

# North East Scotland Pension Fund

Annual Audit Plan 2019/20



 AUDIT SCOTLAND

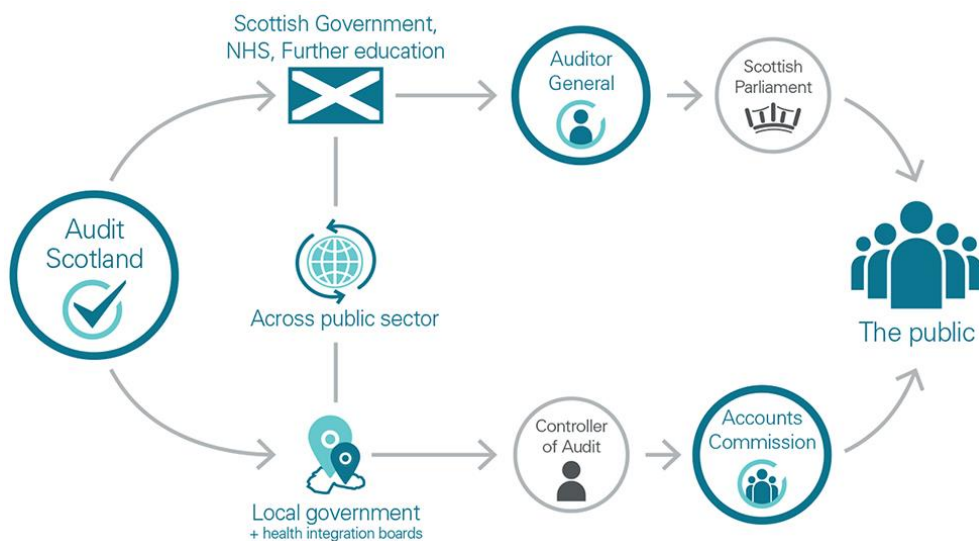
Prepared for Aberdeen City Council Pensions Committee

February 2020

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Risks and planned work

1. Our audit of the North East Scotland Pension Fund (the Fund) is carried out in accordance with the Code of Audit Practice, International Standards on Auditing (ISAs), and [guidance on planning the audit](#). This plan contains an overview of the planned scope and timing of our audit. It sets out the work necessary to allow us to provide an independent auditor's report on the financial statements and to meet the wider scope requirements of public sector audit.

2. The wider scope of public audit contributes to assessments and conclusions on financial management, financial sustainability, governance and transparency, and value for money.


## Adding value


3. We aim to add value to the Fund through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we intend to help the Fund promote improved standards of governance, better management, and decision making, and more effective use of resources.

## Audit risks

4. Building on our knowledge from previous years, discussions with staff, attendance at committee meetings and a review of supporting information we have identified a number of significant financial statement and wider dimension audit risks. These risks are detailed in [Exhibit 1](#).

## Exhibit 1 2019/20 Significant audit risks

 Significant audit risk	Source of assurance	Planned audit work
<b>Financial statement risks</b>		
<p>1 <b>Management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<ul style="list-style-type: none"> <li>Detailed testing of journal entries.</li> <li>Review of accounting estimates.</li> <li>Focused testing of accruals and prepayments.</li> <li>Evaluation of significant transactions that are outside the normal course of business.</li> </ul>
<p>2 <b>Estimation, judgements and classification</b></p> <p>There is a significant degree of subjectivity in the measurement and classification of certain investments and in the actuarial valuation. North East Scotland</p>	<p>The majority of investments are listed and traded on public stock exchanges which provide frequent valuations.</p> <p>Unquoted investments are valued by third parties including investment managers and</p>	<ul style="list-style-type: none"> <li>Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments.</li> <li>Confirmation of valuations to valuation</li> </ul>

	Significant audit risk	Source of assurance	Planned audit work
	<p>Pension Fund investments include investments such as unquoted equity and pooled funds, where valuations involve the application of judgement in determining appropriate amounts.</p> <p>The actuarial valuation depends on a number of assumptions about the future. These include investment returns, contribution rates, commutation assumptions, pensioner mortality, discount rates and earning assumptions.</p> <p>This subjectivity entails a risk of misstatement in the financial statements.</p>	<p>independent valuers who follow detailed professional, accounting and industry guidelines.</p> <p>Use of an experienced and respected Actuary to provide actuarial valuations.</p>	<p>reports and/ or other supporting documentation.</p> <ul style="list-style-type: none"> <li>• Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary.</li> <li>• Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2019/20.</li> </ul>
3	<p><b>Transfer of Strathclyde Fund No.3 (Transport Fund)</b></p> <p>Strathclyde Fund No.3 will merge with Aberdeen City Council Transport Fund during the 2019/20 financial year. This involves the transfer of all the assets, liabilities and records of Fund No.3 to the Transport Fund.</p> <p>The nature of this transaction gives rise to a risk of material misstatement around the presentation and disclosure of the financial statements of the Transport Fund.</p>	<p>All the assets, liabilities and records of Fund No.3 have been successfully transferred with the exception of a small residual balance which has been retained by Strathclyde Pension Fund to meet any remaining costs.</p> <p>The financial statements for the Transport Fund will be compiled using the same systems, sources and processes as in previous years.</p>	<ul style="list-style-type: none"> <li>• Ongoing dialogue with officers around transfer progress.</li> <li>• Focused testing of balances transferred.</li> <li>• Assessment of the presentation and disclosure of financial statements against legislative requirements and guidance.</li> <li>• Confirmation with Strathclyde Pension Fund auditor that the final financial statements of Fund No.3 and the financial statements of the Transport Fund present a complete and consistent account of Fund No.3 for 2019/20.</li> </ul>

Source: Audit Scotland

5. As set out in ISA 240, there is a presumed risk of fraud in the recognition of income. There is a risk that income may be misstated resulting in a material misstatement in the financial statements. We have rebutted the risk of material misstatement caused by fraud in income recognition in 2019/20 for the following reasons:

- The split of responsibilities between the Fund, its fund managers, its custodian and the bank provide a clear separation of duties reducing the risks relating to investment income.
- Further controls are in place around contribution income which is paid over from employers.

6. In line with Practice Note 10, as most public sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. We have rebutted the risk of material misstatement caused by fraud in expenditure in 2019/20 for the following reasons:

- Investments are managed by external investment managers and recorded by the Fund's custodian.
- Pension benefits are the Fund's main expenditure stream. There is no real incentive for the Fund to manipulate the amount of contributions paid.
- Controls are in place to ensure the proper amounts of benefits paid.

**7.** Although we have rebutted these presumed risks of material misstatement arising from fraud, we will still undertake standard audit procedures around journal testing and cut-off for both income and expenditure.

## Reporting arrangements

**8.** Audit reporting is the visible output for the annual audit. All annual audit plans, and the outputs as detailed in [Exhibit 2](#) and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**9.** Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officers to confirm factual accuracy.

**10.** At the end of our audit we will provide the Aberdeen City Council Pensions Committee, the Aberdeen City Council Chief Officer – Finance, and the Controller of Audit with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit. We will also issue an independent auditor's report containing our opinion on the financial statements.

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## Exhibit 2 2019/20 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Plan	10 March 2020	20 March 2020
Annual Audit Report	1 September 2020	11 September 2020
Independent Auditor's Report	11 September 2020	11 September 2020

Source: Audit Scotland

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## Audit fee

**11.** The agreed audit fee for the 2019/20 audit of the Fund is £40,880 (2018/19: £40,000). In determining the audit fee, we have taken account of the risk exposure of the Fund, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited annual accounts, with a complete working papers package on 22 June 2020.

**12.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual accounts or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

## Responsibilities

### Aberdeen City Council Pensions Committee and Chief Officer - Finance

**13.** Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance that enable them to successfully deliver their objectives.

**14.** The audit of the annual accounts does not relieve management or the Aberdeen City Council Pensions Committee, as those charged with governance, of their responsibilities.

### Appointed auditor

**15.** Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice (including supplementary guidance) and guided by the Financial Reporting Council's Ethical Standard.

**16.** Auditors in the public sector give an independent opinion on the financial statements and other information within the annual accounts. We also review and report on the arrangements within the audited body to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

# Audit scope and timing

## Financial statements

**17.** The audit of the annual accounts, including the financial statements, will be the foundation and source for most of the work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of the Fund and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how the Fund will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free from material misstatement.

**18.** We will give an opinion on whether the financial statements:

- give a true and fair view of the financial transactions of the fund during the year ended 31 March 2020 and the amount and disposition as at that date of its assets and liabilities
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union, as interpreted and adopted by the Code of Practice on Local Authority Accounting in the UK 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.



## Statutory other information in the annual accounts

**19.** We review and report on other information published within the annual accounts including the management commentary, annual governance statement and the governance compliance statement. We give an opinion in our independent auditor's report on whether these statements have been compiled in accordance with the appropriate regulations and frameworks.

**20.** We also review the content of the pension fund annual report for consistency with the financial statements and with our knowledge. We consider whether the information is otherwise materially misstated. We report any uncorrected material misstatements in statutory other information.

## Materiality

**21.** We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinions in the independent auditor's report.



22. We calculate materiality at different levels as described below. The calculated planning materiality values for the Fund are set out in [Exhibit 3](#). Figures for the Transport Fund are based on the NESPF Transport Fund and Strathclyde Pension Funds Transport Fund for 2018/19.

### Exhibit 3 Materiality values

Materiality	Main Fund	Transport Fund
<b>Planning materiality</b> – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. For 2019/20 it has been set at 1% of gross assets as at 31 March 2019 based on the latest audited accounts, which are the 2018/19 annual accounts.	£45 million	£3.2 million
<b>Performance materiality</b> – 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 calculated performance materiality at 75% of planning materiality.	£33.75 million	£2.4 million
<b>Reporting threshold (i.e. clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This has been calculated at 2.5% of planning materiality (with a maximum of £250,000 as Audit Scotland considers that the Scottish public would perhaps find it unreasonable that an amount beyond this maximum could ever be described as "clearly trivial").	£250 thousand	£80 thousand

Source: Audit Scotland

### Lower specific materiality

23. In addition to planning materiality we set lower specific materiality levels for certain classes of transaction, account balances or disclosures where lesser amounts could influence the decisions of the users of the accounts.

24. We recognise that pension benefits payable to members are of importance to the users of the accounts and we set specific materiality levels as shown in [Exhibit 4](#).

### Exhibit 4 Lower specific materiality values



Materiality	Main Fund	Transport Fund
<b>Specific materiality</b> - It has been set at 10% of benefits payable for the year ended 31 March 2019 based on the latest audited accounts for 2018/19. (Transport Fund figure is a combination of ACCTF & SPF Fund No.3, pro-rated for part-year of Fund No.3.)	£14 million	£0.8 million
<b>Specific performance materiality</b> – Using our professional judgement we have calculated performance materiality at 75% of the specific materiality.	£10.5 million	£0.6 million

Source: Audit Scotland

## Timetable

**25.** To support the efficient use of resources it is critical that an annual report and accounts timetable is agreed with us to produce the unaudited accounts. We have included an agreed timetable at [Exhibit 5](#).

### Exhibit 5 Annual accounts timetable

 Key stage	 Date
Consideration of unaudited annual report and accounts by those charged with governance	12 June 2020
Latest submission date of unaudited annual report and accounts with complete working papers package	22 June 2020
Latest date for final clearance meeting with Pensions Manager and Aberdeen City Council Chief Officer - Finance	21 August 2020
Agreement of audited unsigned financial statements; Issue of Annual Audit Report including ISA 260 report to those charged with governance	11 September 2020
Independent auditor's report signed	11 September 2020

Source: Audit Scotland

## Internal audit

**26.** Internal audit is provided by the Aberdeenshire Council internal audit service, overseen by the Chief Internal Auditor. As part of our planning process we carried out an annual assessment of the internal audit function to ensure that it operates in accordance with Public Sector Internal Audit Standards (PSIAS).

**27.** We concluded that internal audit has sound documentation standards and reporting procedures in place and complies with the main requirements of the Public Sector Internal Audit Standards (PSIAS).

### Using the work of internal audit

**28.** Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible to reduce duplication.

**29.** Internal audit's planned 2019/20 audit review for the Fund is Investment Strategy and Investment Performance Management, to provide assurance in respect of compliance with the pension fund investment strategy and arrangements in place to monitor the performance of investment managers. We do not plan to place reliance on internal audit's work for our 2019/20 financial statements audit as the scope of this work will not reduce the level of our audit testing in support of our audit opinion on the financial statements. We will however take account of internal audit's findings to inform our wider Code responsibilities.

## Audit dimensions

**30.** Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 6](#).

## Exhibit 6

### Audit dimensions



Source: Code of Audit Practice

### Financial sustainability

**31.** As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on the Fund's financial sustainability. We define financial sustainability as having medium term (two to five years) and longer term (greater than five years) financial plans in place. We will carry out work and conclude on:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and long term
- the appropriateness and effectiveness of funding arrangements and the investment strategy in place to address any identified funding gaps
- whether there are arrangements in place to demonstrate the affordability and effectiveness of funding and investment decisions.

### Financial management

**32.** Financial management in the context of a pension fund is complex and includes not just investment and funding strategy, but also arrangements for contract management, performance review, budget setting, forecasting and the financial control environment. We will review, conclude and report on:

- the Fund's financial performance and funding levels for the year, including performance against its investment strategy
- whether arrangements are in place to ensure systems of internal control are operating effectively
- whether the Fund can demonstrate the effectiveness of the budgetary control system
- whether there are appropriate and effective arrangements in place for the prevention and detection of fraud and corruption.

### Governance and transparency

**33.** 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. The knowledge and skills of

Pensions Committee and Pension Board members is key to this process. We will review, conclude and report on:

- the governance disclosures in the annual report and accounts
- whether the Fund can demonstrate that the governance arrangements in place are appropriate and operating effectively
- whether there is effective scrutiny, challenge and transparency on the decision making and on the financial and performance reporting
- the quality and timeliness of financial and performance reporting on the Fund's administration and investments
- consistency of the annual governance statement and the governance compliance statement with the disclosures made in the financial statements.

### Value for money

**34.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on whether the Fund can demonstrate:

- value for money in the use of resources
- that there is a clear link between money spent, output and outcomes delivered
- that outcomes are improving
- that there is sufficient focus on improvement and the pace of it.

### Independence and objectivity

**35.** Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual "fit and proper" declaration for all members of staff. These arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

**36.** The engagement lead (i.e. appointed auditor) for the Fund is Gillian Woolman, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of North East Scotland Pension Fund.

### Quality control

**37.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

**38.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice (and relevant supporting guidance) issued by Audit Scotland and approved by the Accounts Commission and the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews and internal quality reviews. The Institute of

Chartered Accountants of Scotland (ICAS) have also been commissioned to carry out external quality reviews of our work.

- 39.** As part of our commitment to quality and continuous improvement Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

# North East Scotland Pension Fund

## Annual Audit Plan 2019/20

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)

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