

Lancashire County Pension Fund

**Annual report of the head of internal audit for the year
ended 31 March 2017 and Internal Audit Plan 2017/18**

	Section	Page
1.	Introduction	1
2.	Overall opinion on governance, risk management and internal control	2
3.	Findings of internal audit work undertaken during the year	2
4.	Internal Audit Plan – 2017/18	6
5.	Internal audit quality assurance and improvement	7

Annex A: Scope, responsibilities and assurance

Annex B: Audit assurance levels and classification of agreed actions

1. Introduction

- 1.1. This report summarises the work that the Internal Audit Service undertook during 2016/17 and the key themes arising from it in relation to risk management, governance and control.

The role of internal audit

- 1.2. The Internal Audit Service is an assurance function designed to provide an independent and objective opinion on the adequacy and effectiveness of the control environment. The Public Sector Internal Audit Standards require the head of internal audit to provide an opinion on the control environment and a written report to those charged with governance, timed to support the annual governance statement. This report is based upon the work the Internal Audit Service performed during 2016/17.
- 1.3. The scope of our work, management and audit's responsibilities, the basis of my assessment, and access to this report is set out in Annex A to this report. The levels of assurance the Internal Audit Service provides are set out in Annex B.

Acknowledgements

- 1.4. I am grateful for the assistance that has been provided to the Internal Audit Service in the course of our work during the year.

Ruth Lowry
Head of Internal Audit
Lancashire County Council

2. Overall opinion on governance, risk management and internal control

Overall opinion

- 2.1. On the basis of our programme of work for the year, I can provide substantial assurance over the internal control environment, governance and risk management arrangements of the Lancashire Pension Fund for 2016/17. In my opinion there is a generally sound system of internal control, adequately designed to meet the objectives of the Pension Fund and controls were generally applied consistently.

Summary of assurance provided by the Internal Audit Service

- 2.2. We have fulfilled the work plan outlined in the report to the Pension Fund Committee in June 2016, which addressed the administration of the Fund for its members, the Fund's general ledger accounting arrangements, controls over investment management, and the follow up of our prior year work on performance management and corporate oversight of the Fund's governance arrangements. We have provided full or substantial assurance over each of these areas.
- 2.3. Definitions of the assurance levels used are included in Annex 2.

Wider sources of assurance available to the Pension Fund

- 2.4. Assurance has also been provided to the Head of the Pension Fund by Grant Thornton as the Fund's external auditor. Grant Thornton issued its annual audit letter relating to 2015/16 in September 2016, and gave an unqualified opinion on the Fund's annual financial statements.

Implications for the Annual Governance Statement

- 2.5. On the basis of our work during 2016/17, we are aware of no issues that should be disclosed in the Fund's Annual Governance Statement.

3. Findings of internal audit work undertaken during the year

Administration of the Pension Fund in relation to its membership

- 3.1. We have provided *substantial* assurance that membership of the Pension Fund is properly administered and well controlled. We assessed the controls in place to manage a range of relevant risks and to ensure that:
- Only eligible employees are admitted to the scheme at the correct enrolment date, subject to auto-enrolment and authorised and received opt-out instructions;
 - Transfers in are accepted on the basis of authorised and received instructions and are accurately recorded in Altair on the basis of payments/credits received;
 - Transfers out are processed on the basis of authorised and received instructions and are accurately calculated, paid and recorded in Altair;

- Pension contributions are fully, accurately and promptly entered into Altair contribution records;
- Retirement lump sums and pension payments are processed on the basis of authorised and received instructions and are accurately calculated and paid and recorded in Altair;
- Death grants are processed on the basis of authorised probate instructions/death certificates received and are accurately calculated and paid and recorded in Altair;
- Calculations for transfers, retirements and death grants are subject to supervisory review before processing;
- Contributions due to the Pension Fund from employers are complete and accurate in respect of members of the scheme;
- System upgrades or enhancements are appropriately tested prior to integration into the live environment;
- Overpayments and recoveries are quickly and efficiently collected in line with procedures and policy;
- Complaints and ad hoc appeals are swiftly concluded in line with policy and procedures;
- Performance data and KPIs are regularly reviewed by the appropriate level of management. Explanations and remedial actions are evidenced;
- Procedures and controls for the new online members and employers self-service systems are adequate and fit for purpose;
- Returning services i.e. scanning and the automation of manual processes, are fit for purpose and add value to the service.

3.2. We have no significant findings to report, although we did identify that:

- No senior manager within the Administration Service had responsibility for verifying and certifying system updates;
- Not all employers are submitting data files in accordance with the agreed timescales; and
- Inaccuracies within the KPI data source could lead to inaccurate management information being reported.

3.3. Actions have been agreed to address the above weaknesses in control.

3.4. Our review of the actions raised following our prior year audit demonstrated that one of the actions had been satisfactorily addressed. The other action, which related to pursuing employers who continue to submit data files late is still ongoing.

Pension Fund General Ledger

3.5. We have provided *substantial* assurance over the operation of the accounting system supporting the Pension Fund, covering the following areas of control:

- Pension Fund general ledger access rights are appropriate to job roles and are adequately supervised and authorised;

- There is an appropriate system of control and authorisation for the creation, amendment or disablement of codes on the general ledger;
 - Feeder files are posted and reconciled on a timely basis to the general ledger;
 - Journal entries are processed by authorised staff and can be traced to the originators and reasons for posting;
 - The system automatically prevents/corrects/reports debit/credit imbalances, errors or invalid postings;
 - The system provides authorised hierarchies for all services, enabling the current position in respect of income and expenditure to be reported;
 - Sub-ledgers are reconciled to the general ledger; and
 - Holding or suspense accounts are reviewed and cleared on a regular basis.
- 3.6. There were no areas of major concern found during the course of our review. We did however identify:
- Officers who had access to the general ledger who no longer required this access due to moving on to other roles;
 - Examples where new general ledger codes were not appropriately requested or authorised;
 - In some instances information from a third party was relied upon without any independent validation or verification being performed by finance staff; and
 - One control account from our sample had not been reconciled.
- 3.7. Actions have been agreed to address these matters.
- 3.8. Our review of the actions raised following our prior year audit demonstrated that two of the three actions had not been satisfactorily addressed. These were both associated with the need to better manage access to the Pension Fund general ledger, particularly in relation to leavers. As a result of staff changes, the actions had never been implemented, and as the weakness has not been addressed, a further action has been agreed.

Fund investment management

- 3.9. We have provided *substantial* assurance regarding the adequacy and effectiveness of the controls operating over fund investment management.
- 3.10. The scope of our review included the following:
- Verification that the investment strategy is being reviewed;
 - Verification that personnel are suitably qualified and that LCC are informed of changes to staff as per the advisory agreement;
 - Confirming that investment risk monitoring is undertaken on an ongoing basis;
 - Testing that the monthly and quarterly reports documented in the advisory agreement are provided by the Local Pensions Partnership Limited (LPPL) and are accurate; and

- Ascertaining and verifying the process in place to ensure a balanced portfolio.

3.11. There were no major areas of concern identified, although we noted that whilst a market risk specialist has been appointed, the procedures in relation to investment risk monitoring are still under development.

Oversight of the Pension Fund

3.12. We have provided *substantial* assurance regarding the adequacy and effectiveness of the controls in place to ensure an appropriate oversight of the Pension Fund is maintained by the Council.

3.13. The scope of our review has included the following:

- Verifying that a business plan is produced on an annual basis and subject to regular review;
- Confirmation that a formal governance structure has been established which enforces decision making and approvals at the right levels;
- Determination of the processes in place to ensure that the county council is being consulted on matters reserved and verifying that there is compliance with these requirements;
- Confirming that changes to remuneration have been forwarded to the county council's Employment Committee and are in line with the Shareholders Agreement;
- Verifying for a sample of board meetings that there are appropriate non-executive directors on the board and they have approved all decisions made;
- Determining whether the conflicts policy has been implemented and if compliance with it has been validated by LPPL's Compliance Team;
- Ascertaining the adequacy and effectiveness of the controls in place to ensure compliance with regulations; and
- Confirming that the legal agreements in place between LPPL and the county council are monitored as documented in the Shareholder Agreement.

3.14. There were no major areas of concern identified. However, in relation to 'matters reserved' we noted that decisions are not always communicated to the Head of Fund on a timely basis. We also consider that in the absence of a formal log, there may be decisions required to be ratified by the Head of Fund that are not submitted to her.

3.15. Additionally, reports are being completed and submitted to the Financial Conduct Authority by the Local Pension Partnership Investments Limited Compliance Team using the gabriel system. Our testing confirmed that whilst reports are being submitted in accordance with the monitoring and

compliance timetable, we have been unable to confirm that the information was accurate as the data submitted is unable to be reproduced.

National Fraud Initiative

- 3.16. The NFI is part of the statutory audit process for health, local government and other public sector providers managed by the Cabinet office. The NFI flags inconsistencies in data which may indicate fraud or highlight emerging fraud risks.
- 3.17. Following the submission of data in October 2016, the resulting matches were released by the Cabinet Office in January 2017 and these have started to be investigated by the Local Pensions Partnership. The table below provides details of the total number of matches identified, the number of matches recommended for investigation, the number of matches reviewed and cleared to date and those currently opened and in progress.
- 3.18. The Local Pensions Partnership is currently making good progress in investigating data matches against the Cabinet Office milestone dates.
- 3.19. No savings, frauds or errors have been identified from the cases opened and closed to date.

Category of data	Number of matches identified	Number of matches recommended for investigation	Number of matches processed	Number of matches in progress
Comparison of pension records to deceased person records	559	410	468	91
Comparison of pension and payroll records between and within organisations	943	252	931	9
Total	1502	662	1399	100

4. Internal audit plan 2017/18

- 4.1. The individual assignments which underpin the assurance to be provided to the Head of the Fund in relation to the Lancashire County Pension Scheme is incorporated within the overall audit plan for Lancashire County Council, which has been submitted for approval to the meeting of the Audit and Governance Committee of June 2017.
- 4.2. In outline the work for 2017/18 will include the following:
 - Assessment of the assurance proposed and, in due course, provided by Deloitte LLP over the Lancashire Pension Fund's administration and investment operations outsourced to the Local Pensions Partnership.

- Assessment of the council's governance framework to achieve corporate oversight of the Pension Fund.
- Audit of the custodianship of the assets of the Lancashire Pension Fund.
- Audit of the council's accounting for the Pension Fund through its general ledger.

5. Internal audit quality assurance and improvement

- 5.1. The head of internal audit operates a quality assurance and improvement programme that both monitors the on-going performance of internal audit activity and periodically assesses the Internal Audit Service's compliance with the PSIAS. This includes both internal and external assessments.
- 5.2. A self-assessment of the Internal Audit Service confirmed that the service substantially meets the requirements of PSIAS. A more detailed assessment will build on this in 2017/18 and a full external assessment of the Internal Audit Service's self-assessment of its compliance with PSIAS will take place during November 2017, and the results will be reported to the committee. The outcome of that review will be used to inform a revised quality assurance and improvement programme if necessary.

Scope, responsibilities and assurance

Annex A

Approach

- A.1 In accordance with the Public Sector Internal Audit Standards (PSIAS), the scope of internal audit encompasses all of the Pension Fund's governance, risk management and control processes including where they are provided by other organisations on its behalf.

Responsibilities of management and internal auditors

- A.2 It is management's responsibility to maintain systems of risk management, internal control and governance. Internal audit is an element of the internal control framework assisting management in the effective discharge of its responsibilities and functions by examining and evaluating controls.
- A.3 It is the role of the Internal Audit Service to provide independent assurance that these risk management, control and governance processes are adequately designed and effectively operated. The PSIAS makes clear that the provision of this assurance is internal audit's primary role and that this requires the head of internal audit to provide an annual opinion based on an objective assessment of the framework of governance, risk management and control.
- A.4 This assessment will be supported by the identification, analysis, evaluation and documentation of sufficient information on each individual audit assignment, and the completion of sufficient assignments to support an overall opinion for the organisation as a whole.
- A.5 Internal auditors cannot be held responsible for internal control failures, however, we have planned our work so that we have a reasonable expectation of detecting significant control weaknesses. We have reported all such weaknesses to you as they have become known to us, without undue delay, and have worked with you to develop proposals for remedial action.
- A.6 The requirement to be independent and objective means that the Internal Audit Service cannot assume management responsibility for risk management, control or governance processes. However the Internal Audit Service may support management by providing consultancy services. These are advisory in nature and are generally performed at the specific request of the organisation, with the aim of improving governance, risk management and control and will also contribute to the overall assurance opinion.
- A.7 Accountability for responses to the Internal Audit Service's advice and recommendations for action lies with the Senior Management Team and Head of the Lancashire County Pension Fund, which either accepts and implements the advice or accepts the risks associated with not taking action. Audit advice, including where the Internal Audit Service has been consulted about significant changes to internal control systems, is given without prejudice to the right of the Internal Audit Service to review and

recommend further action on the relevant policies, procedures, controls and operations at a later date.

- A.8 The head of internal audit will provide an annual report incorporating an overall opinion, a summary of the work that supports that opinion, and a statement of conformity with the PSIAS and the results of the quality assurance and improvement programme.
- A.9 The Internal Audit Service is not responsible for the prevention or detection of fraud and corruption. Managing the risk of fraud and corruption is the responsibility of management. Internal auditors will, however, be alert in all their work to risks and exposures that could allow fraud or corruption and to any indications that fraud and corruption may have occurred. Internal audit procedures alone, even when performed with due professional care, cannot guarantee that fraud or corruption will be detected.

Basis of our assessment

- A.10 Our opinion on the adequacy of control arrangements is based upon the result of internal audit reviews undertaken during the period in accordance with the plan approved by the Audit and Governance Committee and submitted for information to the Pension Fund Committee. We have obtained sufficient, reliable and relevant evidence to support the improvements that we proposed and that have been accepted by management.

Limitations to the scope of our work

- A.11 There have been no limitations to the scope of our audit work.

Limitations on the assurance that internal audit can provide

- A.12 There are inherent limitations as to what can be achieved by internal control and consequently limitations to the conclusions that can be drawn from our work as internal auditors. These limitations include the possibility of faulty judgement in decision making, of breakdowns because of human error, of control activities being circumvented by the collusion of two or more people and of management overriding controls. Also there is no certainty that internal controls will continue to operate effectively in future periods or that the controls will be adequate to mitigate all significant risks which may arise in future.
- A.13 Decisions made in designing internal controls inevitably involve the acceptance of some degree of risk. As the outcome of the operation of internal controls cannot be predicted with absolute assurance any assessment of internal control is judgmental.

Access to this report and responsibility to third parties

- A.14 This report has been prepared solely for Lancashire Pension Fund. It forms part of a continuing dialogue between the Internal Audit Service, the senior management of the Fund, and the Pension Fund Committee. It is not

therefore intended to include every matter that came to our attention during each internal audit review.

- A.15 This report may be made available to other parties, such as the external auditors. No responsibility is accepted to any third party who may receive this report for any reliance that may be placed on it and, in particular, the external auditors must determine the reliance placed on the work of the Internal Audit Service.

Audit assurance levels

Annex B

The assurance we can provide over any area of control falls into one of four categories as follows:

Full assurance: there is a sound system of internal control which is adequately designed to meet the service objectives and is effective in that controls are being consistently applied.

Substantial assurance: there is a generally sound system of internal control, adequately designed to meet the service objectives, and controls are generally being applied consistently. However some weakness in the design and/ or inconsistent application of controls put the achievement of particular objectives at risk.

Limited assurance: weaknesses in the design and/ or inconsistent application of controls put the achievement of the service's objectives at risk.

No assurance: weaknesses in control and/ or consistent non-compliance with controls could result/ has resulted in failure to achieve the service objectives.

Classification of agreed actions

All actions proposed by the Internal Audit Service and agreed by management are stated in terms of the residual risk they are designed to mitigate.

Extreme residual risk: Critical and urgent in that failure to address the risk could lead to one or more of the following occurring: catastrophic loss of services, loss of life, significant environmental damage or huge financial loss, with related national press coverage and substantial damage to the service's reputation.

High residual risk: Critical in that failure to address the issue or progress the work would lead to one or more of the following occurring: failure to achieve organisational objectives, disruption to the business, financial loss, fraud, inefficient use of resources, failure to comply with law or regulations, or damage to the service's reputation.

Medium residual risk: Less critical, but failure to address the issue or progress the work could impact on operational objectives and should be of concern to senior management.

Low residual risk: Areas that individually have no major impact on achieving the service objectives or on the work programme, but where combined with others could give cause for concern.