



## **Pensions Committee**

**2.00pm, Wednesday, 24 June 2020**

### **External Audit Annual Plan 2019/20 by Scott-Moncrieff**

**Item number 5.6**

#### **1. Recommendations**

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The Pensions Committee (Committee) is requested to:

- 1.1 note the planned programme of work to support the statutory audit 2019/20. This is shown at Appendix 1 - "Group External Audit Annual Plan 2019-20" by Scott-Moncrieff;
- 1.2 note that suitable provision has been made in the approved budget 2019-20 for the audit fee; and
- 1.3 note that progress against the Group External Audit Annual Plan 2019-20 will be reported to future meetings of the Pensions Audit Sub-Committee and the Committee.

**John Burns**

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# External Audit Annual Plan 2019/20 by Scott-Moncrieff

## 2. Executive Summary

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- 2.1 Scott-Moncrieff, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2019/20. This is shown in full at Appendix 1.
- 2.2 Scott-Moncrieff representative(s) will present the Group External Annual Audit Plan 2019-20 to Committee.

## 3. Background

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- 3.1 The Accounts Commission appointed Scott-Moncrieff as external auditor of the funds for the five-year period 2016/17 to 2020/21.
- 3.2 The External Audit Plan is reported annually to Committee by the external auditor, Scott-Moncrieff.
- 3.3 At its meeting on 20 March 2017, Committee agreed to:
  - 3.3.1 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; and
  - 3.3.2 approve that non-audit services around taxation advice continue to be provided by the external auditor to the Lothian Pension Fund Group (the LPF Group).

## 4. Main Report

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- 4.1 Scott-Moncrieff, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2019/20. This is provided in full at Appendix 1.
- 4.2 Progress against the plan will be reported to future meetings of the Pensions Audit Sub-Committee and thereafter the Committee.

## 5. Financial impact

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- 5.1 The expected audit fee for 2019/20 is £46,418, which represents a very small increase of 0.2% from 2018/19.

- 5.2 The LPF Group has accepted the proposed audit fee of £46,418 for 2019/20 and suitable provision has been made in the 2019/20 budget.

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

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- 6.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the funds and they are invited to comment on the relevant matters at Committee meetings.
- 6.2 There are no adverse health and safety, governance, compliance or regulatory implications arising from this report. External audit is a critical part of the LPF Group's governance and assurance.

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

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- 7.1 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.

## **8. Appendices**

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Appendix 1 – "Group External Audit Annual Plan 2019-20" by Scott-Moncrieff.



**Scott-Moncrieff**  
business advisers and accountants

With **Campbell Dallas**  
a Capital company

# *Lothian Pension Funds*

*Group External Audit Annual Plan 2019/20*

March 2020





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# *1. Introduction*

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## Introduction

1. This document summarises the work plan for our 2019/20 external audit of Lothian 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, and provision of a specified audit opinion, on the 2019/20 annual report and accounts;
  - consideration and reporting on the Funds’ arrangements on the four audit dimensions: financial sustainability, financial management, governance and transparency, and value for money; and
  - any other work requested by Audit Scotland including the contribution to performance audits (including overview reports, performance audit reports, and impact reports).

## 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 2019/20 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 management team.

## Confirmation of independence

6. International Standards on Auditing in the UK (ISAs (UK)) require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.
7. Scott-Moncrieff is also responsible for the audit of the financial statements of the subsidiaries of Lothian Pension Fund, LPFE Ltd and LPFI Ltd. 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. In 2019/20 non-audit fees are estimated to be approximately £9,000.
8. We have outlined the safeguards to our independence in Appendix 2. We confirm that we comply with FRC’s Ethical Standard. In our professional judgement, the audit process is independent, and our objectivity has not been compromised in any way.

## Adding value through the audit

9. 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.

## Feedback

10. 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 any member of your audit team.

## Openness and transparency

11. While this plan is addressed to the Funds, it will be published on Audit Scotland’s website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



## *2. Respective responsibilities of the auditor and the Funds*

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## Respective responsibilities of the auditor and the Funds

### Auditor responsibilities

#### Code of Audit Practice

12. 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.

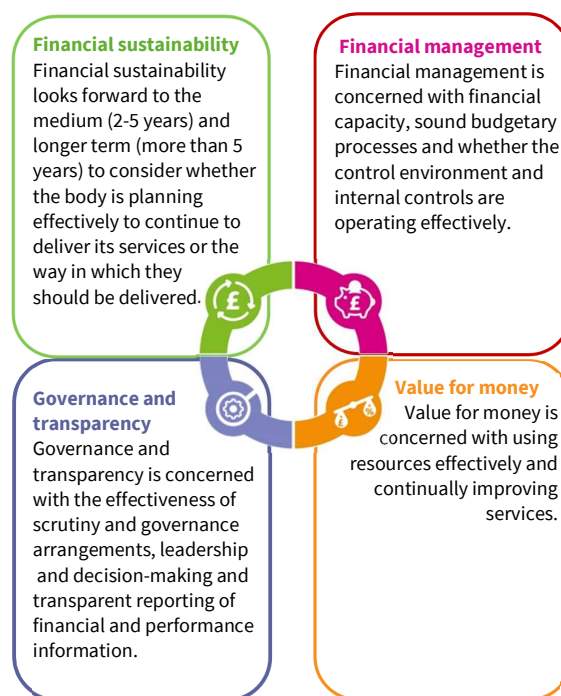
#### Our responsibilities

13. Auditor responsibilities are derived from statute, the Code, International Standards on Auditing (UK) (ISAs (UK)), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities (paragraph 15). 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

14. 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.

### Exhibit 1: Audit dimensions of wider scope public audit



### Wider scope audit work

15. 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.
16. The Code sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.
17. Our assessment takes into account the size, nature and risks of the organisation. 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 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 2 – Funds' responsibilities

Area	Funds' responsibilities
<b>Financial statements:</b> Annual accounts containing financial statements and other related reports should be prepared.	<p>The Funds and the Chief Financial Officer have responsibility for:</p> <ul style="list-style-type: none"> <li>• 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</li> <li>• 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</li> <li>• maintaining proper accounting records</li> <li>• 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</li> </ul>
<b>Financial sustainability:</b> Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfil its functions in an affordable and sustainable manner.	<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"> <li>• Such financial monitoring and reporting arrangements as may be specified;</li> <li>• Compliance with any statutory financial requirements and achievement of financial targets;</li> <li>• Balances and reserves, including strategies about levels and their future use;</li> <li>• How the organisation plans to deal with uncertainty in the medium and long term; and</li> <li>• The impact of planned future policies and foreseeable developments on the financial position.</li> </ul>



Area	Funds' responsibilities
<p><b>Financial management:</b> 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 for ensuring 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 for establishing 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 appropriate arrangements in place.</p>
<p><b>Governance and transparency:</b> 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><b>Value for money:</b> 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:

Discussions with senior officers at Lothian Pension Funds	Our understanding of the sector and its key priorities and risks	Attendance at the Pensions Committee
Guidance from Audit Scotland	Discussions with Audit Scotland and other auditors	Review of internal audit's plan and reports
Review of the Funds' corporate strategies and plans	Review of the Funds' corporate risk register	The outcomes of prior year audits

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 Committee.

### Professional standards and guidance

22. We perform our audit of the financial statements in accordance with International Standards on Auditing (UK) (ISAs (UK)), 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 them 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 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 also consider the extent to which the Funds use the national performance reports as a means to help improve performance at the local level.
26. During the year we may also be required to provide information to Audit Scotland to support the national performance audits or provide information to support the assessment of the impact of specified published performance audit reports.



## Internal audit

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27. We are committed to avoiding duplication of audit effort and ensuring an efficient use of the Funds' total audit resource. We will consider the findings of the work of internal audit within our audit process and look to minimise duplication of effort, to ensure the total audit resource to the Funds' is used efficiently and effectively.



# *4. Annual report and accounts*

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# Annual report and accounts

## Introduction

28. Audited bodies' annual report and accounts 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 accounts.

## Approach to audit of the financial statements

29. Our opinion on the annual accounts (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 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 examine and test compliance with best practice and the Funds' own policies and procedures.
33. We take cognisance of any relevant internal audit reviews of systems and controls.
34. We update the risk assessment following our evaluation of systems and controls which ensures that we continue to focus attention on the areas of highest risk.

### A final audit of the 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 financial statements are free from material misstatement and comply with the

Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 (the Code).

### Assurances from employers' auditors

37. As part of our audit of the financial statements of the Funds, we ask the auditors of a sample of employers within the Funds to conduct testing on employer and employee contributions and the control environment in place to ensure that the employer submissions are accurate.
38. These requests are made in line with Audit Scotland's Protocol for Auditor Assurances 2019/20 – Local Government Pension Schemes.

### Independent auditor's report

39. 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 accounts.
40. We also provide an opinion on the consistency of the information in the management commentary, annual governance statement and governance compliance statement.

### Group accounts

41. 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.
42. As part of our audit we will review the consolidation working papers to ensure the group accounts accurately reflect the merged activities of the Lothian Pension Fund, and both subsidiaries.

### Materiality

43. Materiality is an expression of the relative significance of a matter in the context of the 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 review our assessment of materiality throughout our audit.





44. 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. The primary business of the Funds is to hold sufficient assets to generate returns to meet future pension obligations. We consider that the net assets are of primary interest to the reader of the annual report and accounts. We therefore use net assets to inform our assessment of overall materiality.
45. ISA (UK) 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transactions for which lesser amounts than the overall materiality could influence the decisions of users of the accounts. We consider 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.
46. Our initial assessment of overall materiality is based on approximately 1.5% of net assets. One of the main functions of LPF is to invest appropriately to fund the pensions of members. As a result, net assets are seen to be one of the principal considerations for users of the accounts.
47. Our initial assessment of dealings with members materiality is based on approximately 5% of expenditure. The main dealing with members that the Funds undertake is the collection of contributions and the payment of pensions and lump sums. Therefore, the income and expenditure of the Funds will be a principal consideration for users of the accounts.

Materiality (£million)		
	Overall	Dealing with members
Lothian Pension Fund (group) <sup>1</sup>	117	12
Lothian Pension Fund (single entity)	117	12
Scottish Homes Pension Fund	2.5	0.36

<sup>1</sup> Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

48. Performance materiality is the working level of materiality used throughout the audit. We use performance materiality to determine the nature, timing and extent of audit procedures carried out. 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 at significant risk of material misstatement.
49. Performance materiality is set at a value less than overall materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed overall materiality.

Performance materiality (£million)		
	Overall	Dealings with members
Lothian Pension Fund (group) <sup>1</sup>	76	7.8
Lothian Pension Fund (single entity)	76	7.8
Scottish Homes Pension Fund	1.6	0.23

50. We will also report any misstatements identified through our audit that fall into one of the following categories:
- All material corrected misstatements;
  - Uncorrected misstatements for the group and LPF with a value in excess of £250,000, SHPF with a value in excess of £125,000; and
  - Other misstatements below the £250,000 threshold that we believe warrant reporting on qualitative grounds.

#### Key audit risks in the financial statements

51. Auditing standards require that we inform the Pensions Committee of our assessment of the risk of material misstatement in the 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 Committee if our assessment changes significantly during the audit.



## Exhibit 3 – Key audit risks in the financial statements

### Management override

In any organisation, there exists a risk that management has 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 (UK) 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

52. 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 are valid and accounted for correctly. We will adopt data analytics techniques to review and test aspects of this key audit risk. We will review the key accounting estimates, judgements and decisions made by management.

### Revenue recognition

Under ISA (UK) 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.

53. 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.

### Risk of fraud in the recognition of expenditure

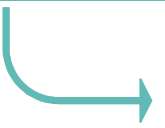
In 2016, the Public Audit Forum issued Practice Note 10 "*The Audit of Public Sector Financial Statements*" which applies to the audit of public sector financial statements for periods commencing after June 2016. This Practice Note recognises that most public sector bodies are net spending bodies and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

54. 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.



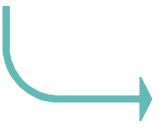
## Valuation of investments

The Funds held investments of £7.789 billion as at 31 March 2019, of which 34% (£2.639 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 publicly 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.

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55. 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.
  56. 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.

## Accounting for investment properties

LPF hold a portfolio of investment properties which as at the 31 March 2019 was valued at £475.4 million. During 2018/19, this portfolio was managed by Standard Life. In 2019/20, the management of this investment has been moved in-house. The management of the properties will be undertaken by JLL, along with the fund accounting for the portfolio. Fund accounting for a portfolio the size of LPF's has not been undertaken by JLL before now. The material nature of this portfolio means that an error in accounting treatment could result in a material error.

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57. In response to this risk, we will review the fund accounting for the investment property portfolio, and the controls in place to ensure their accurate accounting.



## *5. Wider scope*

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## Introduction

58. As described in section 2, the Code frames a significant part of our audit responsibilities in terms of four wider scope 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.
59. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our work in prior years to develop an understanding of the Funds' key priorities and risks. In 2019/20, Audit Scotland has also identified the following wider scope risks, which we will consider during our audit as they relate to the Funds:
- Fraud and corruption in respect of the procurement function; and
  - EU withdrawal
60. At this stage of our audit planning, we have identified one significant risk to the wider scope of our audit in relation to financial sustainability (Exhibit 4).
61. We have not, at this stage, identified any significant risks in relation to the other 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. Exhibit 5 summarises our audit work in respect of each dimension.



## Exhibit 4 – Wider scope significant risk


### Financial sustainability: Market volatility

The Funds held investments of £7.789 billion as at 31 March 2019. Investment strategies are in place for each of the funds which outline the Funds approach to ensure that all members and their dependents receive their benefits when they become payable. The investment strategy was recently updated and approved by the Pensions Committee in December 2019.

The primary objective of the Funds is to ensure that there are sufficient funds available to meet all pension and lump sum liabilities as they fall due for payment. The funding objectives for each Fund are documented in the Committee's Funding Strategy Statement, which is reviewed at least triennially. The funding objectives, together with the rates of return being targeted and levels of risk to be tolerated, are central to each Fund's investment strategy and govern the allocation across various asset classes.

The investment objectives of the Funds are to achieve a return on Fund assets which is sufficient over the long term to meet the funding objectives as outlined in the Funding Strategy Statement. Investment returns are generated by a combination of income (from dividends, interest and rents) and gains or losses on capital.

While it is noted that the Funds investment strategy is designed in such a way to withstand market volatility in the long term, we have noted that worldwide political events had a significant impact on the market in 2018 and 2019, with this volatility expected to continue in 2020. There is a risk that the value of investments is significantly impacted by events within the wider political environment.

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62. We will monitor the Funds approach to monitoring investment performance focusing on the identification of investment risk and the development of mitigating actions.
  63. We will review the Funds investment return performance against benchmark over the short, medium and long term. We will also consider performance against comparators from other Scottish Local Government Pension Funds.



## Exhibit 5 - Our audit approach to the wider scope audit dimensions



### 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>In 2018/19 we concluded that the Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds.</p> <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>Funding levels across the 2 funds improved following the 2017 actuarial valuation.</p>	<p>As part of our work on financial sustainability work in 2019/20 we will review, conclude and report on:</p> <ul style="list-style-type: none"> <li>• The arrangements in place for medium to long term financial planning, budgetary control and financial reporting;</li> <li>• Affordability for employers including the number of employer cessations and current membership levels of the Funds; and</li> <li>• Any findings from the Scheme Advisory Board's consultation on the Review of the Structure of the Scottish Local Government Pension Fund.</li> </ul>



### 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>In 2018/19 we concluded that the Funds have effective arrangements in place for financial management and the use of resources.</p> <p>The key financial indicator across pension funds in Scotland is the return on investments. Lothian Pension fund was above the national average in 2018/19.</p> <p>Both funds have met or exceeded the 5- and 10-year benchmarks however which indicate the investment portfolio is being managed appropriately.</p>	<p>During our 2019/20 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none"> <li>• Whether the Funds continue to have arrangements in place to ensure systems of internal control are operating effectively;</li> <li>• How the Funds have assured themselves that its financial capacity and skills are appropriate;</li> <li>• The effectiveness of the financial and budgetary control system in communicating accurate and timely performance; and</li> </ul>



Consideration	Our audit approach
<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. Both funds were in a net withdrawals position as at 31 March 2019. The reliance on investment income is therefore increased in order to meet the long term cash flow needs.</p>	<ul style="list-style-type: none"> <li>Whether the Fund has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.</li> </ul>



### 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>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.</p>	<p>As part of our work on governance and transparency work in 2019/20 we will review, conclude and report on:</p> <ul style="list-style-type: none"> <li>Whether the Funds can demonstrate that the governance arrangements in place are appropriate and operating effectively;</li> <li>Whether induction arrangements for new Board members support effective scrutiny and challenge;</li> <li>The transparency of decision-making, and on financial and performance reporting; and</li> <li>The Funds' preparations for the potential impact of Brexit.</li> </ul>





## 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 2018-2020. The Pensions Committee receive updates on the service plan at each meeting.</p> <p>The Funds also works collaboratively with other Local Government Pension Funds. It is hoped that collaborative structures will deliver efficiencies.</p> <p>The Funds make use of a range of service providers including investment managers, an actuary and a custodian.</p> <p>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.</p>	<p>As part of our 2019/20 audit we will review, conclude and report on the following:</p> <ul style="list-style-type: none"> <li>• How the Funds' demonstrates a focus on improvement in the context of continuing and significant financial challenge;</li> <li>• How the Funds provide a clear link between investment decisions and actual performance achieved;</li> <li>• The effectiveness of working with partners including collaboration with Fife Council Pension Fund and Falkirk Council Pension Fund; and</li> <li>• Review the process for tendering for new providers and consider this against the value for money principles.</li> </ul>



## *6. Audit outputs, timetables and fees*

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## Audit outputs, timetable and fees

This section of our plan provides details of our audit outputs, timetable and proposed audit fees for the audit of the Funds.

Audit output	Format	Description	Target month
External audit plan	Report	This report sets out the scope of our audit for 2019/20.	March 2020
Independent Auditor's Report	Report	This report will contain our opinion on the financial statements, the governance compliance statement, annual governance statement and management commentary.	September 2020
Annual Report to the Funds and the Controller of Audit	Report	At the conclusion of each year's audit we issue an annual report setting out the nature and extent of our audit work for the year and summarise our opinions, conclusions and the significant issues arising from our work. This report pulls together all of our work under the Code of Audit Practice.	September 2020

### Audit outputs

64. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
65. 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.

	2019/20	2018/19
Auditor remuneration	£40,458	£40,458
Pooled costs	£3,680	£3,570
Audit support costs	£2,280	£2,310
<b>Total expected fee</b>	<b>£46,418</b>	<b>£46,338</b>

### Audit fee

66. Audit Scotland 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.
67. 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.
68. For 2019/20 we propose setting the audit fees at 5% above the expected fee level. This reflects the unique nature of the Funds and the level of risk this brings to the audit.
69. The expected fees for the Funds for the 2019/20 audits are as follows:

70. We will take account of the risk exposure of the Funds and the management assurances in place. We assume receipt of the draft 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.



## Audit timetable

71. A summary timetable, including audit outputs, is set out as follows:

<b>JAN 20</b>	●	Planning meeting to inform the 2019/20 audit
<b>FEB 20</b>	●	Interim audit visit including a review of key financial systems
<b>MAR 20</b>	●	Presentation of External Audit Plan to the Pensions Committee
<b>JUL 20</b>	●	Annual report and accounts presented for audit and final audit visit begins
<b>SEPT 20</b>	●	Annual audit report presented to the Pensions Committee and submitted to the Controller of Audit



# *7. Appendices*

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## Appendix 1: Your audit management team

Scott-Moncrieff is one of Scotland's leading firms of auditors and business advisers. We are part of the fast-growing Cogital Group, giving us a both a UK-wide presence and international reach in 190 offices with 6,500 staff. Cogital Group is an innovator, investor and early adopter of technologies that provide continuous improvement to the service we provide our clients.

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 Sempie Street Edinburgh EH3 8BL	25 Bothwell Street Glasgow G2 6NL	10 Ardross Street Inverness IV3 5NS
(0131) 473 3500	(0141) 567 4500	(01463) 701 940

### Your audit management team



#### Nick Bennett

##### Audit Partner

[nick.bennett@scott-moncrieff.com](mailto: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 has responsibility for the delivery of the audit.



#### Gary Steel

##### Assistant Manager

[gary.steel@scott-moncrieff.com](mailto:gary.steel@scott-moncrieff.com)

Gary has over 7 years' external audit experience. He specialises in pension schemes and has significant experience in delivering external audit services to a range of pension schemes across both public and private sectors.

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



## Emily Rodgers

### Associate

[emily.rodgers@scott-moncrieff.com](mailto:emily.rodgers@scott-moncrieff.com)

Emily joined the firm in 2017 as a public sector audit trainee and is due to complete her ICAS qualification in August 2020. She has experience delivering external audit services to a range of public sector bodies, including local government.

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



## Appendix 2: 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.

In particular, FRC's Ethical Standards stipulate that where an auditor undertakes non audit work, appropriate safeguards must be applied to reduce or eliminate any threats to independence.

Scott-Moncrieff provides accounts preparation, corporation tax services and ad hoc VAT advice to LPFE Ltd and LPFI Ltd which are subsidiaries of Lothian Pension Fund. In 2019/20 non-audit fees are estimated to be approximately £9,000.

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. In addition to this, Scott-Moncrieff also iXBRL tag the financial statements for submission to HMRC along with the corporation tax return. This tagging exercise is performed by an individual who is not involved in the audit of the financial statements.

We confirm that we comply with FRC's Ethical Standards. In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way. In particular there are and have been no relationships between Scott-Moncrieff, the Funds', those charged with governance and senior management that may reasonably be thought to bear on our objectivity and independence.





## Appendix 3: Statement of understanding

### Introduction

The purpose of this statement of understanding is to clarify the terms of our appointment and the key responsibilities of Lothian Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”) and Scott-Moncrieff.

### Annual report and accounts

We will require the annual report and accounts 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 in advance of our final audit visit which sets out our 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 Funds during the course of the audit on matters having a material effect on the annual report and accounts. 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. In particular we require to be notified of all frauds which:

- Involve the misappropriation or theft of assets or cash which are facilitated by weaknesses in internal control
- Are over £5,000

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.

### Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 impose an obligation on the Auditor General to inform the National Crime Agency (NCA) if she knows or suspects that any person has engaged in money laundering or terrorist financing. Audit Scotland has extended this responsibility to the Accounts Commission in respect of local government.

We require the Funds to notify us on a timely basis of any suspected instances of money laundering so that we can inform Audit Scotland who will determine the necessary course of action.

### Ethics

We are bound by the ethical guidelines of our professional body, the Institute of Chartered Accountants in England and Wales.

### 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 you not being satisfied by our response, you



may also wish to bring the matter to the attention of the Institute of Chartered Accountants in England and Wales.

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 Pensions 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.

