

# North East Scotland Pension Fund

Annual Audit Plan 2016/17



 AUDIT SCOTLAND

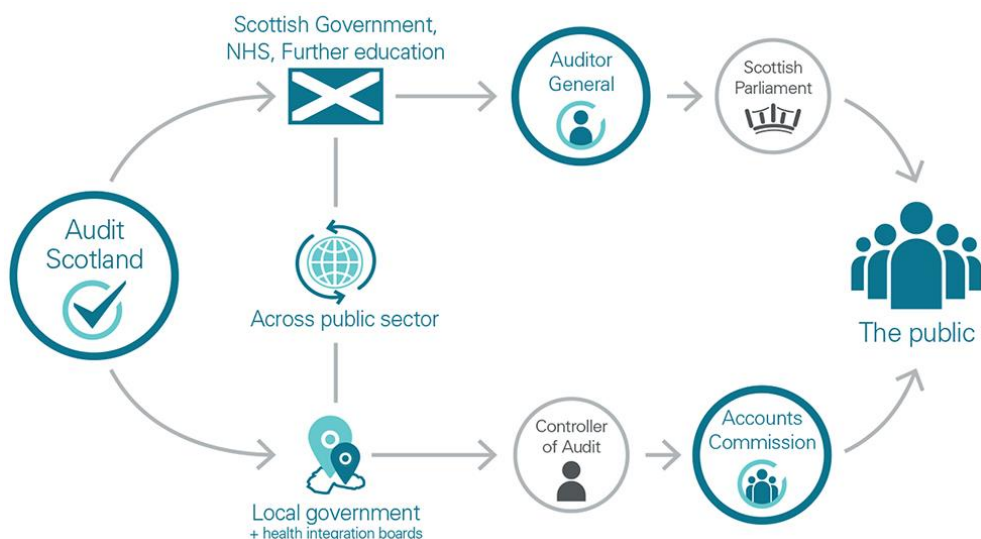
Prepared for members of Aberdeen City Council Pension Committee

March 2017

## 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. This annual audit plan contains an overview of the planned scope and timing of our audit and is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and any other relevant guidance. This plan identifies our audit work to provide an opinion on the financial statements and related matters and meet the wider scope requirements of public sector audit. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Audit risks

2. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for the North East Scotland Pension Fund. We have categorised these risks into financial risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1

Audit Risk	Management assurance	Planned audit work
<b>Financial statement issues and risks</b>		
<p><b>1 Assurances on administering authority key financial systems used by NESPF</b></p> <p>Aberdeen City Council (ACC) is the administering authority for the North East Scotland Pension Fund. Several ACC key financial systems (general ledger; accounts payable; accounts receivable) underpin the NESPF accounting records. We are dependent on the council's external auditor, KPMG, for audit assurances on these systems.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable</p>	<p>Assurances will be agreed with and obtained from KPMG on key Aberdeen City Council financial systems which underpin NESPF accounting records.</p>
<p><b>2 Risk of 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 in order to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>

Audit Risk	Management assurance	Planned audit work
<p><b>3 Risk of fraud over income and expenditure</b></p> <p>ISA 240 presumes a risk of fraud over income; this is expanded to include the risk of fraud over expenditure in the public sector by the Code of Audit Practice and the Financial Reporting Council's <a href="#">Practice Note 10 (revised)</a>.</p> <p>The North East Scotland Pension Fund receives a significant amount of investment income from third party sources. This presents a risk due to the extent and complexity of income.</p> <p>The Pension Fund also makes a high volume of payments, including high value payments, which can constitute a risk of misstatement of expenditure.</p>		<p>Evaluating the effectiveness of systems for income recognition and recording.</p> <p>Conduct a review of third party service providers, where relied upon by management, including review of service auditor reports.</p> <p>Analytical procedures on income and expenditure streams.</p> <p>Agree income to third party confirmation.</p> <p>Substantive testing of expenditure.</p>
<p><b>4 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of investments.</p> <p>This includes level 3 investments such as unquoted equity (private equity) where valuations use techniques that require significant professional judgement in determining appropriate assumptions.</p> <p>This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>These judgements are within the various private equity/venture capital global industry standards of managing and valuing these types of assets.</p>	<p>Completion of 'review of the work of an expert' in accordance with ISA500.</p> <p>Test valuations to valuation reports and/or other supporting documentation.</p>
<p><b>5 Change of a key expert on which the pension fund places reliance</b></p> <p>The custodian for the pension fund changed to BNP Paribas during 2016/17. This introduces the risk that investment assets aren't properly managed and secured.</p>	<p>Custodian procured to ensure experienced and secure management of investment assets.</p>	<p>Conduct a review of third party service providers, where relied upon by management, including review of service auditor reports.</p> <p>Substantive testing of investment assets will provide assurance that investment assets are complete with the proper rights and obligations in place.</p>
<p><b>6 Changes to financial reporting</b></p> <p>There are changes to the accounting code for 2016/17 financial statements:</p> <ul style="list-style-type: none"> <li>• Presentation changes to the format of the pension fund account.</li> <li>• Application of IFRS 13 Fair Value measurement to</li> </ul>	<p>Relevant guidance and regulations will be reviewed to ensure the 2016/17 annual report and accounts meet their requirements.</p>	<p>Communication of technical changes with officers.</p> <p>Review disclosures as part of our financial statements audit.</p> <p>Review of application of IFRS13</p>

Audit Risk	Management assurance	Planned audit work
<p>pension fund investments</p> <ul style="list-style-type: none"> <li>New recommended disclosures in respect of management expenses. (NESPf adopted this approach early, in the 2015/16 accounts.)</li> </ul>		
<b>Wider dimension risks</b>		
<p><b>7 Governance: updates to key governance documentation</b></p> <p>The Orders of Reference within the ACC Standing Orders have not been updated to reflect changes in pension fund governance. The Orders of Reference for the Pension Committee still refer to the Joint Investment Advisory Committee, which no longer exists.</p> <p>The minutes of the ACC Pension Committee do not record attendees other than councillors; it would improve transparency if attendees such as internal audit, external audit or management experts were also listed in the minutes.</p>	<p>The orders of reference have been updated and are with Legal for review.</p>	<p>We will review any updates to governance documents.</p>
<p><b>8 Governance: declaring conflicts of interest</b></p> <p>The 2015/16 audit review of the NESPf Pension Board against the requirements of the 2015 Regulations found that there was no formal process for Pension Board members to declare conflicts of interest and maintain a register of interests. Management agreed in September 2016 to implement a Conflicts of Interest Policy by December 2016.</p>	<p>A policy and procedure has been put in place and is being reported to committee in March 2017.</p>	<p>We will review the policy and its effectiveness in practice through attendance at committees.</p>
<p><b>9 Governance: local government elections</b></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 2017. 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.</p>	<p>Training and support for members is available and they are reminded regularly of opportunities and support available from officers.</p> <p>Training and induction will be provided to new members.</p>	<p>We will monitor the council's arrangements for developing members and preparations for inducting newly elected members.</p>

## Reporting arrangements

- 3.** 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).
- 4.** 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 Aberdeen City Council Head of Finance and the Pensions Manager of the North East Scotland Pension Fund to confirm factual accuracy.
- 5.** We will provide an independent auditor's report to the administering authority and the Accounts Commission summarising the results of the audit of the annual accounts. We will provide the Aberdeen City Council Pension Committee and the Accounts Commission with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

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## Exhibit 2

### 2016/17 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Report including ISA 260 requirements	30 September 2017	15 September 2017
Signed Independent Auditor's Report	30 September 2017	15 September 2017

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## Audit fee

- 6.** The proposed audit fee for the 2016/17 audit of the North East Scotland Pension Fund is £33,420 (2015/16 £46,130). In determining the audit fee we have taken account of the risk exposure of the North East Scotland Pension 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 financial statements, with a complete working papers package, by 30 June 2017.
- 7.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements 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 Pension Committee and Head of Finance

- 8.** 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, propriety and regularity that enable them to successfully deliver their objectives.
- 9.** The audit of the financial statements does not relieve management or the Aberdeen City Council Pension Committee, as those charged with governance, of their responsibilities.

### **Appointed auditor**

**10.** Our responsibilities as independent auditor are established by the Public 1973 Act for local government, the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

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



# Audit scope and timing

## Financial statements

**12.** The statutory financial statements audit will be the foundation and source for the majority of the audit 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 North East Scotland Pension 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 North East Scotland Pension 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 of material misstatement.

**13.** We will give an opinion on the financial statements as to whether they:

- give a true and fair of the financial transactions of the fund during the year ended 31 March 2017 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 adapted 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.

## Materiality

**14.** Materiality defines the maximum error that we are prepared to accept and still conclude that that our audit objective has been achieved. It helps assist our planning of the audit and allows us to assess the impact of any audit adjustments on the financial statements.

**15.** The calculated materiality values for the North East Scotland Pension Fund are set out in [Exhibit 3](#).



characteristics



responsibilities



principal activities



risks



governance arrangements

## Exhibit 3

### Materiality values

Materiality level	Amount
Planning materiality - Fund Account This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 10% of contributions receivable (based on the latest audited accounts, for the year ended 31 March 2016).	Main Fund £12.2 million Transport Fund £0.3 million
Performance materiality - Fund Account 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 50% of planning materiality.	Main Fund £6.1 million Transport Fund £0.1 million
Reporting threshold - We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 2.5% of planning materiality (with a maximum level of £100,000).	Main Fund £100,000 Transport Fund £10,000



**16.** We review and report on other information published with the financial statements including the management commentary and annual governance statement. Any issue identified will be reported to the Aberdeen City Council Pension Committee.

#### Timetable

**17.** To support the efficient use of resources it is critical that a financial statements timetable is agreed with us for the production of the unaudited accounts. An agreed timetable is included at [Exhibit 4](#) which takes account of submission requirements and planned Pension Committee meeting dates.

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Consideration of unaudited financial statements by those charged with governance	By 31 August 2017
Latest submission date of unaudited financial statements with complete working papers package	30 June 2017
Latest date for final clearance meeting with Pensions Manager and ACC Head of Finance	25 August 2017 TBC
Agreement of audited unsigned financial statements; Issue of Annual Audit Report including ISA 260 report to those charged with governance	By 30 September 2017
Independent auditor's report signed	By 30 September 2017

### Internal audit

**18.** 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 and as part of our planning process we carry out an assessment of the internal audit function. Internal audit is provided by the Aberdeenshire Council internal audit service, overseen by the Chief Internal Auditor.

#### Adequacy of internal audit

**19.** We seek to rely on the work of internal audit wherever possible and as part of our planning process we carried out an early assessment of the internal audit function and concluded that it has sound documentation standards and reporting procedures in place and complies with the main requirements of the Public Sector Internal Audit Standards (PSIAS).

#### Areas of reliance

**20.** To support our audit opinion on the financial statements we plan to place formal reliance on the 2016/17 internal audit review of the Pension Fund Payroll.

## Audit dimensions

**21.** Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 5](#).

### Exhibit 5

#### Audit dimensions



**22.** In the local government sector, the appointed auditor's annual conclusions on these four dimensions will contribute to an overall assessment and assurance on best value.

#### Financial sustainability

**23.** 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 in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. 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 arrangements in place to address any identified funding gaps

#### Financial management

**24.** Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. We will review, conclude and report on:

- whether the fund has arrangements in place to ensure systems of internal control are operating effectively
- whether the fund can demonstrate an effective budgetary control system for communicating accurate and timely financial performance
- how the fund has assured itself that its financial capacity and skills are appropriate

- whether the fund has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

### Governance and transparency

**25.** 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. We will review, conclude and report on:

- 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 finance and performance reports
- the quality and timeliness of financial and performance reporting.

### Value for money

**26.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on whether the fund can provide evidence that it is demonstrating value for money in the use of its resources, has a focus on improvement and that there is a clear link to the outcomes delivered.

### Independence and objectivity

**27.** Auditors appointed by Audit Scotland must comply with the Code of Audit Practice. 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 in place robust arrangements to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.

**28.** The engagement lead for the North East Scotland Pension Fund is Gillian Woolman, Assistant Director. Auditing and ethical standards require Audit Scotland 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 North East Scotland Pension Fund.

### Quality control

**29.** 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.

**30.** 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 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, internal quality reviews and is currently reviewing the arrangements for external quality reviews.

**31.** 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 2016/17

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