

Wolverhampton City Council

OPEN DECISION ITEM

Committee / Panel

PENSIONS

Date

17/04/2013

Originating Service Group(s)

WEST MIDLANDS PENSION FUND

Contact Officer(s)/

GEIK DREVER

Telephone Number(s)

2020

Title/Subject Matter

STRATEGY FOR INTERNAL AUDIT 2013/2014 TO 2015/2016

1. **Recommendation**

- 1.1 Members are requested to review and approve the Strategy for Internal Audit 2013/2014 to 2015/2016.



Audit Services

Strategy for Internal Audit

2013/14 to 2015/16

Including the Periodic Assurance Plan for 2013/14



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A Quick guide to the Audit Planning process

Step 1- Audit Universe/Auditable Areas

Identify the Audit Universe (i.e. a list of areas that may require auditing) using a variety of methods:

- Areas of risk identified by the Pension Fund as having the potential to impact upon its ability to deliver its objectives.
- Key Financial Systems work we undertake to assist the external auditors etc.
- Areas where we use auditors knowledge, management request and past experience etc.



Step 2 – Ranking

Score each auditable area as high, medium or low risk using the CIPFA scoring methodology: Materiality/Business Impact/Audit Experience/Risk/ Potential for Fraud



Step 3 – Three Year Strategy

List the medium and high risk auditable areas in the three year Strategy for Internal Audit. High risk areas will be audited annually, medium risks once in a three year cycle, while a watching brief will remain on the low risks.

Appendix A



Step 4 - Next Years Plan

List the areas that will be subject to an audit review in 2013/14 in the Periodic Audit Plan.

Appendix B

A Glossary of Terms

Governance

The arrangements in place to ensure that the Pension Fund fulfils its overall purpose, achieves its intended outcomes for citizens and service users and operates in an economical, effective, efficient and ethical manner.

Control environment

Comprises the systems of governance, risk management and internal control. The key elements include:

- establishing and monitoring the achievement of the Pension Fund's objectives
- the facilitation of policy and decision-making ensuring compliance with established policies, procedures, laws and regulations – including how risk management is embedded
- ensuring the economical, effective and efficient use of resources and for securing continuous improvement
- the financial management of the Pension Fund and the reporting of financial management
- the performance management of the Pension Fund and the reporting of performance management.

System of internal control

The totality of the way an organisation designs, implements, tests and modifies controls in specific systems, to provide assurance at the corporate level that the organisation is operating efficiently and effectively.

Risk management

A logical and systematic method of establishing the context, identifying, analysing, evaluating, treating, monitoring and communicating the risks associated with any activity, function or process in a way that will enable the organisation to minimise losses and maximise opportunities.

Risk based audit and assurance reviews

A review that:

- identifies and records the objectives, risks and controls
- establishes the extent to which the objectives of the system are consistent with higher-level corporate objectives
- evaluates the controls in principle to decide whether or not they are appropriate and can be reasonably relied upon to achieve their purpose, addressing the organisation's risks
- identifies any instances of over and under control and provides management with a clear articulation of residual risks where existing controls are inadequate
- determines an appropriate strategy to test the effectiveness of controls i.e. through compliance and/or substantive testing
- arrives at conclusions and produces a report, leading to management actions as necessary and providing an opinion on the effectiveness of the control environment.

Pensions Committee

The governance group charged with independent assurance of the adequacy of the internal control environment and the integrity of financial reporting.

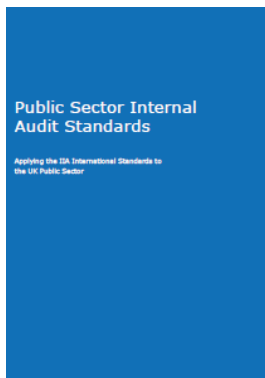
Internal audit

An assurance function that provides an independent and objective opinion to the Pension Fund on the control environment, by evaluating its effectiveness in achieving the Fund's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.

Assurance

A confident assertion, based on sufficient, relevant and reliable evidence, that something is satisfactory, with the aim of giving comfort to the recipient. The basis of the assurance will be set out and it may be qualified if full comfort cannot be given. The Head of Audit may be unable to give an assurance if arrangements are unsatisfactory. Assurance can come from a variety of sources and internal audit can be seen as the 'third line of defence' with the first line being the Pension Fund's policies, processes and controls and the second being managers' own checks of this first line.

Internal Audit standards



The Internal Audit team comply with the standards as laid out in the new Public Sector Internal Audit Standards that come into effect on 1 April 2013.

1 Introduction

- 1.1 The purpose of internal audit is to provide the West Midlands Pension Fund with an independent and objective opinion on risk management, control and governance and their effectiveness in achieving the Fund's agreed objectives. In order to provide this opinion, we are required to review annually the risk management and governance processes within the Fund. We also need to review on a cyclical basis, the operation of internal control systems within the Pension Fund. Internal audit is not a substitute for effective internal control. The proper role of internal audit is to contribute to internal control by examining, evaluating and reporting to management on its adequacy and effectiveness.
- 1.2 The purpose of this document is to provide the Pension Fund with a Strategy for Internal Audit, based upon an assessment of the Fund's audit needs. The Assessment of Assurance Need exercise is undertaken to identify the systems of control and determine the frequency of audit coverage. The Assessment will be used to direct internal audit resources to those aspects of the Fund which are assessed as generating the greatest risk to the achievement of its objectives.

2 Assessing the effectiveness of Risk Management and Governance

- 2.1 The effectiveness of risk management and governance will be reviewed annually, along with a review of the activities the Fund also undertake in this area. The opinion will be reflected in a separate report covering risk management and governance. The review will cover the elements of the risk analysis which we regard as essential for annual review in order to provide a positive, reasonable assurance to the Fund.

3 Assessing the effectiveness of the system of control

- 3.1 In order to be adequate and effective, management should:

- | | |
|---|---|
| • | Establish and monitor the achievement of the Fund's objectives and facilitate policy and decision making |
| • | Identify, assess and manage the risks to achieving the Fund's objectives. |
| • | Ensure the economical, effective and efficient use of resources. |
| • | Ensure compliance with established policies, procedures, laws and regulations. |
| • | Safeguard the Fund's assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption. |
| • | Ensure the integrity and reliability of information, accounts and data. |

These objectives are achieved by the implementation of effective management processes and through the operation of a sound system of internal control. The annual reviews of risk management and governance will cover the control environment and risk assessment elements, at a high level. The programme of work developed as the outcome of the exercise will cover the system level control activities.

- 3.2 The Internal Audit Strategy contained within this report is our assessment of the audit work required in order to measure, evaluate and report on the effectiveness of risk management, governance and internal control.

4 Assessment of assurance need methodology

- 4.1 Internal audit should encompass the whole internal control system and not be limited only to financial control systems, the scope of internal audit work should reflect the core objectives of the Pension Fund and the key risks that it faces. As such, each audit cycle starts with a comprehensive analysis of the whole system of internal control that ensures the achievements of the Fund's objectives.
- 4.2 Activities that contribute significantly to the Fund's internal control system, and also to the risks it faces, may not have an intrinsic financial value necessarily. Therefore, our approach seeks not to try and measure the level of risk in activities but to assign a relative risk value. The purpose of this approach is to enable the delivery of assurance to the Pension Fund over the reliability of its system of control in an effective and efficient manner.
- 4.3 We have undertaken the assessment using the following process:
- We identified the core objectives of the Fund and, where available, the specific key risks associated with the achievement of those objectives.
 - We then identified the auditable areas that impact significantly on the achievement of the control objectives.
 - We assigned risk values to the auditable areas, based on the evidence we obtained.
- 4.4 The Internal Audit Strategy is drawn out of the assessment of audit need. The proposed plan covering the period 2013/14 to 2015/16 is detailed at Appendix A.

5 The assessment of internal audit assurance needs

Identifying the Fund's core purpose and the associated risks

- 5.1 The main purpose of the Fund is:

- To provide a sustainable and affordable final salary pension for members, both present and future;
- To provide an effective service for the members of the West Midlands Authorities Pension Fund;
- To receive monies in respect of contributions, transfer values and investment income;
- To pay out monies in respect of Scheme benefits, transfer values, costs, charges and expenses;
- To be a source of good practice and technical information for interested parties;
- To maintain an accurate database;
- To invest the Fund's assets;
- To provide funds to pay out monies in respect of Scheme benefits, transfer values, costs, charges and expenses.

5.2 The key risks to the Pension Fund, as identified through its risk management process are as follows:

Risks

- Strict timescales and/or late delivery may prevent the Fund applying the normal robust quality controls when reviewing and updating its policies and processes to apply the LGPS Scheme Changes which will impact on the Fund's service provision.
- Scheme accounting records are not appropriately maintained or are inaccurate.
- Civica are unable to complete the system developments in the required time to meet the legislative changes relating to the introduction of Real Time Information.
- No Business Continuity and Disaster Recovery management by WCC resulting in data loss, inability to make payments and collect income etc
- Issues in respect of data quality cause the inability to interact with and provide correct information to members and other external partners;
- Inaccurately and/or incomplete recording of events relating to Scheme members in line with Scheme rules due to loss of employing body expertise;
- Increased workloads and issues with employer management as a result of the introduction of Auto-Enrolment;
- Inability to meet customer expectations and disclosure regulations caused through necessary efficiency savings;
- Inability to maintain business continuity in the event of a disaster or other significant disruption;
- Financial exposure for the fund due to the employer being unable to meet its pension promise i.e. quality of the employer covenant (company strength, contribution, funding levels);
- Impact on service provision due to breakdown of sufficient and effective dialogue between the Fund and employers;
- Ineffective decisions made by Pensions Committee members due to lack of awareness/ insufficiently training;
- Unauthorised or inappropriate access to third party IT systems;
- No clear or defined ownership of data security and risk potentially leading to errors, duplication, security breaches;
- Loss of key staff and knowledge and diversion of attention from service delivery resulting from the current restructure;
- Data used for valuation purposes is of poor quality due to inadequate data flows with employers or insufficient data cleansing.

Identifying the “audit universe”

5.3 In order to undertake the assessment, it is first necessary to define the audit universe for the Pension Fund. The audit universe describes all the systems, functions, operations and activities undertaken by the Fund. Given that the key risk to the Fund is that it fails to achieve its objectives, we have identified the audit universe by determining which systems and operations impact upon the achievement of the core objectives of the Authority, as identified above, and the management objectives in section 3 above. These auditable areas include the control processes put in place to address the key risks. The auditable areas identified within the audit universe are set out in Appendix A.

Assessing the risk of auditable areas

5.4 Risk is defined as “The threat that an event or action will adversely affect an organisation's ability to achieve its Business objectives and execute its strategies.” Source: Economist Intelligence Unit - Executive Briefing.

5.5 There are a number of key factors for assessing the degree of risk within the auditable area. These have been used in our calculation for each auditable area and are based on the following factors:

- Risk
- Business Impact
- Materiality
- Audit Experience
- Potential for Fraud and Error

Deriving the level of risk from the risk values

5.6 In this model, the assignment of the relative values are translated into an assessment of risk. The risk ratings used are high, medium or low to establish the frequency of coverage of internal audit.

6 Developing a strategy for Internal Audit

6.1 The Strategy for Internal Audit is based on management’s risk priorities, as set out in the Pension Fund’s own risk analysis/assessment. The Strategy has been designed so as to, wherever possible, cover the key risks identified by this risk analysis.

6.2 In establishing a strategy for Internal Audit, the relationship between risk and frequency of audit remains absolute. The level of risk will always determine the frequency by which auditable areas will be subject to audit. This ensures that key risk areas are looked at on a frequent basis. The aim of this approach is to ensure the maximum level of assurance can be provided with the minimum level of audit coverage.

6.3 In the course of the period covered by the internal audit strategy, the priority and frequency of audit work will be subject to amendment in order to recognise alterations in the audit needs assessment/risk analysis, caused by change within the Pension Fund. Auditor’s judgement has been applied in assessing the number of days required for each audit identified in the strategic cycle. The Strategy for Internal Audit is not static, but a dynamic plan which may be updated periodically to reflect changes in the risks faced by the Fund.

- 6.4 The assessment of assurance need's purpose is to:
- determine priorities and establish the most cost-effective means of achieving audit objectives;
 - assist in the direction and control of all audit work

7 Considerations required of the Pensions Committee

- Are the objectives and key risks identified consistent with those recognised by the Pension Fund?
- Does the audit universe identified include all those systems which would be expected to be subject to internal audit?
- Are the risk scores applied to the audit universe reasonable and reflect the Service as it is recognised by the Fund?
- Does the Strategy for Internal Audit cover the key risks as they are recognised?
- Is the allocation of audit resource accepted, and agreed as appropriate, given the level of risk identified?

8 Information to support the Internal Audit Strategy

Resources required

Appendices A and B provides details of the resources required for delivery of the strategy over its three year life cycle. It is envisaged that 90 audit days will be required in 2013/14.

Communication of results

The outcome of internal audit reviews is communicated by way of a written report on each assignment undertaken. However, should a serious matter come to light, this will be reported to the appropriate level of management without delay.

Staffing

Where appropriate, audit staff are either professionally qualified, or sponsored to undertake relevant professional qualifications. All staff are subject to an appraisal programme, which leads to an identification of training needs. In this way, we ensure that staff are suitably skilled to deliver the internal audit service. This includes the delivery of specialist skills which are provided by staff within the service with the relevant knowledge, skills and experience.

Quality assurance

Our procedures manual stipulates the quality control mechanisms that will operate on each audit assignment. The manual has been constructed so as to ensure that we meet the requirements of and comply with appropriate professional and technical standards for internal audit work. The quality of work is assured through the review of files of working papers and reports by a Principal Auditor and the Senior Audit Manager.

West Midlands Pension Fund - Strategy for Internal Audit
For the period: 1 April 2013 to 31 March 2015
Appendix A

Auditable Areas:	Risk	13/14	14/15	15/16
Governance				
Overall Governance & Risk Management	High	✓	✓	✓
Financial Control & Investment Accounting				
Contributions (KFS)	High	✓	✓	✓
Accounting Records and Performance Measurement	Medium	✓		
Settlement of Investment Transactions	Medium		✓	
Investments				
Investment Income & Expenditure (KFS)	High	✓	✓	✓
Administration				
Member Records (KFS)	High	✓	✓	✓
Benefit Calculations (KFS)	High	✓	✓	✓
Payroll (KFS)	High	✓	✓	✓
Data Quality	High	✓	✓	✓
Death Grants	Medium	✓		
Employer Covenants	Medium		✓	
Early Retirement Costing & Recharges	Medium		✓	
On-going Business				
National Fraud Initiative	-	✓	✓	✓
Fraud Investigations	-	✓	✓	✓
Counter Fraud Activities	-	✓	✓	✓
Development & Advice	-	✓	✓	✓
Contingency	-	✓	✓	✓
Management	-	✓	✓	✓

Key

✓	Auditable area will be subject to review in this year.
KFS	All key financial systems reviews are undertaken on behalf of the external auditors, in order to enable them to place reliance upon our work and reduce their workload accordingly.

West Midlands Pension Fund - Periodic Audit Plan for the period 1 April 2013 to 31 March 2014

Auditable Area	Purpose	Risk Category
Governance		
Overall Governance and Risk Management	An annual review of aspects of the Fund's governance arrangements, based upon the CIPFA/SOLACE model. The review will also encompass risk management arrangements to ensure the Fund is adequately identifying, assessing and managing the risks it faces in achieving its objectives, including the continued development of a detailed assurance mapping process.	High
Financial Control & Investment Accounting		
Contributions (KFS)	A review of the key financial controls relating the calculation and collection of member contributions.	High
Accounting Records and Performance Measurement	To provide assurance over the accuracy of performance data compiled by reference to the input of data to the Investment accounting system and subsequently custodian records.	Medium
Settlement of Investment Transactions	To provide assurance over the completeness and accuracy of records maintained in respect of all investment transactions from decision through to settlement at the bank.	Medium
Investments		
Investment Income & Expenditure (KFS)	A review of the key financial controls in respect of income and expenditure in relation to investment transactions.	High
Administration		
Administration of Member Records (KFS)	A review of the key financial controls relating to the administration of member records.	High
Benefit Calculations (KFS)	A review of the key financial controls relating to the calculation of benefit payments.	High
Payroll (KFS)	A review of the key financial controls relating to the administration of the Pensions payroll.	High
Data Quality	To provide assurance in respect of the checks and processes in place to promote the accuracy of data submitted by employers (a risk based approach will be used to identify employer data for checking).	High

Auditable Area	Purpose	Risk Category
Death Grants	To provide assurance over arrangements in place for the payment of benefits in respect of death grants to include specific consideration of authorisation processes and division of duties.	Medium
Employer Covenants	To provide assurance over the Fund's compliance with best practice for obtaining guarantees/covenants for employing bodies.	Medium
Early Retirement Costing & Recharges	To provide assurance over the timely and accurate recoupment of costs in respect of early retirements authorised by employing bodies.	Medium

On-going Business		
National Fraud Initiative	In accordance with Audit Commission requirements we will lead on the NFI data matching exercise, including working with the successor body to the Audit Commission.	-
Fraud Investigations	The carrying out of investigations into areas of suspected or reported fraudulent activity across the Pension Fund.	-
Counter Fraud Activities	A series of Authority wide pro-active fraud activities, including the targeted testing of areas open to potential fraudulent activity including maintenance of the fraud risk register, hosting raising fraud awareness seminars and fraud surgeries and the production of a regular anti-fraud and corruption newsletter.	-
Development & Advice	Reviewing system developments on key controls and providing advice relating to systems which are not necessarily covered by audits originally scheduled for 2013/14.	-
Contingency	Special projects, advice and assistance, unplanned and ad-hoc work as and when requested.	-
Management	Day to day management of the internal audit service, quality control, client and External Audit liaison and preparation for, and attendance at various meetings.	-

Key Financial System Reviews are undertaken on behalf of the Authority's external auditors. Where appropriate, using guidance supplied by them, in order to enable them to place reliance upon the work of internal audit and reduce their workload according. All such reviews are deemed as high risk by their very nature.