



## **Pensions Committee**

2.00pm, Tuesday, 22 March 2022

### **Lothian Pension Fund – Proposed Internal Audit plan for 2022/23**

#### **1. Recommendations**

---

The Pensions Committee (Committee) is requested to:

- 1.1 review and approve the proposed Lothian Pension Fund 2022/23 Internal Audit plan.

**Lesley Newdall**

Chief Internal Auditor

Legal and Assurance Division, Corporate Services Directorate

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

# Lothian Pension Fund – Proposed Internal Audit plan for 2022/23

## 2. Executive Summary

---

- 2.1 The purpose of this paper is to present the Lothian Pension Fund (LPF) proposed Internal Audit (IA) plan (the plan) for the period 1 April 2022 to 31 March 2023 to the Committee for review and approval.
- 2.2 Two large scale reviews have been included in the proposed plan that focus on Project Forth design and implementation readiness, and the adequacy and effectiveness of LPFs technology security assurance arrangements. Whilst this is a lower number of audits in comparison to previous years, these reviews should provide assurance on LPF's most significant risks.
- 2.3 The plan will also include ongoing IA follow up on implementation of previously raised findings, and LPF also may be included within the scope of any relevant City of Edinburgh Council (the Council) thematic reviews included in the Council's 2022/23 IA plan.
- 2.4 This concentrated focus on Project Forth does present an assurance risk if Project Forth does not proceed. If this occurs, the annual plan will be refreshed and an alternative plan presented to the Committee for approval, together with an assessment confirming whether it can be delivered in sufficient time to provide an IA annual opinion.
- 2.5 Public Sector Internal Audit Standards (PSIAS) 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 that was approved by the Council's Governance, Risk and Best Value Committee in March 2022 fulfils this requirement.

## 3. Background

---

- 3.1 The LPF IA plan is driven by PSIAS requirements; LPF's organisational objectives and priorities; and an assessment of the risks that could prevent LPF from meeting those objectives and providing pension services to employers and members.
- 3.2 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 the organisation'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.

- 3.3 PSIAS also specifies that internal audit activity must evaluate the effectiveness of risk management processes and contribute to their improvement.
- 3.4 The methodology used to create the LPF IA plan is the same as that applied when developing the Council's 2022/23 IA annual plan that was presented to the Governance, Risk, and Best Value (GRBV) Committee together with the IA charter for approval on 8 March 2022. The Council plan also includes the IA days required to deliver the LPF 2022/23 plan.
- 3.5 The plan has been developed with the LPF senior management team; the Convenor of the Pensions Audit Sub Committee; and the Fund's Independent Professional Observer to ensure that Internal Audit (IA) assurance activity is focused on the most relevant risks for LPF.
- 3.6 The current Internal Audit co-source arrangement will continue be used to in 2022/23 to support delivery of the LPF annual plan.
- 3.7 It should also be noted that Internal Audit is not the sole source of assurance provision for LPF, as a number of 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.

## **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 Additionally, no IA assurance will be provided in relation to 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.

### **Preparation and content of the proposed plan**

- 4.3 The areas proposed for inclusion in the plan were identified by considering the key risks included in the LPF risk register as at November 2021, and discussions with the LPF management team; the Convenor of the Pensions Audit Sub Committee; and the Fund's Independent Professional Observer.
- 4.4 The LPF November 2021 risk register included a total of 37 risks. Of these, 1 risk was rated as high or red (resolve urgently where possible); 16 moderate or amber (resolve where possible); and 20 low or green (monitor).

- 4.5 The high rated risk (risk 33) highlights that LPF employee resources may not be sufficient to support either active or planned projects.
- 4.6 The 16 moderate rated risks highlight the potential impacts associated with:
- Risk 1 - adverse investment performance;
  - Risk 2 - adverse changes in non-investment actuarial assumptions;
  - Risk 3 - failure of employers to pay contributions;
  - Risk 7 - failure of IT systems;
  - Risk 8 - culture, values, and strategy are not consistently applied;
  - Risk 9 - poor Pensions Committee decision making;
  - Risk 11 - business continuity;
  - Risk 12 - loss of confidential member data;
  - Risk 15 - failure to pay pensions;
  - Risk 20 - regulatory breaches;
  - Risk 21 – non-compliance with information rights requirements;
  - Risk 23 - acting beyond delegated authorities;
  - Risk 25 - breach of procurement policies or regulations;
  - Risk 27 - group structure and governance arrangements do not support strategic delivery;
  - Risk 35 - failure of suppliers and third party systems; and
  - Risk 36 - inadequate cyber security protections
- 4.7 The scope of the three reviews planned for the year to 31 March 2023 is included at Appendix 1 together with details of the current LPF risks associated with these areas. Details of 2021/22 audit outcomes (where completed), and assurance coverage and outcomes for the prior four years have also been included for information.
- 4.8 Management has advised that the Fund’s most significant current risk relates to the design and implementation of Project Forth proposals, and the proposed 2022/23 annual plan includes an agile review of the design of Project Forth project management and governance arrangements, and implementation readiness.
- 4.9 The proposed plan also includes a review of the design adequacy of technology security assurance arrangements, and LPF’s progress with implementation of technology assurance recommendations following implementation of the new LPF technology model arrangements in 2021/22.
- 4.10 As the proposed plan is mainly focused on Project Forth and the design of new support services (for example, information governance; procurement; and third-party supplier management arrangements) to be established independently from the

City of Edinburgh Council, there is a risk that the plan may be subject to change and / or delay if Project Forth does not proceed or is delayed, or if new support services are not established or delayed.

- 4.11 If this situation occurs, the annual plan will be rebased, and a refreshed plan based on LPF operational pensions activities will be presented to the Committee for approval, together with a view as to whether this can be completed in sufficient time to support the IA annual opinion.
- 4.12 If Project Forth does proceed, it is expected that a further review will be completed in 2023/24 that focuses on the effectiveness of project implementation, together with review of a sample of operational pensions processes that will be determined from consideration of the new organisation's most significant operational risks.
- 4.13 The proposed Internal audit reviews planned for the year to 31 March 2023 should provide assurance on one high and 8 of the 16 moderate rated risks included in the LPF risk register (please refer Appendix 1). 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.

#### **Agile Auditing and IA Independence**

- 4.14 The 2020/21 and 2021/22 LPF IA annual plans included 'agile' audits of implementation of the Charles River system and LPF Technology Model Development.
- 4.15 Agile auditing is a recognised IA approach that is fully aligned with PSIAS requirements; enables provision of real time as opposed to retrospective assurance; and is especially useful where an organisation is planning significant change, as assurance can be provided on the design of new processes and systems prior to, or soon after, their implementation.
- 4.16 Additionally, the agile auditing concept has been endorsed by the Institute of Internal Auditors (IIA) and the Chartered Institute of Public Finance Accountancy (CIPFA) who jointly co-authored the PSIAS, and the UK Public Sector Internal Audit Standards Advisory Board (IASAB).
- 4.17 When performing an agile audit, IA will make recommendations (where appropriate) on the governance of the project and / or the proposed design and implementation of the new processes or systems for management to consider. IA independence is during an agile audit is maintained by ensuring that all final operational decisions in relation to the design of new processes are made by management.

- 4.18 A paper outlining the Council’s approach to agile auditing was presented to, and approved by the Council’s GRBV Committee in July 2020.

### **Risk Management**

- 4.19 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.
- 4.20 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.
- 4.21 As the last targeted risk management audit for LPF was completed in 2021/22, the proposed 2022/23 reviews will consider whether risks associated with the areas included in scope have been effectively identified; assessed; recorded; and managed.

### **Council wide thematic IA reviews**

- 4.22 It should be noted that LPF may also be included within the scope of any relevant Council wide thematic reviews included in the 2022/23 IA plan that was approved by the GRBV Committee in March 2022.
- 4.23 The three most relevant audits included in the Council’s 2022/23 IA annual plan are:
- Induction, Essential Learning and Training for Employees and Committee Members;
  - Validation of Implementation of IA Management Actions; and
  - Workforce Capacity to Support Service Delivery.

### **Follow-up activity**

- 4.24 Follow-up work will also be performed to confirm whether agreed management actions implemented to support closure of findings raised in previous LPF audits have been effectively implemented and sustained.

## **5. Financial impact**

---

- 5.1 The estimated costs associated with delivery of the LPF 2022/23 IA plan are £80,000, in comparison to the circa £70,000 incurred for 2021/22. This increase reflects an estimate for any additional time required to provide an appropriate level of assurance on Project Forth.

- 5.2 Costs applied to LPF for the 2022/23 plan year will be based on agreed rates as specified in the IA external co-source contract and actual time spent by the Council's IA team as recorded in IA time sheets, and will be discussed and agreed with LPF management.

## **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 2022/23 IA plan.

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

---

- 7.1 [Public Sector Internal Audit Standards](#)
- 7.2 [Internal Audit: Agile Auditing and Consultancy Support paper presented to GRBV July 2020 Paper 8.3](#)

## **8. Appendices**

---

Appendix 1 – LPF: Proposed audits for inclusion in the 2022/23 annual plan

# Appendix 1 - Lothian Pension Fund: Proposed Audits for Inclusion in the 2022/23 Internal Audit Annual Plan

Audits Completed 17/18	Audits Completed 18/19	Audits Completed 19/20	Audits Completed 2020/21	Audits Completed 2021/22	Proposed Audits 2022/23	Relevant LPF Risks (Nov 21)	Proposed Audits 2023/24
<p><b>IT Business Resilience and Disaster Recovery</b> 2 High rated findings raised</p>	<p><b>Unlisted Investment Valuations and Application of Fund Administration Fees and Charges</b> – overall adequate (green) with no findings raised</p>	<p><b>Charles River Project – pre Implementation System Testing</b> – overall effective (green), 1 Medium finding raised</p>	<p><b>LPF Technology Model Development</b> Agile review of the design of the new LPF technology model – no findings raised</p>	<p><b>LPF Technology Model Development</b> – some improvement required (amber), and 3 Medium findings raised.</p>	<p><b>Project Forth</b> – agile review of the design of Project Forth that will include:</p> <ul style="list-style-type: none"> <li>project governance</li> <li>design of new support services (for example information governance; procurement; third party supplier management; health and safety)</li> <li>funds transfer</li> <li>implementation readiness (including colleague transfer)</li> </ul>	<ul style="list-style-type: none"> <li>Risk 33 – adequacy of employee resources to support projects (High)</li> <li>Risk 12 – loss of confidential member date (moderate)</li> <li>Risk 21 – non-compliance with information rights requirements</li> <li>Risk 25 – breach of procurement policies or regulations</li> <li>Risk 35 – failure of suppliers and third party systems</li> </ul>	<p><b>Project Forth</b> – agile review of Project Forth implementation to confirm that the Project has been implemented effectively and as designed.</p>
<p><b>Pensions Tax (Annual and Lifetime Allowances)</b> – 1 High 1 Medium Findings raised</p>	<p><b>Unitisation</b> – overall adequate (green) with 1 Medium and 1 Low Findings raised.</p>	<p><b>Pension Entitlement Calculations</b> – some improvement required (amber), 2 Low rated findings raised</p>	<p><b>Employer Cessation Strategies, Valuations, and Exit Calculations</b> – some improvement required (amber), and 1 High; 1 Medium; and 1 Advisory findings raised.</p>	<p><b>Capital Calls</b> – effective (green) and one Low and one Advisory findings raised.</p>			
<p><b>Payroll Outsourcing Security Due Diligence</b> – 1 High and 1 Low Finding raised</p>	<p><b>Stock Lending</b> – overall adequate (green) with no findings raised.</p>	<p><b>Settlement and Custodian services</b> – significant improvement required (red): 1 High; 2 Medium; and 1 Low findings raised</p>	<p><b>Bulk Transfers</b> – effective (green), and 1 Medium and 1 Low findings raised.</p>	<p><b>Receipt of Employer Contributions</b> – effective (green) and four Low rated findings raised.</p>	<p><b>Adequacy of Technology Security Assurance Arrangements</b> – this review will consider the design adequacy of the ongoing technology assurance provided by Bridewell, and LPF’s progress with implementation of Bridewell assurance recommendations</p>	<ul style="list-style-type: none"> <li>Risk 7 – failure of IT systems (moderate)</li> <li>Risk 36 – inadequate cyber security protections (moderate)</li> <li>Risk 11 – business continuity (moderate)</li> <li>Risk 12 – loss of confidential member data (moderate)</li> </ul>	<p><b>Review of a sample of Pensions operational processes</b> – details to be confirmed based on review of refreshed risk register post Forth Implementation.</p>
<p><b>Information Governance</b> – 2 Medium and 3 Low findings raised</p>				<p><b>Risk Management and Assurance Framework</b> – audit currently in progress.</p>			