

Appendix 'A'

Lancashire County Council: Pension Fund

Internal Audit Service

Annual report for the year ended 31 March 2014,

including the proposed internal audit plan 2014/15



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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 Public Sector Internal Audit Standards require the chief internal auditor 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 2013 to 31 March 2014.

Acknowledgements

- 1.3 We are grateful for the assistance that has been provided to us by staff in the County Treasurer's Directorate and Your Pensions Service.

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. Our detailed findings identify good areas of effective control, raising only a small number of control issues which need to be addressed.

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 the controls relating to auto-enrolment. Employers are required by law to enrol all workers, who meet certain criteria, into the workplace pension

scheme. The review also considered the adequacy and effectiveness of the arrangements operated for the following:

- payment of pensions;
- retirement calculations;
- death grant calculations;
- employee contributions to the scheme and
- transfers into and out of the scheme.

We have made one recommendation relating to evidencing the checks undertaken on the audit logs recording changes made within the pension administration system.

- 2.6 In addition, we reviewed separately the processes and procedures for administering the receipt of employer contributions to the pension fund and are able to provide substantial assurance over the arrangements operated. We have made one recommendation to ensure the prompt reconciliation of the pension administration system and the general ledger.
- 2.7 In relation to pension fund assets and investments our work has encompassed three reviews consisting of the investment strategy, the general ledger and third party assurance reports produced for a sample of the investment managers.
- 2.8 Our review of the investment strategy focused on ensuring that arrangements for investing funds are in accordance with the approved investment strategy and focussed specifically on the role of the Investment Panel in making individual investment decisions during the year rather than simply placing funds with investment managers.
- 2.9 In particular we reviewed that :
- The composition of the Investment Panel is consistent with the agreed terms of reference;
 - Investment opportunities are presented to the Panel and discussed in detail;
 - A detailed due diligence report is compiled for each investment opportunity, signed off by the deputy county treasurer and debated by the Panel;
 - Only investment opportunities that receive unanimous support of the investment panel professionals are approved by the treasurer to the fund; and
 - Decisions to invest, and the reasons for doing so, are clearly presented to the Pension Fund Committee.

- 2.10 We are able to provide full assurance over the systems operated. There were no areas identified that would have a major impact on the achievement of the pension fund's objectives, and the controls were consistently applied.
- 2.11 We have reviewed the accounting arrangements operated through the pension fund general ledger and have provided a substantial assurance opinion, indicating that the procedures are adequately designed and operating effectively in the majority of areas reviewed.
- 2.12 We have made two recommendations to further improve the control arrangements by ensuring that consistent information is included on accounting journals and ensuring changes to access permissions are undertaken promptly for employees who have either left the county council or changed their role.
- 2.13 Our review of the third party assurance reports produced for a sample 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.
- 2.14 The re-tendering of the fund's property management contract has been delayed due to other priorities during the year; consequently we were not able to undertake the intended review of the procurement arrangements for this contract. We are proposing to include this review in the 2014/15 internal audit plan (Section 4).

Fraud/ special investigations

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

National Fraud Initiative (NFI)

- 2.16 In addition to the planned audit reviews we have also undertaken work relating to the National Fraud Initiative (NFI). As part of the county council's duty to protect public funds, the Audit Commission requires all local authorities to participate in the NFI. This exercise has recently been undertaken on a six monthly basis, in order that any overpayments can be identified and recovered at the earliest opportunity. One of the tests included relates to identifying pension claimants that may have died or may have additional employment affecting their pension.
- 2.17 The current NFI exercise identified 2,060 matches for Lancashire. Your Pension Service (YPS) has processed approximately 96 % of these matches to date and has not identified any overpayments. YPS is currently in the process of completing the investigation of the small number of remaining matches.

Implications for the Annual Governance Statement

- 2.18 On the basis of our work during 2013/14, 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 2013/14 was in accordance with the audit plan presented and approved by the Pension Fund Committee in June 2013. 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 8. This shows that 71 days were spent on delivering the audit plan against planned audit activity of 85 days.
- 3.2 This work has been undertaken with liaison with the council's external auditors to minimise any duplication in planned coverage.

4 Internal audit plan 2014/15

- 4.1 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 a little more detail below.

Pension Fund

- 4.2 We have included audit resources within the 2014/15 plan to ensure that there are adequate and effective arrangements in place to monitor the performance and continued appropriateness of the investments made. (20 days)
- 4.3 In line with best practise we will again provide assurance over the accounting arrangements for the pension fund. (10 days)
- 4.4 We are proposing to review the adequacy of the processes employed for the procurement of the property fund mandate which has been deferred from the 2013/14 internal audit plan. (10 days)

Pension administration

- 4.5 We propose to focus this year's work on testing the adequacy and effectiveness of the processes introduced since 1 April 2014 to reflect the significant changes required as part of the Local Government Pension Scheme 2014, in particular the change to a Care Average Revalued

Earnings (CARE) scheme. The allocation of days has been increased from previous years to reflect the requirement to document any new processes and the testing required to provide an appropriate level of assurance over this area. (40 days)

Follow Up

- 4.6 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

- 4.7 An allocation of 3 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 the Audit Commission; and
 - Central reporting.
- 4.8 The proposed plan amounts to 85 days (85 days 2013/14).

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						
Investment strategy	20	15	(5)	✓	✓	The final report was issued in May 2014.
				Full assurance		
General ledger	10	10	0	✓	✓	The draft report was issued in May 2014.
				Substantial assurance		
Third party assurance reports	3	1	(2)	✓	✓	We noted that the expected key controls were in place for the sample reports reviewed and assurance was provided on them in the reports.
				Reliance can be placed on the assurance reports.		
Procurement arrangements - property fund mandate	10	1	(9)	-	-	The days relate to initial discussions and preparatory work. The retender of the property fund contract has been delayed due to other priorities during the year.
Pensions administration	30	32	2	✓	✓	The draft report was issued in May 2014.
				Substantial assurance		
Employer contributions	5	5	0	✓	✓	The final report was issued in May 2014.
				Substantial assurance		
Follow up	2	2	0	✓	✓	This related to the follow up of recommendations for the 2012/13 pension fund reviews. All recommendations had been implemented with the exception of one; ensuring that consistent information is included on all accounting journals (general ledger).
				Substantial 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	85	71	(14)			

Summary of our findings and assurance

1. Scope, responsibilities and assurance

Approach

- 1.1 In accordance with the Public Sector internal Audit Standards, 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 Directorate or Your Pensions Service.

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.