

# Notice of meeting and agenda

## Pensions Audit Sub-Committee

**8:30am, Monday 26 March 2018**

Dunedin Room, City Chambers, High Street, Edinburgh

This is a public meeting and members of the public are welcome to attend

### Contact:

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## **1. Order of business**

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- 1.1 Including any notices of motion and any other items of business submitted as urgent for consideration at the meeting.

## **2. Declaration of interests**

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- 2.1 Members of the Committee and members of the Pensions Board should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

## **3. Deputations**

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- 3.1 If any

## **4. Minute**

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- 4.1 Minute of the Pensions Audit Sub-Committee of 11 December 2017 (circulated) - submitted for approval as a correct record

## **5. Reports**

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- 5.1 Agenda Planning – report by the Executive Director of Resources (circulated)
- 5.2 Lothian Pension Fund Internal Audit Update – 1 November 2017 to 31 March 2018 – report by the Chief Internal Auditor (circulated)
- 5.3 Lothian Pension Fund – Draft Internal Audit Plan for 2018/19 – report by the Chief Internal Auditor (circulated)
- 5.4 External Audit - Annual Audit Plan 2017-18 – report by the Executive Director of Resources (circulated)

## **6. Motions**

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- 6.1 If any

### **Laurence Rockey**

Head of Strategy and Insight

### **Committee Members**

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Councillors Rose (Convener) and Child; John Anzani.

## Information about the Pensions Audit Sub-Committee

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The Pensions Audit Sub-Committee consists of 3 members of the Pensions Committee of which a minimum of two are City of Edinburgh Councillors and its membership is appointed by the Pensions Committee.

The Pensions Audit Sub-Committee usually meets in the City Chambers on the High Street in Edinburgh. The meeting is open to all members of the public.

## Further information

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If you have any questions about the agenda or meeting arrangements, please contact Lesley Birrell, Committee Services, City of Edinburgh Council, Business Centre 2:1, Waverley Court, 4 East Market Street, Edinburgh EH8 8BG, Tel 0131 529 4240 email [lesley.birrell@edinburgh.gov.uk](mailto:lesley.birrell@edinburgh.gov.uk) .

A copy of the agenda and papers for this meeting will be available for inspection prior to the meeting at the main reception office, City Chambers, High Street, Edinburgh.

The agenda, minutes and public reports for this meeting and all the main Council committees can be viewed online by going to [www.edinburgh.gov.uk/meetings](http://www.edinburgh.gov.uk/meetings) .

For remaining items of business, likely to be considered in private, see separate agenda.

## Pensions Audit Sub-Committee of the Pensions Committee

**2.00pm, Monday 11 December 2017**

### **Present**

Councillors Rose (Convener) and Child; John Anzani

### **Pensions Board Members Present:**

Alan Williamson

### **1. Minutes**

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#### **Decision**

To approve the minutes of the Pensions Audit Sub-Committee of the Pensions Committee of 26 September 2017 as a correct record.

### **2. Agenda Planning**

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An overview of potential reports for future Pensions Committee and Pensions Audit Sub-Committee meetings for March and June 2018 was outlined.

#### **Decision**

- 1) To note the agenda planning document.
- 2) To note that the Pension Board were invited to comment on agenda items during Committee meetings.

(Reference – report by the Executive Director of Resources, submitted.)

### **3. Lothian Pension Fund Internal Audit Update – 1<sup>st</sup> September 2016 to 31<sup>st</sup> October 2017**

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A summary was provided of Internal Audit Activity for Lothian Pension Fund during the period 1 September 2016 to 31 October 2017.

Details were provided of open and overdue Internal Audit recommendations at 26 October 2017. Three reviews had been included in the 2017/18 audit plan of which one had been completed, one was at draft reporting stage and another was in progress.

## **Decision**

To note Internal Audit activity and outcomes for the period 1 April to 31 October 2017 and the status of Lothian Pension Fund open and overdue Internal Audit recommendations as at 26 October 2017.

(Reference – report by the Chief Internal Auditor, submitted.)

## **4. Pensions Administration Data Quality**

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Information was given of the ongoing work to enhance the quality of pension administration membership record data.

## **Decision**

To note and be assured by the report by the Executive Director of Resources.

(Reference – report by the Executive Director of Resources, submitted.)

## **5. EU Tax Claims and Income Recovery**

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A summary was provided of activity on EU and other tax claims made on behalf of the Lothian Pension Fund. During the period since the last report, no additional claims had been received and the amount recovered to date remained at £1.3 million.

## **Decision**

- 1) To note the report by the Executive Director of Resources.
- 2) To note the decision by officers not to refresh the older Fokus Bank claims in Italy and note that this was based on an assessment of the cost and the perceived remote likelihood of the claims ultimately being paid as detailed in table 3.10 in the report by the Executive Director of Resources.

(Reference – report by the Executive Director of Resources, submitted.)

## **6. Investment Income Review Cross Border Withholding Tax**

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Information was given of a benchmarking study prepared by Ernst & Young regarding the effectiveness of the procedures in place to manage the tax exposure on the investment income of Lothian Pension Fund and Lothian Buses Pension Fund.

## **Decision**

To note the report by the Executive Director of Resources.

(Reference – report by the Executive Director of Resources, submitted.)

## **7. Global Custody Services Performance**

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The Key Performance Indicator report provided by the Funds' custodian Northern Trust for the 12 months ended 30 September 2017 was presented. Northern Trust was currently meeting the needs of the three Pension Funds.

## **Decision**

To note the report by the Executive Director of Resources.

(Reference – report by the Executive Director of Resources, submitted.)

## **8. Resolution to consider in private**

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The Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the following items of business on the grounds that they involved the disclosure of exempt information as defined in Paragraphs 6 and 9 of Schedule 7(A) of the Act.

## **9. Lothian Pension Fund Internal Audit Update – Payroll Outsourcing Security Review**

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An update was provided of progress on the Payroll Outsourcing Security due diligence review that had been added to the audit plan in September 2017.

### **Decision**

To note the progress with the review and that an opinion on the data security controls operated by the company detailed in the report by the Executive Director of Resources should be provided in early December and that this was dependent on timely responses from the company to the final questions raised by Internal Audit and its review of those responses.

(References – Pensions Audit Committee 26 September 2017 (item 2); report by the Executive Director of Resources, submitted.)

## **10. Investment Controls and Compliance**

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A summary was given of the key matters in relation to investment controls and the development of the in-house investment operations of the Lothian Pension Fund Group.

### **Decision**

To note the update on ongoing compliance, monitoring and other initiatives in relation to enhancing investment controls in relation to the current activity of the Lothian Pension Fund Group and also with future collaboration in mind.

(Reference – report by the Executive Director of Resources, submitted.)

## **11. Risk Management in Depth Review**

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A summary was provided of the Lothian Pension Fund's risk management procedures, including details on the operational risk register and the Fund's action to mitigate these risks.

**Decision**

Detailed in the Confidential Schedule, signed by the Convener, with reference to this minute.

(Reference – report by the Executive Director of Resources, submitted.)

# Pensions Audit Sub Committee

8.30am, Monday, 26 March 2018

## Agenda Planning

Item number	5.1
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

## Executive Summary

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This document provides Committee with an overview of the proposed agendas for future meetings of the Pensions Committee and Pensions Audit Sub Committee. It also provides a more general overview of the current cycle of papers for the Committees.

There will, of course, be specific matters and papers which need to be brought to the attention of the Pensions Committee and the Pensions Audit Sub Committee in addition to those set out herein.



## Agenda Planning

### 1. Recommendations

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Committee is requested to:

- 1.1 Note the agenda planning document; and
- 1.2 Note that the Pension Board are invited to comment on agenda items during Committee meetings.

### 2. Background

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- 2.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings, it was agreed that an agenda planning document be submitted each quarter and highlights any changes to the agenda over the last quarter.

### 3. Main report

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- 3.1 Based on the Committee cycle and the current position, the proposed agendas for the next two meetings are set out below.

#### June 2018

Pensions Committee	Audit Sub Committee
<ul style="list-style-type: none"><li>• Referrals / recommendations from Pensions Audit-Sub Committee</li><li>• LPF Annual Report &amp; Accounts Unaudited</li><li>• Statement of Investment Principles</li><li>• Investment Strategy Panel Activity</li><li>• Annual Investment Updates - Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund</li><li>• Risk management summary</li></ul>	<ul style="list-style-type: none"><li>• LPF Annual Report &amp; Accounts Unaudited</li><li>• Risk Management summary</li></ul>

## September 2018

<b>Pensions Committee</b>	<b>Audit Sub Committee</b>
<ul style="list-style-type: none"><li>• Referrals / recommendations from Pensions Audit-Sub Committee</li><li>• LPFE Limited and LPFI Limited Annual Report</li><li>• LPF Annual Report &amp; Accounts Audited</li><li>• ISA 260 Audit Report</li><li>• Revised Pensions Administration Strategy (to be confirmed)</li><li>• Annual Report by External Auditor</li><li>• Employers participating in Lothian Pension Fund</li><li>• Service Plan Update</li><li>• Risk management summary</li></ul>	<ul style="list-style-type: none"><li>• LPFE Limited and LPFI Limited Annual Report</li><li>• LPF Annual Report &amp; Accounts Audited</li><li>• ISA 260 Audit Report</li><li>• Pensions Data Quality</li><li>• Irrecoverable overpayment of pensions – decisions made under delegated authority</li><li>• Fraud Prevention</li><li>• Annual Report by External Auditor</li><li>• Risk Management summary</li></ul>

**Future Pensions Committee and Audit Sub Committee dates (dates from September 2018 onwards are expected to be approved by Council in March 2018):**

<b>Pensions Committee</b>	<b>Pensions Audit Sub Committee</b>
<ul style="list-style-type: none"><li>• Wednesday 27 June 2018, 2pm, Dunedin Room, City Chambers</li><li>• Wednesday 26 September 2018, 2pm, Dunedin Room, City Chambers</li><li>• Wednesday, 12 December 2018, 2pm, Dunedin Room, City Chambers</li><li>• Wednesday, 27 March 2019, 2pm, Dunedin Room, City Chambers</li><li>• Wednesday, 26 June 2019, 2pm, Dunedin Room, City Chambers</li></ul>	<ul style="list-style-type: none"><li>• Tuesday 26 June 2018, 2pm, Dunedin Room, City Chambers</li><li>• Tuesday, 25 September 2018, 2pm, Dunedin Room, City Chambers</li><li>• Tuesday, 11 December 2018, 2pm, Dunedin Room, City Chambers</li><li>• Tuesday, 25 June 2019, 2pm, Dunedin Room, City Chambers</li></ul> <p>(Sept onwards to be approved by Committee in March)</p>

## 4. Measures of success

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- 4.1 The Committee and Pension Board have greater clarity regarding the content of the Committee cycle.

## 5. Financial impact

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- 5.1 None.

## **6. Risk, policy, compliance and governance impact**

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- 6.1 There is no direct impact as a result of this report. The forward planning of the Committees' agendas should facilitate improved risk management and governance for the pension funds

## **7. Equalities impact**

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- 7.1 There are no adverse equalities impacts arising from this report.

## **8. Sustainability impact**

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- 8.1 There are no adverse sustainability impacts arising from this report.

## **9. Consultation and engagement**

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds and they are invited to comment on the relevant matters at Committee meetings.

## **10. Background reading/external references**

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- 10.1 None

**Stephen S. Moir**

Executive Director of Resources

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## **11. Appendices**

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Appendix – Scheme of Committee Papers

Frequency	Pensions Committee	Audit Sub Committee	Month
Annually	Audit plans and reports (internal and external)	N/A - Draft audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee.	March
	Policies/Strategies/Training (including revised Pension Administration Strategy biennial from March 2016)	N/A	March
	Service Plan (every 2 years)	N/A	March
	Budget	N/A	March
	Governance Update (including Pension Audit Sub-Committee appointments)	N/A	March
	LPF Annual Report & Accounts Unaudited	LPF Annual Report & Accounts Unaudited	June
	Statement of Investment Principles	N/A	June
	Investment Strategy Panel Activity	N/A	June
	Annual Investment Updates - Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund	N/A	June
	LPFE limited and LPFI limited Annual Report	LPFE limited and LPFI limited Annual Report	September
	LPF Annual Report & Accounts Audited	LPF Annual Report & Accounts Audited	September
	ISA 260 Audit Report	ISA 260 Audit Report	September
	N/A	Pensions Data Quality	September
	N/A	Irrecoverable overpayment of pensions – decisions made under delegated authority	September
	N/A	Fraud Prevention	September
	Annual Report by External Auditor	Annual Report by External Auditor	December (or September if available)
	Benchmarking	N/A	December
	N/A	EU Tax Claims & Income Recovery	December
	N/A	Investment Income Review-Cross-Border withholding tax	December
	Stewardship and Engagement	N/A	December
	N/A	Investment Controls & Compliance	December
	N/A	Global Custody Services Performance	December
		Risk Management In-depth review	December

Frequency	Pensions Committee	Audit Sub Committee	Month
Semi Annually	Employers Participating in Lothian Pension Fund	N/A	March & September
3 Times per year	Service Plan Update	N/A	March, September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
Quarterly	Risk management summary	Risk management summary	March, June, September and December
Every 3 years	Actuarial Valuation: LPF/LBPF/SHPF Funding Strategy Statement		December or March
As required	Delegated authorities (provider appointments)	N/A	
	Discretions (death grants etc.)	N/A	
	N/A	Internal Audit Reports	
	Regulatory Update	N/A	
	Investment Strategy Reviews (at least every 3 years)	N/A	
	N/A	Risk management (in depth review)	

# Pensions Audit Sub Committee

8.30am, Monday, 26 March 2018

## Lothian Pension Fund Internal Audit Update – 1 November 2017 to 31 March 2018

Item number	5.2
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

### Executive Summary

This report provides a summary of Internal Audit assurance activity for Lothian Pension Fund (LPF) for the period 1 November 2017 to 31 March 2018, and details of open and overdue LPF Internal Audit recommendations as at 31 January 2018.

Three reviews were included in the 2017/18 Internal Audit annual plan, and one further review was added to the plan in September 2017 at the request of LPF management.

Three reviews have now been completed, with a total of 10 Internal Audit findings (3 High; 2 Medium; 4 Low; and 1 Advisory) raised. The final review of Pensions Tax is at draft reporting stage, and the outcomes will be reported to the June Committee.

This paper includes a summary of the outcomes of the IT Business Resilience and Disaster Recovery review. The Information Governance review was completed in October 2017, with the outcomes reported to Committee in December 2017.

Given the commercially sensitive nature of the third-party Information Security Due Diligence review that was added to the plan, the final outcomes and Internal Audit report have been included in a separate B Agenda paper.

LPF had five open Internal Audit recommendations as at 31 January 2018. Of these, two had not been closed by the agreed implementation date (1 Medium and 1 Low) and were reported as overdue to the Council's Corporate Leadership Team (CLT) and Governance, Risk, and Best Value Committee (GRBV). One of the overdue recommendations was closed in February 2018.

## Lothian Pension Fund Internal Audit Update – 1 November 2017 to 31 March 2018

### 1. Recommendations

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Committee is requested to:

- 1.1 note Internal Audit activity and outcomes for period 1 November 2017 to 31 March 2018, and the status of LPF open and overdue Internal Audit recommendations as at 31 January 2018, and
- 1.2 highlight any points that it would like raised at the Pensions Committee on 26 March 2018.

### 2. Background

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- 2.1 The Internal Audit plan for the Lothian Pension Fund (LPF) was approved by the Pensions Committee on 20<sup>th</sup> March 2017 and includes the following three reviews.
  - 2.1.1 **Review of IT Business Resilience and Disaster Recovery** - Review of the Fund's Business Continuity Plan including IT disaster recovery for systems hosted by the Council and third-party system providers.
  - 2.1.2 **Information governance** – Assessment of the processes and controls in place to ensure member data held by the Pension Fund is accurate, and is managed in compliance with Data Protection legislation.
  - 2.1.3 **Pensions Tax - Pensions tax lifetime and annual allowances** - Review of arrangements in place to ensure that pensions tax legislation is applied accurately, and that members are informed of its impact on their future pension provision.
  - 2.1.4 **Information Security Due Diligence review for Payroll Outsourcing** – this review was added to the 2017/18 Internal Audit plan in September 2017 at the request of LPF management, and assessed the design of information security controls operated by a potential third-party supplier who was being considered as a payroll outsource provider for LPFs subsidiary companies. Given the commercially sensitive nature of this review, a separate update has been provided and will be considered as B agenda item.

## Open and Overdue Internal Audit recommendations

- 2.2 Open and overdue internal audit recommendations and agreed management actions are tracked monthly, with details of overdue recommendations (those that have not been closed by the agreed implementation date) reported monthly to the CLT and quarterly to the GRBV Committee.
- 2.3 Evidence provided by management to support closure is reviewed, validated, and tested (where appropriate) by Internal Audit to confirm that agreed management actions have been effectively implemented and the risks identified in the original audit report effectively mitigated.

## 3. Main report

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- 3.1 Three of the four audits included in the LPF 2017/18 Internal Audit plan have been completed, with a total of 10 findings raised as detailed below:

Review	Findings			
	High	Medium	Low	Advisory
Information Governance	-	2	3	1
Review of IT Business Resilience and Disaster Recovery	2	-	-	-
Information Security Due Diligence for Payroll Outsourcing	1	-	1	-
<b>Total Findings Raised</b>	<b>3</b>	<b>2</b>	<b>4</b>	<b>1</b>

### Review of IT Business Resilience and Disaster Recovery

- 3.2 The Scope of this review assessed the design adequacy and operating effectiveness of the controls established to mitigate the risk of failure to recover LPF business operations and key systems provided by third parties in the event of a disaster or business resilience incident.
- 3.3 Our review confirmed that significant improvements were required to ensure that existing LPF disaster recovery and business continuity arrangements provide assurance that critical systems and processes will be recovered in the event of a disaster.
- 3.4 Consequently, 2 'High' rated findings were raised reflecting the need to improve existing LPF disaster recovery and business continuity arrangements; and that LPF Business Continuity and Disaster Recovery requirements should be specified in third party contracts.
- 3.5 For further details of the findings raised, please refer to the full report which is included at Appendix 1.



#### 4. Open and Overdue Internal Audit Recommendations

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- 4.1 As at 31 January 2018, LPF had 5 open Internal Audit recommendations. Of these, two had not been closed by the agreed implementation date and were reported as overdue to both the CLT and GRBV Committee.

Details of open and overdue recommendations are included in the table below:

Review and Recommendation	Rating	Status	Revised Date	Original Date
IT Business Resilience and Disaster Recovery - RES1706	High	Open	-	30/03/18
IT Business Resilience and Disaster Recovery - RES1706	High	Open	-	30/06/18
LPF Cyber Security – RES1614 (refer 4.2 below)	Medium	Overdue	31/03/18	30/09/17
LPF Information Governance - RES1705	Medium	Open	-	28/02/17
LPF Information Governance - RES1705 (refer 4.3 below)	Low	Overdue closed March 2018	-	31/12/17

- 4.2 The LPF Chief Risk Officer has provided an update on the overdue LPF Cyber Security recommendation which confirms that progress is being made with development of an LPF supplier management framework to provide assurance over third party Cyber Security controls. This work is being combined with LPFs General Data Protection Requirements (GDPR) project and the Fund's existing risk and compliance controls framework, and LPF is now working to a revised date implementation date of 31<sup>st</sup> March 2018.
- 4.3 The Low rated overdue Information Governance recommendation reflected the need to clarify data controller responsibilities between LPF and the Council and update the LPF website to reflect the agreed position, and the need to update welcome letters to include a reference to the privacy policy and data protection content outlined in the website. This recommendation was closed in March 2018 following review of evidence provided by LPF.

#### 5. Measures of success

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- 5.1 Provision of assurance over the key risks faced by the Fund and effective resolution of control weaknesses identified from audits.

## **6. Financial impact**

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6.1 There are no direct financial implications.

## **7. Risk, policy, compliance, and governance impact**

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7.1 There are no adverse impacts arising from this report.

## **8. Equality impact**

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8.1 There are no adverse equality impacts arising from this report.

## **9. Sustainability impact**

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9.1 There are no adverse sustainability impacts arising from this report.

## **10. Consultation and engagement**

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10.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

## **11. Background reading / external references**

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11.1 None.

### **Lesley Newdall**

Chief Internal Auditor

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## **12. Appendices**

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Appendix 1 – Internal Audit report – Review of IT Business Resilience and Disaster Recovery

# Internal Audit

## **Lothian Pension Fund - Review of IT Business Resilience and Disaster Recovery**

### **Final Report**

22<sup>nd</sup> December 2017

# Contents

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This internal audit review is conducted for the City of Edinburgh Council under the auspices of the 2017/18 internal audit plan approved by the Governance, Risk, and Best Value Committee in March 2017. The review is designed to help the City of Edinburgh Council assess and refine its internal control environment. It is not designed or intended to be suitable for any other purpose and should not be relied upon for any other purpose. The City of Edinburgh Council accepts no responsibility for any such reliance and disclaims all liability in relation thereto.

The internal audit work and reporting has been performed in line with the requirements of the Public Sector Internal Audit Standards (PSIAS) and as a result is not designed or intended to comply with any other auditing standards. Although there is a number of specific recommendations included in this report to strengthen internal control, it is management's responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the City of Edinburgh Council. Communication of the issues and weaknesses arising from this audit does not absolve management of this responsibility. High and Critical risk findings will be raised with senior management and elected members as appropriate.

# 1. Background

## Background

In May 2017, Lothian Pension Fund (LPF) recognised that existing Business Continuity (“BC”) and IT Disaster Recovery (“DR”) arrangements did not meet their current requirements, and were not aligned to increasing Financial Conduct Authority (FCA) expectations. As a result, they undertook improvement activity that included further development of their existing Business Continuity Plan.

LPF’s major IT systems<sup>1</sup> are provided by either the City of Edinburgh Council (CEC) via an outsourced arrangement with CGI, or through direct outsourcing arrangements with external third-party providers. As a result, LPF is fully reliant on these suppliers to invoke effective DR procedures in the event of a major IT failure. Consequently, LPF does not maintain a separate Disaster Recovery plan, but considers both DR and BC within their BC plan. Within this report, we will refer to this combined BC and DR plan as “the Plan”.

As LPF is dependent on third parties for DR arrangements, combining BC and DR processes in one document can be justified, providing that the following processes are documented and performed:

- A process for establishing and regularly re-assessing the criticality of LPF systems and determining recovery time (the target time for recovery of systems) and recovery point (the time period representing the maximum amount of data that can be lost) objectives.
- A process for maintaining oversight of supplier DR testing and BC arrangements relevant to the provision of LPF systems;
- A process to regularly assess the alignment of LPF’s recovery objectives with the DR capabilities of suppliers; and
- Procedures for execution, testing and maintenance of BC activities that are within the control of LPF.

The importance of strong IT resilience for LPF was highlighted during the fibre optic cable failure in July 2016 which caused network connectivity failure. As a result, LPF relocated to the CEC building in Waverly Court to continue to perform their most important business operations, such as pension administration and customer services. The delays in restoration of connectivity prompted LPF management to reconsider the level of DR support for connectivity and to engage in talks with the CEC IT and CGI to enhance the criticality of this service.

The systems operated by LPF are used by its wholly owned subsidiary company LPFI, which is authorised and regulated by the Financial Conduct Authority (FCA). In July 2016, the FCA published *“Guidance for firms outsourcing to the ‘cloud’ and other third-party IT services”*. LPF have highlighted an intent to align its resilience and recovery provisions with this guidance.

## Scope

The scope of this review was to:

- Assess LPF’s business continuity plans and confirm that these are consistent with business requirements and aligned to the disaster recovery capability;
- Assess the ability of the business to recover systems assessed as critical in the event of an incident;
- Assess the DR provisions reported by in-scope third parties used by LPF;
- Confirm that testing of disaster recovery plans and business continuity arrangements are performed on a regular basis; and

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<sup>1</sup> CEC IT is outsourced to a third-party company (CGI) that provides LPF with network connectivity, telephone and data infrastructure and web interface hosting. Other major third-party system suppliers that support the LPF technology systems include Aquilla Heywood (pension administration system), Northern Trust (trading system) and Civica (employer communication and data transfer system).

- In the event of a major outage, confirm that LPF have sufficient workplace recovery arrangements to allow the business to operate.

The third-party suppliers originally within the scope of this review were:

- Aquila Heywood (Pension Administration System);
- Civica (Employer Communication and Data Transfer System); and
- Northern Trust (Trading systems).

During our work, we noted that the failure of fibre optic cable in June 2016 exposed LPF to a number of operational and regulatory risks. According to the original Terms and Conditions of this engagement, the third-party supplier to which the provision of the fibre optic cable is outsourced – CGI - was not in scope for the detailed review. Once this event was brought to our attention by LPF management, we reviewed the provision of network connectivity provided by CGI. While this supplier provides LPF with a number of different IT services, network connectivity is the only service delivered by CGI which was considered in detail as part of this review.

*For the full terms of reference see Appendix 2.*

## 2. Executive summary

### Total number of findings

Critical	0
High	2
Medium	0
Low	0
Advisory	0
<b>Total</b>	<b>2</b>

### Summary of findings

Our review confirmed that significant improvements are required to ensure that the current LPF disaster recovery (DR) and business continuity arrangements provide assurance that critical systems and processes will be recovered in the event of a disaster. Consequently, 2 'High' rated Findings have been raised.

We established that LPF does not currently have a clear view of the criticality of their technology systems or internal recovery requirements. Additionally, there is no provision for LPF DR requirements in two out of three of third party system supplier contracts reviewed as part of this audit (please refer to the scope).

Where DR arrangements are included in contracts, we found that they are not consistently aligned with current industry good practice as there is no established process to monitor and regularly update DR arrangements with third parties or ensure visibility of underlying DR testing.

The fibre optic cable failure in July 2016 which resulted in lack of network connectivity for LPF highlighted the requirement to improve the DR service provided by the Council in partnership with CGI. This lack of network connectivity resulted in LPF staff relocating to the Council's building at Waverly Court to ensure ongoing delivery of business operations. Whilst there was no significantly adverse impact on LPF's ability to operate as a result of this incident, implementation of controls recommended in this report could help to mitigate the impact of future incidents caused by failure on the part of third party suppliers.

LPF has already taken some steps towards improving DR and BC processes, notably engaging system suppliers to investigate potential opportunities to improve systems recovery capability. This has included working with CGI to improve the level of network connectivity DR capability provided. LPF has also implemented a third-party supplier questionnaire, which includes an appropriate range of questions covering third party BC and DR arrangements. This questionnaire has been used in a recent tender process.

Whilst this review does not validate alignment of LPF's BC and DR plan with current FCA guidance, we have highlighted specific areas where further management action is required to improve effective alignment.

Our detailed findings and recommendations are laid out within Section 2: *Detailed Findings*.

## 3. Detailed findings

### 1. Adequacy of existing Disaster Recovery and Business Continuity arrangements – High.

#### Findings

Our review established that existing LPF Disaster Recovery (DR) and Business Continuity (BC) processes are not sufficiently robust to provide assurance that LPF systems and services can be recovered in a prioritised and timely manner. Specifically:

1. **System criticality and recovery objectives** - LPF has not specified their system criticality requirements or prioritised recovery time and point objectives for the systems used to support their operations. Instead, LPF adopts existing suppliers' recovery capability as de facto recovery objectives.
2. Adequacy of BC Plan – Review of LPF's current plan confirmed that:
  - **Supplier Recovery Objectives** – Third parties' recovery time and point objectives, currently offered by suppliers for recovery of critical processes, are not documented within the Plan.
  - **Review of Third Party DR Tests** - The Plan does not include a process for oversight, monitoring and follow up of DR testing performed by suppliers to assess the potential impact of the outcomes on LPF. Currently, LPF is not engaged in third party DR testing arrangements (with the exception of pension administration system DR performed by Aquilla Heywood).
  - **Workplace recovery requirements** – LPF has not formally established their workplace recovery requirements with CEC to ensure that operational processes can be relocated in the event of an incident.
  - **Business Impact Assessments** - No process has been established to support completion of ongoing Business Impact Analysis (BIA) for inclusion in the plan.
  - **Critical Processes** – Whilst process owners provided their input to the design of the Plan in relation to critical processes, there is no documented evidence confirming that this input has been obtained.
  - **Responsibilities** - The Plan lists the names of individuals responsible for DR activity, however, it does not clearly specify their roles and responsibilities before, during and after any incident.
  - **BC Training and Awareness** - The Plan does not include a section on provision and completion of BC awareness training for the key staff involved in DR and BC activities.
  - **Business Continuity Rehearsal** - The Plan has been successfully invoked in the past during both planned and unexpected outages. However, LPF has not established an ongoing BC rehearsal programme and currently has no defined plan for future rehearsals under number of different scenarios. Additionally, the Plan does not clearly specify whether CEC workplace recovery provisions meet LPF's operational requirements, and that communication arrangements are effective.
  - **Annual Review of Plan** - The Plan is scheduled to be reviewed annually, or in the event of a serious disruption to the business, organisational, or other change that could impact its effectiveness. We noted that LPF has no established process to review and update the Plan

The Findings detailed above relate to some sections of the FCA guidance. The guidance provides recommendations which include, but are not limited to, the following actions that the organisation should take:

- Document their strategy for maintaining continuity of its operations, including recovery from an event;
- Establish plans for communicating and regularly testing the adequacy and effectiveness of this strategy (testing has been covered below);
- Put in place arrangements to ensure that the regulator has access to data in the event of disruption;
- Regularly update business continuity and planning arrangements and test arrangements to ensure their effectiveness; and



- Consider the likelihood and impact of an unexpected disruption to the continuity of its operations.

Business Implication	Finding Rating
<ul style="list-style-type: none"> <li>LPF cannot assess whether current arrangements with third party suppliers (limited by suppliers' capacity and capability) adequately meet their requirements for recovery of critical systems, resulting in potential unacceptable service recovery delays.</li> <li>LPF have not performed a business systems criticality assessment, which might lead to inappropriate prioritisation of recovery in the event of the incident.</li> <li>Lack of regular business impact assessment exercise may adversely affect the process of updating the Plan. As a result, the Plan might be invalid and affect management's ability to restore services in line with current business requirements.</li> <li>Team members may be unclear on their respective roles and responsibilities in the event of an incident resulting in failure to fully execute the plan.</li> <li>Failure to implement effective testing and staff training may lead to a decreased quality of a response in the event of an incident</li> <li>The content of the plan may not include all necessary critical operational processes.</li> <li>LPF has no assurance that the plan will support effective restoration and relocation of services in the event of a disaster.</li> <li>Not having controls aligned with good practice and the FCA guidance may expose LPFI to regulatory risk.</li> </ul>	<div data-bbox="1201 275 1431 387" style="background-color: red; color: black; text-align: center; padding: 10px; width: 100px; margin: auto;">High</div>
Action plans	
Recommendation	Responsible Officer
<ol style="list-style-type: none"> <li>LPF should identify and document the criticality of systems and processes they rely on to enable service provision in the event of an incident.</li> <li>Criticality requirements, and the procedures that suppliers will apply in the event of an incident, including their recovery time and point objectives for LPF's web based systems should also be reflected in the Plan.</li> <li>LPF should introduce a process for oversight, monitoring and follow-up of DR tests performed by third party suppliers, ensuring that any adverse outcomes that cannot be resolved are recorded in the risk register.</li> <li>LPF should establish and formally communicate their workplace recovery requirements with CEC to ensure that critical operational processes can be relocated in the event of an incident.</li> <li>An annual Business Impact Analysis (BIA) should be performed to establish whether recent internal and external changes affect current DR/BC arrangements. Where changes to the Plan are required, these should be implemented in conjunction with third party suppliers.</li> <li>Involvement of process owners (and other stakeholders) in designing and updating the plan should be recorded to provide an effective audit trail and confirmation that all key processes have been included (where appropriate),</li> <li>The Plan should be updated to include clear roles and responsibilities for all staff before, during and after any incident. This should include allocation of LPF owners for each critical system with specific responsibility for ensuring oversight of third party DR arrangements.</li> </ol>	<p>Chief Executive, Lothian Pension Fund</p>

8. The Plan should be updated to require completion of BC awareness training for key staff.
9. Business continuity rehearsals should be implemented on an ongoing basis at an appropriate frequency (at least annually).
10. The Plan should be assessed and updated on an annual basis to ensure that it is fit for purpose and aligned with LPF's structure and changing internal and external business environment. The process to assess the Plan should be carefully developed and formalised by LPF management, to ensure that approved and robust appraisal criteria are followed.
11. Third party contracts should be reviewed annually in conjunction with the LPF Plan, and processes should be implemented to review contractual arrangements in light of ad hoc changes (for example changes to regulatory requirements regarding IT resilience).
12. The Plan should be formally reviewed and signed-off by the process owner, Chief Executive Officer, and relevant governance forum / committee upon completion of each annual review.

#### **Agreed Management Action**

#### **Estimated Implementation Date**

**To address recommendations 1, 2, 3, 4, 6, 7 & 12:** The Business Continuity plan will be updated to include:

- LPF Business critical systems.
- Procedures that will be applied by third parties in the event of an incident including supplier recovery time and point objectives for the web hosted systems used by LPF.
- Oversight, monitoring and follow-up of supplier DR tests will be performed as part of the annual review of the LPF plan and any adverse outcomes that cannot be resolved will be included in the LPF risk register.
- The LPF Management team will maintain oversight of the plan to ensure that key business processes and team roles and responsibilities in the event of a disaster accurately recorded.
- The revised plan will be reviewed/approved by the LPF management team, the Head of Finance and the Executive Director of Resources and shared with the CEC Resilience Committee to ensure that CEC are fully aware of LPF requirements.

29<sup>th</sup> June 2018.

**To address recommendation 5:** Business Impact Analysis of LPF, including supplier recovery requirements, to be updated and communicated fed into CEC's Business Continuity arrangements, with subsequent updates provided annually.

28<sup>th</sup> February 2018 (for Q4 2017 sign-off)

**To address recommendation 8, 10 and 11:** Annual review of the Business Continuity plan, including Business Impact Analysis and awareness sessions/rehearsals, will be incorporated into the LPF compliance checklist to ensure they are undertaken regularly. Third party contracts will be reviewed annually in conjunction with the LPF Plan and any necessary contractual changes communicated and agreed.

30<sup>th</sup> March 2018

**To address recommendation 9:** LPF accepts the risk associated with lack of formal BC testing on the basis of ongoing cross working between the

N/A – risk accepted

current LPF location (Atria 1) and the CEC main building at Waverley Court and the City Chambers. Additionally, LPF team members regularly work at home, and the only critical requirement to support this is network connectivity.

## 2. LPF Business Continuity and Disaster Recovery requirements are not specified in third party contracts - High

### Findings

There is no established process within LPF to review alignment of third party disaster recovery (DR) contractual requirements and capability with LPF's requirements. Consequently, LPF is unable to identify systems where the DR provision falls short of LPF's requirements and where contracts may need to be revised.

A review of third party contracts supporting provision of LPF technology systems established that they do not consistently include DR provision clauses. Where DR provision is included, the requirements are based on supplier recovery capability which may not be aligned with LPF requirements. Our testing confirmed:

- **Lack of agreed DR provision between the Council (CGI) and LPF** – Provision of network connectivity by the Council via CGI is the most critical service provided to LPF, as connectivity failure significantly impacts LPF's ability to operate, exposing the fund to potential regulatory and reputational risks.  
Following an incident in 2016 where there was no connectivity for 2 days, LPF has commenced dialogue with the CGI via the Council's ICT team and has expressed an interest in increasing the DR criticality rating for the fibre optic cable that supports network connectivity. Whilst there is no evidence available to demonstrate that network connectivity has improved, LPF management has advised that CGI has improved the response time in the event of Atria connectivity failing
- **Lack of DR provision for the Trading Platform** - The DR clause within the current contract with Northern Trust does not include provision for recovery time objectives (RTO) or recovery point objectives (RPO) for the trading platform in the event of an incident where DR procedures are invoked.
- **Historic and inadequate DR arrangements for the Pension Administration System** - Contractual arrangements with Aquila Heywood have not been updated since 2009. The current recovery time objective specified in the contract (48 hours) for the pension administration system is not aligned with the Pensions Administration Standards Association guidance of a 24-hour RTO.
- **Lack of DR provision for communications platform** – The Civica contract, which covers provision of the communication platform between LPF and employers, does not include DR provision. In the event of a disaster, Civica would restore the platform, however this would only be on a "best endeavours" basis as no specific recovery time (RTO) or recovery point objectives (RPO) are guaranteed for LPF.
- **Ongoing communication with suppliers** - As noted in Finding 1, LPF has not articulated recovery objectives for systems that support their business processes. As a result, they are unable to fully articulate BC and DR requirements to CEC ICT or other suppliers. While inclusion of recovery objectives within contracts should be the key process for LPF, maintaining an active communication channel with the suppliers would be also beneficial for ensuring satisfactory DR arrangements. Without ongoing communication, prioritisation of LPF's critical services within suppliers' wider DR plans might not be aligned with LPF's needs.

The Findings detailed above relate to some sections of the FCA guidance in relation to oversight of service providers; risk management and relationships between service providers. The guidance provides recommendations which include, but are not limited to, the following actions that the organisation should take:

#### Oversight of service provider

- be clear about the service being provided and where responsibility and accountability between the firm and its service provider(s) begins and ends;
- allocate responsibility for the day-to-day and strategic management of the service provider;
- verify that suitable arrangements for dispute resolution exist.

#### Risk management

- ensure the contract(s) provide for the remediation of breaches and other adverse events;
- monitor concentration risk and consider what action it would take if the outsource provider failed;
- should carry out a risk assessment to identify relevant risks and identify steps to mitigate them; and
- document this assessment.

Business Implication	Finding Rating
<ul style="list-style-type: none"><li>• Third party suppliers of LPF systems may not have sufficient capability to ensure recovery of critical systems within acceptable timeframes.</li><li>• Failure to address LPF's DR requirements in the contract may leave crucial issues unspecified and open to implicit agreement. This lack of clarity over the DR responsibilities might lead to unexpected delays restoring critical processes in the event of an incident</li><li>• Potential regulatory fines and reputational damage if critical systems and operations cannot be restored.</li></ul>	<div>High</div>
Action plans	
Recommendation	Responsible Officer
<ol style="list-style-type: none"><li>1. LPF system criticality requirements and prioritised recovery objectives (recovery time and point objectives) should be communicated to third party system providers.</li><li>2. Contracts should be reviewed and where necessary renegotiated and updated to include DR provision where this is currently missing, or to ensure that DR clauses are updated to reflect LPF requirements. Contract revisions should include:<ul style="list-style-type: none"><li>• Agreed testing arrangements and frequencies;</li><li>• RTOs and RPOs and penalties for failing to meet these;</li><li>• Back up arrangements, including frequency, data security solutions applied by the supplier (e.g. type of encryption) and security measures in the location where the data will be stored.</li><li>• Where contracts cannot be updated to reflect LPF requirements, the risk should be recorded in the LPF risk register.</li></ul></li><li>3. LPF should request that the Council ICT Service establishes a dedicated LPF relationship manager to support them in defining and agreeing their BC/DR requirements with the Council and CGI.</li><li>4. LPF should also request representation at CEC Resilience Committee meetings to ensure that all relevant LPF recovery and resilience issues are discussed and addressed.</li></ol>	Chief Executive, Lothian Pension Fund
Agreed Management Action	Estimated Implementation Date

**To address recommendations 1 and 2:** The points noted by Internal Audit (including system criticality and recovery objectives) will be discussed with third party providers for services not provided via CGI (pensions administration systems and custodian) and renegotiated/added to contracts where possible and practical. (DR provision is included in the specification of pensions administration system in the tender which is currently underway. However, in other cases LPF's ability to vary established contractual provisions is expected to be limited). Where this cannot be achieved, the risk will be recorded in the LPF risk register.

30<sup>th</sup> March 2018

**To address recommendation 3:** Disaster Recovery requirements will be added to the list of ongoing ICT issues currently being discussed with ICT. LPF's full list of requirements will then be shared with the Resources ICT representative (to be established with ICT) to ensure that these are communicated to ICT.

28<sup>th</sup> February 2018

**To address recommendation 4:** LPF recovery and resilience requirements will be communicated to the Resources Resilience Business Partner for inclusion on the agenda at the next Resources Resilience Meeting.

28<sup>th</sup> February 2018

# Appendix 1 - Basis of our classifications

Finding rating	Assessment rationale
<b>Critical</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Critical</b> impact on operational performance; or</li> <li>• <b>Critical</b> monetary or financial statement impact; or</li> <li>• <b>Critical</b> breach in laws and regulations that could result in material fines or consequences; or</li> <li>• <b>Critical</b> impact on the reputation or brand of the organisation which could threaten its future viability.</li> </ul>
<b>High</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Significant</b> impact on operational performance; or</li> <li>• <b>Significant</b> monetary or financial statement impact; or</li> <li>• <b>Significant</b> breach in laws and regulations resulting in significant fines and consequences; or</li> <li>• <b>Significant</b> impact on the reputation or brand of the organisation.</li> </ul>
<b>Medium</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Moderate</b> impact on operational performance; or</li> <li>• <b>Moderate</b> monetary or financial statement impact; or</li> <li>• <b>Moderate</b> breach in laws and regulations resulting in fines and consequences; or</li> <li>• <b>Moderate</b> impact on the reputation or brand of the organisation.</li> </ul>
<b>Low</b>	<p>A finding that could have a:</p> <ul style="list-style-type: none"> <li>• <b>Minor</b> impact on the organisation's operational performance; or</li> <li>• <b>Minor</b> monetary or financial statement impact; or</li> <li>• <b>Minor</b> breach in laws and regulations with limited consequences; or</li> <li>• <b>Minor</b> impact on the reputation of the organisation.</li> </ul>
<b>Advisory</b>	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

# Appendix 2 – Terms of Reference

## Terms of Reference – Lothian Pension Fund – IT Business Resilience and Disaster Recovery

To: John Burns

From: Lesley Newdall  
Chief Internal Auditor

Date: July 2017

This review is being undertaken as part of the 2017/18 internal audit plan approved by the Pensions Committee.

### Background

The availability and resilience of systems used by the Lothian Pension Fund are important to deliver and maintain service and protect the reputation of the Fund.

Several systems (including the 'Pension Administration System', 'Employer Data Transfer Portal' and 'Global Custody Services') relied on by the Lothian Pension Fund are hosted by third party suppliers. The Fund places reliance on the controls operated by these third parties. For non-third party hosted systems, reliance is placed on the DR and Workplace Recovery arrangements provided by CGI and the City of Edinburgh Council.

This review will consider:

- How LPF'S Business Continuity requirements are captured, maintained, and tested;
- The approach to articulating and maintaining oversight of DR provisions provided by third party suppliers; and
- The scope of controls reported as in place by key third party suppliers identified by Lothian Pension Fund Management.

### Scope

The scope of this review will be to:

- Assess LPF's business continuity plans and confirm that these are consistent with business requirements and aligned to the disaster recovery capability;
- Assess the ability for the business to recover identified critical systems in the event of an incident;
- Assess the DR provisions reported by agreed third parties used by the Lothian Pension Fund.
- Confirm that testing of disaster recovery plans and business continuity arrangements are performed on a regular basis; and
- In the event of a major council outage that LPF have sufficient workplace recovery arrangement to allow the business to operate.

The suppliers currently in scope of this review are:

- Aquila Heywood;
- Civica; and
- Northern Trust.



## Approach

Our audit approach is as follow:

- Obtain an understanding of the Lothian Pension Funds processes through discussions with key personnel, review of documentation and transaction walkthroughs;
- Identify the key risks in relation to the processes;
- Evaluate the design of the key controls in place to address the key risks considered by assessing adequacy of assertions made by third party Management in response to questionnaires issued as part of this review; and
- Test the effectiveness of the key controls operated by LPF.

The sub-processes and related control objectives included in the review are:

Sub-process	Control Objectives
Disaster Recovery Plans	<ul style="list-style-type: none"><li>• Plans are documented, signed off and reviewed regularly.</li><li>• Plans are updated after major changes to the organisations systems and personnel.</li><li>• Recovery Time Objectives and Recovery Point Objectives are agreed and documented between CEC IT and LPF.</li><li>• Plans include latest system configurations and steps to be followed in the event of an incident (including communication with LPF).</li></ul>
Business continuity	<ul style="list-style-type: none"><li>• Critical systems have been agreed between CEC IT and the LPF.</li><li>• System criticality is reviewed on a regular basis.</li><li>• LPF Business Continuity requirements have been articulated to CEC.</li></ul>
Third Party Management	<ul style="list-style-type: none"><li>• Third Parties Disaster Recovery plans are linked with Lothian Pension Funds Business Continuity Plans.</li><li>• Contractual provision for DR is included in third party contracts in scope.</li><li>• Plans are agreed and understood by all parties.</li></ul>
Testing	<ul style="list-style-type: none"><li>• Regular testing of the ability to recover systems is performed.</li><li>• Backups are completed on a regular basis and stored securely.</li><li>• Workplace recovery provision is in place in the event of a major outage.</li></ul>

## Limitations of Scope

The scope of our review is outlined above. The review is limited to the processes in place and to the third-party suppliers that provide critical infrastructure to LPF. The review will not cover services provided to Lothian Pension Fund by the City of Edinburgh Council Group IT function. The review will not undertake site visits to third party suppliers.

Our testing of documentation will be performed on sample basis, using PwC's methodology, agreed with Management at the start of the audit. It is Management's responsibility to develop and maintain sound systems of risk management, internal control, and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for Management's responsibilities for the design and operation of these systems.



## Internal Audit Team

Name	Role	Contact Details
Lesley Newdall	Chief Internal Auditor	0131 469 3216
John Hinchcliffe	Senior Auditor	07702 699 175
Thomas Bruch	Auditor	07907 644 113

## Key Contacts

Name	Role	Contact Details
John Burns	Chief Finance Officer	0131 469 3711
Struan Fairbairn	Chief Risk Officer	0131 529 4689

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## Timetable

Fieldwork Start	17 July 2017
Fieldwork Completed*	28 July 2017
Draft report to Auditee	04 August 2017
Response from Auditee	11 August 2017
Final Report to Auditee	18 August 2017
Final report available for presentation to the Pensions Audit Sub-Committee	TBC

\* The date of completion of fieldwork will depend on the ability of third parties to respond to the DR Provision Questionnaire. In the event of delays we will update target dates in agreement with Management.

# Pensions Audit Sub Committee

8.30am, Monday, 26 March 2018

## Lothian Pension Fund – Draft Internal Audit plan for 2018/19

Item number	5.3
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

### Executive Summary

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The purpose of this paper is to present the Lothian Pension Fund draft Internal Audit plan (the plan) for the period 1 April 2018 to 31 March 2019 to the Committee for approval.

A total of three reviews are included in the draft plan which is in line with Internal Audit coverage in previous years.

The Internal Audit plan has been developed using a risk based methodology to ensure that Internal Audit assurance activity is focused on Lothian Pension Fund's key risks. It should also be noted that Internal Audit is not the sole source of assurance provision for Lothian Pension Fund.

The current Internal Audit co-source arrangement with PwC will continue be used in 2018/19 where the required skills sets are not available within the IA team.

## Lothian Pension Fund – Draft Internal Audit plan for 2018/19

### 1. Recommendations

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Committee is requested to:

- 1.1 The Committee is requested to review the Lothian Pension Fund 2018/19 Internal Audit plan; and
- 1.2 Highlight any points that it would like raised at the Pensions Committee on 26 March 2018.

### 2. Background

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- 2.1 The Lothian Pension Fund (the Fund) Internal Audit (IA) plan is driven by Public Sector Internal Audit Standards (PSIAS) requirements; the Fund's organisational objectives and priorities; and an assessment of the risks that could prevent the Fund from meeting those objectives and providing pension services to employers and members.
- 2.2 The methodology used to create the Fund's IA plan is the same as that applied when developing the City of Edinburgh Council's (the Council) 2018/19 IA annual plan, which was approved by the Governance, Risk, and Best Value Committee on 20 March 2018. The Council IA plan also included details of the proposed 2018/19 Fund reviews.
- 2.3 It should also be noted that IA is not the sole source of assurance provision for Lothian Pension Fund, as assurance on risks faced by the Fund is also provided by external specialists. The Fund is currently preparing an 'assurance map' at the request of the Pensions Audit Sub-Committee, that will illustrate how assurance is provided from all sources across the Fund's key risks.

### 3. Main report

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- 3.1 The areas proposed for inclusion in the plan were identified by considering the key risks included in the Fund's risk register, and discussions with the Fund management team; the convenor of the Pensions Audit Sub-Committee; and the former Independent Advisor to the Pensions Committee.
- 3.2 The scope of the three reviews planned for the year to 31 March 2019 are detailed below:

	Audit Scope	Planned days	Risk Ref
1	<p><u>Unlisted investment valuations and application of fund administration fees and charges</u></p> <p>Review of the design adequacy and operational effectiveness of key controls supporting valuation of unlisted investment valuations. Review will focus on the consistency of the valuation process applied, ensuring that the valuation approach is aligned with applicable guidance, and also completeness and accuracy of the range of fund administration fees and charges applied by Lothian Pension Fund.</p> <p>This review will be performed by PwC specialists.</p>	20	Risk 1 Risk 24
2	<p><u>Unitisation</u></p> <p>Assessment of the design adequacy and operational effectiveness of the control framework supporting the unitisation process. The review will focus on ensuring appropriate segregation of assets; accurate allocation of cash flows; and accurate application of interest and charges. We will also consider completeness and accuracy of reporting to third parties.</p>	20	Risk 2 Risk 3
3	<p><u>Stock Lending</u></p> <p>Review of the design adequacy and operational effectiveness of key controls support stock lending. The review will focus on adequacy of collateral provided to mitigate counterparty risk; adequacy of transfer and title arrangements (in the event that LPF require return of the stock to address market risk or for early settlement); compliance with best execution requirements; controls to mitigate conflicts of interest; and completeness and accuracy of income received from the counterparty.</p>	20	Risk 13

3.3 Information Governance and readiness for the new General Data Protection Requirements (GDPR) that come into force in May 2018 remain key risks for the Fund.

3.3.1 It has recently been confirmed that the Fund will be registered under the Council's Information Commissioner's Office registration for GDPR with the Council assuming data controller responsibilities for the Fund.

3.3.2 Consequently, the Fund will be included within the Council wide GDPR readiness review currently being performed by the Information Governance Unit. The objective of this review is to ensure that the Service Areas across

the Council are fully aware of GDPR compliance requirements and have appropriate action plans in place to address gaps identified.

3.3.3 The Council's IGU GDPR readiness review is currently being audited as part of the 2017/18 IA plan, with additional assurance work included in the 2018/19 IA plan to confirm progress with implementation of GDPR action plans across the Council. The Fund is included in the scope of both reviews.

- 3.4 Given the significant value of assets managed internally (circa £4 billion at 31 March 2017), trading of investments remains a significant risk for the Fund. However, as a new front-office trading system will be implemented during 2018/19, a review of trading controls (including operation of the new trading system) will be included in the 2019/20 IA plan.

#### **4. Measures of success**

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- 4.1 Delivery of a risk based IA plan that provided assurance on the key risks facing the Fund and supports the 2018/19 Internal Audit Annual Opinion.

#### **5. Financial impact**

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- 5.1 No direct financial impact

#### **6. Risk, policy, compliance and governance impact**

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- 6.1 The IA plan has been prepared in compliance with the annual planning requirements specified by the Public Sector Internal Audit standards.

#### **7. Equalities impact**

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- 7.1 None.

#### **8. Sustainability impact**

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- 8.1 None.

#### **9. Consultation and engagement**

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.
- 9.2 The Fund management team; Convenor of the Pensions Audit Sub-Committee; and the former Independent Professional Observer to the Pensions Committee were consulted when developing the 2018/19 IA plan.

## 10. Background reading/external references

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### 10.1 [Public Sector Internal Audit Standards](#)

Quarterly Risk Summary presented to Pensions Committee

### **Lesley Newdall**

Chief Internal Auditor

E-mail: [Lesley.newdall@edinburgh.gov.uk](mailto:Lesley.newdall@edinburgh.gov.uk) | Tel: 0131 469 3216

## 11. Appendices

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None

# Pensions Audit Sub Committee

8.30am, Monday, 26 March 2018

## External Audit – Annual Audit Plan 2017/18

Item number	5.4
Report number	
Executive/routine	
Wards	All
Council Commitments	<a href="#">Delivering a Council that works for all</a>

### Executive Summary

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Scott-Moncrieff, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott Moncrieff Annual Audit Plan 2017-18”.

Claire Gardiner, Manager, Public Sector Audit, Scott-Moncrieff, will present the Annual Audit Plan 2017-18 to Committee.

Progress against the Plan will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee.

The proposed audit fee for 2017/18 is £45,000, which represents an increase of 1.5% from 2016/17.

## External Audit – Annual Audit Plan 2017/18

### 1. Recommendations

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Committee is requested to:

- 1.1 Note that the planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott-Moncrieff Annual Audit Plan 2017-18”.
- 1.2 Note that suitable provision has been made in the approved budget 2017-18 for the audit fee;
- 1.3 Note that progress against the Annual Audit Plan 2017-18 will be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee; and
- 1.4 Highlight any points that it would like raised at the Pensions Committee on 26 March 2018.

### 2. Background

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- 2.1 The Audit Plan is reported annually to Pensions Committee by the external auditor, Scott-Moncrieff.
- 2.2 At its meeting on 20 March 2017, Pensions Committee agreed to:
  - 2.2.1 “Note that there is sufficient separation between Scott-Moncrieff’s payroll, taxation advisory and audit services, and that it does not affect the firm’s ability to provide an independent audit;
  - 2.2.2 Approve the continuation of non-audit services of taxation advice provided by the company’s external auditor to the LPF Group.”

### 3. Main report

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- 3.1 Scott-Moncrieff, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott-Moncrieff Annual Audit Plan 2017-18”.

### 4. Measures of success

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- 4.1 Progress against the Annual Audit Plan 2017-18 will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee. The



prime objective is to ensure an unqualified audit opinion of the Annual Report 2017-18. This will be determined in due course.

## **5. Financial impact**

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- 5.1 The proposed audit fee for 2017/18 is £45,000, which represents an increase of 1.5% from 2016/17.
- 5.2 The Fund has accepted the proposed audit fee of £45,000 for 2017/18 and suitable provision has been made in the 2017/18 budget.

## **6. Risk, policy, compliance and governance impact**

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- 6.1 External audit is a critical part of the governance of the pension funds.

## **7. Equalities impact**

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- 7.1 There are no adverse equalities impact arising from this report.

## **8. Sustainability impact**

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- 8.1 There are no adverse sustainability impacts arising from this report.

## **9. Consultation and engagement**

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- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

## **10. Background reading/external references**

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- 10.1 The responsibilities of Scott-Moncrieff, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, as approved by the Auditor General for Scotland and the Accounts Commission. Appropriate cognisance is also taken of ethical guidance of the auditing profession.

**Stephen S. Moir**

Executive Director of Resources

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## 11. Appendices

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Appendix 1 - Scott Moncrieff Annual Audit Plan 2017-18



**Scott-Moncrieff**  
business advisers and accountants

# **Lothian Pension Funds**

External Audit Plan  
2017/18

**February 2018**

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1

# Introduction

# Introduction

1. This document summarises the work plan for our 2017/18 external audit of Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”).
2. The core elements of our work include:
  - an audit of the 2017/18 financial statements and related matters;
  - a review of arrangements for governance and transparency, financial management, financial sustainability and value for money; and
  - any other work requested by Audit Scotland.

## Audit appointment

3. The Accounts Commission is an independent body appointed by Scottish Ministers responsible for securing the audit of local authorities and other local government bodies. The Commission’s work is governed mainly by the Local Government (Scotland) Act 1973.
4. Audit Scotland is an independent statutory body that provides the Accounts Commission with the services required to carry out their statutory functions, including monitoring the performance of auditors through a quality control process.
5. The Accounts Commission has appointed Scott-Moncrieff as external auditor of the funds for the five year period 2016/17 to 2020/21. This document comprises the audit plan for 2017/18 and summarises:
  - the responsibilities of Scott-Moncrieff as the external auditor;
  - our audit strategy;
  - our planned audit work and how we will approach it;
  - our proposed audit outputs and timetable; and
  - background to Scott-Moncrieff and the audit team.

## Adding value through the audit

6. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Funds through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to help the Funds promote improved standards of governance, better management and decision making and more effective use of resources.
7. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to the audit team or through our online survey: [www.surveymonkey.co.uk/r/S2SPZBX](http://www.surveymonkey.co.uk/r/S2SPZBX)
8. While this plan is addressed to the Funds, it will be published on Audit Scotland’s website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



# **Respective responsibilities of the auditor and the Funds**

# Respective responsibilities of the auditor and the Funds

## Auditor responsibilities

### Code of Audit Practice

9. The Code of Audit Practice (the Code) outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.
10. A new Code of Audit Practice was published in 2016 and applies to external audits for financial years starting on or after 1 April 2016. This Code replaces the previous one issued in 2011.

### Our responsibilities

11. Auditor responsibilities are derived from statute, the Code, International Standards on Auditing (UK) (ISAs), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities (paragraph 13). These are to:
- undertake statutory duties, and comply with professional engagement and ethical standards
  - provide an opinion on audited bodies' financial statements
  - review and report on, as appropriate, other information such as annual governance statements, management commentaries and remuneration reports
  - notify the Controller of Audit when circumstances indicate that a statutory report may be required
  - demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies':
    - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets
    - suitability and effectiveness of corporate governance arrangements

- financial position and arrangements for securing financial sustainability

12. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.



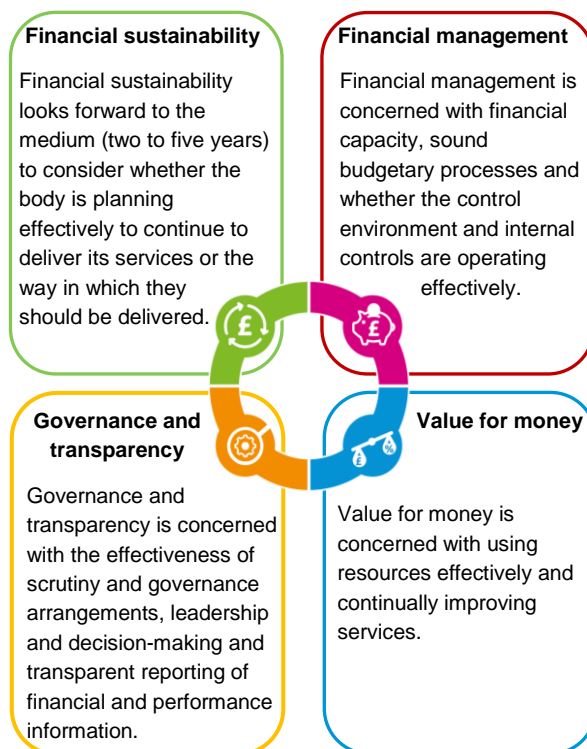
### Wider scope audit work

13. The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.
14. The Code sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.
15. Where the application of the full wider scope is judged by us not to be appropriate then our annual audit work on the wider scope is restricted to:
- Audit work to allow conclusions to be made on the appropriateness of the disclosures in the governance statement; and
  - Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.
16. Our assessment takes into account the size, nature and risks of the organisation.
17. Taking these factors into consideration, we have concluded that application of the full wider scope is appropriate for the Funds.

### Funds' responsibilities

18. The Funds' have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives. The Funds' responsibilities are summarised in Exhibit 2.

### Exhibit 1: Audit dimensions of wider scope public audit



## Exhibit 2 – Funds' responsibilities

Area	Funds' responsibilities
<p><b>Financial statements:</b> Annual report and financial statements containing financial statements and other related reports should be prepared.</p>	<p>The Funds and the Chief Financial Officer have responsibility for:</p> <ul style="list-style-type: none"> <li>• preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;</li> <li>• maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;</li> <li>• maintaining proper accounting records; and</li> <li>• preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements.</li> </ul>
<p><b>Financial sustainability:</b> Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfill its functions in an affordable and sustainable manner.</p>	<p>The Funds are responsible for putting in place proper arrangements to ensure the financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>• Such financial monitoring and reporting arrangements as may be specified;</li> <li>• Compliance with any statutory financial requirements and achievement of financial targets;</li> <li>• Balances and reserves, including strategies about levels and their future use;</li> <li>• How the organisation plans to deal with uncertainty in the medium and long term; and</li> <li>• The impact of planned future policies and foreseeable developments on the financial position.</li> </ul>
<p><b>Financial management:</b> Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<p>It is the Funds' responsibility to ensure that financial affairs are conducted in a proper manner. Management are responsible, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance.</p> <p>The Funds are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at its disposal.</p> <p>It is the Funds' responsibility to establish arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.</p>

## Exhibit 2 – Funds' responsibilities

Area	Funds' responsibilities
<b>Governance and transparency:</b> Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	<p>The Funds are responsible for establishing arrangements to ensure the proper conduct of their affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Those charged with governance should be involved in monitoring these arrangements.</p> <p>The Funds are also responsible for establishing effective and appropriate internal audit and risk management functions.</p>
<b>Value for money:</b> Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.	<p>The Funds have a specific responsibility to ensure that arrangements have been made to secure best value. They are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.</p>

3

# Audit strategy

# Audit strategy

## Risk-based audit approach

19. We follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Funds.

This ensures that our audit focuses on the areas of highest risk. Our audit planning is based on:



20. Planning is a continuous process and our audit plans are therefore updated during the course of our audit to take account of developments as they arise.

## Communications with those charged with governance

21. Auditing standards require us to make certain communications throughout the audit to those charged with governance. We have agreed with the Funds that these communications will be through the Pensions Audit Sub-Committee.

## Professional standards and guidance

22. We perform our audit of the annual report and financial statements in accordance with International Standards on Auditing (UK) (ISAs), the International Standard on Quality Control 1 (UK), Ethical Standards, and applicable Practice Notes and other guidance issued by the Financial Reporting Council (FRC).

## Partnership working

23. We will coordinate our work with Audit Scotland, internal audit, other external auditors and relevant scrutiny bodies, recognising the increasing integration of service delivery and partnership working within the public sector.

## Audit Scotland

24. Although we are independent of Audit Scotland and are responsible for forming our own views and opinions, we do work closely with Audit Scotland throughout the audit. This helps, for example, to identify common priorities and risks, treat consistently any issues arising that impact on a number of audited bodies, and further develop an efficient and effective approach to public audit. We will share information about identified risks, good practices and barriers to improvement so that lessons to be learnt and knowledge of what works can be disseminated to all relevant bodies.
25. Audit Scotland undertakes national performance audits on issues affecting the public sector. We will review the Funds' arrangements for taking action on any issues reported in the national performance reports which may have a local impact. We plan to assess the extent to which the Funds use the national performance reports as a means to help improve performance at a local level.
26. During the year we may also be required to provide information to Audit Scotland to support the national performance audits.

#### Internal audit

27. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Funds' total audit resource. To achieve this, we aim to take full cognisance of the work of internal audit wherever possible



# Annual report and financial statements

# Annual report and financial statements

## Introduction

28. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their financial performance in the use of those resources. This section sets out our approach to the audit of the Funds' annual report and financial statements.

## Approach to the audit of the financial statements

29. Our opinion on the financial statements will be based on:

### Risk-based audit planning

30. We focus our work on the areas of highest risk. As part of our planning process we prepare a risk assessment highlighting the audit risk relating to each of the key systems on which the annual report and financial statements will be based.

### An audit of key systems and internal controls

31. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements.
32. The systems we review and the nature of the work we perform will be based on the initial risk assessment. We will examine and test compliance with best practice and the Funds' policies and procedures.
33. We will take cognisance of any relevant internal audit reviews of systems and controls.
34. We will update the risk assessment following our evaluation of systems and controls and this will ensure that we continue to focus attention on the areas of highest risk.

### A final audit of the annual report and financial statements

35. During our final audit we will test and review the material amounts and disclosures in the financial statements. The extent of testing will be based on our risk assessment.
36. Our final audit will seek to provide reasonable assurance that the annual report and financial statements are free from material misstatement and comply with the Code of Practice on Local

Authority Accounting in the United Kingdom 2017/18 (the Code).

### Independent auditor's report

37. Our opinion on whether the financial statements give a true and fair view of the financial position and the income and expenditure will be set out in our independent auditor's report which will be included in the annual report and financial statements.
38. We also provide an opinion on the consistency of the information in the management commentary, annual governance statement and governance compliance statement.

### Group accounts

39. Lothian Pension Fund prepares its financial statements on a group basis. The group consists of Lothian Pension Fund and two special purpose vehicles, LPFE Ltd and LPFI Ltd.
40. The consolidation of the subsidiaries is not expected to result in a material change to the parent's financial statements.
41. As part of our audit we will review the consolidation working papers to ensure the group accounts accurately reflect the activities of the parent and both subsidiaries.

### Materiality

42. Materiality is an expression of the relative significance of a matter in the context of the annual report and financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement. We will review our assessment of materiality throughout our audit.
43. Our initial assessment of materiality for each Fund is set out in the table below. The Funds hold significant investment assets, which form the largest part of the net asset statements for each pension fund. We consider that the net asset statements are of primary interest to the reader of the annual report and financial



statements and therefore consider that these should be used in the calculation of overall materiality.

44. ISA 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transaction for which lesser amounts than the overall materiality could influence the decisions of users of the accounts. We considered transactions when dealing with members (i.e. contributions and expenditure incurred providing payments to pensioners) to be of key interest to the users. This is reported in the first section of the Fund Account and contains information about the day to day operation of the Funds. We have therefore set a separate materiality based on the expenditure incurred for providing payments to pensioners.

	Overall materiality £million	Dealings with members materiality £million
Lothian Pension Fund (group) <sup>1</sup>	98.5	10.6
Lothian Pension Fund (single entity)	98.5	10.6
Lothian Buses Pension Fund	7.3	0.6
Scottish Homes Pension Fund	2.6	0.4

45. We set a performance (testing) materiality for each area of work which is based on a risk assessment for the area. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be of significant risk of material misstatement.

<sup>1</sup> Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

	Area risk assessment £million		
	High (50%)	Medium (60%)	Low (75%)
Lothian Pension Fund (group) <sup>1</sup>	49.3	59.1	73.9
Lothian Pension Fund (single entity)	49.3	59.1	73.9
Lothian Buses Pension Fund	3.7	4.4	5.5
Scottish Homes Pension Fund	1.3	1.5	1.9

46. Where transactions, or groups of transactions relate to dealings with members, performance materiality will be set using the percentages outlined in the table above.
47. We will report any misstatements identified through our audit that fall into one of the following categories:
- All material corrected misstatements;
  - Uncorrected misstatements with a value in excess of £250,000, less than 1% of the overall materiality figure; and
  - Other misstatements below the 1% threshold that we believe warrant reporting on qualitative grounds.


## Key audit risks in the annual report and financial statements

48. Auditing standards require that we inform the Pensions Audit Sub-Committee of our assessment of the risk of material misstatement in the annual report and financial statements. We have set out our initial assessment below, including how the scope of our audit responds to those risks. We will provide an update to the Pensions Audit Sub-Committee if our assessment changes significantly during the audit.

## Exhibit 3: Key audit risks in the annual report and financial statements


### 1. Management Override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the financial statements. This is treated as a presumed risk area in accordance with ISA 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

- 
49. In response to this risk we will review the Funds' accounting records and obtain evidence to ensure that any significant transactions outside the normal course of business were valid and accounted for correctly.


### 2. Revenue recognition

Under ISA 240- *The auditor's responsibilities relating to fraud in an audit of financial statements* there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the Funds could adopt accounting policies or recognise revenue transactions in such a way as to lead to a material misstatement in the reported financial position.

- 
50. Our work on income will include an evaluation of each type of revenue transaction and a review of the controls in place over revenue accounting. We will consider the Funds' key revenue transactions and streams and carry out testing to confirm that the Funds' revenue recognition policy is appropriate and has been applied consistently throughout the year

### 3. Risk of fraud in the recognition of expenditure

In 2016, the Public Audit Forum issued Practice Note 10 "The Audit of Public Sector Financial Statements" which applies to the audit of public sector financial statements for periods commencing after June 2016. This practice note recognises that most public sector bodies are net spending bodies and notes that there is an increased risk of material misstatement due to improper recognition of expenditure.

- 
51. We have considered the expenditure streams at the Funds' and we do not consider the risk of fraud in expenditure recognition to be material. We have therefore rebutted this risk at the planning stage. We will, however, continue to monitor this position throughout the audit.

### 3. Valuation of investments

The Funds held investments of £6.569 billion as at 31 March 2017, of which 30% (£2.069 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Judgements are taken by the Investment Managers to value those investments whose prices are not publically available. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.



- 52. In response to this risk we will review the design and implementation of controls present at the scheme for ensuring the accurate valuation of investments. We will review the qualifications of the fund managers as experts in accordance with ISA 500.
- 53. For a sample of investments we will confirm the prices quoted to fund manager reports and independent pricing sources. We will assess the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments.

### 4. Pension liability assumptions

An actuarial estimate of the pension fund liability is calculated on an annual basis under IAS 19 and on a triennial funding basis by independent firm of actuaries with specialist knowledge and experience. The latest triennial valuation was as at 31 March 2017 and sets rates for the three-year period commencing 1 April 2018. The estimates are based on the most up to date membership data held by the pension fund and have regard to local factors such as mortality rates and expected pay rises with other assumptions around inflation when calculating the liabilities. There is a risk that the data provided to the actuary is not complete and that assumptions used are not appropriate.



- 54. We will review the controls in place to ensure that the data provided from the fund to the actuary is complete and accurate. We will review the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data. We will agree the disclosures in the financial statements to information provided by the actuary.



# Wider scope audit

# Wider scope audit

## Introduction

55. As described in section 2, the Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we consider and report against these four dimensions; financial sustainability, financial management, governance and transparency and value for money.

56. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our understanding of the Fund's priorities and risks which we developed in 2016/17, discussions with management and review of the Funds' minutes and key strategy documents. In 2017/18 we have also

considered the following risk areas as they relate to the Funds:

- EU withdrawal
- New financial powers
- Ending of public sector pay cap
- Response to cyber security risks
- Openness and transparency.

57. At this stage of our audit planning process, we have not identified any significant risks in relation to the wider scope dimensions. Audit planning however is a continuous process and we will report any identified significant risks, as they relate to the four dimensions, in our annual audit report.



## Financial sustainability

**Financial sustainability looks forward to the medium and longer term to consider whether the organisation's planning processes support the future delivery of services.**

Consideration	Our audit approach
<p>The Funds produce an annual service plan and budget which focuses on the costs associated with dealings with members and covers a two year period of activity. In addition to this the Funds prepare a Funding Strategy Statement and receive a triennial actuarial valuation which builds up a picture of the longer term financial pressures.</p> <p>The latest triennial valuation took place as at 31 March 2017 and will set the rates from 1 April 2018. The Funding Strategy Statement is informed by the results of this triennial valuation and will create a strategy for each of the three funds. T</p> <p>The Funds' management team are currently developing the revised Funding Strategy Statement ensuring that each is designed to allow the fund to meet the demands of future pension costs.</p>	<p>During our 2017/18 audit we will consider the Fund's financial standing. This will involve a review of the arrangements in place for medium to long term financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control Funds' operations and use of resources.</p> <p>This will include consideration of the results of the actuarial valuation and accompanying revised Funding Strategy Statement.</p>



## Financial management

**Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.**

Consideration	Our audit approach
<p>The key financial indicator for the across pension funds in Scotland is the return on investments. The Lothian Pension Funds have consistently performed above the Scottish average in recent years.</p> <p>The net assets of the Funds increased in 2016/17, reflecting the level of returns achieved in year and the relatively strong position of the market in year.</p> <p>The performance of investments is monitored by the Pension Committee, who considers the investments control environment and performance over the annual committee cycle in line with a formal long term agenda plan.</p> <p>The Committee also monitors the budget for income and expenditure incurred when dealing with members. It has been noted that in 2017/18 the number of active members has continued to decrease for Lothian Pension Fund and Lothian Buses Pension Fund. This has caused a fall in contributions against an increase in pensioner and lump sum payments. It is projected that all funds will be in a net withdrawals position as at 31 March 2018. The reliance on investment income is therefore increased in order to meet the long term cash flow needs.</p>	<p>During our 2017/18 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none"><li>• Whether the Funds have arrangements in place to ensure systems of internal control are operating effectively;</li><li>• Whether the Funds can demonstrate the effectiveness of its budgetary control system in communicating accurate and timely performance;</li><li>• How the Funds have assured itself that its financial capacity and skills are appropriate;</li><li>• Whether Funds has established appropriate and effective arrangements for the prevention and detection of fraud and corruption; and</li></ul>



## Governance and transparency

**Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.**

Consideration	Our audit approach
<p>The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.</p> <p>Following the local government elections in May 2017, there have been 2 changes in elected members. An</p>	<p>We will review the effectiveness of the Funds' governance framework and the extent to which the committee roles, membership and terms of reference comply with current guidance: <i>Delivering good governance in local government: framework (2016)</i>.</p> <p>We will consider whether the information provided to</p>

induction programme has been developed for new members to ensure they understand their role and the roles of the committees.

The Pensions Committee and Pensions Audit Sub-Committee meetings are held in public, papers are available in advance and minutes of the meetings are published on the City of Edinburgh Council's website.

the committees is sufficient for members to assess the impact of decisions on resources and performance.

Our work will include consideration of how risk management has been addressed within the Funds. We will also consider Funds' internal audit arrangements to determine their role in examining the control systems established by management.



## Value for money

**Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.**

Consideration	Our audit approach
<p>Investments at the Funds are managed through a combination of external fund managers and the Funds' special purpose vehicles, LPFE Ltd and LPFI Ltd. The proportion of funds managed internally has increased over recent years which has resulted in investment management expenses reducing as a proportion of net investment assets.</p> <p>The Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly and 3 yearly performance measures. This information is presented to the Investment Strategy Panel to allow for scrutiny investment performance of the Funds.</p> <p>The Funds' also focus on administrative performance and have developed a Service Plan covering the period 2016- 2018. The Pensions Committee receive updates on the service plan at each meeting.</p> <p>The Funds make use of a range of service providers including investment managers, an actuary and a custodian. In line with City of Edinburgh Council procedures the Funds maintain a contract register and have considered the position of contracts in year. Where action has been required a tender process has been undertaken. As a result of this process to date the contract with the custodian has been extended and further investment management services have been brought in house. We note there are further tenders due to take place prior to the completion of our audit.</p>	<p>We will work with the Funds' to identify and review evidence which demonstrates the achievement of value for money in the use of its resources.</p> <p>We will seek evidence from the Funds that outcomes are improving and there is sufficient focus on improvement and the pace of it.</p> <p>We will review the process for tendering for new providers and consider this against the value for money principles.</p> <p>Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. We will work with Audit Scotland during the year to understand the outputs from this work and identify any particular reports that the Funds may have a direct interest in.</p>



# Audit outputs, timetable and fees



# Audit outputs, timetable and fees

Audit output	Format	Description	Target month
External audit plan	Report	This report sets out the scope of our audit for 2017/18.	February 2018
Independent Auditor's Report	Report	This report will contain our opinions on the truth and fairness of the annual report and financial statements.	September 2018
Annual Report to the Funds and the Controller of Audit	Report	At the conclusion of each year's audit we will issue an annual report setting out the nature and extent of our audit work for the year and summarising our opinions, conclusions and the significant issues arising from the work. This report will pull together all of our work under the Code of Audit Practice.	September 2018

## Audit outputs

38. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
39. The action plans within the reports will include prioritised recommendations, responsible officers and implementation dates. We will review progress against the action plans on a regular basis.

## Audit fee

40. Audit Scotland has completed a review of funding and fee setting arrangements and as a result revised its fee strategy. It now sets an expected fee for each audit carried out under appointment that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for audit. The expected fee is reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.
41. As auditors we negotiate a fee with the audited body during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.
42. For 2017/18 we propose setting the audit fees at 10% above the expected fee level. This

reflects the unique nature of the Funds and the level of risk this brings to the audit.

43. The expected fee for the Funds for the 2017/18 audits are as follows:

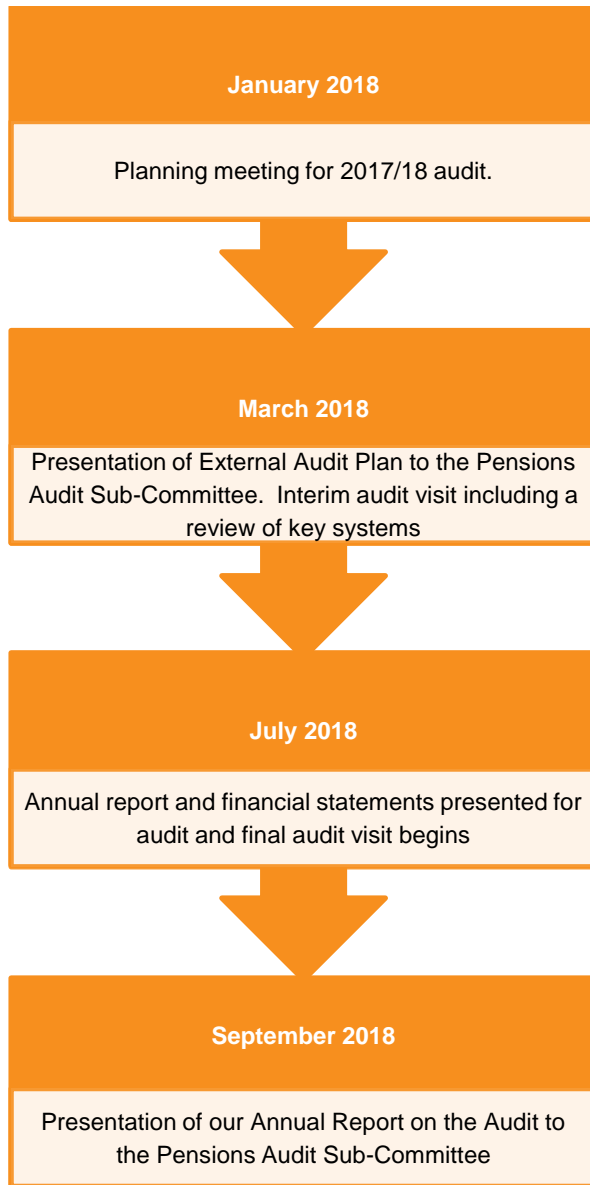
2017/18	
Auditor remuneration	£39,530
Pooled costs	£3,190
Audit support costs	£2,280
<b>Total expected fee</b>	<b>£45,000<sup>2</sup></b>

44. We will take account of the risk exposure of the Funds and the management assurances in place. We assume receipt of the draft accounts and working papers at the outset of our on-site final audit visit. If the draft accounts and papers are late, or agreed management assurances are unavailable, we reserve the right to charge an additional fee for additional audit work. An additional fee will be required in relation to any other significant exercises not within our planned audit activity.

<sup>2</sup> The audit fee in 2016/17 was £44,350

## Audit timetable

45. The dates for our interim and final audits have been discussed with the Chief Financial Officer and the Finance Team. A summary timetable, including audit outputs, is set out below:



# 8

## Appendices

# Appendix 1: Your audit management team

Scott-Moncrieff is one of the largest independent accountancy firms in Scotland. We have 17 partners and over 200 staff operating from Edinburgh, Glasgow and Inverness. We are also part of the global Moore Stephens network.

We have been external auditors within the public sector for at least fifty years. We provide a comprehensive range of services to clients across the public sector, including NHS bodies, local authorities, central government bodies and FE colleges. We also provide services to charities, schools, as well as private and public limited companies.

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## Your audit management team



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**Partner**

[Nick.bennett@scott-moncrieff.com](mailto:Nick.bennett@scott-moncrieff.com)

Nick has over 25 years' experience of public sector auditing and has been heavily involved in developing public sector accounting standards. Nick's experience and expertise is acknowledged both by clients and by other professionals involved right across the public sector.

Nick will have responsibility for the delivery of the audit.



**Claire Gardiner**

**Audit Manager**

[Claire.gardiner@scott-moncrieff.com](mailto:Claire.gardiner@scott-moncrieff.com)

Claire has over 12 years' public sector external audit experience. She has delivered external audit services to a range of public sector bodies, including pension funds, local authorities, health bodies and central government bodies.

Claire will manage the onsite team and work alongside Nick to deliver the audit engagement.



**Rachel Wynne**

**Audit Senior**

[Rachel.wynne@scott-moncrieff.com](mailto:Rachel.wynne@scott-moncrieff.com)

Rachel joined the firm in 2014 as a public sector audit trainee and has since achieved her CA qualification. She has experience delivering external audit services to a range of public sector bodies, including local government.

Rachel will be responsible for the delivery of the onsite work.

## Confirmation of independence

International Standard on Auditing (UK) 260  
“Communication with those charged with governance”  
requires us to communicate on a timely basis all facts  
and matters that may have a bearing on our  
independence.

Scott-Moncrieff is also responsible for the audit of the  
financial statements of LPFE Ltd and LPFI Ltd, the  
subsidiaries of Lothian Pension Fund. In addition to  
the audit of the subsidiaries, Scott-Moncrieff provides  
accounts preparation, corporation tax services and ad  
hoc VAT advice to both LPFE Ltd and LPFI Ltd.

All tax services are provided by an independent tax  
partner and staff who have no involvement in the audit  
of the financial statements.

The accounts are prepared from trial balances  
provided by LPFE Ltd and LPFI Ltd and no significant  
policies, disclosures, adjustments or estimates are  
decided by Scott-Moncrieff.

Moore Stephens provided a Financial Conduct  
Authority Compliance review for LPFI Ltd. The team is  
independent of Scott-Moncrieff and has no  
involvement in the audit of Lothian Pension Fund or its  
subsidiaries.

We confirm that we will comply with FRC’s Revised  
Ethical Standard (June 2016). In our professional  
judgement, the audit process is independent and our  
objectivity has not been compromised in any way.

# Appendix 2: Statement of understanding

## Introduction

The purpose of this statement of understanding is to clarify the terms of our appointment and the key responsibilities of the Funds and Scott-Moncrieff.

## Annual report and financial statements

We will require the annual report and financial statements and supporting working papers for audit by the agreed date specified in the audit timetable. It is assumed that the relevant Funds staff will have adequate time available to deal with audit queries and will be available up to the expected time of completion of the audit. We will issue a financial statements strategy which sets out roles, responsibilities and expectations in terms of audit deliverables. This document helps to ensure we can work together effectively to deliver an efficient and effective audit.

## Scope of audit

As auditors we will take reasonable steps to plan and carry out the audit so as to meet the objectives and comply with the requirements of the Code of Audit Practice. Audit work will be planned and performed on the basis of our assessment of audit risks, so as to obtain such information and explanations as are considered necessary to provide sufficient evidence to meet the requirements of the Code of Audit Practice.

As auditors we do not act as a substitute for the Funds' responsibility to establish proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for and used economically, efficiently and effectively.

As part of our normal audit procedures, we will ask you to provide written confirmation of certain oral representations which we have received from the Partnership during the course of the audit on matters having a material effect on the annual report and financial statements. This will take place by means of a letter of representation, which will require to be signed by the Chief Financial Officer.

## Internal audit

It is the responsibility of the Funds to establish adequate internal audit arrangements. The audit fee is agreed on the basis that an effective internal audit function exists.

We will liaise with internal audit to ensure an efficient audit process.

## Fraud and irregularity

In order to discharge our responsibilities regarding fraud and irregularity we require any fraud or irregularity issues to be reported to us as they arise. We also require a historic record of instances of fraud or irregularity to be maintained and a summary to be made available to us after each year end.

## Ethics

We are bound by the ethical guidelines of our professional body, the Institute of Chartered Accountants of Scotland.

## Fees

We base our agreed fee upon the assumption that all of the required information for the audit is available within the agreed timetable. If the information is not available within the timetable we reserve the right to charge a fee for the additional time spent by our staff. The fee will depend upon the level of skill and responsibility of the staff involved. The indicative financial statements strategy referred to above is a key means for us to clarify our expectations in terms of quality, quantity and extent of working papers and supporting documentation.

## Service

If at any time you would like to discuss with us how our service to you could be improved or if you are dissatisfied with the service you are receiving please let us know by contacting Nick Bennett. If you are not satisfied, you should contact our Ethics Partner, Bernadette Higgins. In the event of your not being satisfied by our response, you may also wish to bring the matter to the attention of the Institute of Chartered Accountants of Scotland.

We undertake to look at any complaint carefully and promptly and to do all we can to explain the position to you.

## Reports

During the course of the audit we will produce reports detailing the results and conclusions from our work.

Any recommendations arising from our audit work will be included in an action plan. Management are responsible for providing responses, including target

dates for implementation and details of the responsible officer.

### **Agreement of terms**

We shall be grateful if the Pension Audit Sub-Committee would consider and note this statement of understanding. If the contents are not in accordance with your understanding of our terms of appointment, please let us know.



**Scott-Moncrieff**  
business advisers and accountants

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