



## **Pensions Committee**

2.00pm, Thursday, 23 March 2023

### **External Audit Annual Plan 2022/23 by Azets**

#### **Item number 6.5**

#### **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 2022/23. This is shown at Appendix 1 - "Lothian Pension Fund External Audit Annual Plan 2022/23" by Azets;
- 1.2 note that progress against the Lothian Pension Fund External Audit Annual Plan 2022-23 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 2022/23 by Azets

## **2. Executive Summary**

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- 2.1 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 2022/23. This is shown in full at Appendix 1.
- 2.2 Azets representative(s) will present the External Annual Audit Plan 2022/23 to Committee.

## **3. Background**

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- 3.1 Azets has been appointed by Audit Scotland as the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund (“the Funds”) for the period 2022/23 to 2026/27.

## **4. Main Report**

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- 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 2022/23. 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 proposed audit fee for 2022/23 is £51,590.
- 5.2 The audit fee is addressed in detail by Azets in Appendix 1, pages 30 to 31.

## **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 it is 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 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**

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Appendix 1 – “Lothian Pension Fund External Audit Annual Plan 2022/23” by Azets.



# Lothian Pension Fund

## External Audit Annual Plan 2022/23

March 2023



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# Introduction

Azets have been appointed by Audit Scotland as the external auditor to Lothian Pension Fund and Scottish Homes Pension Fund (“the Funds”) for the period 2022/23 to 2026/27.

This document summarises the work plan for our 2022/23 external audit of the Funds.

The core elements of our work include:

- audits of the 2022/23 annual report accounts;
- consideration of the wider scope areas of public audit work;
- consideration of the Funds’ arrangements to secure Best Value;
- assessment of the Funds’ participation in the National Fraud Initiative (NFI); and
- any other work requested by Audit Scotland.

## Adding value

All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. We will add value by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to promote improved standards of governance, better management and decision making and more effective use of public money.

Any comments you may have on the service we provide would be greatly appreciated. Comments can be reported directly to any member of your audit team.

## Openness and transparency

This report will be published on Audit Scotland’s website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

# Audit scope and general approach

## Responsibilities of the auditor and the Funds

The [Code of Audit Practice](#) outlines the responsibilities of external auditors appointed by the Accounts Commission and it is a condition of our appointment that we follow it.

Auditor responsibilities are derived from statute, International Standards on Auditing (UK) and the Ethical Standard for auditors, other professional requirements and best practice, the Code of Audit Practice and guidance from Audit Scotland.

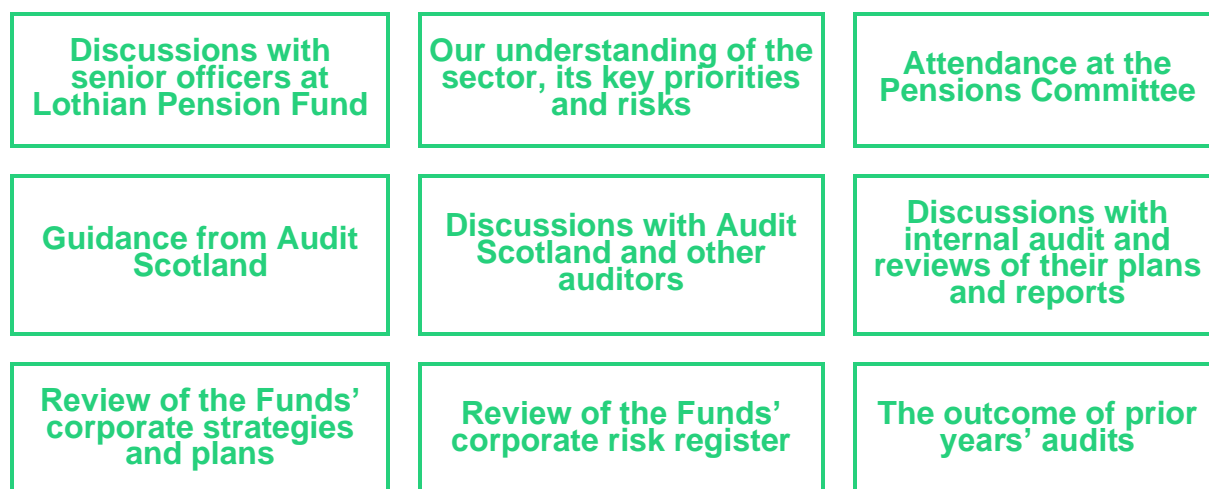
The Funds have primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices. The Funds are also responsible for compliance with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

[Appendix 1](#) provides further detail of both our responsibilities and those of the Funds.

## Risk-based audit approach

We follow a risk-based approach to the audit 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:





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

## Communication with those charged with governance

Auditing standards require us to make certain communications throughout the audit to those charged with governance. These communications will be through the Pension Committee.

## Professional standards and guidance

We perform our audit of the financial statements in accordance with International Standards on Auditing UK (ISAs (UK)), Ethical Standards, and applicable Practice Notes and other guidance issued by the Financial Reporting Funds (FRC).

## Partnership working

We 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.

Our new Audit Scotland appointments include Fife Pension Fund and where practicable and appropriate we will share knowledge to generate efficiencies in the delivery of our audits.

## Audit Scotland

Although we are independent of Audit Scotland and are responsible for forming our own views and opinions, we do work closely with Audit Scotland throughout the audit. This helps identify common priorities and risks, treat issues consistently across the sector, and improve audit quality and efficiency. 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.

Audit Scotland undertakes national performance audits on issues affecting the public sector. We may 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 uses the national performance reports as a means to help improve performance at the local level.

During the year we may also be required to provide information to Audit Scotland to support the national performance audits.

### Internal Audit

As part of our audit, we consider the scope and nature of internal audit work and look to minimise duplication of effort, to ensure the total audit resource to the Funds are used as efficiently and effectively as possible.

## Delivering the audit – post pandemic

### Hybrid audit approach

We intend to adopt a hybrid approach to our audit which combines on-site visits with remote working; learning from the better practices developed during the pandemic.

All of our people have the equipment, technology and systems to allow them to work remotely or on-site, including secure access to all necessary data and information.

All of our staff are fully contactable by email, phone call and video-conferencing.

Meetings can be held over Skype, Microsoft Teams or by telephone.

We employ greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.

### Secure sharing of information

We use a cloud-based file sharing service that enables users to easily and securely exchange documents and provides a single repository for audit evidence.

### Regular contact

During the 'fieldwork' phases of our audit, we will arrange regular catch-ups with key personnel to discuss the progress of the audit. The frequency of these meetings will be discussed and agreed with management.

### Signing annual accounts

Audit Scotland recommends the electronic signing of annual accounts and uses a system called DocuSign.

Electronic signatures simplify the process of signing the accounts. Accounts can be signed using any device from any location and there is no longer a need for duplicate copies to be signed.

## Approach to audit of the annual accounts

Our objective when performing an audit of the annual accounts is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement and to issue an auditor's report that includes our auditor's opinion.

As part of our general approach, we will:

- perform risk assessment procedures including updating our understanding of the entity and its environment, the financial reporting framework and system of internal control;
- review the design and implementation of key internal controls;
- identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement level and the assertion level for classes of transaction, account balances or disclosures;
- design and perform audit procedures responsive to those risks, to obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion; and
- exercise professional judgment and maintain professional scepticism throughout the audit recognising that circumstances may exist that cause the financial statements to be materially misstated.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. We include an explanation in the auditor's report of the extent to which the audit was capable of detecting irregularities, including fraud and respective responsibilities for prevention and detection of fraud.

## Key audit developments in 2022/23

Revised auditing standards<sup>1</sup>, which come into effect from the current year, will have a significant impact on the way we perform our audit, particularly how we assess the risk of material misstatement, our approach to the audit of fraud, and the ways we ensure our audits are performed in line with regulatory requirements and to a high standard. The in-depth nature of these additional procedures, as well as updated tools and techniques that may come into scope, will also offer additional opportunity to provide insights and constructive feedback on the way the Funds manage risks. [Appendix 2](#) provides further details on the implications of these new requirements.

## Materiality

We apply the concept of materiality both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements. In general, misstatements, including omissions, are considered to be material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgments about materiality are made in the light of surrounding circumstances and are affected by our perception of the financial information needs of users of the financial statements, and by the size or nature of a misstatement, or a combination of both.

The basis for our assessment of materiality is set out in [Appendix 3](#).

## Accounting systems and internal controls

The purpose of an audit is to express an opinion on the financial statements. As part of our work, we consider certain internal controls relevant to the preparation of the financial statements such that we are able to design appropriate audit procedures. However, this work is not for the purpose of expressing an opinion on the effectiveness of internal controls.

We will report to the Funds, significant deficiencies in internal controls that we identify during the audit. These matters will be limited to those which we conclude are of sufficient importance to merit being reported. The scope of our work is not designed to be an extensive review of all internal controls.

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<sup>1</sup> Revisions to ISA (UK) 315 on auditors' responsibility to identify and assess the risks of material misstatement in the financial statements and ISA (UK) 240 on material misstatements caused by fraud came into effect for audits of financial statements with periods commencing on or after 15 December 2021.

## Going concern

The concept of going concern applies in the public sector but in a different way to the private sector. In many public sector entities (but not all), the use of going concern basis of accounting is not a significant matter because the applicable financial reporting framework envisage that the going concern basis for accounting will apply where the entity's services will continue to be delivered by the public sector. In such cases, a material uncertainty related to going concern is unlikely to exist.

For many public sector entities, the financial sustainability of the entity is more likely to be of significant public interest that the application of the going concern basis. Our wider scope audit work considers the financial sustainability of the Funds.

## Group audit scope and risk assessment

As Group auditor under ISA (UK) 600 we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Lothian Pension Fund has disclosed the following Group entities in their 2021/22 financial statements:

Component	Significant	Level of response required
LPFE Ltd	No	Analytical
LFPI Ltd	No	Analytical

**Analytical** - the component is not significant to the Group and audit risks can be addressed sufficiently by applying analytical procedures at the Group level.

### Risks at the component-level

We will review the appropriateness of the Group entities during our audit. At this stage of our audit cycle we have not identified any risks in each component.

## Prevention and detection of fraud or error

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.

## National Fraud Initiative

The National Fraud Initiative (NFI) in Scotland is a biennial counter fraud exercise led by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. The most recent NFI exercise commenced in 2022, with matches to be received for investigation from January 2023. As part of our 2022/23 audit, we will monitor the Lothian Pension Fund's participation and progress in the NFI.

## Anti-money laundering

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.

## Correspondence

People or organisations write to Audit Scotland because they have concerns about an issue within a public body that falls under the remit of the Auditor General or the Accounts Commission. An issue of concern may be something such as a breakdown in financial management or governance arrangements.

The key factor in determining whether Audit Scotland examines an issue is the relevance of the issue to Audit Scotland's role and functions. Audit Scotland and appointed auditors will make this judgement using their professional and technical knowledge.

## Wider audit scope work

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. [Appendix 1](#) provides detail of the wider scope areas of public sector audit work. Our initial risk assessment and scope of work planned for 2022/23 is outlined in the '[Wider Scope](#)' section of this plan.

## National risk assessment

Where particular areas of national or sectoral risk have been identified by the Accounts Commission and Auditor General, they will request auditors to consider and report on those risks as they apply at a local level. For 2022/23 the following areas have been identified:

- Climate Change
- Cyber Security

[Appendix 4](#) provides further detail as to the scope of this work.

## Best Value

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

Under the new Code of Audit Practice, the audit of Best Value in Lothian Pension Fund is fully integrated within the annual audit work performed by appointed auditors. We are required to evaluate and report on the performance of the Lothian Pension Fund in meeting their Best Value duties.

## Reporting our findings

We will provide judgements on the pace and depth of improvement in reporting our findings on both Best Value and wider scope areas. We will use the following grading to provide an overall assessment of the arrangements in place as part of our Annual Audit Report.





# Significant and other risks of material misstatement

Significant risks are risks that require special audit consideration and include identified risks of material misstatement that:

- our risk assessment procedures have identified as being close to the upper range of the spectrum of inherent risk due to their nature and a combination of the likelihood and potential magnitude of misstatement; or
- are required to be treated as significant risks due to requirements of ISAs (UK), for example in relation to management override of internal controls.

## Significant risks at the financial statement level

The table below summarises the significant risks of material misstatement identified at the financial statement level. These risks are considered to have a pervasive impact on the financial statements as a whole and potentially affect many assertions for classes of transaction, account balances and disclosures.

Identified risk of material misstatement	Audit approach
<p><b>Management override of controls</b></p> <p>Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Although the level of risk of management override of controls will vary from entity to entity, the risk is nevertheless present in all entities. Due to the unpredictable way in which such override could occur, it is a risk of material misstatement due to fraud and thus a significant risk.</p> <p><b>Risk of material misstatement: Very High</b></p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> <li>• Documenting our understanding of the journals posting process and evaluating the design effectiveness of management controls over journals.</li> <li>• Analysing the journals listing and determining criteria for selecting high risk and / or unusual journals.</li> <li>• Testing high risk and / or unusual journals posted during the year and after the unaudited annual accounts stage back to supporting</li> </ul>

Identified risk of material misstatement	Audit approach
	<p>documentation for appropriateness, corroboration and to ensure approval has been undertaken in line with the Funds' journals policy.</p> <ul style="list-style-type: none"> <li>• Gaining an understanding of the accounting estimates and critical judgements made by management. We will challenge assumptions and consider the reasonableness and indicators of bias which could result in material misstatement due to fraud.</li> <li>• Evaluating the rationale for any changes in accounting policies estimate or significant unusual transactions.</li> </ul>

## Significant risks at the assertion level for classes of transaction, account balances and disclosures

The table below summarises the significant risks of material misstatement at the assertion level for classes of transaction, account balances and disclosures.

Identified risk of material misstatement	Audit approach
<p><b>Fraud in revenue recognition</b></p> <p>Material misstatement due to fraudulent financial reporting relating to revenue recognition is a presumed risk in ISA 240 (The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements).</p> <p>The presumption is that the Funds could adopt accounting policies or recognise income in such a way as to lead to a material misstatement in the reported financial position.</p> <p>Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of income around the year end.</p> <p>In respect of the contributions received from the Funds' funding partners, we do not consider the risk of revenue recognition to be significant due to a lack of incentive and opportunity to manipulate transactions of this nature.</p> <p>However, the risk of fraud in relation to revenue recognition is present in all other revenue streams.</p> <p><b>Inherent risk of material misstatement:</b></p> <ul style="list-style-type: none"> <li><b>Revenue (occurrence / completeness): High</b></li> </ul>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> <li>Evaluation the significant income streams and review the controls in place over accounting for revenue.</li> <li>Consideration of the Funds' key areas of income and obtaining evidence that income is recorded in line with appropriate accounting policies and the policies have been applied consistently across the year.</li> </ul>

Identified risk of material misstatement	Audit approach
<p><b>Fraud in non-pay expenditure</b></p> <p>As most public sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p> <p>Given the financial pressures facing the public sector as a whole, there is an inherent fraud risk associated with the recording of expenditure around the year end.</p> <p><b>Inherent risk of material misstatement:</b></p> <ul style="list-style-type: none"> <li>• <b>Non-pay expenditure (occurrence / completeness): High</b></li> <li>• <b>Accruals (existence / completeness): High</b></li> </ul>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> <li>• Evaluating the significant non-pay expenditure streams and reviewing the controls in place over accounting for expenditure.</li> <li>• Consideration of the Funds' key areas of expenditure and obtaining evidence that expenditure is recorded in line with appropriate accounting policies and the policies have been applied consistently across the year.</li> <li>• Review of accruals around the year end to consider if there is any indication of understatement of balances held through consideration of accounting estimates.</li> </ul>
<p><b>Investments valuations (key accounting estimate)</b></p> <p>The Funds held investments of £9.528 billion as at 31 March 2022, of which 33% (£3.175billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets.</p> <p>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</p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> <li>• Evaluating management processes and assumptions for the calculation of the estimates, the instructions issued to the fund managers and the scope of their work.</li> <li>• Evaluating the competence, capabilities and objectivity of the fund managers.</li> <li>• Considering the basis on which the valuation is carried out and</li> </ul>

Identified risk of material misstatement	Audit approach
<p>balance means that any error in judgement could result in a material valuation error.</p> <p><b>Inherent risk of material misstatement:</b></p> <p><b>Investments (valuation / existence): High</b></p>	<p>the challenge in the key assumptions applied.</p> <ul style="list-style-type: none"> <li>• Testing the information used by the fund managers to ensure it is complete and consistent with our understanding.</li> <li>• Ensuring that the year end valuations have been reflected correctly in the ledger and that accounting treatment within the financial statements is correct.</li> </ul>
<p><b>Investment property valuations (key accounting estimate)</b></p> <p>LPF hold a portfolio of investment properties which as at the 31 March 2022 was valued at £431 million. The management of the properties is undertaken by JLL, along with the Fund accounting for the portfolio. Investment properties are valued annually at fair value, in line with the Code.</p> <p>There is a significant degree of subjectivity in the measurement and valuation of investment properties. This subjectivity and the material nature of the Funds' investment property portfolio represents an increased risk of misstatement in the annual accounts.</p> <p><b>Inherent risk of material misstatement:</b></p> <p><b>Investment property (valuation / existence): High</b></p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> <li>• Ensuring that investment properties are recorded in the annual accounts in accordance with the Code and the Funds' accounting policies, and have been accounted for appropriately. We will review investment property valuations.</li> <li>• Considering the competence, capability and objectiveness of the valuer in line with ISA (UK) 500 Audit Evidence. We will review the valuation report and consider the assumptions used by the valuer against external sources of evidence.</li> <li>• Considering the scope of the valuer's work and the information provided to the valuer for completeness.</li> </ul>

Identified risk of material misstatement	Audit approach
<p><b>Present Value of Retirement Obligations (key accounting estimate)</b></p> <p>An actuarial estimate of the pension fund asset/liability is calculated on an annual basis under IAS 26 and on a triennial funding basis by an independent firm of actuaries with specialist knowledge and experience. The estimates are based on the most up to date membership data held by the Funds and have regard to local factors such as mortality rates and expected pay rises with other assumptions around inflation when calculating the liabilities. There is a risk that the assumptions used are not appropriate.</p> <p><b>Inherent risk of material misstatement:</b></p> <p><b>Retirement obligations (valuation):</b></p> <p><b>High</b></p>	<p>Procedures performed to mitigate risks of material misstatement in this area will include:</p> <ul style="list-style-type: none"> <li>• Reviewing the controls in place to ensure that the data provided to the actuary is complete and accurate.</li> <li>• Considering the reasonableness of the assumptions used in the calculation against other local government pension fund actuaries and other observable data.</li> <li>• Agreeing the disclosures in the financial statements to information provided by the actuary.</li> </ul>

# Wider scope

## Introduction

As described previously, the Code of Audit Practice frames a significant part of our wider scope responsibilities in terms of audit areas:

- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

Our planned audit work against these four areas is risk based and proportionate. Our initial assessment builds upon our understanding of the Funds' key priorities and risks along with discussions with management and review of board minutes and key strategy documents.

We have identified one significant risk in relation to financial sustainability as set out in the table below. At this stage, we have not identified any significant risks in relation to the other wider scope areas.

In addition, we have considered emerging risks around Project Forth, a strategic project still awaiting administering authority deliberation and potential approval. However, due to confidentiality considerations of the Fund, no risk has been included in our plan at this stage. We expect that we will be able to further comment on the project in our Annual Audit Report.

Audit planning however is a continuous process and we will report all identified significant risks, as they relate to the four wider scope areas, in our annual audit report. This section summarises our audit work in respect of each wider scope area.



## Wider scope significant risk

### Financial sustainability

The Funds held investments of £9.528billion as at 31 March 2022. 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 June 2021.

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, inflation levels and other worldwide political events had a significant impact on the market in the recent years. While the last two years saw a return to improved performance, a significant risk remains particularly in relation to impact of the increased inflation, expected government monetary policies and uncertainties in relation to geopolitical situation. There is a risk that the value of investments is significantly impacted by events within the wider environment.

### Our audit response:

We will monitor the Funds approach to monitoring investment performance focusing on the identification of investment risk and the development of mitigating actions.

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.

## Our audit approach to the wider scope audit areas



### Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Consideration	Our audit approach
<p>In 2021/22 we concluded that the Funds have effective arrangements in place to ensure the ongoing sustainability.</p> <p>The focus of the Funds' investment strategy is to ensure a sufficient return over the long term to meet the funding objectives outlined by the Funding Strategy Statement.</p> <p>The key financial indicator across pension funds in Scotland is the return on investments. LPF has delivered strong absolute performance in 2021/22 of 10.8% annual return on investments, which is higher than the benchmark returns of 8.8% while maintaining lower risk. The five-year and ten-year annualised investment returns remain below benchmark, due to significant below benchmark returns on equities in 2020/21 resulting from the defensive positioning.</p> <p>The performance of investments is monitored by the Pension Committee, who considers the investments control environment and performance over the annual committee cycle in line with a formal long term agenda plan.</p> <p>The Triennial Valuation was carried out as at 31 March 2020 and estimated both Funds were fully funded at 106% for LPF and 118% for Scottish Homes Pension Fund. This represents</p>	<p>During our 2022/2023 audit we will develop our assessment of the Funds' financial standing. We will review and conclude 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 continued applicability of the 2020 actuarial valuation and the conclusions on funding levels across the Funds; and</li> <li>• Affordability for employers including the number of employer cessations and current membership levels of the Funds.</li> </ul>

### Consideration

an improvement on the previous triennial valuation where the funding levels were 98% and 105% respectively.

### Our audit approach



### 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 2021/22 we concluded that the Funds have effective arrangements in place for financial management and the use of resources.

In 2021/22 the Funds reported a net increase in the funds held due to increases in market value of the investments. Lothian Pension Fund reported a net withdrawal position in dealings with members of £5.771 million. Scottish Homes reported a net withdrawal position of £6.836 million.

The Funds estimate the negative cashflows will be the case for the foreseeable future, but with the current levels of investment income there is no requirement for the assets selling to fund the ongoing pensioners payments.

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. Annual operating plan updates are provided to each Pension Committee meeting clearly explaining changes in group performance.

### Our audit approach

During our 2022/23 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

### **Consideration**

As reported to the December 2022 Pension Committee meeting the Funds estimate a small underspend of £0.736million on the projected outturn.

### **Our audit approach**

arrangements for the prevention and detection of fraud and corruption.



## Vision, Leadership and Governance

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

### Consideration

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. This aim is supported by two formal documents which establish the Funds' vision and strategy: Statement of Investment Principles and a Funding Strategy.

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.

Project Forth, a proposed merger between Lothian and Falkirk Pension Funds was approved by Lothian Pension Fund's Pensions Committee in September 2021. However, following the May 2022 council elections further consideration and approvals will be required, including those of City of Edinburgh Council and Falkirk Council as administering authorities. The Council is due to consider the proposal in later in the year.

### Our audit approach

As part of our work on governance and transparency work in 2021/22 we will review, conclude and report on:

- Clarity of the vision and strategy and if these are supported by a set of priorities;
- Whether the Funds can demonstrate that the governance arrangements in place are appropriate and operating effectively;
- Whether induction arrangements for new Committee members support effective scrutiny and challenge;
- The transparency of decision-making, and on financial and performance reporting; and
- Progress of Project Forth implementation.



### Use of resources to improve outcomes

Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

#### Consideration

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. During 2022 the Financial Conduct Authority permitted to lift £1.250billion cap on the assets LPFI is able to manage. This allows the company to provide further services to Falkirk and Fife pension funds.

The Funds' performance is reviewed by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly, 3 yearly, 5 yearly and 10 yearly performance measures. This information is presented to the Joint Investment Strategy Panel to allow for scrutiny investment performance of the Funds.

In 2021/22 performance remained strong with nine out of the ten performance measures met. Investment performance and risk over a rolling five year period was noted as being below benchmark.

The Funds' also focus on administrative performance and have developed a Service

#### Our audit approach

As part of our 2022/23 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

### Consideration

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.

### Our audit approach



# Your Azets audit management team

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## Nick Bennett: Engagement Lead

[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.

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## Adrian Kolodziej: Engagement Manager

[adrian.kolodziej@azets.co.uk](mailto:adrian.kolodziej@azets.co.uk)

Adrian will manage the delivery of the onsite work and work alongside Nick to deliver the audit engagement. Adrian has over 14 years of public sector experience performing the external audits of local authorities, pension funds and central government bodies.



# Audit timetable – to update

The submission date for audited annual accounts in local government is generally set to be consistent with the date specified in the accounts regulations by which the Funds are required to approve its audited accounts. The Coronavirus (Scotland) Act 2000 permitted a deferral in 2019/20 and 2020/21 to 30 November, and a temporary amendment to the accounts regulations allowed a submission date of 30 November for 2021/22. However, the submission date is returning to pre-pandemic 30 September for 2022/23.

We have set out below target months which align to the schedule of Pension Committee meetings. We aim to meet these scheduled meetings however this will be monitored during the audit process and may require to be revised to reflect emerging issues.

Audit work/output	Description	Target month/s	Pension Committee	Deadline
Audit plan	Planning meetings, understanding the entity, risk assessment.  Audit plan setting out the scope of our audit, including key audit risks, presented to the Pension Committee	February / March	March 2023	31 March 2023
Interim audit	Interim audit including review of accounting systems.	March - June	N/A	N/A
Final audit	Accounts presented for audit and final audit visit begins	July - September	N/A	N/A

Audit work/output	Description	Target month/s	Pension Committee	Deadline
Independent Auditor's 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	September 2023	30 September 2023
Annual Report to the Pension Committee and the Controller of Audit	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	September 2023	30 September 2023

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

The action plans within the reports will include prioritised recommendations, responsible officers and implementation dates. We will review progress against the action plans on a regular basis.

## Audit fee

For 2022/23, the new appointment process provided Audit Scotland with a fair representation of the current audit market for each individual body with the outcome of this exercise highlighting the increasing requirements, expectations and scrutiny of the audit profession.

The quality of audit work is an essential requirement in successfully delivering a fully compliant ISA and Code of Audit Practice audit. These factors have led to above inflationary increases in the cost of audit. Whilst these increases are significant these are consistent with evidence obtained from the profession and other UK audit agencies. On setting fees, Audit Scotland has ensured that efficiencies have been fully utilised to mitigate the impact.

For the local government sector, the average fee increase is 12.5%. For the Funds this equals to £5,750 which is a difference between the 2022/23 net fee of £51,590 and the base audit fee from 2021/22 of £45,840.

Audit Scotland sets an expected audit fee 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.

As auditors we negotiate a fee with the Funds during the planning process. The fee may be varied above the expected fee level to reflect the circumstances and local risks within the body.

The breakdown of the fee increases for 2022/23 is shown in the table below.

	2022/23	2021/22
Auditor remuneration	£64,360	42,579
Pooled costs	-	4,130
Contribution to PABV costs	-	-
Audit support costs	£2,440	2,110
Sectoral cap adjustment	-£15,210	-
<b>Total fee</b>	<b>£51,590</b>	<b>£48,819</b>
		<b>(£45,840 base fee)</b>

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 independence and objectivity

## 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 2022/23 non-audit fees are estimated to be c.£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 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 committee members and senior management that may reasonably be thought to bear on our objectivity and independence.

# Appendix 1: Responsibilities of the Auditor and the Funds

## The Accounts Commission, Controller of Audit and Audit Scotland

The Accounts Commission is an independent public body. Its members are appointed by Scottish Ministers and are responsible for holding local government to account.

Under statute, the Accounts Commission appoints a Controller of Audit to consider the results of the audit of accounts, including the wider-scope responsibilities and Best Value auditing. The Controller of Audit makes reports to the Accounts Commission on matters arising from the accounts and on Best Value and acts independently of the Accounts Commission when reporting to it.

Audit Scotland is an independent statutory body that co-ordinates and supports the delivery of high-quality public sector audit in Scotland. Audit Scotland oversees the appointment and performance of auditors, provides technical support, delivers performance audit and Best Value work programmes and undertakes financial audits of public bodies.

## Auditor responsibilities

### Code of Audit Practice

The Code of Audit Practice (the Code) describes the high-level, principles-based purpose and scope of public audit in Scotland. The [2021 Code](#) came into effect from 2022/23.

The Code of Audit Practice 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

Auditor responsibilities are derived from the Code, statute, International Standards on Auditing (UK) and the Ethical Standard for auditors, other professional requirements and best practice, and guidance from Audit Scotland.

We are responsible for the audit of the accounts and the wider-scope responsibilities explained below. We act independently in carrying out our role and in exercising professional judgement. We report to the Pension Committee and others, including Audit Scotland, on the results of our audit work.



Weaknesses or risks, including fraud and other irregularities, identified by auditors, are only those which come to our attention during our normal audit work in accordance with the Code and may not be all that exist.

### Wider scope audit work

Reflecting the fact that public money is involved, public audit is planned and undertaken from a wider perspective than in the private sector.

The wider scope audit specified by the Code broadens the audit of the accounts to include additional aspects or risks in areas of financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes.

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## Financial management



Financial management means having sound budgetary processes. Audited bodies require to understand the financial environment and whether their internal controls are operating effectively.

### Auditor considerations

Auditors consider whether the body has effective arrangements to secure sound financial management. This includes the strength of the financial management culture, accountability, and arrangements to prevent and detect fraud, error and other irregularities.

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## Financial sustainability



Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

### Auditor considerations

Auditors consider the extent to which audited bodies show regard to financial sustainability. They look ahead to the medium term (two to five years) and longer term (over five years) to consider whether the body is planning effectively so it can continue to deliver services.

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## Vision, leadership and governance



Audited bodies must have a clear vision and strategy, and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

### Auditor considerations

Auditors consider the clarity of plans to implement the vision, strategy and priorities adopted by the leaders of the audited body. Auditors also consider the effectiveness of governance arrangements for delivery, including openness and transparency of decision-making; robustness of scrutiny and shared working arrangements; and reporting of decisions and outcomes, and financial and performance information.

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## Use of resources to improve outcomes



Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency and effectiveness through the use of financial and other resources, and reporting performance against outcomes.

### Auditor considerations

Auditors consider the clarity of arrangements in place to ensure that resources are deployed to improve strategic outcomes, meet the needs of service users taking account of inequalities, and deliver continuous improvement in priority services.

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## Best Value

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

Our work in respect of the Funds' best value arrangements is integrated into our audit approach, including our work on the wider scope areas as set out in this plan.

## Audit quality

The Auditor General and the Accounts Commission require assurance on the quality of public audit in Scotland through comprehensive audit quality arrangements that

apply to all audit work and providers. The audit quality arrangements recognise the importance of audit quality to the Auditor General and the Accounts Commission and provide regular reporting on audit quality and performance.

Audit Scotland maintains and delivers an [Audit Quality Framework](#).

The most recent audit quality report can be found at <https://www.audit-scotland.gov.uk/publications/quality-of-public-audit-in-scotland-annual-report-202122>

## Funds responsibilities

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 enables it to successfully deliver its objectives. The features of proper financial stewardship include the following:

Area	Funds responsibilities
<b>Corporate governance</b>	<p>The Funds are responsible for establishing arrangements to ensure the proper conduct of its 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>
<b>Financial statements and related reports</b>	<p>The Funds have responsibility for:</p> <ul style="list-style-type: none"> <li>• preparing financial statements which give a true and fair view of its financial position and its 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 its financial statements and related reports disclosures;</li> <li>• ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority; and</li> <li>• preparing and publishing, along with the financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report in accordance with prescribed requirements. Management commentaries should be fair, balanced and understandable.</li> </ul> <p>Management is responsible, with the oversight of those charged with governance, for communicating relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.</p>

Area	Funds responsibilities
	<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 its objectives and safeguard and secure value for money from the public funds at its disposal. The Funds is also responsible for establishing effective and appropriate internal audit and risk-management functions.</p>
<b>Standards of conduct for prevention and detection of fraud and error</b>	<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>
<b>Financial position</b>	<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 statutory financial requirements and achievement of financial targets;</li> <li>• Balances and reserves, including strategies about levels and their future use;</li> <li>• 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>
<b>Best value</b>	<p>The Funds have a specific responsibility to make arrangements to secure Best Value. Best Value is defined as continuous improvement in the performance of the body's functions. In securing Best Value, the local government body is required to maintain an appropriate balance among:</p> <ul style="list-style-type: none"> <li>• The quality of its performance of its functions</li> </ul>

Area	Funds responsibilities
	<ul style="list-style-type: none"> <li>• The cost to the body of that performance</li> <li>• The cost to persons of any service provided by it for them on a wholly or partly rechargeable basis.</li> </ul> <p>In maintaining that balance, the Funds shall have regard to:</p> <ul style="list-style-type: none"> <li>• Efficiency</li> <li>• Effectiveness</li> <li>• Economy</li> <li>• The need to meet the equal opportunity requirements.</li> </ul> <p>The Funds should discharge its duties in a way which contributes to the achievement of sustainable development.</p> <p>In measuring the improvement of the performance of a local government body's functions for the purposes of this section, regard shall be had to the extent to which the outcomes of that performance have improved.</p> <p>The Scottish Government's Statutory Guidance on Best Value (2020) requires bodies to demonstrate that they are delivering Best Value in respect of seven themes:</p> <ol style="list-style-type: none"> <li>1. Vision and leadership</li> <li>2. Governance and accountability</li> <li>3. Effective use of resources</li> <li>4. Partnerships and collaborative working</li> <li>5. Working with communities</li> <li>6. Sustainability</li> <li>7. Fairness and equality.</li> </ol> <p>Specified audited bodies are required to prepare and publish performance information in accordance with Directions issued by the Accounts Commission.</p>

## Appendix 2: Potential impact on the Funds and our audit approach following revisions to auditing standards

Revised auditing standards, which come into effect from the current year, will have a significant impact on the way we perform our audit, particularly how we assess the risk of material misstatement, our approach to the audit of fraud, and the ways we ensure our audits are performed in line with regulatory requirements and to a high standard. The table below provides further detail on the implications of these new requirements.

Key change	Potential impact on the Funds & our approach
<b>Enhanced risk identification and assessment, promoting more focused auditor responses to identified risks</b>	<p>Management and those charged with governance may receive more up-front questions as we plan the audit and identify and assess risks of material misstatement.</p> <p>We may conduct planning and risk assessment procedures at a different time to ensure that our understanding is comprehensive, and that information is leveraged effectively and efficiently.</p> <p>To facilitate a more robust risk-assessment, we may request additional information to enhance our understanding of systems, processes and controls. For example, we may request:</p> <ul style="list-style-type: none"> <li>• a better understanding of the Funds' structure and operations and how it integrates information technology (IT)</li> <li>• more information about the Funds' processes for assessing risk and monitoring its system of internal control</li> </ul>

Key change	Potential impact on the Funds & our approach
	<ul style="list-style-type: none"> <li>• more detailed narratives about how transactions are initiated, recorded, processed and reported</li> <li>• policies and procedure manuals, flowcharts and other supporting documentation to validate our understanding of the information systems relevant to the preparation of the financial statements</li> <li>• more information to support our inherent risk assessment.</li> </ul> <p>This information not only informs our risk assessment but also assists us in determining an appropriate response to risks identified, including any new significant risks which require a different response.</p>
<b>Understanding and acting on risks associated with IT</b>	<p>We will be asking tailored questions and making information requests to understand the IT environment, including:</p> <ul style="list-style-type: none"> <li>• IT applications</li> <li>• supporting IT infrastructure</li> <li>• IT processes</li> <li>• personnel involved in the IT processes.</li> </ul> <p>Combined with the controls that may be needed to address the identified and assessed risks of material misstatement, this understanding may also identify existing and new risks arising from the use of IT. Therefore, we will be asking more focused questions and requesting additional information to understand the general IT controls that address such risks. For example, we may have questions in relation to general IT controls over journal entries (e.g., segregation of duties related to preparing and posting entries) to address risks arising from the use of IT.</p> <p>Depending on our assessment of the complexity of systems and associated risks, we may also involve additional team members, such as IT specialists.</p>
<b>Enhanced procedures in connection with fraud</b>	<p>We will be asking targeted questions as part of an enhanced approach to fraud, including discussing with the Funds:</p> <ul style="list-style-type: none"> <li>• any allegations of fraud raised by employees or related parties</li> </ul>



Key change	Potential impact on the Funds & our approach
	<ul style="list-style-type: none"> <li>the risks of material fraud, including those specific to the local government sector.</li> </ul> <p>Combined with other information, and any inconsistencies in responses from those charged with governance and management, we determine implications for further audit procedures. Work in connection with fraud may also now include the use of audit data analytics, or the inclusion of specialists in our engagement team to ensure we obtain sufficient appropriate audit evidence to conclude whether the financial statements are materially misstated as a result of fraud.</p> <p>In addition to existing communication and reporting requirements relating to irregularities and fraud, there may be further matters we report in connection with management's process for identifying and responding to the risks of fraud in the entity and our assessment of the risks of material misstatement due to fraud.</p> <p>These enhanced requirements may assist in the prevention and detection of material fraud, though do not provide absolute assurance that all fraud is detected or alter the fact that the primary responsibility for preventing and detecting fraud rests with the Funds and management.</p>
<b>Enhanced requirements for exercising professional scepticism</b>	<p>Challenge, scepticism and the application of appropriate professional judgement are key components of our audit approach. You may receive additional inquiries if information is found that contradicts what our team has already learned in the audit or in instances where records or documents seen in the course of the audit appear to have been tampered with, or to not be authentic.</p>
<b>Using the right resources, in the right way, at the right time</b>	<p>One of our new strategic quality objectives sets out that we will strive to use the right resource, in the right way, at the right time. This may mean increasing the use of specialists (for example in relation to general IT controls) or changing the shape of the audit engagement team to ensure that we are able to provide appropriate challenge and feedback in specialist areas.</p> <p>This will include appropriate use of technology, including data analytics.</p>

## Appendix 3: Materiality

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 and is affected by our assessment of the risk profile of the organisation and the needs of users. We review our assessment of materiality throughout the audit.

Whilst our audit procedures are designed to identify misstatements which are material to our audit opinion, we also report to the Funds and management any uncorrected misstatements of lower value errors to the extent that our audit identifies these.

### Group and the Funds materiality (£million)

	Group	Lothian Pension Fund	Scottish Homes Pension Fund
<b>Overall materiality for the financial statements</b>	143	143	2.3
<b>Performance materiality</b>	107.3	107.3	1.7
<b>Trivial threshold</b>	0.250	0.250	0.115
<b>Materiality</b>	<p>Our initial assessment is based on approximately 1.5% of the group and Funds' 2021/22 net investment assets as disclosed in the 2021/22 audited annual accounts. We consider this to be the principal consideration for the users of the annual accounts when assessing financial performance of the Funds' and the group.</p> <p>In performing our audit we apply a lower level of materiality to the audit of the Remuneration Report. Our materiality is set at £5,000.</p>		
<b>Performance materiality</b>	<p>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</p>		

	<p>level of testing on the areas deemed to be at significant risk of material misstatement.</p> <p>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.</p>
<b>Trivial misstatements</b>	<p>Trivial misstatements are matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.</p>

## Special materiality for dealings with members (£million)

	<b>Group</b>	<b>Lothian Pension Fund</b>	<b>Scottish Homes Pension Fund</b>
<b>Dealings with members materiality</b>	13.1	13.1	0.34
<b>Performance materiality</b>	9.8	9.8	0.25
<b>Trivial threshold</b>	0.250	0.250	0.017

<b>Materiality</b>	<p>We apply lower materiality for dealings with members, based on the fact these transactions are significant to the Funds' activities and it would not be appropriate to use the assets based materiality to them. Our initial assessment is based on approximately 5% of the group and Funds' 2021/22 gross expenditure as disclosed in the 2021/22 audited annual accounts. We consider this to be the principal consideration for the users of the annual accounts when assessing financial performance of the Funds' and its group.</p>
<b>Performance materiality</b>	<p>Using our professional judgement, we have calculated performance materiality at approximately 75% of overall materiality.</p>

# Appendix 4: National risk areas under scope of audit in 2022/23

## Climate change

Tackling climate change is one of the greatest global challenges. The Scottish Parliament has set a legally binding target of becoming net zero by 2045, and has interim targets including a 75% reduction in greenhouse gas emissions by 2030. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

There are specific legal responsibilities placed on public bodies to contribute to reducing greenhouse gas emissions, to adapt to climate change, to act sustainably and to report on progress. A number of public bodies have declared a climate emergency and set their own net zero targets, some of which are earlier than Scotland's national targets. All public bodies will need to reduce their direct and indirect emissions, and should have plans to do so. Many bodies will also have a role in reducing emissions in wider society, and in supporting activity to adapt to the current and potential future impact of climate change. For example, working with the private sector and communities to help drive forward the required changes in almost all aspects of public and private life, from transport and housing to business support.

Public audit has an important and clear role to play in:

- helping drive change and improvement in this uncertain and evolving area of work
- supporting public accountability and scrutinising performance
- helping identify and share good practice.

The Auditor General and Accounts Commission are developing a programme of work on climate change. This involves a blend of climate change-specific outputs that focus on key issues and challenges as well as moving towards integrating climate change considerations into all aspects of audit work.

For 2022/23 audits, auditors are required to provide answers to the questions set out in the following table which are intended to gather basic information on the arrangements for responding to climate change in each body:

### Key questions

What targets has the body set for reducing emissions in its own organisation or in its local area?

Does the body have a climate change strategy or action plan which sets out how the body intends to achieve its targets?

How does the body monitor and report progress towards meeting its emission targets internally and publicly?

Has the body considered the impact of climate change on its financial statements?

What are the areas of the financial statements where climate change has, or is expected to have, a material impact?

Does the body include climate change in its narrative reporting which accompanies the financial statements and is it consistent with those financial statements?

## Cyber security

There continues to be a significant risk of cyber-attacks to public bodies, and it is important that they have appropriate cyber security arrangements in place.

A number of recent incidents have demonstrated the significant impact that a cyber-attack can have on both the finances and operation of an organisation.

For 2022/23 audits, auditors are advised to consider risks related to cyber security at audited bodies. However, the revised ISA (UK) 315 includes enhanced requirements for auditors to understand a body's use of IT in its business, the related risks and the system of internal control addressing such risks. The Auditor General and Accounts Commission consider that meeting these additional requirements is likely to be sufficient consideration of cyber security in 2022/23.

# Appendix 5: Best Value 2022/23 Thematic Review

The Best Value thematic work for 2022/23 requires auditors to carry out an overview of the effectiveness of Funds leadership (officers and elected members) in developing new local strategic priorities following the elections in May 2022. In carrying out the overview, we will look to answer the following questions:

Key questions
How clear is the new Funds vision and its priorities?
How effectively have the views of citizens and communities been reflected in the priorities and decisions taken by the Funds?
How effectively do the Funds priorities reflect the need to reduce inequalities and climate change??
How good are the delivery plans and is there alignment of financial, workforce, asset and digital plans with the Funds's priorities
Overall, how effective has the leadership been (political and officer) in setting clear priorities and a sustainable approach to delivering them

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

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