



Agenda Item 5

Pension Fund - Annual Audit Plan

Falkirk Council

Subject: Pension Fund - Annual Audit Plan

Meeting: Joint Meeting of Pensions Committee and Pension Board

Date: 19 March 2020

Submitted by: Director of Corporate and Housing Services

1. Purpose of Report

- 1.1 The purpose of this report is to bring the External Audit Pension Fund Audit Plan for the 2019/20 Annual Report and Accounts to the attention of the Committee and Board.

2. Recommendation

- 2.1 **Committee and Board are asked to note the Annual Audit Plan proposed by Ernst and Young (EY) in relation to the audit of the Pension Fund Annual Report and Accounts for 2019/20.**

3. Annual Audit Plan

- 3.1 Ernst and Young were appointed auditors to Falkirk Council for a five year term starting with the 2016/17 financial year. They have now submitted their formal audit plan for the 2019/20 audit and a copy is attached as an appendix to this report.
- 3.2 The Audit Plan sets out the key objectives of the audit, namely to provide an opinion as to whether the financial statements:
- give a true and fair view; and
 - have been properly prepared in accordance with relevant accounting codes and legislation
- 3.3 The key milestones of the accounts production and audit process are as follows:

17/6/2020	Latest date for Accounts Public Inspection Notice
25/6/2020	Consideration of Unaudited Accounts by Committee
30/6/2020	Latest date for submission of Unaudited Accounts
24/9/2020	Consideration of Audited Accounts by Committee
30/9/2020	Latest date for submission of Audited Financial Statements
30/9/2020	Latest date for issue of ISA 260 and Annual Audit Report

- 3.4 In relation to the auditing of the financial statements, the auditor has highlighted two significant risk areas for the Fund, these being:
- the valuation of unlisted investments (e.g. private equity, private debt, infrastructure assets, etc.)
 - management override of key controls leading to misstatement due to fraud and error
- 3.5 The audit will also review Fund activities in the context of financial management, financial sustainability, governance and transparency, and value for money – the four key elements identified by the Accounts Commission and Audit Scotland in the UK Code of Audit Practice.
- 3.6 The total audit fee for the 2019/20 audit is £24,890 (£24,360 in 2018/19).
- 3.7 It is anticipated that the ISA260 (“Communication of audit matters to those charged with governance”); the Letter of Representation (from the Chief Finance Officer to External Auditor); and the Annual Audit Report will all form part of the papers for the joint meeting of Committee and Board on 24 September 2020.
- 3.8 Colleagues from EY will be in attendance at the joint meeting and will be able to provide further insight into this year’s audit exercise.

4. Previous Audit Recommendations

- 4.1 No specific recommendations were made as a result of the 2018/19 Audit.
- 4.2 Audits prior to 2018/19 have focused on the importance of improving the quality and timeliness of employer data. This continues to be addressed through moving employers onto the i-connect portal to enable their data to be delivered electronically to the Pensions team in a more complete and reliable manner.

5. Internal Audit

- 5.1 The EY Pension Fund audit will be supported by Internal Audit work undertaken during 2019/20.
- 5.2 Internal Audit’s findings on its 2019/20 work will be presented to the joint meeting of the Committee and Board on 25 June 2020 along with the proposed Internal Audit Plan for 2020/21. This will draw on the Fund Risk Register and Assurance Map agreed at the January joint meeting.

6. Implications

Financial

- 6.1 There are no financial implications arising from the report.

Resources

- 6.2 There are no additional administrative resources associated with the report recommendation.

Legal

- 6.3 There is a statutory requirement for the Fund to produce its own annual report and accounts distinct from those of Falkirk Council and for these to be separately audited.

Risk

- 6.4 Failure to complete the audit would result in the Fund being in breach of its statutory duties and would undermine the confidence of stakeholders in the sound financial management of the Fund.

Equalities

- 6.5 There are no equality issues arising from this report.

Sustainability/Environmental Impact

- 6.6 There are no sustainability/environmental issues arising from this report.

Director of Corporate & Housing Services

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Date: 4 March 2020

Appendices

Appendix 1 – Ernst and Young Annual Audit Plan

List of Background Papers:

None

Falkirk Council Pension Fund

Annual Audit Plan
Year ending 31 March 2020

19 March 2020

Contents

Section	Auditor Responsibility	Page
Executive Summary	Summarise the purpose and key information for the 2019/20 audit	03
Sector Developments	Provide a summary of the overall local government pension scheme environment	06
Financial Statements Risks	Summary of audit approach, materiality, risks etc.	08
Wider Scope Audit Risks	Audit approach for reviewing Fund's compliance with the wider public audit scope areas: <ul style="list-style-type: none"> ▶ financial position and arrangements for securing financial sustainability ▶ suitability and effectiveness of corporate governance arrangements ▶ effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets 	13
Appendices	Undertake statutory duties, and comply with professional engagement and ethical standards: <ul style="list-style-type: none"> Appendix A: Code of Audit Practice: responsibilities Appendix B: Auditor Independence Appendix C: Required communications with the Pensions committee and Board Appendix D: Timing and deliverables Appendix E: Audit fees Appendix F: Additional audit information 	16

About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Accounts Commission has appointed us as external auditor of Falkirk Council Pension Fund (the Pension Fund) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Local Government (Scotland) Act 1973 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

This report is for the benefit of the Pension Fund and is made available to the Accounts Commission, the Controller of Audit and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

Complaints

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, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Diane McGiffen, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

1. Executive summary

Our key contacts:

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Our independence:

We confirm that we have undertaken client and engagement continuance procedures, which include our assessment of our continuing independence to act as your external auditor.

Purpose of this report

The Accounts Commission appointed EY as the external auditor of Falkirk Council Pension Fund ("the Pension Fund") for the five year period to 2020/21.

This Annual Audit Plan, prepared for the benefit of the Pension Fund management and the Pensions Committee, sets out our proposed audit approach for the audit of the financial year ending 31 March 2020. This plan sets out the work we will perform to allow us to provide our independent auditor's report on the financial statements and meet the wider scope requirements of public sector audit. After consideration by the Pension Fund, the plan is provided to Audit Scotland and published on their website.

We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; International Standards on Auditing (UK); relevant legislation; and other guidance issued by Audit Scotland. The Code sets out the responsibilities of both the Pension Fund and the auditor, more details of which are provided in Appendix A.

Our Financial Statement Audit

We are responsible for conducting an audit of the financial statements of the Pension Fund. We provide an opinion as to:

- ▶ whether they give a true and fair view in accordance with applicable law and the 2019/20 Code of the financial transactions of the Fund as at 31 March 2020 and of the amount and disposition at that date of its assets and liabilities;
- ▶ have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2019/20 Code; and
- ▶ whether 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.

We also review and report on the consistency of the other information prepared and published by the Pension Fund along with the financial statements.

Materiality

Materiality levels have been set at the planning stage of the audit as follows:

Planning Materiality	Tolerable Error	Reportable differences
£49.8 million	£37.3 million	£250,000
Materiality has been set at approximately 2% of net assets for the year.	Materiality at an individual account level, representing 75% of our planning materiality	Level of error that we will report to committee

Professional judgement is also applied to the materiality of related party transactions and audit of key management personnel disclosures.

Wider Scope audit responsibilities

Under the Code, we are required to provide judgements and conclusions on the four dimensions of wider-scope public audit, as well as an assessment around the Pension Fund’s arrangements for securing Best Value:

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

Audit Risk Dashboard

Key Financial Statement Risks

Significant Risk: Valuation of complex investment (unquoted)	We identified valuation of complex investments as a significant risk reflecting the complexity of this area and expectations around audit differences based on our prior audit experience.
Fraud Risk: Misstatement due to fraud or error	As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud due to the ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. We have determined that the way management could be most likely to override controls is by manipulating the value of the year-end investment asset balances posted in totality to the accounts at year-end.

2. Sector developments

In accordance with the principles of the Code, our audit work considers key developments in the sector. We obtain an understanding of the strategic environment in which the Pension Fund operates to inform our audit approach.

Understanding the Pension Fund's priorities

The responsibility for the governance of the Pension Fund sits with the Pensions Committee as delegated by Falkirk Council, the Administering Authority. The Pensions Committee is supported by a Pensions Board to ensure that decisions are made with the terms of the Fund rules and with good practice. In addition to Fund employers, key partners include local authorities, actuaries, banks, government agencies, fund managers, legal advisers, communications specialists, corporate governance and litigation specialists, and various other financial institutions.

The majority of the Fund's activities are managed in-house by the Council's Pensions Section however there are increasing collaborative links with both Lothian Pension Fund and Fife Pension Fund.

The majority of the Fund's activities are managed in-house by the Council's Pensions Section however there are increasing collaborative links with both Lothian Pension Fund and Fife Pension Fund. Investment management continues to be a key focus, including both monitoring externally managed funds and the strategic investment decisions being made by the Fund. It is also conscious of meeting the fiduciary duties expected from local authorities in its investments. The Fund achieved a return of 8.5% during 2018/19 which was 1.7% above the Fund benchmark of 6.8%.

Responsible investment has become an increasing area of focus and the Pension Fund will be expected to continue to work with its managers and like minded partners in promoting sustainable investments. As part of its wider engagement, the Fund has joined Institutional Investor Group on Climate Change and the Climate Action 100+ Initiative.

A review of investment strategy took place during 2018/19 following an asset liability modelling exercise with the strategic asset allocation remaining similar to previous iterations. New categories of assets, known as policy groups, have been established to facilitate high level analysis, performance monitoring and reporting. The policy groups are Equities, Other Real Assets, Gilts, Non Gilt Debt and Cash.

The Pensions Committee is responsible for setting investment strategy in terms of the five policy groups and the Chief Finance Officer is responsible for implementing the strategy taking proper advice from the Joint Investment Strategy Panel.

The Fund's funding policy is to achieve a fully funded status over a 20 year period whilst keeping contribution rates as constant as possible. The Fund's longer term strategy is to reduce its exposure to more volatile assets. The Funding Strategy Statement was last updated in March 2018 and will be reviewed again as part of the upcoming triennial valuation process.

Other Government initiatives such as GMP reconciliation, Freedom and Choice, and Cost Transparency all continue to impact and alter the responsibilities of Pensions sector in Scotland, as well as more generally the financial climate in which local authorities are operating, including high numbers of retirements and retirement estimates, volatility around asset investments and future forecasts, ongoing ramifications of the McCloud court appeal judgement, and possible future changes around the structure of LGPS schemes in Scotland. This is within the context of increased regulator focus across the sector.

Future Fund structures

A consultation on the review of the current structure of the Local Government Pension Schemes in Scotland was launched in summer 2018 by the Scheme Advisory Board with consultees asked to consider four structural options: the status Quo for 11 funds, increased collaboration between the funds, pooling of assets and fund merger. Consultation is still ongoing and not expected to be finalised until at least Autumn 2020.

Geo-Political uncertainty

Continuing uncertainty exists around a number of political and other factors in the foreseeable future including:

- ▶ **EU withdrawal:** the UK formally exited the EU on 31 January 2020, and will be in a transition period until 31 December 2020. During this transition period, the UK will continue to apply EU laws but it will no longer be represented in the EU institutions. The negotiations on the future partnership between the EU and the UK commenced once the UK has left the EU.
- ▶ **Scotland Independence Referendum:** there is continued uncertainty regarding whether a Scottish independence referendum will be held.
- ▶ **Coronavirus:** Global financial markets have seen significant turbulence in recent weeks as markets react to the spread of the Coronavirus.

We noted in 2019/20 that the Pension Fund had planned appropriately for the implications of EU withdrawal. We also noted that the Pension Fund considers the wider geo-political risks that may impact the Fund and these are reported through the Joint Investment Strategy Panel alongside the Pensions Committee and Board.

We will continue to review how the Pension Fund prepares for, and responds to, the implications of political factors throughout the audit year including the impact on the Fund's short-term investment performance.

3. Financial Statement Risks

Introduction

The Pension Fund's annual financial statements enables it to demonstrate accountability for, and its performance in the use of its resources. They are prepared in accordance with proper accounting practice, which is represented by the 2019/20 Code of Practice on Local Authority Accounting in the United Kingdom.

Audit Opinion

We are responsible for conducting an audit of the financial statements of the Pension Fund. We will provide an opinion on the financial statements as to:

- ▶ whether they give a true and fair view in accordance with applicable law and the 2019/20 Code of the financial transactions of the Fund as at 31 March 2020 and of the amount and disposition at that date of its assets and liabilities;
- ▶ have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2019/20 Code; and
- ▶ whether 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.

We also review and report on the consistency of the other information prepared and published by the Pension Fund along with its financial statements.

Audit Approach

We determine which accounts, disclosures and relevant assertions could contain risks of material misstatement. Our audit involves:

- ▶ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- ▶ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Pension Fund's internal controls.
- ▶ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ▶ Concluding on the appropriateness of management's use of the going concern basis of accounting.
- ▶ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- ▶ Obtaining sufficient appropriate audit evidence regarding the financial information of activities of the Pension Fund to express an opinion on the financial statements
- ▶ Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Pensions Committee and Board reporting appropriately addresses matters communicated by us to the Audit, Risk and Governance Committee and reporting whether it is materially inconsistent with our understanding and the financial statements.
- ▶ Maintaining auditor independence.
- ▶ Substantive tests of detail of transactions and amounts. For 2019/20 we plan to follow a predominantly substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.
- ▶ Engaging with auditors for applicable scheme member bodies in line with the protocols laid out by Audit Scotland for IAS 19 assurance both for Fund and local government body auditors

Materiality

For the purposes of determining whether the financial statements are free from material error, in accordance with ISA (UK) 320 we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements.

The amount we consider material at the end of the audit may differ from our initial determination. At the end of the audit we will form, and report to you, our final opinion by reference to all matters that could be significant to users of the financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

Materiality Level

Planning Materiality £49.8 million	Planning materiality (PM) - the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements. For planning purposes, materiality for 2019/20 has been set at £49.8 million (2018/19: £49.8 million). This represents approximately 2% of the Pension Fund's net assets for the year.
Tolerable Error £37.3 million	Tolerable error (TE) - materiality at an individual account balance, which is set so as to reduce to an acceptably low level that the aggregate of uncorrected and undetected misstatements exceeds PM. We have set it at £37.3 million (2018/19: £24.9 million) which represents 75% (2018/19: 50%) of planning materiality.
Summary of Audit Differences £0.25 million	Summary of Audit Differences (SAD) Nominal amount - the amount below which misstatements whether individually or accumulated with other misstatements, would not have a material effect on the financial statements. The Code requires that auditors report at no more than £0.25 million (2018/19: £0.25 million).

Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition. Factors which we consider include the perspectives and expectations of users of the financial statements as well as our risk assessment as to the likelihood of material misstatements arising in the financial statements.

Based on these considerations, we apply lower materiality levels to the following areas:

- ▶ **Key management personnel disclosures** - given the sensitivity around the disclosure of senior staff remuneration we apply a lower materiality threshold to our audit consideration around the key management personnel disclosure.
- ▶ **Related party transactions** - related party transactions are considered material when they are material to either party in the transaction. As such, we do not apply a specific materiality to related party audit work but consider each transaction individually.

We will therefore review the disclosures related to the above areas in greater detail compared to the materiality thresholds outlined above.

Significant Risks

We have set out one significant risk identified for the current year audit along with the rationale and expected audit approach. The risks identified may change to reflect any significant findings or subsequent issues we identify during the audit.

1. Misstatements due to fraud or error

Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which means we also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

Other than the valuation of investments, we have not identified any specific areas where management override will manifest as a significant fraud risk, however we will continue to consider this across the financial statements throughout the audit.

As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

We have determined that the way management could be most likely to override controls is by manipulating the value of the year-end investment asset balances posted in totality to the accounts at year end.

Work we will perform:

- ▶ Testing the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
- ▶ Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates.
- ▶ Evaluating the business rationale for any significant unusual transactions.
- ▶ Obtaining third party confirmations of the Fund's externally held investment balances at the Pension Fund's year end 31 March 2020 from both custodians and investment managers. We will investigate any differences in valuation between these sources and agree the final agreed balance for investments in the accounts.

2. Valuation of complex investments

We identify significant risk in respect of valuation of complex investments. At this stage of our audit planning, we have not identified any other significant financial statement risks. We will confirm our updated risk assessment as part of our Annual Audit Report.

Valuation of complex investments has been considered as part of our consideration of the fraud risk around management override. We also identified this as a significant risk reflecting the complexity of this area and expectations around audit differences based on our prior audit experience.

As of 31 March 2019, the Fund held investments of £2.5 billion of which around 56% (£1.4billion) were classified as Level 2 and Level 3 investments, meaning there are not publicly quoted prices in place for these types of investments in an active market. We have therefore assigned a significant risk to the valuation of Private Equity and Infrastructure Funds, Managed Property Funds, Pooled Investments and Private Debt. Around 50% of the pooled investments are in listed equities, our audit focus around this risk is focused on the remaining harder to value assets included in pooled investments.

In our previous audit of the Fund financial statements, we identified audit differences related to the valuation of these investments (2018/19 overall difference was £4.5 million). This occurred where valuation gains to 31 March were not reported to the Pension Fund before the unaudited accounts were prepared, but were available by the publication of the audited financial statements. Management has previously elected not to adjust for these differences, noting the financial statements are prepared with the best information available at the time of preparation in line with required statutory requirements.

The identification of unadjusted audit differences drives an additional risk for our audit in line with the requirements of our internal engagement acceptance and continuance process.

Work we will perform:

- ▶ Review relevant controls' reports for qualifications or exceptions that may affect the audit risk and scope, and obtain bridging letters for the period between report dates and financial statement dates where they differ
- ▶ For each Fund manager we will obtain the most up to date Financial Statements for each investment/Fund, and the capital statement for the date of the Financial Statements along with the capital statement as of 31 March 2020. We will review the audit opinions for the fund to identify any possible issues with the valuation in the year and recalculate the Fund's share of the investment based on its percentage ownership.
- ▶ Review the basis of the valuation for unquoted investments to be satisfied that it is in line with the Fund's accounting policy and CIPFA requirements.
- ▶ Assess the impact of any differences arising from the timing of valuation reports for 31 March on the financial statements, including the turnaround impact from the prior year unadjusted difference.

4. Wider scope audit risks

Our wider scope audit work, and the judgements and conclusions reached in these areas, contribute to the overall assessment and assurance on the achievement of Best Value.

We will include commentary within our Annual Audit Report on how the Pension Fund demonstrates that it is meeting its Best Value duties.

The Code sets out the four dimensions that comprise the wider scope audit for public sector in Scotland. These are: financial sustainability, financial management, governance and transparency, and value for money. The Accounts Commission has also set five strategic Audit Priorities for auditors to integrate into our 2019/20 work as they are applicable to each entity:

- ▶ Clear priorities with a focus on outcomes, supported by effective long term planning.
- ▶ Effective appraisal of options for changing how services are delivered in line with their priorities.
- ▶ Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future.
- ▶ Empowering local communities and involving them in the design and delivery of local services and planning for their local area.
- ▶ Reporting on performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.

Our procedures

As part of our risk assessment procedures, we have reviewed each dimension to assess potential areas of risk. We set out our areas of focus, along with specific significant risks relating to each dimension below.

Audit dimension

Significant risk Work we will perform in 2019/20

Financial management: considers the effectiveness of financial management arrangements, including whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively.

No specific additional audit focus

In our 2018/19 annual audit report we concluded that the Pension Fund has established core financial management arrangements.

We will consider and report on the Fund's arrangements in respect of financial monitoring, review and reporting through the year and controlling its income and expenditure.

We will also consider the results of the Pension Fund's Internal Audit findings for the year in relation to financial management.

Audit dimension	Significant risk	Work we will perform in 2019/20
<p>Financial sustainability: considers the medium and longer term sustainability of the Fund including ensuring contributions, investment income and the ability to liquidate investments as required are sufficient to cover benefits over the short term and the Fund as a whole can meet its estimated liabilities as they crystallise over the longer term.</p>	<p>No specific additional audit focus</p>	<p>2017/18 saw the Fund conclude its triennial Funding Valuation as at 31 March 2017. The results saw improvements in the funding level of the Fund from 85% at the 2014 valuation to 92% now. The next triennial valuation is scheduled to take place as at 31 March 2020 with results published the following year. Preparations are underway to assess the key assumptions and the data requirements for the valuation exercise.</p> <p>The Government Actuaries Department ("GAD") published a report into the actuarial valuations of the 11 LGPS in Scotland. The report noted that the LGPS Scotland is in a strong financial position with funding improved from 94% in 2014 to 102% at 2017. The report noted that there were variations across the Funds in the approach taken in developing the valuations, assumptions used and disclosures.</p> <p>The Fund's investment strategy was subject to review in conjunction with the Fund's collaborative partners, Lothian Pension Fund and Fife Pension Fund in 2018/19. The review, supported by Hymans Robertson, has resulted in limited change with the Fund's current allocation of capital to various asset classes determined to be consistent with its funding aims of positioning employer contributions at an affordable level, to achieve the aim of being fully funded over a rolling 20 year period from the Fund valuation date.</p> <p>We will consider the Fund's progress in preparing for the triennial valuation and assess progress in delivering the Fund's investment strategy. We will continue to review the developing relationship with Lothian and Fife Pension Funds.</p>

Audit dimension

Significant risk

Work we will perform in 2019/20

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.

No specific additional audit focus

We noted in our 2018/19 annual audit report that the Fund performance and investment and administration costs remain comparable with the majority of Scottish Pension Funds. In 2018/19, the Fund achieved the joint second highest investment returns compared with other Scottish local government pension schemes. We will review the Fund's performance across the short, medium and longer term against its overall investment strategy and aims.

The transparency of investment management costs remain an area of focus and development for the Fund. Work is underway to develop a cost transparency template and ensure Fund managers are signed up to the programme.

We will continue to assess the steps taken by the Fund to monitor Fund manager performance and review the governance processes for making any changes.

Value for money:

considers whether value for money can be demonstrated in the use of resources. This includes the extent to which there is an alignment between spend, outputs and outcomes delivered and that there is a clear focus on improvement.

No specific additional audit focus

The Pensions Committee and Board, and Chief Finance Officer, have delegated authority for establishing robust governance arrangements in respect of the Pension Fund. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations. We will consider the material arrangements in respect of the Fund's arrangements around governance and transparency, in particular:

- ▶ How the Fund identifies, mitigates and monitors emerging risks
- ▶ Arrangements in place for ensuring compliance with regulatory requirements, addressing requests from the regulator and reporting as identified and applicable.
- ▶ Arrangements around and responsiveness to internal and external audit recommendations to ensure they are implemented in a timely manner.
- ▶ The effectiveness of governance scrutiny arrangements in place through the Fund's Pensions Committee and Board
- ▶ The openness and transparency of the Fund's arrangements.
- ▶ The development and uptake of training for Pensions Committee and Board members



Appendices

A - Code of Audit Practice: responsibilities

B - Independence and audit quality

C - Required communications with the Pensions Committee and Board

D - Timing and deliverables of the audit

E - Audit fees

F - Additional audit information

Appendix A: Code of Audit Practice Responsibilities

Audited Body's Responsibilities

Corporate Governance

Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including audit committees or equivalent) in monitoring these arrangements.

Financial Statements and related reports

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- ▶ 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 support their financial statements and related reports disclosures.
- ▶ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority.
- ▶ maintaining proper accounting records.
- ▶ 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. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.
- ▶ Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework.

Audited bodies 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 their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Standards of conduct / prevention and detection of fraud and error

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

Standards of conduct / prevention and detection of fraud and error

Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- ▶ 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 they plan to deal with uncertainty in the medium and longer term
- ▶ the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Local authority bodies have a statutory duty, under the Local Government (Scotland) Act 1973 and associated statutory guidance, to make arrangements to secure best value through the continuous improvement in the performance of their functions.

Appendix B: Independence Report

The FRC Ethical Standard and ISA (UK) 260 “Communication of audit matters with those charged with governance”, requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	Final stage
<ul style="list-style-type: none"> ▶ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us; ▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▶ The overall assessment of threats and safeguards; ▶ Information about the general policies and process within EY to maintain objectivity and independence. ▶ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard. 	<ul style="list-style-type: none"> ▶ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▶ Details of non-audit services provided and the fees charged in relation thereto; ▶ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▶ Written confirmation that all covered persons are independent; ▶ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▶ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▶ An opportunity to discuss auditor independence issues.

We confirm that we have undertaken client and engagement continuance procedures, which include our assessment of our continuing independence to act as your external auditor.

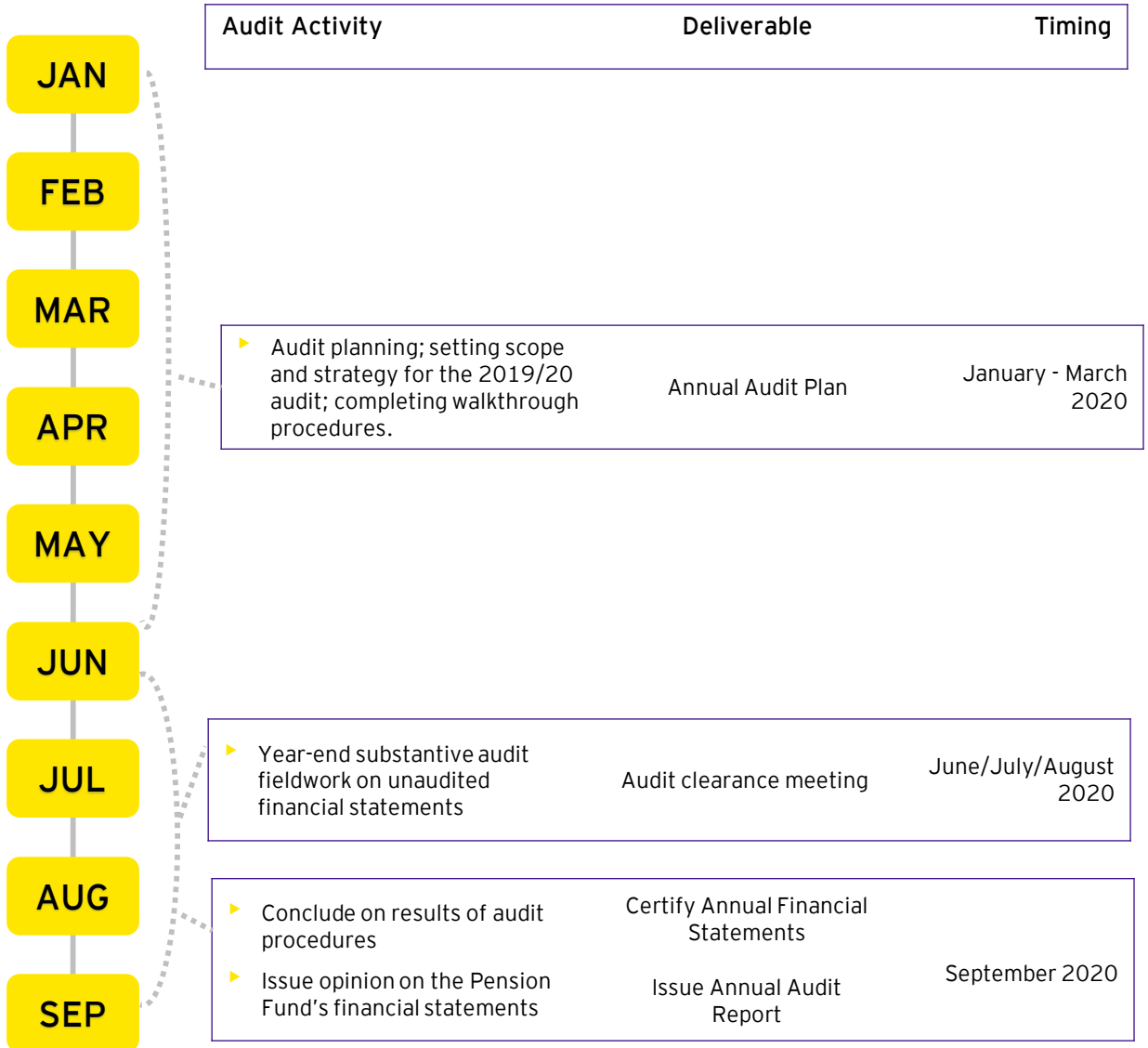
Appendix C: Required Communications

Required communication	Our reporting to you
Terms of engagement / Our responsibilities Confirmation by the Pensions Committee and Board of acceptance of terms of engagement as written in the engagement letter signed by both parties. Our responsibilities are as set out in our engagement letter.	Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice
Planning and audit approach Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Annual Audit Plan
Significant findings from the audit	Annual Audit Plan
<ul style="list-style-type: none"> Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures Significant difficulties, if any, encountered during the audit Significant matters, if any, arising from the audit that were discussed with management Written representations that we are seeking Expected modifications to the audit report Other matters if any, significant to the oversight of the financial reporting process 	Annual Audit Report
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: <ul style="list-style-type: none"> Whether the events or conditions constitute a material uncertainty Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements The adequacy of related disclosures in the financial statements 	Annual Audit Report
Misstatements	Annual Audit Report
<ul style="list-style-type: none"> Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation The effect of uncorrected misstatements related to prior periods A request that any uncorrected misstatement be corrected Corrected misstatements that are significant Material misstatements corrected by management 	
Fraud	Annual Audit Report
<ul style="list-style-type: none"> Enquiries of the Pensions Committee and Board to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity Any fraud that we have identified or information we have obtained that indicates that a fraud may exist A discussion of any other matters related to fraud 	
Consideration of laws and regulations	Annual Audit Report or as occurring if material.
<ul style="list-style-type: none"> Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off Enquiry of the Pensions Committee and Board into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Pensions Committee and Board may be aware of 	

Required communication	Our reporting to you
<p>Related parties</p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> ▶ Non-disclosure by management ▶ Inappropriate authorisation and approval of transactions ▶ Disagreement over disclosures ▶ Non-compliance with laws and regulations ▶ Difficulty in identifying the party that ultimately controls the entity 	<p>No significant matters have been identified.</p> <p>Annual Audit Report or as occurring if material.</p>
<p>Independence</p> <p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence 	<p>Annual Audit Plan</p> <p>Annual Audit Report</p>
<p>Internal controls</p> <p>Significant deficiencies in internal controls identified during the audit</p>	<p>Annual Audit Report</p>
<p>Representations</p> <p>We will request written representations from management and/or those charged with governance.</p>	<p>Annual Audit Report</p>
<p>Subsequent events</p> <p>Where appropriate, asking the Pensions Committee and Board whether any subsequent events have occurred that might affect the financial statements.</p>	<p>Annual Audit Report</p>
<p>Material inconsistencies and misstatements</p> <p>Material inconsistencies or misstatements of fact identified in other information which management has refused to revise</p>	<p>Annual Audit Report</p>
<p>Fee Reporting</p> <ul style="list-style-type: none"> ▶ Breakdown of fee information when the audit plan is agreed ▶ Breakdown of fee information at the completion of the audit ▶ Any non-audit work 	<p>Annual Audit Plan</p> <p>Annual Audit Report</p>

Appendix D: Timing and deliverables of the audit

We deliver our audit in accordance with the timeline set by the Pension Fund, in accordance with guidance from Audit Scotland. Below is a timetable showing the key stages of the audit and the deliverables through the 2019/20 audit cycle.



Appendix E: Audit fees

The audit fee is determined in line with Audit Scotland's fee setting arrangements, set out in recent communications to all audited bodies in line with their publication on '*Our Approach to setting audit fees*' (http://www.audit-scotland.gov.uk/uploads/docs/um/audit_fee_approach.pdf).

Audit Fees		2019/20	2018/19
	Component of fee:		
	Auditor remuneration - expected fee	£21,490	£21,000
	Audit Scotland fixed charges:		
	Pooled costs	£2,100	£2,040
	Audit support costs	£1,300	£1,320
	Total fee	£24,890	£24,360

The expected fee for each body, which for 2019/20 has been set centrally by Audit Scotland, assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and supporting schedules, and meets the agreed timetable for the audit. It also assumes there is no major change in respect of the scope of work in the year and an unqualified audit opinion resulting from the audit.

Should any of these circumstances not be in place throughout the audit, it is expected that additional costs will be incurred through the course of the audit which will be subject to recovery in line with the agreed process and rates set out by Audit Scotland. Under this process, fees can be agreed between the auditor and audited body by varying the auditor remuneration by up to 10% above the level set, or more with the approval of Audit Scotland.

Appendix F: Additional audit information

In addition to the key areas of audit focus outlined within the plan, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

Our responsibilities required by auditing standards

- ▶ Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- ▶ Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Pension Fund's internal control.
- ▶ Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- ▶ Conclude on the appropriateness of the going concern basis of accounting.
- ▶ Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- ▶ Read other information contained in the financial statements, the Audit, Risk & Governance Committee reporting appropriately addresses matters communicated by us to the Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- ▶ Maintaining auditor independence.

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines the locations at which we conduct audit procedures and the level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

Audit Quality Framework / Annual Audit Quality Report

Audit Scotland are responsible for applying the Audit Quality Framework across all audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team responsible are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission.

We support reporting on audit quality by providing additional information including the results of internal quality reviews undertaken on our public sector audits. The most recent audit quality report can be found at: [www. \[https://www.audit-scotland.gov.uk/uploads/docs/report/2019/as_audit_quality_1819.pdf\]\(https://www.audit-scotland.gov.uk/uploads/docs/report/2019/as_audit_quality_1819.pdf\)](http://www.audit-scotland.gov.uk/uploads/docs/report/2019/as_audit_quality_1819.pdf).

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details can be found in our annual Transparency Report:

https://www.ey.com/en_uk/who-we-are/transparency-report-2019

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