East Sussex

Local Government Pension Scheme

Internal Audit Strategy

2018/19

1. Introduction

1.1. The East Sussex Local Government Pension Scheme (The Scheme) is administered by East Sussex County Council. The Scheme provides retirement benefits for County Council employees, but members also include employees of Brighton & Hove City Council, the five borough and district councils in East Sussex and various universities, colleges, academies and other public bodies.

1.2. Orbis Internal Audit & Counter Fraud provides internal audit services to the East Sussex Pension Fund.

2. Objective

2.1. The objective of this Pension Fund Audit Strategy (The Strategy) is to provide the authority with a consistent, risk based approach to determining an internal audit programme for the Pension Fund, which takes maximum advantage of the available sources of internal and external assurance.

2.2. In March 2007, the Local Authority Working Group on the Audit of Investment Managers [LAWGAIM] and the County Chief Auditors Network [CCAN] published '*Good Practice Guidance: Gaining Assurance Over the Governance and Administration of Pension Funds, and Pension Fund Investment Management – A Guide for The Internal Auditor*'. Whilst this guidance is now some 11 years' old, no new guidance has been produced and this, therefore, remains the principal steer in establishing our Strategy. However, we acknowledge that there have been considerable changes to the pension environment and this Strategy has sought to recognise them. In particular, it is not yet clear what impact the introduction of pooling arrangements will have on the Fund.

2.3. The delivery of the Strategy contributes to the annual governance statement and seeks to provide assurance on the following aspects of pension fund activities:

- Pension Fund investments, governance and strategy;
- Pension Fund pooling arrangements
- Pensions administration – processes and systems;
- Internal controls of external fund managers.

3. Approach

3.1. This Strategy uses risk assessment as its foundation. On a periodic basis, existing risks will be reviewed in consultation with members, the Pension Board and management to identify any new risks. The risk assessment will consider the materiality and significance of the processes involved, any negative factors such as problems or significant changes and any positive factors, which provide comfort or assurance. It should be borne in mind that the Pension Fund is a material and fundamental financial system in its own right and, as such, may be subject to a minimum level of coverage in order to meet any requirements of the Scheme's external auditors.

3.2. The outcome of this assessment will be an objective view of those areas of the business where the organisation requires assurance that risks are being managed effectively. Internal Audit will then use a number of potential sources to provide that assurance.

3.3. For externally managed investments, Internal Audit will make use of assurance reports from the investment managers, custodians and property managers. The highest level of assurance will be placed on annual reports that comply with the Institute of Chartered Accountants' AAF 01/06 "Assurance reports on internal controls of services organisations made available to third parties" and the UK Financial Reporting Council's Corporate Governance Code (or international equivalents). These documents may be used to gain assurance over external investment management activities. If such documents are not available or do not comply with these standards, reliance may still be placed on local management assurance processes. Additionally, depending on the level of risk identified, specific internal audit work may be required. Levels of testing will be varied, depending on risk.

4. Professional Standards

4.1. The audit of the pension fund will be carried out in accordance with the professional standards set out in the Public Sector Internal Audit Standards.

5. Reporting Arrangements

5.1. Internal Audit work will be reported in the following manner:

- Terms of Reference, which are based on the risks outlined in Appendix A and include the scope of each audit, will be drafted and agreed with management;
- A draft report will be issued to management for its comments and response to the issues and risks identified;
- A final report that includes agreed actions and implementation dates will be published to management.

5.2. Audit work will be reported in four[1] separate reports to management:

- Pension Fund Investments, Governance and Strategy;

[1] It is likely the work on pooling arrangements will be subsumed into the Investments, Governance and Strategy audit in future years.

- Pension Fund Pooling Arrangements
- Pensions Administration – Processes and Systems; and
- Pension Fund External Control Assurance.

5.3 The results of audit work on the Scheme will also be reported in:

- Progress reports to the Pension Board, Corporate Management Team and the Audit Committee; and
- The Annual Internal Audit Report and Opinion.

6. Timetable

6.1. The timetable, to which Internal Audit seeks to work, should allow a degree of flexibility, but should be broadly as follows:

Task	Audit Days			
	Q1	Q2	Q3	Q4
Review arrangements for the new pooled fund - Pension Fund ACCESS Pool				
Review effectiveness of management assurance processes – Pensions Governance and Investments				
Review effectiveness of management's use of annual reports from those involved in externally managed investments and the degree of assurance that can be taken – External Control Assurance				
Review effectiveness of management assurance processes – Pension Administration - Processes & Systems				

7. The Effect on Audit Planning and External Audit Relationship

7.1. The number and type of reviews undertaken will depend on which processes have been assessed as high risk, how long each process will take to document and test, and how much time is available for this work (bearing in mind the scope of Internal Audit's overall work for the authority). As a consequence, the Pension Fund will have its own audit plan, which will form part of the overall Audit Plan. In addition to planned work, we may carry out *ad hoc* work where the opportunity or need arises. This could include time spent updating the risk assessment and revising the plan. The National Fraud Initiative includes pension payments and the results of this may provide assurance, or indicate areas where further work may be needed.

7.2. The audit reviews will be scheduled over the year according to the assessed risk, with high risk areas covered more frequently than low risk areas. This may mean that some processes may be subject to internal audit work on a less regular basis than others.

Appendix A

1. Risks Arising From the Administration of Pension Funds and Pension Fund Management

1.1 Appendix A sets out the detailed risks to the Pension Fund. These risks have been identified from the Good Practice Guidance and have been supplemented by risks specific to the ESCC Pension Fund, identified by management and Internal Audit. They should not be regarded as exhaustive, and should be the subject of regular re-assessment.

1.2 Risk have been rated high, medium or low according to their inherent risk; i.e., their likelihood and impact if no management controls were in place. In practice, controls will be in place and it is the degree to which these can be relied upon to mitigate the risks, that audit work will be focussed on. Detailed audit coverage will consist of a review of these controls and the provision of assurance that they are being managed effectively.

2. Risks: Pension Fund Governance and Investments

2.1. Overall risks:

The Pension Fund is not managed effectively to ensure that its objectives are met for the benefit of all stakeholders and that account is taken of the impact of increased employer contributions on council taxpayers and/or service provision.

Assets managed by the Pension Fund or entrusted to third parties may not be held securely for the long-term benefit of Scheme members, and those charged with governance may therefore fail their members' objectives in saving for retirement.

2.2 Subsidiary risks:

Risk	Inherent Risk Rating
Fund objectives are not defined, agreed and supported by appropriate performance and risk management processes, to include consideration of fraud risk.	H
Inappropriate investment strategy is adopted.	H
Operational investment processes do not support investment strategy or fail to maximise investment returns.	H
Pooling arrangements may result in reduced control over the Fund, including investment decisions, resulting in financial loss.	H
Investment strategy decisions are not implemented in a timely manner.	H

Risk	Inherent Risk Rating
Performance of external advisors and service providers is not managed to maximise their contribution to the value of the Fund without placing excessive reliance upon them.	M
Lack of clarity in manager's reporting may result in poor value for money not being identified.	M
Fund assets are not sufficient to meet its obligations and liabilities, and consequently there is an adverse impact on the council tax payer/service provision.	H
Failure to maintain accurate accounting records and provide appropriate statutory reports including unqualified statutory accounts.	H
Failure to complete the triennial actuarial valuation in good time leading reputational damage and/or delays in collecting enhanced contributions.	H
Poor quality data leads to inaccurate actuarial valuation resulting in contribution requirements being underestimated and financial loss.	H
Failure to adhere to relevant statutory regulations including governance arrangements or updates to LGPS.	H
Failure to communicate adequately with all relevant stakeholders;	H
Those charged with the governance of the Fund and the Scheme are unable to fulfil their responsibilities effectively, including as a result of the loss of key skills or capacity.	H
Unsatisfactory or disrupted administration services due to unclear governance or ineffective monitoring arrangements.	H
The Pension Fund investment manager or custodian may not have the most appropriate organisational structure or control framework to ensure that services are delivered to clients in the most effective or ethical manner thereby protecting their long term interests.	H
Negligence or fraud by investment fund managers or custodian may result in losses to pension funds.	H
All risks to the integrity of data and appropriate disaster recovery may not have been identified, evaluated and managed.	M
Investment decisions and portfolio management (including property management) may not maximise client returns or be performed in accordance with agreements, guidelines and policies set by the client.	H
Use of Proxy voting by fund managers may not be in accordance with agreements and/or may expose the fund to reputational damage.	M
All Investment transactions may not be properly authorised, executed and allocated in a timely, cost effective and accurate manner.	H
Pension fund assets are not accounted for correctly, held securely, and any income or rights attributable to them are not actioned promptly or accurately and paid into the correct account.	H
Pension fund investments may not be valued accurately.	M

Risk	Inherent Risk Rating
Net cash flow reduction if large numbers of employees leave the Scheme.	H
Negative cash flow might cause the pension fund bank account to become overdrawn.	H

3. Risks: Pensions Administration – Processes and Systems

3.1. Overall risk:

Pensions administration does not ensure that all payments due to and from the fund, through the whole of the employee and employer lifecycle, are made and accounted for fully and accurately and in a timely fashion.

3.2 Key risks:

a) Scheme member lifecycle:

Risk	Inherent Risk Rating
New Scheme members (including transfers in) are not processed and recorded promptly, completely and accurately and in accordance with regulatory requirements and the Scheme's rules.	H
Life events relating to Scheme members (including transfers out, retirement, death and deferred membership) are not processed and recorded promptly, completely and accurately and in accordance with regulatory requirements and the Scheme's rules.	H
Regular Scheme member events (including normal and additional contributions to the fund, receipt of payments from the fund, and receipt of information) are not processed and recorded promptly, completely and accurately via the fund's bank account and in accordance with regulatory requirements and the Scheme's rules.	H

b) Admitted body (employer) lifecycle:

Risk	Inherent Risk Rating
New admitted bodies are not incorporated into the Scheme promptly, completely and accurately and in accordance with the Scheme's rules.	H
Admitted bodies, who leave the Scheme, are not processed and recorded promptly, completely and accurately and in accordance with regulatory requirements and the Scheme's rules.	H
Regular admitted body events (including the collection and payments of employers' and employees' contributions to the fund, and provision of information) are not processed and recorded promptly, completely and accurately and in accordance with regulatory requirements and the Scheme's rules.	H

3.3 Subsidiary risks applying to both members and admitted bodies:

Risk	Inherent Risk Rating
Fund administrators do not have sufficient resources or skills to process transactions effectively.	H
Monies or balances received are not completely, accurately or promptly processed into the Fund and recorded in the administration system; calculations of contribution requirements, transfer values, or other receivables, are inaccurate or are not made promptly.	H
Monies or balances paid are not authorised, completely, accurately or promptly processed from the Fund and recorded in the administration system; payments are made which are inaccurate or are made to ineligible or unauthorised individuals or organisations; calculations of regular payments, lump sums, transfer values, or other payments, are inaccurate or are not made promptly.	H
Standing data and permanent records are not accurate or do not reflect changes of circumstances, leading to data and/or regulatory breaches.	M
Information may not be provided to stakeholders accurately, or with the required timeliness (including annual benefit statements).	M
Unsanctioned, excessive or inappropriate costs and charges may be levied against the Fund, including charges of the administering body.	M
Costs charged to the scheme are unclear leading to reputational damage with key stakeholders.	H

3.4. Pensions administration systems – overall risk:

Physical and logical Pension Fund systems and data may not be secured against inappropriate access and maintained to ensure continuity of service for users.

3.5. Key risks:

Risk	Inherent Risk Rating
Physical and logical Pension Fund systems and data may not be secured against inappropriate access.	H
Physical and logical Pension Fund systems and data may not be maintained in an appropriate environment.	H
Maintenance (or lack of maintenance) of Pensions hardware and software may threaten the integrity or operation of the Fund.	H
Inability to respond to hardware or software issues which cause processing interruptions.	H

Risk	Inherent Risk Rating
Outsourced ICT activities are not managed and controlled adequately.	H
Inadequate disaster recovery or business continuity arrangements leading to a failure to provide the service/pay pensioners/record receipts and/or a loss of data.	H
System upgrades and/or patch management application introduces problems/errors etc. into the system.	M
System support or availability may be lost if the provider goes out of business.	L