

ORGANISATION EUROPÉENNE POUR LA RECHERCHE NUCLÉAIRE
CERN EUROPEAN ORGANIZATION FOR NUCLEAR RESEARCH

Action to be taken

Voting Procedure

For information	FINANCE COMMITTEE 360 th Meeting 13-14 June 2017	-
For information	COUNCIL 185 th Session 15-16 June 2017	-

**Recommendations from the External Auditors
to the CERN Pension Fund Management
on the Annual Report and Financial Statements
for the Year Ended 31 December 2016
and
Comments from the CERN Pension Fund Management
Supreme Audit Office of Poland**



NAJWYŻSZA IZBA KONTROLI
SUPREME AUDIT OFFICE OF POLAND

Audit No. P/17/052-3/CERN PF ML

**EXTERNAL AUDITOR'S MANAGEMENT LETTER
RELATING TO THE FINANCIAL STATEMENTS
OF THE EUROPEAN ORGANIZATION FOR NUCLEAR
RESEACH PENSION FUND (CERN PF)
FOR THE YEAR ENDED 31 DECEMBER 2016**

Warsaw, 19 May 2017

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KST-410.003.01/2017/1

19 May 2017

Dr Thomas Roth
Chairman of the Pension Fund Governing Board
CERN Pension Fund
CH-1211 Geneva 23
Switzerland

*For information: Sijbrand de Jong, President of the CERN Council
Members of the CERN Council*

Dear Doctor Roth,

We have recently completed our audit of the CERN Pension Fund financial statements for the year ended 31 December 2016, which we conducted in accordance with International Standards of Supreme Audit Institutions. Our audit examination was conducted primarily to enable us to express an opinion on the financial statements and compliance with authorities but not for the purpose of expressing an opinion on the effectiveness of the Organization's Pension Fund internal control. Our consideration of internal control was for the limited purpose relevant to the entity's preparation and fair presentation of the financial statements and compliance with authorities and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We have not found any new matters or areas of possible improvement involving internal control and accounting issues. During our audit, we checked and assessed the follow-up of our previous recommendations.

This letter does not affect our audit report dated 19 May 2017 on the Financial Statements of the CERN Pension Fund. We have reviewed the status of two previous recommendations one provided by us and one by previous external auditors and have determined their current status of implementation in the Annex to this Management Letter. We are pleased to announce that both are on good way to final implementation and closure.

Our observations from this year audit are summarized as follows:

There are no observation as regards the financial audit of the CERN Pension Fund for the year 2016 (see the Annex for previous years observations).

The CERN Pension Fund Management's comment on the Emphasis of Matter included in the External Auditor's Report:

CERN Pension Fund comment

As noted in the "Actuarial Status of the Fund" section of the Fund's Annual Report, the most appropriate measure "for assessing the funding situation is the projected benefit obligation (PBO) in an open fund scenario as determined in the Fund's three-yearly Periodic Actuarial Review". According to the results of the last Periodic Actuarial Review of the Pension Fund as at 1.1.2016, the funding ratio at the date of measure was 73.0% (as compared to 69.5% as at 1.1.2013) and the projected funding ratio at 1.1.2041 was 113.6% (as compared to 95.5% at 1.1.2041 as at 1.1.2013). The Council took note of the information on the 2016 Periodic Actuarial Review during its session in June 2016, including the Actuary's explanation of the improvement in the projected funding level at 1.1.2041 from 95.5% in 2013 to 113.6%, confirming that the 2010/2011 package of measures was having the desired effect of helping to restore the financial balance of the Fund.

Our position

Periodic Actuarial Review provides the prediction of the situation for the following period of 25 years, based on agreed actuarial assumptions. This prediction may appear true, although it is exposed to a risk of unexpected market circumstances. A realistic assessment of the Fund's long-term financial situation cannot be made until large part of this period has ended. Our comment in the Emphasis of Matter is based on actual financial data from the period of our audit. In this period the value of net assets diminished by MCHF 10 whereas the technical deficit of the Fund grew by MCHF 1,719 (it was MCHF 4,387 in 2013) when calculated under IPSAS regime and remains fairly stable under the best estimate actuarial assumptions.

Signed by:

Ewa Polkowska



Vice-President of NIK
Chairman of CERN Audit
Steering Committee

Wieslaw Kurzyca



Primary Auditor
of CERN External Audit

CERN Pension Fund

Status of previous year's observations

OBSERVATION / RECOMMENDATION	ACTION TAKEN	STATUS
NIK Management Letter FY 2015, Audit No. P/16/051-2/CERN PF ML:		
<p>Observation 1. The CERN Pension Fund Internal Control System (COSO Framework)</p> <p>The CERN Pension Fund Internal Control System has been fairly well developed, based on the off-the-shelf software and Microsoft SharePoint platform. It addresses most of risks identified for the Fund operations, in reference to brief descriptions of operational cycles, and controls to mitigate the risks identified. However, we have identified room for improvement of the system: many operational processes and risks are too briefly described, descriptions of control activities often do not sufficiently inform what is actually done; it is often the case that operational processes do not clearly show what operational objectives they serve. Overall ICS assessment of the specialised internal auditor (MAZARS) has revealed, mainly in 2013, minor but fairly numerous number of weaknesses and documentation omissions. Three of our last year observations also referred to internal control activities.</p> <p>In general, the current system requires broad and consolidated institutional knowledge to operate well.</p> <p>A new COSO internal control framework, developed on the basis of world-wide experience since 1992, is an overall comprehensive and very consistent concept based on 17 principles grouped within five components of internal control framework: control environment, risk assessment, control activities, information and communication, and monitoring activities. Each of the said principles is further illustrated by 'points of focus', which assist to understand a principle and to evaluate whether a particular principle is present and functioning. The idea is that particular elements of the system "operate together", which</p>	<p><u>Assessment of the External Auditor:</u></p> <p>Action has been taken by the Fund management by developing a CERN Pension Fund Internal Control System Policy, which was presented to the PFGB in November 2016 and approved at the PFGB meeting in February 2017. The policy meets our recommendations and provides solid grounds for the upgrade of the existing system. We noted that the work on such upgrade were concurrently going on by, e.g. providing further details to description of particular processes, more informative control descriptions, marking interrelations between processes, creating hyper-links to relevant documents, etc.</p> <p>We will continue to monitor further implementation of the policy during next year audit. In our view, it is still a room for improvement in:</p> <ul style="list-style-type: none"> - presenting objectives for particular processes and sub-processes (or functions) - marking relation between objectives (operational, reporting, compliance) and risks and controls, - reviewing process descriptions whether they present sequence of actions leading to the achievement of objectives <p>The lacking parts are also:</p> <ul style="list-style-type: none"> - control environment (in relation to the Fund as a whole), 	<p>IN PROGRESS</p>

<p>ensures that identifying missing elements or flaws in the system is easy and rectifying them may be effective.</p> <p>Failure to apply the new COSO framework would mean losing an opportunity to develop a system in which all its five components, while operating together, may collectively and effectively reduce to an acceptable level the risk of not achieving the organisation's objectives.</p> <p>Recommendation:</p> <p>We recommend to develop a transition plan to pass over from the current Internal Control System to the 2013 New COSO Internal Control Framework. In our view this will require:</p> <ul style="list-style-type: none"> - creating a centralized project management function, - transferring knowledge on the new framework to the personnel, - developing a cost-effective approach to converting the underlying documentation, - mapping controls through each of the five components and supporting principles and, to the extent they are applicable, particular points of focus, - designating roles, responsibilities and authorities for converting documentation, - developing a road-map of implementation until the conversion is completed. 	<ul style="list-style-type: none"> - information how the system and particular control activities are communicated to all concerned, and - how it is monitored. 	
ITALIAN COURT OF AUDIT (CORTE DEI CONTI), AUDIT REPORT NO. CERN/FC/5742:		
<p>Recommendation 13. <i>Declarations of potential conflict of interests are to be carefully reviewed by a dedicated body</i></p> <p>This recommendation refers to a potential conflict of interests that may arise “in an environment such as the CERN Pension Fund, where considerable assets are invested in different funds and can materialize at every level of the staff, through the management and Investment Committee, to the PFGB members.” We agree that the conflict of interest may arise and wish to leave this recommendation open, at the same time to consider its content in the future, especially in the context of the manner of verifying declarations about the lack of the conflict of interests made by particular officials.</p>	<p>Assessment of the External Auditor:</p> <p>The CEO of the Fund produced a draft Register of Interest which was consulted with all concerned, including external auditors. The Register of Interest was approved by the PFGB at its meeting in April 2017. The document fully responds to our recommendation and comments made in the consultation process. In the final discussion with the CEO on the approved text we proposed to set the deadline by</p>	<p>IN PROGRESS</p>

	<p>which the Register shall be filled in each year by the relevant personnel.</p> <p>The Register of Interest is intended to be put into effect from the beginning of 2018. We will monitor its implementation during the next year audit.</p>	
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