



Lothian Pension Fund

External Audit Annual Plan 2021/22

March 2022



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Introduction



Introduction

1. This document summarises the work plan for our 2021/22 external audit of Lothian Pension Fund and the Scottish Homes Pension Fund (collectively referred to as the “Funds”).
2. The core elements of our work include audits of:
 - the 2021/22 annual report and accounts and related matters;
 - the Funds’ arrangements for governance and transparency, financial management, financial sustainability and value for money;
 - the Funds’ participation in the National Fraud Initiative (NFI); and
 - any other work requested by Audit Scotland.
3. This document summarises the work plan for our 2021/22 external audit of the Board for the six year period 2016/17 to 2021/22¹. This document reflects the audit plan for 2021/22 and summarises;
6. This document reflects the audit plan for 2021/22 and summarises:
 - the responsibilities of Azets as the external auditor;
 - our audit strategy;
 - our planned audit work and how we will approach it;
 - our proposed audit outputs and timetable; and
 - background to Azets and the audit management team.

Audit appointment

3. The Accounts Commission is an independent body appointed by Scottish Ministers responsible for securing the audit of local authorities and other local government bodies. The Commission’s work is governed mainly by the Local Government (Scotland) Act 1973.
4. Audit Scotland is an independent statutory body that provides the Accounts Commission with the services required to carry out its statutory functions, including monitoring the performance of auditors through a quality control process.
5. The Accounts Commission has appointed Azets as external auditor of

Auditor independence

7. 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.
8. Azets is also responsible for the audit of the financial statements of the subsidiaries of Lothian Pension Fund, LPFE Ltd and LPFI Ltd. In addition to the audit of the subsidiaries, Azets provides accounts preparation, corporation tax services and ad hoc VAT advice to both LPFE Ltd and LPFI Ltd. In 2021/22 non-audit fees are estimated to be approximately £8,000.
9. We have outlined the safeguards to our independence in Appendix 2. We confirm that we complied with the Financial Reporting Council’s (FRC)

¹ In October 2020, the Accounts Commission extended our audit appointment for one year through to the audit of the 2021/22 financial year to provide

continuity and stability in the current challenging environment.

Ethical Standard. In our professional judgement, we remained independent and our objectivity has not been compromised in any way.

Adding value through the audit

10. All of our clients demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to the Funds through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Funds promote improved standards of governance, better management and decision making and more effective use of resources.

Feedback

11. Any comments you may have on the service we provide, the quality of our work and our reports would be greatly appreciated at any time. Comments can be reported directly to any member of your audit team.

Openness and transparency

12. This report will be published on Audit Scotland's website www.audit-scotland.gov.uk.

Respective responsibilities of the auditor and the Funds



Respective responsibilities of the auditor and the Funds

Auditor responsibilities

Code of Audit Practice

13. 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

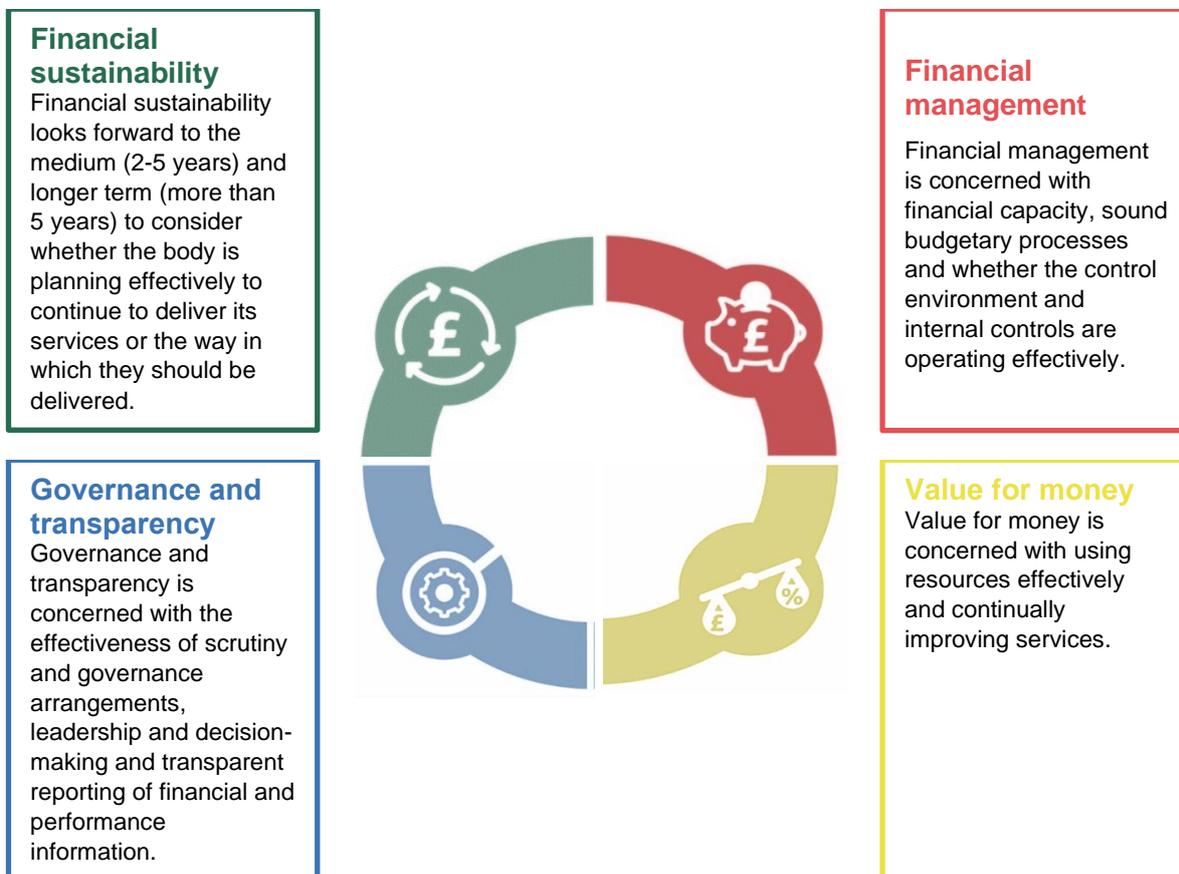
14. Auditor responsibilities are derived from statute, the Code of Audit Practice, International Standards on Auditing (UK), professional requirements and best practice. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on the financial statements;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries and remuneration reports;
- notify the Controller of the Audit when circumstances indicate that a statutory report may be required
- demonstrate compliance with the wider scope of public audit.

Wider scope audit work

15. The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements, but on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.
16. The Code of Audit Practice sets out four audit dimensions that frame the wider scope audit work into identifiable audit areas. These are summarised in Exhibit 1.

Exhibit 1: Audit dimensions within the Code of Audit Practice



17. We have concluded that application of the full wider scope is appropriate at the Funds.
18. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code of Audit Practice and may not be all that exist. Communication by Azets of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Best Value

19. Appointed auditors have a duty to be satisfied that local government bodies have made proper arrangements to secure best value.
20. Our work in respect of the Funds best value arrangements will be integrated into our audit approach, including our work on the wider scope audit dimensions as set out in this plan.
21. Audit Scotland has requested that external auditors focus on the audited body's arrangements relating to the best value theme of fairness and equality. We will consider this in the context of our wider scope audit work

and include commentary in our annual audit report as appropriate.

Funds responsibilities

22. The Pension Committee have primary responsibility for ensuring the proper financial stewardship of public funds,

compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives. The Funds responsibilities are summarised in Exhibit 2.

Exhibit 2: Funds responsibilities

Area	Funds responsibilities
<p>Financial statements: Annual accounts containing financial statements and other related reports should be prepared.</p>	<p>The Funds and the Chief Finance Officer have responsibility for:</p> <ul style="list-style-type: none"> • preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures; and • preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements.

Area	Funds responsibilities
<p>Financial sustainability: Financial sustainability looks forward to the medium and longer term to consider whether the organisation is planning effectively to continue to fulfil its functions in an affordable and sustainable manner.</p>	<p>The Funds are responsible for putting in place proper arrangements to ensure the financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> • such financial monitoring and reporting arrangements as may be specified; • compliance with any statutory financial requirements and achievement of financial targets; • balances and reserves, including strategies about levels and their future use; • how the organisation plans to deal with uncertainty in the medium and long term; and • the impact of planned future policies and foreseeable developments on the financial position.
<p>Financial management: Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<p>The Funds are responsible for ensuring that financial affairs are conducted in a proper manner. Management are responsible, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance.</p> <p>The Funds are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at its disposal.</p> <p>The Funds are responsible for establishing arrangements to prevent and detect fraud, error and irregularities, bribery and corruption and also to ensure that its affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.</p>

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

Audit strategy

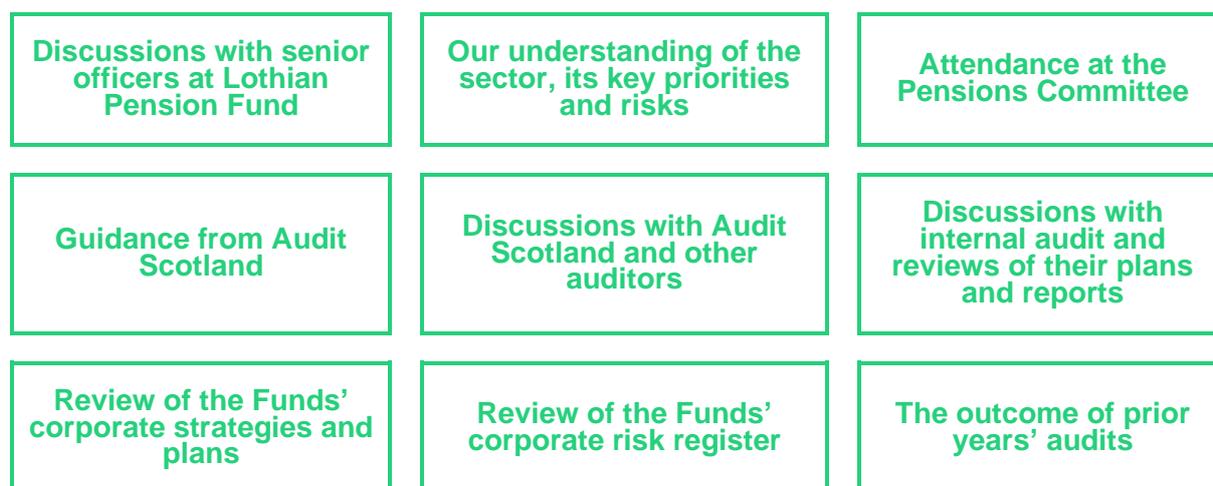


Audit strategy

Risk-based audit approach

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

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



24. 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.

(UK (ISAs (UK)), the International Standard on Quality Control 1 (UK), the Ethical Standard, and applicable Practice Notes and other guidance issued by the Financial Reporting Council (FRC).

Communication with those charged with governance

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

Partnership working

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

Professional standards and guidance

26. We perform our audit of the financial statements in accordance with International Standards on Auditing

Audit Scotland

28. Although we are independent of Audit Scotland and are responsible for forming our own views and opinion, we do work closely with Audit Scotland

throughout the audit. This helps, for example, to identify common priorities and risks, treat consistently any issues arising that impact on a number of audited bodies, and further develop an efficient and effective approach to public audit. We 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.

29. Audit Scotland undertakes national performance audits on issues affecting the public sector. We will review the Funds' arrangements for taking action on any issues reported in the national performance reports which may have a local impact. We also consider the extent to which the Funds use the national performance reports as a means to help improve performance at the local level.

Internal Audit

30. We will consider the work of internal audit within our audit process and look to minimise duplication of effort, to ensure the total audit resource to the Funds' is used as efficiently and effectively as possible.

Service organisations

31. The Funds' uses the City of Edinburgh Council ("the Council") to provide financial ledger services. We will work with the Council to understand the controls in place.

COVID-19 – impact on our 2021/22 audit strategy

32. The COVID-19 pandemic has had, and continues to have, a significant

and profound effect on Scottish society.

33. We appreciate that different organisations have been impacted differently by COVID-19, as have finance teams, and some organisations are better set up for remote working. We also know that plans can change quickly and it only takes the absence of one key member of staff from a finance team to have a big impact. Equally our own teams may also be impacted by the pandemic. The wellbeing of our clients and our staff is paramount. Maintaining a pragmatic and flexible approach will enable change at short notice as new issues emerge, or current risks change in significance.

Remote working

34. We are operating on the basis that we will carry out our 2021/22 audit remotely, whilst keeping this under a watching brief. As in previous periods of auditing during the pandemic, we have the following arrangements in place:

- all of our people have the equipment, technology and systems to allow them to work remotely, including secure access to all necessary data and information;
- all of our staff are fully contactable by email, phone call and video-conferencing;
- meetings are held over Skype, Microsoft Teams or by telephone; and
- we are keeping all of our staff fully up to date with the latest government guidance in order to keep everyone as safe as possible.

35. If resourcing levels in any part of our business are compromised due to illness or inability to work, we will refocus our teams as necessary to deliver to deadlines. Our teams are holding regular catch ups to allow us to re-prioritise workloads as necessary.

Secure sharing of information

36. We use a cloud-based file sharing service that enables users to easily and securely exchange documents.

Audit evidence

37. Working remotely, does unfortunately result in the audit team requesting audit evidence which we would have previously obtained through other means, for example, face to face meetings or access to systems and client premises.
38. Where required we will consider other ways in which we can obtain audit evidence or carry out alternative audit procedures.
39. We will employ greater use of technology to examine evidence, but only where we have assessed both the sufficiency and appropriateness of the audit evidence produced.

Regular contact

40. During the 'fieldwork' phase of our audit, we will look to agree 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.

Audit reporting

41. It may be that the current circumstances lead to more modified opinions in auditor's reports, than

would typically have been the case in previous years.

42. Where necessary, we will engage with the Pension Committee to explain the implications of our proposed report and consider whether there are other procedures that could be undertaken, at a future point yet to be determined, which could mitigate any modification either fully or in part.
43. Sufficient time should be set aside by the Pension Committee to allow for comprehensive, complete and informed communication with the auditor. This will need to take account of the potential for extended communication to explain any modified audit reports, or to report any higher than expected deficiencies or misstatements, that may result from the current circumstances.
44. Similar to the last two years we propose to use DocuSign which is a system for electronic signatures recommended by Audit Scotland for all bodies for signing annual accounts.
45. Electronic signatures simplify the process of signing the accounts. Accounts can be signed using any device from any location. There is no longer a need for duplicate copies to be signed, thus reducing the risk of missing a signature and all signatories have immediate access to a high quality PDF version of the accounts.

Annual report and accounts



Annual Accounts

Introduction

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

Approach to audit of the financial statements

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

Risk-based audit planning

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

An audit of key systems and internal controls

49. We evaluate the key accounting systems and internal controls and determine whether they are adequate to prevent material misstatements in the financial statements

50. The systems we review and the nature of the work we perform will be based on the initial risk assessment. We will examine and test compliance with best practice and the Funds' policies and procedures.

51. We will take cognisance of any relevant internal audit reviews of systems and controls.

52. Since the start of the pandemic, the risk of fraud and error has increased as the control environment and internal controls change. Potential areas of risk include:

- public sector staff working under extreme pressure leading to some internal controls being suspended or relaxed;
- procurement fraud or normal controls being relaxed to allow bodies to buy goods or services which are required urgently, possibly from new suppliers;
- weakened governance arrangements;
- admin and finance staff being redeployed to operational areas; and
- staff working remotely may pose potential security risks, e.g. when using personal devices and/or using removable devices to download data.

53. We will update the risk assessment following our evaluation of systems and controls, considering the impact the pandemic has had on the Funds' accounting systems and controls. This will ensure that we continue to focus attention on the areas of highest risk.

54. 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 to you. The scope of our work is not designed to be an extensive review of all internal controls.

Prevention and detection of fraud or error

55. We plan our audit in such a way as to obtain reasonable assurance of detecting material misstatements in the financial statements resulting from fraud or error.
56. 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.
57. We will assess the susceptibility of the Funds' financial statements to material misstatement, including obtaining an understanding of how fraud might occur, by:
- making enquiries of management as to where they considered there was susceptibility to fraud, their knowledge of actual, suspected and alleged fraud; and
 - considering the internal controls in place to mitigate risks of fraud and non-compliance with laws and regulations.
58. Our work as auditor is not intended to identify any instances of fraud of a non-material nature and should not be relied upon for this purpose. Material misstatements that arise due to fraud can be harder to detect than those that

arise from error as they may involve deliberate concealment or collusion.

Laws and regulations

59. We plan and perform our audit recognising that non-compliance with statute or regulations may materially impact the financial statements. Our audit procedures include the following:
- identification of the laws and regulations applicable to the Funds through enquiries with management, and from our knowledge and experience of the Funds and sector;
 - a focus on specific laws and regulations which we consider may have a direct material effect on the financial statements or the operations of the Funds;
 - reviewing minutes of relevant meetings;
 - enquiring of management and the Funds' legal representatives the position in relation to litigation, claims and assessments; and
 - performing detailed testing of transactions and balances.
60. There are however inherent limitations in our audit procedures described above. The more removed that laws and regulations are from financial transactions, the less likely it is that we would become aware of non-compliance.

A final audit of the financial statements

61. During our final audit we will test and review the material amounts and disclosures in the financial statements. The extent of testing will be based on our risk assessment.

62. Our final audit will seek to provide reasonable assurance that the annual accounts are free from material misstatement and comply with the Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 (the Code).

Assurances from employers' auditors

63. As part of our audit of the financial statements of the Funds, we ask the auditors of a sample of employers within the Funds to conduct testing on employer and employee contributions and the control environment in place to ensure that the employer submissions are accurate.
64. These requests are made in line with Audit Scotland's Protocol for Auditor Assurances 2021/22 – Local Government Pension Schemes.

Independent auditor's report

65. Our opinion on whether the financial statements give a true and fair view of the financial position and net expenditure will be set out in our independent auditor's report which will be included in the annual report and accounts.
66. We also provide an opinion on other prescribed matters including the audited part of the remuneration report, annual governance statement, governance compliance statement and management commentary.

Group accounts

67. Lothian Pension Fund prepares its financial statements on a group basis. The group consists of Lothian Pension Fund and two special purpose vehicles, LPFE Ltd and LPFI Ltd.
68. As part of our audit we will review the consolidation working papers to

ensure the group accounts accurately reflect the merged activities of the Lothian Pension Fund, and both subsidiaries.

Materiality

69. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement. We review our assessment of materiality throughout our audit.
70. Our initial assessment of materiality for each Fund is set out in the table below. The Funds hold significant investment assets, which form the largest part of the net asset statements for each pension fund. The primary business of the Funds is to hold sufficient assets to generate returns to meet future pension obligations. We consider that the net assets are of primary interest to the reader of the annual report and accounts. We therefore use net assets to inform our assessment of overall materiality.
71. ISA (UK) 320 states that in certain circumstances it is appropriate to set a materiality amount for particular classes of transactions for which lesser amounts than the overall materiality could influence the decisions of users of the accounts. We consider transactions when dealing with members (i.e. contributions and expenditure incurred providing payments to pensioners) to be of key interest to the users. This is

- reported in the first section of the Fund Account and contains information about the day to day operation of the Funds. We have therefore set a separate materiality based on the expenditure incurred for providing payments to pensioners.
72. Our initial assessment of overall materiality is based on approximately 1.5% of net assets. One of the main functions of LPF is to invest appropriately to fund the pensions of members. As a result, net assets are seen to be one of the principal considerations for users of the accounts.
73. Our initial assessment of dealings with members materiality is based on approximately 5% of expenditure. The main dealing with members that the Funds undertake is the collection of contributions and the payment of pensions and lump sums. Therefore, the income and expenditure of the Funds will be a principal consideration for users of the accounts.
74. 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.
75. 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.
76. We will also report any misstatements identified through our audit that fall into one of the following categories:
- all material corrected misstatements;
 - uncorrected misstatements for the group and LPF with a value in excess of £250,000, SHPF with a value in excess of £125,000; and
 - other misstatements below the £250,000 threshold that we believe warrant reporting on qualitative grounds.

	Group	Lothian Pension Fund	Scottish Homes	Explanation
	£million	£million	£million	
Overall materiality for the financial statements	128	128	2.3	<p>Our initial assessment is based on approximately 1.5% of the group and Funds' 2020/21 net investment assets as disclosed in the 2020/21 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> <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>
Performance materiality	96	96	1.7	Using our professional judgement we have calculated performance materiality at approximately 75% of overall materiality.

	Group	Lothian Pension Fund	Scottish Homes	Explanation
	£million	£million	£million	
Special materiality for dealings with members	12.5	12.5	0.37	<p>Our initial assessment is based on approximately 5% of the group and Funds' 2020/21 gross expenditure as disclosed in the 2020/21 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> <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>

Performance materiality for dealings with members	9.5	9.5	0.28	Using our professional judgement we have calculated performance materiality at approximately 75% of overall materiality.
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Key audit risks in the financial statements

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

Exhibit 3 – Key audit risks in the financial statements

Management override

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

78. In response to this risk we will review the Funds' accounting records and obtain evidence to ensure that any significant transactions outside the normal course of business are valid and accounted for correctly. We will adopt data analytics techniques to review and test aspects of this significant risk. We will assess whether judgements and assumptions made in determining accounting estimates as set out in the annual accounts are indicative of potential bias.

Revenue recognition

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

79. 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.
80. However, the risk of fraud in relation to revenue recognition is present in all other revenue streams. We will evaluate each material revenue stream, including the controls over revenue accounting. We will conduct substantive testing on all material revenue streams to confirm revenue has been recognised appropriately and in line with accounting policies.

Risk of fraud in the recognition of expenditure

As most public sector bodies are net spending bodies, the risk of fraud is more likely to occur in expenditure. There is an increased risk that expenditure may be misstated due to improper recognition of expenditure, resulting in a material misstatement in the financial statements.

81. We have evaluated the significant non-pay expenditure. Benefits payable to members is subject to separate tailored testing. We do not consider the risk of fraud in the recognition of expenditure to be significant due to materiality. We will, however, continue to monitor this position throughout the audit.

Investment valuations (significant accounting estimate)

The Funds held investments of £8.686 billion as at 31 March 2021, of which 30% (£2.645 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.

82. We will ensure that investments 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 the design and implementation of controls present at the scheme for ensuring the accurate valuation of investments.
83. We will consider the competence, capability and objectiveness of the fund managers in line with ISA (UK) 500 Audit Evidence. We will review the investment valuations and confirm the valuations to external sources of evidence. We will assess the nature and basis of estimated values and consider what assurances management has over the year end valuations provided for these investments.

Investment Property valuations (significant accounting estimate)

LPF hold a portfolio of investment properties which as at the 31 March 2021 was valued at £370 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.

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.

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84. We will ensure 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.
 85. We will consider 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. In addition, we will consider the scope of the valuer's work and the information provided to the valuer for completeness.

Present Value of Retirement Obligations (significant accounting estimate)

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.

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

Other risk factors

Impact of COVID-19 on the financial statements

87. Further to the identification of significant audit risks, we also continue to monitor the impact COVID-19 could have on the financial statements. COVID-19 continues to present unprecedented challenges to the operation, financial management and governance of organisations, including public sector bodies.
88. We continue to monitor government and relevant announcements as they pertain to the audit and will adapt our audit approach as required.

Key accounting estimates

89. Changes to ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures, which is applicable for accounting periods beginning on or after 15 December 2019, places increased regulatory requirements on the auditor in respect of the auditing of significant estimates at the planning and completion stages of the audit.

90. As part of the planning stages of the audit we identify all accounting estimates made by management and determine which of those are significant to the overall annual accounts. Consideration was given to present value of retirement obligations, investment valuations, investment property valuations, accruals, provisions, and depreciation. Other than present value of retirement obligations, investment valuations, investment property valuations, we have not determined the accounting estimates to be significant. We will however revisit our assessment during the fieldwork and completion stages of our audit.

Wider scope audit



Wider scope audit

Introduction

91. As described in section 2, the Code 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.
92. Our planned audit work against these four areas is risk based and proportionate. Our initial assessment builds upon the understanding of the Funds’ key priorities and risks which we developed from previous years, along with discussions with management and review of committee minutes and key strategy documents.
93. We have identified one significant risk to the wider scope of our audit (Exhibit 4). We have not, at this stage, identified any significant risks in relation to the other dimensions.
94. 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
95. Audit planning is a continuous process and we will report any identified significant risks, as they relate to the four dimensions, in our annual audit report. Exhibit 5 summarises our audit work in respect of each dimension.

Exhibit 4 – Wider scope significant risks

Financial sustainability: Market volatility

The Funds held investments of £8.842 billion as at 31 March 2021. 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 and other worldwide political events had a significant impact on the market in 2019 and 2020. While 2021 saw a return to improved performance, a significant risk remains particularly in relation to the tapering off of government support, impact of the increased inflation and uncertainty over the new COVID variants. There is a risk that the value of investments is significantly impacted by events within the wider environment.

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

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



Financial sustainability

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

Consideration	Our audit approach
<p>In 2020/21 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. Despite strong absolute performance in 2020/21, performance against benchmark declined for one-year, five-year and ten-year annualised investment returns. No benchmark is set for Scottish Homes Pension fund as investments are held in gilts.</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 an improvement on the previous triennial valuation where the funding levels were 98% and 105% respectively.</p>	<p>As part of our work on financial sustainability work in 2021/22 we will review, conclude and report on:</p> <ul style="list-style-type: none"> • the arrangements in place for medium to long term financial planning, budgetary control and financial reporting; • the continued applicability of the 2020 actuarial valuation and the conclusions on funding levels across the Funds; • affordability for employers including the number of employer cessations and current membership levels of the Funds; and • any changes following the Review of the Structure of the Scottish Local Government Pension Fund.



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 2020/21 we concluded that the Funds have effective arrangements in place for financial management and the use of resources.

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.

The Lothian Pension Fund was in a net addition position as at 31 March 2021 due to the one of transfer in of £58 million for the consolidation of VisitScotland’s pension scheme into the LPF. The Scottish Homes Pension fund was in a net withdrawal position. The reliance on investment income in the Scottish Homes Pension fund is therefore increased in order to meet the long term cash flow needs.

Our audit approach

During our 2021/22 audit we will review, conclude and report on the following:

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



Governance and transparency

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

Consideration	Our audit approach
<p>The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.</p> <p>The Pensions Committee and Pensions Audit Sub-Committee meetings are held in public, papers are available in advance and minutes of the meetings are published on the City of Edinburgh Council’s website.</p>	<p>As part of our work on governance and transparency work in 2021/22 we will review, conclude and report on:</p> <ul style="list-style-type: none"> • 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; and • the transparency of decision-making, and on financial and performance reporting.



Value for money

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

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.

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 2020/21 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 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

As part of our 2021/22 audit we will review, conclude and report on the following:

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

Audit outputs, timetables and fees



Audit outputs, timetable and fee

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

Audit Scotland has set target dates for 2021/22 which transition to more regular timescales. This is subject to agreement with the Scottish Government, and Audit Scotland will confirm the dates in due course. Audit Scotland has provisionally set a target date of 31 October (which requires a further amendment to the accounts regulations for 2021/22).

We have set out below target months which align to the Funds' annual accounts timetable and 2022 schedule of Pension Committee and Pension Audit Sub-committee meetings. We will 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 as a result of the pandemic.

Audit output	Description	Target month	Deadline for submission to Audit Scotland
External audit plan	This report sets out the scope of our audit for 2021/22.	March 2022	31 March 2022
Independent Auditor's Report	This report will contain our opinion on the financial statements, the audited part of the remuneration report, annual governance statement, governance compliance statement, and management commentary.	September 2022	31 October 2022
Annual Report to the Funds 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 2022	31 October 2022

Audit outputs

98. Prior to submitting our outputs, we will discuss all issues with management to confirm factual accuracy and agree a draft action plan where appropriate.
99. 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

100. Audit Scotland sets an expected fee for each audit carried out under appointment that assumes the body has sound governance arrangements in place, has been operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for audit. The expected fee is reviewed by Audit Scotland each year and adjusted if necessary based on auditors' experience, new requirements, or significant changes to the audited body.
101. 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.
102. The expected fee set by Audit Scotland for the 2021/22 audit of the Funds is £45,840. We propose setting the 2021/22 audit fee at £48,819, which represents an uplift of 6.5% on the expected fee and a 3% increase on the 2020/21 fee. This uplift reflects the relative scale of the Funds and the significant audit work required to conduct a full wider scope audit under the Code of Audit Practice, including

the related significant risks reported in this plan.

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

	2020/21	2021/22
Auditor remuneration	£41,388	£42,579
Pooled costs	£3,690	£4,130
Audit support costs	£2,310	£2,110
Total fee	£47,388	£48,819

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

Audit timetable

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

JAN 22	●	Planning meeting to inform the 2021/22 audit
MAR 22	●	Presentation of External Audit Plan to the Pension Committee
JUL 22	●	Accounts presented for audit and final audit visit begins
AUG 22	●	Presentation of our Annual Report on the Audit to the Pension Committee
SEP 22	●	Annual accounts presented to Pension Committee for approval

Appendices



Appendix 1: Azets

Azets is an international accounting, tax, audit, advisory and business services company that delivers a personal experience, both digitally and at your door.

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

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



Nick Bennett

Audit Partner

nick.bennett@azets.com

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.



Adrian Kolodziej

Senior Manager

adrian.kolodziej@azets.co.uk

Adrian has 13 years' experience delivering successful, high quality audits across the public and third sector audits. Adrian has worked with a wide range of organisations including local government pension schemes, arms length external organisations and central government bodies during his time in audit.

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

Appendix 2: Confirmation of independence

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

In particular, FRC's Ethical Standard stipulates 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 2021/22 non-audit fees are estimated to be approximately £8,000.

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 Standard. 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 3: Statement of understanding

Introduction

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

Annual report and accounts

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

Scope of audit

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

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

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

Internal audit

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

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

Fraud and irregularity

In order to discharge our responsibilities regarding fraud and irregularity we require any fraud or irregularity issues to be reported to us as they arise. In particular we require to be notified of all frauds which:

- involve the misappropriation of theft of assets or cash which are facilitated by weaknesses in internal control; and
- are over £5,000.

We also require a historic record of instances of fraud or irregularity to be maintained and a summary to be made available to us after each year end.

Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 impose an obligation on the Auditor General to inform

the National Crime Agency (NCA) if he knows or suspects that any person has engaged in money laundering or terrorist financing. Audit Scotland has extended this responsibility to the Accounts Commission in respect of local government.

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

Ethics

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

Fees

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

Service

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

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

Reports

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

Any recommendations arising from our audit work will be included in an action plan. Management are responsible for providing responses, including target dates for implementation and details of the responsible officer.

Agreement of terms

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



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