



Lothian Pension Fund and Scottish Homes Pension Fund

2019/20 Annual Audit
Report to Members and the
Controller of Audit

September 2020

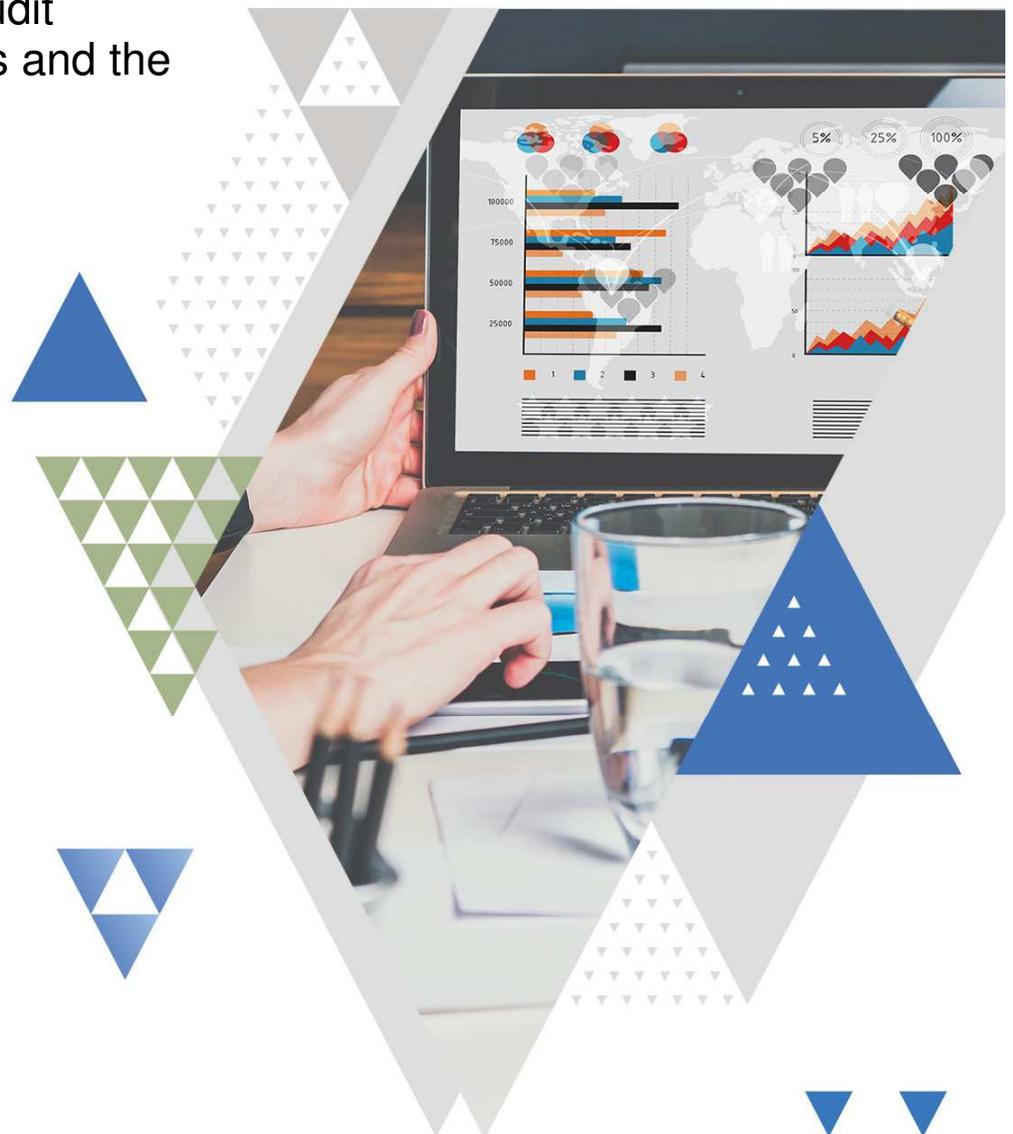


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1. Key messages

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Annual accounts audit

Lothian Pension Funds approved the annual report and financial statements for 2019/20 on 29 September 2020. We reported unqualified opinions on the financial statements and other prescribed matters for Lothian Pension Fund and Scottish Homes Pension Fund (collectively referred to as the “Funds”) within our independent auditor’s report. We also reported that there were no matters which we were required to report by exception.

We have drawn attention in our independent auditor’s report to the Accounting policies and general notes, note 5. ‘Assumptions made about the future and other major sources of estimation uncertainty’ in the financial statements, which describes the effects of a material uncertainty, caused by COVID-19, on the investment property valuations. Our opinion is not modified in respect of this matter.

The annual report and financial statements and supporting schedules were of a high standard. Our thanks go to staff for their assistance with our work.

Wider scope audit

Financial sustainability

The Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds.

The focus of their investment strategy is to ensure a sufficient return over the long term to meet the funding objectives outlined by the Funding Strategy Statement. Performance over 5 years shows they are managing investment at the benchmark.

There is an ongoing risk that the pension scheme is not affordable for admitted bodies and Lothian Pension Fund has reported an increase in the number of bodies leaving the Fund and an increase in the cessation liability following the 2017 triennial valuation.

Financial management

The Funds have effective arrangements in place for financial management and the use of resources

Lothian Pension Fund’s value of investments decreased in 2019/20 due to the impact of the global outbreak of COVID-19 on market prices.

The net assets of Lothian Pension fund have decreased in 2019/20 and Scottish Homes Pension Fund assets have not moved. The funding level has decreased across both funds.

Governance and transparency

Governance arrangements at the Funds are deemed to be appropriate.

Our assessment has been informed by a review of the corporate governance arrangements in place, the information provided to the Board and Committees as well as the risk management arrangements in place.

The COVID-19 outbreak resulted in the Pensions Committee and Pensions Audit Sub-Committee only meeting three times during 2019/20. However, we are satisfied that all relevant reports were reviewed by the committees as required.

Value for money

The Funds’ investment performance is subject to regular review by the Pension Committee.

The Funds have appropriate arrangements in place to secure value for money through appropriate monitoring of performance of investments and the administration of the Funds.



Conclusion

This report concludes our audit for 2019/20. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK) and Ethical Standards.

Azets Audit Services
September 2020

2. Introduction

This report is presented to those charged with governance and the Controller of Audit and concludes our audit of the Lothian Pension Funds for 2019/20.

We carried out our audit in accordance with Audit Scotland’s Code of Audit Practice (May 2016). This report also fulfils the requirements of International Standards on Auditing (UK) 260: Communication with those charged with governance.

We have designated the Pensions Committee as “those charged with governance” for the purposes of audit communication.

Introduction

1. This report summarises the findings from our 2019/20 audit of Lothian Pension Funds (the Funds).
2. We outlined the scope of our audit in our External Audit Plan, which we presented to the Pensions Committee at the outset of our audit. The core elements of our work include:
 - an audit of the 2019/20 annual report and accounts and related matters;
 - a review of the Funds' arrangements for governance and transparency, financial management, financial sustainability and value for money; and
 - any other work requested by Audit Scotland.

Exhibit 1: Audit dimensions within the Code of Audit Practice



3. The Funds are responsible for preparing an annual report and accounts which show a true and fair view and for implementing appropriate internal control systems. The weaknesses or risks identified are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit of the annual report and accounts 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.
4. The report contains an action plan with specific recommendations, responsible officers and dates for implementation. Senior management should assess these recommendations and consider their wider implications before deciding on appropriate actions. We give each recommendation a grading to help the Funds assess their significance and prioritise the actions required.
5. We discussed and agreed the content of this report with the Chief Finance Officer. We would like to thank all management and staff for their co-operation and assistance during our audit.

Confirmation of independence

6. International Standards on Auditing in the UK (ISAs (UK)) require us to communicate on a timely basis all facts and matters that may have a bearing on our independence.
7. We confirm that we have complied with the Financial Reporting Council's (FRC) Revised Ethical Standard. In our professional judgement, the audit process is independent, and our objectivity has not been compromised in any way.
8. We set out in Appendix 1 our assessment and confirmation of independence.

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 standard 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 the audit team or through our online survey:
www.surveymonkey.co.uk/r/S2SPZBX
11. While this report is addressed to the Funds and the Controller of Audit, it will be published on Audit Scotland's website www.audit-scotland.gov.uk

3. Annual report and accounts

The Funds' annual report and accounts are the principal means of accounting for the stewardship of their resources and performance in the use of those resources.

In this section we summarise the findings from our audit of the 2019/20 annual report and accounts.

Annual report and accounts

An unqualified audit opinion on the annual report and accounts

The annual report and accounts for the year ended 31 March 2020 were approved by the Pensions Committee on 29 September 2020. We reported unqualified opinions within our independent auditor's report. We did not identify any significant adjustments to the unaudited annual report and accounts.

The Funds' had good administrative processes in place to prepare the annual report and financial statements and the required supporting working papers.

Overall conclusion

An unqualified audit opinion on the annual report and accounts

12. The annual report and accounts for the year ended 31 March 2020 were considered by the Pensions Committee on 29 September 2020. We reported within our independent auditor's report:
 - an unqualified opinion on the financial statements; and
 - an unqualified opinion on other prescribed matters.
13. We are also satisfied that there are no matters which we are required to report by exception.
14. We have drawn attention via an Emphasis of Matter in our independent auditor's report to Accounting policies, 'Assumptions made about the future and other major sources of estimation uncertainty' of the financial statements. This describes the effects of a material uncertainty, caused by COVID-19, on the investment property valuation report. Our opinion is not modified in respect of this matter.

Good administrative processes were in place

15. We received unaudited annual report and accounts and supporting papers of a good standard, in line with our audit timetable. Our thanks go to staff at the Funds for their assistance with our work.

Our assessment of risks of material misstatement

16. The assessed risks of material misstatement described in Exhibit 2 are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. Our audit procedures relating to these matters were designed in the context of our audit of the annual report and accounts as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the annual report and accounts is not modified with respect to any of the risks described in Exhibit 2.

Exhibit 2 – Our assessment of risks of material misstatement and how the scope of our audit responded to those risks

1. Management override

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

Excerpt from the 2019/20 External Audit Plan

17. We have not identified any indication of management override in the year. We have reviewed the Funds' accounting records and obtained evidence to ensure that transactions outside normal processes were valid and accounted for correctly. We have also reviewed management estimates and the journal entries processed in the period and around the year end. We did not identify any areas of bias in key judgements made by management and judgements were consistent with prior years.
18. While we have not identified any instances of management override from our testing, we noted in 2017/18 that City of Edinburgh Council staff, with access to Oracle, have the ability to post journals to the Funds' financial ledger. This is an ongoing issue in 2019/20, however, we did not identify any instances where journals were posted by inappropriate users.

2. Revenue recognition

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

Excerpt from the 2019/20 External Audit Plan

19. While we did not suspect incidences of material fraud and error, we evaluated each type of revenue transaction and documented our conclusions. We have reviewed the controls in place over revenue accounting and found them to be sufficient.
20. We have evaluated key revenue transactions and streams to gain assurance over the completeness and occurrence of income. We are satisfied income is fairly stated in the financial statements. We also carried out testing to confirm that the Funds' revenue recognition policies are appropriate and have been applied consistently throughout the year.

3. Risk of fraud in the recognition of expenditure

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

Excerpt from the 2019/20 External Audit Plan

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21. At the planning stage of our audit cycle, we reported that we did not believe the risk of fraud in expenditure recognition was material to the financial statements and we therefore rebutted this risk. This position has been reviewed throughout this audit and this conclusion has remained appropriate.
 22. We conducted our testing based on our approach to low inherent risk areas and we evaluated each type of expenditure transaction and documented our conclusions. We gained reasonable assurance over the completeness and occurrence of expenditure and are satisfied that expenditure is fairly stated in the annual accounts. To inform our conclusion we carried out testing to confirm that the Funds’ policy for recognising expenditure is appropriate and has been applied consistently throughout the year.

4. Valuation of investments

The Funds held investments of £7.789 billion as at 31 March 2019, of which 34% (£2.639 billion) were classified as level 2 or level 3 financial instruments, meaning the valuation was not based on unadjusted quoted prices in active markets. Judgements are taken by the Investment Managers to value those investments whose prices are not publicly available. Investments of this nature are complex, difficult to value and include a significant degree of judgement from the investment manager. The material nature of this balance means that any error in judgement could result in a material valuation error.

Excerpt from the 2019/20 External Audit Plan

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23. In 2019/20, the value of level 2 and 3 investments fell by 7% to £2.456 billion (2018/19: £2.639 billion) increasing as a proportion of overall investments to 37% (36% in 2018/19). Fair values of investments of this nature are provided by fund managers and custodian using various bases selected by the investment manager or custodian. The base of investment values can include reference to similar companies or bid prices.
 24. We have considered the valuation basis for a sample of investments and concluded that an appropriate base has been applied in each case. The custodian and investment managers are deemed to be management experts. In line with ISA (UK) 500 we have considered the competence, capability and objectivity of the experts used to inform the valuation. In addition, we have reviewed auditor reports on the internal controls at the custodian and at each key investment manager. Our testing did not raise any issues regarding the qualifications of or work provided by the management experts employed by the Funds.
 25. For a sample of hard to value investments we reviewed the assumptions and bases of the fair value. We challenged the Funds on the rationale for selecting the bases and assumptions and ensured we were satisfied they were appropriate.
 26. The disclosures within the annual report and financial statements are consistent with the information provided by the custodian.

5. Accounting for investment properties

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

Excerpt from the 2019/20 External Audit Plan

27. We have reviewed the transfer process undertaken by Lothian Pension Fund for the management of the investment property portfolio from Standard Life to JLL. This is deemed to have been subject to sufficient checks and confirmations to ensure a complete and accurate transfer of information.
28. Additionally, we have reviewed the year end working papers produced by Lothian Pension Fund and JLL to account for the investment property portfolio. We have assessed the methodology used in these working papers to be in line with the relevant accounting standards and based on appropriate and accurate information.

Update to our initial risk assessment

29. 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. We have specifically updated our risk assessment and audit plan in light of COVID-19. We recognised this as a key audit risk¹.

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.

30. In response to this risk we identified a number of potential areas where there was the risk of material misstatement to the financial statements and/or our audit opinion. These areas included:

- Property valuations
- Group considerations (paragraph 50 – 52)
- Access to audit evidence
- Timescales/administrative processes

Property Valuations

31. During the pandemic, the Royal Institution of Chartered Surveyors (RICS) published guidance which outlines the challenges with regard to the valuation of assets during this period, including the potential for valuations to be “qualified” with a “material valuation uncertainty”.
32. In line with their accounting policies, Lothian Pension Fund obtained an external valuation of their

¹ A key audit risk is one which may result in a material misstatement to the financial statements or significantly impact on our audit judgements and conclusions on the four wider scope

dimensions; financial sustainability, financial management, governance and transparency and value for money.

investment property portfolio as at 31 March 2020. The value of the portfolio reported by the valuer is £370.55 million. The valuations are carried out in accordance with the RICS Valuation Global Standards and the UK National Supplement insofar as these terms are consistent with the agreed requirements of the Scottish Government.

33. In the current year, the valuation report received from the external valuers (CRBE) stated the following:

Material Valuation Uncertainty

“ The outbreak of the Novel Coronavirus (COVID-19), declared by the World Health Organisation as a “Global Pandemic” on the 11 March 2020, has impacted global financial markets. Travel restrictions have been implemented by many countries. Market activity is being impacted in many sectors. As at the valuation date, we consider that we can attach less weight to previous market evidence for comparison purposes, to inform opinions of value. Indeed, the current response to COVID-19 means that we are faced with an unprecedented set of circumstances on which to base a judgement.

Our valuation is therefore reported on the basis of ‘material valuation uncertainty’ as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – should be attached to our valuation than would normally be the case. Given the unknown future impact that COVID-19 might have on the real estate market, we recommend that you keep the valuation of these properties under frequent review.

For the avoidance of doubt, the inclusion of the ‘material valuation uncertainty’ declaration above does not mean that the valuation cannot be relied upon. Rather, the phrase is used in order to be clear and transparent with all parties, in a professional manner that – in the current extraordinary circumstances – less certainty can be attached to the valuation than would otherwise be the case. The material uncertainty clause is a disclosure, not a disclaimer.’

CRBE Valuation of Investment Property Portfolio as at 31 March 2020, Prepared for Lothian Pension Fund

34. A material uncertainty in a valuer’s report does not mean that the valuation cannot be relied upon or that there is a misstatement. However, it indicates that less certainty can be attached to the valuation than would otherwise be the case.

35. Lothian Pension Fund has disclosed the uncertainty and the impact on the amounts recognised in the financial statements within both the management commentary and within the “Assumptions made about the future and other major sources of uncertainty” section of the accounting policies.
36. We considered whether the material uncertainty over the property valuations is of such importance that it is fundamental to users’ understanding of the financial statements. Based on our considerations we have concluded that an emphasis of matter paragraph is required in our independent auditor’s report, which draws attention to the disclosures made in the annual accounts. Our audit opinion is not modified in respect of this matter.

Access to audit evidence

37. Our audit this year has been carried out remotely. As a consequence, we identified a risk that access to and provision of sufficient, appropriate audit evidence in support of our audit opinion may be impacted by the inherently challenging nature of carrying out our audit remotely.
38. We have employed a greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.
39. For all aspects of our audit we have been provided with sufficient evidence to complete the audit in line with our responsibilities. There were no issues noted with the reliability or appropriateness of evidence provided.

Timescales/Administrative processes

40. In Scotland, the administrative deadline for the submission of audited accounts of local government bodies has been extended by three months to 30 December 2020. However, Lothian Pension Fund have decided to continue with the original timescales for the annual accounts and are due to approve the accounts on 28 September 2020.
41. We have been working closely with management throughout the audit to put us in the best position to ensure this timetable is adhered to. From an audit perspective we highlight that, at this time, our audit is not fully completed, and the following work is ongoing:
- Completion of manager and partner review of the audit work performed;



- 2nd partner review and Audit Scotland consideration of our draft independent auditor's report;
- Final review of the draft annual report and accounts presented to the Pensions Audit Sub-Committee; and

- Consideration of subsequent events up to the date of approval of the annual report and accounts.

Our application of materiality

42. The assessment of what is material is a matter of professional judgement and involves considering both the amount and the nature of the misstatement. This means that different materiality levels will be applied to different elements of the financial statements.
43. Our initial assessment of materiality for the financial statements is set out in our annual audit plan. On receipt of the 2019/20 draft financial statements, we reassessed materiality as outlined in the table below. We consider that our updated assessment has remained appropriate throughout our audit.

	Materiality (£million)		
	Lothian Pension Fund Group ²	Lothian Pension Fund Parent	Scottish Homes materiality
Overall	112	112	2.5
Dealings with members	14	14	0.36

44. Our assessment of materiality is set with reference to the Funds' net investment assets. We consider this to be one of the principal considerations for the users of the financial statements when assessing the financial performance.
45. As outlined in our External Audit Plan we considered transactions when dealing with members (i.e. contributions and expenditure incurred providing payments to pensioners) to also 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.
46. ISA 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 decision of the users of the accounts.

We have therefore set a separate materiality for transactions relating to dealings with members, based on the expenditure incurred for providing payments to pensioners.

Performance materiality

47. 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.
48. 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.
49. Our final assessment of performance materiality for the accounts have been set out below.

	Performance materiality (£million)		
	Lothian Pension Fund Group ¹	Lothian Pension Fund Parent	Scottish Homes
Overall	73	73	1.6
Dealings with members	9	9	0.24

50. We agreed with the Pensions Committee that we would report on all material corrected misstatements, and uncorrected misstatements with a value in excess of £250,000 for Lothian Pension Fund and £125,000 for Scottish Homes Pension Fund, as well as other misstatements below

² Lothian Pension Fund group comprises Lothian Pension Fund (incorporating Lothian Buses Pension Fund transactions and balances), LPFE Ltd and LPFI Ltd

that threshold which, in our view, warranted reporting on qualitative grounds.

the internal audit opinion. This will be updated in the revised accounts.

Group accounts

51. The Funds' annual report includes accounts for Lothian Pension Fund and Scottish Homes Pension Fund.
52. Lothian Pension Fund accounts are prepared on a group basis following the creation of two special purpose vehicles, LPFE Ltd and LPFI Ltd in October 2014. The companies are wholly owned and controlled by the City of Edinburgh Council.
53. We reviewed the consolidation process in 2019/20 and concluded the subsidiary companies had been correctly included in the group accounts of Lothian Pension Fund.

Audit differences

54. We are pleased to report that our audit identified no material adjustments. In addition, we can confirm there were no unadjusted errors relating to the 2019/20 financial statements.
55. Guidance issued by the Scottish Government (Local Government Finance Circular 5/2015) also provides a guide as to the minimum required disclosures in the management commentary including:
 - The context of the annual report and financial statements;
 - Insight into the priorities of the Funds' and strategies adopted to achieve these priorities and objectives;
 - Information on future plans;
 - KPIs which measure the investment performance of the Funds'; and
 - Information on the principal risks and uncertainties facing the authority.
56. We have concluded that the management commentary has been prepared in line with the regulations and Scottish Government guidance and is consistent with the financial statements.

Annual governance statement

57. We have reviewed the Funds' annual governance statement against the relevant guidance: Delivering Good Governance in Local Government.
58. We consider the coverage of the annual governance statement to be broadly in line with expectations.
59. We highlighted a minor disclosure issue within the governance statement at paragraph 34 in relation to

60. Subject to this adjustment we have concluded that the annual governance statement is in line with the required guidance and is consistent with the accounts and assurances provided in year.

Governance compliance statement

61. The Local Government Pension Scheme (Scotland) Regulations 2014 require all pension funds to prepare a Governance Compliance Statement. The purpose of this statement is to compare the Funds' governance arrangements with those standards set out in guidance from the Scottish Ministers.
62. We have reviewed the Governance Compliance Statement and we are satisfied the disclosures comply with guidance issued by Scottish Ministers and are not inconsistent with our knowledge of the arrangements in place at the Funds.

Remuneration and staff report

63. In February 2018 staff previously employed by the City of Edinburgh Council with responsibility for the Funds' were transferred to LPFE Ltd. From this point all new staff employed for roles with the Funds were employed by LPFE Ltd.
64. The Local Authority Accounts (Scotland) Regulations 2014 (the 2014 Regulations) require that where a local government body has a subsidiary the details of the Chief Executive's salary and any employee with remuneration over £0.150 million is included in a remuneration report.
65. We have concluded that the audited part of the remuneration and staff report has been prepared in accordance with directions from Scottish Ministers and is consistent with the financial statements.

Legality

66. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts.

The Local Authority Accounts (Scotland) Regulations

67. As part of our audit we reviewed the Funds' compliance with the 2014 Regulations, in particular

with respect to regulations 8 to 103 as they relate to the annual report and financial statements.

68. We have concluded that appropriate arrangements are in place to comply with these Regulations.

Banking arrangements

69. It was highlighted during the course of our audit that the Pension Fund had not been operating its bank account in line with the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010. There is a requirement for administering authorities to hold a separate bank account for funds and this should be used to hold pension fund money.
70. The Funds use the Council bank account to ensure that no unfunded payments are taken from a pension fund bank account.
71. In 2018/19 the Funds have requested that “unfunded discretionary payments” be transferred to the Scottish Public Pensions Agency which would mitigate the requirement for the Funds’ to use the Council’s bank account. However, this has still not been agreed to in 2019/20.

Qualitative aspects of accounting practices and financial reporting

72. During the course of our audit, we consider the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the annual accounts. The following observations have been made:

³ Regulations 8 to 10 relates to the preparation and publication of unaudited accounts, notice of public right to inspect and object to the accounts and consideration and signing of the audited accounts.

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	<p>We have reviewed the significant accounting policies which are disclosed in the annual report and financial statements of the Funds. We consider the policies to be appropriate to the Funds, however, we have noted that the Funds have departed from CIPFA Guidance in relation to investment management expenses.</p> <p>During 2015/16 CIPFA issued guidance stating that pension funds should only report the direct costs of using investment managers. The impact of this is that investment management costs associated with fund of funds transactions would not be reported. The Funds feel this would detract from the transparency of the accounts and have reported indirect costs of £0.955 million for Lothian Pension Fund (2018/19: £5.062 million). This reduction is due to the Fund selling the private equity and infrastructure investments to fund the private debt investments.</p> <p>There were no indirect costs for Scottish Homes in either 2018/19 or 2019/20.</p> <p>The impact of this accounting treatment is to increase the investment management expense which is offset by an increase in the change in market value of investments. The net impact on the fund account is therefore zero.</p>
The timing of the transactions and the period in which they are recorded.	We did not identify any concerns over the timing of transactions or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	<p>The Funds have significant levels of accounting estimates and judgements used by management in preparing the financial statements. The principal areas of estimation concern the valuation of unquoted private equity and infrastructure investments and the actuarial valuation of promised retirement benefits. These estimates have been informed by advice from qualified, independent experts. We evaluated the competence, objectivity and capability of management experts in line with the requirements of ISA (UK) 500 and concluded that use of the expert is appropriate.</p> <p>We are satisfied with the appropriateness of the accounting estimates and judgements used in the preparation of the annual report and financial statements. We have considered the disclosures around the estimates, including sensitivity analysis and concluded that they are appropriate.</p>
The appropriateness of the going concern assumption	We have reviewed the detailed financial forecasts for 2020/21. Our understanding of the legislative framework and activities undertaken provides us with sufficient assurance that the Funds will continue to operate for at least 12 months from the signing date.
The potential effect on the annual accounts of any uncertainties, including significant risks and related disclosures that are required.	We have not identified any uncertainties, including any significant risk or required disclosures, which should be included in the annual accounts beyond those already made.
The extent to which the annual accounts have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed.	From the testing performed, we identified no significant unusual transactions in the period.

Qualitative aspect considered	Audit conclusion
Apparent misstatements in the annual report or material inconsistencies with the financial statements.	The annual report contains no material misstatements or inconsistencies with the financial statements.
Any significant annual accounts disclosures to bring to your attention.	There are no significant annual accounts disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately.
Disagreement over any accounting treatment or annual accounts disclosure.	While disclosure and presentational adjustments were made during the audit, there was no material disagreement during the course of the audit over any accounting treatment or disclosure.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

4. Financial sustainability

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



The Funds have effective arrangements in place to ensure the ongoing sustainability of the pension funds.

The focus of their investment strategy is to ensure a sufficient return over the long term to meet the funding objectives outlined by the Funding Strategy Statement. Performance over 5 years shows they are managing investment around the benchmark.

There is an ongoing risk that the pension scheme is not affordable for admitted bodies and Lothian Pension Fund has reported an increase in the number of bodies leaving the Fund and an increase in the cessation liability following the 2017 triennial valuation.

Significant audit risk

Our audit plan identified a significant risk in relation to financial sustainability under our wider scope responsibilities.

Financial sustainability: Market volatility

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

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

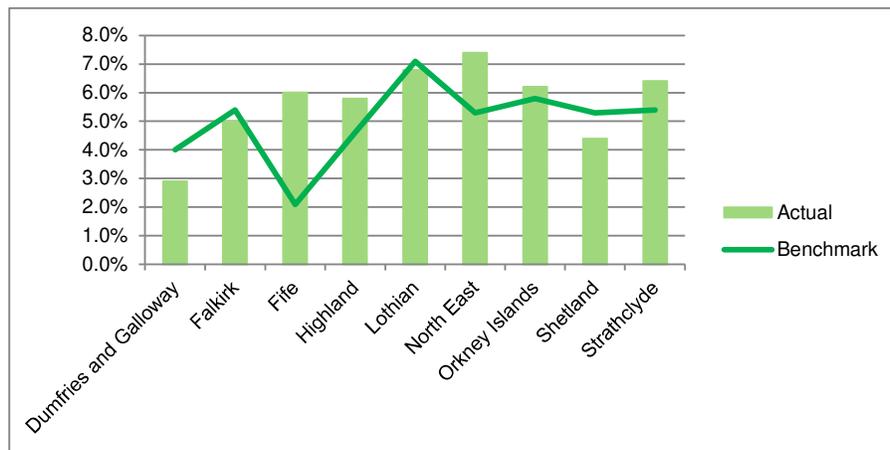
The investment objectives of the Funds are to achieve a return on Fund assets which is sufficient over the long term to meet the funding objectives as outlined in the Funding Strategy Statement. Investment returns are generated by a combination of income (from dividends, interest and rents) and gains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

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

Excerpt from the 2019/20 External Audit Plan

- 73. Financial sustainability of the Funds relates to the performance over the longer term. The investment objective of the Funds is to achieve a return on the fund assets which is sufficient over the long term to meet the funding objectives outlined in the funding statement strategy.
- 74. When considering the risk over market volatility we have considered the performance over the longer term.

Exhibit 3: Annualised 5 year returns across LGPS Scotland Funds against benchmark

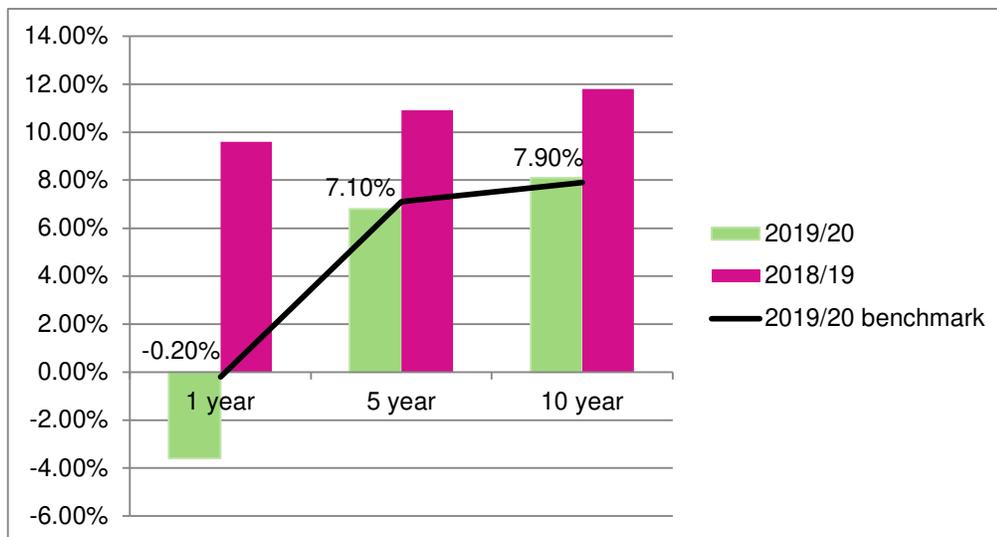


Source: Unaudited Pension Fund Annual Report and Accounts⁴

⁴ Scottish Borders Pension Fund do not publish their 5-year annualised return. As at the time of writing, Tayside Pension Fund have not published their unaudited accounts for 2019/20.

- 75. Benchmarks are set locally to reflect the different long-term investment requirements to support future pension payments of each fund.
- 76. Lothian Pension Fund is reporting the second highest annualised 5-year return. Whilst the 5 year returns for LPF are below benchmark, the 10-year returns are 8.1% against a benchmark of 7.9%.
- 77. No benchmark was set for Scottish Homes Pension Fund as investments are mandated by the Scottish Government to be held in gilts.

Exhibit 4: Performance LPF of against benchmark and compared to prior year



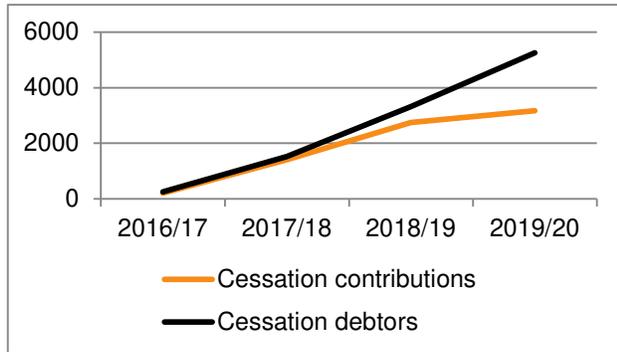
Source: Unaudited Lothian Pension Fund Annual Report and Accounts

- 78. We have concluded that the Funds have an appropriate approach to managing investments; however, within the current political climate market volatility will continue to be a risk.
- 79. The Funds’ have this as a risk on the risk register and it is currently rated green due to the predicted low impact on service delivery and likelihood of occurrence.

Employers within the scheme

- 80. A full actuarial valuation in 2017 highlighted that Lothian Pension Fund was behind the target level for funding (98% against a target of 100%). Both Lothian Buses Pension Fund and Scottish Homes Pension Fund were ahead of target.
- 81. Contribution rates across employers within Lothian Pension Fund generally increased leading to affordability issues.
- 82. In recognition of this Lothian Pension Fund updated their Funding Strategy Statement with a requirement for employing bodies to confirm their commitment to meet the minimum contributions.
- 83. In 2019/20 three employers elected to leave the Fund.
- 84. The level of cessation contributions has increased by 1,424% since 2016/17, with the long-term debtors relating to ceased employers rising by 1,929%.

Exhibit 5: Cessation contributions and debtors (£m)



Source: Lothian Pension Fund annual accounts

85. There is therefore an ongoing risk that an employer fails to pay contributions leading to increased contributions and pressure on other scheduled and admitted bodies.

86. Lothian Pension Fund is a multi-employer fund with 14 scheduled bodies, including 4 Councils, and 58 admitted bodies. The scheme has a significant membership profile with active members being the majority.

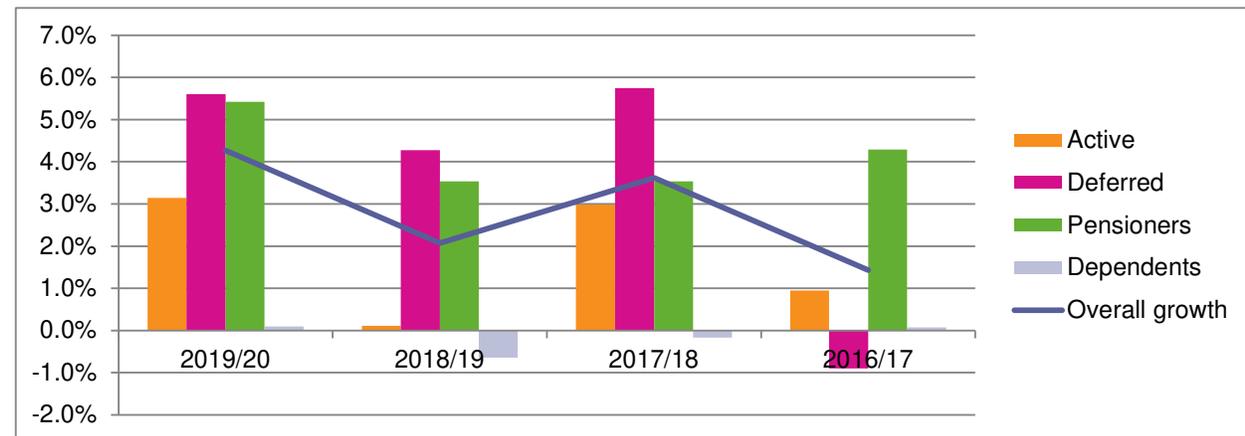
87. This differs from Scottish Homes Pension Fund which is a single employer scheme and have a majority of inactive members (deferred, pensioners and dependents).

88. Following direction from Scottish Ministers received on 31 March 2020, Homeless Action Scotland was transferred from Lothian Pension Fund. This involved transferring 11 deferred members, 4 pensioner members, and 1 dependent member to Scottish Homes Pension Fund.

89. Analysis shows that although there is an overall increase in membership at Lothian Pension Fund, active members have been growing at a slower rate than deferred members and pensioners.

Membership

Exhibit 6: % year on year growth in members across categories



Source: Lothian Pension Funds Annual Report and Accounts

90. The fund relies on active members to meet the payments to pensioners and there is a risk that if growth in pensioners, increases at a faster rate than active members additional affordability pressures will be faced by Lothian Pension Fund.

91. It is, however, noted that active members have only decreased by 1.5% as a proportion of total members moving from 42.1% of members in 2016/17 to 40.6% of members in 2019/20. Pensioners have increased by 0.7% as a proportion of the total members and in 2019/20 make up 30.3% of the membership of Lothian Pension Fund. The movement is therefore slow, and this is likely to be a low risk area with regards to financial sustainability.

5. Financial management

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



The Funds have effective arrangements in place for financial management and the use of resources

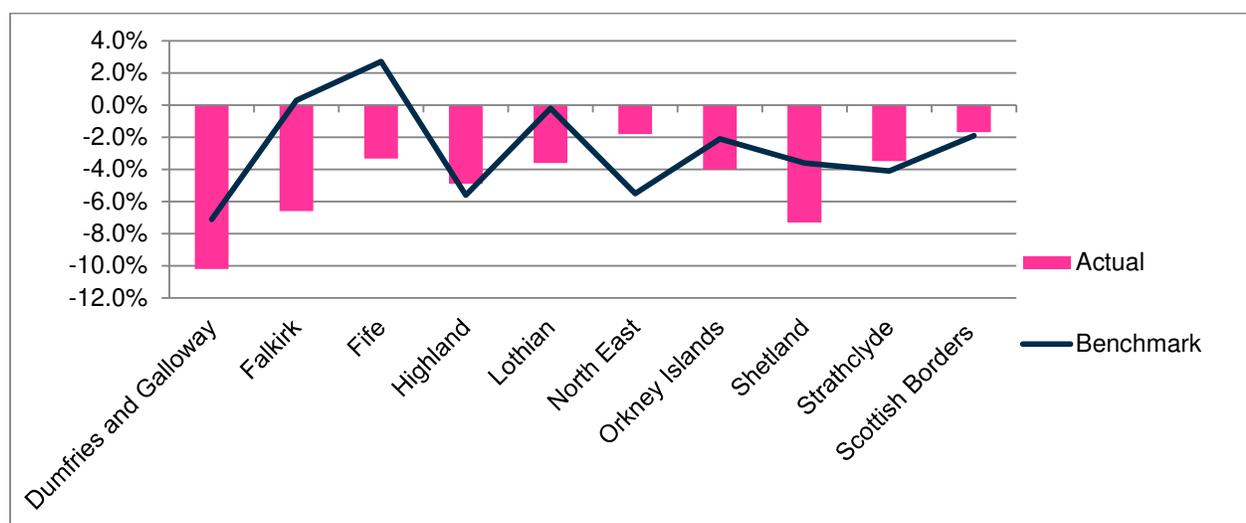
Lothian Pension Fund's investment performance decreased in 2019/20 due to the impact of the global outbreak of COVID-19 on market prices.

The net assets of Lothian Pension fund have decreased in 2019/20 and Scottish Homes Pension Fund assets have not moved. The funding level has decreased across both funds.

Investment performance

92. The Funds report their performance with regards to returns on investments as part of the annual report and financial statements. As shown in Exhibit 8 below Lothian Pension Fund, reported performance below the 1-year benchmark.
93. Investment performance across LGPS in Scotland was weaker in 2019/20 than in 2018/19. The average
94. return on investments in 2019/20 was -4.7% a large decrease from 7.1% in 2018/19.
95. This considerable decrease can be attributed to the impact of the COVID-19 outbreak on the market value of investments as at 31 March 2020.

Exhibit 8: One-year investment performance across LGPS Funds



Source: Unaudited LGPS Scotland Annual Report and Accounts⁵

96. In line with the majority of funds across Scotland Lothian Pension Fund has not achieved their benchmark for the year.
97. We have highlighted in the past that the focus of the funds is long term stability and we have noted in the Financial Sustainability section that the longer-term performance is above benchmark.
98. The long-term results indicate that the investment portfolio is being managed appropriately.

Financial position

99. The movement in net assets of the funds varied across each fund as shown in Exhibit 9. Both funds have reported a net withdrawal position from dealings with members, which is consistent with prior year. In 2019/20 the decrease in the market value of investments at Lothian Pension Fund meant there was an overall decrease in net assets. Scottish Homes Pension Fund return on investments met the net withdrawal meaning the level of net assets was maintained from 2018/19.

Exhibit 9: Lothian Pension Funds' Financial Position (£ million)

	Net assets			Present value of retirement benefits		
	2019/20	2018/19	% Movement	2019/20	2018/19	% Movement
Lothian Pension Fund	7,480	7,819	-4.34%	8,774	9,435	-7.01%
Scottish Homes	166	166	0.00%	122	135	-9.63%

⁵ As at the time of writing, Tayside Pension Fund had not published their unaudited accounts for 2019/20

Source: Lothian Pension Funds Annual Report and Accounts

100. Hymans Robertson provided an estimate of the present value of the promised retirement benefits. The net discount rate after inflation increased from the previous year. This resulted in a decrease in the obligation.

Financial Performance

- 101. As part of our audit we considered the Funds' systems of budgetary control and financial management and did not identify any significant deficiencies.
- 102. Service update reports are provided to each meeting of the Pensions Committee. The reports include forecasts to the year-end and explanations for any movements.
- 103. The annual service plan and in year updates to the Pensions Committee forecasted a net withdrawals position for both Funds.

Exhibit 10: 2019/20 Forecast versus Actual Net Withdrawals from the Fund (£'000)

	2019/20 Forecast	2019/20 Actual	% Difference
Lothian Pension Fund	40,750	35,344	-13.3%
Scottish Homes	7,300	7,294	0.01%

Source: Lothian Pension Funds Annual Report and Accounts

104. In 2019/20 Lothian Pension Fund had a one-off transfer out of the scheme of £20 million for the transfer of Barony Housing Association to Strathclyde Pension Fund. This is considered to be the main driver of the increase in net expenditure from £14.5 million in 2018/19 to £35.3 million in 2019/20.

Systems of internal control

- 105. We have evaluated the Funds' key financial systems and internal financial controls to determine whether they are adequate to prevent material misstatements in the annual accounts. Our approach has included documenting the key internal financial controls and performing walkthroughs to confirm that they are operating as intended.
- 106. From our audit work on the pensions paid in 2019/20 we identified an issue in which two of our sample of 13 pensioners' annual entitlements had been incorrectly calculated by Altair, due to

incorrect GMP data being transferred from the City of Edinburgh Council payroll system to Lothian Pension Fund.

- 107. From discussion with the pension's administration team, this is not deemed to be a control weakness. This is due to the fact that there are regular checks run to ensure the Altair and the payroll system reconcile meaning it is unlikely that this error will go unnoticed in the future.
- 108. No other issues were identified with the system of internal controls from our audit work.
- 109. We identified a number of areas for improvement in 2018/19 which were followed up at the year-end. We have reported progress against outstanding actions in appendix 2.

Prevention and detection of fraud and irregularity

- 110. Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. Lothian Pension Fund was not required to participate in the National Fraud Initiative in 2018/19 but did so voluntarily.
- 111. We found the Funds' arrangements for the prevention and detection of fraud and other irregularities to be adequate and appropriate.

Standards of conduct

- 112. In our opinion the Funds' arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are adequate.
- 113. Our conclusion has been informed by a review of the arrangements for adopting and reviewing standing orders, financial instructions and scheme of delegation and for complying with national and local codes of conduct.

Internal audit

- 114. An effective internal audit service is an important element of the Funds' governance arrangements. The City of Edinburgh Council provide the Funds' internal audit service. During our audit we considered the work of internal audit wherever possible to avoid duplication of effort and make the most efficient use of the Funds' audit resource
- 115. In 2018/19 it was noted that the service did not fully comply with Public Sector Internal Audit Standards (PSIAs) in relation to quality assurance reviews. In

2019/20, it has been noted that these quality assurance reviews have been undertaken and that the internal audit team is now fully compliant with the PSiAs.

116. In 2019/20 we did not place formal reliance on the work of internal audit, however, we have considered their findings in respect of our wider scope responsibilities and we are grateful to the internal audit team for their assistance during the course of our work.

6. 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.



Governance arrangements at the Funds are deemed to be appropriate.

Our assessment has been informed by a review of the corporate governance arrangements in place, the information provided to the Board and Committees as well as the risk management arrangements in place.

The COVID-19 outbreak resulted in the Pensions Committee and Pensions Audit Sub-Committee only meeting three times during 2019/20. However, we are satisfied that all relevant reports were reviewed by the committees as required.

Governance structure

117. The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.
118. As outlined by the City of Edinburgh Council Scheme of Delegation the Pensions Committee has responsibility for the administration, management and investment strategy for the Funds.
119. In line with the requirements of the Public Service Pension Act 2013 the Pensions Committee is supported by a Pensions Board.
120. The Pensions Board is responsible for establishing arrangements that ensure proper conduct of the affairs of the Board and meet quarterly on a concurrent basis with the Pension Committee.
121. The Funds complied with best practice and appointed an independent professional observer to the Board and Committee.
122. In line with legislation if more than half of the members of the Pension Board disagree with a decision of the Pension Committee then they can request in writing that the Pension Committee review that decision. There have been no requests to review decisions in 2019/20.
126. The joint Investment Strategy Panel covers joint working arrangement with Falkirk Pension Fund and Fife Pension Fund.
127. The Joint Investment Strategy Panel meets quarterly and considers the appropriate investment management structure required to implement the Funds' investment strategy. In addition, it is responsible for:
 - making recommendations about investment strategy; and
 - directing and monitoring strategy implementation and risk.
128. The primary focus of the panel during 2019/20 has been the implementation of existing strategies for Lothian Pension Fund and Scottish Homes Pension Fund, as well as the implementation of the strategies of the collaborative partner funds.
129. From December 2019, Lothian Pension Fund operated four investment strategies recognising the differing requirements of the various scheduled and admitted employers.

Training and development

123. Due to the specialised nature of the Funds, it is vital that members have the appropriate knowledge and understanding to provide appropriate challenge and operate effectively. Training is therefore seen as a fundamental requirement for all Committee and Board members.
124. Our review found that all current Pension Committee and Board members met the requirement to have a minimum of 21 hours training.

Joint Investment Strategy Panel

125. The Pensions Committee has delegated responsibility for investment strategy to the Executive Director of Resource who takes advice from a Joint Investment Strategy Panel made up of:
 - Chief Investment Officer, LPFI Ltd;
 - A second senior investment officer of LPFI Ltd; and
 - two external independent investment advisers.

Exhibit 11: Lothian Pension Fund investment strategies



Source: Joint Investment Strategy Panel annual report

130. Scottish Homes Pension fund achieved full funding at the 2017 actuarial valuation and therefore the strategy is low risk and designed to protect from short term market changes. This is similar to Strategy 2 which focuses on investments in UK gilts and cash.

Impact of EU withdrawal

131. Audit Scotland has highlighted EU withdrawal as a significant risk facing public bodies across Scotland. Three streams of potential impact were identified:
- Workforce;
 - Funding; and
 - Regulation.
132. The Funds have considered the impact across all three areas and have identified that this is an area of low risk for the pension fund. From an initial assessment of the workforce and funding streams no significant implications have been identified. This is in line with our understanding of the nature of the Funds’.
133. Regulations may have a more significant impact; however, the Funds consider that as a UK based pension Fund collaborating with other UK based funds the impact is expected to be limited
134. The primary consideration was the impact of the EU withdrawal on movement in investments and as outlined in the financial sustainability and value for money sections the Funds have tailored their

objective and approach to focus on long term safeguarding of returns.

Impact of COVID-19

135. As a result of the COVID-19 pandemic, meetings of the pensions committee and the pensions audit sub-committee have been held remotely.
136. The pensions committee and audit sub-committee are required to meet four times a year, however, in 2019/20 there were only three meetings held due to the cancellation of the committee meetings in March 2020.
137. Business that would have been covered at the March 2020 meeting was appropriately covered at the June 2020 committee meetings.

7. Value for money

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



The Funds' investment performance is subject to regular review by the Pension Committee.

The Funds have appropriate arrangements in place to secure value for money through appropriate monitoring of performance of investments and the administration of the Funds.

Investment manager operations

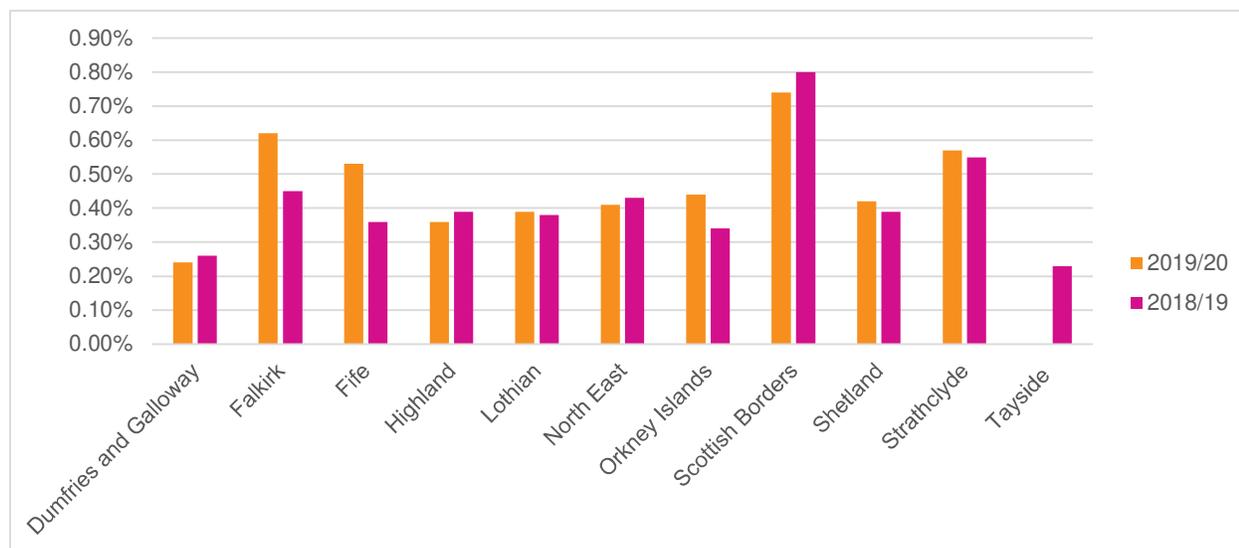
138. Lothian Pension Fund operates two special purpose vehicles: LPFE Ltd and LPFI Ltd. Both companies are wholly owned and controlled by the Council.
139. The special purpose vehicles were established to support the investment programme of the in-house investment team by providing organisational arrangements consistent with the capability, systems and controls of authorised investment companies.
140. Effective leadership is key to the success of the Funds achievement of objectives. There were no significant changes to the leadership team at LPFI Ltd, and the team continued to operate effectively.
141. In 2019/20, the proportion of funds managed internally increased from 85% in 2018/19 to 92% in 2019/20. This is due to the investment property portfolio moving from being managed by Aberdeen Standard Life to being managed in house.

We have reviewed the transfer of the management of the investment property portfolio and detailed our findings in paragraphs 26 - 27.

Management expenses

142. Lothian Pension Fund reported management expenses of £35.126 million in 2019/20, a decrease of 9% from the prior year.
143. Management expenses are split into three main categories: administrative costs; investment manager expenses and oversight and governance costs. Investment management expenses account for 85% of total management expenses.
144. In year Lothian Pension Fund's investment manager expenses (excluding indirect expenses) increased marginally as a proportion of net assets. This is broadly in line with trends across the Local Government Pension Funds.

Exhibit 12: Management expenses as a proportion of net assets



Source: LGPS Scotland Unaudited Annual Report and Accounts⁶

- 145. The analysis above does not include indirect investment management costs as CIPFA guidance states that only direct investment management costs i.e. those that the fund can control should be reported. Lothian Pension Fund reported £0.955 million of indirect manager expenses in 2019/20. It is not possible to benchmark the impact of indirect management costs across Scottish Local Government Pension Funds.
- 146. Investment manager expenses can vary due to a number of factors including actual returns on investments and the nature of the investment assets held.
- 147. The Funds undertake annual benchmarking exercises using externally provided data, covering 37 LGPS funds and a wider global universe of 325 funds.
- 148. Analysis of investment costs is carried out by an independent provider, CEM benchmarking Limited. In 2019/20 Lothian Pension Fund reported an actual investment cost of 0.39% of net assets which was below the benchmark of 0.48%.
- 149. The Funds credit the improved performance against benchmark to the high percentage of assets managed internally.
- 150. Analysis of pension administration costs was undertaken by the Chartered Institute of Public Finance Accountants. Pension cost per member was in £22.09 in 2019/20, which is higher than the average cost of local authority funds of £21.34. The

cost per member is broadly deemed to be in line with other local authority funds who operate within the range of costs of £13 to £48 per member.

- 151. The Funds have noted that there are restrictions over the comparability of the data and that the membership composition can have a significant impact on the cost. It is noted that there is a high degree of variation across the membership across LGPS Funds.

Monitoring investment performance

- 152. There is an annual review of investment performance in June for each of the Funds. The report provides a detailed analysis of each of the Fund’s investment performance against its investment strategy. We concluded that Pension Committee and Board Members are engaged in monitoring the performance of investments.
- 153. In addition to monitoring at a Committee level the Funds’ performance is calculated by an external provider on a monthly basis. The external provider compiles information covering monthly, quarterly, yearly, 3, 5, 10 since inception yearly performance measures. This information is presented to the Joint Investment Strategy Panel to allow for scrutiny of the investment performance of the Funds.

Administrative Performance

- 154. The Funds’ have a Service Plan in place covering the period 2018- 2020. The Pensions Committee receive

⁶ At the time of writing, Tayside Pension Fund had not published their unaudited accounts for 2019/20

updates on the service plan at each meeting. The annual results for 2019/20 are presented in the Funds' Management Commentary.

155. The Performance Report highlights that the Funds are meeting the majority of their targets (70%) with 2 areas where performance was not in line with target levels and 1 area which has not been able to be assessed:
- Colleague engagement index – 69% against a target of 70%
 - Investment performance and risk of LPF over a rolling five-year period – benchmark not met
 - Maintain customer service excellence standard – assessment postponed due to COVID-19 outbreak

8. Appendices

Appendix 1: Respective responsibilities of the Funds and the Auditor

Responsibility for the preparation of the annual report and accounts

It is the responsibility of the Pensions Committee and the Chief Finance Officer, as Accountable Officer, to prepare financial statements in accordance with the Local Government (Scotland) Act 1973 and directions made thereunder.

In preparing the annual report and accounts, the Pensions Committee and the Chief Finance Officer, as Accountable Officer are required to:

- apply on a consistent basis the accounting policies and standards;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Code of Practice on Local Authority Accounting (the Code) have not been followed where the effect of the departure is material;
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the Lothian Pension Fund will continue to operate.

The Chief Finance Officer is also responsible for

- keeping proper accounting records which are up to date; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

Auditor responsibilities

We audit the annual report and accounts and give an opinion on whether:

- give a true and fair view, in accordance with applicable law and the Code, of the state of the affairs of the Funds as at 31 March 2018 and of the income and expenditure of the Council and its group for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the Code;
- they have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003;
- the information given in the Management Commentary is consistent with the annual report and financial statements.

We are also required to report, if in our opinion:

- adequate accounting records have not been kept; or
- the annual accounts and the part of the Remuneration and Staff Report to be audited are not in agreement with accounting records; or
- we have not received all the information and explanations we require for our audit; or
- There has been a failure to achieve a prescribed financial objective.

Wider scope of audit

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.

The Code of Audit Practice frames a significant part of our wider scope responsibilities in terms of four audit dimensions: financial sustainability; financial management; governance and transparency; and value for money.



Independence

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

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

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 £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 Audit Services. In addition to this, Azets Audit Services 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 Audit Services, the Funds', those charged with governance and senior management that may reasonably be thought to bear on our objectivity and independence.

Appendix 2: Action plan

Our action plan details the weaknesses and opportunities for improvement that we have identified during our audit.

Action plan grading structure

To assist the Funds in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated.

The rating structure is summarised as follows:

Grade	Explanation
Grade 5	Very high-risk exposure - Major concerns requiring immediate attention.
Grade 4	High risk exposure - Material observations requiring management attention.
Grade 3	Moderate risk exposure - Significant observations requiring management attention.
Grade 2	Limited risk exposure - Minor observations requiring management attention
Grade 1	Efficiency / housekeeping point.

Follow up of prior year recommendations

Of the seven recommendations raised within our 2017/18 and 2018/19 annual audit reports, we note that five have been completed and two are ongoing. Details are given below.

1. Accuracy of forecasting information

Initial rating	Issue & recommendation	Management comments
Grade 3	<p>Issue In year service update reports highlighted that a net withdrawals position was expected, however, the forecasts were significantly above the year-end position with December being 118% higher than the actual position.</p> <p>Risk There is a risk that the year-end position is significantly different to the forecast position with an adverse variance.</p> <p>Recommendation We recommend the Funds takes action to improve the quality of forecasting information presented to the Pensions Committee.</p>	<p>It should be noted that the cashflow forecasts reported to Pensions Committee as part of the regular “Service Plan update” are prepared on a strict cash basis. This differs from the year end reporting which reflects accrual of both expenditure and income.</p> <p>This clarification is highlighted in the narrative of the regular reporting to Pensions Committee.</p> <p>Relevant extract from the meeting of 26 September 2018 is -</p> <p>Membership and Cashflow monitoring</p> <p>a. The tables below detail the cashflows as at the end of July 2018 and projections for the financial year. These have been prepared on a cashflow basis (compared to the accruals basis of the year-end financial statements and budget projections).</p> <p>In future the financial statements will disclose reconciliation to the cash accounting basis together with explanatory narrative for any significant variances.</p> <p>Responsible officer: Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date: 31 May 2020</p>
Current status	Audit Update	Management response
Complete	The 2019/20 accounts have included a reconciliation to the cash accounting basis together.	Agreed

2. Registers of Interest

Initial rating	Issue & recommendation	Management comments
Grade 3	<p>Issue A compliance email has not been issued to the Pensions Board/Non-Elected Committee Members during 2018/19. This email should be sent on a quarterly basis; however, the last email was sent in March 2017.</p> <p>Risk There is a that the Funds do not hold an up to date register of interests for all the Pensions Board/Non-Elected Committee Members and is therefore unable to identify any potential related party transactions.</p> <p>Recommendation We recommend that compliance e-mails are issued in line with the stated policy.</p>	<p>Pension Board and non-elected members are required to sign a Code of Conduct, as well as making declarations to the Funds dual interest and hospitality register. The last item on the dual interest register was declared in September 2018.</p> <p>At Pension Board meetings, declaration of interest is a standing agenda item. Should there be no declarations of interest, this is recorded in the minutes.</p> <p>The Fund has been undertaking a governance review over the last few months which includes a review of the code of conduct for Pension Board and Non-elected Committee members. If the Committee approves the new Code of Conduct in September 2019, all Committee members and Board members will be required to sign the new Code of Conduct (this includes Councillors). Thereafter, an annual refresh will be required.</p> <p>Although the Fund does consider the risk to be low, it does acknowledge that compliance emails have not been sent to Pensions Board and Committee members (non-Councillors) during the financial year. To strengthen policies and procedures as well as raise the profile of compliance further, quarterly e-updates to Pension Board and Pension Committee members from September onwards will now include a compliance reminder section.</p> <p>Responsible officer: Chief Risk Officer, Lothian Pension Fund</p> <p>Implementation date: 31 October 2019</p>
Current status	Audit Update	Management response
Complete	Through our review of related parties, we have confirmed that the quarterly compliance emails have been sent throughout 2019/20 to committee members.	Agreed

3. Review of bank reconciliations

Initial rating	Issue & recommendation	Management comments
<p>Grade 3</p>	<p>Issue As part of our testing of bank reconciliations we sample checked the controls in place across the year. We noted that for one sampled month the bank reconciliation had been completed but had not been reviewed by a senior member of the finance team.</p> <p>Risk There is a risk that there is an error in the bank reconciliation which is not detected.</p> <p>Recommendation We recommend that all bank reconciliations are subject to review by an appropriate individual.</p>	<p>Change in bank account reconciliation process took place during the year to become paperless. Month -end reconciliations are completed by the Finance team and then e-mailed to Finance management to review. Reconciliations have been reviewed. The recording (sign-off) of this validation, however, has not taken place. Procedure will be reviewed to better capture and record electronic approvals.</p> <p>Responsible officer: Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date: 31 October 2019</p>
Current status	Audit Update	Management response
<p>Complete</p>	<p>Our review of bank reconciliations prepared by Lothian Pension Fund throughout the year did not identify any instances where the bank reconciliations had not been appropriately reviewed.</p> <p>We have reviewed the processes in place for the treasury system at Lothian Pension Fund and found no issues with the internal controls in place.</p>	<p>Agreed</p>

4. Verification of pensioner details

Initial rating	Issue & recommendation	Management comments
Grade 3	<p>Issue As part of our verification of controls we walked through a transfer out of a member. The sampled record did not have their date of birth confirmed or checked to supporting documentation.</p> <p>Risk This is a key control in confirming pension eligibility and could lead to an error in payments made.</p> <p>Recommendation We recommend that verification of key details are conducted in line with the stated procedures.</p>	<p>This case is an interfund transfer rather than a transfer to another pension scheme. An interfund transfer means that the member is transferring to the same scheme (LGPS) and the transfer value payment is simply a way of transferring the liability from one Fund to another.</p> <p>There is an agreement between the Scottish Funds that dates of birth do not need to be verified if already verified by one scheme. In this case, however, this did not happen in either fund.</p> <p>The existing documented LPF administration procedure already reflected requisite date of birth verification. In this case, the procedure had not been correctly followed (human error). The importance of the check has been reiterated to the pensions administration team, both orally and by e-mail communication.</p> <p>Responsible officer: Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date: 30 September 2019</p>
Current status	Audit Update	Management response
Complete	<p>Our audit work performed over transfers out of the scheme did not identify any instances where the pensioner details had not been verified as required.</p> <p>We have confirmed that the required procedures are in place to ensure that all staff are aware of the verification checks required.</p>	Agreed

5. Publication of the financial statements

Initial rating	Issue & recommendation	Management comments
<p>Grade 2</p>	<p>Observation</p> <p>In 2017/18 Lothian Pension Fund received objections to the accounts relating to the public right to inspect the accounts. The objections related to the wording in the public inspection notice and the availability of the annual report and financial statements on the Lothian Pension Fund website.</p> <p>Recommendation</p> <p>We recommend that the annual report and financial statements are posted on the Lothian Pension Fund website, following approval from the Pensions Committee and in line with the public inspection notice.</p>	<p>Recommendation is accepted. Following consideration of the Annual Report 2019 (and Financial Statements) Unaudited by Pensions Committee, this will be posted on the Lothian Pension Fund website, supplementing the prior disclosure of all the reports to that Committee on the Council's website.</p> <p>Responsible officer: Chief Executive Officer, Lothian Pension Fund</p> <p>Implementation date: June 2019</p>
Current status	Audit Update	Management response
<p>Complete</p>	<p>Our review of the public inspection notice for accounts found that the unaudited accounts were posted on Lothian Pension Fund's website for public inspection.</p> <p>We also confirmed that all the regulations had been complied with for the public inspection of accounts.</p>	<p>Agreed</p>

6. Bank accounts

Initial rating	Issue & recommendation	Management comments
Grade 3	<p>Observation</p> <p>The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010. require administering authorities to hold a separate bank account for funds and to be used to hold pension fund money.</p> <p>There is an ongoing issue that although the Funds' held their own bank accounts, monies were transferred to the City of Edinburgh Council holding account and the money was managed through this account. Actions were taken in 2017/18 to progress the issue of compliance, however, significant delays mean that during the year the Funds were not in fully compliant with the regulations.</p> <p>Recommendation</p> <p>We recommend the Funds put arrangements in place to ensure compliance with the regulations.</p>	<p>Quotation for a stand-alone ledger for the Funds was also sought from CGI, the Council's ICT provider, but this did not offer a cost-effective solution. Whilst LPF now fully anticipates a successful project delivery by the Council and CGI, with integration of the LPF requirement in the ledger specification, the option of complete separation, i.e. LPF to procure an alternative to the Council solution, is retained as "last resort".</p> <p>Responsible officer: Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date: As soon as possible, subject to the implementation of a revised financial ledger system by the Council to incorporate this functionality, or alternatively a separate procurement by LPF.</p>

Current status	Audit Update	Management response
Ongoing	<p>The resolution of this issue is linked to the procurement of a new ledger system which has not progressed in 2019/20.</p>	<p>The Fund continues to investigate the possibility of retaining the Oracle accounting system and implementing a "separate book of accounts" to the Council. The Fund has requested a random order of magnitude quotation (ROM), through the Council contract with CGI, for this enhancement. This is being pursued, although it is acknowledged that any implementation would be dependent upon the prior upgrade by the Council to Oracle (version 12). The alternative option of completely separate ledger solution to that of the Council remains.</p> <p>Even if a "separate book of accounts" is achieved by either of these means, it is emphasised that the Fund may continue to require to operate a Council bank account. As is typical within the Local Government Pension Schemes (LGPS), arrangements exist whereby additional discretionary unfunded teachers' and employee pensions are paid with the payment of funded pensions. In order that such are not regarded as "unauthorised payments" by HMRC, these pension payments are met by the administering authority through a general fund bank account and recharged to the body or service which granted the benefits. As disclosed in its Annual Report for the last two years, the Fund has approached the SPPA with a proposal to transfer the administration of all unfunded payments to SPPA, thus eliminating the need for a Council bank account. SPPA has advised that it is currently evaluating the business case and a definitive response is expected shortly.</p>

7. User access controls

Initial rating	Issue & recommendation	Management comments
Grade 3	<p>Observation</p> <p>Our review of the journals environment identified that all City of Edinburgh Council staff with access to Oracle, the financial ledger system, have the ability to post to the Funds' financial ledgers.</p> <p>Recommendation</p> <p>While our audit review in respect of the 2017/18 financial year did not identify any indications of user access being manipulated, we recommend that the Funds' officers in conjunction with City of Edinburgh Council review user access controls for the financial ledger.</p>	<p>Recommendation is accepted.</p> <p>Responsible officer: Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date: March 2019</p>

Current status	Audit Update	Management response
Ongoing	<p>This is an ongoing issue in 2019/20, however, we did not identify any instances where journals were posted by inappropriate users.</p>	<p>Limitations of the current Oracle system preclude an automated solution to this issue, by either the Council or the Fund. Per follow up action 6, the Fund continues to explore the possibility of having its own self-contained book of accounts. The successful implementation of this would give the Fund full control of access to its ledger.</p>



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