

Bath & North East Somerset Council		
MEETING:	AVON PENSION FUND COMMITTEE	
MEETING DATE:	9 DECEMBER 2011	AGENDA ITEM NUMBER
TITLE:	REVIEW OF INTERNAL CONTROL REPORTS OF INVESTMENT MANAGERS & FUND CUSTODIAN	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report:		
None		

1 THE ISSUE

- 1.1 As part of the risk management process the Fund's Officers annually review the internal control reports of the investment managers and the custodian.
- 1.2 The report sets out the conclusions of the review of the internal control reports.

2 RECOMMENDATION

The Committee is asked to:

- 2.1 Note the report and request that the Officers continue to review the internal control reports and report to Committee on at least an annual basis.

3 FINANCIAL IMPLICATIONS

3.1 There are no financial implications.

4 BACKGROUND

- 4.1 As part of the risk management process, the Fund's Officers annually review the internal control reports prepared by the investment managers and the custodian, which describe their internal control environment. These reports are externally audited, but the format and content is not prescribed and therefore they vary in content and the level of detail. Generally, the company's management identifies the controls needed by the organisation to achieve the control objectives. External auditors verify that the controls identified are in place and comment on whether the controls will achieve the control objectives or not.
- 4.2 In the UK, it is best practice for investment managers and custodians to produce an AAF 01/06 Report (Technical Release 01/06 of the Audit and Assurance Faculty of the Institute of Chartered Accountants in England & Wales). The US equivalent is a SAS 70 Report (Statement of Auditing Standards), however for examination periods ending after June 2011 the SAS 70 standards have been superseded by new standards – SSAE No 16 (Statement on Standards for Attestation Engagements). The new standards are similar, but tighten requirements for disclosure. The Fund's Custodian BNY Mellon has reported against the updated standards ahead of time.
- 4.3 It should be noted that these reports are not mandatory and amongst hedge funds it is not standard practice to produce these reports. Where an internal control report is not produced by a manager, the Officers review the relevant Administrator's internal control report in addition to the audited financial statements of the respective fund.
- 4.4 Additional work has been undertaken this year to support the external audit on assessing the risks around the valuation of assets by investment managers and ensuring in particular that investment managers have adequate valuation policies in place.

5 REVIEW OF INTERNAL CONTROL REPORTS

- 5.1 In October 2011 the Officers reviewed the internal control reports for the year ending 31 December 2010 for all of the investment managers and the custodian.
- 5.2 In each case the external auditor's report stated that the controls were in place and achieved the control objective. Last year's only exception (regarding logical access to IT systems at RLAM) has been remedied by RLAM and confirmed by their auditor's report for the current year.
- 5.3 It should be noted that for the first time, a FoHF manager (Man Group) has produced their own full SAS70 report on their own activities. Officers will continue to encourage the other FOHF managers to consider issuing their own internal controls report.

- 5.4 The audited financial statements of FoHFs have been reviewed by the Officers and the external auditor's opinion for the audited accounts was unqualified for each of the FoHFs the Fund is invested in. In addition the internal control reports of their external Administrators have been reviewed and in each case there were no exceptions highlighted by the auditors.
- 5.5 The Officers will continue to review the internal control reports of the Fund's external providers and report to Committee on an annual basis. They will continue to discuss the significance of the internal control reports with investment managers on an ongoing basis.

6 RISK MANAGEMENT

- 6.1 The risk to pension fund assets as a result of a failure in the custodian's operating systems is highlighted in the Council's risk register. An annual review of their SAS 70 report or equivalent is one of the actions identified in the risk register as a means of mitigating any risk to the security of the Fund's assets.
- 6.2 A review of the investment managers' reports is less critical in that the Fund's assets are not directly at risk as they are held either by the Fund's custodian or in the case of pooled funds and hedge funds, by external custodians. However, any shortcoming in an investment manager's operations may have an adverse impact on the manager's performance which is of particular importance with regards to hedge funds.

7 EQUALITIES

- 7.1 This report is for information and therefore an equalities impact assessment is not necessary.

8 CONSULTATION

- 8.1 This report is for information only and therefore consultation is not necessary.

9 ISSUES CONSIDERED REACHING THE DECISION

- 9.1 None as for information only.

10 ADVICE SOUGHT

- 10.1 The Council's Monitoring Officer (Council Solicitor) and Section 151 Officer (Director of Resources and Support Services) have had the opportunity to input to this report and have cleared it for publication.

Contact person	Matt Betts, Assistant Investments Manager (Tel: 01225 395306)
Background papers	AAF 01/06, SAS 70 & SSAE 16 reports from investment managers, custodian and administrators. Audited Financial Statements of Fund of Hedge Funds.