

Pensions Committee

2.00pm, Wednesday 17 March 2021

Lothian Pension Fund - Internal Audit Update for the Period 2 November 2020 to 9 February 2021

1. Recommendations

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.

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2. Executive Summary

- 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 being finalised; one in progress; and the remaining audit currently being planned.
- 2.3 As at 10 February 2021, LPF had 1 Medium rated open Internal Audit finding initially raised in the Settlement and Custodian Services audit completed in 2019/20 that became overdue in September 2020. Further evidence has been provided to support closure of this finding, and is currently being reviewed by IA.
- 2.4 Two IA findings (one High and one Medium) have been closed on the basis that management has accepted the associated risks.

3. Background

- 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 Scottish 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

Progress with delivery of the LPF annual plan

- 4.1 It has been agreed with LPF management that PwC would 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 Consequently, PwC will deliver the Bulk Transfers and the Employer Cessation Strategies, Valuations, and Exit Calculations audits, whilst the Council's IA team will progress the remaining agile LPF Technology Model Development audit.
- 4.3 The Bulk Transfers audit is nearing completion and the draft report is currently being discussed and agreed with LPF management. The Employer Cessation Strategies, Valuations, and Exit Calculations audit is in progress and should be finalised by 31 March 2021 subject to ongoing Covid-19 impacts and any other potential resilience events that could impact delivery.
- 4.4 The remaining LPF Technology Model Development agile audit is at the planning stage, and will continue until completion of the project in financial year 2021/22, with IA findings raised throughout the course of the project; agreed with management; and reported to the Pensions Audit Sub-Committee. A final report will also be prepared detailing the consolidated IA assurance outcomes at the end of the project.

Status of Internal Audit Findings as at 10 February 2021

- 4.5 As at 10 February 2021 LPF had 1 medium rated open Internal Audit finding (raised in the 2019/20 Settlement and Custodian Services audit) that became overdue on 30 September 2020.
- 4.6 This finding highlighted the need for LPF to identify; record and monitor implementation of risks relating to custodian services provided by Northern Trust. Management initially proposed that this finding should be risk accepted, but has now provided further information to IA to support closure of this finding, which is currently being reviewed. Further information is included at Appendix 1.
- 4.7 A further two findings have been closed on the basis of risk acceptance by management. These are:
- i. Settlement and Custodian Audit - High rated finding recommending areas for inclusion in the next refresh of the Northern Trust contract. LPF management accepted this finding on the basis that the contract was agreed at a point in time and reflects LGPS practice then, and remains in use widely today. Management

was also satisfied that the contract, together with the extensive supporting documentation and sub-agreements, is adequate and that the relationship with NT has been positive throughout with no contractual issues or refusal to serve as a result of not being obligated by contract to do so.

- ii. Charles River – Medium rated finding recommending a total of seven operational controls that should be applied post system implementation. Management has risk accepted four of the seven recommendations, and has implemented the remaining three. The four points that were risk accepted related to:
 - Requesting an annual technology assurance report (SOC2) from Charles River. LPF Management has advised that Charles River do not currently produce an annual SOC2 report, but confirmed that they will run a SOC2 audit process next year with a target completion of December 2021. Management has also confirmed that oversight has been provided through their review of Charles River controls.
 - Reviewing the SOC 2 report to identify any potential system control weaknesses and ensure that they are addressed. This recommendation has been risk accepted as Charles River currently does not produce an annual SOC 2 report.
 - Removing Charles River employee developer system administration access rights, and confirming appropriateness of any remaining Charles River employee access to the system. LPF management has advised that developer access rights are required to provide 24/7 global support coverage, and that this access does not enable privileges to initiate and execute trades.
 - Assessing and recording the risks and controls associated with the operation of the CR system, and incorporating appropriate control checks into the established LPF operational control framework. LPF management has advised that there were no material risks identified following completion of the system implementation for inclusion in the LPF risk register, and that risks associated with the ongoing use of the system are managed under broader categories of risks relating to supplier management and ICT systems.

4.8 LPF management has provided appropriate detail and supporting rationale for the risks that have been accepted in relation to these two IA findings.

5. Financial impact

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, attending committee meetings and preparing the LPF annual plan.

- 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

- 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

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

8. Appendices

- Appendix 1 Lothian Pension Fund Internal Audit Overdue Management Actions as at 9 February 2021.

Appendix 1 – Lothian Pension Fund - Internal Audit Open and Overdue Management Actions as at 10 February 2021

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	<p>LPF Custodian Services</p> <p>Regulatory and risk management oversight</p> <p>Stephen Moir, Executive Director of Resources</p>	Medium	<p>RES1913 Recomm 2.1 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&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 Revised Date:</p> <p>No of Revisions 0</p>	<p>Annette Smith Esmond Hamilton Hugh Dunn Jason Koumides John Burns Layla Smith Struan Fairbairn</p>