



Scott-Moncrieff
business advisers and accountants

Lothian Pension Funds

2017/18 Annual Audit Report to Members and
the Controller of Audit

September 2018

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Key messages

Annual report and financial statements

Lothian Pension Funds approved the annual report and financial statements for 2017/18 on 26 September 2018. We reported unqualified opinions on the financial statements and other prescribed matters for Lothian Pension Fund, Lothian Buses 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.

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

Financial sustainability

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

The Funding Strategy Statement has been updated to ensure investment assets are sufficient to meet the full cost of past service benefits.

There is an ongoing risk that the pension scheme is not affordable for admitted bodies and as part of the triennial valuation Lothian Pension Fund required all bodies to conduct an affordability assessment.

Financial management

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

Lothian Pension Fund’s investment performance decreased in 2017/18 and was below the short term benchmark and national average. Medium and long term performance, however, remained above benchmark levels.

Governance & 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.

Value for money

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

The Funds have appropriate arrangements in place to monitor performance of investments and the administration of the Funds.

Key facts

- The net investment assets of Lothian Pension Fund increased by 1% to £6,628 million (2016/17: £6,568 million).
- Return on investments in 2017/18 was 1.4%, which was behind the benchmark of 3.6%, however, the performance over the five and ten year period to 31 March 2018 exceeded the benchmark by an average of 1.1%.
- Lothian Pension Fund reported a net withdrawal position for the second consecutive year with the withdrawal position increasing by 86% to £17.035 million.
- Membership of Lothian Pension Fund continued to grow to 78,856 members, an increase of 3.8%.

Conclusion

This report concludes our audit for 2017/18. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK) and Ethical Standards.

Scott-Moncrieff

September 2018

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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 2017/18.

We carry 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.

At the Lothian Pension Funds, the Pensions Committee has been designated as "those charged with governance".

Introduction

1. Audit Scotland appointed Scott-Moncrieff as auditor to the Funds for the five year period from 2016/17 to 2020/21.
2. The scope of the audit was set out in our External Audit Annual Plan, which was presented to the Pensions Committee on 26 March 2018. The audit was planned in accordance with the revised Code of Audit Practice issued by Audit Scotland in May 2016.

We use this report to summarise our:

- opinion on significant issues arising from our external audit for the year ended 31 March 2018; and
- consideration of the wider dimensions of public audit work, as set out in Exhibit 1, below.

Exhibit 1: Audit Dimensions within the Code of Audit Practice



Source: Code of Audit Practice, May 2016

3. The Funds are responsible for preparing annual report and accounts that 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. This report contains an action plan with specific recommendations, responsible officers and dates for implementation. We give each recommendation a grading to help the Funds assess its significance and prioritise the actions required.
5. We discussed and agreed the content of this report with the Chief Executive Officer and Chief Finance Officer. We would like to thank all members of the Funds' management and staff who have been involved in our work for their co-operation and assistance during our audit work.
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.

Confirmation of independence

7. We confirm that we have complied with Financial Reporting Council's (FRC) Revised Ethical Standard (June 2016). In our professional judgement, the audit process is independent and our objectivity has not been compromised in any way.

Adding value through the audit

8. 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 council 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 Board promote improved standards of governance, better management and decision making and more effective use of resources.

Feedback

9. 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
10. While this report is addressed to the Funds, it will be published on Audit Scotland's website
www.audit-scotland.gov.uk

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Annual report and financial statements

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

In this section we summarise the findings from our audit of the 2017/18 annual report and accounts.

Annual report and financial statements

The annual report and financial statements for the year ended 31 March 2018 were approved by the Pensions Committee on 26 September 2018. 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.

The governance statement disclosures are deemed to be appropriate and highlights that in 2017/18 internal audit reported that significant enhancements were required to the Funds' control environment.

Overall conclusion

Unqualified audit opinions

11. The annual report and financial statements for the year ended 31 March 2018 were approved by the Pensions Committee on 26 September 2018. We reported within our independent auditor's report:

- an unqualified opinion on the financial statements; and
- an unqualified opinion on other prescribed matters.

12. We are also satisfied that there are no matters which we are required to report to you by exception.

Good administrative processes were in place

13. We received draft financial statements and supporting papers of a good standard, in

line with our agreed audit timetable. Our thanks go to management and staff for their assistance.

Our assessment of risks of material misstatement

14. 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. We designed our audit procedures relating to these matters 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 financial statements 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. 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 transactions in such a way as to lead to a material misstatement in the reported financial position.

Excerpt from the 2017/18 External Audit Plan



15. 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.
16. 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.

2. Risk of fraud in the recognition of expenditure

The FRC published Practice Note 10 which applies to the audit of financial statements for periods commencing after June 2016. The 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 2017/18 External Audit Plan



17. 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.

3. 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*.

Excerpt from the 2017/18 External Audit Plan



18. We have not identified any indications of management override in the year. We have reviewed the Funds' accounting records and obtained evidence to ensure that transactions outside the normal course of business 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.

4. Valuation of investments

The Funds held investments of £6.569billion as at 31 March 2017 of which 30% (£2.069 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 publically 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 2017/18 External Audit Plan



19. In 2017/18, the value of level 2 and 3 investments rose by 5% to £2.184 billion increasing as a proportion of overall investments to 33% (31% in 2016/17). 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.
20. 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.
21. 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.
22. The disclosures within the annual report and financial statements are consistent with the information provided by the custodian.

5. Pension liability assumptions

An actuarial estimate of the pension fund liability is calculated on an annual basis under IAS 19 and on a triennial funding basis by an independent firm of actuaries with specialist knowledge and experience. The latest triennial valuation was as at 31 March 2017 and sets rates for the three-year period commencing 1 April 2018. The estimates are based on the most up to date membership data held by the pension fund 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 data provided to the actuary is not complete and that assumptions used are not appropriate.

Excerpt from the 2017/18 External Audit Plan



23. We have reviewed the controls in place for providing information to the actuary and found them to be sufficient. We obtained the information provided to the actuary and agreed to source documentation to confirm the accuracy of data provided. We did not identify any issues from the work performed.
24. The assumptions used by the actuary were compared to the benchmarks across the sector and we concluded that these were reasonable.

Our application of materiality

25. 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 annual accounts.
26. On receipt of the draft 2017/18 accounts, we reassessed materiality which resulted in a change to the level of materiality applied. Our

revised assessment of materiality along with our planning materiality for each Fund is set out in the table below. A key target for the Funds is to manage investments appropriately in order to generate sufficient income to meet the future pensioner needs. We consider net investment assets to be one of the principal considerations for the users of the accounts when assessing financial performance. We have therefore used this as a base for our materiality.

27. 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.

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.

28. ISA 320 states that in certain circumstances it is appropriate to set a materiality amount for

	Overall planning materiality £ million	Dealings with members overall planning materiality £ million	Overall Final materiality £ million	Dealings with members overall final materiality £ million
Lothian Pension Fund (group) ¹	98.5	10.6	100	10.7
Lothian Pension Fund (single entity)	98.5	10.6	100	10.7
Lothian Buses Pension Fund	7.3	0.6	7.6	0.6
Scottish Homes Pension Fund	2.6	0.4	2.3	0.4

Performance materiality

29. Performance materiality is the amount set by the auditor at less than overall materiality for the annual accounts as a whole to reduce to an appropriately low level the probability that the aggregate of the uncorrected and undetected misstatements exceed materiality for the annual accounts as a whole.

30. We set a performance (testing) materiality for each area of work which is based on a risk assessment for that area. We have performed audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we performed a greater level of testing on the areas deemed to be of significant risk of material misstatement. Performance testing thresholds used are set out in the following table:

	Area risk assessment £million		
	High (50%)	Medium (60%)	Low (75%)
Lothian Pension Fund (group and parent)	50	60	75
Lothian Buses Pension Fund	3.8	4.6	5.7
Scottish Homes Pension Fund	1.3	1.5	1.9

31. We agreed to report any misstatements identified through our audit that fall into one of the following categories:

- All material corrected misstatements;

¹ Lothian Pension Fund group comprises Lothian Pension Fund, LPFE Ltd and LPFI Ltd

- Uncorrected misstatements over £250,000, less than 1% of the overall materiality figure;
- Misstatements below the £250,000 threshold we believe warrant reporting on qualitative grounds.

Audit differences

32. 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 2017/18 financial statements.
33. We identified some disclosure and presentational adjustments during our audit, which have been reflected in the final annual report and financial statements.

An overview of the scope of our audit

34. We detailed the scope of our audit in our External Audit Plan. We presented the plan to the Pensions Audit Sub-Committee on 26 March 2018. The plan explained that 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. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.
35. At the planning stage we identified the significant risks that had the greatest effect on our audit. We then designed audit procedures to mitigate these risks.
36. Our standard audit approach is based on performing a review of the key accounting systems in place, substantive tests and detailed analytical procedures. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit manager and audit partner. In performing our work, we have applied the concept of materiality, which is explained earlier in this report.

Other matters identified during our audit

37. During the course of our audit we noted the following:

The Local Authority Accounts (Scotland) Regulations 2014

38. As part of our audit we reviewed the Funds' compliance with the Local Authority Accounts (Scotland) Regulations 2014, in particular with respect to regulations 8 to 10² as they relate to the annual report and financial statements.
39. In 2017/18 we received an objection to the notice of the public right to inspect. Upon review there was found to be an inaccuracy with the inspection notice, which was subsequently rectified. In addition it was noted that the accounts were not available through the Lothian Pension Fund website from the beginning of the inspection period. While the financial statements were available on the City of Edinburgh Council website as part of the Pensions Committee papers, we would recommend that in future they are also placed on the Lothian Pension Fund website following Committee approval.

Action plan point 1

40. Overall we concluded that appropriate arrangements are in place to comply with these Regulations.

Management commentary

41. The management commentary is a requirement of the Local Authority Accounts (Scotland) Regulations 2014 and is intended to assist readers in understanding the financial statements and provide an overview of the organisation and its performance.
42. 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

² 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.

performance of the Funds'; and

- Information on the principal risks and uncertainties facing the authority.

43. 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

44. We have reviewed the Funds' annual governance statement against the relevant guidance: *Delivering Good Governance in Local Government*.

45. We consider the coverage of the annual governance statement to be broadly in line with expectations.

46. The annual governance statement highlights that internal audit provided a 'red'³ rated opinion, reflecting significant enhancements required to the Funds' control environment.

47. The internal audit reports highlighted the need for LPF to ensure that: third party systems suppliers have established adequate and effective resilience arrangements that are aligned with LPF recovery objectives; and they have effective change management controls to provide assurance on the ongoing integrity of their systems.

48. The governance statement highlights the actions planned to address the internal audit issues.

49. The Chief Executive and Head of Finance of the City of Edinburgh Council have considered the internal audit findings and are satisfied that reasonable assurance can be placed upon the adequacy and effectiveness of Funds' systems of internal control.

50. We have concluded that the annual governance statement is in line with the required guidance and is consistent with the financial statements and assurances provided in year.

Governance compliance statement

51. 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.

52. 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.

Legality

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

54. It was highlighted during the course of our audit that the Funds had not been operating their bank accounts 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.

55. Internal audit noted in November 2015, there were issues over the use of bank accounts, particularly that monies were being transferred into a City of Edinburgh bank account and payments made from this account.

56. The Funds noted that the procurement of a new payroll and ledger system would help resolve the payment issues but that there was no proposal to change current procedures.

57. The use of the Council bank account was to ensure that any unfunded payment does not come from a pension fund bank account.

58. The issue of non-compliance has been recognised in the Funds' risk register and work has commenced to deliver an updated ledger system, however, significant delays have been encountered. The issue with regards to the use of bank accounts is therefore on going.

Action plan point 2

Group accounts

59. The Funds' annual report includes accounts for Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund.

60. Lothian Pension Fund accounts are prepared

³ Significant areas of weakness and non-compliance in the control environment and governance and risk management framework that puts the achievement of organisational objectives at risk.

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.

- 61. Group accounts were prepared for the Lothian Pension Fund for the first time in 2015/16 incorporating LPFE Ltd. LPFI Ltd became operational in 2016/17 after the funds received Financial Conduct Authority authorisation.
- 62. We reviewed the consolidation process in 2017/18 and concluded the subsidiary companies had been correctly included in the group accounts of Lothian Pension Fund.

Qualitative aspects of accounting practices and financial reporting

- 63. We have considered 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 financial statements. Our findings are summarised below:

Qualitative aspect considered	Audit conclusion
<p>The appropriateness of the accounting policies used.</p>	<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 £5.574 million for Lothian Pension Fund and £0.34 million for Lothian Buses (there were no indirect costs for Scottish Homes).</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>
<p>The timing of the transactions and the period in which they are recorded.</p>	<p>We did not identify any concerns over the timing of transactions or the period in which they were recognised.</p>
<p>The appropriateness of the accounting estimates and judgements used.</p>	<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>
<p>The appropriateness of the going concern assumption</p>	<p>We have reviewed the detailed financial forecasts for 2018/19. 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.</p>
<p>The extent to which the financial</p>	<p>From the testing performed, we identified no significant unusual</p>

Qualitative aspect considered	Audit conclusion
statements have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed.	transactions in the period.
Apparent misstatements in the management commentary or material inconsistencies with the financial statements.	The financial statements contain no material misstatements or inconsistencies with the annual report and financial statements in the management commentary.
Any significant financial statements disclosures to bring to your attention.	There are no significant financial statements 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 financial statements disclosure.	<p>At the interim stage of our audit we conducted a review of the financial statements to identify areas where improvements to be made to reduce immaterial and surplus disclosures in the financial statements. Our recommendations were made to management and included only minor disclosure and presentational issues. No adjustments were made as a result of this work, however the impact is not considered to be significant.</p> <p>Additional disclosure and presentational adjustments were discussed at the year-end. Over the course of the audit there was no material disagreement over any significant accounting treatment or disclosure.</p>
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

3

Financial management

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

Financial management

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



Lothian Pension Fund's investment performance decreased in 2017/18 and was below the short term benchmark and national average. Medium and long term performance, however, remained above benchmark levels.

The net assets of Lothian Pension Fund and Lothian Buses Pension Fund have risen at a slower rate than in 2016/17 and Scottish Homes Pension Fund assets have decreased marginally. The promised retirement benefits have decreased across all three funds.

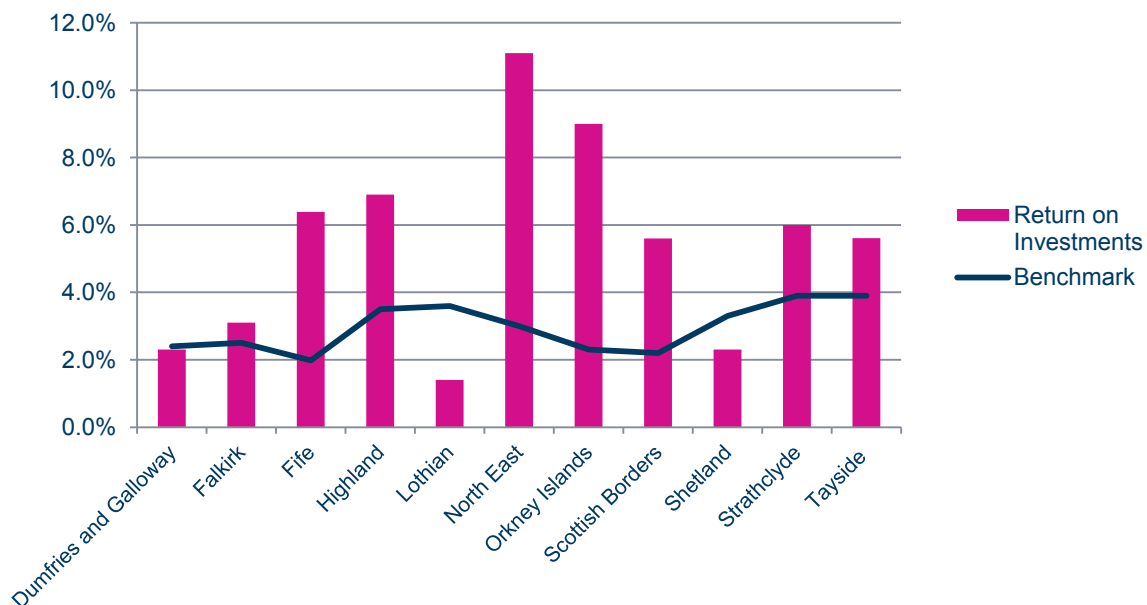
Investment performance in 2017/18

64. The Funds report their performance with regards to returns on investments as part of the annual report and financial statements. As shown in Exhibit 4 below Lothian Pension Fund has reported performance below the one year benchmark for the second year. Lothian Buses Pension Fund is reporting performance above

benchmark and Scottish Homes Pension Fund has dropped behind the 1 year benchmark after reporting returns above benchmark in 2016/17.

65. Investment performance across the local government pension funds in Scotland fell in 2017/18 from a particularly strong year in 2016/17. The average return on investments in 2017/18 was 6.12% a significant decrease compared to 21.19% in 2016/17.

Exhibit 3: LGPS Funds Returns on investments against benchmark



66. Lothian Pension fund was notably below the national average in 2017/18 and was one of only three pension funds to perform below the benchmark. However, the objective of Lothian Pension Fund is that over the short term the

fund should perform better than its strategic allocation if markets fall significantly.

67. Investment management outcomes are required to be considered over the longer term due to the range of factors which can influence

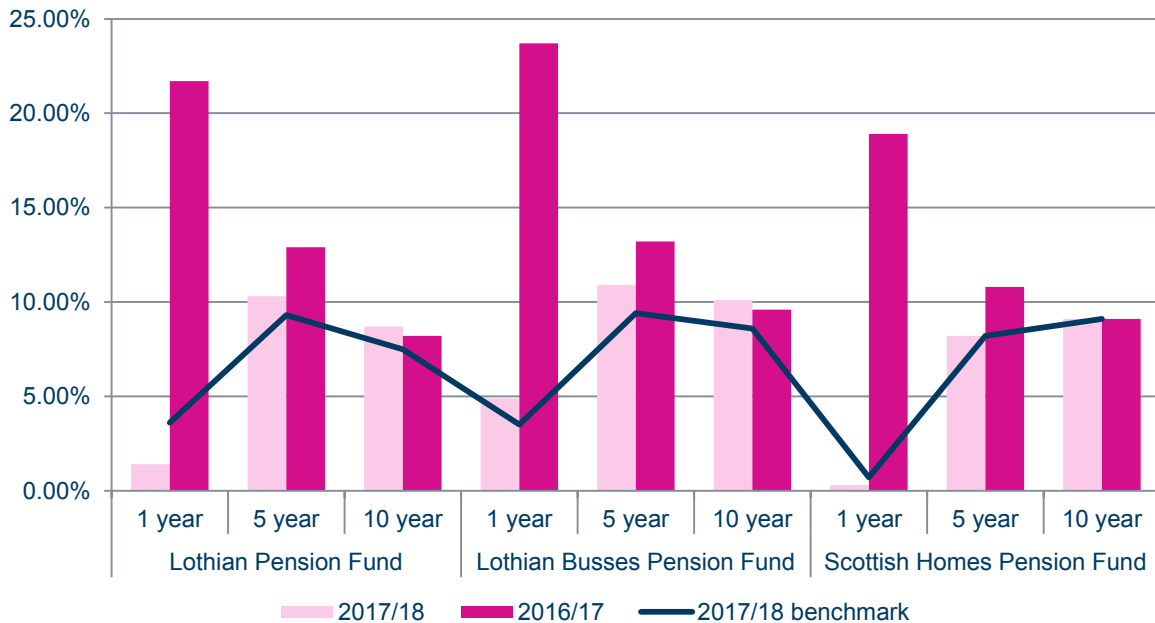
returns including: risk appetite, asset allocation and general market performance. It is therefore important to consider the returns over a longer term.

68. The focus on the funds is stability over the long term which focuses on the medium and long term. The investment portfolio is geared to

achieve this objective and therefore the short term returns are not deemed to be a key performance indicator for the Funds.

69. As shown in Exhibit 4, all three funds have met or exceeded the 5 and 10 year benchmarks which indicates the investment portfolio is being managed appropriately.

Exhibit 4: Performance against benchmark and compared to prior year



Financial position

70. The movement in net assets of the Funds varied across each fund as shown in Exhibit 5. While all three funds reported a net withdrawal position the net return on investments for Lothian Pension Fund and Lothian Buses

Pension Fund exceeded the withdrawals position. The net investments for Scottish Homes Pension Fund was significantly below the withdrawals from dealings with members and this resulted in an overall decrease in the assets of the Fund.

Exhibit 5: LGPS Funds Returns on investments against benchmark

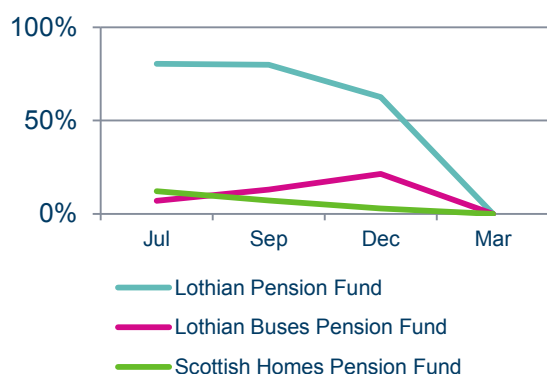
	Net assets			Present value of retirement benefits		
	2017/18 £m	2016/17 £m	% Movement	2017/18 £m	2016/17 £m	% Movement
Lothian Pension Fund	6,665	6,595	1.0%	7,791	8,210	-5.1%
Lothian Buses	509	488	4.3%	463	488	-5.12%
Scottish Homes	164	171	-4.1%	134	145	-7.6%

71. Hymans Robertson provided an estimate of the present value of the promised retirement benefits. Across all three funds the value of the obligation had decreased in year with the most significant decrease on the Scottish Homes Pension Fund.
72. The actuarial calculations are based on the 2017 actuarial valuation rolled forward. It was noted by the actuary in their report that asset returns under the primary investment strategy over the period have been lower than the valuation discount rate but that real bond rates were at a similar level meaning overall funding level is likely to have fallen slightly since the 2017 formal valuation.

Financial monitoring arrangements

73. We have reviewed the Funds' budgetary processes and financial management arrangements in 2017/18.
74. The Pensions Committee receive annual investment updates for each fund in June in line with a formal long term agenda plan. Over the course of the financial year the Pensions Committee has taken reports on the investment strategy panel, investment principles and the performance of the Funds.
75. The Pensions Committee also receive service updates at each committee which includes analysis of the financial position from dealings with members.
76. In year budgets were for a net withdrawal position across all three funds and there was some variation across the year. In all cases the projected position was a higher withdrawal than the actual year end position.

Exhibit 6: Reported movement as a percentage of year end position



77. The Lothian Pension Fund predicted position was in December 2017 was 62.5% higher than the amount reported in the financial statements in March 2018. The movement related to contributions from employers and employees rising further than predicted and lump sum payments decreasing.

Prevention and detection of fraud and irregularity

78. Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity.
79. We found the Funds' arrangements for the prevention and detection of fraud and other irregularities to be adequate.

Standards of conduct

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

Internal Audit

82. 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
83. In 2017/18 it was noted that the service did not fully comply with Public Sector Internal Audit Standards in two areas: follow up and quality assurance reviews. The Pensions Committee were advised that the instances of non-conformance have had no direct impact on the quality of internal audit reviews completed for the Funds in 2017/18.
84. Internal audit have taken remedial actions to put controls in place to address the weaknesses identified.
85. In 2017/18 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.

Systems of internal control

86. 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.
87. We identified a number of areas for improvement in 2016/17 which were followed up at interim and subsequently at year end. We have reported progress against outstanding actions in appendix 1.
88. We identified an issue relating to controls over raising journals as follows:
- In 2017/18 we noted that any member of the City of Edinburgh finance team with ledger access can post to the Funds' ledger. While any incorrect postings should be picked up through budget monitoring, there is a risk that mis-postings are not detected resulting in errors in the financial statements.

Action plan point 3

4

Financial sustainability

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

Financial Sustainability



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

The Funding Strategy Statement has been updated to ensure investment assets are sufficient to meet the full cost of past service benefits.

There is an ongoing risk that the pension scheme is not affordable for admitted bodies and as part of the triennial valuation Lothian Pension Fund required all bodies to conduct an affordability assessment.

Funding level

89. The Funds' undertook an actuarial valuation in 2017 in line with the requirements of the Local Government Pension Scheme Regulations 2014. The 2017 Actuarial Valuation was a triennial valuation which aims to:
- assess whether the funding strategy and assumptions are appropriate;
 - assess the financial health of the Funds; and
 - set future rates for contributions payable by employers.
90. At the 2017 Actuarial Valuation the funding levels increased for all three funds. Lothian Buses Pension Fund and Scottish Homes Pension Fund were achieving their target funding levels.

91. The results of the actuarial valuation show that Lothian Pension Fund has not met its objective to hold sufficient assets to meet the full cost of the past service benefits at 31 March 2017. The increase of 7% shows that progress has been made and the deficit has decreased from £417 million to £145 million.

Contribution rates for employers

92. Contribution rates for employers are set for each scheduled and admitted employer in to Lothian Pension Fund and depend on each body's unique funding position.
93. In general, employer contribution rates across Lothian Pension Fund have increased compared to the 2014 valuation.
94. In recognition of the affordability issues facing many employers within Lothian Pension Fund, management conducted additional work on the Funding Strategy Statement, including a requirement for scheduled and admitted bodies to confirm their commitment to meeting the certified minimum contributions.
95. The Fund also prepared a funding agreement to address repayment of debt on the exit of an employer from the scheme.
96. In 2017/18 a number of employers indicated an intention to leave the Fund. Cessation contributions increased by £1.204 million (5.78%) in year to £1.412 million and at 31 March 2018 there is a long term debtor of £1.525 million related to ceased employers.
97. In line with our recommendation in 2016/17 additional disclosures have been included around the long term debtors relating to employer cessations.

Exhibit 7: Funding level across the Funds

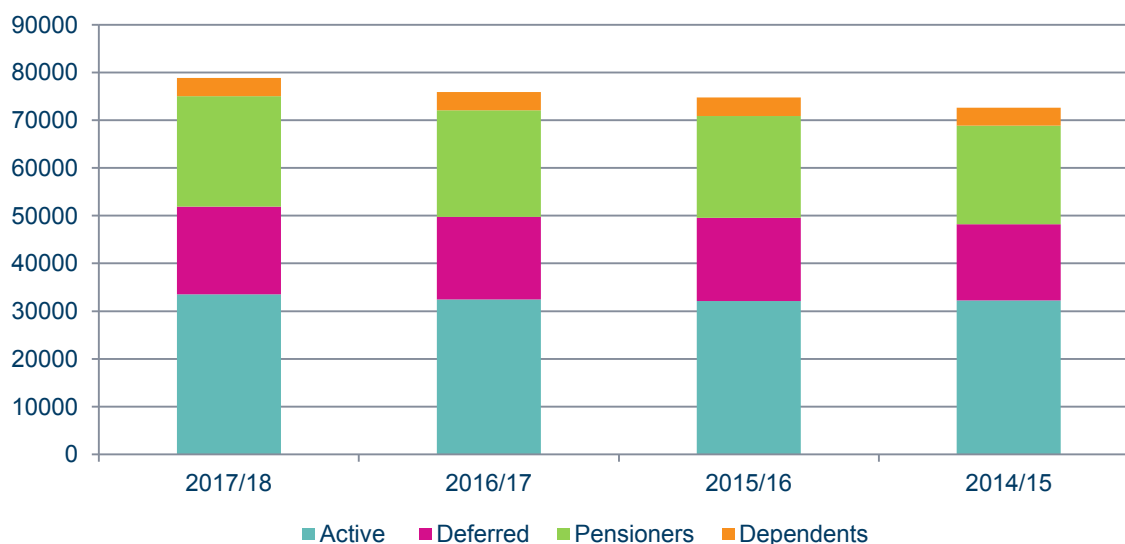
	Actual 2014 (%)	Actual 2017 (%)	Target (%)
Lothian Pension Fund	91%	98%	100%
Lothian Buses	117%	121%	100%
Scottish Homes	89%	105%	93%

Membership

98. Lothian Pension Fund is a multi-employer fund with 14 scheduled bodies, including 4 Councils, and 72 admitted bodies. The scheme has a significant membership profile with active

members being the majority. This differs from Lothian Buses and Scottish Homes Pension Funds which are single employer schemes and have a majority of inactive members (deferred, pensioners and dependents).

Exhibit 8: Membership trend analysis



99. The trend analysis shows that for Lothian Pension Fund the proportion of active members continues to grow while at Lothian Buses Pension Fund and Scottish Homes Pension Fund the level of pensioners and dependents is growing.

100. A revised Funding Strategy Statement was approved by the Pensions Committee in March 2018, following a consultation exercise in July 2017.

101. Key changes to the Funding Strategy included:

- the inclusion of a medium risk strategy which will be open to employers with more than 5 members and which are closed to new members;
- written confirmation of ability to meet contributions are required as outlined above; and
- the creation of alternative options for the payment of pension strain costs.

LGPS Consultation

102. A review of the structure of the Scottish Local Government Pension Schemes was agreed with stakeholders and Scottish Government in 2015 when changes to the scheme and Scheme Advisory Board ('SAB') were introduced.

103. In February 2017, SAB produced a review report which highlighted 4 options for the future structure of the local government pension scheme in Scotland:

- Retain the current structure with 11 funds;
- Promote cooperation in investing and administration between the 11 funds;
- Pool investments between the 11 funds; and
- Merge the 11 funds into one or more new funds.

104. These options were presented to the Cabinet Secretary for Finance, Economy and Fair Work and in January 2018, it was advised that SAB should proceed to seek a consultation with

Scottish LGPS employers and employee membership bodies on the 4 options. The consultation launched in June 2018 and will close in December 2018.

- 105.** We will continue to monitor the developments and outcomes arising from the consultation as part of our 2018/19 audit.

EU withdrawal

- 106.** Audit Scotland has identified EU withdrawal as an emerging significant risk facing public bodies across Scotland. Three streams of potential impact were identified:

- Workforce;
- Funding; and
- Regulation.

- 107.** 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. The primary consideration was the impact of the EU withdrawal on movement in investments and risk mitigating measures were put in place prior to the vote.

- 108.** From an initial assessment of the workforce stream no significant implications have been identified.

5

Governance & transparency

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

Governance & 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.

Governance Structure

- 109.** The Pensions Committee, supported by an Audit Sub-Committee, has been delegated responsibility for governance by the City of Edinburgh Council, the administering authority.
- 110.** 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.
- 111.** From 1 April 2015 all pension funds were required to introduce local pension boards in line with the Public Service Pension Act 2013. This is the third year of operation of the Pension Board.
- 112.** The Pension Board meet quarterly on a concurrent basis with the Pension Committee.
- 113.** The Funds complied with best practice and appointed an independent professional observer to the Board and Committee. The appointed independent observer resigned in February 2018 and to date the post has not been filled.
- 114.** The remit of the Pension Board is to support the Pension Committee in compliance with regulations and the requirements of the Pension Regulator. 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 2017/18.

Training and development

- 115.** 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.

- 116.** Our review found that all current Pension Committee and Board members met the requirement to have a minimum of 21 hours training, however, a member of the Committee who left in 2017/18 would not have met the full training requirement for the year.

Openness and Transparency

- 117.** 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. Information about the Funds is published on the Funds' website including key strategic documents.
- 118.** During the year, the Pensions Committee has evaluated whether further steps could be taken to move to best practice on the accessibility and openness of meetings held through webcasting of meetings. While the final decision was not to webcast meetings, the Committee were provided detailed information to allow a thorough evaluation and an informed decision to be made.
- 119.** We consider the openness and transparency of the Funds to be appropriate and in line with legal requirements.

Risk Management

- 120.** A developed and integrated approach to risk management is a key feature of a robust system of internal control. The Funds maintain a risk register in line with the City of Edinburgh

Council Risk Management Policy and Procedures.

121. Risk management arrangements are firmly embedded in the governance process. The Pensions Committee receive a risk management update on a quarterly basis which provides information of the movement in risks and the actions being taken on the most notable risks.
122. From our review of the risk management arrangements in place we have concluded that there are adequate arrangements in place at the Funds.

Information Governance

General Data Protection Regulations

123. The General Data Protection Regulations (the Regulations) came into force on 25 May 2018. The Regulations replace the Data Protection Act 1998 and as well as strengthening existing regulations, the Act has brought in new legislative requirements for the Funds. The Regulations bring significant potential penalties for non-compliance therefore increasing the importance of compliance.
124. To ensure compliance, LPF has fully reviewed its business processes to ensure they were fully compliant with the new legislation including review of LPF's data storage, information governance, ICT, office procedures and third party relationships.
125. The Pensions Committee has received regular updates on the progress of the project were primarily reported through quarterly risk management summaries.
126. Compliance with the regulations is an ongoing process, which we will monitor as part of our annual audit procedures. We have not identified any significant risks to compliance with the Regulations at this stage.

Cyber Security

127. In May 2017, a number of health boards across NHS Scotland were affected by the Wannacry global ransomware attack. In response to this the Scottish Government launched 'A Cyber Resilience Strategy for Scotland: Public Sector Action Plan, 2017/18'.
128. The action plan outlines a number of requirements that public bodies should be taking forward. This includes an action for

public bodies to achieve a Cyber Essentials Plus certification by the end of October 2018.

129. The Funds currently use City of Edinburgh Council systems for the financial ledger and can place reliance on the Council's assessment. However, for Fund specific systems there is a need to complete the Cyber Essentials accreditation. We recommend that the Funds make arrangements to achieve the Cyber Essentials certification by 31 October 2018.

Action plan point 4

LGPS Regulations

130. Revised Local Government Pension Scheme regulations came into effect from 1 June 2018 with an update on the implications of the new legislation being presented to the June 2018 Pensions Committee.
131. The changes to the regulations aim to consolidate all amendments since April 2015 and include a number of amendments to the scheme rules including:
- members of the LGPS 2015 will be able to elect to take early payment of their pension from age 55, with an actuarial reduction and will no longer need their employers consent;
 - additional flexibility for administering authorities when employers leave the scheme and to provide extra credit to exiting employers if appropriate; and
 - changes to additional voluntary contributions following the introduction of the UK governments "freedom and choice in pensions", to allow payment from age 55 as a lump sum.
132. LPF are currently seeking clarification on some aspects of the regulations and we will consider implications as part of our 2018/19 audit work.

6

Value for Money

Value for money is concerned with using resources effectively and continually improving services. In this section we report on our audit work as it relates to the Funds' reporting of their performance.

Value for money



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

The Funds have appropriate arrangements in place to monitor performance of investments and the administration of the Funds.

Investment manager operations

- 133. Lothian Pension Fund operates two special purpose vehicles: LPFE Ltd and LPFI Ltd. Both companies were wholly owned and controlled by the Council.
- 134. The special purpose vehicles were established to support the investment programme of the in-house investment team by providing operational efficiencies.
- 135. The proportion of funds managed internally has remained steady at approximately 85% of investments since 2015/16.

Staff Transfer

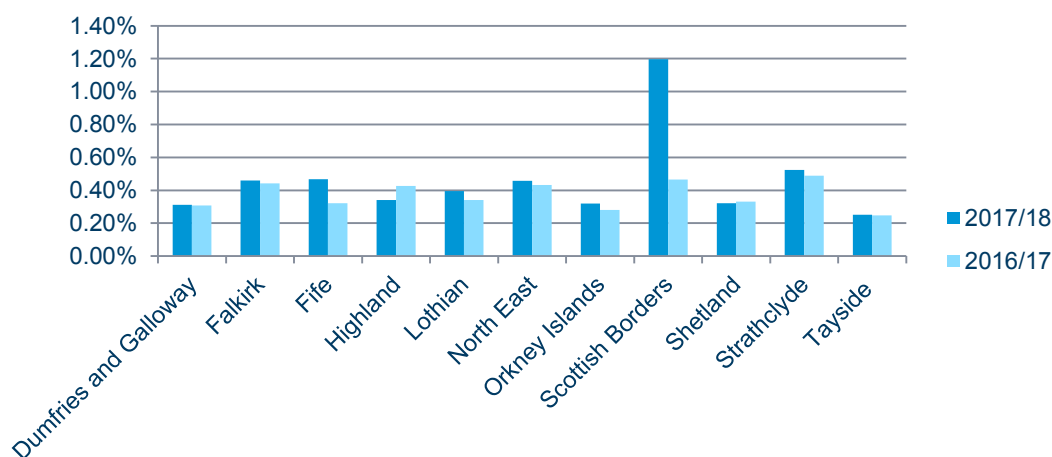
- 136. In 2015, LPF's key investment staff transferred to LPFE Limited. In February 2018, the Funds' remaining staff also transferred to LPFE Limited following engagement with staff and trade unions.

- 137. It is anticipated that employing all staff in a single organisation will enable greater collaborative efforts with other local government pension funds as well as helping to ensure a consistent approach to resourcing.

Management expenses

- 138. Lothian Pension Fund reported management expenses of £35.412 million in 2017/18, an increase of 19% from the prior year.
- 139. Management expenses are split into three main categories: administrative costs; investment manager expenses and oversight and governance costs. Investment management expenses account for 90% of total management expenses.
- 140. In year Lothian Pension Fund's investment manager expenses (excluding indirect expenses) rose marginally as a proportion of net assets. This is broadly in line with trends across the Local Government Pension Funds.

Exhibit 9: Investment manager expenses (excluding indirect costs) as a proportion of net assets



- 141.** 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 £5.574 million of indirect manager expenses in 2017/18. It is not possible to benchmark the impact of indirect management costs across Scottish Local Government Pension Funds.
- 142.** Investment manager expenses can vary due to a number of factors including actual returns on investments and the nature of the investments assets held.
- 143.** The Funds undertake annual benchmarking exercises using externally provided data, covering 33 LGPS funds and a wider global universe of 331 funds.
- 144.** In 2017/18 Lothian Pension Fund reported an actual investment cost of 0.41% of net assets which was below the benchmark of 0.48%
- 145.** The pension administration cost per member was £24.37, which is higher than the average cost of local authority funds of £20.18. 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 £33 per member.

Monitoring investment performance

- 146.** 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.
- 147.** 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 and 3 yearly performance measures. This information is presented to the Investment Strategy Panel to allow for scrutiny investment performance of the Funds.

Investment Strategy Panel

- 148.** The Pensions Committee has delegated responsibility for investment strategy to the Executive Director of Resource who takes

advice from an Investment Strategy Panel made up of:

- Chief Executive, Lothian Pension Fund;
- Chief Investment Officer, Lothian Pension Fund; and
- two external independent investment consultants.

- 149.** Lothian Pension Fund set up a joint working arrangement with Falkirk Pension Fund which includes a joint Investment Strategy Panel. The role of this panel will be to advise the Chief Financial Officers of each administering authority on the implementation of investment strategy. Over the last year, Lothian collaborated with Falkirk Council Pension Fund on 7 infrastructure investments.
- 150.** The Investment Strategy Panel considers the appropriate investment management structure required to implement the Funds' investment strategy. In addition it is responsible for:
- setting objectives and restrictions for internally managed investments; and
 - monitoring the risk and performance of all portfolios.
- 151.** It is noted in the annual report of the Investment Strategy Panel that their focus is long term superior returns rather than short term fluctuations of the investment market.

Administrative Performance

- 152.** The Funds' have a Service Plan in place covering the period 2016- 2018 . The Pensions Committee receive updates on the service plan at each meeting. The annual results for 2017/18 are presented in the Funds' Management Commentary.
- 153.** The Performance Report highlights that the Fund are meeting the majority of their targets (90%) with only 1 area where performance was not in line with target levels:
- The target for the proportion of active members receiving their annual benefit statement by 31 August 2017 was 100% but the Funds' achieved a level of 99.9%. This represents an improvement on prior year performance which was 99.6%. The issue of annual benefits statements by 31 August is a requirement of the Local Government Pension Scheme (Scotland)

2014. The statements not issued related to members employed on a casual basis prior to March but who did not contribute to the scheme up to the end of the year.

Tendering for Services

- 154.** The Funds make use of a range of service providers including investment managers, an actuary and a custodian. In order to ensure the Funds are achieving value for money it is good practice to tender for services at set intervals.
- 155.** The Funds follow the City of Edinburgh Council procurement procedures and maintain a contract register.
- 156.** A paper went to the Pensions Committee in December 2017 providing an update on the contracts register and the procurement decisions which had been made in year.
- 157.** It was noted that a review of the investment managers had been conducted, with further services being brought in house for Scottish Homes Pension Fund. One investment manager contract had been extended to allow more options appraisal work to be considered on the operation of the property management portfolio. This work is due to conclude in 2018/19.

7

Appendices

Appendix 1: Management action plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during our audit in both current and previous audits.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist. The weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist.

Communication of the 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.

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 5	Very high risk exposure – major concerns requiring Board attention
Grade 4	High risk exposure – material observations requiring senior 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

Action plan point	Issue, Risk & Recommendation	Management Comments
1. Publication of the financial statements	<p>Issue</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>Risk</p> <p>There is a risk that Lothian Pension Fund do not meet their statutory duties in respect of the requirements of the Local Authority Accounts (Scotland) Regulations 2014.</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:</p> <p>Chief Executive Officer, Lothian Pension Fund</p> <p>Implementation date:</p> <p>June 2019</p>
Rating		
Grade 2		
Paragraph ref		
39		

Action plan point	Issue, Risk & Recommendation	Management Comments
2. Bank accounts	<p>Issue</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>Risk</p> <p>There is a risk that monies for the Funds are not separately identifiable.</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:</p> <p>Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date:</p> <p>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>
Rating		
Grade 3		
Paragraph ref		
58		

Action plan point	Issue, Risk & Recommendation	Management Comments
3. User access controls	<p>Issue</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>Risk</p> <p>There is a risk that incorrect or fraudulent postings could be made without detection by the Funds' officers.</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:</p> <p>Chief Finance Officer, Lothian Pension Fund</p> <p>Implementation date:</p> <p>March 2019</p>
Rating		
Grade 3		
Paragraph ref		
88		

Action plan point	Issue, Risk & Recommendation	Management Comments
4. Cyber Essentials	<p>Issue</p> <p>In 2017/18 In May 2017, a number of health boards across NHS Scotland were affected by the Wannacry global ransomware attack. In response to this the Scottish Government launched 'A Cyber Resilience Strategy for Scotland: Public Sector Action Plan, 2017/18'.</p> <p>The action plan outlines a number of requirements that public bodies should be taking forward. This includes an action for public bodies to achieve a Cyber Essentials Plus certification by the end of October 2018. The Funds are aware of the work but do not have a formal plan to achieve certification.</p> <p>Risk</p> <p>There is a risk that Lothian Pension Fund are not compliant with Cyber Essentials by the required Scottish Government deadline.</p> <p>Recommendation</p> <p>We recommend that the Funds make arrangements to ensure Cyber Essentials certification is achieved by 31 October 2018.</p>	<p>Recommendation is accepted. LPF is liaising with the Council's Chief Information Officer to secure requisite certification.</p> <p>Responsible officer:</p> <p>Chief Executive Officer, Lothian Pension Fund</p> <p>Implementation date:</p> <p>October 2018</p>
Rating		
Grade 3		
Paragraph ref		
129		

Outstanding recommendations from previous audit reports

Action plan point	Issue & Recommendation	Management Comments	Follow up
1. Authorisation of journals	<p>Observation</p> <p>Our review of the journals environment found that there was a lack of segregation of duties over the posting of journals. Journals are currently posted by individuals without an authorisation process. Journals can be used to override controls and create fraudulent errors therefore it is crucial there are strong controls in place.</p> <p>Recommendation</p> <p>Whilst we were able to obtain alternative audit evidence to provide assurance that there were no material issues with regards to the posting of journals, we recommend that a review process for all journals is put in place.</p>	<p>Agreed the fund will undertake a review of the journals processes.</p> <p>All parties that use the Council's financial systems are affected by this finding. The Fund awaits the Council's response to the issue.</p> <p>The Fund is satisfied that there are sufficient controls in place to prevent an actual cash payment leaving the Fund without full authorisation and that the ability to post journals is limited to staff authorised to do so. The system also records the username of the person posting the journal.</p> <p>Action owner: John Burns</p> <p>Due Date: 31 January 2018</p>	<p>In 2017/18 we noted that there is no authorisation process in place at the Funds.</p> <p>A compensating control has been put in place which requires reconciliation of journals and the ledger by a separate member of the finance team.</p> <p>Action complete</p>
Rating			
Grade 3			

Action plan point	Issue & Recommendation	Management Comments	Follow up
2. Annual Governance Statement	<p>Observation</p> <p>We have reviewed the Funds' Annual Governance Statement and identified that improvements could be made. To be fully compliant with the Delivering Good Governance in Local Government guidance an action plan outlining the actions the Funds' will take to progress improvements in the Funds' governance process should be disclosed.</p> <p>Recommendation</p> <p>We recommend the Funds' consider the disclosures in the Annual Governance Statement to ensure they are meeting applicable guidance.</p>	<p>Agreed to review for next year's accounts</p> <p>Action owner: Struan Fairbairn</p> <p>Due Date: 31 March 2018</p>	<p>The 2017/18 annual governance statement includes details of actions that will be taken to improve governance arrangements and the system of internal control.</p> <p>Action complete.</p>
Rating			
Grade 3			

Action plan point	Issue & Recommendation	Management Comments	Follow up
3. Employer cessation liabilities	<p>Observation</p> <p>Lothian Pension Fund has identified that there are significant pressures facing the employing body members of the Fund. This has increased the risk of employers defaulting on payments required to cover the liability attributable to their employees.</p>	<p>Agreed to review disclosures in management commentary for next year's accounts after the completion of the 2017 triennial actuarial valuation.</p>	<p>Additional commentary has been provided within the debtors section of the financial statements</p>
Rating			<p>Action complete</p>
Grade 3		<p>Contingent assets in respect of Funding Agreements for employers which have terminated membership of the Fund are disclosed to the extent that such default protection is provided to any aligned body (as defined in the Funding Strategy Statement) or other employers in the Fund. Such contingent assets do not have a material impact on net liabilities.</p>	
	<p>Recommendation</p> <p>We recommend that increased disclosure around the nature of the risk, the level of at risk employers within the Fund and the potential impact on the funding level is included in the financial statements.</p>	<p>Action owner: John Burns</p> <p>Due Date: 31 March 2018</p>	

Action plan point	Issue & Recommendation	Management Comments	Follow up
<p>4. Annual benefits statements</p>	<p>Observation</p> <p>The issue of all annual benefit statements by 31 August 2016 is a requirement of the Local Government Pension Scheme (Scotland) Regulations 2014. In 2016/17 the Funds' achieved 99.6% of the annual benefits statements by the deadline.</p>	<p>The Funds have considered this in line with the Pensions Regulator guidance and do not feel this would be of material significance and therefore have deemed it unnecessary to declare the breach to the Pensions Regulator.</p>	<p>The target for the proportion of active members receiving their annual benefit statement by 31 August 2017 was 100% but the Funds' achieved a level of 99.9. The statements not issued related to members employed on a casual basis prior to March but who did not contribute to the scheme up to the end of the year.</p>
<p>Rating</p>			
<p>Grade 2</p>	<p>Recommendation</p> <p>The Pension Committee members should consider whether they deem this to be an issue which should be self-referred to the Pension Regulator.</p>		
			<p>The Funds should consider if this requires reporting to the Pension Regulator.</p> <p>Responsible officer:</p> <p>Chief Finance Officer</p> <p>As previously advised orally to Pensions Committee, this was not considered sufficiently material to warrant a voluntary disclosure to The Pensions Regulator.</p>

Appendix 2: Respective responsibilities of the Pensions Committee 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 by exception if, in our opinion

- adequate accounting records have not been kept;
- we have not received all the information and explanations we require for our audit;
- 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 annual report and 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 frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we will consider and report against these four dimensions: financial management; financial sustainability; governance and transparency; and value for money.

Independence

We are required by International Standards on Auditing to communicate on a timely basis all facts and matters that may have a bearing on our independence. We can confirm that we have complied with the Financial Reporting Council's Ethical Standard.

In addition to our work on the Funds we are also responsible for the audit of the financial statements of LPFE Ltd and LPFI Ltd, the subsidiaries of Lothian Pension Fund. In addition to the audit of the subsidiaries, Scott-Moncrieff provides accounts preparation, corporation tax services and ad hoc VAT advice to both LPFE Ltd and LPFI Ltd.

All tax services are provided by an independent tax partner and staff who have no involvement in the audit of the financial statements.

The accounts are prepared from trial balances provided by LPFE Ltd and LPFI Ltd and no significant policies, disclosures, adjustments or estimates are decided by Scott-Moncrieff.

Moore Stephens provided a Financial Conduct Authority Compliance review for LPFI Ltd. The team is independent of Scott-Moncrieff and has no involvement in the audit of Lothian Pension Fund or its subsidiaries.

In our professional judgement the audit process has been independent and our objectivity has not been compromised. In particular, there have been no relationships between Scott-Moncrieff and the Pensions Committee or senior management that may reasonably be thought to bear on our objectivity and independence.



Scott-Moncrieff
business advisers and accountants

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