



Notice of Meeting and Agenda

Pensions Audit Sub-Committee

3.00 pm Tuesday, 21st March, 2023

LPF Board Room - LPF Board Room, Atria One, 144 Morrison Street, Edinburgh

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

The law allows the Sub-Committee to consider some issues in private. Any items under "Private Business" will not be published, although the decisions will be recorded in the minute.

Contacts:

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1. Quorum Check

- 1.1 The Convener will check to ensure a quorum is in attendance to ensure the meeting can proceed.

2. Order of Business

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

3. Declaration of Interests

- 3.1 Members of the Sub-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.

4. Deputations

- 4.1 If any.

5. Minutes

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| 5.1 | Minute of Pensions Audit Sub-Committee of 6 December 2022 - submitted for approval as a correct record | 7 - 16 |
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6. Reports

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| 6.1 | Agenda Planning – report by the Chief Executive Officer, Lothian Pension Fund (circulated) | 17 - 26 |
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6.2	Lothian Pension Fund – Internal Audit Update – February 2023 - report by the Head of Internal Audit, City of Edinburgh Council (circulated)	27 - 50
6.3	Lothian Pension Fund – Proposed Internal Audit Plan for 2023/24 – report by the Head of Internal Audit, City of Edinburgh Council (circulated)	51 - 64
6.4	External Audit Annual Plan 2022/23 by Azets – report by the Chief Finance Officer, Lothian Pension Fund (circulated)	65 - 116
6.5	Risk Management Summary - report by the Chief Risk Officer, Lothian Pension Fund (circulated)	117 - 134

7. Motions

7.1 If any

Nick Smith

Service Director – Legal & Assurance

Committee Members

John Anzani (Convener), Councillor Phil Doggart and Councillor Neil Ross.

Please note that members of the Pension Board and the Independent Professional Observer will also be invited to attend and participate in this meeting.

Information about the Pensions Audit Sub-Committee

The Pensions Audit Sub-Committee consists of 2 Councillors and 1 external member and is appointed by the City of Edinburgh Council in its separate capacity as administering authority of the Lothian Pension Fund. The Pensions Audit Sub-Committee usually meets 3 times a year.

The Pensions Audit Sub-Committee monitors the operation of the Fund's internal controls, governance, risk and compliance arrangements and financial reporting.

This meeting is being held in the Lothian Pension Fund Boardroom, Atria One, 144 Morrison Street, Edinburgh and is open to members of the public. The meeting will be monitored by Susan Handyside.

Pension Board Members

Alan Williamson, Brian Robertson, Darren May, Jim Anderson, Sharon Dalli, Thomas Carr-Pollock, Tom Howorth, Nick Chapman and Tony Beecher.

Information about the Pension Board

The Pension Board consists of 10 members, 5 members from the employer bodies and 5 members from trade unions representing members within the pension funds as set out in the regulations.

The role of the Pension Board is to help ensure that the operation of the pension funds is in accordance with the applicable law and regulation.

<https://www.lpf.org.uk/us>

Independent Professional Observer

Andy McKinnell

Information about the Independent Professional Observer

The Independent Professional Observer is appointed by the Lothian Pension Fund to help strengthen the Lothian Pension Fund's governance. The role is to provide independent observations to the Pensions Committee and Pension Board.

The purpose of the role is to enhance the scrutiny of the decision making and provide the Committee and Board with additional experience and knowledge impartial from the Lothian Pension Fund's Officers.

City of Edinburgh Council Oversight

The City of Edinburgh Council has statutory responsibility to administer the Lothian and Scottish Homes Pension Funds. In order to most effectively carry out that function (and to reflect the separate statutory responsibilities, and regulation, of the pension funds) the City of Edinburgh Council has delegated management responsibility for the Pension Funds to the Lothian Pension Fund Group and its two arms-length companies LPFE Limited and LPFI Limited. Critical parent oversight continues to be carried out by the Pensions Committee and Dr Deborah Smart, Executive Director of Corporate Services for The City of Edinburgh Council as the Administering Authority for the Fund to ensure that its statutory functions are being properly carried out.

Lothian Pension Fund Senior Leadership Team

The senior leadership team responsible and accountable for the business and activities of the Lothian Pension Fund Group are:

David Vallery, Chief Executive Officer

Bruce Miller, Chief Investment Officer

Kerry Thirkell, Chief Risk Officer

John Burns, Chief Finance Officer

Helen Honeyman, Chief People Officer

Further Information and Contact

If you have any questions about the agenda or meeting arrangements, please contact Susan Handyside, Governance Manager, Lothian Pension Fund, Atria One, 144 Morrison Street, Edinburgh EH3 8EX, Tel 07771378238, email han24S33@lpf.org.uk

The agenda, minutes and public reports for this meeting can be viewed on the City of Edinburgh Council committee portal.

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Pensions Audit Sub-Committee Minutes

2pm, Tuesday 6 December 2022

Present:

John Anzani (Convener); Councillors Phil Doggart and Neil Ross.

Pension Board Member present:

Nick Chapman

Other Attendees:

Andy McKinnell (Independent Professional Observer) and Laura Calder (Senior Audit Manager, City of Edinburgh Council)

1. Quorum

The Clerk confirmed that notice of the meeting had been given and that a quorum was present and the Convener declared the meeting open.

2. Order of Business

The Clerk confirmed that there was no change to the order of business.

3. Declaration of Interests

Decision

Councillor Doggart declared a non-financial interest in item 8 below (Lothian Pension Fund Internal Audit External Quality Assessment) as a contributor to the external audit assessment.

4. Minutes

Decision

To approve the minute of the Pensions Audit Sub-Committee of 27 September 2022 as a correct record.

5. Pension Board oversight

The Pension Board representatives confirmed that the Pension Board would provide comment any relevant matters during the meeting.

6. Agenda Planning

An overview of proposed reports for Pensions Committee and Pensions Audit Sub-Committee meetings for March and June 2023 was presented.

Decision

- 1) To agree that an additional meeting of the Pensions Audit Sub-Committee would be held on 21 March 2023.
- 2) To note that the Convener would consult other Audit Sub-Committee members if any change was required to the additional meeting arrangements.
- 2) To note the agenda planning document for the March and June 2023 meetings.
- 3) To note that the Pension Board Members were invited to comment on agenda items during Committee meetings.
- 4) To note that a review of the committee agenda planning process would take place in early 2023 and that a proposed way forward would be presented to Committee in March.

(Reference – report by the Chief Executive Officer, Lothian Pension Fund, submitted)

7. Lothian Pension Fund – Internal Audit Update at 9 November 2022

An update was provided on progress of Internal Audit assurance activity on behalf of Lothian Pension Fund (LPF) carried out by the City of Edinburgh Council's internal audit team.

Delivery of the four audits included in the 2022/23 internal audit annual plan was underway with the first audit complete and planning for the remaining three audits in progress.

At 9 November 2022, LPF had fourteen agreed management actions. Two actions relating to Cessations and Technology Model Development were past their original implementation date. However, revised dates had been provided for both actions which were expected to be completed by 31 December 2022.

The Senior Audit manager reported to members that the Cessations outstanding action had closed on 6 December 2022.

The outcomes of the Project Forth Programme Assurance audit was also presented for the Sub-Committee's review and scrutiny.

Decision

- 1) To note the outcomes of the recently completed Project Forth Programme Assurance audit.
- 2) To progress with planning delivery of the remaining three Lothian Pension Fund audits which would support delivery of the 2023/24 annual audit opinion.
- 3) To progress with implementation of agreed management actions from previously completed internal audits.

- 4) To note that the Cessations outstanding action had closed on 6 December 2022.
- 5) To congratulate the Senior Audit Manager on her appointment as Chief Internal Auditor with the City of Edinburgh Council.

(References – Pensions Audit Sub-Committee 27 September 2022 (item 9); report by the Senior Audit Manager, City of Edinburgh Council, submitted)

8. Lothian Pension Fund – Internal Audit – External Quality Assessment

During 2021/22 the Chartered Institute of Internal Auditors (IIA) undertook an External Quality Assessment (EQA) of the City of Edinburgh Council's internal audit function in line with the requirements of the Public Sector Internal Audit Standards.

The EQA concluded that the Council's internal audit function generally conformed with the PSIAS which set out the expected standards for internal auditing including a code of ethics, core principles and international standards.

Two recommendations were made by the IIA to address partial conformance with standards. Management responses and action dates had been agreed.

The EQA report also identified a series of continuous improvement opportunities and suggestions which internal audit should use as a basis for future development. Internal audit had implemented a range of improvement actions to take forward these opportunities.

Decision

- 1) To note the outcome of the External Quality Assessment of the Council's Internal Audit function completed by the Chartered Institute of Internal Auditors (IIA) in March 2022.
- 2) To note the IIA recommendations to address the issues identified together with Internal Audit's management response and action dates.
- 3) To note the continuous improvement opportunities identified in the EQA and improvement actions taken by Internal Audit to realise these opportunities.
- 4) To note that updates on Internal Audit's EQA improvement activities would be provided to the Sub-Committee on a quarterly basis through the Internal Audit quarterly update report.

(References – Pensions Audit Sub-Committee 27 September 2022 (item 9); report by the Senior Audit Manager, City of Edinburgh Council, submitted)

9. Lothian Pension Fund - Internal Audit Review 2022

It was proposed to introduce a programme of internal audit for LPFI and LPFE effective from the 2023/24 financial year. The programme would be planned and implemented as part of an integrated programme of internal audit with the Fund and the second line assurance arrangements undertaken and arranged by the risk function of LPF.

The aim of the proposed new arrangements would be to enable a more tailored and efficient process to meet the needs of LPF and would align to the supplier strategy as set out in the 2022/23 strategy and business plan.

Any future audit reports and Annual Audit Opinion would still be made available to the City of Edinburgh Council and therefore there was not expected to be any change in oversight by the Council in its role as Administering Authority.

Decision

To note the proposals being considered to extend and improve the scope and provision of internal audit services for the LPF Group and the intention to bring final proposals to the March 2023 Pensions Committee for decision.

(References – Pensions Audit Sub-Committee 27 September 2022 (item 6); report by the Chief Executive Officer, Lothian Pension Fund, submitted)

10. EU Tax Claims and Other Income Tax Recoveries

A summary was provided of activity on EU and other special tax claims made on behalf of Lothian Pension Fund. No additional claims had been made during the period covering the last two reports and the amount recovered to date remained at £1.37m.

Progress on outstanding claims was reported with the main developments being that Lothian Pension Fund had withdrawn from the Manninen and Manufactured Overseas Dividend claims and Wtax had made additional Fokus claims in Germany on a no win no fee basis.

Decision

- 1) To note the report.
- 2) To note that the Fund had withdrawn from all Manninen and Foreign Income Dividend and also Manufactured Overseas Dividend reclaims.
- 3) To note that, as the success of these reclaims was uncertain, they only appeared as a contingent asset note in the Fund's audited annual accounts. Withdrawal from these reclaims had no impact on the bottom line figures reported.
- 4) To note that, in future, progress on Fokus reclaims would be covered in the Investment Income Cross Border Withholding Tax report.

(Reference – report by the Chief Finance Officer, Lothian Pension Fund, submitted)

11. Pensions Data Quality Update

Information was provided of the ongoing work to enhance the quality of the pension administration membership record data. In accordance with the Pension Administration Strategy, the Fund continued to improve the flow of data from employers through regular reporting and liaison.

Members noted that this year the Fund had focused on cleansing member records for the annual benefit statement production and The Pensions Regulator Scheme return. The Fund had also been preparing for the McCloud remedy and the Pensions Dashboard Programme.

Decision

- 1) To note the report.
- 2) To agree that future reporting should include an alternative metric to demonstrate the member experience.

(Reference – report by the Chief Operations Officer, Lothian Pension Fund, submitted)

12. Investment Income Review Cross Border Withholding Tax

Information was provided on a benchmarking assurance review prepared by Ernst & Young into the effectiveness of the procedures in place to manage the tax exposure on the investment income of the Lothian Pension Fund and the Scottish Homes Pension Fund.

The review showed that Northern Trust was generally applying the correct withholding tax rates on investment income. The Fund had expressed concerns at the lack of progress in some markets to reclaim withheld tax which it was following up with Northern Trust as global custodian directly.

A summary of the opportunities and issues identified was also provided.

Decision

- 1) To note the report.
- 2) To note that, whilst the review by Ernst & Young showed that Northern Trust was generally applying the correct withholding tax rates on investment income, the Fund's global custodian had been reminded of its obligation to take all appropriate steps to expedite receipt of withholding tax reclaims.

(Reference – report by the Chief Finance Officer, Lothian Pension Fund, submitted)

13. Risk Management In-Depth Review

The Sub-Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the item of business on the grounds that it involved the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Schedule 7(A) of the Act.

In line with the Lothian Pension Fund's (LPF) ongoing risk management procedures, an overview was provided of LPF's risk analysis and statement of risk appetite.

The Risk Management Group continued to meet regularly to assess all elements of the LPF Group's risk framework including the risk appetite, register, overall assurance position and any more granular risks escalation from other sub-groups.

Decision

Detailed in the confidential schedule, signed by the Convener, with reference to this minute.

(Reference – report by the Chief Risk Officer, Lothian Pension Fund, submitted)

14. Global Custody Supplier Management and Services Performance

The Sub-Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the item of business on the grounds that it involved the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Schedule 7(A) of the Act.

The key performance indicator report for the 12 months ended 30 September 2022 provided by Lothian Pension Fund's custodian Northern Trust was presented.

Decision

Detailed in the confidential schedule, signed by the Convener, with reference to this minute.

(Reference – report by the Chief Finance Officer, Lothian Pension Fund, submitted)

15. Information Security Update

The Sub-Committee, under Section 50(A)(4) of the Local Government (Scotland) Act 1973, excluded the public from the meeting for the item of business on the grounds that it involved the disclosure of exempt information as defined in Paragraphs 1.3 and 6 of Schedule 7(A) of the Act.

An update was provided on the implementation of Lothian Pension Fund's information security management system.

Decision

Detailed in the confidential schedule, signed by the Convener, with reference to this minute.

(References – Pensions Audit Sub-Committee 27 September 2022 (item 12); report by the Chief Operations Officer, Lothian Pension Fund, submitted)

by virtue of paragraph(s) 1, 3, 6 of Part 1 of Schedule 7A
of the Local Government(Scotland) Act 1973.

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Pensions Audit Sub Committee

3.00pm, Tuesday, 21 March 2023

Agenda Planning

Item number 6.1

1. Recommendations

The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the agenda planning document and the revisions to the agenda planning document.
- 1.2 note that the Pension Board members are invited to comment on agenda items during Committee meetings; and
- 1.3 note the introduction of the new governance portal.

David Vallery

Chief Executive Officer, Lothian Pension Fund

Contact: Susan Handyside, Governance Manager, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

Agenda Planning

2. Executive Summary

- 2.1 This report and the agenda planning document (appendix 1) provides the committee with an overview of the proposed agendas for future meetings of the Pensions Committee and Pensions Audit Sub Committee and the annual cycle.
- 2.2 There will, of course, be specific matters and papers which need to be brought to the attention of the committees in addition to those set out herein.
- 2.3 This report also summarises the proposed revisions of the agenda planning document set out in paragraph 4.3.
- 2.4 In addition, it recommends that timings are allocated to the agenda items for committee and board members, to act as a guide, supporting the effective management of meetings ensuring that they run to time.
- 2.5 Further to the above committee are asked to note the introduction of the new governance portal which aims to improve committee and Pension Board members experience, allowing greater flexibility to review and refer to current and previous papers as well as provide a single place to access all LPF meetings.

3. Background

- 3.1 In order for the Committee and Pension Board to gain an overview of the content of future meetings, and an awareness of the annual cycle of items, an agenda planning document is submitted each quarter.
- 3.2 Committee meetings are held on a quarterly basis and additionally as required; the Audit Sub Committee meetings are generally held three times a year.
- 3.3 In March 2019 the Pensions Committee approved a set of proposals to improve LPF Governance which included establishing an online portal for all papers relating to the LPF Group. In 2022 the Convene portal was procured.
- 3.4 In 2020 LPF investigated whether it would be possible for the unaudited Annual Report and Accounts to be initially considered solely by the Audit Sub Committee, therefore reducing the duplication of a significantly large report for the Pensions Committee. However, after consultation with the external auditor, the Democracy, Governance and Resilience Senior Manager and LPF's CRO it was concluded that LPF were unable to do this.
- 3.5 Committee also considered whether to remove the quarterly risk summary from the December cycle of the Pensions Committee meeting, and instead requested the

Convenor of the Audit Sub Committee update the Pensions Committee on any relevant points following the Audit Sub Committees own detailed review of the risk register and processes that quarter. At the time committee requested that the quarterly risk summary continue in addition to the In-depth risk summary being considered by the Audit Sub Committee.

- 3.6 The committee agreed that only the Annual Group Governance update be removed from the Audit Sub Committee agenda cycle.
- 3.7 In December 2022 it was reported to committee that another review of the committee agenda would take place, the purpose of ensuring that the papers for consideration were fully aligned with the terms of reference and where possible, duplication of committee papers between audit sub-committee and pensions committee be reduced where appropriate.

4. Main Report

- 4.1 The proposed agendas for the June, September and December meetings are set out in the following tables, based on the usual Committee cycle plus any additional and intra-cycle requests.

June 2023

Pensions Committee	Audit Sub Committee
<ul style="list-style-type: none"> Referrals/ recommendations from Pensions Audit Sub Committee LPF Annual Report and Accounts (Unaudited) Statement of Investment Principles Joint Investment Strategy Panel Activity Annual Investment Updates – Lothian Pension Fund and Scottish Homes Pension Fund Annual LPF Group Governance Update Funding Strategy Statement Compliance and Risk Quarterly Update Project Forth Update 	<ul style="list-style-type: none"> LPF Annual Report and Accounts (Unaudited) Internal Audit Update Compliance and Risk Quarterly Update IT Information Security Update (NEW)

September 2023

Pensions Committee	Audit Sub Committee
<ul style="list-style-type: none"> Referrals/ recommendations from Pensions Audit Sub Committee Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund 	<ul style="list-style-type: none"> Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund Annual Report by External Auditor (if available)

<ul style="list-style-type: none"> • Annual Report by External Auditor (if available) • Valuation Update • Stewardship Code Review • Operating Plan and Budget Update • Employer Covenant Review • Lothian Pension Fund Contract Awards Report • Employers Participating in Lothian Pension Fund • Compliance and Risk Quarterly Update • Project Forth Update 	<ul style="list-style-type: none"> • Internal Audit Update • Fraud Prevention • Compliance and Risk Quarterly Update
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December 2023

<p>Pensions Committee</p> <ul style="list-style-type: none"> • Referrals/ recommendations from Pensions Audit Sub Committee • Operating Plan and Budget Update • Employer Covenant Review • Compliance and Risk Quarterly Update <p>Project Forth will be tabled if required.</p>	<p>Audit Sub Committee</p> <ul style="list-style-type: none"> • Investment Income review Cross border Withholding Tax • Global Custody Services Performance • Pensions data Quality • Internal Audit Update • Additional Voluntary Contribution (AVC) Review (NEW) • Internal Audit Update • IT Information Security Update (NEW) • Compliance Update and Risk Management: In depth Review
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Agenda Planning Review

- 4.2 As requested by the Audit Sub Committee and reported to the Pension Committee in December, LPF have reviewed the papers that are presented to both Committees to ensure all unnecessary reporting or duplication of business is removed where possible.
- 4.3 Having reviewed the agenda planning document alongside the Committee Terms of Reference LPF have confirmed that the balance of the two committees remains appropriate. However, the following minor revisions are proposed to ensure committee time is focussed on the most appropriate items:
- **The Policies and Strategies Update, Delegated Authorities Update and Regulatory Update** titles have not been utilised for several cycles. Being nonspecific they have been superseded by the practice of including regulatory or policy updates in related reports or providing specific updates, for example the annual governance update includes a review of all governance policies.

- Two papers presented to the Audit Sub Committee could also be withdrawn; the **EU tax claims and other income tax recoveries report and Irrecoverable overpayment of pension – decisions made under delegated authority**. Both provide more detail than is required for sufficient oversight. However any material concerns and overpayments over £3,000.00 will continue to seek approval in line with council policy.
- **Risk management- In Depth Review and LPF Group Controls and Compliance** is presented to the Audit Sub Committee Annually and will now be merged to provide one Risk and Compliance update for the Committee, further to this the quarterly risk update will include any relevant compliance updates for both committees. The Chief Risk Officer will continue to refine and review reporting throughout the course of the year, taking feedback from committee and boards.
- Two new committee papers have been added to the Audit Sub Committee cycle at the request of the committee; **AVC review** to be presented annually in December and **IT Information Security Update** to be presented twice yearly, June and December.
- The **Benchmarking report** which is presented to the Pensions Committee will be presented in March instead of December to ensure the relevant data is available timeously for committee reporting.

4.4 Appendix one of this report highlights the changes above.

4.5 In addition, it is proposed that timings are allocated to the agenda items for committee and board members which aims to act as a guide, supporting the effective management of meetings ensuring that they run to time. The timings will only be available to committee and board members and not included on the public agenda and pack.

4.6 As highlighted in the 2020 review and in paragraph 3.5 of this report, it is not possible for the unaudited Annual Report and Accounts to be considered solely by the Audit Sub Committee and therefore not possible to reduce the duplicate items. However, by allocating more time to the Audit Committee for the duplicate items and less time for the Pensions Committee it is hoped that the timings will reinforce the Audit Committees role in providing the more detailed scrutiny and allow the Pension Committee to rely on this to a greater extent and spend less time considering the duplicate reports.

Governance Portal

4.7 In March 2019 the Pensions Committee approved a set of proposals to improve LPF Governance which included establishing an online portal for all papers relating to the

LPF Group. In 2022 the Convene portal was procured and LPF are now in the process transitioning all meetings to the new Convene portal.

- 4.8 The Senior Leadership team, LPF Corporate Boards and JISP have also transitioned their meeting packs to the portal. Throughout February and March the governance team arranged training for board and committee members. The team will continue to follow up with board and committee members to ensure any queries are resolved and all members are comfortable with the new portal. All LPF oversight bodies will be using the portal by the end of March 2023.
- 4.9 The Pension Committee and Audit Sub Committee reports and information relating to the meetings will continue to be available via a link on the City of Edinburgh Council's website and, in addition, will also be available on the LPF website. Until the new links have been established committee services will continue to publish the agendas and packs via CEC's modern gov portal.
- 4.10 For the remainder of the year the governance team will continue to develop the portal capabilities and will keep committee informed of its development.

Future Pensions Committee and Audit Sub Committee dates

- 4.11 The Committee meeting dates for 2023/24¹ are set out below and calendar invites have been issued to you. These meetings will be held in person with the option, if required, to attend virtually.

Pensions Committee	Audit Sub Committee
<ul style="list-style-type: none">• Wednesday, 21 June 2023, 2.00pm,• Wednesday 27 September 2023 at 2pm• Tuesday 5 December 2023 at 1.30pm• Wednesday 20 March 2024 at 2pm• Wednesday 26 June 2024 at 2pm	<ul style="list-style-type: none">• Monday, 19 June 2023, 2.00pm,• Tuesday 26 September 2023 at 2pm• Monday 4 December 2023 at 2pm• Tuesday 19 March 2024 at 2pm• Tuesday 25 June 2024 at 2pm

5. Financial impact

- 5.1 None.

¹ Please note that the 2024 Pension Committee and Audit Sub Committee dates will be subject to change depending on progress with Project Forth.

6. Stakeholder/Regulatory Impact

- 6.1 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.
- 6.2 There are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

- 7.1 [City of Edinburgh Council, Committee Terms of Reference \(sections 13 and 24\)](#)

8. Appendices

Appendix 1 – LPF’s Annual Agenda Planning Cycle

Frequency	Pensions Committee	Audit Sub Committee	Month
Every 3 years	Actuarial Valuation: LPF SHPF (next report due Mar 2024)		December or March
	Funding Strategy Statement (review due June 2023 with final version presented for approval in March 2024)	N/A	March
Biennial	Pension Administration Strategy (presented in March 2022)	N/A	September
	Administering Authority Discretions Policy. Next review due September 2022	N/A	September
Annually	LPF Strategy and Business Plan and Budget		March
	Audit Plans (Internal and External)	<i>Draft internal audits and plan will be developed in consultation with the Convenor of the Audit Sub Committee, the CEO (LPF) and, if appropriate, the Independent Professional Observer and circulated to the Audit Sub Committee members for comment.</i>	March
	Policies and Strategies Update (including revised Pension LPF Budget)	N/A	March
	Benchmarking - Investment and Administration Costs	N/A	March
	LPF Annual Report and Accounts (Unaudited)	LPF Annual Report & Accounts (Unaudited)	June
	LPF Internal Audit Opinion	LPF Internal Audit Opinion	June
	Statement of Investment Principles	N/A	June
	Joint Investment Strategy Panel Activity	N/A	June
	Annual Investment Updates - Lothian Pension Fund and Scottish Homes Pension Fund	N/A	June
	Annual LPF Group Governance Update	N/A	June
	Employer Covenant Review	N/A	September
	Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund (including the Annual Report by External Auditor)	Audited Annual Report and Accounts of the Lothian Pension Fund and Scottish Homes Pension Fund (including the Annual Report by External Auditor)	September
	Stewardship Code Review		September
	N/A	Irrecoverable overpayment of pensions — decisions made under delegated authority	September
	N/A	Fraud Prevention	September
	Lothian Pension Fund Contract Awards Report	N/A	September

Frequency	Pensions Committee	Audit Sub Committee	Month
	Annual Report by External Auditor	Annual Report by External Auditor	December (or September if available)
	Benchmarking	N/A	December
	N/A	EU Tax Claims and Other Income Tax Recoveries	December
	N/A	Investment Income Review-Cross-Border Withholding Tax	December
	Stewardship and Engagement	N/A	December
	N/A	Pensions Data Quality	December
	N/A	Global Custody Services Performance	December
	N/A	Compliance Update and Risk Management: In-depth review	December
Semi Annually	N/A	LPF Group Controls and Compliance	December
	N/A	Additional Voluntary Contribution (AVC) Review	December
3 Times per year	Employers Participating in Lothian Pension Fund	N/A	March & September
	N/A	IT Information Security Update	June & December
	Operating Plan and Budget Update	N/A	March ¹ , September & December
	Referrals / recommendations from Pensions Audit-Sub	N/A	June, September & December
		Compliance and Risk Quarterly Update	June, September & December
Quarterly	Compliance and Risk Management Quarterly UpdateSummary	Risk Management Summary (In-depth report in December)	March, June, September and December
	N/A	Internal Audit Update	
As required	Delegated authorities (provider appointments)	N/A	
	Discretions (death grants etc.)	N/A	
	Regulatory Update	N/A	

¹ The March update will have the dual purpose of a business strategy update, budget review and budget approval for the forthcoming financial year.

	Investment Strategy Reviews (at least every 3 years - next due June 2024)	N/A
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Pensions Audit Sub-Committee

3.00pm, Tuesday, 21 March 2023

Lothian Pension Fund - Internal Audit Update - February 2023

Item number 6.2

1. Recommendations

The Pensions Audit Sub-Committee is requested to note:

- 1.1 Progress of delivery with the 2022/23 LPF annual internal audit plan, including the outcomes of the recent Third-Party Supplier Management Audit;
- 1.2 Note progress with delivery of the Information Governance audit currently underway;
- 1.3 Approve a request to defer the Information Security Arrangements audit to the 2023/24 Internal Audit Plan;
- 1.4 Note that the draft 2023/24 LPF annual internal audit plan is presented to the Committee for review and approval in a separate paper at this meeting; and
- 1.5 Progress with implementation of agreed management actions from previously completed internal audits.

Laura Calder

Head of Internal Audit, City of Edinburgh Council

Legal and Assurance, Corporate Services Directorate

E-mail: laura.calder@edinburgh.gov.uk | Tel: 0131 469 3077

Lothian Pension Fund - Internal Audit Update - February 2023

2. Executive Summary

- 2.1 This report provides details of the progress of Internal Audit's (IA) assurance activity on behalf of Lothian Pension Fund (LPF) overseen by the City of Edinburgh Council's (the Council) IA function.
- 2.2 Delivery of the four audits included in the 2022/23 IA annual plan agreed by Committee in September 2022 are underway, with two audits complete and a further audit currently in progress.
- 2.3 A report detailing the outcomes of the Third-Party Supplier Management is included for the Committee's review and scrutiny.
- 2.4 Due to unforeseen absence of key contacts, the Information Security Arrangements audit has been delayed. It is requested that this audit is deferred to quarter 1 of the 2023/24 IA plan.
- 2.5 It is IA's opinion that the three audits due for completion in the 2022/23 IA plan will be sufficient to provide an annual audit opinion for the year end 31 March 2023.
- 2.6 The draft 2023/24 LPF annual internal audit plan has been developed by the Council's IA function with support from PwC. The draft has been reviewed and discussed with management and is presented to the Committee for review and approval within a separate paper for this meeting.
- 2.7 As at 9 February 2023, LPF had 14 agreed management actions with one action passed the original implementation date.

3. Background

2022/23 Internal Audit Annual Plan

- 3.1 A revised 2022/23 LPF IA plan consisting of four audits was approved by the Committee in September 2022.

Internal Audit Follow-Up Process

- 3.2 IA follow up on progress with implementation of management actions arising from IA reports. A risk-based approach to follow-up is applied, with all high rated management actions validated by IA when presented for closure together with a sample of medium actions. The remaining medium actions and low actions are closed via a 'self-attestation' once confirmed as complete by management.

4. Main Report

Progress with delivery of the 2022/23 LPF IA annual plan

- 4.1 The 2022/23 IA annual plan includes the following reviews:
- Project Forth – Programme assurance
 - Third-party supplier management
 - Information governance
 - Information Security Arrangements
- 4.2 The Project Forth - Programme assurance review is complete with outcomes reported to Committee in December 2022.
- 4.3 The Third-Party Supplier Management audit is complete with a report detailing outcomes included at Appendix 1.
- 4.4 The Information Governance audit is currently in fieldwork and is due to complete by end of March 2023 as agreed with management.
- 4.5 Planning is complete for the remaining audit of Information Security Arrangements with a Terms of Reference and programme of work agreed. Fieldwork has been delayed due to unforeseen absence of a key contact. In recognition that the key contact will require time to return to work following absence and to ensure sufficient time to complete this audit work thoroughly, it is proposed that that this audit is deferred to quarter 1 of the 2023/24 IA plan.
- 4.6 It is IA's opinion that the three audits due for completion in the 2022/23 IA plan will be sufficient to provide an annual audit opinion for the year ending 31 March 2023.

Status of Open IA management actions as at 9 February 2023

- 4.7 As at 9 February 2023, LPF had 14 agreed management actions (9 Medium and 5 Low) which were raised across the following audits:
- Project Forth - Programme Assurance (7)
 - Bulk Transfers (4)
 - Risk Management (2)
 - Technology Model Development (1)
- 4.8 One management action has passed its original implementation date, details of which are set out below:

Audit	Action title / due date	Rating	Action and management update
LPF2003 Technology Model Development	3.1.2: Post-Implementation Activities 31/12/2022	Medium	LPF have produced user manuals and documentation for key/business critical systems and will review the requirements and suitability of the currently available generic documentation for the others during 2022. The action to address the issue is partially complete, however due to events out with LPF's control, unplanned leave by the issue owner and delegate, is delaying completion of this item. A revised date will be provided in due course.

- 4.9 The remaining 13 management actions are not yet due for completion and implementation is currently being progressed by LPF. Details of the management actions are provided at Appendix 2.

5. Financial impact

- 5.1 Failure to close management actions and address the associated risks in a timely manner may have financial impacts which are not yet measurable.

6. Stakeholder/Regulatory Impact

- 6.1 IA recommendations are raised as a result of control gaps or deficiencies identified during audits. If agreed management actions are not implemented, LPF will be exposed to the risks set out in the relevant IA reports, including the potential risk of non-compliance with applicable regulations.

7. Background reading/external references

- 7.1 [Public Sector Internal Audit Standards](#)
7.2 [Lothian Pension Fund – Internal Audit Update as at 31 August 2022](#) (item 6.4)

8. Appendices

- Appendix 1 Third-Party Supplier Management Internal Audit Report
Appendix 2 All LPF outstanding audit actions as at 9 February 2023

Internal Audit Report

Lothian Pension Fund - Third Party Supplier Management

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8 March 2023

LPF2203

**Overall
Assessment**

**Significant
improvement
required**

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This Internal Audit review is conducted by the City of Edinburgh Council for the Lothian Pension Fund under the auspices of the 2022/23 internal audit plan approved by the Pensions Audit Sub-Committee in September 2022. The review is designed to help the Lothian Pension Fund 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 are 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 Lothian Pension Fund. 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 members as appropriate.

Executive Summary

Overall Assessment	Significant improvement required
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Overall opinion and summary of findings

Our review of Lothian Pension Fund’s (LPF) Third Party Supplier Management Framework recognises that it has recently been developed and implemented and that it takes time to embed such frameworks. The following findings have been identified which are designed to enhance and strengthen LPF’s control environment:

- **Supplier management processes for Critical Suppliers** – the criteria used for identifying critical suppliers requires improvement to ensure they are specific and consistent with regulatory expectations. Tier 1 criteria is inadequate as it fails to consider a regulatory impact of engaging with a supplier, while the criteria for Tiers 2 and 3 are ambiguous and too subjective.
- **Contract exit planning** – a strategy for contract exit planning or business continuity for suppliers has not yet been documented or considered by LPF.
- **Design of the Supplier Management** – the framework document requires improvement to ensure it provides an adequate level of detail for Third Party Risk Management on key areas such as: governing body responsibility for oversight of outsourcing, intra-group outsourcing (LPFI and LPFE Limited), defined risk appetite, risk and issue identification and management, and exit planning.
- **Supplier onboarding processes** – supplier onboarding processes require improvement to ensure they effectively manage supplier risk. Issues noted include the lack of a Quality Assurance process following the materiality assessment, and gaps and inconsistencies in the Legal review process.
- **Training and awareness** – there is currently no supplier management risk training and awareness programme for relevant LPF employees.

- **Ongoing monitoring and oversight** – there is limited reference to City of Edinburgh Council’s (the Council) role and responsibilities within the supplier management framework. There are also gaps in the processes in place for governance of the framework as well as in the management and oversight of the supplier database.

Areas of good practice












Our review identified the following areas of good practice:

- LPF’s risk register includes supplier risks and consists of key metrics such as impact, probability, target risk level, and mitigation actions.
- The Data Privacy Impact Assessment (DPIA) process is clear and consistent with our discussions with LPF employees. The cooperative approach between LPF (data processor) and the Council (the data controller) in this process is adequate from a design perspective, and the Data Protection Assessment (DPA) approach is successful in assessing the applicability of a supplier DPIA.

Management response

The LPF Supplier Management Framework was developed during 2022 prior to which LPF managed suppliers through a contract database that mirrored and relied on CEC contract management processes. LPF had since acknowledged the need to operate an appropriate standalone framework to facilitate the management and oversight of LPF suppliers to mitigate risks in respect of supplier underperformance or failure. This framework was rolled out during Q2-Q3 2022, and during the period of the review, has only had a limited time to embed in the business. Notwithstanding, LPF management welcome design and operational observations at this early stage of the framework’s maturity which provide an opportunity to reflect on areas which can be improved and make enhancements as appropriate.

Audit Assessment

Audit Area	Control Design	Control Operation	Findings	Priority Rating
Strategy & oversight, risk appetite, and policy maintenance			Finding 1 – Supplier management processes for Critical Suppliers	High Priority
		N/A	Finding 3 – Design of the Supplier Management Framework	Medium Priority
Third-Party Supplier offboarding and exit plans			Finding 2 – Exit planning	High Priority
Third-Party Supplier onboarding			Finding 4 – Supplier onboarding processes	Medium Priority
Monitoring and oversight			Finding 5 – Ongoing monitoring and oversight	Medium Priority
Training and communication			Finding 6 – Supplier Management training and awareness	Low Priority

[See Appendix 1 for Control Assessment and Assurance Definitions](#)

Background and scope

Lothian Pension Fund (LPF) engages with a number of third-party suppliers to support its business functions. These range from ad-hoc arrangements to reliance on larger, more complex service providers. The effective management of all third-party suppliers is key to ensuring business objectives are met. It is therefore expected that Senior Management demonstrates adequate and appropriate oversight, and that monitoring controls are in place to enable a holistic and effective approach to third party supplier risk management.

Scope

The objective of this review was to assess the adequacy of design and current operating effectiveness against industry good practices, PwC’s interactions in the market, and the key controls established (where appropriate) to ensure LPF has appropriate processes and procedures in place to manage its third-party suppliers.

Risks

The review also assessed the following LPF risks:

- **Supplier and third-party systems** - inadequate, or failure of, supplier and other third-party systems (including IT and Data security).

Our assessment included matters that we consider relevant based on our understanding of the key risks to the organisation.

Limitations of Scope

The following areas were excluded from scope:

- the Procurement function and its underlying processes were not within the scope of this review
- the review did not intend to be a complete traceability mapping exercise to regulatory/legislative requirements; hence we have not provided a view or opinion on whether LPF is compliant with the relevant regulatory requirements
- while this review considered due diligence and ongoing monitoring requirements, a detailed review of risk domains such as Information Security of third-party suppliers was not included in the scope of this review. This will be considered as part of the LPF Information Security Arrangements internal audit currently underway
- recognising that the framework has recently been implemented and therefore evidence of operational effectiveness may be limited, this review focused predominantly on the design of the framework.

Reporting Date

Testing was undertaken between 13 January 2023 and 10 February 2023.

Our audit work concluded on 10 February 2023, and our findings and opinion are based on the conclusion of our work as at that date.

Findings and Management Action Plan

Finding 1 – Supplier management processes for Critical Suppliers

Finding
Rating

High Priority

Critical supplier relationships should be managed in line with industry good practices to ensure LPF can exercise effective management, governance and oversight over critical outsourcing arrangements.

Our review noted the following issues with the design and operating effectiveness of LPF's supplier management processes for two critical suppliers, Charles River, and Northern Trust:

1. Business case documentation for Charles River and Northern Trust was not available therefore we were unable to assess whether onboarding processes for critical suppliers are fit for purpose.
2. Supplier monitoring of Charles River has not been carried out in line with the process detailed in the Supplier Management Framework, as detailed notes of key review meetings for Charles River have not been documented.
3. Due diligence has not been completed consistently, as documentation provided (such as additional external assurance documentation) for Northern Trust was not as comprehensive as that provided to us for Charles River.

4. The criteria used to categorise Tier 1 suppliers does not refer to suppliers which are 'critical to the LPF Group's compliance with law and/or regulation'.
5. Management advised that an incident involving Charles River which prevented LPF employees from carrying out their role occurred but was not formally reported internally to LPF Risk & Compliance until two weeks after identification, which indicates that internal compliance reporting processes are not operating effectively.

Risks

Supplier and third-party systems

- inadequate risk management processes for critical suppliers could result in regulatory censure as well as over reliance on dominant service provider(s) for core functions, potentially leading to loss of service on the collapse or withdrawal of that provider, and customer harm/loss. This risk is further elevated due to a limited understanding of the critical supplier risk profile.
- inadequate, or failure of, supplier and other third-party systems (including IT and Data security).

Recommendations and Management Action Plan: Supplier management processes for Critical Suppliers

Ref.	Recommendation	Agreed Management Action	Owner	Contributors	Timeframe
1.1	Business case documentation for all critical suppliers should be stored in line with LPF's record keeping policy.	LPF will review records for existing critical suppliers, and ensure that business case documentation is stored in correct supplier files. Supplier management policy will be	Chief Executive Officer (LPF)	Head of Legal (LPF)	30/09/2023

		updated to specify where supplier records, such as business case, should be stored.			
1.2	Tier 1 supplier monitoring should be carried out in line with LPF's documented supplier monitoring process. This includes the documentation and retention of detailed notes and individual meeting dates to ensure that meetings are taking place in line with agreed frequency.	LPF will carry out targeted training for Tier 1 supplier owners on monitoring, and consider appropriate oversight via RMG reporting.		Head of Legal (LPF)	30/09/2023
1.3	Due diligence should be consistent in terms of the level of scrutiny applied to critical suppliers. Management should ensure that annual due diligence for Northern Trust (and all Tier 1 suppliers) is aligned with Charles River in that recent vulnerability assessment results, penetration test reports and other external assurance reports are obtained and reviewed.	As part of action 1.2, targeted training will cover annual due diligence. Supplier framework document review will consider due diligence templates or checklists with set items, tailored to specific tiers.		Head of Legal (LPF)	30/09/2023
1.4	The tiering criteria used should be amended so that Tier 1 suppliers include those suppliers which are critical to the LPF Group's compliance with law or regulation. Cost of the supplier contract generally should not factor into the assessment of materiality (e.g., Tier 2 suppliers). To avoid subjectivity, the tiering criteria should include key areas highlighted by regulators including the potential impact of a disruption, failure, or inadequate performance of the firm's business continuity, operational resilience, and operational risk.	LPF will review and define the tiering criteria (part of action 3.1), then review tier classification of existing suppliers.		Head of Legal (LPF)	30/09/2023
1.5	Management should communicate the incident reporting policy to all LPF employees, to ensure that incidents are reported in line with documented incident reporting processes.	LPF will recommunicate existing incident reporting policies to all employees.		Chief Risk Officer (LPF)	30/06/2023

Finding 2 – Contract exit planning

Finding
Rating

High Priority

Contract exit plans should provide for all scenarios and should be periodically tested and updated. Consideration should also be given to 'stressed' exits where withdrawal from a supplier relationship is sudden (such as liquidation or insolvency); and viable forms of exit from supplier relationships from such scenarios, with a focus on the ongoing provision of important business services following a stressed exit.

During the audit we noted the following gaps in relation to exit planning:

1. LPF does not have a defined exit planning process or strategy.
2. LPF does not have exit plan templates in place.

Risks

Supplier and third-party systems

- supplier Management Framework may not provide adequate guidance on roles and responsibilities for managing third party arrangements.
- exit plans are not fit for purpose, exceeding LPF's risk appetite and could expose LPF to business disruption.

Recommendations and Management Action Plan: Exit planning

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Ref.	Recommendation	Agreed Management Action	Owner	Contributors	Timeframe
2.1	Management should define an exit planning process or strategy for the exiting of a supplier relationship under 'stressed' and 'non-stressed' scenarios. This should also consider the materiality of a supplier e.g., exit plans for Tier 1 suppliers should be tested and signed off by an appropriate level of management.	LPF will define the supplier exit process, as part of supplier management process review and refresh. See action 3.1.	Chief Executive Officer (LPF)	Chief Risk Officer (LPF) Head of Legal (LPF)	30/06/2023
2.2	Management should create an exit plan template which can be used as part of the Supplier Management Framework.	LPF will create an exit plan template, as part of the exit plan process. See action 3.1.			30/06/2023

Finding 3 – Design of the Supplier Management Framework

**Finding
Rating**

**Medium
Priority**

LPF's Supplier Management Framework should provide end-to-end coverage of the Third Party Risk Management lifecycle.

Our review noted that the LPF Supplier Management Framework does not include a sufficient level of detail around the following key areas:

1. Material outsourcing (e.g., outsourcing of an Important Business Service including regulated activities) vs. non-material outsourcing
2. Supporting process documents
3. Approach to intra-group arrangements
4. Approach to contracting and written agreements
5. Roles and responsibilities (particularly with regards to the Council)
6. RACI matrix
7. Defined risk appetite
8. Risk and issue identification and management processes
9. Exit planning and business continuity plans and processes for suppliers
10. Procedures for the identification, assessment, management, and mitigation of potential conflicts of interest
11. Supplier incident reporting

Risks

Supplier and third-party systems

- insufficiently articulated framework or supporting procedures and guidance for the management of third-party supplier risk, resulting in a lack of clarity over roles and responsibilities, governance, and oversight.
- an inadequate governance framework and structure would fail to ensure effective management of third party arrangements by LPF, leading to potential undermining of LPF's ability to provide a continuous and satisfactory service to its policyholders.
- receiving services without adequate contractual protection which could result in LPF not being able to sufficiently control and monitor its relationships with third party suppliers.

Recommendations and Management Action Plan: Design of the Supplier Management Framework

Ref.	Recommendation	Agreed Management Action	Owner	Contributors	Timeframe
3.1	<p>The Supplier Management Framework should be updated to include the following:</p> <ol style="list-style-type: none"> 1. Clarification on LPF's approach to material outsourcing and if/how it differs to non-material outsourcing. 2. Links to supporting process documents such as ICT Security assessment and DPIA guidance. 	<p>LPF will review existing Supplier Management Framework document and all related supporting document (templates, checklists), and update. New supporting documents will be created where necessary.</p>	<p>Chief Executive Officer (LPF)</p>	<p>Chief Risk Officer (LPF) Head of Legal (LPF)</p>	<p>30/09/2023</p>

	<ol style="list-style-type: none"> 3. Detailed approach to intra-group arrangements including LPFI and LPFE Limited. 4. A defined process for contracts and written agreements (e.g., at what point Legal function is engaged and relevant approval flow). 5. A RACI matrix which includes key business functions (e.g., Legal, ICT Security, DPO, Board) and the Council. 6. Amendment to Roles and Responsibilities section to include the Council. 7. Risk appetite should be developed to detail how Key Risk Indicators (KRIs) should be applied when managing supplier risk and linked to the LPF Group's overarching risk management framework and risk appetite. 8. Risk and issue identification and management process should be outlined or linked within the framework. 9. A business continuity process for suppliers 10. A process for identifying and managing potential conflicts of interest. 11. A process for supplier incident reporting. 	<ol style="list-style-type: none"> 1) Existing Supplier Management Framework review will be updated to ensure it covers: <ul style="list-style-type: none"> • Onboarding process, including approval flows and RACI matrix • Tiering criteria, and tiering approval checks • Exit processes • Approach to outsourcing • Approach to Intra-group arrangements • CEC role and responsibilities • Links or clarifications on application of existing processes to suppliers e.g. Contract review; DPIA, IT assessment, risk appetite, risk and issue reporting, incident reporting, conflicts, business continuity 2) New supporting documents will be created to cover: <ul style="list-style-type: none"> • Onboarding process / checklist • Exit plan template / checklist • Legal contract review process / checklist • Legal standard contract template • Critical supplier due diligence review templates (may replace existing monitoring template) 		<p>Service Director, Finance and Procurement (CEC)</p> <p>Interim Head of Commercial and Procurement Services (CEC)</p>	
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Finding 4 – Supplier onboarding processes

Finding Rating	Medium Priority
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Robust onboarding processes help to support effective management and oversight of risks posed by new suppliers and the services provided by them.

Our review identified the following issues which indicate that LPF's onboarding processes require further development to ensure that they are adequately designed and operating effectively:

1. There is no internal secondary review of the tiering assessment, or its outcome carried out during the onboarding process. Therefore, there is limited assurance that the tier assigned to a given supplier is correct and proportionate to the risk posed by it.
2. Certain aspects of the Legal review process do not provide adequate contractual protection, including the following:
 - a) LPF's standard Terms and Conditions do not contain the following key clauses:
 - Frequency of review of Key Performance Indicators (KPIs)
 - Business continuity clauses
 - Right to audit, incident handling and reporting
 - Exit planning and strategy

b) LPF's contractual review checklist does not include the following expected checks:

- Right to audit
- Supplier incident handling and reporting
- Business continuity clauses

c) LPF's contractual review checklist lacks clarity with regards to which suppliers require a clearly defined set of KPIs.

3. In addition, there is no mechanism in place to alert the ICT Security team that a supplier ICT security assessment has not been carried out.

Risks

Supplier and third-party systems

- inadequate onboarding processes could result in LPF onboarding an inappropriate supplier that is not capable of providing the required services to the requisite level.
- inadequate, or failure of, supplier and other third-party systems (including IT and Data security).

Recommendations and Management Action Plan: Supplier onboarding processes

Ref.	Recommendation	Agreed Management Action	Owner	Contributors	Timeframe
4.1	Management should consider the inclusion of an internal secondary review of the tiering assessment and its outcome during in the onboarding process. This should be carried out by an appropriate level of management when a supplier's tier has been assigned.	LPF will implement a review of the tiering assessment during the onboarding process (action 3.1)	Chief Executive Officer (LPF)	Chief Risk Officer (LPF) Head of Legal (LPF)	30/09/2023

4.2	<p>LPF's Supplier Contract Legal review process should be amended to include the following:</p> <ol style="list-style-type: none"> 1. Addition of the following clauses to LPF's standard Terms & Conditions: <ul style="list-style-type: none"> • Frequency of review of KPIs • Business continuity clauses • Right to audit • Incident handling and reporting including defined timelines • Exit planning and strategy 2. Addition of the following checks to LPF's contractual review checklist: <ul style="list-style-type: none"> • Right to audit • Supplier incident handling and reporting including defined timelines • Business continuity clauses 3. LPF's contractual review checklist should be amended to clarify criteria for which suppliers require a clearly defined set of KPIs. Generally, language like 'if appropriate' should be avoided. 	<p>LPF will review the existing contract review process, add suggested checks to the checklist. (overlap with action 3.1).</p>		<p>Head of Legal (LPF)</p>	<p>30/06/2023</p>
4.3	<p>LPF's supplier onboarding process should include a clear mechanism which notifies the ICT Security team if an assessment is not carried out. This could include the inclusion of a requirement to notify ICT Security if a supplier service processes LPF data/confidential data.</p>	<p>LPF will review the supplier onboarding process as part of Supplier Management Framework document update (action 3.1), and introduce a clearer, centralised process with defined approvals to be followed for all new suppliers.</p>		<p>Chief Risk Officer (LPF)</p> <p>Head of Legal (LPF)</p>	<p>30/09/2023</p>

Finding 5 – Ongoing monitoring and oversight

Finding
Rating

Medium
Priority

Ongoing monitoring controls support LPF Senior Management and their ability to demonstrate adequate and appropriate oversight over supplier management activities.

During the audit, the following issues were noted with regards to ongoing monitoring and oversight:

1. LPF's supplier database and the data fields included are not in line with industry good practices.
2. The Council's roles and responsibilities in relation to overseeing and managing third party supplier relationships for LPF are not defined.
3. LPF's governance structure does not sufficiently cover supplier management.

Risks

Supplier and third-party systems

- management may not receive appropriate visibility of key risks, issues, escalations, incidents, and threats preventing effective decision making, remediation and management of third-party risks.
- the Supplier Management Framework may not provide adequate guidance on roles and responsibilities for managing supplier arrangements, which could result in ineffective supplier risk management.

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Recommendations and Management Action Plan: Ongoing monitoring and oversight

Ref.	Recommendation	Agreed Management Action	Owner	Contributors	Timeframe
5.1	Management should consider the following actions: <ol style="list-style-type: none">1. Inclusion of data fields to record recent supplier assessments (e.g., ICT Security, The Data Privacy Impact Assessment (DPIA) carried out as well as their outcomes.2. The supplier database should also be reviewed by an appropriate level of management and the results of this review should be stored somewhere easily accessible to enable LPF Senior Management to exercise effective oversight of suppliers.	<p>LPF will enhance existing supplier database to include additional data fields, including dates of IT assessment and DPIA, and links to full records.</p> <p>A review of the database will be established, with results provided to senior management as part of RMG oversight.</p>	Chief Executive Officer (LPF)	Chief Risk Officer (LPF) Head of Legal (LPF)	30/09/2023

5.2	The Council's role and responsibilities in relation to supplier management and oversight for LPF should be defined in the Supplier Management Framework document.	This will be documented as part of refresh of Supplier Management Framework document (3.1).			30/09/2023
5.3	<p>Management should consider the following:</p> <ol style="list-style-type: none"> 1. Inclusion of a supplier management section within the Risk Management Group (RMG) pack and Terms of Reference (ToR). 2. Addition of a version control and review history section to the Risk Management Group's Terms of Reference. In addition, the Terms of Reference should be reviewed annually to ensure they are relevant and up-to-date. 3. Supplier management should be included as a distinct agenda item at the RMG. The discussion could include issues identified relating to Tier 1 suppliers, recent Tier 1 suppliers onboarded, and consideration of exit strategies and plans. 	<p>LPF will update RMG responsibilities to include supplier management, and consider how best to incorporate into existing agenda and MI.</p> <p>LPF will add document control to RMG Terms of Ref, including version history and frequency of review.</p>		Chief Risk Officer (LPF)	30/06/2023

Finding 6 – Supplier Management Training and awareness

Finding
Rating

Low Priority

Training and awareness controls support core third party supplier management procedures and help to ensure LPF employees are aware of their roles and responsibilities in relation to supplier management.

During the audit, we noted that there is no risk training or awareness programme in place at LPF for supplier management.

Risks





Supplier and third-party systems

- training is insufficient, inadequate, or misaligned to recognised good practices which could result in LPF employees not carrying out their role as effectively as possible with regards to Third Party Supplier management.

Recommendations and Management Action Plan: Supplier Management Training and awareness

Ref.	Recommendation	Agreed Management Action	Owner	Contributors	Timeframe
6.1	<p>Management should consider establishing a supplier management risk training and awareness programme, for all employees and new joiners with a role within supplier management.</p> <p>The training and awareness programme should be reviewed annually or in line with any material changes to ensure that it remains relevant and up-to-date, and employees should be required to complete regularly to ensure sufficient knowledge and awareness.</p>	<p>LPF will carry out training and awareness following update of all documents and processes referred to in other actions; and consider how to incorporate into existing annual training plan and onboarding.</p>	<p>Chief Executive Officer (LPF)</p>	<p>Chief Risk Officer (LPF)</p> <p>Head of Legal (LPF)</p>	<p>31/12/2023</p>

Appendix 1 – Control Assessment and Assurance Definitions

Control Assessment Rating		Control Design Adequacy	Control Operation Effectiveness
Well managed		Well-structured design efficiently achieves fit-for purpose control objectives	Controls consistently applied and operating at optimum level of effectiveness.
Generally Satisfactory		Sound design achieves control objectives	Controls consistently applied
Some Improvement Opportunity		Design is generally sound, with some opportunity to introduce control improvements	Conformance generally sound, with some opportunity to enhance level of conformance
Major Improvement Opportunity		Design is not optimum and may put control objectives at risk	Non-conformance may put control objectives at risk
Control Not Tested	N/A	Not applicable for control design assessments	Control not tested, either due to ineffective design or due to design only audit

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Overall Assurance Ratings	
Effective	The control environment and governance and risk management frameworks have been adequately designed and are operating effectively, providing assurance that risks are being effectively managed, and LPF's objectives should be achieved.
Some improvement required	Whilst some control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks, they provide reasonable assurance that risks are being managed, and LPF's objectives should be achieved.
Significant improvement required	Significant and / or numerous control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks. Consequently, only limited assurance can be provided that risks are being managed and that LPF's objectives should be achieved.
Inadequate	The design and / or operating effectiveness of the control environment and / or governance and risk management frameworks is inadequate, with several significant and systemic control weaknesses identified, resulting in substantial risk of operational failure and the strong likelihood that LPF's objectives will not be achieved.

Finding Priority Ratings	
Advisory	A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.
Low Priority	An issue that results in a small impact to the achievement of objectives in the area audited.
Medium Priority	An issue that results in a moderate impact to the achievement of objectives in the area audited.
High Priority	An issue that results in a severe impact to the achievement of objectives in the area audited.
Critical Priority	An issue that results in a critical impact to the achievement of objectives in the area audited. The issue needs to be resolved as a matter of urgency.

Appendix 2 - All LPF outstanding audit actions as at 9 February 2023

Audit	Date raised	Recommendation Title	Recommendation	Agreed Management Action	Priority Rating	Date Due
LPF – Bulk Transfers	13/08/2021	LPF2001 - Rec 1.1 Management oversight of external project management	LPF management should review and project plans; delivery progress; and the overall project RAG (red, amber, green) status to confirm their completeness and accuracy, and actively challenge external project managers to understand the reasons for any delivery delays, and their overall impact on the project. Details of this review and challenge should be recorded in project board / governance meeting minutes and logs, with appropriate action implemented by the external project manager to ensure that any concerns raised by the LPF management team are effectively addressed.	<p>LPF commissioned specialist project management services from Hymans Robertson LLP in order to draw upon its expertise and experience in large scale LGPS bulk transfers. Accordingly, in light of the audit feedback, LPF sought and received comment from the company thereon. The key extract is: “Each Highlight report has the narrative to acknowledge that dates can and do move throughout the project – an example is noted as follows: Some milestone dates in the highlight report have altered since the last report, this is due to movement on some activities and refining of the plan. We would only expect to change any RAG status if there was a negative impact as a result of any delays. In a project like this, we know that there are a number of activities where issues can arise that are outside of our control, however we can we build in contingency to help manage them.</p> <p>In both scenarios, the signing of the Actuaries letters and the provision of DSAs, there was no negative impact on critical activities, therefore the RAG would remain Green and on track. Progress on each of these areas were discussed at the project meetings. As a result of the feedback, for future reports, the description of the RAG status at the foot of the highlight report will be updated to be more specific around the impact of any date changes to avoid any ambiguity.” LPF echoes the sentiments expressed by Hymans Robertson LLP. Accordingly, with an expectation that a RAG status would only change if there was a negative impact as a result of any delays, LPF considers that the project management provided appropriate oversight and control. As stated, however, to avoid any potential ambiguity in future, suitable clarification will be embedded in procedures for any similar exercises.</p>	Low Priority	31/12/2024
LPF – Bulk Transfers	13/08/2021	LPF2001 - Rec 2.1 Maintenance and oversight of a data transfer issues log	For any future data transfer exercises, LPF should maintain a data transfer issues log that should include but not be restricted to: A description of the errors identified; The date they were identified; The significance of the errors (for example, high, medium and low); What action is being / has been taken to correct the error;Who is addressing / has addressed the error; and Date of resolution.The issues log should be reviewed by an independent team member to: Confirm that all issues identified have a clear action, owner, and implementation date for resolution; Confirm that there is satisfactory progress with resolution of all significant issues prior to implementation date; andEnsure that any concerns in relation to lack of implementation progress is escalated to senior management.A sample review of actions completed to address data quality issues identified should be performed prior to live implementation to confirm that issues have been closed appropriately, and that evidence has been retained (where possible) to support their closure. Appropriate evidence of this review (including details of the sample testing methodology applied) should also be retained.	<p>LPF accepts the recommendation.</p> <p>As part of the process (outlined in the implementation study), the Fund’s software supplier Aquila Heywood provided system generated reports reconciling the number of members transferred and several data items. This provided assurance that data taken from the ceding funds and loaded into LPF TEST service was identical. Any issues would have been flagged up at that time. Following receipt of these reports (which showed that the information between ceding fund and LPF tallied), LPF carried out a further data cleansing exercise using a portal created by the Actuary. This is an additional step in the process that LPF chose to do to ensure the quality of transferred data (please see Appendix B of the Fund’s Funding Strategy Statement). The number of errors identified by this further cleanse was extremely small and covered only minor issues. An example was a postcode warning for an overseas pensioners – this is due to the difference in formats of UK and overseas postcodes. The small number of errors identified could be resolved very quickly and easily. Further data quality assurance was obtained in carrying out more than one parallel payroll run.LPF acknowledges that this transfer included a relatively small number of members and that data in this case was of a high standard, and that subsequent transfers may involve greater member numbers and poorer quality data.</p>	Medium Priority	31/12/2024
LPF – Bulk Transfers	13/08/2021	LPF2001 - Rec 2.2 Completion of parallel payroll runs	When performing parallel payroll runs to confirm the accuracy of payroll data prior to live transfer, LPF should implement a formal process for confirming satisfactory completion of the payroll run and / or ensuring that all issues identified are recorded in the issues log (refer recommendation 1.1.). This could be confirmed via email to management confirming, as a minimum:The source of the data used;The month for the payroll run;The name of the team member who initiated and performed the payroll run;The name of the other team member who closed the payroll run;Confirmation that significant issues were / were not identified and will be addressed prior to live implementation; andConfirmation regarding whether the live implementation date can still be achieved.	<p>LPF accepts the recommendation.</p> <p>Parallel payroll runs were carried out using a process set out by the Fund’s software supplier which has been developed and used successfully on many other occasions, together with documented processes for running payroll which are already fully documented and integrated within LPF. LPF’s decision to carry out more than one parallel payroll run provided additional assurance that information supplied was correct.</p>	Medium Priority	31/12/2024
LPF – Bulk Transfers	13/08/2021	LPF2001 - Rec 2.3 Review of membership communication listing	For future communications with members, LPF should ensure that:A reconciliation is performed between the total members on the communication list to the complete list of transferring members from the ceding funds;An independent review of is performed of the nature of communications (communication labels) to be provided to members to confirm their accuracy based on membership status and other relevant information;The listing contains details of the preparer and reviewer, and relevant dates; andThe reviewed listing is distributed by email communication to ensure a trail of accountability.	<p>LPF accepts the recommendation.</p> <p>Following the successful completion of the transfer, a system generated report listed all member data required for communications. This report was generated for members of each ceding fund and showed member status and member address. No differentiation in communication was required for active and deferred members (i.e. all active members received the same letter, and all deferred members received the same letter). As reports were produced by ceding fund and member status was included, the data was available in order to successfully identify which pensioner letter was to be used. Prior to sending letters, proofs were spot-checked against the initial report and LPF’s Communications Partner reconciled the numbers back to the original report and confirmed with the Employer and Member Payroll Manager.</p>	Medium Priority	31/12/2024

LPF – Technology Model Development	03/03/2022	LPF2003 Recommendation 3.1.2: Post-Implementation Activities	1. A post-implementation review on the migration to the new externally hosted LPF technology network has not yet been performed or planned to identify improvements that could be applied to subsequent projects.LPF management has advised that a post implementation review will be completed by the end of December 2021. 2. Whilst user manuals are in place for some LPF third party hosted systems such as Charles River, Altair, and the Cased Dimensions technology, not all systems have manuals, such as Moorepay, Legal e-sign, and Bamboo.	LPF have produced user manuals and documentation for key/business critical systems and will review the requirements and suitability of the currently available generic documentation for the others during 2022.	Medium Priority	31/12/2022
LPF Risk Management	23/08/2022	LPF2103 2.1 Recommendation: Maintenance of risk registers	LPF management should: a) Review the risks included in the risk registers and ensure they are appropriately articulated. b) Agree definitions of Low/Medium/High impact and likelihood assessments and embed their application at risk subgroups.c) Review the controls listed in the corporate risk register to ensure that they are appropriately articulated in line with the who, what, why, and how control description principles included at Appendix 3 in this report. d) Ensure that all mitigating actions are specific, measurable, achievable, realistic and timely.	Likewise, we will look to re-review the sub-group registers (and tie-in with main group register) with these points in mind We will consider within Risk Management Group (RMG) and report back through the usual channels with any updates arising.	Low Priority	31/03/2023
LPF Risk Management	23/08/2022	LPF2103 1.1 Recommendation: Aligning corporate risks with strategic objectives and risk definitions	1. Management should review the current population of LPF corporate risks to confirm that they are complete and ensure that they align with the strategic objectives and goals set out in the LPF Strategy and Business Plan. 2. Risk definitions should be established for each risk category; agreed by management; and communicated across LPF for ongoing reference when identifying and assessing risks.	We will look to re-review our risks with this finding in mind and use it as an opportunity to step back and consider more holistically the risks we capture and how we can effectively manage and cascade granularity of definition with both ongoing operational risk management and reporting/governance in mind. The Risk Management Group (RMG) does seek to do this on an ongoing basis, and to strike the important balance between maintaining and reporting on the right number of risks (omitting gaps) and distracting the focus away from critical risks/strategic analysis with too much detail, but this is a helpful and timely point to review this. We will consider within RMG and report back through the usual channels with any updates arising.	Medium Priority	31/03/2023
LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 2.1 Recommendation: Assurance plan	The Council and LPF should agree and plan internal audit, and any other programme assurance related activities such as those over data migration. These should be entered onto the plan to support key project milestone stage gates.The deviation from the planned assurance as per the PID should also be tabled at Steerco for visibility/transparency.	To ensure good project governance is maintained, LPF will propose a further review is included in CEC IA's 23/24 plan, to be scheduled after council approval. Meanwhile regular project updates will be shared with CEC IA as part of routine BAU meetings.In addition, place markers for audits are noted on the Plan on a Page ('POAP'). Once dates are provided the project plan and the POAP can be updated. An update on the PwC audit will be provided verbally to Steering Group in December 2022. The deviation will be raised at that time.	Medium Priority	31/03/2023
LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 3.1 Recommendation: Benefits Management plan	A formal Benefits Management plan/approach should be documented, approved, and communicated to all appropriate stakeholders. Typically, this would include plans for at least: identification/ evaluation/ planning/realisation.review. The plan/approach should be referenced in the PID, and benefits should be mapped to specific tasks, risks, and deliverables.	A Benefits Management plan will be created post merger approval. Meanwhile a task to create the benefits management plan on the project plan will be referenced in the PID.	Medium Priority	30/06/2023
LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 4.1 Recommendation: Formal Risk Management approach	A formal Risk Management plan/approach for identifying and capturing risks, assigning owners, and tracking and mitigating risks should be documented, approved, communicated to all appropriate stakeholders, and referenced to in the PID. The RAID log should be updated to include the milestones, dependencies, and benefits (see finding 5) that are impacted by each risk. The revised Business Case should be used as a source for this exercise; this will create clear linkage between, and visibility of, all key project documentation.	Project approach to risks will be added to the PID and shared at Steering Group and Working Group. The RAID log notes the deliverable the risk relates to. This will be enhanced to cover risks being raised against milestones and dependencies where appropriate	Medium Priority	31/03/2023
LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 5.1: Recommendation: Quality Management plan	A formal, risk based, quality management plan should be documented, approved by all key stakeholders, and referenced to in the PID, RAID, and all other appropriate governance documentation.The plan should be robust and cover, at minimum, the following elements: quality planning,/ assurance (testing) /control /continuous improvement/ roles and responsibilitiesManagement should also ensure that staff used for assurance/testing are appropriately skilled i.e., have received appropriate training.	The WIDs highlight success criteria alongside deliverables for each workstream. The workstream lead is responsible for the quality of delivery of the workstream and each workstream has an executive (SLT) sponsor overseeing this. Additional scrutiny is provided by the steering group who have ultimate accountability. Specific and explicit quality assurance will be put in place for specific deliverables. We are particularly focussed on proportional quality management especially regarding the Heywood Migration Plan, employee consultation and TUPE, and the IT Data Transfer Plan, and will consider quality criteria, as appropriate.	Low Priority	30/06/2023
LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 6.1 Recommendation: Absence of a Data Migration plan	As soon as is practicable after merger approval, a migration plan should be agreed with Heywoods; this should be included in all appropriate governance documentation. This should cover, at minimum:completeness, accuracy, and timeliness of data migration / definition of an agreed 'cut off' point for existing systems / roles & responsibilities i.e., Access, administration, change control etc.Any additional features / changes within the existing Heywoods application should also be documented as a user training manual post migration.	Placeholder exists in the project plan for the Heywood Data Transfer Plan, which will be the migration plan. This will be tailored to the project requirements as agreed by the Operations WSL. A mini data discovery session is planned between Heywood and LPF during Q1 to baseline some high-level expectations and enable costs to be proposed on a more informed basis.	Low Priority	30/06/2023
LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 7.1 Recommendation: Critical path	Management should: define a 'critical path' and ensure that all workstream leaders understand it - particularly the key milestones, create an escalation process to address any threats to the critical path at the earliest opportunity - this could be done through the RAID log, document the impact of the critical path through all workstreams, considering findings 1 - 6.	The critical path cannot be properly defined until the legal structure has been agreed and consequent required actions and activities determined. In the meantime, PMO will create an event driven critical path. This will be shared at Steering Group and Working Group meetings. Threats to the critical plan will be reflected in the RAID where appropriate.	Low Priority	31/03/2023

LPF - Project Forth Programme Assurance	11/01/2023	LPF2201 1.1 Recommendation: Change Management policy	Management should formally document, approve, and communicate the current informally applied change management policy to all appropriate stakeholders. This should reference all currently used documents and should cover: what constitutes a significant change, when/how to undertake change, the documentation levels required, potential Red, Amber, Green (RAG) ratings, resolution times for each priority level currently defined in the RAID log.Once complete, this policy should be referred to in the Governance policy document (V1.1), as well as the RAID log to link all existing project governance documentation.	Project approach to change will be added to the PID and shared at Steering Group and Working Group. The RAID log summarises the change request, which is held in the project documentation.	Medium Priority	31/03/2023
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Pensions Audit Sub Committee

3.00pm, Tuesday, 21 March 2023,

Lothian Pension Fund – Proposed Internal Audit plan for 2023/24

Item number 6.3

1. Recommendations

The Pensions Committee is requested to:

- 1.1 review and approve the proposed Lothian Pension Fund 2023/24 Internal Audit plan;
- 1.2 note the expansion of the audit universe to include LPFE and LPFI enabling provision of single integrated audit programme; and
- 1.3 approve proposals to adopt the CIPFA standard definitions for audit report overall opinions from 2023/24 onwards.

Laura Calder

Head of Internal Audit, City of Edinburgh Council

Legal and Assurance, Corporate Services Directorate

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Lothian Pension Fund – Proposed Internal Audit plan for 2023/24

2. Executive Summary

- 2.1 The purpose of this paper is to present the Lothian Pension Fund (LPF) proposed Internal Audit (IA) plan for the period 1 April 2023 to 31 March 2024 to the Committee for review and approval.
- 2.2 The audit universe has been expanded for 2023/24 to include the LPF group structure and provide assurance for the LPFI and LPFE boards where appropriate.
- 2.3 The plan will also include ongoing IA follow up on implementation of management actions arising from previous internal audit reports.
- 2.4 In April 2020, the Chartered Institute of Public Finance and Accountancy (CIPFA) recommended introduction of standard definitions for audit report opinions to support consistency across public body organisations. It is proposed that the standard CIPFA definitions are adopted and will apply for LPF IA reports from 2023/24 onwards.

3. Background

- 3.1 The LPF IA plan is driven by requirements of section 2010 of the [Public Sector Internal Audit Standards \(PSIAS\)](#) which requires IA to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals.
- 3.2 In doing so, IA has reviewed LPF's organisational objectives and priorities, and completed an assessment of the risks that could prevent LPF from meeting those objectives and providing pension services to employers and members.
- 3.3 The PSIAS specifies that the risk-based plan must consider the requirement to produce an annual IA opinion. Consequently, IA work performed must be appropriately scoped to cover LPF's most significant risks, with an appropriate depth of testing performed to provide sufficient assurance on the control environment, governance, and risk management frameworks to support provision of the opinion.
- 3.4 PSIAS also specifies that internal audit activity must evaluate the effectiveness of risk management processes and contribute to their improvement.
- 3.5 The plan has been developed with the LPF senior leadership team, the Convenor of the Pensions Audit Sub Committee, and the Fund's Independent Professional Observer to ensure that IA assurance activity is focused on the most relevant risks for LPF.

- 3.6 Following discussion with management, the Pensions Committee, and both the LPFI and LPFE Boards, the audit universe has been expanded for 2023/24 to include the LPF group structure and to provide a single integrated audit programme and provide assurance for the LPFE and LPFI Boards where appropriate.
- 3.7 Noting the earlier discussion about the Pension Committee being empowered to make their own audit arrangements, in discussion with LPF it has been agreed that the 2023/24 audit programme will be led by CEC IA working in conjunction with PWC. LPF intend to explore alternative arrangements during 2023 for further consideration prior to the 2024/25 year.
- 3.8 It should also be noted that Internal Audit is not the sole source of assurance provision for LPF, as several additional external third line assurance providers are engaged (in addition to the annual external audit review of LPF's financial statements) to provide additional assurance coverage.

Internal Audit Charter

- 3.9 PSIAS also specify that the purpose, authority, and responsibility of IA must be formally defined in an Internal Audit Charter (the Charter) that is periodically reviewed and presented to senior management and the board for approval. The Council's IA charter, approved by the Council's Governance, Risk and Best Value Committee in March 2023 fulfils this requirement for LPF.

CIPFA standard IA engagement opinion definitions

- 3.10 The Chartered Institute of Public Finance and Accountancy (CIPFA) sets the standards for internal audit, governance, and financial accounting across the public sector.
- 3.11 The current IA engagement opinion definitions for LPF (see Appendix 3) were introduced in April 2019. In April 2020, CIPFA completed a review of [IA Engagement Opinions – Setting Common Definitions](#) in recognition that there was no common practice across the public sector in how best to report the overall results of internal audit work at the end of each engagement.

4. Main Report

Scope of Internal Audit Assurance

- 4.1 The scope of IA assurance provided to LPF in relation to regulatory compliance is specifically limited to confirming LPF's ongoing compliance with Local Government Pension Scheme (Scotland) requirements.
- 4.2 The audit universe has been expanded across the LPF group for 2023/24 with the inclusion of the operation of the Fund's two wholly owned subsidiary companies LPFE and LPFI Ltd that are responsible for providing employee resources to

administer the pension funds, and provision of Financial Conduct Authority regulated services to both LPF and other Local Government Pension Scheme Funds.

- 4.3 Expansion of the audit programme should also enable an unlimited annual IA opinion to be provided for 2023/24, with removal of the limited opinion expressly related to excluding LPFE and LPFI from scope as in previous years.

Preparation and content of the proposed plan

- 4.4 The areas proposed for inclusion in the plan were identified by considering the key risks included in the LPF risk register as at December 2022, and discussions with the LPF management team, the Convenor of the Pensions Audit Sub Committee, and the Fund's Independent Professional Observer.
- 4.5 The LPF November 2022 risk register included a total of 39 risks, of which there were nil high rated, 13 moderate rated and 26 low rated risks.
- 4.6 The 13 moderate risks were considered together with the outcome of previously completed audits, other assurance sources and key regulatory requirements.

Project Forth

- 4.7 During 2023, LPF will continue with proposals to merge with Falkirk Pension Fund (Project Forth). LPF have assessed the options, taken legal advice, and has initiated a project with programme management support to pursue the merger.
- 4.8 As LPF is a subsidiary of City of Edinburgh Council the merger would require a sign off from the Council, which will be considered during 2023.
- 4.9 A readiness review for Project Forth – Programme Assurance was completed as part of the 2022/23 internal audit programme, with additional internal audit assurance to be completed during 2023/24.

Proposed 2023/24 Internal Audit Plan

- 4.10 The proposed IA plan for 2023/24 includes the following five audits:
- Information Security Arrangements – This audit was originally included in the 2022/23 IA plan, however, due to unforeseen absence of key contacts, fieldwork was delayed. This audit will be completed in quarter 1 2023/24 and will consider the design of the suite of IT policies, standards, and procedures, and provide assurance on information rights supplier and third-party systems risks.
 - Project Forth – In recognition of Project Forth, project and change is a top scoring moderate risk, therefore a targeted assurance review on Project Forth will be undertaken. The area of review will be agreed with management and the Pensions Audit Sub Committee as the merger progresses.
 - Business Continuity and Incident Response – Cybersecurity is also a top scoring moderate risk. LPF has undertaken other assurance including an

independent cyber security maturity assessment in December 2021 and external phishing testing in October 2022. The Business Continuity and Incident Response internal audit will consider general business continuity controls as the organisation transitions to post pandemic operations.

- Senior Managers and Certification Regime (SM&CR) – Regulatory breach remains a top scoring moderate risk in recognition of the increased regulatory burden for FCA regulated services.

The SM&CR replaced the FCA's Approved Persons Regime and created two new categories of controlled function - 'Senior Management Functions' (SMFs) and 'Certified Functions'. The review will aim to provide assurance of compliance with the key elements and prescribed responsibilities of the SM&CR.

- People Processes – Staff resource and recruitment are top scoring moderate risks. The audit will provide assurance that robust people processes have been established including consideration of the employee lifecycle. It will also consider the People and Communications team to ensure they carry out their responsibilities effectively and comply with relevant legislative and regulatory requirements to safeguard against the risk of financial and reputational loss and the failure to meet LPF's objectives.

- 4.11 A high level scope for each of the five reviews planned for 2023/24 is included at the LPF Annual IA plan document at Appendix 1, together with details of the entity where assurance will be provided and current LPF risks associated with these areas. Details of audits completed across the last five years have also been included within the plan document for information.
- 4.12 Reports detailing outcomes of each review will be presented to the Pensions Sub Committee. All reviews completed for LPFI/LPFE will also be presented to the relevant Board.
- 4.13 The proposed Internal audit reviews planned for the year 1 April to 31 March 2024 should provide assurance on 8 of the 13 moderate rated risks included in the LPF risk register. Extending to include work performed in 2022/23 provides assurance a total of 9 risks.
- 4.14 Consequently, it is important that the Committee confirms that appropriate assurance coverage will be provided across LPFs remaining population of moderate risks and (in particular) the risks associated with 'business as usual' operational activities by the additional assurance providers engaged by the Fund.

Risk Management

- 4.15 PSIAS requires that an appropriate depth of testing is performed to provide sufficient assurance on the control environment, governance, and risk management frameworks to support provision of the annual IA opinion.
- 4.16 Whilst sufficient information is generally collated across multiple audits to provide an understanding of the effectiveness of risk management processes to support the annual opinion, IA typically also performs targeted risk management audits to assess and provide assurance on the adequacy and effectiveness of the risk management framework across the entire organisation.
- 4.17 As the last targeted risk management audit for LPF was completed in 2021/22, the proposed 2023/24 reviews will consider whether risks associated with the areas included in scope have been effectively identified, assessed, recorded, and managed.

Follow-up activity

- 4.18 Follow-up work will also be performed in line with a risk-based approach to confirm whether agreed management actions implemented to support closure of findings raised in previous LPF audits have been effectively implemented.

CIPFA standard IA engagement opinion definitions

- 4.19 The current IA engagement opinion definitions for LPF (see appendix 2) were introduced in April 2019. CIPFA's 2020 review of [IA Engagement Opinions – Setting Common Definitions](#) recommended that Heads of Audit in public sector organisations adopted the standard definitions (see Appendix 2) to assist the sharing, comparability and understanding of assurance across public sector organisations.
- 4.20 CIPFA recommends that IA make the change at the start of the financial year so that all engagement opinions for the year are reported on a consistent basis. Therefore, it is proposed that LPF adopts the standard definitions for all audit engagements from 1 April 2023 onwards.

5. Financial impact

- 5.1 The estimated costs associated with delivery of the LPF 2023/24 IA plan are circa £107,000 which reflects:
- direct recharging of costs based on agreed rates as specified in the Council's IA co-source contract (five audits at £21,000 each)
 - costs associated with time for the Council's IA function including preparation of the annual plan, review and oversight of all IA reviews, preparation of Committee reports, attendance at Committee meetings, as well as ongoing review and

validation of previously raised audit actions. This will be charged on an actual costs basis through IA timesheets.

6. Stakeholder/Regulatory Impact

- 6.1 The LPF management team, the Convenor of the Pensions Audit Sub Committee, and the Fund's Independent Professional Observer were consulted when developing the 2023/24 IA plan.

7. Background reading/external references

- 7.1 [Public Sector Internal Audit Standards](#)

8. Appendices

Appendix 1 – Lothian Pension Fund 2023-24 Internal Audit Plan

Appendix 2 - Current IA engagement definitions and proposed CIPFA standard definitions



Internal Audit

2023/24 Annual Plan

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Introduction and approach

Introduction

In line with the Internal Audit Charter, Internal Audit (IA) provides independent and objective assurance on the overall effectiveness of the Lothian Pension Fund's (LPF) governance, risk, and control frameworks.

This document sets out the scope of the IA 2023/24 annual plan with the objective of delivering independent assurance on the key controls established across the LPF group to mitigate high and moderate risks.

Approach

The approach to preparing the annual plan is set out at Figure 1. The plan is driven by LPF's objectives and priorities, and an assessment of the risks that could prevent LPF from meeting its objectives.

The audit universe has been expanded for 2023/24 to include the LPF group structure and provide assurance for the LPFI and LPFE Boards where appropriate.

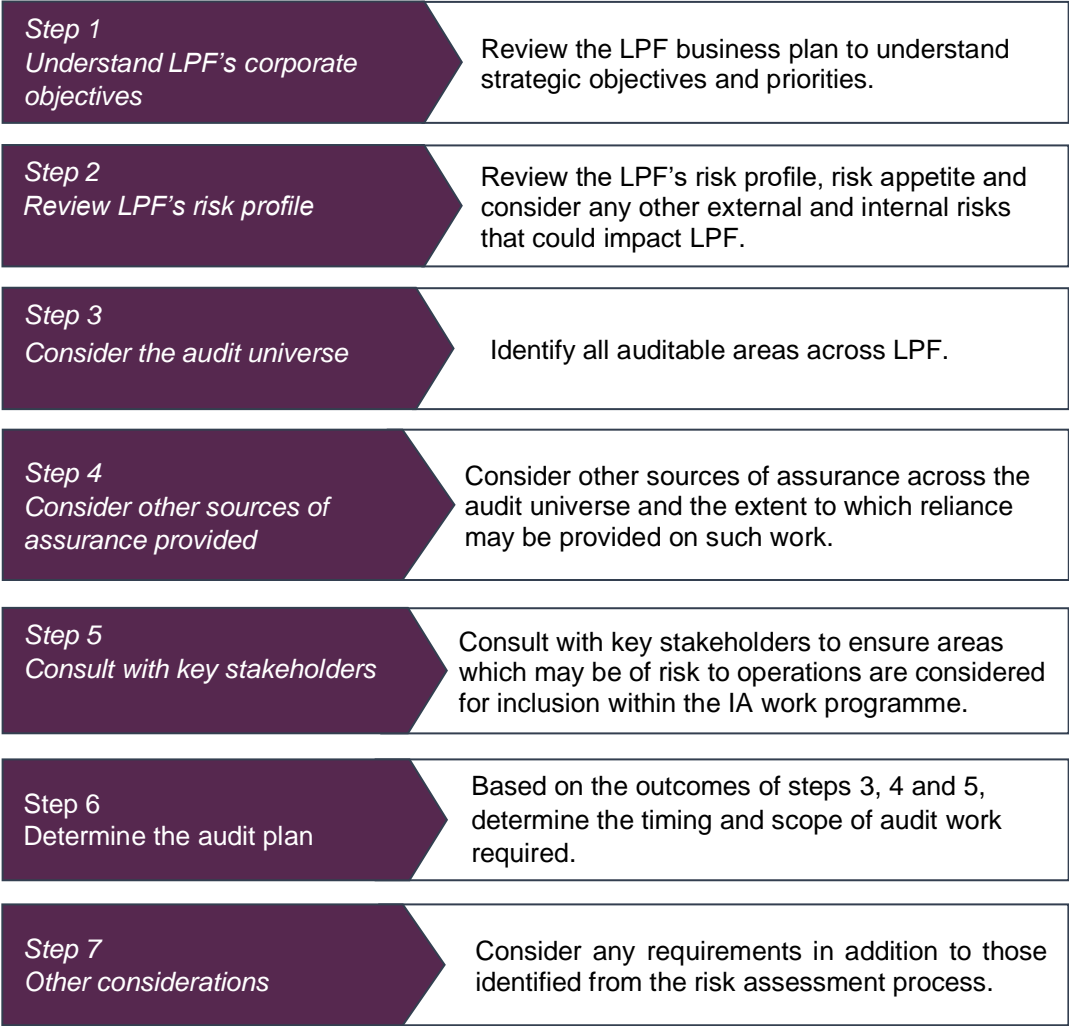
The LPF Business Plan 2022-23, sets out four broadly defined strategic goals:

- *develop and deliver a member and employer proposition for service excellence*
- *earn an appropriate risk adjustment investment return as responsible officers*
- *extend collaboration and services to existing partners and deepen where possible*
- *achieve greatness in our people, teams, and culture.*

Project Forth

LPF is proposing to merge with Falkirk Pension Fund (Project Forth). LPF have assessed the options, taken legal advice, and has initiated a project to pursue the merger. As LPF is a subsidiary of City of Edinburgh Council the merger would require a sign off from the Council, which will be considered during 2023.

Figure 1: Approach to developing the draft 2023/24 IA Annual Plan



Risk Assessment

To ensure a risk-based approach to the LPF Group IA annual plan which is proportionate and aligned to business-critical risks and emerging issues, consideration was given to the LPF group's priorities as detailed in the Business Plan 2022-23, and the LPF group risk profile as reported to the Pensions Committee in December 2022. The risk profile is supported by a risk assessment for each of the 39 risks LPF group risks, a summary of which is below at Figure 2).

Figure 2: LPF group risk profile as at December 2022

Total risks	High	Moderate	Low
39	0	13	26

The highest scoring moderate risks (those with a score between 25-32) were considered (see Figure 3) together with the outcome of previously completed audits, other assurance sources (see [Appendix 1](#)) and key regulatory requirements.

Key stakeholders including senior management, committee members, external audit (Azets) and professional co-source audit providers (PwC) have been invited to provide input into the IA annual plan to help ensure that the relevant areas are targeted for review.

Other sources of assurance

Internal Audit is only one of a number of sources of assurance over the LPF groups risks. In developing our risk assessment and plan we have taken into account other sources of assurance and have considered the extent to which reliance can be placed upon these other sources (for example, external audit, BDO, Mercer and LPF's Risk and Compliance function).

IA does not intend to place formal reliance upon these other sources of assurance but would not seek to duplicate the work they do.

Figure 3: LPF Group - Moderate risks as at December 2022

Risk	Score	22/23 audits and Proposed 23/24 audit coverage Other sources of assurance
Cybersecurity	32	23/24 Business continuity and incident response <i>Independent cyber security maturity assessment completed in Dec 2021</i>
Project and Change	32	22/23 Project Forth Programme Assurance 23/24 Project Forth – audit area to be decided
Governance	30	23/24 Senior Managers and Certification Regime (SMCR) <i>BDO Compliance Assurance Monitoring Programme (LPFI)</i>
Regulatory Breach	30	
Information Rights	30	22/23 audits of Information Governance 23/24 - Information Security Arrangements
Delegations	30	No audit work proposed for 2023/24 as review and refresh of the scheme of delegations is currently underway.
Procurement	30	22/23 audit of Third-Party Contract Management
Staff Resource	30	23/24 People Processes
Recruitment	28	
Employer Contributions	28	No audit work proposed for 2023/24 – will be considered for future audit plans
Investment performance	25	No audit work proposed for 2023/24 <i>Mercer Systems and Controls Review (LPFI)</i>
Adverse Movement - pressure on employer contributions	25	No audit work proposed for 2023/24 – will be considered for future audit plans
Supplier and third-party systems	25	22/23 audit of Third-Party Contract Management 23/24 Information Security Arrangements

2023/24 Draft Internal Audit Plan

The following table sets out the draft LPF internal audit work programme for the period 1 April 2023 to 31 March 2024. 4.2.11 Reports detailing outcomes of each review will be presented to the Pensions Sub-Committee. All reviews completed for LPFI/LPFE will also be presented to the relevant Board.

While the audit plan includes a short summary of the area proposed for review, IA will meet with key officers prior to commencing each audit to further understand the key risks and to develop and refine the scope of each review. It should be noted, that if areas are identified during testing that are outwith scope but impact the risk and control framework, findings and recommendations will still be raised and reported on, where appropriate.

Audit	Assurance entity	Risks
<u>Information Security Arrangements</u> The audit will review the design of the suite of IT policies, standards and procedures that have been developed during 2022 to prevent, respond and manage information security across LPF, as well as ensuring they are aligned to the IT strategy due to be formalised during 2023.	All	Information Rights Supplier and Third-Party Systems
<u>Project Forth</u> Project Forth – audit to be decided. Suggested areas include project delivery or associated elements such as resulting Transfer of Undertakings - Protection of Employment (TUPE) or asset transfer.	All	Project and Change
<u>Business continuity and incident response</u> Review of the adequacy and operating effectiveness of key controls and processes established to provide assurance that LPF maintains business continuity plans to ensure they maintain services during an emergency or extended incident. Will include consideration of roles and responsibilities, policies and procedures, Business Continuity Plans, testing, lessons learned and monitoring and reporting arrangements.	All	Cyber Security
<u>Senior Managers and Certification Regime (SM&CR)</u> Review of the adequacy and operating effectiveness of governance processes established to provide assurance of compliance with the key elements and prescribed responsibilities of the SM&CR.	LPF LPFI	Regulatory breach
<u>People Processes</u> Review of the adequacy and operating effectiveness of established people processes to ensure robust controls are in place, complied with and support achievement of LPF objectives. Will include consideration of the employee lifecycle, and responsibilities of the People and Communications team which includes brand, people practices, strategic communications, and colleague, member, and employer engagement.	LPF LPFE	Staff resource/recruitment

Appendix 1 - Previously completed audits

The table below provides details of audit work completed over the last five years across LPF’s auditable areas.

2018/19	2019/20	2020/21	2021/22	2022/23
<ul style="list-style-type: none">• Stock Lending• Unitisation (Employer Asset Tracking)• Unlisted Investment Valuations and Application of Fund Administration Fees and Charges	<ul style="list-style-type: none">• Settlement and Custodian Services• Pensions Entitlement Calculations• Charles River Project – pre-implementation system testing	<ul style="list-style-type: none">• Cessations• Bulk Transfers	<ul style="list-style-type: none">• Risk Management• Capital Calls• Technology Model Development	<ul style="list-style-type: none">• Project Forth – Programme Assurance• Information Governance• Third-Party Supplier Management

Appendix 2: Current IA engagement definitions and proposed CIPFA standard definitions

Current Assurance Ratings	
Effective	The control environment and governance and risk management frameworks have been adequately designed and are operating effectively, providing assurance that risks are being effectively managed, and the Council's objectives should be achieved.
Some improvement required	Whilst some control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks, they provide reasonable assurance that risks are being managed, and the Council's objectives should be achieved.
Significant improvement required	Significant and / or numerous control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks. Consequently, only limited assurance can be provided that risks are being managed and that the Council's objectives should be achieved.
Inadequate	The design and / or operating effectiveness of the control environment and / or governance and risk management frameworks is inadequate, with a number of significant and systemic control weaknesses identified, resulting in substantial risk of operational failure and the strong likelihood that the Council's objectives will not be achieved.

Proposed Assurance Ratings	
Substantial Assurance	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.
Reasonable Assurance	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.
Limited Assurance	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.
No Assurance	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.



Pensions Audit Sub Committee

3.00pm, Tuesday, 21 March 2023

External Audit Annual Plan 2022/23 by Azets

Item number 6.4

1. Recommendations

The Pensions Committee (Committee) is requested to:

- 1.1 note the planned programme of work to support the statutory audit 2022/23. This is shown at Appendix 1 - "Lothian Pension Fund External Audit Annual Plan 2022/23" by Azets;
- 1.2 note that progress against the Lothian Pension Fund External Audit Annual Plan 2022-23 will be reported to future meetings of the Pensions Audit Sub-Committee and the Committee.

John Burns

Chief Finance Officer, Lothian Pension Fund

Contact: John Burns, Chief Finance Officer, Lothian Pension Fund

E-mail: lpfgovernancecomms@lpf.org.uk | Tel: 0333 996 1900

External Audit Annual Plan 2022/23 by Azets

2. Executive Summary

- 2.1 Azets, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2022/23. This is shown in full at Appendix 1.
- 2.2 Azets representative(s) will present the External Annual Audit Plan 2022/23 to Committee.

3. Background

- 3.1 Azets has been appointed by Audit Scotland as the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund (“the Funds”) for the period 2022/23 to 2026/27.

4. Main Report

- 4.1 Azets, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2022/23. This is provided in full at Appendix 1.
- 4.2 Progress against the plan will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Committee.

5. Financial impact

- 5.1 The proposed audit fee for 2022/23 is £51,590.
- 5.2 The audit fee is addressed in detail by Azets in Appendix 1, pages 30 to 31.

6. Stakeholder/Regulatory Impact

- 6.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the funds and it is invited to comment on the relevant matters at Committee meetings.

- 6.2 There are no adverse health and safety, governance, compliance or regulatory implications arising from this report. External audit is a critical part of the LPF Group's governance and assurance.

7. Background reading/external references

- 7.1 The responsibilities of Azets, 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.

8. Appendices

Appendix 1 – “Lothian Pension Fund External Audit Annual Plan 2022/23” by Azets.



Lothian Pension Fund

External Audit Annual Plan 2022/23

March 2023



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Introduction

Azets have been appointed by Audit Scotland as the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund (“the Funds”) for the period 2022/23 to 2026/27.

This document summarises the work plan for our 2022/23 external audit of the Funds.

The core elements of our work include:

- audits of the 2022/23 annual report accounts;
- consideration of the wider scope areas of public audit work;
- consideration of the Funds’ arrangements to secure Best Value;
- assessment of the Funds’ participation in the National Fraud Initiative (NFI); and
- any other work requested by Audit Scotland.

Adding value

All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. We will add value by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to promote improved standards of governance, better management and decision making and more effective use of public money.

Any comments you may have on the service we provide would be greatly appreciated. Comments can be reported directly to any member of your audit team.

Openness and transparency

This report will be published on Audit Scotland’s website www.audit-scotland.gov.uk.

Audit scope and general approach

Responsibilities of the auditor and the Funds

The [Code of Audit Practice](#) outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.

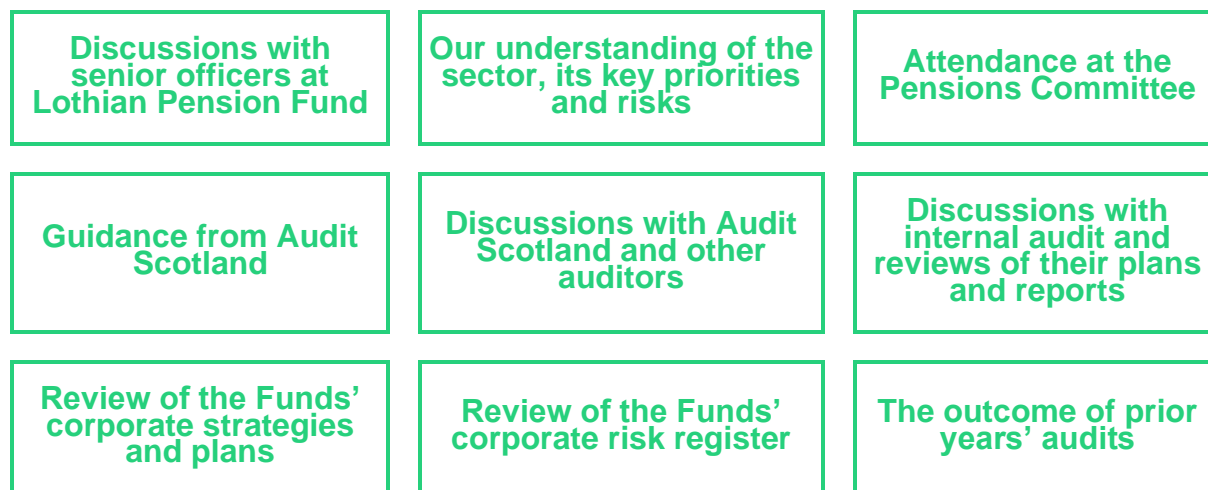
Auditor responsibilities are derived from statute, International Standards on Auditing (UK) and the Ethical Standard for auditors, other professional requirements and best practice, the Code of Audit Practice and guidance from Audit Scotland.

The Funds have primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices. The Funds are also responsible for compliance with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

[Appendix 1](#) provides further detail of both our responsibilities and those of the Funds.

Risk-based audit approach

We follow a risk-based approach to the audit 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:



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

Communication with those charged with governance

Auditing standards require us to make certain communications throughout the audit to those charged with governance. These communications will be through the Pension Committee.

Professional standards and guidance

We perform our audit of the financial statements in accordance with International Standards on Auditing UK (ISAs (UK)), Ethical Standards, and applicable Practice Notes and other guidance issued by the Financial Reporting Funds (FRC).

Partnership working

We 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.

Our new Audit Scotland appointments include Fife Pension Fund and where practicable and appropriate we will share knowledge to generate efficiencies in the delivery of our audits.

Audit Scotland

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 identify common priorities and risks, treat issues consistently across the sector, and improve audit quality and efficiency. We 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.

Audit Scotland undertakes national performance audits on issues affecting the public sector. We may review the Funds' arrangements for taking action on any issues reported in the national performance reports which may have a local impact. We also consider the extent to which the Funds uses the national performance reports as a means to help improve performance at the local level.

During the year we may also be required to provide information to Audit Scotland to support the national performance audits.

Internal Audit

As part of our audit, we consider the scope and nature of internal audit work and look to minimise duplication of effort, to ensure the total audit resource to the Funds are used as efficiently and effectively as possible.

Delivering the audit – post pandemic

Hybrid audit approach

We intend to adopt a hybrid approach to our audit which combines on-site visits with remote working; learning from the better practices developed during the pandemic.

All of our people have the equipment, technology and systems to allow them to work remotely or on-site, including secure access to all necessary data and information.

All of our staff are fully contactable by email, phone call and video-conferencing.

Meetings can be held over Skype, Microsoft Teams or by telephone.

We employ greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.

Secure sharing of information

We use a cloud-based file sharing service that enables users to easily and securely exchange documents and provides a single repository for audit evidence.

Regular contact

During the 'fieldwork' phases of our audit, we will arrange regular catch-ups with key personnel to discuss the progress of the audit. The frequency of these meetings will be discussed and agreed with management.

Signing annual accounts

Audit Scotland recommends the electronic signing of annual accounts and uses a system called DocuSign.

Electronic signatures simplify the process of signing the accounts. Accounts can be signed using any device from any location and there is no longer a need for duplicate copies to be signed.

Approach to audit of the annual accounts

Our objective when performing an audit of the annual accounts is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement and to issue an auditor's report that includes our auditor's opinion.

As part of our general approach, we will:

- perform risk assessment procedures including updating our understanding of the entity and its environment, the financial reporting framework and system of internal control;
- review the design and implementation of key internal controls;
- identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement level and the assertion level for classes of transaction, account balances or disclosures;
- design and perform audit procedures responsive to those risks, to obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion; and
- exercise professional judgment and maintain professional scepticism throughout the audit recognising that circumstances may exist that cause the financial statements to be materially misstated.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. We include an explanation in the auditor's report of the extent to which the audit was capable of detecting irregularities, including fraud and respective responsibilities for prevention and detection of fraud.

Key audit developments in 2022/23

Revised auditing standards¹, which come into effect from the current year, will have a significant impact on the way we perform our audit, particularly how we assess the risk of material misstatement, our approach to the audit of fraud, and the ways we ensure our audits are performed in line with regulatory requirements and to a high standard. The in-depth nature of these additional procedures, as well as updated tools and techniques that may come into scope, will also offer additional opportunity to provide insights and constructive feedback on the way the Funds manage risks. [Appendix 2](#) provides further details on the implications of these new requirements.

Materiality

We apply the concept of materiality both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgments about materiality are made in the light of surrounding circumstances and are affected by our perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both.

The basis for our assessment of materiality is set out in [Appendix 3](#).

Accounting systems and internal controls

The purpose of an audit is to express an opinion on the financial statements. As part of our work, we consider certain internal controls relevant to the preparation of the financial statements such that we are able to design appropriate audit procedures. However, this work is not for the purpose of expressing an opinion on the effectiveness of internal controls.

We will report to the Funds, significant deficiencies in internal controls that we identify during the audit. These matters will be limited to those which we conclude are of sufficient importance to merit being reported. The scope of our work is not designed to be an extensive review of all internal controls.

¹ Revisions to ISA (UK) 315 on auditors' responsibility to identify and assess the risks of material misstatement in the financial statements and ISA (UK) 240 on material misstatements caused by fraud came into effect for audits of financial statements with periods commencing on or after 15 December 2021.

Going concern

The concept of going concern applies in the public sector but in a different way to the private sector. In many public sector entities (but not all), the use of going concern basis of accounting is not a significant matter because the applicable financial reporting framework envisage that the going concern basis for accounting will apply where the entity's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist.

For many public sector entities, the financial sustainability of the entity is more likely to be of significant public interest that the application of the going concern basis. Our wider scope audit work considers the financial sustainability of the Funds.

Group audit scope and risk assessment

As Group auditor under ISA (UK) 600 we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Lothian Pension Fund has disclosed the following Group entities in their 2021/22 financial statements:

Component	Significant	Level of response required
LPFE Ltd	No	Analytical
LFPI Ltd	No	Analytical

Analytical - the component is not significant to the Group and audit risks can be addressed sufficiently by applying analytical procedures at the Group level.

Risks at the component-level

We will review the appropriateness of the Group entities during our audit. At this stage of our audit cycle we have not identified any risks in each component.

Prevention and detection of fraud or error

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. In particular we require to be notified of all frauds which:

- Involve the misappropriation of theft of assets or cash which are facilitated by weaknesses in internal control
- Are over £5,000.

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.

National Fraud Initiative

The National Fraud Initiative (NFI) in Scotland is a biennial counter fraud exercise led by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. The most recent NFI exercise commenced in 2022, with matches to be received for investigation from January 2023. As part of our 2022/23 audit, we will monitor the Lothian Pension Fund's participation and progress in the NFI.

Anti-money laundering

We require the Funds to notify us on a timely basis of any suspected instances of money laundering so that we can inform Audit Scotland who will determine the necessary course of action.

Correspondence

People or organisations write to Audit Scotland because they have concerns about an issue within a public body that falls under the remit of the Auditor General or the Accounts Commission. An issue of concern may be something such as a breakdown in financial management or governance arrangements.

The key factor in determining whether Audit Scotland examines an issue is the relevance of the issue to Audit Scotland's role and functions. Audit Scotland and appointed auditors will make this judgement using their professional and technical knowledge.

Wider audit scope work

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. [Appendix 1](#) provides detail of the wider scope areas of public sector audit work. Our initial risk assessment and scope of work planned for 2022/23 is outlined in the '[Wider Scope](#)' section of this plan.

National risk assessment

Where particular areas of national or sectoral risk have been identified by the Accounts Commission and Auditor General, they will request auditors to consider and report on those risks as they apply at a local level. For 2022/23 the following areas have been identified:

- Climate Change
- Cyber Security

[Appendix 4](#) provides further detail as to the scope of this work.

Best Value

Appointed auditors have a duty to be satisfied that local government bodies have made proper arrangements to secure best value.

Under the new Code of Audit Practice, the audit of Best Value in Lothian Pension Fund is fully integrated within the annual audit work performed by appointed auditors. We are required to evaluate and report on the performance of the Lothian Pension Fund in meeting their Best Value duties.

Reporting our findings

We will provide judgements on the pace and depth of improvement in reporting our findings on both Best Value and wider scope areas. We will use the following grading to provide an overall assessment of the arrangements in place as part of our Annual Audit Report.



Significant and other risks of material misstatement

Significant risks are risks that require special audit consideration and include identified risks of material misstatement that:

- our risk assessment procedures have identified as being close to the upper range of the spectrum of inherent risk due to their nature and a combination of the likelihood and potential magnitude of misstatement; or
- are required to be treated as significant risks due to requirements of ISAs (UK), for example in relation to management override of internal controls.

Significant risks at the financial statement level

The table below summarises the significant risks of material misstatement identified at the financial statement level. These risks are considered to have a pervasive impact on the financial statements as a whole and potentially affect many assertions for classes of transaction, account balances and disclosures.

Identified risk of material misstatement	Audit approach
<p>Management override of controls</p> <p>Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk.</p> <p>Risk of material misstatement: Very High</p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> • Documenting our understanding of the journals posting process and evaluating the design effectiveness of management controls over journals. • Analysing the journals listing and determining criteria for selecting high risk and / or unusual journals. • Testing high risk and / or unusual journals posted during the year and after the unaudited annual accounts stage back to supporting

Identified risk of material misstatement	Audit approach
	<p>documentation for appropriateness, corroboration and to ensure approval has been undertaken in line with the Funds' journals policy.</p> <ul style="list-style-type: none"> • Gaining an understanding of the accounting estimates and critical judgements made by management. We will challenge assumptions and consider the reasonableness and indicators of bias which could result in material misstatement due to fraud. • Evaluating the rationale for any changes in accounting policies estimate or significant unusual transactions.

Significant risks at the assertion level for classes of transaction, account balances and disclosures

The table below summarises the significant risks of material misstatement at the assertion level for classes of transaction, account balances and disclosures.

Identified risk of material misstatement	Audit approach
<p>Fraud in revenue recognition</p> <p>Material misstatement due to fraudulent financial reporting relating to revenue recognition is a presumed risk in ISA 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements).</p> <p>The presumption is that the Funds could adopt accounting policies or recognise income in such a way as to lead to a material misstatement in the reported financial position.</p> <p>Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of income around the year end.</p> <p>In respect of the contributions received from the Funds' funding partners, we do not consider the risk of revenue recognition to be significant due to a lack of incentive and opportunity to manipulate transactions of this nature.</p> <p>However, the risk of fraud in relation to revenue recognition is present in all other revenue streams.</p> <p>Inherent risk of material misstatement:</p> <ul style="list-style-type: none"> Revenue (occurrence / completeness): High 	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> Evaluation the significant income streams and review the controls in place over accounting for revenue. Consideration of the Funds' key areas of income and obtaining evidence that income is recorded in line with appropriate accounting policies and the policies have been applied consistently across the year.

Identified risk of material misstatement	Audit approach
<p>Fraud in non-pay expenditure</p> <p>As most public sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p> <p>Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of expenditure around the year end.</p> <p>Inherent risk of material misstatement:</p> <ul style="list-style-type: none"> • Non-pay expenditure (occurrence / completeness): High • Accruals (existence / completeness): High 	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> • Evaluating the significant non-pay expenditure streams and reviewing the controls in place over accounting for expenditure. • Consideration of the Funds' key areas of expenditure and obtaining evidence that expenditure is recorded in line with appropriate accounting policies and the policies have been applied consistently across the year. • Review of accruals around the year end to consider if there is any indication of understatement of balances held through consideration of accounting estimates.
<p>Investments valuations (key accounting estimate)</p> <p>The Funds held investments of £9.528 billion as at 31 March 2022, of which 33% (£3.175billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets.</p> <p>Judgements are taken by the Investment Managers to value those investments whose prices are not publicly 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</p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> • Evaluating management processes and assumptions for the calculation of the estimates, the instructions issued to the fund managers and the scope of their work. • Evaluating the competence, capabilities and objectivity of the fund managers. • Considering the basis on which the valuation is carried out and

Identified risk of material misstatement	Audit approach
<p>balance means that any error in judgement could result in a material valuation error.</p> <p>Inherent risk of material misstatement:</p> <p>Investments (valuation / existence): High</p>	<p>the challenge in the key assumptions applied.</p> <ul style="list-style-type: none"> • Testing the information used by the fund managers to ensure it is complete and consistent with our understanding. • Ensuring that the year end valuations have been reflected correctly in the ledger and that accounting treatment within the financial statements is correct.
<p>Investment property valuations (key accounting estimate)</p> <p>LPF hold a portfolio of investment properties which as at the 31 March 2022 was valued at £431 million. The management of the properties is undertaken by JLL, along with the Fund accounting for the portfolio. Investment properties are valued annually at fair value, in line with the Code.</p> <p>There is a significant degree of subjectivity in the measurement and valuation of investment properties. This subjectivity and the material nature of the Funds' investment property portfolio represents an increased risk of misstatement in the annual accounts.</p> <p>Inherent risk of material misstatement:</p> <p>Investment property (valuation / existence): High</p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> • Ensuring that investment properties are recorded in the annual accounts in accordance with the Code and the Funds' accounting policies, and have been accounted for appropriately. We will review investment property valuations. • Considering the competence, capability and objectiveness of the valuer in line with ISA (UK) 500 Audit Evidence. We will review the valuation report and consider the assumptions used by the valuer against external sources of evidence. • Considering the scope of the valuer's work and the information provided to the valuer for completeness.

Identified risk of material misstatement	Audit approach
<p>Present Value of Retirement Obligations (key accounting estimate)</p> <p>An actuarial estimate of the pension fund asset/liability is calculated on an annual basis under IAS 26 and on a triennial funding basis by an independent firm of actuaries with specialist knowledge and experience. The estimates are based on the most up to date membership data held by the Funds 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 assumptions used are not appropriate.</p> <p>Inherent risk of material misstatement:</p> <p>Retirement obligations (valuation):</p> <p>High</p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> • Reviewing the controls in place to ensure that the data provided to the actuary is complete and accurate. • Considering the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data. • Agreeing the disclosures in the financial statements to information provided by the actuary.

Wider scope

Introduction

As described previously, the Code of Audit Practice frames a significant part of our wider scope responsibilities in terms of audit areas:

- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

Our planned audit work against these four areas is risk based and proportionate. Our initial assessment builds upon our understanding of the Funds' key priorities and risks along with discussions with management and review of board minutes and key strategy documents.

We have identified one significant risk in relation to financial sustainability as set out in the table below. At this stage, we have not identified any significant risks in relation to the other wider scope areas.

In addition, we have considered emerging risks around Project Forth, a strategic project still awaiting administering authority deliberation and potential approval. However, due to confidentiality considerations of the Fund, no risk has been included in our plan at this stage. We expect that we will be able to further comment on the project in our Annual Audit Report.

Audit planning however is a continuous process and we will report all identified significant risks, as they relate to the four wider scope areas, in our annual audit report. This section summarises our audit work in respect of each wider scope area.

Wider scope significant risk

Financial sustainability

The Funds held investments of £9.528billion as at 31 March 2022. Investment strategies are in place for each of the funds which outline the Funds approach to ensure that all members and their dependents receive their benefits when they become payable. The investment strategy was updated and approved by the Pensions Committee in June 2021.

The primary objective of the Funds is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. The funding objectives for each Fund are documented in the Committee's Funding Strategy Statement, which is reviewed at least triennially. The funding objectives, together with the rates of return being targeted and levels of risk to be tolerated, are central to each Fund's investment strategy and govern the allocation across various asset classes.

The investment objectives of the Funds are to achieve a return on Fund assets which is sufficient over the long term to meet the funding objectives as outlined in the Funding Strategy Statement. Investment returns are generated by a combination of income (from dividends, interest and rents) and gains or losses on capital.

While it is noted that the Funds investment strategy is designed in such a way to withstand market volatility in the long term, we have noted that COVID-19, inflation levels and other worldwide political events had a significant impact on the market in the recent years. While the last two years saw a return to improved performance, a significant risk remains particularly in relation to impact of the increased inflation, expected government monetary policies and uncertainties in relation to geopolitical situation. There is a risk that the value of investments is significantly impacted by events within the wider environment.

Our audit response:

We will monitor the Funds approach to monitoring investment performance focusing on the identification of investment risk and the development of mitigating actions.

We will review the Funds investment return performance against benchmark over the short, medium and long term. We will also consider performance against comparators from other Scottish Local Government Pension Funds.

Our audit approach to the wider scope audit areas



Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Consideration	Our audit approach
<p>In 2021/22 we concluded that the Funds have effective arrangements in place to ensure the ongoing sustainability.</p> <p>The focus of the Funds' investment strategy is to ensure a sufficient return over the long term to meet the funding objectives outlined by the Funding Strategy Statement.</p> <p>The key financial indicator across pension funds in Scotland is the return on investments. LPF has delivered strong absolute performance in 2021/22 of 10.8% annual return on investments, which is higher than the benchmark returns of 8.8% while maintaining lower risk. The five-year and ten-year annualised investment returns remain below benchmark, due to significant below benchmark returns on equities in 2020/21 resulting from the defensive positioning.</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 Triennial Valuation was carried out as at 31 March 2020 and estimated both Funds were fully funded at 106% for LPF and 118% for Scottish Homes Pension Fund. This represents</p>	<p>During our 2022/2023 audit we will develop our assessment of the Funds' financial standing. We will review and conclude on:</p> <ul style="list-style-type: none"> • The arrangements in place for medium to long term financial planning, budgetary control and financial reporting; • The continued applicability of the 2020 actuarial valuation and the conclusions on funding levels across the Funds; and • Affordability for employers including the number of employer cessations and current membership levels of the Funds.

Consideration

an improvement on the previous triennial valuation where the funding levels were 98% and 105% respectively.

Our audit approach



Financial management

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

Consideration

In 2021/22 we concluded that the Funds have effective arrangements in place for financial management and the use of resources.

In 2021/22 the Funds reported a net increase in the funds held due to increases in market value of the investments. Lothian Pension Fund reported a net withdrawal position in dealings with members of £5.771 million. Scottish Homes reported a net withdrawal position of £6.836 million.

The Funds estimate the negative cashflows will be the case for the foreseeable future, but with the current levels of investment income there is no requirement for the assets selling to fund the ongoing pensioners payments.

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. Annual operating plan updates are provided to each Pension Committee meeting clearly explaining changes in group performance.

Our audit approach

During our 2022/23 audit we will review, conclude and report on the following:

- Whether the Funds continue to have arrangements in place to ensure systems of internal control are operating effectively;
- How the Funds have assured themselves that its financial capacity and skills are appropriate;
- The effectiveness of the financial and budgetary control system in communicating accurate and timely performance; and
- Whether the Fund has established appropriate and effective

Consideration

As reported to the December 2022 Pension Committee meeting the Funds estimate a small underspend of £0.736million on the projected outturn.

Our audit approach

arrangements for the prevention and detection of fraud and corruption.



Vision, Leadership and Governance

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

Consideration

The primary objective of the Funds is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. This aim is supported by two formal documents which establish the Funds' vision and strategy: Statement of Investment Principles and a Funding Strategy.

The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.

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.

Project Forth, a proposed merger between Lothian and Falkirk Pension Funds was approved by Lothian Pension Fund's Pensions Committee in September 2021. However, following the May 2022 council elections further consideration and approvals will be required, including those of City of Edinburgh Council and Falkirk Council as administering authorities. The Council is due to consider the proposal in later in the year.

Our audit approach

As part of our work on governance and transparency work in 2021/22 we will review, conclude and report on:

- Clarity of the vision and strategy and if these are supported by a set of priorities;
- Whether the Funds can demonstrate that the governance arrangements in place are appropriate and operating effectively;
- Whether induction arrangements for new Committee members support effective scrutiny and challenge;
- The transparency of decision-making, and on financial and performance reporting; and
- Progress of Project Forth implementation.



Use of resources to improve outcomes

Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

Consideration

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. During 2022 the Financial Conduct Authority permitted to lift £1.250billion cap on the assets LPFI is able to manage. This allows the company to provide further services to Falkirk and Fife pension funds.

The Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly, 3 yearly, 5 yearly and 10 yearly performance measures. This information is presented to the Joint Investment Strategy Panel to allow for scrutiny investment performance of the Funds.

In 2021/22 performance remained strong with nine out of the ten performance measures met. Investment performance and risk over a rolling five year period was noted as being below benchmark.

The Funds' also focus on administrative performance and have developed a Service

Our audit approach

As part of our 2022/23 audit we will review, conclude and report on the following:

- How the Funds' demonstrates a focus on improvement in the context of continuing and significant financial challenge;
- How the Funds provide a clear link between investment decisions and actual performance achieved;
- The effectiveness of working with partners including collaboration with Fife Council Pension Fund and Falkirk Council Pension Fund; and
- The process for tendering for new providers and consider this against the value for money principles

Consideration

Plan. The Pensions Committee receive updates on the service plan at each meeting.

The Funds also works collaboratively with other Local Government Pension Funds. It is hoped that collaborative structures will deliver efficiencies.

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.

Our audit approach

Your Azets audit management team

Nick Bennett: Engagement Lead

nick.bennett@azets.com

Nick has over 20 years' experience of public sector auditing and has been heavily involved in developing public sector accounting standards.

Nick's experience and expertise is acknowledged by both clients and other professionals right across the public sector.

Nick will be your appointed Engagement Lead.



Adrian Kolodziej: Engagement Manager

adrian.kolodziej@azets.co.uk

Adrian will manage the delivery of the onsite work and work alongside Nick to deliver the audit engagement. Adrian has over 14 years of public sector experience performing the external audits of local authorities, pension funds and central government bodies.



Audit timetable – to update

The submission date for audited annual accounts in local government is generally set to be consistent with the date specified in the accounts regulations by which the Funds are required to approve its audited accounts. The Coronavirus (Scotland) Act 2000 permitted a deferral in 2019/20 and 2020/21 to 30 November, and a temporary amendment to the accounts regulations allowed a submission date of 30 November for 2021/22. However, the submission date is returning to pre-pandemic 30 September for 2022/23.

We have set out below target months which align to the schedule of Pension Committee meetings. We aim to meet these scheduled meetings however this will be monitored during the audit process and may require to be revised to reflect emerging issues.

Audit work/output	Description	Target month/s	Pension Committee	Deadline
Audit plan	Planning meetings, understanding the entity, risk assessment. Audit plan setting out the scope of our audit, including key audit risks, presented to the Pension Committee	February / March	March 2023	31 March 2023
Interim audit	Interim audit including review of accounting systems.	March - June	N/A	N/A
Final audit	Accounts presented for audit and final audit visit begins	July - September	N/A	N/A

Audit work/output	Description	Target month/s	Pension Committee	Deadline
Independent Auditor's Report	This report will contain our opinion on the financial statements, the audited part of the remuneration report, annual governance statement and management commentary.	September	September 2023	30 September 2023
Annual Report to the Pension Committee and the Controller of Audit	At the conclusion of each year's audit we issue an annual report setting out the nature and extent of our audit work for the year and summarise our opinions, conclusions and the significant issues arising from our work. This report pulls together all of our work under the Code of Audit Practice.	September	September 2023	30 September 2023

Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.

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

For 2022/23, the new appointment process provided Audit Scotland with a fair representation of the current audit market for each individual body with the outcome of this exercise highlighting the increasing requirements, expectations and scrutiny of the audit profession.

The quality of audit work is an essential requirement in successfully delivering a fully compliant ISA and Code of Audit Practice audit. These factors have led to above inflationary increases in the cost of audit. Whilst these increases are significant these are consistent with evidence obtained from the profession and other UK audit agencies. On setting fees, Audit Scotland has ensured that efficiencies have been fully utilised to mitigate the impact.

For the local government sector, the average fee increase is 12.5%. For the Funds this equals to £5,750 which is a difference between the 2022/23 net fee of £51,590 and the base audit fee from 2021/22 of £45,840.

Audit Scotland sets an expected audit fee 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.

As auditors we negotiate a fee with the Funds during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.

The breakdown of the fee increases for 2022/23 is shown in the table below.

	2022/23	2021/22
Auditor remuneration	£64,360	42,579
Pooled costs	-	4,130
Contribution to PABV costs	-	-
Audit support costs	£2,440	2,110
Sectoral cap adjustment	-£15,210	-
Total fee	£51,590	£48,819
		(£45,840 base fee)

We will take account of the risk exposure of the Funds and the management assurances in place. We assume receipt of the draft 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.

Audit independence and objectivity

Appendix 2: 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.

In particular, FRC's Ethical Standard stipulate that where an auditor undertakes non audit work, appropriate safeguards must be applied to reduce or eliminate any threats to independence.

Azets provides accounts preparation, corporation tax services and ad hoc VAT advice to LPFE Ltd and LPFI Ltd which are subsidiaries of Lothian Pension Fund. In 2022/23 non-audit fees are estimated to be c.£9,000.

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 Azets. In addition to this, Azets also iXBRL tag the financial statements for submission to HMRC along with the corporation tax return. This tagging exercise is performed by an individual who is not involved in the audit of the financial statements.

We confirm that we comply with FRC's Ethical Standards. In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Azets and the Funds, its committee members and senior management that may reasonably be thought to bear on our objectivity and independence.

Appendix 1: Responsibilities of the Auditor and the Funds

The Accounts Commission, Controller of Audit and Audit Scotland

The Accounts Commission is an independent public body. Its members are appointed by Scottish Ministers and are responsible for holding local government to account.

Under statute, the Accounts Commission appoints a Controller of Audit to consider the results of the audit of accounts, including the wider-scope responsibilities and Best Value auditing. The Controller of Audit makes reports to the Accounts Commission on matters arising from the accounts and on Best Value and acts independently of the Accounts Commission when reporting to it.

Audit Scotland is an independent statutory body that co-ordinates and supports the delivery of high-quality public sector audit in Scotland. Audit Scotland oversees the appointment and performance of auditors, provides technical support, delivers performance audit and Best Value work programmes and undertakes financial audits of public bodies.

Auditor responsibilities

Code of Audit Practice

The Code of Audit Practice (the Code) describes the high-level, principles-based purpose and scope of public audit in Scotland. The [2021 Code](#) came into effect from 2022/23.

The Code of Audit Practice outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.

Our responsibilities

Auditor responsibilities are derived from the Code, statute, International Standards on Auditing (UK) and the Ethical Standard for auditors, other professional requirements and best practice, and guidance from Audit Scotland.

We are responsible for the audit of the accounts and the wider-scope responsibilities explained below. We act independently in carrying out our role and in exercising professional judgement. We report to the Pension Committee and others, including Audit Scotland, on the results of our audit work.

Weaknesses or risks, including fraud and other irregularities, identified by auditors, are only those which come to our attention during our normal audit work in accordance with the Code and may not be all that exist.

Wider scope audit work

Reflecting the fact that public money is involved, public audit is planned and undertaken from a wider perspective than in the private sector.

The wider scope audit specified by the Code broadens the audit of the accounts to include additional aspects or risks in areas of financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes.

Financial management



Financial management means having sound budgetary processes. Audited bodies require to understand the financial environment and whether their internal controls are operating effectively.

Auditor considerations

Auditors consider whether the body has effective arrangements to secure sound financial management. This includes the strength of the financial management culture, accountability, and arrangements to prevent and detect fraud, error and other irregularities.

Financial sustainability



Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Auditor considerations

Auditors consider the extent to which audited bodies show regard to financial sustainability. They look ahead to the medium term (two to five years) and longer term (over five years) to consider whether the body is planning effectively so it can continue to deliver services.

Vision, leadership and governance



Audited bodies must have a clear vision and strategy, and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

Auditor considerations

Auditors consider the clarity of plans to implement the vision, strategy and priorities adopted by the leaders of the audited body. Auditors also consider the effectiveness of governance arrangements for delivery, including openness and transparency of decision-making; robustness of scrutiny and shared working arrangements; and reporting of decisions and outcomes, and financial and performance information.

Use of resources to improve outcomes



Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency and effectiveness through the use of financial and other resources, and reporting performance against outcomes.

Auditor considerations

Auditors consider the clarity of arrangements in place to ensure that resources are deployed to improve strategic outcomes, meet the needs of service users taking account of inequalities, and deliver continuous improvement in priority services.

Best Value

Appointed auditors have a duty to be satisfied that local government bodies have made proper arrangements to secure best value.

Our work in respect of the Funds' best value arrangements is integrated into our audit approach, including our work on the wider scope areas as set out in this plan.

Audit quality

The Auditor General and the Accounts Commission require assurance on the quality of public audit in Scotland through comprehensive audit quality arrangements that

apply to all audit work and providers. The audit quality arrangements recognise the importance of audit quality to the Auditor General and the Accounts Commission and provide regular reporting on audit quality and performance.

Audit Scotland maintains and delivers an [Audit Quality Framework](#).

The most recent audit quality report can be found at <https://www.audit-scotland.gov.uk/publications/quality-of-public-audit-in-scotland-annual-report-202122>

Funds responsibilities

The Funds have 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 enables it to successfully deliver its objectives. The features of proper financial stewardship include the following:

Area	Funds responsibilities
Corporate governance	<p>The Funds are responsible for establishing arrangements to ensure the proper conduct of its 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>
Financial statements and related reports	<p>The Funds have responsibility for:</p> <ul style="list-style-type: none"> • preparing financial statements which give a true and fair view of its financial position and its expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support its financial statements and related reports disclosures; • ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority; and • preparing and publishing, along with the financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report in accordance with prescribed requirements. Management commentaries should be fair, balanced and understandable. <p>Management is responsible, with the oversight of those charged with governance, for communicating relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.</p>

Area	Funds responsibilities
	<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 its objectives and safeguard and secure value for money from the public funds at its disposal. The Funds is also responsible for establishing effective and appropriate internal audit and risk-management functions.</p>
Standards of conduct for prevention and detection of fraud and error	<p>The Funds are responsible for establishing 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>
Financial position	<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"> • Such financial monitoring and reporting arrangements as may be specified; • Compliance with statutory financial requirements and achievement of financial targets; • Balances and reserves, including strategies about levels and their future use; • Plans to deal with uncertainty in the medium and long term; and • The impact of planned future policies and foreseeable developments on the financial position.
Best value	<p>The Funds have a specific responsibility to make arrangements to secure Best Value. Best Value is defined as continuous improvement in the performance of the body's functions. In securing Best Value, the local government body is required to maintain an appropriate balance among:</p> <ul style="list-style-type: none"> • The quality of its performance of its functions

Area	Funds responsibilities
	<ul style="list-style-type: none"> • The cost to the body of that performance • The cost to persons of any service provided by it for them on a wholly or partly rechargeable basis. <p>In maintaining that balance, the Funds shall have regard to:</p> <ul style="list-style-type: none"> • Efficiency • Effectiveness • Economy • The need to meet the equal opportunity requirements. <p>The Funds should discharge its duties in a way which contributes to the achievement of sustainable development.</p> <p>In measuring the improvement of the performance of a local government body's functions for the purposes of this section, regard shall be had to the extent to which the outcomes of that performance have improved.</p> <p>The Scottish Government's Statutory Guidance on Best Value (2020) requires bodies to demonstrate that they are delivering Best Value in respect of seven themes:</p> <ol style="list-style-type: none"> 1. Vision and leadership 2. Governance and accountability 3. Effective use of resources 4. Partnerships and collaborative working 5. Working with communities 6. Sustainability 7. Fairness and equality. <p>Specified audited bodies are required to prepare and publish performance information in accordance with Directions issued by the Accounts Commission.</p>

Appendix 2: Potential impact on the Funds and our audit approach following revisions to auditing standards

Revised auditing standards, which come into effect from the current year, will have a significant impact on the way we perform our audit, particularly how we assess the risk of material misstatement, our approach to the audit of fraud, and the ways we ensure our audits are performed in line with regulatory requirements and to a high standard. The table below provides further detail on the implications of these new requirements.

Key change	Potential impact on the Funds & our approach
Enhanced risk identification and assessment, promoting more focused auditor responses to identified risks	<p>Management and those charged with governance may receive more up-front questions as we plan the audit and identify and assess risks of material misstatement.</p> <p>We may conduct planning and risk assessment procedures at a different time to ensure that our understanding is comprehensive, and that information is leveraged effectively and efficiently.</p> <p>To facilitate a more robust risk-assessment, we may request additional information to enhance our understanding of systems, processes and controls. For example, we may request:</p> <ul style="list-style-type: none"> • a better understanding of the Funds' structure and operations and how it integrates information technology (IT) • more information about the Funds' processes for assessing risk and monitoring its system of internal control

Key change	Potential impact on the Funds & our approach
	<ul style="list-style-type: none"> • more detailed narratives about how transactions are initiated, recorded, processed and reported • policies and procedure manuals, flowcharts and other supporting documentation to validate our understanding of the information systems relevant to the preparation of the financial statements • more information to support our inherent risk assessment. <p>This information not only informs our risk assessment but also assists us in determining an appropriate response to risks identified, including any new significant risks which require a different response.</p>
Understanding and acting on risks associated with IT	<p>We will be asking tailored questions and making information requests to understand the IT environment, including:</p> <ul style="list-style-type: none"> • IT applications • supporting IT infrastructure • IT processes • personnel involved in the IT processes. <p>Combined with the controls that may be needed to address the identified and assessed risks of material misstatement, this understanding may also identify existing and new risks arising from the use of IT. Therefore, we will be asking more focused questions and requesting additional information to understand the general IT controls that address such risks. For example, we may have questions in relation to general IT controls over journal entries (e.g., segregation of duties related to preparing and posting entries) to address risks arising from the use of IT.</p> <p>Depending on our assessment of the complexity of systems and associated risks, we may also involve additional team members, such as IT specialists.</p>
Enhanced procedures in connection with fraud	<p>We will be asking targeted questions as part of an enhanced approach to fraud, including discussing with the Funds:</p> <ul style="list-style-type: none"> • any allegations of fraud raised by employees or related parties

Key change	Potential impact on the Funds & our approach
	<ul style="list-style-type: none"> the risks of material fraud, including those specific to the local government sector. <p>Combined with other information, and any inconsistencies in responses from those charged with governance and management, we determine implications for further audit procedures. Work in connection with fraud may also now include the use of audit data analytics, or the inclusion of specialists in our engagement team to ensure we obtain sufficient appropriate audit evidence to conclude whether the financial statements are materially misstated as a result of fraud.</p> <p>In addition to existing communication and reporting requirements relating to irregularities and fraud, there may be further matters we report in connection with management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud.</p> <p>These enhanced requirements may assist in the prevention and detection of material fraud, though do not provide absolute assurance that all fraud is detected or alter the fact that the primary responsibility for preventing and detecting fraud rests with the Funds and management.</p>
Enhanced requirements for exercising professional scepticism	<p>Challenge, scepticism and the application of appropriate professional judgement are key components of our audit approach. You may receive additional inquiries if information is found that contradicts what our team has already learned in the audit or in instances where records or documents seen in the course of the audit appear to have been tampered with, or to not be authentic.</p>
Using the right resources, in the right way, at the right time	<p>One of our new strategic quality objectives sets out that we will strive to use the right resource, in the right way, at the right time. This may mean increasing the use of specialists (for example in relation to general IT controls) or changing the shape of the audit engagement team to ensure that we are able to provide appropriate challenge and feedback in specialist areas.</p> <p>This will include appropriate use of technology, including data analytics.</p>

Appendix 3: Materiality

Materiality is an expression of the relative significance of a matter in the context of the 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 and is affected by our assessment of the risk profile of the organisation and the needs of users. We review our assessment of materiality throughout the audit.

Whilst our audit procedures are designed to identify misstatements which are material to our audit opinion, we also report to the Funds and management any uncorrected misstatements of lower value errors to the extent that our audit identifies these.

Group and the Funds materiality (£million)

	Group	Lothian Pension Fund	Scottish Homes Pension Fund
Overall materiality for the financial statements	143	143	2.3
Performance materiality	107.3	107.3	1.7
Trivial threshold	0.250	0.250	0.115
Materiality	<p>Our initial assessment is based on approximately 1.5% of the group and Funds' 2021/22 net investment assets as disclosed in the 2021/22 audited annual accounts. We consider this to be the principal consideration for the users of the annual accounts when assessing financial performance of the Funds' and the group.</p> <p>In performing our audit we apply a lower level of materiality to the audit of the Remuneration Report. Our materiality is set at £5,000.</p>		
Performance materiality	<p>Performance materiality is the working level of materiality used throughout the audit. We use performance materiality to determine the nature, timing and extent of audit procedures carried out. 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</p>		

	<p>level of testing on the areas deemed to be at significant risk of material misstatement.</p> <p>Performance materiality is set at a value less than overall materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed overall materiality.</p>
Trivial misstatements	<p>Trivial misstatements are matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.</p>

Special materiality for dealings with members (£million)

	Group	Lothian Pension Fund	Scottish Homes Pension Fund
Dealings with members materiality	13.1	13.1	0.34
Performance materiality	9.8	9.8	0.25
Trivial threshold	0.250	0.250	0.017

Materiality	<p>We apply lower materiality for dealings with members, based on the fact these transactions are significant to the Funds' activities and it would not be appropriate to use the assets based materiality to them. Our initial assessment is based on approximately 5% of the group and Funds' 2021/22 gross expenditure as disclosed in the 2021/22 audited annual accounts. We consider this to be the principal consideration for the users of the annual accounts when assessing financial performance of the Funds' and its group.</p>
Performance materiality	<p>Using our professional judgement, we have calculated performance materiality at approximately 75% of overall materiality.</p>

Appendix 4: National risk areas under scope of audit in 2022/23

Climate change

Tackling climate change is one of the greatest global challenges. The Scottish Parliament has set a legally binding target of becoming net zero by 2045, and has interim targets including a 75% reduction in greenhouse gas emissions by 2030. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

There are specific legal responsibilities placed on public bodies to contribute to reducing greenhouse gas emissions, to adapt to climate change, to act sustainably and to report on progress. A number of public bodies have declared a climate emergency and set their own net zero targets, some of which are earlier than Scotland's national targets. All public bodies will need to reduce their direct and indirect emissions, and should have plans to do so. Many bodies will also have a role in reducing emissions in wider society, and in supporting activity to adapt to the current and potential future impact of climate change. For example, working with the private sector and communities to help drive forward the required changes in almost all aspects of public and private life, from transport and housing to business support.

Public audit has an important and clear role to play in:

- helping drive change and improvement in this uncertain and evolving area of work
- supporting public accountability and scrutinising performance
- helping identify and share good practice.

The Auditor General and Accounts Commission are developing a programme of work on climate change. This involves a blend of climate change-specific outputs that focus on key issues and challenges as well as moving towards integrating climate change considerations into all aspects of audit work.

For 2022/23 audits, auditors are required to provide answers to the questions set out in the following table which are intended to gather basic information on the arrangements for responding to climate change in each body:

Key questions

What targets has the body set for reducing emissions in its own organisation or in its local area?

Does the body have a climate change strategy or action plan which sets out how the body intends to achieve its targets?

How does the body monitor and report progress towards meeting its emission targets internally and publicly?

Has the body considered the impact of climate change on its financial statements?

What are the areas of the financial statements where climate change has, or is expected to have, a material impact?

Does the body include climate change in its narrative reporting which accompanies the financial statements and is it consistent with those financial statements?

Cyber security

There continues to be a significant risk of cyber-attacks to public bodies, and it is important that they have appropriate cyber security arrangements in place.

A number of recent incidents have demonstrated the significant impact that a cyber-attack can have on both the finances and operation of an organisation.

For 2022/23 audits, auditors are advised to consider risks related to cyber security at audited bodies. However, the revised ISA (UK) 315 includes enhanced requirements for auditors to understand a body's use of IT in its business, the related risks and the system of internal control addressing such risks. The Auditor General and Accounts Commission consider that meeting these additional requirements is likely to be sufficient consideration of cyber security in 2022/23.

Appendix 5: Best Value 2022/23 Thematic Review

The Best Value thematic work for 2022/23 requires auditors to carry out an overview of the effectiveness of Funds leadership (officers and elected members) in developing new local strategic priorities following the elections in May 2022. In carrying out the overview, we will look to answer the following questions:

Key questions
How clear is the new Funds vision and its priorities?
How effectively have the views of citizens and communities been reflected in the priorities and decisions taken by the Funds?
How effectively do the Funds priorities reflect the need to reduce inequalities and climate change??
How good are the delivery plans and is there alignment of financial, workforce, asset and digital plans with the Funds's priorities
Overall, how effective has the leadership been (political and officer) in setting clear priorities and a sustainable approach to delivering them

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Pensions Audit Sub Committee

3.00pm, Tuesday, 21 March 2023

Risk Management Summary

Item number 6.5

1. Recommendations

The Pensions Audit Sub Committee (Committee) is requested to:

- 1.1 note the LPF group's Risk Register and Quarterly Risk Overview, and raise any relevant points arising from the review with the Pensions Committee on 23 March; and
- 1.2 note that exploratory work and analysis has commenced regarding the creation of a single integrated audit programme for LPF, however due to governance complexities and ambiguities with existing arrangements, no changes will be made in the 2023/24 cycle arrangements, and the proposed scope of CEC's Internal Audit plan for the next year will be extended to provide coverage to LPFE and LPFI.

Kerry Thirkell

Chief Risk Officer, Lothian Pension Fund

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Risk Management Summary

2. Executive Summary

- 2.1 This paper provides an overview of monitoring and assurance undertaken in LPF since the last meeting, noting any material observations or exceptions.
- 2.2 This paper also provides a summary of the work to enhance current risk management arrangements.

3. Risk Management Arrangements

- 3.1 Having noted the intention to review the risk management arrangements in the previous report, a detailed paper and operating plan have been created to support the proposed changes to LPF's existing risk management arrangements. The proposed improvements and additions to existing arrangements will create a framework based on the following principles:
- focus on managing risk across the business in a proportionate and pragmatic way, and which acknowledges finite resources across the business and within the R&C team;
 - ensure arrangements are scalable with an emphasis on investing for the future and building resiliency; and
 - reduce complexity by standardising processes wherever possible and
 - appropriate and not doing different things within different parts of LPF group.
- 3.2 The proposed enhancements can be broken into three key parts which will be delivered through a two year programme:
- Risk Management Framework review;
 - Procurement of a Governance Risk & Compliance system; and
 - Operating model of the Risk & Compliance team.
- 3.3 The programme of work has already commenced. A key part of the operational plan will be an evaluation of the effectiveness of changes as they are introduced and embedded, through observation, feedback and testing. Willingness and flexibility to adapt, change, modify or remove aspects is critical to the successful implementation and embedding of the new risk management framework and any changes will need business support and engagement. Training and awareness will underpin the programme and ensure that staff understand their role in the framework. Specific training sessions, attendance at team meetings, drop in sessions and lunch and learns will all be considered for raising staff awareness and understanding around

risk management. Regular updates will be provided to the Committee on the programme.

4. Monitoring & Assurance Summary

Themed Reviews

4.1 Investment Services Review

4.1.1 A themed review on Investment Services commenced in Q4 2022, to evaluate LPFI's regulated activities to ensure LPFI is continuing to meet ongoing FCA regulatory requirements and demonstrate good business practice. This review has now concluded, noting several material findings requiring prompt remediation. The themes include:

- Governance & Conflicts
- Client Management (and presentation of 'advice')
- Documentation & Record-keeping
- Risk Management Framework
- Middle Office
- Supplier Management

4.1.2 The review was undertaken by external consultants, Derek Pennor and Andrew Johnstone, pulling on their extensive industry knowledge and experience and time served at the FCA.

4.1.3 A remediation programme is being developed to address the observations. Coincidentally, the FCA issued a Dear CEO Letter (a standard regulatory communication) to all asset management firms on 3 February on their Asset Management Supervision Strategy. This communication highlights the areas and themes that FCA will focus on throughout 2023 and beyond, and explains that it expects all regulated firms to consider how the risks of harm highlighted are being managed. Themes contained in the letter relevant to LPFI around operational resiliency and managing suppliers, as well as aspects of the risk management framework resonate with some of the themes observed in the Investment Services review. Consequently, we are confident that LPFI will be well placed to address these FCA focus areas due to the proposed risk management framework improvements already identified, and the programme anticipated to remediate gaps and weaknesses highlighted through the Investment Services review.

Financial Crime Review

4.2 A themed review of Financial Crime has commenced and the first part is expected to complete by end Q1 2023. This review is split into two parts, the first covering Anti-

Money Laundering, Counter Terrorist Financing and Sanctions, with the second part covering Anti-Bribery and Corruption, Market Abuse and Fraud. The purpose of this review programme is to evaluate the adequacy and effectiveness of the arrangements in place to manage the risks of financial crime, and consider if there are appropriate systems and controls to ensure we continue to meet relevant legal requirements and regulatory guidance.

BDO Compliance Monitoring Programme (CMP)

- 4.3 All testing scheduled for the Q4 2022 period was satisfactorily completed. A total of 7 new issues were identified and are noted below.

Best Execution review

- 4.4 A one-off Best Execution themed review was completed in December 2022 by BDO. This review by BDO was commissioned earlier in 2022, to evaluate the effectiveness of LPFI's processes and controls in relation to best execution – which is the obligation to execute client orders on terms most favourable to them.
- 4.5 The review concluded that LPFI should formalise execution monitoring procedures across equity and fixed income portfolios, to be better able to evidence consistent best execution for clients. The report noted that:
- There is a clear order execution policy setting out LPFI's approach to best execution. This policy is issued to clients and is publicly available on LPFI's website.
 - There is a good understanding across both fixed income and equity teams on the best execution obligations and the need to obtain best possible results in the execution of orders.
 - However, there are no documented procedures describing how monitoring of these results is carried out. There is also insufficient evidence of internal review and sign off of monitoring done, outcomes and resolution.

Findings & Recommendations

- 4.6 The following enhancements were recommended by BDO:
- consistent onboarding training modules for new joiners;
 - identify material risk takers, in line with remuneration code requirements;
 - improve version control records for committee terms of reference and policies;
 - conflicts of interest documentation, including how they are mitigated;
 - registering NEDs as FCA Directory persons;
 - establishing a BCP testing schedule, with appropriate reporting to senior management; and

- Enhanced best execution procedures, and consistency across equity/fixed income.

Non-FCA Compliance Monitoring Programme ('CMP')

- 4.7 As reported previously, a broader reaching CMP has been developed to provide more substantive oversight and assurance in respect of non-FCA regulatory requirements, predominantly covering The Pensions Regulator ('tPR') requirements. We expect to develop this complimentary monitoring further during the course of 2023 and meanwhile the highlights from Q4 results are noted below.
- 4.8 75 tests were undertaken, with 51 of these assessed as 'fully compliant'. The remaining tests were not fully compliant primarily due to:
- 4.9 Poor or incomplete record keeping. A number of tests showed no documentary evidence existed for processes. Follow-up verbal discussions provided some comfort that processes had been carried out – but unable to independently verify.
- 4.10 Processes not clearly defined or repeatable. This is consistent with findings raised in other assurance by audit or BDO – general lack of written processes and procedures.
- 4.11 All issues identified above through monitoring and assurance work will continue to be recorded and tracked through the standard issue management process.

Internal Audit

- 4.12 Details of recent and current internal audit engagements are noted below:

4.12.1 Project Forth Governance

A review in respect of Project Forth governance was completed in Q4 2022. The findings did not highlight any material observations and have raised some recommendations regarding project management best practice and change control. These items have been added to the LPF issue log and will be tracked and reported on in line with standard procedures.

4.12.2 Third Party Supplier Management

The objective of this review was to assess the adequacy of design and current operating effectiveness against industry good practices to ensure LPF has appropriate arrangements in place to manage its third-party suppliers. This review has concluded and we await the final report.

4.12.3 Information Governance

This review is in progress. It's objective is to assess the adequacy of design effectiveness of the key controls over data strategy and information governance, including how the roles and responsibilities of LPF stakeholders fit together to ensure that the data is managed well, as well as reviewing data classification and ownership, and data content management.

4.12.4 Adequacy of Technology Security Assurance Arrangements

This audit has been delayed but due to start in late February. The purpose of this audit is to perform a high-level review of the relevant IT policies, standards and procedures that have been developed during 2022 to prevent, respond and manage cybersecurity information security across LPF, as well as ensuring these are aligned to IT strategy.

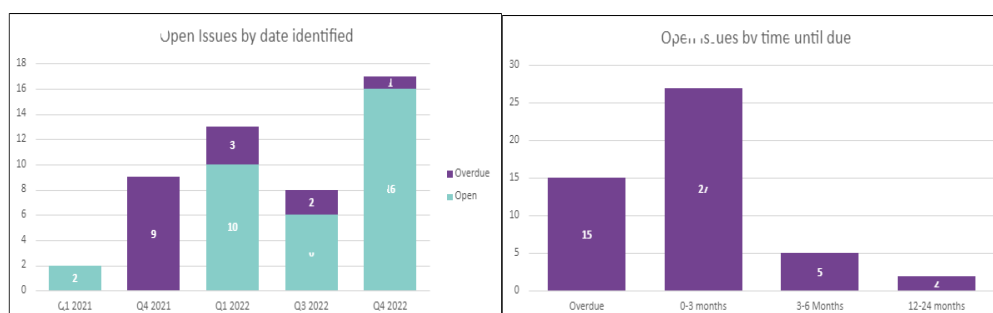
- 4.13 Noting earlier support from the Pensions Committee and Audit Sub-Committee, as well as the LPFI & LPFE Boards in December to extend the scope of LPF internal audit arrangements to include LPFI and LPFE, exploratory work and analysis has commenced. Although there is a clear appetite to create a single integrated audit programme, and to engage directly with an internal audit service provider (preferably PwC to leverage existing LPF relationship and knowledge), rather than through CEC arrangements, the steps required to do so are ambiguous. There are also conflicting views regarding the governance steps required to remove LPF from the existing CEC arrangements and connected co-source agreement with PwC, with a view to engaging directly with PwC on a wider LPF 'group' scope. Therefore, no changes will be made to arrangements for the forthcoming audit cycle.
- 4.14 Meanwhile, we have discussed possible reviews for the 23/24 period with CEC Internal Audit, acknowledging a desire to extend the current LPF arrangements to ensure the scope of these reviews are relevant to, and appropriate for, LPFI and LPFE, to provide some independent 3LoD assurance for these entities. Presented to the Committee separately, CEC Internal Audit will propose and seek approval for the following reviews to be covered in their 23/24 plan:
- **Project Forth:** a follow up review to the governance review undertaken during Q4 22, with scope to be agreed as the merger progresses
 - **Business Continuity & Incident Response:** the audit will consider general business continuity controls as the organisation transitions to post pandemic operations
 - **Senior Managers & Certification Regime:** to provide assurance of compliance with the key elements and prescribed responsibilities of the SM&CR
 - **People Processes:** to provide assurance on the people processes supporting the employee lifecycle.

Issues & Incidents

- 4.15 Improvements continue to be made to the processes, governance and reporting regarding LPF Issues and incidents. A summary status of issues and incidents from Q4 2022 is noted below.

4.15.1 Issues

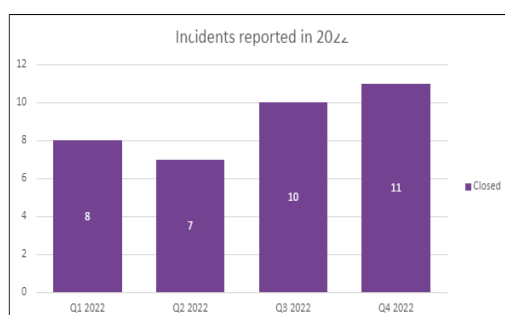
During Q4, 40 issues were closed and 19 new ones were raised. At the close of the quarter, there were a total of 49 open issues. These issues comprise findings from internal audit and 2LoD (including BDO CMP) monitoring and assurance work, as well as any other self-identified items.



- 4.15.2 At the time of writing, there are currently 49 open issues. For those open issues, 15 of these are overdue, the majority of which are in relation to information security/technology related findings. 27 issues have a due date by the end of March 2023 and the Risk & Compliance team continue to actively engage with issue stakeholders to ensure agreed actions are being taken.

4.15.3 Incidents

Eleven incidents were raised during Q4 2022, 4 of which were classified as FCA regulatory breaches, and one as a non-reportable data breach. Required actions to remediate these incidents were completed during Q4, and all incidents were subsequently closed.



- 4.16 As the quality of information being recorded continues to improve, over time, more meaningful reporting will be developed that will support identification of common

themes or trends. Meanwhile, 3 further incidents have been raised within LPF 'group' in Q1, and remain under investigation.

4.17 Further information on issues and incidents is available on request.

5. Financial impact

5.1 There are no direct financial implications as a result of this report.

6. Stakeholder/Regulatory Impact

6.1 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.

6.2 Except as otherwise stated in the report itself, there are no adverse health and safety, governance, compliance or regulatory implications as a result of this report.

7. Background reading/external references

7.1 None.

8. Appendices

Appendix 1 – Quarterly Risk Summary as at 7 February 2023



Quarterly Risk Overview

07 Feb 2023

Executive Summary

This document provides a summary of the assessment of the LPF group's risks by the Risk Management Group (RMG) on 7 Feb 2023. The RMG reviews the LPF group risk register on at least a quarterly basis.

Risk Register at 07 Feb 2023

Total risks	High	Moderate	Low
39	1*	12	26

*see Regulatory Breach summary below

See Appendix 2 for full list of risks.

Changes since last review 07 Nov 2022:

New	Closed	Improved	Deteriorated	Unchanged
1	1	2	1	35

Summary of changes:


- New - **Key Person** risk added.
- Closed - **Power Outage** risk removed.
- Improved - **Data Protection & Information Rights** risk scores improved.
- Deteriorated - **Regulatory Breach** risk score worsened, from Moderate to High, to take into account observations from the Investment Services review.

Further detail is provided on the following pages.

New and Closed Risks

Any risks added or removed from register since last RMG meeting on 07 Nov 2022.

New risk:







Risk	Score	Movement	Update
39. Key Person Risk of disruption due to key person absence or departure, caused by over-reliance without succession plans or cover, leading to material impact on business operations.	 25	N/A - new	New risk added at RMG, Feb 2023, regarding risk of disruption due to unforeseen key personnel absence or departure. LPF's small size means we must accept some element of key person risk, although existing mitigants are in place. Succession plans are in place and reviewed at least annually by LPFE Board.

Closed risk:

Risk	Score	Movement	Update
Power outages Risk of energy outages caused by planned or unforeseen blackouts, leading to operational disruption.	N/A	N/A - closed	Decision taken Feb 23 to close risk. Probability of planned or unforeseen blackouts now reduced - existing business continuity & disaster recovery measures judged sufficient, no further mitigating actions required.









Risk Scoring Changes











Score changes to existing risks since last RMG meeting on 07 Nov 2022.





Risk	Score	Movement	Update
9. Regulatory Breach Risk of regulatory breach, caused by failure of processes, systems or controls, leading to reputational damage or enforcement action.	 35	 Deteriorated	Score deteriorated from 30 to 35, Amber to Red, due to an increase in probability. Current Investment Services assurance work has provisionally identified potential FCA regulatory breaches within LPFI. Probability has therefore increased to likely. Indication is no material or significant reportable breaches, waiting for final report and validation of findings.
12. Data Protection Breach of Data Protection Act, caused by members' confidential data is lost or made public.	 24	 Improved	Score improved from 24 to 20. Dec 22 - Previous DPIA and audit findings signed off as addressed by CEC DPO. Confirmed that CEC are happy with levels of assurance, approach to data breaches, data protection assessments. Quarterly catch-ups with IGU re-established to provide assurance and ensure LPF continue to meet obligations. Internal audit on Information Governance to begin Q1 2023 and review new framework.
21. Information Rights Information Rights processes (including FOI and Subject Rights) not in accordance with laws and regulations	 20	 Improved	Score improved from 30 to 20, Amber to Green. Refreshed policies and procedures have been implemented, and training and communications issued to LPF colleagues. CEC IGU have confirmed they are comfortable with our FOI processes and timescales. IGU are also satisfied with our explanation of member SAR process but have requested evidence / sampling as further assurance.

Risk Update

Update on all remaining 'High' or 'Moderate' risks, detailing the risk score (0-100), and a narrative update on the current assessment and mitigating plans.

Risk	Score	Movement	Update
36. Cybersecurity Cybersecurity protections and/or back-up not sufficient to prevent/minimise cyber-attacks.	 32	 Unchanged	External phishing testing carried out in Oct 22. Results that security controls work well; but staff ability to identify and report suspicious emails could be improved. Training and communications have been carried out to increase awareness. Further phishing tests will be carried out and score reconsidered. Existing information security project has delivered a number of enhancements, final actions delayed but targeted for delivery end Feb 2023. Internal Audit on this area in Q1 2023 will provide further assurance.
38. Project and change Project and change activities not effectively managed	 32	 Unchanged	Currently main driver is Project Forth but encompasses all project & change risk. Current mitigation actions are: project & change control process being introduced Q1 2023; Forth project management by 3rd party; improved reporting on change activities.
27. Governance Group structure and governance not fully compliant and up-to-date or working effectively	 30	 Unchanged	Recent elections increased probability of disruption to the schedule of committee meetings, and timing of decisions. The score has improved as committee membership has been confirmed, dates scheduled, and induction training for new members complete. LPF governance structure is in process of further improvement in order to work effectively – including a new governance portal, and transfer of committee services from CEC to LPF. Risk will remain elevated until portal and SLA are in place.
23. Delegations Acting beyond proper authority / delegations.	 30	 Unchanged	A review and refresh of the Scheme of Delegations is underway, to clearly map them to the functions within the LPF group. Score unchanged while mitigating actions are in process – the risk remains moderate, although there has been no breach in existing delegations.

Risk	Score	Movement	Update
25. Procurement Breach of procurement/framework regulations	 30	 Unchanged	<p>LPF is continuing to work with CEC to align procurement processes to the needs of LPF group business while also satisfying CEC's oversight requirements.</p> <p>Score will be reviewed and likely reduce Q1 2023 once an updated Contracts Standing Order (CSO) confirmed in place. This will ensure appropriate actions including procurement compliance in respect of LPF's contract letting.</p>
33. Staff Resource Staff Resource within the Fund not sufficient to carry out core tasks	 30	 Unchanged	<p>Forth continues to elevate score, and ability to meet project deliverables while carrying out BAU remains under close review. Management stretch in context of project, change and assurance activities is being closely monitored. Risk score is trending to improve but remains amber and will be reassessed Q1 2023 - recent mitigations include review and approval of organisational plans, succession plans and recruitment.</p>
3. Employer contributions Failure of an employer to pay contributions causes either a significant fall in funding level or requires higher contributions from other employers	 28	 Unchanged	<p>Employers continue to be under increasing financial pressure due to the current economic situation. The fund continues to monitor this on an ongoing basis with regular employer contact and existing controls.</p>
4. Recruitment Failure to recruit, engage and retain talent leads to workforce capability gaps with implications for oversight, control, administration and achievement of service plan goals	 28	 Unchanged	<p>Unchanged. There has been successful recruitment in a number of areas however it is a candidate market, particularly in more technical roles, leading to the fund incurring more recruitment related costs.</p>
2. Investment performance Adverse investment performance causes funding levels to fall requiring higher employer contributions	 25	 Unchanged	<p>JISP advisers and asset allocation and policy group investment committees have been meeting frequently to ensure the Pension Committee's investment strategy is implemented within prescribed constraints, and to respond to material market changes, such as the September 2022 dislocation in the gilts market.</p>

Risk	Score	Movement	Update
2. Adverse Movement – pressure on employer contributions Adverse change in non-investment actuarial assumptions causes either funding levels to fall or requiring higher employer contributions	 25	 Unchanged	The employer contribution rates approach has changed from deterministic to risk-based, with Funding Strategy Statement updated and employers consulted and informed.
35. Supplier and third-party systems Inadequate, or failure of, supplier and other third-party systems (including IT and Data security).	 25	 Unchanged	Our supplier management processes have been reviewed, and a risk-based framework implemented to ensure greater consistency across providers. Score will remain Amber until we have carried out assurance that processes are working as expected.

Appendix 1a – Risk Scoring & Distribution Chart

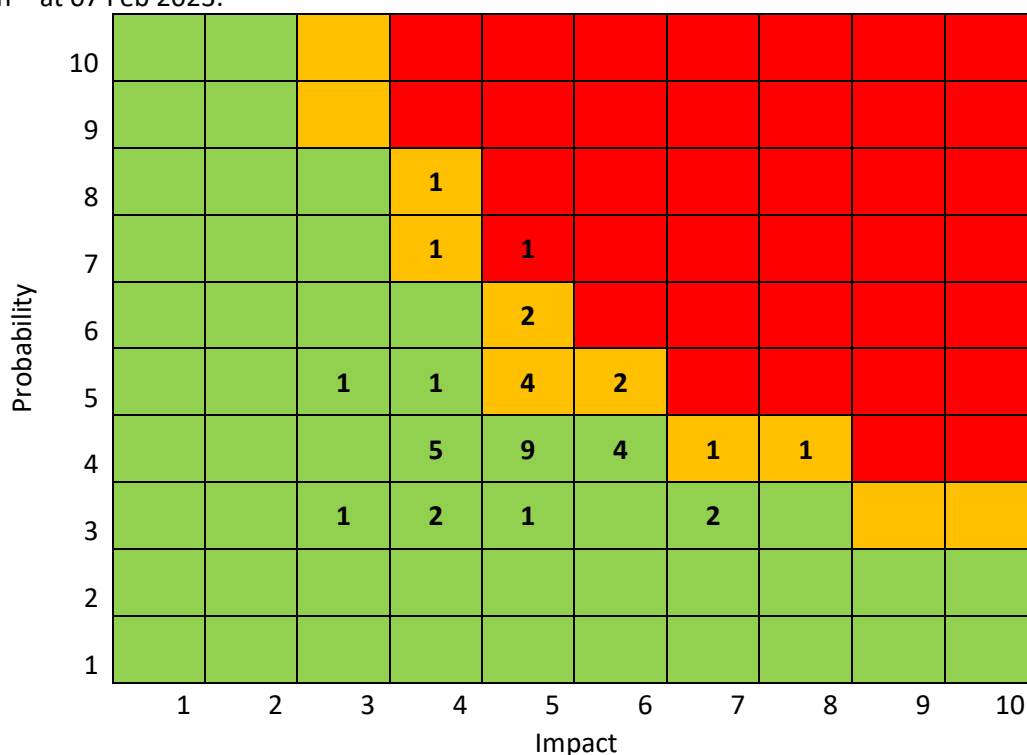
Risk scoring:

	Impact	Probability
1	No discernible effect	Virtually impossible
2	Little discernible effect	Extremely unlikely
3	Some effect noticeable	Remotely possible
4	Some effect on service provision	May occur
5	Noticeable effect on service provision	Fairly likely to occur
6	Some disruption of service	More likely to occur than not
7	Significant service disruption	Likely to happen
8	Material disruption to services	Probably will happen
9	Major service disruption	Almost certainly will happen
10	Catastrophic	Already happening

RAG (Red Amber Green) status:

Risk Status	
 	High: resolve urgently where possible (probability and impact total 35 and above)
 	Moderate: resolve where possible (probability and impact total 25 to 34)
 	Low: monitor (probability and impact total 24 and below)

Risk Distribution – at 07 Feb 2023:



Appendix 1b – Risk Register

One page overview of risk register & RAG status at 07 Feb 2023.

Code	Risk name	RAG & Score
1	Investment Performance	
2	Adverse Movement - pressure on employer contributions	
3	Failure of an employer to pay contributions	
4	Recruitment & retention	
5	Fraud by LPF staff or relating to members	
6	Staff competence	
7	IT systems	
8	Culture & engagement	
9	Pension Committee decisions	
10	Pension Board effectiveness	
11	Business continuity	
12	Data protection	
13	Responsible Investment	
14	Incorrect pension payments	
15	Late payment of pension	
16	Market abuse	
17	Investment operations	
18	Disclosure of confidential information	
19	Material breach of contract	
20	Regulatory breach	
21	Information Rights	
22	Member communications	
23	Acting beyond proper authority/delegations	
24	Inappropriate use of pension fund monies	
25	Procurement/framework breach	
26	Procurement process	
27	Group structure and governance	
28	Claim or liability arising from shared services	
29	Employer systems access	
30	Incorrect member data	
31	Inadequate contractual protection	
32	Over reliance on single core service provider	
33	Staff Resource	
34	Health and safety	
35	Supplier and third-party systems	
36	Cybersecurity	
37	Climate change	
38	Project and change activities	
	Power outages	
39	Key Person	

Appendix 1c – Three-year risk trends

Ref	Risk name	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022
1	Investment Performance	●	●	●	●	●	●	●	●	●	●	●	●
2	Adverse Movement - pressure on employer contributions	●	●	●	●	●	●	●	●	●	●	●	●
3	Failure of an employer to pay contributions	●	●	●	●	●	●	●	●	●	●	●	●
4	Recruitment & retention	●	●	●	●	●	●	●	●	●	●	●	●
5	Fraud by LPF staff or relating to members	●	●	●	●	●	●	●	●	●	●	●	●
6	Staff competence	●	●	●	●	●	●	●	●	●	●	●	●
7	IT systems	●	●	●	●	●	●	●	●	●	●	●	●
8	Culture & engagement	●	●	●	●	●	●	●	●	●	●	●	●
9	Pension Committee decisions	●	●	●	●	●	●	●	●	●	●	●	●
10	Pension Board effectiveness	●	●	●	●	●	●	●	●	●	●	●	●
11	Business continuity	●	●	●	●	●	●	●	●	●	●	●	●
12	Data protection	●	●	●	●	●	●	●	●	●	●	●	●
13	Responsible Investment	●	●	●	●	●	●	●	●	●	●	●	●
14	Incorrect pension payments	●	●	●	●	●	●	●	●	●	●	●	●
15	Late payment of pension	●	●	●	●	●	●	●	●	●	●	●	●
16	Market abuse	●	●	●	●	●	●	●	●	●	●	●	●
17	Investment operations	●	●	●	●	●	●	●	●	●	●	●	●
18	Disclosure of confidential information	●	●	●	●	●	●	●	●	●	●	●	●
19	Material breach of contract	●	●	●	●	●	●	●	●	●	●	●	●
20	Regulatory breach	●	●	●	●	●	●	●	●	●	●	●	●
21	Information Rights	●	●	●	●	●	●	●	●	●	●	●	●
22	Member communications	●	●	●	●	●	●	●	●	●	●	●	●
23	Acting beyond proper authority/delegations	●	●	●	●	●	●	●	●	●	●	●	●
24	Inappropriate use of pension fund monies	●	●	●	●	●	●	●	●	●	●	●	●
25	Procurement/framework breach	●	●	●	●	●	●	●	●	●	●	●	●
26	Procurement process	●	●	●	●	●	●	●	●	●	●	●	●
27	Group structure and governance	●	●	●	●	●	●	●	●	●	●	●	●
28	Claim or liability arising from shared services	●	●	●	●	●	●	●	●	●	●	●	●
29	Employer systems access	●	●	●	●	●	●	●	●	●	●	●	●
30	Incorrect member data	●	●	●	●	●	●	●	●	●	●	●	●
31	Inadequate contractual protection	●	●	●	●	●	●	●	●	●	●	●	●
32	Over reliance on single core service provider	●	●	●	●	●	●	●	●	●	●	●	●
33	Staff Resource	●	●	●	●	●	●	●	●	●	●	●	●
34	Health and safety	●	●	●	●	●	●	●	●	●	●	●	●
35	Supplier and third-party systems	●	●	●	●	●	●	●	●	●	●	●	●
36	Cybersecurity	●	●	●	●	●	●	●	●	●	●	●	●
37	Climate change	●	●	●	●	●	●	●	●	●	●	●	●
38	Project and change activities	●	●	●	●	●	●	●	●	●	●	●	●
39	Key Person	●	●	●	●	●	●	●	●	●	●	●	●