

Appendix 'A'

Lancashire Pension Fund

Annual report of the head of internal audit for the year ended 31 March 2016 and the audit plan for 2016/17



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1. Introduction

- 1.1. This report summarises the work that the Internal Audit Service undertook during 2015/16 and the key themes arising from it. It provides my opinion on the overall adequacy and effectiveness of the systems of governance, risk management and internal control. It also provides an outline of the internal audit work planned for 2016/17. 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 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 2015/16.
- 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 2015/16. In my opinion that 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 2015, which addressed the administration of the Fund for its members, the Fund's general ledger accounting arrangements, controls monitoring the Fund's listed equities and performance monitoring. 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 Pension Fund by Grant Thornton as the Fund's external auditor. Grant Thornton issued its annual audit letter relating to 2014/15 in September 2015, 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 2015/16, 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 well controlled. We assessed the controls in place to manage a range of relevant risks and to ensure that:
- The Altair system is correctly configured;
 - 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 and lump sums are calculated and paid correctly; and,
 - Contributions are properly monitored.
- 3.2. We have no significant findings to report, although we found that the Epic system is not being fully utilised as files are not being submitted regularly by all employers. We also found that Your Pensions Service were correcting errors on the LCC payroll files, which should not be the case. Your Pension Service should maintain their independence, and the errors should be returned to LCC for correction.

Pension Fund General Ledger

- 3.3. We have provided substantial assurance over the operation of the accounting system supporting the Pension Fund, covering the following areas of control:
- New user requests and 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;
 - Feeder files are posted and reconciled to the general ledger on a timely basis;
 - 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.
- 3.4. We did not identify any major areas of concern, although we identified officers who had access to the general ledger who no longer required this access after moving on to other roles. Additionally a number of unreconciled items on the quarterly reconciliation of the added year recharges control account had not been followed up. Actions have been agreed to address each of these matters.
- 3.5. Work has also been undertaken to ascertain the progress made in implementing the two agreed actions arising from the 2014/15 review of this area. One action, relating to the reconciliation of the BACS control account has been appropriately implemented. The second action, relating to a review of the transactions coded to the Pension Fund payment codes has not been implemented; whilst we have been informed that the transactions are reviewed, no evidence of the review process is maintained.

Listed equities

- 3.6. We have provided full assurance that the controls operating over listed equities are adequately designed and were operating effectively. Our review included examination of the following areas of control:
- A signed agreement is in place with each fund manager detailing management charges payable;

- Performance of the investments are regularly monitored through the Investment Panel and the Pension Fund Committee;
- The information used to monitor performance is reliable; and
- Management fees paid to each of the fund managers is in accordance with the agreements and invoices are checked and authorised appropriately before being paid.

Performance monitoring

- 3.7 Following audit work begun in 2014/15, we have provided substantial assurance over the controls in place to manage receipt, analysis and monitoring of the performance information received from fund managers.
- 3.8 This audit focussed on the monitoring arrangements specifically for investments which fall within the credit strategy and infrastructure classes only. We examined controls over the key risk that investments which do not achieve the minimum return or do not remain appropriate are not identified, and remedial action is not undertaken because:
- Investment performance information is not available;
 - Investment performance is not monitored and benchmarked;
 - Information and intelligence on changes in relation to the investment manager, including management team composition, acquisitions and mergers, and conflicts of interest are not obtained and reviewed; or,
 - Prompt action is not taken on any issues identified from the monitoring activity.
- 3.9 Financial and performance information in relation to the investments held by the Pension Fund is received on a monthly basis and is recorded and reported by the Investment Management team. These asset valuations are not independently audited, with the only independently verified information currently received being the annual audited accounts which are not used for monitoring purposes. Accordingly, it has been agreed that fund managers will additionally be asked to submit SAS70 reports (relating to the audit of controls within a service organisation), which will provide assurance over the operational controls within their systems.
- 3.10 Whilst analysts review and report to investment managers on the information received on a quarterly basis, controls could also be strengthened if this analysis was documented and the review process evidenced.
- 3.11 In addition to the monitoring undertaken by the analysts and investment managers, performance and asset allocations are reviewed by the Investment Panel. Although the value of the investments held as at February 2015 exceeded the benchmark asset allocation by a small amount, the position is being appropriately monitored.
- 3.12 Subsequent to the due diligence process completed prior to the initial investment decision being taken, there is limited evidence provided to the

Pension Fund Investment Management team to confirm that key qualitative factors within the Fund Management organisation are still appropriate. It has therefore been agreed that fund managers will be asked to complete an annual questionnaire to provide formal assurance that key people are still in place and that the value and types of funds being managed are consistent with expectations.

National Fraud Initiative

- 3.13 The matches from the 2014/15 exercise, shared with Your Pensions Service and investigated to date are shown in the table below:

	Number of data matching reports	Number of matches recommended for investigation	Number of records processed and cleared
Comparison of pension records to deceased person records	810	221	773
Comparison of pension and payroll records between and within organisations	957	244	945
	1767	465	1718

- 3.14 As at 9 May 2016, no financial errors had been identified from the 1718 records that had been opened and cleared. Nine records were still in the process of being investigated.
- 3.15 Only records from the latest data release of December 2015 have not yet been opened.

4. Internal audit plan 2016/17

- 4.1. The internal audit plan for 2016/17 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 2015/16.
- 4.2. We will additionally consider the adequacy and effectiveness of the council's governance framework to achieve corporate oversight of the Pension Fund.

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 and from May 2016 has been set out in a formal Quality Assurance and Improvement Programme.

- 5.2. The results of the quality assurance and improvement programme including any areas of non-conformance with PSIAS will be reported annually to the county council's Management Team and Audit and Accounts Committee.
- 5.3. There are no areas of non-conformance with PSIAS to report.

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, 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 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.