

## **Pensions Committee**

**2.00pm, Wednesday, 17 March 2021**

### **External Audit Annual Plan 2020/21 by Azets**

#### **1. Recommendations**

---

The Pensions Committee (Committee) is requested to:

- 1.1 note the planned programme of work to support the statutory audit 2020/21. This is shown at Appendix 1 - "Lothian Pension Fund External Audit Annual Plan 2020-21" by Azets; and
- 1.2 note that progress against the Lothian Pension Fund External Audit Annual Plan 2020-21 will be reported to future meetings of the Pensions Audit Sub-Committee and the Committee.

#### **John Burns**

Chief Finance Officer, Lothian Pension Fund

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

E-mail: [john.burns@edinburgh.gov.uk](mailto:john.burns@edinburgh.gov.uk) | Tel: 0131 469 3711

# External Audit Annual Plan 2020/21 by Azets

## 2. Executive Summary

---

- 2.1 Azets, formerly 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 2020/21. This is shown in full at Appendix 1.
- 2.2 Azets representative(s) will present the External Annual Audit Plan 2020-21 to Committee.

## 3. Background

---

- 3.1 The Accounts Commission appointed Scott-Moncrieff (now Azets) as external auditor of the funds for the five-year period 2016/17 to 2020/21.
- 3.2 In October 2020, Audit Scotland advised that Covid-19 had resulted in significant disruption for public bodies and to auditors of the public sector. Due to this, the Auditor General for Scotland and the Accounts Commission for Scotland announced on 10 June an intention to extend the current audit appointments by one year in the first instance. The Accounts Commission has now confirmed the one-year extension. These appointments were for the audit of public bodies for the financial years 2016/17 to 2020/21 inclusive. The extension would be through to the audit of the 2021/22 year so Azets Audit Services will remain the auditor for Lothian Pension Fund throughout this period.
- 3.3 The current Code of Audit Practice, which was due to be renewed later this year, will apply to the extended appointments. Following our public consultation on the new draft Code, we will engage further with stakeholders on aspects of the draft Code later this year. We aim to finalise the new Code in early 2021. These are challenging times for public bodies and auditors. By extending the current audit appointments, we can safeguard the high quality of public audit and continue providing the people of Scotland with assurance about how public money is being spent.”
- 3.4 The External Audit Plan is reported annually to Committee by the external auditor.
- 3.5 At its meeting on 20 March 2017, Committee agreed to:
  - 3.5.1 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

- 3.5.2 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**

---

- 4.1 Azets, the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund, has detailed its planned programme of work to support the statutory audit 2020/21. 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**

---

- 5.1 The proposed audit fee for 2020/21 is £47,388, which represents an increase of 2.1% on the previous year. Lothian Pension Fund has accepted this proposed fee.
- 5.2 This fee is marginally in excess of the specific budget provision in 2020/21, but this will be contained in overall spending.
- 5.3 The audit fee is addressed in detail by Azets in Appendix 1, paragraphs 75 to 79.

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

---

- 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**

---

- 7.1 The responsibilities of Azets, 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**

---

Appendix 1 – “Lothian Pension Fund External Audit Annual Plan 2020-21” by Azets.



# Lothian Pension Fund

External Audit Annual Plan 2020/21

March 2021



# Table of Contents

---

Introduction	3
Respective responsibilities of the auditor and the Funds	6
Audit strategy	11
Annual accounts	14
Wider scope audit	21
Audit outputs, timetables and fees	28
Appendices	31

---

# Introduction



## Introduction

1. This document summarises the work plan for our 2020/21 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 specific audit opinion on, the 2020/21 annual accounts and related matters.
  - consideration and reporting on the Funds’ arrangements on the four audit dimensions: governance and transparency, financial management, financial sustainability 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 Audit 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 Azets as external auditor of the Funds for the six year period 2016/17 to 2021/22. This document

summarised the audit plan for 2020/21 and summarises;

- The responsibilities of Azets 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 Azets and the audit management team.

## Auditor 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. Azets 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, Azets provides accounts preparation, corporation tax services and ad hoc VAT advice to both LPFE Ltd and LPFI Ltd. In 2020/21 non-audit fees are estimated to be approximately £10,000.
8. We have outlined the safeguards to our independence in Appendix 2. We confirm that we complied with the Financial Reporting Council’s (FRC) Ethical Standard. In our professional judgement, we remained independent and our objectivity has not been compromised in any way.

## Adding value through the audit

9. All of our clients 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. This report will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://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

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 statement 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:
  - i. effectiveness of performance management arrangements in driving economy, efficiency and

- effectiveness in the use of public money and assets
- ii. suitability and effectiveness of corporate governance arrangements
- iii. 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.

### 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.

**Exhibit 1: Audit dimensions within the Code of Audit Practice**



17. Our assessment takes into account the size, nature and risks of the organisation. On this basis, we have concluded that application of the full wider scope is appropriate for the Funds.

**Best Value**

18. Appointed auditors have a duty to be satisfied that local government bodies have made proper arrangements to secure best value.

19. Our work in respect of the Funds’ best value arrangements will be integrated into our audit approach, including our work on the wider scope audit dimensions as set out in the wider scope section of this plan.

**Strategic audit priorities for local government**

20. The Accounts Commission has set the following five strategic audit priorities that it expects auditors to consider in all work across local government:

- Having clear priorities with a focus on outcomes, supported by effective long term planning.
- Demonstrating the effective appraisal of options for changing

how services are delivered in line with their priorities.

- Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future.
- Empowering local communities and involving them in the design and delivery of local services and planning for their local areas.
- Reporting the organisation’s performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.

21. Our consideration of these priorities will be integrated into our 2020/21 audit work. The extent to which we will report on these will be dependent of the findings of our work as it relates to the four dimensions referred to above and is considered in section 5 of this plan.

## Funds' responsibilities

22. The Funds and the Chief Financial Officer 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
<p><b>Financial statements:</b> Annual accounts 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"> <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>• 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>
<p><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>	<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> </ul>

Area	Funds' responsibilities
	<ul style="list-style-type: none"> <li>The impact of planned future policies and foreseeable developments on the financial position.</li> </ul>
<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>The Funds are responsible 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>The Funds are responsible 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 proper 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. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.</p>

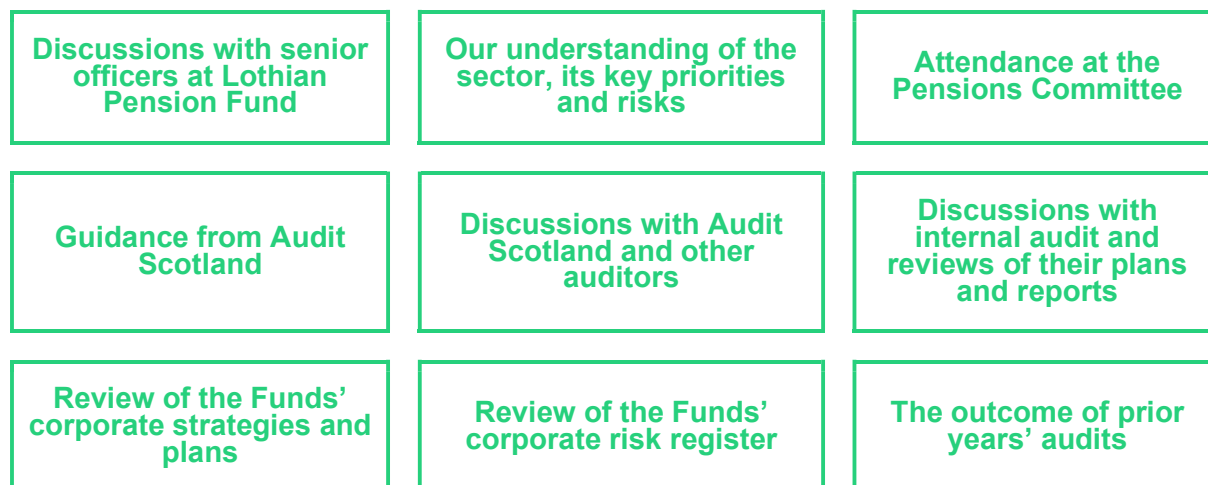
# Audit strategy



## Audit strategy

### Risk-based audit approach

23. 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
24. our audit focuses on the areas of highest risk. Our audit planning is based on:



25. 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.

### Communication with those charged with governance

26. 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

27. 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), the Ethical Standard, and applicable Practice Notes and other guidance issued by the Financial Reporting Council (FRC).

### Partnership working

28. 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 with the public sector.

### Audit Scotland

29. Although we are independent of Audit Scotland and are responsible for forming our own views and opinion, 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 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.



30. 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.
31. 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

32. 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.

#### Shared systems and functions

33. The Funds rely on financial systems operating in the City of Edinburgh Council to produce financial reports. We will seek assurances on the operation of this system from the Azets audit of this body.

# Annual accounts



## Annual Accounts

### Introduction

34. Audited bodies' annual 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 accounts.

### Approach to audit of the financial statements

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

#### Risk-based audit planning

36. 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. Our work will once again be undertaken remotely.

#### An audit of key systems and internal controls

37. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements
38. 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' own policies and procedures.
39. We will take cognisance of any relevant internal audit reviews of systems and controls.
40. 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 financial statements

41. 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.
42. 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 2020/21 (the Code).

#### Changes to auditing standards

43. Changes were made to auditing standards in December 2019 as part of a suite of measures implemented by the Financial Reporting Council to improve public confidence and trust in audit. Areas affected include the procedures we undertake to document and justify our assessment of the reasonableness of management's accounting estimates and the application of going concern. The key accounting estimates relate to the valuation of some investments and the Funds' actuarial liabilities.
44. Our assessment of the risk of material misstatement, as outlined below, considered the inherent and control risk associated with accounting estimates and the going concern assessment. No additional risks have been identified at the planning stage in relation to these areas.

#### Assurances from employers' auditors

45. 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.

46. These requests are made in line with Audit Scotland's Protocol for Auditor Assurances 2020/21 – Local Government Pension Schemes.

### Independent auditor's report

47. Our opinion on whether the financial statements give a true and fair view of the financial position and its net expenditure and of the regularity of transactions will be set out in our independent auditor's report which will be included in the annual accounts.
48. We also provide an opinion on the audited part of the remuneration report, annual governance statement and management commentary.

### Group accounts

49. 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.
50. 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

51. 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.

52. 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.

53. 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.

54. 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.

55. 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	Dealings with members
Lothian Pension Fund (group)	112	14
Lothian Pension Fund (single entity)	112	14
Scottish Homes Pension Fund	2.5	0.36

56. 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.
57. 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)	84	10.5
Lothian Pension Fund (single entity)	84	10.5

Performance materiality (£million)		
Scottish Homes Pension Fund	1.8	0.27

58. 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

59. 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 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 (UK) 240 - *The auditor's responsibilities relating to fraud in an audit of financial statements*.

60. 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. We will adopt data analytics techniques to review and test aspects of this significant 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 income and expenditure transactions in such a way as to lead to a material misstatement in the reported financial position.

61. We have identified that for contributions received from the Funds' funding partners, the risk of revenue recognition can be rebutted due to a lack of incentive and opportunity to manipulate transactions of this nature.

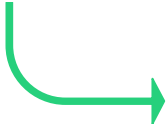
### Risk of fraud in the recognition of expenditure

Practice Note 10 - *The Audit of Public Sector Financial Statements* 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.

- 
62. 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 £7.445 billion as at 31 March 2020, of which 37% (£2.455 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.

- 
63. 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.
64. 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 2020 was valued at £454 million. The management of the properties is undertaken by JLL, along with the Fund accounting for the portfolio. In 2019/20 the valuation of this investment property, undertaken by CBRE, was qualified with a material valuation uncertainty given the unknown future impact that COVID-19 might have on the real estate market. Our audit opinion included an emphasis of matter drawing this matter to the attention of the reader.

65. For a sample of investments, we will confirm the values shown against valuation reports. 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.

## COVID-19

The COVID-19 pandemic is presenting unprecedented challenges to the operation, financial management and governance of organisations, including public sector bodies. Core areas of service delivery have been suspended or substantially reduced, systems and processes have been amended to support remote working, arrangements for governance, decision making and performance management have been adapted, and many organisations are forecasting large operating deficits due to loss of income and/or additional cost pressures. It is uncertain how long these challenges will persist.

The implications of these risks and uncertainties are under consideration by the Board, the public sector and the Scottish Government. We continue to monitor government and relevant announcements as they pertain to the audit and have adapted our audit approach as required.

66. In response to this risk we have identified a number of potential areas where there is the risk of material misstatement to the financial statements and/or our audit opinion. These areas include:
- Property valuations (paragraph 65)
  - Group considerations (paragraph 49)
  - Access to audit evidence (paragraph 36)
  - Timescales/administrative processes (paragraph 80).



# Wider scope audit



## Wider scope audit

### Introduction

67. 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
68. 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. Audit Scotland has highlighted that the risk profile of public bodies for 2020/21 audits is significantly affected by the COVID-19 pandemic, highlighting the following wider scope risk areas which we will consider during our audit as they relate to the Funds:
- Appropriateness of revised governance arrangements in response to the pandemic, including services delivered by, or in partnership with, others;
  - Risk that performance reporting does not meet users' needs;
  - Management of the financial impact of the pandemic;
  - Appropriateness of risk management processes in response to the pandemic;
  - Risk of fraud and error as the control environment and internal controls change; and
  - Risk of fraud in procurement function
69. Exhibit 4 summarises the significant risk in relation to our wider scope audit responsibilities that we have identified at this stage of our audit planning.
70. We have identified one significant risk in relation to financial sustainability and market volatility. We have not, at this stage, identified any other 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 risks

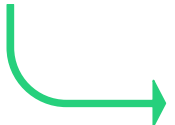
### Financial sustainability: Market volatility

The Funds held investments of £7.443 billion as at 31 March 2020. 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 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 COVID-19 and other worldwide political events had a significant impact on the market in 2019 and 2020, with this volatility expected to continue in 2021. There is a risk that the value of investments is significantly impacted by events within the wider environment.

- 
71. We will monitor the Funds approach to monitoring investment performance focusing on the identification of investment risk and the development of mitigating actions.
  72. 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 2019/20 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 2020/21 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>• The 2020 actuarial valuation and the conclusions on funding levels across the Funds;</li> <li>• Affordability for employers including the number of employer cessations and current membership levels of the Funds; and</li> <li>• Any changes following 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

In 2019/20 we concluded that the Funds have effective arrangements in place for financial management and the use of resources.

The key financial indicator across pension funds in Scotland is the return on investments. Lothian Pension Fund was below the 5 year returns benchmark in 2019/20 but above the 10 year benchmark returns. No benchmark is set for Scottish Homes Pension fund as investments are held in gilts.

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.

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 2020. The reliance on investment income is therefore increased in order to meet the long term cash flow needs.

#### Our audit approach

During our 2020/21

audit we will review, conclude and report on the following:

- Whether the Funds continue to have arrangements in place to ensure systems of internal control are operating effectively;
- How the Funds have assured themselves that its financial capacity and skills are appropriate;
- The effectiveness of the financial and budgetary control system in communicating accurate and timely performance; and
- Whether the Fund has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.



### 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
---------------	--------------------

The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.

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.

As part of our work on governance and transparency work in 2020/21 we will review, conclude and report on:

- Whether the Funds can demonstrate that the governance arrangements in place are appropriate and operating effectively;
- Whether induction arrangements for new Board members support effective scrutiny and challenge;
- The transparency of decision-making, and on financial and performance reporting; and



### 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

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.

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.

The Funds' also focus on administrative performance and have developed a Service Plan. The Pensions Committee receive updates on the service plan at each meeting.

The Funds also works collaboratively with other Local Government Pension Funds. It is hoped that collaborative structures will deliver efficiencies.

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 part of our 2020/21 audit we will review, conclude and report on the following:

- How the Funds' demonstrates a focus on improvement in the context of continuing and significant financial challenge;
- How the Funds provide a clear link between investment decisions and actual performance achieved;
- The effectiveness of working with partners including collaboration with Fife Council Pension Fund and Falkirk Council Pension Fund; and
- The process for tendering for new providers and consider this against the value for money principles.

# Audit outputs, timetables and fees





## Audit outputs, timetable and fee

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 2020/21.	March 2021
Independent Auditor's Report	Report	This report will contain our opinion on the financial statements, the audited part of the remuneration report, annual governance statement and management commentary.	September/October 2021
Annual Report to the Funds and the Controller of the 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/October 2021

### Audit outputs

73. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
74. 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.

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.

76. As auditors we negotiate a fee with the audited body during the planning process. The auditor remuneration element of the fee may be varied by up to 20% above the expected fee level to reflect the circumstances and local risks within the body.

### Audit fee

75. 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
77. The expected fee set by Audit Scotland for the 2020/21 audit of the Funds is £44,590. We propose setting the 2020/21 audit fee at £47,388, which represents an uplift of 6.3% on the expected fee and a 2.1% increase on the 2019/20 fee. This uplift reflects the

relative scale of the Edinburgh Funds and the significant audit work required to conduct a full wider scope audit under the Code of Audit Practice, including the related significant risks reported in this plan.

78. The audit fee for the prior and current year are set out in the table below.

	2019/20	2020/21
Auditor remuneration	£40,458	£41,388
Pooled costs	£3,680	£3,690
Audit support costs	£2,280	£2,310
<b>Total fee</b>	<b>£46,418</b>	<b>£47,388</b>

79. 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

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

- JAN 21** ● Planning meeting to inform the 2020/21 audit
- MAR 21** ● Presentation of External Audit Plan to the Audit and Assurance Committee

- JUN 21** ● Accounts presented for audit
- JUL 21** ● Final audit visit begins
- SEPT/  
OCT 21** ● Annual audit report presented to Audit and Assurance Committee and submitted to the Controller of Audit

# Appendices



## Appendix 1: Azets

On 7 September 2020, the CogitalGroup of companies (Scott-Moncrieff, Campbell Dallas, Baldwins and Wilkins Kennedy) came together as Azets. Whilst it is a new name, we still deliver the same personal approach to accounting, tax, audit, advisory and business services, digitally and at your door.

We work hard, recruiting bright people who genuinely enjoy solving client's problems.

With over 6,500 advisers and specialists across our office network, we help people and organisations of all shapes and sizes save time, work smarter and achieve their goals. Our job is to give you the support you need so you can focus on what you do best.

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.



### Nick Bennett

#### Audit Partner

[nick.bennett@azets.com](mailto:nick.bennett@azets.com)

Nick has over 20 years' experience of public sector auditing and has been heavily involved in developing public sector accounting standards.

Nick's experience and expertise is acknowledged by both clients and other professionals right across the public sector.

Nick will be your appointed Engagement Lead.



### 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.

## 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 Standard stipulate that where an auditor undertakes non audit work, appropriate safeguards must be applied to reduce or eliminate any threats to independence.

Azets 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 £10,000.

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 Azets. In addition to this, Azets 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 Azets and the Funds, its Board members 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 the FUNDS and Azets.

### 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 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 financial statements. This will take place by means of a letter of representation, which will require to be signed by the section 95 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 of 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.

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 and the Code of Audit Practice.

## 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 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 Audit 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.



© Azets 2021. All rights reserved. Azets refers to Azets Audit Services Limited. Registered in England & Wales Registered No. 09652677. VAT Registration No. 219 0608 22. Registered to carry on audit work in the UK and regulated for a range of investment business activities by the Institute of Chartered Accountants in England and Wales.

We are an accounting, tax, audit, advisory and business services group that delivers a personal experience both digitally and at your door.

**Accounting | Tax | Audit | Advisory | Technology**

---