

Pensions Audit Sub Committee

8.30am, Monday, 26 March 2018

External Audit – Annual Audit Plan 2017/18

Item number	5.4
Report number	
Executive/routine	
Wards	All
Council Commitments	Delivering a Council that works for all

Executive Summary

Scott-Moncrieff, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott Moncrieff Annual Audit Plan 2017-18”.

Claire Gardiner, Manager, Public Sector Audit, Scott-Moncrieff, will present the Annual Audit Plan 2017-18 to Committee.

Progress against the Plan will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee.

The proposed audit fee for 2017/18 is £45,000, which represents an increase of 1.5% from 2016/17.

External Audit – Annual Audit Plan 2017/18

1. Recommendations

Committee is requested to:

- 1.1 Note that the planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott-Moncrieff Annual Audit Plan 2017-18”.
- 1.2 Note that suitable provision has been made in the approved budget 2017-18 for the audit fee;
- 1.3 Note that progress against the Annual Audit Plan 2017-18 will be reported to future meetings of the Pensions Audit Sub-Committee and the Pensions Committee; and
- 1.4 Highlight any points that it would like raised at the Pensions Committee on 26 March 2018.

2. Background

- 2.1 The Audit Plan is reported annually to Pensions Committee by the external auditor, Scott-Moncrieff.
- 2.2 At its meeting on 20 March 2017, Pensions Committee agreed to:
 - 2.2.1 “Note that there is sufficient separation between Scott-Moncrieff’s payroll, taxation advisory and audit services, and that it does not affect the firm’s ability to provide an independent audit;
 - 2.2.2 Approve the continuation of non-audit services of taxation advice provided by the company’s external auditor to the LPF Group.”

3. Main report

- 3.1 Scott-Moncrieff, the external auditor to the Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2017/18. This is shown at Appendix 1 - “Scott-Moncrieff Annual Audit Plan 2017-18”.

4. Measures of success

- 4.1 Progress against the Annual Audit Plan 2017-18 will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Pensions Committee. The

prime objective is to ensure an unqualified audit opinion of the Annual Report 2017-18. This will be determined in due course.

5. Financial impact

- 5.1 The proposed audit fee for 2017/18 is £45,000, which represents an increase of 1.5% from 2016/17.
- 5.2 The Fund has accepted the proposed audit fee of £45,000 for 2017/18 and suitable provision has been made in the 2017/18 budget.

6. Risk, policy, compliance and governance impact

- 6.1 External audit is a critical part of the governance of the pension funds.

7. Equalities impact

- 7.1 There are no adverse equalities impact arising from this report.

8. Sustainability impact

- 8.1 There are no adverse sustainability impacts arising from this report.

9. Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Fund and they are invited to comment on the relevant matters at Committee meetings.

10. Background reading/external references

- 10.1 The responsibilities of Scott-Moncrieff, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, as approved by the Auditor General for Scotland and the Accounts Commission. Appropriate cognisance is also taken of ethical guidance of the auditing profession.

Stephen S. Moir

Executive Director of Resources

Contact: John Burns, Chief Finance Officer, Lothian Pension Fund

E-mail: john.burns@edinburgh.gov.uk | Tel: 0131 469 3711

11. Appendices

Appendix 1 - Scott Moncrieff Annual Audit Plan 2017-18



Scott-Moncrieff
business advisers and accountants

Lothian Pension Funds

External Audit Plan
2017/18

February 2018

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Introduction

Introduction

1. This document summarises the work plan for our 2017/18 external audit of Lothian Pension Fund, the Lothian Buses Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”).
2. The core elements of our work include:
 - an audit of the 2017/18 financial statements and related matters;
 - a review of arrangements for governance and transparency, financial management, financial sustainability and value for money; and
 - any other work requested by Audit Scotland.

Audit appointment

3. The Accounts Commission is an independent body appointed by Scottish Ministers responsible for securing the audit of local authorities and other local government bodies. The Commission’s work is governed mainly by the Local Government (Scotland) Act 1973.
4. Audit Scotland is an independent statutory body that provides the Accounts Commission with the services required to carry out their statutory functions, including monitoring the performance of auditors through a quality control process.
5. The Accounts Commission has appointed Scott-Moncrieff as external auditor of the funds for the five year period 2016/17 to 2020/21. This document comprises the audit plan for 2017/18 and summarises:
 - the responsibilities of Scott-Moncrieff as the external auditor;
 - our audit strategy;
 - our planned audit work and how we will approach it;
 - our proposed audit outputs and timetable; and
 - background to Scott-Moncrieff and the audit team.

Adding value through the audit

6. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Funds through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to help the Funds promote improved standards of governance, better management and decision making and more effective use of resources.
7. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to the audit team or through our online survey:
www.surveymonkey.co.uk/r/S2SPZBX
8. While this plan is addressed to the Funds, it will be published on Audit Scotland’s website
www.audit-scotland.gov.uk.



Respective responsibilities of the auditor and the Funds

Respective responsibilities of the auditor and the Funds

Auditor responsibilities

Code of Audit Practice

9. The Code of Audit Practice (the Code) outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.
10. A new Code of Audit Practice was published in 2016 and applies to external audits for financial years starting on or after 1 April 2016. This Code replaces the previous one issued in 2011.

Our responsibilities

11. Auditor responsibilities are derived from statute, the Code, International Standards on Auditing (UK) (ISAs), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities (paragraph 13). These are to:
 - undertake statutory duties, and comply with professional engagement and ethical standards
 - provide an opinion on audited bodies' financial statements
 - review and report on, as appropriate, other information such as annual governance statements, management commentaries and remuneration reports
 - notify the Controller of Audit when circumstances indicate that a statutory report may be required
 - demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies':
 - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets
 - suitability and effectiveness of corporate governance arrangements

- financial position and arrangements for securing financial sustainability

12. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Wider scope audit work

13. The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.
14. The Code sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.
15. Where the application of the full wider scope is judged by us not to be appropriate then our annual audit work on the wider scope is restricted to:
- Audit work to allow conclusions to be made on the appropriateness of the disclosures in the governance statement; and
 - Consideration of the financial sustainability of the organisation and the services that it delivers over the medium and longer term.
16. Our assessment takes into account the size, nature and risks of the organisation.
17. Taking these factors into consideration, we have concluded that application of the full wider scope is appropriate for the Funds.

Funds' responsibilities

18. The Funds' have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives. The Funds' responsibilities are summarised in Exhibit 2.

Exhibit 1: Audit dimensions of wider scope public audit

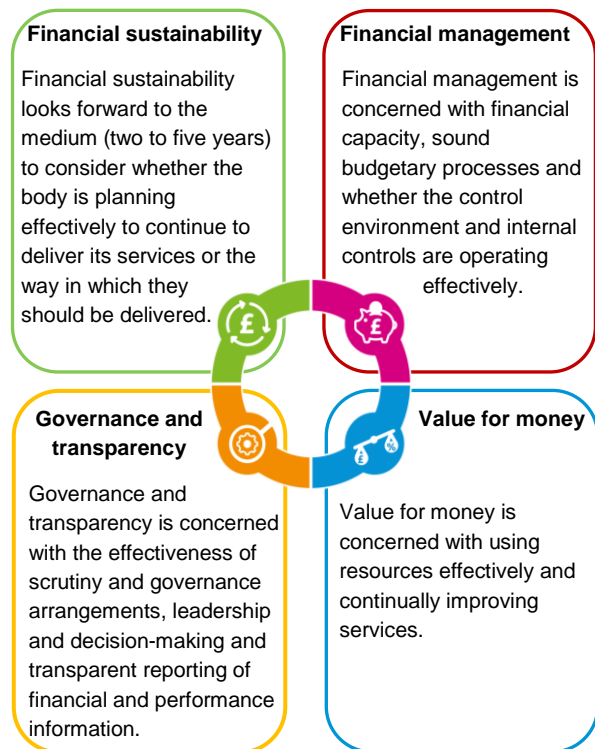


Exhibit 2 – Funds' responsibilities

Area	Funds' responsibilities
<p>Financial statements: Annual report and financial statements containing financial statements and other related reports should be prepared.</p>	<p>The Funds and the Chief Financial Officer have responsibility for:</p> <ul style="list-style-type: none"> • preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures; • maintaining proper accounting records; and • preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements.
<p>Financial sustainability: Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfill its functions in an affordable and sustainable manner.</p>	<p>The Funds are responsible for putting in place proper arrangements to ensure the financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> • Such financial monitoring and reporting arrangements as may be specified; • Compliance with any statutory financial requirements and achievement of financial targets; • Balances and reserves, including strategies about levels and their future use; • How the organisation plans to deal with uncertainty in the medium and long term; and • The impact of planned future policies and foreseeable developments on the financial position.
<p>Financial management: Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<p>It is the Funds' responsibility to ensure that financial affairs are conducted in a proper manner. Management are responsible, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance.</p> <p>The Funds are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at its disposal.</p> <p>It is the Funds' responsibility to establish arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.</p>

Exhibit 2 – Funds’ responsibilities

Area	Funds’ responsibilities
<p>Governance and transparency: Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<p>The Funds are responsible for establishing arrangements to ensure the proper conduct of their affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Those charged with governance should be involved in monitoring these arrangements.</p> <p>The Funds are also responsible for establishing effective and appropriate internal audit and risk management functions.</p>
<p>Value for money: Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.</p>	<p>The Funds have a specific responsibility to ensure that arrangements have been made to secure best value. They are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.</p>

3

Audit strategy

Audit strategy

Risk-based audit approach

19. We follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Funds.

This ensures that our audit focuses on the areas of highest risk. Our audit planning is based on:



20. Planning is a continuous process and our audit plans are therefore updated during the course of our audit to take account of developments as they arise.

Communications with those charged with governance

21. Auditing standards require us to make certain communications throughout the audit to those charged with governance. We have agreed with the Funds that these communications will be through the Pensions Audit Sub-Committee.

Professional standards and guidance

22. We perform our audit of the annual report and financial statements in accordance with International Standards on Auditing (UK) (ISAs), the International Standard on Quality Control 1 (UK), Ethical Standards, and applicable Practice Notes and other guidance issued by the Financial Reporting Council (FRC).

Partnership working

23. We will coordinate our work with Audit Scotland, internal audit, other external auditors and relevant scrutiny bodies, recognising the increasing integration of service delivery and partnership working within the public sector.

Audit Scotland

24. Although we are independent of Audit Scotland and are responsible for forming our own views and opinions, we do work closely with Audit Scotland throughout the audit. This helps, for example, to identify common priorities and risks, treat consistently any issues arising that impact on a number of audited bodies, and further develop an efficient and effective approach to public audit. We will share information about identified risks, good practices and barriers to improvement so that lessons to be learnt and knowledge of what works can be disseminated to all relevant bodies.
25. Audit Scotland undertakes national performance audits on issues affecting the public sector. We will review the Funds' arrangements for taking action on any issues reported in the national performance reports which may have a local impact. We plan to assess the extent to which the Funds use the national performance reports as a means to help improve performance at a local level.
26. During the year we may also be required to provide information to Audit Scotland to support the national performance audits.

Internal audit

27. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Funds' total audit resource. To achieve this, we aim to take full cognisance of the work of internal audit wherever possible



Annual report and financial statements

Annual report and financial statements

Introduction

28. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their financial performance in the use of those resources. This section sets out our approach to the audit of the Funds' annual report and financial statements.

Approach to the audit of the financial statements

29. Our opinion on the financial statements will be based on:

Risk-based audit planning

30. We focus our work on the areas of highest risk. As part of our planning process we prepare a risk assessment highlighting the audit risk relating to each of the key systems on which the annual report and financial statements will be based.

An audit of key systems and internal controls

31. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements.
32. The systems we review and the nature of the work we perform will be based on the initial risk assessment. We will examine and test compliance with best practice and the Funds' policies and procedures.
33. We will take cognisance of any relevant internal audit reviews of systems and controls.
34. We will update the risk assessment following our evaluation of systems and controls and this will ensure that we continue to focus attention on the areas of highest risk.

A final audit of the annual report and financial statements

35. During our final audit we will test and review the material amounts and disclosures in the financial statements. The extent of testing will be based on our risk assessment.
36. Our final audit will seek to provide reasonable assurance that the annual report and financial statements are free from material misstatement and comply with the Code of Practice on Local

Authority Accounting in the United Kingdom 2017/18 (the Code).

Independent auditor's report

37. Our opinion on whether the financial statements give a true and fair view of the financial position and the income and expenditure will be set out in our independent auditor's report which will be included in the annual report and financial statements.
38. We also provide an opinion on the consistency of the information in the management commentary, annual governance statement and governance compliance statement.

Group accounts

39. Lothian Pension Fund prepares its financial statements on a group basis. The group consists of Lothian Pension Fund and two special purpose vehicles, LPFE Ltd and LPFI Ltd.
40. The consolidation of the subsidiaries is not expected to result in a material change to the parent's financial statements.
41. As part of our audit we will review the consolidation working papers to ensure the group accounts accurately reflect the activities of the parent and both subsidiaries.

Materiality

42. Materiality is an expression of the relative significance of a matter in the context of the annual report and financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement. We will review our assessment of materiality throughout our audit.
43. Our initial assessment of materiality for each Fund is set out in the table below. The Funds hold significant investment assets, which form the largest part of the net asset statements for each pension fund. We consider that the net asset statements are of primary interest to the reader of the annual report and financial

statements and therefore consider that these should be used in the calculation of overall materiality.

44. ISA 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transaction for which lesser amounts than the overall materiality could influence the decisions of users of the accounts. We considered transactions when dealing with members (i.e. contributions and expenditure incurred providing payments to pensioners) to be of key interest to the users. This is reported in the first section of the Fund Account and contains information about the day to day operation of the Funds. We have therefore set a separate materiality based on the expenditure incurred for providing payments to pensioners.

	Overall materiality £million	Dealings with members materiality £million
Lothian Pension Fund (group) ¹	98.5	10.6
Lothian Pension Fund (single entity)	98.5	10.6
Lothian Buses Pension Fund	7.3	0.6
Scottish Homes Pension Fund	2.6	0.4

45. We set a performance (testing) materiality for each area of work which is based on a risk assessment for the area. We perform audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we perform a greater level of testing on the areas deemed to be of significant risk of material misstatement.

¹ Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

	Area risk assessment £million		
	High (50%)	Medium (60%)	Low (75%)
Lothian Pension Fund (group) ¹	49.3	59.1	73.9
Lothian Pension Fund (single entity)	49.3	59.1	73.9
Lothian Buses Pension Fund	3.7	4.4	5.5
Scottish Homes Pension Fund	1.3	1.5	1.9

46. Where transactions, or groups of transactions relate to dealings with members, performance materiality will be set using the percentages outlined in the table above.
47. We will report any misstatements identified through our audit that fall into one of the following categories:
- All material corrected misstatements;
 - Uncorrected misstatements with a value in excess of £250,000, less than 1% of the overall materiality figure; and
 - Other misstatements below the 1% threshold that we believe warrant reporting on qualitative grounds.


Key audit risks in the annual report and financial statements

48. Auditing standards require that we inform the Pensions Audit Sub-Committee of our assessment of the risk of material misstatement in the annual report and financial statements. We have set out our initial assessment below, including how the scope of our audit responds to those risks. We will provide an update to the Pensions Audit Sub-Committee if our assessment changes significantly during the audit.

Exhibit 3: Key audit risks in the annual report and financial statements


1. Management Override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the financial statements. This is treated as a presumed risk area in accordance with ISA 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

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49. In response to this risk we will review the Funds' accounting records and obtain evidence to ensure that any significant transactions outside the normal course of business were valid and accounted for correctly.


2. Revenue recognition

Under ISA 240- *The auditor's responsibilities relating to fraud in an audit of financial statements* there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the Funds could adopt accounting policies or recognise revenue transactions in such a way as to lead to a material misstatement in the reported financial position.

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50. Our work on income will include an evaluation of each type of revenue transaction and a review of the controls in place over revenue accounting. We will consider the Funds' key revenue transactions and streams and carry out testing to confirm that the Funds' revenue recognition policy is appropriate and has been applied consistently throughout the year

3. Risk of fraud in the recognition of expenditure

In 2016, the Public Audit Forum issued Practice Note 10 "The Audit of Public Sector Financial Statements" which applies to the audit of public sector financial statements for periods commencing after June 2016. This practice note recognises that most public sector bodies are net spending bodies and notes that there is an increased risk of material misstatement due to improper recognition of expenditure.

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51. We have considered the expenditure streams at the Funds' and we do not consider the risk of fraud in expenditure recognition to be material. We have therefore rebutted this risk at the planning stage. We will, however, continue to monitor this position throughout the audit.

3. Valuation of investments

The Funds held investments of £6.569 billion as at 31 March 2017, of which 30% (£2.069 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Judgements are taken by the Investment Managers to value those investments whose prices are not publically available. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.



- 52. In response to this risk we will review the design and implementation of controls present at the scheme for ensuring the accurate valuation of investments. We will review the qualifications of the fund managers as experts in accordance with ISA 500.
- 53. For a sample of investments we will confirm the prices quoted to fund manager reports and independent pricing sources. We will assess the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments.

4. Pension liability assumptions

An actuarial estimate of the pension fund liability is calculated on an annual basis under IAS 19 and on a triennial funding basis by independent firm of actuaries with specialist knowledge and experience. The latest triennial valuation was as at 31 March 2017 and sets rates for the three-year period commencing 1 April 2018. The estimates are based on the most up to date membership data held by the pension fund and have regard to local factors such as mortality rates and expected pay rises with other assumptions around inflation when calculating the liabilities. There is a risk that the data provided to the actuary is not complete and that assumptions used are not appropriate.



- 54. We will review the controls in place to ensure that the data provided from the fund to the actuary is complete and accurate. We will review the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data. We will agree the disclosures in the financial statements to information provided by the actuary.



Wider scope audit

Wider scope audit

Introduction

55. As described in section 2, the Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we consider and report against these four dimensions; financial sustainability, financial management, governance and transparency and value for money.

56. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our understanding of the Fund's priorities and risks which we developed in 2016/17, discussions with management and review of the Funds' minutes and key strategy documents. In 2017/18 we have also

considered the following risk areas as they relate to the Funds:

- EU withdrawal
- New financial powers
- Ending of public sector pay cap
- Response to cyber security risks
- Openness and transparency.

57. At this stage of our audit planning process, we have not identified any significant risks in relation to the wider scope dimensions. Audit planning however is a continuous process and we will report any identified significant risks, as they relate to the four dimensions, in our annual audit report.



Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the organisation's planning processes support the future delivery of services.

Consideration	Our audit approach
<p>The Funds produce an annual service plan and budget which focuses on the costs associated with dealings with members and covers a two year period of activity. In addition to this the Funds prepare a Funding Strategy Statement and receive a triennial actuarial valuation which builds up a picture of the longer term financial pressures.</p> <p>The latest triennial valuation took place as at 31 March 2017 and will set the rates from 1 April 2018. The Funding Strategy Statement is informed by the results of this triennial valuation and will create a strategy for each of the three funds. T</p> <p>The Funds' management team are currently developing the revised Funding Strategy Statement ensuring that each is designed to allow the fund to meet the demands of future pension costs.</p>	<p>During our 2017/18 audit we will consider the Fund's financial standing. This will involve a review of the arrangements in place for medium to long term financial planning, budgetary control and financial reporting. It is important that such arrangements are adequate in order to properly control Funds' operations and use of resources.</p> <p>This will include consideration of the results of the actuarial valuation and accompanying revised Funding Strategy Statement.</p>



Financial management

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Consideration	Our audit approach
<p>The key financial indicator for the across pension funds in Scotland is the return on investments. The Lothian Pension Funds have consistently performed above the Scottish average in recent years.</p> <p>The net assets of the Funds increased in 2016/17, reflecting the level of returns achieved in year and the relatively strong position of the market in year.</p> <p>The performance of investments is monitored by the Pension Committee, who considers the investments control environment and performance over the annual committee cycle in line with a formal long term agenda plan.</p> <p>The Committee also monitors the budget for income and expenditure incurred when dealing with members. It has been noted that in 2017/18 the number of active members has continued to decrease for Lothian Pension Fund and Lothian Buses Pension Fund. This has caused a fall in contributions against an increase in pensioner and lump sum payments. It is projected that all funds will be in a net withdrawals position as at 31 March 2018. The reliance on investment income is therefore increased in order to meet the long term cash flow needs.</p>	<p>During our 2017/18 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none">• Whether the Funds have arrangements in place to ensure systems of internal control are operating effectively;• Whether the Funds can demonstrate the effectiveness of its budgetary control system in communicating accurate and timely performance;• How the Funds have assured itself that its financial capacity and skills are appropriate;• Whether Funds has established appropriate and effective arrangements for the prevention and detection of fraud and corruption; and



Governance and transparency

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

Consideration	Our audit approach
<p>The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.</p> <p>Following the local government elections in May 2017, there have been 2 changes in elected members. An</p>	<p>We will review the effectiveness of the Funds' governance framework and the extent to which the committee roles, membership and terms of reference comply with current guidance: <i>Delivering good governance in local government: framework (2016)</i>.</p> <p>We will consider whether the information provided to</p>

induction programme has been developed for new members to ensure they understand their role and the roles of the committees.

The Pensions Committee and Pensions Audit Sub-Committee meetings are held in public, papers are available in advance and minutes of the meetings are published on the City of Edinburgh Council's website.

the committees is sufficient for members to assess the impact of decisions on resources and performance.

Our work will include consideration of how risk management has been addressed within the Funds. We will also consider Funds' internal audit arrangements to determine their role in examining the control systems established by management.



Value for money

Value for money is concerned with the appropriate use of resources and ensuring continual improvement of services delivered.

Consideration	Our audit approach
<p>Investments at the Funds are managed through a combination of external fund managers and the Funds' special purpose vehicles, LPFE Ltd and LPFI Ltd. The proportion of funds managed internally has increased over recent years which has resulted in investment management expenses reducing as a proportion of net investment assets.</p> <p>The Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly and 3 yearly performance measures. This information is presented to the Investment Strategy Panel to allow for scrutiny investment performance of the Funds.</p> <p>The Funds' also focus on administrative performance and have developed a Service Plan covering the period 2016- 2018. The Pensions Committee receive updates on the service plan at each meeting.</p> <p>The Funds make use of a range of service providers including investment managers, an actuary and a custodian. In line with City of Edinburgh Council procedures the Funds maintain a contract register and have considered the position of contracts in year. Where action has been required a tender process has been undertaken. As a result of this process to date the contract with the custodian has been extended and further investment management services have been brought in house. We note there are further tenders due to take place prior to the completion of our audit.</p>	<p>We will work with the Funds' to identify and review evidence which demonstrates the achievement of value for money in the use of its resources.</p> <p>We will seek evidence from the Funds that outcomes are improving and there is sufficient focus on improvement and the pace of it.</p> <p>We will review the process for tendering for new providers and consider this against the value for money principles.</p> <p>Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. We will work with Audit Scotland during the year to understand the outputs from this work and identify any particular reports that the Funds may have a direct interest in.</p>



Audit outputs, timetable and fees

Audit outputs, timetable and fees

Audit output	Format	Description	Target month
External audit plan	Report	This report sets out the scope of our audit for 2017/18.	February 2018
Independent Auditor's Report	Report	This report will contain our opinions on the truth and fairness of the annual report and financial statements.	September 2018
Annual Report to the Funds and the Controller of Audit	Report	At the conclusion of each year's audit we will issue an annual report setting out the nature and extent of our audit work for the year and summarising our opinions, conclusions and the significant issues arising from the work. This report will pull together all of our work under the Code of Audit Practice.	September 2018

Audit outputs

38. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
39. The action plans within the reports will include prioritised recommendations, responsible officers and implementation dates. We will review progress against the action plans on a regular basis.

Audit fee

40. Audit Scotland has completed a review of funding and fee setting arrangements and as a result revised its fee strategy. It now sets an expected fee for each audit carried out under appointment that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for audit. The expected fee is reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.
41. As auditors we negotiate a fee with the audited body during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.
42. For 2017/18 we propose setting the audit fees at 10% above the expected fee level. This

reflects the unique nature of the Funds and the level of risk this brings to the audit.

43. The expected fee for the Funds for the 2017/18 audits are as follows:

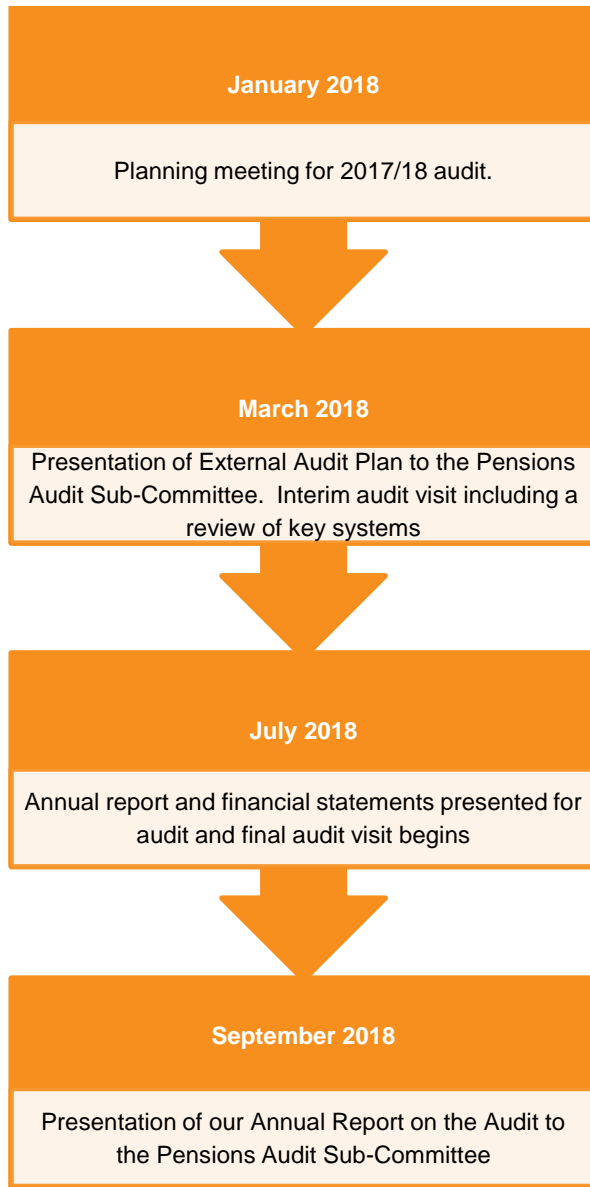
2017/18	
Auditor remuneration	£39,530
Pooled costs	£3,190
Audit support costs	£2,280
Total expected fee	£45,000²

44. We will take account of the risk exposure of the Funds and the management assurances in place. We assume receipt of the draft accounts and working papers at the outset of our on-site final audit visit. If the draft accounts and papers are late, or agreed management assurances are unavailable, we reserve the right to charge an additional fee for additional audit work. An additional fee will be required in relation to any other significant exercises not within our planned audit activity.

² The audit fee in 2016/17 was £44,350

Audit timetable

45. The dates for our interim and final audits have been discussed with the Chief Financial Officer and the Finance Team. A summary timetable, including audit outputs, is set out below:





Appendices

Appendix 1: Your audit management team

Scott-Moncrieff is one of the largest independent accountancy firms in Scotland. We have 17 partners and over 200 staff operating from Edinburgh, Glasgow and Inverness. We are also part of the global Moore Stephens network.

We have been external auditors within the public sector for at least fifty years. We provide a comprehensive range of services to clients across the public sector, including NHS bodies, local authorities, central government bodies and FE colleges. We also provide services to charities, schools, as well as private and public limited companies.

Edinburgh	Glasgow	Inverness
Exchange Place 3 Semple Street Edinburgh EH3 8BL	25 Bothwell Street Glasgow G2 6NL	Scott-Moncrieff 10 Ardross Street Inverness IV3 5NS
(0131) 473 3500	(0141) 567 4500	(01463) 701 940

Your audit management team



Nick Bennett

Partner

Nick.bennett@scott-moncrieff.com

Nick has over 25 years' experience of public sector auditing and has been heavily involved in developing public sector accounting standards. Nick's experience and expertise is acknowledged both by clients and by other professionals involved right across the public sector.

Nick will have responsibility for the delivery of the audit.



Claire Gardiner

Audit Manager

Claire.gardiner@scott-moncrieff.com

Claire has over 12 years' public sector external audit experience. She has delivered external audit services to a range of public sector bodies, including pension funds, local authorities, health bodies and central government bodies.

Claire will manage the onsite team and work alongside Nick to deliver the audit engagement.



Rachel Wynne

Audit Senior

Rachel.wynne@scott-moncrieff.com

Rachel joined the firm in 2014 as a public sector audit trainee and has since achieved her CA qualification. She has experience delivering external audit services to a range of public sector bodies, including local government.

Rachel will be responsible for the delivery of the onsite work.

Confirmation of independence

International Standard on Auditing (UK) 260
“Communication with those charged with governance”
requires us to communicate on a timely basis all facts
and matters that may have a bearing on our
independence.

Scott-Moncrieff is also responsible for the audit of the
financial statements of LPFE Ltd and LPFI Ltd, the
subsidiaries of Lothian Pension Fund. In addition to
the audit of the subsidiaries, Scott-Moncrieff provides
accounts preparation, corporation tax services and ad
hoc VAT advice to both LPFE Ltd and LPFI Ltd.

All tax services are provided by an independent tax
partner and staff who have no involvement in the audit
of the financial statements.

The accounts are prepared from trial balances
provided by LPFE Ltd and LPFI Ltd and no significant
policies, disclosures, adjustments or estimates are
decided by Scott-Moncrieff.

Moore Stephens provided a Financial Conduct
Authority Compliance review for LPFI Ltd. The team is
independent of Scott-Moncrieff and has no
involvement in the audit of Lothian Pension Fund or its
subsidiaries.

We confirm that we will comply with FRC’s Revised
Ethical Standard (June 2016). In our professional
judgement, the audit process is independent and our
objectivity has not been compromised in any way.

Appendix 2: Statement of understanding

Introduction

The purpose of this statement of understanding is to clarify the terms of our appointment and the key responsibilities of the Funds and Scott-Moncrieff.

Annual report and financial statements

We will require the annual report and financial statements and supporting working papers for audit by the agreed date specified in the audit timetable. It is assumed that the relevant Funds staff will have adequate time available to deal with audit queries and will be available up to the expected time of completion of the audit. We will issue a financial statements strategy which sets out roles, responsibilities and expectations in terms of audit deliverables. This document helps to ensure we can work together effectively to deliver an efficient and effective audit.

Scope of audit

As auditors we will take reasonable steps to plan and carry out the audit so as to meet the objectives and comply with the requirements of the Code of Audit Practice. Audit work will be planned and performed on the basis of our assessment of audit risks, so as to obtain such information and explanations as are considered necessary to provide sufficient evidence to meet the requirements of the Code of Audit Practice.

As auditors we do not act as a substitute for the Funds' responsibility to establish proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for and used economically, efficiently and effectively.

As part of our normal audit procedures, we will ask you to provide written confirmation of certain oral representations which we have received from the Partnership during the course of the audit on matters having a material effect on the annual report and financial statements. This will take place by means of a letter of representation, which will require to be signed by the Chief Financial Officer.

Internal audit

It is the responsibility of the Funds to establish adequate internal audit arrangements. The audit fee is agreed on the basis that an effective internal audit function exists.

We will liaise with internal audit to ensure an efficient audit process.

Fraud and irregularity

In order to discharge our responsibilities regarding fraud and irregularity we require any fraud or irregularity issues to be reported to us as they arise. We also require a historic record of instances of fraud or irregularity to be maintained and a summary to be made available to us after each year end.

Ethics

We are bound by the ethical guidelines of our professional body, the Institute of Chartered Accountants of Scotland.

Fees

We base our agreed fee upon the assumption that all of the required information for the audit is available within the agreed timetable. If the information is not available within the timetable we reserve the right to charge a fee for the additional time spent by our staff. The fee will depend upon the level of skill and responsibility of the staff involved. The indicative financial statements strategy referred to above is a key means for us to clarify our expectations in terms of quality, quantity and extent of working papers and supporting documentation.

Service

If at any time you would like to discuss with us how our service to you could be improved or if you are dissatisfied with the service you are receiving please let us know by contacting Nick Bennett. If you are not satisfied, you should contact our Ethics Partner, Bernadette Higgins. In the event of your not being satisfied by our response, you may also wish to bring the matter to the attention of the Institute of Chartered Accountants of Scotland.

We undertake to look at any complaint carefully and promptly and to do all we can to explain the position to you.

Reports

During the course of the audit we will produce reports detailing the results and conclusions from our work.

Any recommendations arising from our audit work will be included in an action plan. Management are responsible for providing responses, including target

dates for implementation and details of the responsible officer.

Agreement of terms

We shall be grateful if the Pension Audit Sub-Committee would consider and note this statement of understanding. If the contents are not in accordance with your understanding of our terms of appointment, please let us know.



Scott-Moncrieff
business advisers and accountants

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