

Internal Audit Report

Pension Fund Investments

Assignment Lead: Zahir Khan, Auditor
Assignment Manager: David John, Audit Manager
Prepared for: Surrey County Council
Date: March 2021

Final Report Distribution List

Mamon Zaman, Senior Pensions Finance Specialist
Neil Mason, Strategic Finance Manager Pensions
Leigh Whitehouse, Executive Director of Resources
Anna D'Alessandro, Director, Corporate Finance
Mark Hak-Sanders, Strategic Finance Business Partner (Corporate)
Cath Edwards, Senior Finance Business Partner
Tim Oliver, Leader of the Council
Nick Harrison, Chairman, Resource and Performance Committee
Will Forster, Vice Chairman, Resource and Performance Committee
Tim Evans, Chairman, Pension Fund Committee
Ben Carasco, Vice Chairman, Pension Fund Committee
Audit & Governance Committee
External Audit – Grant Thornton UK LLP

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.

Surrey County Council - Internal Audit Key Contact Information

Chief Internal Auditor: Russell Banks, ☎ 07824 362739, ✉ russell.banks@eastsussex.gov.uk

Audit Manager: David John, ☎ 07768235586, ✉ David.John@surreycc.gov.uk

Anti-Fraud Hotline: ☎ 0800 069 8180, ✉ surreycc@ethicspoint.com

1. Introduction

- 1.1. Surrey County Council (SCC) has a statutory responsibility to administer and manage the Surrey Pension Fund on behalf of all participating employees from the Council and other partner organisations. The primary objective of the fund is to ensure that assets are managed for the long-term benefit of scheme members in accordance with the rules of the scheme and the regulatory framework (including statute) and to maximise the Fund's growth whilst minimising the investment risk.
- 1.2. The Pension Fund investment is managed by the Head of Pensions located within the Finance Team of Surrey County Council.
- 1.3. The latest actuarial valuation of the fund as at 31st March 2019 reported assets of £4,286m against liabilities of £4,483m resulting in a funding level of 96%.
- 1.4. This review was part of the agreed Internal Audit Plan for 2020/21 and focuses solely on the investments relating to the Surrey Pension Fund, and no external organisations. Due to the impact of COVID-19 the audit had been suspended and then restarted later in 2021.
- 1.5. 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:
 - A lack of operational controls in place over fund & fund managers can expose authority to risk of fraud, losses and reduced return of investments;
 - To gain assurance that the fund has a suitable statement of objectives which is linked to measurable targets and performance indicators;
 - To ensure that the fund's investment strategy is robust and strategic decisions are implemented correctly and in a timely manner; and provide assurance over the internal control environment of the fund managers and custodians.

3. Audit Opinion

3.1. **Reasonable Assurance is provided in respect of Pension Fund Investments.**

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

- 4.1. We have been able to give an opinion of Reasonable Assurance in respect of this system for the following reasons:
- 4.2. The performance of the pension fund was subject to scrutiny and review by the Pension Fund Committee on a quarterly basis.
- 4.3. A review of minutes from the Surrey Local Pension board for the last year provided us with assurance that appropriate and robust governance arrangements are in place, and that they are compliant with Local Government Pension Scheme regulations.
- 4.4. We were able to draw additional assurance over the administration of cashflow and interest payments from our recently completed Treasury Management audit, which reported in December 2020.
- 4.5. A review of cash balances held in the fund against agreed cash management strategy, noted a couple of instances when balances exceeded 20m threshold for short term cash holdings, these balances were addressed within a few days.
- 4.6. A Pension Fund risk register was in place; this document was reviewed and found to include current risks the fund was exposed to, together with the impact of these risks and mitigating actions taken to address and manage them.
- 4.7. The Pension Fund had a current business plan in place; this was found to be compliant with expected requirements detailing objectives of the fund identified along with detailing progress made towards achievement of these objectives.
- 4.8. Payments to fund managers and private equity funds were reviewed and were found to be in line with expected processes. In addition, the process for drawing down funds for investments was reviewed, sample transactions reviewed were within agreed commitment levels and had supporting documents in place.
- 4.9. Testing was undertaken on a sample of funds to ensure approved agreements were in place for these funds, copies of current agreements were provided for all reviewed funds.
- 4.10. Our audit did identify a few areas where controls were not in place as expected, and where improvements could therefore be made. A review of control documents for investment partners was undertaken, not all copies of contract documents were held within the team as per procedure. These had to be requested from investment partners, however not all documents were available for review.

- 4.11. A review of the 2019/20 Northern Trust reports and SAP data provided us with assurance that the reported end of year position was accurate. At the time of the review it was noted that due to resourcing pressures within the team the service has been unable to complete any quarterly reconciliations for the current financial year, this can result in errors and mispostings not being detected within a timely manner.
- 4.12. A current investment strategy was in place and this was compliant with the requirements of the local government pension regulations. A key element of this strategy is the investment policy, which includes targets for the allocation of assets across a range of investment types. A comparison of asset allocations at December 2020 against this guidance found that current investments in Bonds, Private Markets were above agreed guidance levels for a time. We note, however, that these are only target allocation amounts, and that the Deputy Section 151 was aware of the allocated levels from ongoing management review.

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.	1	1
Low	This represents good practice; implementation is not fundamental to internal control.	2	2,3
Total number of agreed actions		3	

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

Internal Audit Report – Pension Fund Investments 2019/20
Detailed Findings

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
1	<p>Reconciliation of Northern Trust Reports to SAP</p> <p>At the time of the review it was noted that quarterly reconciliation of Northern Trust (NT) accounts had not been completed for any periods during the 2020/21 financial year. The quarterly reconciliation of accounts is a key control which ensures that SAP accurately reflects the cash movements of the Pension Fund's assets. It was noted that the absence of these records didn't have any impact on the information shared with committees which are based on asset valuation and performance reports from the Fund's Custodian.</p>	A failure to complete reconciliation's in a timely manner could potentially result in omission of pertinent data for financial reporting purposes	Medium	The Fund has begun recruitment for additional resources to boost resilience, as well as to ensure control procedures can be carried out in a timely manner.
Responsible Officer:		Mamon Zaman	Target Implementation Date:	September 2021

Internal Audit Report – Pension Fund Investments 2019/20
Detailed Findings

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
2	<p>Investment Manager Agreements</p> <p>Investment Management Agreements (IMA) are important documents that Includes detail of fees to be paid to the Investment partner, Investment partners responsibilities and the expectations of Trustees. The service was asked to provide copies of IMA for a sample of five investment partners. The service was unable to provide agreements for one of the funds reviewed and a further agreement had to be requested from the partner organisation as a local copy was not available.</p>	<p>A failure to maintain IMA can hinder the ability of the staff to understand the terms and conditions of the investments made.</p>	Low	<p>The Fund has begun recruitment for additional resources to boost resilience, as well as to ensure control procedures can be carried out in a timely manner. This will also involve ensuring that background agreements are closely monitored and archived.</p>
Responsible Officer:		Mamon Zaman	Target Implementation Date:	September 2021

Internal Audit Report – Pension Fund Investments 2019/20

Detailed Findings

Ref	Finding	Potential Risk Implication	Risk	Agreed Action
3	<p>Diversification of Asset Mix</p> <p>A key element of Surrey Pension Fund Investment Strategy is a diversified asset mix. The current investment strategy includes guidance on the expected level of investment in various asset types. When we compared the guidance against the actual Pension Fund Investments as at December 2020, we found that investments in the following asset types were more than the agreed allocation policy guidance:</p> <ul style="list-style-type: none"> -Investment in multi asset credit bonds was 11.58% which was above the target of 9.7% -Investments in private markets was 7.2% which was above the target of 5%. 	Investment levels in asset types above identified allocation targets exposes the fund to increased risk from changing market conditions.	Low	<p>Multi Asset Credit allocation - The Fund had invested this after the markets dropped between March – June 2020 due to COVID and saw this as a good opportunity to invest our excess cash while prices were low. We opted for Multi Asset Credit mainly due to this being the most appropriate asset class in our portfolio, while the other asset classes we were either moving out of or moving the funds over to BCPP. We therefore do not see this as a risk but an opportunity we had capitalised on.</p> <p>Private Equity – The Pension Fund Committee had also agreed to increase our allocation to private markets in June 2019 to 20%, so this isn't a risk but in line with our expectations. We are still making changes to our Investment Strategy Statement (ISS), so this is the reason why the ISS isn't updated yet to reflect this. With the nature of Private Market funds, capital</p>

Internal Audit Report – Pension Fund Investments 2019/20
Detailed Findings

			allocations are made on a gradual basis, as and when investment opportunities are identified by our Private Market managers. The Fund can take the action to update the ISS accordingly to reflect these changes.
Responsible Officer:	Mamon Zaman	Target Implementation Date:	September 2021

Appendix A

Audit Opinions and Definitions

Opinion	Definition
Substantial Assurance	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Reasonable Assurance	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Partial Assurance	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.
Minimal Assurance	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.