



Pensions Audit Sub-Committee

2.00pm, Tuesday 7 December 2021

Lothian Pension Fund - Internal Audit Update as at 5 November 2021

1. Recommendations

The Pensions Committee is requested to note:

- 1.1 progress with delivery of the Lothian Pension Fund (LPF) 2021/22 IA Internal Audit (IA) annual plan;
- 1.2 progress with implementation of agreed management actions to support closure of LPF IA findings raised; and
- 1.3 the content of the final Cessations IA report that supported the 2020/21 IA annual opinion presented to the Pensions Committee in August 2021.

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Lothian Pension Fund - Internal Audit Update as at 5 November 2021

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 four audits included in the 2021/22 IA annual plan is in progress, with one audit nearing completion and three currently being planned.
- 2.3 As at 5 November 2021, LPF had four open IA findings that are not yet due for completion and one Medium rated open Internal Audit finding that became overdue in September 2020.
- 2.4 The 2020/21 Cessations IA report that supported the 2020/21 IA annual opinion has now been finalised and is included for the Committee's review and scrutiny.

3. Background

2021/22 Internal Audit Annual Plan

- 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 2021/22 LPF IA plan was approved by the Pensions Committee in March 2021, and included the following four audits:
 - 3.2.1 Technology Model Development;
 - 3.2.2 Capital Calls;
 - 3.2.3 Receipt of Employer Contributions; and
 - 3.2.4 Risk Management and Assurance Framework
- 3.3 The outcomes of the audits included in the plan will support the 2021/22 LPF Internal Audit annual opinion and inform the annual Governance Statement included in the financial statements.

Annual Plan Scope Limitations

- 3.4 Whilst the Plan is delivered by the Council's IA team with support (where appropriate) from PwC through the Council's established co-source arrangements, 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.

- 3.5 Details of additional assurance provided on LPF activities is included in the LPF assurance map maintained by management.
- 3.6 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.
- 3.7 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.
- 3.8 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.
- 3.9 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).

Internal Audit Follow-Up Process

- 3.10 Where control weaknesses are identified, Internal Audit findings are raised, and management agree recommendations and completion timeframes 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.
- 3.11 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.
- 3.12 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.
- 3.13 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.
- 3.14 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.

- 3.15 A ‘started’ status recorded by management confirms that the agreed management action remains open and that implementation progress ongoing.
- 3.16 A ‘pending’ status recorded by management confirms that the agreed management action remains open with no implementation progress evident to date.

2020/21 Internal Audit Annual Opinion

- 3.17 The 2020/21 IA annual opinion was presented to the Pensions Committee in August 2021. The opinion was ‘limited’ as IA does not provide assurance across the full population of LPF risks.
- 3.18 Whilst the opinion included the outcomes of the Cessations audit report as the overall report rating and the ratings of findings raised had been agreed, it noted that LPF management’s responses to IA’s recommendations were being agreed, and confirmed that the final report would be presented to the Pensions Audit Sub-Committee once finalised.

4. Main Report

Progress with delivery of the 2021/22 LPF IA annual plan

- 4.1 It has been agreed with LPF management that PwC would deliver three of the four audits included in the 2020/21 IA annual plan under the direction of the Council’s Chief Internal Auditor as part of the Council’s established IA co-source arrangements.
- 4.2 Consequently, PwC will deliver the Capital Calls; Employer Contributions; and Risk Management and Assurance Framework audits, whilst the Council’s IA team will progress the remaining agile LPF Technology Model Development audit.
- 4.3 Delivery of the three PwC audits is currently being planned, and completion timeframes for the reviews have been agreed with LPF management team that should ensure delivery by 31 March 2022.
- 4.4 The Technology Model Development audit is nearing completion and should be completed by December 2021.

Status of Internal Audit Findings as at 5 November 2021

Open IA Findings

- 4.5 LPF currently has four open IA findings (three medium, and one low) that were raised in the Bulk Transfers audit completed in August 2021.

- 4.6 All four findings are due for completion by 31 December 2024. This extended timeline reflects the earliest opportunity to provide evidence to support closure of the IA findings raised given the infrequency of bulk transfer requests received from employers.

Overdue IA findings

- 4.7 As at 5 November 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.
- 4.8 This finding highlighted the need for LPF to identify; record and monitor implementation of risks relating to custodian services provided by Northern Trust.
- 4.9 Management initially proposed that this finding should be risk accepted in September 2020, however this approach was not accepted by IA as LPF acknowledged that further work was required, and plans were being progressed to improve their existing risk management processes.
- 4.10 Further evidence was then provided by LPF in December 2020 to support closure of the finding, however IA did not support closure of the finding as the evidence provided had either been reviewed during the Settlement and Custodian Services audit, or pre-dated the audit.
- 4.11 IA then recommended that the finding remained open with a revised completion date allocated that aligns with planned changes to the LPF risk management framework. No revised completion date has yet been provided.
- 4.12 IA's view was further supported by PwC independently raising a similar finding in relation to established risk management processes in the Cessations audit (refer recommendation 2.1 in the report included at Appendix 2)
- 4.13 Further information on the overdue Settlement and Custodian Services audit finding is included at Appendix 1.

Final report supporting the 2020/21 IA Annual Opinion - Cessations

- 4.14 Whilst the IA annual opinion presented to the Pensions Committee in August 2021 included the outcomes of the Cessations audit report as the overall report rating (amber: some improvement required) and the ratings of findings raised (one high; one medium; and one advisory) had been agreed, LPF management's responses to IA recommendations were in the process of being finalised.
- 4.15 The report has now been finalised, and the review outcomes confirm that reasonable assurance has been provided that employer cessation risks are being managed, and that LPF's objectives to support affordable employer cessations in line with Scottish Local Government Pensions Scheme (SLGPS) regulatory requirements should be achieved.

- 4.16 The two findings raised in the report highlight the need to improve documentation and records management to confirm that all steps of the cessations process have been completed; and improve cessations risk management and governance arrangements.
- 4.17 The final report is included at Appendix 2.

5. Financial impact

- 5.1 The estimated cost for delivery of the 2021/22 IA annual plan is circa £80K. PwC has confirmed an initial estimate of £63K for the three specialist audits, although this may vary depending on their scope; complexity; and time involved. The balance of £17K 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 5 November 2021.
- Appendix 2 Final Cessations Internal Audit Report

Appendix 1 – Lothian Pension Fund - Internal Audit Open and Overdue Management Actions as at 5 November 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

Project/Owner	Issue Type	Issue/Status	IA Recommendation	Agreed Management Action	Dates	Contributor
<p>LPF Custodian Services</p> <p>Regulatory and risk management oversight</p> <p>Stephen Moir, Executive Director of Resources</p>	<p>Medium</p>	<p>RES1913 Recomm 2.1 Regulatory and risk management oversight</p> <p>Implemented</p>	<p>Whilst the LPF risk register includes a generic supplier management risk, specific risks relevant to outsourced custodian services and supporting action plans identified from the annual Northern Trust site visit have not been recorded in departmental risk registers.</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.</p> <p>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.</p> <p>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.</p> <p>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</p> <p>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>

The City of Edinburgh Council

Internal Audit

Lothian Pension Fund Cessations

Final Report

5th November 2021

LPF 2002

Overall report rating:

**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 that Lothian Pension Fund's ("LPF's") objectives should be achieved.

Contents

1. Background and Scope	1
2. Executive summary	3
3. Detailed findings	4
Appendix 1: Basis of our classifications	100
Appendix 2: Areas of audit focus	111

This internal audit review is conducted for the Lothian Pension Fund (“LPF”) under the auspices of the 2020/21 internal audit plan approved by the Pensions Audit Sub Committee in June 2020. 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 a number of specific recommendations included in this report to strengthen internal control, it is management’s responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the 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 Pensions Committee members as appropriate.

1. Background and Scope

Background

Employers can trigger an exit or “cessation” event from LPF under the Local Government Pension Scheme (LGPS) Regulations (see below).

This can occur with no direct employer action, most commonly when the last remaining active member ceases to be active, but can also occur through a voluntary employer decision to cease further accruals and exit the Fund

LPF maintains an exit policy that outlines its cessation approach as part of its wider Funding Strategy that includes instructions to the Fund actuary to complete an exit valuation; details the nature of the actuarial assumptions to be applied; and includes discretion to postpone the cessation via a suspension notice.

Whilst immediate collection of any exit payment or “debt” due is the preferred approach, LPF also enables some employers to repay their exit debt over an agreed timeframe by arranging individual ‘funding agreements’ that consider both specific covenant risks and employer affordability, whilst balancing the interests of all relevant parties including other remaining Fund employers.

Since late 2019 there have been 6 exiting employers and, in the majority of cases, the exit debt has not been paid immediately but has been supported by funding agreements that set out the required payment structure.

As at September 2020, 16 funding agreements were in place and a further two were under discussion. The total value of agreed but outstanding payments for the former group were £5.86m.

Applicable Regulations and Fund Strategies

The regulatory requirements supporting exit valuations and the collection of exit payments due into local government pension schemes are specified in [The Local Government Pension Scheme \(Scotland\) Regulations 2018](#) regulation 61.

It is important to note that LGPS Regulations could potentially be amended in the future as the Scottish Public Pensions Agency (SPPA) published a consultation in January 2020 (closed March 2020) about possible improvements to the suspension notice facility to defer an exit valuation payment. More recently the SPPA has written to LGPS Funds in Scotland about the possible introduction of new regulations covering employer exit flexibilities more explicitly as introduced in England and Wales in September 2020. However, it is not yet known when any such amended regulations and associated guidance would be introduced in Scotland.

LPF has a publicly available Funding Strategy Statement (FSS) last updated in March 2021 that is a non-exhaustive summary of the Fund’s cessation approach.

Details of the overriding principles that help ensure compliance with regulatory requirements are included at Section 7.10 and Appendix C of the FSS. The Pensions Administration Strategy (PAS) last updated in 2019, is also relevant as it outlines LPF’s responsibilities to determine a member’s benefits when membership ceases.

Scope

The audit considered the design adequacy of LPF funding strategies and policies (including use of suspension notices and funding agreements) to support affordable employer cessations where non-local government employers (for example charitable sector employers and trusts) have either

triggered or requested and exit in line with Scottish Local Government Pensions Scheme (SLGPS) regulatory requirements.

We also considered the design adequacy and operating effectiveness of key controls supporting the “cessation” process, with focus on the following areas:

- monitoring of all ongoing employers to understand the likelihood of an exit event;
- adequacy of communications with, and information gathering from, past and present potential exiting employers, including the use of suspension notices;
- accuracy of updates to member records post exit;
- ensuring that instructions to the Fund actuary are appropriate and that valuations received are compliant with the policy on exit valuation assumptions;
- reviewing, approving and processing proposals from employers who state they are unable to make immediate one-off lump sum exit payments; and
- establishing appropriate funding agreements that balance the needs of relevant parties, and ongoing management of these agreements

Limitations of Scope

The following areas were specifically excluded from the scope of the audit:

- Compliance of any funding agreements with International Financial Reporting Standard (IFRS) 9.
- This review only considered employer exit events that still pose an active risk to LPF.

Reporting Date

Our audit work concluded on 14 May 2021 and our findings and opinion are based on the conclusion of our work as at that date.

2. Executive summary

Total number of findings: 4

Summary of findings raised	
High	1. Cessation documentation and evidence retention
Medium	2. Risk management and governance
Advisory	3. Terminology within funding agreements

Opinion

Some significant; moderate; and minor control weaknesses were identified in both the design and effectiveness of the control environment and governance and risk management frameworks established by Lothian Pension Fund (LPF) to support the employer cessation process

However reasonable assurance has been provided that employer cessation risks are being managed, and that LPF's objectives to support affordable employer cessations in line with Scottish Local Government Pensions Scheme (SLGPS) regulatory requirements should be achieved.

Consequently, one High, and one Medium rated findings have been raised that highlight the need for:

- creation of a cessation checklist that is consistently applied to all cessations to confirm that all steps of the process have been completed; LPF responsibilities; and the file location of key documents (finding 1);
- stronger documentation evidencing the review and analysis performed on employer's funding proposals to confirm their affordability, and guidance on due diligence to be performed to identify potential security options (finding 1);
- Improved records of communications with the actuary (finding 1);
- improved employee cessation risk management processes (finding 2); and
- improved governance arrangements for the Employer Oversight Group (finding 2).

One advisory point has also been included in relation to irrevocability of funding agreements and the revocation of employer discretions. This has been raised as an advisory point as the elements covered are not a current requirement of the Scottish LGPS regulations and have only recently been considered in relation to the application of the English LGPS regulations. With this information, LPF can begin to consider how these changes may impact their operations.

Further detail is included at section 3 below.

Areas of good practice

The following areas of good practice were also noted during our review:

- **Clear delegation of authority and regular reporting to the Pensions Committee** – there was clear evidence of formal delegation from the Pensions Committee to the Chief Officers of Lothian Pension Fund that included the review and approval of individual funding agreements, and evidence of regular reporting to the Committee on employer cessations.

- **Regular updates to employers regarding their current exit position** – there was clear evidence of proactive communication with employers on the status of their formal exit valuation and associated funding agreement. Additionally, as part of the triennial valuation, actuaries prepare an indicative exit valuation that is shared with all individual employers by management.
- **Seeking legal advice and counsel on complex matters** – LPF seeks support from external legal firms in relation to complex matters including drafting a funding agreement template, and inclusion of security arrangements in funding agreements. This helps ensure that a consistent legal approach is applied across all cessations.

3. Detailed findings

1. Cessation documentation and evidence retention

High

1. Document Retention

Delays were experienced with receipt of documentation from LPF to support the cessations audit. This could have been due to:

- resource constraints (Risk 11 within LPF's risk register dated November 2020);
- issues locating the evidence requested; or
- a combination of both.

Management confirmed that most employer cessations evidence is retained in emails and stored in employer specific folders on the LPF network that are not indexed to support extraction of relevant documents.

Additionally, employer specific folders often contained many hundreds of emails which increases the difficulty in locating specific information and documents, and is not aligned with the requirements of the Council's [Information Governance Policy](#) and supporting [e-mail management guidance](#).

2. Design of the cessations decision making process

Review of the cessations decision making process confirmed that:

- no checklist has been established to ensure that all key elements of the cessations process (communication with actuaries, receipt of the funding proposal, review of the funding proposal by employers and approval of the funding agreements) are completed and recorded; and
- a number of operational roles and responsibilities for each stage of the process (for example, employer affordability calculations; due diligence / employer financial analysis; confirmation of member data accuracy; and actuarial engagement) have not been clearly defined and documented.

3. Effectiveness of the cessations process

Review of a sample of 5 employer cessations confirmed that there was insufficient documentation available to demonstrate that LPF had effectively considered the affordability and security aspects of employer funding proposals:

- On two occasions (FourSquare and St Columba's Hospice) employer funding proposals were approved by a member of senior management. Whilst management advised that financial analysis had been performed to assess affordability, no evidence was provided to confirm completion or demonstrate what senior management had considered when approving the funding proposal.
- In the case of FourSquare, there was no evidence of completion of due diligence on the availability of security to reduce LPF's risk of financial exposure. Communications provided confirmed that

property was only considered as security when the employer raised a query around the impact of selling property on the enactment of the anti-embarrassment clause.

4. Actuarial Engagement

As LPF does not maintain a communication log between employers, LPF and the actuary for each cessation, the only available evidence or review was email chains that were not consistently clear on exact timelines for requests, and when responses were received from the actuary.

Review of the effectiveness of LPF's engagement of actuaries across a sample of five employer cessations highlighted varying timeframes in relation to actuarial engagement.

It is acknowledged that this is mainly attributable to the time required for receipt and collation of all relevant information and data cleansing, however this was not clear from the records provided.

Specifically:

- AMEY – upon completion of their contract with the Council, AMEY was required to exit the scheme. This was confirmed on 15th August 2020, however, the request for the final exit valuation was not sent by LPF to the actuary until 9th October 2020, circa eight weeks after confirmation of the exit date.
- Scottish Legal Complaints Commission – the employer notified LPF of their request to exit on 28th October 2019, however, the actuary was not informed until 10th December 2019, which is more than over six weeks following the notification date.
- Victim Support Scotland – no written evidence of the request being made to actuary was provided. Consequently, we were unable to determine the length of time between request to exit and engagement of the actuary.

Risk

The potential risks associated with our findings are:

- Non-alignment with the requirements of and the guidance supporting the Council's Information Governance Policy.
- Inability to locate key cessation documents to respond to complaints and support external reviews.
- LPF cannot demonstrate that all aspects of the cessation process have been completed, and were completed in a timely manner.
- LPF cannot confirm which employees have been responsible for, and who has authorised the relevant stages of the cessation process.
- LPF is unable to demonstrate that employer affordability has been fully and effectively considered, resulting in acceptance of employer funding proposals that either over or under commit the employer. This could lead to financial loss; reputational damage; and further risk to active employers where payments are either not received, or are received more slowly than is actually affordable by the existing employer.
- Potential security options remain unidentified, exposing LPF to financial risk.
- LPF is unable to confirm whether the actuary has provided exit valuations within agreed timeframes (the final exit valuation within ten working days per the agreement with Hyman's Robertson) and may not be able to identify and address any significant actuarial delays.

1.1 Recommendation: Cessation checklist

1. A cessations checklist should be prepared and consistently applied to (at least) all complex employer cessations where an exit debt is established and not immediately settled. It is acknowledged that each employer cessation is unique, however there are standard processes and

documentation that are essential for all cessation events.

The checklist should include (as a minimum):

- Date the employer requested to exit and confirmed exit date;
 - Timestamp details of communications with the actuary (refer finding 3 below);
 - File location of the funding proposal provided by the employer;
 - The file location of and team member responsible for completion of affordability analysis and due diligence on potential employer securities;
 - Senior management responsible for reviewing and approving the funding proposal analysis;
 - Details of the measures taken to reduce risk to other employers (short term agreement / obtaining security / anti-embarrassment clauses);
 - The file location of and team member responsible for drafting the funding agreement;
 - Senior management responsible for reviewing and approving the funding agreement; and
 - Detail of any unique or specific risks associated with each individual cessation (refer finding 2 below).
2. Management should prepare this summary for each employer cessation and review it regularly throughout the exit process to ensure that the process has been consistently applied and completed on time.

1.1 Agreed Management Action: Cessation checklist

Recommendation (1) We intend to introduce a cessation checklist. We would expect this checklist to evolve as experience is gained.

Recommendation (2) The checklist will be prepared and used for each cessation.

Owner: Stephen Moir, Executive Director of Resources

Contributors: Hugh Dunn, Head of Finance; David Vallery, Chief Executive, Lothian Pension Fund;

Implementation Date:
31/12/2021

1.2 Recommendation: Affordability and due diligence templates

1. LPF management should prepare an affordability assessment template that clearly defines affordability, and what financial and non-financial metrics should be considered to assess and approve an employer's funding proposal.
2. A due diligence template should also be prepared that details the relevant steps to be applied and questions to be asked of the employer to determine the extent of security available to support the funding arrangements.
3. The affordability and due diligence assessments should be prepared for each employer, reviewed by an appropriate member of senior management and their file locations recorded in the cessations checklist for future reference.

1.2 Agreed Management Action: Affordability and due diligence templates

We will look to see whether enhancements can be made to the existing documentation of calculations and affordability assessment.

Owner: Stephen Moir, Executive Director of Resources

Implementation Date:
31/3/2022

Contributors: Hugh Dunn, Head of Finance; David Vallery, Chief Executive, Lothian Pension Fund;

1.3 Recommendation: Actuary Communication log

1. LPF should consider whether a service level agreement should be developed and included in the funding strategy that specifies timeframes for receipt of information and data cleansing and actuarial notification.
2. LPF should implement an actuary communication log that includes (at a minimum) the key dates noted below and is regularly reviewed to identify and address any significant or unexpected delays:
 - Date of employer's request to exit;
 - Date exit valuation request submitted to actuary by LPF, together with supporting rationale for any delays;
 - Date all information was provided to the actuary; and
 - Date of response from the actuary.
3. LPF management should review the communication log regularly to ensure that SLAs continue to be met and any delays are investigated and expedited.
4. The communication log should be cross referenced in the cessations checklist (refer 1.1 above) and centrally stored.

1.3 Agreed Management Action: Actuary Communication log

LPF will seek to ensure the Cessations checklist being introduced will include appropriate communications aspects and will be reviewed throughout the process and stored centrally.

LPF will explore the possibility of an SLA.

Owner: Stephen Moir, Executive Director of Resources

Contributors: Hugh Dunn, Head of Finance; David Vallery, Chief Executive, Lothian Pension Fund;

Implementation Date:
31/12/2021

2. Risk management and governance

Medium

Review of the risk management and governance controls supporting the LPF cessations process confirmed that:

1. Identification of employee operational cessations risks - whilst LPF maintains an overarching risk register (maintained by the Risk Management Group) that included 36 high level risks as at November 2020 (including employer risk), no granular employer cessation risks are recorded.

We understand that LPF is currently refreshing its risk management framework following successful recruitment of a Risk Management and Compliance Manager. Management has also advised that there has been progress with this between completion of IA fieldwork on the risk management process (January 2021), and finalisation of the audit in May 2021.

2. Risk management oversight – the Employer Oversight Group (EOG) is responsible for oversight of both active and exited employers. Whilst regular meetings are held, there is limited evidence of agendas or meeting minutes. Consequently, we have been unable to determine whether risk is considered regularly by the EOG or how new risks are identified and escalated to the Risk

Management Group for inclusion in the LPF risk register.

Risks

The potential risks associated with our findings are:

- LPF does not have a comprehensive view of their employer cessation risks.
- New and emerging employer cessation risks are not identified; assessed; recorded and managed by implementation of appropriate action plans to mitigate these risks.

2.1 Recommendation: Employer cessations risk register

LPF management should:

1. Complete an exercise to identify; assess; and record all new and existing original (inherent) and current (residual) risks associated with the employer cessation process.
2. Once completed, an assessment should be performed to determine whether current risks are within or exceed LPF's risk appetite.
3. Where risks exceed risk appetite, appropriate action plans and implementation timeframes should be established, with responsibility for completion of actions allocated to appropriate LPF employees.
4. Consideration of emerging and existing employer cessation risks should feature as a standing agenda item (at an appropriate frequency) for the Employer Oversight Group.
5. An escalation process should be established to support escalation of significant employer cessation risks from the Employer Oversight Group to the LPF Risk Management Group for inclusion in the main LPF risk register.

2.1 Agreed Management Action: Employer cessations risk register

Recommendations 1-5: In creating the cessations and communication checklist and considering governance and oversight arrangements (see below), both of which will improve risk management, we will consider whether additional improvements can be made.

Owner: Stephen Moir, Executive Director of Resources

Contributors: Hugh Dunn, Head of Finance; David Vallery, Chief Executive, Lothian Pension Fund;

Implementation Date:

31/3/22

2.2 Recommendation: Employer Oversight Group agenda and minutes

1. A standing agenda and minutes of Employer Oversight Group meetings should be maintained.
2. The status of open actions should be reviewed at subsequent meetings to confirm that they have been completed.

2.2 Agreed Management Action: Employer Oversight Group agenda and minutes

A Governance review across LPF is commencing in 4Q21 and will, inter-alia, consider the benefit of introducing formal minutes to the EOG and clarify decision-making and authorities across the LPF Group. This is intended to be completed by 31/12/21.

Owner: Stephen Moir, Executive Director of Resources

Contributors: Hugh Dunn, Head of Finance; David Vallery, Chief Executive, Lothian Pension Fund;

Implementation Date:

31/12/2021

3. Terminology within funding agreements

Advisory

As part of our review, we considered the future landscape of LGPS regulations. There has been updates to regulations and recommendations written in England which may impact Scottish regulations in future. As such, we have raised these points as an advisory note to management so they can consider the potential impact on their current operations.

The evidence reviewed for communications with exiting employers did not explicitly cover the changed relationship which an "exiting employer" has with the LPF i.e. an employer in the process of paying off an exit payment over time in accordance with a funding agreement.

It is recommended that a clear communication is issued to avoid any future misunderstanding and should include:

- the irrevocability of the funding agreement such that the employer cannot elect to switch back to becoming an employer subject to ongoing valuations, for example, where they believe this could reduce contributions due where the employer expects to experience a sustained period of high investment returns;
- the changed accounting requirements of the employer's pensions obligation to be discussed with an individual employer's auditor; and
- the significant changes to the employer's discretionary benefits policy shared with the LPF such that the LPF will take over the majority of the discretionary powers previously held by the employer but should confirm any which remain with the exiting employer.

LPF Management Response

We intend to await the completion of the SPPA consultation having input to this consultation before amending procedures. We are aware that changes to the Local Government Pension Scheme (Scotland) Regulations have been mooted.

Appendix 1: Basis of our classifications

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

Appendix 2: Areas of audit focus

The areas of audit focus and related control objectives that were included in the review are:

Audit Area	Control Objectives	Risks
LGPS Regulatory Compliance	<ul style="list-style-type: none"> Processes have been established to confirm ongoing compliance with the most recent Funding Strategy Statement and Pensions Administration Strategy for all employer exits The Fund has confirmed that its exiting employer approach is compliant with LGPS regulations. 	<ul style="list-style-type: none"> Employer exits are not carried out in accordance with the most recent Funding Strategy Statement or Pensions Administration Strategy The LPF cessation approach is not LGPS compliant.
Employer Monitoring and Engagement	<ul style="list-style-type: none"> The status of employers is regularly monitored. Any employers that reach the threshold of five active employees are switched to the low risk funding and investment strategy. Employers are provided with appropriate cessation estimates periodically and on request. Any request from an employer to exit the fund is managed appropriately with action taken to progress the request including gathering of relevant information, including affordability constraints, availability of security and wider covenant information. Employers are given sufficient notice to respond to any changes in the rates and adjustments certificate. If considered unaffordable, the Fund will facilitate the termination process for the respective employer to avoid further accumulation of liabilities. 	<ul style="list-style-type: none"> Employers that are close to exit are not managed appropriately, leading to increased risk over their exit valuation. Employers who do not alter their contribution profile will increase the risk of unaffordable exit debts. Employers are not aware of the potential quantum of exit payments due prior to cessation. Requests by employers to exit the fund are not managed appropriately leading to delays in exit and employer relation issues. Changes to the rates and adjustments certificate render membership of the Fund unaffordable to employers. Late notification to employers could result in unplanned exits and subsequent financial risk.
Management of suspension notices and funding agreements	<ul style="list-style-type: none"> There is a robust process for offering suspension notices and funding agreements to 	<ul style="list-style-type: none"> The Fund faces reputational risk if processes are not in place, or are ineffective, resulting in unaffordable

	<p>employers, where appropriate.</p> <ul style="list-style-type: none"> • All agreements have been drafted by appropriately skilled legal personnel and approved by senior management. • All employer proposals for funding agreements undergo suitable due diligence prior to being entered into and are approved in line with applicable delegated authorities, as determined by the Pensions Committee in 2015. • Employers are monitored regularly with appropriate monitoring conditions imposed. • Anti-embarrassment clauses are included in all agreements to facilitate cash flow adjustments upon receipt of new information. • Fund officers have sufficient training and opportunities to consult to review proposals received including offers of security and evidence of affordability constraints • There is a robust process over invoicing employers for agreed payments and record keeping of all payments received. • The fund performs annual covenant analysis for all employers. 	<p>contributions adversely impacting employers.</p> <ul style="list-style-type: none"> • Proposals are not reviewed appropriately with legal input (where required) and finalised in a timely manner. • Key information pertaining to the financial and operational health of the employer is missed, leading to incorrect suspension and funding agreement decisions • Employer financial status changes over time, changing their ability to repay their exit payment i.e. debt to the Fund. • The funding strategy risk profile is not commensurate with the security offer accepted, if applicable. • Funding agreements are inappropriately long and / or back ended payments, resulting in increased financial risk to the fund. • Failure to collect payments from employers increases cash flow risks to the Fund.
<p>Governance and decision making</p>	<ul style="list-style-type: none"> • Fund officers make regular reports to the Pension Committee to ensure oversight over exiting employers and any subsequent suspension notices or funding agreements. • There is a clearly defined delegation authority for the relevant Fund Officer which has been approved by the Pension Committee. 	<ul style="list-style-type: none"> • The number and exit payment i.e. debt value of exiting employers is not properly reported. • LPF's exposure in relation to suspension notices or funding agreements is not fully reported and understood. • Fund officers are not authorised to make decisions on funding agreements and suspension notices for large exit debts.

Management of Member Data	<ul style="list-style-type: none"> Member records are updated accurately in a timely manner. 	<ul style="list-style-type: none"> Exit valuation positions or benefit awards are delayed
Use and management of actuaries and of actuarial results	<ul style="list-style-type: none"> Upon request to exit, actuaries are engaged to provide an exit valuation on a timely basis to help inform the decision making of the employer. The Fund makes all reasonable efforts to ensure the actuaries are fully aware of employer information. e.g. type of admission body. Compliance with regulations on updated Rates and Adjustment Certificates is achieved. 	<ul style="list-style-type: none"> The actuaries do not have complete information in relation to the employer, impacting valuation techniques used. Exit valuations produced by the actuaries are inaccurate or received in a timely manner. The Rates and Adjustment Certificate is not updated on time, in a complete manner.
Risk Management	<ul style="list-style-type: none"> LPF Risks associated with cessation have been identified; assessed; and recoded in the LPF risk register. Appropriate actions implemented to ensure that the risks identified are effectively managed and mitigated (where possible). 	<ul style="list-style-type: none"> Risks are not identified and crystallise to become issues that impact either completion of the cessation process, or repayment of exit debt to LPF.