

# Scottish Borders Council Pension Fund

Annual Audit Plan 2021/22



 AUDIT SCOTLAND

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

March 2022

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# Introduction

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## Summary of planned audit work

**1.** This document summarises the work plan for our 2021/22 external audit of Scottish Borders Council Pension Fund (the Fund). The main elements of our work include:

- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- an audit of the annual accounts and the provision of an Independent Auditor's Report which includes an opinion on statutory information published in the annual accounts, comprising the Management Commentary, the Annual Governance Statement and the Governance Compliance Statement
- consideration of arrangements in relation to the audit dimensions: financial management, financial sustainability, governance and transparency and value for money that frame the wider scope of public sector audit

## Impact of Covid-19

**2.** The coronavirus (Covid-19) pandemic has had a significant impact on public services and public finances, and the effects will be felt well into the future.

**3.** The Auditor General for Scotland, the Accounts Commission and Audit Scotland continue to assess the risks to public services and finances from Covid-19 across the full range of our audit work, including annual audits and the programme of performance audits. The well-being of audit teams and the delivery of high-quality audits remain paramount. Changes in our approach may be necessary and where this impacts on annual audits, revisions to this Annual Audit Plan may be required.

## Adding value

**4.** We aim to add value to the Fund through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we will help the Fund promote improved standards of governance, better management and decision making and more effective use of resources. Additionally, we attend meetings of the Pension Fund Committee and the Council's Audit and Scrutiny Committee and actively participate in discussions.

## Respective responsibilities of the auditor and the Fund

5. The [Code of Audit Practice \(2016\)](#) sets out in detail the respective responsibilities of the auditor and the Fund. Key responsibilities are summarised below.

### Auditor responsibilities

6. Our responsibilities as independent auditors are established by the Local Government (Scotland) Act 1973 and the [Code of Audit Practice](#) (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

7. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual accounts. We also review and report on the arrangements within the Fund to manage its performance and use of resources. In doing this, we aim to support improvement and accountability.

### The Fund's responsibilities

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

9. Also, the Fund has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance and propriety that enable them to deliver their objectives.

## Managing the transition to 2022/23 audits

10. Audit appointments are usually for five years but were extended to six years due to Covid-19. 2021/22 is the final year of the current appointment and we will work closely with our successors to ensure a well-managed transition.

# Financial statements audit planning

## Materiality

**11.** Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. We are required to plan our audit to determine with reasonable confidence whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.

### Materiality levels for the 2021/22 audit

**12.** We assess materiality at different levels as described in [Exhibit 1](#). The materiality values for the Fund are set out in [Exhibit 1](#).

## Exhibit 1

### 2021/22 Materiality levels for the Fund

Materiality	
<b>Planning materiality</b> – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1% of gross assets based on the latest investment adviser reports for assets valued as at 30 September 2021 for 31 March 2022.	£9.1 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 65% of planning materiality.	£5.9 million
<b>Reporting threshold (i.e. clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£250,000

Source: Audit Scotland

## Lower specific materiality levels for the 2021/22 audit

**13.** In addition to overall materiality, we can set lower, specific materiality levels for certain classes of transaction, account balances or disclosures where lesser amounts could influence the decisions of the users of the financial statements.

**14.** We recognise that transactions with members and payments to pensioners are areas of importance to the users of the accounts and we set specific materiality levels as shown in [Exhibit 2](#).

### Exhibit 2

#### 2021/22 Lower specific materiality levels for the Fund

Materiality	
<b>Specific materiality</b> – It has been set at 10% of benefits paid for the year ended 31 March 2022 based on the latest audited financial statements for 2020/21.	£2.5 million
<b>Specific performance materiality</b> – Using our professional judgement, we have calculated specific performance materiality at 60% of the specific materiality.	£1.5 million

Source: Audit Scotland

## Significant risks of material misstatement to the financial statements

**15.** Our risk assessment draws on our cumulative knowledge of the Fund, its major transaction streams, key systems of internal control and risk management processes. Also, it is informed by our discussions with management, meetings with internal audit, attendance at committees and a review of supporting information.

**16.** Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 3](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

**Exhibit 3****2021/22 Significant risks of material misstatement to the financial statements**

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p><b>1. Risk of material misstatement due to fraud caused by the management override of controls</b></p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable.</p>	<ul style="list-style-type: none"> <li>• Assess the design and implementation of controls over journal entry processing.</li> <li>• Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</li> <li>• Test journals at the year-end and post-closing entries and focus on significant risk areas.</li> <li>• Consider the need to test journal entries and other adjustments during the period.</li> <li>• Evaluate significant transactions outside the normal course of business.</li> <li>• Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements.</li> <li>• Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</li> <li>• Focussed testing of accounting accruals and prepayments.</li> </ul>
<p><b>2. Estimations applied to level 3 investments</b></p> <p>The pension fund has a significant portfolio of level 3 investments, for example unquoted equities, where valuations involve the application of a</p>	<p>Unquoted investments are valued by third parties including investment managers and independent valuers who follow detailed</p>	<ul style="list-style-type: none"> <li>• Confirmation of year end valuations to valuation reports and/or other supporting documentation.</li> <li>• We will review user entity controls in relation to the use of service organisations.</li> <li>• Review the relevant investment manager controls' reports for qualifications or exceptions that may affect the audit risk.</li> <li>• Review the arrangements in place at the Fund to assess investment managers' governance arrangements.</li> </ul>

Significant risk of material misstatement	Sources of assurance	Planned audit response
variety of estimates in determining appropriate valuations. This subjectivity gives rise to a significant risk of material misstatement in the financial statements.	professional, accounting and industry codes and guidelines.	<ul style="list-style-type: none"> <li>Review the disclosures included in the accounts to ensure these are adequate in directing the user of the accounts to acknowledge the areas of major sources of estimation and uncertainty with regards to level 3 assets.</li> </ul>

Source: Audit Scotland

**17.** As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statements*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements. We have rebutted this risk for the Fund because whilst the possibility of fraud exists, we do not judge it to be a significant risk due to the nature of the Fund's income streams.

**18.** In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have rebutted this presumed risk in 2021/22 because, whilst the possibility of fraud exists, we do not judge it to be a significant risk due to the nature of the expenditure at the Fund.

**19.** We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

## Other areas of audit focus

**20.** As part of our assessment of audit risks, we have identified other areas where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider these to represent significant risks. We will keep these areas under review as our audit progresses. If our assessment of risk changes and we consider these risks to be significant, we will communicate this to management and those charged with governance and revise our planned audit approach accordingly.

**21.** The areas of specific audit focus are:

- Estimations applied to the actuarial valuation: The actuarial valuation depends on a range of financial and demographic estimations about the future. The subjectivity around these estimates gives rise to a risk of material misstatement in the financial statements.
- Valuation of level 1 and level 2 assets: Investments held by the Pension Fund are subject to market price fluctuations and a degree of estimation. The Pension Fund holds material level 1 (where valuation derived directly from unadjusted quoted active market price) and level 2 (where the instrument is traded in a market not considered to be active or where the fair value is determined using valuation techniques based on market prices). Due to the material amounts and in particular, the degree of subjectivity and complexity in the valuation of level 2, this gives rise to a risk of material misstatement in the financial statements.

## **Audit risk assessment process**

**22.** Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and where relevant, report them to those charged with governance.

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# Audit dimensions

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## Introduction

**23.** The [Code of Audit Practice](#) sets out the four dimensions that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the audit dimensions in audited bodies.

## Audit dimensions

**24.** The four dimensions that frame our audit work are shown in [Exhibit 4](#).

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### Exhibit 4 Audit dimensions



Source: Code of Audit Practice

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**25.** In summary, the four dimensions cover the following:

- **Financial management** – financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Financial sustainability** – as auditors, we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on financial sustainability in the

medium/longer term. We define this as medium term (two to five years) and longer term (longer than five years).

- **Governance and transparency** – 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.
- **Value for money** – value for money refers to using resources effectively and continually improving services.

## Audit dimension risks

**26.** We have not identified any significant audit dimension risks.

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# Reporting arrangements, timetable, and audit fee

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## Reporting arrangements

**27.** Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 5](#), 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).

**28.** 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.

**29.** We will provide an independent auditor's report to the Fund and the Accounts Commission setting out our opinions on the annual accounts. We will provide the Fund and the Accounts Commission with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

**30.** [Exhibit 5](#) outlines the target dates for our audit outputs, and we aim to issue the independent auditor's report by the statutory deadline of 31 October 2022. We acknowledge this will be challenging due to the ongoing pressures and uncertainties caused by Covid-19.

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## Exhibit 5 2020/21 Audit outputs

Audit Output	Target date	Committee Date
Annual Audit Plan	31 March 2022	17 March 2022
Independent Auditor's Report	31 October 2022	To be confirmed
Annual Audit Report	31 October 2022	To be confirmed

Source: Audit Scotland

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## Timetable



**31.** To support an efficient audit, it is critical that the timetable for producing the annual accounts for audit is achieved. We have included a proposed timetable for the audit at [Exhibit 6](#) that has been discussed with management.

**32.** Covid-19 has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. To this end, 2021/22 is a transition year with the reporting deadline brought forward by one month relative to the two prior years. We are identifying ways to work more efficiently to expedite the 2021/22 audits whilst at the same time maintaining high standards of quality.

**33.** We will continue to work in close partnership with management with clarity over timescales and the requirement for high quality unaudited accounts and supporting working papers. Progress will be discussed with management and finance officers over the course of the audit.

### Exhibit 6

#### Proposed annual accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual accounts by those charged with governance	29 June 2022
Latest submission date for the receipt of the unaudited annual accounts with complete working papers package.	30 June 2022
Latest date for final clearance meeting with management	To be confirmed
Issue of Letter of Representation and proposed Independent Auditor's Report	To be confirmed
Agreement of audited and unsigned annual accounts	To be confirmed
Issue of Annual Audit Report to those charged with governance.	To be confirmed
Signed Independent Auditor's Report	To be confirmed

Source: Audit Scotland

## Audit fee

**34.** The proposed audit fee for the 2021/22 audit of the Fund is £22,110 (2020/21: £21,510). In determining the audit fee, we have taken account of the risk exposure

of the Fund, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit.

**35.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual accounts, the absence of adequate supporting working papers 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.

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# Other matters

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## Internal audit

**36.** International standards on Auditing (UK) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect on external audit procedures;
- obtain an understanding of internal audit activities to inform our planning and develop an effective audit approach that avoids duplication of effort;
- perform a preliminary assessment of the internal audit function when there is scope for relying on internal audit work which is relevant to our financial statements' responsibilities; and
- evaluate and test the work of internal audit, where use is made of that work for our financial statements responsibilities to confirm its adequacy for our purposes.

**37.** From our initial review of the internal audit plans, we do not plan to use the work of internal audit for our financial statements' responsibilities. We will however take account of internal audit's findings to inform our wider Code responsibilities.

## Independence and objectivity

**38.** Auditors appointed by the Auditor General for Scotland or 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 robust arrangements in place to ensure compliance with these standards including an annual '*fit and proper*' declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

**39.** The engagement lead (i.e. appointed auditor) for the Fund is Gillian Woolman, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of the Fund.

## Quality control

**40.** International Standard on Quality Control (UK) 1 (ISQC1) requires a system of quality control to be 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.

**41.** 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 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 and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

**42.** 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.

# Scottish Borders Council Pension Fund

## Annual Audit Plan 2021/22

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