

# Strathclyde Pension Fund

Annual Audit Plan 2017/18



 AUDIT SCOTLAND

Prepared for Strathclyde Pension Fund  
February 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 Strathclyde Pension Fund (the 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 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 considering 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 in this instance.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>
<p><b>2 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>Collection of investment income is outsourced to the Fund's global custodian, Northern Trust as an integral part of their asset servicing responsibilities. Northern Trust has resource, systems, and controls designed to manage the complexity of this process across a global investment</p>	<p>Evaluation of the effectiveness of systems for income recognition and recording.</p> <p>Review of custodian arrangements and completion of 'review of work by service auditors' in accordance with ISA 402 for the global custodian.</p> <p>Analytical procedures on</p>

Audit Risk	Source of assurance	Planned audit work
<p>The Fund receives a significant amount of income from third party sources. This presents a risk due to the extent and complexity of income.</p> <p>The Fund also makes a high volume of payments, including high value payments, which can constitute a risk of misstatement of expenditure.</p>	<p>base.</p> <p>Income monitoring, pensions payroll system, and other internal controls are in place and are subject to internal audit.</p>	<p>income and expenditure streams.</p> <p>Agree income to third party confirmation.</p> <p>Substantive testing of expenditure.</p> <p>Evaluation of the outcomes of the 2017 National Fraud Investigation exercise.</p>

### 3 Estimation and judgements

There are two areas in the financial statements which involve a significant degree of subjectivity:

- the measurement and valuation of investments
- the actuarial valuation.

Investments include level 3 investments such as unquoted equity, where valuations involve the significant application of judgement in determining appropriate amounts.

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.

This subjectivity entails a risk of misstatement in the financial statements.

The majority of investments are listed and traded on public stock exchanges which provide frequent valuations.

Unquoted investments are valued by third parties including investment managers and independent valuers who follow detailed professional, accounting and industry codes and guidelines.

The Government Actuary's department will carry out a review of the 2017 actuarial valuations of the Scottish Local Government Pension Scheme funds in accordance with Section 13 of the Public Service Pensions Act 2013.

Completion of 'review of the work of an expert' in accordance with ISA 500, for significant unquoted investments.

Confirmation of valuations to valuation reports and/ or other supporting documentation.

Completion of 'review of the work of an expert' in accordance with ISA 500, for the work of the actuary.

Consideration of the report by the consulting actuary to Audit Scotland on actuarial assumptions in use in 2017/18.

### Wider dimension risks

#### 4 Financial sustainability

The Fund reported an overall deficit in dealings with members in 2016/17. The cash flow projection for 2017/18 shows a continuing deficit position in this area, which will be funded through the use of investment income.

The triennial valuation can have a significant impact on the financial position of the Fund and of its member bodies.

Funding pensions from investment income is a business as usual activity for many funds.

The Fund's cash flow forecasting, monitoring and reporting procedures are well established and continue to be developed.

The Fund's investment strategy has been adapted to recognise the maturing liability profile and changing cash flow.

Review of cash flow forecasts.

Consideration of actuarial valuation reports.

Audit Risk	Source of assurance	Planned audit work
<p>There is a risk that the position of the Fund may deteriorate over time, with potential impact on its ability to meet all of its future liabilities.</p>	<p>Actuarial assumptions are, as far as possible, derived from market data, scenario modelling and membership experience.</p>	
<p><b>5 Governance and transparency</b></p> <p>Our prior year audit identified areas for improvement in the presentation of the annual report and accounts. This included potential changes to the wording of the financial statements sections within the annual report.</p> <p>Officers agreed to review the existing structure and presentation of the annual report to identify opportunities for streamlining the presentation of information.</p> <p>There is a risk that information in the annual report is unclear and does not assist the user in understanding the accounts.</p>	<p>The structure and presentation are reviewed each year and improvements are introduced. The adjustments suggested by Audit Scotland will be implemented in this year's report.</p>	<p>Communication with officers.</p> <p>Review of disclosures as part of our financial statements audit.</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 officer(s) to confirm factual accuracy.
6. We will provide an independent auditor's report to Strathclyde Pension Fund and the Accounts Commission setting out our opinions on the annual accounts. We will provide the administering authority's Executive Director of Financial Services 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	Strathclyde Pension Fund Committee date
Annual Audit Plan	14 February 2018	28 February 2018
Management Report	9 May 2018	23 May 2018
Annual Audit Report	By 30 September 2018	September 2018 (TBC)
Independent Auditor's Report	By 30 September 2018	September 2018 (TBC)

### Audit fee

**7.** The proposed audit fee for the 2017/18 audit of Strathclyde Pension Fund is £54,250 (2016/17: £53,450). In determining the audit fee we have taken account of the risk exposure of Strathclyde 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 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

#### Strathclyde Pension Fund Committee and the Executive Director of Financial Services

**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 Strathclyde Pension Fund Committee, as those charged with governance, of their responsibilities.

#### Appointed auditor

**11.** Our responsibilities as independent auditor are established by the 1973 Act for local government and the Code of Audit Practice (including supplementary guidance) 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 Strathclyde 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 Strathclyde 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 Strathclyde Pension Fund and the amount and disposition of its assets and liabilities at the financial year end
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.

## 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 Strathclyde Pension Fund are set out in [Exhibit 3](#).





## Exhibit 3

### Materiality values

Materiality level	Amount
<b>Planning materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 0.5% of net assets for the year ended 31 March 2018 based on the latest audited accounts.	Fund No.1
	£98.497 million
	Fund No.3
	£1.054 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 75% of planning materiality.	Fund No.1
	£73.873 million
	Fund No.3
	£0.791 million
<b>Reporting threshold (i.e. clearly trivial)</b> – 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 1% of planning materiality. (with a maximum level of £250,000)	Fund No.1
	£250,000
	Fund No.3
	£10,000

**17.** When establishing the audit approach, materiality for the financial statements is determined as a whole. However in certain circumstances it is appropriate to apply a lower level of materiality to one or more particular classes of transactions, account balances or disclosures, where misstatements of lesser amounts could influence the economic decisions of users taken on the basis of the financial statements. In the case of the Fund this applies to member contributions, pension payments and investment income. Therefore we will use a lower materiality level when assessing these income and expenditure streams.



**18.** We review and report on other information published with the financial statements including the management commentary, annual governance statement and the governance compliance statement. Any issue identified will be reported to the Strathclyde Pension Fund Committee.

#### Timetable

**19.** 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 Strathclyde Pension Fund Committee meeting.

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Consideration of unaudited financial statements by those charged with governance	By 31 August 2018
Latest submission date of unaudited annual accounts with complete working papers package	30 June 2018
Latest date for final clearance meeting with Executive Director of Financial Services	TBC
Issue of letter of representation and proposed independent auditor's report	By mid September 2018
Agreement of audited unsigned annual accounts	By 30 September 2018
Issue of Annual Audit Report including ISA 260 report to those charged with governance	By mid September 2018
Independent auditor's report signed	By 30 September 2018

### Internal audit

**20.** 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 Glasgow City Council internal audit overseen by the Head of Audit and Inspection.

#### Adequacy of internal audit

**21.** 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 internal audit reliance

**22.** To support our wider dimension audit responsibilities we plan to consider areas of internal audit work including:

- preparedness for auto enrolment
- transfers
- guarantors/covenants
- I-connect
- investments
- European directives.

## Audit dimensions

**23.** 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

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

#### Financial sustainability

**25.** 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.

#### Financial management

**26.** 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 arrangements 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

**27.** 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

**28.** 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 is demonstrating value for money in the use of resources, has focus on improvement and that there is a clear link to the outcomes delivered.

### Independence and objectivity

**29.** 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.

**30.** The engagement lead for Strathclyde Pension Fund is Dave McConnell, Assistant Director of Audit. 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 Strathclyde Pension Fund.

### Quality control

**31.** 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.

**32.** 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 is currently reviewing the arrangements for external quality reviews.

**33.** 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

**34.** Through our audit work we aim to add value to the Audited Body. 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 Audited Body 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.

# Strathclyde Pension Fund

## Annual Audit Plan 2017/18

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