



Pensions Audit Sub Committee

2.00pm, Tuesday, 19 June 2023

Lothian Pension Fund - Internal Audit Annual Report and Opinion for the Year Ended 31 March 2023

Item number 6.3

1. Recommendations

The Pensions Audit Sub Committee is requested to:

- 1.1 note the Internal Audit Annual Report and Opinion for Lothian Pension Fund (LPF) for the year ended 31 March 2023.

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Lothian Pension Fund - Internal Audit Annual Report and Opinion for the Year Ended 31 March 2023

2. Executive Summary

- 2.1 This report outlines the work completed by the City of Edinburgh Council's Internal Audit (IA) function for the Lothian Pension Fund (LPF) the year 1 April 2022 to 31 March 2023.
- 2.2 The report also details Internal Audit's annual opinion on the adequacy and effectiveness of LPF's governance, risk and control frameworks for the year ended 31 March 2023, which should be used to inform the Annual Governance Statement.
- 2.3 The annual opinion is based on the outcomes of the three audits completed during 2022/23, follow-up action for previously completed audits, and an overall understanding of issues impacting LPF.
- 2.4 IA's annual opinion for 2022/23 is '**Reasonable Assurance**' (amber), reflecting that assurance activity has assessed LPF as having a generally sound system of governance, risk management and control in place. IA work completed during the year has identified some issues, areas of non-compliance and scope for improvement which may put at risk the achievement of objectives if not addressed, however management have agreed appropriate corrective actions.
- 2.5 The 2022/23 IA opinion remains 'limited' as work completed by IA during the year was limited to LPF only. As agreed by Committee in [March 2023](#), the audit universe has been expanded from 2023/24 onwards to enable IA to provide assurance across the LPF Group, with inclusion of both LPFI and LPFE.
- 2.6 Consequently, the Committee should consider the assurance outcomes provided by other sources during 2022/23 when forming their view on the design and effectiveness of LPF Group's governance, risk, and control frameworks.

3. Background

- 3.1 Internal Audit operates in accordance with the [Public Sector Internal Audit Standards](#) (PSIAS) which requires the Chief Audit Executive to provide an annual opinion on the adequacy and effectiveness of LPF's governance, risk and internal control environment. This is achieved through completion of a risk-based plan audit plan, the results of which should provide an appropriate level of assurance.

- 3.2 Internal control can be defined as the whole system of checks and controls, financial or otherwise, established by management to provide assurance regarding the achievement of an organisation's objectives.
- 3.3 No system of internal control can provide absolute assurance that control weaknesses or irregularities do not exist, or that there is no risk of material errors, losses, fraud or breaches of laws and regulations. Accordingly, the Committee should seek continual improvement in the effectiveness of LPF's systems of internal control.
- 3.4 In [March 2023](#), the Committee approved adoption of the Chartered Institute of Public Finance and Accountancy's (CIPFA) standard definitions for audit opinions to support consistency across public body organisations. Details of the standard definitions are provided at [Appendix 1](#).
- 3.5 The annual opinion does not imply that Internal Audit has reviewed all risks relating to LPF. It is the responsibility of senior management to establish an appropriate and sound system of governance, risk, and internal control, and to monitor the continuing effectiveness of that system.

4. Main Report

2022/23 Internal Audit annual activity

- 4.1 The audit plan approved in September 2022 included input of circa 85 days across the following four audits:
- Project Forth – Programme Governance
 - Third Party Supplier Management
 - Information Governance
 - Information Security Arrangements
- 4.2 The Information Security Arrangements audit was deferred to the 2023/24 Internal Audit plan at the request of management, and subsequently approved by the Pensions Audit Sub-Committee in March 2023.
- 4.3 The plan also included follow-up of previously completed audits, subsequently completion of the three audits and follow-up resulted in circa 65 days in total being delivered during 2022/23.
- 4.4 Internal Audit work was performed by the Council's co-source internal audit provider, PwC. All work was performed in accordance with PwC's Internal Audit methodology which is in conformance with the Public Sector Internal Audit Standards, with oversight from the Council's Head of Internal Audit.

Audit outcomes

- 4.5 Three internal audits were completed during 2022/23, with two assessed as 'Reasonable Assurance' and one assessed as 'Limited Assurance'.
- 4.6 A total of 19 findings were raised across the three audits (4 high; 9 medium; and 6 low). Further detail on the overall outcomes of the audits findings raised is provided within Table 1 with detailed narrative below.

Table 1: Outcomes of completed 22/23 LPF internal audits

Audit	Date completed	Overall assurance rating	No of findings		
			H	M	L
Project Forth – Programme Governance	January 2023	Reasonable Assurance	0	4	3
Third Party Supplier Management	February 2023	Limited Assurance	2	3	1
Information Governance	April 2023	Reasonable Assurance	2	2	2
Total			4	9	6

Alignment to risk management

- 4.7 Issues identified across the three audits completed were related to following LPF risks:
- Project and change** (7 issues) – while no major project management gaps were identified in the Project Forth – Programme Assurance review, a number of opportunities to strengthen key project controls were identified. This included formalising project governance controls such as change control; management of benefits, risk, and quality.
- It was recognised that due to the uncertainty around whether Project Forth would proceed, a proportionate and measured approach was required in this instance. However, LPF should ensure that formal governance processes are adopted as a standard approach to ensure that projects are consistently and effectively managed.
- As at March 2023, the score for the Project and Change risk as recorded on LPF's risk register was 32 (amber), which reflects a fair assessment of the governance, risk, and control environment. Management plan to mitigate this further through the introduction of a project and change control process in Q1 2023.

- **Data protection / Information Rights** (6 issues) – the move to a new IT provider in 2021 necessitated creation of a new Information Governance framework for LPF, with refreshed policies and procedures agreed with the Council’s Information Governance Unit, and a formal Information Security project established. Due to unforeseen circumstances, progress was delayed during 2022/23.

Internal Audit recognises the progress made and LPF’s overall aspiration and commitment to implement a robust control framework. A number of recommendations were made to support and enhance development of that framework including developing a roadmap to formalise development of the supporting suite of policies and procedures; implementation of access management procedures; alignment of data classifications; and development of governance and monitoring controls.

As at March 2023, the scores for the both the Data protection / Information Rights risks as recorded on LPF’s risk register were 24 and 20 (green) respectively. This scoring should be reviewed based on both audit outcomes and in line with progress of ongoing mitigating actions, to ensure that it accurately reflects the current effectiveness of key controls.

- **Supplier/third-party systems** (6 issues) – LPF developed its Supplier Management Framework during 2022 which was recognised to be in the early stages of implementation at the time of audit work.

Audit findings and recommendations aimed to support ongoing development and implementation of the framework including development of key processes such as contract exit planning; improving supplier onboarding processes; training and awareness and ongoing monitoring.

As at March 2023, the score for the Supplier/third-party systems risk as recorded on LPF’s risk register was 25 (green). This scoring should be reviewed based on both audit outcomes and in line with progress of ongoing mitigating actions, to ensure that it accurately reflects the current effectiveness of key controls.

Follow-up of previously raised Internal Audit actions

- 4.8 As at 31 March 2023, there were a total of 28 outstanding management actions arising from internal audit reviews.
- 4.9 A total of 18 audit actions (1 high; 7 medium; and 10 low rated) were closed during 2022/23 and 29 new actions were raised following completion of audits.
- 4.10 Three actions are passed their original implementation date, however revised dates aligned to ongoing management activities have been agreed.
- 4.11 The closure of 18 actions demonstrates management’s commitment addressing audit actions and strengthening the overall governance, risk and control environment.

4.12 Details of follow-up activity during 2022/23 and the status of previously raised IA actions is provided at Table 2 below.

Table 2: Previously completed audits followed-up 2022/23

Audit	Audit date	Status	Comments
Settlement and Custodian Services	June 2020	Closed August 2022	All actions closed
Bulk Transfers	August 2021	25% Complete 4 actions 1 complete 3 not yet due	Not yet due
Cessations	November 2021	Closed December 2022	All actions closed
Technology Model Development	February 2022	86% Complete 7 actions 6 complete 1 action overdue (revised date provided)	Work done to date has identified that a wider review and categorisation of systems by criticality is required, to allow a proportionate approach. Completion of this will be co-ordinated with other projects (IT and Supplier Management).
Capital Calls	March 2022	Closed December 2022	All actions closed
Employer Contributions	March 2022	Closed December 2022	All actions closed
Risk Management	August 2022	33% Complete 3 actions 1 complete 2 overdue (revised dates provided)	A wider review and uplift of LPF's Risk Management Framework is underway and the observations made by Internal Audit will be integrated into this review.

Audit	Audit date	Status	Comments
Project Forth – Programme Assurance	January 2023	Closed March 2023	All actions closed

2022/23 Internal Audit annual opinion

- 4.13 The Internal Audit annual opinion for 2022/23 is **‘Reasonable Assurance’** (amber), reflecting that assurance activity has assessed LPF as having a generally sound system of governance, risk management and control in place. IA work completed during the year identified a number of issues, areas of non-compliance and scope for improvement which may put at risk the achievement of objectives if not addressed, however management have agreed appropriate corrective actions.

Assurance definitions are provided at Appendix 1.

Comparison to prior year (2021/22)

- 4.14 The opinion of Reasonable Assurance remains aligned to 2021/22 annual opinion.
- 4.15 A direct comparison between Internal Audit annual opinions is not always possible as the scope of the audits included in the annual plans and the risks associated with open and overdue IA findings will vary in line with the changing LPF risk profile.
- 4.16 The four LPF audits completed in 2021/22 were assessed as one amber (reasonable assurance) and three green (substantial assurance) with a total of 12 (4 medium and 8 low) IA findings raised.
- 4.17 The increased number of findings raised in 2022/23 (from 12 to 19) is mainly attributable to the nature of the areas reviewed, Project Forth and the ongoing development of the LPF information governance and supplier management framework all of which are essential parts of LPF’s strategy. It is not unexpected to see a higher level of improvement actions as processes are embedded, the number of issues should reduce as the design and operating effectiveness of controls matures.
- 4.18 The status of open IA findings at 31 March 2023 remains broadly aligned to 2021/22. Management have committed to completing actions associated with the majority of findings by 31 December 2023.

Internal Audit Independence and Conformance with Public Sector Internal Audit Standards

- 4.19 In line with PSIAS, IA must be independent, and all internal auditors must be objective in performing their work. To ensure conformance with these requirements, IA has established processes to ensure that both team and individual independence is consistently maintained and that any potential conflicts of interest are effectively managed.

- 4.20 We do not consider that we have faced any significant threats to our independence during 2022/23, nor do we consider that we have faced any inappropriate scope or resource limitations when completing our work.
- 4.21 Detailed Internal Audit work was performed by the Council's co-source internal audit provider, PwC during 2022/23. All work was performed in accordance with PwC's Internal Audit methodology and quality standards which is in conformance with the PSIAS, with oversight from the Council's Head of Internal Audit.
- 4.22 An Internal Quality Assessment and PSIAS self-assessment was performed during the period, led by a senior auditor. The assessment team concluded that IA has complied with PSIAS requirements during the period 1 April 2022 to 31 March 2023. A number of minor improvements were identified, mainly linked to efficiency and workflow. It is envisaged that the majority of these will be mitigated through implementation of our new audit system due to go live in June 2023.

5. Financial impact

- 5.1 There are no direct financial impacts arising from this report, although failure to close management actions and address the associated risks in a timely manner may have some inherent financial impact where associated financial risks have been identified.

6. Stakeholder/Regulatory Impact

- 6.1 IA recommendations are raised when control gaps or deficiencies are identified during audits. If management actions are not implemented, LPF will be exposed to the risks associated with the key processes, including the potential risk of non-compliance with applicable regulations.

7. Background reading/external references

- 7.1 [Public Sector Internal Audit Standards](#)
- 7.2 [2022/23 approved rebased Internal Audit Plan – Item 6.4 September 2022](#)
- 7.3 [2023/24 approved Internal Audit Plan – Item 6.3 March 2023](#)

8. Appendices

- Appendix 1 [Internal Audit Opinion Definitions March 2023](#)
- Appendix 2 [Limitations and responsibilities of internal audit and management responsibilities](#)

Appendix 1 – Internal Audit Opinion Definitions March 2023

In line with the Chartered Institute of Public Finance and Accountancy (CIPFA) April 2020 [review of IA Engagement Opinions – Setting Common Definitions](#), in March 2023, LPF adopted the CIPFA standard audit opinion definitions as detailed below:

Substantial Assurance	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of LPF objectives.
Reasonable Assurance	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 LPF objectives.
Limited Assurance	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 LPF objectives.
No Assurance	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 LPF objectives.

Professional judgement is exercised in determining the appropriate opinion, and it should be noted that in giving an opinion, assurance provided can never be absolute.

Appendix 2 - Limitations and responsibilities of internal audit and management responsibilities

Limitations and responsibilities of internal audit

The opinion is based solely on the internal audit work performed for the financial year 1 April 2022 to 31 March 2023. Work completed was based on the terms of reference agreed with management for each review. However, where other matters have come to our attention that are considered relevant, they have been considered when finalising our reports and the annual opinion.

There may be additional weaknesses in the LPF control environment and governance and risk management frameworks that were not identified as they were not included in the 2022/23 LPF annual internal audit plan, were excluded from the scope of individual reviews, or were not brought to Internal Audit's attention. Consequently, management and the Committee should be aware that the opinion may have differed if these areas had been included.

Control environments, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls, and the impact of unplanned events.

Future periods

The assessment of controls relating to LPF is for the year ended 31 March 2023. Historic evaluation of effectiveness may not be relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation, or other areas or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of Management and Internal Audit

It is Management's responsibility to develop, implement, and maintain effective control environments and governance and risk management frameworks that are designed to prevent and detect irregularities and fraud. Internal audit work should not be regarded as a substitute for Management's responsibilities for the design and operation of these controls.

Internal Audit endeavours to plan its work so that it has a reasonable expectation of detecting significant control weaknesses and, if detected, performs additional work directed towards identification of potential fraud or other irregularities. However, Internal Audit procedures alone, even when performed with due professional care, do not guarantee that fraud will be detected. Consequently, Internal Audit reviews should not be relied upon to detect and disclose all fraud, defalcations or other irregularities that may exist.