

## **Pensions Audit Sub Committee**

2pm, Tuesday, 6 December 2022

### **Lothian Pension Fund - Internal Audit – External Quality Assessment**

#### **1. Recommendations**

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The Pensions Audit Sub Committee is requested to note:

- 1.1 the outcome of the External Quality Assessment (EQA) of the Council's Internal Audit function (IA) completed by the Chartered Institute of Internal Auditors (IIA) in March 2022;
- 1.2 the IIA recommendations to address the issues identified, together with IA's management response and action dates;
- 1.3 the continuous improvement opportunities identified in the EQA, and improvement actions taken by IA to realise these opportunities; and
- 1.4 that updates on IA's EQA improvement activities will be provided to Committee on a quarterly basis through the IA quarterly update report.

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# Lothian Pension Fund - Internal Audit: External Quality Assessment

## 2. Executive Summary

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- 2.1 During 2021/22, the Chartered Institute of Internal Auditors (IIA) undertook an External Quality Assessment (EQA) of the City of Edinburgh Council's Internal Audit (IA) function in line with the requirements of the Public Sector Internal Audit Standards (PSIAS).
- 2.2 The EQA concluded that the Council's IA function generally conforms with the PSIAS, which set out the expected standards for internal auditing, including a code of ethics, core principles and international standards.
- 2.3 Two recommendations were made by the IIA to address partial conformance with standards. Management responses and action dates have been agreed.
- 2.4 The EQA report also identified a series of continuous improvement opportunities and suggestions which IA should use as a basis for future development. IA has implemented a range of improvement actions to take forward these opportunities.

## 3. Background

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- 3.1 The City of Edinburgh Council is the administering authority for the Lothian Pension Fund (LPF). The Council's Internal Audit function is responsible for assessing and reporting on the effectiveness of LPF's internal control environment, and provision of an annual audit opinion to the Pensions Audit Committee.

### External Quality Assessment (EQA)

- 3.2 The PSIAS require all IA functions to have an external quality effectiveness review completed on a five-yearly basis. The objective of the review is to promote improvement in the professionalism, quality, consistency, and effectiveness of IA across the public sector.
- 3.3 An EQA of the Council's IA function was undertaken by the Chartered Institute of Internal Auditors (IIA) during 2021/22. The timescales for completion of the review were as follows:
  - planning for the review was completed in November / December 2021; and
  - fieldwork including review of processes and stakeholder engagement was completed between January and March 2022
  - draft reporting between April and May 2022, and a [final report](#) detailing outcomes was presented to the Council's Governance, Risk and Best Value Committee in October 2022.

## 4. Main Report

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- 4.1 This report provides the Committee with a summary of the outcomes of the EQA of the Council's IA function completed by the IIA in 2021/22. A copy of the final IIA report in full is available [here](#).

### **External Quality Assessment Outcomes**

- 4.2 The IIA concluded that the Council's IA function is generally conforming with the PSIAS.
- 4.3 Two recommendations to address partial conformance with the standards were made by the IIA. Details of these together with IA's management response and actions dates are provided in the table in Appendix 2.
- 4.4 Further detail on the IIA feedback and recommendations is provided in section 2 (pages 8 - 9) of the full [EQA report](#).

### **Continuous Improvement Opportunities**

- 4.5 The EQA also provided suggestions for further development based upon the wide range of guidance published by the IIA, with an aim to offer advice and a degree of challenge to help IA functions continue their journey towards best practice and excellence.
- 4.6 The IIA identified a series of continuous improvement opportunities and suggestions which the Council's IA function should use as a basis for future development.

### **Internal Audit EQA improvement actions**

- 4.7 The Council's IA function is committed to continuous improvement and have implemented a range of improvement actions to realise the improvement opportunities identified by the IIA during the EQA.
- 4.8 Following receipt of the draft report, IA identified 'quick wins' and introduced with immediate effect, a number of changes to IA processes and procedures.
- 4.9 Details of the improvement opportunities identified during the EQA and IA improvement actions to address these are set out in the table in Appendix 2.
- 4.10 Full details of the improvement opportunities are provided at section 3.2 (pages 12 - 13) within the [EQA report](#).

### **Implications for LPF Audit work**

- 4.11 Since 2021, completion of audits supporting the LPF annual plan has been mainly undertaken by the Council's co-source partners Price Waterhouse Coopers (PwC) with oversight from the Council's IA Chief Internal Auditor.
- 4.12 Much of the audit work undertaken for LPF is specialist in nature, with PwC processes and methodology applied, including PwC internal quality assurance reviews to ensure that audit reports and findings are accurate.

- 4.13 It is acknowledged that the EQA report refers to IA work within the Council, however where relevant, IA will (in consultation with LPF management) reflect any identified changes to processes, procedures and methodology into any future pensions audit undertaken.
- 4.14 The two recommendations in relation to risk based annual planning and consideration of where reliance can be placed on other assurance sources will inform development of future LPF annual plans, where relevant.
- 4.15 Improvement actions including introduction of a risk-based follow-up process, shorter focused audit reporting and committee reporting will apply to audit work undertaken for LPF from September 2022 onwards.
- 4.16 Steps to improve engagement and working relationships between the Council's IA function and LPF management have been taken with positive outcomes evident. This includes regularly reporting of IA activity to the committee on a quarterly basis.

## **5. Next Steps**

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- 5.1 Progress updates on IIA recommendations and improvement opportunities will be provided to LPF through the IA quarterly update report, where relevant.
- 5.2 IA will complete an ongoing annual self-assessment of compliance with the PSIAS, the outcomes of which will be reported in the LPF annual opinion.

## **6. Financial impact**

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- 6.1 There are no direct financial impacts arising from this report, although failure to ensure that scopes of audit engagements are risk based and proportionate could have a financial impact.

## **7. Stakeholder/Community Impact**

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- 7.1 Stakeholder impacts are detailed within this report and will be captured through audit surveys with a summary of key themes reported on a six-monthly basis to the Pensions Committee.

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

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- 8.1 [Public Sector Internal Audit Standards \(PSIAS\)](#)
- 8.2 [The City of Edinburgh Council's External Quality Assessment of Internal Audit – report by the Chartered Institute of Internal Auditors \(item 8.1\)](#)

## **9. Appendices**

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- 9.1 Appendix 1: IIA EQA Report - Table of recommendations
- 9.2 Appendix 2: EQA – IA improvement opportunities and actions

## Appendix 1: IIA EQA Report - Table of recommendations

Recommendation 1 - Audit Planning (to address partial conformance with standard 2010)
<p>We recommend that the methodology for the design of the audit plan is updated to ensure a risk-based approach focused more on the Council's strategic risks, core governance and control areas. We recommend the approach includes:</p> <ul style="list-style-type: none"><li>• Presentation of the plan starting from the Council's critical risks with demonstration of alignment and explanations of any different views held by internal audit on the risk areas.</li><li>• A mix of engagement styles from more light touch to more in-depth reviews and upfront advisory work.</li><li>• Highlighting the engagements on which the annual opinion has a key dependency at the outset to ensure these can be prioritised for delivery.</li></ul>
Management Response and Action Date
<p>Agreed, the methodology applied to the risk and control effectiveness assessments supporting the IA annual plan was revised in March 2021 to align with the Council's refreshed operational risk management framework and therefore the Council's key risks. This included extending the rolling coverage of all areas from 3 to 5 years and introducing a range of engagement styles (including light-touch Covid-19 reviews and consultancy work).</p> <p>It is acknowledged that further refinement of the annual planning process would be beneficial to enable a dynamic and flexible approach aligned to priorities and available resources. This will be taken into consideration for the mid-year review of the 2022/23 plan and the 2023/24 plan year onwards. <b>Action date: 31 March 2023</b></p>
Recommendation 2 - Audit Co-ordination (to address partial conformance with standard 2050)
<p>As the maturity of the risk management framework improves and further second line activity is embedded (e.g., in the role of the Operations Managers), the approach to internal audit planning should be re-considered to take account of other sources of assurance even if they are not yet fully mature.</p>
Management Response and Action Date
<p>Agreed, work is ongoing to design and roll-out the Council's Governance and Assurance framework which will help coordinate and / or complete first line governance; risk management; and assurance activities which IA can then take account of and place reliance on. The framework is expected to be operational by 31 March 2023.</p> <p>In the interim, and in addition to the above, IA will take into account other first line assurance processes and sources in operation when planning engagements to establish the extent to which reliance can be placed and to avoid duplication where possible. <b>Action date: 30 June 2023</b></p>

## Appendix 2: EQA – IA improvement opportunities and actions

1. Engagement Audit Methodology
<ul style="list-style-type: none"><li>a) The approach to the audit plan should be revised to focus on business-critical risks and core controls at organisational level. Re-based audit plans should provide an option for delivering an internal audit opinion only in relation to the work completed, (i.e., limited in scope).</li><li>b) A clearer focus is required on the link between the Council's critical risks, the internal audit programme, and core controls with consideration of completing quarterly or six-monthly planning reviews.</li><li>c) The audit engagement process should be redesigned, and the scope of the audits undertaken should clearly focus on the key risks and key controls under review.</li></ul>
IA Improvement actions
<ul style="list-style-type: none"><li>a) IA has engaged with Council services to develop a proposal for a re-based 2022/23 IA annual plan with the aim of ensuring a focus on the current business-critical risks and core controls aligned to available resources.</li><li>b) It is proposed that the annual plan is reviewed quarterly from 2023/24 onwards this will ensure that the audit plan continues to be aligned to business-critical risks and priorities.</li><li>c) A review of our electronic working papers and audit methodology has been completed and the audit process has now been simplified and streamlined. Scoping of audits has also been streamlined to ensure a focus on key risks and controls, with shorter focused terms of reference.</li></ul>
2. Closure of Audit Actions
<ul style="list-style-type: none"><li>a) The follow-up process should be revised to review supporting evidence on a risk-based approach.</li></ul>
IA Improvement actions
<ul style="list-style-type: none"><li>a) The IA follow-up process has been revised, with a move from the current full review and validation of 100% of management actions to a risk-based approach based on the rating of recommendations made.</li></ul>
3. Risk Resolution Processes and Responsibility for Acceptance of Risk
<ul style="list-style-type: none"><li>a) If the audit plan and audit engagements undertaken focused on key controls the need for risk acceptance would be far less as the audit recommendations would be more likely to align to significant matters.</li><li>b) The boundaries of responsibility require to be clearly re-drawn, internal audit are responsible for exposing the risk, management are responsible for considering and responding to this. A</li></ul>

clear understanding must be in place that the level of risk tolerance and risk appetite is a matter for management, as are the potential consequences of deciding to accept a risk.

#### **IA Improvement actions**

- a) Scoping of audits and terms of reference have been streamlined to focus on key controls. In addition, recommendations made will consider management's risk appetite in the relevant areas.
- b) IA are clear on responsibilities for risk acceptance – with recognition that management is responsible for considering and responding to this. The IA risk acceptance proforma captures the service's understanding of mitigating actions and residual risk. This is processed by IA following approval from the relevant Executive Director/Chief Officer.

#### **4. Audit Reporting**

- a) The internal audit reporting we reviewed including the annual plan, engagement reports and annual opinion were lengthy, largely word-based documents. This makes it more difficult to ascertain key messages and hinders stakeholders who have limited time available to review and comment on the content of the reporting.

We suggest the style of reporting requires an overhaul to introduce more concise reporting with headlines key messages and use of graphics, to convey messages

#### **IA Improvement actions**

- a) The style of the internal audit report has been revised to ensure that our reporting is more concise and clearer, with key messages highlighted and easy to understand.

A dashboard has been introduced for monitoring and reporting IA activity including progress with implementing agreed actions; audit plan delivery and key performance indicators for both services and IA.

Reports for Committee have been streamlined to ensure a focus on key messages and scrutiny of performance.

#### **5. Monitoring of Internal Audit Performance**

- a) The audit engagements reviewed were significantly over their day's budget which appears to be a frequent issue. A revision of the engagement methodology will help in this regard.

Internal Audit have a timesheet system to enable greater insight as to the usage of internal audit resources. This is a positive step and should be used to provide insight on the usage of internal audit time and comparison to budget allocations.

We also note there is an intention to introduce metrics reporting (e.g. against the audit reporting milestones) and undertake an annual stakeholder survey. We welcome both of these



initiatives which will provide information on the effective delivery of the internal audit programme.

#### **IA Improvement actions**

- a) The proposals for the re-based 2022/23 IA annual plan will enable delivery of the IA plan within the capacity and resource available with limited need for external co-source (PwC) resources, with the exception of audits in specialist areas such as Information Technology and Pensions.
- Revisions to the IA methodology and scoping have been implemented to ensure a focus on key risks and controls only, and alignment to the time budgeted for the audit.
- Timesheets are currently completed for each audit and audit stage; this data will be used to inform a realistic and achievable 2023/24 IA annual plan.
- Audit surveys are issued following completion of every audit, with generally positive feedback received from service areas. Key themes are reviewed, and improvements identified where required.

#### **6. Role of Head of Audit and Risk**

- a) The need for more deputising of the Head of Audit & Risk role was commented on by internal audit team members and stakeholders. Whilst it is understood deputising takes place to some degree, this is not transparent to many stakeholders who would value more 1:1 engagement with other senior internal audit team members.
- b) We note that the Head of Audit took on the additional role of Head of Risk in 2020. There are adequate safeguards in place to ensure this does not impact on the independence of internal audit. However, we note that, considering the challenging environment especially in relation to debates around risk appetite, having the same individual responsible for both audit and risk, may not be the best option in this case. A range of voices in regard to risk management arrangements would be preferable in the longer term.

#### **IA Improvement actions**

- a) The structure of the IA function is currently being reviewed to ensure less key person dependency at Head of Audit level, and to enhance opportunities for stakeholder engagement and development across the IA team.
- b) The structure of the Risk Management function is also being reviewed, with the Head of Health and Safety (who has considerable local government risk management experience) currently managing the function on an interim basis.