

Lancashire Pension Fund

**Internal Audit Service annual report for 2015/ 2014 and
annual plan for 2014/15**



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1. Introduction

- 1.1. This report summarises the work that the county council's Internal Audit Service undertook during 2014/15 and the key themes arising in relation to the Pension Fund's internal control, governance and risk management. It also provides an outline of the internal audit work planned for 2015/16. It is made under the Public Sector Internal Audit Standards issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors (IIA), with which the Internal Audit Service conforms.

The role of internal audit

- 1.2. The Internal Audit Service is an assurance function that provides an independent and objective opinion on the adequacy and effectiveness of the council's control environment. The Public Sector Internal Audit Standards require the chief internal auditor to provide an opinion on the Pension Fund's 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 2014/15.
- 1.3. An explanation of the scope of our work, management and internal audit's responsibilities, the basis of our assessment, and access to this report is set out in Annex A. The levels of assurance the Internal Audit Service provides are set out in Annex B.

2. Overall assessment of internal control, risk management and governance

- 2.1. On the basis of our programme of work for 2014/15 we can provide substantial assurance there is a generally sound system of internal control, risk management and governance designed to meet the Pension Fund's objectives, and controls are generally being applied consistently.
- 2.2. Management's responses to our work have been positive and action has been, or will be, taken where we have identified control issues.

Summary of assurance provided by the Internal Audit Service

- 2.3. We have fulfilled the work plan outlined in the report to the Pension Fund Committee in June 2014, which addressed administration of the Fund for its members, controls monitoring the Fund's investments, the Fund's accounting arrangements, and the renewal of the property fund mandate. We have provided full or substantial assurance over each of these areas.

Wider sources of assurance available to the Pension Fund

- 2.4. Assurance has also been provided to the Pension Fund by Grant Thornton as the Fund's external auditor. Grant Thornton issued its annual audit letter relating to 2013/14 in September 2014, and gave an unmodified opinion on the Fund's annual financial statements. A copy of the report is available at:

<http://mgintranet/ieListDocuments.aspx?CId=183&MId=3104&Ver=4> (item 18). The external auditor's annual audit letter for 2014/15 is expected to be available in September 2015.

Implications for the Annual Governance Statement

- 2.5. On the basis of our work during 2014/15, 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 the Pension Fund is properly administered and is well controlled. We assessed the controls in place to manage a range of relevant risks and to ensure that:

- Eligible employees have been automatically enrolled into the pension scheme in accordance with the regulations;
- Only eligible employees are admitted to the pension scheme;
- Employees who opt-out and retirees are removed correctly from the pension scheme;
- Transfers in are processed correctly, the funds are received and employees correctly accrue service credit;
- Transfers out are processed correctly;
- Retirement payments are calculated and paid correctly;
- Death grants are calculated and paid correctly; and,
- Contributions are properly monitored.

The accounting system

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

- Access rights are appropriate to job roles and are adequately supervised and authorised;
- The creation, amendment and disabling of codes on the general ledger are appropriately authorised;
- The system automatically prevents or corrects and reports debit/ credit imbalances, errors and invalid postings;
- The system provides appropriate hierarchies for all services, enabling the current position in respect of income and expenditure to be reported;
- Feeder files are posted and reconciled to the general ledger on a timely basis;
- Sub-ledgers are reconciled to the general ledger;
- Journal entries are properly processed and can be traced to the originators and reasons for posting; and,
- Holding or suspense accounts are regularly reviewed and cleared.

Investment management

- 3.3. We reviewed the Fund's arrangements for monitoring its investments in non-investment grade assets (secured loans, emerging markets, impaired credit) and infrastructure, to ensure that these investments remain appropriate and their performance meets targets. Since 2010 investments have been made in sixteen non-investment grade funds/ assets with a value of approximately £775 million and ten infrastructure assets with a value of approximately £315 million as at June 2014.
- 3.4. At the time of this work, a formal system was still being developed and investment analysts recruited, and we provided some additional suggestions to support this. Further audit work on this area will be undertaken during 2015/16.
- 3.5. However we provided full assurance over the re-tendering and procurement of a property fund investment manager. Controls were operated effectively to ensure that the tender was process operated in full compliance with Lancashire County Council, UK and European Union public procurement regulations, and proper practices.

4. Internal audit plan 2015/16

- 4.1. The internal audit plan for 2015/16 will again focus on the administration of the Fund for its members, the core accounting system supporting it, and oversight of the investments supporting the Fund, as well as following up the actions taken in response to our work in 2014/15. We will specifically review the Fund's arrangements for monitoring its investments in non-investment grade assets as noted in paragraph 3.4 above.
- 4.2. At this point, we have not planned specifically to address any further changes to the operation of the Fund (following, for example, the significant change to the calculation of members' pensions during 2014/15). However we are aware that a number of significant developments are being considered that could significantly affect the Pension Fund and our work in future years, and that the Pension Fund's governance arrangements will in particular be affected by the creation of the new Pension Board. We will of course undertake additional work as required if the need is identified during the year.

5. Internal audit quality assurance and improvement

- 5.1. In order to place reliance on the work of the Internal Audit Service and, in conformance with the Public Sector Internal Audit Standards, it is important that the Pension Fund receives assurance regarding its quality. The Internal Audit Service therefore undertook a self-assessment in 2012 against the professional standards in place during at the time (the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006). This self-assessment was verified externally by the Council's external auditor, and the Audit Commission's findings were reported to the Audit and Governance Committee in September 2012.

- 5.2. The Audit Commission concluded that:
- 'the Council's Internal Audit function meets each of the eleven standards for Internal Audit set out in the CIPFA Code of Practice for Internal Audit in Local Government.
- 'Our review has also concluded that the Internal Audit function demonstrates many of the characteristics of best practice as set out in the CIPFA Statement on the role of the Head of Internal Audit and The Excellent Internal Auditor. In particular, the Internal Audit work programme includes proactive fraud awareness work, thematic and corporate reviews to promote good governance across the organisation, and the annual plan is based on a comprehensive risk assessment process.'
- 5.3. Like the rest of Lancashire County Council, the Internal Audit Service will be subject to further restructuring, and a full externally validated reassessment against the Public Sector Internal Audit Standards published in 2013 will be necessary in due course.

Scope, responsibilities and assurance

Annex A

Approach

- A.1 In accordance with the Public Sector internal Audit Standards, the scope of internal audit encompasses all of the Pension Fund's operations, resources and services 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. Internal auditors cannot therefore be held responsible for internal control failures.
- A.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.
- A.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.
- A.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

- A.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

- A.7 No limitations have been placed on the scope or extent of the work we carried out during the year.

Limitations on the assurance that internal audit can provide

- A.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.
- A.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.

Access to this report and responsibility to third parties

- A.10 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.11 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.