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ADDITIONAL CIRCULATION



To: Councillor Cooke, Convener; Councillor MacGregor, Vice Convener; and Councillors Allard, Alphonse, Cross, Davidson, Henrickson, Massey, McLellan, McRae and van Sweeden and two vacancies (Pensions Committee); Mrs M Lawrence, Chairperson; Councillor Smith, Vice-Chairperson; Councillors Leadbitter and Mennie; and Mr I Hodgson, Mr N Stirling, Mr A Walker and Mr G Walters (Pension Board).

Town House,
ABERDEEN, 11 September 2023

PENSIONS COMMITTEE AND PENSION BOARD

The undernoted item is circulated in connection with the meeting of the **PENSIONS COMMITTEE AND PENSION BOARD** to be held here in the Town House on **FRIDAY, 15 SEPTEMBER 2023 at 10.00am**. This is a hybrid meeting and Members may also attend remotely.

The meeting will be webcast and a live stream can be viewed on the Council's website. <https://aberdeen.public-i.tv/core/portal/home>

JENNI LAWSON
INTERIM CHIEF OFFICER – GOVERNANCE (LEGAL)

BUSINESS

INTERNAL AND EXTERNAL AUDIT

8.1 External Audit - NESPF Annual Audit Report (Pages 3 - 38)

Should you require any further information about this agenda, please contact Stephanie Dunsmuir, email sdunsmuir@aberdeencity.gov.uk

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Aberdeen City Council Pensions Committee

11 September 2023

Town House
Broad Street
Aberdeen
AB10 1AB

North East Scotland Pension Fund Audit of 2022/23 Annual Report and Accounts

Independent auditor's report

1. Our audit work on the 2022/23 Annual Report and Accounts is now substantially complete. Subject to the satisfactory conclusion of the outstanding matters referred to in paragraph 9 of this letter and final review of the audited Annual Report and Accounts, we anticipate being able to issue unqualified audit opinions in the independent auditor's report on 15 September 2023. The proposed report is attached at [Appendix A](#).

Annual audit report

2. Under International Standards on Auditing in the UK, we report specific matters arising from the audit of the financial statements to those charged with governance of a body in sufficient time to enable appropriate action. We present for the Pensions Committee's consideration our draft Annual Audit Report on the 2022/23 audit. The section headed "Significant findings and key audit matters" sets out the issues identified in respect of the annual accounts.
3. The report also sets out conclusions on the wider scope areas that frame public audit as set out in the Code of Audit Practice.
4. This report will be issued in final form after the annual accounts have been certified.

Unadjusted misstatements

5. We also report to those charged with governance all unadjusted misstatements which we have identified during our audit, other than those of a trivial nature and request that these misstatements be corrected. We have identified one unadjusted misstatement of £556,000 which is set out at Appendix 2 of the report. If adjusted, this would have no effect on the net decrease in the net assets available for benefits during the year.

Fraud, subsequent events and compliance with laws and regulations

6. In presenting this report to the Pensions Committee, we seek confirmation from those charged with governance of any instances of any actual, suspected or alleged fraud; any subsequent events that have occurred since the date of the financial statements; or material non-compliance with laws and regulations affecting the entity that should be brought to our attention.

Representations from Section 95 Officer

7. As part of the completion of our audit, we are seeking written representations from the Chief Officer – Finance as Section 95 Officer on aspects of the annual accounts, including the judgements and estimates made.

8. A draft letter of representation is attached at [Appendix B](#). This should be signed and returned to us by the Chief Officer – Finance with the signed annual accounts prior to the independent auditor's report being certified.

Outstanding matters

9. While the audit is substantially complete, we are currently concluding a small number of matters in the following areas:

- Concluding our review of journal entries processed by North East Scotland Pension Fund.
- Undertaking and concluding final subsequent event transaction testing by 14 September 2023. These are routine checks required to cover the period right up until the date of the independent auditor's report to ensure there are no events which might materially affect the figures in the accounts at 31 March 2023.
- A final review of the Fund's Annual Report and Accounts.

Appendix A: Proposed Independent Auditor's Report

Independent auditor's report to the members of Aberdeen City Council as administering authority for North East Scotland Pension Fund and the Accounts Commission

Reporting on the audit of the financial statements

Opinion on financial statements

I certify that I have audited the financial statements in the annual report of North East Scotland Pension Fund for the year ended 31 March 2023 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Fund Account, the Net Assets Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and UK adopted international accounting standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2022/23 (the 2022/23 Code).

In my opinion the accompanying financial statements:

- give a true and fair view of the financial transactions of the fund during the year ended 31 March 2023 and of the amount and disposition at that date of [its/their] assets and liabilities;
- have been properly prepared in accordance with UK adopted international accounting standards, as interpreted and adapted by the 2022/23 Code; and
- 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.

Basis for opinion

I conducted my audit in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)), as required by the [Code of Audit Practice](#) approved by the Accounts Commission for Scotland. My responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of my report. I was appointed by the Accounts Commission on 3 April 2023. My period of appointment is five years, covering 2022/23 to 2026/27. I am independent of the fund in accordance with the ethical requirements that are relevant to my audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and I have fulfilled my other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the council as administering authority for the fund. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Conclusions relating to going concern basis of accounting

I have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work I have performed, I have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the fund's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from when the financial statements are authorised for issue.

These conclusions are not intended to, nor do they, provide assurance on the fund's current or future financial sustainability. However, I report on the fund's arrangements for financial sustainability in a separate Annual Audit Report available from the [Audit Scotland website](#).

Risks of material misstatement

I report in my Annual Audit Report the most significant assessed risks of material misstatement that I identified and my judgements thereon.

Responsibilities of the Chief Officer – Finance and the Pensions Committee for the financial statements

As explained more fully in the Statement of Responsibilities, the Chief Officer – Finance is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Chief Officer – Finance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Officer – Finance is responsible for assessing the fund ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention to discontinue the fund's operations.

The Pensions Committee is responsible for overseeing the financial reporting process.

Auditor's responsibilities for the audit of the financial statements

My objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decisions of users taken on the basis of these financial statements.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. I design procedures in line with my responsibilities outlined above to detect material misstatements in respect of irregularities, including fraud. Procedures include:

- using my understanding of the local government sector to identify that the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, the Local Government in Scotland Act 2003, and The Local Government Pension Scheme (Scotland) Regulations 2018 as amended are significant in the context of the fund;
- inquiring of the Chief Officer – Finance and Interim Chief Officer – Governance as to other laws or regulations that may be expected to have a fundamental effect on the operations of the fund;
- inquiring of the Chief Officer – Finance and Interim Chief Officer – Governance concerning the fund's policies and procedures regarding compliance with the applicable legal and regulatory framework;
- discussions among my audit team on the susceptibility of the financial statements to material misstatement, including how fraud might occur; and

- considering whether the audit team collectively has the appropriate competence and capabilities to identify or recognise non-compliance with laws and regulations.

The extent to which my procedures are capable of detecting irregularities, including fraud, is affected by the inherent difficulty in detecting irregularities, the effectiveness of the fund's controls, and the nature, timing and extent of the audit procedures performed.

Irregularities that result from fraud are inherently more difficult to detect than irregularities that result from error as fraud may involve collusion, intentional omissions, misrepresentations, or the override of internal control. The capability of the audit to detect fraud and other irregularities depends on factors such as the skilfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved.

A further description of the auditor's responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website www.frc.org.uk/auditorsresponsibilities. This description forms part of my auditor's report.

Reporting on other requirements

Other information

The Chief Officer – Finance is responsible for the other information in the annual report. The other information comprises the Management Commentary, Statement of Responsibilities, Annual Governance Statement, Governance Compliance Statement, and other reports included in the annual report other than the financial statements and my auditor's report thereon.

My responsibility is to read all the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the course of the audit or otherwise appears to be materially misstated. If I identify such material inconsistencies or apparent material misstatements, I am required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon except on the Management Commentary, Annual Governance Statement and Governance Compliance Statement to the extent explicitly stated in the following opinions prescribed by the Accounts Commission.

Opinions prescribed by the Accounts Commission on the Management Commentary, Annual Governance Statement and Governance Compliance Statement

In my opinion, based on the work undertaken in the course of the audit:

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003;

- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016): and
- the information given in the Governance Compliance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with The Local Government Pension Scheme (Scotland) Regulations 2018.

Matters on which I am required to report by exception

I am required by the Accounts Commission to report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- I have not received all the information and explanations I require for my audit.

I have nothing to report in respect of these matters.

Conclusions on wider scope responsibilities

In addition to my responsibilities for the annual report, my conclusions on the wider scope responsibilities specified in the Code of Audit Practice are set out in my Annual Audit Report.

Use of my report

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 108 of the Code of Audit Practice, I do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Michael Oliphant FCPFA
Audit Director
Audit Scotland
4th Floor
102 West Port
Edinburgh
EH3 9DN

Appendix B: Letter of Representation (ISA 580) - to be reproduced on client's letterhead

Michael Oliphant
Audit Director
Audit Scotland
4th Floor
102 West Port
Edinburgh

Dear Michael

Aberdeen City Council Annual Accounts 2022/23

- 1.** This representation letter is provided about your audit of the annual report and accounts of North East Scotland Pension Fund (herein referred to as North East Scotland Pension Fund or the Fund) for the year ended 31 March 2023 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the financial reporting framework, and for expressing other opinions on the management commentary, annual governance statement and the governance compliance statement.
- 2.** I confirm to the best of my knowledge and belief and having made appropriate enquiries of Aberdeen City Council's Corporate Management Team and North East Scotland Pension Fund's Management Team, the following representations given to you in connection with your audit of the Fund's annual accounts for the year ended 31 March 2023.

General

- 3.** The Fund and I have fulfilled our statutory responsibilities for the preparation of the 2022/23 annual accounts. All the accounting records, documentation and other matters which I am aware are relevant to the preparation of the annual accounts have been made available to you for the purposes of your audit. All transactions undertaken by the Fund have been recorded in the accounting records and are properly reflected in the financial statements.
- 4.** I confirm that the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole. I am not aware of any uncorrected misstatements other than those reported by you.

Financial Reporting Framework

- 5.** The annual accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2022/23 (2022/23 accounting code), the requirements of the Local Government (Scotland) Act 1973, the Local Government in Scotland Act 2003 and The Local Authority Accounts (Scotland) Regulations 2014.
- 6.** In accordance with the 2014 regulations, I have ensured that the financial statements give a true and fair view of the financial position of North East Scotland Pension Fund at 31 March 2023 and the transactions for 2022/23.

Accounting Policies & Estimates

- 7.** All significant accounting policies applied are as shown in the notes to the financial statements. The accounting policies are determined by the 2022/23 accounting code where

applicable. All accounting policies applied are appropriate to the Fund's circumstances and have been consistently applied.

8. The significant assumptions used in making accounting estimates are reasonable and properly reflected in the financial statements. Judgements used in making estimates have been based on the latest available, reliable information. Estimates have been revised where there are changes in the circumstances on which the original estimate was based or as a result of new information or experience.

Going Concern Basis of Accounting

9. I have assessed the Fund's ability to continue to use the going concern basis of accounting and have concluded that it is appropriate. I am not aware of any material uncertainties that may cast significant doubt on the Fund's ability to continue as a going concern.

Assets

Investments

10. For the year ended 31 March 2023, the amounts included in the net assets statement reflect investments managed/held both internally and externally by appointed fund managers and the global custodian on behalf of the funds. Amounts have been calculated in accordance with approved bases of valuation and fairly represent the values at 31 March 2023. In making these assertions I am reliant on the opinions of the appointed fund managers. As far as we can reasonably ascertain, all assets are free from any lien, encumbrance or charge except as disclosed in the financial statements.

Long Term Assets

11. For the year ended 31 March 2023, the amount included in the net assets statement for the insurance buy-in contract is the valuation provided by the Fund's actuary. The pension assumptions made by the actuary in this valuation have been considered and I confirm that they are consistent with management's own view.

Banking and Cash Flow Arrangements

12. North East Scotland Pension Fund maintains separate bank accounts and while these accounts form part of Aberdeen City Council's treasury management arrangements, the pension fund can demonstrate that there is no borrowing from the administering authority. Amounts due to the administering authority to cover daily cash flows such as payments through the council's systems are reimbursed on a regular basis.

Other Current Assets

13. On realisation in the ordinary course of the fund's business, the other current assets in the Net Assets Statements are expected, in my opinion, to produce at least the amounts at which they are stated. In particular adequate provision has, in my opinion, been made against all amounts owing which are known or may be expected to be irrecoverable.

Liabilities

14. All liabilities at 31 March 2023 of which I am aware have been recognised in the financial statements.

15. Provisions have been recognised in the financial statements for all liabilities of uncertain timing or amount at 31 March 2023 of which I am aware where the conditions specified in the 2022/23 accounting code have been met. The amount recognised as a provision is the best

estimate of the expenditure likely to be required to settle the obligation at 31 March 2023. Where the effect of the time value of money is material, the amount of the provision has been discounted to the present value of the expected payments.

16. Provisions recognised in previous years have been reviewed and adjusted, where appropriate, to reflect the best estimate at 31 March 2023 or to reflect material changes in the assumptions underlying the calculations of the cash flows.

17. The pension assumptions made by the actuary in the IAS 19 report for North East Scotland Pension Fund have been considered and I confirm that they are consistent with management's own view.

18. There are no plans or intentions that are likely to affect the carrying value or classification of the liabilities recognised in the financial statements.

Contingent liabilities

19. There are no significant contingent liabilities, other than those disclosed in Note 25 to the financial statements, arising either under formal agreement or through formal undertakings requiring disclosure in the accounts. All known contingent liabilities have been fully and properly disclosed, including any outstanding legal claims which have not been provided under the 2022/23 accounting code and IAS 37.

Fraud

20. I have provided you with all information in relation to:

- my assessment of the risk that the financial statements may be materially misstated because of fraud
- any allegations of fraud or suspected fraud affecting the financial statements
- fraud or suspected fraud that I am aware of involving management, employees who have a significant role in internal control, or others that could have a material effect on the financial statements.

Laws and Regulations

21. I have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

Related Party Transactions

22. All material transactions with related parties have been appropriately accounted for and disclosed in the financial statements in accordance with the 2022/23 accounting code. I have made available to you the identity of all the Fund's related parties and all the related party relationships and transactions of which I am aware.

Management commentary

23. I confirm that the Management Commentary has been prepared in accordance with the statutory guidance and the information is consistent with the financial statements.

Corporate Governance

24. I confirm that North East Scotland Pension Fund has undertaken a review of the system of internal control during 2022/23 to establish the extent to which it complies with proper practices set out in the Delivering Good Governance in Local Government: Framework 2016. I

have disclosed to you all deficiencies in internal control identified from this review or of which I am otherwise aware.

25. I confirm that the Annual Governance Statement has been prepared in accordance with the Delivering Good Governance in Local Government: Framework 2016 and the information is consistent with the financial statements. Other than the changes already reflected in the audited accounts, there have been no changes in the corporate governance arrangements or issues identified, since 31 March 2023, which require to be reflected.

Events Subsequent to the Date of the Balance Sheet

26. All events subsequent to 31 March 2023 for which the 2022/23 accounting code requires adjustment or disclosure have been adjusted or disclosed.

Yours sincerely

Jonathan Belford
Chief Officer – Finance

North East Scotland Pension Fund

2022/23 Annual Audit Report – DRAFT



 AUDIT SCOTLAND

Prepared for Aberdeen City Council Pensions Committee and the Controller of Audit
15 September 2023

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Key messages

2022/23 annual report and accounts

- 1 Audit opinions on the annual report and accounts are unmodified.
- 2 The financial statements give a true and fair view of the state of affairs of North East Scotland Pension Fund as at 31 March 2023 and have been properly prepared in accordance with the financial reporting framework.

Financial management and sustainability

- 3 The fund has appropriate financial management arrangements in place which includes comprehensive reporting of investment performance and appropriate medium term financial planning.
- 4 Following a challenging year, the fund reported a negative performance below the target benchmark but it continues to outperform in the longer term.
- 5 Effective financial internal controls are in place including satisfactory counter fraud arrangements.

Governance and resources

- 6 Considerable change in the Pensions Committee membership may have reduced the effectiveness of scrutiny.
- 7 Effective arrangements are in place for monitoring investment management and performance.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of North East of Scotland Pension Fund. The scope of the audit was set out in our annual audit plan which was considered by the Pensions Committee in March 2023. This Annual Audit Report comprises:

- significant matters arising from the audit of the fund's annual report and accounts
- conclusions on the following wider scope areas that frame public audit as set out in the [Code of Audit Practice 2021](#):
 - Financial Management
 - Financial Sustainability
 - Governance and Resources.

2. This report is addressed to the Pension Committee of Aberdeen City Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Audit appointment from 2022/23

3. We have been appointed by the Accounts Commission as auditors of North East Scotland Pension Fund and Aberdeen City Council for the five-year period from April 2022 until March 2027. The 2022/23 financial year was the first year of that appointment. Our appointment coincides with the new [Code of Audit Practice](#) which was introduced for financial years commencing on or after 1 April 2022.

4. We would like to thank officers and elected members for their cooperation and assistance during the year and we look forward to working together constructively over the course of the five-year appointment.

Responsibilities and reporting

5. As the administering authority for North East Scotland Pension Fund, Aberdeen City Council has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing the pension fund's annual report and accounts that are in accordance with proper accounting practices. The administering authority is also responsible for compliance with legislation, and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

6. The responsibilities of the independent auditor are established by the Local Government (Scotland) Act 1973 and the [Code of Audit Practice 2021](#), and supplementary guidance and International Standards on Auditing in the UK.
7. 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. Communicating these does not absolve management of the administering authority from its responsibility to address the issues we raise and to maintain adequate systems of control.
8. This report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation.

Auditor Independence

9. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2022/23 audit fee of £48,370 as set out in our 2022/23 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

1. Audit of 2022/23 annual accounts

Public bodies are required to prepare annual accounts comprising financial statements and other related reports. These are the principal means of accounting for the stewardship of public funds.

Main judgements

Our audit opinions on the annual report and accounts are unmodified.

The annual accounts give a true and fair view of the state of affairs of North East Scotland Pension Fund as at 31 March 2023 and have been properly prepared in accordance with the financial reporting framework.

Audit opinions on the annual report and accounts are unmodified

10. The Pension Committee is scheduled to approve the fund's 2022/23 annual report and accounts on 15 September 2023. As reported in the independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with UK adopted international accounting standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2022/23
- the management commentary, annual governance statement and governance compliance statement were consistent with the financial statements and properly prepared in accordance with the applicable requirements.

Overall materiality was assessed as £116 million

11. Broadly, the concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and hence impact their opinion set out in the independent auditor's report.

12. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature. It is ultimately a matter of the auditor's professional judgement.

13. Our initial assessment of materiality was carried out during the risk assessment and planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

Exhibit 1

Materiality values

Materiality level	Amount
Overall materiality – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. Materiality has been set based on our assessment of the needs of the users of the financial statements and the nature of the fund's operations. For the year ended 31 March 2023, we have set our materiality at 2% of net assets based on the unaudited financial statements.	£116 million
Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 65% of overall materiality reflecting issues noted during planning and the fact that this is the first year of our audit appointment.	£75 million
Reporting threshold– We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£250,000

14. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

Materiality was separately assessed for benefits expenditure and contribution income

15. We assessed that benefits expenditure and contribution income could reasonably be expected to influence the economic decisions of users of the annual accounts, despite the comparatively small value of these areas in relation to overall materiality. In line with International Standards on Auditing (UK) 320, we set a specific materiality value of £18 million for these areas based on benefits payable.

Our audit work responded to the risks of material misstatement we identified in the annual accounts

16. [Exhibit 2](#) sets out the significant risks of material misstatement we identified in our 2022/23 Annual Audit Plan. In addition, it includes our identified “areas of audit focus” where we considered there to be risks of material misstatement to the financial statements. We have obtained audit assurances over these risks through the further audit procedures we performed and the conclusions we reached having completed this work.

Exhibit 2

Risks of material misstatement in the annual accounts

Significant risks	Assurance procedure	Results and conclusions
<p>1. Risk of material misstatement due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management’s ability to override controls that otherwise appear to be operating effectively.</p>	<p>Assessed the design and implementation of controls over journal entry processing and tested a sample of journals with a focus on risk areas.</p> <p>Made enquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</p> <p>Assessed any changes since the prior year to the methods and underlying assumptions used to prepare accounting estimates.</p>	<p>Based on the audit work undertaken, there was no evidence of management override of control.</p>

Areas of audit focus (risks of material misstatement)	Assurance procedure	Results and conclusions
<p>1. Aberdeen City Council Transport Fund merged with North East Scotland Pension Fund on 1 April 2022. In terms of the 2022/23 annual report and accounts, this was largely a consolidation of the results of the two funds. Any re-allocation of investments may be implemented as part of a longer term strategy.</p>	<p>The funds merged on the basis of transfer by absorption which means the date of the transfer is the start date for the new, combined authority. As a result, there was no requirement to restate prior year figures.</p> <p>We reviewed the accounting treatment and disclosures for the transfer in of the Transport</p>	<p>We requested a change in the positioning of the transfer in on the fund account. In line with the Code, such transactions should be separate from the year’s normal business activities.</p> <p>This change has been reflected in the audited accounts. Otherwise, we</p>

Areas of audit focus (risks of material misstatement)	Assurance procedure	Results and conclusions
	Fund against the requirements of the Code of Practice for Local Authority Accounting (the Code).	concluded that the accounting treatment was in accordance with the Code.
2. An actuarial valuation of future retirement benefits is calculated on an annual basis under IAS 26 by the fund's actuary. Valuation estimates are based on a number of assumptions about the future (e.g. investment returns, pensioner mortality, discount rates) and therefore, there is a risk that the assumptions used are not appropriate.	In accordance with ISA 500, we undertook a review of the work of the actuary as a management expert. This included a review of the assumptions on which the valuation was based. In addition, Audit Scotland engaged a consulting actuary to review actuarial work across Scottish local government pension funds. We considered the consulting actuary's report and followed up local variations.	No issues were identified from our audit work in this area. We concluded that we could place reliance on the work of the actuary.
3. An insurance buy-in contract is in place to meet the pension commitments for a number of transport fund pensioners. The liability on the fund's Net Asset Statement is revalued annually by the actuary. The valuation is made on similar assumptions about the future as the IAS 26 retirement benefit valuation.	Assurance was taken from the review of the actuary's work undertaken in respect of the IAS26 retirement benefit valuation (Refer no 2 above).	No issues were identified from our audit work in this area. We concluded that we could place reliance on the work of the actuary.
4. There is a significant degree of subjectivity in the measurement and classification of certain investments, in particular private equity funds.	In accordance with ISA 500: Audit Evidence, we undertook a review of the work of relevant management experts. This included fund managers - Harbour Vest and IFM who manage the main private equity portfolios. Such investments are not quoted and therefore market values are not readily available. We therefore rely on fund managers' expertise where they are responsible for determining investment	The figures in the unaudited accounts were based on the latest available information ie results for the quarter to 31 December 2022 rolled forward. Management has made an adjustment to reflect the final valuation of private equity investments. This increased the net return on investments and net assets by £15.3 million. Otherwise, no significant issues were identified from

Areas of audit focus (risks of material misstatement)	Assurance procedure	Results and conclusions
	<p>valuations. We reviewed their valuation reports and agreed these to the values in the annual accounts.</p> <p>We also identified and assessed other sources of assurance relied on by management.</p>	<p>our audit work in this area. We concluded that we could place reliance on private equity valuations prepared by the relevant fund managers.</p>

Significant findings and key audit matters

17. The unaudited annual accounts were received by 30 June 2023, in line with the agreed audit timetable. The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team during the audit.

18. Under International Standard on Auditing (UK) 260, we communicate significant findings from the audit to the pension fund, including our view about the qualitative aspects of the fund's accounting practices. The Code of Audit Practice also requires us to communicate key audit matters within the annual audit report under International Standard on Auditing (UK) 701. These are matters that we judged to be of most significance in our audit of the financial statements.

19. The accounts have been amended to reflect actual private equity investment valuations at 31 March 2023. As described in Exhibit 2, management has made an adjustment to reflect the final valuation of private equity investments. This increased the net return in investments and net assets by £15.3 million.

20. We identified one misstatement above our reporting threshold which was not amended by management. This relates to a private equity investment performance fee initially estimated by the fund manager as £5.6 million but revised to £1.5 million when they submitted their March 2023 statement. This matter has identified some inconsistency in the performance fee information provided by private equity managers which would merit further consideration by the fund. The misstatement reflects the reversal of the entry posted by the fund to record the estimated fee. This is not considered to be material and has therefore been included in appendix 2 as an unadjusted misstatement.

Recommendation 1

The fund should review the accounting treatment of private equity management fees and implement any changes considered necessary to ensure a consistency in approach of management fee disclosures.

21. Other than the matters covered by our audit procedures in response to the identified risks of material misstatement set out in Exhibit 2, there are no significant findings to draw to your attention from the audit of the annual report and accounts.

Other information

22. The Local Authority Accounts (Scotland) Regulations 2014 require the annual report and accounts to include a management commentary prepared in accordance with statutory guidance and an annual governance statement that is consistent with the disclosures made in the financial statements and provide assurance on the operation of the governance arrangements for the financial year.

23. The fund's management commentary and annual governance statement are comprehensive and meet the requirements on content set out in guidance.

2. Financial management and sustainability

Financial management means having sound budgetary processes and the ability to understand the financial environment. Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Conclusions

The fund has appropriate financial management arrangements in place which includes comprehensive reporting of investment performance and appropriate medium term financial planning.

Following a challenging year, the fund reported negative performance below the target benchmark but continues to outperform in the longer term.

Effective financial internal controls are in place including satisfactory counter fraud arrangements.

The fund has appropriate financial management arrangements in place which includes comprehensive reporting of investment performance

24. The fund has appointed several external investment managers. Individual investment manager performance is reviewed regularly by the Pensions Committee and the Fund's investments team also undertake regular monitoring activities in respect of each appointed fund manager.

25. When considering the investment performance of the fund during 2022/23, it is important to recognise the impact of world events on financial markets and investments. The impact of the conflict in Ukraine, high inflation and interest rates resulting in cost of living crisis have all significantly increased market volatility. The fund's performance in 2022/23 is summarised in [Exhibit 3](#)

Exhibit 3**Assets, funding level and investment performance**

Decrease in net assets	Funding level	Investment performance
£5.804 billion (-6.6%) Closing net assets as at 31 March 2023	1.26% Net assets vs promised retirement benefits as at 31 March 2023	6.9% Average annual return on investments over 5 years
£6.216 billion* Opening net assets at 1 April 2022	0.98% Opening net assets as a proportion of promised retirement benefits	-4.1% Return on investments 2022/23

*Transport Fund Net Assets of £290 million added for comparative purposes.

Source: 2022/23 North East Scotland Pension Fund annual report and accounts

26. The fund experienced a challenging year in 2022/23. The net assets of the fund decreased by £412 million resulting in a negative performance for the year of -4.1%, compared with a benchmark of -2.2%. In the longer term the fund continues to outperform against the benchmark (Exhibit 4).

Exhibit 4**Investment performance**

	1 Year	3 Year	5 Year
Return on Investments (Benchmark)	-4.1% (-2.2%)	9.4% (9.4%)	6.9% (5.8%)

Source: 2022/23 North East Scotland Pension Fund annual report and accounts

27. The promised retirement benefits at 31 March 2023 have been estimated at £4.6 billion (31 March 2022: £6.3 billion) or a 27.4% reduction. This estimate uses assumptions in line with Internal Accounting Standards (IAS) 19 requirements, for the purposes of the fund's financial statements. It is not directly comparable to the liability measured on a funding basis. The decrease can be attributed mainly to the increase in the discount rate from 2.8% to 4.8%.

28. During 2022/23, benefits payable by the fund exceeded contributions receivable by £13 million. This is a continuing trend being experienced by the fund in recent years. The number of pensioner members continues to increase, with an additional 927 during the year, an increase of 3.5%. This makes the funding of pension payments increasingly challenging. For now, the number of active members continues to outweigh the number of pensioners

(27,751 active: 26,146 pensioners) but the ratio of active members to pensioners has reduced significantly in recent years.

29. The Chief Officer - Finance for Aberdeen City Council is the Proper Officer responsible for North East Scotland Pension Fund. The council's financial regulations, as administering authority, apply to the fund. We consider these to be current, comprehensive and support good financial management.

30. The Pensions Committee receives administration and performance reports at its quarterly meetings. These reports are comprehensive and include fund performance trends, investment managers performance against benchmarks and movements in asset allocations.

Effective financial control arrangements are in place

31. From our review of the systems of internal control relevant to our audit approach and the testing of the operating effectiveness of specific controls, we did not identify any significant internal control weaknesses which could affect the fund's ability to record, process, summarise and report financial and other relevant data which can result in a material misstatement in the financial statements.

32. Overall, we concluded that the controls in place were satisfactory. While we noted a few minor weaknesses during the completion of our audit work which should be addressed, we do not believe they would result in any significant risk of material misstatement to the financial statements. We noted that the evidencing of which officer carried out checks is not always clear e.g. review of deceased pensioner report and independent check of changes to supplier bank details. Also, there is no process for periodic review of financial system user access rights to ensure that only authorised users have access to data.

Recommendation 2

Make improvements to internal control by ensuring checks of key control areas are evidenced, and implementing a periodic review of user access rights to ensure leavers are promptly removed and only authorised users have access to systems.

33. Internal Audit carried out a review of the fund's governance arrangements to provide assurance over the arrangements in place including risk management and performance management. They concluded that a sound system of governance, risk management and control exist, with internal controls operating effectively and consistently.

Standards of conduct and arrangements for the prevention and detection of fraud and error were appropriate

34. In the public sector there are specific fraud risks, including those relating to welfare benefits, grants and other claims made by individuals and organisations. Public sector bodies are responsible for implementing effective systems of internal control, including internal audit, which safeguard public assets and prevent and detect fraud, error and irregularities, bribery and corruption.

35. In our view, the fund has adequate arrangements in place to prevent and detect fraud or other irregularities.

There are appropriate arrangements for financial sustainability

36. The results of a triennial valuation are in effect a snapshot of the fund at a point in time. Following each triennial valuation, the fund reviews and revises its funding and investment strategies. The funding strategy sets out a summary of the fund's approach to funding liabilities and the investment strategy outlines the types and split of investment to be held.

37. The results of the 2020 triennial valuation of the North East Scotland Pension Fund showed a funding level of 103%, a marginal decline to the 2017 level of 107%. The Transport Fund was assessed as 114% funded, an increase in the funding position from the 2017 level of 94%. Overall, both funds' had sufficient assets to meet their respective estimated liabilities.

38. Following the triennial valuation in 2020, the actuary agreed employer contribution rates with individual employers for the 3 year period from 1 April 2021. For councils this ranged from 17.9% to 19.3% and for other employers, the range was 11.9% to 65.8%. For the majority of employers, the funding surplus is being used to subsidise and stabilise contribution rates. For a small number of employers, these rates include an element of deficit recovery contributions to support employers' financial planning. The approximate split of all contributions received in year is set out at [Exhibit 5](#).

39. The next triennial valuation as at 31 March 2023 is in progress and will set the funding strategy and employer contribution rates for the period April 2024 to March 2027. Membership, employer data and cashflow information have been provided to the actuary. Senior officers have also met with the actuary to determine the valuation approach and discuss potential outcomes. Whole fund results are due to be shared with employers in September 2023 with individual employer results being available by December 2023. There will also be consultation with participating employers around the funding strategy including the approach and the assumptions.

Exhibit 5**Contributions in 2022/23**

	Administering authority £m	Other scheduled bodies £m	Admitted bodies £m	Total £m
Employers' contributions	32.179	78.035	11.738	121.952
Employees' contributions	10.140	23.341	3.575	37.056
Strain Contributions	0.515	0.750	1.260	2.525

Source: North East Scotland Fund 2022/23 audit annual report and accounts

40. On 1 April 2022, the Aberdeen City Council Transport Fund merged with the North East Scotland Pension Fund. The merger was aimed at not only reducing the risk to the Transport Fund which has declining membership but also the administrative burden of carrying two funds.

3. Governance and resources

Public sector bodies must have a clear strategy and priorities. They need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners.

Conclusions

Considerable change in the Pensions Committee membership may have reduced the effectiveness of scrutiny.

Effective arrangements are in place for monitoring investment management and performance.

Considerable change in the Pensions Committee membership may have reduced the effectiveness of scrutiny

41. The Pensions Committee carries out the functions of an audit committee for the Pension Fund. Following the Local Government election in May 2022, Aberdeen City Council brought membership of the committee into line with other council committees. Consequently, its membership was increased from nine to thirteen.

42. There has however been considerable change in committee membership during 2022/23. Eight members of the committee have provided continuity since May 2022. We noted that three members were appointed to the committee and subsequently resigned within weeks without attending a meeting of the committee. At 31 March 2023, there were three vacancies on the committee which has subsequently been reduced to two vacancies by September 2023.

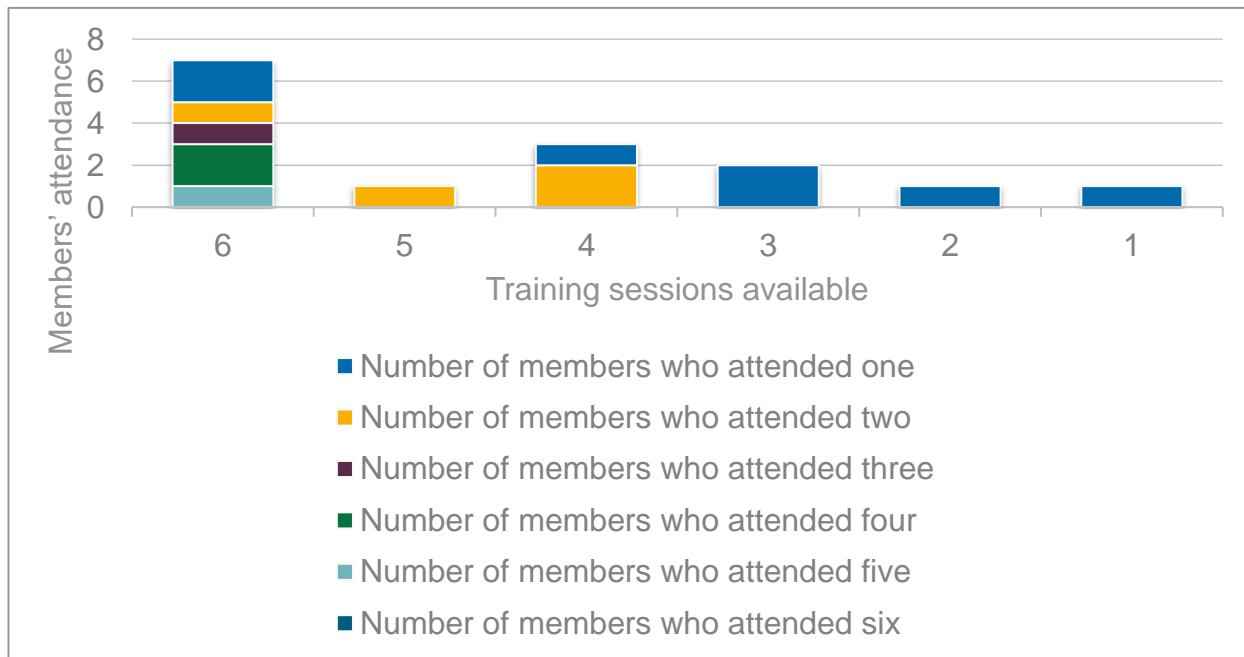
43. In December 2022, the previous external auditor reported that 'political disagreement had entered into Pensions Committee discussions and detracted from member engagement in their scrutiny role; committee membership changes also followed this political disagreement. We recognise that local government is a political environment but members should be mindful of the role and remit of the committee'. It appears that the ongoing vacancies on the Pension Committee may be linked with these political disagreements.

44. Given the specialist nature of the committee's business, the level of change in its membership may have impacted on the effectiveness of scrutiny.

While we note that all members attended induction training, attendance at other training events has been more variable as shown in [Exhibit 6](#).

Exhibit 6

Pensions Committee - members' attendance at training sessions



Source: North East Scotland Fund 2022/23 audit annual report and accounts

45. In relation to the Pension Board, we note there was better attendance at training events across the year but that attendance at induction training was limited.

Recommendation 3

We encourage Aberdeen City Council, as the administering authority, to fill the vacancies on the Pensions Committee and for members to work together for the benefit of the fund. There is a need for ongoing training to support members in building their knowledge in this complex area and provide them with essential skills for effective scrutiny.

Audit work has addressed the wider scope risks identified in our Annual Audit Plan

46. [Exhibit 7](#) sets out the wider scope risks relating to Governance and Resources we identified in our 2022/23 Annual Audit Plan. It summarises the audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 7

Risks identified from the auditor's wider responsibility under the Code of Audit Practice

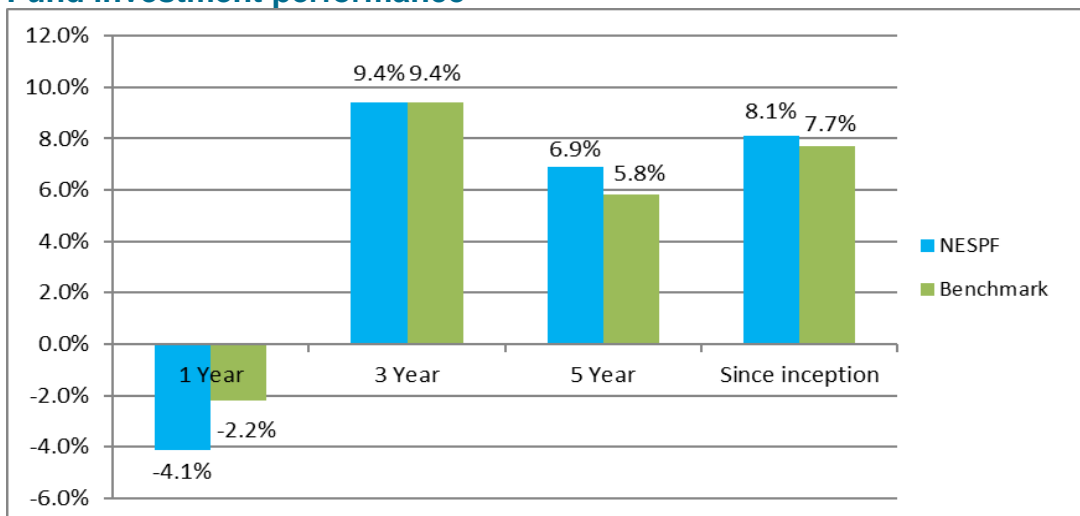
Areas identified for review	Audit findings and conclusions
<p>Investment performance</p> <p>Fund investment performance levels in 2021/22 were below target. There has been improvement in 2022/23 after a turbulent start to the year. While high inflation and energy costs continue to have an adverse impact on quarterly returns, performance continues to outperform medium and longer term benchmarks. We will review performance against benchmark over the short, medium and long terms. We will also consider performance against Scottish local government pension fund comparators.</p>	<p>We reviewed performance against benchmark over the short, medium and long terms. We also considered performance against Scottish local government pension fund comparators. (Refer paragraphs 48-50 below).</p> <p>Conclusions</p> <ul style="list-style-type: none"> • Following a challenging year, the fund reported negative performance below the target benchmark but continues to outperform in the longer term. • Effective arrangements are in place for monitoring investment management and performance
<p>Cyber security arrangements</p> <p>There continues to be a significant risk of cyber-attacks to public bodies. We will therefore review the fund's arrangements to mitigate such risks.</p>	<p>North East Scotland Pension Fund's cyber security policy is currently being developed. To assist this process, data is being collated for all the systems used by the pension fund team including for example security policies, accreditations, how data is used and stored.</p> <p>Conclusions</p> <p>Good work is in progress which we will continue to monitor during the audit appointment.</p>
<p>Climate change</p> <p>The public sector has a key role to play in ensuring that national climate change targets are met and in adapting the impacts of climate change. The Accounts Commission is developing a programme of work on climate change. As part of this work, auditors will initially focus on a body's arrangements for responding to climate change. We will therefore consider whether the fund has developed a strategy and action plan, what targets have been set and how they will be monitored and reported.</p>	<p>The Scottish Parliament has set a legally binding target of becoming net zero by 2045 and has interim targets including a 75% reduction in greenhouse gas emissions by 2030. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change. For the pension fund, the responsibility for meeting these targets lies with the administering authority.</p> <p>The fund is supporting climate change initiatives through collaboration with the Local Authority Pension Fund Forum (LAPFF) and its external fund managers. The fund believes that by working together, investors can use their collective size to influence decision making and promote the highest standards of corporate governance and corporate responsibility.</p>

Areas identified for review	Audit findings and conclusions
	<p>Preparations are also underway to gather data which may be required from local government pension funds by the Task Force on Climate-Related Financial Disclosures by 31 March 2024.</p> <p>More importantly, a conversation has started at North East Scotland Pension Fund about whether it should set a net zero commitment and its implications and how this can be balanced with the main aim of the pension fund which is to grow return on its investments to meet future pension payments.</p> <p>Conclusions</p> <p>The pension fund's consideration of its responsibilities with regard to climate change are at an early stage of development. We will continue to monitor during the audit appointment.</p>

The continuing impact of world events on global markets significantly reduced annual returns

47. When considering the investment performance of the Fund during 2022/23, it is important to recognise the impact of world events on financial markets and investments. The impact of the conflict in Ukraine, high inflation and interest rates resulting in cost of living crisis have all significantly increased market volatility. Global stocks and bonds markets consequently tumbled. The Fund's performance in 2022/23 is summarised in [Exhibit 8](#)

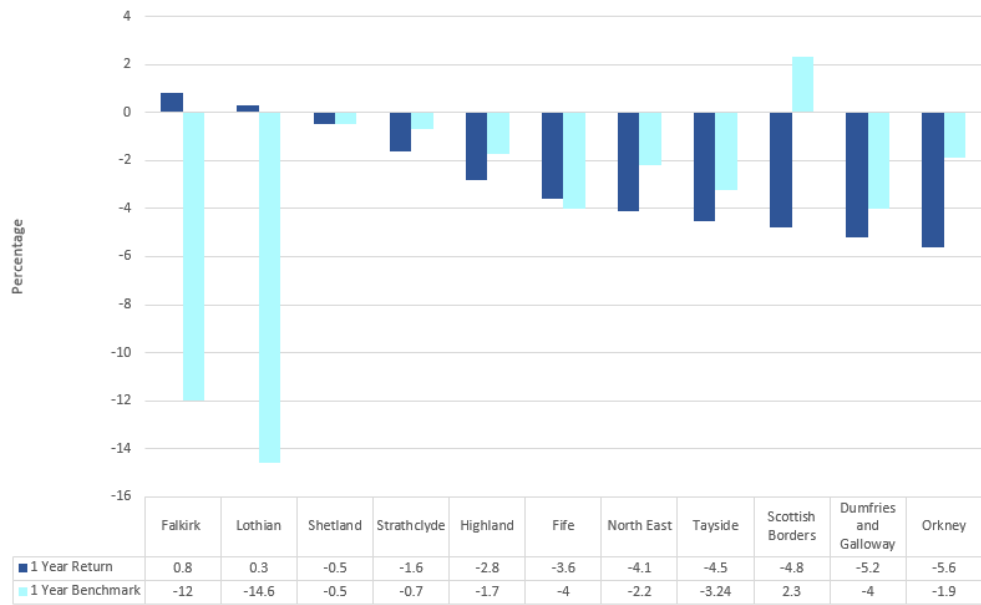
Exhibit 8 Fund investment performance



Source: North East Scotland Fund 2022/23 audit annual report and accounts

Exhibit 9

Comparison of actual return on investments and benchmark for 2022/23



Source: Audit Scotland – Unaudited annual report and accounts of Pension Funds in Scotland

48. The fund experienced a challenging year in 2022/23 resulting in a negative performance for the year of -4.1%, compared with a benchmark of -2.2%. Other Scottish funds had similar experiences against benchmark in 2022/23 as shown by [Exhibit 9](#).

49. North East Scotland Fund believes that re-balancing efforts done in previous years have been advantageous as these have resulted in long-term performance outweighing relevant benchmarks.

50. The North East Scotland Pension Fund Committee meets on a quarterly basis and receives regular reports on both fund administration and investment performance. The focus of measuring the performance of pensions administration includes both member experience and statutory compliance.

Appendix 1: Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Private equity performance fees.</p> <p>One of the private equity fund managers included accrued performance fees for the first time. This is inconsistent with the fund's experience of working with other managers and merits further review. On the basis of materiality, the amount has not been included in the 2022/23 accounts.</p>	<p>The fund should review the accounting treatment of private equity management fees and implement any changes considered necessary to ensure a consistent approach in respect of management fee disclosures.</p>	<p>Pensions Manager 31 March 2024</p>
<p>2. Internal control weaknesses</p> <p>The following were noted during our audit work:</p> <ul style="list-style-type: none"> • there was no evidence of who carried out the review of mortality screening reports • There is no independent check of changes to supplier bank details • There is no periodic review of financial /administration system user access rights. <p>Risk – weaknesses in internal control increase the risk of fraud and/or misstatement in the financial statements.</p>	<p>Make improvements to internal control by:</p> <ul style="list-style-type: none"> • ensuring checks of key control areas are evidenced. • implementing a periodic review of user access rights to ensure leavers are promptly removed and only authorised users have access to systems. 	<p><u>Agreement by Pensions Manager:</u></p> <ul style="list-style-type: none"> • Record officer initials and dates to improve the audit trail for mortality screening report checks (or similar process when mortality screening is automated) • Reviewing user access rights to the pensions administration system. <p>31 March 2024</p> <p>Where financial services are provided by the administering authority, the pension fund takes assurance from the operation of the council's internal controls.</p>

Issue/risk	Recommendation	Agreed management action/timing
		<p><u>Agreement by Chief Officer – Finance in respect of council matters:</u></p> <ul style="list-style-type: none"> • Reviewing user access rights to the financial ledger • Confirming arrangements for new/changes to pension fund supplier bank details. <p>31 March 2024</p>
<p>3. Considerable change in Pension Committee membership has reduced the effectiveness of scrutiny.</p> <p>There has been significant change in the membership of the committee during the year and there are two long term vacancies on the committee. There was good attendance at induction training but attendance at other training events was variable.</p> <p>Given the specialist nature of the committee’s business, the level of change in its membership may have impacted on the effectiveness of scrutiny</p>	<p>We encourage Aberdeen City Council, as the administering authority, to fill the vacancies on the Pensions Committee and for members to work together for the benefit of the fund. There is a need for ongoing training to support members in building their knowledge in this complex area and provide them with essential skills for effective scrutiny.</p>	<p>Steps will be taken to address vacancies in Pensions Committee membership.</p> <p>Chief Officer – Finance</p> <p>31 March 2024</p> <p>The Pension Fund continues to promote and encourage internal and external training opportunities.</p> <p>Pensions Manager</p> <p>31 March 2024</p>

Appendix 2. Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £250,000.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality. We are therefore satisfied that these misstatements do not have a material impact on the financial statements.

Narrative	Account areas	Fund Account		Net Assets Statement	
		Dr £000	Cr £000	Dr £000	Cr £000
Accounting Misstatements					
Remove management performance fee which was initially based on an incorrect estimate.	Management performance fee		556		
	Changes in market value of investments	556			

North East Scotland Pension Fund

2022/23 Annual Audit Report – DRAFT

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