

## **Pensions Committee**

2.00pm, Thursday, 23 March 2023

### **Lothian Pension Fund – Proposed Internal Audit plan for 2023/24**

#### **Item number 6.4**

#### **1. Recommendations**

---

The Pensions Committee is requested to:

- 1.1 review and approve the proposed Lothian Pension Fund 2023/24 Internal Audit plan;
- 1.2 note the expansion of the audit universe to include LPFE and LPFI enabling provision of single integrated audit programme; and
- 1.3 approve proposals to adopt the CIPFA standard definitions for audit report overall opinions from 2023/24 onwards.

**Laura Calder**

Head of Internal Audit, City of Edinburgh Council

Legal and Assurance, Corporate Services Directorate

E-mail: [laura.calder@edinburgh.gov.uk](mailto:laura.calder@edinburgh.gov.uk) | Tel: 0131 469 3077

# Lothian Pension Fund – Proposed Internal Audit plan for 2023/24

## 2. Executive Summary

---

- 2.1 The purpose of this paper is to present the Lothian Pension Fund (LPF) proposed Internal Audit (IA) plan for the period 1 April 2023 to 31 March 2024 to the Committee for review and approval.
- 2.2 The audit universe has been expanded for 2023/24 to include the LPF group structure and provide assurance for the LPFI and LPFE boards where appropriate.
- 2.3 The plan will also include ongoing IA follow up on implementation of management actions arising from previous internal audit reports.
- 2.4 In April 2020, the Chartered Institute of Public Finance and Accountancy (CIPFA) recommended introduction of standard definitions for audit report opinions to support consistency across public body organisations. It is proposed that the standard CIPFA definitions are adopted and will apply for LPF IA reports from 2023/24 onwards.

## 3. Background

---

- 3.1 The LPF IA plan is driven by requirements of section 2010 of the [Public Sector Internal Audit Standards \(PSIAS\)](#) which requires IA to establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organisation's goals.
- 3.2 In doing so, IA has reviewed LPF's organisational objectives and priorities, and completed an assessment of the risks that could prevent LPF from meeting those objectives and providing pension services to employers and members.
- 3.3 The PSIAS specifies that the risk-based plan must consider the requirement to produce an annual IA opinion. Consequently, IA work performed must be appropriately scoped to cover LPF's most significant risks, with an appropriate depth of testing performed to provide sufficient assurance on the control environment, governance, and risk management frameworks to support provision of the opinion.
- 3.4 PSIAS also specifies that internal audit activity must evaluate the effectiveness of risk management processes and contribute to their improvement.
- 3.5 The plan has been developed with the LPF senior leadership team, the Convenor of the Pensions Audit Sub Committee, and the Fund's Independent Professional Observer to ensure that IA assurance activity is focused on the most relevant risks for LPF.

- 3.6 Following discussion with management, the Pensions Committee, and both the LPFI and LPFE Boards, the audit universe has been expanded for 2023/24 to include the LPF group structure and to provide a single integrated audit programme and provide assurance for the LPFE and LPFI Boards where appropriate.
- 3.7 Noting the earlier discussion about the Pension Committee being empowered to make their own audit arrangements, in discussion with LPF it has been agreed that the 2023/24 audit programme will be led by CEC IA working in conjunction with PWC. LPF intend to explore alternative arrangements during 2023 for further consideration prior to the 2024/25 year.
- 3.8 It should also be noted that Internal Audit is not the sole source of assurance provision for LPF, as several additional external third line assurance providers are engaged (in addition to the annual external audit review of LPF's financial statements) to provide additional assurance coverage.

#### **Internal Audit Charter**

- 3.9 PSIAS also specify that the purpose, authority, and responsibility of IA must be formally defined in an Internal Audit Charter (the Charter) that is periodically reviewed and presented to senior management and the board for approval. The Council's IA charter, approved by the Council's Governance, Risk and Best Value Committee in March 2023 fulfils this requirement for LPF.

#### **CIPFA standard IA engagement opinion definitions**

- 3.10 The Chartered Institute of Public Finance and Accountancy (CIPFA) sets the standards for internal audit, governance, and financial accounting across the public sector.
- 3.11 The current IA engagement opinion definitions for LPF (see Appendix 3) were introduced in April 2019. In April 2020, CIPFA completed a review of [IA Engagement Opinions – Setting Common Definitions](#) in recognition that there was no common practice across the public sector in how best to report the overall results of internal audit work at the end of each engagement.

## **4. Main Report**

---

### **Scope of Internal Audit Assurance**

- 4.1 The scope of IA assurance provided to LPF in relation to regulatory compliance is specifically limited to confirming LPF's ongoing compliance with Local Government Pension Scheme (Scotland) requirements.
- 4.2 The audit universe has been expanded across the LPF group for 2023/24 with the inclusion of the operation of the Fund's two wholly owned subsidiary companies LPFE and LPFI Ltd that are responsible for providing employee resources to

administer the pension funds, and provision of Financial Conduct Authority regulated services to both LPF and other Local Government Pension Scheme Funds.

- 4.3 Expansion of the audit programme should also enable an unlimited annual IA opinion to be provided for 2023/24, with removal of the limited opinion expressly related to excluding LPFE and LPFI from scope as in previous years.

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

- 4.4 The areas proposed for inclusion in the plan were identified by considering the key risks included in the LPF risk register as at December 2022, and discussions with the LPF management team, the Convenor of the Pensions Audit Sub Committee, and the Fund's Independent Professional Observer.
- 4.5 The LPF November 2022 risk register included a total of 39 risks, of which there were nil high rated, 13 moderate rated and 26 low rated risks.
- 4.6 The 13 moderate risks were considered together with the outcome of previously completed audits, other assurance sources and key regulatory requirements.

#### **Project Forth**

- 4.7 During 2023, LPF will continue with proposals to merge with Falkirk Pension Fund (Project Forth). LPF have assessed the options, taken legal advice, and has initiated a project with programme management support to pursue the merger.
- 4.8 As LPF is a subsidiary of City of Edinburgh Council the merger would require a sign off from the Council, which will be considered during 2023.
- 4.9 A readiness review for Project Forth – Programme Assurance was completed as part of the 2022/23 internal audit programme, with additional internal audit assurance to be completed during 2023/24.

#### **Proposed 2023/24 Internal Audit Plan**

- 4.10 The proposed IA plan for 2023/24 includes the following five audits:
- Information Security Arrangements – This audit was originally included in the 2022/23 IA plan, however, due to unforeseen absence of key contacts, fieldwork was delayed. This audit will be completed in quarter 1 2023/24 and will consider the design of the suite of IT policies, standards, and procedures, and provide assurance on information rights supplier and third-party systems risks.
  - Project Forth – In recognition of Project Forth, project and change is a top scoring moderate risk, therefore a targeted assurance review on Project Forth will be undertaken. The area of review will be agreed with management and the Pensions Audit Sub Committee as the merger progresses.
  - Business Continuity and Incident Response – Cybersecurity is also a top scoring moderate risk. LPF has undertaken other assurance including an

independent cyber security maturity assessment in December 2021 and external phishing testing in October 2022. The Business Continuity and Incident Response internal audit will consider general business continuity controls as the organisation transitions to post pandemic operations.

- Senior Managers and Certification Regime (SM&CR) – Regulatory breach remains a top scoring moderate risk in recognition of the increased regulatory burden for FCA regulated services.

The SM&CR replaced the FCA's Approved Persons Regime and created two new categories of controlled function - 'Senior Management Functions' (SMFs) and 'Certified Functions'. The review will aim to provide assurance of compliance with the key elements and prescribed responsibilities of the SM&CR.

- People Processes – Staff resource and recruitment are top scoring moderate risks. The audit will provide assurance that robust people processes have been established including consideration of the employee lifecycle. It will also consider the People and Communications team to ensure they carry out their responsibilities effectively and comply with relevant legislative and regulatory requirements to safeguard against the risk of financial and reputational loss and the failure to meet LPF's objectives.

- 4.11 A high level scope for each of the five reviews planned for 2023/24 is included at the LPF Annual IA plan document at Appendix 1, together with details of the entity where assurance will be provided and current LPF risks associated with these areas. Details of audits completed across the last five years have also been included within the plan document for information.
- 4.12 Reports detailing outcomes of each review will be presented to the Pensions Sub Committee. All reviews completed for LPFI/LPFE will also be presented to the relevant Board.
- 4.13 The proposed Internal audit reviews planned for the year 1 April to 31 March 2024 should provide assurance on 8 of the 13 moderate rated risks included in the LPF risk register. Extending to include work performed in 2022/23 provides assurance a total of 9 risks.
- 4.14 Consequently, it is important that the Committee confirms that appropriate assurance coverage will be provided across LPFs remaining population of moderate risks and (in particular) the risks associated with 'business as usual' operational activities by the additional assurance providers engaged by the Fund.

## **Risk Management**

- 4.15 PSIAS requires that an appropriate depth of testing is performed to provide sufficient assurance on the control environment, governance, and risk management frameworks to support provision of the annual IA opinion.
- 4.16 Whilst sufficient information is generally collated across multiple audits to provide an understanding of the effectiveness of risk management processes to support the annual opinion, IA typically also performs targeted risk management audits to assess and provide assurance on the adequacy and effectiveness of the risk management framework across the entire organisation.
- 4.17 As the last targeted risk management audit for LPF was completed in 2021/22, the proposed 2023/24 reviews will consider whether risks associated with the areas included in scope have been effectively identified, assessed, recorded, and managed.

## **Follow-up activity**

- 4.18 Follow-up work will also be performed in line with a risk-based approach to confirm whether agreed management actions implemented to support closure of findings raised in previous LPF audits have been effectively implemented.

## **CIPFA standard IA engagement opinion definitions**

- 4.19 The current IA engagement opinion definitions for LPF (see appendix 2) were introduced in April 2019. CIPFA's 2020 review of [IA Engagement Opinions – Setting Common Definitions](#) recommended that Heads of Audit in public sector organisations adopted the standard definitions (see Appendix 2) to assist the sharing, comparability and understanding of assurance across public sector organisations.
- 4.20 CIPFA recommends that IA make the change at the start of the financial year so that all engagement opinions for the year are reported on a consistent basis. Therefore, it is proposed that LPF adopts the standard definitions for all audit engagements from 1 April 2023 onwards.

## **5. Financial impact**

---

- 5.1 The estimated costs associated with delivery of the LPF 2023/24 IA plan are circa £107,000 which reflects:
- direct recharging of costs based on agreed rates as specified in the Council's IA co-source contract (five audits at £21,000 each)
  - costs associated with time for the Council's IA function including preparation of the annual plan, review and oversight of all IA reviews, preparation of Committee reports, attendance at Committee meetings, as well as ongoing review and

validation of previously raised audit actions. This will be charged on an actual costs basis through IA timesheets.

## **6. Stakeholder/Regulatory Impact**

---

- 6.1 The LPF management team, the Convenor of the Pensions Audit Sub Committee, and the Fund's Independent Professional Observer were consulted when developing the 2023/24 IA plan.

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

---

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

## **8. Appendices**

---

Appendix 1 – Lothian Pension Fund 2023-24 Internal Audit Plan

Appendix 2 - Current IA engagement definitions and proposed CIPFA standard definitions





# **Internal Audit**

## **2023/24 Annual Plan**



# Contents

Introduction and approach .....3

Risk Assessment.....4

2023/24 Draft Internal Audit Plan .....5

Appendix 1 - Previously completed audits .....6

# Introduction and approach

## Introduction

In line with the Internal Audit Charter, Internal Audit (IA) provides independent and objective assurance on the overall effectiveness of the Lothian Pension Fund’s (LPF) governance, risk, and control frameworks.

This document sets out the scope of the IA 2023/24 annual plan with the objective of delivering independent assurance on the key controls established across the LPF group to mitigate high and moderate risks.

## Approach

The approach to preparing the annual plan is set out at Figure 1. The plan is driven by LPF’s objectives and priorities, and an assessment of the risks that could prevent LPF from meeting its objectives.

The audit universe has been expanded for 2023/24 to include the LPF group structure and provide assurance for the LPFI and LPFE Boards where appropriate.

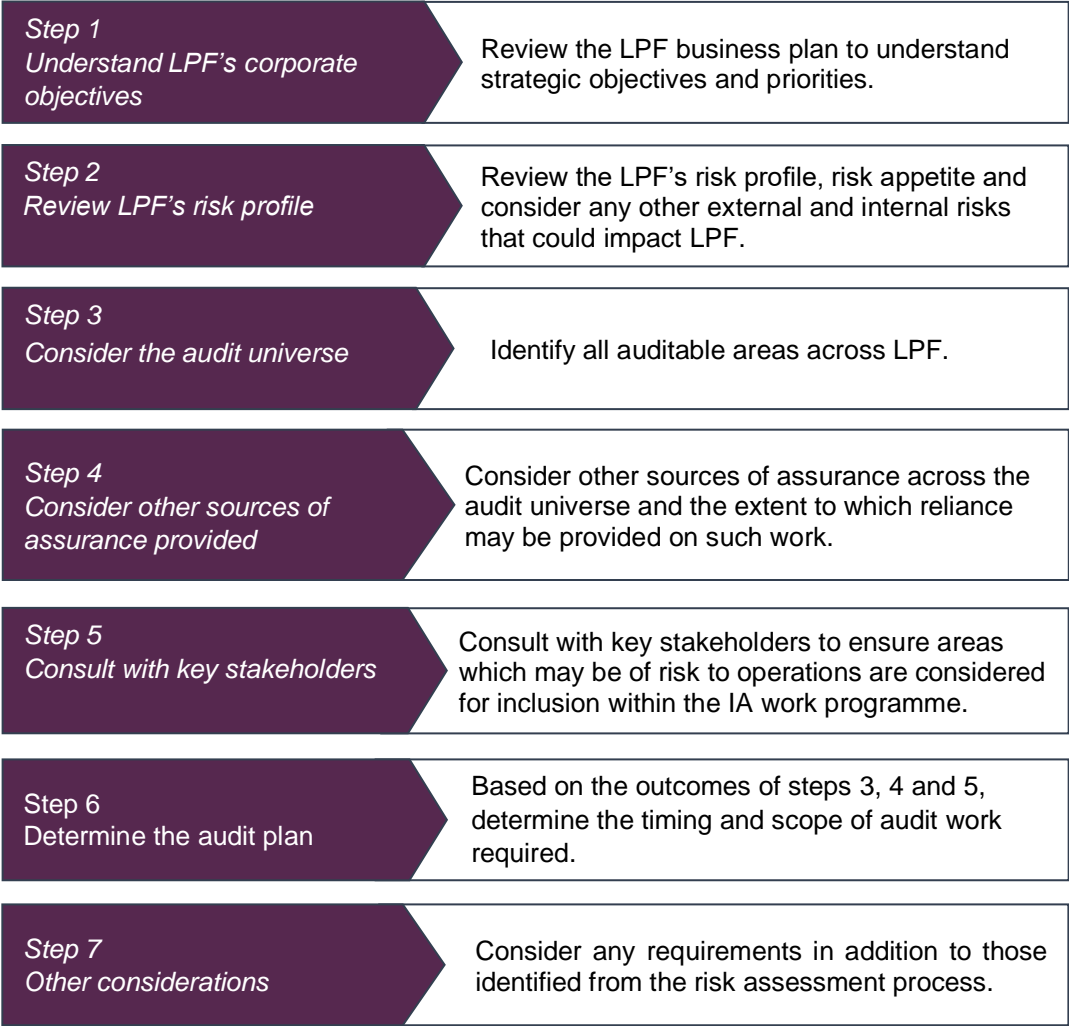
The LPF Business Plan 2022-23, sets out four broadly defined strategic goals:

- *develop and deliver a member and employer proposition for service excellence*
- *earn an appropriate risk adjustment investment return as responsible officers*
- *extend collaboration and services to existing partners and deepen where possible*
- *achieve greatness in our people, teams, and culture.*

## Project Forth

LPF is proposing to merge with Falkirk Pension Fund (Project Forth). LPF have assessed the options, taken legal advice, and has initiated a project to pursue the merger. As LPF is a subsidiary of City of Edinburgh Council the merger would require a sign off from the Council, which will be considered during 2023.

Figure 1: Approach to developing the draft 2023/24 IA Annual Plan



# Risk Assessment

To ensure a risk-based approach to the LPF Group IA annual plan which is proportionate and aligned to business-critical risks and emerging issues, consideration was given to the LPF group's priorities as detailed in the Business Plan 2022-23, and the LPF group risk profile as reported to the Pensions Committee in December 2022. The risk profile is supported by a risk assessment for each of the 39 risks LPF group risks, a summary of which is below at Figure 2).

**Figure 2:** LPF group risk profile as at December 2022

Total risks	High	Moderate	Low
39	0	13	26

The highest scoring moderate risks (those with a score between 25-32) were considered (see Figure 3) together with the outcome of previously completed audits, other assurance sources (see [Appendix 1](#)) and key regulatory requirements.

Key stakeholders including senior management, committee members, external audit (Azets) and professional co-source audit providers (PwC) have been invited to provide input into the IA annual plan to help ensure that the relevant areas are targeted for review.

## Other sources of assurance

Internal Audit is only one of a number of sources of assurance over the LPF groups risks. In developing our risk assessment and plan we have taken into account other sources of assurance and have considered the extent to which reliance can be placed upon these other sources (for example, external audit, BDO, Mercer and LPF's Risk and Compliance function).

IA does not intend to place formal reliance upon these other sources of assurance but would not seek to duplicate the work they do.

**Figure 3:** LPF Group - Moderate risks as at December 2022

Risk	Score	22/23 audits and Proposed 23/24 audit coverage <i>Other sources of assurance</i>
Cybersecurity	32	<b>23/24 Business continuity and incident response</b> <i>Independent cyber security maturity assessment completed in Dec 2021</i>
Project and Change	32	22/23 Project Forth Programme Assurance <b>23/24 Project Forth – audit area to be decided</b>
Governance	30	<b>23/24 Senior Managers and Certification Regime (SMCR)</b> <i>BDO Compliance Assurance Monitoring Programme (LPFI)</i>
Regulatory Breach	30	
Information Rights	30	22/23 audits of Information Governance <b>23/24 - Information Security Arrangements</b>
Delegations	30	No audit work proposed for 2023/24 as review and refresh of the scheme of delegations is currently underway.
Procurement	30	22/23 audit of Third-Party Contract Management
Staff Resource	30	<b>23/24 People Processes</b>
Recruitment	28	
Employer Contributions	28	No audit work proposed for 2023/24 – will be considered for future audit plans
Investment performance	25	No audit work proposed for 2023/24 <i>Mercer Systems and Controls Review (LPFI)</i>
Adverse Movement - pressure on employer contributions	25	No audit work proposed for 2023/24 – will be considered for future audit plans
Supplier and third-party systems	25	22/23 audit of Third-Party Contract Management <b>23/24 Information Security Arrangements</b>

# 2023/24 Draft Internal Audit Plan

The following table sets out the draft LPF internal audit work programme for the period 1 April 2023 to 31 March 2024. 4.2.11 Reports detailing outcomes of each review will be presented to the Pensions Sub-Committee. All reviews completed for LPFI/LPFE will also be presented to the relevant Board.

While the audit plan includes a short summary of the area proposed for review, IA will meet with key officers prior to commencing each audit to further understand the key risks and to develop and refine the scope of each review. It should be noted, that if areas are identified during testing that are outwith scope but impact the risk and control framework, findings and recommendations will still be raised and reported on, where appropriate.

Audit	Assurance entity	Risks
<u>Information Security Arrangements</u> The audit will review the design of the suite of IT policies, standards and procedures that have been developed during 2022 to prevent, respond and manage information security across LPF, as well as ensuring they are aligned to the IT strategy due to be formalised during 2023.	All	Information Rights Supplier and Third-Party Systems
<u>Project Forth</u> Project Forth – audit to be decided. Suggested areas include project delivery or associated elements such as resulting Transfer of Undertakings - Protection of Employment (TUPE) or asset transfer.	All	Project and Change
<u>Business continuity and incident response</u> Review of the adequacy and operating effectiveness of key controls and processes established to provide assurance that LPF maintains business continuity plans to ensure they maintain services during an emergency or extended incident. Will include consideration of roles and responsibilities, policies and procedures, Business Continuity Plans, testing, lessons learned and monitoring and reporting arrangements.	All	Cyber Security
<u>Senior Managers and Certification Regime (SM&amp;CR)</u> Review of the adequacy and operating effectiveness of governance processes established to provide assurance of compliance with the key elements and prescribed responsibilities of the SM&CR.	LPF LPFI	Regulatory breach
<u>People Processes</u> Review of the adequacy and operating effectiveness of established people processes to ensure robust controls are in place, complied with and support achievement of LPF objectives. Will include consideration of the employee lifecycle, and responsibilities of the People and Communications team which includes brand, people practices, strategic communications, and colleague, member, and employer engagement.	LPF LPFE	Staff resource/recruitment

# Appendix 1 - Previously completed audits

The table below provides details of audit work completed over the last five years across LPF's auditable areas.

2018/19	2019/20	2020/21	2021/22	2022/23
<ul style="list-style-type: none"><li>• Stock Lending</li><li>• Unitisation (Employer Asset Tracking)</li><li>• Unlisted Investment Valuations and Application of Fund Administration Fees and Charges</li></ul>	<ul style="list-style-type: none"><li>• Settlement and Custodian Services</li><li>• Pensions Entitlement Calculations</li><li>• Charles River Project – pre-implementation system testing</li></ul>	<ul style="list-style-type: none"><li>• Cessations</li><li>• Bulk Transfers</li></ul>	<ul style="list-style-type: none"><li>• Risk Management</li><li>• Capital Calls</li><li>• Technology Model Development</li></ul>	<ul style="list-style-type: none"><li>• Project Forth – Programme Assurance</li><li>• Information Governance</li><li>• Third-Party Supplier Management</li></ul>

## Appendix 2: Current IA engagement definitions and proposed CIPFA standard definitions

Current Assurance Ratings	
<b>Effective</b>	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.
<b>Some improvement required</b>	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 the Council's objectives should be achieved.
<b>Significant improvement required</b>	Significant and / or numerous control weaknesses were identified, in the design and / or effectiveness of the control environment and / or governance and risk management frameworks. Consequently, only limited assurance can be provided that risks are being managed and that the Council's objectives should be achieved.
<b>Inadequate</b>	The design and / or operating effectiveness of the control environment and / or governance and risk management frameworks is inadequate, with a number of significant and systemic control weaknesses identified, resulting in substantial risk of operational failure and the strong likelihood that the Council's objectives will not be achieved.

Proposed Assurance Ratings	
<b>Substantial Assurance</b>	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.
<b>Reasonable Assurance</b>	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.
<b>Limited Assurance</b>	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.
<b>No Assurance</b>	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.