

**DRAFT Internal Audit Report
Pension Fund Investment
04 November 2022**

To: Phillip Gregory Financial Director
David Dickinson Group Manager
Jesmine Anwar Pensions Accountant

From: Christopher Martin Head of Assurance
Benjamin Davie Key internal audit contact
Gagandeep Kanwar Auditor

This is a draft prepared for discussion purposes only and should not be relied upon; the contents are subject to amendment or withdrawal and our final conclusions and findings will be set out in our final deliverable.

We would like to thank management and staff of the Pension Fund Investment teams for their time and co-operation during the course of the internal audit.

1. Executive Summary

Assurance level	Scope area	Number of recommendations by risk category			
		Critical	High	Medium	Low
Reasonable	Governance	-	-	-	-
	Forecasting/Cashflow	-	-	-	1
	Investments - Strategy	-	-	1	-
	Investments - Transactions	-	-	-	-
	Investments - Management	-	-	-	-
<u>Audit objective and scope</u>					
<p>The objective of this audit is to evaluate the control design and test the operating effectiveness of key controls in place for Pension Fund Investments relevant to the potential risks for each scope area. Specifically, the review considered the following areas detailed within the agreed scope:</p> <ul style="list-style-type: none"> ● Governance ● Forecasting/Cashflow ● Investments - Strategy ● Investments - Transactions ● Investments - Management <p>An extract from the Terms of Reference detailing the scope of this review is available at Appendix C.</p>					
<u>Summary of findings</u>					
<p>The Pension Fund Investment process is fairly mature with an established strategy in place, which is agreed and overseen by the Pension Committee. This review has generally found that the controls in place are operating effectively. The fund is now fully funded by investments and so is currently going through a process of changing in it's investment strategy as it moves to a lower risk model, as it requires lower returns from investments. This internal audit noted that two agreements with the Council around divesting the fund from tobacco, as part of the Pensions fund meeting in September 2014, and non-Paris Climate Agreement compliance stocks, as part of the Council's wider Climate commitments, has not yet fed through into the Investment Strategy. As a result, we noted that there are some small investments in funds that contain Tobacco products and that are not compliant with net zero commitments. With the review of the strategy it is a time to review the ethical considerations for the fund and update the strategy accordingly.</p>					

We identified some areas of good practice including:

- There is a clear governance process for the pension investment's with an Investment Strategy being approved by the Pensions Committee annually.
- The Pensions Committee gets regular updates on the investments at each of the quarterly meetings, including information on cash flow and performance.
- The Council has used consultants to develop and review it's long-term investments strategy. These reviews has driven changes to the investments strategy as the fund has reached 100% funding.

We have identified one medium risk. These are:

- *Pension fund Invested in restricted industry (Medium)* – The Pensions Committee had previously agreed that the Pension fund will not invest in tobacco firms or firms that are not compliant with the Paris Climate agreement. However, this is not reflected in the current Investment Strategy, and we noted that some investments do not meet these ethical restrictions.

We also identified one low risk finding that is set out in the findings and action plan section below.

2. Findings and Action Plan

REF	FINDING	RISK	RISK CATEGORY	Proposed MANAGEMENT ACTION	RESPONSIBLE OFFICER TARGET DATE
1	<p>Pension Fund invested in restricted industry</p> <p>Public Pension funds commonly have an ethical policy that sets out restrictions on investments that the Council sees as unethical or not aligned to its values. These are then excluded from the portfolio.</p> <p>The Pensions team have in the past agreed, with the Council, to remove tobacco companies from investments, this was agreed in the September 2014 Pension Committee, and have recently agreed, as part the Council's wider Climate Commitments that investments should align to the Paris climate targets.</p> <p>The current Pensions Investment Strategy does not capture these agreements and while investments set out in these agreements do not have funds that are not compliant with Paris or contain tobacco there are other investments excluded from these agreements that do. This may lead to the perception that the Council is not living up to it's ethical commitments.</p>	<p>The Council may suffer reputational and legal damage if it does not sufficiently restrict unethical investments Pension funds that have been agreed and publicised.</p>	Medium	<ol style="list-style-type: none"> 1. The Council should update its Pensions Investment Strategy to set out the ethical requirements for the Pension fund. 2. Investments should only be made if they are in line with the requirements in this updated Strategy. 	<p>Responsible Officer: David Dickenson (Group Manager)</p> <p>Target date: 31st January 2023</p>
2	<p>Lack of evidence for review performed</p>	<p>There is a risk of financial issues</p>	Low	<p>The Council should ensure that the annual cash flow is</p>	<p>Responsible Officer:</p>

REF	FINDING	RISK	RISK CATEGORY	<i>Proposed</i> MANAGEMENT ACTION	RESPONSIBLE OFFICER TARGET DATE
	<p>The Council undertakes an annual review of the cash flow forecasts to ensure that it will have sufficient cash on hand to meet its liabilities.</p> <p>This audit was able to obtain this forecast for 2022, however no evidence could be provided to support a review of this forecast by anyone other than the preparer.</p>	<p>arising, such as an inability to make payments due to lack of available cash, if an error in the forecast is not identified due to lack of review.</p>		<p>reviewed and that this is formally documented.</p>	<p>David Dickenson (Group Manager)</p> <p>Target date: 31st January 2023</p>

Appendix A: Definition of risk categories and assurance levels in the Executive Summary

Risk rating	
<p>Critical</p> <p>••</p>	<p>Immediate and significant action required. A finding that could cause:</p> <ul style="list-style-type: none"> • Life threatening or multiple serious injuries or prolonged work place stress. Severe impact on morale & service performance (e.g. mass strike actions); or • Critical impact on the reputation or brand of the organisation which could threaten its future viability. Intense political and media scrutiny (i.e. front-page headlines, TV). Possible criminal or high profile civil action against the Council, members or officers; or • Cessation of core activities, strategies not consistent with government's agenda, trends show service is degraded. Failure of major projects, elected Members & Senior Directors are required to intervene; or • Major financial loss, significant, material increase on project budget/cost. Statutory intervention triggered. Impact the whole Council. Critical breach in laws and regulations that could result in material fines or consequences.
<p>High</p> <p>•</p>	<p>Action required promptly and to commence as soon as practicable where significant changes are necessary. A finding that could cause:</p> <ul style="list-style-type: none"> • Serious injuries or stressful experience requiring medical many workdays lost. Major impact on morale & performance of staff; or • Significant impact on the reputation or brand of the organisation. Scrutiny required by external agencies, inspectorates, regulators etc. Unfavourable external media coverage. Noticeable impact on public opinion; or • Significant disruption of core activities. Key targets missed, some services compromised. Management action required to overcome medium-term difficulties; or • High financial loss, significant increase on project budget/cost. Service budgets exceeded. Significant breach in laws and regulations resulting in significant fines and consequences.
<p>Medium</p> <p>•</p>	<p>A finding that could cause:</p> <ul style="list-style-type: none"> • Injuries or stress level requiring some medical treatment, potentially some workdays lost. Some impact on morale & performance of staff; or • Moderate impact on the reputation or brand of the organisation. Scrutiny required by internal committees or internal audit to prevent escalation. Probable limited unfavourable media coverage; or • Significant short-term disruption of non-core activities. Standing orders occasionally not complied with, or services do not fully meet needs. Service action will be required; or • Medium financial loss, small increase on project budget/cost. Handled within the team. Moderate breach in laws and regulations resulting in fines and consequences.
<p>Low</p> <p>•</p>	<p>A finding that could cause:</p> <ul style="list-style-type: none"> • Minor injuries or stress with no workdays lost or minimal medical treatment, no impact on staff morale; or • Minor impact on the reputation of the organisation; or • Minor errors in systems/operations or processes requiring action or minor delay without impact on overall schedule; or • Handled within normal day to day routines; or • Minimal financial loss, minimal effect on project budget/cost.
Level of assurance	
<p>Substantial</p> <p>•</p>	<p>There is a sound control environment with risks to key service objectives being reasonably managed. Any deficiencies identified are not cause for major concern. Recommendations will normally only be Advice and Best Practice.</p>
<p>Reasonable</p> <p>•</p>	<p>An adequate control framework is in place but there are weaknesses which may put some service objectives at risk. There are Medium priority recommendations indicating weaknesses but these do not undermine the system's overall integrity. Any Critical recommendation will prevent this assessment, and any High recommendations would need to be mitigated by significant strengths elsewhere.</p>
<p>Limited</p> <p>•</p>	<p>There are a number of significant control weaknesses which could put the achievement of key service objectives at risk and result in error, fraud, loss or reputational damage. There are High recommendations indicating significant failings. Any Critical recommendations would need to be mitigated by significant strengths elsewhere.</p>
<p>No</p> <p>•</p>	<p>There are fundamental weaknesses in the control environment which jeopardise the achievement of key service objectives and could lead to significant risk of error, fraud, loss or reputational damage being suffered.</p>

Appendix B: Internal Audit Roles and Responsibilities

Limitations inherent to the internal auditor's work

We have undertaken this audit subject to the following limitations:

- **Internal control:** Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgement in decision-making, human error, control processes being deliberately circumvented by employees and others, management overruling controls and the occurrence of unforeseeable circumstances.
- **Future periods:** Our assessment of controls is for the period specified only. Historic evaluation of effectiveness is not relevant to future periods due to the following risks:
 - The design of controls may become inadequate because of changes in operating environment, law, regulation or other changes.
 - The degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

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.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

Appendix C: Terms of Reference Extract – Scope of the Review

The audit considered the potential risks set out in the table below:

Objectives	Risks
<p>Governance</p> <p>There are clear governance arrangements for the management and oversight of the Fund’s investments and finances</p>	<p>Governance arrangements may not be sufficient to ensure clear oversight of investments leading to financial and reputational damage to the Council if:</p> <ul style="list-style-type: none"> ● Governance responsibilities, including key accountabilities, are not clearly defined; ● There is a lack of documentation of the responsibility and accountability of those involved in managing pension fund investments. ● Management information highlighting the performance of investments is not accurate or is not produced to facilitate oversight and scrutiny; or
<p>Forecasting/cashflow</p> <p>The fund has a clear forecast of its liabilities and thus cashflow to ensure income from investments and contributions can fund liabilities as they come due.</p>	<p>Inaccurate forecasting of cash flow could lead to the fund being unable to make payments resulting in pensioners not getting their full pension if:</p> <ul style="list-style-type: none"> ● The fund does not have an accurate forecast of its expenditure and contributions; or ● The fund does not time investments to ensure that there is enough cash available to support its cashflow forecasts.
<p>Investments – strategy</p> <p>The Fund has an approved investment strategy statement and this statement is complied with by the Fund</p>	<ul style="list-style-type: none"> ● The Fund’s investments may not be made in accordance with strategy if an investment strategy statement does not exist or has not been approved.
<p>Investments – transactions</p> <p>Investment transactions are recorded accurately and completely.</p>	<p>The Fund’s records of investments held and investment transactions may be inaccurate if:</p> <ul style="list-style-type: none"> ● Investments can be made without sufficient approval per the Schedule of Delegation. ● Officers have the ability to make investments without the any review of approval. ● Investment activities are not recorded correctly on the fund’s general ledger.

Appendix C: Terms of Reference Extract – Scope of the Review (Contd.)

Objectives	Risks
<p>Investments - management</p> <p>Investments are managed in accordance with the Fund's investment strategy statement and investment performance issues are identified and mitigating actions implemented.</p>	<p>The Fund's investments may not be managed appropriately or performance issues not identified if:</p> <ul style="list-style-type: none">• Those managing investments make investments outside of those permitted by the Fund;• Investments made outside of the Fund's investment strategy statement are not identified; or• Investment performance monitoring does not allow poor performance to be identified promptly and addressed.