



Pensions Committee

2pm, Tuesday, 22 March 2022

Lothian Pension Fund - Internal Audit Update as at 28 February 2022

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; and
- 1.2 progress with implementation of agreed management actions to support closure of LPF IA findings raised.

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Lothian Pension Fund - Internal Audit Update as at 28 February 2022

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 three audits completed and one in progress.
- 2.3 As at 28 February 2022, LPF had 5 open IA findings (1 High; 3 Medium; 1 Low) and 7 supporting agreed management actions (1 High; 5 Medium; 1 Low) raised in the Bulk Transfers; Cessations; and Custodian Services reviews. Of these one medium rated finding raised in the Custodian Services audit was overdue. Implementation progress for this overdue finding will be considered as part of the current Risk Management audit.
- 2.4 Reports detailing the outcomes of the Technology Model Development (some improvement required); Capital Calls; (effective) and Receipt of Employer Contributions (effective) reviews are 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 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.
- 3.3 The 2021/22 LPF IA plan was approved by the Pensions Committee in March 2021, and included the following four audits:
 - 3.3.1 Technology Model Development (City of Edinburgh Council);
 - 3.3.2 Capital Calls (PwC);
 - 3.3.3 Receipt of Employer Contributions (PwC); and
 - 3.3.4 Risk Management and Assurance Framework (PwC)

- 3.4 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

- 3.5 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.
- 3.6 Details of additional assurance provided on LPF activities is included in the LPF assurance map maintained by management.
- 3.7 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.
- 3.8 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.
- 3.9 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.
- 3.10 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

- 3.11 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.
- 3.12 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.

- 3.13 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.
- 3.14 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.
- 3.15 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.
- 3.16 A 'started' status recorded by management confirms that the agreed management action remains open and that implementation progress ongoing.
- 3.17 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 2021/22 LPF IA annual plan

- 4.1 Three of the four audits included in the 2021/22 IA annual plan have now been completed. Further details of the outcomes of these reviews is included below.
- 4.2 The Risk Management audit is currently in progress and should be completed by the end of March 2022.

Technology Model Development (Some Improvement Required)

- 4.3 This review provided reasonable assurance on the design and effectiveness of the project governance and risk management frameworks established to support the transition to the new externally hosted LPF technology network
- 4.4 Some moderate control weaknesses were identified in relation to project management and governance; testing; and post implementation activities, and three medium rated findings were raised.
- 4.5 Recognising that projects of this scale occur relatively infrequently at LPF, it was agreed that current management actions would not be implemented to address IA recommendations that will be addressed as part of future LPF projects.

Consequently, management actions have been agreed only for the finding in relation to post implementation activities.

- 4.6 The final report is included at Appendix 1.

Capital Calls (Effective)

- 4.7 The review confirmed that the control environment and governance and risk management frameworks supporting the capital calls process have been adequately designed and are operating effectively, providing assurance that all capital calls should be processed in line with established capital call agreements.
- 4.8 One low rated finding was raised highlighting the need to update the 'alternatives procedures' that support the capital calls process.
- 4.9 The final report is included at Appendix 2.

Employer Contributions (Effective)

- 4.10 The review confirmed that the control environment and governance and risk management frameworks supporting the LPF employers contribution process are adequately designed and are operating effectively, providing assurance that employer contributions are paid to the Fund in accordance with Fund regulation requirements.
- 4.11 Four low rated findings were raised highlighting the need to update policies and procedures; ensure that all contribution differences or issues are followed up when identified; define the parameters that should be applied to identify exceptions for escalation to the Pensions Committee; and upgrade the technology portal supporting the employers contribution process to support automated calculation of any differences between expected and actual employer contributions.
- 4.12 The final report is included at Appendix 3.

Status of Internal Audit Findings as at 28 February 2022

Open IA Findings

- 4.13 As at 28 February 2022, LPF had 5 open IA findings (1 High; 3 Medium; 1 Low) and 7 supporting agreed management actions (1 High; 5 Medium; 1 Low) raised in the Bulk Transfers; Cessations; and Custodian Services reviews.
- 4.14 The high rated open finding was raised in the Cessations audit and highlighted the need for LPF to document and retain evidence of consideration of due diligence; affordability assessments; and other decisions made during the cessations process.
- 4.15 Of these 5 open findings, 4 findings and 6 management actions are not yet due for completion, with implementation currently being progressed by LPF.

Overdue IA findings

- 4.16 As at 28 February 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.
- 4.17 Progress towards closure of this finding will be considered as part of the 2021/22 Risk Management review that is currently in progress.
- 4.18 Further information on the overdue Settlement and Custodian Services audit finding is included at Appendix 4.

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 Final Technology Model Development Internal Audit Report
- Appendix 2 Final Capital Calls Internal Audit Report
- Appendix 3 Final Employer Contributions Internal Audit Report

Appendix 4 Lothian Pension Fund Internal Audit Overdue Management Actions as at 28 February 2022

The City of Edinburgh Council

Internal Audit

Lothian Pension Fund Technology Model Development

Final Report

1 February 2022

LPF2003

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 LPF's objectives should be achieved.

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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

Lothian Pension Fund (LPF) has procured a new, bespoke technology managed service to replace the previous service which was provided by the City of Edinburgh Council and CGI, who are also the Council's technology partner. This was a key part of the wider LPF technology strategy.

The objectives for changing providers were to meet the requirements of LPF's Technology Strategy; increase resilience; and to meet the [Financial Conduct Authority's](#) (FCA) control and governance standards.

The design of the new model includes provision and ongoing management of a new hosted technology network, telephony service and website; and engaging a cybersecurity adviser to provide independent assurance on ongoing network security and the cloud-based technology applications used by LPF.

Procurement Process

The procurement process applied to select both the new technology managed service provider and the cybersecurity adviser followed the "Competitive procedure with negotiation" approach as defined in [The Public Contracts \(Scotland\) Regulations 2015](#).

A contract was signed between LPF and [Cased Dimensions](#) on 31 March 2021 for provision of the hosted network and telephony system. The services provided by Cased Dimensions include:

- A secure network that will support the storage of LPF's data on SharePoint, following the data migration from the current supplier;
- A secure telephony and call recording system;
- Support services, including service desk, capacity management, and security; and
- Professional services, including ICT strategic advice and web hosting.

The independent cybersecurity firm [Bridewell](#) has been selected to provide ongoing assurance on the security of the new system, and LPF's cloud-based applications, including:

- An initial security review once the service is up and running, including an assessment of the Cased Dimension's security plan, all systems used by LPF (including cloud-based providers), and penetration testing;
- An annual security review, which will include network and perimeter security, access control, and management of third-party providers and risks;
- Ongoing accreditation support, for example with achievement of Cyber Essentials accreditation; and
- Ad-hoc security advice, for example in the event of technology or regulatory changes.

Professional Support

Professional advisers were engaged for all key stages of the project. LPF's Technology Strategy and Specification were reviewed by an independent professional adviser and the Council's Digital Services team, and external legal services were engaged to support the legal evaluation of procurement responses and contract preparation.

Submissions by bidders were reviewed and scored by LPF's Chief Executive Officer, and IT Oversight and Governance Manager, with support from the Council's Commercial and Procurement Services team.

Project Oversight and Governance

The working group responsible for project implementation was the LPF ICT Procurement Steering Group, which included attendees from LPF, and the Council's Finance; Digital Services; Commercial and Procurement Services; and Internal Audit teams. The project group met weekly and discussed and tracked all elements of the project. In addition, the steering group met at each major milestone, and the LPF Senior Leadership Team also reviewed progress at the monthly IT Oversight and Governance Group and could be called upon to make decisions at any time.

Project Implementation

A two-stage implementation approach was applied prior to going live with the new Cased Dimensions network.

Stage 1 involved completion of independent penetration testing by Bridewell on the new technology environment prior to data migration, and completion of a satisfactory data privacy impact assessment (DPIA) for the data migration process.

Following successful completion of stage 1, the decision to transfer LPF data from the current to the new network was taken on 6 August 2021, and the data transfer process has now been completed.

Stage 2 required confirmation of ongoing security; data and records management and governance arrangements (supported by completion of a further DPIA); and satisfactory completion of user acceptance testing.

Following this, users were migrated to the new Cased Dimensions system.

Weekly Project Board review meetings were held between LPF, the Council, and Cased Dimensions to ensure the project progressed towards full implementation.

Scope

The scope of this review assessed the design and operating effectiveness of key project management controls established to support implementation of the new LPF network and assurance arrangements to mitigate the following Lothian Pension Fund risks:

- **Technology (General Resilience)** – Failure of IT systems used in the Fund with serious consequences for investment management, benefit administration and oversight activities;
- **Financial / Regulatory / Reputational** - Human Resource within the Fund not sufficient to carry out core tasks in conjunction with active or anticipated projects;
- **Financial / Regulatory / Reputational** - Cybersecurity protections and/or back-up not sufficient to prevent cyber-attacks or minimise their impact; and
- **Financial / Regulatory / Reputational** - Inadequate, or failure of, supplier and other third-party systems (including IT and Data security).

Our areas of audit focus as detailed in our terms of reference are included at Appendix 2.

Testing was performed across the period July to November 2021.

Limitations of Scope

The scope of our review was limited to the design and implementation of the new managed ICT service and did not consider the operating effectiveness of the new arrangements, or other aspects of the LPF technology strategy, including further development of the LPF website.

Stage 2 was also specifically excluded from the scope of our review. The operating effectiveness of the new arrangements and other aspects of the LPF technology strategy will potentially be considered in future IA reviews.

Reporting Date

Our audit work concluded on 19 November 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: 3

Summary of findings raised

Medium	1. Project Management and Governance
Medium	2. Testing
Medium	3. Post Implementation Activities

Opinion

Some improvement required

Whilst some moderate control weaknesses were identified, in the design and effectiveness of the project governance and risk management frameworks established to support the transition to the new externally hosted LPF technology network, they provide reasonable assurance that risks are being managed, and that LPF's objectives to transition securely to the new network were achieved.

The transition to the new LPF network was generally well managed, with supplier contracts established prior to migration; an established project plan and governance arrangements; and independent external testing performed on the new network prior to migration.

Whilst recognising the size and scale of the LPF organisation, there was a significant key person dependency on the LPF Head of IT for effective delivery of the project, which involved ensuring that the new network would securely and effectively support connectivity to the wide range of cloud-based systems used by LPF; would provide LPF with secure email, telephony, and network arrangements; and support the secure transfer of all existing LPF data from the Council network.

It is also important to note that both project and key person dependency risks were substantially mitigated by appropriate contingency arrangements which ensured that existing LPF network arrangements provided by the Council in partnership with CGI would continue to operate if required.

However, some moderate weaknesses were identified in the governance; risk management; and testing arrangements established to support the project, highlighting the need to:

- ensure that a project risk appetite is established to support decision making throughout the project;
- develop more granular plans for some elements of the project (for example data cleansing and migration)
- record and monitor progress with implementation of all assurance recommendations throughout the project;
- establish comprehensive 'go / no go' decision criteria that considers all aspects of the project, including completion of all relevant testing;
- ensure that all project decisions are recorded, especially in relation to assurance recommendations or elements of the project that have not been completed prior to migration.
- complete a post implementation review.

Consequently, 3 Medium rated Internal Audit findings have been raised.

Further information on these findings is included at Section 3, and a list of findings which have been risk accepted by LPF are included at Appendix 3.

Internal Audit Follow-Up

Recognising that projects of this scale occur relatively infrequently at LPF, it has been agreed with LPF management that the routine Internal Audit follow-up process will not be applied to actions that will be implemented to support future LPF projects. Consequently, implementation dates for these future actions have not been agreed.

Instead, the management actions agreed to address the moderate risks identified will be considered as part of any future project assurance reviews completed by Internal Audit.

Areas of good practice

The following areas of good practice were identified during the review:

- The scope of the project had been determined and agreed by the project steering group
- Contracts were in place with all of the suppliers, with these contracts having been reviewed by LPF, the Council, and third-party experts
- There was effective oversight of the work by the project steering group
- An external security firm was employed to perform testing of the new system.
- Appropriate contingency arrangements had been established to ensure that LPF could continue to operate on the Council's network in the event that the transition to the new network was either not possible, or if the new network did not operate effectively.

LPF Overall Management Response

The approach taken with this project's management and governance was influenced by our size, the resources available and the scale/impact of the project.

Overall, the project was successful with the objectives achieved and with appropriate governance, strong risk management and comprehensive communication throughout. We acknowledge that there are always things that can be done differently with hindsight and with lessons learned and we thank Internal Audit for their Agile review of how this process was carried out and their diligence in compiling this report.

The management of projects within LPF will be receiving renewed focus in the coming year with the development and implementation of a project methodology to ensure that all projects are managed in an organised and consistent way relative to their size and complexity. The findings from this report will be incorporated into this methodology.

3. Detailed findings

1. Project Management and Governance

Medium

Review of the project management and governance arrangements supporting implementation of the new LPF technology network externally hosted by Cased Dimensions established that:

1. Risk Appetite

- No project risk appetite statement was created that clearly defined the risks LPF was prepared to accept in relation to project delivery and implementation by the third parties involved in the

project and support key project decisions.

It is acknowledged that management was implicitly aware of the risks associated with the project and that these were regularly discussed. Additionally, details of current technology operational risks and LPF's appetite to reduce these were discussed at Pensions Committee.

2. Data Privacy Impact Assessments (DPIA)

- As at 18 November 2021 4 of the 31 recommendations resulting from the Council's Information Governance Unit's (IGU) review of DPIAs completed by LPF on the governance and security of the new environment and arrangements for transfer of data to the new system had not been implemented. These related to:
 - a) Microsoft 365 control assurance
 - b) Review of the new network high level design
 - c) Bridewell security assurance activities
 - d) Vulnerability and patch management
- There is currently no requirement in established LPF technology policies to complete a DPIA for any significant technology or data management process changes.

3. Other Assurance Recommendations

- Other assurance recommendations received (for example, from Bridewell or the Council's Internal Audit team) were not centrally recorded and monitored to confirm whether they had either been risk accepted, or effectively implemented.
- Implementation of assurance recommendations was also managed by a single LPF employee, with delivery oversight from the LPF IT Oversight and Governance Group.
- Not all assurance recommendations received were resolved prior to data migration. LPF has confirmed that the risks associated with these remaining recommendations were accepted, although this was not formally recorded. However, LPF did not provide a formal statement relating to this acceptance, which could have included a statement on risk ratings and risk appetite. Management have advised that there was, however, extensive risk management performed for the project.

4. Data Cleansing and Migration

- No data cleansing plan was established and used by LPF to support data cleansing in advance of migrating data to the new network.

LPF management has advised that no data cleansing plan was required as the work involved was not complex and covered only the content of the existing LPF shared drive on the Council's corporate network. Management has confirmed that a data cleansing exercise will be performed post-migration.

- The LPF data migration plan did not include details of the physical transfer of data from CGI to Cased Dimensions and the potential risks associated with this physical migration process.

Both LPF and Cased Dimensions have confirmed that they were comfortable with the process applied and that there were no significant associated data loss risks. LPF management has also confirmed that a data migration risk was included in the risk register.

5. Go / no go Migration Decision Criteria

- 5.1. Go / no go migration decision criteria established by LPF did not require confirmation that the following had been completed prior to migration:
- user acceptance testing (UAT) work (e.g. for telephony),

- implementation of all relevant assurance recommendations,

LPF management has advised that new telephony solution did not need to be fully tested prior to the migration, as staff used their mobile phones as an interim solution, and the new LPF phone number did not go live until completion of training post migration.

- 5.2. Go / no go migration decision criteria was approved internally within LPF and had not shared with other teams and organisations (for example the Council's IGU and Digital Services teams, and CGI) who were also involved in the migration process.

Risks

The potential risks associated with our findings are:

- **Financial / Regulatory / Reputational** - Inadequate, or failure of, supplier and other third-party systems (including IT and Data security) – risk that the decision has been taken to migrate to the new system without fully understanding the risks associated with aspects of the project that are not yet fully complete.

1.1 Recommendation: Data Protection Impact Assessments

1. The outstanding recommendations arising from the IGU review of the two DPIAs should be actioned, with confirmation of completion provided to both the Council's Information Governance Unit (IGU), and the project steering group.
2. The requirement to conduct DPIAs for any significant changes to IT or data management should be stated in LPF's IT policy.

1.1 Agreed Management Action: Data Protection Impact Assessments

1. LPF is currently working closely with IGU to implement the recommendations from the DPIAs, this is progressing as a different workstream to the main migration project and will encompass areas out-with the IT migration.
2. LPF agree that there is a requirement to review data implications within projects and evaluate if a DPIA is required. This will be updated within a relevant policy, although the exact policy will be determined after our Information Security review.

Owner: Stephen Moir, Executive Director of Corporate Services
Contributors: Hugh Dunn, Service Director – Finance and Procurement; David Vallery, Chief Executive Officer (LPF); Anne Mitchell, Head of IT (LPF); Struan Fairbairn, Chief Risk Officer (LPF)

Implementation Date:
30 September 2022

1.2 Recommendation: Project Risk Appetite Statement and Assurance Log

For future LPF projects:

1. A risk project appetite statement should be defined that details the level of acceptable project delivery and implementation risks applicable to all parties involved in the project and should be used to support project decision making.
2. An assurance log should be implemented and maintained that records all assurance recommendations received.
3. Implementation progress should be tracked and monitored through all relevant project governance forums.
4. Assurance recommendations that have not yet been addressed should be considered as part of

any go / no go implementation decisions.

1.2 Agreed Management Action: Project Risk Appetite Statement Assurance Log

1. LPF agree that a risk project appetite statement should be produced for future projects, and this will become part of our Project Management methodology.
2. An overall project assurance or feedback log would be useful for future projects and will also become part of our PM methodology.
3. Progress of project implementation will continue to be tracked and monitored via the appropriate forums, which will be determined at the project outset.
4. LPF will ensure that any assurance recommendations that have not been addressed will be part of any go/no go decisions.

1.3 Recommendation: Data cleansing and transfer arrangements

1. Where data cleansing is required for future projects, a data cleansing plan should be created and approved by relevant project governance forums.
2. All future data transfer processes should also be fully documented; agreed by all parties involved; and approved by relevant project governance forums.

1.3 Agreed Management Action: Data cleansing and transfer arrangements

1. Data cleansing and/or transfer will be considered at the outset of any future projects and a decision made as to a course of action. In the event of a data cleansing plan being created, this will be shared with the relevant stakeholders and governance forums.
2. As with the IT data migration, LPF agree that any data transfer processes should be documented and agreed with appropriate approval from data owners and governance forums.

1.4 Recommendation: Go / No Go Implementation Decision Criteria

For future projects, the go / no go implementation decision criteria should:

1. include (but not be limited to) all key points noted in recommendations 1.1 to 1.3 above.
2. Be shared with all relevant parties involved in the project to confirm its completeness and accuracy.

1.4 Agreed Management Action: Go / No Go Criteria

LPF agree (as also captured in our Lessons Learnt exercise), that project go/no go decision criteria should be agreed at an earlier point and evaluated to ensure that it is reviewed and agreed by any relevant parties.

2. System Testing

Medium

Review of the LF system testing approach applied established that:

1. Bridewell performed a security check and raised 3 High; 17 Medium; and 5 Low rated findings in relation to the security risks associated with the migration to the new network.

2. No repeat testing was performed by Bridewell to confirm that these issues had been addressed by Cased Dimensions prior to implementation.

LPF management advised that these recommendations were not considered significant, and that effective remediation would be covered by subsequent testing across the network to be performed by Bridewell as part of their established contract to provide ongoing assurance in relation to LPF's externally hosted technology arrangements.

Risk

The potential risks associated with our findings are:

- **Financial / Regulatory / Reputational** - Inadequate, or failure of, supplier and other third-party systems (including IT and Data security) – risk that the decision has been taken to migrate to the new system without fully understanding the risks associated with testing outcomes that have not been fully remediated.

2.1 Recommendation: Testing

For future projects, where system security tests have identified potential vulnerabilities, LPF should either:

1. Repeat the tests to confirm that all potential vulnerabilities were effectively addressed prior to implementation; or
2. Record that further testing is not required as the risks associated with testing outcomes are aligned with LPF's risk appetite for the project.

2.1 Agreed Management Action: Testing

LPF agree with these recommendations and will ensure that security testing and vulnerabilities continue to be documented and either remediated or accepted.

3. Post-Implementation Activities

Medium

1. A post-implementation review on the migration to the new externally hosted LPF technology network has not yet been performed or planned to identify improvements that could be applied to subsequent projects.

LPF management has advised that a post implementation review will be completed by the end of December 2021.

2. Whilst user manuals are in place for some LPF third party hosted systems such as Charles River, Altair, and the Cased Dimensions technology, not all systems have manuals, such as Moorepay, Legal e-sign, and Bamboo.

Risk

The potential risks associated with our findings are:

- **Financial / Regulatory / Reputational** - Inadequate, or failure of, supplier and other third-party systems (including IT and Data security) – risk that the project does not achieve its objectives and that lessons learned are not identified and incorporated into future projects.

3.1 Recommendation: Post-Implementation Activities

1. LPF should perform a post-implementation review of the implementation of the new technology and identify any lessons learned that can be applied to any future projects.
2. User manuals should be introduced for all systems used by LPF.

3.1 Agreed Management Action: Post-Implementation Activities

1. LPF agree that a post-implementation review is an invaluable part of the project lifecycle, a lessons learnt exercise has been carried out for the IT migration project and is currently with internal stakeholders for comment. This will form the main part of the PIR.
2. LPF have produced user manuals and documentation for key/business critical systems and will review the requirements and suitability of the currently available generic documentation for the others during 2022.

Owner: Stephen Moir, Executive Director of Corporate Services

Contributors: Hugh Dunn, Service Director – Finance and Procurement; David Vallery, Chief Executive Officer (LPF); Anne Mitchell, Head of IT (LPF)

Implementation Date:

30 June 2022 (Action 1)

31 December 2022 (Action 2)

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 included in the review are:

Sub-process	Control Objectives
Project Scope and Planning	<ul style="list-style-type: none"> • The project scope has considered all relevant Council and external guidelines and regulations including procurement requirements; the IT Acceptable Use Policy; Cloud-Based Protocol, Records Management policies; Data Protection guidelines and regulations; and Scottish Government cyber resilience strategic framework requirements. • The project budget has been defined, and progress against budget is included in ongoing project delivery progress reports. • Project roles and delivery responsibilities have been clearly defined and allocated together with delivery timeframes. • Risks, issues, and dependencies have been identified and recorded, with responsibilities for resolution appropriately allocated, and project risk status is included in ongoing project delivery progress reports. • A detailed project plan has been developed that includes all deliverables and dependencies and specifies the critical path. • A change control process has been established to ensure that all scope changes are approved by the Project Board prior to incorporation in the project plan. • A Data Privacy Impact Assessment (DPIA) has been completed that future data protection and systems security governance and assurance arrangements.
Project Governance	<ul style="list-style-type: none"> • A Project Board has been established that includes senior membership from LPF and the Council, and relevant experts such as project managers, procurement and Digital Services. • The Project Board has reviewed and approved the project plan. • Project delivery progress reports are prepared, and project delivery is assessed using agreed clearly defined RAG (red; amber; green) or other relevant criteria. • Project delivery criteria is based on a combination of delivery; budget; and project risks, issues and dependencies. • Reporting to the Project Board and relevant committees is complete, accurate, and timely.

	<ul style="list-style-type: none"> • There is evidence of appropriate scrutiny of project progress, budgets and costs, and risks by the Project Board. • Project Board decisions and actions are recorded, with progress towards closure of actions monitored at subsequent meetings.
Procurement and support arrangements	<ul style="list-style-type: none"> • The Council's procurement processes have been correctly applied, in accordance with the Scheme of Delegation, existing contracts and Contract Standing Orders when sourcing potential system suppliers; • Appropriate contractual arrangements have been established with the system suppliers, which include clearly defined roles and responsibilities; service levels / key performance indicators; and appropriate exit clauses; • All contracts have been reviewed and approved at an appropriate level of authority, at both LPF and the Council; and • Post implementation system support agreements (including support and ongoing licencing costs) are finalised prior to system implementation and approved at an appropriate level of authority.
System Design	<p>Detailed system design specifications (technical and operational) have been prepared and approved by LPF. It is expected that these will specify:</p> <ul style="list-style-type: none"> • required functionality based on analysis of current technology services and other examples of good practice. • system security requirements including user access and system administrator profiles and access controls. • appropriate technology user and security controls (for example: user profiles that are mapped to user roles, and firewall security). • exception and management information reports to be produced by the system.
Data Migration and Security	<ul style="list-style-type: none"> • A data migration plan has been developed and approved by the Project Board that includes appropriate data reconciliation controls, and data cleansing work; and • A Data Privacy Impact Assessment (DPIA) has been performed and reviewed by Information Governance to confirm that sensitive data is adequately protected from both internal and external threats during the data migration process.
System Testing	<ul style="list-style-type: none"> • Testing strategies and plans have been developed that define the scope of and volume of testing to be performed. It is expected that these will include:

	<ol style="list-style-type: none"> 1. design and interface testing; 2. stress testing; 3. system acceptance testing (including regression testing) 4. user acceptance testing; and 5. system security and penetration testing. <ul style="list-style-type: none"> • Responsibilities for completion and volume of testing to be performed are clearly defined; • A defect resolution process has been developed to record and address any necessary changes identified from testing; and • Final testing outcomes are reported to the Project Board, include details of any defects that cannot be addressed prior to implementation, and have been RAG categorised.
System Implementation	<ul style="list-style-type: none"> • A systems implementation plan has been prepared that includes implementation responsibilities and critical path; • The basis of the go / no go decision for full implementation has been defined and clearly states responsibilities for this decision; • A roll back plan has been prepared for implementation in the event of a 'no go' implementation decision; and • Appropriate contingency plans have been developed (for example, extension of system support arrangements with existing suppliers) if the new system cannot be implemented.
Communication and Training	<ul style="list-style-type: none"> • A formal communication plan has been developed, and effective communication across LPF teams is evident pre and post implementation; • A training plan has been developed for all system users and technology system administrators, and presented to the project Board for review and approval; • Detailed process notes / user manuals have been prepared for all parts of LPF and include details of all key system and manual process controls; and • Appropriate post 'go live' support plans (for example user help desk, internal systems 'champions') is available for all parts of LPF.
Post Implementation	<ul style="list-style-type: none"> • A post implementation review is performed to confirm that the systems are operating effectively, and delivery of expected benefits; • There are regular ongoing reviews of systems security; and • Supplier management review processes are in place, and will be sufficient to ensure ongoing contract compliance.

Appendix 3: Risk-accepted findings

Some of the issues raised during this review by Internal Audit and Bridewell were risk accepted by LPF, namely:

- Following the creation of the new system by Cased Dimensions, Bridewell performed a security check, with the resulting report containing 3 High findings, 17 Medium findings, and 5 Low findings.

Work was then performed by Cased Dimensions to resolve these issues, but just prior to the migration taking place the outstanding open findings were 1 High, 16 Mediums, and 4 Lows.

LPF management advised that these remaining issues would not be resolved prior to the migration, and would be risk-accepted.

As at 19 November 2021, LPF management have advised that all of the issues had been resolved

- Prior to the data migration, some of the UAT work had not been completed.

Specifically, document printing had not been tested, and one LPF tester was not available to complete their allocated user acceptance tests.

LPF management confirmed that this outstanding testing was considered low risk.

The City of Edinburgh Council

Internal Audit

Lothian Pension Fund - Capital Calls

Final Report

1 March 2022

Overall report rating:

Effective

The control environment and governance and risk management frameworks have been adequately designed and are operating effectively, providing assurance that risks are being effectively managed and the Lothian Pension Fund's objectives should be achieved.

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This internal audit review is conducted for the Lothian Pension Fund (“LPF”, “the Fund”) under the auspices of the 2021/22 internal audit plan approved by the Pensions Audit Sub Committee in March 2021. 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

A capital call (also referred to as a drawdown) of a capital commitment is the legal right of an investment firm to demand a portion of the funds committed to it by an investor.

These funds are typically maintained in a capital call fund by the investor, and the capital call transaction transfers the committed funds to the investment manager or firm. A capital call agreement defines the terms of capital call transactions.

The primary objective of the Fund is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. The investment objectives of the Fund are to achieve a return on assets which is sufficient over the long term to meet the funding objectives as outlined in the Fund's Funding Strategy Statement.

In order to achieve these objectives, the Fund invests in a range of listed and unlisted assets (also known as Alternative assets). The unlisted assets (c. £1bn AUM as at December 2021) consist of Private Equity, Private Debt, Infrastructure, Timber and Real Estate. The unlisted funds will typically involve a closed-ended structure whereby a certain amount of capital is committed at inception. This capital is then drawn down during the investment period, and returned (along with income distributions) as the fund matures.

LPF Capital Call Approach

The Fund has a process and controls in place to manage the payment of capital calls due on behalf of the Fund. Investment managers or firms will issue capital call notices which LPF and the custodian, Northern Trust, receive via email. The LPF finance team and investment team are responsible for reviewing and authorising payment via the Northern Trust IT platform. Northern Trust, who maintains the vast majority of the Fund's assets, is responsible for transferring cash to the relevant investment manager or firm to settle the capital call.

The majority of capital committed is in GBP, there are some foreign currency commitments, particularly USD and EUR. Currency translations are primarily carried out by Northern Trust. Cash levels are monitored by the finance and investment teams, and subject to review by fund officers and external independent advisors on the Joint Investment Strategy Panel at their regular quarterly meetings.

A separate system, Burgiss Private I ("Private I"), is used to record cashflows and unfunded commitments and is specifically designed to support ongoing maintenance and analysis of private capital portfolios.

Scope

The review assessed the design adequacy and operating effectiveness of key processes and controls established relating to LPF capital calls to ensure that all capital calls are processed in line with established capital call agreements.

The review also assessed the following low rated LPF risks:

- R002 – fraudulent payment of capital calls
- R003 - capital call not processed to deadline

Our assessment included matters that we consider relevant based on our understanding of the key

risks to the organisation.

Limitations of Scope

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

- Financial Conduct and Pensions Regulatory Authority regulations that apply to the LPFI subsidiary. The scope of our review was specifically limited to the Lothian Pension Fund parent company and applicable LGPS regulatory requirements; and
- Review of other transactions not related to capital calls (e.g. distributions).
- Review of operational processes performed by Northern Trust. Coverage in this area was limited to confirming that Northern Trust's performance is regularly reviewed in comparison to any agreed capital calls performance metrics; and
- Review of Private I operational security and system controls. Coverage in this area was limited to confirming that LPF receives regular ongoing assurance in relation to effectiveness of key security; resilience; change management; and data protection controls operated by the system provider.

Reporting Date

Our audit work concluded on 4 February 2022 and our findings and opinion are based on the conclusion of our work as at that date.

2. Executive summary

Total number of findings: 1

Summary of findings raised	
Low	1. Capital calls processes
Advisory	2. Third Party Assurance

Opinion

LPF has investments in over 100 different Alternative assets. During 2021 there were over 50 capital call transactions which totalled over £100m.

Our review confirmed that the control environment and governance and risk management frameworks supporting the LPF capital calls process have been adequately designed and are operating effectively, providing assurance that LPF's objectives of ensuring that all capital calls are processed in line with established capital call agreements should be achieved.

One low rated finding has been raised highlighting the need to update the 'Alternatives procedures' that support the capital calls process.

Areas of good practice

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

- **Authorisations** - Northern Trust and LPF have responsibility to review capital call notices and monitor the payments being made. We note that authorisations are carried out by people with the relevant experience and with an appropriate level of due care. Northern Trust's policy allows payment authorisation to be approved by one or two LPF individuals. We noted the higher level of two LPF approvals for Northern Trust payment authorisations have been adopted.
- **Reconciliation of the Burgiss System** - The Burgiss Private I system contains data relating to Net Asset Values and asset cashflows for the Alternative assets. This data is input by Northern Trust. LPF reconcile this data against their records which are overseen by both the finance and investment teams. It is also reconciled against Northern Trust data which is compiled by an independent team to the team responsible for data entry into the Burgiss Private I system.
- **Regular review of access lists** - LPF has a formal list of individuals, and their email address, who receive capital call information and have access to retrieve capital call information from the fund managers online portals. We noted that the email address access lists are reviewed and updated on a quarterly basis and also whenever there are changes in staff operations.

3. Detailed findings

1. Capital calls processes	Low
<p>LPF has established Alternatives procedures and Trade Order User Guide documents to support consistent application of the capital calls process.</p> <p>Management has confirmed that the Finance team owns the Alternatives procedure documents and is responsible ensuring that they are up to date. Whilst management has confirmed that regular process and procedures reviews are performed, we noted that the procedures do not include an effective date confirming the last review date.</p> <p>We also noted that the procedures do not include clear guidance on the following areas:</p> <ol style="list-style-type: none"> 1. transferring additional funds from internal accounts to pay the capital call, including where the transfer requires a foreign currency transaction. 2. managing a change to the receiver's bank details recorded in the Northern Trust Trade Order System, including the checks undertaken to verify the change. 	
Risk	
<p>The potential risks associated with our findings are:</p> <ul style="list-style-type: none"> • operational inconsistencies and payment delays leading to investment fines or losses. 	
1.1 Recommendation: Procedure updates and regular reviews formalised	
<ol style="list-style-type: none"> 1. Policies and procedures should be reviewed annually or sooner if required, for example as a result of any changes in working practices or regulations during the year. 2. The review process should be formalised, and version controls applied to documents to facilitate the review process. 3. The Alternatives procedures should be updated to include the processes applied when transferring funds from another internal account to make a capital call; and changing receiver's bank details in the Northern Trust Trade Order System. 	
1.1 Agreed Management Action: Procedure updates and regular reviews formalised	
<p>Policies and procedures should be reviewed annually or sooner if required, for example as a result of any changes in working practices or regulations during the year. Implement as recommended</p> <p>The review process should be formalised, and version controls applied to documents to facilitate the review process. Implement as recommended</p> <p>The Alternatives procedures should be updated to include the processes applied when transferring funds from another internal account to make a capital call; and changing receiver's bank details in the Northern Trust Trade Order System. Implement as recommended</p>	
<p>Owner: Hugh Dunn, Service Director, Finance and Procurement</p> <p>Contributors: David Vallery, Chief Executive LPF; John Burns, Chief Financial Officer LPF; Jason Koumides, Senior Finance Manager, LPF</p>	<p>Implementation Date: 31 December 2022</p>

2. Appropriate performance metrics

Advisory

LPF has a range of established key performance indicators (KPIs) with Northern Trust for the services that they provide, and these are regularly monitored and reviewed by LPF and discussed with Northern Trust at ongoing supplier management meetings.

As the KPIs cover the full range of services Northern Trust provide to LPF, they are high level and do not specifically cover capital calls.

We recommend that a KPI should be established to ensure that payments authorised by LPF in the Northern Trust in the Trade Order System that are made by Northern Trust and subsequently fail are identified and managed as part of the established KPI framework.

Appendix 1: Basis of our classifications

Finding rating	Assessment rationale
Critical	A finding that could have a: <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	A finding that could have a: <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	A finding that could have a: <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	A finding that could have a: <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	A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.

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
Capital Calls processes	<ul style="list-style-type: none"> • The capital call notices are received by the relevant people and logged into the system. The authorisations are carried out in a timely manner. • Authorisations are carried out by people with the relevant experience with an appropriate level of due care. • The Fund has appropriate monitoring of the custodian in place. Northern Trust's performance is reviewed on a periodic basis and any issues are raised with them in a timely manner (for example, if a payment has not been made). • The Burgiss system is reconciled against manager records and Northern Trust data. • The cash levels are monitored regularly in conjunction with expected capital calls. 	<ul style="list-style-type: none"> • Not all stakeholders have been made aware of the process and are not sufficiently informed as to the process and impact if not followed. • Notices are missed or not completed in a timely manner to meet the deadline and payment is late resulting in Interest charges or an investment opportunity lost. • Incorrect payment is authorised leading to financial loss and additional administrative burden. • A payment which has been approved in Northern Trust's system fails leading to Interest charges or an investment opportunity lost. • Incorrect balances recorded in the Burgiss Private I system resulting in incorrect forecasting of undrawn capital and additional administrative burden to reconcile. • Insufficient cash is available resulting in a forced sale of assets which crystallises investment losses.
Third Party Assurance	<ul style="list-style-type: none"> • Appropriate capital calls performance metrics have been agreed with Northern Trust. • LPF monitors Northern Trust's performance against the agreed metrics, and any specific capital calls issues are raised with them in a timely manner (for example, if a payment has not been made). • LPF obtains appropriate assurance from Burgiss, the Private i system provider that confirms the ongoing effectiveness of security; resilience; change management; and data protection arrangements supporting their use of the system. 	<ul style="list-style-type: none"> • Northern Trust failures in the process are not identified, and where appropriate resolved, leading to late payment resulting in Interest charges or an investment opportunity lost. • Disruption to the Burgiss Private I system resulting in incorrect forecasting of undrawn capital and additional administrative burden to reconcile.

The City of Edinburgh Council

Internal Audit

Lothian Pension Fund Employer Contributions

Final Report

1 March 2022

LPF 261121

Overall report rating:

Effective

The control environment and governance and risk management frameworks have been adequately designed and are operating effectively, providing assurance that risks are being effectively managed and the Council's objectives should be achieved.

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This internal audit review is conducted for the Lothian Pension Fund ("LPF") under the auspices of the 2021/22 internal audit plan approved by the Pensions Audit Sub Committee in March 2021. 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

Lothian Pension Fund (LPF) is a multi-employer Local Government Pension Scheme (LGPS) with over £8billion assets and is 106% funded. LPF manages 84,000 members and 69 employers and is currently the second-largest LGPS fund in Scotland.

All Scottish Local Authorities are required to automatically enrol their employees in a local government pension scheme (LGPS) and make contributions. The current average employer contribution rate is circa 19%.

Specific employer contribution rates are determined by actuarial valuations performed every three years, although rates can be subject to review if there are changes in employer circumstances between valuations.

LPF employers use a secure transfer portal (i-connect) to submit their monthly contributions information. i-connect interfaces directly with LPF's cloud based pension administration system (Altair) to automatically transfer and update the information on corresponding member records.

LPF uses a tracker and dashboard on i-connect to manage the employer contributions data submission process. The dashboard shows the submission status for each employer, allocating a 'green' status once submitted; 'amber' if the submission deadline date is approaching; or 'red' if it is overdue. A separate tracker is also maintained for receipt of employer contribution payments.

Employer contributions and employee contributions deducted from the members salary must be paid to the Fund in accordance with any requirements in the Fund regulations.

Applicable Regulations and Fund Strategies

The regulatory requirements supporting employer contributions in respect to local government pension schemes are specified in [The Local Government Pension Scheme \(Scotland\) Regulations 2018](#) Sections 9-19 and 62-66.

LPF has a publicly available [Funding Strategy Statement](#) (FSS) last updated in 2021 that is a non-exhaustive summary of the employer contributions approach. Details of the overriding principles that help ensure compliance with regulatory requirements are included at Section 5.6 of the FSS.

The [Pensions Administration Strategy](#) (PAS) last updated in 2019, is also relevant as it outlines the responsibilities of both the employers and LPF regarding the employer contributions process.

The PAS also sets out costs which may be recharged to employers in relation to late payment of contributions. This includes the option to apply interest to any late contributions received after the statutory deadline, and charges (£50 per occurrence and 5p per active member) where monthly contribution returns information is either not received on time, or in the prescribed format.

Scope

The review assessed the design adequacy and operating effectiveness of key LPF employer contribution controls established to support ongoing receipt of complete and accurate employer financial contributions and supporting information returns.

The audit confirmed whether these are aligned with both the most recent actuarial valuations and applicable SLGPS regulatory requirements, and that appropriate action is taken by LPF where payments and supporting information are not received on time.

Assurance has also been provided in relation to the following LPF risks:

- Risk 3 (Amber) - Failure of an employer to pay contributions
- Risk 30 (Green) - Limited or incorrect data from employers leading to incorrect valuation of liabilities/benefit payments and potential for fines from the Pensions Regulator.

Limitations of Scope

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

- Financial Conduct and Pensions Regulatory Authority regulations that apply to the Lothian Pension Fund Investments subsidiary. The scope of our review was specifically limited to the Lothian Pension Fund parent company and applicable LGPS regulatory requirements; and
- Accuracy of actuarial employer and employee contribution rate calculations.

Reporting Date

Our audit work concluded on 28 January 2022 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	
Low	1. Updating policies and procedures
Low	2. Follow up of contribution differences or issues identified
Low	3. Pension Committee oversight
Low	4. Upgrade of i-connect fields

Opinion

Our review confirmed that the control environment and governance and risk management frameworks supporting the LPF employers contribution process have been adequately designed and are operating effectively, providing assurance that LPF's objectives of ensuring that employer contributions are paid to the Fund in accordance with any requirements in the Fund regulations should be achieved

At the beginning of February 2022, only one employer (Scotland's Learning Partnership (SLP) out of seventy one employers had an outstanding contribution payment (secondary rate payment of £15,750). SLP have paid all primary rate contributions due and LPF has raised an invoice for the Scottish Government to pay the outstanding contributions (secondary rate payments) as SLP's guarantor.

On the data submission side, only one employer (with 2 members) out of 71 employers (38,679 members) has an overdue i-connect return relating to the December 2021 payroll. The low number of minor outstanding items supports the overall assessment that the contributions process is effectively managed.

Consequently, four low rated findings have been raised that highlight the need to:

- Ensure policies and procedures are regularly reviewed to confirm alignment with current legislation and work practices;
- Ensure that all the differences identified between actual and expected employer contributions issues are followed up and resolved in a timely manner;
- Recommend that the Pensions Committee delegates authority to the LPF employer oversight group to deal with any exceptions that fall below an agreed materiality threshold, with any exceptions above the threshold reported to the Pensions Committee.
- Upgrade the i-connect portal and to enable employers to input source contribution allocation data and support automated calculation of and comparison with expected contributions.

Further detail is included at section 3 below.

Areas of good practice

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

- **Use of i-connect dashboard facility** – the i-connect home page includes a dashboard showing progress with employer monthly contribution returns using a traffic light system, enabling LPF to identify employers who have completed their returns (green); those that are still to be completed (amber); and those still to be submitted (red), and take appropriate action.
- **User guides** – Altair and i-connect are managed by a third party called Aquila Heywood, and LPF holds monthly meetings with the supplier to discuss any issues. Aquila Heywood provides i-connect user guides which are available to the employers on the LPF website.
- **i-connect audit trail** - LPF runs a daily audit report from Altair to show all i-connect changes which in the last 24 hours. This report is then reviewed to ensure there are no significant issues with the data.
- **i-connect tolerances** - LPF uses the i-connect system tolerances that block completion of a submission if values including total contributions or pay have changed by more than 10% in comparison to the previous month. Where this occurs, the employer must provide LPF with a satisfactory explanation before the return can be processed.

3. Detailed findings

1. Updating policies and procedures	Low
<p>LPF has employer contribution policies and procedure documents to provide guidance to both LPF staff and the employers to be able to perform their roles/tasks correctly and in a consistent manner. Management confirmed that the Pensions Data Manager and the Finance Manager have ownership of the policy and procedure documents and are responsible for ensuring that they are up to date.</p> <p>However, we noted that there is no established policy review process to ensure that updates have been made to reflect the current working practices and applicable regulations.</p> <p>We also identified an error in the Non payers and late payments procedure policy which states that an employer contribution payment difference of 1% of expected employer contributions OR £50 should be followed up.</p> <p>This was queried with management as it was different from the current working practice where differences of 1% of expected employer contributions AND £50 are followed up.</p> <p>Management confirmed that the policy document should be updated to reflect current operational practice.</p>	
Risk	
<p>The potential risk associated with our finding is:</p> <ul style="list-style-type: none"> • Incorrect policies could result in operational inconsistencies and non-compliance with the latest regulations. 	
Recommendation: Updating policies and procedures	
<ol style="list-style-type: none"> 1. Policies and procedures should be reviewed annually or sooner if required, for example as a result of any changes in working practices or regulations during the year. 2. The review process should be formalised, and version controls applied to documents to facilitate the review process. 	

Agreed Management Action: Updating policies and procedures

Recommendations are accepted.

Owner: Hugh Dunn, Service Director, Finance and Procurement

John Burns, Chief Finance Officer, Lothian Pension Fund

Contributors: David Vallery, Chief Executive Officer, LPF; John Burns, Chief Finance Officer, LPF; Laura Forsyth, Senior Finance Manager, LPF

Implementation Date:
31 December 2022

2. Follow up of contribution differences or issues identified

Low

The LPF Non payers and late payments procedure policy requires any differences between actual and expected employer contributions that are greater than 1% or £50 to be recorded on the Employer Contribution and AVC Issues spreadsheet.

A monthly process is applied to compare actual and expected contribution rates, with differences recorded on the spreadsheet, together with notes detailing difference resolutions or comments from employers.

Our review identified a difference of £1,000 (which was less than 1% of expected employer contributions) for the CHAS (employer) September 2021 contribution payment received that had not been followed up as at 12 January 2022. The difference can be regarded as an isolated incident as the other subsequent months (October to December) did not have any differences.

Management advised that there was no evidence (notes from the LPF employer team) of follow up on the spreadsheet as the team had problems in contacting the employer to resolve the difference.

Risks

The potential risk associated with our findings is:

- If contribution differences are not resolved in line with policy requirements, incorrect contribution payments from employers could be processed, leading to incorrect valuation of liabilities/benefit payments.

Recommendation: Follow up of contribution differences or issues identified

1. The Employer Contribution and AVC Issues spreadsheet should be periodically reviewed to ensure that differences have been communicated to employers and resolution achieved.
2. This review process should be formalised and evidenced.

Agreed Management Action: Follow up of contribution differences or issues identified

Recommendations are accepted.

Owner: Hugh Dunn, Service Director, Finance and Procurement John Burns, Chief Finance Officer, Lothian Pension Fund Contributors: David Vallery, Chief Executive Officer, LPF; John Burns, Chief Finance Officer, LPF; Laura Forsyth, Senior Finance Manager, LPF	Implementation Date: 31 December 2022
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3. Pension Committee oversight	Low
<p>Our review noted that an annual data quality report which contains employer contribution information is provided to the Pensions Committee to facilitate the Committee's oversight of employer contributions.</p> <p>Throughout the rest of the year, monthly meetings of the employer oversight group (which has senior management representation from LPF) are held, with reporting to the Committee by exception (for example where significantly late payments are received). However, there are currently no clearly defined thresholds that confirm which exceptions should be reported to the Committee.</p> <p>Management has confirmed that the employer oversight group does not have delegated authority from the Pensions Committee.</p>	
Risks	
<p>The potential risks associated with our findings are:</p> <ol style="list-style-type: none"> 1. Limited oversight of employers contributions by the Pensions Committee during the year. 2. Dependency on LPF management to identify and address any thematic control weaknesses or issues identified. 	
Recommendation: Pension Committee oversight	
<ol style="list-style-type: none"> 1. Define the parameters that should be applied to identify exceptions that should be reported to the Pensions Committee. 2. Have the Pensions Committee delegate authority to the employer oversight group to deal with any exceptions that fall below the agreed threshold. 	
Agreed Management Action: Pension Committee oversight	
<p>Recommendations accepted, albeit that, to clarify re 2, Pensions Committee has delegated decision-making responsibility to the Chief Executive Officer (CEO) rather than to the Employee Oversight Group (EOG). The CEO has then delegated to the Chief Finance Officer (CFO) with management oversight being provided by the EOG.</p>	
Owner: Hugh Dunn, Service Director, Finance and Procurement John Burns, Chief Finance Officer, Lothian Pension Fund Contributors: David Vallery, Chief Executive Officer, LPF; John Burns, Chief Finance Officer, LPF; Laura Forsyth, Senior Finance Manager, LPF	Implementation Date: 31 December 2022

4. Upgrade i-connect portal

Low

Allocation of employer contributions to employees is provided to LPF by employers using the AB1 form (spreadsheet), which is similar to a remittance advice detailing the allocation of the payment to individual employees.

A manual calculation of expected employer contributions and comparison to actual contributions received is also performed manually by LPF using spreadsheets and data provided on the AB1 form.

These processes are manual as the i-connect portal currently does not have the functionality to support this source data input and calculations.

Any discrepancies highlighted are subsequently highlighted in monthly employer team meetings.

Risks

The potential risks associated with our findings are:

- Transaction processing errors due to the process being manual
- Reduced levels of efficiency and increased costs associated with completion of manual processes.

Recommendation: Upgrade i-connect portal

1. Upgrade i-connect to include all the key fields required to automate the processes such as calculation of the expected contribution.

Agreed Management Action: Upgrade i-connect portal

Recommendation is accepted. LPF's software supplier is currently developing an upgrade where payment information and tolerance checks on employer contributions will be built into the i-connect monthly return. As this information will now be captured and held within i-connect, there will no longer be a requirement for a separate AB1 form.

Owner: Hugh Dunn, Service Director, Finance and Procurement

John Burns, Chief Finance Officer, Lothian Pension Fund

Contributors: David Vallery, Chief Executive Officer, LPF; John Burns, Chief Finance Officer, LPF; Laura Forsyth, Senior Finance Manager, LPF

Implementation Date:

31 December 2022

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
Policies and procedures	<ul style="list-style-type: none"> • Comprehensive policies and procedural guidance have been established. • There is clear ownership and accountability for managing key policies, procedures, and processes. • Policies and procedures are regularly reviewed and updated, with appropriate version control and sign-off documented. • Employers are provided with detailed guidance to ensure their submissions are made in the required format; are complete and accurate and; are submitted on time.
Employer Contributions Information	<ul style="list-style-type: none"> • The Administering Authority monitors the actual employer contributions received to ensure they are in line with expectations. • The Administering Authority confirms that employer contributions received are in line with statutory timelines. • Any employers with overdue contributions are identified and issues are followed up with the employer or escalated (as appropriate) on a timely basis. • All investigations and communications with employers are documented and retained.
Employer Contribution Payments	<ul style="list-style-type: none"> • Contribution payments into the LPF bank account are reconciled to the contribution files received from the employers. Any discrepancies are identified, followed up and resolved in a timely manner. • Contribution payments into the LPF bank account are received in line with statutory deadlines.
Employer contribution data	<ul style="list-style-type: none"> • The data transfer process between i-connect and Altair operates securely effectively. All security and performance / availability issues are identified and corrected in a timely manner. • LPF performs regular checks to confirm that Altair member records have been completely and accurately updated with employee / employer contributions data submitted through the iconnect portal.
Governance and reporting	<ul style="list-style-type: none"> • Monitoring and reporting arrangements are in place to ensure appropriate oversight over the employer contributions process is provided to the Pension Committee. • Performance against the key performance indicators (KPIs) is monitored and reported to the appropriate committees. • Significantly late payments are included in reporting to the Pension Committee and if materially significant, to the regulator.

Appendix 4 – Lothian Pension Fund - Internal Audit Open and Overdue Management Actions as at 28 February 2022

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	IA Recommendation	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>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</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>