

North East Scotland Pension Fund

Annual Audit Plan 2022/23



 AUDIT SCOTLAND

Prepared for Aberdeen City Council Pensions Committee

March 2023

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Introduction

Summary of planned audit work

1. This document summarises the work plan for our 2022/23 external audit of 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 accounts, leading to an independent audit opinion
- independent audit opinions on statutory information published in the annual accounts, comprising the Management Commentary, the Annual Governance Statement and the Governance Compliance Statement.
- consideration of arrangements in relation to wider scope areas: financial management; financial sustainability; vision, leadership and governance; and use of resources to improve outcomes.

Audit Appointment

2. We are pleased to be appointed as the external auditor of the fund for the five year period 2022/23 to 2026/27 inclusive. An introduction to the core members of your audit team is at [Appendix 1](#).

3. In the first year of the audit appointment, we invest significant time gaining an understanding of the fund and identifying and assessing the risks of material misstatement to the financial statements. While we use our initial assessment to inform our planned audit approach, we keep this under review as the audit progresses. We will inform you of any significant changes in our assessment of risk and/or our planned audit work.

4. Our Annual Audit Plan has been prepared on the basis that North East Scotland Pension Fund manages one pension fund and will produce one set of financial statements in respect of financial year 2022/23. This reflects the planned merger of the Aberdeen City Council Transport Fund with the Main Fund by 31 March 2023.

5. The audit team will actively engage with you over the course of the audit to ensure our work continues to be focused on risk.

Adding value

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

Respective responsibilities of the auditor and the fund

7. The [Code of Audit Practice 2021](#) sets out in detail the respective responsibilities of the auditor and the fund. Key responsibilities are summarised below.

Auditor responsibilities

8. 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.

9. 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 wider scope arrangements within the fund. In doing this, we aim to support improvement and accountability.

The fund's responsibilities

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

11. 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, propriety and regularity that enable them to deliver their objectives.

Financial statements audit planning

Introduction

12. The annual accounts are an essential part of demonstrating the fund's stewardship of resources and its performance in the use of those resources.

13. We focus our work on the areas of the highest risk. As part of our planning process we prepare a risk assessment highlighting the audit risks relating to each of the key systems on which the financial statements will be based.

Materiality

14. The concept of materiality is applied by auditors in planning and performing the audit, and in evaluating the effect of any uncorrected misstatements on the financial statements. We are required to plan our audit to obtain reasonable assurance that 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 2022/23 audit

15. 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

2022/23 Materiality levels for the Fund

Materiality

Planning 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 audited financial statements for 2021/22. £124m

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 planning materiality. £80m

Materiality

Reporting threshold– We are required to report to those charged with governance £250,000 on all unadjusted misstatements more than the 'reporting threshold' amount.

Source: Audit Scotland

Lower specific materiality levels for the 2022/23 audit

16. 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.

17. We recognise that transactions relating to fund members such as contributions receivable, payments to pensioners, benefits and transfers out of/into the fund account are likely to be of key interest to the users of the financial statements and we set specific materiality levels as shown in [Exhibit 2](#).

Exhibit 2

2022/23 Lower specific materiality levels for the Fund

Materiality

Specific materiality – It has been set at 10% of payments to pensioners for the year ended 31 March 2023 based on the latest audited financial statements for 2021/22. £18m

Specific performance materiality – Using our professional judgement, we have calculated specific performance materiality at 65% of the specific materiality. £12m

Source: Audit Scotland

Significant risks of material misstatement to the financial statements

18. Our risk assessment draws on our cumulative knowledge of the fund, its major transaction streams, key systems of internal control and risk management processes. In addition, it is informed by our discussions with management, meetings with internal audit, the work of the Pensions Committee and a review of supporting information. In this, the first year of our audit appointment, we have also held a handover meeting with the outgoing external auditor.

19. 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.

20. Based on our initial 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

2022/23 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"> • Assess the design and implementation of controls over journal entry processing. • Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments. • Test journals at the year-end and post-closing entries and focus on significant risk areas. • Consider the need to test journal entries and other adjustments during the period. • Evaluate significant transactions outside the normal course of business. • Assess any changes since the prior year to the methods and underlying assumptions used to prepare accounting estimates.

Source: Audit Scotland

21. As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statements*, 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.

22. We have rebutted this risk for the pension fund on the basis that employee contributions follow a predictable pattern and consist of a high volume of low value transactions. Investment income and unrealised gains on investments on the other hand, are derived from investing activities managed by the global fund custodian and individual fund managers who are independent of management. There is therefore limited opportunity for fraudulent manipulation of income, and we have not identified a significant risk in this area.

23. 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.

24. We have also rebutted this risk because controls are in place to ensure benefits paid are correct. Such payments also follow a predictable pattern and consist of a high volume of low value transactions. There is no real incentive for the fund to manipulate benefits paid. Management expenses largely relate to fund managers' fees and these can be agreed to fund managers reports. The risk of material manipulation of the financial statements due to fraudulent expenditure recognitions is therefore low.

25. We have not, therefore, extended the planned audit work in these areas beyond our standard audit procedures.

Other areas of audit focus

26. As part of our assessment of audit risks, we have identified other areas where we consider there are 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.

27. The areas of specific audit focus are:

- There is a significant degree of subjectivity in the measurement and classification of certain investments, in particular private equity funds. These investments are valued by the investment managers. 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. We will also discuss with officers and assess other sources of assurances management relies on.
- An actuarial valuation of future retirement benefits is calculated on an annual basis under IAS 26 by an independent firm of actuaries with specialist knowledge and experience. Valuation estimates are based on a number of assumptions about the future and therefore, there is a risk that the assumptions used are not appropriate. Assumptions 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, review actuarial assumptions and consider the report by Audit Scotland's consulting actuary on actuarial valuations across Scottish local government pension funds.
- Aberdeen City Council Transport Fund will merge with the Main Fund by 31 March 2023. With regard to the 2022/23 annual report and accounts, this will largely be reflected as a consolidation of the results of the two funds. Any re-allocation of investments may be implemented as part of a longer term strategy. We will undertake an early discussion of the merger

accounting treatment and disclosure requirements for the 2022/23 annual accounts with officers.

- The Transport Fund held an insurance buy-in which is also revalued annually by the actuary and based on similar assumptions about the future. 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.

Wider Scope

Introduction

28. The [Code of Audit Practice](#) sets out the four areas 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 wider scope areas in audited bodies.

29. In summary, the four wider scope areas cover the following:

- **Financial management** – we consider the financial capacity of the fund and whether there are sound internal controls in place including budgetary and forecasting processes.
- **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).
- **Vision, leadership and governance** – we conclude on the arrangements in place to deliver the fund’s vision, strategy and priorities. We also consider the effectiveness of the governance arrangements adopted in managing the fund.
- **Use of resources to improve outcomes** – we will consider how the fund demonstrates economy, efficiency and effectiveness through the use of financial and other resources.

Wider scope risks

30. We have not identified any significant wider scope risks. However, we have identified the following areas which will be kept under review as the audit progresses.

31. Investment performance - 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.

32. Pension Service Business Plan - There has been limited formal reporting of progress against business plan aims and objectives since it was approved by the Pension Committee. Also, there is limited narrative to the committee to explain how significant risks are managed and mitigated. It is therefore unclear how those charged with governance monitor the fund’s progress in delivering the

plan or the adequacy of scrutiny around the pace of delivery and the management/mitigation of identified risks. Through our engagement with the committee, we will assess the arrangements in place to ensure it has effective oversight of governance.

33. Cyber security – 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.

34. Climate change – 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.

Reporting arrangements, timetable, and audit fee

Reporting arrangements

35. All Annual Audit Plans and reports , as detailed in [4](#), and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

36. 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.

37. 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 Controller of Audit with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

38. [4](#) outlines the target dates for our audit outputs, and we aim to issue the independent auditor's report by the statutory deadline of 30 September 2023.

Exhibit 4 2020/21 Audit outputs

Audit Output	Target date per audit planning guidance	Aberdeen City Council Pensions Committee
Annual Audit Plan	31/03/2023	24/03/2023
Independent Auditor's Report	30/09/2023	15/09/2023
Annual Audit Report	30/09/2023	15/09/2023

Source: Audit Scotland

Timetable

39. 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. We are identifying ways to work more efficiently to expedite the 2022/23 audits whilst at the same

time maintaining high standards of quality. Our proposed timetable for the audit is included at [Exhibit 5](#) and this has been discussed with management.

40. We intend to take a hybrid approach to the 2022/23 audit with a blend of remote and onsite working as required. We will work closely with management to identify the most efficient approach as appropriate and will keep timeframes and logistics for the completion of the audit under review. Progress will be discussed with management and finance officers over the course of the audit.

Exhibit 5 Proposed annual accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual accounts by those charged with governance	23 June 2023
Latest submission date for the receipt of the unaudited annual accounts with complete working papers package.	30 June 2023
Latest date for final clearance meeting with the Director of Finance	18 August 2023
Approval of audited accounts for signature and consideration of Annual Audit Report by those charged with governance	15 September 2023
Submission of signed accounts and Annual Audit Report	By 30 September 2023

Source: Audit Scotland

Audit fee

41. Audit Scotland's fees have increased in 2022/23 and this is a reflection of the current audit market and the rising costs in delivering high quality audit work. There are increased regulatory expectations and risks placed on audit and its quality, as well as a widening in the scope of work audit must cover.

42. In determining the audit fee for the fund, we have taken account of our risk assessment and the planned management assurances in place. The proposed audit fee for 2022/23 is £48,370 (2021/22 £44,100).

43. In setting the fee, we have assumed that the fund has sound governance arrangements in place and operating effectively and will prepare comprehensive and accurate financial statements for audit, including supporting papers. It also assumes there is no major change in respect of the scope of the audit work in year. Where our audit cannot proceed as planned, a supplementary fee may be levied.

Other matters

Internal audit

44. It is the responsibility of the fund to establish adequate internal audit arrangements. Services are currently provided by the chief internal auditor of Aberdeenshire Council. We review the internal audit plan and consider the impact of internal audit's findings on our audit work.

45. We intend to draw general assurance from internal audit when assessing the fund's governance arrangements. We are not however currently planning to use the work of internal audit to provide assurance for our audit procedures on the financial statements.

Independence and objectivity

46. Auditors appointed by the 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.

47. 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 Executive Director of Innovation and Quality, who serves as Audit Scotland's Ethics Partner.

48. The appointed auditor for the fund is Michael Oliphant, 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

49. Quality is at the core of public audit in Scotland and is the foundation for building consistency and confidence across all audit work. High quality audits provide assurance, add value and can support public bodies to achieve their objectives.

50. Until 2021/22, the applicable audit quality standard was International Standard on Quality Control 1 (ISQC (UK) 1). This set out an audit practice's responsibilities for its system of quality control for audits.

51. ISQC(UK) 1 has been replaced by two new audit quality standards: Internal Standards on Quality Management (ISQM (UK) 1), applicable from 15 December 2022, and (ISQM(UK) 2) effective for the 2023/24 audits. Work is underway at Audit Scotland to meet the requirements of these quality standards.

52. Audit Scotland is committed to delivering high quality audits. The foundation of our quality framework is our Audit Guide, which incorporates the [Code of Audit Practice](#) and the application of professional auditing, quality and ethical standards. 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 England and Wales (ICAEW) have been commissioned to carry out external quality reviews.

53. 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 and/or manager.

Appendix 1. Your audit team

54. The senior team involved in the external audit of the fund have significant experience in public sector audit

Name	Position
Michael Oliphant moliphant@audit-scotland.gov.uk	Audit Director/Engagement Lead
Anne MacDonald amacdonald@audit-scotland.gov.uk	Senior Audit Manager/Engagement Manager
Arlene Deeming adeeming@audit-scotland.gov.uk	Senior Auditor
Deirdre Sim dsim@audit-scotland.gov.uk	Auditor

55. The local audit team is supported by a specialist technical accounting team, all of whom have significant experience of public bodies and work with accounting regulatory bodies.

North East Scotland Pension Fund

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Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

www.audit-scotland.gov.uk/accessibility

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