

# North East Scotland Pension Fund

Annual Audit Plan 2017/18



 AUDIT SCOTLAND

Prepared for members of Aberdeen City Council Pensions Committee

March 2018

## 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.

2. 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

3. 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 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

### 2017/18 Key audit risks

Audit Risk	Source of 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>	<ul style="list-style-type: none"> <li>Pension fund officers will ensure arrangements are in place for the external auditor of the administering authority to provide assistance to the external auditors of the pension fund.</li> </ul>	<ul style="list-style-type: none"> <li>Assurances will be agreed with and obtained from KPMG on key Aberdeen City Council financial systems which underpin NESPF accounting records.</li> </ul>
<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</p>	<ul style="list-style-type: none"> <li>Owing to the nature of this risk, assurances from management are not applicable.</li> </ul>	<ul style="list-style-type: none"> <li>Detailed testing of journal entries.</li> <li>Review of accounting estimates.</li> <li>Evaluation of significant transactions that are outside the normal course of business.</li> </ul>

Audit Risk	Source of assurance	Planned audit work
<p>controls in order to change the position disclosed in the financial statements.</p>		
<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>	<ul style="list-style-type: none"> <li>• Monthly reasonableness checks of employers' contributions and timeliness of payments.</li> <li>• Reconciliations of contributions received with monthly and year end returns from employers and pension administration system.</li> <li>• Annual assurance requested from key employers.</li> <li>• Monthly cash reconciliations.</li> <li>• Segregation of duties between fund staff for any income transactions keyed into the custodian system.</li> <li>• Reconciliations between custodian and fund manager records.</li> </ul>	<ul style="list-style-type: none"> <li>• Evaluating the effectiveness of systems for income recognition and recording.</li> <li>• Conduct a review of third party service providers, where relied upon by management, including review of service auditor reports.</li> <li>• Analytical procedures on income and expenditure streams.</li> <li>• Agree income to third party confirmation.</li> <li>• Substantive testing of expenditure.</li> <li>• Assurances on contributions obtained from scheduled body external auditors.</li> </ul>
<p><b>4 Estimation and judgements</b></p> <p>There are two areas with a significant degree of subjectivity:</p> <ul style="list-style-type: none"> <li>• the measurement and valuation of investments;</li> <li>• the actuarial valuation.</li> </ul> <p>Investments include level 3 investments such as unquoted equity (private equity) where valuations use techniques that require significant judgement in determining appropriate assumptions.</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 represents an increased risk of misstatement in the financial statements.</p>	<ul style="list-style-type: none"> <li>• Quarter 2 (June 2018) custodian's valuation reports.</li> <li>• Triennial Review Report by the Actuary.</li> <li>• Supporting documents relating to the Triennial Review.</li> </ul>	<ul style="list-style-type: none"> <li>• Confirm valuations to valuation reports and/or other supporting documentation.</li> <li>• Completion of 'review of the work of an expert' in accordance with ISA500, for the work of the actuary and the custodian.</li> <li>• Consideration of the report by PwC in their capacity as consulting actuary to Audit Scotland on actuarial assumptions in use in 2017/18.</li> <li>• Consideration of GAD reports under Section 13 of the Local Government Pension Scheme (Scotland) of LGPS Scotland funding valuations and employer contribution rates.</li> </ul>
<p><b>5 Changes to financial reporting</b></p> <p>Pension funds will be required to disclose information on</p>	<ul style="list-style-type: none"> <li>• Relevant guidance and regulations will be reviewed to ensure the 2017/18 annual report</li> </ul>	<ul style="list-style-type: none"> <li>• Communication of technical changes with officers.</li> <li>• Agree amounts in</li> </ul>

Audit Risk	Source of assurance	Planned audit work
<p>investment management transaction costs, including the amount for each asset class, their nature, and how they arise for different types of investment.</p> <p>It is essential that the pension fund is in a position to capture these costs.</p>	<p>and accounts meet their requirements.</p>	<p>primary financial statements to supporting documentation from third parties.</p>

## Reporting arrangements

4. 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).

5. 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.

6. We will provide an independent auditor's report to the administering authority and the Accounts Commission setting out our opinions on the annual accounts. We will provide the Aberdeen City Council Pensions 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.

## Exhibit 2

### 2017/18 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Plan	6 March 2018	16 March 2018
Annual Audit Report	4 September 2018	14 September 2018
Independent Auditor's Report	14 September 2018	14 September 2018

## Audit fee

7. The proposed audit fee for the 2017/18 audit of North East Scotland Pension Fund is £40,000 (2016/17 £33,420; 2015/16 £46,130). In determining the audit fee we have taken account of the risk exposure of 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 on 29 June 2018.

8. 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 Pensions Committee and Head of Finance

**9.** 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.

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

### Appointed auditor

**11.** Our responsibilities as independent auditor are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

**12.** Auditors in the public sector give an independent opinion on the financial statements and other specified information accompanying 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

**13.** 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 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 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.

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

- give a true and fair view of the financial transactions of the fund during the year ended 31 March 2018 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.



## Materiality

**15.** 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 opinion in the auditor's report.

**16.** We calculate materiality at different levels as described below. The calculated materiality values for North East Scotland Pension Fund are set out in [Exhibit 3](#).



## Exhibit 3

### Materiality values

Materiality level	Amount
<p>Planning materiality</p> <p>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 2017).</p>	<p>Main Fund £13.0 million</p> <p>Transport Fund £0.25 million</p>
<p>Performance materiality</p> <p>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.</p>	<p>Main Fund £9.7 million</p> <p>Transport Fund £0.1 million</p>
<p>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).</p>	<p>Main Fund £100,000</p> <p>Transport Fund £10,000</p>



17. 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 Pensions Committee.

### Timetable

18. 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 Pensions Committee meeting dates:

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Consideration of unaudited financial statements by those charged with governance	22 June 2018
Latest submission date of unaudited financial statements with complete working papers package	30 June 2018
Latest date for final clearance meeting with Pensions Manager and ACC Head of Finance	24 August 2018
Agreement of audited unsigned financial statements; Issue of Annual Audit Report including ISA 260 report to those charged with governance	14 September 2018

## Internal audit

**19.** 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

**20.** 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).

**21.** We do not plan to place reliance on internal audit's work for our 2017/18 financial statements audit. The scope of the internal audit 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

**22.** 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



Source: Code of Audit Practice

## 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 body'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
- whether the fund can demonstrate the affordability and effectiveness of funding and investment decisions it has made.

### 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 the effectiveness of budgetary control system in 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.** 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 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 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 Director of Audit Services, 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 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 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 (and relevant 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, internal quality reviews and have recently secured new 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.

## Adding Value

**32.** Through our audit work we aim to add value to the North East Scotland Pension Fund. We will do this by ensuring our Annual Audit Report provides a summary of the audit work done in the year together with clear judgements and conclusions on how well the North East Scotland Pension Fund has discharged its responsibilities and how well it has demonstrated the effectiveness of its arrangements. Where it is appropriate we will recommend actions that support continuous improvement and summarise areas of good practice identified from our audit work.

# North East Scotland Pension Fund

## Annual Audit Plan 2017/18

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