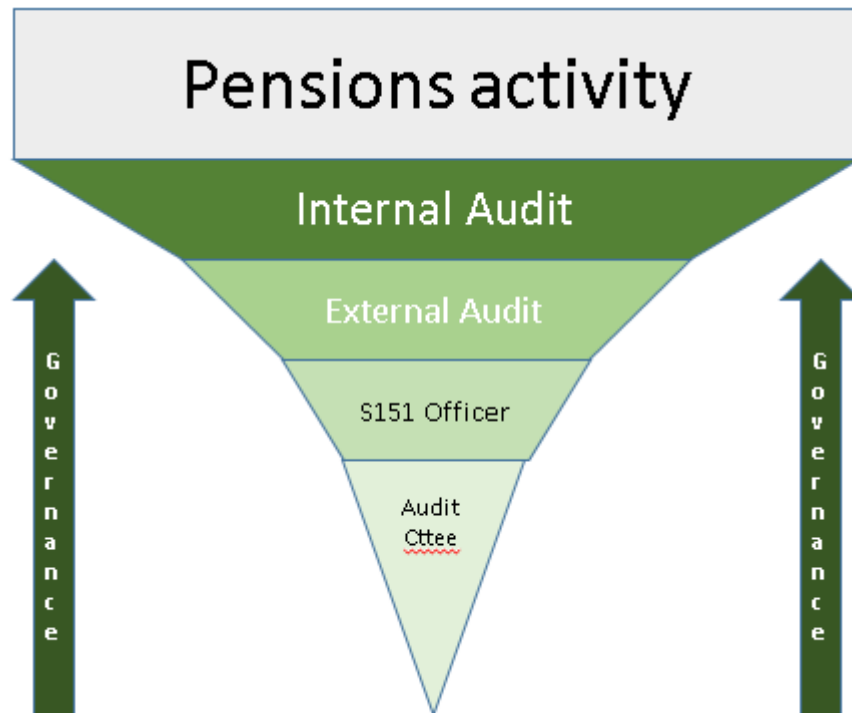
14. In addition to the above, six-monthly reports are formally presented to the Audit Committee to set out progress against the Annual Audit Plan. These incorporate summaries of each report issued, noting the audit opinion and a reminder of the key findings.
15. Internal Audit carries out regular follow-up work to obtain assurance that the actions proposed by management in response to the service's recommendations are being taken. This assurance is obtained in two phases, as set out below in **Table 2**:

Table 2 – two-stage approach to the follow-up of audit recommendations

Priority rating of recommendation	Management assurance	Internal Audit assurance
High	Assurance is sought from management that all agreed actions have been taken	Compliance testing scheduled to confirm all agreed actions relating to high priority recommendations are carried out consistently.
Medium		Compliance testing is scheduled for selected medium priority actions
Low		No Internal Audit compliance testing is carried out
Value For Money (VFM)		Compliance testing may be scheduled for the more significant VFM recommendations

16. The potential span of Internal Audit's coverage places it at the forefront of scrutiny within the overall governance framework for pensions activity. Allied with the inputs of the external auditor, and the over-arching monitoring roles of the Council's s151 Officer and the Audit Committee, the current arrangements provide for a tiered approach, as depicted below in **Table 3**.

Table 3 – Tiered approach to scrutiny over pensions activity



Recent and planned Internal Audit coverage of pensions

17. The following sets out the Internal Audit work carried out over the past three years, along with details of work planned for the coming financial year.

Topic	Type of audit input	Outcome
2014/15		
Pension Fund Management	Assurance	<p>Audit Opinion: Reasonable assurance</p> <p>Controls were effective in many risk areas relating to the management and governance of pension fund investment activities. Notably, effective arrangements were in place for the selection of investments and the assessment of risk and for the selection and use of suitable counterparties for investment. Reliable procedures were being followed to ensure cash is available to meet the Council's needs and to meet statutory requirements for treasury management activity.</p> <p>Two medium-priority recommendations were raised and accepted for implementation:</p> <ul style="list-style-type: none"> • Business continuity - Arrangements in case of service disruption, including staff cover and resilience, should be documented in a business continuity plan and regularly reviewed • Authority to deal with brokers - Brokers used by the Council should be issued a list of officers authorised to make deals on behalf of the Council <p>In addition to the above, low priority recommendations were made in relation to the following:</p> <ul style="list-style-type: none"> • Pension fund committee member self-assessments • Documentation and update of procedure notes

Topic	Type of audit input	Outcome
		<ul style="list-style-type: none"> Periodic purge of access to network files Evidence of the independent authorisation of reconciliations Set-up and use of payment templates for regular counter-parties
Prosecution of fraudulent activity	Counter-fraud	Advice and support with the prosecution of the daughter of a deceased pensioner who failed to notify the Council of her mother's death in 1986 and continued cashing monthly cheque payments. Approximately £68,000 was cashed fraudulently and the perpetrator was given a 26-week prison sentence, suspended for two years, plus an order to pay an £80 victim surcharge. It has not proved possible to recover any further monies.
National Fraud Initiative	Counter-fraud	A biennial data-matching exercise administered by the Cabinet Office, including the matching of pensions in payment against the Department of Work and Pensions records of deaths. Internal Audit takes responsibility for compiling the data for submission to the Cabinet Office and subsequently for overseeing the investigation of data-matches reported back to the Council. Data was compiled and submitted in this financial year.
2015/16		
Civica UPM Pensions System implementation project	Advisory/consultancy	Advisory input to the project for the replacement of the pensions administration system. Internal Audit advice focused on the controls over system testing and data migration from the previous system.
Pensions to payroll data-matching	Advisory/consultancy	Data analysis input using specialist data-matching software to identify, for further investigation by management, value discrepancies between records on the pension system and those on the payroll system. Records on the former pension system and on the new Civica UPM system were also compared. Recommendations were made for the discrepancies identified to be investigated on a risk-basis, and this issue will be followed up as part of the next assurance review of pensions administration.
National Fraud Initiative	Counter-fraud	Oversight of the investigation of data-matches reported back by the Cabinet Office. There were no pensions related issues identified.
2016/17		
Pensions administration	Assurance	<p>Assurance review focusing on the following key risks:</p> <ul style="list-style-type: none"> Incorrect contributions are paid into the fund for NCC employees and those of other organisations Incorrect or out of date data held in the system in respect of individuals Benefit payments incorrectly calculated or made to the wrong persons Failure to perform annual reconciliations with the resulting lack of visibility of any issues existing <p>Having commenced the audit in the final quarter of 2016/17, resources had to be diverted to another urgent review. It is now planned that this audit will continue in the first quarter of 2017/18.</p>
National Fraud Initiative	Counter-fraud	Compilation of data sets and submission to the Cabinet Office, including pensions data.
2017/18 – Planned work		
Pensions administration	Assurance	Scheduled continuation of the assurance review commenced in 2016/17
National Fraud Initiative	Counter-fraud	Oversight of the investigation of data-matches reported back by the Cabinet Office

Reason/s for Recommendation/s

18.To present information to the Board about the system of audit over the Nottinghamshire Pension Fund.

Statutory and Policy Implications

19.This report has been compiled after consideration of implications in respect of crime and disorder, finance, human resources, human rights, the NHS Constitution (Public Health only), the public sector equality duty, safeguarding of children and vulnerable adults, service users, sustainability and the environment and ways of working and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

RECOMMENDATION/S

1) That the report be noted.

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For any enquiries about this report please contact:

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Constitutional Comments

20.Because this report is for noting only no Constitutional Comments are required.

Financial Comments (KRP 5/4/17)

21.There are no financial implications arising from the contents of this report.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

None