



# Internal Audit Report

## Pension Fund Investments

### Final

Assignment Lead: Elsie Awe, Principal Auditor  
Assignment Manager: Danny Simpson, Principal Auditor  
Prepared for: East Sussex County Council  
Date: March 2022



## Internal Audit Report – Pension Fund Investments

### Report Distribution List

#### **Draft Report:**

Sian Kunert, Head of Pensions  
Russell Wood, Pension Fund Investment Manager

#### **Final Report, as per Draft Report with the inclusion of:**

Phil Hall, Chief Operating Officer  
Ian Gutsell, Chief Finance Officer  
Pension Board  
Pension Committee

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

**Chief Internal Auditor:** Russell Banks, ☎ 07824362739, ✉ russell.banks@eastsussex.gov.uk

**Audit Manager:** Nigel Chilcott, ☎ 07557541803, ✉ nigel.chilcott@eastsussex.gov.uk

**Anti-Fraud Hotline:** ☎ 01273481995, ✉ confidentialreporting@eastsussex.gov.uk

## Internal Audit Report – Pension Fund Investments

### 1. Introduction

- 1.1. East Sussex County Council (ESCC) administers and manages the East Sussex Pension Fund (the Fund) on behalf of 127 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 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. The Pool became live on 1 April 2018, in line with the deadline set by Central Government. As of 30 June 2021, members of the ACCESS Pool had assets worth £59.0bn, of which £32.6bn were managed by the Pool itself. The figures for the East Sussex Pension Fund were £4.5bn and £2.3bn, respectively.
- 1.4. As part of this audit, we reviewed the arrangements to manage investments, including pooling arrangements, and the internal controls of external fund managers.
- 1.5. This review is part of the agreed Internal Audit Plan for 2021/22.
- 1.6. 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:
  - Investment performance is in line with the expectations of the Fund.
  - Investment returns are received in full in a timely manner.
  - Investment transactions are accurately reflected within the accounting system.
  - The ACCESS Operator, Fund Managers and the Custodian maintain adequate systems of internal control.
  - Benefits of economies of scale deliver cost savings and value for money.
  - Actions from previous audit have been implemented.

### 3. Audit Opinion

- 3.1. **Substantial Assurance** is provided in respect of Pension Investments (2021/22). This opinion means that 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

- 4.1. We have provided **Substantial Assurance** over the controls in place for Pension Investments for the following reasons:
- 4.2. There are robust processes in place to ensure that investments are aligned with the expectations of the Fund, which include the review, monitoring, and quarterly reporting to the Pension Committee.
- 4.3. The Fund maintains appropriate records of all investment managers, including the Custodian.
- 4.4. The Custodian (Northern Trust) collects, records and reports on dividends/income earned on investments on behalf of the Fund in a timely manner.
- 4.5. Quarterly reports are provided to the Fund showing the movements in investment balances, which are reviewed, approved and journals posted to reflect these in the accounting records (SAP).
- 4.6. Investment decisions are based on appropriate guidance from professional investment advisors and are made within the terms of the framework set by the Pension Committee to maximise the likelihood that investment performance meets the requirements of the Fund.
- 4.7. However, a small number of areas were identified, where controls could be strengthened further, including:
- 4.8. Ensuring that, where control weaknesses are identified in a fund manager's internal control report, the fund manager should be chased more robustly to provide an explanation, and in particular, to provide assurance that the weaknesses identified do not impact on the ESPF's investments.
- 4.9. The need to produce process notes covering the management of investments, to ensure a consistent approach is applied and to provide resilience in the absence of key staff.
- 4.10. The posting of journals more promptly to ensure that SAP reflect the Fund's current position.

## Internal Audit Report – Pension Fund Investments

### 5. Action Summary

5.1. The table below summarises the actions that have been agreed together with the risk:

Risk	Definition	No	Ref
High	This is a major control weakness requiring attention.		
Medium	Existing procedures have a negative impact on internal control or the efficient use of resources.		
Low	This represents good practice; implementation is not fundamental to internal control.	5	1 - 5
	<b>Total number of agreed actions</b>	<b>5</b>	

5.2. Full details of the audit findings and agreed actions are contained in the detailed findings section below.

5.3. 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. Acknowledgement

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

**Internal Audit Report – Pension Fund Investments**  
**Detailed Findings**

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
1	<p><b>Meetings with the Custodian</b></p> <p>Weekly service calls are held with Northern Trust to review matters relating to the Fund's investments. However, no record is maintained of the key discussions and agreed actions from the meetings.</p>	<p>A lack of a written record of decisions and actions reached at meetings increases the risk that decisions are not implemented.</p>	Low	<p>The Fund have now started recording actions from the weekly meetings with the Custodian to ensure any action or outstanding issue is captured and acted upon.</p>
<b>Responsible Officer:</b>		Russell Wood	<b>Target Implementation Date:</b>	February 2022

**Internal Audit Report – Pension Fund Investments**  
**Detailed Findings**

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
2	<p><b>Process for Addressing Issues Identified in Control Assurance Reports</b></p> <p>Our review noted that the UBS Asset Management control report, for the year ending 31 December 2020, received a qualified opinion. This was mainly due to ineffective controls around the setting up of new securities, the recording of dividend income data, controls over change management and access controls.</p> <p>The report was received in August 2021, and an email was sent to UBS in October 2021, requesting additional information about the issues raised in it, to ascertain the degree to which these may affect ESPF investments. At the time of the audit, in January 2022, no response had been received from UBS and no further follow up action had been undertaken by the Fund.</p>	<p>Without following up or escalating enquiries relating to unfavourable opinions where no response has been received, the opportunity to take appropriate corrective action may be delayed.</p>	Low	<p>A response has since been received and this information has been provided to the Pension Committee to advise of the report. The Control Assurance reports are a last step in the control environment on Fund managers due to the time lapse in the reporting of this information back to investors.</p> <p>The Fund agree that a more proactive approach should have been taken to chase the response and linked to ref 5 on procedure notes. Guidance will be produced covering the process to be followed when internal control reports with adverse opinions are received, including follow-up or escalation procedures.</p>
<b>Responsible Officer:</b>		Russell Wood	<b>Target Implementation Date:</b>	June 2022

**Internal Audit Report – Pension Fund Investments**  
**Detailed Findings**

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
3	<p><b>External Control Reports for ACCESS Pool Investments</b></p> <p>As noted in the last audit, there is no centralised process, within the ACCESS Pool, to review the External Control Assurance reports of fund managers, thus resulting in these reviews being duplicated across the Pool’s members.</p> <p>One of the benefits of being in the ACCESS pool is the ability to use economies of scale to reduce inefficiencies and costs. We acknowledge that the Pool’s members receive consolidated reports about fund managers’ performance.</p>	Where the benefits of the pooling arrangement are not fully utilised, the Fund may incur unnecessary costs.	Low	<p>The Fund anticipate this to be a very long way down the list of activities for the pool as the primary function of the pool is to provide investment sub funds and not ancillary services for efficiencies; however, this is a good to have and the Fund will continue to work with the ACCESS Pool to identify areas where efficiencies can be gained.</p> <p>As this is not a primary function of the pool, and is outside our control, we are unable to provide a target implementation date.</p>
<b>Responsible Officer:</b>		Russell Wood	<b>Target Implementation Date:</b>	N/A



**Internal Audit Report – Pension Fund Investments**  
**Detailed Findings**

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
4	<p><b>The Posting of Investment Journals</b></p> <p>Our review of the accounting process for the investment funds revealed that journals are not being posted on time to bring the SAP balances in line with the investment transactions recorded by the Custodian.</p> <p>The investment journal for quarter 2, ending 30 September 2021 (c.£231m), was not posted until January 2022.</p>	<p>Without the timely processing of journals, investment balances in the accounting record (SAP) may not be correctly stated at the end of each quarter.</p>	<p>Low</p>	<p>The position has improved over the past year in that there are now quarterly journals; however, the Fund agrees that timeliness can be improved.</p> <p>It is worth noting however that this journal is a reflection in the balance sheet on assets as provided by the Fund’s Custodian who provide accounting services to the Fund. There is no decision making or reporting on this data within the SAP system, other than the Final account production, as in-year reporting is completed within the Custody system.</p> <p>A per ref 5, guidance will be produced covering the timeliness of the posting of journals.</p>
<p><b>Responsible Officer:</b></p>		<p>Russell Wood</p>	<p><b>Target Implementation Date:</b></p>	<p>June 2022</p>

**Internal Audit Report – Pension Fund Investments**  
**Detailed Findings**

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
5	<p><b>Lack of Documented Procedures for Fund Accounting</b></p> <p>As noted in the previous audit, there are no process notes in place for Fund accounting, covering the required standards and policies.</p> <p>In addition, our review of investment fees noted that there are no process notes in place for the review of the Custodian’s fees, including checks for accuracy.</p>	<p>Without appropriate supporting guidance, staff may not be fully aware of their responsibilities and key tasks may not be performed as required.</p>	Low	<p>Processes will be documented, covering the key accounting and control processes, to strengthen resilience and ensure a consistent approach is applied.</p> <p>A long timeline is suggested for this action as documenting all areas of Investments and Accounting will take time due to the scale. The two specific procedures highlighted above will be prioritised.</p>
<b>Responsible Officer:</b>		Russell Wood	<b>Target Implementation Date:</b>	December 2022

# 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.