

Scottish Borders Council Pension Fund

Annual Audit Plan 2017/18



 AUDIT SCOTLAND

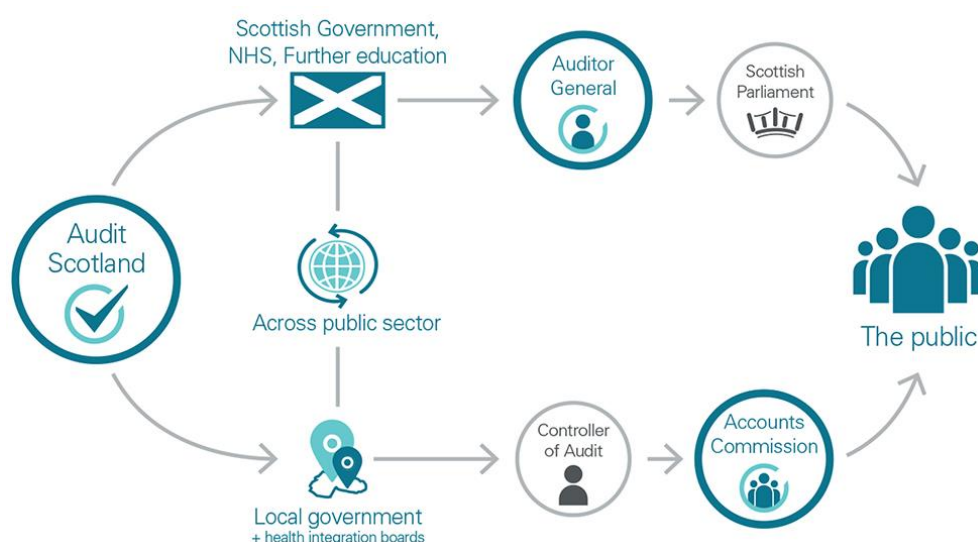
Prepared for Scottish Borders Council as administering authority for Scottish Borders Council Pension Fund

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 management, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for Scottish Borders Council Pension Fund (“the Fund”). We have categorised these risks into financial statements 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 |
|---|---|---|
| Financial statements issues and risks | | |
| 1 Risk of management override of controls Although we have not identified any specific risks of management override relating to the Fund, 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. | Owing to the nature of this risk, assurances from management are not applicable. | Detailed testing of journal entries. Review of accounting estimates. Evaluation of significant transactions that are outside the normal course of business. |
| 2 Risk of fraud over expenditure Practice Note 10 (Audit of financial statements of public sector bodies in the UK) and the Code of Audit Practice expands the ISA 240 requirements to aspects of expenditure such as | Regular budget monitoring and reporting Review and authorisation controls in place over expenditure to mitigate risk of error or manipulation. | Analytical procedures on payment streams. Focussed substantive testing of expenditure from areas of greatest risk. |

| Audit Risk | Source of assurance | Planned audit work |
|--|--|--|
| <p>pension payments and investments.</p> | | |
| <p>3 Estimation and judgements</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 equities where valuers use techniques that require significant judgement in determining appropriate assumptions for valuation.</p> <p>In addition, the actuarial valuation depends on several assumptions about the future, including investment returns, contribution rates, pensioner mortality and discount rates.</p> <p>This subjectivity represents an increased risk of misstatement in the financial statements.</p> | <p>Most investments are listed and traded on public stock exchanges which provide frequent valuations.</p> <p>Unquoted investments are valued by third parties including investment managers and independent valuers who follow detailed professional, accounting and industry codes and guidelines.</p> <p>Use of an experienced and respected Actuary to provide actuarial valuations.</p> | <p>Completion of 'review of work by service auditors' in accordance with ISA 402, for significant unquoted investments.</p> <p>Test valuations to valuation reports and/or other supporting documentation.</p> <p>Completion of 'review of the work of an expert' in accordance with ISA500 for the work of the actuary.</p> <p>Consideration of the report by PwC in their capacity as consulting actuary to Audit Scotland on actuarial assumptions in use in 2017/18.</p> <p>Consideration of Government Actuary's Department (GAD) reports under Section 13 of the Local Government Pension Scheme (Scotland) of LGPS Scotland funding valuations and employer contribution rates.</p> |
| <p>4 Reporting Disclosures</p> <p>The Code of Practice on Local Authority Accounting now requires Funds to disclose transaction costs broken down by major asset classes to increase transparency.</p> <p>A change to accounting disclosures raises a risk that the required disclosures are not made appropriately.</p> | <p>More detailed transaction cost information across asset classes has been requested from fund managers by officers.</p> | <p>Review the transaction cost disclosures against the Code, and available data to determine the completeness of disclosures and costs.</p> |
| <p>5 New Financial System</p> <p>Scottish Borders Council introduced a new financial system, Business World ERP, in April 2017. Some issues have been experienced with the operation of the system since its implementation, including manual intervention required to process some transactions.</p> <p>There is a risk that financial</p> | <p>Internal audit work on the implementation of the new system and testing of controls.</p> <p>Work being done during the year to address issues with the system.</p> <p>Effective governance and scrutiny arrangements in place to monitor system</p> | <p>Review of internal work on the systems of internal control.</p> <p>Testing of the operation and effectiveness of the controls in place over the system.</p> <p>Review the governance arrangement over the implementation of Business World.</p> |

| Audit Risk | Source of assurance | Planned audit work |
|---|---------------------|--------------------|
| information may not be robust, which could impinge on members' scrutiny role. There may also be an adverse impact on the council's system of internal controls and the preparation and audit of the financial statements. | implementation. | |

Wider dimension risks

6 Financial sustainability

In 2016/17, benefits paid out exceeded contributions paid into the Fund. The recently established cash flow models for 2017/18 shows a continuing deficit position, which will be funded using investment income.

Furthermore, the triennial valuation of the Fund can have a significant impact on the financial position of the Fund and of its member bodies and there is a risk that the 2017 valuation will cause member bodies to re-assess the financial sustainability of membership.

Officers are modelling the cash flows of the Fund, which helps inform the investment decisions to address the negative cash flow.

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

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

Monitor the financial position of the Fund and the quality of the financial reporting.

Review of cash flow forecasting.

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.

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 Scottish Borders Council as administering authority of the Scottish Borders Council Pension Fund and the Accounts Commission setting out our opinions on the annual accounts. We will provide Scottish Borders Council 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.

Exhibit 2

2017/18 Audit outputs

| Audit Output | Target Date | Audit & Scrutiny Committee Date |
|---------------------|-------------------|---------------------------------|
| Annual Audit Plan | 9 March 2018 | 19 March 2018 |
| Annual Audit Report | 14 September 2018 | 24 September 2018 (TBC) |

| Audit Output | Target Date | Audit & Scrutiny Committee Date |
|------------------------------|-------------------|---------------------------------|
| Independent Auditor's Report | 28 September 2018 | N/A |

Audit fee

7. The audit fee for the 2017/18 audit of Scottish Borders Council Pension Fund is £19,990 (2016/17 - £19,710). In determining the audit fee we have taken account of the risk exposure of Scottish Borders Council 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 annual report and financial statements, with a complete working papers package on 2 July 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 out with our planned audit activity.

Responsibilities

Audit and Scrutiny Committee and Management

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 Audit and Scrutiny 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 the Scottish Borders Council 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 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.

We will give an opinion on the financial statements as to:

- whether they give a true and fair view in accordance with applicable law and the 2017/18 Code of the financial transactions of the fund during the year ended 31 March 2018, and of the amount and disposition at that date of its assets and liabilities
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.



characteristics



responsibilities



principal activities



risks



governance arrangements

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 Scottish Borders Council Pension Fund are set out in [Exhibit 3](#).

Exhibit 3

Materiality values

| Materiality level | Amount |
|--|---------------|
| Planning materiality – 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 gross value of benefits and transfers out for the year ended 31 March 2017 (latest audited accounts). | £2.2 million |
| Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 70% of planning materiality. | £1.54 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 5% of planning materiality, but capped at £100k. | £100 thousand |

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, investment costs and investment income and therefore we will use a lower materiality level when assessing these income and expenditure streams where necessary.



18. We review and report on other information published with the financial statements including the management commentary and annual governance report. Any issue identified will be reported in our annual audit report.

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 Audit Committee dates.

Exhibit 4

Financial statements timetable

|  Key stage |  Date |
|---|--|
| Consideration of unaudited financial statements by those charged with governance | 26 June 2018 |
| Latest submission date of unaudited annual report and financial statements with complete working papers package | 2 July 2018 |
| Latest date for final clearance meeting with Chief Financial Officer | 7 September 2018 |
| Agreement of audited unsigned annual report and financial statements | 24 September 2018 |
| Issue of Annual Audit Report including ISA 260 requirements | 24 September 2018 |
| Independent auditor's report signed | 28 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 a team of Scottish Borders Council staff overseen by the Chief Officer Audit & Risk.

Adequacy of Internal Audit

21. Our review of internal audit concluded that the internal audit function operates in accordance with the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place.

Areas of Internal Audit reliance

22. To support our audit opinion on the financial statements we plan to place formal reliance on the following planned internal audit reviews:

- Business World implementation

23. In respect of our wider dimension audit responsibilities we also plan to consider other areas of internal audit work including:

- Review of Fund governance arrangements

Audit dimensions

25. 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

26. 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; short term (less than two years), medium term (two to five years) and longer term (more 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 longer term
- the appropriateness and effectiveness of arrangements in place to address any identified funding gaps
- whether the Fund can demonstrate the effectiveness of funding and investment decisions it has made.

Financial management

27. 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 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

28. 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

29. 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
- the Fund can demonstrate that outcomes are improving
- the Fund can demonstrate that investment costs are minimised whilst receiving good quality investment advice.

Independence and objectivity

30. 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. 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.

31. The engagement lead for the Scottish Borders Council 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 Scottish Borders Council Pension Fund.

Quality control

32. 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.

33. 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 has recently secured new arrangements for external quality reviews.

34. 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

35. Through our audit work we aim to add value to Scottish Borders Council 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 Scottish Borders Council 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.

Scottish Borders Council Pension Fund

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