

North East Scotland Pension Fund

Annual Audit Plan 2021/22



 AUDIT SCOTLAND

Prepared for Aberdeen City Council Pensions Committee

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Contents

Introduction	3
Financial statements audit planning	5
Audit dimensions	9
Reporting arrangements, timetable, and audit fee	11
Other matters	14

Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2021/22 external audit of the North East Scotland Pension Fund (the Fund). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the annual report and accounts and provision of an Independent Auditor's Report
- work to support our audit opinions on the other statutory information published within the 2021/22 annual report and accounts, including the Management Commentary, Annual Governance Statement and the Governance Compliance Statement
- consideration of arrangements in relation to the audit dimensions: financial management, financial sustainability, governance and transparency that frame the wider scope of public sector audit

Impact of Covid-19

2. The coronavirus (Covid-19) pandemic has had a significant impact on public services and public finances, and the effects will be felt well into the future.

3. The Auditor General for Scotland, the Accounts Commission and Audit Scotland continue to assess the risks to public services and finances from Covid-19 across the full range of our audit work, including annual audits and the programme of performance audits. The well-being of audit teams and the delivery of high-quality audits remain paramount. Changes in our approach may be necessary and where this impacts on annual audits, revisions to this Annual Audit Plan may be required.

Adding value

4. 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 will help the Fund promote improved standards of governance, better management and decision making and more effective use of resources. Additionally, we attend meetings of the Aberdeen City Council Pensions Committee and actively participate in discussions.

Respective responsibilities of the auditor and the Fund

5. The [Code of Audit Practice \(2016\)](#) sets out in detail the respective responsibilities of the auditor and the Fund. Key responsibilities are summarised below.

Auditor responsibilities

6. 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.

7. 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 Fund to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

The Fund's responsibilities

8. The Fund is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

9. Also, the Fund has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance and propriety that enable them to deliver their objectives.

Managing the transition to 2022/23 audits

10. Audit appointments are usually for five years but were extended to six years due to Covid-19. 2021/22 is the final year of the current appointment and we will work closely with our successors to ensure a well-managed transition.

Financial statements audit planning

Materiality

11. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. We are required to plan our audit to determine with reasonable confidence whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

Materiality levels for the 2021/22 audit

12. We assess materiality at different levels as described in [Exhibit 1](#). The materiality values for the Fund are set out in [Exhibit 1](#).

Exhibit 1

2021/22 Materiality levels for the Fund

Materiality	Main Fund	Transport Fund
Planning materiality – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1% of gross assets for the year ended 31 March 2022 based on the latest audited financial statements for 2020/21.	£58 million	£3 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 75% of planning materiality.	£43.5 million	£2.25 million
Reporting threshold (i.e. clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£250 thousand	£75 thousand

Source: Audit Scotland

Lower specific materiality levels for the 2021/22 audit

13. In addition to overall materiality, we can 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 financial statements.

14. We recognise that benefits payable to members are important to the users of the financial statements and we set specific materiality levels as shown in [Exhibit 2](#).

Exhibit 2 2021/22 Lower specific materiality levels for the Fund

Materiality	Main Fund	Transport Fund
Specific materiality – It has been set at 10% of benefits payable for the year ended 31 March 2022 based on the latest audited financial statements for 2020/21.	£17 million	£1.1 million
Specific performance materiality – Using our professional judgement, we have calculated specific performance materiality at 75% of the specific materiality.	£12.75 million	£0.825 million

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

15. Our risk assessment draws on our cumulative knowledge of the Fund, its major transaction streams, key systems of internal control and risk management processes. Also, it is informed by our discussions with management, meetings with internal audit, attendance at committee and a review of supporting information.

16. Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 3](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

Exhibit 3**2021/22 Significant risks of material misstatement to the financial statements**

Significant risk of material misstatement	Sources of assurance	Planned audit response
<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>Owing to the nature of this risk, assurances from management are not applicable in this instance</p>	<ul style="list-style-type: none"> • Detailed testing of journal entries. • Review of accounting estimates. • Focused testing of accruals and prepayments. • Evaluation of significant transactions that are outside the normal course of business.

Source: Audit Scotland

17. As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements. We have rebutted this risk for the Fund 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.

18. In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have rebutted this risk for the Fund 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 benefits paid.
- Controls are in place to ensure the proper amounts of benefits paid.

19. We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

Other areas of audit focus

20. As part of our assessment of audit risks, we have identified other areas where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider these to represent significant risks. We will keep these areas under review as our audit progresses. If our assessment of risk changes and we consider these risks to be significant, we will communicate this to management and those charged with governance and revise our planned audit approach accordingly.

21. The areas of specific audit focus are:

- actuarial valuation of future retirement benefits. 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. As a result we will carry out a 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary and review actuarial assumptions, and consider the report by Audit Scotland's consulting actuary on the actuarial valuations;
- valuation of unquoted investments. There is a significant degree of subjectivity in the measurement and classification of certain investments. As a result we will carry out a 'review of the work of an expert' in accordance with ISA 500, and confirm valuations to valuation reports and/ or other supporting documentation for significant unquoted investments;
- actuarial valuation of the Transport Fund insurance buy-in contract. The 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. We will carry out a 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary and review actuarial assumptions.

Audit risk assessment process

22. Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and where relevant, report them to those charged with governance.

Audit dimensions

Introduction

23. The [Code of Audit Practice](#) sets out the four dimensions that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the audit dimensions in audited bodies.

Audit dimensions

24. The four dimensions that frame our audit work are shown in [Exhibit 4](#).

Exhibit 4 Audit dimensions



Source: Code of Audit Practice

25. In summary, the four dimensions cover the following:

- **Financial management** – financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Financial sustainability** – 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 financial sustainability in the longer term.

We define this as medium term (two to five years) and longer term (longer than five years).

- **Governance and transparency** – governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership, and decision-making and transparent reporting of financial and performance information.
- **Value for money** – value for money refers to using resources effectively and continually improving services.

Audit dimension risks

26. We have identified audit risks in the areas set out in [Exhibit 5](#). This exhibit sets out the risks, sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurances over the risks.

Exhibit 5 2021/22 Audit dimension risks

Description of risk	Sources of assurance	Planned audit response
<p>1. Local Government Elections</p> <p>There may be changes to the composition of the Pension Committee and the Pension Board as a result of the local government elections in May 2022. There is a risk that following the elections, a number of new members do not have the necessary experience and understanding of their role and responsibilities in such areas as governance, scrutiny and decision making in respect of the Pension Fund.</p>	<ul style="list-style-type: none"> • Elected member training has been arranged for the 16 June prior to the June 25 Pensions Committee/ Pension Board meeting. In addition to this the Fund has procured an online training portal purely for the LGPS providing modular training for all committee and board members. This is also in addition to the current training policy that is in place. 	<p>We will monitor the council's arrangements for developing members and preparations for inducting newly elected members.</p>

Source: Audit Scotland

Reporting arrangements, timetable, and audit fee

Reporting arrangements

27. Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 6](#), and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

28. 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.

29. We will provide an independent auditor's report to the Fund and the Accounts Commission setting out our opinions on the annual accounts. We will provide the Fund and the Accounts Commission with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

30. [Exhibit 6](#) outlines the target dates for our audit outputs. Audit Scotland has set a provisional deadline of 31 October 2022 for the certification of the annual accounts. However the impact of Covid-19 led to delays in completing 2020/21 audits, which has affected available resources to deliver 2021/22 audits. We anticipate that the NESPF audit will complete in October for sign-off of the accounts in November (which would require a special meeting) or at the scheduled December committee meeting.

Exhibit 6 2021/22 Audit outputs

Audit Output	Target date	Pensions Committee date
Annual Audit Plan	17 March 2022	25 March 2022
Independent Auditor's Report	TBC	TBC
Annual Audit Report	TBC	TBC

Source: Audit Scotland

Timetable

31. To support an efficient audit, it is critical that the timetable for producing the annual accounts for audit is achieved. We have included a proposed timetable for the audit at [Exhibit 7](#) that has been discussed with management.

32. Covid-19 has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. To this end, 2021/22 is a transition year with the reporting deadline brought forward by one month relative to the two prior years. We are identifying ways to work more efficiently to expedite the 2021/22 audits whilst at the same time maintaining high standards of quality.

33. We will continue to work in close partnership with management with clarity over timescales and the requirement for high quality unaudited accounts and supporting working papers. Progress will be discussed with management and finance officers over the course of the audit.

Exhibit 7

Proposed annual accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual accounts by those charged with governance	24 June 2022
Latest submission date for the receipt of the unaudited annual accounts with complete working papers package.	31 August 2022
Latest date for final clearance meeting with the Chief Officer - Finance	TBC
Issue of Letter of Representation and proposed Independent Auditor's Report	TBC
Agreement of audited and unsigned annual accounts	TBC
Issue of Annual Audit Report to those charged with governance.	TBC
Signed Independent Auditor's Report	TBC

Source: Audit Scotland

Audit fee

34. The proposed audit fee for the 2021/22 audit of the Fund is £44,100 (2020/21: £43,000). 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.

35. Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual accounts, the absence of adequate supporting working papers 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 out with our planned audit activity.

Other matters

Internal audit

36. International standards on Auditing (UK) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect on external audit procedures;
- obtain an understanding of internal audit activities to inform our planning and develop an effective audit approach that avoids duplication of effort;
- perform a preliminary assessment of the internal audit function when there is scope for relying on internal audit work which is relevant to our financial statements' responsibilities; and
- evaluate and test the work of internal audit, where use is made of that work for our financial statements responsibilities to confirm its adequacy for our purposes.

37. From our initial review of the internal audit plans, we do not plan to place formal reliance on internal audit's work for our financial statements responsibilities. However, we do plan to consider the findings of internal audit's work in terms of our wider audit dimension responsibilities.

Independence and objectivity

38. Auditors appointed by the Auditor General for Scotland or Accounts Commission 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. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

39. 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 the Fund.

Quality control

40. International Standard on Quality Control (UK) 1 (ISQC1) requires a system of quality control to be 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.

41. 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 supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

42. 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.

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
Phone: 0131 625 1500 Email: info@audit-scotland.gov.uk
www.audit-scotland.gov.uk