

# Internal audit assurance for the Pension Fund Committee

## 1 Introduction

- 1.1 Lancashire County Council, as the administering authority of the Lancashire County Pension Fund, has prepared a governance policy statement that sets out the role of the council's Pension Fund Committee, Investment Panel and Pension Board. The Pension Board's terms of reference include the requirements that it should, "monitor internal and external audit reports" and "review the outcome of internal and external audit reports in relation to the Fund".
- 1.2 The county council's Audit, Risk and Governance Committee has a wider remit as set out in its terms of reference as follows:

"The primary purpose of the committee is to provide independent assurance to the members (being those charged with governance) of the adequacy of the risk management framework and the internal control environment. It provides independent review of the Council's governance, risk management and control frameworks and oversees the financial reporting and annual governance processes. It oversees internal audit and external audit, helping to ensure efficient and effective assurance arrangements are in place."
- 1.3 The Audit, Risk and Governance Committee's terms of reference address its oversight of the work of the Internal Audit Service in some detail, and include a requirement to,

"Consider reports from the head of internal audit on internal audit's performance during the year, including the performance of external providers of internal audit services. These will include updates on the work of internal audit including key findings, issues of concern and action in hand as a result of internal audit work...."
- 1.4 The Internal Audit Service's annual programme of work includes work relating to the Pension Fund and the Audit, Risk and Governance Committee considers both the annual plan and the outcomes of the work done during the year.
- 1.5 This report is therefore presented to the Pension Fund Committee for information regarding the outcomes of the internal audit work done during 2017/18 and the work included in the annual plan for 2018/19 relating to the Lancashire County Pension Fund.
- 1.6 It focusses on the work of the county council's Internal Audit Service but also refers to the work undertaken by Deloitte LLP for the Local Pension Partnership Ltd.

## 2 Internal audit work 2017/18

- 2.1 The work undertaken by the Internal Audit Service and the assurance it provides for 2017/18 are as follows. More details on the findings of the three audits undertaken are set out below.

Audit work	Assurance
<b>Oversight of the Lancashire County Pension Fund</b>	
Assessment of the council's governance framework to achieve corporate oversight of the Fund.	Substantial
Audit of the custodianship of the assets of the Fund.	Substantial
Audit of the council's accounting for the Fund through its general ledger.	Full
<b>Obtaining and understanding the assurance provided by the Pension Fund's own internal auditors</b>	
Assessment of the assurance proposed and, in due course, provided by Deloitte LLP over the Fund's administration and investment operations outsourced to Local Pensions Partnership Ltd.	Substantial

- 2.2 Explanations of the assurance provided by the Internal Audit Service are set out in section 5 of this report below.

### **Oversight of the Lancashire County Pension Fund**

- 2.3 A framework of controls is in place to ensure that the Fund is properly governed, and the county council is able to appropriately oversee the Fund's activities through the Pension Fund Committee and the Lancashire Pension Board both of which include representation from the Fund's wider membership as well as the council. The committee takes executive and strategic decisions whilst the board's role is to ensure that legal and regulatory requirements are complied with, due process is followed, and risks are identified and controlled. Both reviewed their terms of reference during 2017, and the committee approved those of the board.
- 2.4 The control framework includes a three-year strategic plan reviewed by the committee, a suite of policies including a governance policy, an actively maintained risk register reviewed by both the committee and board, notification of impending regulatory changes and confirmation of compliance with regulations, quarterly stakeholder meetings and training for committee members. The Fund's financial performance and Local Pension Partnership Ltd's compliance with key performance indicators are presented to the committee quarterly, and meetings of the stakeholders in the partnership are held quarterly.
- 2.5 Whilst the committee has not reviewed all its policies as intended and not all members take up all offers of training, the governance and oversight framework is actively managed and appropriately implemented.

### Custodianship of assets

- 2.6 To minimise operational investment risk, financial assets are held by a regulated, external custodian who keeps a register of holdings, collects income and distributes monies. The custodianship contract expires on 31 July 2018 and the Fund is currently procuring a new contract. The custodian previously held a number of different assets on behalf of the Fund but in 2016/17 the global equity portfolio was transitioned into a single pooled vehicle in which the Fund holds a share. As the Fund now holds fewer asset types the custodian role will focus more on accounting and performance reporting in future.
- 2.7 The data provided by the current custodian is appropriately reviewed and is reported consistently, reconciliations are undertaken and variances are identified and resolved.

### Accounting for the Pension Fund through the council's general ledger

- 2.8 Lancashire County Council is the administering body for the Lancashire County Pension Fund and as such is responsible for its financial accounting arrangements. The controls in place to account for the Fund on the council's general ledger are effectively operated. We considered access to the Oracle Financials system, the management of accounting codes on the ledger, posting and reconciliation of feeder files and sub-ledgers, authorisation of journal entries to the system, clearance of suspense accounts and system controls to prevent, correct or report imbalances, errors and invalid postings.
- 2.9 We also confirmed that each of the actions agreed during our previous audit in 2016/17 have been implemented.

## 3 Internal audit work undertaken by Deloitte LLP during 2017/18

- 3.1 Local Pensions Partnership Ltd has appointed Deloitte LLP as its internal auditor and the committee should note the scope of work undertaken for this service provider to the Lancashire County Pension Fund. Deloitte disclaims any liability to the Council and Lancashire County Pension Fund for any reliance they may place on this work but have agreed that their conclusions may be reported to the Audit, Risk and Governance Committee and Pension Fund Committee.
- 3.2 At the time this report was prepared, Deloitte had completed and reported eight audits under the first year of its three-year risk-based audit plan.

Control area	Assurance
<b>Lancashire Pension Fund</b>	
Benefit administration.	Effective
Governance.	Effective with scope for improvement
Investment governance.	Effective with scope for improvement
Oversight of LPPL's business and transformation change (phase 1).	Effective with scope for improvement
General IT controls operating over the Altair and Access Dimensions systems.	Effective with scope for improvement

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Control area	Assurance
Core systems and infrastructure migration (phase 1).	Effective with scope for improvement
Oversight of administration business transformation (phase 1).	Effective with scope for improvement
Financial closing and reporting.	Effective with scope for improvement

## 4 Internal audit plan 2018/19

- 4.1 The following work relating to the Lancashire County Pension Fund has been included on the audit plan for the county council in 2018/19.

Operational area of activity	Audit work
Oversight of the Lancashire County Pension Fund.	Follow up of 2017/18 audit work.
Performance management in the Fund	Audit of the adequacy and effectiveness of performance management arrangements including reporting and data quality.
New custodianship arrangements for the Fund	Audit of new arrangements following the award of a new contract, including compliance testing.
Audit of the council's accounting for the Fund through its general ledger.	Follow-up of the action agreed in 2017/18.
Core financial systems: cash flow management.	Audit of arrangements to ensure the Fund is able to meet payments as they become due.
Obtaining and understanding the assurance provided by the Pension Fund's own internal auditors.	Assessment of the assurance provided by Deloitte LLP over the operation of the Fund by Local Pensions Partnership Ltd.

- 4.2 The work that Deloitte plans to undertake for Local Pensions Partnership Ltd is as follows:

Coverage	Key risk areas
Data protection/ privacy	The EU General Data Protection (GDPR) comes into force on the 25 May 2018. The new law will introduce a range of requirements that will have significant impacts on LPP due to the significant amount of personal data the organisation holds and its plan to introduce home working for staff within the Administration business.
Cybersecurity	Strong controls over cyber security are essential. We will focus on the development of the cyber strategy including LPP's ability to defend and respond to this risk.
Core systems and infrastructure (phase 2)	Migration of the LPP network on to a private cloud is a key enabling activity for further change within the LPP businesses.
Investments – MiFID II compliance	A review of the policies and procedures in place for monitoring compliance with FCA regulatory requirements and an evaluation of

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Coverage	Key risk areas
	process by which the regulatory impact of changes in the business are identified and planned for to including horizon scanning. To include an assessment of compliance with MIFID II including best execution, conflicts of interest and personnel account dealing.
Third party oversight	Dependence on outsourced providers for key business activities leads to high impact of control failure and increased likelihood of operational failure, reputational loss and financial loss if outsourcing arrangements are not adequately monitored and controlled. LPP outsource part of the investment management and custodianship function and a review of the oversight of these relationships, such as review SLAs and monitoring of KPIs, is key to confirming effective supervision.
Core financial controls	The design and operation of core financial controls is essential to enable effective function of LPP. In year two of the plan we would focus on quality of Management Information and reporting.
Investments – legal and regulatory compliance	A review of policies in place for monitoring compliance with regulatory compliance and an evaluation of the process by which the regulatory compliance and an evaluation of the process by which the regulatory impact of changes in the business are identified and planned for including horizon scanning. To include assessment of compliance with financial crime regulations including Bribery Act, Market Abuse Regulations and Anti-Money Laundering Regulations.
Benefits administration	There is significant variation in the complexity of benefit awards that the LPP Administration calculates and pays to members of the participating funds. The calculation of these benefits are performed by a number of geographical dispersed teams. In year two of our plan we would focus on transfers out of the local government pension scheme, teachers' compensation scheme, firefighters' pensions, police pensions and member complaints.
Administration transformation (phase 2)	The Administration business has set itself a significant change agenda. The change is planned to be delivered by April 2018 and will need to be delivered whilst maintaining quality of service to members.

## 5 Audit assurance levels and classification of residual risks

- 5.1 The assurance levels and classification of risks within Lancashire County Council's Internal Audit Service for 2017/18 are as follows. Please note that these definitions will be amended for work undertaken in 2018/19.

**Assurance levels**

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

Substantial assurance: there is a generally sound system of internal control, 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 objectives at risk.

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

**Classification of residual risks requiring management action**

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 the county council's services, loss of life, significant environmental damage or huge financial loss, with related national press coverage and substantial damage to the council's reputation. Remedial action must be taken immediately.

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 council's reputation. Remedial action must be taken urgently.

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. Prompt specific action should be taken.

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. *Specific remedial action is desirable.*

- 5.2 The overall risk ratings applied by Deloitte to its reports, and the descriptions of risk mitigation and control effectiveness are as follows.

Overall report rating	Description of risk mitigation and control effectiveness
Ineffective	Risk mitigation or control absent or ineffective – high risk of failure in prevention, detection, and risk mitigation and/ or control activities for audited functions, processes and activities.  Multiple high priority findings/ issues or significant number of either high or medium priority findings/ issues.

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Overall report rating	Description of risk mitigation and control effectiveness
Effective with scope for improvement	<p>Risk mitigation activities and controls may be compromised or fail – moderate risk of failure in risk mitigation and control with some need and justification to improve risk mitigation and control activities for audited functions, processes and activities.</p> <p>Some high priority issues or a significant number of medium and low priority findings/ issues.</p>
Effective	<p>Compliant (adequate in the circumstances) – low risk of failure in risk mitigation and control and some scope or justification to improve risk mitigation and control activities for audited functions, processes and activities.</p> <p>No high priority findings/ issues. Some moderate and low priority findings/ issues.</p>

Risk rating	Description of risk mitigation and control effectiveness
High	<p>The issue presents a risk that involves a direct exposure to significant assets or a significant potential financial loss. Lack of appropriate controls could have a considerable impact on operations, compliance with laws and regulations, or financial results.</p>
Medium	<p>The issue presents a risk, which involves an indirect exposure to significant assets and could have a moderate impact on operations, compliance with laws and regulations, or financial results.</p>
Low	<p>The issue and associated risks have limited impact on operations, compliance with laws and regulations, or financial results.</p>