

# Internal Audit Report

## Pension Fund: Governance, Strategy and Investments 2019/20

### Final

Assignment Lead: Jodie Lulham, Senior Auditor

Assignment Manager: Danny Simpson, Principal Auditor

Prepared for: East Sussex County Council

Date: October 2020

# Internal Audit Report – Pension Fund: Governance, Strategy and Investments 2019/20

## Report Distribution List

### Draft Report:

Michelle King, Interim Head of Pensions  
Ian Gutsell, Chief Finance Officer  
Russell Wood, Pensions Investment Manager

### Final Report:

Sian Kunert, Head of Pensions  
Ian Gutsell, Chief Finance Officer  
Kevin Foster, Chief Operating Officer  
Russell Wood, Pensions Investment Manager  
Pension Committee  
Pension Board

This audit report is written for the officers named in the distribution list. If you would like to share it with anyone else, please consult the Chief Internal Auditor.

## East Sussex County Council - Internal Audit Key Contact Information

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**1. Introduction**

- 1.1. East Sussex County Council (ESCC) administers and manages the East Sussex Pension Fund (the Fund) on behalf of 134 employers.
- 1.2. The Fund is responsible for managing assets for the long-term benefit of scheme members in accordance with statutory regulations.
- 1.3. The Pension Committee is responsible for making arrangements for the administration of the Fund and its investments, receiving advice as appropriate from the Pension Board, which is a statutory requirement to assist the Scheme Manager (ESCC) in securing compliance with all relevant pensions' law, regulations and directions. The administration of the Pension Fund is carried out by Orbis Business Operations.
- 1.4. The Fund is a member of the ACCESS Pool, a collaboration of 11 LGPS Administering Authorities who are working together to reduce investment costs and gain economies of scale; this was implemented in line with the 1 April 2018 deadline set by Central Government. The ACCESS Pool currently has a value of £46 billion, with the Fund having invested £2.8 billion.
- 1.5. We reviewed the adequacy of governance arrangements over the East Sussex Pension Fund, covering strategy and the arrangements to manage investments, including pooling arrangements, and the internal controls of external fund managers.
- 1.6. This review was part of the agreed Internal Audit Plan for 2019/2020.
- 1.7. This report has been issued on an exception basis whereby only weaknesses in the control environment have been highlighted within the main body of the report.

**2. Scope**

- 2.1. The purpose of the audit was to provide assurance that controls are in place to meet the following objectives:
  - To ensure that investments (inside and outside the ACCESS Pool) are well managed and that all income due is received promptly and intact;
  - To ensure that governance arrangements provide sufficient and effective oversight;
  - To ensure that risk management arrangements are robust;
  - To ensure that communication is efficient and effective; and
  - Accounting provides an accurate representation of Fund's financial position.
- 2.2. The findings in this report are based on a review of the control environment before the national response to COVID-19. Any assurance given does not extend to interim measures or changes to management arrangements implemented due to COVID-19.

**3. Audit Opinion**

**Reasonable Assurance** is provided in respect of **Pension Fund - Governance, Strategy and Investments 2019/20**. This opinion means that most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.

*Appendix A provides a summary of the opinions and what they mean and sets out management responsibilities.*

**4. Basis of Opinion**

We have been able to provide Reasonable Assurance over the controls operating within the area under review because:

- 4.1. Appropriate governance structures are in place, including a Pension Committee and Pension Board, supported by up to date terms of reference. Meetings are held in accordance with the Council's Standing Orders and are minuted effectively. Both bodies' members are adequately qualified and knowledgeable in order to fulfil their roles in accordance with their respective Terms of Reference.
- 4.2. Investment performance is regularly reported to the Board and Committee and reviewed as appropriate.
- 4.3. There is an independent advisor in place with the relevant knowledge and skills to support the Fund and its decision making.
- 4.4. However, we identified some areas where improvement is required:
- 4.5. Governance arrangements within the ACCESS Pool could be strengthened. There is no agreed and formalised process to manage the performance of Fund Managers or Investments. A Governance Manual has been prepared but still awaits approval by the ACCESS Pool, meaning that it has not yet been implemented. In addition, External Control Assurance Reports from fund managers have not yet been reviewed by Link Fund Solutions, meaning that any control weaknesses affecting investments may continue to exist without the Fund's awareness.
- 4.6. There is a high level of reliance placed upon the knowledge of individuals within the Fund as opposed to formally recorded processes, which may lead to a loss of such knowledge should individuals leave the role or be unavailable due to illness.
- 4.7. The Fund has lent money for short periods to the main ESCC group bank accounts in order to avoid the Council's bank account becoming overdrawn. Email evidence exists to demonstrate that the Fund was made aware of the transactions before they happened. No concerns were raised by the Pension Fund team at the time that this was against Local Government Pension Scheme Regulations and there was no evidence of formal approval from the Fund for the transactions. They did, however, follow normal

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ESCC treasury management processes, with approval from two members of the ESCC Treasury Management team on each occasion.

- 4.8. A small number of officers have out of date or no declarations in the register of interests.
- 4.9. Records in SAP and those held by the Fund’s Custodian are not reconciled frequently enough, increasing the risk of error.

### 5. Action Summary

Risk Priority	Definition	No	Ref
High	Major control weakness requiring immediate implementation	0	N/A
Medium	Existing procedures have a negative impact on internal control or the efficient use of resources	4	1, 2, 4, 5, 6
Low	Represents good practice but its implementation is not fundamental to internal control	3	3, 7
<b>Total number of agreed actions</b>		<b>7</b>	

- 5.1. As part of our quarterly progress reports to Audit Committee, we track and report progress made in implementing all high priority actions agreed. Medium and low priority actions will be monitored and re-assessed by Internal Audit at the next audit review or through random sample checks.

### 6. Acknowledgements

- 6.1. We would like to thank all staff that provided assistance during the course of this audit.

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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
1	<p><b>Governance of the ACCESS Pool</b></p> <p>Although there are a number of processes in place designed to provide good governance over the Fund, there are no controls in place to ensure that these measures are effective and operational.</p> <p>To support robust and effective oversight of the ACCESS Pool, a Governance Manual was drafted by the partnership, but it is yet to be agreed and implemented.</p> <p>The Governance Manual for the ACCESS Pool has not yet been implemented, meaning that governance measures over the Pool may not be effective. However, we acknowledge that the agreement and implementation of the Governance Manual is the responsibility of the Pool as a whole, as opposed to the East Sussex Pension Fund in isolation.</p>	Without generally agreed procedures, governance of the ACCESS Pool may be weakened.	Medium	The Fund will work with its partners in the ACCESS Pool to ensure that the Governance Manual for the ACCESS Pool is agreed and implemented.
<b>Responsible Officer:</b>		Head of Pension Fund	<b>Target Implementation Date:</b>	31 January 2021

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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
2	<p><b>Review of Inadequate Performance</b></p> <p>An ‘operator’, Link Fund Solutions, has been appointed to manage investments in the ACCESS Pool on a day to day basis. However, the performance of the Link Operator has not always met the expectations of the Fund. For instance, the Link Operator transferred assets of an ineligible class into a sub-fund and subsequently had to transfer them out. Whilst the error arose through a misunderstanding between a fund manager and the Custodian, we would have expected Link to query illegitimate investment instructions.</p> <p>There is no formally established process within the ACCESS Pool for following up inadequate performance, although work is in progress to draw up a process for this purpose. However, we recognise that, as one member of the ACCESS Pool, the ESPF is unable to resolve any issues without the collaboration of the other funds.</p>	Without a robust mechanism for managing the performance of the Link Operator, there is an increased risk of error which may lead to financial loss.	Medium	<p>The Fund will work with our partners in the ACCESS Pool to establish a process to manage the performance of the Link Operator and investments within the ACCESS Pool.</p> <p>The Head of Pensions will raise the issue with the Interim Director of the ACCESS Support Unit.</p>
<b>Responsible Officer:</b>		Head of Pension Fund	<b>Target Implementation Date:</b>	31 January 2021

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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
3	<p><b>Review of External Control Reports</b></p> <p>To provide assurance that fund managers, responsible for the Fund’s investment assets, have robust controls in place, reports from their auditors are obtained.</p> <p>It is important to ensure that these External Control Assurance reports are reviewed in a timely manner in order to identify any weaknesses in control that could put the Fund’s investments or data at risk.</p> <p>As part of the pooling arrangements, it should be the responsibility of Link Fund Solutions, as the operator, to obtain and review External Control Assurance reports and provide assurance or feedback any concerns to the Pool, which, in turn, should advise individual funds. However, the operator has provided no such assurance and, whilst the Fund has obtained the most recent sets of External Control Reports for itself, they have not yet been reviewed.</p>	<p>Failure to ensure that External Control Assurance reports are reviewed in a timely manner may result in risks to Fund investments going unnoticed, thus increasing the potential for financial loss or reputational damage if investments are held by non-compliant managers.</p>	Low	<p>The Fund will request that Link undertake a review of External Control Assurance reports and report back any findings as soon as possible.</p> <p>The Head of Pensions will raise the issue with the Interim Director of the ACCESS Support Unit.</p>
<b>Responsible Officer:</b>		Head of Pension Fund	<b>Target Implementation Date:</b>	31 October 2020



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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
4	<p><b>Segregation of Fund and Non-Fund Accounts</b></p> <p>We found two occasions on which the Fund has lent money to the main ESCC group bank account, overnight on one occasion and for two nights on another, to prevent the ESCC bank account becoming overdrawn. These movements were carried out by the ESCC Treasury Management Team and records confirm the amounts borrowed and the interest paid to the Fund.</p> <p>Email evidence exists to demonstrate that the Fund was made aware of the transactions before they happened. No concerns were raised by the Pension Fund team at the time that this was against Local Government Pension Regulations and there was no evidence of formal approval from the Fund for the transactions. They did, however, follow normal ESCC treasury management processes, with approval from two members of the ESCC Treasury Management team on each occasion.</p>	<p>The transfer of funds between the Pension Fund and County Council main group accounts, or payments being made on behalf of the employer from the Pension Fund, is non-compliant with the Local Government Pension Scheme Regulations 2009.</p>	Medium	<p>We will apply the breaches policy to assess the implications of this.</p> <p>We shall cease paying unfunded benefits from the Fund account.</p> <p>The Pension Fund shall introduce access and approval controls to ensure that no loans are made from the Fund to the Council.</p>

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	<p>In addition, the Fund became overdrawn on one occasion, when a payment that was due to the Fund to cover an employer’s liability for unfunded benefits to members, was not received before the pension payroll was run. This payment was subsequently received in full.</p>			
<p><b>Responsible Officer:</b></p>	<p>Head of Pension Fund</p>	<p><b>Target Implementation Date:</b></p>	<p>31 October 2020</p>	

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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
5	<p><b>Declarations of Interest</b></p> <p>We found that a number of officers in the Fund had either not completed an entry in the on-line register of interests, or had not updated their declarations, annually, in accordance with the Employee Code of Conduct.</p>	<p>Failure to ensure that all officers maintain an up to date declaration within the Register of Interests may result in undeclared conflicts materialising, or public perception that a conflict is present, thus resulting in reputational damage to the Fund.</p>	Medium	<p>All officers will be reminded to maintain an up to date declaration within the register of interests.</p>
<b>Responsible Officer:</b>		Head of Pension Fund	<b>Target Implementation Date:</b>	1 October 2020

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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
6	<p><b>Reconciling SAP and Custodian Records</b></p> <p>There is an expectation, based on previous practice, that information will be journaled and reconciled between SAP and the Custodian's data source, 'Passport', on a quarterly basis.</p> <p>This, however, is not undertaken and the data is, instead, journaled over on an annual basis to join up with end of year accounting procedures. This process relies on the cumulate experience of individuals throughout the year to identify any errors.</p>	Reliance upon personal knowledge in order to reconcile Fund accounts to SAP on an annual basis increases the risk of error, or financial misstatement.	Medium	Reconciliations between the Custodian's Passport system and SAP will be carried out on a quarterly basis.
<b>Responsible Officer:</b>		Head of Pension Fund	<b>Target Implementation Date:</b>	1 October 2020

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Ref	Finding	Potential Risk Implication	Priority	Agreed Action
7	<p><b>Fund Accounting - Contingency</b></p> <p>There are no individual process notes in place specific to Fund accounting for the East Sussex Pension Fund. This may mean that, should anyone other than the usual officers be required to undertake any part of the accounting process, errors may be made due to their unfamiliarity with the process.</p> <p>It is noted that the Interim Head of Pensions is able to undertake Fund Accounting should contingency be required.</p>	<p>Failure to provide comprehensive legal guidance for Fund accounting may mean that accounting is not completed to the required standard should a change in officers occur, increasing the risk of error or misstatement in the accounts.</p>	Low	<p>Relevant legal guidance, including Pension Fund Accounting Manuals, will be made available to all undertaking Fund Accounting. In addition, the Interim Head of Pensions is able to undertake Fund accounting as a contingency should the usual officer be unavailable.</p>
<b>Responsible Officer:</b>		Head of Pension Fund	<b>Target Implementation Date:</b>	1 January 2021

# Appendix A

## Audit Opinions and Definitions

Opinion	Definition
<b>Substantial Assurance</b>	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
<b>Reasonable Assurance</b>	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
<b>Partial Assurance</b>	There are weaknesses in the system of control and/or the level of non-compliance is such as to put the achievement of the system or service objectives at risk.
<b>Minimal Assurance</b>	Controls are generally weak or non-existent, leaving the system open to the risk of significant error or fraud. There is a high risk to the ability of the system/service to meet its objectives.

## Management Responsibilities

The matters raised in this report are only those which came to our attention during our internal audit work and are not necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required.

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

This report, and our work, should not be taken as a substitute for management's responsibilities for the application of sound business practices. We emphasise that it is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal Audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.