

## **Pensions Audit Sub Committee**

### **2.00pm, Tuesday, 8 December 2020**

### **Lothian Pension Fund - Internal Audit Update for the Period 1 April to 30 October 2020**

#### **1. Recommendations**

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The Pensions Committee is requested to note:

- 1.1 progress with delivery of the Lothian Pension Fund (LPF) 2020/21 Internal Audit (IA) plan; and
- 1.2 progress with implementation of agreed management actions to support closure of LPF IA findings raised.
- 1.3 the update on costs associated with delivery of the 2020/21 IA annual plan included at section 5.

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# Lothian Pension Fund - Internal Audit Update for the Period 1 April to 30 October 2020

## 2. Executive Summary

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- 2.1 This report provides details of the progress of IA assurance activity on behalf of LPF performed by the City of Edinburgh Council's (the Council) IA team.
- 2.2 Delivery of the three audits included in the 2020/21 IA Plan approved by the Committee in June 2020 has been impacted by Covid-19, and commenced in November 2020 with one audit now in progress, and the remaining two audits currently being planned.
- 2.3 As at 30 October 2020, LPF had a total of 7 open Internal Audit findings (1 high; 3 medium; and 3 low) that relate to the three audits completed in 2019/20.
- 2.4 Of the 7 open findings, (1 High; 2 Medium; and 3 Low) were overdue as at 30 October as management actions were not satisfactorily completed by the agreed implementation dates due to a lack of suitable evidence. However, evidence had been provided by LPF to Internal Audit to support closure of three of the findings (1 High; 1 Medium; 1 Low) and the High rated finding has since been closed.

## 3. Background

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- 3.1 The LPF IA plan is risk based and is developed from review of the LPF risk register and discussion with management, with the audits included in the plan designed to test the effectiveness of the controls, and governance and risk management frameworks established to mitigate and manage LPF's risks.
- 3.2 The 2020/21 LPF IA plan was approved by the Pensions Audit Sub Committee in June 2020.
- 3.3 The outcomes of the audits included in the plan will support the 2020/21 LPF Internal Audit annual opinion and inform the annual Governance Statement included in the financial statements.
- 3.4 Whilst the Plan is delivered by the Council's IA team, IA is not the only source of assurance provided to LPF as there are a number of additional assurance sources (for example, external audit) that the Committee should consider when forming their own view on the design and effectiveness of the LPF control environment and governance and risk management frameworks. Details of additional assurance provided on LPF activities is included in the LPF assurance map maintained by management.
- 3.5 Lothian Pension Fund Investments (LPFI Ltd) is a fully owned subsidiary of LPF and has been registered with the Financial Conduct Authority (FCA) since June 2016 to

advise on investments, with the exception of pensions transfers and opt outs. Whilst the same operational processes and controls are applied by both LPF and LPFI, IA has not been requested to provide assurance on LPFI investment advice activities, and the extent of their compliance with FCA and other applicable regulatory requirements. Consequently, IA assurance is currently limited to the activities of LPF and the extent of their compliance with Local Government Pension Scheme (LGPS) regulatory requirements.

- 3.6 Where relevant, any LPF control weaknesses identified that could result in potential FCA concerns, or non-compliance with FCA regulatory requirements are highlighted in IA findings raised for management's attention.
- 3.7 All LPF IA reports prepared by the Council are presented to the LPF Pensions Audit Sub Committee for scrutiny, and then referred to the Pensions Committee for information (where appropriate).
- 3.8 Where control weaknesses are identified, Internal Audit findings are raised, and management agree recommendations to address the gaps identified. However, it is the responsibility of management to address and rectify the weaknesses identified via timely implementation of these agreed management actions.
- 3.9 Findings raised by IA in audit reports typically include more than one agreed management action to address the risks identified. IA methodology requires all agreed management actions to be closed in order to close the finding.
- 3.10 The IA definition of an overdue finding is any finding where all associated agreed management actions have not been evidenced as implemented by management and validated as closed by IA by the date agreed by management and IA and recorded in relevant IA reports.
- 3.11 The IA definition of an overdue management action is any agreed management action supporting an IA finding that is either open or overdue, where the individual action has not been evidenced as implemented by management and validated as closed by IA by the agreed date.
- 3.12 Where management considers that actions are complete and sufficient evidence is available to support IA review and confirm closure, the action is marked as 'implemented' on the IA follow-up system. When IA has reviewed the evidence provided, the management action will either be 'closed' or will remain open and returned to the relevant owner with supporting rationale provided to explain what further evidence is required to enable closure.
- 3.13 A 'started' status recorded by management confirms that the agreed management action remains open and that implementation progress ongoing.
- 3.14 A 'pending' status recorded by management confirms that the agreed management action remains open with no implementation progress evident to date.

## 4. Main Report

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### **Progress with delivery of the LPF annual plan**

- 4.1 It has been agreed with LPF management that PwC will be asked to deliver two of the three audits included in the 2020/21 IA annual plan under the direction of the Chief Internal Auditor as part of the established IA co-source arrangements, enabling the Council's IA team focus on the new Covid-19 risks currently impacting the Council.
- 4.2 The PwC team has been engaged, and the Bulk Transfers audit is in progress, with the audit of Employer Cessation Strategies, Valuations, and Exit Calculations currently being planned. The remaining audit will be delivered by the Council's IA team (LPF Technology Model Development) is also at the planning stage.
- 4.3 All audits will be completed by March 2020 (or earlier), although this will be dependent on ongoing Covid-19 impacts and any other potential resilience events that could impact delivery.

### **Status of Internal Audit Findings as at 30 October 2020**

- 4.4 As at 30 October 2020 LPF had a total of 7 open Internal Audit findings (1 High; 3 Medium; and 3 Low) that relate to the three audits (Charles River Project Pre-Implementation System Testing; Pensions Entitlement Calculations; and Settlement and Custodian Services) completed in 2019/20.
- 4.5 As at 30 October, 6 of these findings (1 High; 2 Medium; and 3 Low) were overdue, as management actions had not been completed by the agreed implementation dates, as illustrated in Appendix 1.
- 4.6 However, evidence had been provided to IA by LPF to support closure of three of the findings (1 High; 1 Medium; 1 Low) by 30 October, and the High rated finding was closed in November. Engagement is ongoing with the LPF management team in relation to the evidence required to support closure of the remaining findings.
- 4.7 The overdue High rated finding that has now been closed was raised in the Settlement and Custodian Services audit and included two management actions that highlighted the need for LPF to confirm:
  - 4.7.1 that the existing 2011 contract for settlement and custodian services adequately reflected the current operating environment, including relationships with other LPF suppliers; the current regulatory landscape; the need for inclusion of agreed key performance indicators; and the requirement for ongoing provision of assurance reports. This action has now been closed as the risks were accepted by management as being within their

risk appetite. It should be noted, however, that as LPF does not have an established risk appetite statement approved by the Committee, closure is based on discussion with management

4.7.2 adequacy of the technology security; data protection; and legal arrangements supporting access to the Charles River Investment Management System by the settlement and custodian services provider via a new secure file transfer protocol arrangement. This action has been closed based on evidence provided.

4.8 The 6 overdue IA findings are supported by a total of 8 agreed management actions that require to be closed in order to close the finding. Details of the status of these management actions as at 30 October is included at Appendix 2.

## **5. Financial impact**

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5.1 The IA annual plan included an estimated cost of £50K for delivery of the 2020/21 IA annual plan. PwC has confirmed an initial estimate of £32K for the two specialist audits, although this may vary depending on their scope; complexity; and time involved. The balance of £18K reflects the costs associated with the remaining Technology Model Development audit to be completed by the Council's IA team; the costs associated with ongoing follow-up activity; and the costs involved with preparing reports and attending committee meetings.

5.2 It is also important to note that failure to close IA findings raised and address the associated risks in a timely manner may also have some inherent financial impact.

## **6. Stakeholder/Regulatory Impact**

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6.1 IA findings are raised as a result of control gaps or deficiencies identified during audits. If agreed management actions are not implemented to support closure of Internal Audit findings, 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**

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7.1 [Public Sector Internal Audit Standards](#)

## **8. Appendices**

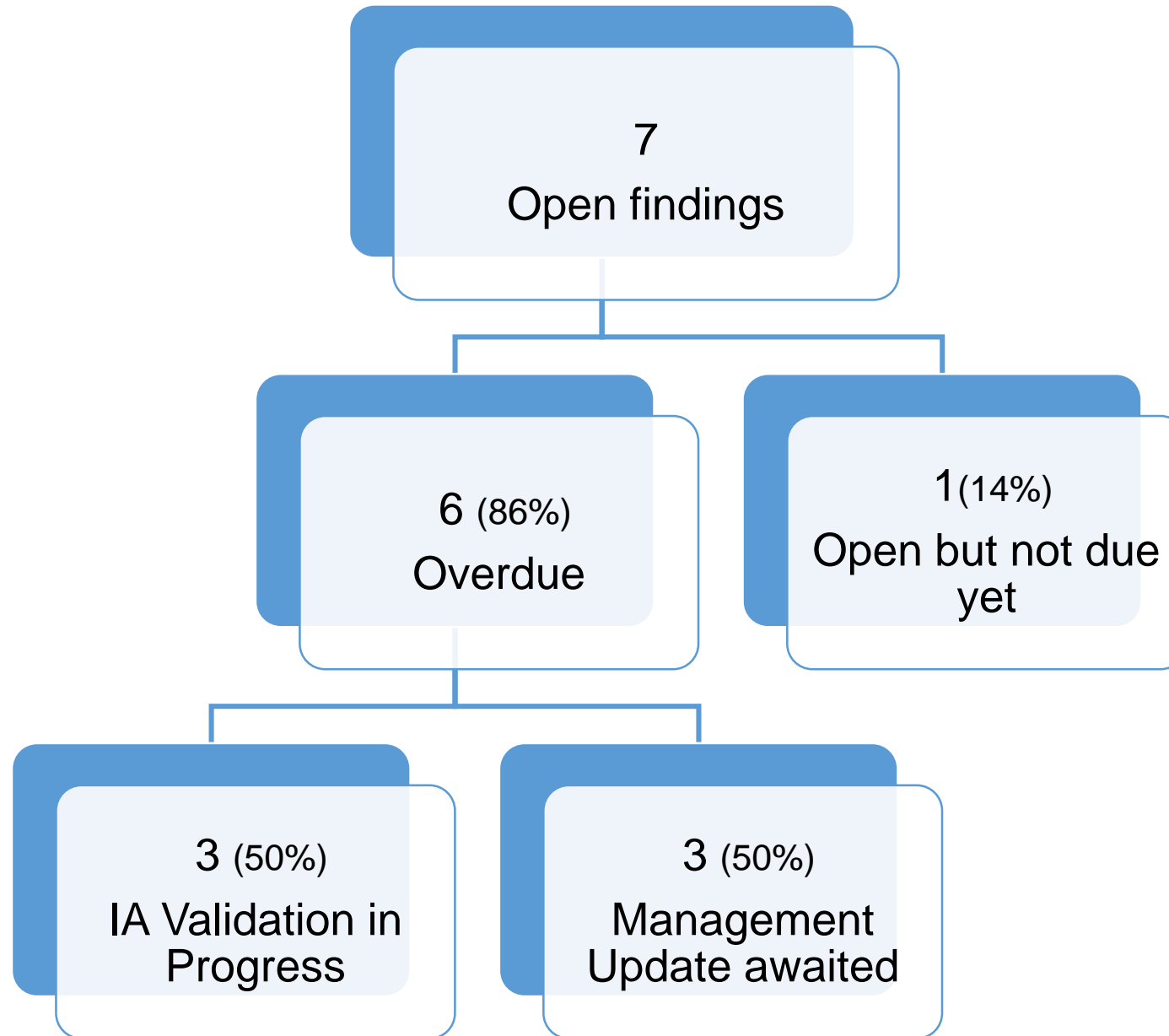
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Appendix 1 Graphic of Lothian Pension Fund Internal Audit Open and Overdue findings position as at 30 October 2020.

Appendix 2 Lothian Pension Fund Internal Audit Overdue Management Actions as at 30 October 2020.

# Appendix 1 - Lothian Pension Fund

## Internal Audit Open and Overdue findings position as at 30 October 2020





## Appendix 2 – Lothian Pension Fund - Internal Audit Open and Overdue Management Actions as at 30<sup>th</sup> October 2020

### Glossary of terms

1. **Project** – This is the name of the audit report.
2. **Owner** – The Executive Director responsible for implementation of the action.
3. **Issue Type** – This is the priority of the audit finding, categorised as Critical, High, Medium, Low and Advisory.
4. **Issue** – This is the name of the finding.
5. **Status** – This is the current status of the management action. These are categorised as
  - Pending (the action is open and there has been no progress towards implementation),
  - Started (the action is open and work is ongoing to implement the management action),
  - Implemented (the service area believe the action has been implemented and this is with Internal Audit for validation).
6. **Agreed Management action** – This is the action agreed between Internal Audit and Management to address the finding.
7. **Estimated date** – the original agreed implementation date.
8. **Revised date** – the current revised date. **Red** formatting in the dates field indicates the last revised date is overdue.
9. **Number of revisions** – the number of times the date has been revised since July 2018. **Amber** formatting in the dates field indicates the date has been revised more than once.
10. **Contributor** – Officers involved in implementation of an agreed management action

Ref	Project/Owner	Issue Type	Issue/Status	Agreed Management Action	Dates	Contributor
1	LPF Custodian Services Northern Trust Contract Stephen Moir, Executive Director of Resources	High	RES1913 Rec 1.1 Northern Trust relationships with other LPF suppliers Implemented as at 30 October and closed 16 November	This is now under investigation but the timing of this falls against other priorities for LPF and it will take time to investigate between LPF, Charles River and Northern Trust in order to determine the existence and extent of any gap. We are investigating this as a priority and, for now, acknowledge the potential gap as highlighted by Internal Audit. LPF will investigate contractual arrangements supporting NT access to CR by 30 June.	Estimated Date: 30/06/2020 Revised Date: No of Revisions 0	Annette Smith Doug Heron Esmond Hamilton Hugh Dunn Jason Koumides John Burns Layla Smith Struan Fairbairn

Ref	Project/Owner	Issue Type	Issue/Status	Agreed Management Action	Dates	Contributor
2	<p>LPF Custodian Services</p> <p>Regulatory and risk management oversight</p> <p>Stephen Moir, Executive Director of Resources</p>	Medium	<p>RES1913 Rec 2.1</p> <p>Regulatory and risk management oversight</p> <p>Implemented</p>	<p>LPF will prepare a fully developed and detailed action plan by 30 September 2020, that will consider recommendations 2.1; 3.1; and 4.1 of this report. LPF Management consider that our risk management process adequately takes into account and considers custodian risk within LPF when that is appropriate. It does this through monitoring key suppliers, regulatory breaches and other associated risks which are purposefully focused on LPF's own business. We can evidence appropriate risks having been identified, actioned and monitored over time, however, LPF does not seek to include all granular operational risks identified by sub-groups or specific supplier management processes but does have sufficient governance in place to ensure that where those risks are sufficiently material, they are escalated through the risk group for consideration and potential inclusion in the register. LPF's LR&amp;C team are also involved in NT supplier management at appropriate junctures. A further response to this finding will be provided as part of the fully developed plan in response to the audit that will be prepared by 30 September 2020.</p>	<p>Estimated Date: 30/09/2020</p> <p>Revised Date:</p> <p>No of Revisions 0</p>	<p>Annette Smith</p> <p>Doug Heron</p> <p>Esmond Hamilton</p> <p>Hugh Dunn</p> <p>Jason Koumides</p> <p>John Burns</p> <p>Layla Smith</p> <p>Struan Fairbairn</p>



Ref	Project/Owner	Issue Type	Issue/Status	Agreed Management Action	Dates	Contributor
3	<p>LPF Custodian Services</p> <p>Northern Trust Supplier Management</p> <p>Stephen Moir, Executive Director of Resources</p>	Low	<p>RES1913 Iss4 Rec 4.1</p> <p>Supplier Management</p> <p>Implemented</p>	<p>LPF will prepare a fully developed and detailed action plan by 30 September 2020, that will consider recommendations 2.1; 3.1; and 4.1 of this report. LPF considers that the approach taken to our oversight of NT is more robust than is indicated here. Beyond this point, we will conduct an internal review on the effectiveness of the arrangements for documenting service review meetings and due diligence reviews, but we believe substantial and effective reviews have been undertaken and appropriate action points raised.</p>	<p>Estimated Date: 30/09/2020</p> <p>Revised Date:</p> <p>No of Revisions 0</p>	<p>Annette Smith</p> <p>Doug Heron</p> <p>Esmond Hamilton</p> <p>Hugh Dunn</p> <p>Jason Koumides</p> <p>John Burns</p> <p>Layla Smith</p> <p>Struan Fairbairn</p>
4	<p>LPF Charles River Project</p> <p>RES1911[LPF] Iss1 Post implementation operational processes and controls</p> <p>Stephen Moir, Executive Director of Resources</p>	Medium	<p>RES1911 Iss.1 Rec.1</p> <p>Post implementation operational processes and controls</p> <p>Started</p>	<p>LPF management accepts the findings noted above and has established a Phase 2 action plan to ensure that these are addressed prior to full Business as usual implementation of the system.</p>	<p>Estimated Date: 14/02/2020</p> <p>Revised Date: 14/06/2020</p> <p>No of Revisions 0</p>	<p>Anne Mitchell</p> <p>Bruce Miller</p> <p>Doug Heron</p> <p>Hugh Dunn</p> <p>Michelle Vanhegan</p> <p>Struan Fairbairn</p>

Ref	Project/Owner	Issue Type	Issue/Status	Agreed Management Action	Dates	Contributor
5	<p>LPF Pensions entitlement calculations</p> <p>1. Review of Altair system user access profiles</p> <p>Stephen Moir, Executive Director of Resources</p>	Low	<p>1.1: Review of Altair system user access profiles</p> <p>Started</p>	<p>Altair role profiles will be reviewed and aligned as far as possible on to ensure standardisation on a 'least access' privilege basis; Toxicity scenarios will be assessed and mitigating controls documented. A risk based Altair entitlement review process will be implemented with all employees covered at least once per year.</p>	<p>Estimated Date: 30/09/2020</p> <p>Revised Date: 01/02/2021</p> <p>No of Revisions 0</p>	<p>Doug Heron Hugh Dunn John Burns Struan Fairbairn</p>
6	<p>LPF Pensions entitlement calculations</p> <p>1. Review of Altair system user access profiles</p> <p>Stephen Moir, Executive Director of Resources</p>	Low	<p>1.2: Connected user access rights</p> <p>Started</p>	<p>The Internal Audit recommendation will be implemented as detailed above.</p>	<p>Estimated Date: 30/09/2020</p> <p>Revised Date: 01/02/2021</p> <p>No of Revisions 0</p>	<p>Doug Heron Hugh Dunn John Burns Struan Fairbairn</p>
7	<p>LPF Pensions entitlement calculations</p> <p>2. Ongoing maintenance of procedure manuals</p> <p>Stephen Moir, Executive Director of Resources</p>	Low	<p>2.1: Ongoing maintenance of procedure manuals</p> <p>Started</p>	<p>The Internal Audit recommendation will be implemented as detailed above.</p>	<p>Estimated Date: 30/09/2020</p> <p>Revised Date: 01/02/2021</p> <p>No of Revisions 0</p>	<p>Doug Heron Hugh Dunn John Burns Struan Fairbairn</p>

Ref	Project/Owner	Issue Type	Issue/Status	Agreed Management Action	Dates	Contributor
8	LPF Custodian Services System Access and Security Stephen Moir, Executive Director of Resources	Medium	RES1913 Iss 3 Rec.3.1 System access controls Started	<p>1. Agree with recommendation, access reports will be requested and reviewed quarterly. Whilst this review has been undertaken annually, it is accepted that formal evidence should be retained.</p> <p>2. Agreed – this action will be implemented as recommended.</p> <p>3. Agreed – this action will be implemented as recommended.</p> <p>4. Agreed – all non LPF user profiles will be reviewed and removed. LPF will prepare a fully developed and detailed action plan by 30 September 2020, that will consider recommendations 2.1; 3.1; and 4.1 of this report.</p>	<p>Estimated Date: 30/09/2020</p> <p>Revised Date:</p> <p>No of Revisions 0</p>	<p>Annette Smith Doug Heron Esmond Hamilton Hugh Dunn Jason Koumides John Burns Layla Smith Struan Fairbairn</p>