

Lancashire County Council: Pension Fund

Internal Audit Service

**Annual report for the year ended 31 March 2013,
including the proposed internal audit plan 2013/14**



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1 Introduction

- 1.1 Internal Audit is an assurance function that primarily provides an independent and objective opinion on the adequacy of the organisation's control environment. The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom requires the head of internal audit to provide a written report to those charged with governance, timed to support the Annual Governance Statement, which includes an opinion on the overall adequacy and effectiveness of the organisation's governance arrangements, including the control environment. This report presents our opinion based upon the work we have performed.
- 1.2 This report covers the period 1 April 2012 to 31 March 2013.

Acknowledgements

- 1.3 We are grateful for the assistance that has been provided to us by staff in the County Treasurer's Directorate in the course of our work.

2 Assessment of internal controls

Overall opinion

- 2.1 Based on the internal audit work undertaken during the year we are able to provide **substantial** assurance over the internal control environment for the pension fund and pension administration.
- 2.2 It is our opinion that there is a generally sound system of internal control which is adequately designed and controls are being consistently applied in the majority of areas reviewed, although there are some areas where control needs to be strengthened.
- 2.3 Management responses to the findings from our work have been positive and indicate that action has or will be taken where issues have been identified. Whilst recognising there are a small number of control issues which need to be addressed, our detailed findings identify good areas of effective control.

Key issues and themes arising during the period

- 2.4 The findings of the individual reviews are briefly set out in the following paragraphs.
- 2.5 We are able to provide substantial assurance over the pension administration procedures operated during the year which included consideration of both manual and ICT controls.

2.6 In respect of the manual controls we considered:

- transfer of the payment of pensions to the Altair system;
- authorisation of new members;
- retirement calculations;
- death grant calculations;
- employee and employer contributions to the scheme and
- transfers into and out of the scheme.

We have made two recommendations to ensure the appropriate cancellation of tasks within the Altair system, in order that performance statistics can be fully relied upon and the appropriate separation of duties is operated within the system.

2.7 We found the ICT controls operated within the system were of a reasonable standard overall, but highlighted improvements were required in relation to the business continuity and disaster recovery arrangements to effectively mitigate the impact of system loss or disruption. We are aware that this area has been given priority during the year and work is continuing to address the issues raised.

2.8 In relation to pension fund assets and investments our work has encompassed three reviews consisting of the new investment strategy, the new accounting arrangements and third party assurance reports produced for three of the investment managers.

2.9 Our review of the investment strategy focused specifically on the procurement arrangements operated for the selection of a bench of investment managers for the global equity mandate. The selection and procurement process was undertaken in line with procurement regulations and we were able to provide substantial assurance. We have made one recommendation to further enhance the governance arrangements in this area, to ensure Investment Management Agreements are in place for all the selected investment managers whether or not they have been allocated funds to manage.

2.10 From April 2012 the pension fund was established as a separate organisation with a separate general ledger to that of the county council as part of the upgrade of the county council's financial systems. We have reviewed the new accounting arrangements and provided a substantial assurance opinion indicating that the procedures are adequately designed and operating effectively in the majority of areas reviewed. A small number of recommendations have been made to further enhance the controls in place.

- 2.11 Our review of the third party assurance reports produced for three of the fund manager's systems enabled us to conclude that reliance can be placed on the control statements which did not identify any significant control issues.

Fraud/ special investigations

- 2.12 There were no days used in the investigation of suspected financial irregularities in relation to the pension fund.

Implications for the Annual Governance Statement

- 2.13 On the basis of our work during 2012/13, we are aware of no internal control weakness that requires disclosure in the Annual Governance Statement.

3 Internal audit work undertaken

- 3.1 Work carried out during 2012/13 was in accordance with the audit plan presented and approved by the Pension Fund Committee in May 2012. Details of the assurance provided, and key issues identified for each of the areas covered are set out in the 'Summary of our Findings and Assurance' table attached at page 7. This shows that 67 days were spent on delivering the full audit plan against planned audit activity of 75 days.
- 3.2 This work has been undertaken with liaison with the council's external auditors to minimise any duplication in planned coverage.
- 3.3 A number of areas of work were completed on or just after the end of the financial year. A number of reports were still in draft at the time of writing this report. As all reports have been discussed with the appropriate managers, we feel it is appropriate to include our opinion for these reviews in the summary of findings.

4 Internal audit plan 2013/14

- 4.1 Our work will continue to take maximum advantage of existing management assurance processes and reports, and follow an approach in line with guidance issued by the Society of County Treasurers and CIPFA.
- 4.2 The plan again focuses on two distinct areas which cover the governance and management of the pension fund's assets and pension administration. The audit reviews identified under each of these areas is explained in more detail below.

Pension Fund

- 4.3 We have included audit resources within the 2013/14 plan to review that arrangements for investing pension funds are in accordance with the approved investment strategy. We will consider the adequacy and effectiveness of the governance arrangements for making investment decisions through the Investment Panel through to reporting those decisions to the Pension Fund Committee. (20 days)
- 4.4 We will again provide assurance over the adequacy and effectiveness of the accounting arrangements operated for the pension fund. (10 days)
- 4.5 As part of the pension fund's ongoing review of the current fund manager mandates, we will review the adequacy of the processes employed for the procurement of the property fund mandate. (10 days)
- 4.6 Our work will continue to take maximum advantage of existing management assurance processes and reports, and follow an approach in line with guidance issued by the Society of County Treasurers and CIPFA. This will involve using statutory reporting from the investment managers and custodian in the first instance. These documents will be used to gain assurance over the external investment management activities where appropriate. (3 days)

Pension administration

- 4.7 In the same way that we are required to consider controls over the county council's corporate financial systems, any assessment of the risks to the pension fund will require our assurance over the key controls over the administration of the fund. This year's work will be focussed on testing the key controls we documented as part of last year's review, including the system for auto enrolment of new employees. (30 days)
- 4.8 In addition to the main pensions administration review, we will provide assurance over the system operated for the collection of employer contributions. (5 days)

Follow Up

- 4.9 Audit resources have been identified to ensure that all reviews are followed up and our findings are re-assessed as the actions previously agreed with management are implemented. (2 days)

General Management

- 4.10 An allocation of 5 days has also been made to cover other management and tasks in support of the internal audit service to the pension fund:
- Attendance at meetings;
 - Liaison with external audit; and
 - Central reporting.
- 4.11 The proposed plan amounts to 85 days, which is an increase of 10 days to the 2012/13 audit plan. This is not reflective of a perceived increase in risk surrounding the pension fund, but relates to the cyclical nature of some of the audit reviews we undertake. We have not reviewed the system for collecting employer contributions over the last three years and feel it is timely to include this area in the audit plan this year.

5 Scope, responsibilities and assurance

- 5.1 Details of the scope of our work, and management's and internal audit's responsibilities regarding systems of risk management, internal control are explained in pages 8 and 9. This sets out the basis of our assessment and limitations on the assurance that we can provide.

Access to this report and responsibility to third parties

- 5.2 We have prepared this report solely for Lancashire County Council, and the Pension Fund Committee. As you are aware, this report forms part of a continuing dialogue between the Internal Audit Service, the Treasurer to 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.
- 5.3 We acknowledge that this report may be made available to other parties, such as the external auditors. We accept no responsibility to any third party who may receive this report for any reliance that they may place on it and, in particular, we expect the external auditors to determine for themselves the extent to which they choose to utilise our work.

6 Summary of findings

Overall summary and assurance provided

- 6.1 We have set out in the table on page 7 below a brief summary of each review undertaken during this year. This sets out the planned and actual days we have spent on each review, and a summary of the assurance we have been able to provide in relation to each system or operational area of

your business. The key issues/comments encapsulate the significant issues and areas where key recommendations were made. They reflect the findings at the time the work was carried out.

- 6.2 We have distilled the assurance into an assessment of the adequacy of each system, and its effectiveness in operation.
- 6.3 **System adequacy:** We have defined a system as adequate if its design enables it to achieve its core control objectives which, if operating as intended, serve to manage its inherent risks.
- 6.4 **System effectiveness:** We have defined a system as operating effectively if, after testing or other supporting evidence has been found, it is operating as intended.
- 6.5 It is therefore possible that a system would, if operated as intended, provide adequate control over its inherent risks, but that lapses in controls in practice leave the system exposed to risk.
- 6.6 It is also possible that a system may be inadequate in its design, but is nonetheless operating as intended, albeit with inbuilt weaknesses that mean that the control objectives cannot be met.
- 6.7 Ideally, a system will be adequately designed to achieve its control objectives, and operated effectively in practice.
- 6.8 The table below indicates briefly with simple ticks (✓) and crosses (x) our overall assessment of each system we have reviewed during the year and the assurance you may take from its operation in supporting effective internal control.

Summary of our findings and assurance

Review area	Audit days			Assurance		Key issues / Comments
	Planned	Actual	Variation	Adequacy	Effectiveness	
Audit Areas						
Pensions administration – manual controls & ICT controls	25	32	7	✓	✓	Action has been agreed to address the issues raised to improve the control arrangements.
				Substantial assurance		
New investment strategy – global equity procurement arrangements	25	15	(10)	✓	✓	Action has been agreed to address the issue raised to improve the control arrangements.
				Substantial assurance		
New accounting arrangements	10	10	0	✓	✓	A draft report was issued in May 2013 for management consideration.
				Substantial assurance		
Third party assurance reports	5	3	(2)	✓	✓	We noted that the expected key controls were in place and assurance was provided on them in the reports.
				Reliance can be placed on the assurance reports		
Follow up	5	2	(3)	✓	✓	This related to the follow up of recommendations for the 2011/12 pension fund reviews.
				Full assurance		
Planning and management	5	5	0	-	-	This time relates to the production of the annual plan and report, planning/ progress meetings and general advice.
Total Days	75	67	(8)			

Summary of our findings and assurance

1. Scope, responsibilities and assurance

Approach

- 1.1 In accordance with the CIPFA Code of Audit Practice, the scope of internal audit encompasses all of the Council's operations, resources and services including where they are provided by other organisations on their behalf.

Responsibilities of management and internal auditors

- 1.2 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. Internal auditors cannot therefore be held responsible for internal control failures.
- 1.3 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.
- 1.4 Internal audit procedures alone do not guarantee that fraud will be detected. Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud or other irregularities which may exist, unless we are requested to carry out a special investigation for such activities in a particular area.
- 1.5 Internal audit's role includes assessing the adequacy of the risk management processes, key internal control systems and corporate governance arrangements put in place by management and performing testing on a sample of transactions to ensure those controls were operating for the period under review.

Basis of our assessment

- 1.6 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 Pension Fund Committee. We have obtained sufficient, reliable and relevant evidence to support the recommendations that we have made.

Limitations to the scope of our work

- 1.7 No limitations have been placed on the scope or extent of the work we carried out during the year by the management or staff of the County Treasurer's Department.

Limitations on the assurance that internal audit can provide

- 1.8 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.
- 1.9 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.

Audit assurance levels

- 1.10 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.